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NBFC

THEMATIC	MICROFINANCE	November 17, 2023

Get Set Consolidate!

The MFI industry was born in the mid-70s to serve BPL population neglected by banks. At ₹5.4tn AUM (24% 10-year CAGR), industry has reached ~2/3rd penetration. We expect ~20% CAGR (FY23-28) led by increasing penetration in north/south/central India. Capital oversupply in FY15-19 caused low-quality growth, ending in high NPA/low RoE. With the industry maturing, a similar cycle is unlikely. Expect consolidation as penetration saturates at ~90% by FY33. Players with competitive pricing, large distribution, high-quality customer service and diversification capabilities will gain market share. Developments like RBI's Mar'22 guidelines, bureau maturity, cross-linkage and Aadhaar ID seeding will reduce credit information asymmetry, addressing longstanding issue of customer over-leveraging. Lower credit costs should aid excess RoE of 2-3% vs (-)5% in last 4-5 years, aiding shareholder value creation. Amid high sector aversion from investors, CREDAG is an outlier (>50% premium to peers) owing to 100-200bps higher RoE than the industry.

Increasing penetration will drive ~20% AUM CAGR by FY28E

MFI industry was born to enable access to credit for the BPL population as it was credit-neglected. High distribution costs and high-risk perception were constraints for large banks. Since starting in the mid-70s, TAM penetration is ~65% today with industry AUM at ₹5.4tn (24% CAGR, FY13-23). Low branch set-up costs aided 95% district coverage. Low/medium MFI penetration in north/south/central India despite a big BPL population will drive ~20% industry AUM CAGR and 83% penetration by FY28E.

Consolidation inevitable as penetration reaches ~90% by FY33E

MFI sector witnessed capital oversupply during FY15-19, when <40% penetration provided prospects of sustained high growth for at least a decade. As companies focused on aggressive growth practices, economic events/shocks (political, demonetization, Covid) caused high NPAs. Over-leveraging went unchecked. A similar cycle looks unlikely with penetration at ~65%. Larger MFIs consolidating market share are more likely to attract further capital. Over FY28-33E, we expect consolidation as penetration saturates at ~90% by FY33E.

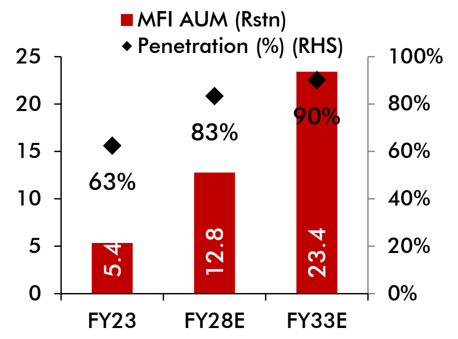
New guidelines address the whole sector, not just MFIs!

Credit information asymmetry yielded customer over-leveraging. Despite taking cognizance, older RBI guidelines missed addressing the whole sector and aimed only at NBFC-MFIs (35-40% of industry). RBI's Mar'22 guidelines addressed this issue structurally. Further, cross-linkage among credit bureaus and Aadhaar ID seeding during KYC reduced chances of identity manipulation. So, bureau rejection rates increased to 45-50% vs 30% earlier. There is global evidence that credit bureau linkage helps in avoiding over-indebtedness.

Amid investor aversion, CREDAG stands out

The MFI sector has delivered (-)5% excess returns on average (FY18-22). RoE (average 10-12%) was hit by customer over-leveraging and economic events (demonetization/Covid). Thus, most MFI stocks delivered (-)3% to (+)3% CAGR since listing (barring CREDAG). Investors' aversion to the sector is reflected in MFIs trading at 20-50% discount to other NBFC segments. CREDAG stands out with superior asset quality, competitive pricing, scalability and high capitalization. With RBI/industry developments aimed at plugging credit information asymmetry, expect credit costs of 2-2.5% (3-3.5% historically), aiding 2-3% excess RoE. Large players with competitive pricing, large distribution, high-quality customer service and diversification capabilities are likely consolidators.

Increasing distribution reach and widening credit net will drive penetration higher



Source: MFIN, MoSPI, Ambit Capital research

Maturing penetration will drive consolidation

- Increasing distribution reach will drive MFI/household penetration to 83%/90% by FY28/33E.
- Consolidation (industry CAGR FY28-33E: 13%) would be led by larger MFIs with competitive pricing, distribution and customer service quality.

Source: Company, Ambit Capital research

Larger players are likely consolidators

Criteria	Fusion	Spand.	Credag	Asirvad
Pricing	◕	◑	●	◕
Distribution	●	◕	◕	●
Customer service	◕	◔	●	◑

Source: Companies, Ambit Capital research. Note: ● - strong, ◕ - Average, ◑ - Relatively Weak, ◔ - Weak

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Saturating penetration to pave the way for consolidation

MFI industry's right to existence is born out of high share of BPL population being credit-neglected by banks due to high distribution costs and high risk perception. Rural India's entrepreneurship drive led MFI industry to AUM of ₹5.4tn (FY23), a 10-year CAGR of 24%. Though low barriers to distribution creation aided 95% district coverage by >200 MFIs, 5% of players account for 57% of the industry AUM (oligopoly). During FY15-19, market was over-supplied by players flush with fresh equity capital. However, industry's growth aggression (AUM CAGR: 45%) led to customer over-leveraging, ultimately resulting in high NPAs/collapsing RoE triggered by political events/demonetization/Covid. Such a capital cycle is unlikely to repeat as RBI Mar'22 guidelines made the operating environment tough. We expect the last stage of high industry growth (FY23-28: ~20% CAGR) to be followed by consolidation (FY28-33E: 13% CAGR). Players with competitive funding, proven history of market share gains and ability to diversify profitably will be winners (CreditAccess, Fusion).

What is the MFI industry's right to existence?

In order to better understand the MFI sector's right to existence, it is important to understand the origins of microfinance. Microfinance is the brainchild of Bangladeshi economist Mohammed Yunus. He opened the Grameen Bank, the first ever microfinance institution, to help the disadvantaged (often below poverty line/BPL). Before such an institution came into existence, low-income villagers had to depend on local money lenders charging high interest rates. Lack of assets or credit history was a major challenge for banks. The typical MFI customer is a woman seeking credit either for herself or for her husband and for income generation activity. In general, MFI has been limited to women as they are thought of as most responsible in a household and would always invest in her family well-being.

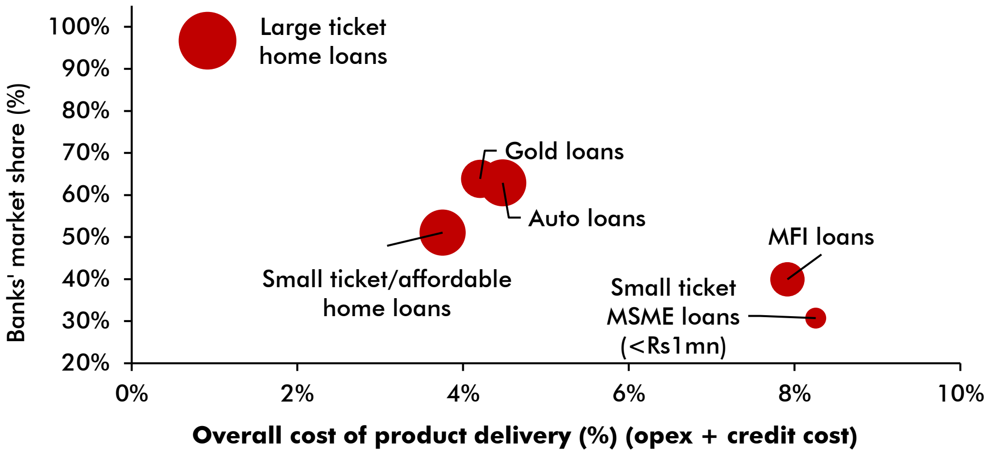
Exhibit 1: A typical MFI customer is a woman; is neglected by banks due to un/under-developed banking habits, lack of asset ownership, high risk perception

Typical MFI borrower	Score	Comments
Asset ownership	◔	1 two-wheeler in the house, 1 buffalo. No material/aspiration possessions. Minimal jewellery.
Financial safety net	◔	Low savings net. For example, if they miss 2 EMIs or become NPAs, it is extremely difficult to recover money/regularize.
Income generation ability	◑	They lack technical skills. In most cases, they engage in buffalo milking and daily labour.
Steadiness/stability of monthly income	◔	Income can fluctuate widely in some months.
Banking readiness/habits	◔	Banking habits are very low. As overall savings net is low, it is mostly kept in cash. They tend to avoid bank it is time consuming for them.
Type of mobile phone	Feature phone in most cases	One person in the house may have a smartphone but most ladies have a feature phone.
Dwelling type	◑	They live in a pakka house.

Source: Ambit Capital research. Note: ● - strong, ◕ - Average, ◑ - Relatively Weak, ◔ - Weak

High cost of distribution in MFI is a major deterrent in keeping large credit institutions from adequately serving such customers. Despite multiple pushes by RBI on grounds of financial inclusion, scheduled commercial banks have only 40% market share in MFI loans, whose industry size is 17%/44% of home/auto loans, where banks have ~70%/63% market share.

Exhibit 2: Banks tend to focus less on products where overall cost of delivery is high, such as MFI loans and MSME loans (<₹1mn ticket size). Even within the broader home loan segment, banks have a greater focus on larger ticket (>₹2.5mn ticket size) loans



Source: Statista, Crisil, RBI, Ambit Capital research. Note: Size of the bubble represents total market size.

Among the formal finance options available to BPL customers with no prior credit history and negligible assets to leverage, MFI loan has been a preferred choice. Given the small ticket sizes, often ₹25,000-40,000 in the first loan cycle, monthly repayments are easier to accommodate over 1-2 years. This also helps such customers to initiate credit track record and subsequently moved to higher loan amounts as they make economic progress.

Exhibit 3: A new-to-credit customer living in a village with negligible asset ownership and no prior credit history, MFI loan is usually the first and only entry point into formal credit

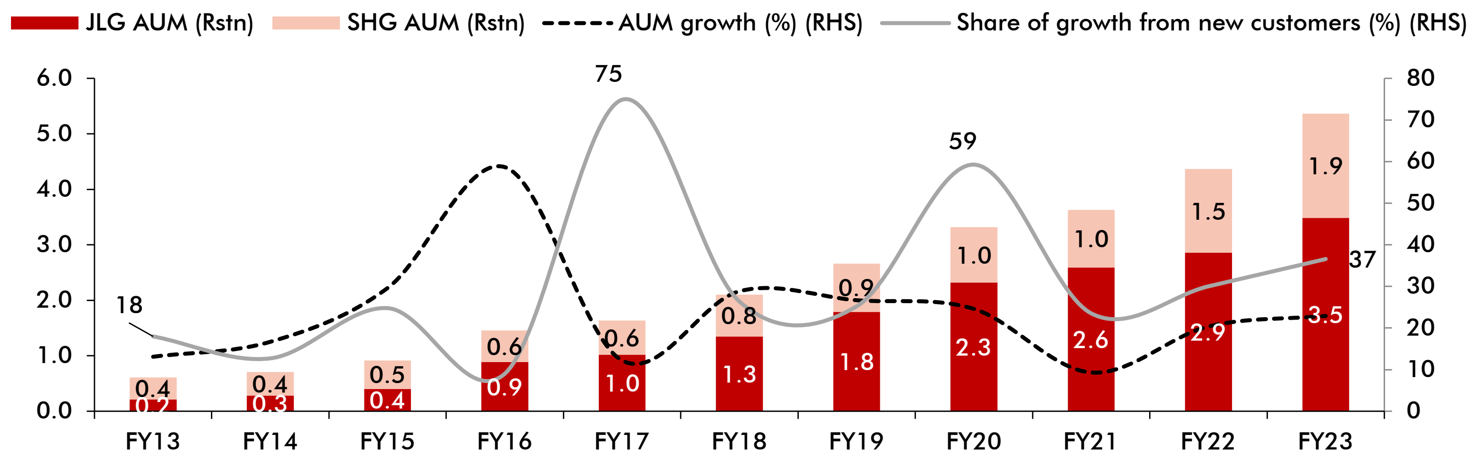
Particulars	Gold loan	MFI loan	Secured business loan
Ticket size (₹)	₹50,000-1,00,000	₹30,000-1,50,000	₹3,00,000-5,00,000
Loan end-use	Income generation, personal consumption	Income generation	Income generation
Turnaround time (TAT)	5-30 mins; as gold is security, documentation requirement is negligible.	5-10 days	7-10 days
Tenor	6-12 months (short term loan)	12-24 months (medium-term loan)	4-7 years (long-term loan)
Collateral	Loan secured by gold	Loan is unsecured	Loan is secured by property

Source: Ambit Capital research

Rural animal spirits powering MFI industry growth

India has one of the highest proportion of BPL population, at 22%, in South Asia. However, that has not held back animal spirits among micro-entrepreneurs in India. The Global Entrepreneurship Monitor (GEM) ranks India in top 5 globally in terms of rate of entrepreneurial activity. More specifically in rural India, as per PLFS, self-employment and casual labor together account for ~80% of employment type. Due to high distribution cost and high credit risk perception, access to formal credit has been a key challenge. Recognizing these challenges, especially for women, microfinance was first introduced in India by SEWA Bank in Gujarat in mid-70s. Subsequently, in 1992, NABARD launched a pilot programme SHG-BLP to address need for economic inclusion of women and rural poor. Today, the total MFI industry AUM is ₹5.4tn (FY23), having grown at 24% CAGR (FY13-23). MFI can be characterized as a high growth industry during the last decade, having grown at or more than 25% in 5 out of 10 years (FY13-23). There are multiple supply/demand factors for such high industry growth: (i) RBI's push towards financial inclusion, (ii) low penetration despite rural population mix at 75% and (iii) ability to charge high rates, leading to higher RoE/attractive profitability.

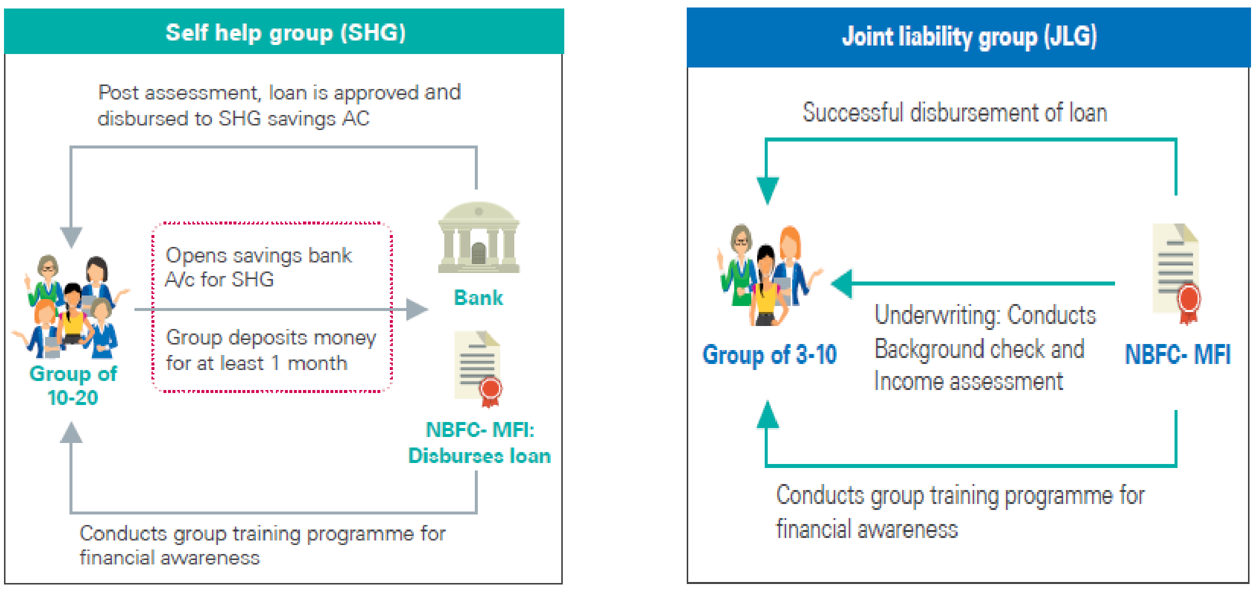
Exhibit 4: The MFI industry posted ~25% CAGR in the last decade. During periods of very high growth, such as FY15-19, growth was led by increasing customer exposure rather than new customer acquisition



Source: Company, Ambit Capital research. Note: The data in the above charts takes into account loans outstanding as well as currently active customers for JLG and SHG. The aggregate data for JLG and SHG has been adjusted for 30% overlap.

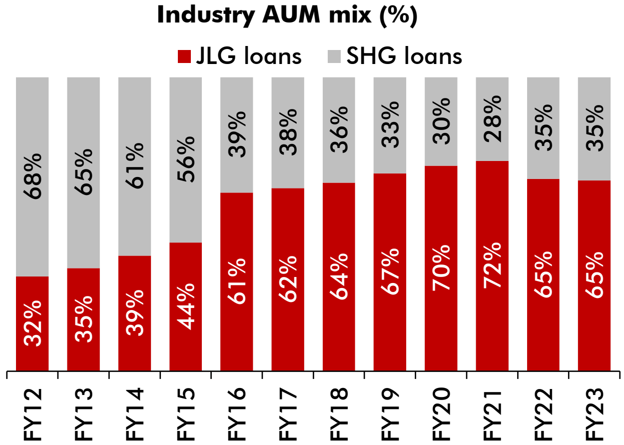
MFI industry operates on two models: (i) joint liability group (JLG) and (ii) self-help group (SHG). Till about a decade back, the SHG model used to dominate the industry with AUM share of 68% (FY12) and the remaining (32%) was JLG. However, given the faster turnaround time (TAT) and higher loan size offered under JLG, such a model found more favor among the target segment. As a result, as of FY23, the share of JLG-led MFI lending increased to 65% of industry AUM. One of the more probable reasons why JLG gained popularity is the lower cost of transaction for the customer. As per NABARD, the cost of transaction for a JLG customer is ~15% lower than in a SHG model, mainly pertaining to lower opportunity cost (faster TAT/less intense training) under JLG.

Exhibit 5: Given the higher customer turnaround time due to longer training period, the opportunity cost of taking a loan under SHG is about 15-16% higher vs JLG loans



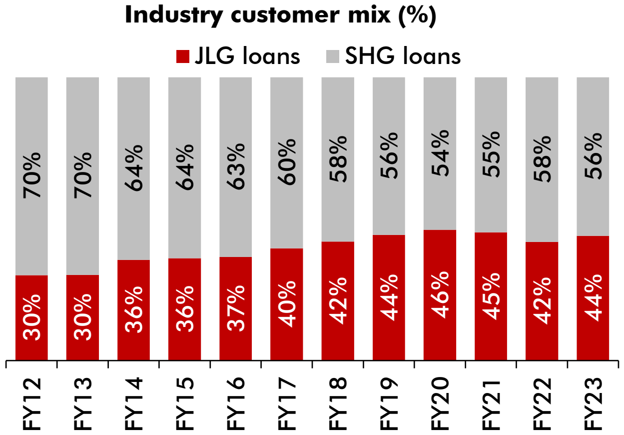
Source: KPMG, Ambit Capital research

Exhibit 6: Under JLG, a customer can get a higher loan amount. Over time, despite JLG customers being 44% of the industry borrower base, account for 65% of AUM



Source: NABARD, MFIN, Sa-Dhan, Ambit Capital research

Exhibit 7: Given the benefits of JLG over SHG, borrowers have shifted to JLG over time

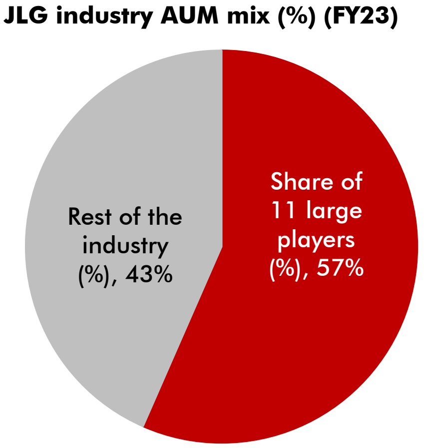


Source: NABARD, MFIN, Sa-Dhan, Ambit Capital research

Characterized as quasi-oligopoly

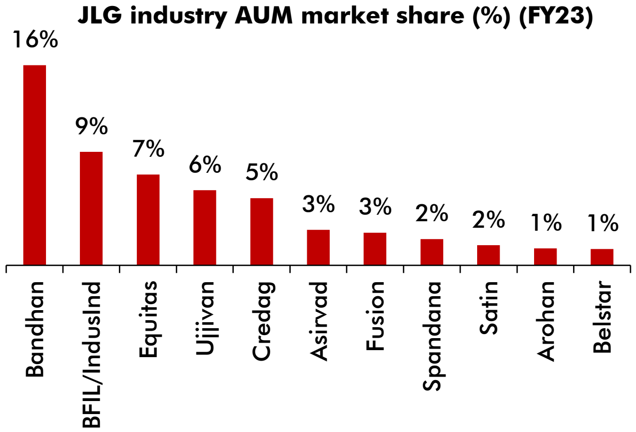
For a prospective entrant, MFI industry economics are attractive given 20-25% RoE in good years, <6 months branch break-even and minimum net worth of only ₹50mn (RBI regulation). However, scalability has been a challenge for most due to lack of funding availability for investments into controls/processes and distribution. As per MFIN, there are >200 MFI lending institutions in the industry, making up ₹5.4tn AUM. However, only 5% of players account for 57% of the total industry AUM. Such a market construct indicates the quasi-oligopoly nature of the industry.

Exhibit 8: 5% of the players account for 57% of the JLG industry AUM, indicating oligopolistic nature of the industry



Source: MFIN, Sa-Dhan, Ambit Capital research

Exhibit 9: Banks are amongst the largest players, accounting for majority of the JLG industry AUM



Source: Companies, MFIN, Sa-Dhan, Ambit Capital research

Low barriers to distribution set-up aided reasonable penetration

As of FY23, MFI industry had 105mn unique active borrowers/households, taking into account JLG and SHG borrowers as reported by MFIN and NABARD, respectively. The gross aggregate number has been adjusted for 30% overlap between JLG/SHG. This implies that the MFI/household penetration is 63% (FY23). Key drivers of penetration have been expanding distribution and district coverage. With increasing scale, the marginal cost of entering a new district and setting up a branch is typically low. Further, the risk of loss is low vis-à-vis potential returns. The marginal cost of a new branch is estimated to be ₹0.6mn, which can be easily covered by business generated by only one loan officer on a bi-weekly collection model. ROA would be higher if collection model is monthly. We further estimate that at scale, a typical branch break-even period is less than

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6 months. Given the low barriers to entry and distribution expansion in this business, the MFI industry has now covered 95% of all-India districts.

Exhibit 10: Target addressable household is estimated to be 60% of the total Indian household

Urban		Rural	
Annual household income:	**No. of households (#)**	**Annual household income**	**No. of households (#)**
>₹335k	9.2mn	>₹138k	37mn
₹193-335k	18.5mn	₹101-138k	37.8mn
₹67-193k	55.6mn	₹63-101k	74.5mn
<₹67k	9.2mn	<₹63k	36.8mn
Addressable households (#)	**56mn**	**Addressable households (#)**	**112mn**
Total addressable households (#)	**168mn**		

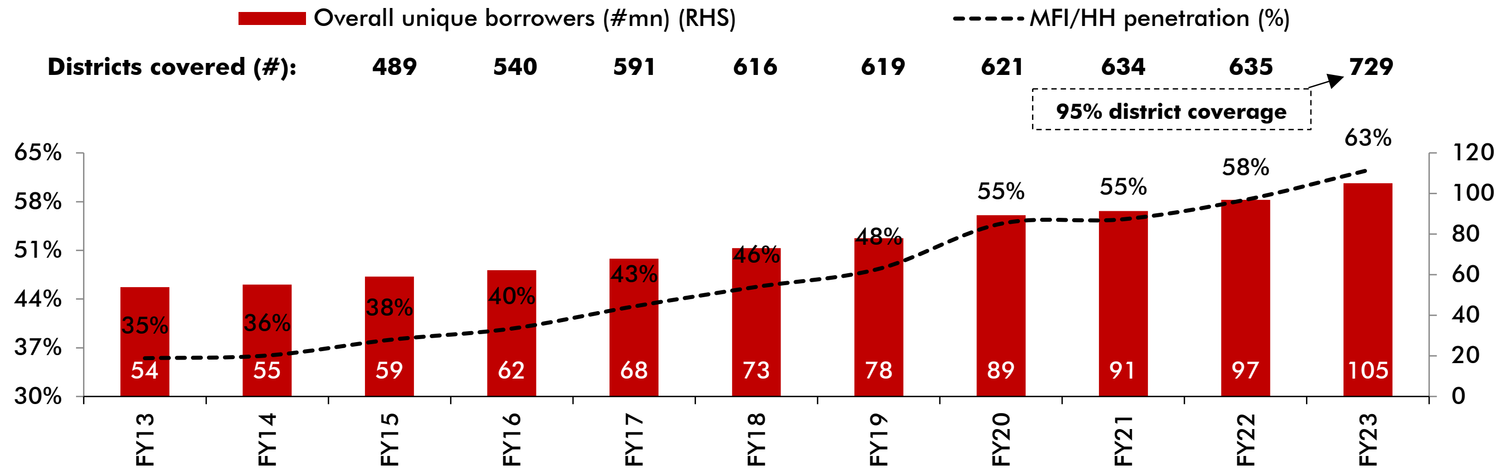
Source: KPMG, Ambit Capital research. Note: Household consumption rate assumed at 69% of income. Household with annual income of ₹60-70k have been excluded from target market computation.

Exhibit 11: In order to cover marginal cost of a new branch, the ask-rate on break-even AUM requirement is an easy deliverable. This implies that the cost of setting up new distribution is low vis-à-vis potential returns

Business requirement estimates for covering marginal cost of a new branch	
Marginal cost of opening a new branch per month (₹ mn)	0.6
ROA aspiration (%) (assumption)	4%
Required AUM (₹ mn)	15.0
Ticket size per member (₹) (assumption)	40,000
No. of members required (#)	375
Members per group (#) (assumption)	8
No. of groups required (#)	47
No. of groups covered by 1 officer in a day (#) (assumption)	4
Assuming bi-weekly repayment, no. of meeting days per month (#)	23
Man-hours utilization per month (%)	90%

Source: Ambit Capital research, Amit Capital estimates.

Exhibit 12: In absence of any meaningful entry barriers to the MFI business, low marginal cost of setting up distribution and attractive RoE, the industry has penetrated 95% of districts across India

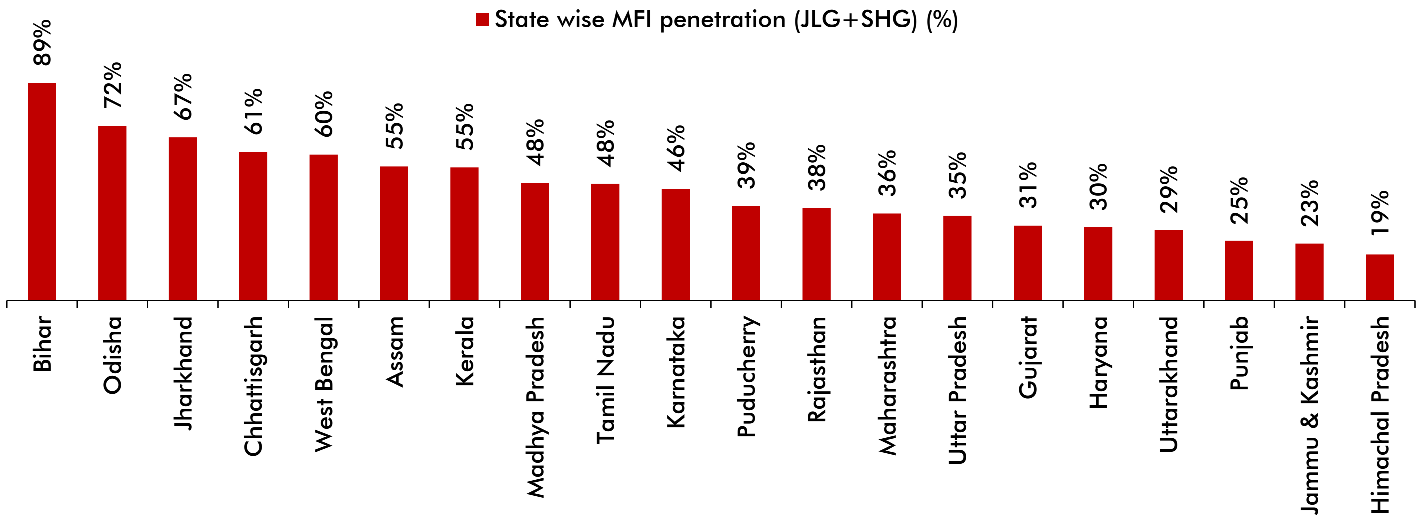


Source: MFIN, NABARD, Ambit Capital research. Note: The market penetration calculated above is on aggregate basis for JLG and SHG, adjusted for 30% overlap.

Penetration is linearly related to share of BPL population

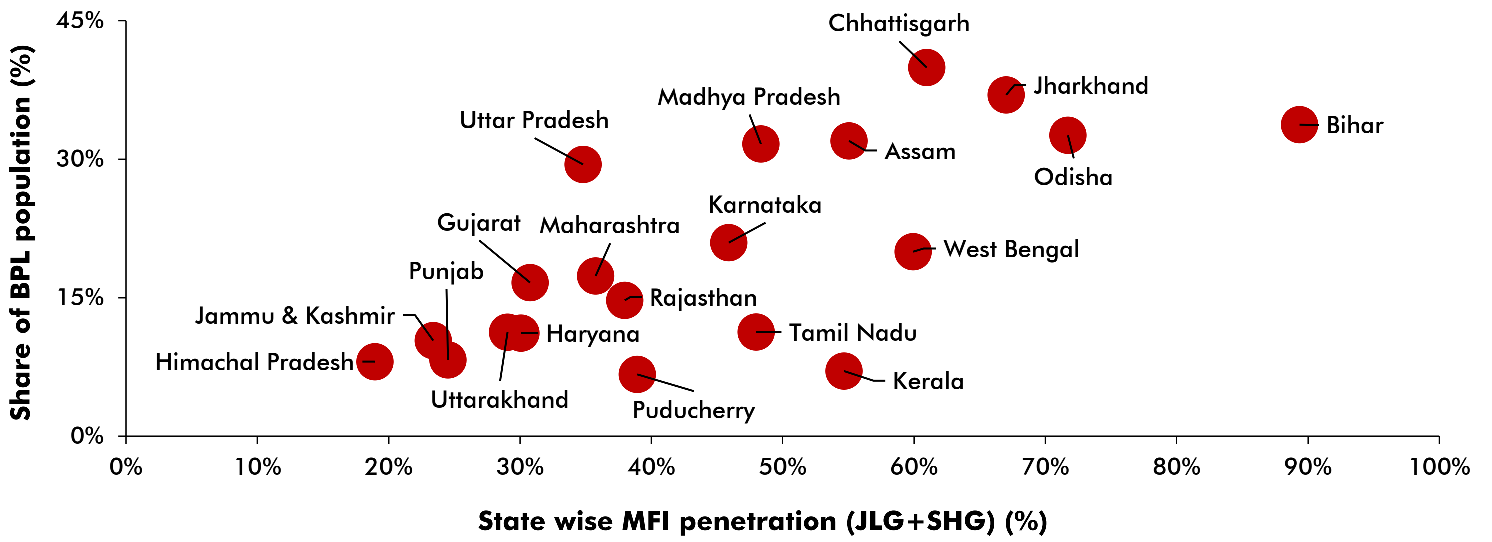
In terms of region, eastern states have a higher level of penetration; most notably ~90% in Bihar. A couple of reasons for higher level of MFI penetration in eastern states are: (i) minimum net worth of ₹20mn at the time of registration with RBI, lower than ₹50mn in the rest of India and (ii) higher level of population living below poverty line (BPL). As per the 2011 census, eastern states have 36% share of population living below the poverty line on average, higher than the national average of 19%. Even Assam, which has 32% share of population below BPL, is estimated to have 55% MFI penetration. On the other hand, states with lower BPL population have lower MFI penetration; Punjab, Uttarakhand, Haryana, Maharashtra and Gujarat to name some. Overall, there seems to be a linear relationship between a state's share of BPL population and MFI penetration. We expect northern states such as UP to witness higher growth given the higher share of BPL population but lower MFI penetration. Even in the west, despite share of BPL population being similar or lower than southern states, MFI penetration is lower.

Exhibit 13: Given that east has a higher share of BPL population, MFI penetration has been naturally higher



Source: Ministry of Rural Development, MoSPI, MFIN, Sa-Dhan, Ambit Capital research. Note: State-wise penetration calculated above is on aggregate basis for JLG and SHG, adjusted for 30% overlap.

Exhibit 14: Given BPL population relative to MFI penetration, north & south are growth markets. In north, UP is most attractive. In south, TN and Karnataka better penetrated while Andhra and Telangana offer fresh opportunity after Telangana HC ruling



Source: Niti Aayog, Census 2011, Ministry of Rural Development, MoSPI, MFIN, Ambit Capital research.

