Initiating Coverage

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SKS Microfinance

Play on Indian demographics = best earnings compounding financial stock

CMP	Target Price
Rs460	Rs580 (▪)
Rating	**Upside**
BUY (▪)	26.1 %

Post the AP crisis, SKS Microfinance (SKSMF) has evolved stronger and is poised to gain from structural opportunity in an underpenetrated microfinance industry (MFI). With low political risk and regulatory harness, we expect SKSMF (leader in MFI) to deliver superior AUM CAGR of 40%, maintain asset quality and more than double the EPS over FY15-18E. Additionally, SKSMF is better placed to receive a small bank license. We estimate that sustainable RoEs (over the medium term) under the banking ambit to remain superior in the range of 20-24%, similar to our expectation for NBFC-MFI model. Based on our probability weighted residual income model, we value the company at Rs580 per share (implied FY17PBV of 4.7x).

- **SKSMF, a strong contender for small bank, to enjoy RoAs of 4%+:** SKSMF is likely to be the frontrunner for a small bank license, thanks to its strong rural reach (310 districts; 18 states), niche offerings (centric around financial inclusion) and able management. To meet the requisite shareholding structure, equity capital requirement at current market price (CMP) would be ~Rs25bn (44% of equity dilution) from domestic investors. Dilution would be book value accretive and add Rs109 to FY17E BV. Additionally, it would compensate for regulatory transition and keep RoAs strong at 4%+. While RoEs may dip to 13% in the initial year, sustainable RoEs are likely to be in the range of 20-24%. Immunity from political risk, loan and revenue diversification would drive valuations. We have a favorable view on SKSMF being awarded the small bank license. However, we assign a probability of 15%, to this event as it is based on RBI's discretion. We value SKSMF Bank at Rs900 (3.8x FY17E BV).
- **SKSMF NBFC, best compounding financial stock:** AP crisis had a catastrophic effect and led to substantial write-offs in the state of AP and loss of earnings. But, even during this phase, collection efficiency of 95% in non-AP states, indicated the inherent strength of the business model. Now, with regulatory cover and low political risk, we believe SKSMF is on a strong growth path and have factored AUM CAGR of 40% over FY15/18E. We expect EPS to more than double and BV CAGR to be 23% over FY15-18E. This is our base case (probability of 70%) and we value SKSMF NBFC at Rs565 per share.
- **Asset quality to remain robust:** Regulatory supervision by RBI and introduction of credit information bureau has strengthened credit appraisal standards and reduced political risk. Additionally, recent steps taken by RBI like increasing the first cycle disbursement by 70/100%, indicates RBI's confidence in the MFI business model. SKSMF follows a more conservative NPL recognition standards than required by RBI, which is a big positive for it either ways, as a NBFC-MFI or a small bank.
- **Premium valuations to sustain:** Strong outperformance in the last two years captures improvement in operational parameters, and now strong earnings compounding will drive stock returns. Additionally, if SKSMF receives a small bank license, it would act as a tailwind for the business and valuations. Based on our probability based (15% SKSMF coverts into a bank, 70% base case SKSMF NBFC and 15% bear case SKSMF NBFC) residual income method, we arrive at a TP of Rs580. **Risks:** (1) AP like crisis, (2) management change and (3) overhang of equity dilution, if it receives small bank license.

Financial Snapshot (Standalone)

(Rs mn)	FY14	FY15	FY16E	FY17E	FY18E
Net income	3,306	5,235	6,554	8,808	11,388
Net profit	699	1,876	2,216	3,044	3,954
EPS (Rs)	6.5	14.9	17.5	24.1	31.3
BV (Rs)	42.4	82.9	100.3	124.4	155.7
RoA (%)	2.6	5.2	4.4	4.4	4.1
RoE (%)	16.4	24.9	19.2	21.5	22.4
PE (x)	71.2	31.0	26.2	19.1	14.7

Source: Company, Emkay Research

Change in Estimates	
EPS Chg FY16E/FY17E (%)	NA
Target Price change (%)	NA
Previous Reco	NA

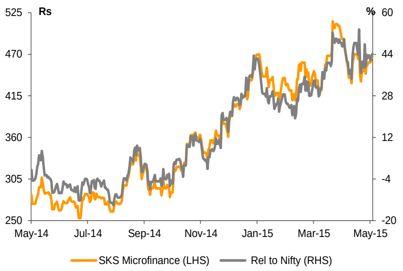
Emkay vs Consensus

EPS Estimates	FY16E	FY17E
Emkay	17.5	24.1
Consensus	19.4	27.4
Mean Consensus TP		Rs 520

Stock Details	
Bloomberg Code	SKSM IN
Face Value (Rs)	10
Shares outstanding (mn)	126
52 Week H/L	525 / 221
M Cap (Rs bn/USD bn)	58 / 0.90
Daily Avg Volume (nos.)	25,35,549
Daily Avg Turnover (US$ mn)	17.7

Shareholding Pattern Mar '15	
Promoters	9.3%
FIIs	47.1%
DIIs	14.4%
Public and Others	29.2%

Relative price chart



Source: Bloomberg

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SKSMF, as a small bank likely to enjoy RoAs of 4%+

- MFIs fulfill the genesis of a small bank, as their business model is centric around financial inclusion. SKSMF, which has applied for a small bank license, will be a frontrunner in our view, given its strong rural franchise and customer base. We have assigned it a probability of 15%, as the event is based on RBI's discretion. RoAs are estimated to remain superior at 4%+, under banking model. We value SKSMF small bank at Rs900 (3.8x FY17E BV)
- The biggest hurdle for most MFI contenders on being rewarded a small bank license is shareholding requirement. Even SKSMF faces a similar challenge with (1) promoter (foreign) holding at 9% and (2) resident Indian ownership of ~30% at the end of Mar-15
- If SKSMF is to be awarded an in-principle approval for the small bank, equity dilution and funding requirement through domestic investors would be 44% (on current equity base) and Rs25bn+ (at CMP) respectively. This may be an overhang, but looking at equity assistance provided by the investors to financial companies providing healthy returns, we expect SKSMF would be able to raise the money as well. Additionally, this would not only help SKSMF in meeting the regulatory norms but also aid earnings growth
- Low leverage of 2.8x may lead to lower RoEs of ~13% in the initial year, but thereafter, expansion in AUM could drive RoEs to ~19% by FY20 (i.e. after three years of incorporation as a small bank). In our view, steady state RoEs of this business could be in the range of 20-25%

MFIs have an edge in meeting the guidelines of a small bank

Given the goal of financial inclusion and services to lower strata of the economy, MFIs and SKSMF, in particular, will be strong contenders for small bank license

RBI has clearly stated that the rationale for setting up small banks is to facilitate financial inclusion by (1) providing savings instruments and (2) loans to lower strata of the economy. Most MFIs (rural) fulfill these basic criteria and have an edge over other applicants as they are best placed to meet some of the norms like:

- 75% of the loans to be in priority sector, of which, 40% should be in sub-segments as directed under PSL norms for scheduled commercial banks,
- All loans should be less than Rs2.5mn, and
- Minimum capital requirement of Rs1bn+ *(detailed guidelines Annexure 1)*.

SKSMF - a frontrunner among MFIs on the back of its distribution franchise

SKSMF is better placed than other MFI applicants for small bank license. Janalakshmi and Ujjivan are at par with SKSMF in terms of AUM, but they are urban centric. The closest rural focused MFI is ESAF Microfinance, but its AUM is ~40% lower than SKSMF. Additionally, SKSMF has a more diversified reach covering 18 states, 310 districts and 3.5mn+ clients (13.9% market share), which is significantly higher than other MFI applicants. The second largest rural MFI, ESAF has presence in 6 states and covers only 41 districts.

Exhibit 1: SKSMF: Largest MFI with rural focus *(Detailed profile of MFI applicants Annexure 3)*

Name	Area of operation	States covered	Districts covered	Branches	Clients (mn)	AUM MS	RoA*	RoE*	Leverage*
SKS Microfinance Ltd.*	**Rural**	**18**	**310**	**1,138**	**3.5**	**10.2**	**2.9**	**16.5**	**5.7**
Disha Microfinance	N.A.	3	29	72	0.2	0.7	1.6	6.3	4.0
Equitas Holding	Urban/Rural	7	122	354	2.2	6.3	3.7	19.5	5.3
ESAF Microfinance	Rural	6	41	175	0.5	2.5	1.9	12.9	6.9
GramaVidiyal	Rural	4	50	268	0.8	2.6	0.5	3.5	6.8
Jagaran Microfinance	Rural	3	14	50	0.1	0.2	7.5	9.5	1.3
Janalakshmi Financial	Urban	16	146	223	2.0	9.4	2.9	13.4	4.6
RGVN (North East)	Rural	5	31	102	0.2	0.6	3.3	16.1	4.9
Suryoday Microfinance.	Urban	2	38	138	0.4	1.3	3.1	11.1	3.6
Ujjivan Finance Services	Urban	24	188	405	1.6	9.1	3.5	15.7	4.5
Utkarsh Microfinance	Urban/Rural	8	55	208	0.4	1.9	2.4	11.5	4.9

*Source: Mix Market, MFIN, Emkay Research * data represents FY14, other data of 3QFY15*

AUM mix of SKSMF is PSL compliant as required for a small bank

Meets RBI's loan mix requirements for a small bank

For a small bank, RBI has stipulated that 75% of the loans should be to priority sector (PSL), of which, 40% should be in the sub-segments viz. small and marginal farmers + weaker sections, as applicable to universal banks. SKSMF AUM is in conformity with the requirement.

Additionally, the new recommendation (final guidelines yet to be issued) allows banks to subscribe/issue priority sector lending certificates (PSLC), if they have shortage/surplus in meeting the PSL requirements. In our view, demand for PSLC in the system will go up with:

SKSMF will continue to enjoy the benefits of niche lending as PSLC will help it earn fees and funding

- Entry of new universal banks and RBIs endeavor to make this an ongoing process,
- Dependence of private banks on niche players for meeting their PSL requirements
- Alignment of priority sector targets of foreign banks with a considerable branch presence in India (>20) with domestic banks by FY18 and foreign banks, which open subsidiaries.

This would be beneficial for SKSMF, as PSL is its focus segment and will help the company receive funding at lower cost and also earn fees on PSLC.

Exhibit 2: Current loan mix of SKS fulfills PSL requirement (%)

Regulatory requirement	% of ABNC		SKS Loan Mix	(% of AUM)
PSL	40.0	✓	Livestock	26
- Agriculture	18.0	✓	Tailoring, cloth weaving	11
- Small & Marginal farmers	8.0	✓	Grocery, stores and other retail outlets	9
MSME	7.5	✓	Masonry, Painting, Plumbing etc.	8
Export Credit		✓	Trading of Veg. & Fruits	8
Weaker Section	10.0	✓	Trading of agricultural commodities	5
Other PSL	35.0	✓	Others	34

Source: RBI, Company, Emkay Research

Management's execution capability well tested

Proven track record, diversified network reaching 310 districts (highest among MFIs), and 3.5mn+ client base in rural region, makes SKSMF a strong contender for small bank license

After Bandhan (which has received a universal banking license), SKSMF is the second largest MFI in India. SKSMF's management has demonstrated strong execution skill during/post the AP crisis, where 27% of AUM had to be written off on account of AP ordinance. Even in this challenging environment, the company was able to service its debt obligation, raise capital and maintain asset quality in non-AP states and steer itself back to profitability. Notably, most AP based MFIs had to restructure their debt, struggle to grow their balance-sheet and be profitable. This highlights the execution capabilities of the management. Diversification of the portfolio and strong capitalization helped SKSMF emerge stronger.

Our interaction with the top management also instills faith in second layer of management, having work experience of 10-30 years and an average working tenure of five years with SKSMF. Hence, even second layer of the management was instrumental in turning around SKSMFs operations post AP-crisis, which augurs well for the company.

Exhibit 3: Barring SKSMF, AP crisis hit-micro finance companies were struggling for growth and had a negative net-worth

	AUM (Rs mn)				PAT (Rs mn)				Net-worth (Rs mn)			
	FY11	FY12	FY13	FY14	FY11	FY12	FY13	FY14	FY11	FY12	FY13	FY14
SKSMF	**27,058**	**13,200**	**20,155**	**28,368**	**1,116**	**-13,606**	**-2,971**	**699**	**17,808**	**4,347**	**3,904**	**4,592**
Asmita	13,248	11,994	10,711	9,471	210	-1,515	-5,846	-492	2,151	4,006	-1,744	-2,396
Share	20,649	2,110	19,315	17,577	91	-2,566	-9,453	-449	3,014	7,151	-2,091	-2,863
Spandana	34,582	27,152	22,232	21,072	-92	-2,698	-11,757	643	4,744	12,263	-105	-107

Source: Mix Market, MFIN, Emkay Research

Exhibit 4: Management of the company has been able to successfully turnaround operations of SKSMF

Mr. M R Rao	MD & CEO	An alumni of BITS Pilani, he has over 25 years of experience in Profit Centre Management, setting up distribution in Insurance, Retail Banking and Consumer Finance. Prior to SKSMF, he was associated with ING Vysya Life Insurance, American Express, Standard Chartered Bank and Esanda Finanz & Leasing Limited. He joined SKSMF in October 2006.
Mr. Dilli Raj	President	Dilli Raj has 23 years of experience in corporate finance, treasury, policy advocacy and corporate tax planning. Dilli Raj played a strategic role in SKSMF' turnaround and managing the AP MFI crisis by focusing on cash flow management, and cost structure optimization. He is a member of the financial inclusion committee of FICCI.

Source: Company, Emkay Research

What will SKSMF gain as a small bank?

Immunity from political risk through the life cycle

Risk of political intervention will no longer be a threat

If SKSMF becomes a small bank, accepting deposits at the regional level and RBI regulatory authority would immunize SKSMF from political risks (e.g. AP ordinance). Additionally, with MFI bill and incorporation of the MUDRA, regulatory and political clarity will emerge for smaller players/NGOs, thereby reducing the fear of contagion effect. However it is difficult to predict the timing and form of MUDRA and MFI Bill. The other challenge for SKSMF being a rural player is of moral hazard such as agriculture debt waiver scheme. But, in the past, it has come unscathed due to its niche business model and we expect it will be able to do so in the future as well.

Additional streams for AUM growth…

Customer base doubles as family member of the existing member could be targeted; depends on willingness and pilot project of SKSMF to cater to this sub set

Becoming a bank gives access to additional streams of business growth and fee income. Our interaction with the management suggests that in terms of AUM growth, the company will continue to focus on the MFI business. However, in the long run, we believe the company can run pilot projects and diversify its lending base (MSME, small housing loans and gold loans). Banking platform also increases the targeted client base (spouse/family members of 3.5mn existing client base). Hence, even as a bank, sustainable AUM CAGR for SKSMF for the next five years is likely to be 30%+.

…and revenue will be unveiled and expect gradual gains

Building gradual improvement in fees; client/customer base does not support significantly high value fee income generations as compared to other private banks and would be more driven by volume

SKSMF fee income generation exhibits high cross sell ratio of products to its existing customer base and indicates strength of its franchise. Becoming a bank would give SKSMF access to additional streams of fee income from transaction banking (payments & transfers) and distribution of third-party products. We have built in a gradual improvement in fee income to average assets, though the contribution would remain low as profile of customer base necessitates higher volumes as compared to universal banks.

Minimum Promoter/ Indian holding of 26%/ 51% will necessitate equity dilution

RBI, in its guideline, has mentioned the requisite shareholding structure:

- Promoter holdings need to be at-least 40% or at-least 26%, if as NBFC, it has reduced its stake in normal course of business
- 51% of the shareholders must be Indian resident.

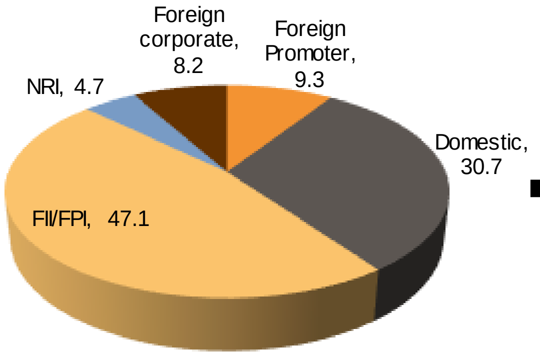
As of end- Mar'15, SKSMF had foreign promoter holding of 9.3% and domestic investor holding of ~31%. Hence, SKSMF will have to dilute its equity stake to comply with the regulations and the company has two options: (1) rope an Indian promoter or (2) go 'THE IDFC' way, i.e. the holding company structure. We believe the latter option is more feasible and can be adopted.

SKSMF can be the holding company and small bank will become a subsidiary

In order to comply with the shareholding requirements of a small bank, SKSMF may float a 100% subsidiary and transfer the lending business to this subsidiary. SKSMF does not have any other business. Hence, creating such a structure becomes simpler. In this case, SKSMF will become the 'HOLDCO' and would require equity dilution of 44% and capital support of Rs25bn+ (at CMP) from domestic investors.

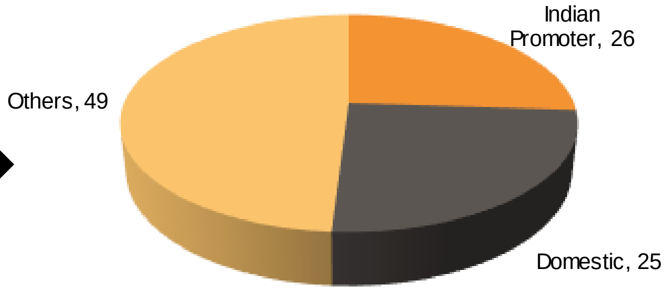
In our view, RBI may not be overly concerned about this structure and identifiable promoter may not be necessary. In the recent past, RBI has allowed IDFC to follow a similar structure when it received an in-principle approval for a universal banking license. Even few well run private banks are without promoters and the business is driven by the professional board of directors, which may strengthen the case for SKSMF. The rationale for direct promoter holding seems to make the new businesses accountable; but, in case of SKSMF, its proven track record and strong management can be viewed positively.

