

## Eminent leader with huge scope of untapped opportunity

**About the stock:** CreditAccess Grameen (CAG) is a Bengaluru based MFI promoted by Credit Access India BV (CAI), with ~73% stake as of December 2022. It caters to low income households lacking access to formal source of financing.

- CAG's gross loan portfolio (GLP) was at ₹ 17786 crore, of which ~96% is given as income generation small ticket size loans
- Operations are spread across 14 states and one UT with 1,727 branches and 16,807 employees with a major presence in Karnataka (contributes ~35% of AUM), Maharashtra (~21%) and Tamil Nadu (~21%)

### Key triggers for future price performance:

- We expect industry AUM to grow at a healthy pace led by 1) substantial untapped opportunity, 2) favourable regulatory changes, 3) new borrowers accretion with geographical expansion and 4) increase in ticket size
- Entry in new geography is to aid customer acquisition & improve granularity, while product flexibility to enable better customer retention at 80-90%
- Increased threshold of household income is seen aiding both retention of existing customers and improved pace of new client acquisition
- CAG's entry in asset backed loan segment to aid business growth. Share of non-micro book to increase to ~10% in next four to five years. Expect overall AUM to grow at 20-25% CAGR in FY23-25E
- Relatively lower yields (at ~20% vs. ~22-25% for peers) & removal of interest cap to improve NIMs ahead (management guidance at ~12%)
- Steady opex/asset at ~5% and decline in credit cost to propel earnings trajectory at 52% CAGR in FY22-25E, thereby leading to improvement in RoA ahead of 4% and RoE at ~20%, thus aiding premium valuation

**What should investors do?** Niche player with sustained market leadership and consistent performance across cycles gives confidence on robust business model. We believe CAG is well positioned to capture huge untapped opportunity in MFI space via deeper penetration in new, existing geographies and increase in customer base. Anticipated healthy earnings growth at 52% CAGR in FY22-25E and RoA at ~4% are expected to drive valuations.

- We initiate coverage on the stock with a **BUY** recommendation

**Target Price & Valuation:** We value CAG at ~2.5x FY25E ABV to arrive at a target price of ₹ 1100 per share.

**Alternate Stock Idea:** Apart from CAG, we like IndusInd Bank in our coverage space.

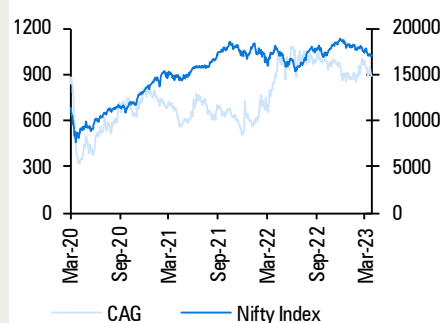
- IndusInd Bank is one of the largest private banks with a pan India presence of 2384 branches as of December 2022
- BUY with a target price of ₹ 1450



### Particulars

Particulars	Amount
Market Capitalisation	₹ 14295 crore
52 week H/L	1154 / 830
Net Worth	4,598
Face value	₹ 10
DII holding (%)	12.5
FII holding (%)	9.6

### Share price performance



### Shareholding Pattern

(in %)	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22
Promoter	73.9	73.9	73.8	73.7	73.7
FII	8.8	8.2	8.7	9.3	9.6
DII	10.0	10.9	10.8	12.7	12.5
Others	7.2	7.0	6.8	4.3	4.2

### Key risks

- Geographic concentration & rising competitive intensity
- Assessment of borrowings from informal sources remains a grey area

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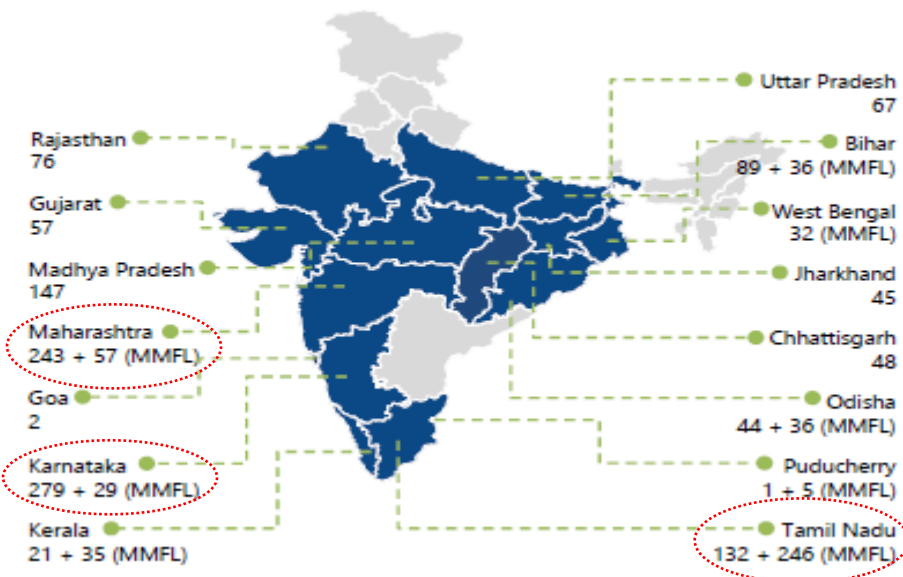
### Key Financial Summary

₹ crore	FY19	FY20	FY21	FY22	3 Year CAGR (FY19-FY22)	FY23E	FY24E	FY25E	3 Year CAGR (FY22-25E)
NII	802	1,055	1,361	1,583	25%	1,915	2,397	2,953	23%
PPP	573	699	952	1,078	23%	1,342	1,725	2,164	26%
PAT	322	335	131	357	4%	705	970	1,250	52%
ABV (₹)	164.8	189.9	237.3	255.2		300.4	362.7	442.9	
P/E	40.2	38.6	106.6	39.3		19.9	14.5	11.2	
P/ABV	5.5	4.7	3.8	3.5		3.0	2.5	2.0	
RoE (%)	16.9	13.2	4.1	9.3		16.3	18.8	19.9	
RoA (%)	5.2	3.4	1.0	2.2		3.6	4.1	4.3	

## Company Background

CreditAccess Grameen (CAG) is a Bengaluru (Karnataka) based micro finance institution (MFI) promoted by Credit Access India BV (CAI). Parent CAI, Netherlands headquartered, specialises in financing micro, small enterprises and currently holds ~73% stake in CAG. In FY20, CAG acquired Tamil Nadu based Madura Micro Finance (MMFL) (~76% stake as of December 2022). The operations of CAG are spread across 14 states and one union territory (UT) with 1,727 branches and 16,807 employees as of December 2022. CAG has a major presence in Karnataka (contributes ~35% of book), Maharashtra (~21%), Tamil Nadu (~21%), which together contributes ~77% of gross loan portfolio (GLP) followed by Madhya Pradesh (~7% share).

Exhibit 1: Major presence in Tamil Nadu, Maharashtra, Karnataka (December 2022)



Source: Company, ICICI Direct Research

CAG primarily offers income generation loans (96% of GLP including MMFL), family welfare loans (0.3% of GLP), home improvement (3% of GLP) and retail finance (0.6% of GLP). All loans offered are through Joint Liability Group (JLG) mechanism where self-chosen group of 5 to 10 members is formed and each member is liable for repayment of group members.

Exhibit 2: Product classification

Loan Type	Products	Purpose	Ticket Size (₹)	Tenure (Months)
Group	Income Generation Loan (IGL)	Business Investments and Income Enhancement activities	5,000 - 1,00,000	12 - 36
Group	Home Improvement Loan	Water Connections, Sanitation and Home Improvement & Extensions	5,000 - 50,000	12 - 36
Group	Family Welfare Loan	Festival, Medical, Education and Livelihood Improvement	upto 20,000	3- 12
Group	Emergency Loan	Emergencies	1000	3
Retail Finance	Retail Finance Loan	Purchase of inventory, machine, assets or for making capital investment in business or business expansion	upto 20,00,000	6-180

Source: Company, ICICI Direct Research

CAG has delivered a resilient performance over the past few years despite pandemic related disruptions. GLP grew at a CAGR of ~29% and PAT at ~14% over FY18-22. For FY22, RoA and RoE were at 2.2% and 9.3%, respectively. GNPA was <2% in the past years excluding FY21 & FY22 in which GNPA increased to 4.38% and 3.61%, respectively. However, it has improved to 1.71% as of December 2022.

