

ICICI Securities Limited
is the author and
distributor of this report

Company update

Financials

Target price: Rs600

Shareholding pattern

| | Nov '22 | Dec '22 |
|-------------------------|------------|------------|
| Promoters | 68.2 | 68.2 |
| Institutional investors | 20.3 | 17.0 |
| MFs and others | 7.4 | 9.6 |
| FI/Banks | 1.7 | 0.0 |
| Insurance Cos. | 1.5 | 2.1 |
| FII's | 9.7 | 5.3 |
| Others | 11.5 | 14.8 |

Source: NSE

ESG disclosure score

| Year | 2020 | 2021 | Chg |
|-------------|------|------|-----|
| ESG score | NA | NA | NA |
| Environment | NA | NA | NA |
| Social | NA | NA | NA |
| Governance | NA | NA | NA |

Note - Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures.

Source: Bloomberg, I-sec research

Fusion Micro Finance

BUY
Maintain

Underlying business trends remain robust; RoA to sustain at >4% going ahead

Rs402

We met the apex management, including MD & CEO Mr. Devesh Sachdev, of Fusion Microfinance (Fusion) to understand the prevailing business trends in microfinance sector and how the company is placed. Management remains upbeat about growth sustainability and healthy profitability given that industry dynamics continue to be favourable. Management is confident of delivering >4% RoA and 17-20% RoE on steady-state basis. Company has delivered robust AUM growth of 28% and average RoA of 4.5%, for FY23-TD. While lending rate for MFI loans has increased by 150-250bps across players to 21-25%, Fusion has kept its lending rate marginally lower (22.65 - 22.95%) to maintain competitive edge. Management also highlighted that its quality underwriting, proactive risk management and deep understanding of demographics in the states where it operates are key factors for the company's better asset quality performance during its decade-long journey. As of Dec'22, GNPL stood at 3.7% with PCR at 73% and standard restructured book at 0.3% of AUM.

Fusion's continued investment towards distribution expansion (opened >250 branches during the past 1.5 years) and deep presence in underpenetrated states (e.g. Uttar Pradesh, Bihar, Jharkhand, Punjab, Haryana) would ensure sustainability of robust growth in the near term, in our view. Collection efficiency at 109.5% in Q3FY23 in the new book (comprising ~97% of MFI AUM originated post Mar'21), NNPL at <1% and standard restructured book at only 30bps – would keep credit cost at manageable levels. Maintain BUY with an unchanged target price of Rs600, based on 2x Sep'23E BVPS.

- **High growth during covid phase was strategic and with stringent underwriting.** Higher-than-industry CAGR during covid phase at 37% between FY20-FY22 appeared counter-intuitive and raised concerns over Fusion's near-term asset quality. However, management highlighted that the growth during covid phase was calibrated and on a low base (AUM at Rs36bn in FY20). Further, during covid phase, it tightened its credit filters (e.g. ticket-size cap at Rs30,000, maximum 2 lenders per borrower, no fresh lending to customers in >30-DPD bucket, etc.) to ensure quality growth. Negligible stressed asset pool at 1.3% (NNPL 1% + std. restructured book 0.3%) as of Dec'22 is testimony to quality growth.
- **Tight check on customer leverage.** Key feature of Fusion's growth journey so far, has been its thrust on customer-led growth and close eye on customer leverage. In order to ensure low customer leverage, it maintain tight underwriting policies – such as: i) negligible top-up loans at <1%, and ii) first-cycle loan cap at Rs40,000 and up to Rs15,000 increase in ticket-size for customers entering next loan cycles. As a result, loan per customer stands at only one vs two loans per customer for industry. Quality underwriting, stable management team, strong rural presence (less vulnerable than urban) and negligible exposure in highly covid-impacted states (e.g. Kerala, Maharashtra, West Bengal, Assam) helped Fusion sail through the pandemic phase with relatively better asset quality metrics.
- **Key risks.** AUM growth deceleration, and stress unfolding higher than we anticipate.