Exhibit 5: Current shareholding structure (%)



Source: Company, Emkay Research

Exhibit 6: Regulatory requirement (%)



Source: RBI, Emkay Research

Free net-worth will aid NIMs and compensate for regulatory impact

Maintaining CRR/SLR from day one of operations will have an impact but in-built requirement of equity will boost NIM upward and more than compensate for transitory costs

RBI has stipulated that new small banks have to maintain CRR and SLR from day one of its operations and this will have a definite impact. However for adhering to small bank norms, SKSMF is likely to raise equity of Rs25bn, which is 2.5x FY15 net-worth and 60% of the FY15 AUM. This would propel NIMs upwards for next two to three years despite negative carry on account of (1) building of lower yielding investment book, and (2) CRR, as higher proportion of balance-sheet will get funded through equity (zero cost). Hence, we expect NIMs to improve by 140bp over FY16-18E.

Over medium to long term, we expect SKSMF to pass on the benefits of cost of funds and operating leverage to the borrowers and NIMs will gradually decline and be near similar levels of some of the niche NBFCs like Shriram Transport Finance, Mahindra and Mahindra Financial services and Shriram City Union.

Exhibit 7: Spreads will go down but higher equity contribution will help in NIM expansion over next two to three years (%)

	FY15	FY16e	FY17e	FY18e	FY19e	FY20e	FY21e	FY22e	FY23e	FY24e	FY25e
Yield on Funds	25.6	25.1	23.2	20.4	19.0	18.5	17.8	16.9	16.5	16.5	16.5
Cost of Funds	13.0	12.0	11.3	10.5	9.7	9.3	9.3	9.1	9.1	9.1	9.1
Spreads	12.6	13.1	11.9	9.9	9.4	9.2	8.5	7.9	7.4	7.4	7.4
NIM	10.7	12.2	14.8	12.1	10.8	10.8	10.0	9.1	8.5	8.4	8.4
Equity as a % of Earnings assets	30.9	47.5	44.1	34.2	27.2	23.7	20.5	18.6	17.0	15.9	15.1

Source: Company, Emkay Research

Liability mix to change; raising deposits to help in addressing political risk

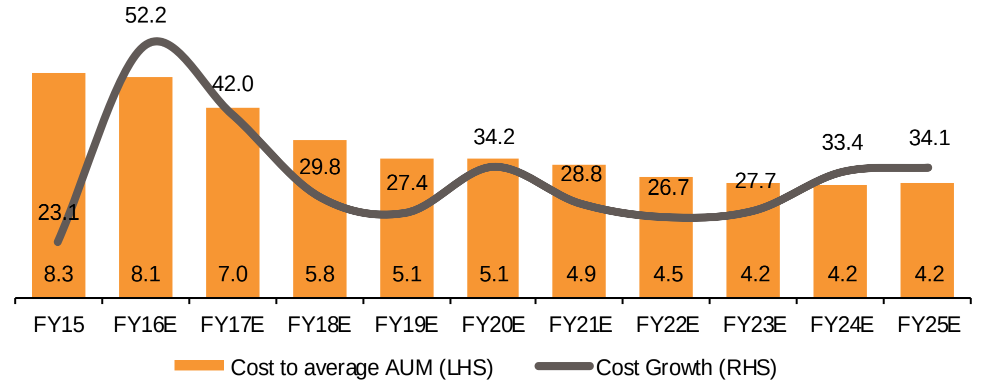
As a bank, we expect funding mix to change as opportunities of getting refinanced from NABARD, SIDBI and MUDRA Bank (at a later stage) will open up. SKSMF can still continue to borrow from banks, in the form of IBPC and PSLC (based on new recommendations of PSL). However, SKSMF's current platform and employee acumen does not indicate a strong accretion in CASA in the near term. Our interaction with the management also indicates that they do not see it as a big opportunity. Hence, while the company would raise retail deposits, mobilization of low cost CASA deposits will be gradual. Nevertheless, raising deposits from public would certainly help in addressing the political risk. Additionally, raising money from wholesale deposits would be easier as the risk profile/premium will be lower for SKSMF as a bank. Hence, we expect readjustment of liability mix to take place and it may turn out to be a cheaper source of funding.

Rise in operating cost to be neutralized by productivity gain

Transitional cost to be in the form of new hiring; branch expansion/reallocation will be strategic in nature as focus will remain on the door step delivery model

In our view, in the initial years, opex growth would increase on account of (1) fresh hiring, especially at senior management level, (2) rebranding, (3) relocating some of the existing networks and (4) enhancing technology. But, since SKSMF will continue to focus on MFI and door-step delivery model, branch rollout could be more strategic and we expect cost discipline to remain good. Opex growth and AUM growth is non-linear. Hence, risk if any to our assumption of cost ratios and RoAs will be of lower than expected AUM growth, rather than intermittent rise in cost structure.

Exhibit 8: Cost growth to be high but strong revenue traction to drive productivity gains (%)



Source: Company, Emkay Research

Factored higher credit cost of 0.6% on AUM (cross cycle average)

Factored credit cost increase over next few years as the business model revolves around unsecured lending

The joint liability group model of MFIs has played out well as the group members pitch in to provide temporary line of support, in case a member is facing temporary hardship. Ex-AP crisis, average credit cost of SKSMF over the cycle has been 60bp, with FY15 at 30bp. However, as the loans are small ticket and unsecured, default rates may be high and conservatively, we factor credit cost of 50-60bp.

We also note that SKSMF currently follows a NPL recognition norm of recognizing NPL post 60 days overdue. This is more stringent than (1) RBI norms for NBFC – MFI and (2) banking norms, as these require recognizing of NPLs past 90 days overdue. In our view, this will also help SKSMF maintain asset quality standards.

Exhibit 9: NPL recognition and provisioning policy more conservative than regulatory requirement

	Banks	SKSMF
NPL recognition norm		
Standard assets	0-90 days	0-60 days
Sub-standard assets	For 1 year after becoming NPL	61-180
Doubtful	For 1 to 3 years after becoming substandard	N.A.
Loss assets	Loss identified by bank	>180 days
NPL provisioning norms		
Standard assets	0.25-1%	0.25-1%
Sub-standard assets	15-25%	50% of outstanding principal
Doubtful /Loss assets	25-100%	100% of outstanding principal/write-off

Source: Company, Emkay Research

RoAs to be strong; RoEs, a function of leverage

RoA's of SKSMF as a bank to be 2x than the next best i.e. HDFCB 2%; Sustainable RoEs on leverage of 6x to be ~25%

In our view, SKSMF is likely to remain highly profitable and niche offerings would keep RoAs significantly higher in the range of 4-5%, way above the universal banking business RoAs of ~2% (best in class). Higher capitalization (Tier I of 52, post equity dilution) would drag RoEs lower to 13% in the initial year, but with increase in leverage, RoEs are estimated to rise (expect 19% by FY20, i.e. three years of incorporation as a small bank).

For SKSMF small bank, we have built AUM CAGR of 40% and credit cost of 0.4-0.6% over FY16-20E. CAR requirement under the small bank is 15% (Tier I of 7.5%), similar to current requirement of NBFCs, which indicates a higher leveraging capability. However, as SKSMF business would revolve around unsecured loans, we expect SKSMF's leverage to be lower at 6x and sustainable RoEs to be in the range of 20-25%.

Tailwind from small bank license offers strong potential

SKSMF has applied for small bank license and will be a frontrunner on account of its strong rural franchise. Conservatively, we build a 15% probability of SKSMF converting into a small bank as the event is based on RBI's discretion. Superior return ratios, immunity from political risk and option of diversifying its AUM and revenue base will be key positives. If the event plays out, we value SKSMF small bank at Rs900 (3.8x FY17E BV of the small bank).

Exhibit 10: Profitability of SKSMF even under the banking ambit will remain superior (% of average assets)

	FY15e	FY16e	FY17e	FY18e	FY19e	FY20e	FY21e	FY22e	FY23e	FY24e	FY25e
Interest Income	17.4	18.9	18.4	16.8	16.1	16.6	16.5	15.6	15.2	15.3	15.5
Income from Securitization	1.8	1.6	0.6	-	-	-	-	-	-	-	-
Interest Expended	7.7	7.5	6.7	6.8	6.9	7.0	7.2	7.2	7.4	7.5	7.6
Net Interest Income	**9.7**	**11.3**	**11.7**	**10.0**	**9.2**	**9.6**	**9.3**	**8.4**	**7.8**	**7.8**	**7.9**
Non-interest Income	**4.7**	**2.9**	**1.7**	**1.5**	**1.5**	**1.5**	**1.6**	**1.5**	**1.5**	**1.5**	**1.4**
Loan processing fees	1.3	1.2	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Recovery against loans written off	0.7	0.5	0.3	0.3	0.2	0.2	0.2	0.2	0.1	0.1	0.1
Other miscellaneous income	1.4	1.2	0.5	0.4	0.4	0.4	0.4	0.4	0.5	0.4	0.4
Total income	**14.4**	**14.3**	**13.4**	**11.5**	**10.6**	**11.2**	**10.9**	**9.9**	**9.3**	**9.3**	**9.3**
Operating Expenses	**8.8**	**8.1**	**7.0**	**5.8**	**5.1**	**5.1**	**4.9**	**4.5**	**4.2**	**4.2**	**4.2**
Salaries & Benefits	6.4	5.7	4.9	4.0	3.6	3.6	3.4	3.1	2.9	2.9	2.9
Provisions	**0.3**	**0.5**	**0.4**	**0.4**	**0.4**	**0.4**	**0.4**	**0.4**	**0.3**	**0.3**	**0.3**
PBT	**5.3**	**5.6**	**6.0**	**5.4**	**5.2**	**5.6**	**5.6**	**5.1**	**4.8**	**4.8**	**4.8**
Tax	0.2	1.2	1.3	1.1	1.1	1.4	1.4	1.3	1.2	1.2	1.2
RoA	**5.2**	**4.5**	**4.8**	**4.2**	**4.1**	**4.2**	**4.2**	**3.8**	**3.6**	**3.6**	**3.6**
Leverage (x)	4.8	3.3	2.8	3.2	3.9	4.4	4.9	5.6	6.1	6.5	6.9
RoE	**24.9**	**14.7**	**13.4**	**13.5**	**16.1**	**18.8**	**20.7**	**21.3**	**22.1**	**23.5**	**24.8**

Source: Company, Emkay Research

SKS-NBFC: Even if not a small bank, opportunity >Rs3tn

- As per 2011 World Bank statistics, about 24% of India's population earns less than USD 1.25 a day (defined as below the poverty line), while another 35% of the population earns in between USD 1.25-2.00 per day. Based on average of 4.8 members per household, overall 163mn households can be targeted, which translates into a micro-financing opportunity of Rs2.7-3tn
- RBI has recently revised the eligibility limits for microfinance loans and also the disbursement amount. This in our view can be catapult for AUM growth as it expands the customer segmentation as well as provides an opportunity for higher average ticket size
- Prime channels to deliver micro finance in India are the Self-Help Group and MFIs. The former exists since a long time and is concentrated in southern India but capacity to grow is limited because of their business model and inefficiency. We believe customer centric approach and stable regulatory environment is likely to drive market share gains for MFIs

Formal source of financing is still low

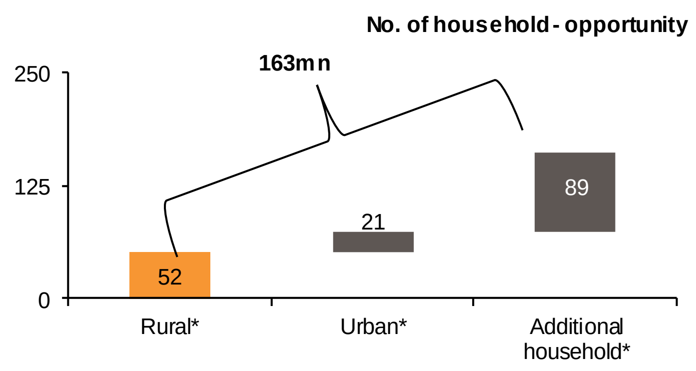
Demand for MFI lending is strong as interest rates are below that of alternatives such as money lenders and formal financing penetration is limited in the lower-income segment. Based on RBI/NSSO surveys, 35% of population relies on money lenders for their funding needs, which is significantly high in comparison to some of the other developing countries.

One borrower per poor household translates into Rs3tn opportunity

25% of population earns less than US$1.25 a day; additionally, 36% of the population earns below US$2 a day

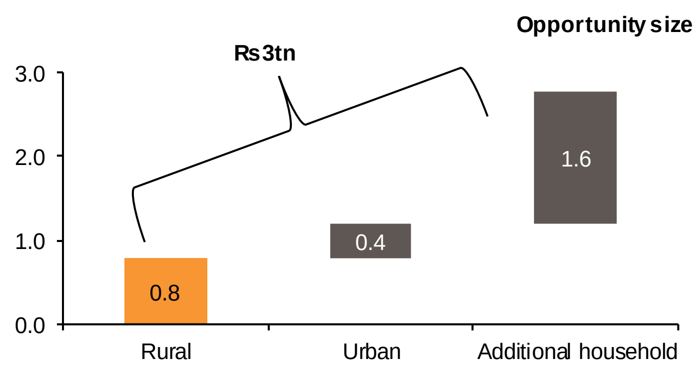
As per 2011 World Bank statistics, about 24% of India's population earns less than USD1.25 a day (defined as below the poverty line) and another 35% of the population earns USD1.25-2.00 per day. Assuming a household constitutes an average of 4.8 members (national consensus estimate), approximately 163m households are the targeted customer base. And if we peg an average financing need of Rs20-25k per household, overall demand for microfinance loans could be Rs2.7-3tn.

Exhibit 11: Untapped number of households pegged at 163mn…



Source: NSSO, World Bank, Emkay Research

Exhibit 12: …translating into Rs3tn opportunity



Source: NSSO, World Bank, Emkay Research

RBI has raised exposure and eligibility limits augurs well for AUM growth

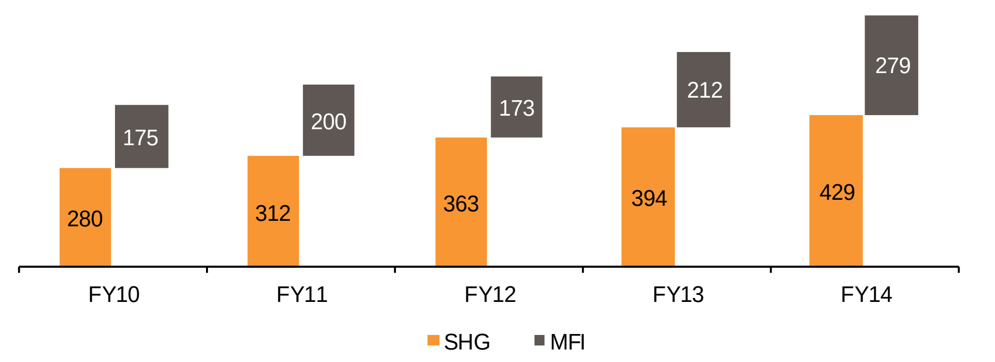
In the context of higher inflation and better income growth in rural economy (since the time RBI came with a guideline) prompted RBI to revise the eligibility limits for microfinance loans. This in our view, augurs well for AUM growth as the targeted customer base increase and so does the average ticket size. The changes done by RBI are 1) the borrower's household annual income does not exceed Rs.0.1mn for rural and Rs.0.16mn for urban areas, (v/s Rs0.06mn and Rs 0.12mn earlier), (2) maximum indebtedness of the borrower does not exceed Rs0.1mn (from Rs0.05mn earlier) and (3) maximum loan size does not exceed Rs0.06mn (earlier Rs0.035mn in the first cycle) and Rs0.1mn (from Rs0.05mn earlier) in subsequent cycles. RBI's view to harness and enhance growth of MFIs provides comfort on sustainability of the business.

SHGs still have higher market share but are fast losing ground; 2/3rd of opportunity still untapped

SHG and MFI - largest and formal sources of financing for the poor

Prime channels to deliver micro finance in India are the Self-Help Group – Bank Linkage Program and MFIs. While the former exists since a long time, capacity to grow is limited because of their business model and inefficiency. SHG members are required to save for six months before they can avail the first loan. Additionally, inefficiencies in terms of customer servicing, credit risk appraisal have also constrained the AUM growth. MFIs, taking advantage of this, gained rapid pace and market share rose, prior to AP crisis. The crisis led to shrinkage in the book. However, with normalcy, we expect growth and market share gains to remain strong.

Exhibit 13: Of Rs3tn+ opportunity, less than 1/3rd is captured (AUM; Rs bn)



Source: NABARD, Emkay Research

70% of the SHG AUM is concentrated in three states and asset quality challenges remain high

SHGs strong in South India, but presence limited in other regions

As per NABARD, top 3 states in South India made up about 70% of the total SHG loan book as of FY14 and about 85% of the disbursements. The SHG presence in other regions is limited, where the MFIs have increased their presence and growth rates remain strong.

