SPARK CAPITAL

INVESTMENT BANKING NEWSLETTER
FINANCIAL SERVICES

JANUARY 2018

FROM THE DIRECTOR'S DESK

Dear Reader,

It gives me great pleasure to welcome you to the first edition of the financial services newsletter by Spark Capital. With this newsletter, we have tried to give you a flavour of various happenings across the banking and financial services spectrum.

We have been privileged to work with a diverse set of clients across the lending and distribution spectrum and have spent considerable amount of time on the field to interact with end borrowers/ customers/ teams at the branch level. As we look ahead into 2018, here are some of our thoughts on the key BFSI sub segments :

- Overall themes for the year:
    - Retail NBFCs, especially those with less than INR 20 bn of assets, should continue to see growth in excess of 50% on the back of increased demand for housing, pick up in economic activity (impacting vehicle finance positively) and businesses springing back from a pause mode post twin effects of demonetization and GST (higher consumption demand);
    - We see increasing use of technology by NBFCs across segments in underwriting, sourcing and collections – yet, we remain sceptical of businesses built on pure play tech driven underwriting to informal retail customers
    - Increasing borrowing costs may impact profitability in the short term for some NBFCs, especially for those businesses with fixed rate assets
    - We see some of the distribution businesses of broking, wealth, insurance and AMCs doing very well, driven by higher financialization of savings, high use of technology (proven in retail and insurance broking) and ability to cross sell products to end clients. Tier 2 and tier 3 towns (beyond the top 15 towns) provide great opportunity to build scale with pricing power. The non-lending sector has seen close to USD 8 bn of equity raise in CY18; we could see increasing M&A activity in the unlisted space this year;
- The MFI sector, in our view, offers one of the best risk-reward metrics currently. Most of the effects of demonetization seem to have played out and the provisions for the "troubled period" of November 2016-March 2017 seem to have been made through moderate doses of equity infusion (mostly rights issuances). The portfolio quality for most good quality lenders, for disbursements post April 2017 seems to have returned to pre demonetisation levels. There has been no structural impact on the livelihood of borrowers and the inherent profitability of these businesses (one of the highest among NBFCs) remain intact. We see continued M&A activity and equity capital raise in the sector this calendar;

FROM THE DIRECTOR’S DESK

- SFBs have gone through a “set up/ build out” period of ~2 years and should see growth coming back;
- SME lenders should continue to find favour with investors, particularly those SME lenders with more than INR 10 bn loan books, given paucity of pure play assets in this segment;
- We remain cautious on the scale-up and asset quality of some of the LAP lenders and HFCs given the spurt of licenses granted in the last 24 months. There are 77 HFCs on last count and a large number of NBFCs scaling up through a LAP product. Challenges could come from rising cost of capital, managing quality branch-level hiring, stress in portfolio related to GST impact on certain borrower classes, and building right leverage levels in the book;
- Select rural based agri-finance companies and used vehicle finance companies should do well given deep rural distribution networks and increased farm incomes (two continuous good monsoons, focus of government in increasing farm productivity through use of drip irrigation, fertilizers, etc);
- We remain optimistic on PSU banks given initial signs of pick up in capex cycle, de-leveraging among stressed borrowers (capital raise, asset sales), NPA resolution through NCLT, government plans of recapitalization with select banks taking QIP route. There are structural changes to be addressed in terms of governance, impending mergers and impact, attracting human capital and “retailization” of loan books. Rising G-Sec yields could impact treasury income. Private sector banks seem much better placed, having the opportunity to raise equity capital (almost at will), adopting technology in a big way and now looking at inorganic route to onboard retail clients.

In this edition, we caught up with Mr. D. Lakshmipathy, CMD of Five Star Business Finance, a South India based small business financier. We also met Kapil Mehta and Abhishek Bondia, founders of SecureNow, an insurance broking firm using first-of-its-kind technology to target the underpenetrated SME segment.

We have also covered in this edition, field notes from our visits to microfinance and agri-equipment finance borrowers, and latest developments across the Indian financial services sector.

We hope that you will find this Newsletter insightful and look forward to your feedback on this ongoing initiative. We aim to roll-out a new edition of the newsletter once every two months.

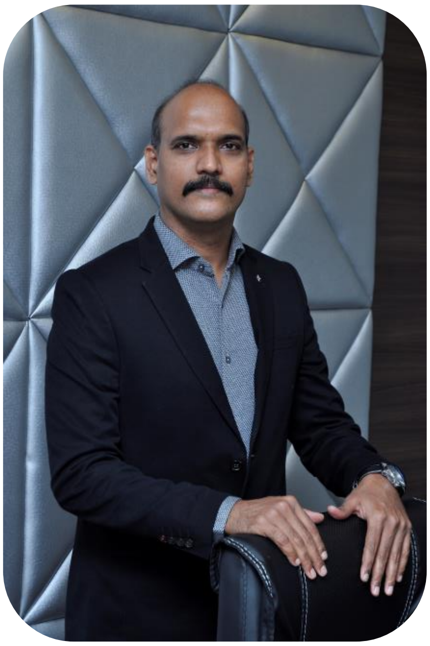
We thank the founder(s) of Five Star, SecureNow, and all the other constituents that we interacted with, for their inputs in preparing this newsletter. With your support, we hope to make this a great success.

See you in March next! ”

Abhijit Chiripal

Director & Head – Financial Services
Investment Banking

WHAT'S INSIDE?