Past – Market oversupply, Future – Consolidation

FY15-19: Classic case of market oversupply aiding industry value destruction

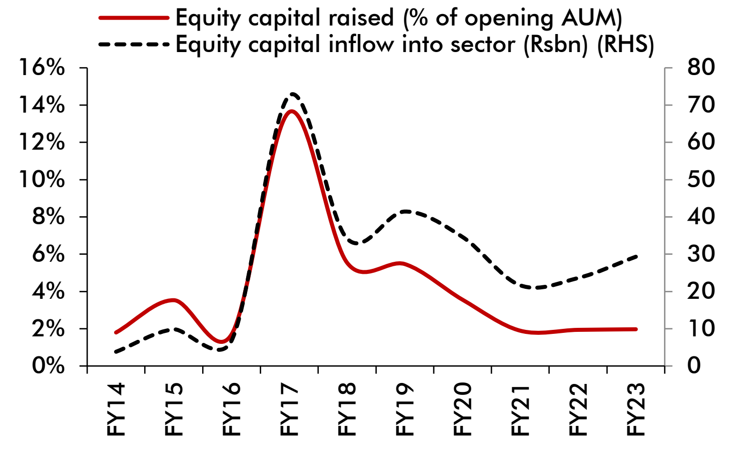
FY15-19 had all the ingredients required for disruptive market behaviour by existing as well as new players. During this period, the industry witnessed higher-than-average change in individual company market share. This was likely fuelled by record high supply of fresh equity capital into the sector along with 22% CAGR in customer exposure vs normalised annual growth rate of 10-12%. In view of GDP growing at 11-12% CAGR during FY15-19, MFI was an oversupplied market rather than demand-led.

Exhibit 15: Industry trends (FY15-19) w.r.t capital inflow into the sector and larger part of capital deployment towards increasing customer exposure for gaining market share reflect characteristics of an over-supplied market

High capital inflow into MFI sector	High growth in customer exposure, indicating customer over-leveraging	High intensity of market share changes among individual companies
The period FY15-19 saw abundant supply of capital coming into the MFI sector, likely driven by prospects of high growth/profitability as penetration was ~36% till FY14 and industry RoEs were attractive at 20-22%. During this period, the average equity capital raised as % of opening AUM was 6% compared to 2% outside of this period. In fact, equity raised during FY17-19 accounted for ~55% of the total capital raised during the last decade (FY13-23). During FY16/17, multiple NBFC-MFIs received SFB license from the RBI, followed by ₹78bn worth of equity infusion over FY17/18.	Flush with fresh equity capital, the MFI industry registered AUM CAGR of 45% (FY15-19). The growth was driven mostly by increase in customer exposure, which increased at 29% CAGR while unique active customer base increased at 13% CAGR. Customer exposure growing at >2x the growth in customer base likely indicated customer over-leveraging. A large MFI pointed out similar concern in its FY18/19 annual report. Another highly reputed MFI expert pointed out that some of the large MFIs were lending higher amounts to same customers, thus leading to over-indebtedness.	Abundant capital supply and prospects of sustained high growth rates due to low penetration led to aggressive growth practices by industry players. Increasing customer exposure/over-leveraging seemed like one such strategy. As a result of such competitive market behaviour, the absolute average change in market share during FY15-18 was 1.3% compared to average of 0.7% outside this period. The higher average change in individual company market share during FY15-18 reflected capital-fuelled disruptive market behaviour across the industry.

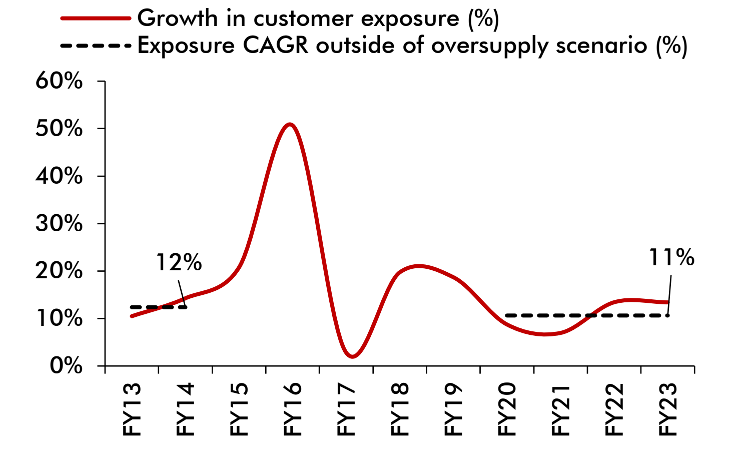
Source: Ambit Capital research

Exhibit 16: During FY15-19, capital supply into the MFI sector by private equity was high



Source: Company, Ambit Capital research. Note: NBFC-MFIs considered for above analysis are Spandana, Fusion, CreditAccess Grameen, Asirvad, Satin, Belstar, Arohan, Satya, Chaitanya, Annapurna, BSS MFI, IIFL Samasta, Muthoot Microfin, Svatantra.

Exhibit 17: But the quality of growth was low as it was led by increasing customer exposure at nearly 2x the GDP growth rate rather than new customer acquisition



Source: MFIN, NABARD, Ambit Capital research

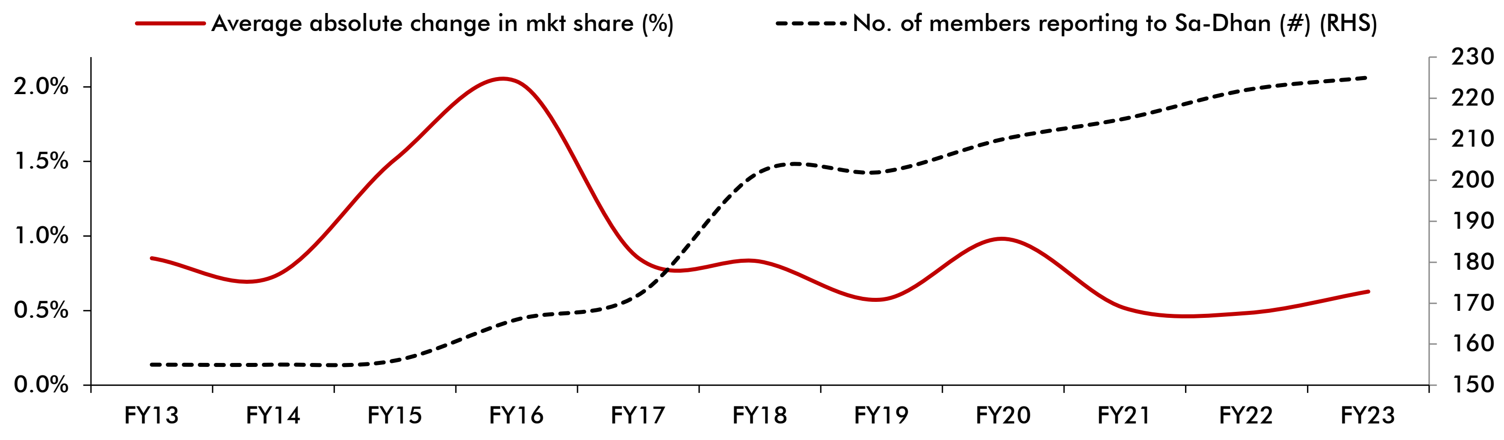
Exhibit 18: The SRO took note of over-leveraging back in 2016

"Few leading players have grown their gross loan portfolios by over 80% in the 12 months of 2015-16. Such steep growth in loan portfolios without proportionate growth in borrower base indicate towards potential case of over-indebtedness and subsequent lack of client protection."

– The Bharat Microfinance Report 2016, Sa-Dhan

Source: Sa-Dhan, Ambit Capital research

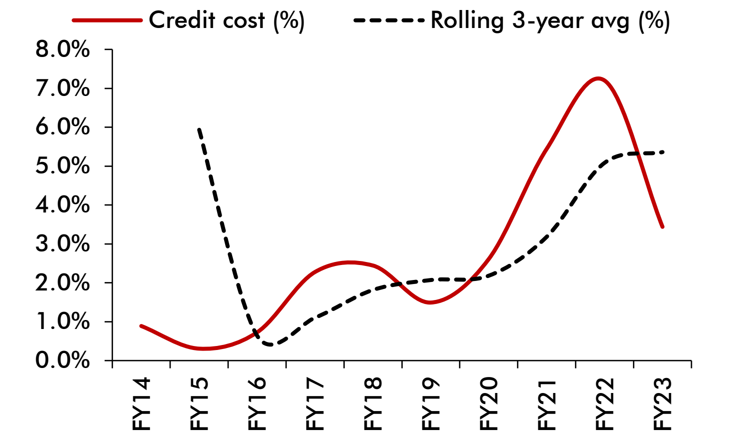
Exhibit 19: Given that the industry was flush with fresh capital, players were aggressive in gaining market share as indicated by high intensity of average market share change during FY15-17



Source: Companies, Sa-Dhan, Ambit Capital research. Note: Companies considered for analysis are Bandhan, SKS/BFIL, Spandana, Fusion, CreditAccess, Asirvad, Ujjivan, Equitas, Satin, Belstar, Arohan.

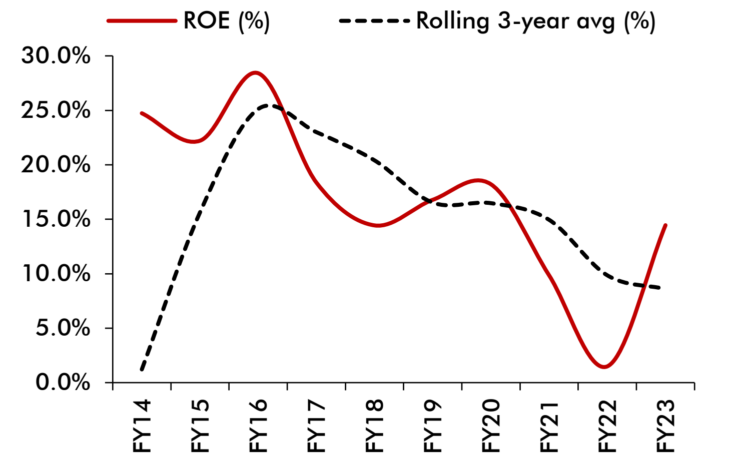
The result of such an oversupplied market was higher-than-cross-cycle credit losses, which impacted RoE. Key negative triggers/catalysts were political events (Maharashtra, Karnataka, Assam), demonetisation (FY17-18) and Covid (FY20-22).

Exhibit 20: As a result of increasing customer leverage, followed by negative triggers, massive asset quality issues cropped up, resulting in high credit costs…



Source: Companies, Ambit Capital research. Note: Rolling 3-year average RoE is based on average of individual annual RoEs (on closing equity). Companies considered for above calculation are Spandana, Fusion, CreditAccess Grameen, Asirvad, Ujjivan, Equitas Satin, Belstar, Arohan.

Exhibit 21: …which adversely impacted RoE



Source: Companies, Ambit Capital research. Note: Rolling 3-year average RoE is based on average of individual annual RoEs (on closing equity). Companies considered for above calculation are Spandana, Fusion, CreditAccess Grameen, Asirvad, Ujjivan, Equitas Satin, Belstar, Arohan.

Capital cycle of FY15-19 unlikely to repeat; larger MFIs attracting more capital

In the last few years, the supply of capital into the MFI sector reduced, averaging 2% (FY20-23) vs 6% (FY15-19). A key reason for lower capital inflow is that the sector underwent a massive downturn during two Covid waves which impacted asset quality and RoE. In FY23, the industry recovered as indicated by large players such as Fusion/CreditAccess making 20%+ RoE. Capital cycle seen during FY15-19 is unlikely to repeat. The operating environment has become more challenging due to stringent RBI guidelines (Mar'22). Further, ability to grow AUM by over-leveraging customers reduced significantly given household linkage with multiple credit bureaus, 96% Aadhaar penetration and mandatory Aadhaar-based loan application log-in. As industry growth declines to ~20% CAGR (FY23-28E), 500bps lower than last decade, capital providers are likely to be more prudent. Larger, stable players with (i) proven history of scaling up/market share gains, (ii) competitive funding cost/pricing to withstand long-term market consolidation and (iii) well-developed/developing non-MFI capabilities (MSME or gold loans) will attract more capital. In the last few years primary market capital raises have been limited to a select few large NBFC-MFIs.

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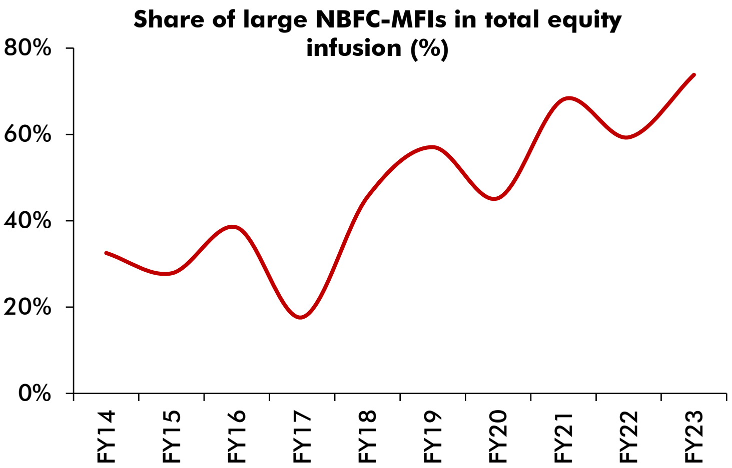
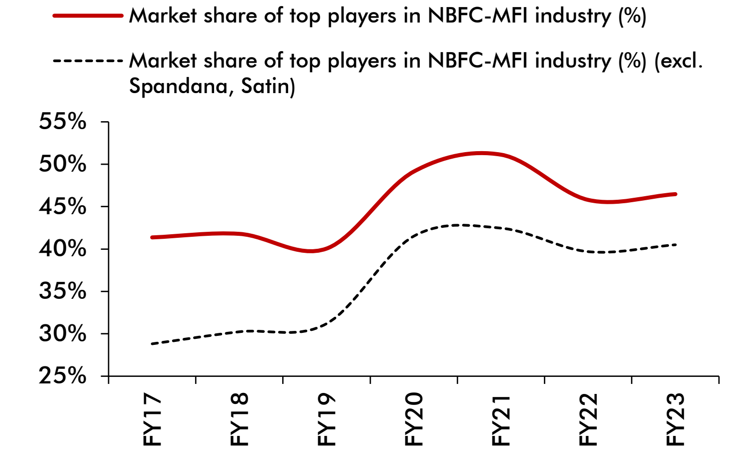
Exhibit 22: Large NBFC-MFIs seem to have cornered a larger part of the private capital flows



Source: Companies, Ambit Capital research. Note: NBFC-MFIs considered for above analysis are Spandana, Fusion, CreditAccess Grameen, Asirvad, Satin, Belstar, Arohan, Satya, Chaitanya, Annapurna, BSS MFI, IIFL Samasta, Muthoot Microfin, Svatantra.

Exhibit 23: Over the last 7 years, aggregate market share of larger, more stable NBFC-MFIs has increased



Source: Companies, Ambit Capital research. Note: Companies considered are Spandana, Fusion, CreditAccess, Asirvad, Satin, Belstar, Arohan.

Exhibit 24: Over the last few years, smaller NBFC-MFIs have been folding into larger institutions, hinting at ongoing/early stage consolidation

Target	Acquirer	Transaction timeline
Madura MFI	CreditAccess	Nov'19
Midland MFI	ICICI Bank	Oct'21 (ICICI bank acquired minor stake)
SMILE MFI	Northern Arc Capital	Feb'22
Sonata MFI	Kotak Mahindra Bank	Feb'23
Chaitanya MFI	Svatantra MFI	Aug'23
Fincare SFB	AU SFB	Oct'23

Source: Companies, Ambit Capital research

"While we continue to be a very active investor in the Impact space in India, since 2014, we have not made any new investment in microfinance. We believe the sector is maturing and growth levels are slowing as expected with any sector which is reaching maturity."

- Lok Capital, Jul'23 (link)

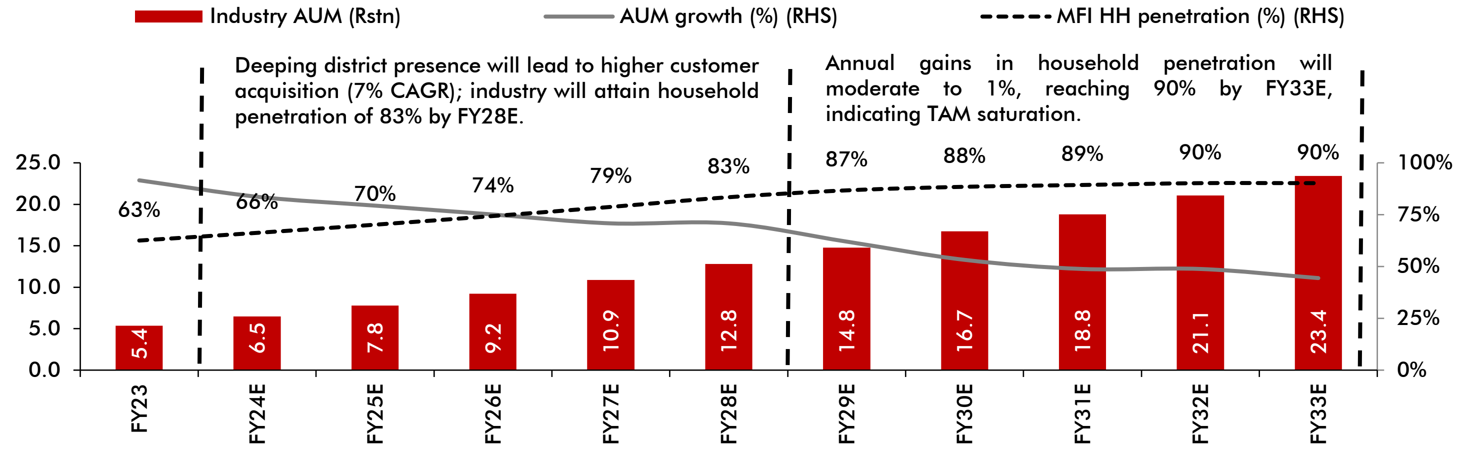
In recent times, Yes Bank and Federal Bank also expressed interest in acquiring a microfinance company.

Market consolidation is inevitable

Despite the industry having reached household penetration of 63% (FY23), we believe the industry can grow at ~20% CAGR for the next 5 years (FY23-28E). By FY28/29E, we expect MFI household penetration to start saturating at 85-90%. Over FY28-33E, we expect industry AUM CAGR to moderate to 13%, increase in exposure size being the key driver.

- **High growth phase (FY23-28E):** We expect MFI household penetration to increase to ~85% by FY28E led by ~20% AUM CAGR. Though MFI industry's district coverage was 95% as of FY23, deepening district presence will lead to higher customer acquisition.
- **Consolidation phase (FY28-33E):** Post FY28E, we expect further gains in MFI household penetration to moderate to 1% and reach ~90% by FY33E. As this phase would be characterized by target addressable market (TAM) saturation, we expect the industry to consolidate. Players having competitive pricing, large distribution and offering good customer service will witness market share gains (CreditAccess, Fusion, Belstar, Asirvad). For example, women borrowers running 2 parallel MFI loans, each from two different lenders, have incentive to stick to just one lender which is offering a lower rate/ better customer service.

Exhibit 25: Over FY28-33E, we expect industry TAM to start saturating as MFI reaches ~90% of households

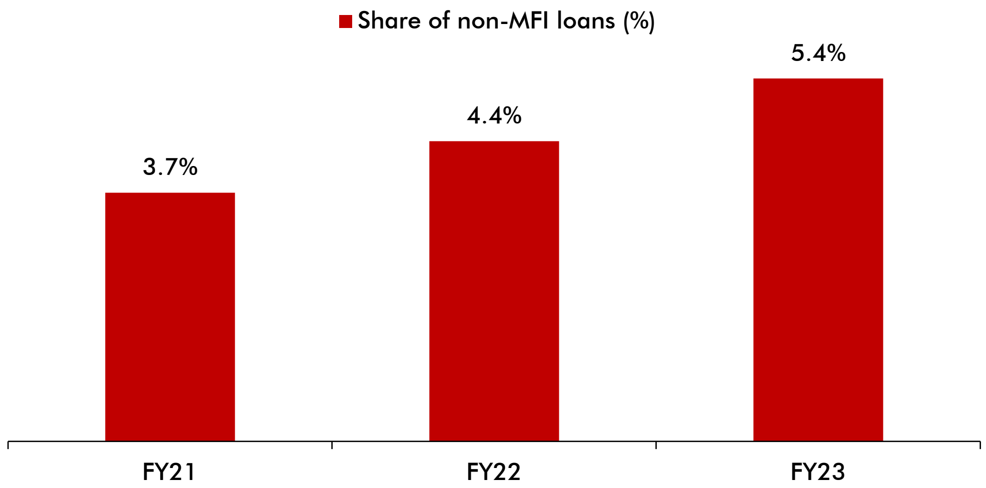


Source: MFIN, NABARD, MoSPI, Ambit Capital research

Multi-product approach to growth longevity

With the MFI industry growth rate declining to 13-15% over FY28-33E, we expect NBFC-MFIs to diversify into non-MFI products. Note that RBI's Mar'22 guidelines relaxed non-MFI asset mix to 25% compared to 15% earlier. Further, taking cognizance of likely industry saturation 7-10 years ahead, most NBFC MFIs have started developing non-MFI products, most commonly secured MSME loans. The development of this product is premised on loaning higher amounts to graduated MFI customers, albeit with a tighter credit filter. In some cases, companies have devised a strategy to chart open-market customer acquisition rather than focusing on existing MFI customers for MSME.

Exhibit 26: In last 3 years, the share of non-MFI loans has been increasing, primarily led by micro-LAP/secured MSME loans



Source: Company, Ambit Capital research. Note: Share of non-MFI loans (in total AUM) is estimated based on AUM mix for Fusion, CreditAccess, Spandana, Satin, Asirvad.

Exhibit 27: Product adjacency to MFI loans is high as existing MFI customers who are progressing would eventually graduate to a micro-MSME loan. Plus, MFI's expertise in informal income assessment will help in scalability

Company	Non-MFI products	Launch timeline	Product adjacency to MFI loans	Customer acquisition/business growth strategy
Spandana	LAP, nano-enterprise, MSME loan	FY23/24	◕	Focus on semi-urban markets and new customer acquisition primarily; will not emphasize on selling to existing MFI customer.
CreditAccess	Mortgages/LAP	FY22-23	◕	Graduated MFI customers with higher loan needs; 2+ years of vintage; multiple sources of income.
Satin	MSME loan	FY17	◕	Targeting customers which have completed more than 2 loan cycles and have bigger credit requirements.
Fusion	Micro-LAP/MSME loan	FY19	◕	Targeting mix of existing MFI customers as well as open market/new customer acquisition.

Source: Companies, Ambit Capital research. Note: ● - strong, ◕ - Average, ◑ - Relatively Weak, ◔ - Weak

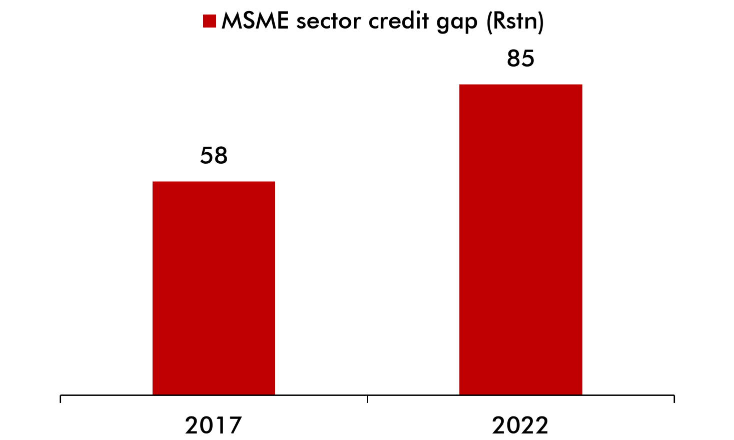
As per TransUnion CIBIL, only 40% of MSMEs in India have ever availed formal credit. Further, as per IFC, MSME sector credit gap is estimated at ₹85tn in India, which is ~40% of GDP. Some of the key challenges faced by MSMEs, ~94% sole proprietors, are lack of income evidence, banking habits, unregistered businesses. Also, low ticket sizes are not attractive for low-cost large financiers due to opex-intensive nature of such loans. As a result of the high-risk perception of the targeted customer segment and the prohibitive cost of physical distribution, traditional institutions' ability to provide credit to such customers has been constrained. Given MFI's wide/deep distribution and well-developed expertise in small-ticket retail lending operations, they are better placed to cater to small ticket MSME loan market. Note that the market for <₹1mn ticket size MSME loans has grown at 22% CAGR (FY18-22), partly aided by new-to-credit customers, at 28% of new business acquisition vs ~10% in FY18.

Exhibit 28: Challenges to accessing credit by MSMEs are well noted

BCG, Omidyar Network (link)	40% of this MSME credit demand is served by informal credit channels. Another 25% is borrowing via invisible channels such as proprietorship. Informal interest rates are 2x of formal market.
IFC (2018) (link)	Majority of the credit demand by MSMEs is addressed informal channels, which account for 84%. Friends and family are an important source of financing and support for MSMEs. For larger ticket sizes, MSMEs turn to moneylenders who charge high interest rates and unclear terms of lending.
IFC, World Bank (2022) (link)	Studies show that SMEs are less likely to secure bank loans than large firms. Instead, they rely on internal funds or cash from friends and family to launch and run their enterprises. In developing countries, 50 percent of formal SMEs do not have access to formal credit, and the number goes up to 70 percent for all microenterprises. Countries with the largest economies, such as India and Nigeria, have the largest SME finance gap in absolute numbers.

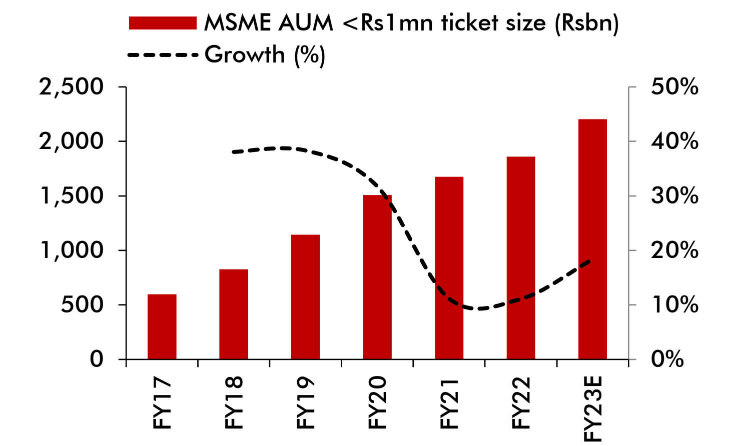
Source: Ambit Capital research, BCG, IFC

Exhibit 29: MSME credit gap is nearly 40% of GDP...



Source: IFC, Ambit Capital research

Exhibit 30: ...so the <₹1mn ticket size MSME lending market has grown at 22% CAGR in the last 5 years



Source: CRISIL, Ambit Capital research

But scaling up non-MFI isn't easy

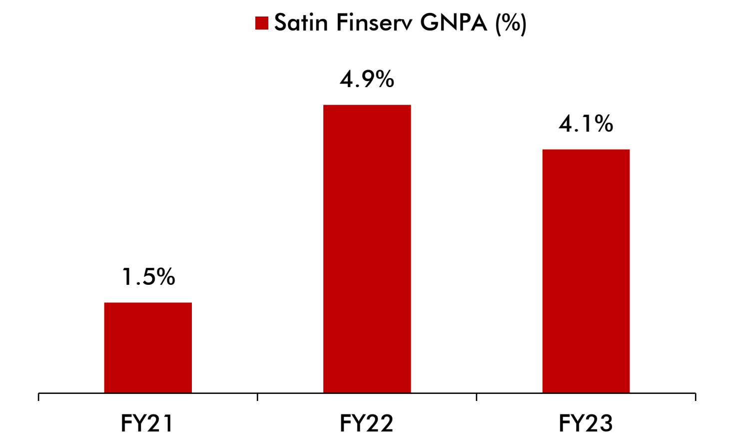
Non-MFI portfolio asset quality analysis of Ujjivan/Bandhan/Satin indicates that scaling up non-MFI products is difficult. While these institutions have increased share of non-MFI products (MSME, home loans) to 20-50% of total AUM, they have not been able to manage asset quality as effectively. For example, Ujjivan/Bandhan have 2.4%/4% GNPA in home loans, higher than 1-1.5% higher than some of the affordable housing finance companies. Key reason cited for such poor asset quality in home loans seems to be lack of investment/underinvestment in proper systems and processes. In case of Ujjivan, while the bank incentivized employees for basis of business volumes, it did not invest adequately enough in underwriting and collections. Their underwriting process seemingly did not differentiate between different income-profiles (self-employed/salaried) and collections was handled by the same team as MFI.

Exhibit 31: In recent years, former MFI players have focused on increasing non-MFI business but it has come at the cost of higher NPAs

Particulars	AUM mix (%)	GNPA (%)
Ujjivan SFB		
Affordable housing loan	14%	2.4%
MSME	6%	9.8%
Bandhan Bank		
Retail	3%	1.8%
Home loans	26%	4.0%
Commercial banking	21%	4.9%

Source: Companies, Ambit Capital research. Note: AUM mix and GNPA as of 1QFY24.

Exhibit 32: Satin Finserv, MSME/micro-LAP arm of Satin Credit Care, has seen NPAs increase to alarmingly high levels since business launch in FY19



Source: Company, Ambit Capital research

Exhibit 33: Ujjivan's revised strategy in home loans gives a good perspective on how lenders tend to under-invest in new businesses, especially where systems, processes, skills-set are required to be different such as MFI vs micro-LAP/home loans

Strategic Parameter	Housing 1.0	Housing 2.0
Geography	West region focussed business with significant builder Loans.	Evenly spread across regions with a focus on individual properties Equitable sourcing from all tiers in a geography Focus on Tier 2 & 3
Focus	Focus on Business Volume	Focus on Profitability
ROI	Based on customer income profile	Based on customer income profile & collateral type
Collateral Policy	One policy for Pan-India	State Specific Policy
Product	Standard	Highly customized basis local needs
Process	Largely Manual	Largely Digital
Collections	One collection team for MFI and Secured business	Separate collection team for secured business

Strategic Parameter	Housing 1.0	Housing 2.0
Sourcing Channel	Direct & Connector	Multi Channel Approach
Credit Underwriting	Similar Process - Irrespective of income profile	Separate process for SF & Formal segments with lesser TAT
Customer Engagement	Transactional	Relationship based on multi-product engagement
Employee Incentive	Based on Business Volume	Linked to business profitability
People	Regular engagement & Standard training module	Need based engagement and customised training
Distribution Model	Branch based	Hub based Better TAT - local decisioning Increased productivity Adding regions for better control on process & close employee engagement
Customer Segment	High focus on Informal segment along with semi formal	Added a small sourcing % of formal segment & increased focus to tap micro-segment through Micro-LAP product

Source: Company, Ambit Capital research

Leading NBFC-MFIs are on a gradual learning phase before ramping up

As opposed to having strong internal audit/operations in MFI, secured MSME/micro-LAP is about developing strong capabilities in informal income assessment and underwriting. In this regard, we note that leading NBFC-MFIs such as CreditAccess and Fusion seem to have invested at least 3-5 years so far in understanding the nuances of the mortgage business. Spandana also seems to be ramping up gradually having started LAP only 6 months ago. The key point to note here is that besides having invested 3-5 years in understanding this business, these NBFC-MFI are also setting up an infrastructure (branches, senior/junior team) which is completely separate from MFI.

Exhibit 34: Larger players such as CreditAccess, Fusion have spent considerable time understanding underwriting in small ticket LAP/mortgages before ramping up

Timeline of launch	FY17	FY18	FY19	FY20	FY21	FY22	FY23	1HFY24
Fusion			Pilot started					Gradual scale up
CreditAccess					Pilot started			Gradual scale up
Spandana							Pilot started	Gradual scale up
Satin	Launched MSME loans							Non-MFI: 12% of AUM
Asirvad					Launched gold loans			Non-MFI: 7-8% of AUM

Source: Companies, Ambit Capital research

Exhibit 35: NBFC-MFIs strategy to invest in MSME as a completely separate business makes sense because MFI and mortgage underwriting require very different kind of specialization and skill sets

MSME/micro-lap/retail loans	CreditAccess	Fusion	Spandana
Branch network	Separate from MFI	Separate from MFI	Separate from MFI
Field team	Separate from MFI, called retail finance loan officers	Separate from MFI	Separate from MFI
Management team	Common with MFI	Separate from MFI except CFO	Led by separate CBO
Sourcing	Leads from MFI officers, direct sourcing by retail finance officers	n/a	n/a
Underwriting	Separate and decentralized credit team at the branch	Separate from MFI	n/a
Collections	n/a	n/a	n/a

Source: Companies, Ambit Capital research

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RBI finally attacks the root cause

MFI's problem with customer over-indebtedness/high NPAs is a result of credit information asymmetry. Earlier, allowing a long list of alternative documents led to individuals manipulating identities, thus circumventing CIBIL checks for assessing indebtedness. Though RBI has been aware of the challenges, their regulations mainly aimed at NBFC-MFIs (35-40% of industry) not the whole MFI sector. Some structural/regulatory changes in the last few years will help address the issue of customer over-leveraging. RBI's Mar'22 guidelines (loan obligation/income: <50%, household CIBIL, weekly data reporting) address the MFI sector, irrespective of institution type. Further, cross-linkage among MFI/retail credit bureaus and Aadhaar ID seeding during KYC reduced chances of identity manipulation. So, bureau rejection rates increased to 45-50% vs 30% earlier. A study by The Economist provides global evidence that credit bureau linkage helps in assessing household debt and thus, avoiding over-indebtedness. Key sector risk: Highly subjective nature of income assessment.

Credit information asymmetry has led to customer over-indebtedness in the past

IFMR's study on the Kolar crisis aptly captures some of key issues that have plagued the MFI industry's performance (average RoE: 12-13%). One of the key issues was lack of proper assessment of customer indebtedness. A dipstick study by Grameen Koota Financial Services of around 200 clients showed that ~25% of the defaulting clients had loans from more than six MFIs.

Political interference is another key challenge

Given the industry's client base is largely BPL, MFI has always been a politically sensitive subject. The Andhra MFI crisis (2010) was an unprecedented collapse of India's MFI sector. Excessive lending by MFIs led to customer over-indebtedness (partly due to inadequate regulation), resulting in defaults. As coercive recovery methods of MFI resulted in number of borrower suicides, the Andhra Government intervened. In Oct'10, an ordinance by the Andhra government halted the operations of MFIs. In the last few years, many local politicians in Karnataka, Assam, Tamil Nadu and Maharashtra interfered in the MFI industry driven by populist measures for the poor. However, recent judgments have made it clear that state laws/acts cannot regulate NBFCs registered with RBI.