Exhibit 14: Ex-AP growth in AUM for SHG has been volatile (%)

	FY10	FY11	FY12	FY13	FY14
Andhra Pradesh	31.9	13.9	14.8	13.9	20.9
Tamil Nadu	22.3	9.7	4.0	7.9	-5.0
Karnataka	27.3	9.3	54.5	-5.1	18.9
West Bengal	26.4	13.0	4.7	54.4	-10.1
Uttar Pradesh	151.7	3.4	-16.8	39.1	-1.0
Kerala	6.7	55.0	13.1	-5.7	1.6
Odisha	14.5	4.2	4.7	8.7	-14.1
Maharashtra	-15.5	-13.1	11.3	5.7	7.4
Bihar	22.6	42.7	30.8	-10.5	-3.6
Assam	49.2	4.9	22.3	3.0	0.9
Total SHG	**23.6**	**11.4**	**16.4**	**8.4**	**9.0**

Source: NABARD, Emkay Research

Exhibit 15: Asset quality challenge across regions (SHG, GNPL, %)

	FY10	FY11	FY12	FY13	FY14
Northern	6.6	7.1	6.9	11.2	13.7
North Eastern	5.5	8.4	5.2	8.6	8.9
Eastern	3.2	4.3	7.3	10.3	11.1
Central	8.1	10.7	13.2	17.3	18.9
Western	4.5	7.3	8.2	8.6	11.1
Southern	1.9	3.3	5.0	5.1	4.6
All India	**2.9**	**4.7**	**6.1**	**7.1**	**6.8**

Source: NABARD, Emkay Research

Exhibit 16: MFIs AUM mix more diversified; SHG top 3 states form 70% of AUM

	FY09	FY10	FY11	FY12	FY13	FY14	MFI GLP mix*
Andhra Pradesh	39.0	42.0	43.0	42.0	44.0	49.0	12.0
Tamil Nadu	15.0	15.0	15.0	13.0	13.0	11.0	14.0
Karnataka	7.0	7.0	7.0	10.0	8.0	9.0	9.0
West Bengal	5.0	5.0	5.0	4.0	6.0	5.0	14.0
Uttar Pradesh	3.0	6.0	5.0	4.0	5.0	5.0	7.0
Kerala	4.0	4.0	5.0	5.0	4.0	4.0	NA
Odisha	6.0	5.0	5.0	5.0	5.0	4.0	4.0
Maharashtra	6.0	4.0	3.0	3.0	3.0	3.0	9.0
Bihar	2.0	2.0	3.0	3.0	2.0	2.0	6.0
Assam	1.0	2.0	2.0	2.0	2.0	2.0	4.0
Others	12.0	8.0	7.0	9.0	8.0	6.0	21.0

*Source: NABARD, MFIN, Emkay Research *GLP= gross loan portfolio as on 3QFY15*

Banks unlikely to compete in this segment

Microfinance loans are small-ticket unsecured loans to low-income households that are traditionally not considered creditworthy and typically lack access to financial services on account of improper documentation. Additionally, ease of servicing (door step delivery model) adopted by MFIs cannot be replicated by the banks on account of higher cost of operations and lack of focus, lowering the convenience factor of the borrowers.

Political risk has waned off; Regulatory framework provides comfort

- One of the key concerns for SKSMF is political risk. While AP like crisis is difficult to predict, we believe there is low probability of similar event recurring on account of RBI being the sole regulatory authority. Moreover, sensitive period of state and central election along-with rural slowdown did not see disruption in the MFI business
- The contentious issues, which brought about the AP ordinance, are addressed in the regulatory framework designed by RBI: (1) **exorbitant interest rate charged:** Regulation puts a cap on lending rates and spreads, (2) **overleveraging of the customer:** Now, post regulations borrower can avail loans from maximum of two MFIs and Rs0.1mn is the maximum loan amount, (3) **coercive recovery:** Under the new framework, recovery can be done only at the center and recovery agent is not allowed to go to the premise of the borrowers at-least till two payments are defaulted
- Additionally, the strength of joint liability group is exhibited from the fact that contagion of the AP crisis did not spread to other states and SKSMF maintained collection efficiency of 95%+ in non-AP states, even as it ran down the AUM
- Incorporation of MUDRA and adoption of MFI Bill would immunize unregistered NGOs and small micro finance institutions from political intervention. The concept of MUDRA also shows the intent of both Central Government and the RBI to facilitate MFI growth, realizing their importance in financing the lower strata of the economy

AP ordinance brought the MFI business to a virtual halt, raising concerns over sustainability of the business

AP ordinance raised a question on MFI operations

In Oct'10, questions were raised on the very existence of MFIs as the erstwhile AP government implemented an ordinance to regulate the MFIs. The rationale was high interest charged (leading to super-normal profits at the cost of poor), coercive recovery practices and aggressive lending by MFIs, translating into over leveraging of the borrowers.

The steps embarked by the ordinance were (1) MFIs in the state would be required to register with respective authorities in each district they operate, (2) restricted one member of Self-help group to be a member of another self-help group/MFI and (3) stringent rules and conditions laid for disbursement and recoveries and elongating of repayment period to at-least one month raised operational difficulties and brought the business virtually to a halt in the state of AP.

Exhibit 17: AP ordinance made functioning of the MFI defunct

	Prior to AP Act	AP Ordinance
Registration	NGO/NBFCs were free to operate	Registration with district authorities at every district they operate
Borrower sourcing	Free to source	No member of SHG can be a member of other SHG/MFI
Interest rate Charged	Free to charge rates, which included various fees as well	Nothing except interest should be charged which should be mentioned explicitly. Additionally, interest charged cannot be higher than the principal amount
Recovery	Recovery efforts could have been made at the doorstep of the borrower	Recoveries can be done only at the central locations
Undertaking by CEOs	No requirement	CEO becomes directly liable for action if there is any lapse in operations even if happens at the branch level

Source: AP Ordinance, RBI, Emkay Research

Despite state and national elections, collection efficiency remained high in non-AP states reducing concerns of contagion effect and strength of joint liability group

Fear of contagion effect but business model well accepted by other states

The risk for MFIs was other states may follow suit by formulating their own regulations and policies and spoil the credit culture. While in selected pockets local politicians tried to disrupt MFI business, at the aggregate level, states refrained from formulating ordinance. This was even at a time when many states were close to elections and our interaction with industry experts suggest most of the states have accepted the current MFI business model. Additionally, even during the phases of state elections collection efficiency remained strong.

Exhibit 18: State elections post AP ordinance; Nothing unfolded except minor disruptions

2011	2012	2013	2014
Kerala	Goa	Tripura	Andhra Pradesh
Tamil Nadu	Manipur	Meghalaya	Arunachal Pradesh
Assam	Punjab	Nagaland	Orissa
Puducherry	Uttarkhand	Karnataka	Sikkim
West Bengal	Uttar Pradesh	Delhi	Maharashtra
	Gujarat	Rajasthan	Haryana
	Himachal Pradesh	Madhya Pradesh	Jammu and Kashmir
		Chhattisgarh	Jharkhand
		Mizoram	

Source: Government of India, Emkay Research

Exhibit 19: Sparse cases of collection efficiency dropping ex-AP (%)

	3QFY11	4QFY11	1QFY12	2QFY12	3QFY12	4QFY12	1QFY13	2QFY13	3QFY13	4QFY13
AP	43.6	10.5	12.1	10.7	25.2	NA	NA	NA	NA	NA
Karnataka	99.5	99.3	99.1	99.5	99.9	100.0	99.8	99.8	99.8	99.8
Orissa	99.1	98.1	96.8	96.3	96.7	97.9	99.8	99.7	99.8	99.9
Maharashtra	99.5	97.9	97.5	98.0	99.4	99.9	99.8	99.9	99.9	99.9
Bihar	99.8	99.8	99.4	99.5	99.6	99.9	99.6	99.7	99.8	99.8
West Bengal	95.3	90.5	88.3	86.0	81.7	80.2	89.1	95.9	99.3	99.8
Uttar Pradesh	99.7	99.6	99.4	99.2	99.5	99.8	99.8	99.7	99.7	99.8
Kerala	100.0	100.0	99.9	100.0	100.0	100.0	99.8	99.9	99.9	99.9
Madhya Pradesh	99.8	99.4	98.6	98.1	98.2	99.3	99.2	99.7	99.8	99.9
Rajasthan	99.1	99.3	99.0	99.0	99.2	100.0	99.7	99.8	99.8	99.9
Jharkhand	99.2	99.1	98.7	100.0	99.8	100.0	99.8	99.8	99.8	99.9
Punjab							99.8	99.8	99.8	99.8
Haryana	98.1	98.7	99.2	99.7	100.0	100.0	99.7	99.8	99.9	99.9
Uttaranchal	99.9	100.0	99.8	99.9	99.7	100.0	99.6	99.8	99.9	99.9
Chhattisgarh	99.2	99.7	99.6	99.9	99.9	100.0	99.8	99.9	99.9	99.9
Other states	99.5	96.7	91.5	92.0	97.3	99.9	99.9	33.9	46.1	NA

Source: Company, Emkay Research

RBI steps in and strengthens the regulation – now the sole regulator

Regulatory authority of RBI provides comfort on functioning of the MFIs

AP crisis, led to a sudden drop in collection efficiencies and AP based MFIs (large players) saw profitability and networth erosion, raising concerns over the existence of MFI industry. RBI intervened by appointing a committee under Y. H. Malegam to study the practices of MFIs and came out with a regulatory framework to strengthen the functioning of MFIs and abate the risk of political intervention.

Exhibit 20: RBI lay stringent guidelines, which addresses the critical issues surrounding the sector

	Guideline	Issue addressed
Pricing	Spread Cap for large MFIs = 10%; Spread cap for small MFIs = 12%; Interest rate charged = cost of funds + 10% or average base rate of five largest commercial banks by assets multiplied by 2.75 times, whichever is lower; Processing fees can be maximum of 1% of disbursement	Prevents fear of exorbitant interest rates charged + higher rates charged under the disguise of processing fees
Prevention of multiple borrowings	Borrower at no time can borrow from more than two MFIs Max loan amount Rs100,000 (raised from 50,000); Disbursement of Rs60,000 (enhanced from Rs35,000) in first cycle and Rs100,000 (raised from 50,000) in subsequent cycles	Resolves issue related to overleveraging of borrowers
Recovery	Recoveries at residence only if customer fails to appear the designated place more than twice	End to coercive recovery practices
Transparency	Ban on collection of security deposits; Detailed loan card to every borrower	Improved process
Loan characteristic	Loan towards income generation activities > 70% of overall assets	
Funding access	MFI loans continue to qualify as PSL	Liquidity support

Source: RBI, Emkay Research

Expect AUM CAGR of 40% over FY15-18E

- SKSMF AUM CAGR (non-AP) was 47% over the last three years and we expect the momentum to continue driven by (1) rapid gain in client addition through utilization of existing network and employee addition and (2) gradual rise in average ticket size. We have factored disbursement and AUM CAGR of 40% each over FY15-18E
- Entry barriers, led by regulatory supervision of MFI, have increased, which would shift the balance in favor of the incumbents/large players. This is visible in dominant market share of 80% for MFIs, with GLP of Rs5bn+ (i.e. 13 players).
- Leadership, conservative lending practices and diversified and well established branch network and rapid increase in customer base positions SKSMF to grow on the back of this structural opportunity
- The company is adequately capitalized with CAR of ~32%, which would support growth. Additional strong internal accruals (earnings less dividend payout), of ~20% would add to the lending capacity

Regulatory supervision has raised the bar for entry into the MFI business

Stringent norms by RBI on functioning of MFIs has raised entry barriers and new players will find it difficult to gain dominance

Untapped potential in MFI business remains high. However, stringent regulations post the fallout of the AP crisis has heightened the entry barriers in this segment.

- Cap on lending rates (average base rate of top 5 banks * 2.75) / spreads (10% or 12%) will require companies to contain their cost of funds. New / small players have small balance-sheet and absorption of any unforeseen losses can potentially wipe out their networth. The risk associated is high. Hence, banks will continue to charge higher interest rates and in our view, smaller players will remain marginal players
- MFI business is manpower-intensive and with regulatory supervision, companies will keep on investing in technology. This will keep cost of operations high and with fixed spread on loans, earnings profile can be under pressure, till economies of scale flow in. Additionally, loss, given default in micro-financing, is high. Hence, investments and conservative credit underwriting standards will be important in ascertaining profitability and sustainability of the business.

Regulation of "Not more than 2 MFIs can lend to the same borrower" will help leaders

Early mover advantage will help leaders in MFI space to maintain/gain market share; smaller players have to go deeper to find their space

In its bid to reduce multiple lending and over leveraging of the borrowers, RBI has prescribed that a borrower can borrow from a maximum of two MFIs. This, on one hand, will reduce the concern of overleveraging, while on the other hand, will give an advantage to the incumbents. In our view, the existing large players would have tapped easy-to-reach customers and smaller players will find it difficult to lure them away on account of low differentiation. MFIs with GLP of greater than 5bn have maintained their AUM market share at 80%+, and in our view, this will remain steady.

Exhibit 21: Top 13 players continue to enjoy MS of 80%+ in an industry of 47 players

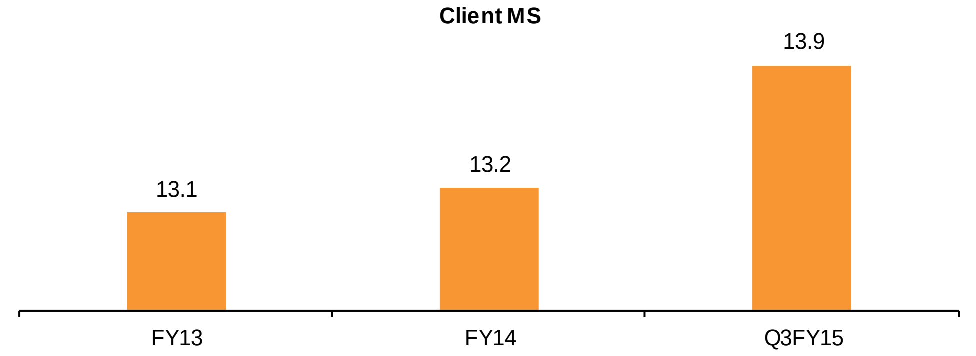
	FY12	FY13	FY14	Q3FY15
GLP	87.2	85.3	83.5	82.9
Branches	77.3	77.9	75.9	71.5
Employees	75.4	78.7	77.9	76.9
Clients	82.3	83.7	82.9	82.2
Loans disbursed	87.1	83.9	84.0	85.4
Loan amount disbursed	77.2	83.9	83.6	85.3

Source: MFIN, Emkay Research

SKSMF client market share is on the rise

SKSMF is the second largest MFI and its client market share is on a gradual rise. It increased from 13.1% in FY13 to 13.9% in 9MFY15. This has been driven by presence in 310 districts, highest amongst MFIs.

Exhibit 22: Client market share gradually rising, which in our view, should continue (%)



Source: MFIN, Emkay Research

Diversified and well established network has created visibility and acceptability for SKSMF

Visibility and diversified network to help AUM growth for SKSMF

SKSMF has a diversified network with presence of over 5 years in most of the states. In non-southern states like Orissa, Jharkhand and Rajasthan, SKSMF has market share of 20%+ and this is likely to remain strong on account of lower competition and established brand name. In the past, diversification has helped SKSMF. If growth slows down in one state, the company can shift growth engine to other states, keeping overall AUM growth robust. Strategy of diversification would keep growth momentum intact with lower risks.

Exhibit 23: Dominant MS in some of the states with long term presence will aid growth

	Branches	MS*	Vintage		Branches	MS*	Vintage
Karnataka	170	18.3	7.3	Jharkhand	41	22.0	6.3
Odhisa	147	26.3	6.9	Chattisgarh	21	9.5	6.7
West Bengal	135	10.2	6.4	Punjab	18	NA	5.6
Bihar	121	17.6	6.7	Haryana	16	15.2	5.9
Maharashtra	120	13.4	6.8	Uttaranchal	11	NA	5.0
UP	114	14.3	6.0	HP	3	NA	0.3
MP	67	8.6	6.8	Gujarat	1	0.3	7.2
Rajasthan	59	22.3	6.6	Delhi	1	1.6	5.7
Kerela	48	24.3	5.0	**Overall**	**1091**	**NA**	**6.6**

*Source: Company, MFIN, Emkay Research * branch MS pertains to 3QFY15*

Significant productivity gains over FY12-15

Client market share of SKSMF has improved and we expect it to rise going forward as well

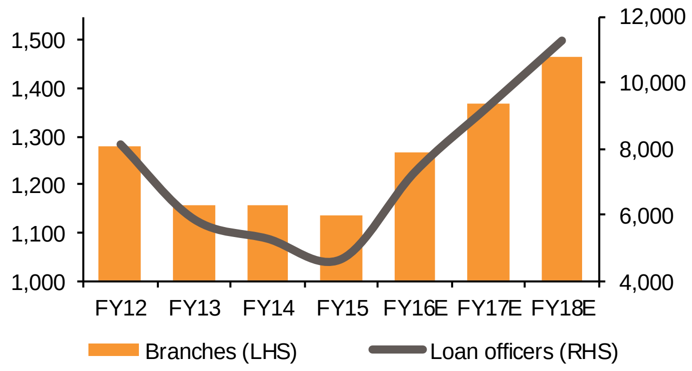
SKSMF has upped the utilization of its existing network, which is evident from the increasing productivity of its branches and loan officers. While number of branches has remained stagnant at ~1,100 and loan officers declined significantly to 4,638 in last three years, (1) active client base in non-AP states increased at a CAGR of 13% and (3) AUM CAGR was 47%.

Utilizing existing network by deploying higher number of loan officers

Employee addition will aid optimal utilization of network and growth; additionally, technological initiatives taken by the company will aid productivity and faster ramp up in AUM growth

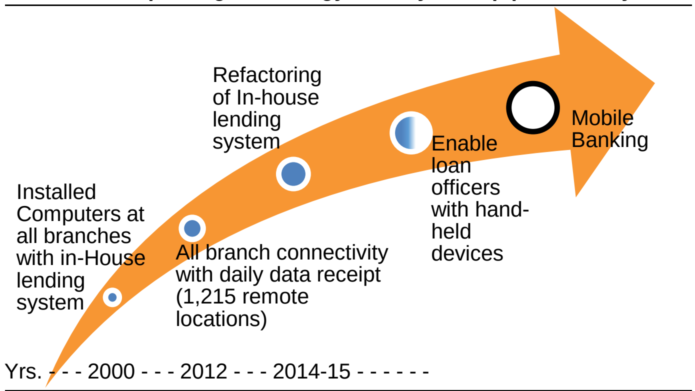
SKSMF has significantly improved its operational efficiency, with customer/ branch and customer/ loan officer of 3,214 and 787 in FY15 as compared to 1,984 and 312 in FY12. However, when we compare loan officer per branch with its peers, it is lower at 4 as compared to 6 and 8 for its peers. While some of the MFIs would require lower number of loan officers due to its presence in urban region, it would not be true for all the players. In our view, SKSMF has enough room to increase the loan officers at its existing branch network and drive higher center/clients addition and hence, disbursement and AUM growth. We factor in employee addition of 2000 each over the next three years, thereby accelerating centre and client addition CAGR of 29% and 32% respectively.