### Top Shareholders

As of Mar'23	Holdings (%)
CreditAccess India B.V	73.7
Nippon Life India AMC	3.9
T. Rowe Price Group	1.3
Government Pension Fund Global	1.2
Norges Bank	1.1
Vanguard Group	1.0
TATA AIA Life Insurance Co.	1.0
PGIM India AMC	0.9
UTI AMC	0.9
SBI Fund Management	0.8

Source: Bloomberg

Exhibit 3: Product Mix based on Gross Loan Portfolio

Product Mix - GLP	Q3FY22		Q4FY22		Q1FY23		Q2FY23		Q3FY23	
	₹ crore	% of GLP	₹ crore	% of GLP	₹ crore	% of GLP	₹ crore	% of GLP	₹ crore	% of GLP
IGL (Incl. MMFL)	13,894	95.2%	15,949	96.1%	14,937	95.7%	15,801	95.5%	17,054	95.9%
Family Welfare	59	0.4%	38	0.2%	121	0.8%	185	1.1%	125	0.7%
Home Improvement	371	2.5%	414	2.5%	408	2.6%	429	2.6%	486	2.7%
Emergency	1	0.0%	3	0.0%	4	0.0%	7	0.0%	9	0.1%
Retail Finance	263	1.8%	196	1.2%	145	0.9%	117	0.7%	113	0.6%
<b>Total</b>	<b>14,588</b>		<b>16,600</b>		<b>15,615</b>		<b>16,539</b>		<b>17,787</b>	

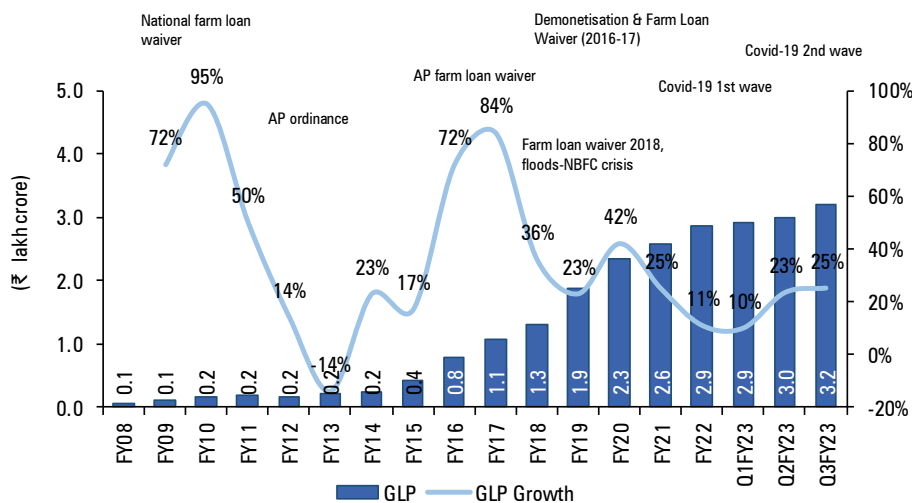
Source: Company, ICICI Direct Research

## Industry Overview

MFI sector has witnessed various headwinds since FY10 (refer Exhibit 4) and overcome substantially growing at ~16x over FY10 to FY22 in terms of gross loan portfolio. Recently, NBFC-MFIs witnessed hiccups due to pandemic as collections were impacted and increased risk aversion of lenders. However, gradually situation improved for most of the players. The MFI sector rebounded registering growth of ~10% in GLP in FY22 and further at ~25% in 9MFY23. Expect industry AUM to grow at a healthy pace led by;

- 1) substantial untapped opportunity,
- 2) favourable regulatory changes,
- 3) tapping of new borrowers with geographical expansion and
- 4) increase in ticket size.

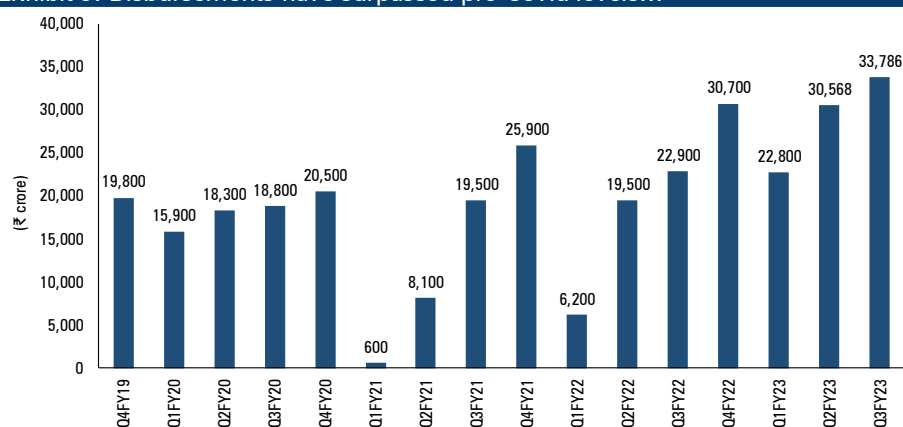
Exhibit 4: Despite various setbacks MFI Industry stood resilient...



Source: CRISIL, MFN, ICICI Direct Research

Disbursements growth was moderated significantly during the pandemic partly attributed to lower collections and MFIs focus on preserving liquidity. Subsequently, with a recovery in economic activities collections started to improve, and disbursements registered a growth of 141%, 17% and 19% YoY in Q2FY22, Q3FY22 and Q4FY22 respectively.

Exhibit 5: Disbursements have surpassed pre-Covid levels...



Source: CRISIL, MFIN, ICICI Direct Research

### Favourable regulatory changes

Exhibit 6: Regulatory revision favours industry growth

Area of Regulation	Old Regulation	New Regulation
Loan pricing	Margin cap at 10% for large MFIs (loan portfolios > ₹1 billion); 12% for small MFIs (loan portfolios < ₹1 billion)	No pricing cap. Based on risk based analysis, risk premium to be charged to the borrower for loan underwriting. Board-approved policy for pricing of loans to be put in place including interest rate model
Processing fees	Not more than 1% of gross loan amount	
Qualifying criteria	85% loans unsecured	The minimum requirement for MFI loans for NBFC-MFIs revised to 75% of total assets. Maximum limit for NBFCs (excluding NBFC-MFIs) changed to 25% of total assets
Household income	Rural areas: ₹125,000 per annum Urban areas: ₹200,000 per annum	Annual household income: up to ₹3,00,000 in urban and rural areas (Higher than the limits mentioned in the consultation paper released in June 2021 – up to ₹1,25,000 for rural areas and ₹2,00,000 for urban and semi-urban areas)  Board-approved policy for assessment of household income
Ticket size of loans	₹75,000 in the first cycle and ₹125,000 in the subsequent cycles	
Tenure of loans	Not to be less than 24 months for loan amount in excess of Rs. 30,000	
Lending to the same borrower	Not more than 2 lenders allowed per borrower	Maximum loan repayment limit of a household towards all loans: 50% of monthly household income
Overall borrower indebtedness	Should not exceed ₹125,000	

Source: RBI, CRISIL, MFIN, ICICI Direct Research

### Substantial untapped opportunity

The total microfinance portfolio was at ₹ 3.2 lakh crore as of December 2022 catering to ~6.4 crore borrowers via 12.6 crore loan accounts. Disbursements were at ₹ 77,877 crore with average ticket size of ~ ₹ 41000. In Q3FY19-Q3FY23, total portfolio grew at 18-20% CAGR. If compared to other retail loans like credit cards, housing and auto loans, MFI loans have grown at a CAGR of 29% over FY15-22. In contrast, credit cards have grown at a CAGR of 25% followed by housing at 14% and auto loan at 7% during the same period. With an increase in eligibility criteria of annual income of households, the customer base is likely to increase substantially.

Despite healthy growth in micro finance AUM in previous fiscals, untapped opportunity in micro finance segment continues to remain substantial. Out of total household, ~16.6 crore remained eligible (assuming rejection rate of 20%) with untapped opportunity of ~₹ 6.6 lakh crore. Further, the market potential is expected to increase 1.4x in FY22-25E led by a gradual increase in number of households and average ticket size.

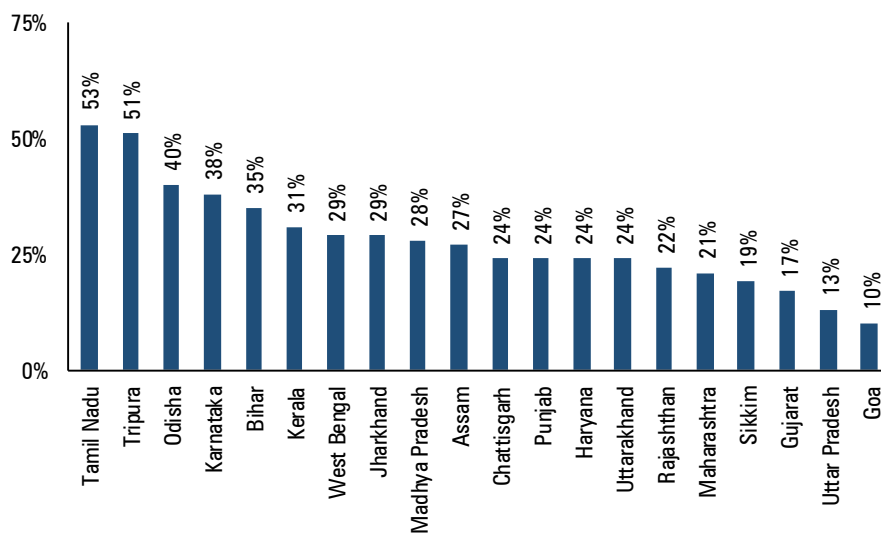
**Exhibit 7: Substantial untapped market offers sustainable growth opportunity**