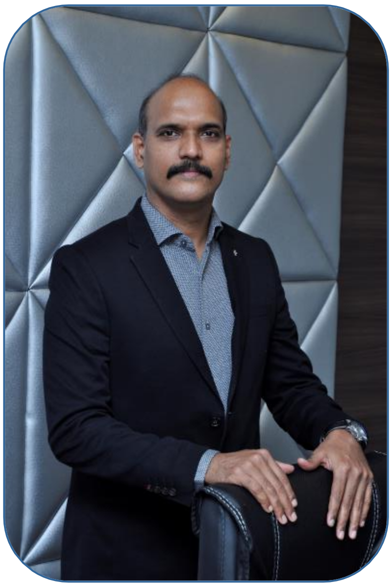


Funding The Unfunded

INSIGHTS FROM AN INDUSTRY VETERAN

FIVE STAR Business Finance Limited

We interacted with Mr. D. Lakshmipathy, Chairman & MD of Five Star Business Finance, on the company's journey, small business financing landscape, and various macro developments impacting the sector



Lakshmipathy D.

Chairman & MD, Five Star

Five Star is an MSME focused lender headquartered in Chennai. Over the last five years, the company has been silently but steadily making strides and has evolved into a niche NBFC specializing in providing small business and small housing loans. During this period, the company has grown its portfolio ~15x and has attracted investment from marquee investors including Matrix Partners, Morgan Stanley, Sequoia India, and Norwest Venture Partners.

1. What are your thoughts on this long and fruitful journey as the CMD of Five Star? Do you believe you have achieved the goal you might have set for yourself at the beginning of this journey?

I have been leading Five Star as a Managing Director for the last 5 years and the journey has been very fruitful. I do not come from finance background but when you have an interest and you see yourself as the driving force and couple it with hard work and perseverance, you can leave your footprints in any sector.

I came into Five Star under trying circumstances and my initial goal was to just turnaround this company. I can safely say that I have successfully achieved this a few years back. My goal has then evolved into making Five Star a truly outstanding financial institution and the journey is still on.

2. What made you choose to target MSME customers with a service economy orientation? Why was this segment hitherto under-serviced or un-serviced in your opinion?

The services segment is largely underserved because there are huge entry barriers. Working with this segment is not easy as underwriting to this segment cannot be templatized. A deeper understanding of the customers' cash flow cycles and their psyche and behaviour during the highs and lows of their business is very important.

While these are difficult entry barriers, once understood, the service segment offers the lenders a very safe business model. Manufacturers, often the smaller ones down the value chain, are the first to be affected and the worst impacted by business cycles.

Given these nuances, the services segment has become our mainstay for business.

Spark fact file

Investment Banking

USD 5.5 Bn
Total transaction value till date

USD 3.7 Bn
Capital raised till date

USD 1.8 Bn
M&A transaction value till date

300+
Number of fund relationships globally

USD 700 Mn
Average annual deal closure value for the last 3 years

11
No. of transactions > USD 100 Mn

~USD 1.2 Bn
Current value of transactions being executed

Financial Services

USD 1.7 Bn
Total transaction value till date

~USD 400 Mn
Current value of transactions being executed

EXPERT SPEAK

Full Service, Mid-Market I-Bank

- Investment Banking (VC, PE, M&A, IPO, QIP, PIPE)
- Institutional Equities
- Fixed Income solutions
- Investment Advisory

Knowledge Banking

- Dedicated sector teams with deep domain expertise
- Ability to bring new ideas to the market
  - Manappuram (2007)
  - Equitas (2010)
  - Wildcraft (2013)
  - India Shelter (2015)

Relationship Banking

- Over 24 clients for whom we have closed multiple transactions
- Consummated ~USD 1.5 Bn of transaction value in repeat business

Deep Distribution

- Extensive reach to over 300 funds across
  - Private Equity
  - Hedge Funds
  - Family Offices
  - Sovereign Funds
  - Corporates

3. While MSME financing has always been a visible blue sky opportunity, what do you believe could be the reasons only a few players like Five Star have been able to build a meaningful business out of it? What have been the key pillars of your success?

What makes Five Star unique is that we patiently understood the sector before scaling up because it's not a templatized way of lending.

Five Star has created a very good, conservative business model with unique underwriting parameters including family guarantee and attaching strong emotional collateral to the loan, which helps us in recovery.

I won't say others are not doing well; they are doing well. The difference has been that many others have wanted to build their balance sheet without understanding the sector while Five Star has built its balance sheet slowly after deepening its understanding of the sector.

Discipline and patience to understand the sector before growing faster has provided an edge to Five Star.

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4. It has been a year now since demonetization. Do you believe that your customers and your target customer segment have broadly recovered from demonetization? Have you seen any long term adverse impact on any part of your customer base on account of demonetization?

De-mon was out of our mind in just a quarter. Our customers, like everyone, suffered demonetization impact for the first few weeks/months. Their business was not going out of their hand. Their cash flows were stuck for a few weeks but the cash flows came back. From December, our collections were normal, and from March onwards, our collections were very good. By the end of March, we had one of the lowest 90+ overdues. We didn't have a lasting impact of demonetization and I credit the business model for that – selection of customers (who are involved in day-to-day business activities), small ticket size loans, and small EMIs, backed by strong emotional assets, ensured that Five Star was on top of the mind of the customers to repay loans.

5. Has GST impacted your customer segment adversely, especially due to the initial confusion and the resultant impact on their revenues? How have your customers coped with it and has the Company modified its approach on account of the same?