Exhibit 24: Gradual expansion in branches; employee base to rise



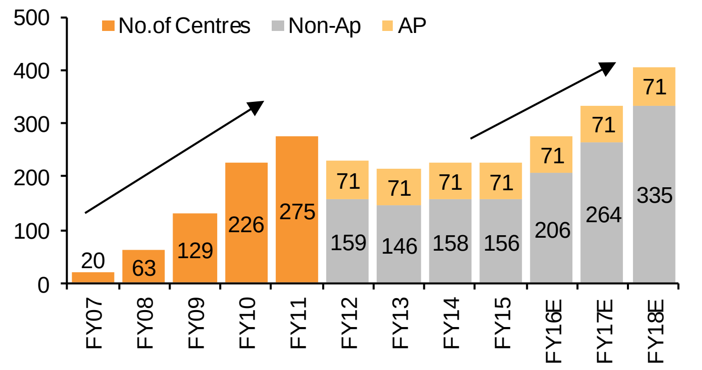
Source: Company, Emkay Research

Exhibit 25: Improving technology is likely to help productivity



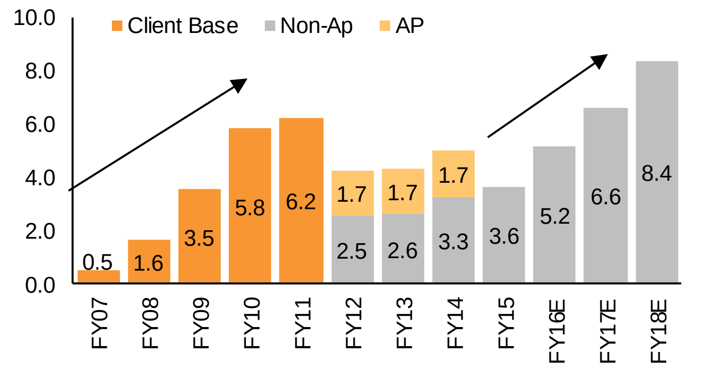
Source: Company, Emkay Research

Exhibit 26: Post consolidation, expect SKSMF to expand…



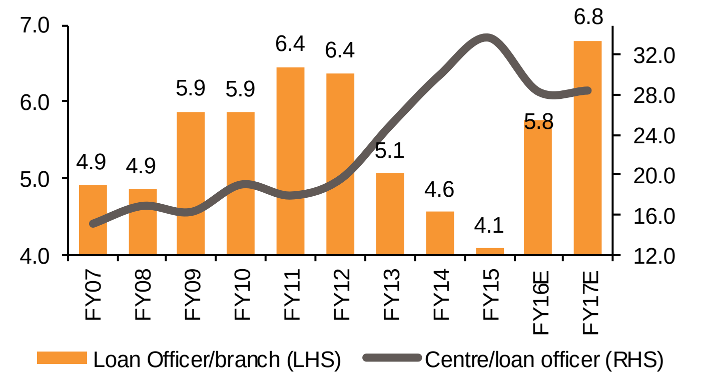
Source: Company, Emkay Research

Exhibit 27: …this would translate into faster customer acquisition



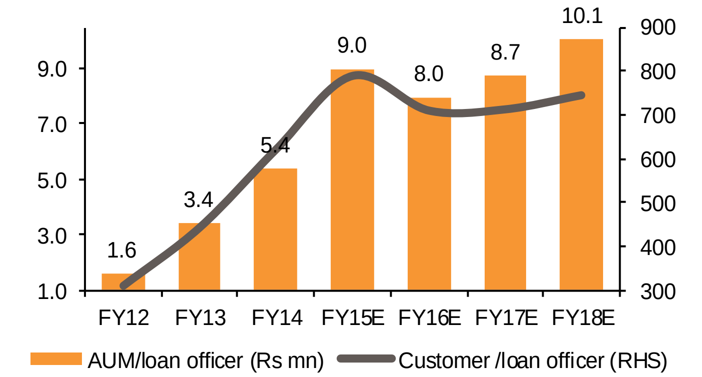
Source: Company, Emkay Research

Exhibit 28: Employee addition to underutilized branch network



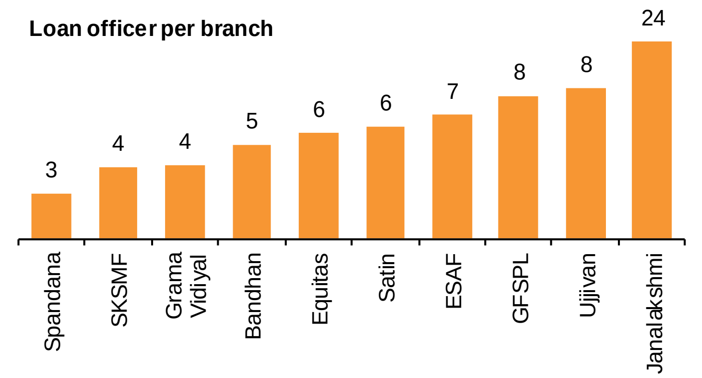
Source: Company, Emkay Research

Exhibit 29: Not factored significant rise in clients per loan officer



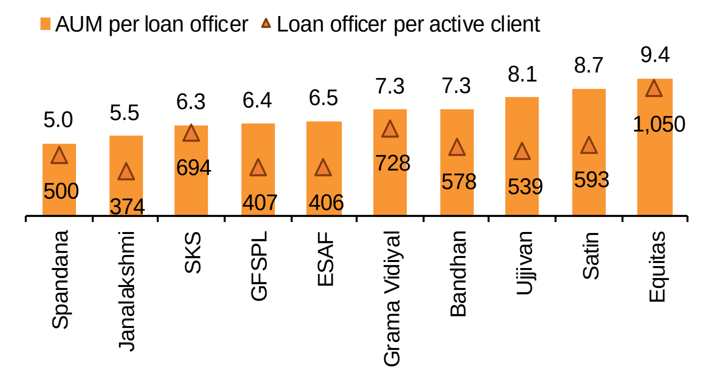
Source: Company, Emkay Research

Exhibit 30: Branch network of SKSMF underutilized vs. peers



Source: MFIN, Emkay Research

Exhibit 31: Employee productivity better than peers (Rs bn)



Source: MFIN, Emkay Research

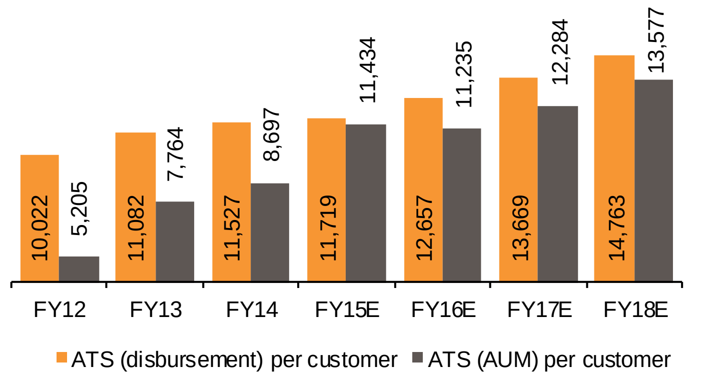
Contrary to general perception of the investors, average ticket size for disbursement has remained relatively constant in last three years.

Higher average ticket size to aid growth

One of the other stimuli for AUM growth is higher average ticket size per customer. This has increased at a CAGR of 27% over the last two years to Rs10,738, but it is still lower than most of the other MFIs. We note average ticket size per disbursement has not grown significantly and is in the range of Rs10, 000-12,000 (CAGR of 5% over FY12-15E), despite rising inflation.

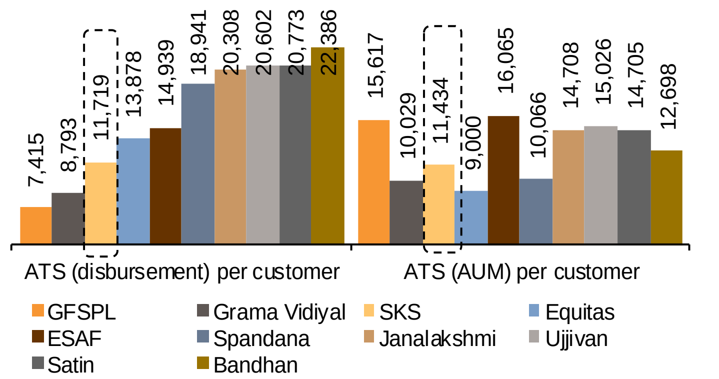
During the interactions with the management/employees/clients, we note that there is demand for higher ticket size loan. SKSMF, has a conservative approach and has kept average ticket size per disbursement in a narrow range. However, going forward SKSMF is also confident of growing its AUM in long term loans where average ticket size is higher at Rs28,739 i.e. more than double the average ticket size of income generation loans. Client eligibility for these loans would be only those who has completed two cycle of payments of lower tenure loans. This again would be under JLG model and hence risk would be low. We factor a gradual increase of 8% per annum in average ticket size per disbursement, which would help AUM growth. The real push to AUM will still be new customer additions.

Exhibit 32: Factoring gradual improvement in ATS (Rs)



Source: MFIN, Emkay Research

Exhibit 33: ATS lower than most of its peers room for improvement



Source: MFIN, Emkay Research

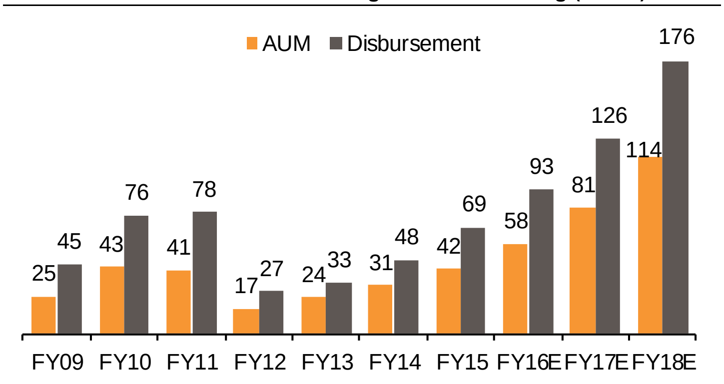
Conducive environment, underpenetrated industry, strong capitalization to support robust AUM growth over the next three years

On a strong growth path

AP crisis resulted in a write-down of the portfolio in the state of Andhra Pradesh. This led to erosion of networth, as SKSMF absorbed losses and faced liquidity constraints as banks became risk averse and were reluctant to lend to MFIs. Hence, even non-AP portfolio of SKSMF declined by 60%+ over FY10-12 to Rs16.7bn.

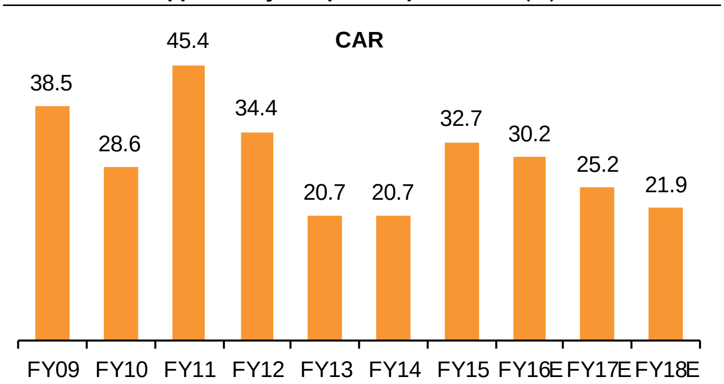
Since then, SKSMF has fully recovered by paying its debt obligation (only AP-based MFI who did not opt for debt restructuring) and is equipped with capital (raised capital of Rs2.6bn and Rs4bn in FY13 and FY15; Tier I of 32% as of FY15). SKSMF non-AP AUM CAGR was 47% over the last two years. We expect the momentum to continue and have factored disbursement and AUM CAGR of 40% over FY15-18E.

Exhibit 34: Disbursement and AUM growth to be strong (Rs bn)…



Source: Company, Emkay Research

Exhibit 35: …supported by adequate capitalization (%)



Source: Company, Emkay Research

Perceived risk to asset quality higher than actual

- AUM of SKSMF is more diversified as compared to last cycle and tested business model of joint liability group will keep collection efficiency robust
- SKSMF has, in the past, demonstrated that recovery rate/performance of non-AP portfolio was healthy despite the fear of contagion impact of AP crisis spreading to other states and company winding down its AUM pool. This, in our view, is a comforting factor against the thesis of ever-greening of loans, as when growth fell, GNPLs were still under control
- The recovery has started flowing in AP portfolio, albeit at a slower pace raising hope for the recovery of Rs15bn write offs. While management is not too optimistic about strong recoveries from this portfolio, any positive development can provide cushion against higher credit cost estimates of 60bp over FY16-18E as compared to almost nil in FY15

Barring state of AP (crisis period), asset quality performance remained strong

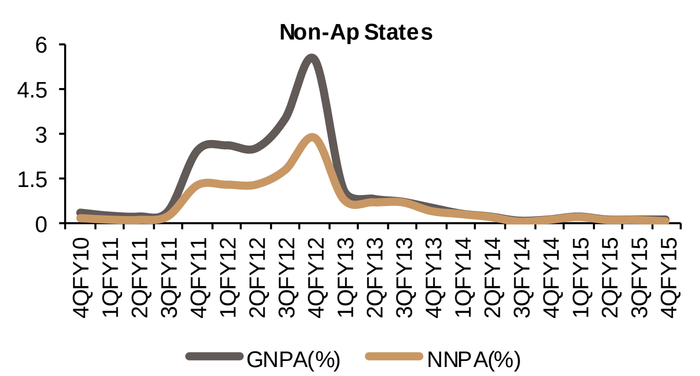
Collection efficiency in non-AP states was strong even at the time SKSMF was unwinding its AUM

AP-crisis created a fury for the MFI industry, as it resulted in a sharp rise in GNPLs% and NNPLs% for SKSMF, which increased to 35.4% and 32.1% as compared to average of 0.25% and 0.1% over FY10-13. Rise in NPLs primarily came from the state of Andhra Pradesh, where the entire loan portfolio had to eventually be written off. Ex-AP, GNPLs and NNPLs peaked at 5.5% and 2.9% respectively. The phase also brought to the fore, the inherent strength of the joint liability group model as asset quality held up well (1) despite fears of contagion impact of AP crisis spreading to other states.

Additionally, SKSMF pruned its portfolio in other states and still maintained its asset quality. This, in our view, is comforting, as anecdotal evidence suggests that if growth slows down, GNPLs rise if risk appraisal is not stringent. Hence, even when SKSMF saw a material slowdown in growth, GNPLs were contained, providing evidence of strong risk appraisal and the company not into the practices of ever-greening of loans. Currently, SKSMF's GNPL and NNPL in non-AP states are closer to 0.1% each.

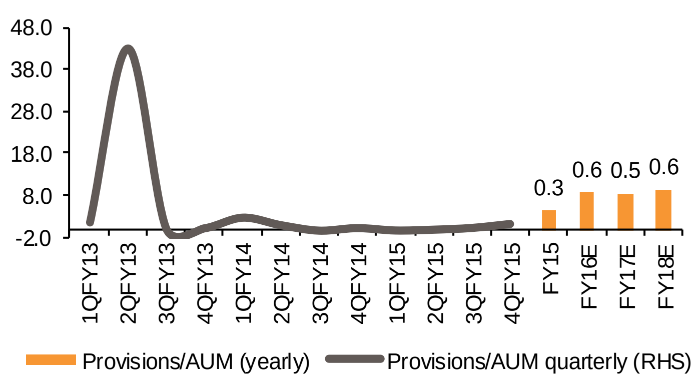
While there is no clear method to predict or model an AP-like crisis, steps taken by the regulator as well as SKSMF reduces the probability of similar impact. SKS has diversified its portfolio and has capped its exposure at a state, district, and branch level. Today, Orissa is the largest exposure at 16.8% vs. 27% for AP at the time of the crisis. Also, strong growth has been coming from some of the states, where SHG presence is lower, reducing the tail risks.

