INITIATION

InCred Equities

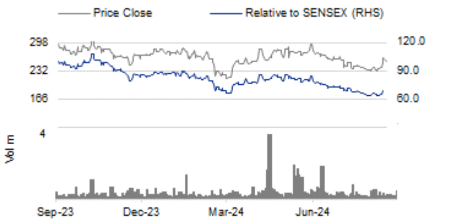
India

ADD *(Initiating coverage)*

Consensus ratings*:	Buy 5	Hold 0	Sell 0

Current price:	Rs256
Target price:	Rs350
Previous target:	NA
Up/downside:	36.7%
EIP Research / Consensus:	-2.5%
Reuters:	UGRO BO
Bloomberg:	UGRO IN
Market cap:	US$327m
	Rs23,772m
Average daily turnover:	US$1.6m
	Rs119.5m
Current shares o/s:	69.2m
Free float:	97.8%

*Source: Bloomberg



Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	3.8	(7.2)	(13.8)
Relative (%)	(0.4)	(15.2)	(32.7)

Major shareholders	% held
DANISH SUS Fund (IFU)	16.4
Clear Sky investments (ADV Partners)	16.3
TPG New Quest Asia	16.3

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Ugro Capital

Sprinting on tech & tie-ups

- UGRO Capital is well positioned to enter the next phase of its growth with a rising market share in the growing landscape of MSME lending.
- We expect strong AUM growth with a stable margin along with operating leverage to drive ~4% RoA and ~14% RoE by FY27F.
- We initiate coverage on the stock with an ADD rating, valuing it at ~1.5x FY26F P/BV to arrive at a target price of Rs350.

MSME lending – mastering the tricks of the trade

The micro, small and medium enterprises or MSME sector is one of the fastest-growing sectors in India and plays a crucial role in the country's growth story. MSME also remains one of the most financially underserved sectors due to its inherent dependency on cash transactions. This is where UGRO Capital is stepping in to tap the US$819bn debt demand of the sector. However, instead of jumping the gun, the non-banking finance company or NBFC has adopted a more focused approach and shortlisted nine MSME sub-sectors after rigorous scrutiny of the opportunity and looming external and macroeconomic risks.

Streamlined its underwriting practices - putting data to work

UGRO Capital has commendably built an in-house underwriting scorecard leveraging technology in an optimized manner with an extensive algorithm-led system, taking into consideration the low level of formalization of the sector. Its underwriting model is customized as per sectors to process specific statistics. The underwriting model is under constant review and has a proven track record of containing GNPAs under 3% since FY21.

Business burgeoning on co-lending/co-originating tie-ups

The credit scoring model is being well recognized by its larger peers, which is aiding UGRO Capital to foster tie-ups with some of the biggest lenders in the industry. The off-balance sheet book is a win-win for both parties, as it renders a capital-conservative method for UGRO Capital to expand its loan book at a higher pace while larger lenders get access to priority sector loans or PSLs which are well monitored. Since 2021, the company has added several partners and currently has 15 co-lending partners. The company's AUM grew ~7x since FY21 to Rs92bn, with an ~45% off-balance sheet book as of 1QFY25-end.

Initiate coverage with an ADD rating and a target price of Rs350

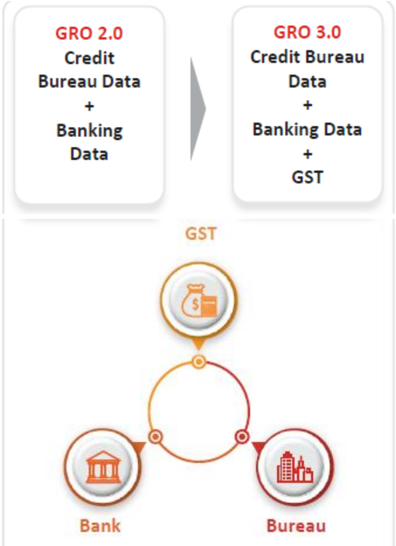
UGRO Capital is well-positioned to enter the next phase of its growth, with a rising market share in the growing landscape of MSME lending. We expect a strong AUM growth (+34.2% CAGR over FY24-27F) led by both on-and off-balance sheet growth resulting in improving margins (+160bp) along with operating leverage kicking in, which will shore up return ratios to ~4% RoA and ~14% RoE (adjusting for equity infusion of Rs12.7bn) by FY27F. We initiate coverage on the stock with an ADD rating, valuing it at ~1.5x FY26F P/BV to arrive at a target price of Rs350. Slower growth and weak asset quality are the key downside risks to our investment thesis.

Financial Summary	Mar-23A	Mar-24A	Mar-25F	Mar-26F	Mar-27F
Net Interest Income (Rsm)	1,896	2,636	3,919	5,637	7,882
Total Non-Interest Income (Rsm)	2,008	3,752	4,923	6,881	9,168
Operating Revenue (Rsm)	3,905	6,388	8,842	12,518	17,050
Total Provision Charges (Rsm)	(568)	(1,163)	(1,819)	(2,581)	(3,820)
Net Profit (Rsm)	398	1,193	1,909	3,297	4,872
Core EPS (Rs)	5.75	13.03	20.84	23.37	34.54
Core EPS Growth	260%	127%	60%	12%	48%
FD Core P/E (x)	44.47	19.62	12.27	10.94	7.40
DPS (Rs)	0.00	0.00	0.00	0.00	0.00
Dividend Yield	0.00%	0.00%	0.00%	0.00%	0.00%
BVPS (Rs)	142.2	157.1	177.9	228.6	263.1
P/BV (x)	1.80	1.63	1.44	1.12	0.97
ROE	4.1%	9.9%	12.4%	13.6%	14.0%
% Change In Core EPS Estimates					
InCred Research/Consensus EPS (x)					

SOURCE: INCRED RESEARCH, COMPANY REPORTS

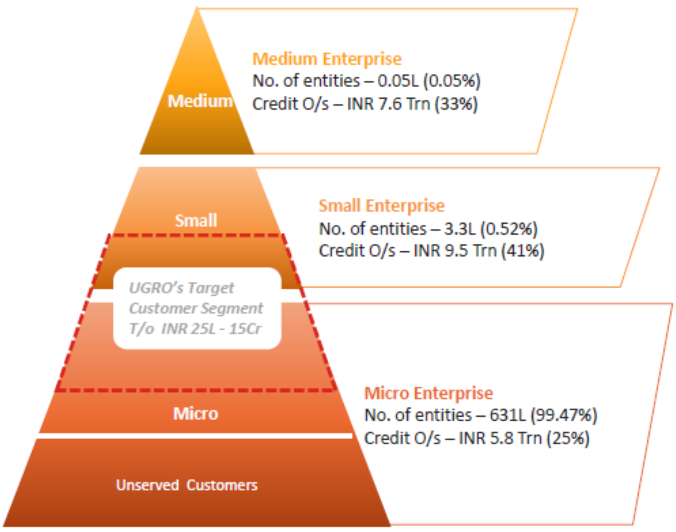
Key charts

Figure 1: GRO Score 3.0 is one of the key pillars of growth



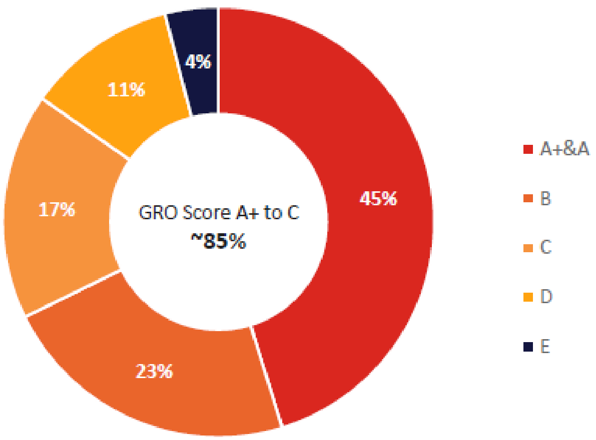
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 2: Clear focus segment for UGRO Capital