Our customers are far below the GST's thresholds. Our Average Ticket Size is INR 3L and EMIs of INR 8,000-9,000. For an INR 9,000 EMI, the customer's monthly cash flow should be INR 25,000-30,000, which translates to INR 3-4L a year. GST starts at INR 20L of revenue. So, our customers are not even near to its threshold. Our customers sell daily-need items, such as groceries, milk, etc., directly to the consumers and thus are not a part of a chain of larger ecosystem. Some procedural confusions were there initially with respect to applicability of GST but those are getting normalized now. Overall, GST didn't have any major impact.

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6. What is the extent of competition that you see from NBFCs and SFBs?

It's still early days for SFBs and they are very busy focusing on their liability side and consolidating their business model. Five Star has been working with MSME customers for decades now and has the niche edge to take the lead because of its deeper understanding of the sector. The industry is growing fast and is big enough to accommodate many more players, including SFBs.

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7. On your product strategy, do you expect to diversify beyond small business financing as you go forward?

On diversification, whatever product we decide to grow, we will always keep two things in our mind. First, we will not change our focus from the current [customer] segment. We have been dealing with the customers in this segment for the past 3 decades and we know their positives and negatives. Secondly, we will not venture into unsecured lending.

Whatever product fits these criteria, we will be happy to explore. Our Housing Finance foray is a case in point here. We intended to diversify into another product and that's

EXPERT SPEAK

Select Financial Services Transactions

Advisor

To

December 2017

Private Equity Fund Raise

From

~USD 32 Mn

Advisor

To

November 2017

Private Equity Fund Raise

From

~USD 15 Mn

Exclusive Advisor

To

July 2017

Private Equity Fund Raise

From

USD 52 Mn

Exclusive Advisor

To

March 2017

Private Equity Fund Raise

From

USD 100 Mn

why we started our housing finance business. It's almost 3 quarters since we started and have already built around INR 25 Cr of business. This is a new product, with a little higher debt and longer tenure of 11-15 years, to the same profile of customers. We want to be a little cautious on how this HFC market evolves.

8. Will you continue to be a South India-focused player as you expand your business?

We are not only a Tamil Nadu and Andhra Pradesh focused player anymore; we are also focused on Telangana, where we have 20 branches, and Karnataka, where we have 15-16 branches, and we are getting good business from both Telangana and Karnataka. In the next Financial Year, we want to break new grounds and to have 2 branches in Maharashtra and few branches in Madhya Pradesh. In these newer locations, we have also selected places to open our first few branches. These branches are meant to be "learning" branches, which will give us vital data points that we want to get from the ground level. Going forward, our clear focus is to be a pan-India player. Whatever we did in Tamil Nadu will be replicated in other states we expand into.

9. Where do you see the Company in a few years from now?

We intend to close this financial year (FY18) with over INR 1,000 Cr of AUM, about 32,000 customers, and 130 branches. We have a 3-year plan, which we call "2020 plan". We have one of the best second-level management teams with a highly professional Board. We also have the backing of world-class investors. We would like to use this opportunity to make our presence felt wherever we intend to. Growing 3x is the plan now onwards for the next 3 years. Three years down the line, we want Five Star to be a dominant player in small business and small housing lending.

EXPERT SPEAK

Select Financial Services Transactions

Exclusive Advisor

To

CreditAccess Asia

March 2017

Private Equity Fund Raise

From

ADB Asian Development Bank

USD 32 Mn

Co-Book Running Lead Manager

For

BSE

February 2017

IPO

~USD 183 Mn

Exclusive Advisor

To

Suryoday

June 2016

Private Equity Fund Raise

From

USD 32 Mn

Exclusive Advisor

To

CreditAccess Asia

January 2016

Structured Capital Raise

From

Olympus Capital Asia

USD 30 Mn

The Insurance Messiahs

THE UP-AND-COMING

SecureNow

We interviewed the founders of SecureNow, one of India's up-and-coming insurance brokerage firms, on how they serendipitously came together to pursue the same vision of providing easy access to commercial insurance for SMEs

Kapil Mehta
Founder & CEO

Abhishek Bondia
Founder & Principal Officer

1. What brought the both of you together in this venture? Tell us a little about your background and journey at SecureNow?

Kapil: When at Prudential Financial, I met a few first-generation entrepreneurs in the US and India. They had built fabulous businesses distributing pure risk products efficiently and were able to sustain revenues of over $100 million. There was clearly a demand for such pure risk insurances in the Indian market, both in life and general insurance. I was introduced to Abhishek by a common friend. Abhishek was looking for something entrepreneurial as well and had worked extensively in insurance. That's how we got started. The first eight months were spent getting a license to operate. We finally began in early 2012. At that time, very few companies would trust a newbie like us with their insurances. In the entire first year we probably had about 15 new clients. We've now come some way because we get 15 new clients each day.

Abhishek: We could see that insurers had good products in India, but what was missing were the bridges that linked insurers to customers. At McKinsey, I had worked in insurance in the US and India. The commercial insurance market in India which included property, marine, liability and group insurances was huge, but buyers were mostly large companies with assets of over ₹100 Cr. The 20-30 million SMEs in the country were not served and would struggle to buy insurance. Very early in our journey we received an enquiry from an exporter in Chandigarh for a public liability insurance. His contract with a US buyer required him to have this. The exporter had reached out to insurers, agents, banks and his chartered accountant but had not been able to get a quote. We placed that insurance within a day and then went ahead and made a calculator that gave the quote within 1 minute. From that starting point we have aggressively built the business with the single minded objective of making insurance buying for SMEs easier and reliable. We now have over 6,000 clients. That's a large number but still a long way to go.