Estimated Microfinance market size	FY22	FY23E	FY24E	FY25E
Number of Households in India (crore)	32	33	33	34
HHs with < ₹ 2 lakhs income p.a.	65%	65%	65%	65%
Potential Households (crore)	20.8	21.2	21.6	22.1
Rejection rate assumed @ 20%	4.2	4.2	4.3	4.4
<b>Potential Households (crore)</b>	<b>16.6</b>	<b>17.0</b>	<b>17.3</b>	<b>17.7</b>
Avq size loans (₹)	39,990	43,189	47,508	52,259
<b>Estimated Demand (₹ lakh crore)</b>	<b>6.7</b>	<b>7.3</b>	<b>8.2</b>	<b>9.2</b>

Source: CRISIL, MFIN, ICICI Direct Research

**Tapping of new borrowers with geographical expansion**

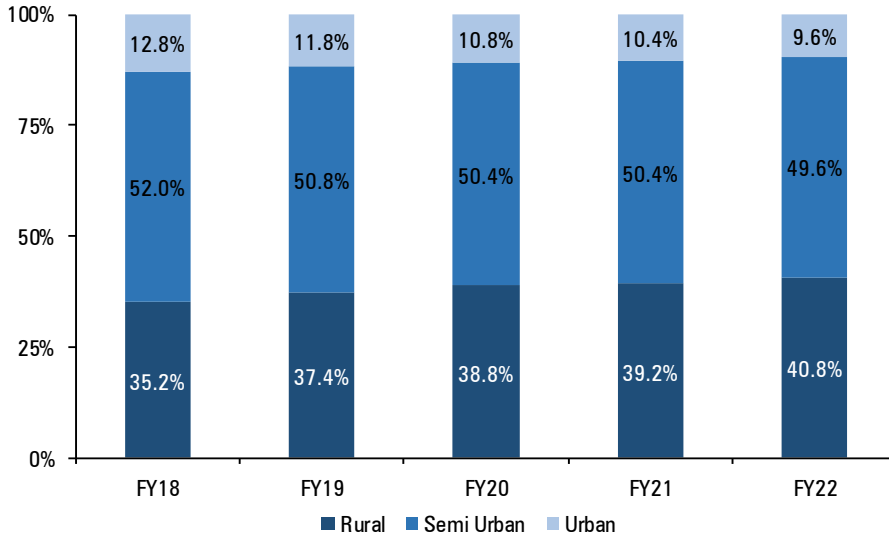
In the past few years, most MFI players have opened branches in untapped districts, which increased their presence in newer geographies. States like Odisha, Madhya Pradesh and Bihar, where large number of population is still unserved, provides an opportunity for existing players to penetrate deeper and improve their market share. As per Crisil Research, underpenetrated states like Uttar Pradesh, Gujarat, Uttarakhand and Manipur are seen driving future growth along with some moderately penetrated states such as Rajasthan, Maharashtra and Madhya Pradesh.

**Exhibit 8: MFI penetration in key states (as of March 2022)**

Source: CRISIL, MFIN, ICICI Direct Research; Note: Penetration is calculated as no. of unique active borrower / estimated number of households.

As per CRISIL, rural share in overall outstanding MFI portfolio has increased from ~35% in FY18 to ~41% in FY22. GDP contribution by rural areas is ~47%, though rural share in credit is ~10% of overall credit, which offers huge market opportunity for rural focused MFI players. Last year, RBI allowed households earning up to ₹ 3 lakh per annum (earlier ₹ 1.25 lakh in rural areas and ₹ 2 lakh in non-rural areas) to be classified as eligible for micro loans. As per MFIN, ~70% of total households in rural locations are expected to benefit from enhancement of income level. This is likely to aid in deeper penetration into existing markets as well as entry in new markets.

**Exhibit 9: Rural region accounts for ~41% share in MFI loans**

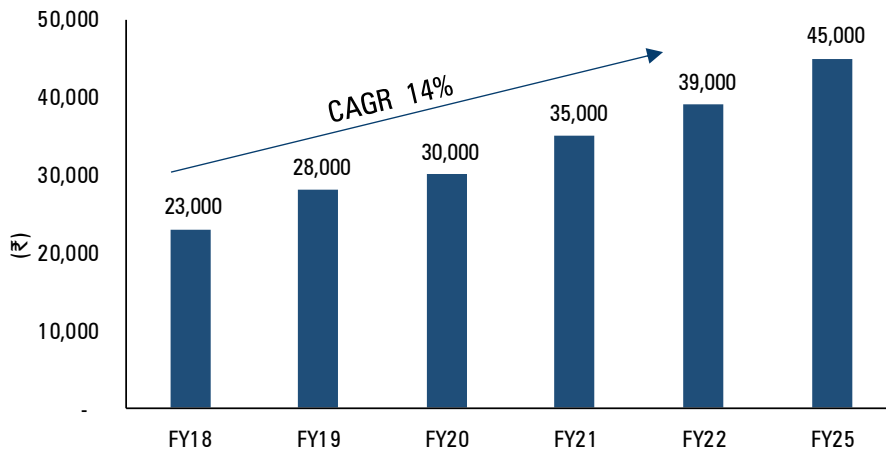


Source: CRISIL, MFN, ICICI Direct Research

**Increase in ticket size**

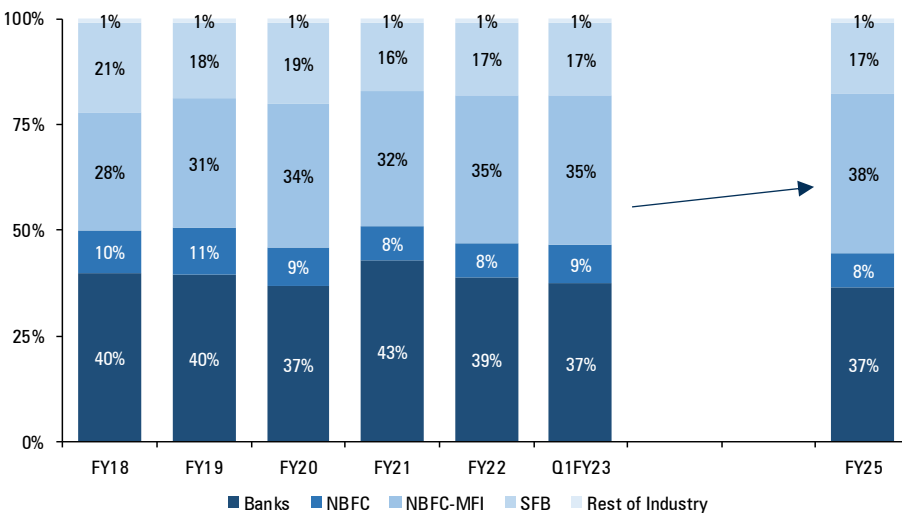
The average ticket size (ATS) at industry level has increased from ₹ 23000 in FY18 to ₹ 39000 in FY22 (grew at a CAGR of 14%). CRISIL Research expects it to increase further to ₹ 45000 in FY25E. We believe increase in ATS would partly aid loan growth of MFI players.

**Exhibit 10: ATS of NBFC-MFI players to increase at ~5% CAGR in FY22-25E**



Source: CRISIL, MFN, ICICI Direct Research

**Exhibit 11: NBFC-MFIs to gain market share**

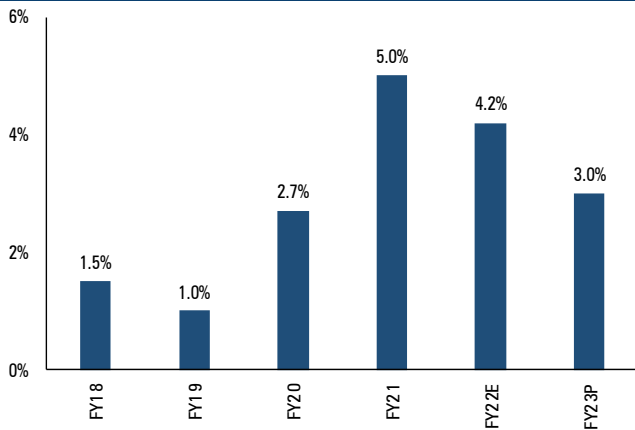


Source: CRISIL, MFN, ICICI Direct Research

**Margin improvement, decline in provision, steady opex to aid earnings**

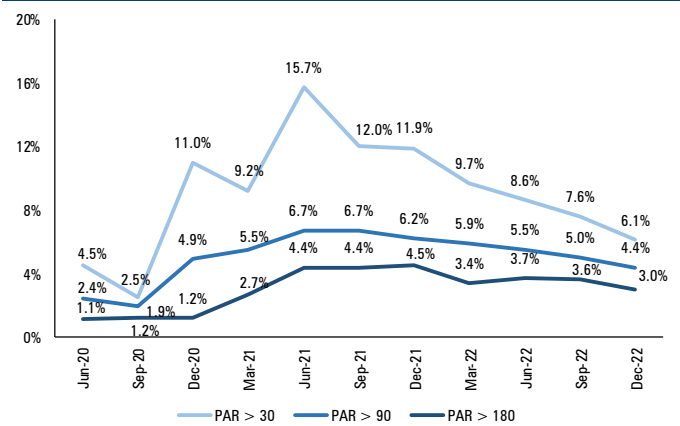
MFI industry witnessed substantial impact on business growth as well as profitability during Covid. However, as economy settled, industry reported impressive recovery and is now poised to deliver healthy business growth coupled with gradual improvement in profitability, primarily led by improvement in margins, steady opex to asset ratio and decline in credit cost ahead. The impact of rising cost of funds is expected to be offset by higher lending rates, which will sustain margin trajectory for MFI players. As per revised MFI guidelines, the enhanced flexibility to set lending rates will be one of the key drivers for NIM expansion. During FY21, credit costs of the MFI sector increased to ~5% mainly due to higher pandemic led provisions. As MFIs had already set aside extra provisions to strengthen their balance sheet, incremental credit cost is expected to be lower assuming slippages will be limited. Thus, credit cost is expected to come down gradually in FY23E and FY24E, which will aid bottom-line and return ratios.

