

Fusion Micro Finance | BUY

In-line quarter; collection efficiency improvement key monitorable

Fusion reported profits of INR 1.26bn (+4.3% QoQ, +32.2% YoY), in-line with our estimates. However, AUM growth was a tad soft (24.6% YoY, 7.5% QoQ) and credit cost remained relatively high (at 3.4% vs 3.6% QoQ). Continued NIM expansion to 11.12% (+23bps QoQ) led by moderation in marginal cost of borrowings aided the earnings performance for the quarter. AUM stood at INR 100.3bn on the back of softer disbursement trends (+14.2% YoY, +2.6% QoQ) impacted by unseasonal rains and floods. MFI AUM grew slower (+22.6% YoY, +2.8% QoQ) whereas MSME AUM grew rapidly (+104.7% YoY, +15.7% QoQ). Credit costs were elevated driven by high write-offs of INR 1.03bn and increase in management overlay by INR 102.3mn. Of the write-offs, ~30% emanated from the pre-Apr'21 portfolio while balance has come through the post-Apr'21 portfolio. Lower collection efficiency in some of the states (highlighted in 1QFY24) such as Punjab, Rajasthan, etc is driving stress inflow for Fusion and mgmt. intends to recalibrate its collection strategy to drive better collection efficiency over the next couple of quarters. Mgmt. remains confident of restricting credit costs for FY24 at ~3% (after avg credit costs ~3.5% for 1HFY24). We build credit costs of 270bps (% of AUM) over FY24/FY25 (with 3% in FY24). Fusion's sticky credit costs will be a key monitorable over the next couple of quarters given that some of the similar sized peers have reported better collection efficiencies (though mgmt. had highlighted credit costs should trend meaningfully lower in 2HFY24 in 4QFY24 itself). We expect growth to accelerate given seasonally stronger second half and continued momentum on customer addition. We maintain BUY with a target price of target price of INR 700 (values Fusion at 2.1x FY25e P/BV).

- **Soft AUM growth:** In 2Q24, AUM stood at INR 100.3bn (+24.6% YoY, +3.2% QoQ) on the back of softer disbursement trends (+14.2% YoY, +2.6% QoQ) impacted by unseasonal rains and floods. Active borrower's stands at 3.69mn with 0.16mn added in first half of the year. While Fusion has seen moderation in AUM growth in first half of the year, mgmt. expects growth to be backended with traction observed in Sep and Oct having an average disbursement of ~INR 8.5bn. We build AUM CAGR of 29% over FY24-25E. Fusion's overall unique customers stand at 31% (vs 34% as of Mar'23) and healthy trends are observed in the top 5 states hinting not much has changed on competition intensity front. Fusion reported an inline quarter with PAT at INR 1.26bn (+4.3% QoQ, 32.2% YoY) aided by controlled opex (cost to income at 36.4% flat QoQ) and slight moderation in credit costs (3.4% vs 3.6% QoQ). NIMs expanded by 23bps to 11.12% on account of increased proportion of higher yielding funds (+20bps) and improvement in marginal cost of borrowing (-10bps). We build EPS CAGR growth of 33% over FY24-25E.
- **Write-offs remain elevated due to change in policy:** GNPA/NNPA improved 52bps/13bps QoQ to 2.68%/0.65%, credit costs (to AUM) stood at 3.4% (-20bps QoQ) driven by high write-offs of INR 1.03bn and increase in management overlay by INR 102.3mn. Mgmt. cited that write-offs remained high on account of change in its policy from 360 to 270 days since 1Q24 and is expected to normalise by 4Q24. Of the write-offs, ~30% emanated from the pre-Apr'21 portfolio while balance has come through the post-Apr'21



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Recommendation and Price Target

Current Reco.	BUY
Previous Reco.	BUY
Current Price Target (12M)	700
Upside/(Downside)	23.0%
Previous Price Target	720
Change	-2.8%

Key Data – FUSION IN

Current Market Price	INR569
Market cap (bn)	INR57.5/US\$0.7
Free Float	45%
Shares in issue (mn)	100.3
Diluted share (mn)	
3-mon avg daily val (mn)	INR153.5/US\$1.8
52-week range	691/321
Sensex/Nifty	64,942/19,407
INR/US\$	83.3