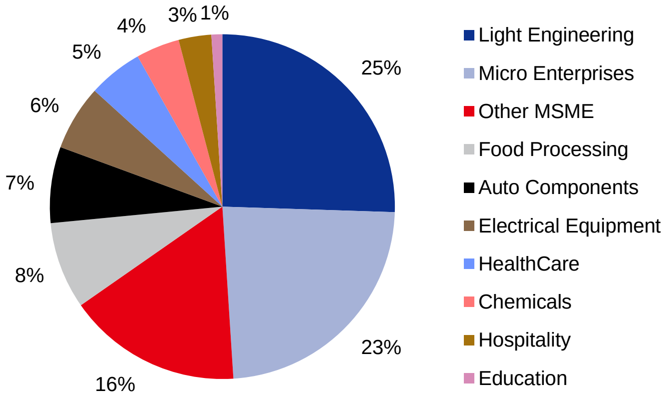
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 3: Score band-wise break-up of disbursals (Jan-Jun 2024)



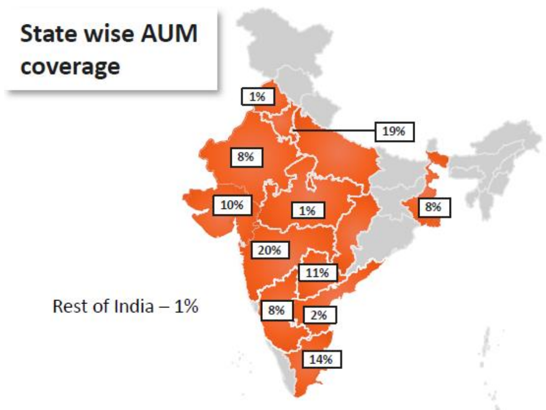
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 4: Shortlisted nine sub-sectors after a deep-dive study



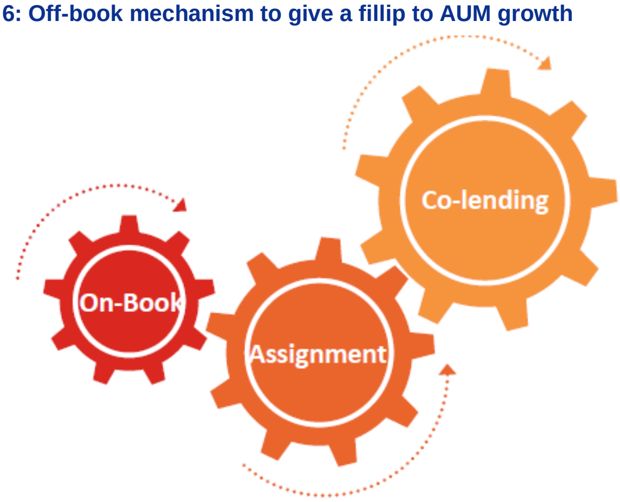
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 5: Geographic diversification to give impetus to growth



SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 6: Off-book mechanism to give a fillip to AUM growth



SOURCE: INCRED RESEARCH, COMPANY REPORTS

MSME lending - mastering tricks of the trade

UGRO Capital has a specific focus on one of the fastest growing sectors which is the apple of the eye of all lenders – MSME financing. The huge debt demand is estimated at US$819bn, where all lenders can have a slice of the pie. Moreover, strong government aid with multiple schemes, right from employment generation to skill development to stress asset support along with rapidly increasing formalization of credit demand, only serves well for the sector.

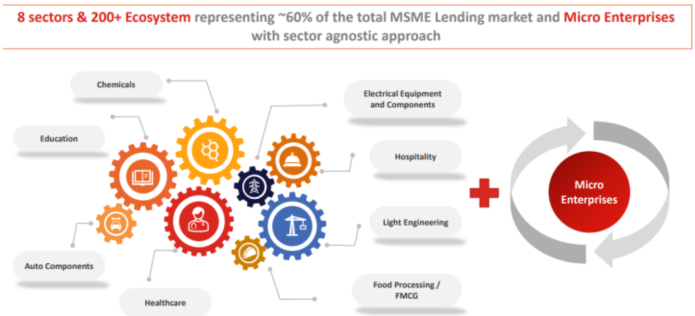
Invests with a deep disciplined approach

Over the last five years, UGRO Capital has established a robust foundation for high-potential MSME lending by tapping technology and a focus on key sectors. The company undertook an extensive 18-month study on more than 180 sub-sectors in the MSME space in conjunction with market experts like Crisil. The initial screening was based on factors like the demand-supply gap, working capital cycle, impact of technology, government policies and so on. This resulted in narrowing down to 20 sub-sectors, where the company further studied key metrics like revenue growth, interest coverage, EBIDTA margin, etc. This was further narrowed down to nine sub-sectors based on future size, lending opportunity, competitive lending environment, impact on regulatory developments, etc. Within the nine sub-sectors as well there is a filter based on management expertise.

Figure 7: Management conducted a deep-dive analysis...

SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 8: ...to arrive at a specifically curated sector focus

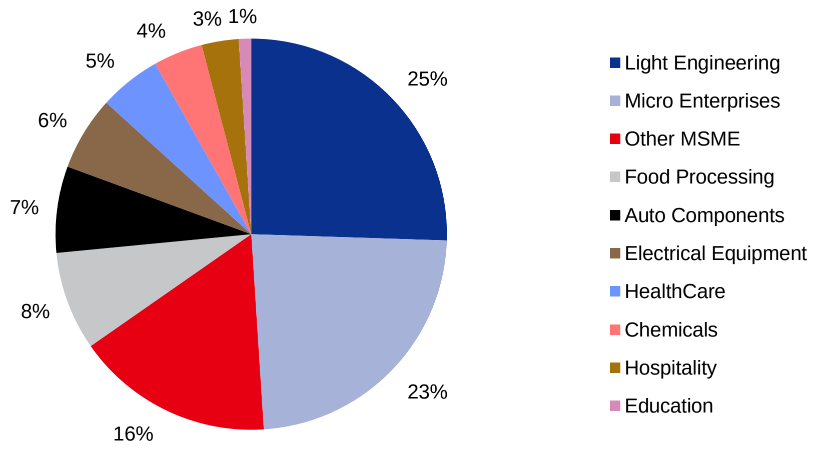


SOURCE: INCRED RESEARCH, COMPANY REPORTS

Product diversity provides comfort – profitability under focus

Within the large MSME universe, after undertaking an extensive study of loan repayment data, the company is focused on nine sub-sectors - automobile components, chemicals, education, electrical equipment, food processing, healthcare, hospitality, light engineering, and micro enterprises. The choice of sectors is based on macroeconomic and other external risks.

Figure 9: Focused sectoral diversification (AUM as of 1QFY25-end)



SOURCE: INCRED RESEARCH, BLOOMBERG

Further, there is bifurcation between business verticals into prime, micro, ecosystem, and partnership verticals – where customers are independently serviced. All the verticals offer customized services, right from product offering to onboarding to grievance redressal, thus blending the core of the company to suit the requirements of the customer.

Customer-centric approach provides the edge to grow faster

UGRO Capital's management has a clear focus on tapping customers having (1) a financial history, and (2) are in the mid-to-upper band of micro lending, avoiding the new-to-bank customers. Moreover, all the customers are registered on Udyam. The proprietary scoring model and niche sector focus places UGRO Capital in a sweet spot, over and above other lenders offering MSME loans.

The means maturing of recently opened micro branches

The NBFC has shored up its branch network by ~67% since FY23 to 164 branches in Jun 2024, mainly led by micro branches which currently account for ~86% of the total branch network.

Figure 10: Branch distribution as of Jun 2024-end

State-wise branches	Micro	Prime	Total
Tamil Nadu	30	1	31
Rajasthan	24	2	26
Karnataka	15	1	16
Telangana	15	1	16
Andhra Pradesh	13	2	15
Gujarat	14	1	15
Madhya Pradesh	12	3	15
Uttar Pradesh	11	1	12
Other states	7	11	18
Total	**141**	**23**	**164**

SOURCE: INCRED RESEARCH, COMPANY REPORTS

Tamil Nadu, Rajasthan and Karnataka remain the three largest states for the company. Geographically, the expansion marks its entry into the states of Madhya Pradesh, Uttar Pradesh and Andhra Pradesh, which currently contribute to only 3% of its assets under management or AUM, cumulatively. These are seasoned states with high financial inclusion and a huge opportunity for MSME lending. We believe this expansion will open more avenues for UGRO Capital to extend its reach to original equipment manufacturers or OEMs and fintech partners.

