# IPO NOTE
2nd August 2023

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BY ASIT C. MEHTA INVESTMENT INTERRMEDIATES LTD

## Subscribe

| Issue Details | |
|---|---|
| Price Band (Rs) | Rs. 54 - 57 |
| Face Value (Rs) | 10.00 |
| Issue Size (Rs) | 1,025 Cr |
| Issue Type | Book Building |
| Minimum lot | 260 Shares |
| Issue Opens | August 03, 2023 |
| Issue Closes | August 07, 2023 |
| Listing on | BSE, NSE |

| Indicative Timeline | On or before |
|---|---|
| Finalization of Basis of Allotment | August 10, 2023 |
| Unblocking of Funds | August 11, 2023 |
| Credit of shares to Demat Account | August 14, 2023 |
| Listing on exchange | August 16, 2023 |

| Other Detail | |
|---|---|
| Book Running Lead Managers | ICICI Securities Limited, Axis Capital Limited and Kotak Mahindra Capital Company Limited. |
| Registrar | Kfin Technologies Limited. |

| IPO Shareholding (%) | | |
|---|---|---|
| **Category** | **Pre-Issue** | **Post-Issue** |
| Promoters | 80.48% | 65.50% |
| Public | 19.52% | 34.50% |
| **Total** | **100.00%** | **100.00%** |


**Distribution Team**

E: ipo@acm.co.in

D: +91 22 6132 5931

**Retail Research**

E: retailresearch@acm.co.in

D: +91 22 2858 3208


# SBFC Finance Limited

## Company Background

SBFC Finance Limited (SBFC) was incorporated on January 25, 2008. SBFC Finance Limited is a systemically important, non-deposit-taking Non-Banking Finance Company (NBFC-ND-SI). The primary customer base of the company includes entrepreneurs, small business owners, self-employed individuals, and salaried and working-class individuals. It provides its services in the form of Secured MSME Loans and Loans against Gold. SBFC Finance tends to extend its services to entrepreneurs and small business owners who are underserved or unserved by traditional financial institutions like banks.

SBFC's approach is to reimagine lending. Company have developed a "PhyGital" model which uses technology and authentic in-person service to create loans which support the ambitions of their customers. It engage directly with small business owners and work through loan applications together, in person, at the customer's pace.

## Issue Details

Fresh Issue of Equity Shares aggregating upto Rs.  600 Crore and Offer for Sale of Equity shares aggregating upto Rs. 425 Cr.

## Issue Objectives

The Company proposes to utilize the Net Proceeds towards augmenting the Company's capital base to meet their future capital requirements arising out of the growth of the business and assets.

## IPO share allotment pattern

| Category | Allocation | Number of Shares at Rs. 57 | Value at upper band (Rs. in Cr.) |
|---|---|---|---|
| QIB ( Institutional) | 50% | 8,90,13,156 | 507.38 |
| Non Institutional | 15% | 2,67,03,948 | 152.21 |
| Retail | 35% | 6,23,09,210 | 355.16 |
| Employee* | | 18,63,636 | 10.25 |
| **Total** | - | **17,98,89,950** | **1,025.00** |

Note: Employee Discount 2 Rs. Per share
Source: Company RHP, ACMIIL Research

## Outlook and Valuations

SBFC Finance is one of the leading financial services institution focused on providing credit to small businesses and consumers. SBFC has a diversified pan-India presence, with an extensive network in their target customer segment. Among MSME-focused NBFCs in India, SBFC has one of the highest assets under management (AUM) growth, at a CAGR of 44% in the period from Fiscal 2019 to Fiscal 2023 and also witnessed robust disbursement growth, at a CAGR of 40% between Fiscal 2019 and Fiscal 2023. At the upper price band of Rs.57/-, stock is priced at 35.18x its FY23 EPS. Hence, we recommend subscribing the issue from a long-term prospective.

## Company & Business Overview

SBFC is a systematically important, non-deposit taking non-banking finance company ("NBFC-ND-SI") offering Secured MSME Loans and Loans against Gold, with a majority of their borrowers being entrepreneurs, small business owners, self-employed individuals, salaried and working-class individuals.