Price Performance

%	1M	6M	12M
Absolute	-3.7	28.6	0.0
Relative*	-2.1	20.9	0.0

* To the BSE Sensex

Financial Summary

	(INR mn)				
Y/E March	FY21A	FY22A	FY23E	FY24E	FY25E
Net Profit	439	218	3,871	4,900	6,895
Net Profit (YoY) (%)	-36.9%	-50.5%	1,679.6%	26.6%	40.7%
Assets (YoY) (%)	37.7%	24.9%	28.4%	25.3%	26.2%
ROA (%)	0.9%	0.3%	4.6%	4.6%	5.2%
ROE (%)	3.6%	1.7%	21.2%	19.4%	22.7%
EPS	5.6	2.6	38.6	48.8	68.7
EPS (YoY) (%)	-36.9%	-52.7%	1,367.7%	26.6%	40.7%
P/E (x)	102.3	216.5	14.7	11.7	8.3
BV	158	162	231	273	331
BV (YoY) (%)	3.8%	2.5%	43.1%	17.9%	21.4%
P/BV (x)	3.61	3.52	2.46	2.09	1.72

Source: Company data, JM Financial. Note: Valuations as of 07/Nov/2023

JM Financial Institutional Securities Limited

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Bloomberg - JMFR <GO>,
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portfolio. Collection efficiency stood at 97.6% (+3bps QoQ) impacted by floods and unseasonal rains. Lower collection efficiency in some of the states (highlighted in 1QFY24) such as Punjab, Rajasthan, etc. is driving stress inflow for Fusion and mgmt. intends to recalibrate its collection strategy to drive better collection efficiency over the next couple of quarters. Coverage ratio stands at 73% and is expected to increase going forward. Mgmt. expects credit costs to normalise by 4Q24 to ~3%. We expect avg. credit costs of 270bps over FY24-25E.

- **Valuation and view:** Fusion is currently trading at 1.7x FY25E BVPS and we expect the stock to deliver superior return metrics of 4.7%/23.4% RoA/RoE for FY25E. Although, Fusion's sticky credit costs will be a key monitorable over the next couple of quarters given that some of the similar sized peers have reported better collection efficiencies (though mgmt. had highlighted credit costs should trend meaningfully lower in 2HFY24 in 4QFY24 itself). We expect growth to accelerate given seasonally stronger second half and continued momentum on customer addition. We maintain BUY with a target price of INR 700 (values Fusion at 2.1x FY25e P/BV).