- In May'22, the Supreme Court held that state enactments such as Kerala Money Lenders Act, 1958 and Gujarat Money Lenders Act, 2011 had no application to NBFCs registered with RBI.
- In Feb'23, Telangana High Court ruled that NBFCs registered with RBI will not be governed by local state acts.

Focus is now on the whole microfinance sector, not just NBFC-MFIs

RBI has been cognizant of micro-finance borrowers being vulnerable to over-indebtedness. This is well-reflected in RBI constantly emphasizing credit institutions to check for borrower over-indebtedness in their regular updates. Despite recognizing the problem, RBI had only focused on regulating the aspect of over-indebtedness from an NBFC-MFI standpoint until the Mar'22 guidelines. For example, the cap of maximum 2 loans was only applicable towards NBFC-MFIs, not banks. This meant that a borrower could have her third or subsequent loan from a scheduled commercial/small finance bank. There have also been plenty of cases where the cap of maximum 2 NBFC-MFI loans has been violated.

Exhibit 36: Earlier regulations were aimed mostly at NBFC-MFIs, which account for only 35-40% of the market. Hence, the problem of over-leveraging at the sector level was not being addressed

Timeline	Regulation	What could have been the weak points?
Jul-12	More than 2 NBFC-MFIs cannot lend to the same borrower.	This regulation aimed only at capping exposure from NBFC-MFIs, not banks. This meant that a borrower already running two loans could have taken a third loan from a bank. In some cases, even the 2 NBFC-MFIs per borrower rule was also violated.
Aug-12	Ensure NBFC-MFIs are members of at least one CIC, provide timely and accurate data to comply with conditions on customer over indebtedness.	The credit bureaus were still in a nascent stage, lacking strength in terms of cross-linkages across the financial system and data repository on household debt. Hence, comprehensive information on MFI borrowers would have been less. Plus, MFI bureaus were separate and did not capture information pertaining to retail loans on the same borrower. Hence, NBFC-MFIs would not have been aware if a prospective client was already leveraged with retail loans.
Apr-15	Increased maximum customer indebtedness to ₹100k from ₹50k earlier.	Despite credit bureau systems still in development stage and risk of over indebtedness due to MFI loan from banks, the maximum level of customer indebtedness was doubled.
Apr-15	Increased first cycle/subsequent cycle loan amounts to ₹60k/₹100k from ₹35k/50k earlier.	Similarly as above, the size of loan cycle-wise was also doubled.

Source: RBI, Ambit Capital research

RBI's latest set of guidelines, dated Mar'22, attack the root cause of the problem, i.e., customer indebtedness. We believe so because the latest guidelines now lay emphasis on the repayment capacity of the borrower by capping the monthly loan obligation at 50% of the income. Further, the sole focus on considering the borrower's absolute value of indebtedness only from NBFC-MFIs has been replaced by total household indebtedness from all credit institutions (banks + NBFCs). In essence, the latest guidelines give a common definition to microfinance applicable to all regulated entities. Maximum loan amount eligibility has been tied to the household's disposable monthly income.

Exhibit 37: Latest guidelines lay emphasis on the MFI sector, irrespective of institution type, and not just NBFC-MFIs

Timeline	Regulation	Comments
Jun-16	Incorporation of SHG member level data into existing Microfinance data sharing file format.	This helped in collecting information of SHG members with the aim of detecting overlap between SHG and JLG borrowers and thus checking for over-indebtedness.
Aug-17	RBI directed CICs to issue comprehensive credit information reports to credit institutions as opposed to issuing specific reports as such as MFI/retail loans.	This facilitated a more comprehensive credit/CIBIL check on the prospective MFI borrower by taking into account retail loans as well rather than just checking for MFI loans.
Mar-21	RBI directed to include 'Restructured due to Covid-19' catalogue value in all credit bureau report formats, i.e., consumer, commercial, MFI.	This helped in assessing whether the customer's account was restructured during Covid, potentially reflecting about her ability to pay during tough times.
Oct-21	RBI mandated credit institutions to record and report information/data pertaining to relationship segment to CICs in order to establish cross-linkages between consumer, commercial and MFI bureaus.	This helped in integrating any cross-linkages between the 3 modules of credit bureaus to check for overlap and thus, higher leverage.
Mar-22	Threshold for annual household income set at ₹300k for rural/urban in order to classify loan under microfinance.	Common maximum threshold on household income has been defined for all.
Mar-22	REs to mandatorily submit household income information to CICs. Reasons for deviation vs already submit info to be ascertained from borrowers before submission to CICs.	Submission of household income to CICs will facilitate greater information sharing among credit institutions, thus enabling better/more informed credit decision-making.
Mar-22	Loan repayment obligation capped at 50% of monthly household income. The computation of loan repayment shall take into account all outstanding loans of the household (MFI + retail).	While evaluating prospective customers for micro finance loans, credit institutions will have to ensure that the monthly loan obligation does not exceed 50% of monthly income as assessed by them. This will ensure some buffer for savings or other expenses.
Mar-22	REs to provide timely and accurate data to CICs (weekly) and use the data available with them to ascertain borrowers' household indebtedness.	Updated information on customers' household indebtedness will keep a check on customer over-indebtedness, in addition to 50% cap on loan obligation-to-income ratio.

Source: RBI, Ambit Capital research

Capping monthly loan obligation at 50% of income will aid in restricting customer over-leveraging. The regulation on loan obligation takes a wholesome view of the microfinance customer rather than just taking into account MFI debt from NBFC-MFIs.

Exhibit 38: Given RBI's new guidelines, the upper threshold on monthly loan obligation for a MFI household earning ₹0.3mn annually is now ₹12,500

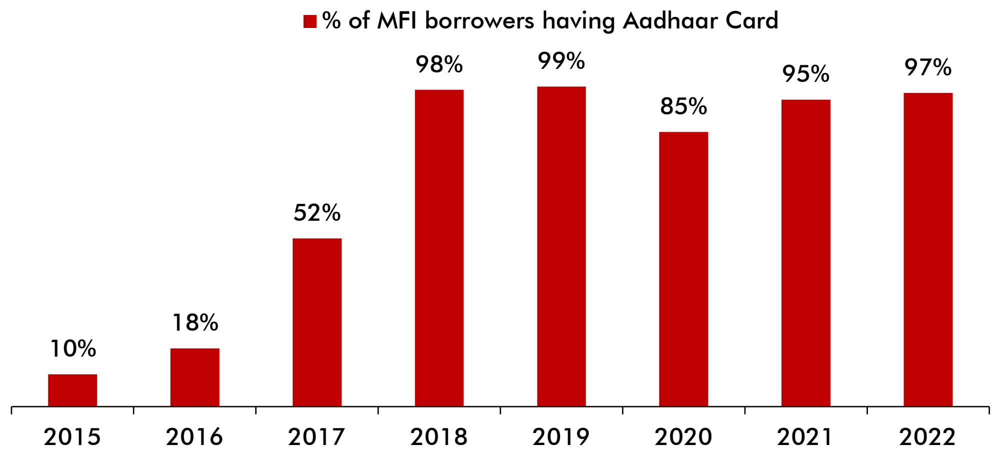
Criteria	Upper threshold
Upper threshold on annual household income to be eligible for MFI loan (₹)	300,000
Monthly income (₹)	25,000
Maximum loan obligation as % of income	50%
Maximum loan obligation per month (₹)	12,500

Source: RBI, Ambit Capital research

Credit bureau linkage is a boon as indicated by global experience

Earlier, allowing a long list of alternative documents led to individuals manipulating identities. This meant that Credit Information Reports captured incomplete credit information pertaining to the individual, leading to over-indebtedness. Also, earlier access to only MFI bureau (not retail) was another constraint in assessing debt exposure. However, linkage with multiple credit bureaus, comprehensive (MFI+retail) CIBIL check of every earning member and seeding of Aadhaar ID during KYC helped in addressing the problem of credit information asymmetry with respect to assessing overall household debt. As of 2022, 97% of MFI borrowers held an Aadhaar card. This means that for 97% of the MFI industry borrower base, comprehensive overview of debt exposure is available.

Exhibit 39: For 97% of the MFI industry borrower base, a potential lender has a comprehensive CIBIL check to assess indebtedness



Source: The Bharat Microfinance Report 2022, Sa-Dhan, Ambit Capital research

Exhibit 40: With the industry moving to Aadhaar ID seeding as part of KYC, issues of multiple identities/identity manipulation have been addressed. 97% of borrowers today have an Aadhaar card

Aadhaar which is slated to address the authentication problems especially for such segment of customers, is now the most available identifier in the country with coverage across nearly 79 crore adults (as of August 2016). Barring few states such as Assam and Meghalaya, other states have 90%+ adult population is covered under Aadhaar. 55% of newly disbursed loans by MFIN members in last 15 months are seeded with Aadhaar (UID). Other lenders are also increasingly preferring Aadhaar as the proof of identity. Lenders are now testing and exploring use of Aadhaar biometric-based eKYC service, which once implemented across the system will help address the matter of "presence" in addition to that of "identity".

– The Bharat Microfinance Report, 2016, Sa-Dhan

Source: Sa-Dhan, Ambit Capital research

Over time, multiple CICs such as CRIF, Equifax, CIBIL and Experian have come up with MFI-specific bureau scores, aiding development of industry-wide MFI credit history. As a result of this, coupled with latest RBI guidelines, reject rates increased to 45-50% across the industry compared to 30% earlier (link). A 2013 report by The Economist indicates that there is global evidence that linkage with credit bureaus helps in assessing overall household debt and thus, over-indebtedness.

Exhibit 41: Historical experiences of multiple countries indicate that a mature credit bureau is critical to assessing and controlling over-indebtedness

Country	Excerpts
Cambodia	Cambodia's credit bureau completed its first year of operation and MFIs have recognised the bureau for helping them avoid lending to over-indebted clients.
Peru	Peru's microfinance market features low barriers to entry and a competitive marketplace, characterised by adequate supervision and solid credit bureaus.
Egypt, Morocco, Yemen	Egypt, Morocco and Yemen, regulated MFIs have some level of access to existing bureaus or access to bureaus specifically focused on microfinance. Yemen's microfinance CIS lacks complete information, but participation in bureaus in Morocco and Egypt is higher and prevents multiple borrowing.
India	In India, credit bureaus have started to make a difference in spotting clients with multiple loans. However, they still constitute an imperfect tool to deal with the problem of over-indebtedness, because of the many informal sources of finance that are not covered by the credit bureaus.
Nepal	Over-indebtedness in rural areas has emerged as a key concern. In a bid to mitigate risks and in the absence of a microfinance credit bureau, banks now voluntarily share information about clients seeking loans above ₹30,000 (US$430).
Bosnia and Herzegovina	The state-run credit bureau includes all credit data for the entire country. Financial institutions (FIs) therefore have a good overview of the number of loans and amount of debt carried by a potential client.
Kyrgyz Republic	The Bill on exchange of credit information, discussed in parliament, may finally help transform the country's sole not-for-profit credit bureau into a fully-fledged commercial venture. Better credit information exchange is expected to address over-indebtedness.
Haiti	The lack of a credit bureau still acts as a large obstacle to raising the overall standard of the market in Haiti. There is discussion that the Banque de la Republiqued'Haiti (the central bank) is developing a system. The lack of a national identification system is another obstacle in developing a credible credit bureau.

Source: The Economist, Ambit Capital research

Income assessment is highly subjective – a key risk for the sector

While latest RBI guidelines have been welcomed by the industry as a key structural positive, there are still some pockets of risks. Two of the most common forms of income generation activities are buffalo milking and labour, both of which are cash income. Given the informal occupation of the end-customer segment, the income assessment by field officers is highly subjective. A lender focused on growth can make an aggressive estimate of income and end up loaning a larger amount. This may lead to over-leveraging in case the actual income of the borrower is lesser than estimated.

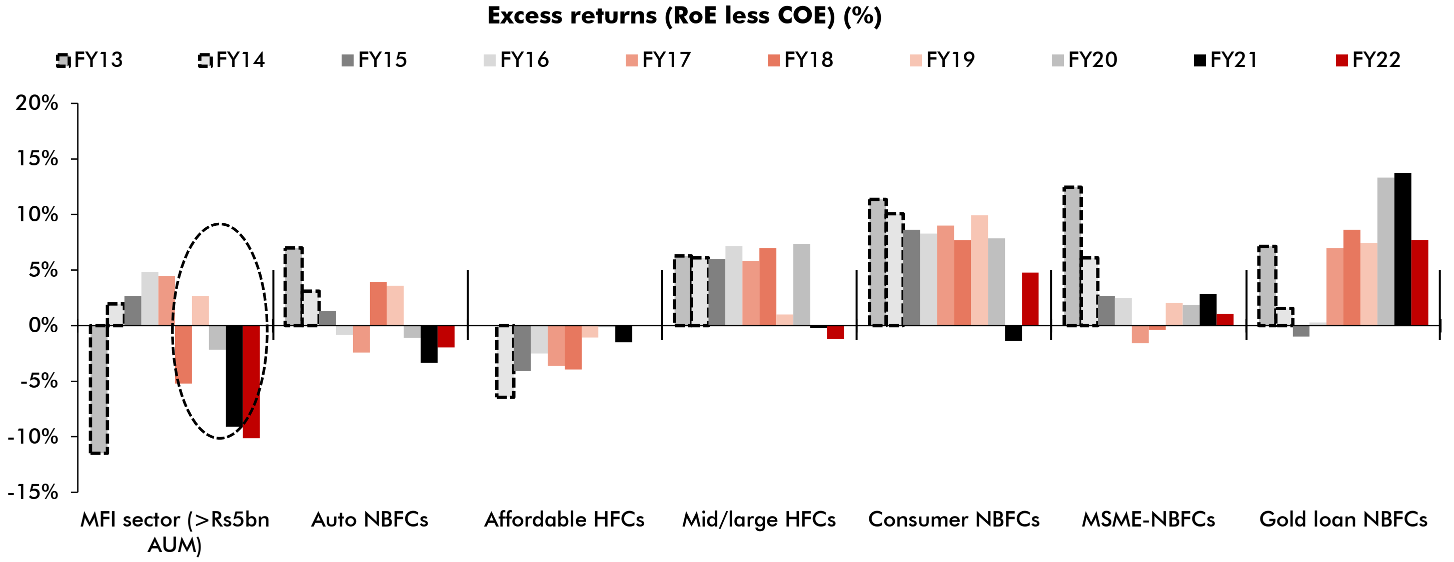
Can the tables turn?

In last one year, MFIs have yielded 70-90% stock returns as EPS growth recovered to 30-90%. But, over a cycle, MFI stocks have not been wealth creators. Most MFIs have delivered -3% to +3% CAGR returns since listing (excl. CREDAG), underperforming other NBFC sectors (auto, consumer, housing). Given the asset quality issues since demonetization (FY17), followed by political events and Covid disruptions, MFI excess returns (RoE less COE) have averaged (-)5% (FY17-22) vs 1-8% for other NBFC sectors (excl. AHFCs). Hence, MFIs trade at 20-50% discount to other NBFCs. With multiple developments aimed at plugging the asymmetry, structural credit costs can be lower, enabling (+)2-3% excess returns, making a case for sustained shareholder value creation. CREDAG stands out with cross-cycle RoEs of 13-14%, 100-200bps higher than the industry, owing to superior asset quality performance, competitive pricing, strong capitalization, scalability. This has resulted in 27% stock CAGR since listing and 60-100% valuation premium over Fusion/Spandana.

MFI has not generated shareholder value on cross-cycle basis

During an entire life cycle as listed companies, MFI stocks have not created shareholder value. During FY12-22, average annual excess returns in MFI sector were (-)3% (average RoE: 10-12%). This is the lowest among the broader product categories such as auto NBFCs, mid/large HFCs, consumer NBFCs, MSME and gold loan NBFCs. MFI sector faced high negative excess returns, particularly during FY17-22. During this period, the country suffered two of the biggest economic shocks (demonetisation, Covid), impacting asset quality and thus, RoE. Very often during our discussions with investors on NBFCs/broader BFSI space, there is immense aversion to MFI stocks given that the sector tends to see an asset quality cycle every couple of years.

Exhibit 42: Given consistent asset quality issues due to customer over-leveraging in the past, the MFI sector has not been known for shareholder value generation



Source: Companies, Ambit Capital research. Note: The dotted circle for MFI excess return FY18-22 represents the period of impact of demonetisation and Covid. Cost of equity assumptions: MFI: 14.5%, auto NBFCs: 13.75%, affordable HFCs: 14%, mid/large HFCs: 13%, consumer NBFCs: 13.5%, MSME-NBFCs: 14%, gold loan NBFCs: 14%. MFIs: CreditAccess Grameen, Spandana, Fusion; auto NBFCs: Chola, Shriram Fin, M&M Fin; affordable HFCs: Aavas, Home First, Aptus; Mid/large HFCs: HDFC Ltd, LIC HF, Can Fin; consumer NBFCs: Bajaj Fin, SBI Cards; MSME-NBFCs: Five-Star; gold loan NBFCs: Manappuram, Muthoot Finance.

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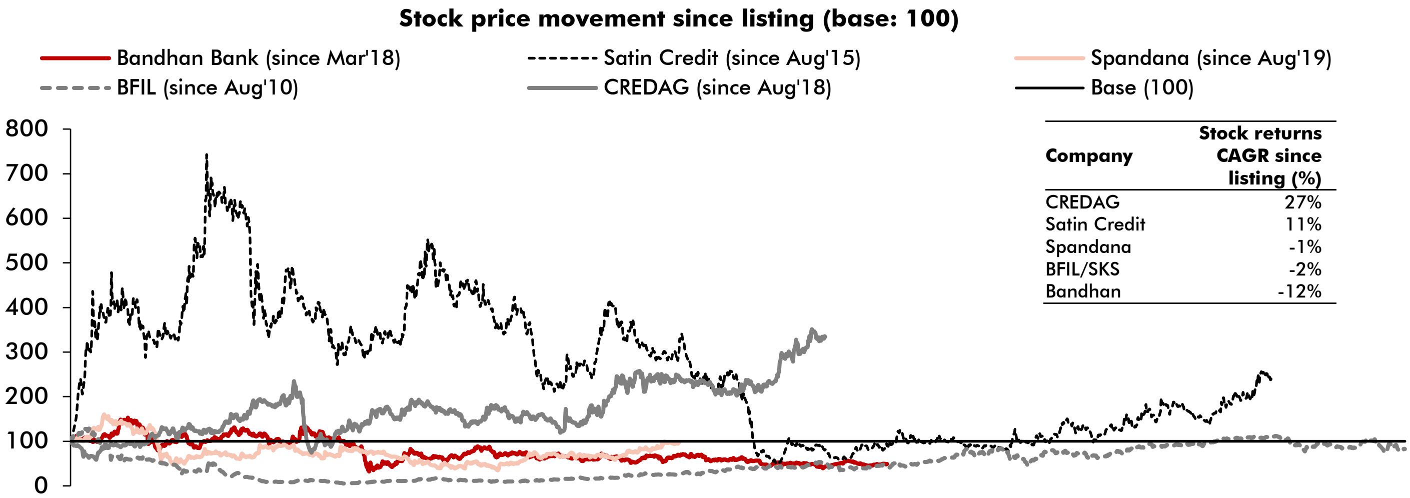
The overall value destruction by MFIs is well-reflected in stock price performance too. Barring CreditAccess Grameen, all MFI stocks have delivered sub-par returns.

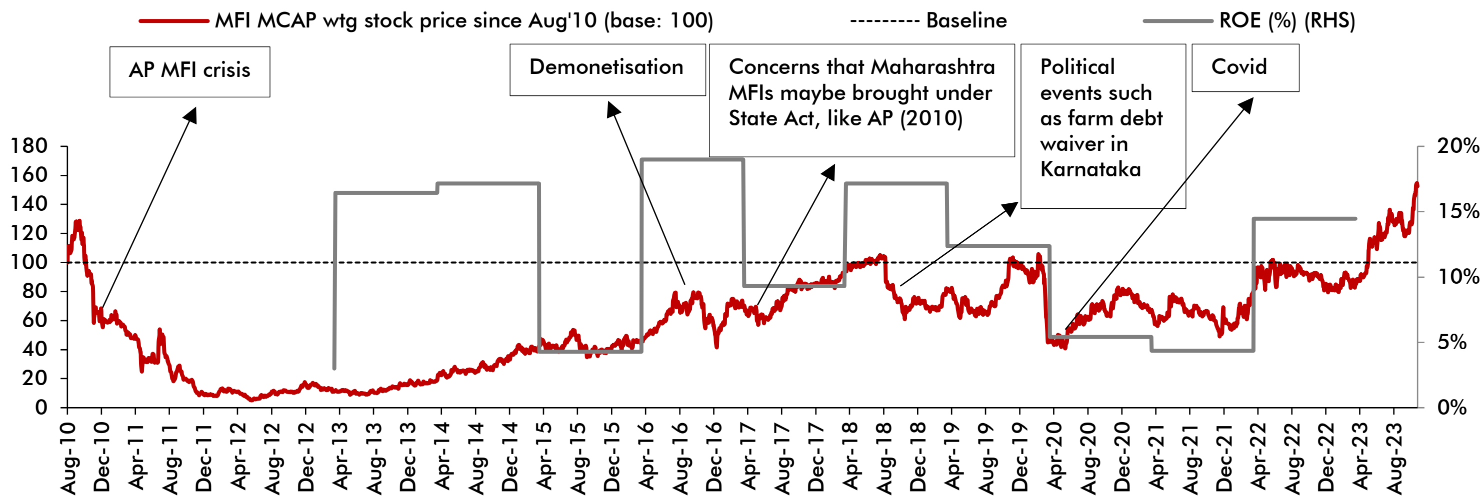
Exhibit 43: Most MFI stocks have delivered low stock returns since listing, hence the high sector aversion from investors



Source: Companies, Ace Equity, Ambit Capital research

At the time of each of the two IPOs – BFIL/SKS (Aug'10) and CREDAG (Aug'18) – the subsequent market performance of the sector was disappointing. BFIL/SKS listing in Aug'10 was followed by announcement of AP government ordinance (Oct'10) curbing MFI activities, impacting asset quality/RoE for the sector until FY13 (RoE: 3%). As average RoE recovered to 18% (FY14-17), so did valuations. Similarly, CREDAG's listing in Aug'18 (FY19) was followed by another sector asset quality downturn led by demonetisation spill-over effect, adverse political events and Covid (FY20-22).

Exhibit 44: Sub-par RoE led to unattractive stock price returns for the MFI sector

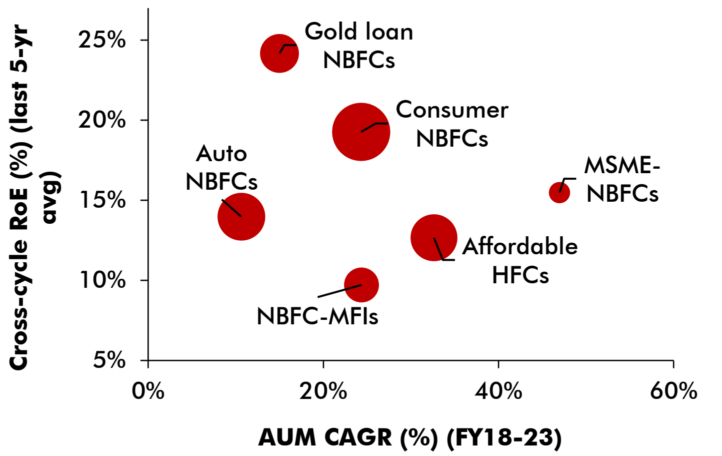


Source: Companies, Ace Equity, Ambit Capital research. Note: MFI MCAP wtg stock price has been calculated considering BFIL/SKS, CreditAccess Grameen, Spandana, Satin CreditCare, Fusion.

MFIs' high earnings volatility has warranted discount to other NBFC sectors

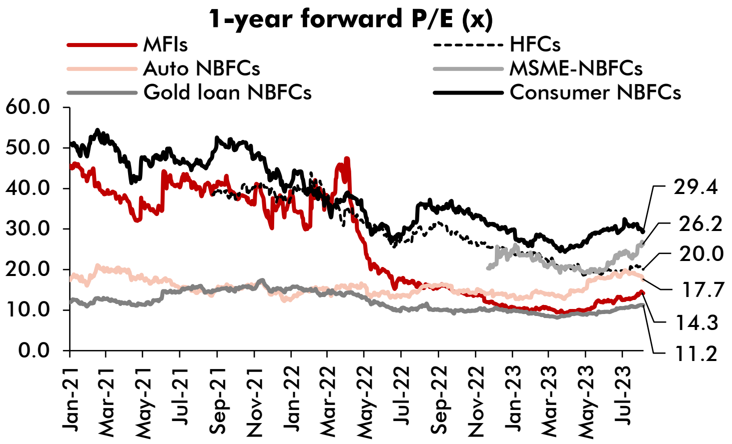
MFI was a high-growth sector in the last decade with industry AUM CAGR (FY13-23) at 24%. However, cross-cycle RoE lagged at 10-12% (10-year average) due to asset quality issues. As a result, MFI sector has not been a consistent generator of shareholder value despite its high growth potential, warranting valuation discount to peer categories. Gold loan NBFCs trade at lower valuation multiples due to lower sector growth (FY13-23: 13%) though its profitability is one of the highest. Consumer NBFCs are most richly valued (~30x 1-year forward EPS) given 10-year AUM CAGR/cross-cycle RoE of 30%/21%.

Exhibit 45: Despite ~25% AUM CAGR over the last decade, MFIs' earnings volatility has been high due to asset quality issues/target market vulnerability, resulting in lower RoE



Source: Companies, Ace Equity, Ambit Capital research. Note: (1) Size of the bubble represents industry AUM. (2) For SHFL in auto NBFCs, AUM growth has been considered over FY12-22. (3) Gold loan NBFCs: Muthoot Finance, Manappuram; Consumer NBFCs: Bajaj Finance, SBI Cards; MSME-NBFCs: Five-Star; Auto NBFCs: Shriram Finance, Chola, M&M Finance; Affordable HFCs: Aavas, Aptus, Home First Finance.

Exhibit 46: So, amongst high-growth NBFC sectors, MFIs command the lowest valuation multiples

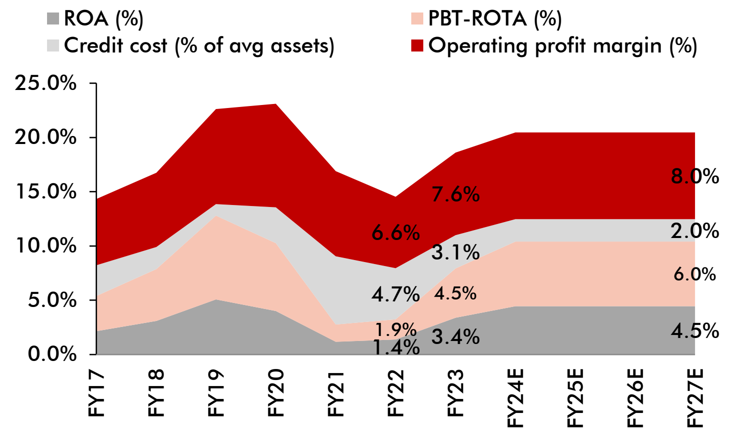


Source: Companies, Ace Equity, Ambit Capital research

Can plugging asymmetry yield higher excess returns?

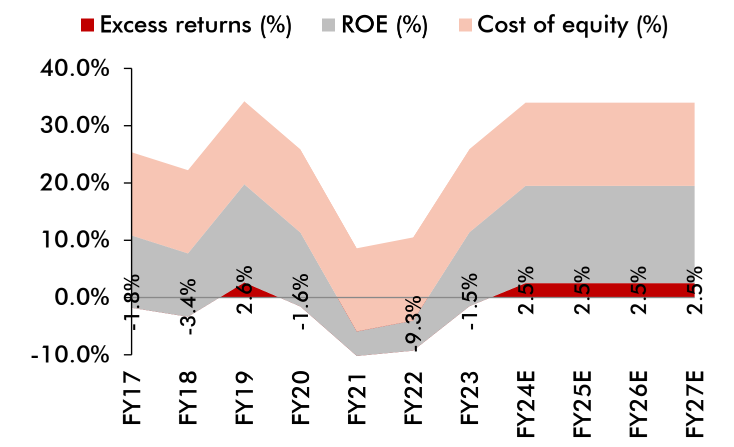
In the past, credit information asymmetry led to over-leveraging. Economic shocks such as demonetization/Covid triggered asset quality challenges, leading to high credit costs (~3%). We expect some of structural/regulatory changes with development/maturing of credit bureaus in last few years should help address the issue of customer over-leveraging. As a result, we expect blended average credit cost (% of average assets) of 2% for MFIs vs 3-3.5% in last 7-8 years. Note that this average is heavily influenced by the key events such as Covid, when average credit cost was 5-7.5% (FY21-22). Assuming stable operating profit margins (~8%) implies that the sector would be able to generate 17%/2.5% RoEs/excess returns sustainably vs ~11%/(-)3% in last 7 years.

Exhibit 47: Demonetisation (FY17-18) and Covid (FY21-22) were periods of high value destruction as economic activities were disrupted…



Source: Companies, Ambit Capital research. Note: Companies considered for above calculation: CreditAccess Grameen, Fusion, Spandana Spoorthy.

Exhibit 48: …which resulted in asset quality shocks stemming from high vulnerability of the target market

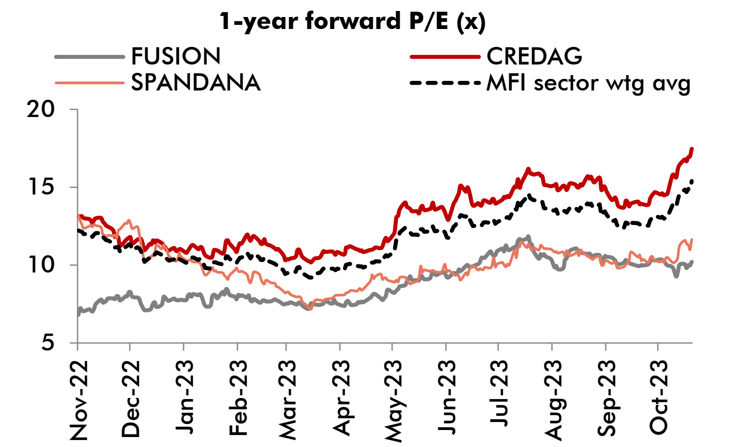


Source: Company, Ambit Capital research. Note: Companies considered for above calculation: CreditAccess Grameen, Fusion, Spandana Spoorthy.

CreditAccess Grameen is an outlier

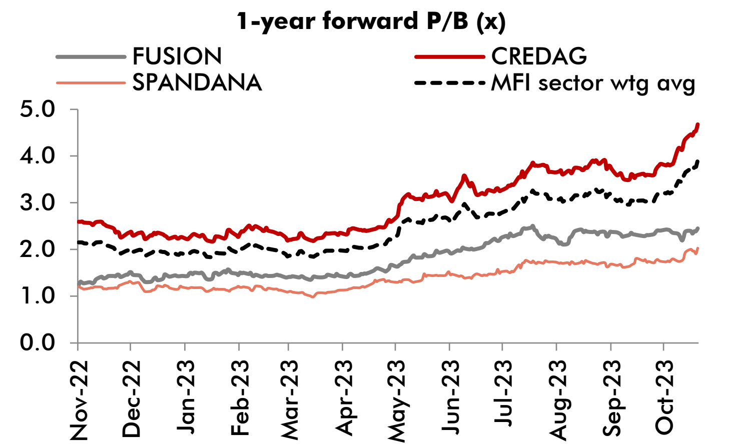
In a sector with high investor aversion, CreditAccess Grameen stands out. It is a preferred bet delivering cross-cycle RoE of 13-14%, 100-200bps higher than the MFI sector. Such performance has also been rewarded as the stock delivered 27% CAGR returns since listing.

Exhibit 49: CREDAG's RoE has been 100-200bps higher than that of the MFI industry…



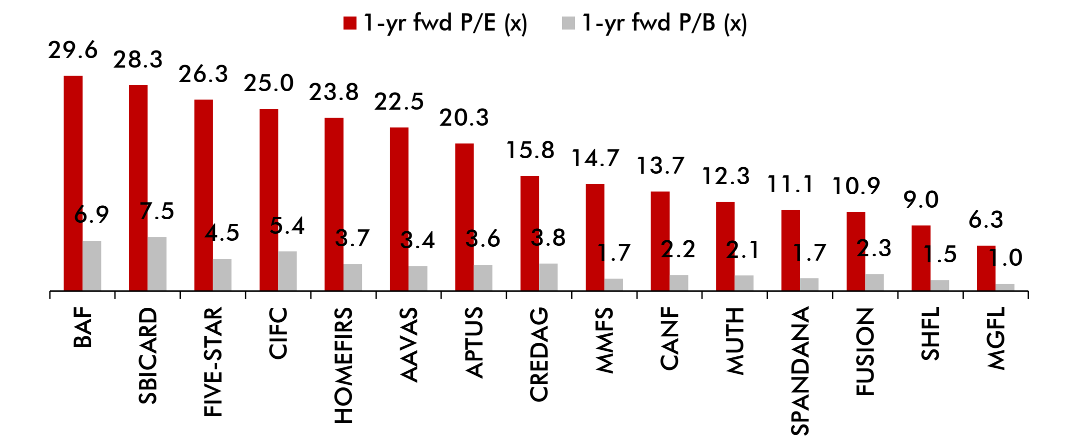
Source: Companies, Bloomberg, Ambit Capital research

Exhibit 50: …leading to valuation premium over other MFI stocks



Source: Companies, Bloomberg, Ambit Capital research

Exhibit 51: Even in the broader NBFC space, CREDAG trades at a premium to non-MFI peers such as MMFS, CANF, SHFL and gold loan NBFCs



Source: Companies, Bloomberg, Ambit Capital research

What has CreditAccess done right?