EXPERT SPEAK

Select Financial Services Transactions

Exclusive Advisor

To

Select Institutional Buyers

September 2015 Onwards

Secondary Stake Acquisition

In

NSE

USD 403 Mn

Exclusive Advisor

To

ISFC India Shelter Finance Corporation

May 2015

Private Equity Fund Raise

From

SEQUOIA NEXUS WESTBRIDGE CAPITAL

USD 43 Mn

Exclusive Advisor

To

MANAPPURAM FINANCE LIMITED

February 2015

Majority Stake Acquisition

In

ASIRVAD

~USD 18 Mn

Exclusive Advisor

To

NEWQUEST CAPITAL PARTNERS

January 2015

Minority Stake Acquisition

In

Ujjivan Build a Better Life

USD 20 Mn

2. What was your rationale behind positioning SecureNow in the commercial B2B insurance broking space? What is the Company's long-term vision in this space?

We focused on the B2B space because it was large, over $15 billion; growing fast, over 20% for several years when we began; underpenetrated, less than a third of world averages; and brokers were contributing a low 30% of total sales. There was another reason as well – the B2B business generates real cash, fast and we did not believe in the high cash burn B2C model. The SMEs offered several other benefits that appealed to us. For starters, the decision-making is much faster and there are few conflicts of interest. The insurance that is best for the company is what the proprietor will buy. In large companies, decision-making is complex as departmental issues come into play. The purchasers are employees who may have their own objectives to meet. Also, our SME business operates at full margin unlike large clients' insurances where margins are squeezed by the ruthless procurement process!

Insurance distributors are currently sub-scale. There are just a handful (mostly with a captive customer base) that garner premiums of Rs. 1,000 cr or more annually. About 70% of commercial insurance is distributed directly by the insurers or their agents. That is not the way enterprises buy insurance anywhere else in the world. I think in the next five years there will be at least 5 distributors with over a billion dollars of insurance premium. That's the group we want to be in. Worldwide, distributors are larger than the insurance companies and far more capital efficient. The question really is how fast can we drive that change here.

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3. What do you believe are the key success factors for companies to succeed in the commercial insurance broking space? What has SecureNow done to distinguish itself along these facets?

Succeeding in the commercial insurance broking space is difficult. Many speak about the SME opportunity but few have been successful. That suits us just fine. The difficulty is in reaching SMEs cost effectively, offering a proposition that is genuinely valuable and impossible for the SMEs to get on their own, and building infrastructure to support the extensive service and claim requirements. Our distinctiveness comes from our ability to do all these things. We have a magical blend of domain knowledge, technology and execution capability.

We use our understanding of the domain to design specific products for SMEs. For example, we offer group health insurance to companies with as few as 5 employees. Our liability insurance has features such as legal support and pricing that is unmatchable. We recently sold one of the country's first solar panel performance warranty insurances. Our workman compensation insurance can be issued instantly. The design of these products is specific to SMEs and professional groups within that. We don't carry the risk in these insurances but are actively designing them.

In the insurance world, technology has a material role in customer engagement, service and delivery. Our website is intuitive. You should try to buy a commercial insurance for your company on our website to see what I mean. We've essentially reduced the research process from a month to minutes. Our portals and mobile apps are used in the back-end delivery of policy copies, mediclaim cards, and endorsement requests. In terms of execution, we have codified our ability to train people and disaggregated the typical broking business. One evidence of this is that fewer than 5 of our 140 people are from the insurance industry. We have our own, effective systems of attracting and developing talent.

The peer-group recognizes what we have achieved. SecureNow has been selected as a top 3 insurance broker by the Asian Insurance Review Industry Awards for 2015 and 2016. This is judged by an international, well-respected peer-group and is one of the best regarded industry awards. We have won the international claims innovation award by the Claims Award Asia-Pacific, another peer reviewed group (http://www.claimsclubasia.com/awards/static/2016-winners). Our mobile app, Notify, was a top three in the TechHR Spotlight awards during its launch in 2015. We have made it to the long list of the Fintech Innovation Awards 2015, London. SecureNow has also been accepted into the prestigious UnisonSteadfast network of

Select Financial Services Transactions

Exclusive Advisor
To
DCB BANK
August 2014
QIP
USD 42 Mn

Exclusive Advisor
To
Karur Vysya Bank
August 2014
QIP
USD 65 Mn

Exclusive Advisor
To
shubham
August 2014
Private Equity Fund Raise
From
Motilal Oswal
USD 20 Mn

Exclusive Advisor
To
Chola
July 2014
QIP
USD 83 Mn

international brokers.

4. How is SecureNow positioned differently from other players in this space – say, traditional commercial insurance brokers, web aggregators, pure play online insurance brokers?

There are three areas where we are very different from other distributors. First, we operate through an insurance broking license that allows us the maximum flexibility in terms of activity. We can sell as well as service insurance. We are not tied to any limited set of insurers. Other legal entities have restrictions in terms of activity and scope. Second, we are focused on a segment, commercial insurances for SMEs, different from others. The existing web aggregators and online brokers are B2C focused. There is a chasm between B2B and B2C. The fundamental DNA of the two businesses are different, in terms of products knowledge, people and technologies required. Finally, the extensive use of technology across the business chain makes us different. Our clients see all their documents on our portal, endorsements can be made and tracked on the platform, policy details for individuals gets distributed through the mobile app. In the back-end allocation of RFQs and internal capacity management is all automated. The infrastructure we have built is keeping in mind that we will grow to many times our current size.

5. Give us an idea of the kind of commercial establishments you are targeting and the products you would sell to these organizations. How are you thinking about the go-to-market for these clients?