| | |
|-------------------------|--------------------|
| Market Cap | Rs40.5bn/US\$489mn |
| Bloomberg | FUSION IN |
| Shares Outstanding (mn) | 100.6 |
| 52-week range (Rs) | 434/325 |
| Free Float (%) | 31.8 |
| FII (%) | 5.3 |
| Daily Volume (US\$/000) | NA |
| Absolute Return 3m (%) | 10.8 |
| Absolute Return 12m (%) | NA |
| Sensex Return 3m (%) | (2.1) |
| Sensex Return 12m (%) | 5.3 |

| Year to Mar | 2022 | 2023 | 2024E | 2025E |
|-------------------------|-------|--------|--------|--------|
| Revenue (Rs mn) | 6,553 | 10,026 | 12,880 | 16,290 |
| Rec. Net Income (Rs mn) | 217 | 3,763 | 5,060 | 6,241 |
| EPS (Rs) | 2.3 | 38.1 | 51.2 | 63.2 |
| % Chg YoY | Nmf | nmf | 34.4 | 23.3 |
| P/E (x) | 154.6 | 10.6 | 7.9 | 6.4 |
| BVPS (Rs) | 2.5 | 1.7 | 1.4 | 1.2 |
| P/BV (x) | 1.6 | 0.9 | 0.8 | 0.8 |
| NNPL (%) | 161.7 | 234.3 | 285.6 | 348.8 |
| RoA (%) | 0.3 | 4.4 | 4.5 | 4.4 |
| RoE (%) | 1.7 | 20.6 | 19.7 | 19.9 |

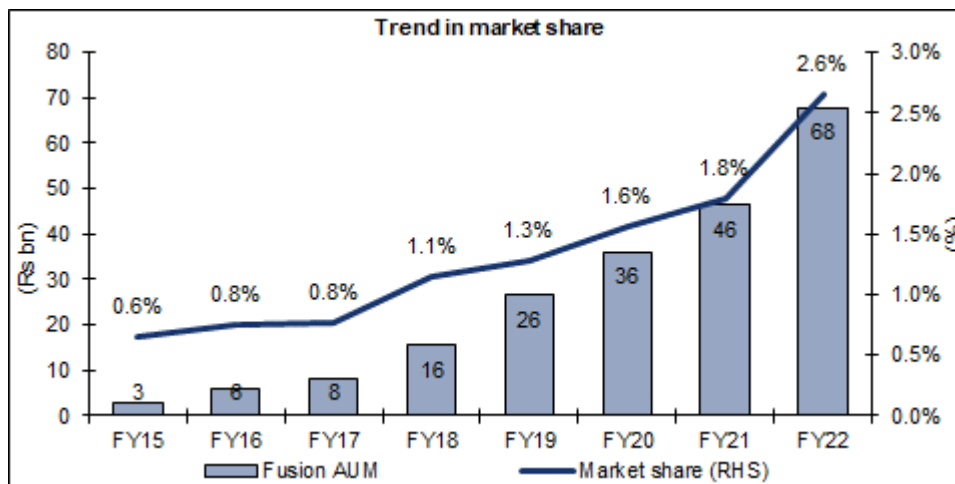
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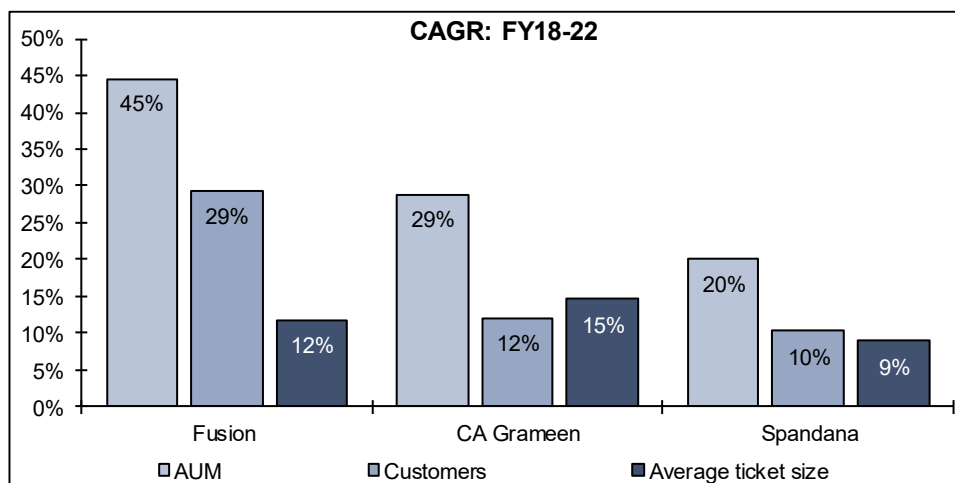
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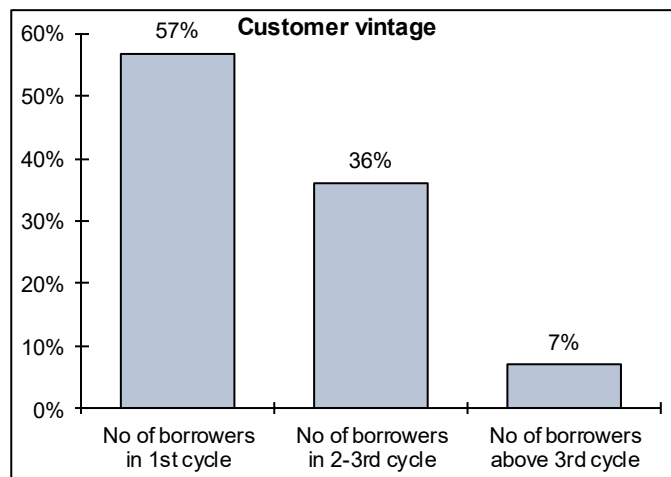
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Chart 1: Steady increase in market share even during covid phase...