Acquisition of MyShubhLife to fuel granular retail growth

In May 2024, UGRO Capital acquired MyShubhLife (MSL), a prominent embedded finance fintech platform headquartered in Bengaluru, for an enterprise value of Rs 450m through a combination of 64:36 equity/cash transaction, thereby making it a wholly-owned subsidiary. MSL, a leader in embedded finance fintech platforms, has existing integration with other fintech partners like Pine Labs, Fino, Airtel Payments Bank, Mobikwik, Spice Money and EasyPay for merchant/retailer financing. UGRO Capital aims to onboard ~0.2m new retailers through the MSL platform in the next three years and achieve AUM of Rs15bn, with a net profit of Rs1bn. Loans will be unsecured in nature, but will be backed by the supply chain flow and hence, the product will also carry a higher yield of around ~26%.

Business burgeoning on co-lending tie-ups

After having the right underwriting practices in place, UGRO Capital has moved a step ahead by tapping the co-lending mechanism to augment growth in a faster asset-light way. The company swiftly fostered tie-ups with some of the biggest lenders in the industry. Since 2021, it has added several partners and currently has 15 co-lending partners including private sector banks like Karnataka Bank, public banks like State Bank of India (SBI) and Bank of Baroda (BoB) along with institutions like SIDBI and NBFCs such as Tata Capital.

The catalyst: co-lending to aid capital-conservative growth

UGRO Capital is also heavily investing in fostering tie-ups with existing and new partners for co-lending. The company has among the highest co-lending tie-ups among NBFCs and is gaining the confidence of public sector banks, private banks and other NBFCs. This comes on the back of a strong push by its management towards forming tie-ups with other large lenders with a plate full of PSL offerings.

Figure 11: Co-origination and co-lending partnerships

	Partner	Type	Since
1	State Bank of India	PSU bank	2021
2	Bank of Baroda	PSU bank	2021
3	Central Bank of India	PSU bank	2021
4	IDBI Bank	PSU bank	2021
5	Punjab & Sind Bank	PSU bank	2022
6	UCO Bank	PSU bank	2023
7	Karnataka Bank	Private bank	2024
8	Karur Vysya Bank	Private bank	2024
9	SIDBI	Financial institution	2023
10	Hinduja Leyland	NBFC	2022
11	MAS Financial	NBFC	2022
12	Tata Capital	NBFC	2023
13	Godrej Capital	NBFC	2023
14	Ambit Finvest	NBFC	2023
15	Hero Fincorp	NBFC	2023

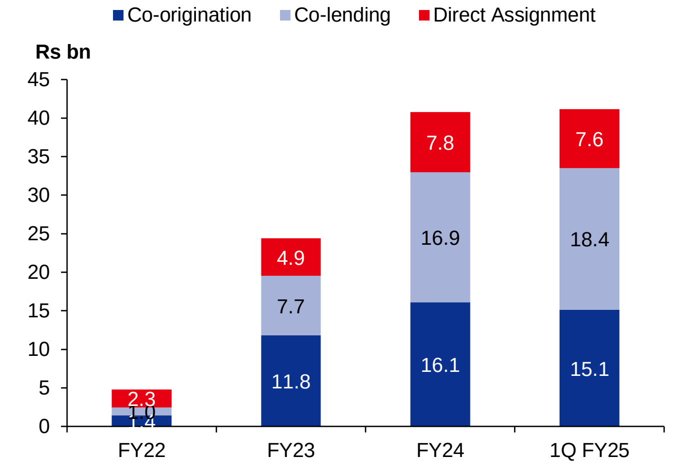
SOURCE: INCRED RESEARCH, BLOOMBERG

We believe the co-lending model will act as a good catalyst for asset-light growth.

Tech-led methodology makes UGRO Capital a preferred partner

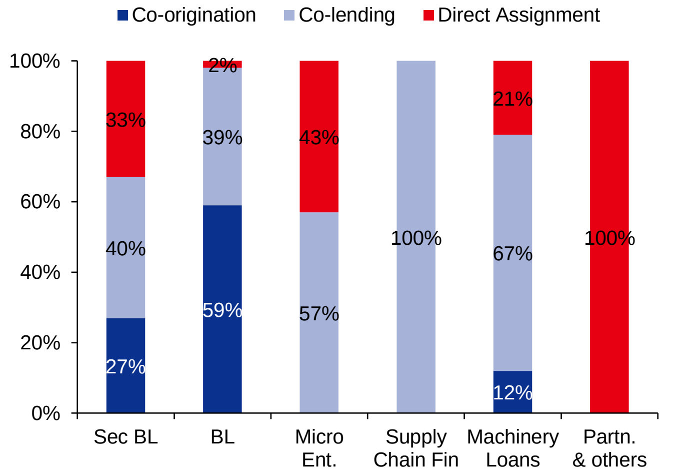
Banks often face challenges in meeting priority sector lending (PSL) requirements in the MSME segment due to complexity of the scorecard processes embedded within their systems. This is where UGRO Capital steps in with its successful in-house scorecard model specifically tailored for mid-level MSMEs. This approach has been widely accepted by its co-lending partners, who benefit from the company's comprehensive data and processing capabilities.

Figure 12: Off-balance sheet AUM sees strong demand



SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 13: BL, micro & machinery loans witness strong demand



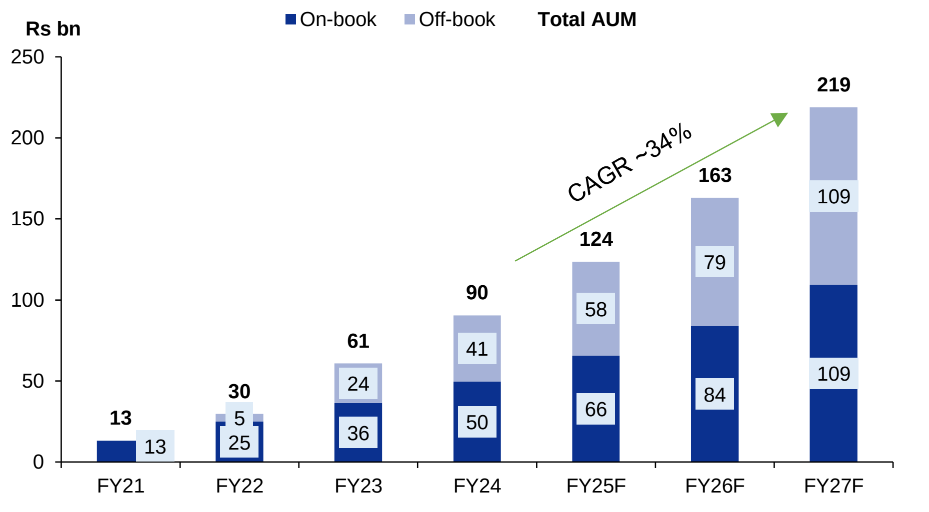
SOURCE: INCRED RESEARCH, COMPANY REPORTS

In 1QFY25, ~45% of the company's AUM was off book led by co-lending and co-origination along with a smaller proportion of direct assignments. There's a strong demand for co-lending, particularly for secured business loans, micro-enterprise loans and machinery loans, where the off-book share in AUM is close to 50%.

Asset-light model to double AUM by FY27F

We expect the company's AUM to more than double from the Rs90bn level in FY24 to Rs218bn by FY27F, led by both off-book and on-book lending. We expect its off-book AUM growth of 37-42% to outpace on-book AUM growth of 28-32% over the same period. Consequently, the contribution of off-book AUM is expected to increase to ~50% by FY27F, driven by consistently high focus on deepening tie-ups in co-lending and co-origination. Having the underwriting model tested in the last few years, we expect AUM to grow at a robust pace of ~34% CAGR over FY24-27F, as the company is in expansion mode and is seeking off-balance sheet partnerships which will support asset-light AUM growth.

Figure 14: Asset-light model to augur AUM growth



SOURCE: INCRED RESEARCH, BLOOMBERG

The stage is set for a fantastic AUM growth path, with a huge opportunity in the MSME sector. The deeply analytical tech-based in-house underscoring model gives a heads-up to the NBFC over other lenders. Its niche in the industry is being recognized well by the large lenders, leading to strong partnerships. We believe these partnerships and the maturing of recently opened branches in new and existing states will be key triggers for robust AUM growth.