Our focus is on building bridges between insurers and small companies. To do this effectively, we segment the market in many different ways. One is by the online familiarity of the SME, the other is by professions and then by identifying large groups of service providers that have specific insurance requirements for their clients.

For those companies that search for information online, we have by far the best information and tools available. I see buyers with very specific risk related queries coming to our website in search for information and following up with us. Professions have their own requirement. For example, contractors need to buy comprehensive general liability and workman compensation insurance to operate. These are complicated insurances but we have designed specific, bespoke options that can easily be distributed and meet the requirements of the group. We currently work with about 10 such professions. Then there are groups like labour consultants or chartered accountants who need insurance for their clients. Insurance is not something central to their proposition but something that they just need to get done. That's where SecureNow comes in. Of course, to bring all of this to life, we have diverse technological tools making the wheels turn!

6. What role do you envisage for technology intervention in this space? What is SecureNow doing on this aspect?

This business cannot be scaled up without technology. Particularly in the case of SMEs, since the premiums are low, technology helps in reaching out to these clients and offering insurance services. We have several technology tools. These help build the business but they are also geared to retaining business each year. Since much of the insurances we distribute are yearly renewable, it becomes important for us to lock-in clients with services they want to keep using.

Most of our operations are now technology driven. We believe that the ability of the broking firm to build a long term connect and maintain continuous engagement with clients, insurers and employees through portals and applications contributes greatly to the scaling up process. Traditional broking requires days to procure quotes. We have been able to translate and integrate the complex underwriting into our proprietary online calculators that display options within seconds. These calculators explain underlying terms, exclusions and warranties transparently. We have a functionality, "Hovertips" that describes the meaning of technical terms simply. The calculators are available on our website.

Select Financial Services Transactions

Exclusive Advisor
To
City Union Bank Ltd
June 2014
QIP
USD 100 Mn

Exclusive Advisor
To
equitas
December 2013
Private Equity Fund Raise
From
CDC FMO
USD 38 Mn

Exclusive Advisor
To
Hinduja Leyland Finance
July 2013
Private Equity Fund Raise
From
EVERSTONE
USD 33 Mn

Exclusive Advisor
To
equitas
October 2012
Private Equity Fund Raise
From
IFC International Finance Corporation
IIFL
USD 31 Mn

EXPERT SPEAK

We have also been working on building a knowledge platform for all the participants in the insurance sector. A result of our efforts is Insuropedia, SecureNow's proprietary tool, that is available on our website. You can ask any question on insurance and get meaningful responses. Insuropedia is backed by intelligent search technology and vast content. Intelligent search suggests queries as users begin to type. The most frequently asked questions are shown first and the order is refined over time based on actual search history. We get over 25,000 people every month searching for information on Insuropedia.

We have a fully functional customer policy administration portal that provides all the insurance documents, active lists and contact persons in one place. The online uploads of endorsements and claims significantly increase efficiency. The system sends renewal reminders and updates seamlessly. Our app Notify, available on Google Play and iOS, delivers medical insurance cards electronically to the phone, within three days of the insurance being placed. The standard industry process is to give physical cards, which are never found when you need them most, three to four weeks after the insurance start date. The app also allows claimants to reach us at any time. The app remains valid even if we change the insurer on renewal – we electronically replace the mediclaim cards. The app seamlessly stores information on personal insurances with reminders and records of original documents carefully maintained.

7. How do you see the insurance broking space evolving in the next few years?

I think the distribution landscape will change significantly and that too at a pace that is not understood today. To be at world average penetration, the commercial insurance would need to increase from $15 billion to $45 billion. There is just no way this can take place with the current infrastructure. So, I see considerable emphasis on groups being formed. In a sense these groups are companies with similar needs that buy a specific insurance. We can see such groups cutting across professions such as chartered accountants, lawyers, contractors, shopkeepers; economic strata such as unorganized workers or farmers and geographical regions. As already mentioned, there would be a shift from depending on personal relationships for business to using technology to reach out to clients. If we look at the largest insurance distributor in the market today, it has a size of about $0.3 billion, which is insignificant in the overall scheme of things. I can't imagine why 4 or 5 distributors should not be at least a billion dollars in size in the next few years. Also, from serving less than 30% of the market today brokers will be over 50% in a few years.

As SecureNow, we will be expanding our current business aggressively. In the next two years we should be present in all the major state capitals and have specialized products for at least 25 SME segments. We will also apply for a reinsurance broking license over the next few months. This will allow us to work directly with reinsurers to develop the products for our market segments. Our platform should be the one-stop for all parts of the insurance eco-system. We are actively considering acquisitions or investments that help create the eco-system we want. Partnerships in rural markets is another untapped opportunity. There is much work to be done.

SNIPPETS FROM THE GROUND

Select Financial Services Transactions

Exclusive Advisor
To
Select Institutional Buyers
April 2012
Secondary Stake Acquisition
In
Karur Vysya Bank
USD 55 Mn

Exclusive Advisor
To
Select Institutional Buyers
March 2012
Secondary Stake Acquisition
In
Manappuram Finance Limited
USD 32 Mn

Exclusive Advisor
To
equitas
March 2010
Private Equity Fund Raise
From
helion, CLSA, Aquarius
USD 46 Mn

Exclusive Advisor
To
Manappuram Finance Limited
February 2010
QIP
USD 55 Mn

AGRI-EQUIPMENT FINANCE

Field Visit Notes

#1

We interacted with suppliers and customers (farmers) of agri-equipment finance in Nashik and Pune districts over two days

Streamlined subsidy allocation and increasing awareness driving drip adoption and mechanized farming

Government has increased its focus on micro irrigation over the last decade through dedicated subsidy programmes (including PMKSY). The increased offtake is evident in the growing revenues of the drip irrigation dealers (~20-30% YoY growth). Project states (states which have a streamlined subsidy disbursement machinery) such as Gujarat, AP and Telangana have a streamlined machinery for subsidy disbursements while other states such as Maharashtra, Karnataka, Tamil Nadu, etc. offer ample opportunity to finance farmer needs (including irrigation and ancillary activities).