**Exhibit 12: Credit cost to improve further**



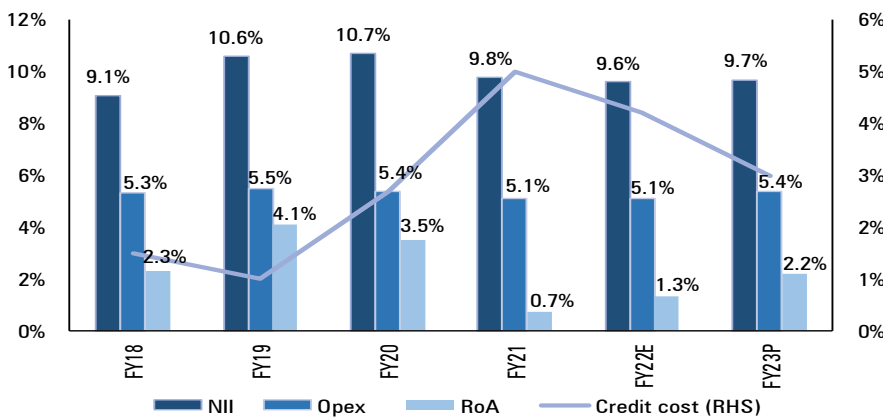
Source: CRISIL, MFII, ICICI Direct Research

**Exhibit 13: PAR on declining trend led by healthy collections**



Source: CRISIL, MFII, ICICI Direct Research

**Exhibit 14: Profitability of MFI sector to improve in FY23E**



Source: CRISIL, MFII, ICICI Direct Research

## Peer Comparison

Exhibit 15: CAG stands out on most parameters...

FY22	CAG	Fusion MFI	Satin Creditcare	Belstar MFI	Asirvad MFI	Spandana Sphoorty
GLP (₹ crore)	16,600	6,650	6,410	4,365	7,000	6,150
Yields (%)	19.2%	20.6%	21.3%	20.8%	23.1%	20.6%
CoF (%)	8.2%	9.7%	10.5%	9.2%	11.2%	11.6%
NIM (%)	9.7%	8.7%	7.5%	9.6%	9.6%	9.7%
RoA (%)	2.8%	0.3%	0.5%	1.1%	0.2%	0.6%
CI Ratio (%)	29.7%	44.3%	64.4%	48.4%	49.7%	32.8%
RoE (%)	10.1%	1.7%	2.6%	6.5%	1.3%	1.6%
GNPA (%)	3.1%	5.7%	8.0%	6.0%	1.7%	17.7%
NNPA (%)	0.9%	1.6%	2.4%	1.5%	0.3%	9.7%
Credit Cost (%)	3.3%	5.6%	2.3%	3.7%	6.3%	6.1%
CAR (%)	22.8%	21.9%	27.8%	24.1%	20.8%	50.7%
Credit Rating	CRISIL A+ (Stable) IND AA- (Stable) ICRA AA+ (CE) / ICRA A+ (Stable)	CRISIL A- (Stable) CARE A- (Stable) ICRA A- (Stable)	CARE BBB+ (Stable) ICRA A-/ICRA A (CE) (Stable)	CRISIL AA- (Stable) CARE AA- (Stable) ICRA A+ (Stable)	CRISIL AA- (Stable) BWR AA- (Stable)	ICRA A- (Stable) CRISIL A (Stable) IND A (Stable)
Clients (in Lakhs)	29	27	25	18	26	23
Employees (nos)	11,951	8,716	10,736	5,939	12,581	8,379
Client per Loan Officer (nos)	354	464	348	555	343	366
No. of States	14	18	23	18	24	18

Source: Company, ICICI Direct Research; Note: CAG - standalone



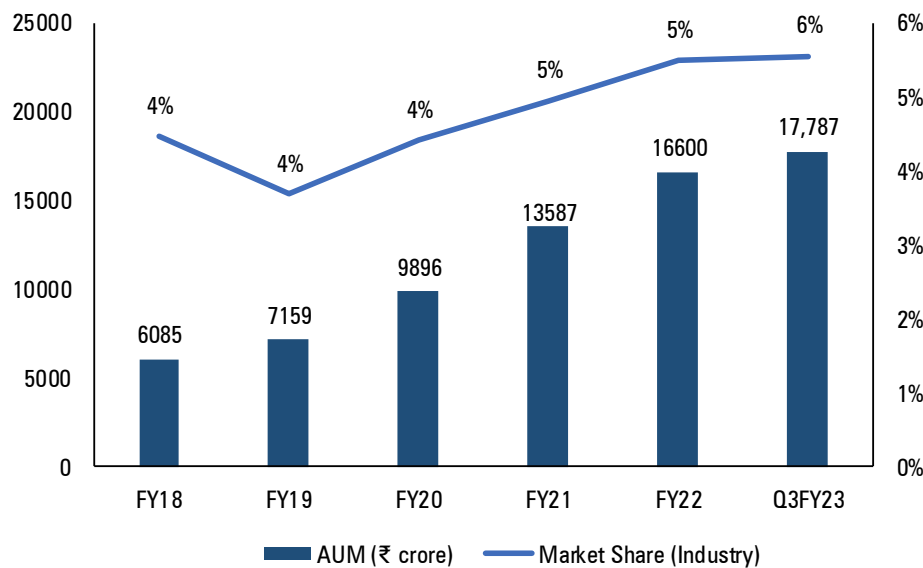
## Investment Rationale

### Sustained market leadership gives confidence

CAG is the largest NBFC-MFI in terms of GLP with ~16% share among NBFC-MFI (as of December 2022). Within overall MFI industry, CAG has ~6% share as of December 2022. Market share in four primary states of business operations remain substantial at 24.3% in Karnataka, 16.3% in Maharashtra, 9.4% in Tamil Nadu and 7.1% in Madhya Pradesh as of March 2022. In FY20, CAG acquired a Chennai based micro finance player - Madura Micro Finance (MMFL), which gave access to newer states like Bihar and Odisha.

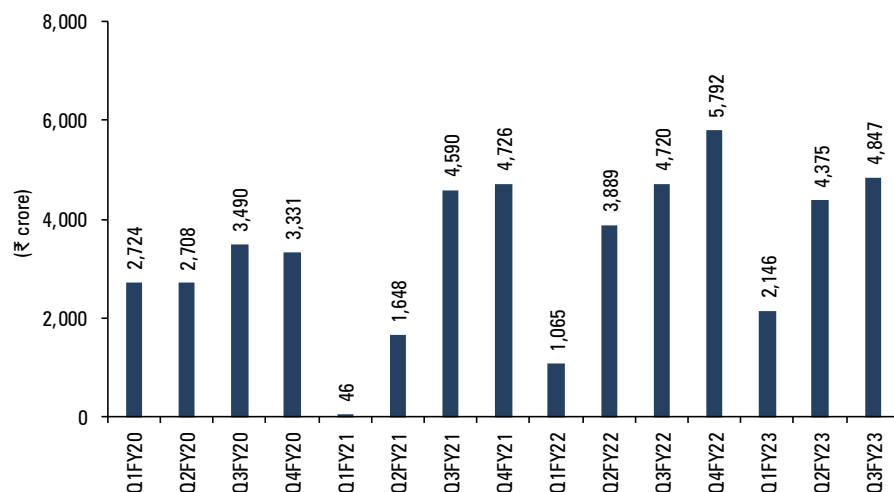
CAG reported AUM CAGR of ~29% and disbursement CAGR of ~26% over FY18-22. During the pandemic, AUM growth slowed down due to ~6% YoY growth in disbursements in FY21 vs. average growth of ~25-30% in previous years. However, as economic activities gathered pace, the company witnessed healthy business traction. The company mainly focuses on rural customers (>80% of its total customers) under the JLG model and offers income generation (96% of GLP), family welfare, home improvement, emergency and retail loans (secured). The management has guided for AUM growth of 20-25% YoY, which, we believe, is achievable given leadership of company in market with huge untapped opportunity.

Exhibit 16: CAG is largest NBFC-MFI with ~6% share (December 2022)



Source: Company, MFN, ICICI Direct Research

Exhibit 17: Disbursements back on track...