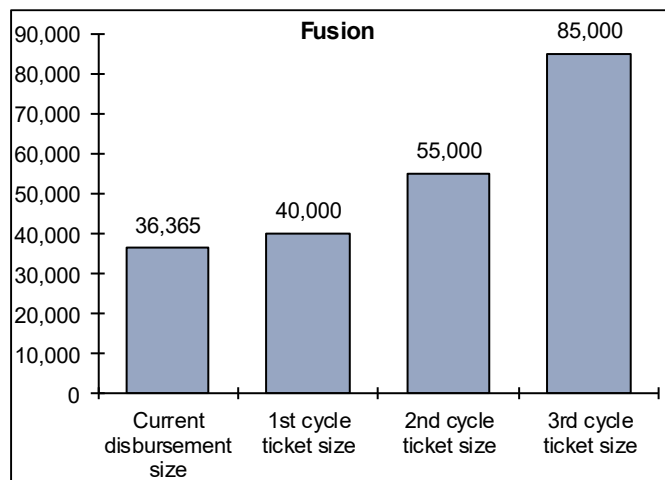
Source: Company data, I-Sec research

Chart 2: ...was driven by new customer acquisition as reflected in highest new customer addition CAGR at 29% between FY18-FY22

Source: Company data, I-Sec research

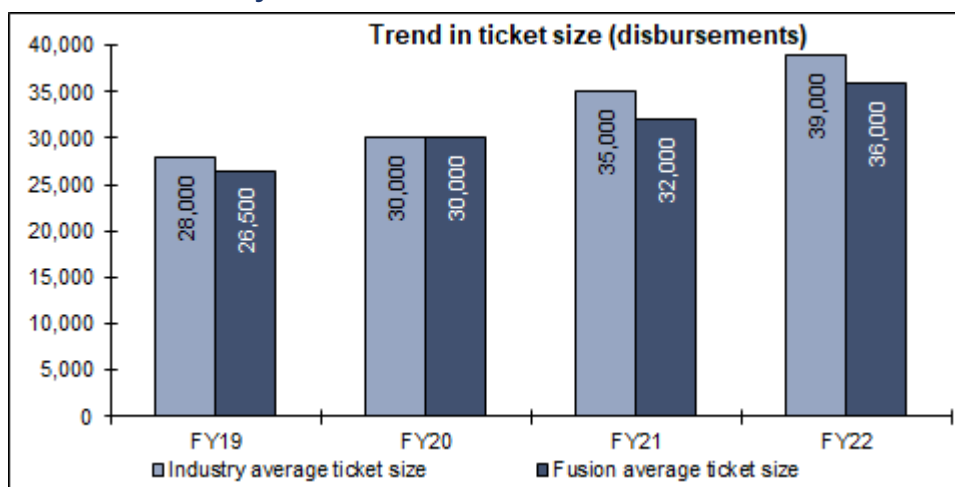
Chart 3: Higher share of first-cycle borrower reflects focus on new customer acquisition