CreditAccess' cross-cycle RoE of 13-14% (higher than industry) while being the largest NBFC-MFI in the country is a testimony of its ability to scale up and execution capability. This attracted stock valuations of 15.3x/3.1x FY25E EPS/BVPS, the richest among MFI stocks. CreditAccess' performance can be attributed to:

- **Superior asset quality performance:** Net slippages over FY17-23 were one of the lowest for CreditAccess despite the much larger scale than peers.
- **Competitive pricing:** Credit access enjoys the lowest cost of funding among NBFC-MFIs. Naturally, its pricing is also the most competitive, which enables cherry picking good quality customers.
- **Top-notch sponsor/promoter:** CreditAccess is 66.7%% owned by CreditAccess India (CAI), a company of healthy and secure financial standing based in Netherlands. CAI is a professionally managed company in which Asian Development Bank holds 9%. The initial shareholders are a large group

of family offices and HNWIs who still collectively own 50% of share capital. CRISIL notes that CAI has demonstrated a track record of equity support to CreditAccess Grameen.

- **Strong capitalization levels:** In the last 10 years, CreditAccess Grameen's tier-1 capital never went below 17%. It went below 20% only once, in FY16. Consistently maintaining high capitalization levels is a good indicator of balance sheet strength.
- **Scalability:** CreditAccess Grameen has a track record of over 2 decades. It is the largest NBFC-MFI with total industry market share of ~4% (FY23). The company has a unique customer base of 4.3mn, which represents unique customer market share of ~4%.
- **Optionality play:** With the MFI industry expected to enter consolidation between FY30-33E, CreditAccess Grameen is best-positioned among NBFC-MFIs to sustain market share gains as it has all the required ingredients: (i) competitive funding cost, (ii) large distribution, (iii) customer service quality and (iv) support from parent. Besides the MFI business, CreditAccess Grameen has diversified into other retail products such as individual unsecured loans, micro-LAP, affordable housing loans and gold loans. Scaling up these businesses would only enhance earnings at the overall portfolio level.

Exhibit 52: CreditAccess envisages cross/up-sell opportunities to capture rural India's aspirational purchases

Source: Company, Ambit Capital research

In MFI or any lending business, managing and mitigating risk is the most critical aspect. Going by history, risk mismanagement has caused high growth rates to collapse, impacting valuation multiples. Keeping this in mind, we believe CreditAccess Grameen is probably best-positioned among the lot in terms of risk and governance. Besides having its own systems, processes and an independent board, it gets the benefit of group risk management.

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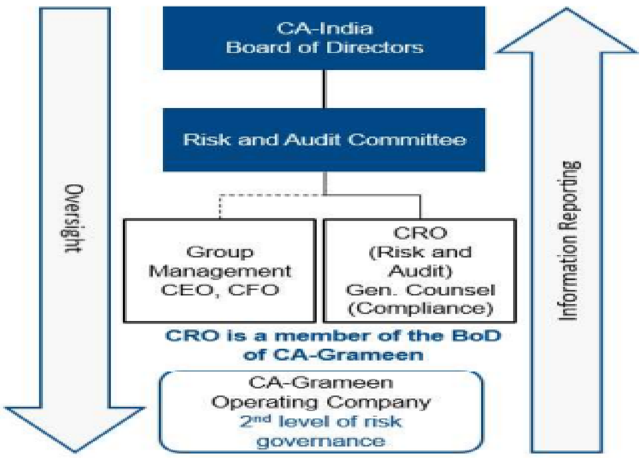
Exhibit 53: CreditAccess India (CAI), parent of CreditAccess Grameen, provides additional risk oversight on the MFI business

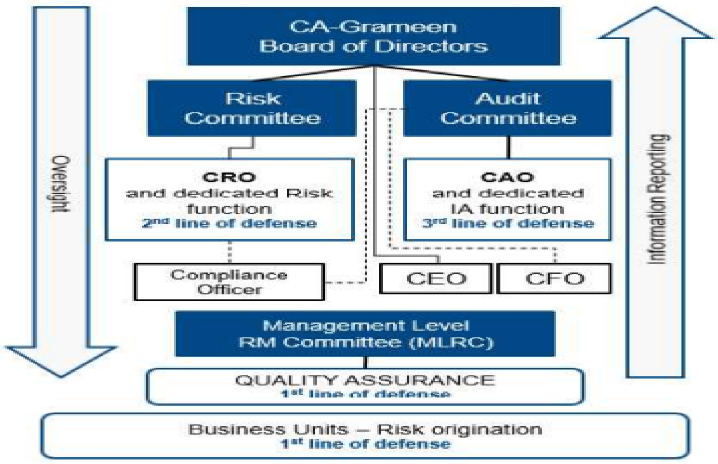
Source: CreditAccess India B.V. annual report, Ambit Capital research

Exhibit 54: Group Chief Risk Officer being a board member at CreditAccess Grameen provides additional governance



Source: CreditAccess India B.V. annual report, Ambit Capital research

Exhibit 55: Multiple lines of defence ensure that business quality is not compromised



Source: CreditAccess India B.V. annual report, Ambit Capital research

Exhibit 56: CreditAccess Grameen has delivered cross-cycle RoE of 13-14%, higher than the industry owing to competitive pricing and superior asset quality management

RoE tree (%)	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23
Net interest income	7.4%	9.2%	10.5%	12.0%	11.6%	13.2%	10.5%	10.1%	9.7%	10.8%
Other income	0.6%	0.9%	0.4%	0.2%	0.2%	0.0%	0.0%	0.0%	0.0%	0.0%
Total net income	4.8%	4.7%	4.9%	5.0%	4.5%	4.5%	4.0%	3.9%	3.8%	3.9%
Operating expenses	4.8%	4.7%	4.9%	5.0%	4.5%	4.5%	4.0%	3.9%	3.8%	3.9%
Operating profit	3.2%	5.4%	6.1%	7.2%	7.3%	8.7%	6.5%	6.3%	5.9%	7.0%
Provisions	0.6%	0.5%	0.6%	3.4%	2.9%	1.1%	2.2%	5.1%	3.3%	1.9%
PBT	2.6%	4.9%	5.5%	3.9%	4.4%	7.6%	4.3%	1.2%	2.7%	5.1%
Taxes	0.9%	1.7%	2.0%	1.4%	1.6%	2.7%	1.2%	0.3%	0.7%	1.3%
RoA	1.8%	3.2%	3.5%	2.5%	2.8%	4.9%	3.1%	0.9%	1.9%	3.8%
Leverage (x)	5.9	5.2	5.6	5.6	4.1	3.5	4.2	4.7	4.7	4.7
RoE	10.5%	16.7%	19.9%	14.0%	11.8%	17.0%	13.2%	4.1%	9.1%	18.0%
Business										
AUM (₹ bn)	8	14	25	31	50	71	120	136	166	210
AUM growth (%)	55%	79%	75%	21%	62%	43%	69%	13%	22%	27%

Source: Company, Ambit Capital research

Exhibit 57: NBFC coverage performance summary – expect 9-36% EPS CAGR (FY24-26E) for coverage NBFCs

Companies	AUM CAGR	NIM (%)			Credit cost (%)			ROA (%)			RoE (%)		
	(FY23-26E) (%)	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Auto NBFCs													
CIFC	25.0	7.8	7.8	7.7	1.3	1.2	1.2	2.4	2.4	2.4	18.8	18.8	19.5
SHFL	15.4	9.5	9.6	9.6	2.2	2.4	2.3	3.3	3.3	3.4	15.5	16.4	16.8
MMFS	17.3	6.5	6.4	6.4	1.8	1.8	1.9	1.7	1.7	1.8	10.0	11.0	11.9
HFCs													
LICHF	8.5	2.9	2.7	2.7	0.6	0.4	0.4	1.6	1.6	1.6	15.7	15.1	14.4
APTUS	26.4	12.6	12.0	11.6	0.3	0.5	0.4	7.3	6.8	6.5	17.0	18.1	19.5
AAVAS	23.1	6.2	6.2	6.2	0.3	0.3	0.4	3.3	3.4	3.3	14.2	15.4	15.9
CANF	15.9	3.5	3.4	3.4	0.2	0.2	0.1	2.0	2.0	2.0	17.7	17.7	17.5
HFFC	28.7	6.7	6.2	6.0	0.5	0.5	0.5	3.6	3.2	3.1	14.9	15.1	16.2
Diversified NBFCs													
BAF	26.7	10.1	9.5	9.4	1.7	1.6	1.7	4.2	4.0	4.0	21.2	20.3	21.0
Gold loan NBFCs													
MUTH	15.2	10.2	10.2	10.1	0.3	0.2	0.2	5.1	5.2	5.2	17.8	18.3	18.2
NBFC-MFIs													
Fusion	33.6	13.3	13.0	12.8	2.7	2.7	2.7	4.7	4.8	4.9	20.4	22.5	24.0

Source: Company, Ambit Capital research

Exhibit 58: We prefer SHFL, MUTH and LIC HF among our coverage universe where we believe the longer-term prospects are being undermined by markets due to poor earnings growth in the recent past

Companies	Mcap	CMP	TP	Rating	P/E (x)			P/B (x)		
	(US$bn)	(₹)	(₹)		FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Auto NBFCs										
CIFC	12.2	1,162	942	SELL	31	24	20	5.0	4.2	3.5
SHFL	9.5	2,031	2,355	BUY	10	8	7	1.5	1.3	1.2
MMFS	4.3	277	218	SELL	19	16	14	1.8	1.7	1.6
HFCs										
LICHF	3.2	462	600	BUY	5	5	5	0.8	0.7	0.6
APTUS	1.9	300	270	SELL	25	21	17	4.0	3.6	3.2
AAVAS	1.5	1,494	1,756	BUY	23	18	15	3.1	2.6	2.2
CANF	1.2	749	572	SELL	14	12	10	2.3	2.0	1.7
HFFC	1.0	952	700	SELL	28	24	20	3.9	3.4	3.0
Diversified NBFCs										
BAF	55.1	7,361	5,912	SELL	33	27	22	6.0	5.1	4.3
Gold loan NBFCs										
MUTH	6.6	1,325	1,599	BUY	13	11	9	2.1	1.8	1.6
NBFC-MFIs										
Fusion	0.7	592	818	BUY	11	8	6	2.0	1.6	1.3

Source: Company, Ambit Capital research

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A worthy contender

Fusion bucked industry norms to become the second-largest MFI. While the industry's go-to growth strategy is higher ticket size (10-year CAGR, 16%), Fusion stuck to customer acquisition which yielded 3.4% unique customer market share. Key advantages: expansive distribution (400 districts, 93% rural) and customer service quality (to strengthen with improving funding cost), aiding competitiveness/AUM market share gains (1.8%, FY26E). Improved risk/audit controls, low sector delinquencies (PAR 30+, ~2%) and systemic reduction in credit information asymmetry will drive ~2.5% credit cost vs 3.5% long-term average. Stable senior management and low field attrition should aid scalability (AUM CAGR FY23-26E, 25%). In the long term, key advantages position Fusion as an industry consolidator as MFI penetration reaches ~90% by FY33E.

Competitive position: STRONG | Changes to this position: POSITIVE

Granular approach to scale

Fusion's growth philosophy is focus on customer acquisition. Over FY13-23, branch network posted 48% CAGR; district coverage is ~400 (highest among peers). Rural-based distribution along with superior customer service led to 3/4th of AUM growth driven by new customer acquisition vs 34% for the industry.

Culturally prudent, low field attrition to aid stability

High management vintage in audit/operations and proactive identification of possible slippages and mitigation measures provided operational stability and lower-than-industry fraud intensity. Rewarding culture (ESOP formation in 2014) aided staff performance – 85% state managers internally promoted, 35% field attrition (lower vs peers). Proactive investments in risk/bureau linkage aided 4.3% average net slippage (FY19-23) vs 2.3-8.1% for peers. Business curtailment ahead of time in 6 problematic/vulnerable states demonstrates ability to foresee risk.

Increasing competitiveness to aid scale

Stable asset quality (~2.5% credit cost), strong internal accruals (~20% RoE) and healthy capitalization (tier-1 at 26.6%) warrant reduction in borrowing costs (50-100bps), aiding price competitiveness. Thirty new districts annually along with deepening existing presence will strengthen mass reach. These competitive advantages will drive 25% AUM CAGR (FY23-26E) with ~20% RoE. North and south India are attractive on the opportunity framework.

Fusion's strengthening industry positioning to drive earnings growth

Increasingly competitive pricing, supported by large distribution and improved risk/audit controls, will drive 26% EPS CAGR (FY23-26E). Given competitive advantages, 40%/12%/45% discount to CreditAccess/Spandana/NBFC sector indicates that markets are under-appreciating Fusion as a potential MFI consolidator in the long run and an MSME optionality play.

Exhibit 59: Key financials

Year to March	FY22	FY23	FY24E	FY25E	FY26E
AUM (₹ bn)	68	93	116	145	181
Customer base (#mn)	2.7	3.5	4.0	4.5	5.1
Net operating income (₹ mn)	7,054	11,572	15,375	18,843	23,203
Net profit (₹ mn)	218	3,871	5,041	6,250	7,819
EPS (₹)	2.6	38.6	50.1	62.1	77.7
RoE (%)	1.7	21.2	19.6	19.9	20.4
P/E (x)	227.1	15.5	11.9	9.6	7.7

Source: Company, Ambit Capital research

NBFC

Recommendation

Mcap (bn):	₹59/US$0.7
6M ADV (mn):	₹158/US$1.9
CMP:	₹592
TP (12months):	₹818
Upside (%):	38%

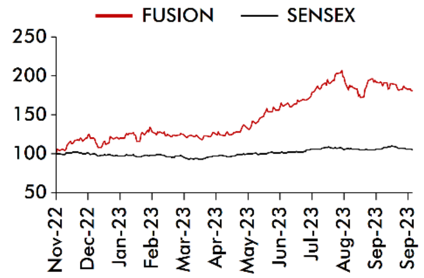
Flags

Accounting:	GREEN
Predictability:	AMBER
Earnings Momentum:	AMBER

Catalysts

- 25-30 new districts and deepening existing presence to drive 13% customer CAGR (FY23-25E).
- High capitalization, improved asset quality, internal accruals and pricing power to aid CoF/stable spreads (11.2-11.5%) vs 10.5% (5-year average).

Performance



Source: ICE, Ambit Capital Research

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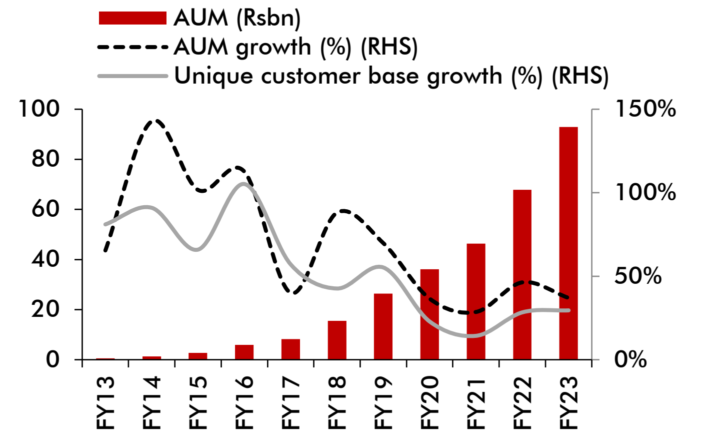
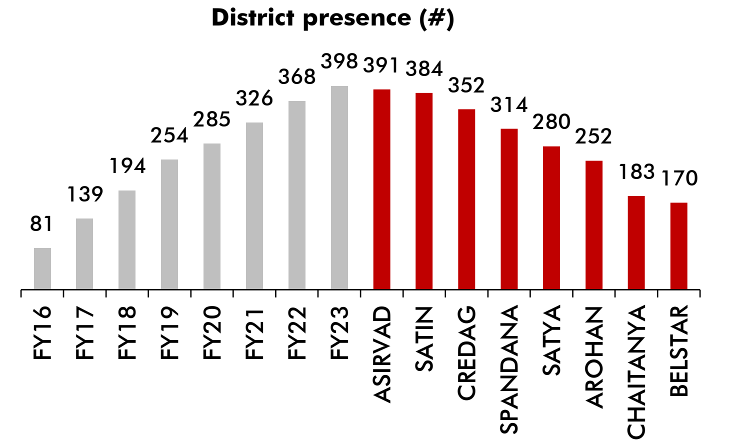
The Narrative in Charts

Exhibit 60: Fusion has emerged as second-largest NBFC-MFI



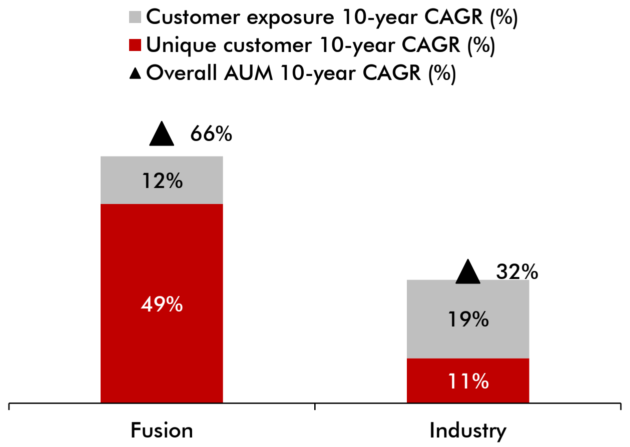
Source: Company, Ambit Capital research

Exhibit 61: District coverage is largest among key peers…



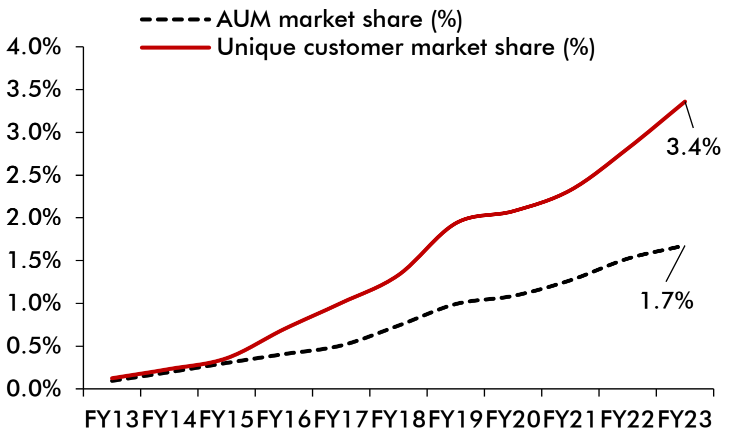
Source: Company, Ambit Capital research

Exhibit 62: …aiding customer-led growth vs industry reliance on increasing customer exposure



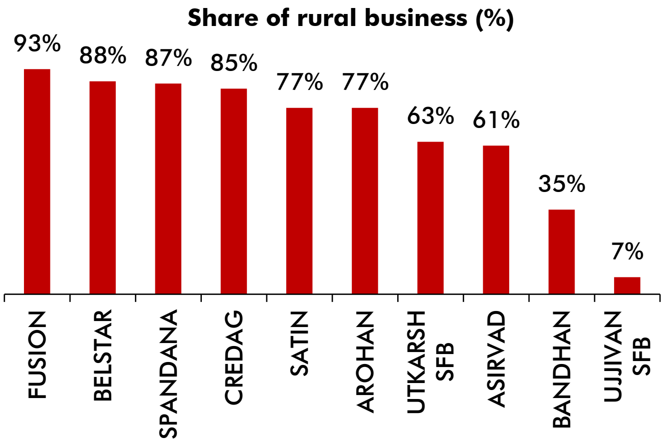
Source: MFIN, NABARD, Company, Ambit Capital research. Note: Industry refers to only JLG model.

Exhibit 63: Greater focus on new customer acquisition led to customer market share nearly tripling in the last 5 years



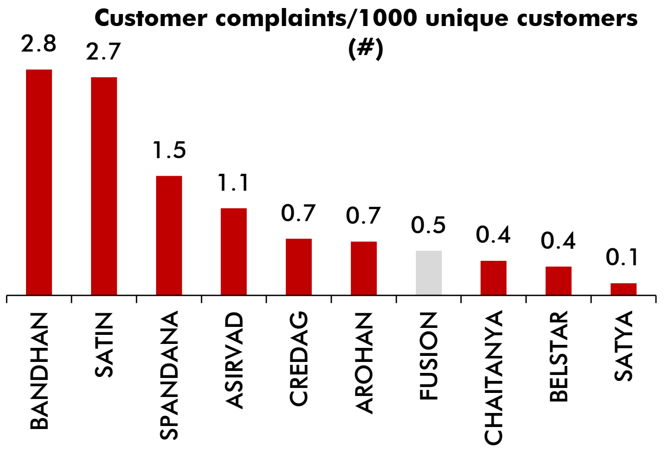
Source: MFIN, NABARD, Company, Ambit Capital research. Note: For AUM market share calculation, denominator is sum of JLG and SHG loans outstanding. For customer base market share, denominator is sum of JLG and SHG customers, adjusted for 30% overlap.

Exhibit 64: Higher focus on rural where penetration is lower



Source: Companies, Ambit Capital research

Exhibit 65: Customer centricity has aided better service quality, boosting customer retention and recall



Source: Companies, Ambit Capital research

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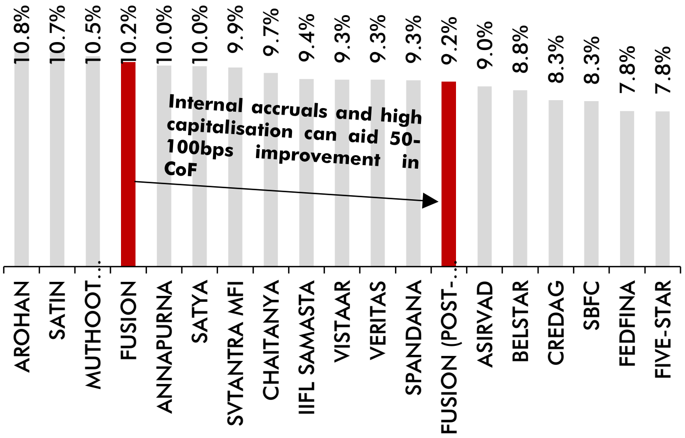
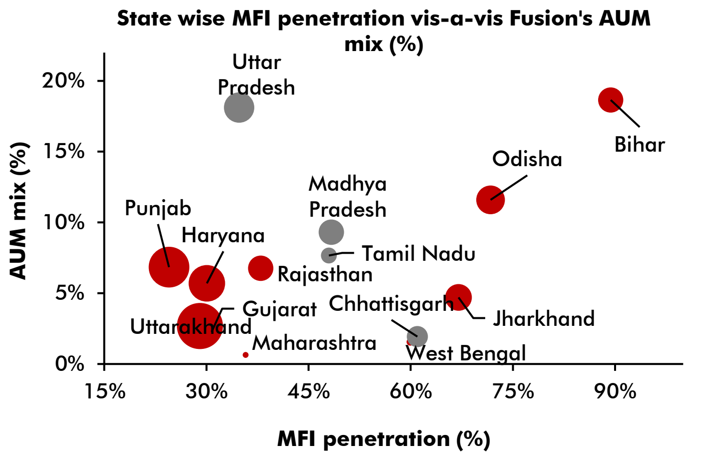
Exhibit 66: Internal accruals and high capitalisation can aid 50-100bps credit spread reduction, leading to lower funding cost and thus price competitiveness



Source: Companies, Ambit Capital research

Exhibit 67: Given Fusion's state-wise presence/AUM mix vs MFI penetration & BPL population mix, north/south/central look appealing. Started operations in AP/Telangana very recently



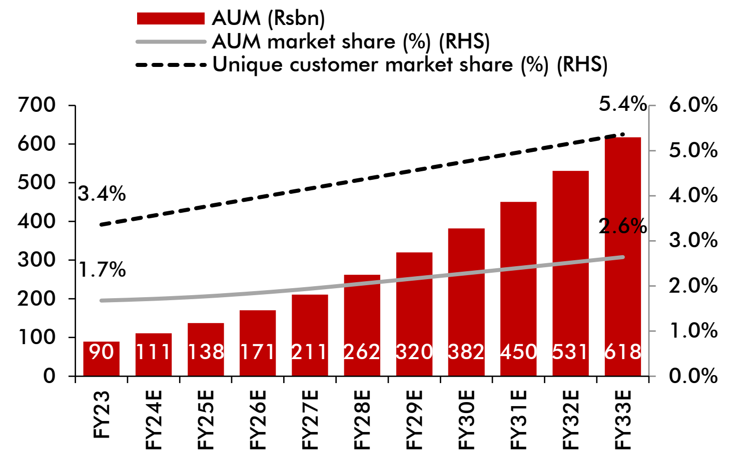
Source: Niti Aayog, Census 2011, MoSPI, MFIN, Ambit Capital research. Note: Size of the bubble indicates Fusion's state market share. States with grey bubbles represent opportunity states.

Exhibit 68: Fusion scores well on John Kay's IBAS framework

Category	FUSION	CREDAG	SPANDANA	Comments
Innovation				Fusion adopted a non-traditional approach to scaling up. Over the last decade, while most of the industry has focused on increasing ticket-size/exposure per customer to attain scale, Fusion has focused expanding district coverage (highest among peers). This has enabled customer acquisition-led growth, yielding unique customer market share of 3.4%.
Brand				Fusion's strong brand equity is reflected in its second-largest NBFC-MFI status, which has been achieved while maintaining superior customer service quality as reflected in low number of customer complaints. From a workplace standpoint too, Fusion's attrition rates are lower, indicating brand equity among employees.
Architecture				Fusion has scaled up its AUM/unique customer market share of 1.7%/3.4% (FY23). The company promotes a risk-averse environment across business functions as well as rewards performing employees. For example (i) it has one of the lowest branches per auditors, thus ensuring higher bandwidth per audit employee (ii) stricter credit policies towards overdue customers vs peers (iii) ESOP allotment to performing managers and lower field level attrition.
Strategic Assets				Fusion's pan-India branch distribution and understanding of the bottom-of-the-pyramid customers w.r.t to their lifestyle and income sources places it well to cross/up-sell additional products in the future, such as micro-LAP/housing loans. Most rural customers live in their own houses.

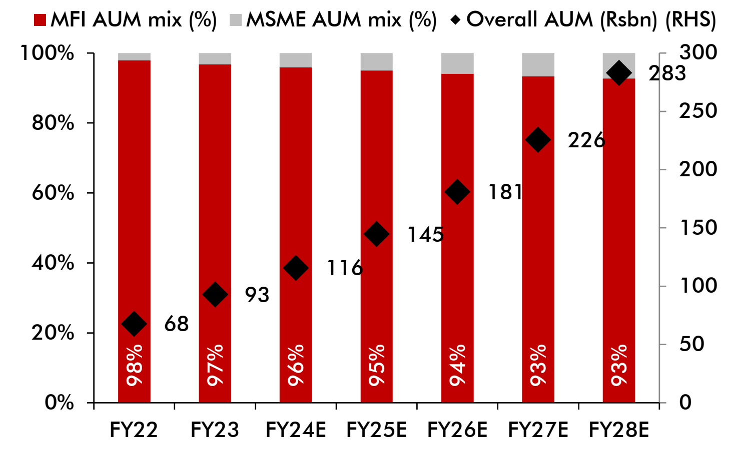
Source: Companies, Ambit Capital research

Exhibit 69: Improving competitiveness will aid AUM, unique customer market share gains over the next decade



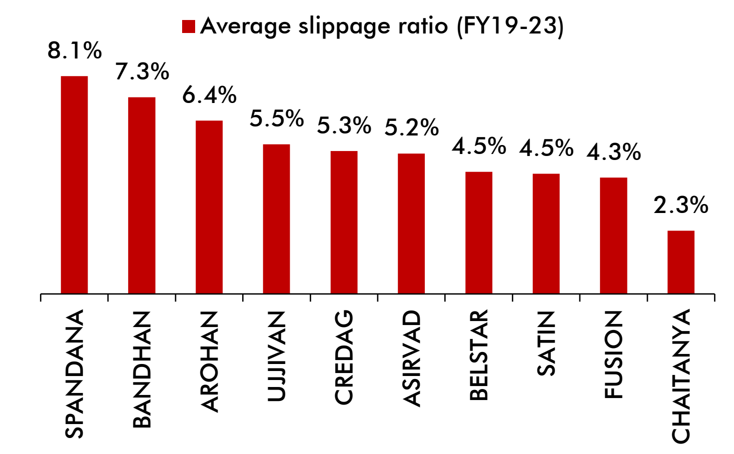
ource: MFIN, NABARD, Company, Ambit Capital research. Note: We have ssumed Fusion would gain 20bps customer market share annually, in line with istorical trend. In last 5 years (FY18-23), average customer market share gain has een 40bps.

Exhibit 70: Launching MSME product will support AUM growth longevity



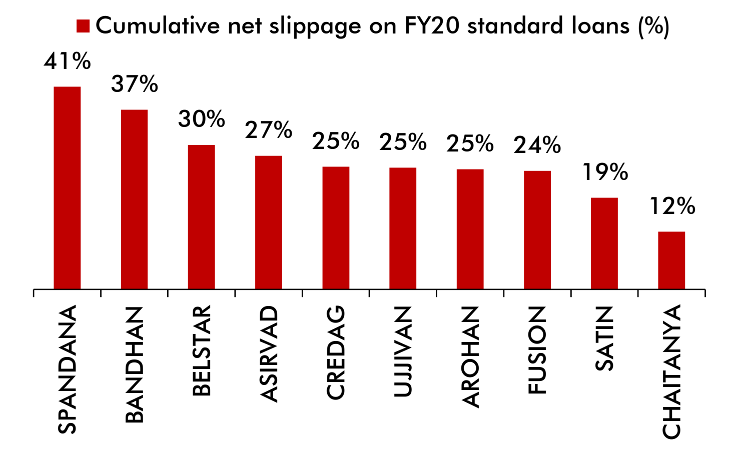
Source: Company, Ambit Capital research

Exhibit 71: Fusion's bad asset formation lower in last 4 years on better risk/audits control and overall operations…



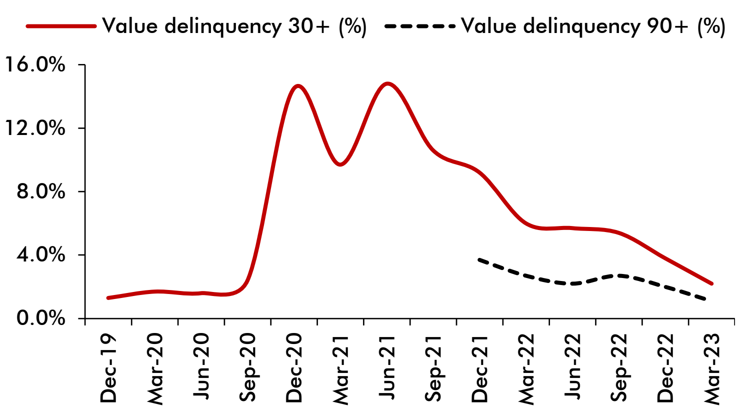
Source: Companies, Ambit Capital research

Exhibit 72: …even lower than some of the leading industry players that have a bigger scale



Source: Companies, Ambit Capital research

Exhibit 73: Overall system level delinquencies have normalised to pre-Covid levels after massive hit during Covid



Source: CRIF, Ambit Capital research

Exhibit 74: Expect credit costs to be stable at ~2.5% as currently there are no asset quality concerns for the sector

ECL model	FY23	FY24E	FY25E	FY26E
Gross stage 1 (%)	95.8%	96.3%	96.6%	96.7%
Gross stage 2 (%)	0.7%	0.8%	0.8%	0.8%
Gross stage 3 (%)	3.5%	2.9%	2.6%	2.6%
ECL stage 1 provisions (%)	0.9%	1.1%	1.1%	1.1%
ECL stage 2 provisions (%)	40.0%	41.5%	41.5%	41.5%
ECL stage 3 provisions (%)	75.5%	76.2%	76.2%	76.2%
Total ECL provisions (%)	3.7%	3.6%	3.3%	3.3%
Write-offs (% of opening GNPAs)	69.2%	70.0%	70.0%	70.0%
Net slippage (%)	3.0%	2.7%	2.5%	2.5%
Net credit cost (%)	2.7%	2.8%	2.4%	2.3%

Source: Company, Ambit Capital research

Exhibit 75: Fusion's higher audit strength per branch along with higher branch audit frequency than most peers drives disciplined operations at the field level

Audit & risk management comparison	CreditAccess	Spandana	Fusion	Asirvad	Satin	Arohan	Muthoot Microfin
First cycle loan amount (₹)	Up to ₹30k	Up to ₹40k	₹10-40k	₹20-40k	₹10-45k	₹25-55k	₹25-30k
Maximum loan amount (₹)	₹100k	₹80k	₹90k	₹80k	₹75k	₹75k	₹75-80k
Loan utilization checks	Within 5-10 weeks; follow-up check in 11-15 weeks.	n/a	Within 1 month by LOs for 100% of loans	Within 60 days	Within 2 instalments from date of disbursement	n/a	Within 1 month of disbursal
Branches/audit staff (#)	6	8	3	3	9	5	2
Branch audit frequency	2 months	3 months	2 months	1 month	3 months	3 months	2 months
District cap (% of AUM)	No district contributes >4%	2%	4%	1%	96% districts <1% AUM; no district >2% AUM	n/a	n/a
State cap (% of AUM)	n/a	20%	20%	10%	20%	n/a	n/a
Internal audit reports to	Audit committee	Audit committee	Audit committee	Audit committee	Audit committee	Audit committee	Audit committee

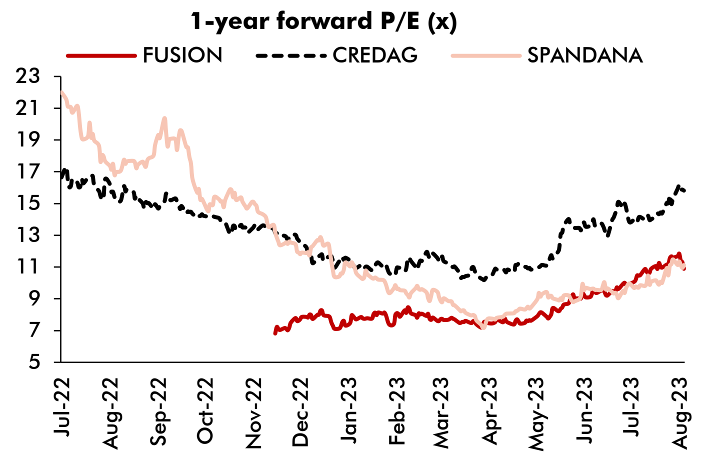
Source: Companies, Ambit Capital research

Exhibit 76: Fusion's high-vintage management compared to most peers has helped it scale up to the status of second-largest NBFC-MFI in the country

Management vintage (years)	Fusion	Spandana	Credit Access	Satin	Arohan	Asirvad
MD/CEO	13	2	MD 8 years, CEO 4 years	33	11	1-2
CFO	8	2	4	23	7	2
Credit & operations	13	1	23	n/a	6	n/a
COO	6	<1	n/a	4	n/a	n/a
Head - Risk	3	1	3	2	6	5
Head - Audit	9	<1	14	4	5-8	<1
CBO	9	1-2	20-25	n/a	<1	4
Head - MSME loans	4	1	20-25	n/a	n/a	3
AUM (₹ bn) (FY23)	**93**	**85**	**210**	**79**	**54**	**100**

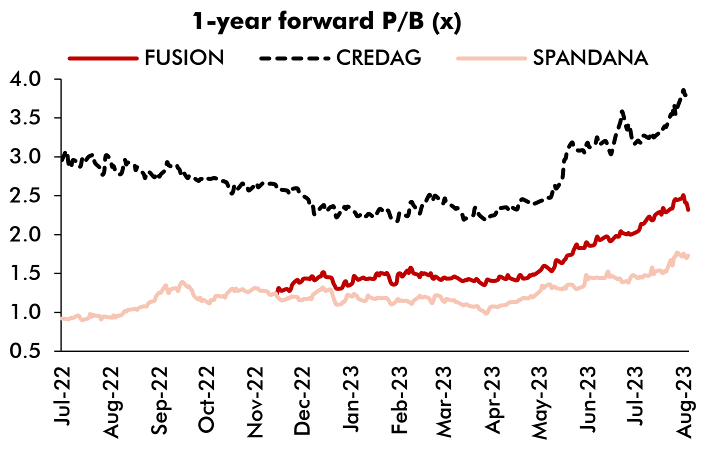
Source: Companies, Ambit Capital research

Exhibit 77: MFI stock valuations improved in the last 6-9 months due to sector tailwinds



Source: Bloomberg, Companies, Ambit Capital research

Exhibit 78: Despite Fusion's improved competitiveness, it trades at a 35% discount to CEDAG



Source: Bloomberg, Companies, Ambit Capital research

Taken the hard way to second-largest MFI

Incorporated in 1994, Fusion was granted NBFC-MFI status in Jan'14. The company expanded operations to five states in 2015. UP/Bihar are currently the biggest markets, accounting for ~42% of AUM. Fusion is the second largest NBFC-MFI in the country with AUM/unique customer market share of 1.7%/3.4% (FY23). This was possible owing to expansive distribution set-up/largest district coverage supported by regular capital infusion. Fusion stands out for chasing customer-led AUM growth. 75% of AUM growth over the last decade (FY13-23) came from new customer acquisition vs 34% for the industry. Fusion's exposure/customer is one of the lowest in the industry at ₹25k, indicating granularity. Having gone through two bad asset quality cycles successively (demonetisation, Covid) Fusion's RoE has suffered since FY17 but picked up to 21% in FY23 owing to bad asset clean-up. Though Fusion has high PE ownership, it has not prevented rating upgrades over the years.