Source: Company, ICICI Direct Research

## Entry in new geography aids customer acquisition & granularity

CAG has a network of 1,727 branches, across 14 states and one union territory. The company has a strong presence in Karnataka, Maharashtra and Tamil Nadu, which constitutes ~30% of industry micro finance loans. Focusing on aforesaid regions with substantial opportunity, CAG has ~57% of branches in these three states as of December 2022 (contributing ~76.5% of CAG's AUM). Targeting geographic expansion, CAG has opened 19 branches in Bihar, seven in Uttar Pradesh, six in Madhya Pradesh, which together constitute ~26% of MFI industry loans as of June 2022.

Loan Tenure	Avg. Weekly Installment per ₹ 10,000 loan
1 Year	₹ 216-218
2 Years	₹ 18-119
3 years	₹ 86-88


Source: Company, ICICI Direct Research


Exhibit 18: Consistent growth in infrastructure with focus on new geographies

States	FY22	Q1FY23	Q2FY23	Q3FY23
Bihar	35	10	-	19
Chhattisgarh	5	2	-	-
Gujarat	28	5	1	-
Jharkhand	10	5	-	-
Madhya Pradesh	20	1	-	6
Karnataka	10	-	-	-
Kerala	6	-	-	-
Maharashtra	6	9	-	6
Odisha	9	-	-	-
Rajasthan	35	6	-	5
Tamil Nadu	1	-4	-	-
Uttar Pradesh	35	5	-	7
West Bengal	11	7	2	-
<b>Total</b>	<b>211</b>	<b>46</b>	<b>3</b>	<b>43</b>


Source: Company, ICICI Direct Research

Exhibit 19: Focus on customer centricity, loyalty & retention


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**One of the lowest lending rates in MFI industry**
- 

**Diverse product suite:**

  - Income generation, education, festival, medical, emergency, water, sanitation, home improvement, livelihood improvement, business expansion
- 

**Loan size flexibility:**

  - Ability to borrow as required within assigned credit limit
  - Ability to avail multiple loans with flexible size
- 

**Repayment flexibility:**

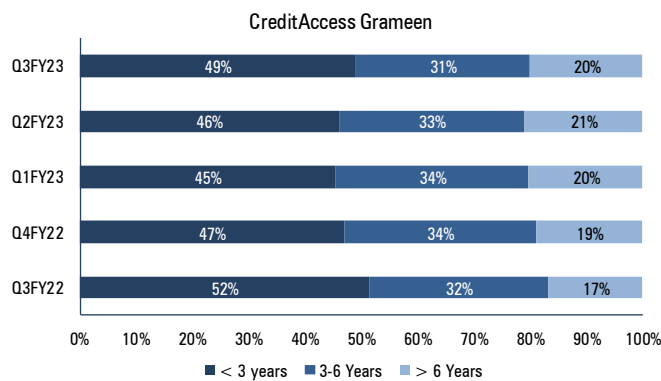
  - Weekly/ bi-weekly/ monthly repayment options
  - Ability to choose repayment frequency based on cash flow cycle
  - No pre-payment penalty

Source: Company, ICICI Direct Research

The borrower concentration has also reduced substantially over the years as share of borrowers from top three states, which was ~80% in FY20, has dropped to ~69% in Q3FY23. ~47% of borrowers added in the past 12 months were from outside the top three states. Such contiguous expansion has resulted in healthy new client acquisition and improved granularity in terms of risk diversification. Exposure of districts (as percentage of total GLP) has become more granular over the years and no single district contributes >4% of total GLP. The management is focusing on new geographies/deeper penetration into existing geographies and guided that there will be 10% YoY growth in the branch network.

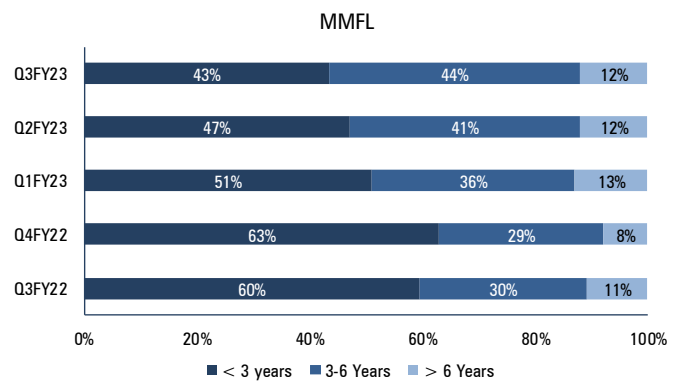
Despite a relatively large AUM and customer base, CAG has reported healthy customer retention in previous years. CAG has been able to achieve customer retention rates between 80% and 90%, led by 1) focus on customer centric business model, 2) wide range of products offerings and 3) flexibility in loan ticket size and repayment (weekly/bi-monthly/monthly options, no pre-payment penalty, etc). Further, increased household income threshold (increased to ₹ 3 lakh from earlier ₹1.25, ₹ 2 lakh for rural, urban, respectively), is seen aiding both in retention of existing customer base and improved pace of acquisition of new clients.

Exhibit 20: Borrower vintage of CAG



Source: Company, ICICI Direct Research

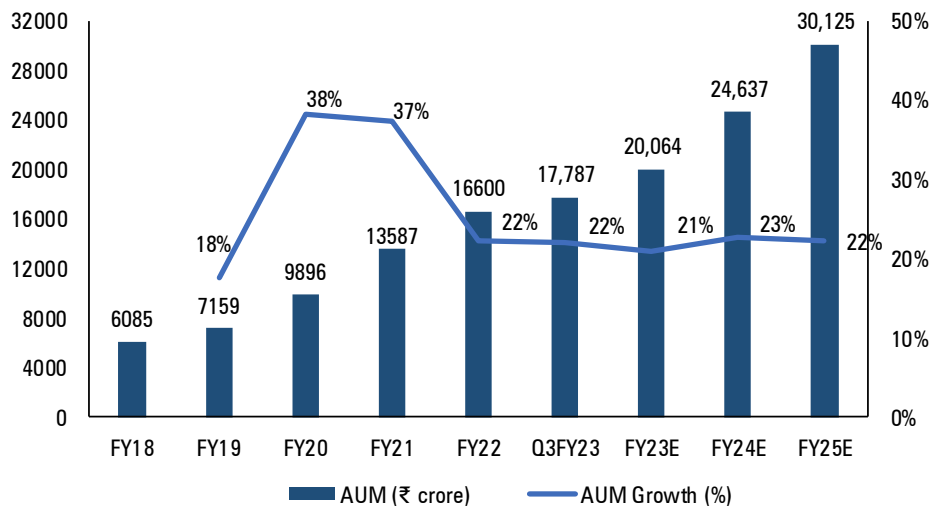
Exhibit 21: Borrower vintage of MMFL



Source: Company, ICICI Direct Research

CAG has highest overlap of loans with IndusInd Bank (via BhaFin portfolio) at ~15% of GLP. Rest, with all other key players, the overlap is <5%, which, we believe, is not substantial for a player like CAG and still offers huge opportunity to grow. We believe customer retention and focus on new geographies will aid in business growth.

Exhibit 22: AUM grows at CAGR of ~30% (FY18-22)



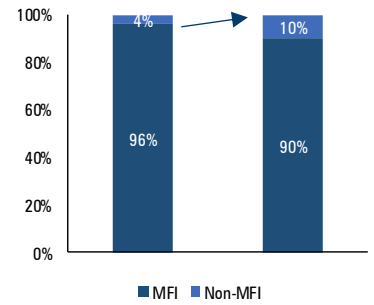
Source: Company, ICICI Direct Research

## Relatively lower yields but diversified borrowings to aid NIMs

In the micro finance segment, accessibility of funds is more important compared to yields charged on the loan. However, competitive offering in terms of yields and accessibility remains beneficial for lenders, especially in states with healthy penetration level. CAG has lowest lending rates among NBFC-MFIs (~20% yields vs. ~22-25% for peers as of December 2022), which enables it to face competition through better customer retention. Removal of cap on margin (in recent regulations) offers great flexibility in loan pricing. Now lenders can offer differential pricing for its customers based on customer risk profile, track record & vintage. In the current scenario of rising interest rates, CAG has the ability to pass on increase in rates to customers and still remain competitive, which is seen aiding better customer engagement. Further, shorter duration of loans enables faster repricing of the book, which will lead to improvement in margins in coming quarters.

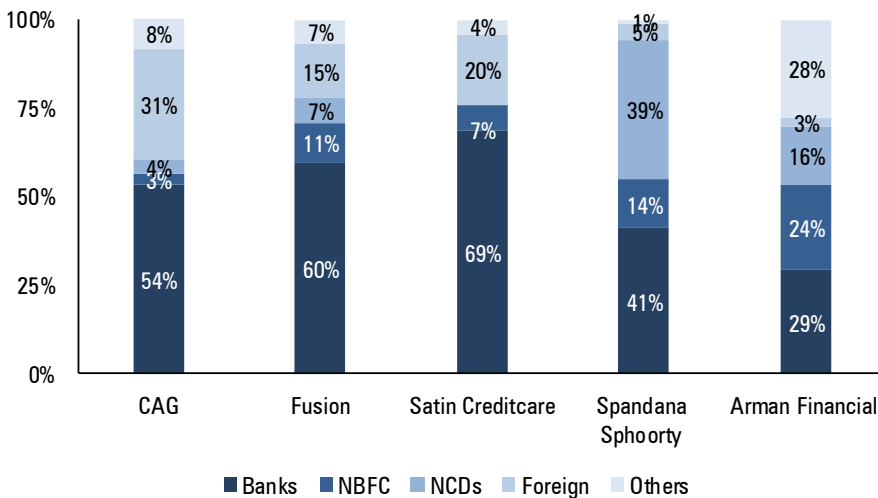
In 2016, CAG started diversifying its AUM mix through entry in secured retail loans (vehicle finance, affordable housing, gold loans, LAP and individual loans). These loans have lower yields compared to micro finance business. Thus, while faster growth in new category of loans could have marginal impact on margins, entry in new segments will entail higher business growth. Currently, the share of non-MFI book is <1% of total GLP. The management aims to increase this share to ~10% in the next four to five years.