Source: Company data, I-Sec research

Chart 4: Maximum ticket-size capped at Rs85,000 even for vintage customers

Source: Company data, I-Sec research

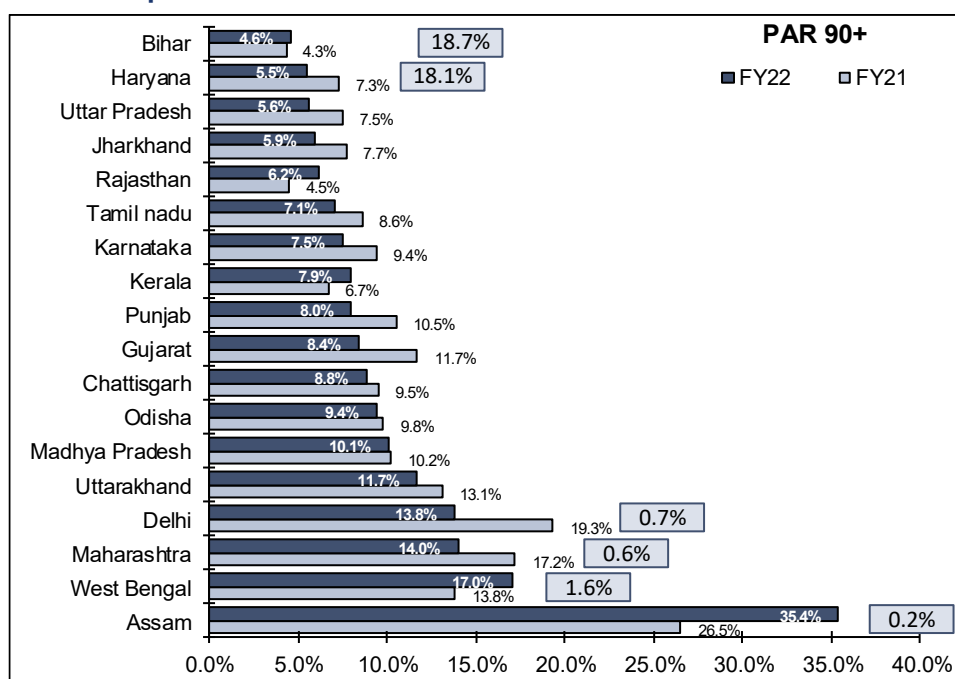
Chart 5: Fusion has always maintained its average disbursement ticket-size at lower-than-industry level



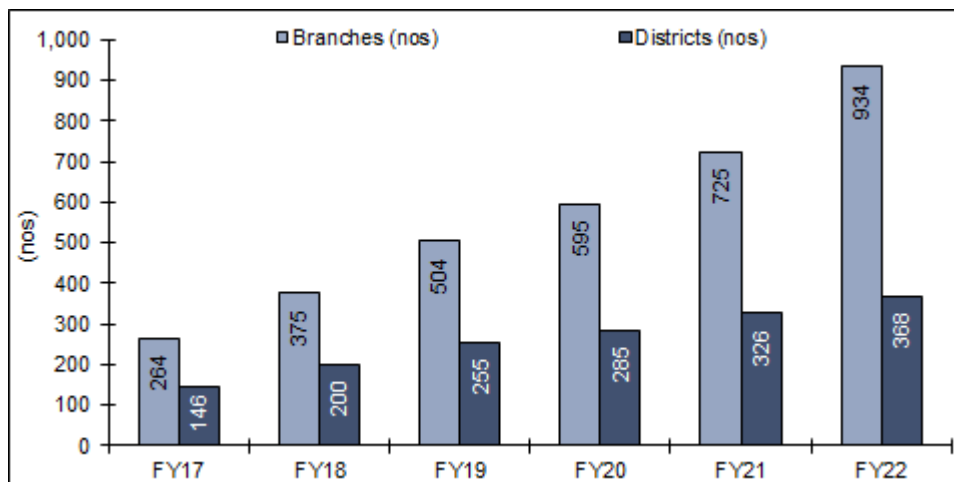
Source: Company data, I-Sec research

Chart 6: Careful selection of geographies, which also reflects Fusion's strong domain expertise

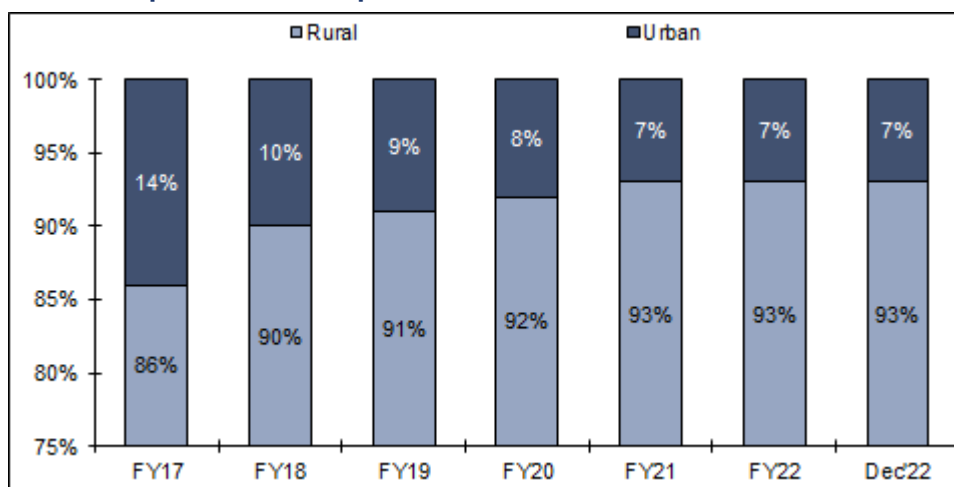
Fusion's careful selection of geography and calibrated approach has resulted in its negligible exposure to a few vulnerable geographies like West Bengal, Assam, Kerala, Maharashtra (based on historical PAR trend).