SBFC Holdings Pte. Ltd., Clermont Financial Pte. Ltd. (together, "Clermont Group"), Arpwood Capital Pvt Ltd, Arpwood Partners Investment Advisors LLP and Eight45 Services LLP (together, "Arpwood Group") are the corporate promoters of the company.

SBFC has a diversified pan-India presence, with an extensive network in their target customer segment. As of March 31, 2023, they have an expansive footprint in 120 cities, spanning 16 Indian states and 2 union territories, with 152 branches.
Their AUM is diversified across India, with 30.84% in the North, 38.53% in the South, and 30.63% in the West and East collectively, as of March 31, 2023.

The company's complete portfolio of loans has in-house origination and benefits from their risk management framework. Leveraging their significant operational experience, they have set up stringent credit quality checks and customised operating procedures that exist at each stage for comprehensive risk management.

They primarily focus on small enterprise borrowers, with a demonstrable track record of servicing loans such as gold loans, loans for 2-wheeler vehicles and have a CIBIL score above 700 at the time of origination. They source customers directly through their sales team of 1,911 employees as of March 31, 2023, and have adopted a direct sourcing model.

Their risk management and underwriting processes, including their extensive customer assessment methods, and monitoring systems, have resulted in healthy portfolio quality indicators such as low rates of Gross NPAs and Net NPAs.

As of March 31, 2023, approximately 89.49% of their Secured MSME Loan collections and 90.92% of the unsecured loan collections were non-cash-based EMI collections, thus reducing their cash management risk, and enabling customers to receive real-time payment receipts through SMS.

Their mobile application also enables customers to manage existing loans, in addition to servicing loans online. They have introduced 'Leviosa', a loan origination platform capable of onboarding and disbursing loans. For their Loan against Gold portfolio, they have set up a dedicated 'Gold Genie' sales application, enabling gold loan disbursal at a customer's home.

Their collection services are aided by a mobile application 'Delta' and a web application 'Omega', which are collections applications providing a priority list of overdue customers to the collection team in real time.

SBFC has an experienced and dedicated management team with significant industry experience and who have demonstrated their ability to deliver growth and profitability, across business cycles. The significant business expertise of their management team positions them well to capitalize on future growth opportunities. Each of them have extensive experience in the banking or related industry such as finance, commercial operations, strategy, audit, business development, human resources, compliance and public relations.

They are backed by marquee institutional investors such as the Clermont Group, Arpwood Group and Malabar Group, who provide their expertise to their operations, including through their representatives on their Board. In addition to providing them with capital, their institutional shareholders have assisted them in their growth through strategic guidance based on their previous experience and insight into the financial services sector in India.

## Competitive Strengths

### Diversified pan-India presence with an extensive network

SBFC is a lender that provides loans to borrowers being entrepreneurs, small business owners, and self-employed individuals, salaried and working-class individuals. As of March 31, 2023, they have an expansive footprint in 120 cities, spanning 16 Indian states and 2 union territories, with 152 branches. Their extensive, geographically diverse distribution network allows them to penetrate underbanked populations in tier II and tier III cities in India. Also, less than 15% of the approximate 70 million MSMEs in India have access to formal credit in any form which is consequently limited or restricted to informal lending channels.

### 100% in-house sourcing, leading to superior business outcomes

SBFC acknowledges the complexities of underwriting loans, and to ensure positive business outcomes, 100% of their loan portfolio has in-house origination, limiting their reliance on direct selling agents or connectors in order to ensure a more direct, thorough understanding of the customer's profile. They source customers directly through their sales team of 1,911 personnel as of March 31, 2023, and have adopted a direct sourcing model through branch-led local marketing efforts, repeat customers or through walk-ins. Their in-house sourcing model helps them make a better credit evaluation of customers on a wide range of parameters after collating all customer information in their database. They are aided in their loan origination process by technology.