CAG has a diversified borrowing mix with focus on long-term funding with diversification between domestic and foreign sources thereby aiding in effective liability management. The company aims to meet its funding requirement through foreign/longer term sources (supported by parent) over the medium term. The management is aiming for ~50% bank borrowings and foreign borrowings at ~15% in the long run. Also, CAG has A+ / AA- rating for long term instruments by key rating agencies, which gives them benefit of lower cost of funds. For Q3FY23, cost of funds was at 9.6% (lowest in peers) vs. average ~11% for peers. The management has guided that weighted average cost of funds will be in the range of 9.3-9.4% for FY23E. We believe CAG's ability to pass on rates effectively and lowest cost of funds led by diversified borrowing profile will aid margin trajectory (~12% in FY24E as per management guidance).



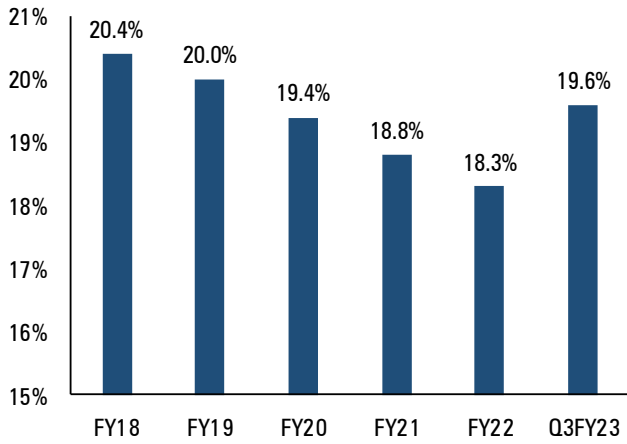
Source: Company, ICICI Direct Research

Exhibit 23: Well diversified borrowing mix ...



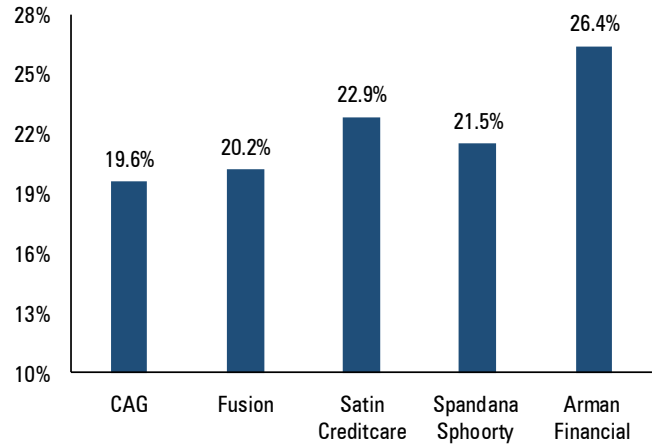
Source: Company, ICICI Direct Research; Note – Others includes DA and borrowings from FIs.

Exhibit 24: CAG's yield trend



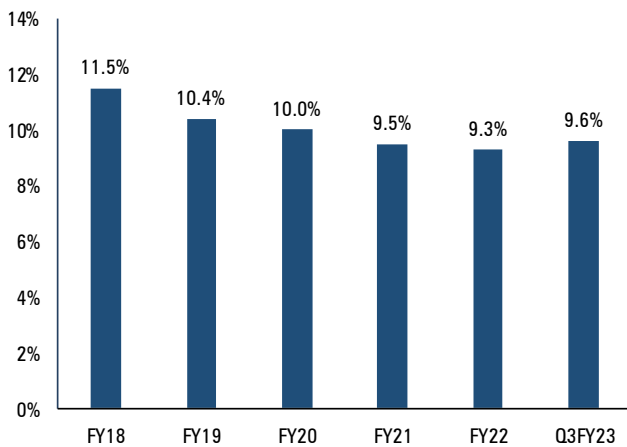
Source: Company, ICICI Direct Research

Exhibit 25: Player wise yield (Dec 2022)



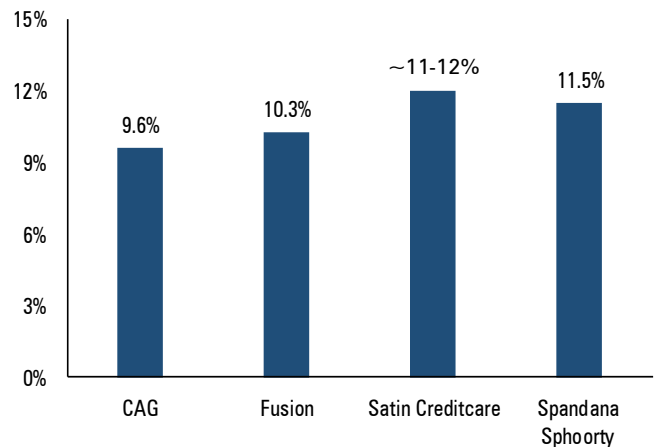
Source: Company, ICICI Direct Research

Exhibit 26: CAG's CoF largely steady at ~9.5-10%



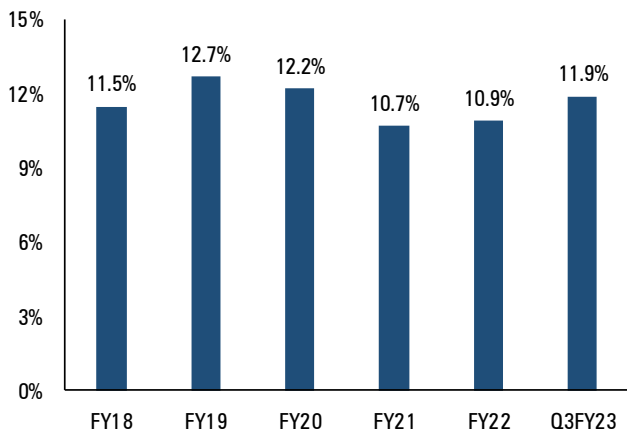
Source: Company, ICICI Direct Research

Exhibit 27: CAG has lowest CoF among peers (Dec 2022)



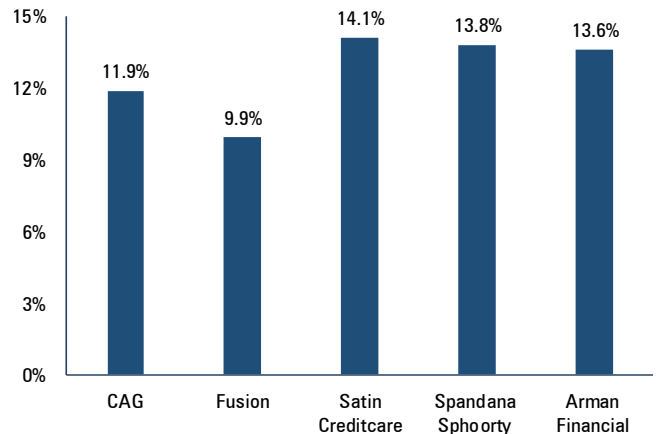
Source: Company, ICICI Direct Research

Exhibit 28: Margins to sustain at ~12%



Source: Company, ICICI Direct Research

Exhibit 29: Player wise NIMs as of December 2022



Source: Company, ICICI Direct Research

## Opex to remain steady supporting bottom line

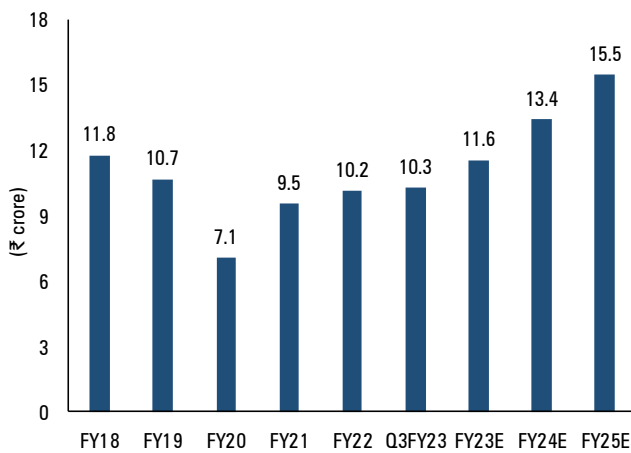
CAG’s business model depends substantially on physical infrastructure both in terms of branches and human resource. A substantial branch network is required for deeper penetration and loan officers are needed to conduct regular meetings with customers for better engagement. Driven by continuous technology enhancements and improved productivity, cost to Income and opex to GLP ratios at ~36% and 5% as of December 2022, respectively, are expected to remain steady. Further, the management expects an efficient cost structure, deep rural penetration, district based expansion strategy, high customer retention to aid business efficiency. With a gradual improvement in operating metrics (loan officer per branch, borrowers per employee, AUM per branch), we expect opex to remain in the range of ~32-34% over FY23-25E. Factoring in ~10% branch addition annually, we expect earnings growth to remain healthy at ~52% CAGR in FY22-25E.