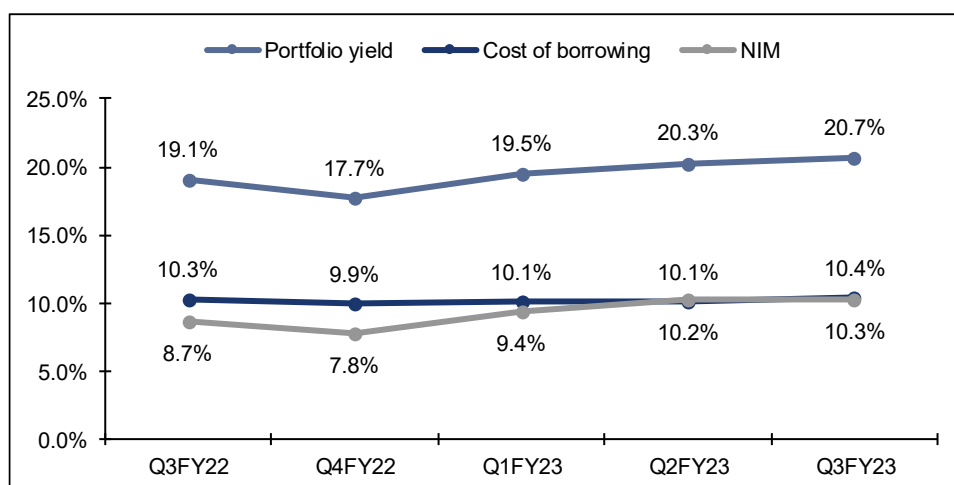
Source: Company data, I-Sec research

Chart 7: Focus on building deep distribution network...

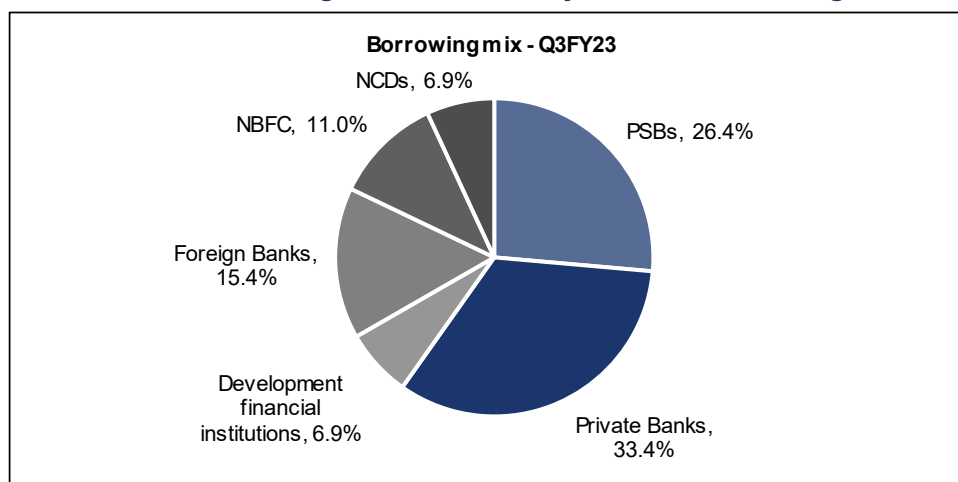
Source: Company data, I-Sec research.