Second-largest NBFC-MFI in 13 years led by ops-heavy skilled CEO

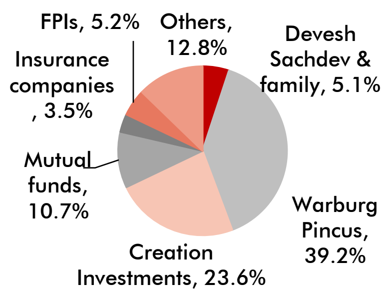
Fusion was originally incorporated as Ambience Fincap Pvt Ltd in Sep'94. In May'09, Ambience was acquired by Devesh Sachdev and Ashish Tewari and renamed Fusion Microfinance Pvt Ltd (Fusion). The name Fusion came about by combining financial and social. Currently, Fusion is led by Devesh Sachdev (MD/CEO), who owns 5.1% stake. At the time of founding, his core idea was to create opportunities at bottom-of-pyramid by providing financial services to un/under-served women in rural India. Devesh Sachdev comes with 25+ years of experience in the service industry. He started his career with Citigroup in its credit card operations before joining a mid-size logistics company, BSA. In his last assignment, he was heading all group companies as at BSA. He spearheaded BSA's growth from single city operations to pan-India foothold – 26 cities, 500 employees, 4mn transactions/month. Given his background in credit card ops and logistics, Devesh brings large-scale/pan-India operations management in a cost-efficient way as a key skill-set to Fusion. Under his leadership, Fusion has grown to be the second-largest NBFC-MFI in the country. Devesh Sachdev is supported by a large, high-vintage management team. Most senior management members have been associated with the company for a long time and have worked in financial services prior to joining Fusion.

Exhibit 79: Having started operations in 2010, Fusion today has an operating history of more than a decade

Year	Event
1994	The Company was incorporated as Ambience Fincap Private Limited.
2010	Started operating under the brand name 'Fusion'.
	First investment by RIF North 2 in our Company.
2013	First investment by NMI Frontier Fund and the other foreign shareholder of the Company at that time.
2014	RBI grants NBFC-MFI status.
2015	Expanded operation in up to five states.
	First investment by Oikocredit Ecumenical Development Cooperative Society U.A. and Belgian Investment Company in our Company.
2016	First investment by Creation I and Global Impact Funds, S.C.A., SICAR and certain existing shareholders, in our Company.
2017	Achieved AUM of over INR 1,000 Crore.
2018	Expanded operations up to 18 states.
	First investment by Honey Rose, which is directly owned by certain private equity funds managed by Warburg Pincus LLC and follow-on round by Creation I in our Company.
2019	Follow-on round from Honey Rose, which is directly owned by certain private equity funds managed by Warburg Pincus LLC and Creation II.
2021	Reached 2,200,000 active loan clients through 725 branches across 18 states.
2022	IPO in Nov'22; raised ₹6bn in primary capital.

Source: Company, Ambit Capital research

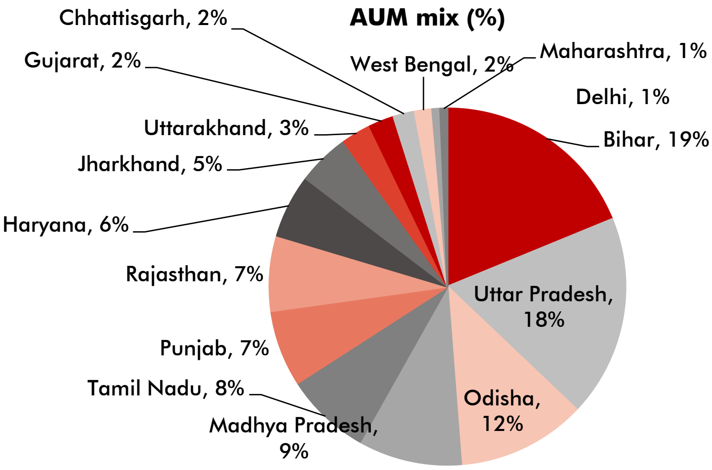
Fusion is majorly owned by Pes



Originated in the north, but diversifying across India

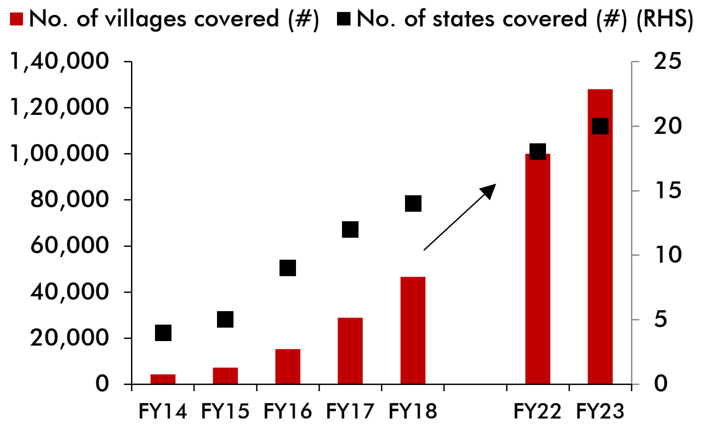
Fusion started operations in UP and Bihar. Back in the day, these were relatively underpenetrated markets. These two states together account for 37% of AUM. Over time, Fusion diversified into other states. As of FY23, the company had a total network of 1,086 branches. In terms of branch network, UP accounts for 20% followed by Bihar at 13% and Madhya Pradesh at 10%.

Exhibit 80: Having started from the north, UP still accounts for one of the biggest business contributors alongside Bihar



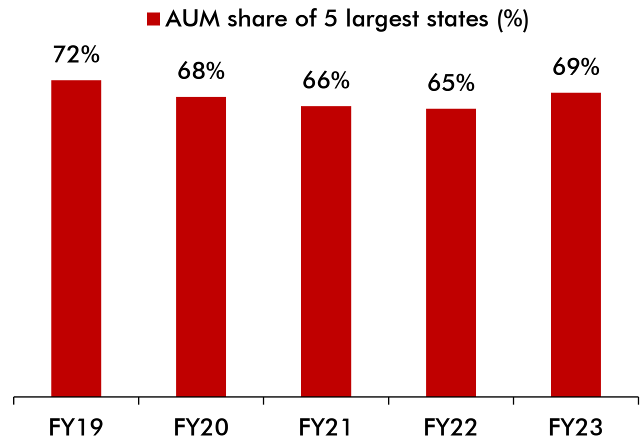
Source: Company, Ambit Capital research. Note: State-wise AUM mix as of FY22.

Exhibit 81: Led by its strategy to focus on new customer acquisition, Fusion expanded distribution to a large number of villages across 20 states



Source: Company, Ambit Capital research

Exhibit 82: Fusion laid thrust on growing outside its biggest markets, thus addressing state concentration risks; however, concentration increased in FY23



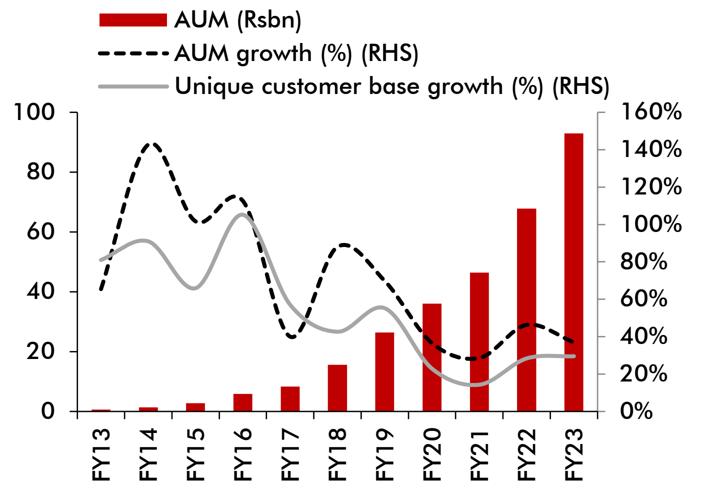
Source: Company, Ambit Capital research

Gaining market share

As of FY23, Fusion commands AUM/unique customer market share of 1.7%/3.4%. One of the key tenets of Fusion's growth strategy is focus on new customer acquisition. This translated into a unique customer base CAGR of 49% (FY13-23) compared to 12% CAGR in customer exposure. Over FY13-23, overall AUM registered 67% CAGR.

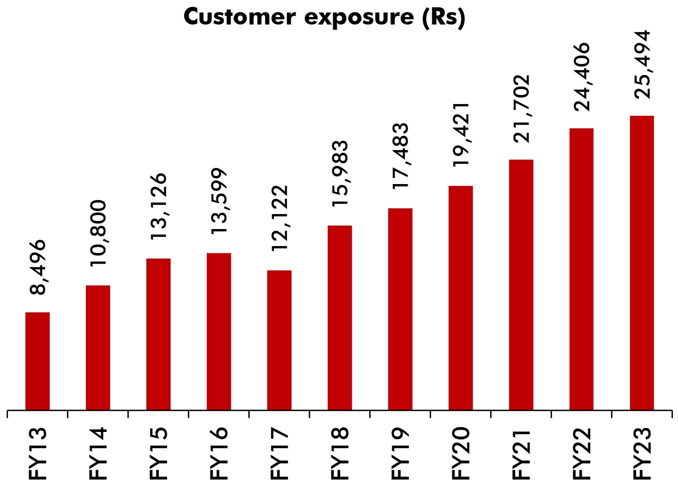
cellita.monteiro@ambit.co 2023-12-15 Friday 22:51:27

Exhibit 83: Since starting out in 2010, Fusion has emerged as the second-largest NBFC-MFI



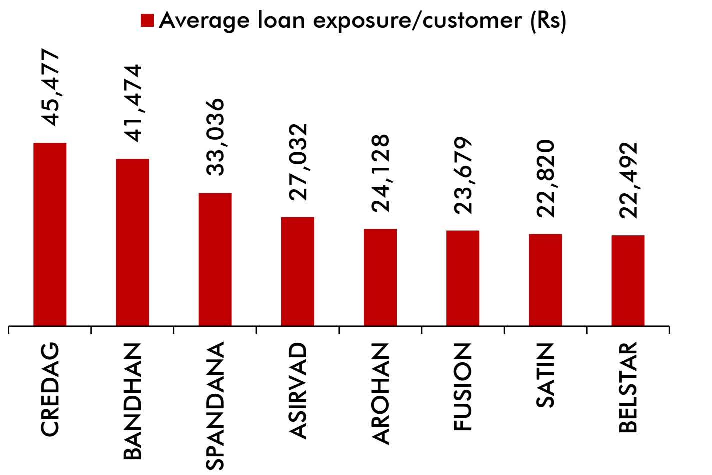
Source: Company, Ambit Capital research

Exhibit 84: Fusion has focused on maintaining low customer exposure



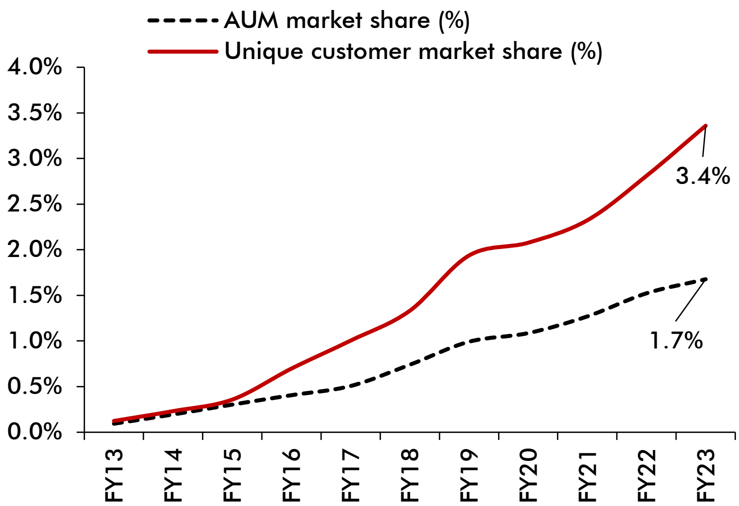
Source: Company, Ambit Capital research. Note: Customer exposure = MFI loans outstanding/no. of unique customers.

Exhibit 85: Exposure among key peers is one the lowest…



Source: Companies, Ambit Capital research

Exhibit 86: …as Fusion relied more on new customer acquisition for building business

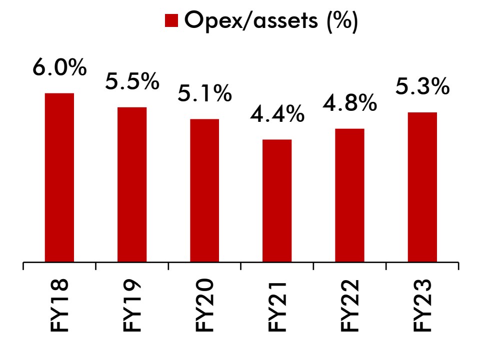


Source: MFIN, NABARD, Company, Ambit Capital research. Note: For AUM market share calculation, denominator is sum of JLG and SHG loans outstanding. For customer base market share, denominator is sum of JLG and SHG customers, adjusted for 30% overlap.

Maximizing asset utilization

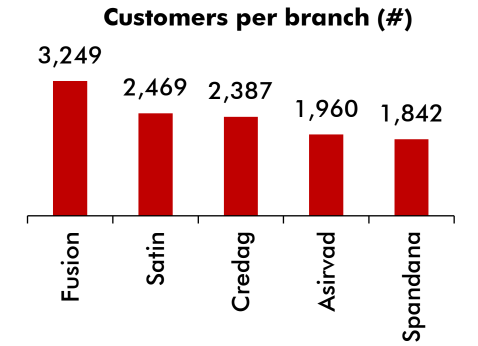
Fusion has focused on maximizing branch and manpower utilization as indicated in number of customers handled per branch and per loan officer are the highest among peers group. Fusion's salary levels seem to be in line with CreditAccess, at around ₹310k annually. However, CreditAccess' other opex per branch is ~70% higher likely due to its much larger scale of operations.

Exhibit 87: Opex ratios stable in the last few years due to increase in scale



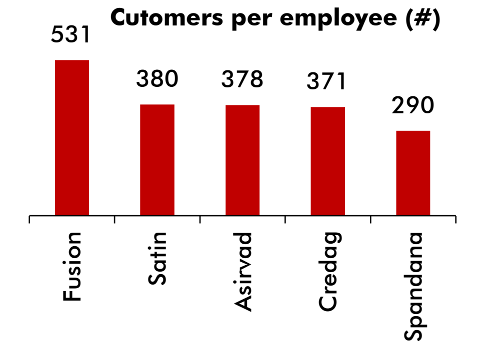
Source: Company, Ambit Capital research

Exhibit 88: Fusion's branch utilization is higher vs peers...



Source: Companies, Ambit Capital research

Exhibit 89: ...and so is its employee/man-hour utilization



Source: Companies, Ambit Capital research

Economic shocks dampened RoE track record

Having started operations in FY10, RoE reached 22% in FY16, improving from 13% in FY14. This was led by improving fee income, opex efficiency and increasing leverage. However, credit costs shot up massively during FY17/18 on account of demonetization. In fact, during FY18, Fusion decided to upfront the stress formation due to demonetization, resulting in ~₹400mn of net loss. Having taken multiple improvements during FY18-20 and focusing on customer-led growth, Fusion was able manage asset quality during Covid better than peers. In FY23, the company delivered 21% RoE.

Exhibit 90: Fusion's RoE has suffered given back-to-back disruptions caused by demonetisation/Covid

Business metrics	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23
RoE tree (%)											
Net interest income	6.4%	12.7%	11.5%	12.8%	9.6%	7.4%	8.0%	9.2%	9.2%	9.6%	12.9%
Non-interest income	0.3%	0.8%	0.3%	0.5%	1.8%	0.8%	0.8%	0.8%	0.7%	1.1%	1.0%
Net operating income	6.7%	13.5%	11.7%	13.4%	11.3%	8.2%	8.7%	10.0%	9.9%	10.7%	13.9%
Total opex	6.0%	8.5%	7.6%	7.8%	7.5%	6.0%	5.5%	5.1%	4.4%	4.8%	5.3%
Employee opex	*4.3%*	*6.0%*	*5.1%*	*5.5%*	*5.3%*	*4.1%*	*3.7%*	*3.8%*	*3.3%*	*3.6%*	*3.9%*
Other opex	*1.7%*	*2.5%*	*2.5%*	*2.3%*	*2.2%*	*1.9%*	*1.8%*	*1.3%*	*1.0%*	*1.2%*	*1.4%*
Operating profit	0.7%	5.0%	4.1%	5.5%	3.8%	2.2%	3.2%	4.9%	5.5%	6.0%	8.6%
Provisions	0.1%	0.7%	0.7%	0.7%	3.3%	5.5%	0.7%	2.4%	4.4%	5.6%	2.4%
Profit before tax	0.6%	4.3%	3.4%	4.8%	0.5%	-3.4%	2.5%	2.5%	1.1%	0.4%	6.1%
Tax	0.2%	1.6%	1.1%	1.9%	0.1%	-0.9%	0.6%	0.8%	0.3%	0.0%	1.5%
ROA	0.3%	2.7%	2.3%	2.9%	0.4%	-2.5%	1.8%	1.8%	0.9%	0.3%	4.6%
Leverage (x)	3.8	5.0	6.3	7.6	6.2	6.6	6.3	4.3	4.1	5.1	4.6
RoE	1.3%	13.3%	14.5%	22.0%	2.8%	-16.4%	11.5%	7.6%	3.6%	1.7%	21.2%
Key operational highlights											
Equity infusion (₹ mn)		0	197	103	1,456	746	3,175	5,034	35	698	5,968
AUM (₹ mn)	568	1,378	2,779	5,908	8,272	15,556	26,414	36,065	46,378	67,860	92,962
AUM growth (%)	*65%*	*143%*	*102%*	*113%*	*40%*	*88%*	*70%*	*37%*	*29%*	*46%*	*37%*
MFI AUM market share (%)	*0.1%*	*0.2%*	*0.3%*	*0.4%*	*0.5%*	*0.7%*	*1.0%*	*1.1%*	*1.3%*	*1.5%*	*1.7%*
No. of customers (#mn)	0.1	0.1	0.2	0.4	0.7	1.0	1.5	1.9	2.1	2.7	3.5
Average exposure/customers (₹)	8,496	10,800	13,126	13,599	12,122	15,983	17,483	19,421	21,702	24,406	25,494
Growth in customer exposure (%)	*-9%*	*27%*	*22%*	*4%*	*-11%*	*32%*	*9%*	*11%*	*12%*	*12%*	*4%*
Unique customer market share (%)	*0.1%*	*0.2%*	*0.4%*	*0.7%*	*1.0%*	*1.3%*	*1.9%*	*2.1%*	*2.3%*	*2.8%*	*3.4%*
No. of branches (#)	21	41	61	149	248	359	504	591	725	934	1,086
No. of states (#)	4	4	5	9	12	14	18	18	18	18	20
GNPA (%)	0.1%	0.2%	0.5%	0.3%	0.4%	4.8%	1.5%	1.1%	5.5%	5.7%	3.5%
Net slippage (%)	0.0%	0.3%	1.1%	0.4%	1.2%	17.3%	0.4%	1.3%	7.4%	9.0%	3.0%

Source: Company, Ambit Capital research

Board has adequate representation from independent directors

Fusion's board has adequate representation from independent directors (50%). Apart from the MD, at least two other board members have prior experience in the MFI sector which should help in providing strategic guidance. Management has zero representation on audit and nomination/remuneration committees, indicating that such committees are independent in letter and spirit. Risk management committee is a mix of management executives and independent directors. Note that the appointment, removal and terms of remuneration o the Chief Risk Officer are reviewed by the risk management committee.

Exhibit 91: Contours of the board independence and committee composition don't point to any governance concerns

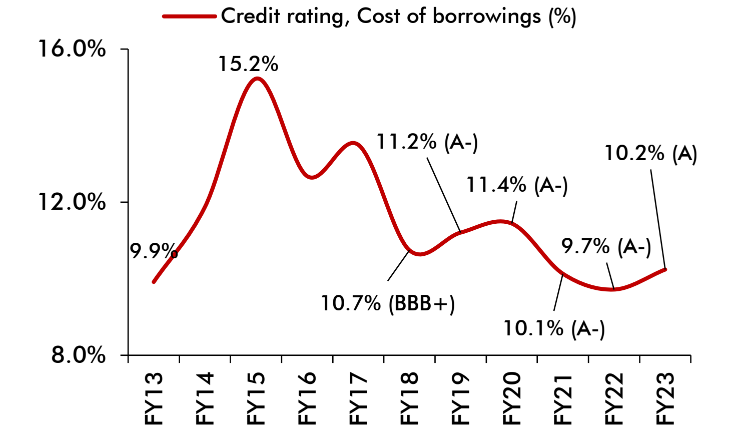
Board member	Designation	Background
Devesh Sachdev	Promoter, MD & CEO	Chairperson of MFIN; 26 years of experience in service industry; XLRI graduate
Narendra Ostawal	Nominee Director	MD at Warburg Pincus; previously worked with 3i India and McKinsey, PGDM from IIM-B
Kenneth Dan Vander Weele	Nominee Director	Served on board of CreditAccess Grameen and Muthoot Microfinance; holds PhD from the Oxford Centre for Mission Studies, Opex University
Ratna Dharashree Vishwanathan	Independent Director	More than 35 years of work experience with Government of India, MFIN, Oxfam; currently on board of Moneyboxx, Dilip Buildcon
Namrata Kaul	Independent Director	More than 34 years of experience with Grindlays Bank and Deutsche Bank; currently on board of Havells India and Schneider Electric
Pankaj Vaish	Independent Director	Currently on board of IIFL Wealth, Krishna Institute Of Medical Sciences and Indium Software

Source: Company, Ambit Capital research

Steady operations have attracted credit rating upgrades

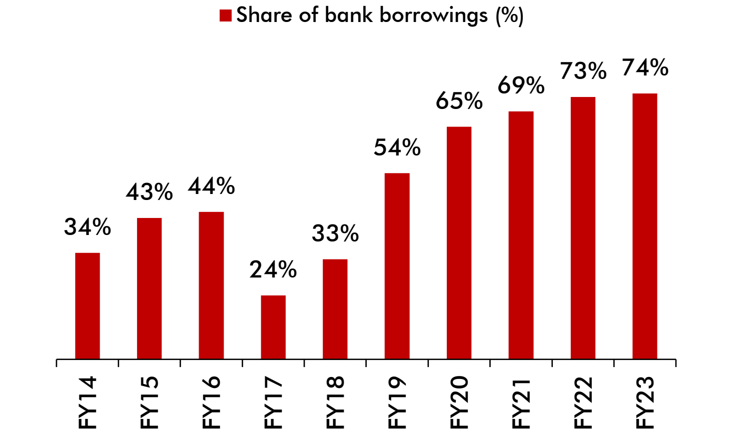
Fusion's credit rating was recently (Oct'23) upgraded to A+, noting its highly capitalized balance sheet, long operating history and improved sector outlook. With increasing scale of operations, the company has added more and more lenders to its kitty. From 25 in FY17, the number of lenders increased to 55-60 in FY23. As a result, share of low cost bank borrowings has increased over time, while reliance on NBFC funding has declined.

Exhibit 92: With successive rating upgrades since FY18, cost of funds has declined; rating upgraded to A+ in Oct'23



Source: Company, Ambit Capital research. Note: Credit rating in parenthesis.

Exhibit 93: With increase in scale of operations, Fusion has been able to increase share of low cost bank borrowings



Source: Company, Ambit Capital research

Exhibit 94: SWOT analysis – Fusion's strengths outweigh its weaknesses. While the company has untapped growth opportunities which can provide scale, there are threats too

Strengths	Weaknesses
▪ **Customer profile:** Mostly first-time borrowers (new to credit: 26%), neglected by banks due to lack of banking habits and informal income. ▪ **Geographical focus:** With 93% business share, Fusion is most rural-focused, giving it a competitive distribution advantage. ~400 districts coverage is highest among MFIs. ▪ **Investments in audit and risk systems:** Strengthening risk and audit system has helped in lower-than-industry fraud ratio. During Covid, net slippage ratio was amongst the lowest (4.3%).	▪ **Cost of funds is higher vs peers:** Current cost of funds (10.4%) is 20-160bps higher than most peers, thus making it relatively less competitive. ▪ **High PE ownership may restrict leverage:** High PE ownership (~63%) may concern rating agencies due to possibility of ownership change.
Opportunities	**Threats**
▪ **MSME lending:** Given the unmet credit demand from the micro-enterprises (IFC estimates ₹85tn), MSME lending (3% of AUM) provides large scale growth opportunity. ▪ **Northern/southern markets:** Increasing penetration in north (34% vs 63% pan-India) and low market share in south (0.9%) are key growth opportunities.	▪ **Sector cyclicality:** MFI sector has gone through multiple asset quality cycles in last 8 years (demonetisation, Covid). Such events can have a major impact on asset quality and thus RoE. ▪ **High attrition:** Recent attrition in BFSI industry has increased significantly (40-50% in some cases), which can impact resource productivity and/or collections. ▪ **Highly subjective nature of income assessment:** Income assessment is highly subjective. Another player can assess income to be higher and potentially over-leverage an existing borrower, thus impacting asset quality.

Source: Company, Ambit Capital research

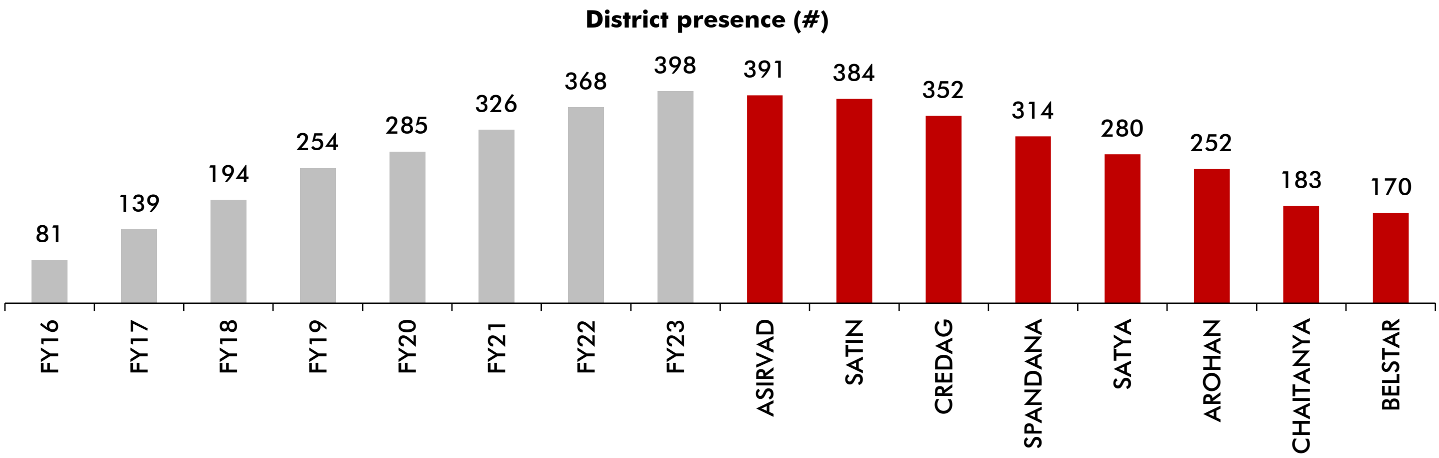
Competitiveness to strengthen

Fusion has been prudent in chasing customer-led growth while the industry resorted to unhealthy practices of customer over-leveraging. Over FY13-23, 75% of AUM growth came from new customer acquisition, vs 34% for the industry yielded 3.4% unique customer market share. Key drivers: (i) distribution expansion (highest district coverage), (ii) customer service quality (lowest number of complaints) and (iii) rural focus (relatively underpenetrated). Greater disclosures, healthy capitalization (tier-1: 26.6%) and internal accruals (RoE: ~20%) should aid 50-100bps funding cost improvement, strengthening competitiveness. Competitive pricing would be critical for customer acquisition/growth sustainability during industry consolidation in the long run. Expect UP to remain a focus state given under-penetration. South also looks attractive. Besides benefitting from MFI industry consolidation, diversification into MSME lending provides visibility on AUM growth longevity. MSME customer market share should increase as funding cost improves. Expect AUM CAGR of 25% over FY23-26E.

District expansion and rural orientation are key inputs to growth strategy

As of FY23, Fusion covers 398 districts across 20 states. Among key large MFIs, Fusion's district coverage is the highest, underscoring its philosophy to chase volume-led growth. Management's prudence in terms of business growth is well reflected in a recent interview, wherein the CEO has shown aversion to growing the business by increasing customer exposure. The context here is that, in the past, the industry has shown signs of customer overleveraging due to high credit supply, leading to asset quality problems.