**Exhibit 30: Sustainable operational efficiency...**

Particulars	FY20	FY21	FY22	FY23E	FY24E	FY25E
Number of branches (nos)	929	1,424	1,635	1,733	1,837	1,947
Employee / branch (nos)	12	10	10	10	10	10
Number of employees (nos)	10,824	14,399	15,667	16,464	18,003	19,473
Borrower per employee (nos)	268	272	244	251	248	247
Number of borrowers ('000)	2,905	3,912	3,824	4,130	4,460	4,817
GLP / borrowers (₹)	34,065	34,732	43,410	48,583	55,237	62,537

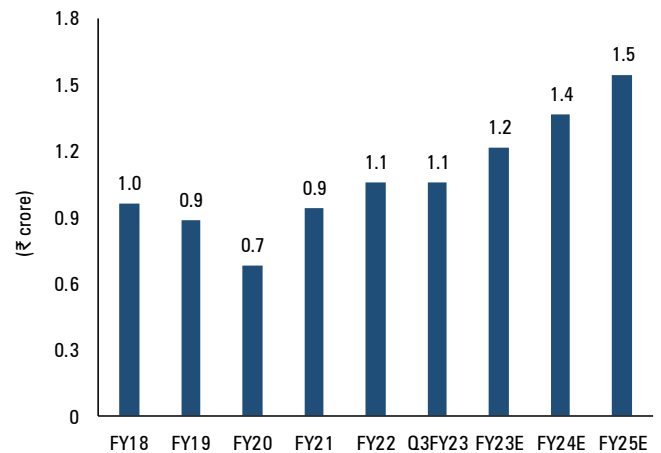
Source: Company, ICICI Direct Research; Note – Others includes DA and borrowings from Fls.

**Exhibit 31: AUM per branch trend**



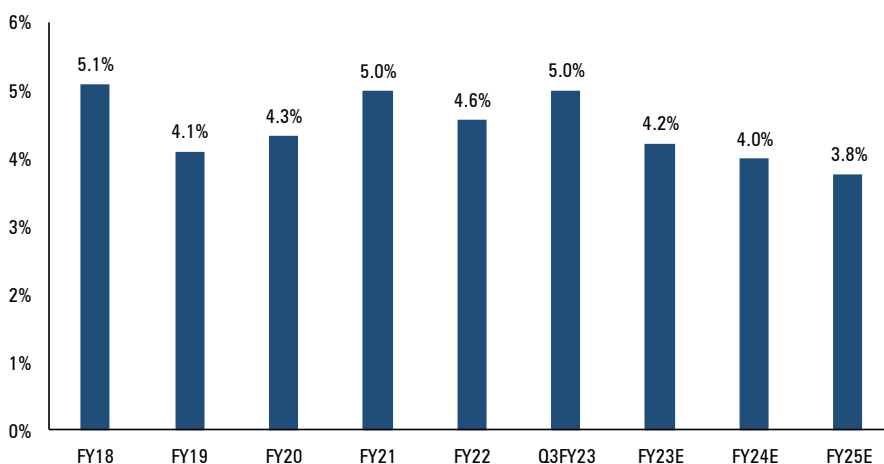
Source: Company, ICICI Direct Research

**Exhibit 32: Rising AUM per employee reflects productivity**



Source: Company, ICICI Direct Research

**Exhibit 33: Opex to AUM largely remain controlled**



Source: Company, ICICI Direct Research

## Controlled delinquencies, amid superior underwriting to propel return ratios

CAG's conservative credit underwriting practices, robust risk management framework, extensive customer assessment has aided in controlled delinquencies despite major uncertain events in the past.

With risk management being integral to core business strategy and operating processes, CAG's superior underwriting architecture is characterised by 1) contiguous district-based expansion strategy, 2) stringent customer on-boarding process, 3) checks from credit bureau and physical visits, 4) training to borrowers. Robust audit and risk management process including appropriate limits on risk exposures, internal caps on borrower and rigorous audits aids in early stress recognition and frauds.

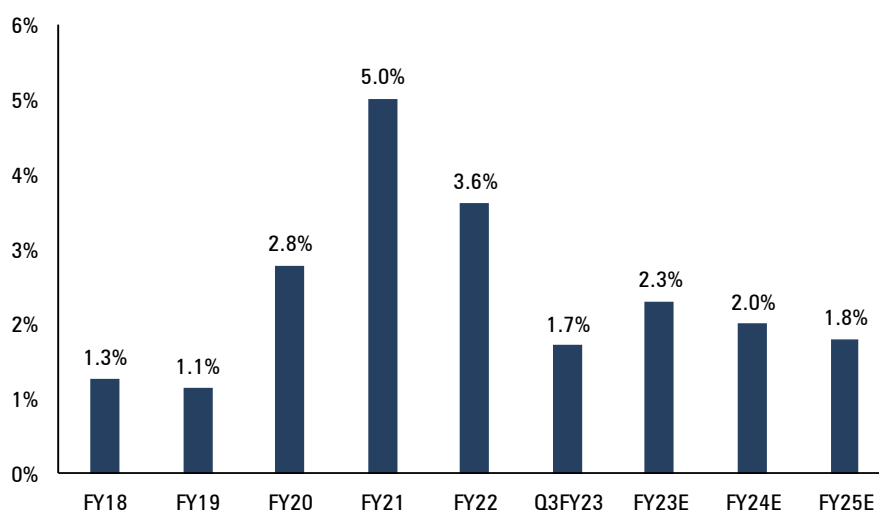
In FY20, FY21 and FY22, GNPA ratio remained higher at 1.6%, 4.4% and 3.1%, respectively, due to floods in key operating states (Karnataka & Maharashtra) followed by pandemic led disruptions, which resulted in higher slippages. Since Q1FY23, as pandemic challenges were behind and collections improved, asset quality had shown meaningful improvement with GNPA ratio improving from 3.1% in FY22 to 1.7% in Q3FY23.

CAG follows a conservative NPA recognition policy with 60+ days past due (dpd) for group loans (vs. industry standard of 90+dpd) recognised as Stage 3 and 15+dpd (vs. industry standard of 30+ dpd) as Stage 2. The 60+ dpd declined to 1.6% in Q3FY23 vs. 2% in Q2FY23, while 90+ dpd declined to 2.2% vs. 3.1% during the same period. On a consolidated basis, the company holds an ECL cover of 2.04% as of December 2022 (higher than the reported GNPA of 1.7%). CAG has lowest restructured book at ₹ 50 core as of December 2022 compared with peers. Total write offs from FY21 to 9MFY23 were ₹ 1600 crore, of which ~10% has been recovered.

Regular engagement with borrowers through weekly/bi-monthly/monthly model helps early identification of stress, better collection efficiency and quick recoveries. For most MFI players collection efficiency has reached pre-Covid levels including CAG (~98% as of December 2022).

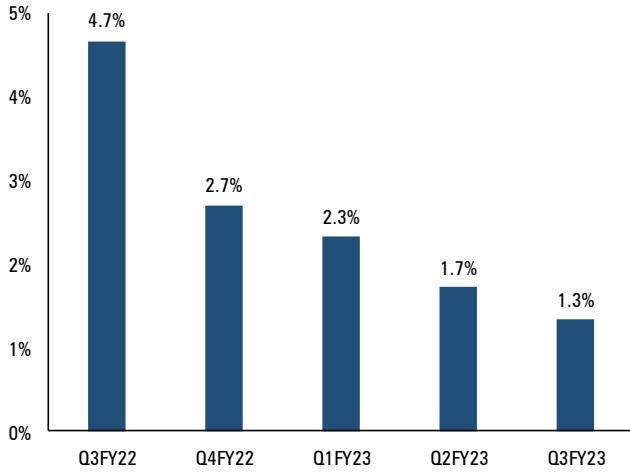
CAG has been able to maintain credit cost of <2% in the past (barring FY21 & FY22). As pandemic led challenges are behind and impact of MMFL book is minimal, credit cost is expected to normalise from FY23E onwards (guidance of 2.3-2.4% for FY23E) resulting in RoA, RoE of >4%, ~19-20%, respectively, in 24-25E.