Fast moving co-lending model in India

The co-lending model in India had evolved to touch ~Rs1 tr in AUM, as per latest estimates by CRISIL, and is expected to grow at 35-40% annually. The growth was largely led by a surge in personal loans segment, accounting for ~34% of the AUM, followed by housing loans, unsecured MSME loans, and gold loans. However, there an evident shift in focus towards loans for MSMEs and home loans as the increased risk weights for personal loans are making lenders cautious. Future growth will hinge on maintaining asset quality and adapting to regulatory changes, while government initiatives are likely to boost the share of MSME and home loans in the portfolio.

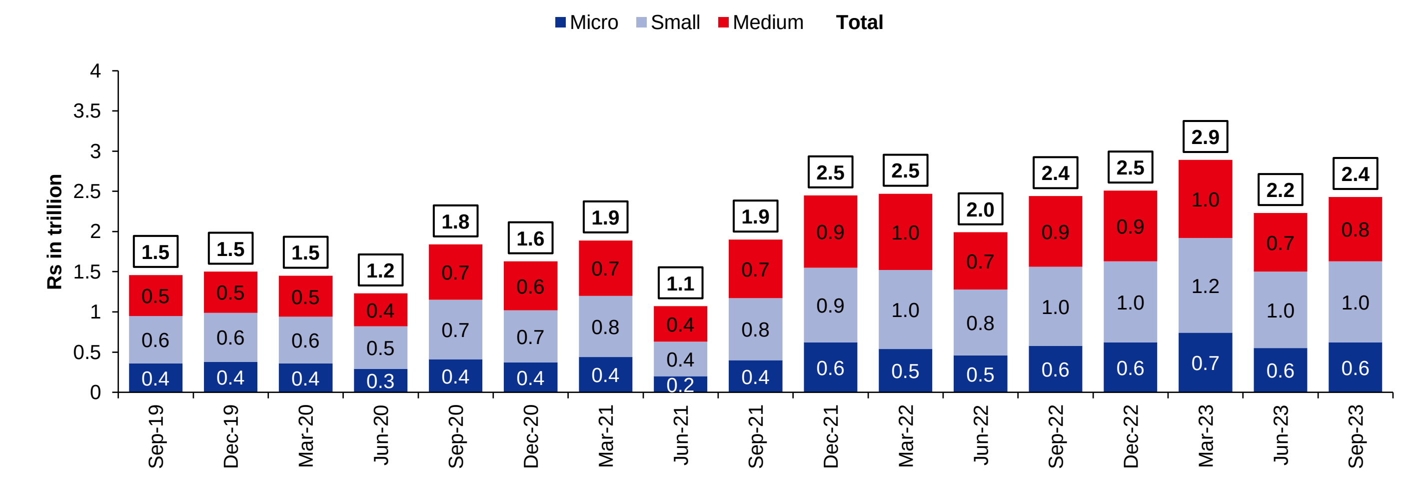
MSME lending in India

MSMEs currently contribute ~30% to India's GDP and ~45% to total exports. As the country's economy is expected to touch US$5tr, MSMEs will play a pivotal role in accelerating this growth. MSMEs will require more credit to invest and grow to achieve this level of growth, implying an immense potential for expansion and development of the institutions offering credit facilities to MSMEs.

Measuring the depth of MSME ocean

In the absence of a formal industry, there is no accurately available measure for the untapped credit potential in the MSME sector. The last available estimates by the RBI suggested debt demand of US$819bn. The dynamics have changed following the deepening of the Goods and Services Tax or GST and the recent Covid-19 pandemic whereby a major part of informal society is moving towards formalization at a rapid pace. The incoming generation of the historically cash-driven sector realizes the importance of maintaining a certain CIBIL score and the cost benefit of formal sources of credit.

Figure 15: Improvement in incremental MSME disbursements post Covid-19 pandemic (Rs tr)



SOURCE: INCRED RESEARCH, MSME PULSE, COMPANY REPORTS

Hits inflection point with digital push, expanding the size of the pie

The MSME credit exposure of scheduled commercial banks was ~Rs 26tr as of 3QFY24-end, which grew ~20% yoy, while lending by NBFCs towards the sector was estimated to be ~14% of the total outstanding. As regards scheduled commercial banks or SCBs, ~48% of their total loans were towards micro enterprises, ~32% towards small enterprises and the rest towards medium enterprises. We believe NBFCs stand a higher chance to tap into the sector with a more focused approach and a niche network.

Union Budget 2024-25 is favourable for MSME lending

The Union Budget 2024-25 has given special attention to the MSME sector through labour-intensive, manufacturing, regulatory and technology support.

- The new credit guarantee scheme has proposed to facilitate term loans for MSMEs to purchase machinery and equipment by pooling credit risks and without collateral or third-party guarantee. It is envisaged to provide a guaranteed coverage up to Rs1bn per applicant against a fee provided by the lender, even though the loan amount may exceed the limit.
- Thus, the corpus is self-financing, which will include pooling of upfront fees where the borrower who wants a term loan can also avail a credit guarantee facility for that loan. This is expected to reach a larger audience, specifically in the small- to mid-scale manufacturing sector.
- The budget also proposed a new mechanism to extend credit support to stressed MSMEs which are a part of the special mention account (SMA) stage. Credit availability will be supported through a guarantee from a government-promoted fund.

GRO Score 3.0: Putting data to work

Despite dealing with an unorganized sector, UGRO Capital has leveraged technology in an optimized manner. Most lenders to the MSME segment often override the outputs of automation put in place, despite being backed by the latest technology. This is where UGRO Capital differentiates itself with an extensive algorithm-led system, which involves limited human oversight. The underwriting model, Gro Score 3.0, constantly reviewed and has a proven track record in containing gross non-performing assets or GNPAs under 3% since FY21.

The USP in tailor-made underwriting method

One of the USPs is the in-house underwriting model Gro Score 3.0, which is a statistical framework using artificial intelligence (AI) and machine learning (ML)-driven statistical model to process 25,000+ parameters from banking and bureau records to categorize a particular customer across five bands of ‘A’ to ‘E’, with ‘A’ being the least risky. The underwriting model is customized as per sectors to process nine sub-sector specific statistics and has 25+ sub-segment specific scorecards which use GST data, credit bureau data and bank statements for a complete assessment which allows loan disbursement within 60 minutes.

Stringent initital screening with efficient human intervention

Customer profiles are closely scrutinized by a slew of key business metrics like repayment history, bank transactions, sales and purchase momentum, GST transactions, etc. For instance, in a batch of 100 loan applications received, the algorithm cuts out 50% based on initial screening, and of the remaining, 40% is cut out by credit officers after scrutiny while the rest are sanctioned loans. Automated initial screening frees up employee engagement for other services.

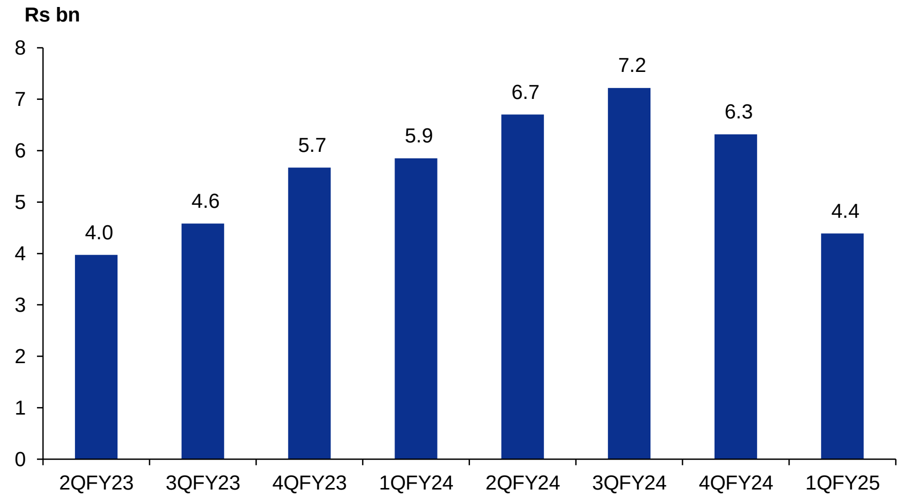
Asset quality backed by safe bets and highly secured book

The NBFC avoids the risky new-to-banks segment and focuses on mid-level MSME segment lending with around two-thirds of the AUM being secured, and of the rest ~25% backed by the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE). The company uses in-house analytics for early warning signals and has a dedicated litigation team which focuses on collections.