... with emphasis on rural presence

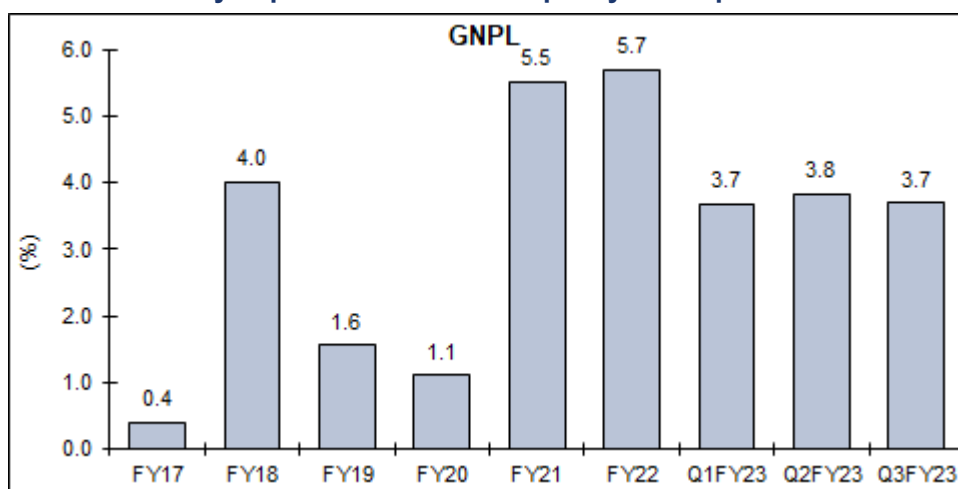
Source: Company data, I-Sec research

Chart 8: NIM sustained at 10% despite cost of borrowing increasing by 30bps QoQ

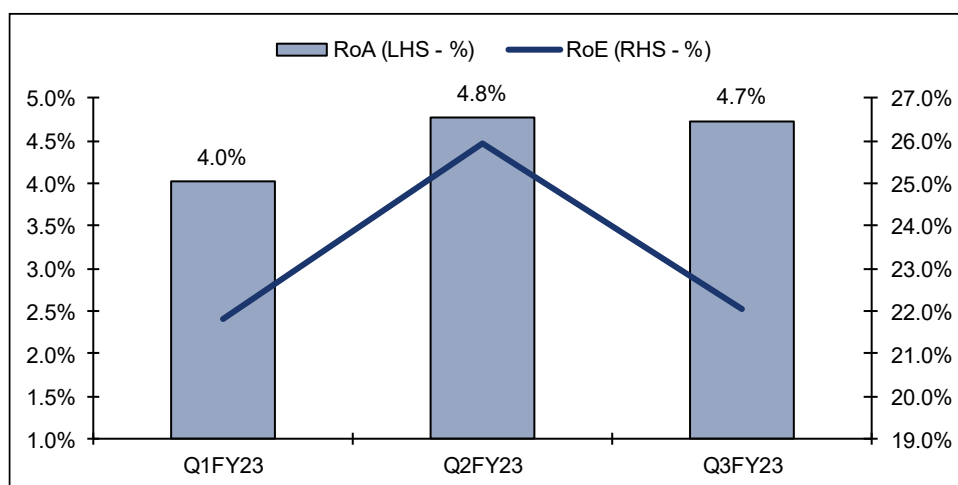
Source: Company data, I-Sec research

Chart 9: Bank borrowing remained the major source of funding

Source: Company data, I-Sec research

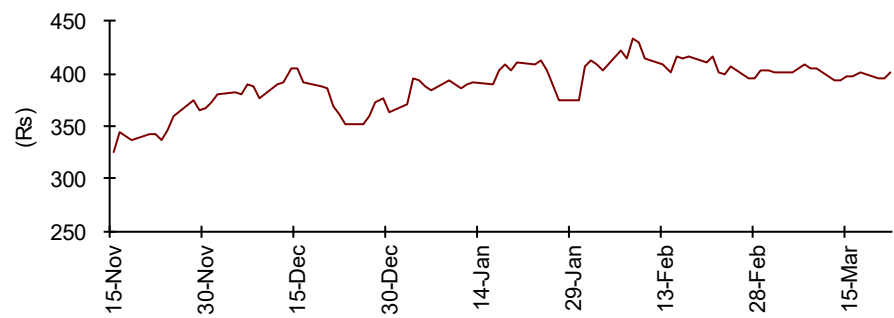
Chart 10: Steady improvement in asset quality ratios post covid

Source: Company data, I-Sec research

Chart 11: Profitability remained healthy; fresh capital raising during Q3FY23 led to decline in RoE