Exhibit 36: Collection efficiency in non AP states held up well



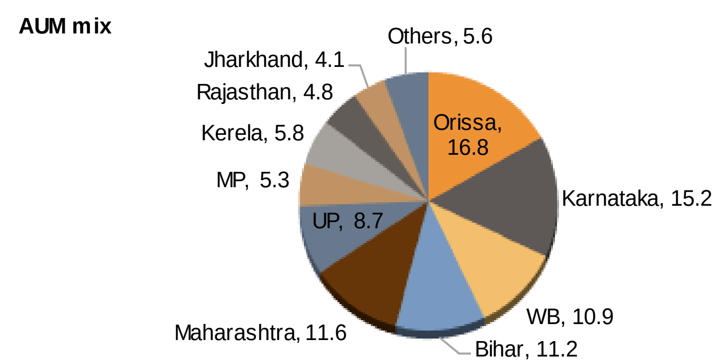
Source: Company, Emkay Research

Exhibit 37: Factored gradual increase in credit cost (%)



Source: Company, Emkay Research

Exhibit 38: Diversified AUM to aid asset quality



Source: Company, Emkay Research

Internal practices of SKSMF more prudent than regulatory requirement

SKSMF follows more conservative asset quality norms than those required by RBI i.e. SKSMF classifies loans as NPLs, once if they remain unpaid for 60 days versus RBI norms of 90 days. Also, RBI norms require provisioning on overdue installments but SKSMF's internal policy is to provide on the outstanding principal

Exhibit 39: Internal norms at SKSMF more stringent than what RBI prescribes

		RBI NBFC MFI norms	SKS Compliance
Asset Classification	Standard assets	0-90 days	0-60 days
	Substandard assets	91-180 days	61-180 days
	Loss assets	>180 days	>180 days
Provisioning Norms	Standard assets	1% of overall portfolio reduced by provisions for NPA (if provisions for NPA < 1% of overall portfolio)	0.25-1% depending on NPA or as stipulated by RBI, whichever is higher
	Substandard assets	50% of overall installments due	50% of outstanding principal
	Loss assets	100% of installment due	100% of outstanding principal/write-off

Source: Company, Emkay Research

Credit bureaus will drive better underwriting standards

Credit bureau in MFI segment can help replicate the improvement in underwriting standards seen for retail loans

RBI requirements for an overall individual loan cap of Rs60,000 (rural) and Rs0.1mn (urban) and the upper limit of two MFI lenders per borrower, necessitate the need for setting up of centralized collection of data, for which credit bureau (CB) was formed. At present, MFIs have registered with, and have been contributing credit information to, two credit rating bureaus, Equifax and CRIF High Mark. The former's credit bureau for microfinance was launched in May 2011. It now has 200 registered members. Together, Equifax and CRIF High Mark have 67mn unique borrower records, comprising of 22mn live borrowers. As the processes develop and more information is captured and sanitized, CB could have a positive impact on asset quality of MFIs as it did for the retail banking space. Credit bureaus are a big deterrent for borrowers as if they default, future access to credit would be cut.

Equifax India: Facilitating better risk management practices

Equifax India is a solution provider related to credit information, business analytics and risk management, across India. It has more than 200 members in aggregate and 147 microfinance members. They cover almost 99% of the AUM of the MFIs.

- **Business growth and collection efficiency remains strong:** Business opportunities in MFI segment remains strong and the aggregate data depicts strong collection efficiency of 99%+ across geographies. Default rates may be volatile in some of the districts but strength of the unique business model is driving better performance. Defaults are likely to take place largely due to employee fraud or due to pressure / influence from a higher authority (religious leader / Sarpanch etc.)
- **SHG model not competitive:** The business model of SHG requires up front savings from the members before loans are disbursed. Hence it is more difficult to get loans from an SHG than a MFI; door-step banking by MFI is giving them the advantage over banks for growth
- **Addressing the need of overleveraging and of the customers:** Equifax, being the aggregator and covering 99% of the MFI industry AUM, helps in meeting with the RBI norms of one borrowers cannot take loans from more than two lenders. Additionally, it also helps in assessing the overleveraging of the customers.
- **Efforts to collect data from SHGs:** The missing link however is that data for SHGs are not available as banks are reluctant to collect/share the data. RBI has been pushing the banks to compile this data and it is been facilitated by Planet Finance, but it is at least a year away. This would further enhance the credibility and strengthen the risk management practices.
- **Technology has scaled up and is now robust for large players:** Top ten MFIs have significantly scaled-up their technology and back end processes, which used to be poor some years back. This provides better assimilation of the data and is helpful from the risk management perspective.
- **Data used for business strategies:** The data assimilated by Equifax could be used to tap growth, improve collection efficiency and to launch different products. Top 5 MFIs make good use of Equifax products and have been trying to design strategies and products revolving around it.

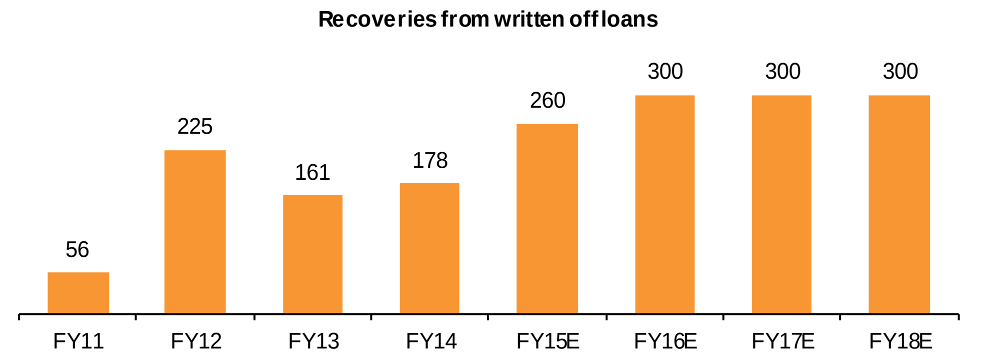
- **Monitoring the end use of the loans:** Cash is fungible. Hence, end use of the funds cannot be established with certainty. However, in rural lending, the end use can be monitored in a much better manner than in urban geographies. Most of the rural MFIs provide loans for income generation activities, whereas for urban region it could be for consumption purpose as well e.g. loan provided to maids, workers etc. SKSMF has a strong monitoring of the end use of the funds, though it may not be conclusive every time. Managers of SKSMF are on the field to check the inventories etc. and this is across geographies. Among MFIs, SKSMF is a conservative lender with strong risk management abilities.
- **HDFCB strong in microfinance:** HDFCB and ICICIBC has strengthened its reach in the rural regions. This has resulted in each having a microfinance loan portfolio of Rs15-20bn
- **Difficult to estimate market opportunity:** At the pan India level, opportunity size of microfinance is huge. However, to ascribe a certain number state-wise is difficult. The loan penetration of micro-finance, in each state has its own dynamics viz. UP has a challenge of women empowerment, NE and east are facing Naxalite issues.
- **Jan DhanYojna – Can it be a game changer?** While banks have opened the accounts and would help the objective of financial inclusion in the longer term. The differentiated business model of MFIs and high cost of operations would be deterrents for banks.

Gradual recovery from Andhra Pradesh to provide cushion to credit cost

We have factored Rs300mn of recoveries each year over FY15-18. Can be higher if environment improves in state of AP

SKSMF had Rs14.9bn of AUM in the state of Andhra Pradesh at the time the crisis started. This had to be entirely written-off and the company recovered just Rs900mn in the last three years. Management of SKS mentioned that post interim relief order from Supreme Court, it continues to maintain contacts with borrowers through low disbursements. At present, it intends to disburse only 70% of its recoveries in AP as fresh loans. In FY15, pace of recoveries improved to Rs310mn and we have estimated overall recoveries of Rs300mn every year from FY16-18E.

Exhibit 40: Building gradual recoveries from written-off portfolio (Rs mn)



Source: Company, Emkay Research

Expect asset quality to be stable but building higher credit cost as cushion

We expect asset quality to remain stable. We assume SKSMF will continue to build loan loss reserves, given strong profitability. Additionally, we keep our credit cost estimates high as a cushion against adverse events and the unsecured nature of loans.

Profitability likely to moderate but remain superior

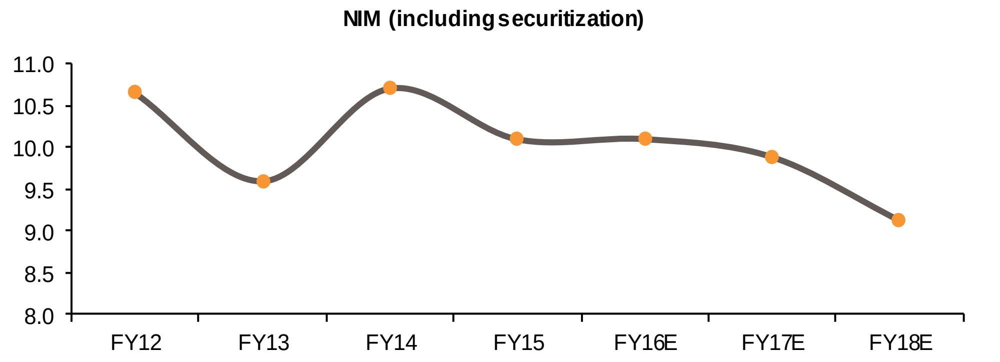
- Fall in the systemic interest rate would help in reduction of cost of funds, driven by ALM profile. However, spreads are capped at 10%and incremental benefits would be passed on to the borrower and lending yields will come down
- The company has initiated various cross-sells of products, which not only provides it an opportunity to provide loans but also earn facilitation fees. This business is strong from perspective of return on investment
- As discussed earlier, branch network of SKSMF is still under-utilized and continued growth momentum will require additional rise in employee force, rather than branches. Hence, we expect other expenses to be in line with its long term trend. We factor in employee addition of 2,000 every year for the next three years and therefore, employee cost CAGR to be 24%. Other expenses CAGR are estimated to be lower at 15%, driving cost to average AUM and cost to income ratio lower to 6.0% and 51% as compared to 8.8% and 61% at the end of FY15 respectively.
- Building of higher credit cost and increase in tax rate would however, lead to RoAs on average AUM declining from 5.2% to 4.4% (still will be superior). The leverage of the company remains the lowest and as it improves, RoEs are likely to remain strong at 24% by FY18E

Regulatory compulsion on one hand and pricing power on the other, will keep NIMs in a narrow range

NIMs to decline gradually; Regulations will nullify cost of fund benefits

Loan spreads for MFIs (with loan assets of more than Rs1bn) have been capped at 10%. Hence, SKSMF's loan spreads are not vulnerable to interest-rate fluctuations. On one hand, if the interest rate hardens, SKSMF has the ability to pass on the rise in cost of funds to the borrowers (pricing power), whereas if the cost of funds moderate, spread cap of 10% nullifies the benefit. Hence, we expect spreads to remain stable, though over a longer term, SKSMF would pass the benefit of operating leverage in the form of reduced cost for its borrowers, which may lead to some NIM compression. However, it would be profitability neutral.

Exhibit 41: NIMs to remain in the narrow range



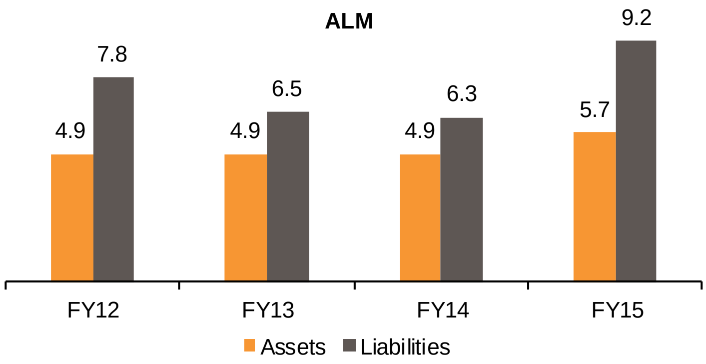
Source: Company, Emkay Research

93% of the borrowings comes from banks, which should help reduction in cost of funds and help lower the interest rates for borrowers

Liability composition skewed towards banks

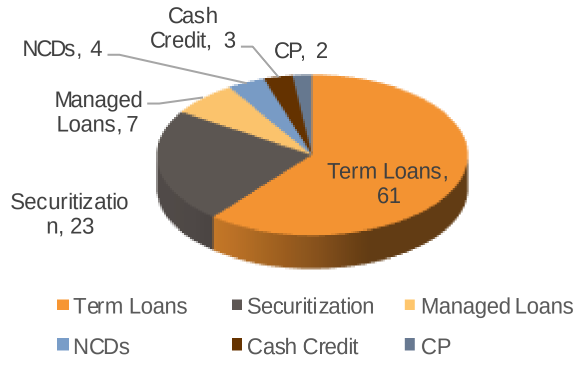
SKSMF is primarily dependent on bank borrowings to fund its loan growth. Bank borrowings made up 94% of total balance sheet borrowings as of Mar-15, and about 30% of AUM were securitized and sold to banks. Access to other sources of borrowings such as capital CPs, debentures, though was virtually absent post AP crisis. Banks receive "priority sector" status on loans to MFIs (both on-balance sheet and securitizations), which ensures healthy demand from the banking sector. Hence, we do not expect any funding constraint to arise for SKSMF in the near to medium term. Additionally, reduction in base rate of the banks would allow passing on the benefits to the borrowers, which would be viewed positively.

Exhibit 42: ALM of the company



Source: Company, Emkay Research

Exhibit 43: Borrowing mix of the company



Source: Company, Emkay Research

Increase in cross-sell ratio depicts strength of SKSMF's franchise and we believe this would be RoA accretive

Cross-sell of products - RoA accretive

With loan spreads and processing fees capped, SKSMF has been actively focusing on cross-sell of products to boost revenues. A strong reach and a large number of clients at its disposal provide SKSMF an opportunity to leverage. This also helps the seller of the product to access the large number of customer base without incurring higher cost and in return, he pays facilitation fee on the sale of the product.

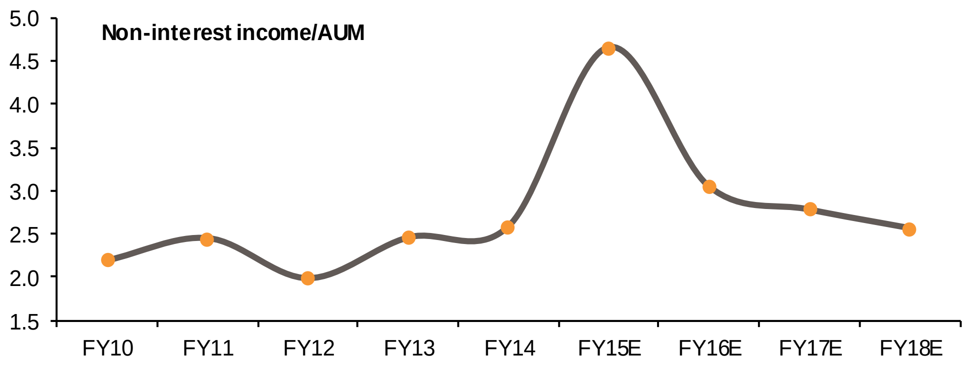
SKSMF provides loans for mobile phones priced below Rs2,500 and earns a facilitation fee (Rs200; i.e. average of 10% returns without incurring any additional expense) from the equipment provider. Since inception, the company has facilitated mobile purchase of 0.7mn handsets to its borrowers. Similarly, SKSMF also provides solar lamps and would soon introduce sewing machines as product cross-sells. Management targets contribution from fee income to total income to reach 15% – this is without any deployment of funds. Hence, it would be RoA accretive.

Exhibit 44: Increasing product penetration depicts strength of SKSMF's franchise

	FY14	FY15	FY16E	FY17E	FY18E
Mobiles sold (m)	0.2	0.5	0.6	0.8	1.0
Penetration %	4.0	8.5	8.6	9.2	9.8
Solar lamps sold (m)	0.3	0.4	0.5	0.7	0.9
Penetration %	5.0	7.3	7.4	8.0	8.5
Sewing machines sold (m)			0.2	0.3	0.4
Penetration %			2.9	3.4	3.9
Total cross-sell income	**82**	**237**	**258**	**346**	**447**

Source: Company, Emkay Research

Exhibit 45: Non-interest income to average AUM to remain strong



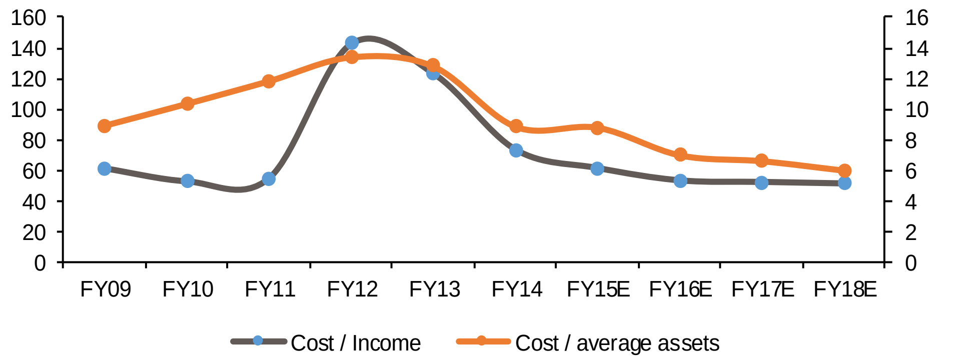
Source: Company, Emkay Research

Employee productivity and utilization of existing branch network will drive operating leverage

Room for operating leverage, expect better productivity

Branch network of SKSMF is still under-utilized as loan officer per branch is lower than peers, which can go up to aid customer acquisition. We believe continued growth momentum will require additional rise in employees, though branches and other expenses would not see a material shift from its long term trend. We factor in employee addition of 2,000 every year for next three years and therefore, employee cost CAGR to be ~24%. Other expenses CAGR are estimated to be lower at 15%, driving down cost to average AUM and cost to income ratio to 6.0% and 51% as compared to 8.8% and 61% for FY15 respectively.

Exhibit 46: Productivity gains and utilization of branch network will drive operating leverage (%)



Source: Company, Emkay Research

Superior RoAs and RoEs to be maintained in Indian Financial space

Profitability are likely to moderate but will remain superior

Superior NIMs – RoA accretive contribution from other income, benefits of operating leverage will keep operating profits to average assets superior at 6%+. Building of higher credit cost of 60bp and increase in tax rate to 21%. This will lead to RoAs on AUM declining from 5.2% to 4%+ (still will be superior). The leverage of the company remains the lowest and hence, despite falling RoAs, RoEs to be strong at 22-24% by FY18E.