Constant review mechanism bodes well for stress management

We appreciate the company management’s prompt action and evolving outlook on the sector. It decided to slow down supply chain lending due to unfavourable profitability. However, the company swiftly decided to add new lending segments like lending to small shop owners. The market size for this segment is ~Rs1.1tr and the acquisition of MyShubhLife fits perfectly to boost growth in the same.

Figure 16: Sharp decline in supply chain financing AUM in the past two quarters

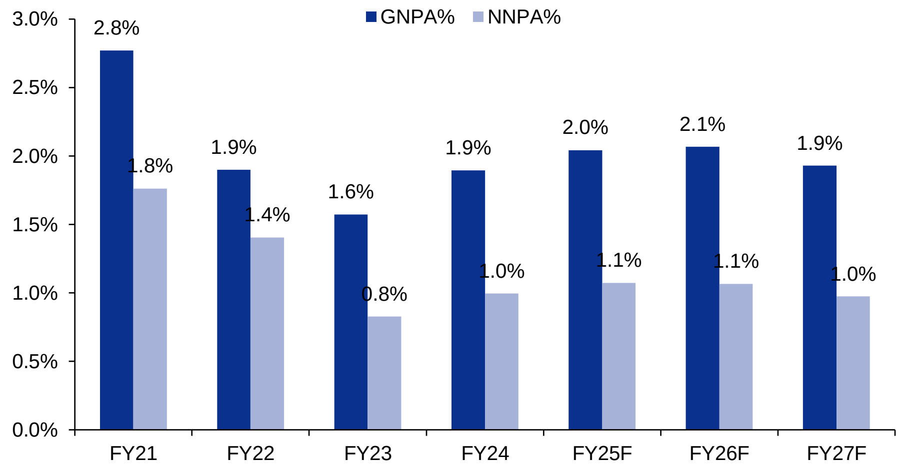


SOURCE: INCRED RESEARCH, BLOOMBERG

Asset quality to remain well-contained

The NBFC has demonstrated strong asset quality post Covid-19 pandemic, with the gross NPA ratio being contained under 3% since FY21. 100% of its customers are National Automated Clearing House or NACH-registered. There are strong collection and litigation teams which conduct quarterly account reviews and an annual financial review. The systems and processes are closely monitored for improvement and the NBFC is working on Gro Score 4.0. We expect the asset quality to remain largely range-bound at ~2% over FY25F-27F.

Figure 17: In-house score card contained GNPA percentage since FY21

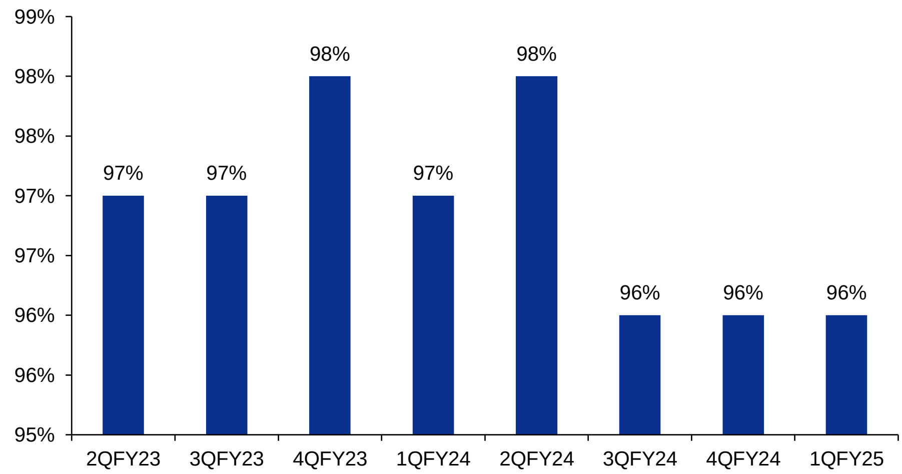


SOURCE: INCRED RESEARCH, BLOOMBERG

Collection mechanism remains healthy throughout cycles

Gro Score 3.0 aids in predicting potential customer defaults through its analytics-driven early warning system flagging off accounts which need attention. This enables the formulation of targeted repayment and collection strategies. Supporting this advanced system is a sizable in-house team of approximately 250 professionals divided into two primary divisions: the on-field collection team and the litigation team. The on-field team handles collections based on portfolio size and product type, while the litigation team manages legal proceedings. The divisions are overseen by the separate heads for secured and unsecured loans in addition to a litigation head. This structured leadership ensures that the team remains agile and responsive, upholding the highest standards of risk management and operational efficiency.

Figure 18: Effective and proactive collection management leads to stable collections



SOURCE: INCRED RESEARCH, BLOOMBERG

Margin profile turns favourable

UGRO Capital has witnessed volatile margin trajectory in the past amid elevated cost of funds. However, going ahead, along with AUM growth, UGRO Capital is also focusing on profitability with consistent efforts on shifting the AUM mix towards high-yielding assets along with cutting the exposure to low-yielding assets. On the liability side, the company has achieved two rating upgrades in the last six months, which will ease the overall cost of funds further.

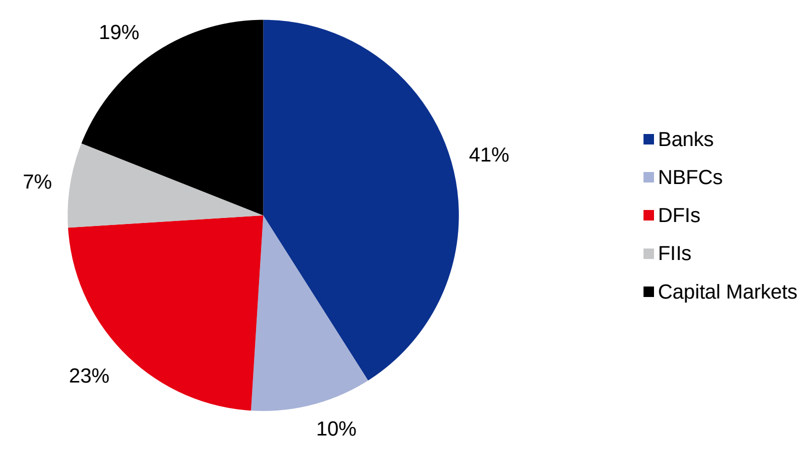
Rising share of high-yielding AUM with economies of scale

MSME lending is a highly competitive business, but still UGRO Capital has managed to maintain healthy yields as its management has categorically focused on the segments having better yields. Supply chain financing, which has a yield of ~14%, is being replaced by small shop-owner lending which enjoys a yield of ~26%. Further, the company sees high potential in tier-3 to tier-6 cities and has consequently invested heavily in expanding micro branches. The micro loans offered by them are having an average ticket size of Rs0.8m and carry a yield of ~21%. Currently, micro loans contribute only 10% to AUM but are guided to be one of the key drivers of growth, more than doubling their contribution to the AUM mix by FY26F. Furthermore, these micro branches will be offering multiple products, aiding branch returns, and thus resulting in higher economies of scale.

Diversified funding to maintain low-cost benefit

On the liability side, UGRO Capital has a well-diversified funding profile comprising 55+ lenders. Its exposure to banks is ~41% of the total borrowings followed by ~23% from development finance institutions and ~19% from capital markets. The company's management indicated its intention to consolidate borrowers by raising ticket sizes from borrowers.