Exhibit 95: Fusion's largest district coverage among key peers underscores its philosophy to chase customer-led growth



Source: Companies, Ambit Capital research

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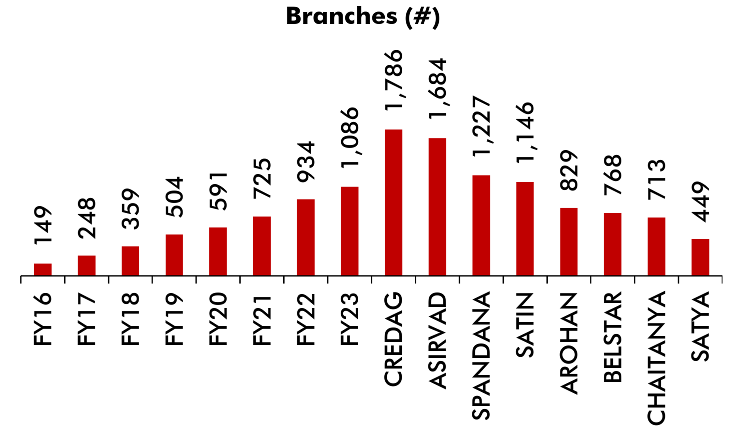
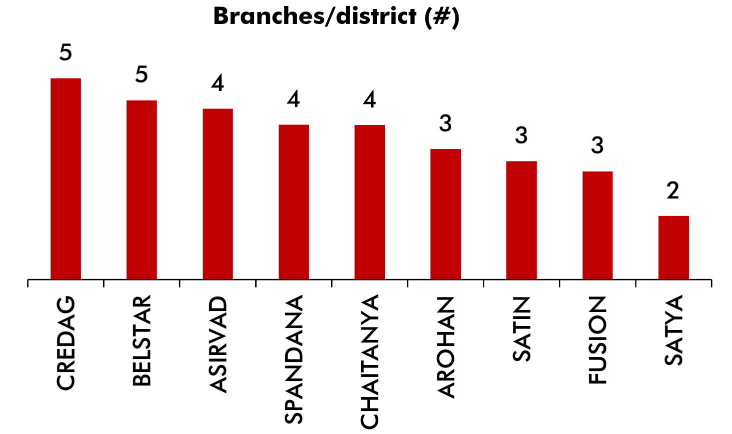
Exhibit 96: Fusion has supported district expansion with commensurate effort in branch expansion



Source: Companies, Ambit Capital research

Exhibit 97: Fusion's lower branch density per district has potential to improve as it deepens penetration. This will aid new customer acquisition and thus granular AUM growth



Source: Companies, Ambit Capital research

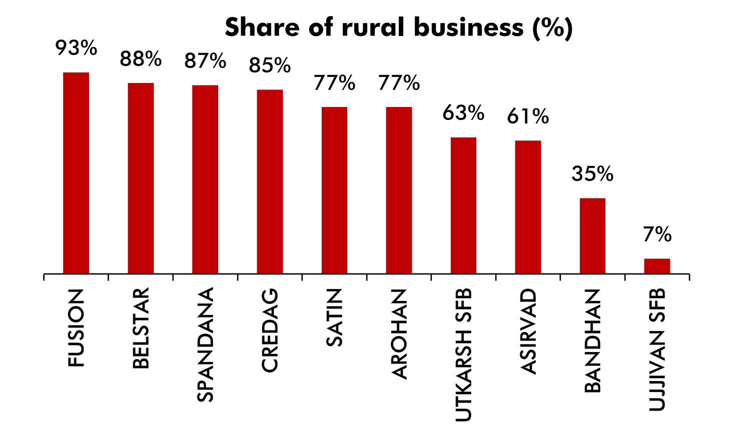
Fusion has focused on deeper markets as seen in share of rural business being the highest among key peers. Besides the growth opportunity being larger in rural areas due to lack of credit substitutes, repayment rates are also better. Rural MFI business has higher degree of group cohesion, lower retail overlap (12-15% in rural vs 30-35% in urban) and lower fixed expenses (such as no rent). For instance – (i) lower home ownership in urban areas (69%) vs rural (95%) means higher share of households living on rent and thus higher fixed obligation and (ii) as of Sep'22, CRIF data shows that MFI PAR 90+ was 2.7% for MFI sector, lower than 4.1% for MFI borrowers with additional retail exposure.

Exhibit 98: Rural MFI borrowers tend to have lower fixed expenses given that they live in their own house (no rent!) and have lower retail loan overlap, thus making for better repayment rates

Criteria	Rural	Urban	Comments
Degree of group cohesion	◕	◑	Cohesion is higher in case of rural as group members are familiar to each other. In urban, neighbours are often unknown to each other and are unaware of each other's household dynamics.
Customer leverage/retail overlap	◔	◑	In urban, retail overlap with MFI loan is higher (35-35%), thus indicating higher customer leverage.
Customers' fixed expense	◑	◕	In rural, home ownership is 95%, higher than 69% in urban. In urban, often MFI borrowers are living in rented premises, which increases their fixed obligation.
Customer traceability	◕	◑	Rural people are not very familiar with places outside their villages. Urban people are more exposed to places outside their cities. In times of crisis, rural people are likely to be more traceable.

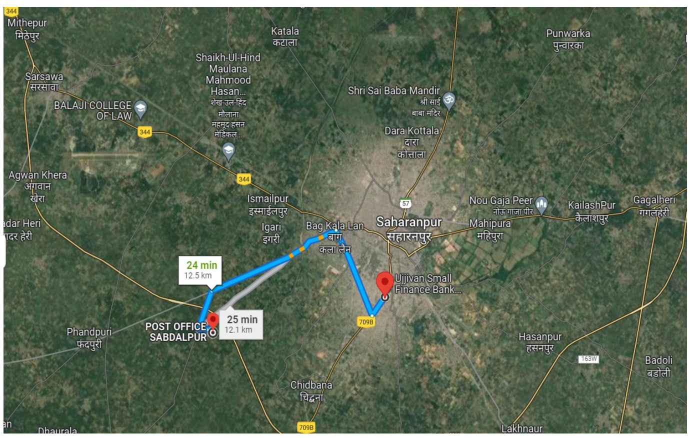
Source: MoHUA, Census 2011, Ambit Capital research. Note: ● - strong, ◕ - Average, ◑ - Relatively Weak, ◔ - Weak

Exhibit 99: Fusion's higher focus on rural areas vs peers goes well with its customer-led growth strategy as such areas tend to have low credit penetration



Source: Companies, Ambit Capital research

Exhibit 100: Fusion serves customers located deep in rural markets as shown below in one of the villages, Sabdalpur in Saharanpur (UP), which is 12km away from the main district

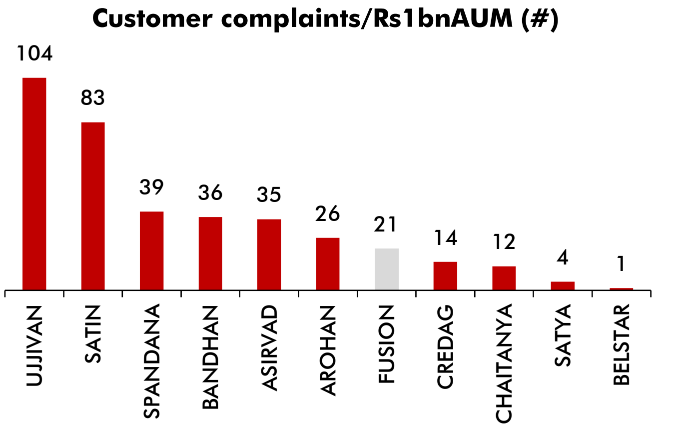


Source: Google Maps, Company, Ambit Capital research. Note: The above Google map screenshot shows distance from Ujjivan SFB to the village. Ujjivan SFB has been taken as a reference point as Fusion's branch is right next to it.

Lower customer complaints vs peers indicate better service levels

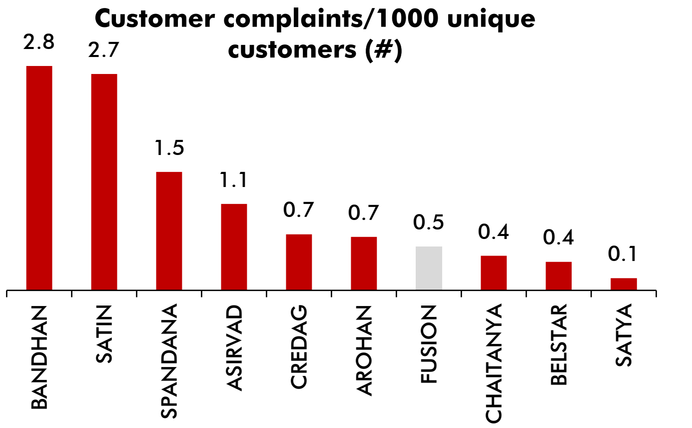
The MFI business model entails a very high degree of customer engagement. For example, in most other loan products, EMI repayments are on a monthly basis and in most such products, EMIs are paid without any physical intervention from company staff. MFI is one of the very few product segments (probably the only one) where the industry operates on a weekly/bi-weekly/monthly repayment model. Further, the repayment/collection process is a part of a larger physical group meeting. In such meetings, members are expected to be present at a centralized location, which is addressed by the branch staff. Hence, the frequency of physical customer engagement is high. Naturally, the quality of customer service is very important for customer retention. This holds even more significance in a highly competitive industry like MFI. Fusion has performed well on this parameter as its number of customer complaints per ₹1bn of AUM is lower than some of its key peers but higher than industry leader CREDAG.

Exhibit 101: Customer centricity is a core value at Fusion…



Source: Companies, Ambit Capital research

Exhibit 102: …leading to better customer service quality than most peers, thus aiding customer retention and recall



Source: Companies, Ambit Capital research

Listing benefits/rating upgrade, efficiency will improve competitive positioning

After raising ₹6bn in fresh equity capital during the IPO, Fusion's tier-1 capital improved to 26.6% as of FY23. As a listed entity with a long operating history, strong internal accruals and healthy capitalisation/ability to raise capital, there is likelihood of further reduction in borrowing spreads (estimate, 50-100bps). In Oct'23, the company was upgraded by CRISIL to A+, citing healthy capitalisation, improving profitability and asset quality along with sound risk management practices. Also, historically, we note that as NBFCs get listed, they tend to witness at least 100bps reduction in spreads over MCLR.

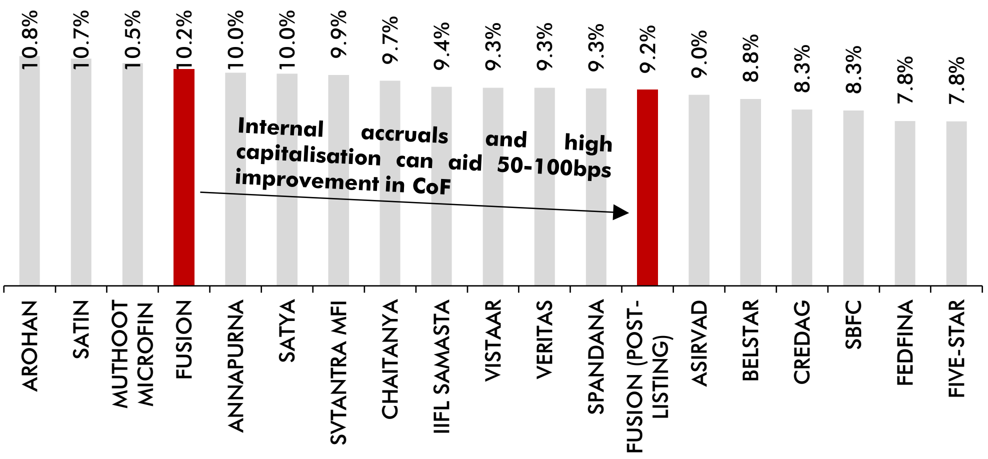
Exhibit 103: After listing, NBFCs' funding costs typically improve by at least 100-150bps

CoB spread over MCLR (%)	Year of listing	FY17	FY18	FY19	FY20	FY21	FY22	FY23
AAVAS	mid-FY19	-0.4%	0.3%	-0.5%	-0.4%	0.5%	-0.5%	-1.2%
HFFC	end-FY21	1.4%	-0.6%	-0.1%	0.3%	0.4%	-0.6%	-0.5%
APTUS	mid-FY22	3.2%	0.8%	0.8%	1.8%	1.7%	0.7%	0.6%
FIVE-STAR	FY23		2.7%	1.4%	4.6%	3.8%	2.8%	-0.1%
CREDAG	mid-FY19	4.1%	2.9%	1.2%	0.6%	0.4%	1.0%	0.4%

Source: RBI, Companies, Ambit Capital research.

In line with the historical sector trends, assuming Fusion's cost of borrowings declines by ~100bps to 9.2% in the medium term, its competitiveness would increase significantly as it would be able to price its products lower.

Exhibit 104: After listing, internal accruals and high capitalisation should aid 50-100bps credit spread reduction, leading to lower funding cost. This would immensely increase Fusion's industry competitiveness



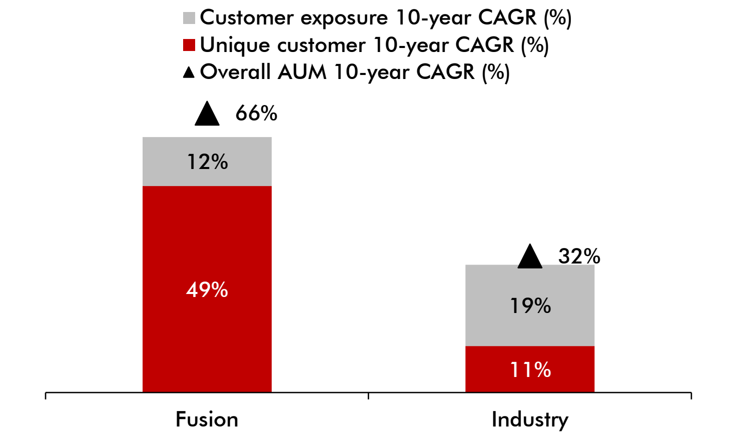
Source: Companies, Ambit Capital research. Note: We have assumed 100bps reduction in Fusion's current cost of borrowings

Even though customers do not understand percentage ROI, they are fully aware of the absolute value of EMI they are paying on each of the 2 loans running parallel. In this case, it is quite likely that the customer could switch the second loan to the cheaper alternative/lender. As the MFI industry reaches 85-90% penetration (FY28-33E) and starts to saturate/consolidate, competitive funding cost/pricing will be a key determinant of growth. In this backdrop, as Fusion's funding cost improves and its pricing becomes more competitive vs industry, it would benefit from higher customer acquisition. In FY23, 16% of Fusion's customers closed their loans with other lenders and came to Fusion, partly due to better pricing.

Deep distribution + customer service enabled market share gains

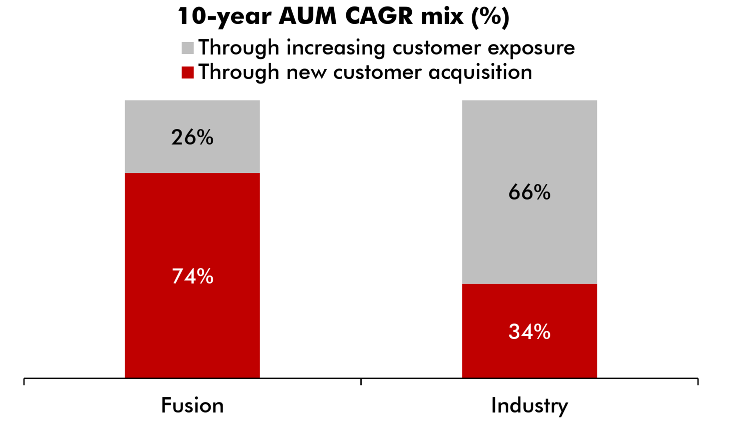
Fusion's growth strategy is supported by its focus on deeper markets (rural), mining of new customers and ensuring better customer service quality. Since inception, the company has focused majorly on north/east India markets, UP and Bihar being the largest. As a result, Fusion's AUM clocked 67% CAGR over FY13-23. Fusion's philosophy of customer-led growth is reflected in customer market share expanding to 3.4% in FY23. We think Fusion's quality of growth has been superior to most peers. Majority (~75%) of AUM growth is attributed to new customer acquisition while average exposure per unique customer has increased at 12% CAGR (FY13-23). In contrast, the industry's approach to AUM growth has majorly relied on increasing customer leverage. Over FY13-23, industry's exposure per customer increased at 19% CAGR, nearly 2x of unique customer CAGR of 11% over the same period. As highlighted before, a company's growth strategy relying on increasing customer exposure can be detrimental to asset quality due to increased customer indebtedness.

Exhibit 105: Fusion's growth strategy has relied on acquiring new customers, bucking the industry trend of customer exposure-led growth



Source: MFIN, NABARD, Company, Ambit Capital research. Note: Industry refers to only JLG model.

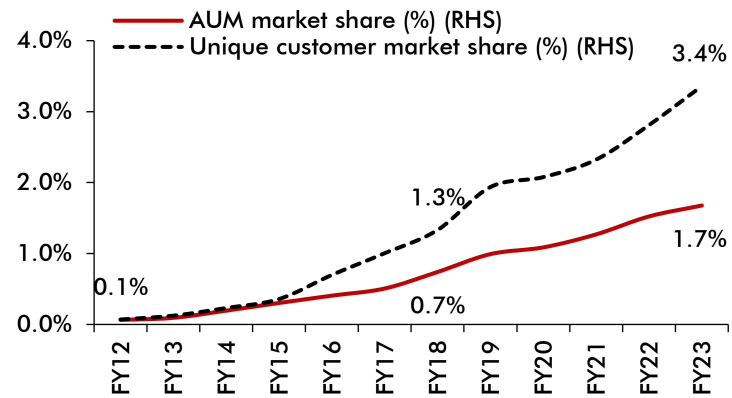
Exhibit 106: Fusion's customer-led growth strategy has yielded much greater granularity compared to the industry



Source: MFIN, NABARD, Company, Ambit Capital research

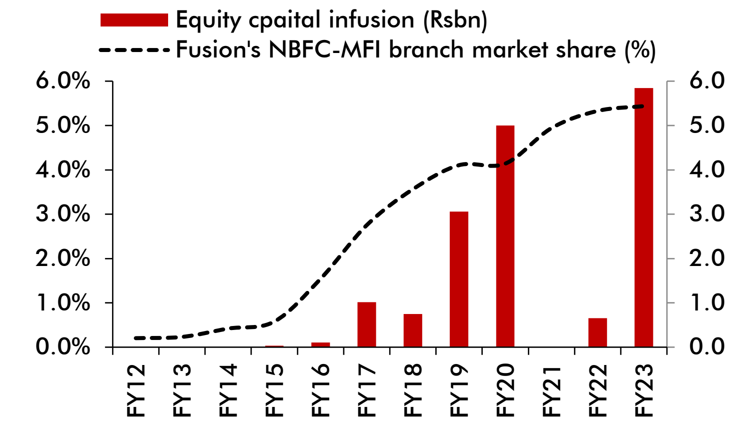
The key reason for Fusion's ability to chart customer-led growth is because of consistent branch expansion. In turn, ability to expand branches can be attributed to regular equity capital supply into Fusion. Over the last 10 years, Fusion has attracted the second-highest amount of primary equity capital after CreditAccess among the 14-15 top NBFC-MFIs today.

Exhibit 107: As a result of greater focus on new customer acquisition, Fusion's unique customer market share has nearly tripled in the last 5 years



Source: MFIN, NABARD, Company, Ambit Capital research. Note: For AUM market share calculation, denominator is sum of JLG and SHG loans outstanding. For customer base market share, denominator is sum of JLG and SHG customers, adjusted for 30% overlap.

Exhibit 108: A key reason for Fusion's ability to mine new customers has been distribution expansion, in part owing to regular infusion of growth capital

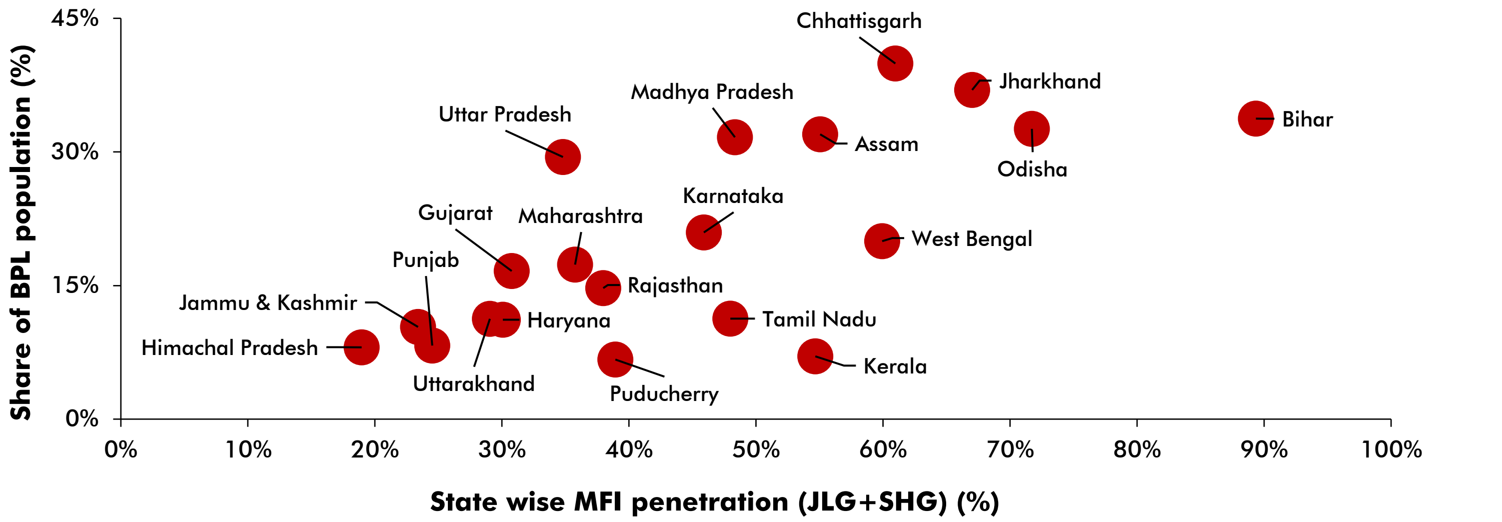


Source: MFIN, Company, Ambit Capital research

Under-penetration in north and low MS in south are opportunities as competitiveness increases

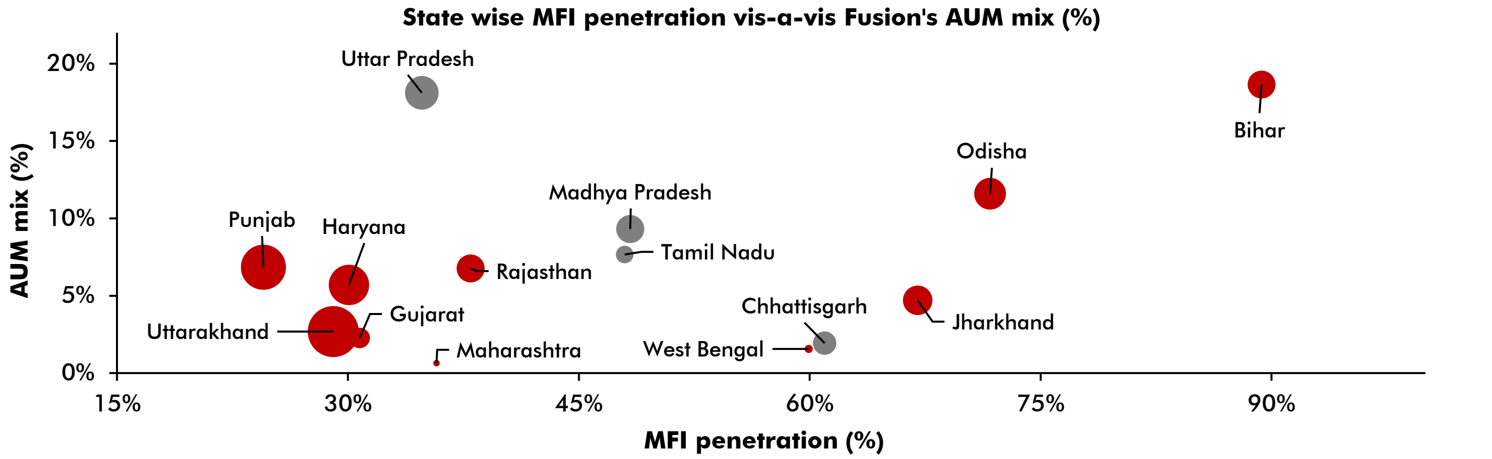
Currently, Fusion's largest markets are Bihar, UP and Odisha. Given high penetration levels in Bihar and Odisha, the company has been growing at a slower rate in these states as reflected in reducing AUM mix. UP's AUM mix increased to 22% (FY23) vs 17-18% (FY18-22) given that the state's MFI penetration is lower than all-India levels. UP is one of the most populated states in India with the highest number of MSMEs (~14% share) and ~30% BPL population. Also, in the last few years, the state's PAR 30 behaviour has improved, trending better than industry since FY20. Hence, we expect UP to remain a core focus state for Fusion. Further, despite higher MFI industry penetration in Tamil Nadu and Karnataka, Fusion's market share is 0-1%. In Fusion's stronghold markets, it commands AUM market share of 3.5-5%. Taking a cue from this, there is huge potential to increase market share in south India, especially with a competitive pricing. The company has also launched operations in Andhra Pradesh and Telangana. We expect Fusion's growth in north/south to be aided by increasing penetration as well as market share gains.

Exhibit 109: In our state-wise opportunity evaluation framework, we believe north and south have greater growth potential vis-à-vis share of BPL population



Source: Niti Aayog, Census 2011, Ministry of Rural Development, MoSPI, MFIN, Ambit Capital research.

Exhibit 110: Given Fusion's state-wise presence/AUM mix vis-à-vis MFI penetration and BPL population mix, north, south and central markets look appealing. In Andhra Pradesh/Telangana, Fusion started operations very recently



Source: Niti Aayog, Census 2011, MoSPI, MFIN, Ambit Capital research. Note: Size of the bubble indicates Fusion's state market share. States with grey bubbles represent opportunity states.

Fusion to benefit from long-term MFI consolidation and portfolio diversification

As the MFI industry consolidates over FY28-33E, players with larger/deeper distribution, better customer service and lower cost of borrowings would stand to gain. Fusion scores well on all these parameters.

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Exhibit 111: Among key peers, Fusion ranks nearly at par with CreditAccess on key determinants of long-term success in MFI

Criteria	FUSION	SPANDANA	CREDAG	BELSTAR	ASIRVAD	Comments
Competitive pricing	◕	◑	●	◕	◕	Improvement in funding cost will lead to more competitive pricing. As industry moves from current level of medium-penetration (63%) to high-penetration (85-90%) by FY30-33E, competitive pricing will be an important determinant of customer acquisition and thus, growth.
District coverage	●	◕	◕	◑	●	MFIs with large distribution are better placed to acquire new customers. Among key peers, Fusion has the highest district coverage (~400) as well as highest share of rural business (93%).
Customer service quality	◕	◔	●	◕	◑	Fusion has the lowest number of customer complaints per 1,000 unique customers. Superior customer service will aid customer retention and benefit asset growth.

Source: Companies, Ambit Capital research. Note: ● - strong, ◕ - Average, ◑ - Relatively Weak, ◔ - Weak

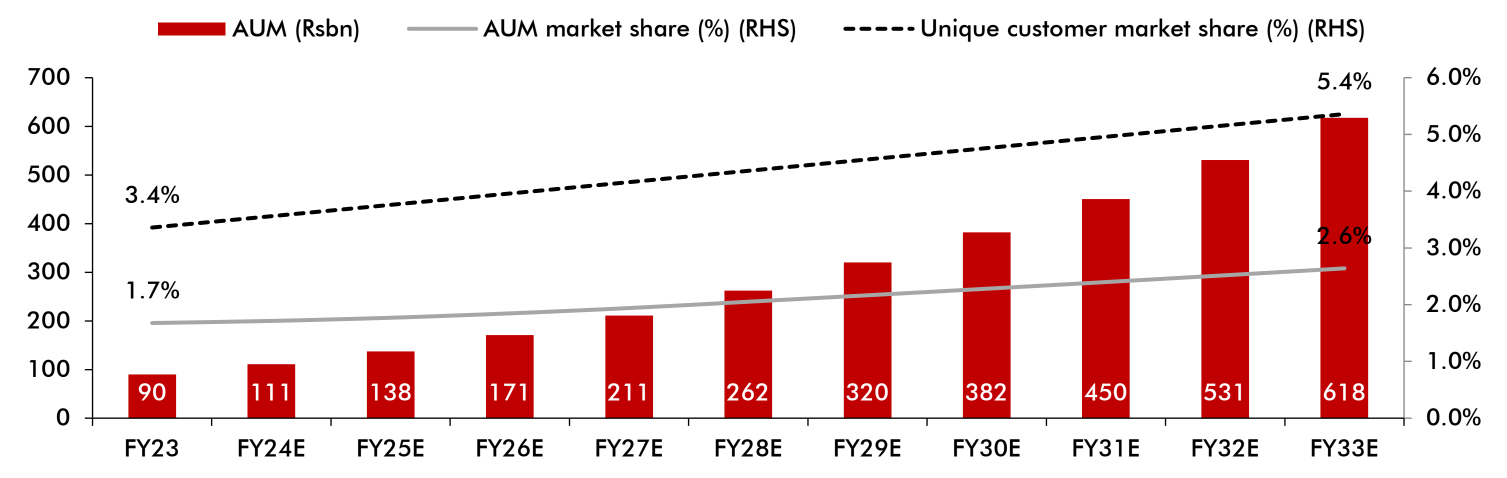
Exhibit 112: Fusion scores well on John Kay's IBAS framework

Category	FUSION	CREDAG	SPANDANA	Comments
Innovation	●	◕	◑	Fusion adopted a non-traditional approach to scaling up. Over the last decade, while most of the industry has focused on increasing ticket-size/exposure per customer to attain scale, Fusion has focused expanding district coverage (highest among peers). This has enabled customer acquisition-led growth, yielding unique customer market share of 3.4%.
Brand	◕	●	◕	Fusion's strong brand equity is reflected in its second-largest NBFC-MFI status, which has been achieved while maintaining superior customer service quality as reflected in low number of customer complaints. From a workplace standpoint too, Fusion's attrition rates are lower, indicating brand equity among employees.
Architecture	◕	◕	◑	Fusion has scaled up its AUM/unique customer market share of 1.7%/3.4% (FY23). The company promotes a risk-averse environment across business functions as well as rewards performing employees. For example (i) it has one of the lowest branches per auditors, thus ensuring higher bandwidth per audit employee (ii) stricter credit policies towards overdue customers vs peers (iii) ESOP allotment to performing managers and lower field level attrition.
Strategic Assets	◕	◕	◕	Fusion's pan-India branch distribution and understanding of the bottom-of-the-pyramid customers w.r.t to their lifestyle and income sources places it well to cross/up-sell additional products in the future, such as micro-LAP/housing loans. Most rural customers live in their own houses.

Source: Company, Ambit Capital research. Note: ● - strong, ◕ - Average, ◑ - Relatively Weak, ◔ - Weak

As Fusion enjoys a greater competitive positioning in the industry, we expect further customer market share gains. By FY28E, we expect Fusion's pan-India AUM/customer market share to expand to 2.1%/4.4%. Over FY23-28E/28-33E, we expect MFI AUM CAGR of 25%/19%.

Exhibit 113: Fusion's improving competitiveness will aid MFI AUM/unique customer market share gains over the next decade



Source: MFIN, NABARD, Company, Ambit Capital research. Note: We have assumed Fusion would gain 20bps customer market share annually, in line with historical trend. In last 5 years (FY18-23), average customer market share gain has been 40bps.

In addition to the MFI business, Fusion has been pilot-testing its MSME loan product since FY19. Majority of such business is micro-LAP (like Five Star). IFC estimates India's MSME credit gap at ₹85tn. Mortgage-backed business loan is a very different business from MFI. In MFI, operations and strong audit is much more important than underwriting due to high degree of cash involvement and requirement to maintain customer relationships. In mortgage backed MSME lending, customer cashflow-based underwriting is the key to success. Keeping this in mind, Fusion is building its MSME business as a separate vertical with separate set of branches and team. Note that despite MSME AUM share being 3% as of FY23, the MSME vertical-dedicated team strength is 7% of total workforce. Only the Compliance Officer and Chief Financial Officer are common.

Exhibit 114: While improving MFI competitiveness, Fusion has been incubating the micro-LAP/MSME lending business since FY19; expected to scale up in coming years

Fusion MSME business	FY22	FY23	1QFY24	2QFY24
AUM (₹ bn)	1.4	3.0	3.5	4.0
Contribution to AUM (%)	2.1%	3.2%	3.6%	4.0%
Branches (#)	34	67	70	76
Customers (#)	5,016	10,747	12,397	13,685
Average exposure/client (₹ mn)	0.3	0.3	0.3	0.3
Team strength (#)		738	785	820
Employees/branch (#)		11	11	11

Source: Company, Ambit Capital research

With only ~14k customers in the fold, Fusion's micro-LAP/MSME market share is negligible. Besides building a separate infrastructure, Fusion's long-vintage knowhow of local rural markets would help in building the micro-LAP/MSME business successfully. Our survey of small business shops in Saharanpur (western UP) indicates a few nuances about the micro-enterprises ecosystem.

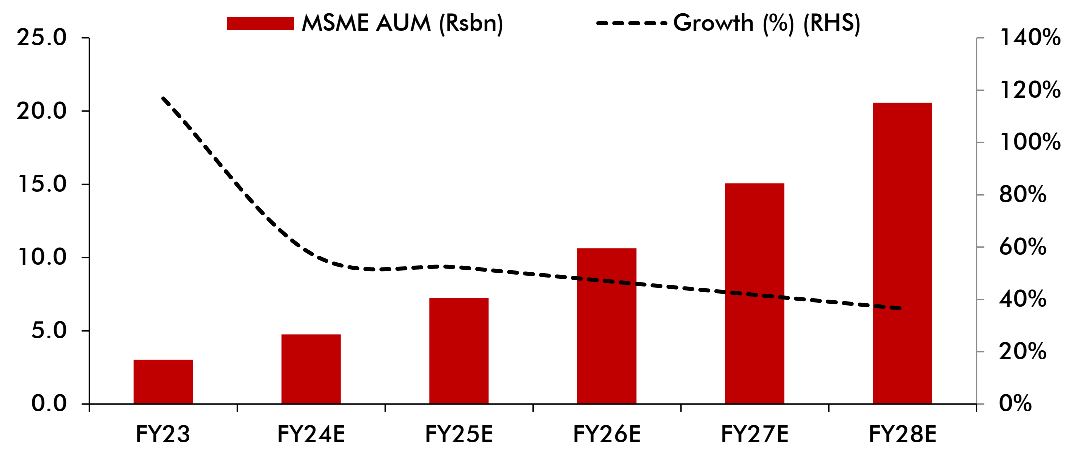
Exhibit 115: In our survey across, small loan amount vs requirement and lack of documents were often key reasons for not being able to avail a loan despite intent. We also noted that most shops surveyed owned the premises, which can be leveraged in future

Shop type	Ever taken loan?	Ever been approached for loan?	Reasons for not taking loan/getting rejected?	Shop premises
Groceries shop	No	Yes	Loan amount was too small	Owned since last 50 years
Kids' toys shop	Yes; has OD	Yes	n/a	Own
Appliances repair shop; also sells used appliances	No	Yes	n/a	Own
Clothes shop	Yes; has OD	Yes	Lack of documents + NPA in the past	Own
Wood works shop	No	Yes	Lack of documents	Own
Stationery shop	Yes; had OD	Content with OD	n/a	Own

Source: Ambit Capital research. Note: The above description is compiled basis 1x1 conversations with small business owners/shopkeepers. Total interaction sample size was 15 shopkeepers/small business owners.