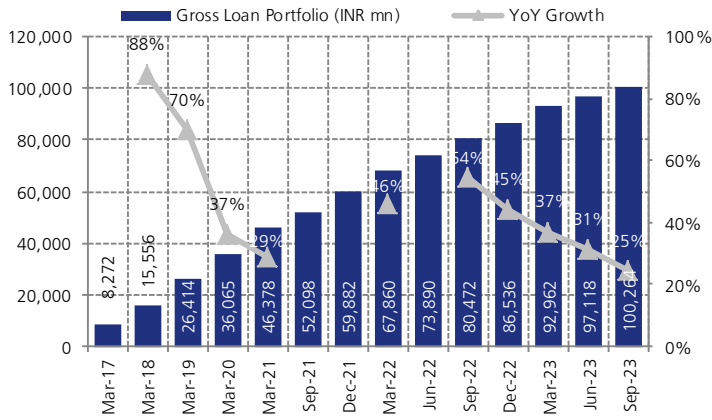
Fusion 2Q24 trends

Exhibit 1. Fusion 2Q24 : Results summary

Earnings Table (INR mn)	2Q'23	1Q'24	2Q'24	YoY (%)	QoQ (%)
Interest Income	4,307	5,042	5,263	22.2%	4.4%
Interest Expenses	1,573	1,835	1,910	21.4%	4.1%
Net interest income	2,733	3,207	3,353	22.7%	4.6%
Non-Interest Income	217	486	449	107.6%	-7.5%
Total Income	2,950	3,693	3,803	28.9%	3.0%
Employees Cost	797	978	993	24.6%	1.5%
Other Expenditure	280	361	392	39.8%	8.6%
Total Operating Expenses	1,077	1,339	1,385	28.5%	3.4%
Operating Profit (PPP)	1,873	2,354	2,418	29.1%	2.7%
Provisions & Write Offs	612	759	762	24.5%	0.4%
PBT	1,261	1,595	1,656	31.3%	3.8%
Tax	310	390	399	28.6%	2.3%
Reported Profit	951	1,205	1,257	32.2%	4.3%
Balance Sheet Data (INR bn)					
Assets Under Management	80.5	97.1	100.3	24.6%	3.2%
Disbursements	20.5	22.8	23.4	14.2%	2.6%
Ratios Analysis (%)					
Cost to Income (%)	36.5%	36.3%	36.4%	-0.11%	0.15%
Effective Tax Rate (%)	25%	24%	24%	-1%	0%
Asset Quality					
Gross NPA (%)	3.83%	3.20%	2.68%	-1.15%	-0.52%
Net NPA (%)	1.12%	0.78%	0.65%	-0.47%	-0.13%
Coverage (%)	67.8%	72.8%	73.0%	5.1%	0.1%
Capital Adequacy (%)					
CAR (%)	20.97%	28.26%	28.78%	7.81%	0.52%
Du-pont Analysis (%)					
NII / Assets (%)	13.75%	13.29%	13.17%	-0.58%	-0.12%
Non-Interest Inc. / Assets (%)	1.09%	2.01%	1.76%	0.68%	-0.25%
Operating Cost / Assets (%)	5.42%	5.55%	5.44%	0.02%	-0.11%
Operating Profits / Assets (%)	9.42%	9.76%	9.50%	0.08%	-0.26%
Provisions / Assets (%)	3.08%	3.15%	2.99%	-0.08%	-0.15%
PBT / Assets (%)	6.34%	6.61%	6.50%	0.16%	-0.11%
ROA (%)	4.78%	4.99%	4.94%	0.16%	-0.06%
Du-pont Analysis (%) - AUM					
NII / AUM (%)	14.17%	13.50%	13.59%	-0.58%	0.09%
Other income / AUM (%)	1.12%	2.05%	1.82%	0.70%	-0.22%
Cost to AUM (%)	5.58%	5.64%	5.61%	0.03%	-0.02%
PPP / AUM (%)	9.70%	9.91%	9.80%	0.09%	-0.11%
Provisions / AUM (%)	3.17%	3.20%	3.09%	-0.08%	-0.11%
PBT / AUM (%)	6.53%	6.71%	6.71%	0.18%	0.00%
ROAUM (%)	4.93%	5.07%	5.09%	0.17%	0.02%