### Comprehensive credit assessment, underwriting and risk management framework

The company has a credit assessment and risk management framework to identify, monitor and manage risks inherent in their operations. Credit management is crucial to their business since a significant number of their customers are from the underserved financial segment. They focus on customers who have better income profiles, providing them with a stable growth trajectory. Accordingly, as a lender, their lending decisions are contingent on their evaluation of the ability of the individual and the business to service the loan, and the basis for such assessment is a combination of credit history and present cash flows. Company's risk management committee has developed risk management policies, addressing credit risk, market risk, liquidity risks and operational risks. Leveraging their significant operational experience, they have set up stringent credit quality checks and customised operating procedures that exist at each stage for comprehensive risk management.

### Extensive on-ground collections infrastructure leading to maintenance of robust asset quality

Company's underwriting model contributes to suitable customers being on-boarded and they have also created an extensive on-ground collections infrastructure to ensure that they maintain a high asset quality. They have a 3-tier collections infrastructure, comprising (i) tele-calling, (ii) field collection, and (iii) legal recovery, in order to optimize collections and minimize NPAs. They also track collections in real time through their mobile application. Additionally, they deploy collection agencies to assist their in-house collections team, and as of March 31, 2023, they have engaged 19 such agencies which are dedicated to their Secured MSME Loan portfolio. Their collection services are aided by a mobile application 'Delta' and a web application 'Omega', which are collections applications providing a priority list of overdue customers to the collection team in real-time. They leverage their collections infrastructure to assist collections on behalf of third parties.

### Healthy liability franchise with low cost of funds

The company intends to continue to diversify their funding sources, identify new sources and pools of capital and implement ALM policies with the aim of further optimizing their borrowing costs and expanding their net interest margin. They have secured financing from diversified sources of capital, including term loans, proceeds from loans securitized, proceeds from the issuance of NCDs from banks and financial institutions to meet their capital requirements. The company has the ability to access borrowings at a competitive cost due to their stable credit history, credit ratings, and conservative risk management policies and brand equity. They have received a rating of CARE A+; Stable for their long-term bank facilities in April 2023. Their ratings indicate resilient liability origination despite challenges faced by the Indian economy for varied factors. In addition, they have entered into a co-origination agreement with ICICI Bank in 2019, through which ICICI Bank and the company co-originate Secured MSME Loans at a mutually agreed ratio of 80:20, respectively.

### Consistent financial performance backed by profitable growth

In a limited period, the company has demonstrated a history of healthy financial performance. As of March 31, 2023, their average yield on Gross Loan Book was 15.91%, with Secured MSME Loans and Loans against Gold accounting for 15.89% and 15.64%, respectively. Their Secured MSME Loans have progressively increased from comprising 64.93% of their AUM as of March 31, 2021, to 79.31% as of AUM as of March 31, 2023, reflecting their increased focus on this segment. The Return on Tangible Equity was 10.02%, 6.55% and 12.01% in Fiscal 2021, 2022 and 2023. Further, the Return on Total Tangible Assets was 2.15%, 1.57% and 3.07% in Fiscal 2021, 2022 and 2023. The company also provides loan management services to third party financial institutions as a master service provider and act as a backup servicer to a leading global bank, where such institutions benefit from their experienced portfolio management, collection, and related services.

**Experienced, cycle-tested and professional management team with strong corporate governance**

The company has an experienced and dedicated management team, including KMPs and Senior Management with significant industry experience and who have demonstrated their ability to deliver growth and profitability, across business cycles. Their Key Managerial Personnel and Senior Management includes a combination of management executives and independent members who bring in significant business experience, which positions them well to capitalize on future growth opportunities. Each of them have extensive experience in the banking or related industry such as finance, commercial operations, strategy, audit, business development, human resources, compliance, and public relations. The industry experience of heads of functional groups, such as operations, risk, finance, audit, and collections, enhance the quality of their management.

al management team with industry experience and backed by private equity investors

## Key Business Strategies for future growth

**Leverage the pan-India network to deepen the penetration in the target customer segment**

The company's business model is scalable and by drawing on the experience of their team, they expect to be able to expand their operations efficiently, with low incremental costs. Owing to their geographical diversification at present, they intend to undertake geographical expansion by penetrating further in states in which they are already present. They are constantly evaluating additional locations using their criteria and expect to continue to add branches to grow out network in the near term. As of March 31, 2023, they had reached an average district level penetration of 27.68% in the states in which they operate, calculated on the basis of location of their branches.