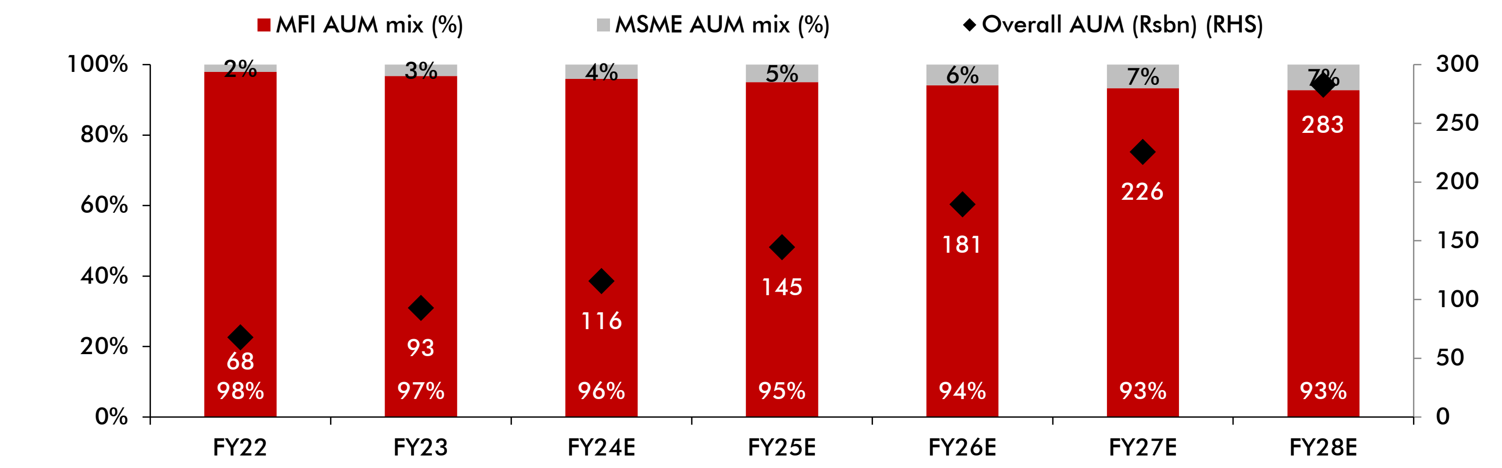
Further, the management may look at spinning off the MSME business into a separate NBFC as indicated by the CEO in an interview last year, though only in the long term. Key to scaling up micro-LAP/MSME lending would be investment in collections infra along with ability to assess property collateral and informal income. In micro-LAP/MSME lending, while property collateral may provide comfort during underwriting, such assets are difficult to liquidate in rural areas, which could pose a problem for NPA recoveries.

Exhibit 116: Expect MSME AUM ramp up



Source: Company, Ambit Capital research

Exhibit 117: Having pilot tested the MSME loan product so far, Fusion will be scaling it over the near-to-medium term



Source: Company, Ambit Capital research

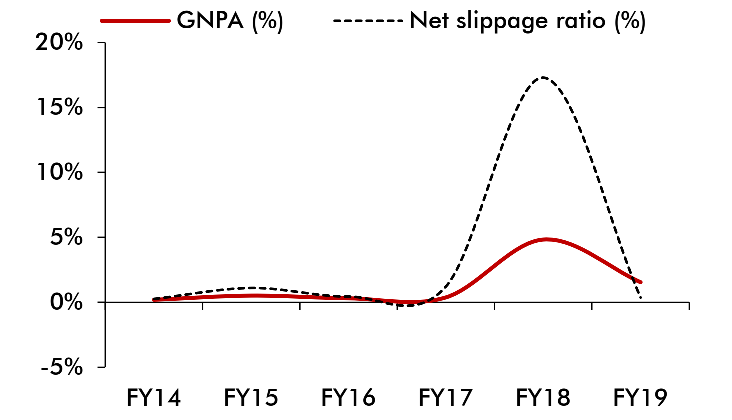
Came back from the brink

FY18 was a major setback. A comparison of asset quality performance across peers during FY17-18 indicates that the impact of demonetization was higher on Fusion partly because it decided to upfront stress recognition. Having gone through the pain, Fusion undertook multiple investments such as development of mobile app for real-time credit checks, decentralization of operations, strengthening of credit checks and credit bureau integration among others. Thus, asset quality experience during Covid was superior to peers. Fusion has also demonstrated ability to foresee and control risk. For example, Fusion reduced business in 6 states ahead of time as these states were either reeling through problems or were vulnerable. Avoiding customer over-leveraging helped Fusion. Over FY19-23, Fusion's customer exposure growth/net slippages were lower than Spandana/Satin/Bandhan/Credag. Upfronting provisions at the first sign of stress/early write-offs indicates prudent behavior. Expect stable credit costs (~2.5%) over FY24-26E.

Every crisis is an opportunity to learn

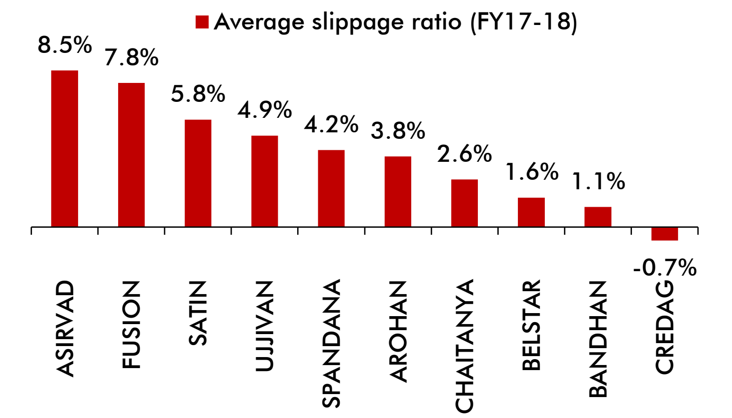
One of the major setbacks for the company was demonetization. Subsequent to this event, Fusion experienced higher slippages over FY17-18 as it decided to upfront stress recognition. As a result, GNPA increased to 5% despite taking massive write-offs in FY17/18. A comparison of asset quality performance across peer group during FY17-18 clearly indicates that the impact was higher on Fusion partly because it decided to upfront stress recognition.

Exhibit 118: Fusion's stress formation shot up in FY17-18 as it upfronted stress recognition due to demonetisation...



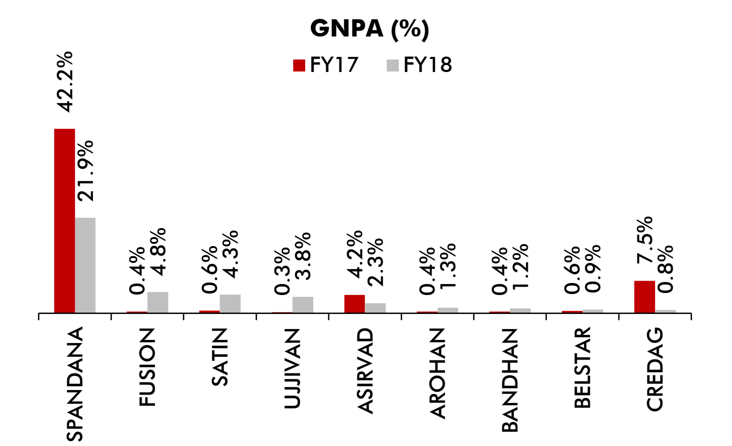
Source: Company, Ambit Capital research

Exhibit 119: ...resulting in industry-high slippages



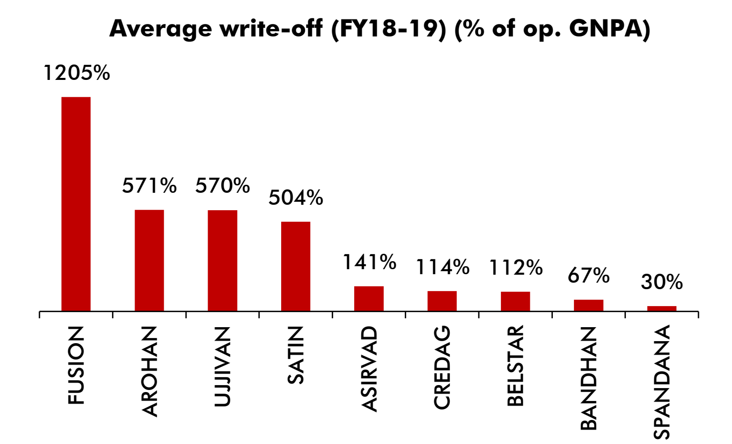
Source: Companies, Ambit Capital research

Exhibit 120: Fusion's NPA was one of the highest in the peer group...



Source: Companies, Ambit Capital research

Exhibit 121: ...despite taking massive write-offs



Source: Companies, Ambit Capital research

Remedial measures were quick

Having learned hard lessons in FY18, the company decided to invest in improving controls and processes. In FY18/19, the company undertook various measures such as mobile-app based real-time credit checks, decentralization of operations, strengthening of credit filters, and integration with multiple bureaus for customer leverage checks, data analytics for micro-market/district analysis for earning warning signals and branch-based risk scoring.

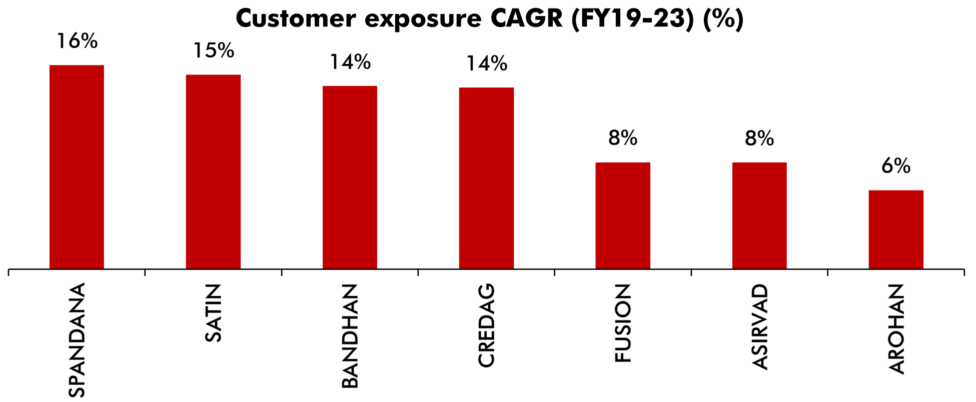
Exhibit 122: After demonetisation hit, Fusion undertook multiple measures to improve controls and processes

Initiative taken	Details
Trial launch of mobile app for real-time credit checks	Launched a mobile app on trial basis which allowed credit officers to check the credit worthiness of applicants on real time basis.
Decentralization of back-end operations	Moved back-end operations (credit check and loan processing) from the head office to regional offices. Such a decentralization move was supported by creating decision-makers in the middle level management, which over the year will help in creating leadership pipeline.
Real-time daily reconciliation	This enhanced productivity at branch and head office by reducing reconciliation time.
Introduced cash pullback at branches	Introduced a cash pull back system which transferred idle funds at the branch level to the head office beyond a threshold. This helped in better cash management.
Started working with multiple bureaus	Started working with multiple credit agencies to verify data accuracy of every application and checking for over leveraging of customers.
Formation of IT strategy committee	The board formed the IT strategy committee during FY18.
Formal launch of mobile app	Successfully launched mobile application called mShakti (for customer on-boarding and collection). Besides the mobile app, the company started developing other digital applications for internal audit, L&D and use of data analytics for improving the portfolio hygiene.
Developing risk matrix for better insights	The company started work on risk matrix/data analytics solutions to provide deep insights about the company's loan portfolio across various parameters
Creation of corporate audit team	In addition to the institutionalised internal audit infrastructure and team, company created a corporate audit team comprising experts in the field to audit every business function at least once in a year.
System integration with multiple bureaus for real-time credit checks	In FY20, company invested in licences with multiple credit bureaus to gain access to their data bases. The data repository provides state/individual-level rich insights into: (i) performance of asset portfolio in each district and each state against peers (ii) delinquency and loan cycle patterns (iii) insight into every person's leverage position and repayment trends. It also helps to identify locations showing promise and those which pose risks.

Source: Company, Ambit Capital research

As a result of improvisation measures, Fusion demonstrated better asset quality trends compared to peers in the last 4-5 years (FY19-23). In FY20, the company invested in licenses with multiple credit bureaus and integrated the same with its mobile application called mShakti. This laid the foundation for the company to take knowledge/data-based credit decisions as well as analyze geographies for potential growth opportunities and closures/risks. Further, in FY20, the company started piloting Audit 360, a digital platform enabling early warning signals in the portfolio. Not to forget, Fusion has consistently focused on chasing AUM growth via new customer acquisition as opposed to increasing customer leverage. Over FY19-23, Fusion's CAGR in customer exposure was at the lower end when compared to peers.

Exhibit 123: During Covid, Fusion's growth in average exposure per customer lagged peers, suggesting it avoided customer over-leveraging, which often led to asset quality problems for the industry



Source: Companies, Ambit Capital research

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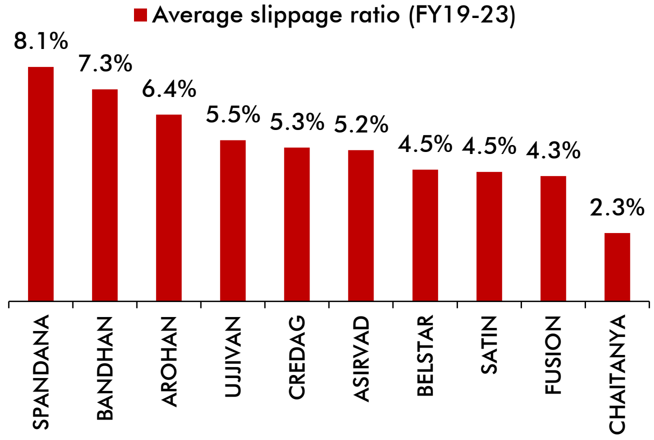
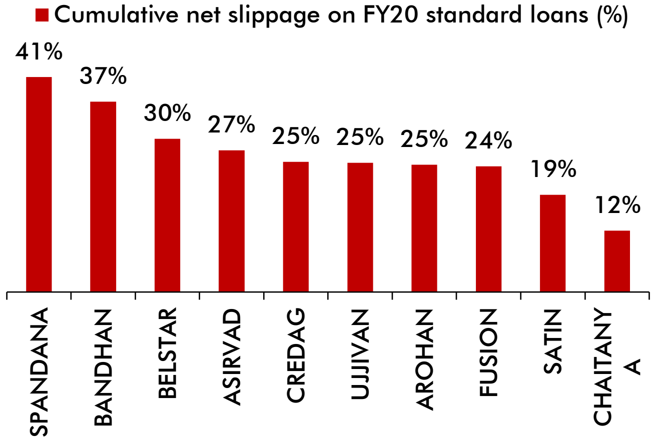
Exhibit 124: Having strengthened risk/audits controls and overall operations, Fusion's bad asset formation has been low in the last 4 years...



Source: Companies, Ambit Capital research

Exhibit 125: ...even lower than some of the leading industry players which have bigger scale



Source: Companies, Ambit Capital research. Note: Cumulative net slippage is sum of net slippages during FY21/22/23.

Fusion's ability to anticipate and mitigate risk is reflected no clearer than in its FY18 annual report. Fusion had called out MFI customers' ability to take multiple loans, thus leading to customer over-leveraging as a key risk in the industry. As highlighted before, FY16 onwards, MFI industry saw a capital supply glut leading to excessive competition. Customer exposure increasing at 30% CAGR (FY15-19) for the industry was an indicator of over-leveraging.

Exhibit 126: Excerpts from annual reports indicate management's proactive culture towards risk recognition

FY18	As competition intensified, *customer knowledge about nuances to secure loans from multiple agencies increased*. This *resulted in over-indebtedness* and defaults.
FY19	The *overleverage of customers from multiple microfinance companies could impact collections* and lead to greater provisioning.

Source: Company, Ambit Capital research

Having recognized the key paint point of the sector, i.e., customer overleverage and subsequently implementing risk-mitigating measures, the company has done well in avoiding states with asset quality problems.

Avoiding states ahead of potential problems

Fusion has demonstrated the ability to reduce or control growth ahead of time in states where the industry witnessed higher delinquencies. This view is substantiated by studying 6 states where Fusion reduced business as such states were either already reeling through problems or were highly vulnerable to asset quality hiccups. Such a feat is an outcome of the company's business philosophy to reduce focus on states where competition is increasing as indicated by either customer base growth or increasing customer leverage.

Exhibit 127: Historical analysis of Fusion's state-wise growth trends vs state-level delinquencies suggests Fusion has reasonably good foresight and monitoring, capable of anticipating stress development and thus, avoiding/slowing growth in such states

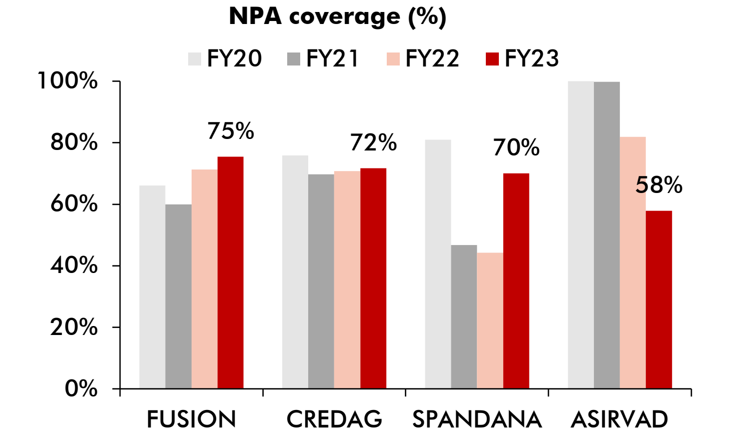
States	FY18	FY19	FY20	FY21	FY22	Comments
West Bengal						
Growth in MFI client base (%) (industry)	38%	22%	-14%	-5%	-5%	Fusion defocused on WB as stress levels increased substantially and were 2x of the sector in FY21.
PAR 30+ (%) (industry)	0.9%	0.4%	0.7%	18.6%	8.8%	
Fusion's exposure (%)	0.8%	1.9%	2.0%	1.8%	1.6%	
Karnataka						
Growth in MFI client base (%) (industry)	1%	7%	-16%	4%	8%	Fusion entered Karnataka in 3QFY23. Before this, they have avoided the state due to higher than industry stress.
Growth in customer exposure (%) (industry)	32%	20%	24%	18%	9%	
PAR 30+ (%) (industry)	2.2%	0.7%	3.1%	4.4%	4.7%	
Fusion's exposure (%)	0.0%	0.0%	0.0%	0.0%	0.0%	
Maharashtra						
Growth in MFI client base (%) (industry)	18%	13%	3%	-6%	0%	Even though Maharashtra may not have seen very high increase in customer base, the state has been plagued with farmer protests between 2015 and 2018. This likely indicates distress among farmers and potential asset quality concerns. Historically, state has seen higher-than-industry PAR 30. This is not a focus state for Fusion.
Growth in customer exposure (%) (industry)	20%	21%	7%	12%	16%	
PAR 30+ (%) (industry)	2.4%	0.8%	1.1%	11.7%	5.5%	
Fusion's exposure (%)	0.7%	0.7%	0.7%	0.6%	0.6%	
Madhya Pradesh						
Growth in MFI client base (%) (industry)	18%	8%	10%	4%	10%	Even though MP has not seen high customer base growth, customer exposure has grown at a higher rate vs MFI industry along with higher-than-industry PAR 30.
Growth in customer exposure (%) (industry)	35%	11%	13%	15%	14%	
PAR 30+ (%) (industry)	2.3%	1.4%	1.5%	7.1%	6.0%	
Fusion's exposure (%)	11.7%	10.7%	10.2%	9.4%	9.3%	
Odisha						
Growth in MFI client base (%) (industry)	36%	19%	-14%	-6%	1%	During pre-Covid, the MFI industry growth was unbridled along with uptick in PAR 30.
Growth in customer exposure (%) (industry)	19%	15%	1%	14%	10%	
PAR 30+ (%) (industry)	0.4%	2.9%	1.3%	8.6%	5.3%	
Fusion's exposure (%)	14.8%	14.2%	13.7%	13.5%	11.6%	
Assam						
Growth in MFI client base (%) (industry)	4%	88%	-12%	-15%	-32%	Assam saw unprecedented increase in PAR 30 amid Covid and political tension. By FY22, Fusion has cut down on the business significantly.
Growth in customer exposure (%) (industry)	8%	9%	1%	5%	-1%	
PAR 30+ (%) (industry)	0.3%	0.4%	13.9%	24.4%	4.8%	
Fusion's exposure (%)	0.0%	0.8%	1.1%	0.8%	0.2%	

Source: MFIN, CRIF, Company, Ambit Capital research

Provisioning policies are conservative

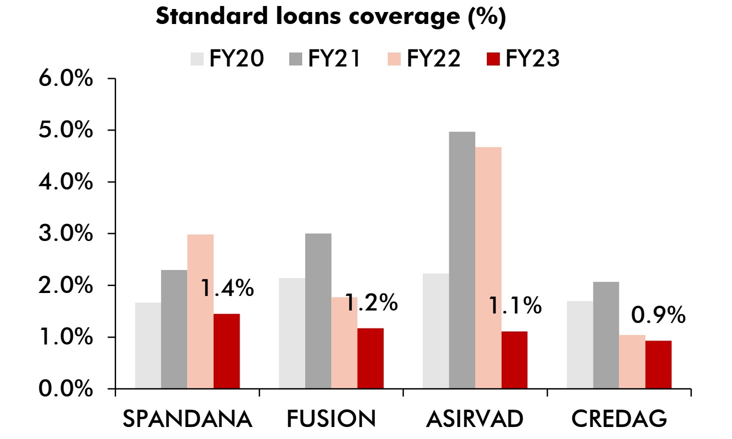
Fusion stage-wise coverage indicates that the company's provisioning policies are prudent. During demonetisation year (FY17), the company was proactive to shore up standard asset provisions to 3.7% in FY17 and subsequently take a massive write-off/clean-up in FY18. Similarly, at the onset of Covid, Fusion shored up standard asset provisions to 2-3%. In fact, during FY19-23, Fusion increased coverage on stage 3/NPA loans despite taking ~90% write-offs (% of opening NPAs) while players such as Spandana, Credag and Asirvad saw NPA coverage decline compared to FY19 levels. Fusion's average credit cost during FY20-23 (Covid period) at 4.5% was similar to the industry. Recently, the company tightened its write-off policy from 365 days earlier to 270 days now.

Exhibit 128: Prudent provisioning policies are reflected in NPA coverage increasing during Covid even as peers kept it same or reduced it



Source: Companies, Ambit Capital research

Exhibit 129: Standard asset coverage in line with peers

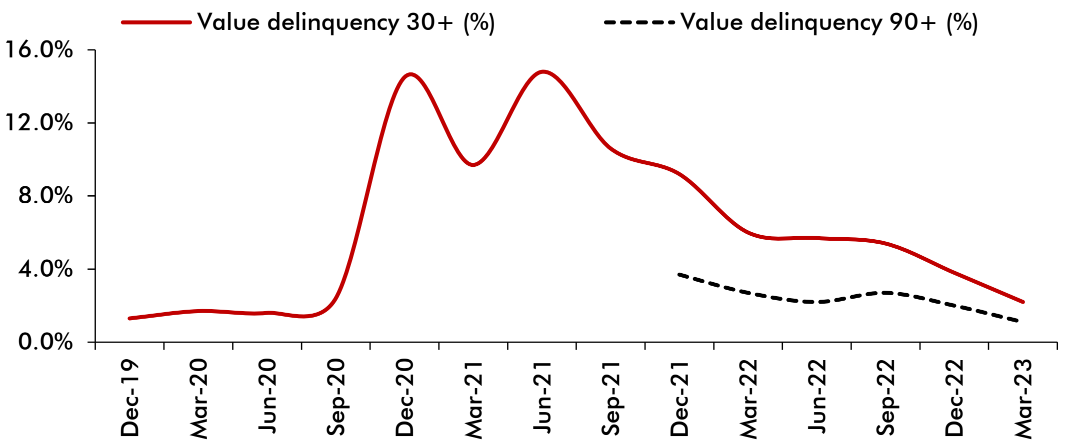


Source: Companies, Ambit Capital research

No asset quality concerns for the sector as of now

In the last 5 years (FY19-23), Fusion's net slippage ratio has been lower than peers, only higher than Chaitanya. We believe such trend improvement, compared to FY17-18, is due to measures taken by the company, most importantly avoiding over-leveraging. Also, having taken upfont asset quality hit during FY18, the company was not carrying any stress baggage due to demonetisation. Further, improving funding costs and resulting competitive pricing would enable Fusion to acquire better quality customers. As of Mar'23, 16% of customers had closed their loans with other MFIs and switched to Fusion partly due to better pricing. At the industry level, RBI's latest guidelines (Mar'22) and maturing ecosystem (more awareness, credit bureau linkage) bode well as they would aid better and more informed credit underwriting. Since implementation of RBI's new guidelines, the MFI industry's application rejection rates increased to 45-50% compared to 30% earlier (link). In view of such developments, we expect average net credit cost of ~2.5% for Fusion over FY23-26E.

Exhibit 130: Overall system-level delinquencies normalised to pre-Covid levels after a massive hit during Covid; don't expect any major asset quality hiccups in the near term



Source: CRIF, Ambit Capital research

Exhibit 131: Expect credit cost to be stable at ~2.5% as currently there are no asset quality concerns for the sector

ECL model	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Gross stage 1 (%)	94.8%	98.1%	98.4%	87.7%	92.2%	95.8%	96.3%	96.6%	96.7%
Gross stage 2 (%)	0.3%	0.4%	0.5%	6.8%	2.1%	0.7%	0.8%	0.8%	0.8%
Gross stage 3 (%)	4.8%	1.5%	1.1%	5.5%	5.7%	3.5%	2.9%	2.6%	2.6%
ECL stage 1 provisions (%)	0.4%	0.4%	1.9%	1.1%	1.0%	0.9%	1.1%	1.1%	1.1%
ECL stage 2 provisions (%)	46.9%	46.9%	50.0%	27.7%	34.5%	40.0%	41.5%	41.5%	41.5%
ECL stage 3 provisions (%)	66.2%	64.2%	66.1%	60.0%	71.3%	75.5%	76.2%	76.2%	76.2%
Total ECL provisions (%)	3.8%	1.6%	2.9%	6.1%	5.7%	3.7%	3.6%	3.3%	3.3%
Write-offs (% of opening GNPAs)	2365.8%	44.9%	90.4%	87.7%	114.8%	69.2%	70.0%	70.0%	70.0%
Net slippage (%)	17.3%	0.4%	1.3%	7.4%	9.0%	3.0%	2.7%	2.5%	2.5%
Net credit cost (%)	8.4%	1.0%	3.1%	5.5%	6.7%	2.7%	2.8%	2.4%	2.3%

Source: Company, Ambit Capital research

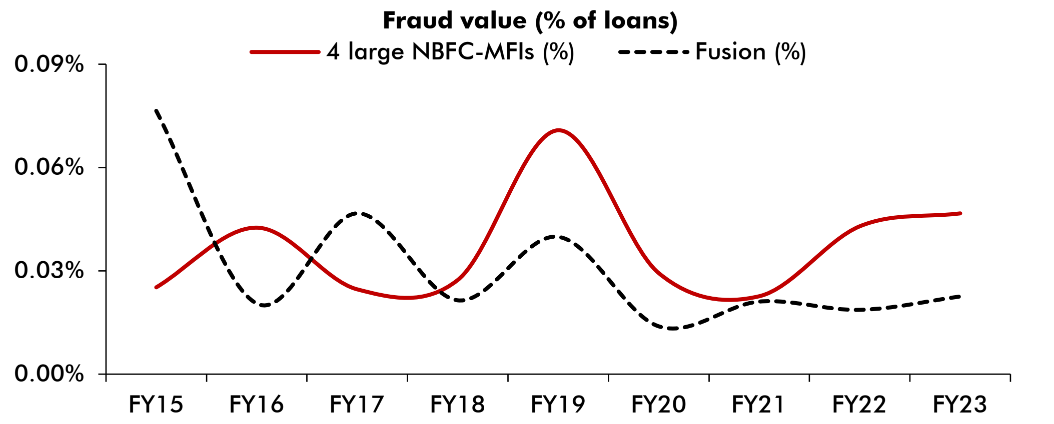
Risk identification is a culture; rewarding performance curbs attrition

The MFI industry is infamous for internal/external frauds. Hence, the need for strong audit systems and controls is non-negotiable. Fusion has been able to manage fraud intensity better than peers. Fusion boasts a large internal audit team (3 branches/audit staff) with special powers to halt business if deemed risky. Chief Risk Officer and Head of Audit have special veto powers to reject proposals on new expansion. Over the last decade, Fusion took steps to identify possible slippages and set up mitigation measures such as audit digitization, geo-tagging branches/group meeting locations and surprise audits. Further, since converting into NBFC-MFI, Fusion always had a Big-4 as statutory auditor. Fusion also boasts high management vintage across peers, providing stability to operations. Performance is rewarded (ESOP formation in 2014), thus curbing attrition. 85% of state managers are internally promoted. At the field officer level too, attrition rates are lowest at 35%.

Hawk's eye on audit and risk controls

Historically, MFI players have often been plagued with issues of lack of monitoring (operations & audit) and frauds. One of the reasons for this could be low-paying nature of field jobs. Across multiple NBFC-MFIs, we estimate that the average annual salary of a field officer is around ₹250-300k, which is 50-60% lower than that in affordable HFCs. High share of collections from customers in cash also adds to potential incentive to commit fraud. In this regard, Fusion has been able to manage/control intensity of fraudulent activities better than peers.

Exhibit 132: Strengthening of internal audit systems has kept fraud intensity lower than peers over the years



Source: Companies, Ambit Capital research. Note: 4 Large NBFC-MFIs considered are CreditAccess, Fusion, Spandana and Satin.

Fusion stands out with respect to strength of operations and audit infrastructure. Its audit team is extensively involved in new branch openings at Fusion. When evaluating branch/area expansion, the company undertakes Area Lucrative Index (ALI) analysis. ALI essentially involves assessment of credit demand, income levels, literacy rate, competition, road access and mobile connectivity amongst many other variables. Though this study is undertaken by two separate teams (operations and risk/audit) and submitted to the head office, the Chief Risk Officer and Head of Audit have special veto powers to reject proposals. Another example is that in a group, if there is more than 1 kin relationship, the audit team members can stop/flag the file. Even if somehow the team accepts one kin relationship in a group, they have to ensure that the two families have different livelihoods. In FY21, the company launched Audit 360, a digital platform to complement the current scope of Audit framework. This enabled the audit team to enlarge the scope of coverage while optimizing bandwidth and building intelligence tools highlighting early warning flags in the portfolio. A unique feature of this initiative will be to digitize supporting documentation that will enable more constructive and real time reviews leading to quicker remedial action.

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Exhibit 133: FY22 gives a good perspective on regular steps taken by Fusion to enhance risk and audit functions to ensure quality of business operations is not compromised

02 Risks that may impact the **quality of our business**

Q. In a rapidly expanding and growing business, there are chances that certain malpractices could creep in, leading to revenue loss. This needs to be plugged before it snowballs into large losses - revenue and reputation. Does the Company have the bandwidth and tools to arrest leakages and loopholes?

A. Mindful of this reality, Fusion has taken important steps to ensure that all possible slippages are identified early and plugged to ensure that they do not recur. For this, the Company has:

One, two separate teams - the Audit team and the Risk management team with clear KRAs and functionalities to protect the Company from all kinds of frauds and malpractices through rigorous review mechanism.

Two, as part of the Audit digitisation, the Audit team uses data analytics for more incisive audit which enables it to identify and zero-in on areas of concern by exception which in earlier years remained undetected at the initial stages.

Three, geotagging of branches and group meeting locations allows the audit team to undertake surprise audits with ease - the number of such audits have increased substantially in recent months. This has mandated the field staff to remain on their toes at all times.

Four, the Company is working on creating a specialised Fraud control unit with the key responsibility of early detection of fraud and plugging gaps in a manner that such incidents do not recur.

Source: Company, Ambit Capital research

Fusion also boasts of one of the lowest number of branches per audit staff. This means that given the limited man hours per audit staff, the intensity/bandwidth per branch is higher than that of peers. On credit policies too, our ground checks suggest Fusion is more stringent compared to peers.