Farmers have successfully used drip irrigation technique and it has become an essential component of farming in the grape growing belts of Nashik with increase in yields by ~30-50%. It also has the potential to result in export quality grapes that are ~30-40% larger in size than the domestic variety. We observed that farmers belonging to low- to mid-income categories are also willing to invest in high quality agri-equipment even though it may result in an higher outlay (not fully covered by subsidy).

Agri-equipment demand recovering from a double whammy of Demonetization and GST

The demand for irrigation equipment suffered in the immediate aftermath of demonetization but was nearly back to normal by mid-2017. GST implementation and the uncertainty around the same set the recovery back a few months. Given that the GST rates have been finalized at 18%, drip irrigation companies are working to reduce the costs (at a 3-4% premium to pre-GST costs) being transferred to customers. As a result, agri-equipment products are seeing a demand recovery and are expected to return to normalcy during Q4FY18.

Large global manufacturers are operationally well set to address the opportunity

Based on our interaction, we understand that the farmers look for ease of availability/ access and support through agronomists, after-sales services, etc. Therefore, large global manufacturers find themselves optimally placed to fulfill financing needs of farmers through:

- Well entrenched dealer network across agri-belts; and
- Innovation-led product offering, augmented by value adding services.

Companies with low opex footprint best suited to operate in these belts

Widespread dealer network provides a platform that directs and filters initial leads, assisting in underwriting (with their local knowledge) and collection for agri-equipment financiers. This helps it bypass the branch network necessitated by the target segment thereby lowering operating costs and build entry barriers. Geotagging of farmlands enable financiers to track plant growth and thereby schedule timely collections.

Traditional lenders are unable to cater to the equipment financing needs of farmers

We understand from the farmers that they find it convenient to obtain financing from agri-equipment financiers rather than banks due to low TAT and products structured to suit their cash flows and repayments aligned to harvest. A financier with deep rooted knowledge acquired through local presence, supply chain linkages and long vintage of servicing the farmers is better suited than banks to service them.

SNIPPETS FROM THE GROUND

Select Financial Services Transactions

Exclusive Advisor
To
MANAPPURAM FINANCE LIMITED
November 2008
Private Equity Fund Raise
From
Ashmore
SEQUOIA
USD 23 Mn

Exclusive Advisor
To
TVS Finance & Services Ltd.
April 2008
Delisting
From
Undisclosed

Exclusive Advisor
To
MANAPPURAM FINANCE LIMITED
December 2007
Private Equity Fund Raise
From
SEQUOIA
USD 18 Mn

Exclusive Advisor
To
SHRIRAM City
December 2006
Private Equity Fund Raise
From
Merrill Lynch Global Private Equity
ChrysCapital
Cambridge Place Investment Management
USD 55 Mn

MICROFINANCE BRANCHES

Field Visit Notes

#2

We visited MFI branches in Rohtak and Meham, Haryana to review the MFI landscape one year post demonetization

Impact of demonetization has largely disappeared, with strong asset quality on post-demonetization disbursements

We understand from our discussion with the microfinance customers that demonetization, per se, did not structurally affect their livelihoods. While availability of cash for 3-4 months hindered repayment and collection efforts, data suggests that bulk of these borrowers continue to service future instalments, and some are paying past dues post the closure of ongoing contracts through tenor extensions.

Delinquency on post demonetization disbursements is minimal (back to historical levels) with collection efficiency for such disbursements close to 100%. Demonetization was not a structural event for micro finance borrowers.

Branch and area selection are key determinants of asset quality

Companies have started to use the pin code level data made available by credit scoring agencies. Key assessment parameters from the pin code analysis include propensity and requirement of micro credit in a location, competition, income assessment and nature of livelihood – all of which help to take an informed decision on further penetration and expansion.

Moving towards Cashless disbursements

Customers are open to the idea of cashless disbursements with some companies experiencing 75%+ disbursements through the bank route. The industry is also trying to move into cashless collections through tie-ups with wallet companies.

Rural focused MFIs witnessed strong bounce back in growth and collections

Based on our interaction with the customers we understand that there are fewer players in rural geographies compared to the hyper-competitive urban markets. Interest rates were also holding up between 23-24% for rural markets with average outstanding per borrower lower than urban markets.

Move towards strengthening audit and risk functions and processes

Companies have started to adhere to processes more diligently with strong risk functions coming into play and each branch getting audited at least 2-3 times a year. We saw that branches were very disciplined in record-keeping which was cross verified by the audit team. Also, there was strong cash monitoring at branches and focus was to minimise the cash on hold.

Competition is differentiated by softer parameters

Microfinance companies have penetrated across majority of the geographies, with at least 4-5 competitors present in each market. Key softer aspects that differentiated MFIs included intensity of customer relationship and engagement and fair, transparent and ethical business practices.