Exhibit 34: GNPA to remain steady at ~2% over FY23-25E



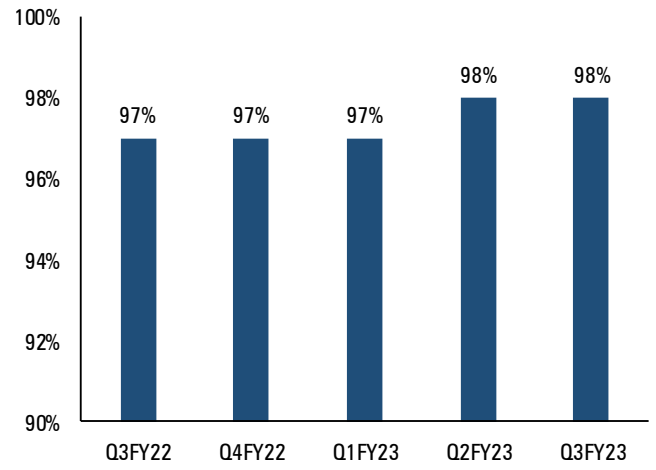
Source: Company, ICICI Direct Research

Exhibit 35: PAR 90+ dpd



Source: Company, ICICI Direct Research

Exhibit 36: Collection efficiency healthy, back to pre-Covid



Source: Company, ICICI Direct Research



## Valuation

### Market leader with consistent performance justifies valuations

CAG has an established track record of sustainable performance for more than 20 years and is a market leader with ~15% share in NBFC-MFIs and ~6% share in overall MFI (in GLP terms as of December 2022). CAG has demonstrated a healthy business traction despite major headwinds in the past and reported a CAGR of ~30% in GLP, ~33% in NII and ~14% in PAT over FY18-22. Prudent underwriting and focus on continued customer engagement ensured healthy asset quality evident from GNPA level below 1.5% in FY18-20 (prior to Covid). During Covid, GNPA increased from 1.5% in FY20 to 4.4% in FY21 but gradually declined to 3.6% in FY22 and further to ~1.7% in Q3FY23. CAG's deeper penetration in rural markets, strengthening leadership position in key states like Karnataka, Maharashtra and Tamil Nadu along with focus on new geographies (Bihar, Madhya Pradesh, etc), borrower base with high retention rate of more than 80% augur well for business and earnings growth. Further, board approval for extension of MD & CEO Udaya Kumar Hebbar for two years from June 2023 warrants confidence in continuity in top management.

At the CMP, CAG trades at ~2x FY25E ABV, which seems reasonable given leadership and sustained performance. Factoring anticipated business growth, we initiate coverage on the stock with a BUY rating and a target price at ₹ 1100/share. We expect GLP to grow at a 22%, NII at 24% and PAT at 53% CAGR over FY22-25E and RoE and RoA at ~20% and ~4.5%, respectively, by FY25E.

Exhibit 37: Key valuation parameters

(Year-end March)	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
EPS (₹)	22.4	23.3	8.4	22.9	45.3	62.2	80.2
ABV (₹)	164.8	189.9	237.3	255.2	300.4	362.7	442.9
P/E	40.2	38.6	106.6	39.3	19.9	14.5	11.2
P/adj.BV	5.5	4.7	3.8	3.5	3.0	2.5	2.0

Source: Company, ICICI Direct Research

Exhibit 38: Valuation of peers

(Year-end March)	ROE				ROA				P/BV				P/E			
	FY22	FY23E	FY24E	FY25E	FY22	FY23E	FY24E	FY25E	FY22	FY23E	FY24E	FY25E	FY22	FY23E	FY24E	FY25E
CAG	9.3%	16.3%	18.8%	19.9%	2.2%	3.6%	4.1%	4.3%	3.6	3.0	3.7	2.1	37.1	12.0	15.7	13.6
Fusion MFI *	1.7%	20.6%	21.0%	22.0%	0.3%	4.4%	4.7%	4.6%	2.4	1.7	1.4	1.2	151.9	10.3	7.4	6.0
Spandana Sphoorthy *	2.4%	2.9%	11.4%	15.8%	0.9%	1.2%	3.7%	4.6%	1.2	1.2	1.1	0.9	53.4	32.6	9.3	5.9

Source: Bloomberg, company, ICICI Direct Research

## Risks and concerns

### Partial stake sale by parent

At present, CAI (promoter) holds ~73% stake in CAG. The promoter had various rounds of capital infusion in CAG along with secondary purchase from FY09 to FY17. In addition, CAI provides access to global fundraising opportunities. The management of CAG had indicated that promoters are planning to sell ~10-12% in CAG stake through block deals over a couple of years. This may pose near term supply pressure on the stock price.

### Geographic concentration

CAG has a significant concentration in three states with ~77% of total GLP coming from Karnataka (34.7%), Maharashtra (21%) and Tamil Nadu (20.8%). Total ~69% of borrowers and ~57% of branches are from these three states as of December 2022. Any adverse developments in these states may impact operations, business growth and asset quality. The business may also be impacted due to change in local politics, natural calamity, etc.

### Borrowings from informal sources remain grey area

As per the latest MFI guidelines, loan repayment amount (EMIs) cannot exceed 50% of monthly household income of the borrower. However, borrowings from informal sources, especially from moneylenders, landlords, friends and relatives does not get captured in credit bureau check, which ultimately impacts the repaying capacity of the borrower due to increase in fixed obligation to income ratio (FOIR). Thus, assessment of informal borrowing, if any, remains a grey area and could impact the repayment capacity of borrower.

### Increase in competitive intensity

Micro finance remains a segment with a large untapped growth opportunity. Thus, it is attracting increased number of lenders. Though a large untapped opportunity exists in micro finance space, entry of banks, NBFCs and small finance banks in MFI segment with focus on faster growth is leading to increased competitive intensity. Thus, business growth and/or profitability could be prone to risk as competition intensifies.

### Opex intensive model

CAG follows a business model, which needs substantial branch expansion for deeper penetration and regular meetings with customers for closer engagement. Loan officers meet their customers on a weekly basis. Thus, high frequency of physical engagement with customers entails relatively higher opex. Further, continued investment in distribution infrastructure – branches and human resource is seen keeping opex to asset ratio elevated when compared to other segments of lending. Relatively higher proportion of cash transaction entails higher opex and exposes to risk of theft, fraud, misappropriation.

## Financial Summary

### Exhibit 39: Profit and loss statement

(Year-end March)	FY21	FY22	FY23E	FY24E	FY25E
Interest Earned	2,290	2,567	3,116	3,867	4,792
Interest Expended	929	984	1,202	1,470	1,839
Net Interest Income	1,361	1,583	1,915	2,397	2,953
% growth	29.0	16.3	20.9	25.2	23.2
Non Interest Income	176	183	201	221	243
Net Income	1,537	1,766	2,116	2,618	3,196
Employee cost	380	438	487	563	644
Other operating Exp.	206	251	288	330	388
Operating Profit	952	1,078	1,342	1,725	2,164
Provisions	771	597	401	431	497
PBT	180	481	940	1,294	1,667
Taxes	49	124	235	323	417
Net Profit	131	357	705	970	1,250
% growth	(60.8)	171.8	97.5	37.6	28.9

Source: Company, ICICI Direct Research

### Exhibit 40: Balance sheet

(Year-end March)	FY21	FY22	FY23E	FY24E	FY25E
<b>Sources of Funds</b>					
Capital	156	156	156	156	156
Reserves and Surplus	3,536	3,822	4,527	5,497	6,748
Networth	3,692	3,978	4,683	5,653	6,903
Borrowings	10,932	12,921	15,505	18,606	22,699
Other Liabilities & Provisions	436	496	1,221	1,789	2,032
<b>Total</b>	<b>15,059</b>	<b>17,395</b>	<b>21,409</b>	<b>26,048</b>	<b>31,635</b>
<b>Applications of Funds</b>					
Fixed Assets	24	32	33	38	44
Investments	-	-	438	438	438
Advances	11,721	14,765	18,259	22,420	27,414
Other Assets	3,315	2,598	2,679	3,151	3,739
<b>Total</b>	<b>15,059</b>	<b>17,395</b>	<b>21,409</b>	<b>26,048</b>	<b>31,635</b>

Source: Company, ICICI Direct Research

### Exhibit 41: Key Ratios

(Year-end March)	FY21	FY22	FY23E	FY24E	FY25E
<b>Valuation</b>					
No. of Equity Shares	15.6	15.6	15.6	15.6	15.6
EPS (₹)	8.4	22.9	45.3	62.2	80.2
BV (₹)	237.3	255.2	300.4	362.7	442.9
ABV (₹)	237.3	255.2	300.4	362.7	442.9
P/E	106.6	39.3	19.9	14.5	11.2
P/BV	3.8	3.5	3.0	2.5	2.0
P/adj.BV	3.8	3.5	3.0	2.5	2.0
<b>Yields &amp; Margins (%)</b>					
Yield on Advances	16.9%	15.5%	17.0%	17.3%	17.5%
Avg. cost on funds	8.5%	7.6%	7.8%	7.9%	8.1%
Net Interest Margins	11.6%	10.5%	10.4%	10.7%	10.8%
Spreads	8.4%	7.8%	9.3%	9.4%	9.4%
<b>Quality and Efficiency</b>					
Cost / Total net income	38.1%	39.0%	36.6%	34.1%	32.3%
GNPA%	4.4%	3.6%	2.3%	2.0%	1.8%
NNPA%	0.0%	0.4%	0.7%	0.6%	0.5%
ROE (%)	4.1%	9.3%	16.3%	18.8%	19.9%
ROA (%)	1.0%	2.2%	3.6%	4.1%	4.3%

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

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Sell: <-15%



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