Exhibit 134: Fusion's higher audit strength per branch along with higher branch audit frequency than most peers aid disciplined operations at the field level

Audit & risk management comparison	CreditAccess	Spandana	Fusion	Asirvad	Satin	Arohan	Muthoot Microfin
First cycle loan amount (₹)	Up to ₹30k	Up to ₹40k	₹10-40k	₹20-40k	₹10-45k	₹25-55k	₹25-30k
Maximum loan amount (₹)	₹100k	₹80k	₹90k	₹80k	₹75k	₹75k	₹75-80k
Loan utilization checks	Within 5-10 weeks; follow-up check in 11-15 weeks.	n/a	Within 1 month by LOs for 100% of loans	Within 60 days	Within 2 instalments from date of disbursement	n/a	Within 1 month of disbursal
Branches/audit staff (#)	6	8	3	3	9	5	2
Branch audit frequency	2 months	3 months	2 months	1 month	3 months	3 months	2 months
District cap (% of AUM)	No district contributes >4%	2%	4%	1%	96% districts <1% AUM; no district >2% AUM	n/a	n/a
State cap (% of AUM)	n/a	20%	20%	10%	20%	n/a	n/a
Internal audit reports to	Audit committee	Audit committee	Audit committee	Audit committee	Audit committee	Audit committee	Audit committee

Source: Companies, Ambit Capital research

Exhibit 135: Ground checks corroborate Fusion's strict policies with respect to concentration and underwriting

Avoids concentration even at the customer level	Fusion tries to have people from different community in a group. Members from the same community can unite and influence each other. Fusion ensures it is giving loan to only one member of the family. There are players who tend to focus on giving loan to multiple members of the same family. Fusion asks for details of the family and extended family. If there is a common relative between two members, it asks one to leave the group. In a group, if there is more than 1 kin relationship, the audit guys will stop/flag the file.
Does not compromise on quality of customers	Fusion does not give loans to any overdue customers. This includes customers who have closed their loans but have been overdue at some point in their entire loan cycle. If Fusion is considering giving loan to an overdue customer, it will have to take approval from the top management (CEO).
Ensuring strict employee conduct	If the employee is found of doing cash fraud, he is immediately terminated. If his loan sourcing is of inferior quality (resulting in NPAs), he is given 3 warnings. In third warning, his employment is terminated.

Source: Company, Ambit Capital research

Exhibit 136: Fusion has had a Big-4 statutory auditor since the start

Statutory auditors	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23
Fusion	BSR/KMPG	BSR/KMPG	BSR/KMPG	BSR/KMPG	S R Batliboi/EY	S R Batliboi/EY	S R Batliboi/EY	S R Batliboi/EY	Deloitte
Chaitanya MFI	Ramesh Ashwin & Karanth	Ramesh Ashwin & Karanth	Ramesh Ashwin & Karanth	Ramesh Ashwin & Karanth	Ramesh Ashwin & Karanth	Walker Chandiok	Walker Chandiok	Varma and Varma	Varma and Varma
Belstar	N. Sankaran	N. Sankaran	N. Sankaran	N. Sankaran	N. Sankaran	N. Sankaran	N. Sankaran	Varma and Varma	Varma and Varma
Satin	A. K. Gangaher	A. K. Gangaher	A. K. Gangaher	Walker Chandiok	Walker Chandiok	Walker Chandiok	Walker Chandiok	S Kothari Mehta	S Kothari Mehta
Asirvad	Deloitte	Deloitte	Deloitte	Deloitte	Deloitte	Deloitte	Walker Chandiok	M. P. Chitale & Co	M. P. Chitale & Co
Arohan	Walker Chandiok	Walker Chandiok	Walker Chandiok	Walker Chandiok	Walker Chandiok	Walker Chandiok	Walker Chandiok	MSKA & Associates	MSKA & Associates
Spandana	S R Batliboi/EY	S R Batliboi/EY	S R Batliboi/EY	S R Batliboi/EY	S R Batliboi/EY	S R Batliboi/EY	S R Batliboi/EY	Walker Chandiok	Walker Chandiok
Credit Access	S R Batliboi/EY	S R Batliboi/EY	S R Batliboi/EY	S R Batliboi/EY	S R Batliboi/EY	S R Batliboi/EY	Deloitte	Deloitte	Varma and Varma

Source: Companies, Ambit Capital research

Management longevity is important for scalability

Management longevity is one of the critical factors in a company's success. Industry leading examples, such as Cholamandalam and Bajaj Finance, have shown that there is a linear relationship between a company's success and management team longevity/vintage. In our comparative analysis of management vintage across multiple NBFC-MFIs, Fusion scores higher. Most senior management members have been associated with the company for a long time. Granting ESOPs to top management personnel has been a key part of the company's employee retention strategy. The company introduced its first ESOP plan (ESOP 2014) in FY15 with the objective to reward credible/eligible employees based on performance. As of today, over 300 have ESOPs. The company runs its ESOP plan under a trust structure, which was formed on 24th June 2014 for the purpose of issuing ESOPs.

Exhibit 137: Fusion's high-vintage management compared to most peers has aided its scale-up to second-largest NBFC-MFI in the country

Management vintage (years)	Fusion	Spandana	Credit Access	Satin	Arohan	Asirvad
MD/CEO	13	2	MD 8 years, CEO 4 years	33	11	1-2
CFO	8	2	4	23	7	2
Credit & operations	13	1	23	n/a	6	n/a
COO	6	<1	n/a	4	n/a	n/a
Head - Risk	3	1	3	2	6	5
Head - Audit	9	<1	14	4	5-8	<1
CBO	9	1-2	20-25	n/a	<1	4
Head - MSME loans	4	1	20-25	n/a	n/a	3
AUM (₹ bn) (FY23)	**93**	**85**	**210**	**79**	**54**	**100**

Source: Companies, LinkedIn, Ambit Capital research

Exhibit 138: Fusion has rewarded employees, aiding employee retention, a critical ingredient for business culture longevity

"At Fusion, the Company has a reliable Management team which has rich experience in their area of operations and have been with the Company for quite some time. As a first step towards rewarding their patient and passionate efforts in building the business, the Company has graduated its team into co-owners through its two ESOP schemes – strengthening their bond with the organisation. Further, the Company is working on developing its next generation of leaders who will take the Company to the next orbit." – FY19 Annual Report

Source: Company, Ambit Capital research

The team at Fusion is led by Devesh Sachdev, who founded the company in 2010. He is a graduate of XLRI. He started his career with Citigroup after which his entrepreneurial hunger led him to join a mid-sized logistics firm, BSA. Devesh Sachdev has been on the Governing Body at MFIN since FY17 and is presently the Chair of Governing Body. Currently, he/his family owns 5.1% stake in the company, indicating shareholder alignment. On a fully diluted basis, employees currently own 2.5-3% of the company.

Exhibit 139: Senior management team is led by Devesh Sachdev. Key management members in critical areas of audit and operation are at least 6 years old in Fusion

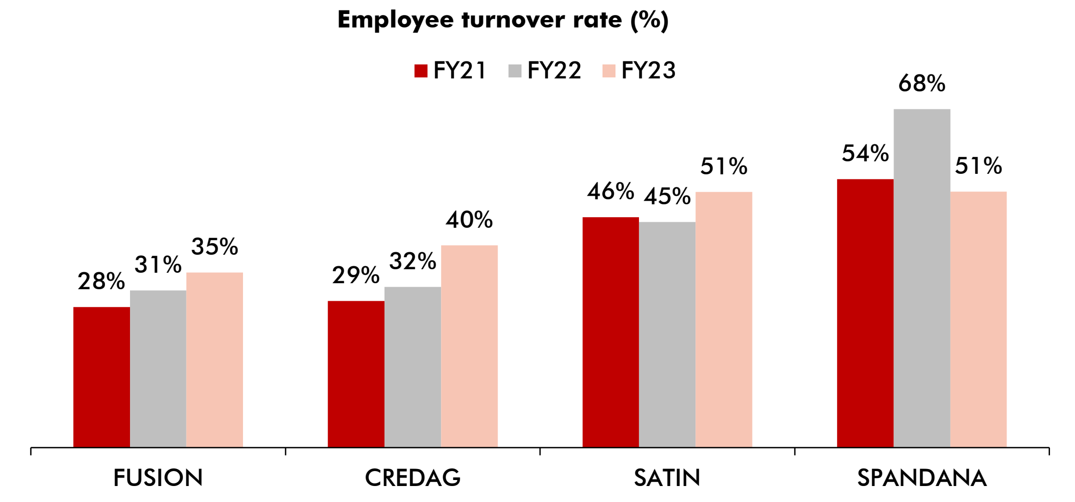
Name	Designation	Joined	Work experience
Devesh Sachdev	MD, CEO	Dec-10	XLRI graduate with 25 years of experience in service industry prior to starting Fusion in FY10.
Tarun Mehndiratta	COO (MFI)	Jun-17	Seasoned veteran in the asset backed finance sector; was among the founding group at Citicorp Finance India.
Kamal Kumar Kaushik	COO (MSME)	Jul-19	Joined from Religare Housing Development Finance, prior to which he was with Fullerton (rural project). Earlier stints include Birla Home Finance, ICICI Bank and HDFC Bank.
Gaurav Maheshwari	CFO	Feb-16	Previously worked in corporate finance at Aditya Birla Group and Avantha.
Deepak Madaan	Chief Compliance Officer & CS	Jun-13	Previously worked with Almondz Group in Merchant Banking, Secretarial & Legal Department.
Pooja Mehta	CHRO	Dec-22	Has majority of corporate experience with PwC and Mercer; has worked extensively across multiple HR domains.
Ankush Ahluwalia	Chief Business Officer	Apr-15	Several years of experience in business operations and people management. Previously worked with GE Capital, Kotak Mahindra, Religare. Before Fusion, he was with Magma Fincorp.
Sanjay Mahajan	CIO	Feb-23	31 year of experience in business technology leadership. Previously worked with Eicher Group, Bata, Gillette, Yum Brands, Satin Credit. Prior to Fusion, he was CEO at SAS Tech.
Satish Mani	SVP - Audit	Apr-15	Several years of experience in bank credit risk and audits. Prior to Fusion, he was with GE Capital, Kotak Mahindra Bank, Sundaram Finance.
Sanjay Vishwanathan Choudhary	Chief Risk Officer	Sep-20	Several years of experience in risk management, auditing, accounting and finance. Before Fusion, he was with Satin Credit. Vast exposure and knowledge in operational risk, credit risk and back-end operations.
Md. Hossain	Deputy Vice President - Credit & Operations	Jul-10	n/a
Nitish Kumar	Lead - Central Credit & Risk, MSME (Mortgage - Secured & Unsecured)	Sep-22	n/a

Source: Company, Ambit Capital research

Rewarding culture as aided lower attrition rates

Anecdotally, it seems that a middle/junior management level employee tends to stay at Fusion for 6-7 years on average. This is based on employment data across 30 LinkedIn profiles. Our view is also corroborated by lower employee attrition at Fusion compared to other MFIs. Here again, key motivator/retainer for such employees has been ESOPs. A rewarding culture at the company has resulted in most state managers being internally promoted (17 out of 20). Currently over 300 employees have ESOPs.

Exhibit 140: Most managers, being internally promoted and granted ESOPs, set an inspirational example for field-level officers, aiding industry-low attrition rates



Source: Companies, Ambit Capital research

More bang for the buck

Fusion has bucked the industry norm of customer over-leveraging, and focused on increasing customer market share, yielding 3.4% unique customer market share. Improving cost of funds would add to Fusion's existing arsenal of expansive distribution, top quality customer service standards, rural edge and boost its competitive position (FY28E customer market share, 4.4%). Industry developments like cross-bureau linkage, reduction in identity manipulation, 50% FOIR coupled with Fusion's strong risk/audit systems should drive ~2.5% credit costs vs 3.5% long-period average. High-vintage/stable senior management and employee retention will support scalability over the next decade (FY28E AUM market share, 2.1%). As penetration saturates (~90%) by early FY30s, Fusion is likely to emerge as a consolidator. Spinning off MSME foray offers value unlocking optionality play in the future. Current valuation of 9.6x/1.7x FY25E EPS/BV looks inexpensive considering Fusion is the second-largest NBFC-MFI and a potential long-term consolidator in an improved risk environment.

Competitive industry positioning to aid earnings growth

We expect Fusion's MFI customer/AUM market to increase to 4.4%/2.1% by FY28E. This would be aided by distribution expansion/district deepening in the north and south. UP, Fusion's biggest market, still offers plenty of room for growth given 30% BPL population but only 30% MFI penetration. After its listing last year, Fusion's credit spreads should improve, enabling it to offer competitive pricing to customers. Last 10 years' records show that Fusion has not shied away from building distribution. In fact, it is a critical piece of Fusion's customer-led growth strategy rather than depending on increasing customer exposure (which is dangerous!). A performance-driven and rewarding culture has helped retain talent. High-vintage management team will be critical for the next leg of scalability. Over FY23-28E, we expect AUM CAGR of 25% and EPS CAGR of 27% with RoE averaging 20-21%.

Exhibit 141: Over FY23-28E, we expect AUM growth to be driven by new customer acquisition, which in turn will be led by deepening presence in existing districts as well as expanding to new districts. Expect spreads/NIMs to decline as industry penetration increases. Credit costs to be stable

Particulars	FY22	FY23	FY24E	FY25E	FY26E	FY27E	FY28E	Comments
Assumptions								
AUM growth (YoY) (%)	46%	37%	25%	25%	25%	25%	25%	AUM growth will be driven by new customer acquisition and increase in customer exposure.
Customer base growth (YoY) (%)	28%	30%	13%	13%	13%	12%	12%	Customer base growth will be driven by new distribution expansion and deepening in existing markets.
Customer exposure growth (YoY) (%)	12%	4%	9%	10%	10%	10%	11%	Customer exposure growth assumed in line with historical trend.
NIM (%)	11.0%	13.4%	13.7%	13.4%	13.2%	13.0%	12.8%	NIMs will decline as competition increases in an upcycle and spreads normalizes lower.
Opex/income (%)	44%	38%	40%	41%	41%	39%	37%	
Opex/asset ratio (%)	4.8%	5.3%	5.8%	5.9%	5.7%	5.4%	5.1%	Increasing scale will lead to better efficiency.
Credit cost (%)	6.7%	2.7%	2.8%	2.4%	2.3%	2.3%	2.3%	Credit costs to be lower than last 10-year average of 3.5%.
Output (₹ bn)								
AUM	68	93	116	145	181	226	283	
Customer base (#mn)	2.7	3.5	4.0	4.5	5.1	5.7	6.4	
NII	6.3	10.7	14.3	17.5	21.5	26.5	32.7	
Operating profit	3.9	7.1	9.3	11.1	13.8	17.5	22.1	
Net profit	0.2	3.9	5.0	6.2	7.8	10.0	12.7	
EPS (₹)	3	39	50	62	78	99	126	
BVPS (₹)	162	231	281	343	421	520	646	
ROA (%)	0.3%	4.6%	4.8%	4.7%	4.7%	4.8%	4.9%	
RoE (%)	1.7%	21.2%	19.6%	19.9%	20.4%	21.1%	21.6%	

Source: Company, Ambit Capital research

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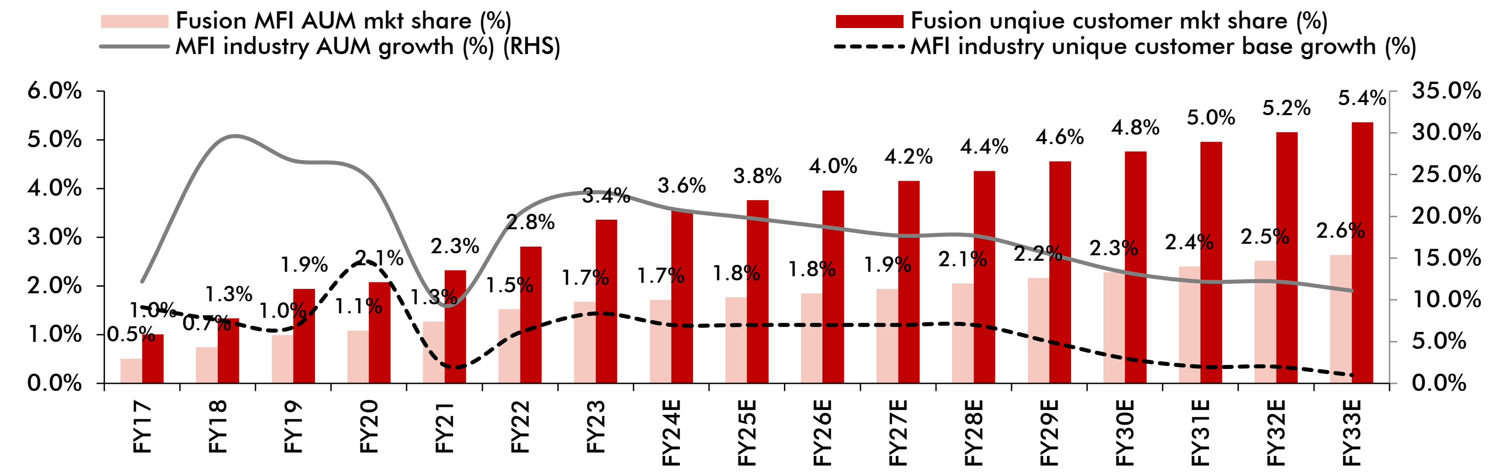
Fusion is a likely consolidator; will aid re-rating

Over FY28-33E, in the backdrop of industry consolidation due to saturating MFI/household penetration, we expect Fusion will be one of the NBFC-MFI consolidators. Key factors that would support Fusion's ability to gain further market share: (i) competitive pricing, (ii) extensive distribution reach, (iii) sound underwriting/risk management and (iv) better customer service quality.

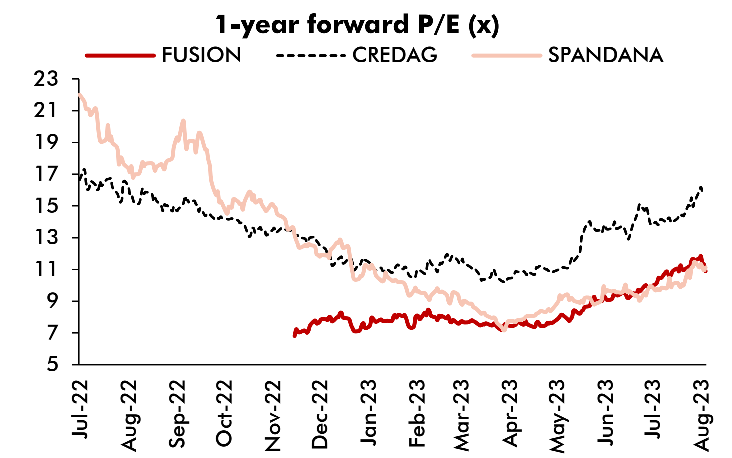
Exhibit 142: Over the next decade, as the industry enters consolidation phase by FY30E, Fusion's increased competitiveness will ensure continued AUM and unique customer market share gains



Source: MFIN, NABARD, Company, Ambit Capital research

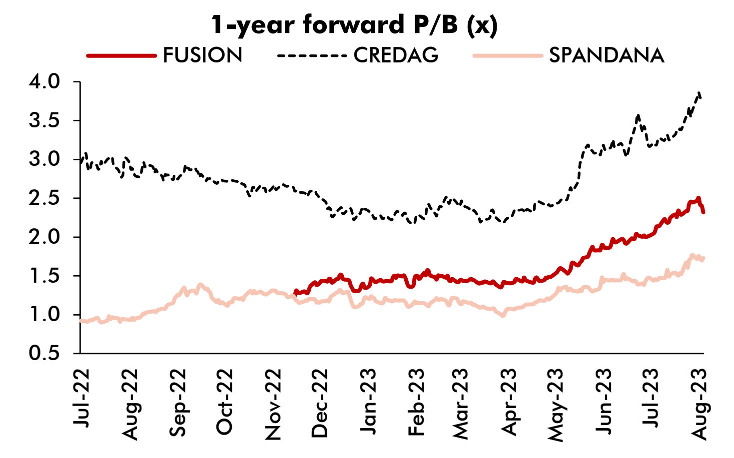
Our fair value-implied upside of 38% is mostly a function of EPS CAGR of 26% (FY23-26E) and ~10% re-rating. We expect re-rating to be driven by Fusion's improving MFI industry competitiveness, visibility of MSME lending scale-up and a likely perception of being a long-term consolidator. Our fair value estimate assumes (i) cost of equity of 14.5%, highest in our NBFC coverage given MFI industry's higher vulnerability to economic shocks and (ii) terminal growth rate of 5%.

Exhibit 143: Taking note of the sector tailwinds, MFI stock valuations improved in the last 6-9 months



Source: Bloomberg, Companies, Ambit Capital research

Exhibit 144: Despite Fusion's improvement competitiveness, it trades at a 35% discount to CREDAG



Source: Bloomberg, Companies, Ambit Capital research

Exhibit 145: Sensitivity of valuations to long-term growth and RoE assumptions

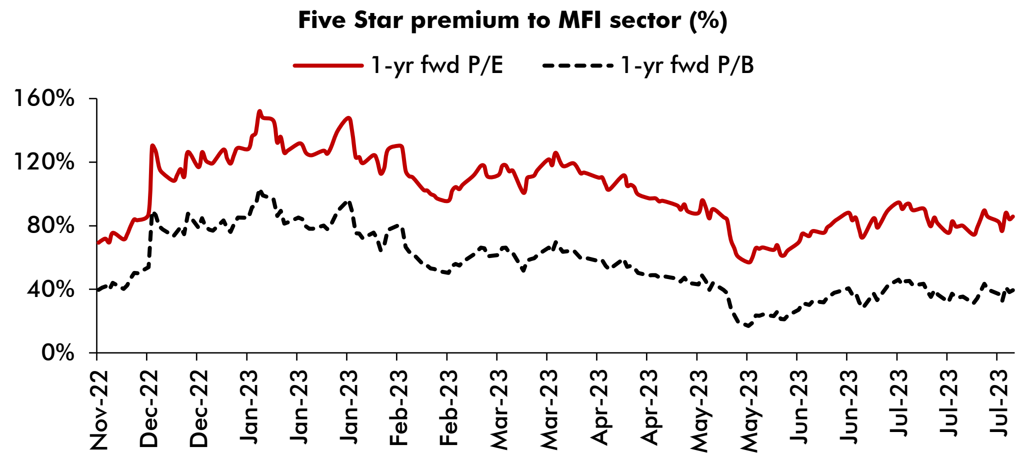
FY26-43E	Bear case	Base case	Bull case	Comments
Average assets growth	15.6%	17.5%	17.7%	In the bear case, we are assuming competitive intensity to be higher. In the bull case, we have assumed that industry consolidation would be faster, thus benefiting Fusion.
Average ROA	4.0%	4.7%	4.9%	Bear case average NIM/credit cost: 12.1%/2.4%, Bull case average NIM/credit cost: 12.4%/2%
Average RoE	15.8%	18.6%	18.4%	
Target price (₹)	**478**	**818**	**860**	
Implied P/E - FY25E	7.7	13.2	13.9	
Implied P/B - FY25E	1.4	2.4	2.5	

Source: Company, Ambit Capital research

Spin-off of MSME lending arm offers optionality play

In an Economic Times article, MD/CEO Devesh Sachdev indicated at scaling up of the MSME business and spinning it off into a separate NBFC entity. Successful scale-up of the MSME business could fetch premium valuations to the MSME-NBFC as indicated by Five Star's valuations being at a 40-90% premium to the MFI sector.

Exhibit 146: Micro-LAP focused lender Five Star's premium to MFI sector is a likely indication of the potential value creation should Fusion decide to spin off its MSME lending into a separate NBFC



Source: Bloomberg, Company, Ambit Capital research

Exhibit 147: Among the larger players, CreditAccess stands out in terms of RoE owing to lower opex and credit costs

Particulars	Fusion MFI				CreditAccess Grameen				Spandana Spoorthy			
	FY20	FY21	FY22	FY23	FY20	FY21	FY22	FY23	FY20	FY21	FY22	FY23
RoE tree (%)												
Net operating income	10.0%	9.9%	10.7%	13.9%	12.3%	11.1%	10.9%	11.9%	20.4%	14.9%	12.0%	12.4%
Opex	5.1%	4.4%	4.8%	5.3%	4.7%	4.2%	4.2%	4.2%	4.1%	3.3%	4.6%	5.6%
Employee cost												
Other opex												
Operating profit	4.9%	5.5%	6.0%	8.6%	7.7%	6.9%	6.6%	7.7%	16.4%	11.6%	7.4%	6.8%
Provisions	2.4%	4.4%	5.6%	2.4%	2.7%	5.6%	3.7%	2.0%	5.0%	8.9%	6.1%	6.6%
PBT	2.5%	1.1%	0.4%	6.1%	5.0%	1.3%	3.0%	5.6%	11.3%	2.8%	1.2%	0.2%
Tax	0.8%	0.3%	0.0%	1.5%	1.4%	0.4%	0.8%	1.4%	4.9%	0.8%	0.3%	0.1%
PAT-ROA	1.8%	0.9%	0.3%	4.6%	3.6%	1.0%	2.2%	4.2%	6.5%	2.0%	0.9%	0.2%
Leverage (x)	4.3	4.1	5.1	4.6	3.6	4.3	4.2	4.3	2.4	2.7	2.7	2.7
RoE	7.6%	3.6%	1.7%	21.2%	13.0%	4.1%	9.1%	18.0%	15.6%	5.4%	2.4%	0.4%
Key business metrics												
AUM (₹ bn)	36	46	68	93	120	136	166	210	68	82	66	85
AUM growth (%)	37%	29%	46%	37%	38%	13%	22%	27%	54%	19%	-19%	29%
Total industry AUM market share (%)	1.1%	1.3%	1.6%	1.7%	3.6%	3.7%	3.8%	3.9%	2.1%	2.2%	1.5%	1.6%
Unique customer base (#mn)	1.9	2.1	2.7	3.5	4.1	3.9	3.8	4.3	2.6	2.5	2.4	2.3
Total industry customer market share (%)	2.1%	2.3%	2.8%	3.4%	4.5%	4.3%	3.9%	4.1%	2.9%	2.7%	2.4%	2.2%
Average customer exposure (₹)	19,428	21,857	24,917	26,349	29,583	34,732	43,407	49,322	26,572	33,294	28,076	37,660
Branch & employee productivity												
AUM per branch (₹ mn)	61	64	73	86	80	82	90	107	49	63	47	61
No. of customers/field officer (#)	490	513	466	531	419	409	355	371	408	365	360	290
Business diversification/concentration												
Top 5 states (% of AUM)*	68%	66%	65%	69%	92%	84%	78%	74%	69%	70%	67%	63%
Share of non-MFI AUM (%)	0%	1%	2%	3%	5%	4%	4%	4%	-	-	-	-
Tier-I capital ratio (%)	33.1%	25.5%	19.9%	26.6%	22.3%	30.5%	25.9%	22.7%	47.3%	39.7%	50.6%	36.9%
Geographical spread												
Top 3 states	Bihar, Uttar Pradesh, Odisha				Karnataka, Maharashtra, Tamil Nadu				Madhya Pradesh, Odisha, Karnataka			
Branches (#)	591	725	934	1,086	1,393	1,424	1,635	1,786	1,010	1,052	1,120	1,227
Districts (#)	285	326	368	398	230	265	319	352	280	289	294	314
Asset quality												
GNPA (%)	1.1%	5.5%	5.7%	3.5%	1.5%	4.4%	3.7%	1.2%	0.4%	5.8%	19.3%	2.1%
Net slippage (%)	1.3%	7.3%	9.0%	3.0%	2.3%	9.3%	10.9%	2.7%	2.9%	15.5%	14.0%	7.2%

*Source: Companies, Ambit Capital research. * Top 3 for CreditAccess Grameen.*

Risks & Catalysts

Risks

High concentration in Bihar: Bihar is a highly penetrated state where Fusion has ~20% AUM exposure. A possible overheating in the state could impact Fusion's asset quality and thus RoE.

Cyclical nature of the industry: MFI industry is known to be cyclical given that the last 8 years saw two economic shocks, resulting in massive impact on sector RoE. Such events are usually unanticipated. Hence, any such event (like demonetization, Covid) could impact Fusion's asset quality and RoE.

Political announcements can impact repayments: In the past, announcement of populist measures (loan waivers) by political parties have impacted MFI repayment behavior significantly. Though awareness about the nuances of such political schemes have increased among MFI borrower, repayment rates still remain vulnerable to such events.

A capital cycle like FY15-19 can impact asset quality: In the past, the MFI industry witnessed a cycle of excess capital supply, which led to unhealthy lending practices, ultimately leading to high NPAs in subsequent years.

Overestimating customer income can lead to aggressive underwriting: Income assessment is highly subjective in the MFI business as the customer lacks any formal income proof. Overestimating income/loan serviceability could impact asset quality.

Catalysts

Expanding distribution/deepening district presence: Addition of 30 districts coupled with deepening presence in existing districts will aid customer base CAGR of 13% (FY23-25E). Geographically, growth opportunity lies in the north (increasing MFI penetration) and south (market share gain potential).

Stable spreads and credit cost to aid earnings: Continued demonstration of healthy asset quality, strong internal accruals (RoE at 20%) and high capitalization (tier1, 26.6%) warrants reduction in credit spreads. We expect stable spreads of 11.2-11.5% over FY24-25E along with competitive pricing. We expect credit cost of 2.5% given no major concerns on asset quality.

Exhibit 148: Explanation of our flags on the coverage page

Segment	Score	Comments
Accounting	GREEN	We do not find anything unusual in the company's accounting policies and believe reported numbers are a true reflection of performance.
Predictability	AMBER	Historically, MFIs' earnings predictability has been low due to asset quality issues. In FY23, earnings for Fusion as well as the whole sector recovered from Covid lows. With improving underwriting, predictability is likely to improve.
Earnings momentum	AMBER	There is not enough coverage on the stock and, hence, lack of consensus earnings.

Source: Company, Ambit Capital research

Financials – Standalone

Income statement

Particulars (₹ mn)	FY22	FY23	FY24E	FY25E	FY26E
Net interest income	**6,305**	**10,738**	**14,321**	**17,521**	**21,547**
Non-interest Income	748	834	1,055	1,322	1,656
Total Income	**7,054**	**11,572**	**15,375**	**18,843**	**23,203**
Total opex	**3,123**	**4,448**	**6,094**	**7,778**	**9,418**
Pre provision profit	**3,931**	**7,124**	**9,281**	**11,064**	**13,785**
Provisions	3,687	2,004	2,605	2,786	3,428
Profit before tax	**244**	**5,120**	**6,676**	**8,278**	**10,357**
Tax	27	1,248	1,636	2,028	2,537
PAT - Standalone	**218**	**3,871**	**5,041**	**6,250**	**7,819**

Source: Ambit Capital research, Company

Balance sheet

Particulars (₹ mn)	FY22	FY23	FY24E	FY25E	FY26E
Net worth	13,380	23,219	28,263	34,513	42,332
Borrowings	57,758	67,784	85,408	108,041	136,132
Total liabilities	**72,905**	**93,635**	**117,316**	**147,027**	**184,177**
Loans	59,182	80,416	100,601	125,937	157,642
Cash & investments	11,536	10,650	13,238	16,746	21,100
Other assets	2,187	2,570	3,477	4,343	5,434
Total assets	**72,905**	**93,635**	**117,316**	**147,027**	**184,177**

Source: Ambit Capital research, Company

Key Ratios

Particulars	FY22	FY23	FY24E	FY25E	FY26E
AUM growth (%)	46.3	37.0	24.7	24.9	25.1
EPS growth (%)	-50	1368	30	24	25
Net interest margin (NIM) (%)	11.0	13.4	13.7	13.4	13.2
Cost to income (%)	44.3	38.4	39.6	41.3	40.6
Opex (% of assets)	4.8	5.3	5.8	5.9	5.7
Gross NPAs (%)	5.7	3.5	2.9	2.6	2.6
Credit costs (% of loans)	6.7	2.7	2.8	2.4	2.3
Total ECL coverage (%)	5.7	3.7	3.6	3.3	3.3
Leverage (x)	5.1	4.6	4.1	4.2	4.3

Source: Ambit Capital research, Company

Valuation

Particulars	FY22	FY23	FY24E	FY25E	FY26E
BVPS (₹)	162	231	281	343	421
EPS (₹)	2.6	38.6	50.1	62.1	77.7
ROA (%)	0.3	4.6	4.8	4.7	4.7
RoE (%)	1.7	21.2	19.6	19.9	20.4
P/E	227.1	15.5	11.9	9.6	7.7
P/BV	3.7	2.6	2.1	1.7	1.4

Source: Ambit Capital research, Company

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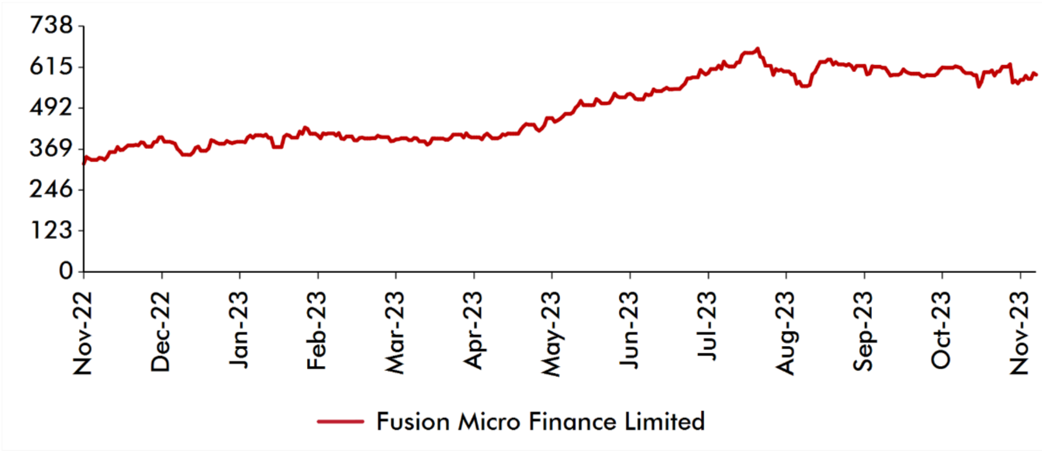

Source: ICE, Ambit Capital research

Explanation of Investment Rating - Our target prices are with a 12-month perspective. Returns stated are our internal benchmark

Investment Rating	Expected return (over 12-month)
BUY	We expect this stock to deliver more than 10% returns over the next12 month
SELL	We expect this stock to deliver less than or equal to 10 % returns over the next 12 months
UNDER REVIEW	We have coverage on the stock but we have suspended our estimates, TP and recommendation for the time being NOT
NOT RATED	We do not have any forward-looking estimates, valuation, or recommendation for the stock.

Note: At certain times the Rating may not be in sync with the description above as the stock prices can be volatile and analysts can take time to react to development.

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