Figure 19: Well-diversified funding profile as of Jun 2024-end aids cost control



SOURCE: INCRED RESEARCH, BLOOMBERG

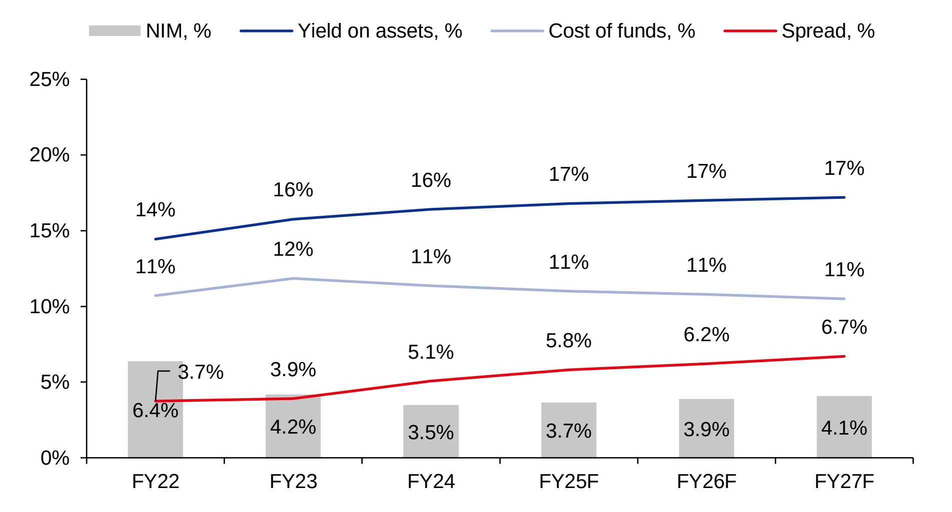
Recent rating upgrades to aid stable cost of funds

More recently, the company achieved two rating upgrades - one from India Ratings in Jul 2024 where the rating was upgraded to A+/Stable from A/Stable earlier, and the other from CRISIL in Mar 2024 where the rating was upgraded to A/Stable from A-/Positive earlier. This was the second consequent rating upgrade by CRISIL in 12 months, with the earlier one in Mar 2023 having the outlook revised to 'Positive' from 'Stable'. As UGRO Capital refinances its borrowings, we expect the rating upgrades to give a good impetus to lowering the cost of funds in the coming quarters. Furthermore, the rating upgrades also strengthen lenders' confidence in UGRO Capital for more co-lending and co-origination partnerships, as banks and NBFCs prefer dealing with an 'A' and above-rated entity.

We are building in margin improving by ~60bp over FY24-27F

We expect the net interest margin or NIM to post a healthy improvement over FY24-27F at ~60bp, notwithstanding the tight interest rate scenario, being led by strong AUM growth, AUM mix improving towards a high-yielding book and incrementally lower cost of funds. We expect the NIM to reach ~4.1% level by FY27F.

Figure 20: Changing AUM along with lower cost of funds to aid margin improvement



SOURCE: INCRED RESEARCH, COMPANY

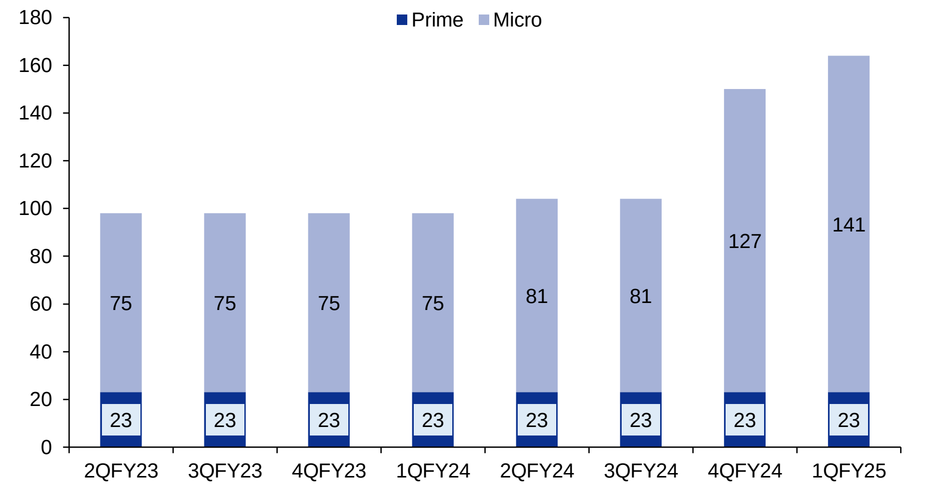
Operating leverage to aid RoE expansion

Thus, strong AUM growth with stable NIM, rising fee income from co-lending, along with maturing of recently opened branches and rationalized expenses going ahead will lead to an improving operating leverage.

Reaping the benefits of expanding micro branches

Of the total branch count, ~37% have been opened in the last one year and will mature in 2HFY25F/FY26F. On the branch expansion front, management has given branch addition guidance of ~120 branches per year, with high focus on micro branches. As compared to prime branches, micro branches are low cost and achieve breakeven within ~1-1.5 years.

Figure 21: Rapid micro branch expansion to augur micro lending book

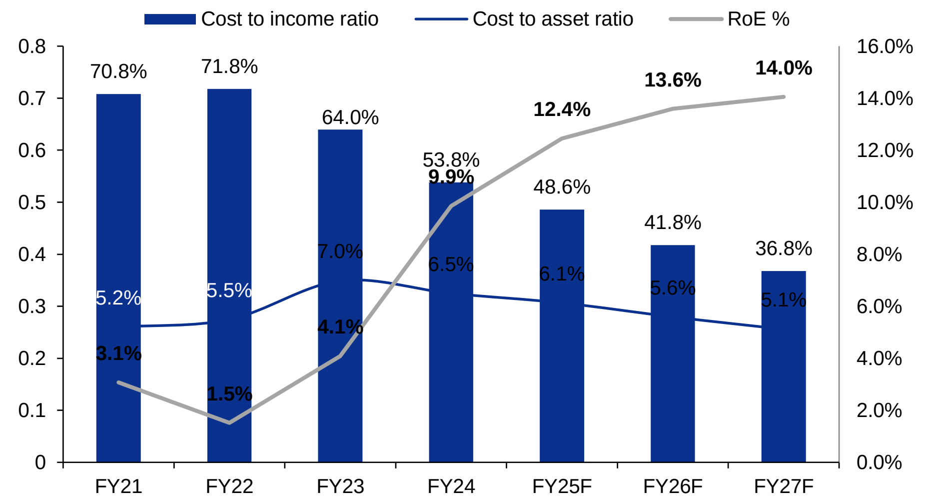


SOURCE: INCRED RESEARCH, COMPANY REPORTS

We expect ~140bp decline in cost-to-average assets by FY27F

We believe the operating leverage will be one of the key triggers in augmenting return ratios, and expect the cost-to-income ratio to improve to ~36.8% by FY27F.

Figure 22: Sharply improving cost ratios to be key trigger in enhancing return ratios



SOURCE: INCRED RESEARCH, COMPANY REPORTS

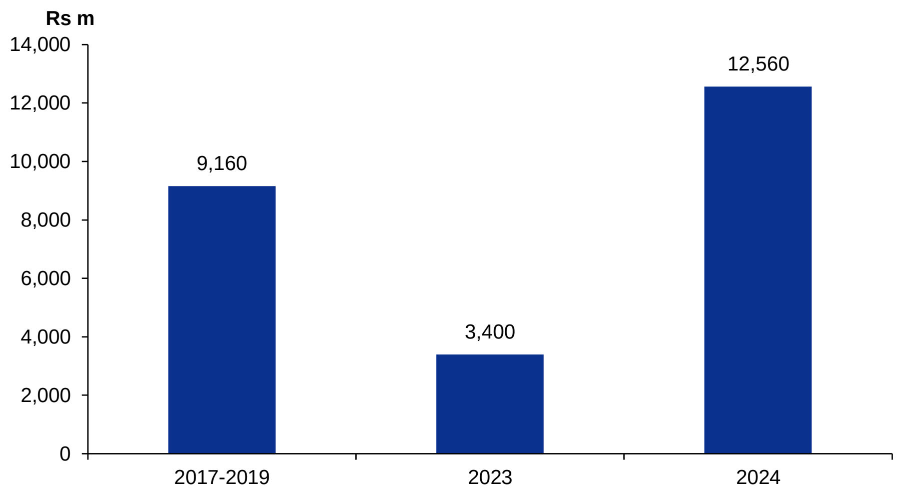
Strong capital-backing provides comfort

We believe the company has sufficient capital for growth over the next couple of years. We expect limited risk of dilution in the coming years amid recent capital infusion, improving profitability and the company's intentional shift towards the low-risk co-lending model, which anyhow requires low capital.