Exhibit 47: Return Ratios to remain strong (%)

	FY11	FY12	FY13	FY14	FY15	FY16E	FY17E	FY18E
Interest Income	27.7	14.4	15.0	17.3	17.4	18.4	18.2	18.0
Income from Securitization	*2.8*	*1.2*	*2.9*	*2.0*	*1.8*	*1.4*	*1.2*	*1.1*
Interest Expended	8.3	6.9	7.1	7.8	7.7	8.3	8.4	8.9
Net Interest Income	**19.4**	**7.4**	**7.9**	**9.5**	**9.7**	**10.1**	**9.9**	**9.1**
Non-interest Income	2.4	2.0	2.5	2.6	4.7	3.0	2.8	2.6
Loan processing fees	*0.2*	*0.3*	*1.1*	*1.2*	*1.3*	*1.3*	*1.3*	*1.3*
Recovery against loans written off	*0.1*	*0.8*	*0.8*	*0.7*	*0.7*	*0.6*	*0.4*	*0.3*
Other miscellaneous income	*2.0*	*0.9*	*0.5*	*0.7*	*1.4*	*1.1*	*1.0*	*0.9*
Total income	**21.8**	**9.4**	**10.4**	**12.1**	**14.4**	**13.1**	**12.7**	**11.7**
Operating Expenses	11.9	13.4	12.8	8.8	8.8	7.0	6.6	6.0
Salaries & Benefits	*7.7*	*9.0*	*8.6*	*6.1*	*6.4*	*5.2*	*4.9*	*4.6*
Other Operating Expenses	*4.1*	*4.4*	*4.3*	*2.8*	*2.4*	*1.8*	*1.6*	*1.4*
Pre-provisioning profit	**10.0**	**(4.0)**	**(2.4)**	**3.2**	**5.6**	**6.2**	**6.1**	**5.7**
Provisions	5.9	41.8	12.3	0.7	0.3	0.6	0.5	0.6
PBT	**4.1**	**(45.8)**	**(14.8)**	**2.6**	**5.3**	**5.6**	**5.5**	**5.1**
Tax	1.4	1.3	-	-	0.2	1.2	1.2	1.1
RoA	**2.6**	**(47.1)**	**(14.8)**	**2.6**	**5.2**	**4.4**	**4.4**	**4.1**
Leverage (x)	3.1	2.6	4.9	6.4	4.8	4.3	4.9	5.5
RoE	**8.2**	**(122.8)**	**(72.0)**	**16.4**	**24.9**	**19.2**	**21.5**	**22.4**

Source: Company, Emkay Research

Strong earnings/BV compounding = premium valuation

- SKSMF's operational performance, niche presence in an underpenetrated micro-finance industry and strong capitalization (Tier I of 33%) provides comfort over disbursement and AUM CAGR of 40%+ over FY15-18E
- Superior NIMs of 10%+, rising contribution from cross-sell (CAGR of 30%+) and operating leverage (decline of180bp) are estimated to drive EPS and BV CAGR of 30%+ and 24%, over FY15-18E respectively
- Even with lowest leverage of 5.5x among Indian financials under our coverage, average RoEs is estimated to be the best at 22%+ over FY15-18E. Strong internal accruals would keep Tier I ratio at 21%+ in FY18E, implying dilution free growth in medium term
- In the last two years, the stock has outperformed, factoring better fundamentals of the business and scarcity premium for sustainable growth. We expect this will continue on account of superlative balance-sheet/earnings growth and stock returns will be driven by earnings compounding. We assign 70% probability to our base case MFI business and value it at Rs565 per share (4.5x FY17E BV)

RoEs estimated to be at 22%+ over FY15-18 with lowest leverage amongst Indian financials under our coverage

Best earnings compounding in financials: EPS to double over FY15-18E

Post AP crisis in FY10, SKSMF reported AUM decline and earnings erosion for two years. But as the environment stabilized, SKSMF emerged stronger and has delivered on key operating parameters. SKSMF's diversified network/reach, conservative lending practices, and strong capitalization support in an under-penetrated microfinance industry will ensure sustainable business growth in the medium term. In our view, superior NIMs of 10%+, increasing contribution from cross-sell (factored 30%+ CAGR over FY15-18E) and improving efficiency would keep earnings momentum strong (CAGR of 30%+ over FY15-18E) and BV to compound at 24%+ over FY15-18E – best in the Indian financials under our coverage. Average RoE is expected to be 22%+over FY15-18E, with low leverage of ~5.5x at the end of FY18E.

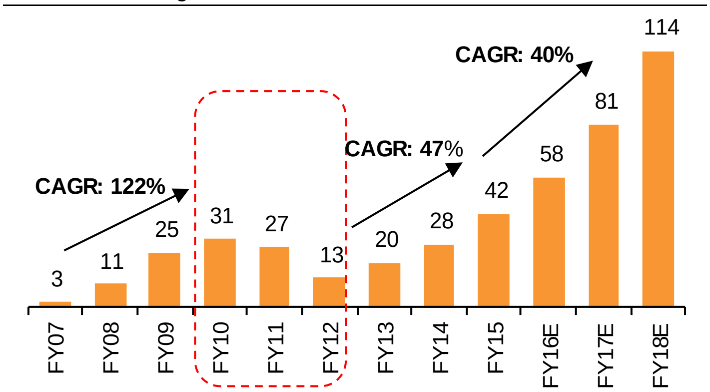
Stable regulatory environment, benefits of economies of scale, underpenetrated market will keep earnings momentum strong

Earnings cycle more favorable than the past

The last decade saw volatility in earnings during (1) **FY05-07:** investments to build/scale the business/operations and (2) **FY11-13:** AP ordinance which led to write-offs of large proportion of AUM in AP and withdrawal from business in other states. Hence, one of the concerns for investors could be profitability over a longer cycle.

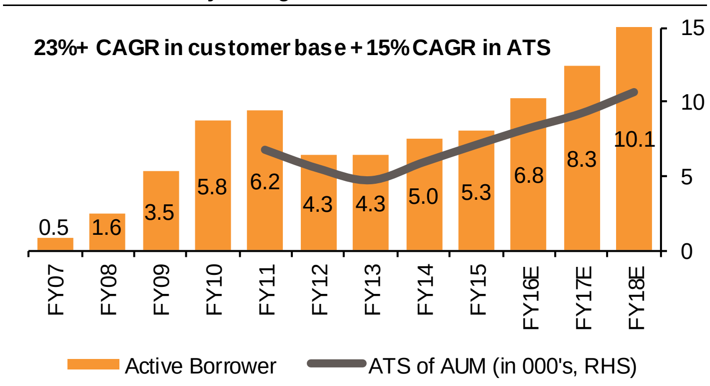
In our view, the next cycle will be different for earnings profile and stability will emerge as (1) regulatory support by RBI/MFI bill/ MUDRA Bank, will ensure smooth and sustainable business, (2) vast untapped potential and diversified presence (as compared to higher concentration in last cycle) will ensure strong AUM and earnings growth in medium term, (3) conservative lending practices and formation of central database viz. Equifax and CRIF Max will mitigate asset quality risk and (4) if SKSMF receives small bank in-principle approval, it would act as a tailwind and comfort level for the sustainability of business will rise with an option of SKSMF diversifying its offerings over medium to long term.

Exhibit 48: AUM growth to remain robust



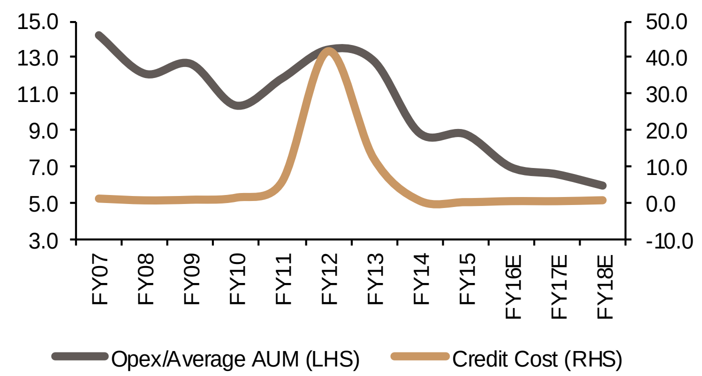
Source: Company, Emkay Research

Exhibit 49: Driven by strong customer addition and not ticket size



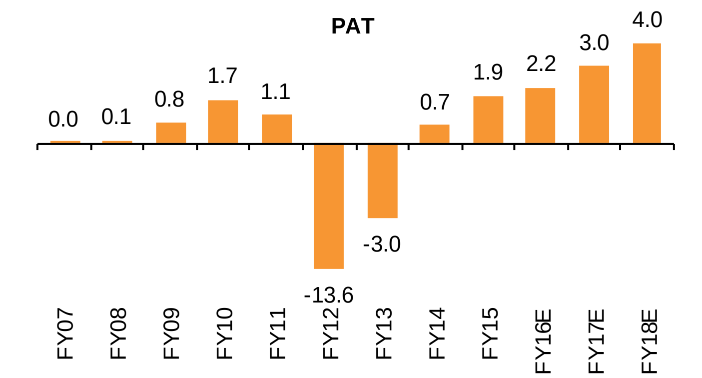
Source: Company, Emkay Research

Exhibit 50: Operating leverage and asset quality expected to be maintained



Source: Company, Emkay Research

Exhibit 51: With stability, expect sustainable profitable growth



Source: Company, Emkay Research

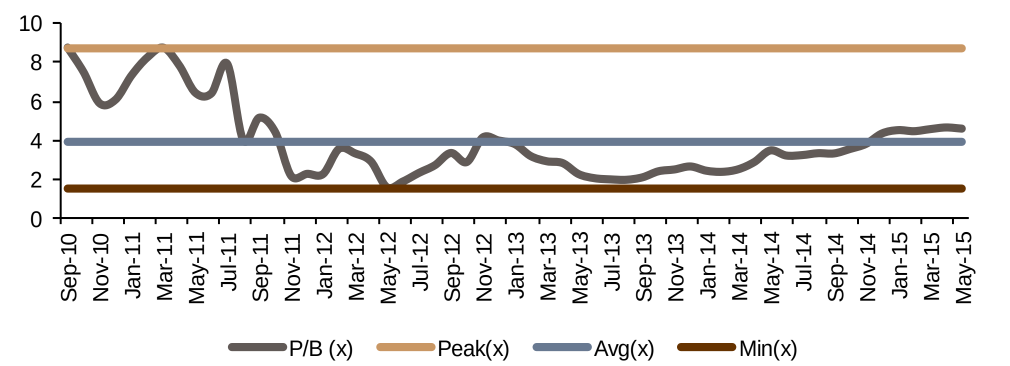
Earnings and BV compounding of 30%+ and 25%+ over FY15-18E expected to be the best in the Indian Financials under our coverage

Strong stock returns capturing improvement in business operations

SKSMF's stock price has risen 170%+ over the past 18 months. However, this is likely to have been driven by (1) turnaround in business operations and (2) scarcity and growth premium of select niche financiers, which is not SKSMF specific. Additionally, even though SKSMF has risen from its low, it is still lower by 51% from its peak valuations though earnings profile is better than the earlier years.

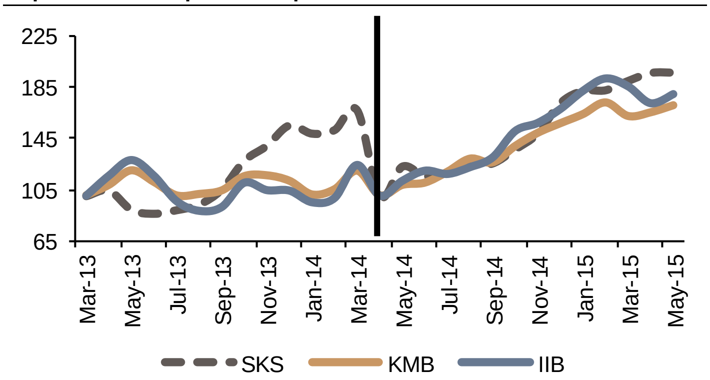
Premium valuations to sustain: We believe SKSMF, is a play on a structural growth story and will continue to trade at a premium as (1) it provides strong growth visibility in an challenging economic environment for Indian financials (2) earnings and BV CAGR to be 30%+ and 25% and (3) average RoAs and RoEs of 4% and 22%+ (higher than best in Indian financials) with the lowest leverage of 4.4x. We assign 70% probability to our base case MFI business and value it at Rs565 per share (4.5x FY17E BV).

Exhibit 52: Valuations have improved factoring improvement in business operations



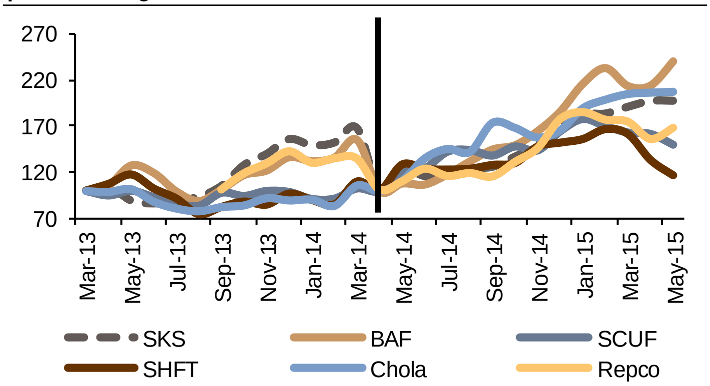
Source: Company, Emkay Research

Exhibit 53: First phase of outperformance was driven by improvement in operational performance…



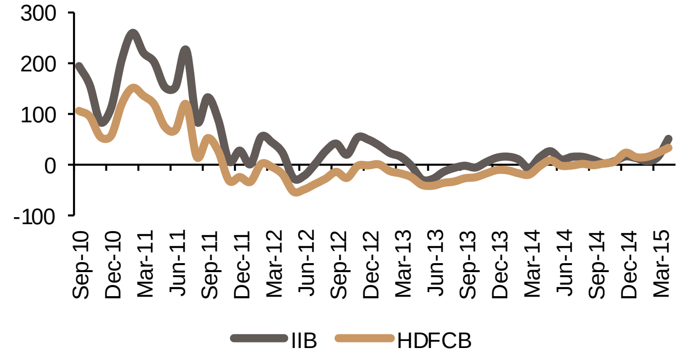
Source: Company, Emkay Research

Exhibit 54: …while second phase strong performance was driven by premium for growth



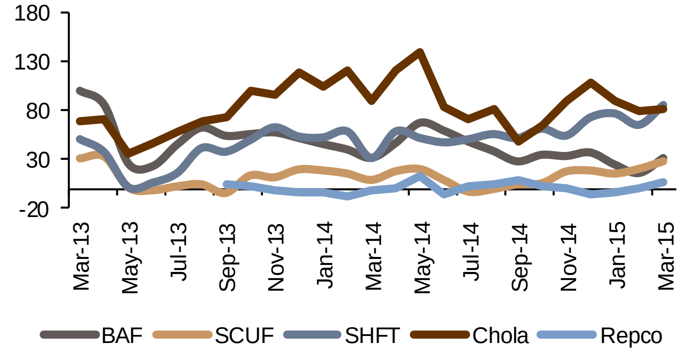
Source: Company, Emkay Research

Exhibit 55: Trades at 10% and 18% premium to IIB and HDFCB as growth rates and return profile to be higher



Source: Company, Emkay Research

Exhibit 56: Trades at premium to other NBFCs on back of higher growth expectation and better return profiles



Source: Company, Emkay Research

Exhibit 57: SKSMF is one of the best compounding play hence deserves a premium valuation

		ICICIBC	HDFCB	AXSB	YES	IIB	FB	DCBB	HDFC	LICHF	MMFS	SKSMF
CMP	Rs	318	1021	558	874	852	141	131	1,267	419	269	460
Target	Rs	400	1,250	605	928	984	169	140	1,309	484	268	580
Upside (Downside)	%	25.8	22.5	8.4	6.7	15.5	20.1	7.0	3.3	15.6	(0.4)	26.1
Recommendation		Buy	Accumulate	Accumulate	Accumulate	Hold	Buy	Buy	Hold	Hold	Reduce	Buy
FY15-17 EPS CAGR	%	14.9	22.5	20.8	24.9	25.8	17.5	23.2	16.4	17.3	22.0	27.4
FY15-17 EPS CAGR	%	11.5	14.6	16.1	17.9	18.8	11.8	14.4	8.7	16.6	13.2	22.5
P/BV (x)	FY15	1.8	4.1	3.0	3.1	4.4	1.6	2.4	4.0	2.7	2.7	5.6
	FY16	1.7	3.6	2.6	2.7	3.7	1.4	2.1	3.6	2.3	2.4	4.6
	FY17	1.5	3.1	2.2	2.2	3.1	1.2	1.8	3.3	2.0	2.1	3.7
Target P/BV (x)	FY15	2.4	5.1	3.2	3.3	5.1	1.9	2.6	4.2	3.1	2.7	7.0
	FY16	2.2	4.5	2.8	2.8	4.3	1.7	2.3	3.8	2.7	2.4	5.8
	FY17	2.0	3.9	2.4	2.4	3.6	1.5	2.0	3.5	2.3	2.1	4.7
P/E (x)	FY15	16.5	25.1	18.0	18.2	25.1	12.0	19.3	33.0	15.3	18.3	31.0
	FY16	14.4	20.1	15.0	14.1	19.8	10.6	19.3	28.2	12.9	15.4	26.2
	FY17	12.6	16.7	12.3	11.7	15.9	8.7	12.7	24.4	11.1	12.3	19.1
RoE%	FY15	14.5	19.4	17.8	21.3	19.0	13.7	13.9	20.3	18.1	15.4	24.9
	FY16	15.1	19.3	18.4	20.0	20.3	13.9	11.4	21.5	19.3	16.4	19.2
	FY17	15.5	20.3	19.3	20.7	21.3	15.2	15.1	22.4	19.3	18.1	21.5
RoA %	FY15	1.8	1.9	1.7	1.6	1.8	1.3	1.3	2.5	1.4	2.5	5.2
	FY16	1.8	2.0	1.8	1.7	1.9	1.3	1.1	2.5	1.4	2.6	4.4
	FY17	1.8	2.0	1.8	1.6	2.0	1.3	1.3	2.5	1.3	2.8	4.4
EPS Rs	FY15	19.2	40.8	31.0	48.0	33.9	11.7	6.8	38.4	27.5	14.7	14.9
	FY16	22.1	50.7	37.2	60.8	43.0	13.3	6.8	44.9	32.4	17.5	17.5
	FY17	25.3	61.2	45.3	73.9	53.6	16.2	10.3	52.0	37.8	21.9	24.1
BV Rs	FY15	138	247	188	280	194	90	54	198	155	100	83
	FY16	154	280	217	328	229	101	61	216	181	113	100
	FY17	171	325	254	387	273	113	71	234	211	129	124
Leverage x	FY15	8.0	10.3	10.2	13.0	10.0	10.7	10.6	8.1	13.1	6.2	4.8
	FY16	8.2	9.7	10.5	12.0	10.3	11.1	10.8	8.5	14.2	6.2	4.3
	FY17	8.4	10.0	10.7	12.7	10.5	11.9	11.9	9.1	14.4	6.4	4.9

Source: Company, Emkay Research

Probability based TP of Rs580, P/BV of 4.7x FY17

SKSMF is a strong play in an under-penetrated Indian Financials space, which may convert into a small finance bank. Hence, we base our target price on the basis of probability-weighted residual income valuations BASE CASE: 70% (NBFC MFI); BEAR CASE: 15% (NBFC MFI but growth moderates and credit cost rise); BULL CASE: 15% (SKSMF converts into a small finance bank). Our price target based on this model works out to Rs580 (26% upside), implying a P/BV of 4.7x FY17E as SKSMF NBFC-MFI.