Source: Company data, I-Sec research

Price chart



Source: Bloomberg

Financial summary

Table 1: Profit and Loss statement

(Rs mn, year ending March 31)

| | FY21 | FY22 | FY23E | FY24E | FY25E |
|---|--------------|---------------|---------------|---------------|---------------|
| Interest income on portfolio loans | 8,060 | 10,566 | 16,144 | 21,162 | 27,072 |
| Y-Y growth | 24% | 31% | 53% | 31% | 28% |
| Other Interest Income | 498 | 946 | 886 | 1,148 | 1,479 |
| Finance costs | 3,751 | 4,960 | 7,004 | 9,430 | 12,262 |
| NII | 4,807 | 6,553 | 10,026 | 12,880 | 16,290 |
| Y-Y growth | 26% | 36% | 53% | 28% | 26% |
| Net Revenue | 4,980 | 7,054 | 10,882 | 14,089 | 17,718 |
| Total Opex | 2,204 | 3,123 | 4,191 | 5,327 | 6,799 |
| Employee benefits expenses | 1,686 | 2,331 | 3,112 | 3,930 | 4,999 |
| Y-Y growth | 14% | 38% | 34% | 26% | 27% |
| Other expenses | 479 | 738 | 1,006 | 1,303 | 1,678 |
| Y-Y growth | -2% | 54% | 36% | 30% | 29% |
| Depreciation and amortisation expenses | 39 | 54 | 73 | 95 | 122 |
| PPoP | 2,776 | 3,931 | 6,691 | 8,762 | 10,918 |
| Y-Y growth | 44% | 42% | 70% | 31% | 25% |
| Provision and write-offs | 2,208 | 3,687 | 1,673 | 2,015 | 2,597 |
| Adjusted PBT | 568 | 244 | 5,018 | 6,747 | 8,322 |
| Exceptional items (IV) | | 0 | 0 | 0 | 0 |
| Profit before tax | 568 | 244 | 5,018 | 6,747 | 8,322 |
| Tax | 128 | 27 | 1,254 | 1,687 | 2,080 |
| Profit after tax | 439 | 217 | 3,763 | 5,060 | 6,241 |

Source: Company data, I-Sec research

Table 2: Balance sheet

(Rs mn, year ending March 31)

| | FY21 | FY22 | FY23E | FY24E | FY25E |
|---|---------------|---------------|---------------|-----------------|-----------------|
| Share capital | 790 | 828 | 988 | 988 | 988 |
| Reserves and surplus | 11,673 | 12,552 | 22,155 | 27,215 | 33,456 |
| Shareholders' funds | 12,464 | 13,380 | 23,143 | 28,203 | 34,444 |
| Borrowings (other than debt securities) | 33,251 | 48,295 | 71,514 | 94,452 | 1,23,278 |
| Subordinated liabilities | 1,167 | 1,626 | 1,544 | 1,467 | 1,394 |
| Other financial liabilities | 1,266 | 1,334 | 1,268 | 1,204 | 1,144 |
| Equity and liabilities | 58,379 | 72,905 | 97,901 | 1,25,759 | 1,60,692 |
| Assets | | | | | |
| Tax assets | 120 | 354 | 371 | 390 | 409 |
| Property, plant and equipment | 103 | 122 | 128 | 135 | 141 |
| Intangible assets | 2 | 1 | 1 | 1 | 1 |
| Right of use asset | 78 | 69 | 73 | 76 | 80 |
| Other non-financial assets | 23 | 62 | 65 | 68 | 71 |
| Loan Portfolio | 43,607 | 59,182 | 82,482 | 1,08,107 | 1,38,596 |
| DTA | 765 | 868 | 876 | 885 | 894 |
| Trade receivables | 28 | 43 | 43 | 43 | 43 |
| Cash and bank balances | 13,353 | 11,536 | 12,372 | 14,054 | 18,018 |
| Other financial assets | 301 | 669 | 1,490 | 2,000 | 2,439 |
| Assets | 58,379 | 72,905 | 97,901 | 1,25,759 | 1,60,692 |