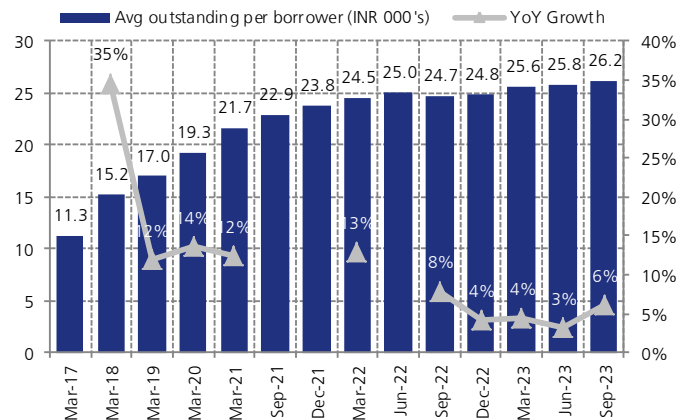
Source: Company, JM Financial

Exhibit 2. Fusion: Trends in Gross Loan Portfolio



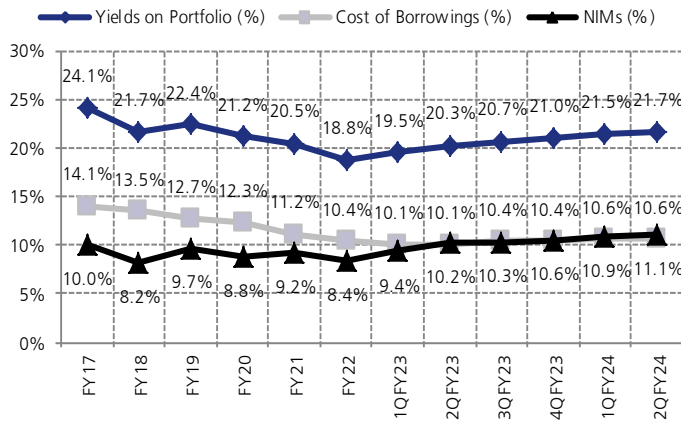
Source: Company, JM Financial

Exhibit 3. Fusion: Trends in avg. outstanding per borrower



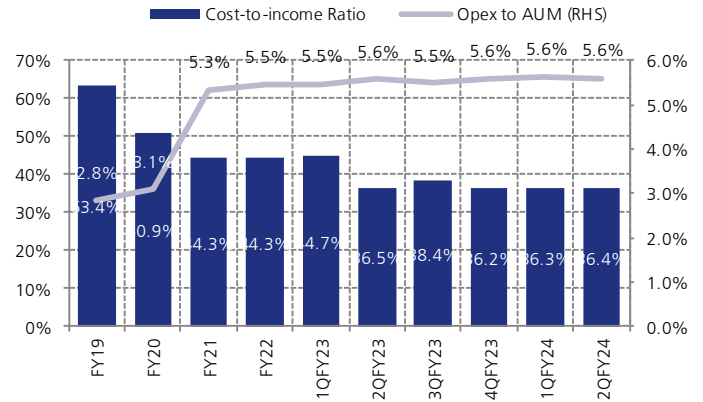
Source: Company, JM Financial

Exhibit 4. Fusion: Trends in yields, cost of borrowing and NIMs



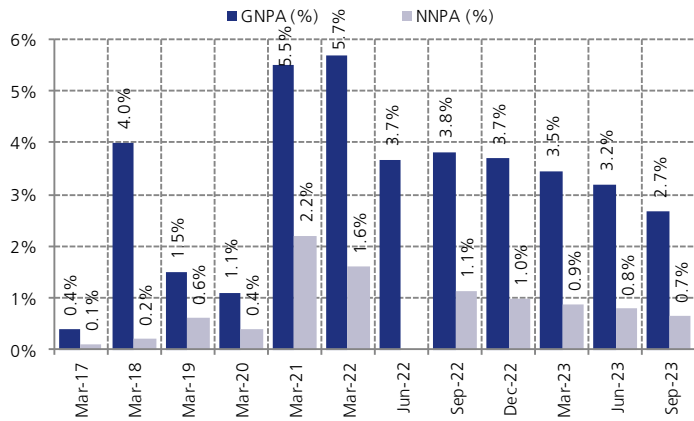
Source: Company, JM Financial

Exhibit 5. Fusion: Trends in Cost/Income and Opex/GLP



Source: Company, JM Financial

Exhibit 6. Fusion: Trends in GNPA and NNPA



Source: Company, JM Financial

Financial Tables (Standalone)

Income Statement					
	(INR mn)				
Y/E March	FY21A	FY22A	FY23E	FY24E	FY25E
Net Interest Income (NII)	4,632	6,292	10,542	14,380	18,558
Non Interest Income	347	762	1,030	1,236	1,510
Total Income	4,980	7,054	11,572	15,616	20,068
Operating Expenses	2,204	3,123	4,448	5,899	7,524
Pre-provisioning Profits	2,776	3,931	7,124	9,717	12,544
Loan-Loss Provisions	2,208	3,687	2,004	2,540	2,845
Others Provisions	0	0	0	600	443
Total Provisions	2,208	3,687	2,004	3,140	3,288
PBT	568	244	5,120	6,577	9,256
Tax	128	27	1,248	1,677	2,360
PAT (Pre-Extra ordinaries)	439	218	3,871	4,900	6,895
Extra ordinaries (Net of Tax)	0	0	0	0	0
Reported Profits	439	218	3,871	4,900	6,895
Dividend	0	0	0	735	1,034
Retained Profits	439	218	3,871	4,165	5,861

Source: Company, JM Financial

Balance Sheet					
	(INR mn)				
Y/E March	FY21A	FY22A	FY23E	FY24E	FY25E
Equity Capital	790	828	1,003	1,003	1,003
Reserves & Surplus	11,673	12,552	22,216	26,381	32,242
Stock option outstanding	0	0	0	0	0
Borrowed Funds	44,323	57,758	67,784	86,764	111,057
Deferred tax liabilities	0	0	0	0	0
Preference Shares	0	0	0	0	0
Current Liabilities & Provisions	1,593	1,767	2,632	3,159	3,790
Total Liabilities	58,379	72,905	93,635	117,306	148,093
Net Advances	43,607	59,182	80,416	103,036	132,554
Investments	0	0	0	0	0
Cash & Bank Balances	13,353	11,536	10,650	10,304	13,255
Loans and Advances	0	0	0	0	0
Other Current Assets	471	1,127	1,580	2,750	777
Fixed Assets	183	192	212	242	276
Miscellaneous Expenditure	0	0	0	0	0
Deferred Tax Assets	765	868	778	974	1,230
Total Assets	58,379	72,905	93,635	117,306	148,093