RECENT BFSI TRANSACTIONS IN INDIA

Select Non-BFSI Transactions

Advisor
To
Specsmakers
December 2017
Private Equity Fund Raise
From
EIGHT ROADS
~USD 10 Mn

Advisor
To
Yellow Diamond
October 2017
IPO
~USD 74 Mn

Advisor
To
intellect Design for Digital
September 2017
Rights Issue
USD 31 Mn

Exclusive Advisor
To
Apollo Touching Lives
November 2016
Private Equity Fund Raise
From
IFC International Finance Corporation World Bank Group
USD 68 Mn

A Private Equity Transactions

Target	Investor(s)	Amount (~INR Cr)
Banks		
AXIS BANK	BainCapital	11,661
NBFCs		
Profectus Capital	actis	1,300
SPANDANA	Ontario Teachers' Pension Plan, KEDAARA	1,250
KKR (KKR India Financial Services)	ADIA	600
Ujjivan	Creador	215
SK Finance	Norwest Venture Partners, evolvence India, Baring Private Equity Partners India	~200
Utkarsh Micro Finance Ltd.	CDC, responsAbility, Aavishkaar, Lok Foundation, Faering Capital	150
HFCs		
pnb Housing Finance Limited	GENERAL ATLANTIC	335
Insurance		
HDFC Life	UC-RNT Fund	95

For the period Nov-Dec 2017

B M&A Transactions

Target	Acquirer(s)	Amount (~INR Cr)
NBFC		
KARVY FINANCE (NBFC arm)	Richard Chandler Corp, Arpwood Capital	845
SWADHAAR FinServe Pvt. Ltd.	RBL BANK	NA
Asset Management		
ZODIUS	Avendus^	NA
ASHBURTON INVESTMENTS	IIFL	NA

For the period Nov-Dec 2017

RECENT BFSI TRANSACTIONS IN INDIA

Select Non-BFSI Transactions

Exclusive Advisor
To
Qwikcilver
August 2016
Private Equity Fund Raise
From
SISTEMA, ACCEL PARTNERS, helion venture partners, amazon
USD 10 Mn

Exclusive Advisor
To
CORONA Remedies Pvt. Ltd.
July 2016
Private Equity Fund Raise
From
Creador
USD 17.5 Mn

Exclusive Advisor
To
RAMESH HOSPITALS
May 2016
Majority Stake Acquisition
By
Aster We'll Treat You Well
USD 28 Mn

Exclusive Advisor
To
UNBXD
March 2016
Private Equity Fund Raise
From
NIRVANA VENTURE ADVISORS, ICP INVENTUS CAPITAL PARTNERS, Indian Angel Network, IDG Ventures India
Undisclosed

C Capital Market Transactions

Date	Company	Amount (~INR Cr)
IPOs		
7-Nov-17	HDFC Life	8,695
1-Nov-17		9,600
QIPs		
12-Dec-17	SyndicateBank	1,149
11-Dec-17	punjab national bank	5,000
07-Dec-17	Union Bank of India	2,000
04-Dec-17	Bank of Maharashtra	313
30-Nov-17	Mahindra FINANCE	1,055
15-Nov-17	Edelweiss	1,500
06-Nov-17	muthoot CAPITAL	165
Rights Issue		
24-Nov-17	LAKSHMI VILAS BANK	780

For the period Nov-Dec 2017

SPARK CAPITAL

Source: Public sources

LATEST NEWS AND ANNOUNCEMENTS

Select Non-BFSI Transactions

Exclusive Advisor
To
SUMERU Frozen Foods
February 2016
Buyout
By
PEEPUL
Undisclosed

Exclusive Advisor
To
aasaanjobs
December 2015
Private Equity Fund Raise
From
Aspada, ICP INVENTUS CAPITAL PARTNERS, IDG Ventures India
Undisclosed

Exclusive Advisor
To
POLARIS live your dream
November 2015
Majority Stake Acquisition
By
virtusa Accelerating Business Outcomes
USD 270 Mn

Exclusive Advisor
To
Sportz Village
November 2015
Private Equity Fund Raise
From
Gaja Capital
USD 10 Mn

Banks

GOVT'S ₹2.11 LAKH CRORE RECAPITALISATION PLAN FOR BANKS

A welcome move from the Govt

Banks to get ₹1.35 lakh crore from bonds and ₹18,000 crore from the Budget, and will raise the remaining ₹58,000 crore through share sales.

Opining on the development, RBI Governor Urjit Patel said, "It is a decisive package to restore the health of the Indian banking system and a monumental step forward in safeguarding the country's economic future."

FinTech

BITCOIN BREAKING THE BAR!

A bubble about to burst?

Bitcoin is breaking the bar with an unprecedented rise in prices. Some experts have labelled it as 'speculative mania'.

Union finance minister of India Arun Jaitley said, "The government's position is clear, we don't recognize bitcoins as legal currency as of now."

MFI

INDUSIND BANK ACQUIRES BFIL

Consolidation ahead in MFI Industry?

IndusInd Bank has agreed to merge with BFIL for 639 of the bank's shares for 1,000 shares of the microfinance company. Following the INR 15,486 Cr all-stock deal, none of BFIL's 15,284 employees will lose their jobs, at least for the first three years after the merger is formalized, which is likely to happen by July 2018.

Ramesh Sobti, MD & CEO, IndusInd Bank said, "The subsidiary model would allow BFIL to retain its infrastructure and culture."

Macro

MOODY'S UPGRADES INDIA'S GOVT BOND RATING

…a mixed blessing

Moody' has upgraded the GoI's local and foreign currency issuer rating to *Baa2* from *Baa3* and also changed the outlook on the rating to *stable* from *positive*.

ET Reported: Getting a rating upgrade is impressive. But given the importance that the assessment places on fiscal improvement, Moody's indirect warning to the government is to refrain from having a populist Budget next year, and stay away from the temptation of undoing its fiscal consolidation in an effort to boost growth.