Source: Company data, I-Sec research

Table 3: Key ratios*(Year ending March 31)*

| | FY21 | FY22 | FY23E | FY24E | FY25E |
|-------------------------------------|---------------|---------------|---------------|-----------------|-----------------|
| Average Yields | 19.6% | 18.5% | 20.8% | 21.0% | 20.9% |
| Average cost of borrowing | 9.9% | 9.5% | 10.5% | 11.0% | 11.0% |
| Cal NIM | 11.2% | 10.6% | 11.8% | 11.6% | 11.4% |
| Opex/AUM (Cal.) | 5.3% | 5.5% | 5.4% | 5.3% | 5.2% |
| Cost/Income ratio | 44.3% | 44.3% | 38.5% | 37.8% | 38.4% |
| RoA | 1.1% | 0.3% | 4.4% | 4.5% | 4.4% |
| RoE | 3.6% | 1.7% | 20.6% | 19.7% | 19.9% |
| Asset quality | | | | | |
| GNPA (%) | 5.5 | 5.7 | 3.0 | 2.7 | 2.7 |
| NNPA (%) | 2.2 | 1.6 | 0.9 | 0.8 | 0.8 |
| PCR | 60% | 72% | 70% | 70% | 70% |
| Credit cost | 5.4% | 6.5% | 2.2% | 2.0% | 2.0% |
| Per share data (Rs) | | | | | |
| Year to March | | | | | |
| No of shares | 79 | 83 | 99 | 99 | 99 |
| Diluted EPS | 5.6 | 2.6 | 38.1 | 51.2 | 63.2 |
| EPS growth (%) | (36.9) | (52.9) | 1,354.6 | 34.4 | 23.3 |
| Book value per share | 157.7 | 161.7 | 234.3 | 285.6 | 348.8 |
| BVPS growth (%) | 3.8 | 2.5 | 44.9 | 21.9 | 22.1 |
| P/E | 72.8 | 154.6 | 10.6 | 7.9 | 6.4 |
| P/BV | 2.6 | 2.5 | 1.7 | 1.4 | 1.2 |
| RoA decomposition | | | | | |
| Interest Income | 16.0% | 16.1% | 18.9% | 18.9% | 18.9% |
| Interest exp | 7.4% | 7.6% | 8.2% | 8.4% | 8.6% |
| Net interest income (%) | 9.9% | 10.7% | 12.7% | 12.6% | 12.4% |
| Other income (%) | 1.3% | 2.2% | 2.0% | 2.1% | 2.0% |
| Total income (%) | 9.9% | 10.7% | 12.7% | 12.6% | 12.4% |
| Employee expenses (%) | 3.3% | 3.6% | 3.6% | 3.5% | 3.5% |
| Depre (%) | 1.0% | 1.1% | 1.2% | 1.2% | 1.2% |
| Other operating expenses (%) | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% |
| Total operating expenses (%) | 4.4% | 4.8% | 4.9% | 4.8% | 4.7% |
| Pre provisioning profits (%) | 5.5% | 6.0% | 7.8% | 7.8% | 7.6% |
| Provisions (%) | 4.4% | 5.6% | 2.0% | 1.8% | 1.8% |
| Pre tax profits (%) | 1.1% | 0.4% | 5.9% | 6.0% | 5.8% |
| Tax (%) | 0.3% | 0.0% | 1.5% | 1.5% | 1.5% |
| RoAUM (%) | 0.9% | 0.3% | 4.4% | 4.5% | 4.4% |
| Leverage | 4.1 | 5.1 | 4.7 | 4.4 | 4.6 |
| RoE (%) | 3.6% | 1.7% | 20.6% | 19.7% | 19.9% |
| Operating data | | | | | |
| Portfolio (Rs mn) | 46,378 | 67,860 | 87,747 | 1,13,797 | 1,45,891 |
| Disbursements | 37,013 | 61,798 | 83,427 | 1,08,455 | 1,37,738 |
| Repayments | 26,700 | 40,316 | 63,541 | 82,405 | 1,05,645 |
| Collections | 65% | 71% | 82% | 82% | 81% |
| Active Borrowers (in mn) | 2 | 3 | 3 | 4 | 4 |
| Avg ticket size | 21,877 | 24,949 | 28,052 | 31,635 | 35,267 |
| Capital Adequacy | | | | | |
| Tier I Capital | 11,547 | 12,370 | 22,155 | 27,215 | 33,456 |
| Tier II Capital | 788 | 1,244 | 1,244 | 1,244 | 1,244 |
| Total Capital | 12,335 | 13,614 | 23,400 | 28,459 | 34,701 |
| Total Risk Weighted Assets | 45,245 | 62,049 | 91,656 | 1,29,511 | 1,82,035 |
| CRAR - Tier I capital (%) | 25.5% | 19.9% | 24.2% | 21.0% | 18.4% |
| CRAR - Tier II capital (%) | 1.74% | 1.97% | 1.4% | 1.0% | 0.7% |
| CRAR (%) | 27.3% | 21.9% | 25.5% | 22.0% | 19.1% |

Source: Company data, I-Sec research

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