UGRO Capital witnessed successful rounds of capital raising

UGRO Capital has witnessed good capital traction from various investors since the takeover by the existing management team. The company has successfully raised ~Rs3.4bn in early FY24, which was backed by an arm of the Denmark government along with other large qualified institutional investors. This was followed by a recent equity capital raising of Rs12.7bn through a combination of compulsory convertible debentures and warrants. The capital raising includes strong backing from existing private equity investor Samena Capital, which committed Rs5bn through warrants, which instils more confidence in the company.

Figure 23: Capital raising since 2017

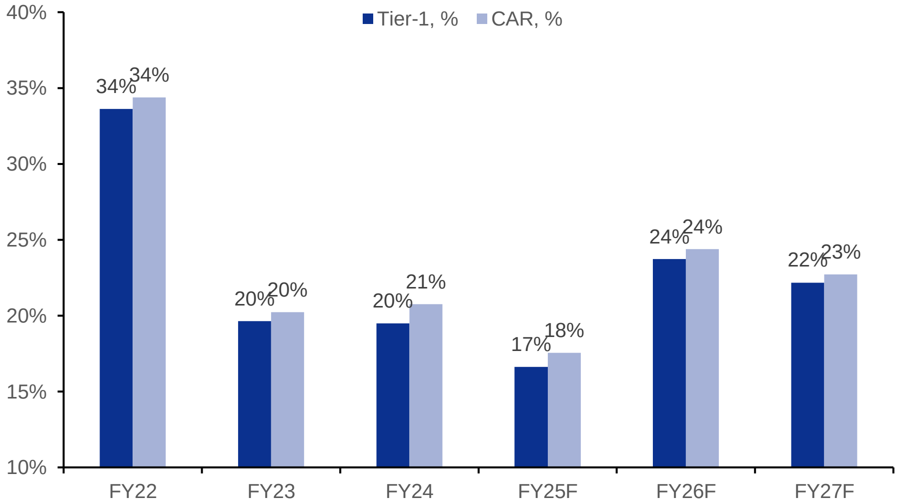


SOURCE: INCRED RESEARCH, COMPANY REPORTS

Sufficient capital base to aid healthy growth

We expect its capital adequacy ratio or CAR to be in the range of 23-24% between FY26-27F post warrant conversion, also buoyed by net profit accretion and asset light growth.

Figure 24: We expect its CAR to improve post conversion of warrants in FY26F



SOURCE: INCRED RESEARCH, COMPANY REPORTS

Outlook and valuation

- **UGRO Capital is one of the fastest-growing NBFCs in India, leveraging on data analytics and co-lending, leading to risk-calibrated growth. The company has commendably scaled up its AUM by ~7x since FY21 to Rs92bn by 30 Jun 2024, spread over 164 branches and 11 states.**
- The company is purely focused on lending to one of the pillars of India's growth story - the MSME sector. Within the MSME sector, there is a high focus on nine sub-sectors which are fast-growing and have a relatively lower macroeconomic risk.
- The company is focused on an asset-light model, with a target of ~50% off-balance sheet growth, by fueling its co-lending and co-origination model which will aid AUM growth. With 15 partners already on board, there is still a strong demand for more partnerships, particularly for secured business loans, micro-enterprise loans, and machinery loans.
- **Having the underwriting model tested in the last few years, we expect its AUM to grow at a robust pace of 34% CAGR over FY24-27F, as the company is in expansion mode and is seeking to augur off-balance sheet partnerships which will support asset-light AUM growth.**
- UGRO Capital has a well-diversified funding profile, with 55+ lenders to meet its borrowing needs. Its exposure to banks is low at ~41% of total borrowings followed by ~23% to development finance institutions such as the Asian Development Bank, FMO, etc. and ~19% to capital markets. Moreover, strong backing seen in recent capital raising instils more confidence in the company.
- **Most of the technology-related investments are behind and the company is focusing on asset-light investments with limited branch expansion going ahead. Thus, we expect the operating leverage to kick in, with the cost-to-income ratio improving by ~17pp to ~36.8% by FY27F.**
- In-house underwriting model, Gro Score 3.0, is one of the USPs of the NBFC which has ensured strong asset quality. The model analyses cash flow-based banking transactions and repayment behaviour of the customer in the sector in which it operates to draw sharper insights of the customer.
- **We are factoring in credit costs in the range of ~1.7%-2% over FY25F-27F to incorporate the sharp rise in AUM. The company is continuously improving its collection and underwriting mechanism supported by a dedicated collection team.**
- **Accordingly, we are building in a PAT CAGR of ~59.8% over FY24-27F backed by robust AUM growth, steady margins, and provisioning.**
- **The RoA of UGRO Capital is likely to remain in the range of ~4% whereas RoE is expected to improve to ~14% by FY27F, adjusting for capital dilution.**

Figure 25: DuPont analysis of UGRO Capital

Du-Pont ratios	FY21	FY22	FY23	FY24	FY25F	FY26F	FY27F
NII/Avg. Assets	6.9%	5.9%	5.3%	5.0%	5.6%	6.0%	6.4%
Non-interest income/Avg Assets	0.4%	1.7%	5.6%	7.1%	7.0%	7.4%	7.5%
Cost / Avg Assets	5.3%	3.3%	3.5%	4.7%	4.9%	4.6%	4.3%
PPOP / Avg Assets	2.1%	2.2%	3.9%	5.6%	6.5%	7.8%	8.8%
Provisions / Avg Assets	1.3%	1.3%	1.6%	2.2%	2.6%	2.8%	3.1%
PBT / Avg Assets	0.8%	0.9%	2.3%	3.4%	3.9%	5.0%	5.7%
Tax / Avg Assets	-1.1%	0.2%	1.2%	1.1%	1.2%	1.5%	1.7%
ROA	1.9%	0.6%	1.1%	2.3%	2.7%	3.5%	4.0%
Leverage(x)	1.58	2.40	3.67	4.37	4.57	3.85	3.53
ROE	3.1%	1.5%	4.1%	9.9%	12.4%	13.6%	14.0%

SOURCES: INCRED RESEARCH, COMPANY REPORTS

- **We have valued UGRO Capital on an excess return on equity (ERoE) basis with a risk-free rate of 7% (equivalent to banks' five-year fixed deposit rate), market risk premium of 6% and a beta of 1.0 (Bloomberg estimate).**

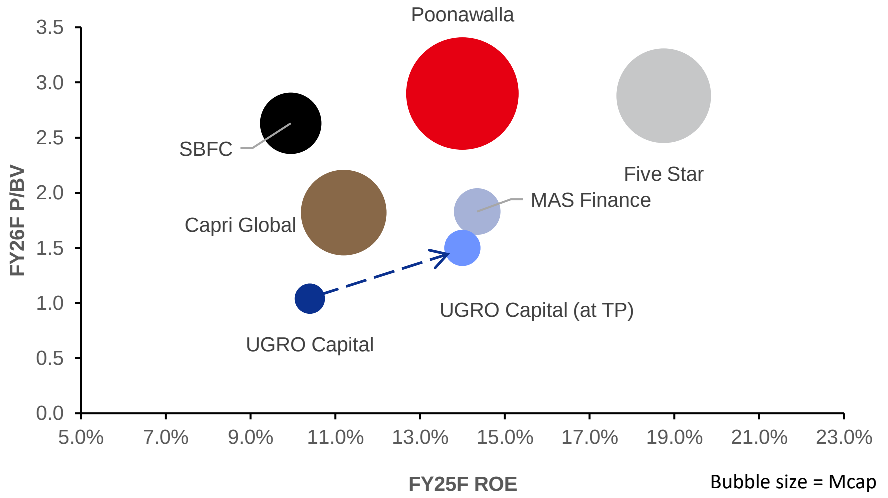
Figure 26: Valuation parameters

Parameter	Rate	Methodology
Risk-free rate	7.0%	Commercial banks' five-year fixed-deposit rate
Risk premium	6.0%	Standard for our entire coverage
Beta	1.0	From Bloomberg: adjusted daily beta vs. Nifty-50 over last two years.
Cost of equity	**14.2%**	