**Expand the product portfolio through offering affordable housing finance to the target customer segment, utilising their existing network**

In December 2022, SBFC Finance has incorporated a subsidiary, SBFC Home Finance Pvt Ltd, through which they intend to commence their housing finance business. The subscription to the equity share capital of the Subsidiary is proposed to be funded from the company's internal accruals. They intend to focus on providing financing for affordable housing loans to individual borrowers from the EWS, LIG, and middle-income segments, with a focus on tier II and tier III cities and towns, which benefit from higher transparency in the sector, increasing affordability and urbanisation, and government schemes such as Housing for All.

**Diversify the source of borrowings and improve operating leverage**

The company has diversified their funding sources by using term loans, proceeds from loans securitized, proceeds from the issuance of NCDs from banks and financial institutions to ensure that their debt capital requirements are met at optimal costs. Their average cost of borrowings was 8.11%, 7.65% and 8.22% in Fiscal 2021, 2022 and 2023, respectively. They intend to expand and diversify their lender base. They are focused on their asset and liability management to ensure that they continue to have a positive asset-liability position. This will help them improve their credit ratings further and reduce the average cost of their borrowings. Their developed distribution and collections infrastructure is a key factor in their operating leverage and will help reduce their operating expenses. They will continue to review and identify means to improve their cost to income ratio and improve their overall net interest margin from current levels, which stands at 9.32% as of March 31, 2023.

**Utilize technology to drive operational efficiency**

The company has made strategic investments in their information technology systems and implemented automated, digitized technology-enabled platforms and tools, to strengthen their offerings and derive greater operational, cost and management efficiencies. They plan to ensure that their information technology systems continue to help them with several functions, including loan origination, credit underwriting, collections, and customer service. They intend to strategically invest their resources for leveraging technology for efficient operations as they scale up to ensure increased effectiveness of their operations.

## Financial Snapshot (Consolidated) as on 31st March 2023:

| Particulars (Rs. Cr.) | 2021 | 2022 | 2023 |
|---|---|---|---|
| Share Capital | 796.67 | 806.8 | 889.57 |
| Reserves | 408.43 | 480.37 | 837.7 |
| Net Worth | 1,205.11 | 1,287.17 | 1,727.27 |
| Revenue from Operations | 507.1 | 529.05 | 732.81 |
| Revenue Growth (%) | - | 4.33% | 38.51% |
| EBITDA | 362.06 | 319.09 | 490.53 |
| Profit before Tax | 114.07 | 86.7 | 201.37 |
| Net Profit for the year | 85.01 | 64.52 | 149.74 |
| Net Profit Margin (%) | 16.76% | 12.20% | 20.43% |
| EPS – Basic (Rs.) | 1.09 | 0.81 | 1.71 |
| RONW (%) as stated | 7.67% | 5.18% | 9.93% |
| Net Asset Value (Rs.) | 14.66 | 15.42 | 19.26 |
| ROA (%) | 2.01% | 1.48% | 2.92% |
| Source: Company RHP, ACMIIL Research | | | |