Source: Company, JM Financial

Key Ratios					
Y/E March	FY21A	FY22A	FY23E	FY24E	FY25E
Growth (YoY) (%)					
Borrowed funds	49.0%	30.3%	17.4%	28.0%	28.0%
Advances	30.4%	35.7%	35.9%	28.1%	28.6%
Total Assets	37.7%	24.9%	28.4%	25.3%	26.2%
NII	30.1%	35.8%	67.6%	36.4%	29.1%
Non-interest Income	-5.3%	119.4%	35.1%	20.0%	22.1%
Operating Expenses	10.2%	41.7%	42.5%	32.6%	27.5%
Operating Profits	44.0%	41.6%	81.2%	36.4%	29.1%
Core Operating profit	55.0%	39.5%	85.1%	37.5%	29.6%
Provisions	138.2%	67.0%	-45.7%	56.7%	4.7%
Reported PAT	-36.9%	-50.5%	1,679.6%	26.6%	40.7%
Yields / Margins (%)					
Interest Spread	9.68%	9.85%	10.74%	10.87%	10.85%
NIM	9.40%	9.86%	13.03%	14.07%	14.32%
Profitability (%)					
ROA	0.87%	0.33%	4.65%	4.65%	5.20%
ROE	3.6%	1.7%	21.2%	19.4%	22.7%
Cost to Income	44.3%	44.3%	38.4%	37.8%	37.5%
Asset quality (%)					
Gross NPA	5.67%	5.81%	3.50%	3.10%	2.72%
LLP	5.73%	7.17%	2.87%	3.42%	2.79%
Capital Adequacy (%)					
Tier I	25.52%	19.93%	26.59%	25.20%	24.40%
CAR	27.26%	21.94%	27.94%	26.28%	25.25%

Source: Company, JM Financial

Dupont Analysis					
Y/E March	FY21A	FY22A	FY23E	FY24E	FY25E
NII / Assets	9.19%	9.58%	12.66%	13.63%	13.98%
Other Income / Assets	0.69%	1.16%	1.24%	1.17%	1.14%
Total Income / Assets	9.88%	10.75%	13.90%	14.81%	15.12%
Cost / Assets	4.37%	4.76%	5.34%	5.59%	5.67%
PPP / Assets	5.51%	5.99%	8.55%	9.21%	9.45%
Provisions / Assets	4.38%	5.62%	2.41%	2.98%	2.48%
PBT / Assets	1.13%	0.37%	6.15%	6.24%	6.97%
Tax rate	22.6%	10.9%	24.4%	25.5%	25.5%
ROA	0.87%	0.33%	4.65%	4.65%	5.20%
Leverage	4.7	5.4	4.0	4.3	4.5
ROE	3.6%	1.7%	21.2%	19.4%	22.7%

Source: Company, JM Financial

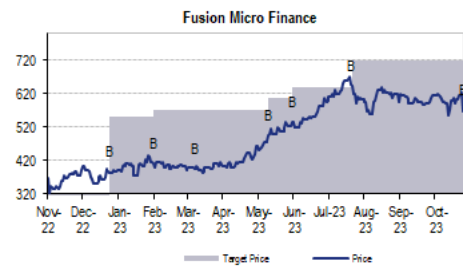
Valuations					
Y/E March	FY21A	FY22A	FY23E	FY24E	FY25E
Shares in Issue	79.0	82.8	100.3	100.3	100.3
EPS (INR)	5.6	2.6	38.6	48.8	68.7
EPS (YoY) (%)	-36.9%	-52.7%	1,367.7%	26.6%	40.7%
P/E (x)	102.3	216.5	14.7	11.7	8.3
BV (INR)	158	162	231	273	331
BV (YoY) (%)	3.8%	2.5%	43.1%	17.9%	21.4%
P/BV (x)	3.61	3.52	2.46	2.09	1.72
DPS (INR)	0.0	0.0	0.0	7.3	10.3
Div. yield (%)	0.0%	0.0%	0.0%	1.3%	1.8%

Source: Company, JM Financial

History of Recommendation and Target Price

Date	Recommendation	Target Price	% Chg.
6-Jan-23	Buy	550	
13-Feb-23	Buy	570	3.6
21-Mar-23	Buy	570	0.0
23-May-23	Buy	605	6.1
13-Jun-23	Buy	640	5.8
3-Aug-23	Buy	720	12.5
7-Nov-23	Buy	720	0.0

Recommendation History



APPENDIX I

JM Financial Institutional Securities Limited

Corporate Identity Number: U67100MH2017PLC296081

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Rating	Meaning
Buy	Total expected returns of more than 10% for stocks with market capitalisation in excess of INR 200 billion and REITs* and more than 15% for all other stocks, over the next twelve months. Total expected return includes dividend yields.
Hold	Price expected to move in the range of 10% downside to 10% upside from the current market price for stocks with market capitalisation in excess of INR 200 billion and REITs* and in the range of 10% downside to 15% upside from the current market price for all other stocks, over the next twelve months.
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* REITs refers to Real Estate Investment Trusts.

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