Bull Case (Probability 15%): SKS Small Bank TP Rs900, implied 3.8x FY17E BV

SKSMF, as a small bank, to enjoy RoAs of 4%+: SKSMF has applied for a small bank license, where the business model is centric around financial inclusion. In our view, SKSMF will be the frontrunner, thanks to its strong rural reach (310 districts; 18 states), niche offerings and able management. We have a favorable view on SKSMF being awarded the small bank license. However, we assign it a probability of 15%, as this is an event based on RBI's discretion. The challenge would be to meet the requisite shareholding structure and equity capital requirement to meet this norm will be ~Rs25bn+ (44% of equity dilution) from domestic investors. At current market price (CMP), dilution would be book value accretive and add Rs109 to FY17E BV. Additionally, it will compensate for regulatory transition and keep RoAs strong at 4%+. While in the initial years RoEs may drop to 13%, sustainable RoEs will be in the range of 20-24%. Immunity from political risk, loan and revenue diversification will drive valuations. We value SKSMF Bank at Rs900 (3.8x FY17E BV).

Base Case (Probability 70%): SKSMFI: TP of Rs565, implies4.5x FY17E BV

Earnings compounding to drive stock returns: Strong AUM CAGR of 40%+ over FY15-18E, steady NIMs of 11.5%+, increasing contribution of non-interest income and operating leverage will drive operating profit CAGR of 40% over FY15-18E. Asset quality is likely to remain strong. However, we have factored provisions/ average AUM of 0.6% as compared to marginal write-back in FY15, as we expect SKSMF to build buffer. RoAs and RoEs are estimated to average 4.3% and 21% over FY15-18E.

Bear Case (Probability 15%) SKSMFI Target Price Rs320, implies2.6x FY17E BV

Business growth to slow down and credit cost to rise: We build slowdown in AUM CAGR to ~25% over FY15-18E, which would translate into lower earnings growth of 20% over FY15/18E.

Exhibit 58: Target Price of Rs580 per share, (4.7x FY17 BV)

	FY17E
BEAR CASE - SKS MFI	
Probability of the event (%)	15
BV	121
Target Multiple	2.6
Target Price	**320**
BASE CASE - SKS MFI	
Probability of the event (%)	**70**
BV	125
Target Multiple	4.5
Target Price	**565**
BULL CASE - SKS BANK	
Probability of the event (%)	15
BV	235
Target Multiple	3.8
Target Price	**900**
Target Price factoring the probability	**580**
CMP	**460**
Upside/Downside (%)	**26**

Source: Company, Emkay Research

Uncharted business model in India; looking at valuations of global peers

If awarded the banking license, SKSMF would be the first listed small bank in India. Hence, peer comparison is difficult. Globally, some of the peers are generating similar/ higher RoEs, but SKSMF will deliver significantly higher growth due its lower base and structural opportunity

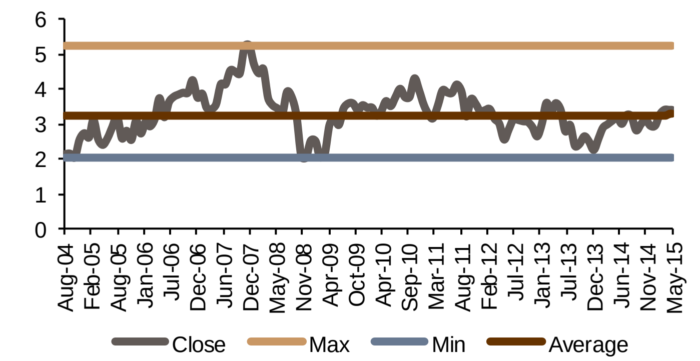
SKSMF valuations of 4.6/3.7xx FY16/17E BV is at a premium to best run private banks. So if SKSMF comes under the banking umbrella, how should one view the valuations, especially as SKSMF will be the first small bank that will be listed in India? We believe strong growth potential, superior RoAs of 4%+ due to niche business model will keep valuations at a premium, notwithstanding the dilution overhang. The company will be immune from political uncertainty. Opportunity of diversifying the asset base by venturing into small housing loans, gold loans and small businesses loans etc. under the bank and access to stable funding will provide comfort over long term sustainability of the business.

In the absence of any domestic benchmark, we have studied the valuations and business growth of global peers over the last few years. Globally, Gentera (Banco Compartamos taken over by Gentera), Bank of Rakyat are in to the business of micro finance. We note that the long period average P/BV of Gentera (Banco Compartamos) is 5x. This is on back of 38% average RoEs. But, it should also be noted that over the last two years, growth has moderated to 15% and RoAs and RoEs have moderated to 10% and 28% respectively. Yet, the stock trades at 3.2x. Similarly, Bank of Rakyat, has traded at an average one year forward P/BV multiple of 3.2x with consistent AUM growth of 24%+ and RoEs of 25%+ over a long period of time.

Bank of Rakyat, Indonesia

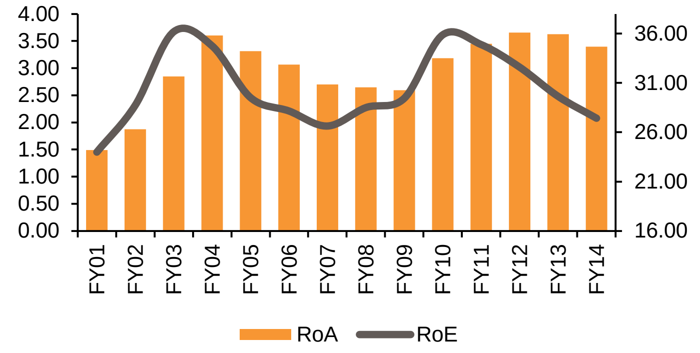
Bank of Rakyat, Indonesia specializes in small scale and microfinance segment and serves approximately 4.5mn active borrowers through its 5,000+ branch network. AUM and earnings of the bank have compounded at a rate of 24% over the last twelve years. Return ratios have improved gradually, with RoAs rising from 1.5% in FY02 to 3.6% over the last four years. Similarly, the company has consistently delivered RoEs of 25%+.

Exhibit 59: One year forward P/BV (Bank of Rakyat, Indonesia)



Source: Bloomberg, Emkay Research

Exhibit 60: Return ratios continue to remain strong (%)

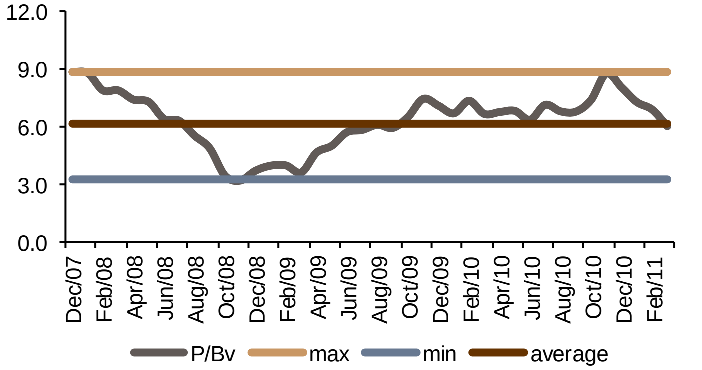


Source: Bloomberg, Emkay Research

Banco Compartamos– acquired by Gentera

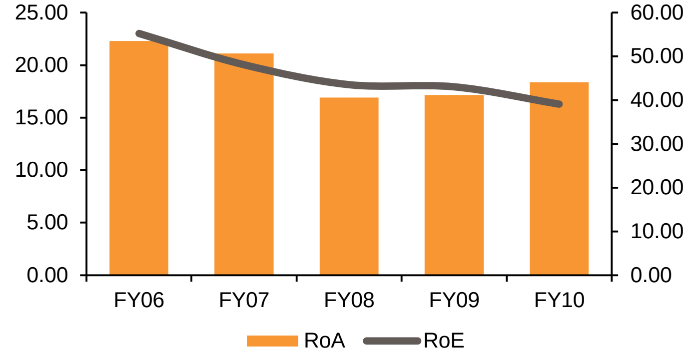
Erstwhile Banco Compartamos was a microfinance bank based in Mexico and offered group and individual loans in rural and urban areas. Banco Compartamos provided loans to low-income people for business and home improvement purposes. It also offered voluntary savings and insurance products. It reported an AUM and BV CAGR of 36% and 43% over FY05/10. Return ratios were high with RoAs at 18.4% and 39% in FY10. Under the ambit of Gentera, the company reported AUM CAGR of 18% over FY11-14. However, return ratios have moderated with RoAs of 11% and RoEs of 30% for FY14.

Exhibit 61: One year forward P/BV (Banco Compartamos)



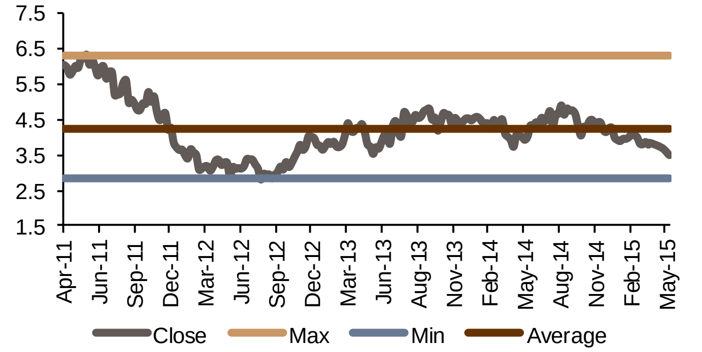
Source: Bloomberg, Emkay Research

Exhibit 62: Superior return ratios despite gradual decline (%)



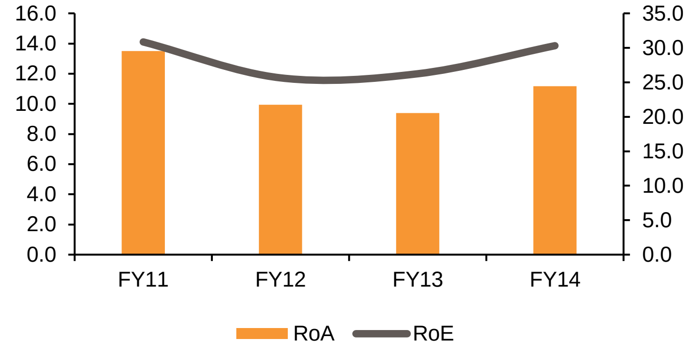
Source: Bloomberg, Emkay Research

Exhibit 63: One year forward P/BV (Gentera)



Source: Bloomberg, Emkay Research

Exhibit 64: Superior RoEs of 30%+ (%)



Source: Bloomberg, Emkay Research

Risk to our call

AP-like crisis hits again

While there is no clear method to predict or model an AP-like crisis, steps taken by the regulators well as SKSMF (diversified AUM) reduces the probability of similar impact that occurred in FY11. Nevertheless, we draw a hypothesis in which we exhibit if SKSMF may have to write-off 10% of AUM and adjusted net-worth will fall down to Rs60 per share and have a meaningful impact on share price.

Exhibit 65: AP-like crisis could adversely impact operations

Distressed Valuations	FY17E
AUM	81,093
Write-off of 10% of AUM	8,109
Networth	15,708
Share Capital	1,263
Adjusted Networth (Adjusting for write-off from highest state)	7,599
BV	60
Target Multiple	1.9
Target Price	**114**

Source: Company, Emkay Research

Management change can impact functionality of the business

SKSMF is in a niche business model and management expertise has driven the business performance even through one of the most challenging times. The average tenure of the management is 4 years+, with few of them being with the company for more than eight years. Change in management can impact the functioning of the business.

Transition phase if it receives small bank license

SKSMF is a strong contender for receiving a small bank license. While we expect transition to be smooth, raising of equity and disruption if any in terms of AUM growth could impact earnings.

ANNEXURE 1

Guidelines for Licensing of Small Banks

Objective

- Increasing financial inclusion by (a) provision of savings vehicles to under-served and un-served sections of the population, and (b) supply of credit to small business units, small farmers, micro and small industries, and other unorganized sector entities through high technology-low cost operations.

Eligibility criteria

- Resident individuals/professionals with 10 years of experience in Banking and Finance, companies, and societies, (b) Existing NBFCs, MFIs, and LABs can also opt for conversion. Local focus and the ability to serve smaller customers will be a key criterion in licensing such banks.
- Joint ventures by different promoter groups for the purpose of setting up small finance banks would not be permitted. Proposals from large public sector entities and industrial and business houses, including from NBFCs promoted by them, will also not be entertained.

Branch expansion

- For the initial five years, prior RBI approval would be required. At least 25% of branches would be required to be opened in unbanked rural centers (population of up to 9,999)

Scope of activities

- Small finance bank will primarily undertake basic banking activities of acceptance of deposits and lending to underserved sections of society.
- It can undertake non-risk sharing financial services activities such as distribution of MF, Insurance and MF products.
- The small finance bank can also become a Category II Authorized Dealer in foreign exchange business for its clients' requirements.
- There will not be any restriction in the area of operations of small finance banks. However, preference will be given to those applicants, who in the initial phase, set up the bank in a cluster of under-banked States / districts, such as in the North-East, East and Central regions of the country
- The other financial and non-financial services activities of the promoters, if any, should be kept distinctly ring-fenced and not comingled with the banking business.

Capital requirements

- Minimum paid-up equity capital of INR 1b
- Minimum CAR – 15%; Tier 1 – 7.5% as per Basel-I computations

Promoter shareholding

- Minimum initial shareholding of 40% with lock-in of 5 years
- If shareholding above 40%, it should be brought down to 40% within 5 years, to 30% within 10 years and to 26% within 12 years
- Mandatory listing once the networth reaches INR5b
- If the existing NBFCs / MFIs / LABs have diluted the promoters' shareholding to below 40%, but above 26%, due to regulatory requirements or otherwise, RBI may not insist on the promoters' minimum initial contribution.

Prudential norms

- Robust risk management framework is required.
- Would be subject to all prudential norms and RBI regulations that apply to existing commercial banks, including maintenance of CRR and SLR. No
- Small Banks will have to meet PSL targets, including sub-targets.
- Minimum 75% of loans should be towards priority sectors
- Borrowers/issuers would be restricted to 10%/15% of capital funds.

Other conditions

- Foreign shareholding as per prevailing FDI regulations for private banks
- The small finance bank will be required to use the words "Small Finance Bank" in its name in order to differentiate it from other banks.
- If a promoter setting up a SFB, desires to set up a payment bank, it should set up both types of banks under a Non-Operative Financial Holding Company (NOFHC) structure.
- Additional conditions for NBFCs/MFIs/LABs converting into a bank, NBFC / MFI will cease to exist; all business which a bank cannot statutorily undertake needs to be divested / disposed of.
- In case of existing NBFCs / MFIs / LABs converting into SFB, where there is shareholding in excess of 10% by entities other than the promoters, RBI may consider providing time up to 3 years for bringing it down to 10%.