Broking

EDELWEISS TAKES ON RELIGARE'S SECURITIES BUSINESS

Broking space attracting limelight…

Edelweiss will also take on the pan-India distribution of around 1,250 points of presence, including over 90 branches, over 1 million clients and the employees of the business, Edelweiss Group said in a statement

Nitin Jain, CEO, Global Wealth & Asset Management, Edelweiss Group said, "The complementary nature of Religare's business to our wealth management platform made for an attractive choice, as it expands our offering and supports our growth plans."

Source: Public sources
** Price as on 3rd Jan 2018*

FROM OUR EQUITIES DESK

Institutional Equities Highlights

198
Stocks under coverage

USD 1.2 Tn
Total market cap of stocks under coverage

INR 260 Bn
Total cash market volume in H1FY18

350+
Number of fund relationships globally

"Go-to" broker for stocks in the mid-market space

THOMSON REUTERS 2017 INDIA ANALYST AWARDS

THOMSON REUTERS ANALYST AWARDS 2017 WINNER

Institutional Investor

5th position in 2017
All India research team

Financial Services

28
Stocks under coverage

~USD 330 Bn
Total market cap of Stocks under coverage

Key snippets from some interesting notes by Spark's Equities Team

1 *Analysis of bank stock price returns – retained earnings vs capital raises*

- We analysed 10 year stock price returns – that which is attributable to operational performance and that which is attributable to capital raises
- Breaking down the book value appreciation into that attributable to normal business compounding and that attributable to capital raises over time, a striking disparity emerges. **While most private sector witnessed >10% contribution in FY07 – FY18 book value per share appreciation through equity infusion**, old-gen banks & PSU banks derive very little contribution from capital infusions for a completely different set of reasons
- While **old-gen banks suffer owing to raising capital through rights issues priced at a discount to book value, PSU banks suffer due to repeated capital infusion by GoI at substantial discounts to book value barring the case of SBIN**
- From an RoRE perspective (Return on Retained Earnings) perspective, barring Axis Bank, ICICI Bank, SIB and KVB, private sector banks' performance stand out with consistent RoREs of ~20%, over both 5 year and 10 year time periods, IIB setting the benchmark at 25%; PSU banks' RoREs cannot be calculated owing to the losses over FY16 & FY17, barring SBIN whose 10 year RoRE comes in at an anaemic 5%.

2 *Outlook on impact of increasing interest cost on NBFC liabilities*

We believe that the easing rate cycle is drawing to an end and that we are entering into a phase of hardening rates with a likely ~50bps increase in policy rates in CY18.

In this context, we assessed the impact this would have on our coverage NBFCs; while the stress on profitability is expected to build in gradually from FY19 and flow through entirely in FY20, we believe the front ended collateral damage caused on account of change in sentiments (due to rise in rates) could be more debilitating. Based on our analysis, we foresee HFCs to be impacted the most due to their misplaced ALM for FY19-20 combined with limited abatement in competitive intensity from banks. In the AFC universe, we see an ROA impact of 5-7bps in FY19 for all companies with NIMs declining by 7-10bps on our extant models.

3 *Spark initiates coverage of AU Small Finance Bank*

In a constantly evolving, fluidic operating environment, AU SFB's ability to pick industry trends well in advance, 'ears on the ground' approach to lending, ability to not be swayed by the action of peers, out of the box thinking and propensity to challenge generally accepted norms – the bank's paperless banking thrust being a case in point – make it a unique proposition. We believe the bank is strongly positioned to morph into a full fledged universal bank, beyond the current confines of the small finance bank. Nonetheless, we take note of the emerging macro headwinds led by hardening interest rates, ebbing liquidity and slowing systemic deposit accretion impacting what has hitherto been a smooth SFB transition. A cyclical vehicle financing book, fragilities in the SME book and a still young wholesale banking practice are other areas of disquiet. We believe current valuations factor in a seamless, extended period of high growth, serene SFB transition and profitability with little, if no room for error.

Accordingly, we approach the stock with a 'buy on dips' approach and initiate coverage with a REDUCE rating, valuing AUSFB at Rs. 630 (5.8x FY20E ABV).

Source: SPARK Research

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- All enquiries relating to this document should be directed to Spark Capital personnel mentioned in this document.

FINANCIAL SERVICES TEAM

Abhijit Chiripal

Director

abhijit@sparkcapital.in

Suchai Iyengar

Vice President

suchai@sparkcapital.in

Ramprashanth Ganesan

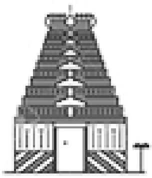
Assistant Vice President

ramprashanth@sparkcapital.in

Nikhil Kookada

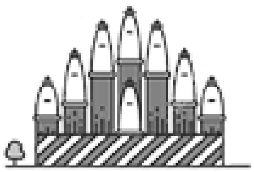
Assistant Vice President

nikhil@sparkcapital.in



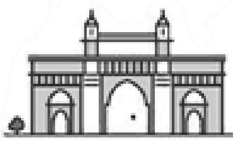
CHENNAI

No.2 ‘Reflections’, Leith Castle Centre Street,
Santhome High Road,
Chennai – 600 028



BENGALURU

Unit Nos. 503 & 504, 5^{th} Floor, Prestige Towers
No. 99/100, Residency Road,
Bengaluru – 560 025



MUMBAI

Unit No. 1108-C, 11^{th} Floor, ONE BKC
Bandra Kurla Complex
Mumbai – 400 051

SPARK CAPITAL