## Key Financial and Operational Parameters as on 31st March 2023:

| Particulars (Rs. Cr.) | 2021 | 2022 | 2023 |
|---|---|---|---|
| Customers | 56,587 | 72,816 | 1,02,722 |
| AUM (Rs. Cr) | 2,221.32 | 3,192.18 | 4,942.82 |
| Net Worth (Rs. Cr) | 1,205.11 | 1,287.17 | 1,727.27 |
| Tangible Net Worth (Rs. Cr) | 944.72 | 1,026.78 | 1,466.88 |
| Leverage (AUM/ Net worth) | 1.84 | 1.63 | 2.86 |
| AUM/ Tangible Net Worth | 2.35 | 3.11 | 3.37 |
| Restated Profit After Tax for the Year / Period (Rs. Cr) | 85.01 | 64.52 | 149.74 |
| ROA (%) | 2.01% | 1.48% | 2.92% |
| ROE (%) | 7.67% | 5.18% | 9.93% |
| Return on Tangible Equity | 10.02% | 6.55% | 12.01% |
| Branches | 124 | 135 | 152 |
| Employees | 1,471 | 2,048 | 2,822 |
| AUM per branch (Rs. Cr) | 17.91 | 23.65 | 32.52 |
| AUM per employee (Rs. Cr) | 1.51 | 1.56 | 1.75 |
| Disbursement (Secured MSME Loans) per branch per month (Rs. Cr) | 0.4 | 0.82 | 1.25 |
| Disbursement (Secured MSME Loans) per employee per month (Rs. Cr) | 0.07 | 0.09 | 0.11 |
| Gross NPA ratio (%) | 3.16% | 2.74% | 2.43% |
| Net NPA ratio (%) | 1.95% | 1.63% | 1.41% |
| Operating Expenses to Average AUM (%) | 6.59% | 6.59% | 5.70% |
| Average cost of borrowing (%) | 8.11% | 7.65% | 8.22% |
| Cost to income ratio (%) | 46.34% | 57.19% | 49.82% |
| Provision Coverage Ratio (%) | 38.25% | 40.44% | 42.04% |
| Average yield on Gross Loan Book (%) | 15.09% | 14.89% | 15.91% |
| Net Interest Margin (%) | 11.73% | 9.39% | 9.32% |
| Source: Company RHP, ACMIIL Research | | | |

## Comparison with Listed Peers as on 31st March 2023:

| Name of the Company | Consolidated/ Standalone | Face Value | Total Income for FY 2023 (Rs. Cr) | EPS Diluted | | NAV | P/E | RoNW (%) | Networth (Rs. Cr) | PAT FY2022 (Rs. Cr) |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Basic | Diluted | | | | | |
| SBFC Finance Ltd | Standalone | 10 | 740.36 | 1.71 | 1.62 | 19.26 | 35.18 | 9.93 | 1,727.33 | 149.80 |
| Aavas Financiers Ltd | Consolidated | 10 | 1,610.61 | 54.38 | 54.26 | 413.58 | 28.80 | 13.14 | 3,269.66 | 429.64 |
| Home First Finance Co India Ltd | Standalone | 2 | 795.60 | 26.01 | 25.20 | 206.48 | 31.12 | 12.56 | 1,817.34 | 228.29 |
| Aptus Value Housing Finance India | Consolidated | 2 | 1,129.00 | 10.11 | 10.08 | 67.05 | 24.80 | 15.06 | 3,339.33 | 503.02 |
| AU Small Finance Bank Ltd | Standalone | 10 | 9,239.87 | 21.86 | 21.74 | 164.64 | 35.01 | 13.01 | 10,977.34 | 1,427.93 |
| Five Star Business Finance Ltd | Standalone | 1 | 1,528.93 | 20.71 | 20.49 | 148.94 | 32.47 | 13.91 | 4,339.53 | 603.50 |
| Source: Company RHP, ACMIIL Research | | | | | | | | | | |

## Risks and concerns

1. Price volatility Risk arising from gold provided as collateral
2. Substantial Rise in Interest rates may affect growth in business & also fear of NPA levels.
3. The company have geographic concentration in certain states and therefore are dependent on the general economic conditions and activities in these states.
4. Any kind of slowdown in credit growth due to slowdown in economy may affects overall business and subsequently profitability of the company.


Asit C. Mehta
INVESTMENT INTERRMEDIATES LTD.

**Retail Research Desk:**

Email: retailresearch@acm.co.in

**Research Analyst Registration Number: INH000002483**

**CIN: U65990MH1993PLC075388**



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