ANNEXURE 2

Exhibit 66: 70+ applicants have applied for small bank license of which fourteen are microfinance players

Leading MFIs	Other companies/societies			Individual
Disha Microfin	Aamcol Trexim Pvt. Ltd & Mackmorn Comm Pvt. Ltd	Home First Finance	Proficient Leasing & Finance Ltd	Mr. Ajay Singh Bimbhet & others
Equitas Holding	Apex Abishek Fin.	Idhayam – G Fin & Invst. Srvs Ltd	S. E. Investments Ltd.	Mr. Ajit Kumar Sharan
ESAF MicroFin.	Ashika Global Securities Pvt. Ltd	IIFL Holdings Ltd.	Sahara Utsarga Welfare Society	Mr. Collin R Timms & others
Grama Vidiyal Micro Fin.	Asomi Fin.	Indigo Fincap Pvt. Ltd	Saija Finance Pvt. Ltd.	Mr. Kiran Dhondopant Thakur & others
IntelleCash MicroFin.	Au Financiers (India)	Inventure Finance Pvt. Ltd	Satin Creditcare Network Ltd	Mr. M. R. Seetharam
Jagaran Microfin	Bhartiya Samruddhi Invst. & Cons Srvs	Ishan Developers & Infrastructure	Sonata Finance Pvt. Ltd.	Mr. Manish Khera
Janalakshmi Fin. Srvs	BRD Securities Ltd	Jainco Projects (India) Ltd.	Sri Jayalakshmi Automotives Pvt. Ltd.	Mr. Nijay Kumar Gupta
Light MicroFin.	Bretton Woods Exim Private Ltd	Kerala Permanent Benefit Fund Ltd.	Sunmarg Welfare Society	Mr. V.Balakrishnan & others
Repco Micro Fin.	Calance Software Private	Kosamattam Finance	Tri-Deep Leasing And Finance Ltd	Mr. Vinod Jain
RGVN (North East) MicroFin.	Capital Local Area Bank Ltd	Kotalipara Development Society	UAE Exchange & Financial Services Ltd.	Dr. K. Cherian Varghese
SKS MicroFin. Ltd.	Capital Trust Ltd.	Lulu Forex Pvt. Ltd	VAYA Finserv Private Ltd	Dr. Shubhro Sen
Suryoday Micro Fin. pvt. Ltd.	Chaitanya India Fin Credit	Mahanadhi Finance Ltd.	Village Financial Services Pvt. Ltd.	Ms. Rajni Aneja
Ujjivan Fin. Srvs	Coastal Local Area Bank Ltd	Mangal Keshav Capital Ltd	Vinayak Local Area Bank Ltd.	
Utkarsh Micro Fin.	Dewan Housing Fin. CorP	Microsec Resources Pvt. Ltd.	Vsoft Technologies Pvt. Ltd	
	Electronica Fin. Ltd.	Pareka Investment Pvt. Ltd		
	Elite Green Pvt. Ltd.	Professional Management &Advisory Services (P) Ltd.		

Source: Company, Emkay Research

Disha Microfinance

Disha Microfinance private Ltd, a Gujarat-based MFI started its operations in 1996 as a distributor of financial service products and ventured into the microfinance business in 2009. The company has two major products, Gati and Pragati. The company operates through a network of 72 branches in Gujarat and has a loan portfolio of Rs1.6bn as of end of Dec-14. Return on assets and equity for the company at the end of FY14 was 1.6% and 6.4% respectively.

Exhibit 67: Strong asset quality, concentrated in state of Gujarat

	FY10	FY11	FY12	FY13	FY14
GLP (Rs mn)	51	240	407	760	1,666
Growth (%)		*367.6*	*69.2*	*86.8*	*119.4*
No. of Active borrowers	5,837	34,715	43,926	69,053	1,41,189
Growth (%)		*495*	*27*	*57*	*104*
GLP/Active borrower (Rs)	8,802	6,921	9,255	11,001	11,802
Portfolio at Risk (%)		0.05	0.14	0.12	0.01
RoA (%)		3.2	2.4	2.1	1.6
RoE (%)		7.0	4.4	6.4	6.4

Source: Mix Market, Emkay Research

ESAF Microfinance and Investments private Ltd

Evangelical Social Action Forum (ESAF) was established by Mr.K. Paul Thomas in Kerela and commenced its operations in 1995. ESAF has a network of 175 branches predominantly in Kerela, Tamil Nadu, Chattisgarh and Madhya Pradesh. The company has a gross loan portfolio of Rs6bn as of FY14. Return on assets and equity for the company at the end of FY14 was 1.9% and 13% respectively.

Exhibit 68: Strong growth in gross loan portfolio aided by higher ticket size

	FY08	FY09	FY10	FY11	FY12	FY13	FY14
GLP (Rs mn)	793	757	1,556	2,087	2,813	4,216	6,041
Growth (%)	*41.3*	*-4.6*	*105.7*	*34.1*	*34.8*	*49.8*	*43.3*
No of Active borrowers	1,45,712	1,45,701	2,20,011	3,22,590	3,35,834	3,84,250	4,48,490
Growth (%)	*32*	*0*	*51*	*47*	*4*	*14*	*17*
GLP/Active borrower (Rs)	5,444	5,194	7,074	6,468	8,377	10,971	13,469
Portfolio at Risk (%)	1.10	0.38	0.26	0.59	0.99	0.69	0.99
RoA (%)	0.7	0.8	0.3	0.6	2.1	2.0	1.9
RoE (%)	16.4	8.2	1.5	3.4	9.2	11.5	13.0

Source: Mix Market, Emkay Research

Grama Vidiyal Microfinance Ltd

Grama Vidiyal started its microfinance operations in early 2008. The company acquired the entire loan portfolio of Grama Vidiyal trust which engaged in microfinance activities since 1996. The company's operations are primarily concentrated in Tamil Nadu and recently the company has ventured into Maharashtra and Madhya Pradesh. Loan portfolio of the company stood at Rs7.2bn as of end of FY14. Return on assets and equity for the company at the end of FY14 was 0.5% and 3.5% respectively.

Exhibit 69: Rural microfinance, modest GLP growth (%)

	FY08	FY09	FY10	FY11	FY12	FY13	FY14
GLP (Rs mn)	1,152	1,623	6,052	5,200	5,200	5,411	7,255
Growth (%)	*43.5*	*41.0*	*272.8*	*-14.1*	*0.0*	*4.1*	*34.1*
No. of Active borrowers	2,22,148	3,60,466	7,72,050	9,32,286	8,18,146	7,38,218	6,52,087
Growth (%)	*23*	*62*	*114*	*21*	*-12*	*-10*	*-12*
GLP/Active borrower (Rs)	5,184	4,503	7,838	5,578	6,356	7,330	11,126
Portfolio at Risk (%)	0.01	0.00	0.00	0.16	0.14	0.00	0.00
RoA (%)	1.6	4.1	3.7	3.1	-1.7	0.6	0.5
RoE (%)	15.1	21.0	25.5	21.4	-9.3	3.4	3.5

Source: Mix Market, Emkay Research

Intellecash Microfinance Network Company Private Ltd.

Intellecash microfinance, acquired Arohan, a Kolkatta based Microfinance Company in 2012. Post-acquisition the microfinance portfolio of IntelleCash was consolidated with Arohan. The company predominantly operates in West Bengal and Bihar. Loan portfolio of the company stood at Rs1.9bn as of end of FY14. Return on assets and equity for the company at the end of FY14 was 2.1% and 6% respectively.

Exhibit 70: A small regional player in microfinance industry

	FY08	FY09	FY10	FY11	FY12	FY13	FY14
GLP (Rs mn)	130	419	978	898	539	904	1,903
Growth (%)	*333.5*	*223.0*	*133.4*	*-8.1*	*-40.0*	*67.7*	*110.4*
No. of Active borrowers	34,261	86,237	1,87,754	2,14,059	1,07,612	1,13,665	2,19,701
Growth (%)	*245*	*152*	*118*	*14*	*-50*	*6*	*93*
GLP/Active borrower (Rs)	3,787	4,859	5,209	4,197	5,012	7,956	8,660
Portfolio at Risk (%)	0.40	0.14	0.54	2.79	0.40	0.66	0.37
RoA (%)	0.2	3.4	2.1	0.3	-16.1	-0.3	2.1
RoE (%)	0.8	14.8	13.6	1.7	-64.5	-0.6	6.0

Source: Mix Market, Emkay Research

Janalakshmi Financial services Ltd

Janalakshmi Financial services limited, provides microfinance services to the urban poor. Apart from microfinance the company also offers other loan products such as enterprise loans, housing loans and individual loans. The company operates in the states with Karnataka and Tamil Nadu being the major portion of the lending. Loan portfolio of the company stood at Rs20.6bn as of end of FY14. Return on assets and equity for the company at the end of FY14 was 3% and 13.4% respectively.

Exhibit 71: A fast growing urban microfinance company

	FY09	FY10	FY11	FY12	FY13	FY14
GLP (Rs mn)	306	670	1,813	3,507	9,608	20,529
Growth (%)		*119.3*	*170.4*	*93.5*	*173.9*	*113.7*
No. of Active borrowers	43,157	82,161	1,93,014	3,00,847	6,95,974	14,12,738
Growth (%)		*90*	*135*	*56*	*131*	*103*
GLP/Active borrower (Rs)	7,083	8,160	9,392	11,659	13,805	14,532
Portfolio at Risk (%)		0.41	1.17	0.94	0.14	0.30
RoA (%)		-3.1	-1.4	0.4	2.0	3.0
RoE (%)		-9.0	-4.9	1.5	8.7	13.4

Source: Mix Market, Emkay Research

RGVN (northeast) microfinance ltd

Rashtriya Grameen Vikas Nidhi (RDVN Society) is a leading non-governmental organization founded in 1990. Headquartered in Guwahati, RGVN operates through a network of 102 branches in the states of Assam, Nagaland, Meghalaya, Arunachal Pradesh and Sikkim. Loan portfolio of the company stood at Rs1.2bn as of end of FY14. Return on assets and equity for the company at the end of FY14 was 3.3% and 16.2% respectively.

Exhibit 72: Improved return profile concentrated in north eastern states of India

	FY08	FY09	FY10	FY11	FY12	FY13	FY14
GLP (Rs mn)	256	361	560	765	1,022	1,171	1,243
Growth (%)	105.5	40.9	55.3	36.6	33.6	14.6	6.1
No. of Active borrowers	44,722	65,052	1,01,389	1,29,189	1,41,420	1,55,026	1,66,623
Growth (%)	79	45	56	27	9	10	7
GLP/Active borrower (Rs)	5,728	5,547	5,527	5,924	7,229	7,555	7,461
Portfolio at Risk (%)	3.75	4.06	5.53	3.18	0.57	0.45	0.47
RoA (%)	3.4	4.7	3.3	1.2	3.4	3.2	3.3
RoE (%)	173.6	122.2	99.4	19.8	28.4	22.6	16.2

Source: Mix Market, Emkay Research

Suryoday Microfinance Private Ld.

Incorporated in 2008, Suryoday microfinance private ltd. Provides group loan using the Grameen Bank Model. It has presence through 138 branch network across 38 districts in the states of Maharasthra, TamilNadu, Odhisa, Rajasthan and Karntaka. Loan portfolio of the company stood at Rs3.3bn as of end of FY14. Return on assets and equity for the company at the end of FY14 was 3.1% and 11.2% respectively.

Exhibit 73: Accelerating growth on a lower base accompanied by higher average ticket size

	FY10	FY11	FY12	FY13	FY14
GLP (Rs mn)	156	482	936	1,526	3,268
Growth (%)	*28,525.1*	*208.8*	*94.0*	*63.0*	*114.2*
No. of Active borrowers	24,678	87,063	1,04,571	1,56,204	2,74,057
Growth (%)		*253*	*20*	*49*	*75*
GLP/Active borrower (Rs)	6,331	5,541	8,951	9,767	11,923
Portfolio at Risk (%)		4.34	0.06	0.00	0.05
RoA (%)	-5.6	2.6	0.7	1.5	3.1
RoE (%)	-14.6	6.1	1.6	4.0	11.2

Source: Mix Market, Emkay Research

Ujjivan Financial services Ltd

Ujjivan financial service is an urban microfinance company with its operational spread across 24 states and 188 districts through a branch network of 405. The focus is largely on urban centers. Loan portfolio of the company stood at Rs16.1bn as of end of FY14. Return on assets and equity for the company at the end of FY14 was 3.6% and 15.9% respectively.

Exhibit 74: A strong player in urban microfinance industry

	FY08	FY09	FY10	FY11	FY12	FY13	FY14
GLP (Rs mn)	366	1,690	3,708	6,251	7,034	11,260	16,173
Growth (%)	*333.8*	*362.0*	*119.4*	*68.6*	*12.5*	*60.1*	*43.6*
No. of Active borrowers	58,646	2,61,993	5,66,929	8,47,671	8,19,400	10,06,052	12,97,131
Growth (%)	*201*	*347*	*116*	*50*	*-3*	*23*	*29*
GLP/Active borrower (Rs)	6,236	6,450	6,540	7,375	8,585	11,192	12,468
Portfolio at Risk (%)	0.11	0.05	0.33	0.53	1.06	0.13	0.07
RoA (%)	-11.3	-0.6	3.2	2.1	0.2	3.4	3.6
RoE (%)	-46.5	-1.2	9.4	10.3	1.1	11.9	15.9

Source: Mix Market, Emkay Research

Utkarsh Microfinance Private Ltd

Utkarsh Microfinance promoted by Mr. Govind Singh commenced its operation in 2009. The company is one of the fastest growing mid-sized MFI and has 208 branches. Loan portfolio of the company stood at Rs3.6bn as of end of FY14. Return on assets and equity for the company at the end of FY14 was 2.4% and 11.6% respectively.

Exhibit 75: Fastest growth mid-sized MFI

	FY10	FY11	FY12	FY13	FY14
GLP (Rs mn)	63	319	753	1,783	3,556
Growth (%)	*605.9*	*402.2*	*136.4*	*136.7*	*99.5*
No. of Active borrowers	10,840	55,506	1,06,371	1,98,181	3,20,315
Growth (%)		*412*	*92*	*86*	*62*
GLP/Active borrower (Rs)	5,852	5,739	7,080	8,994	11,103
RoA (%)	-17.0	1.7	2.3	2.2	2.4
RoE (%)	-26.8	3.7	4.8	7.7	11.6

Source: Mix Market, Emkay Research

Key Financials (Standalone)

Income Statement

Y/E Mar (Rs mn)	FY14	FY15	FY16E	FY17E	FY18E
Net interest income	**2,600**	**3,540**	**5,036**	**6,876**	**8,892**
Other income	**706**	**1,695**	**1,518**	**1,931**	**2,496**
Fee income	338	460	640	895	1,256
Net income	**3,306**	**5,235**	**6,554**	**8,808**	**11,388**
Operating expenses	2,421	3,200	3,474	4,580	5,808
Pre provision profit	**885**	**2,035**	**3,080**	**4,228**	**5,580**
PPP excl treasury	**885**	**2,035**	**3,080**	**4,228**	**5,580**
Provisions	187	100	275	375	575
Profit before tax	**699**	**1,935**	**2,805**	**3,853**	**5,005**
Tax	0	59	589	809	1,051
Tax rate	0	3	21	21	21
Profit after tax	**699**	**1,876**	**2,216**	**3,044**	**3,954**

Balance Sheet

Y/E Year End (Rs mn)	FY14	FY15	FY16E	FY17E	FY18E
Equity	1,082	1,263	1,263	1,263	1,263
Reserves	3,510	9,202	11,401	14,445	18,399
Net worth	**4,592**	**10,465**	**12,664**	**15,708**	**19,662**
Borrowings	15,313	32,800	42,636	65,686	95,244
Total liabilities	**24,972**	**46,987**	**60,260**	**87,980**	**1,23,695**
Cash and bank	6,397	15,368	15,131	22,609	29,045
Investments	2	2	3	4	6
Loans	17,528	29,584	42,897	62,200	90,190
Total assets	**24,972**	**46,987**	**60,260**	**87,980**	**1,23,695**

Key Ratios (%)

Y/E	FY14	FY15	FY16E	FY17E	FY18E
Net Interest Income	**9.5**	**9.7**	**10.1**	**9.9**	**9.1**
Non-interest Income	2.6	4.7	3.0	2.8	2.6
Total income	**12.1**	**14.4**	**13.1**	**12.7**	**11.7**
Operating Expenses	8.8	8.8	7.0	6.6	6.0
Pre-provisioning profit	**3.2**	**5.6**	**6.2**	**6.1**	**5.7**
Provisions	0.7	0.3	0.6	0.5	0.6
PBT	**2.6**	**5.3**	**5.6**	**5.5**	**5.1**
Tax	-	0.2	1.2	1.2	1.1
RoA	**2.6**	**5.2**	**4.4**	**4.4**	**4.1**
RoE	**16.4**	**24.9**	**19.2**	**21.5**	**22.4**
NNPA	0.1	0.1	0.3	0.4	0.4

Per Share Data (Rs)	FY14	FY15	FY16E	FY17E	FY18E
EPS	6.5	14.9	17.5	24.1	31.3
BVPS	42.4	82.9	100.3	124.4	155.7
ABVPS	42.3	82.7	99.4	122.3	155.7
DPS	-	-	-	-	-

Valuations (x)	FY14	FY15	FY16E	FY17E	FY18E
PER	72.0	31.0	26.2	19.1	14.7
P/BV	10.8	5.5	4.6	3.7	2.9
P/ABV	10.8	5.5	4.6	3.7	2.9
P/PPOP	56.2	28.5	18.8	13.7	10.4
Dividend Yield (%)	-	-	-	-	-

Growth (%)	FY14	FY15	FY16E	FY17E	FY18E
NII	62.5	36.2	42.3	36.5	29.3
PPOP	(280.8)	129.9	51.4	37.2	32.0
PAT	(123.5)	168.6	18.1	37.3	29.9
AUM	40.7	47.0	39.0	39.9	40.4

Quarterly (Rs mn)	Q4FY14	Q1FY15	Q2FY15	Q3FY15	Q4FY15
NII	7,627	6,802	7,369	7,388	8,299
NIM (%)	9.2	8.0	8.6	8.3	9.3
PPOP	5,439	4,611	5,000	4,771	5,519
PAT	3,107	1,549	2,071	1,364	1,976
EPS (Rs)	22.05	10.99	14.70	9.68	14.03

Shareholding Pattern (%)	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Promoters	27.9	10.5	9.3	9.3	9.3
FIIs	38.8	44.6	44.7	48.2	47.1
DIIs	4.7	12.8	15.3	15.0	14.4
Public and Others	28.6	32.1	30.7	27.5	29.2

Emkay Rating Distribution

BUY	Expected total return (%) (Stock price appreciation and dividend yield) of over 25% within the next 12-18 months.
ACCUMULATE	Expected total return (%) (Stock price appreciation and dividend yield) of over 10% within the next 12-18 months.
HOLD	Expected total return (%) (Stock price appreciation and dividend yield) of upto 10% within the next 12-18 months.
REDUCE	Expected total return (%) (Stock price depreciation) of upto (-) 10% within the next 12-18 months.
SELL	The stock is believed to underperform the broad market indices or its related universe within the next 12-18 months.

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