SOURCE: INCRED RESEARCH, BLOOMBERG

- **We have arrived at a valuation of Rs350, corresponding to ~1.5x P/BV and ~15x P/E on Mar 2026F. We initiate coverage on the stock with an ADD rating, maintaining our Outperform view on the BFSI sector.**
- **We believe that UGRO Capital is attractively placed as compared to peers and has a good impetus to re-rate with market share expansion, increased partnerships, stable asset quality and improving return ratios.**

Figure 27: Valuation parameters



SOURCE: INCRED RESEARCH, BLOOMBERG

Risks to our investment thesis

- **Geographic concentration risk:** The NBFC has a high concentration in tier-I and tier-II cities of Maharashtra and New Delhi. Both the geographies have around six branches and accounted for ~20% and ~19% of the AUM, respectively, as of 1QFY25-end. These primarily consist of large-ticket loans business loans which can dent the balance sheet if there is stress in any geography. We are keeping a close eye on this portfolio, given the upcoming assembly elections in Maharashtra, which can result in a spike in credit costs and delay RoE momentum.
- **High risk unsecured lending**: Around 60% of the AUM comprises business loans through loans against property and unsecured loans. Of the unsecured business loans, only ~25% are backed by the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) which offers a coverage of 75%-85%. The remaining unsecured loan book carries high risk, and we remain watchful on this book. Any stress in the unsecured loan book can result in high credit costs and a slowdown in the AUM. This can also potentially impact the tie-ups with other lenders.
- **Sector/product concentration:** Even though the sub-sectors are closely chosen, there is a high risk of sectoral stress which can impact a large part of the AUM, two sectors - lighting and engineering and micro enterprises - account for ~48% of the AUM. There's also a slowdown in supply chain financing in recent quarters, leading to a rundown of the book. This can result in slow AUM growth and elevated credit costs.
- **Limited track record:** UGRO Capital's underwriting model has performed well post Covid-19 pandemic, when the industry witnessed some of the best asset quality times. However, the model is new and is yet to witness a complete business cycle. The true strength of the model will be tested during the times of higher asset quality stress.
- **Regulatory risks:** In general, NBFCs encounter relatively softer Reserve Bank of India or RBI regulations than banks, as they drive the government's financial inclusion target and increase credit penetration in India. However, the RBI or any other regulator can impose stringent norms to keep the entire lending and payments chain in check.
- **Partnership risk:** UGRO Capital's lending is heavily reliant on co-lending and co-origination partnerships. Any lapse on the part of the company or any stress build-up in the MSME sub-segments in which it operates can result in a sudden halt to partnerships, which can potentially leave AUM growth in the slow lane till the partnerships get refurbished or further capital is raised.

About the company

UGRO Capital is an India-based non-deposit taking middle-layer NBFC offering credit solutions for the MSME sector. The company was established by the acquisition of listed investment company, Chokhani Securities Private Limited, by Mr. Shachindra Nath (vice chairman and managing director) in 2018. Along with the acquisition, UGRO Capital onboarded its first PE investors – TPG NewQuest, Samena Capital, ADV Partners and PAG.

UGRO Capital has a data-driven underwriting approach through its in-house underwriting model Gro Score 3.0, which leverages technology to result in a highly efficient output. Its product offerings are focused on the micro-small customer range with a turnover Rs 2.5-150m. These products are offered to the top nine MSME sub-sectors (representing ~50% of MSME credit demand). UGRO Capital collaborates with banks, fintech, and NBFC partners for co-lending, thus expanding its outreach across India.

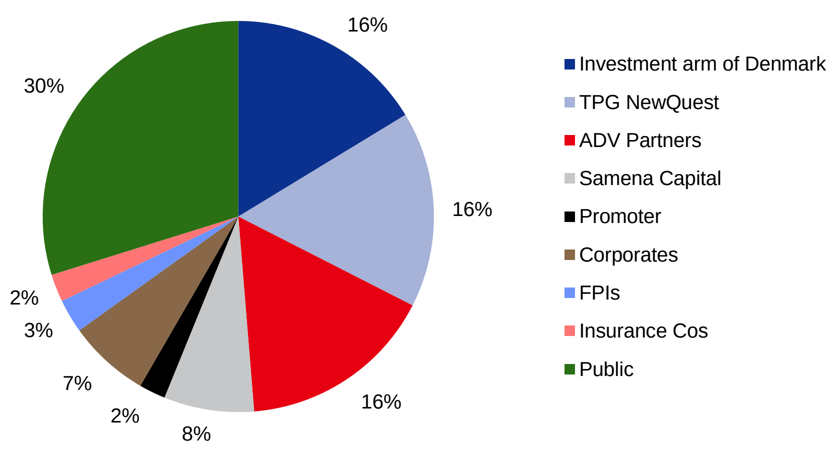
As on 30 Jun 2024, with a network of 164 branches across 11 states, UGRO Capital has assets under management (AUM) worth Rs92bn.

Figure 28: Key management profile as of end-Jun 2024

Name	Designation	Background
Mr. Shachindra Nath	Founder and Managing Director	Mr. Nath is the founder of UGRO Capital. Earlier, he was a co-founder & last served as the Group CEO at Religare Enterprises, where he worked for ~16 years. He holds ~30 years of work experience and is a qualified lawyer and is a rank holder from Banaras Hindu University.
Mr. Kishore Lodha	Chief Financial Officer	Mr. Lodha joined UGRO Capital in 2022, prior to which he was the CFO of Hinduja Leyland Finance and in the past has been in a similar role at various other organisations, including Future Group and SREI Infrastructure. He is a qualified chartered accountant.
Mr. Amit Mande	Chief Revenue Officer	Mr. Mande joined UGRO Capital in 2021, prior to which he was CEO and head of lending business at Mswipe (Ditya Finance Pvt ltd). He has ~24 years of work experience with a large part in SME and consumer lending at companies including RattanIndia Finance, Capital First, Barclays, ABN Ambro among others.
Mr. Anuj Pandey	Chief Risk Officer	Mr. Pandey was a part of the founding members of UGRO Capital in an earlier role of a Chief Operating Officer. Prior to this, he was a part of Mr Nath's team at Religare as Regional Business Head for SME loans. Earlier, he had worked in institutions like Barclays, ABN Ambro and GSK.

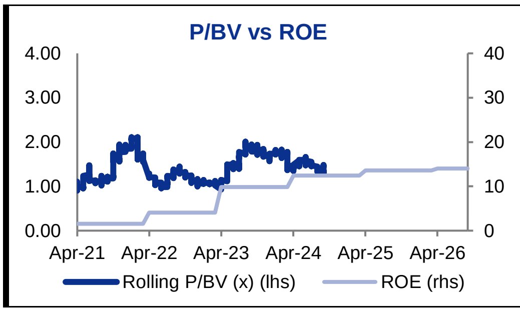
SOURCE: INCRED RESEARCH, COMPANY REPORTS

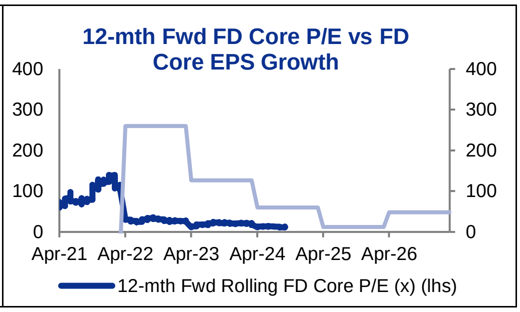
Figure 29: Shareholding pattern as of end-Jun 2024



SOURCE: INCRED RESEARCH, BLOOMBERG

BY THE NUMBERS





Profit & Loss

(Rsm)	Mar-23A	Mar-24A	Mar-25F	Mar-26F	Mar-27F
Net Interest Income	1,896	2,636	3,919	5,637	7,882
Total Non-Interest Income	**2,008**	**3,752**	**4,923**	**6,881**	**9,168**
Operating Revenue	3,905	6,388	8,842	12,518	17,050
Total Non-Interest Expenses	**(2,499)**	**(3,437)**	**(4,296)**	**(5,228)**	**(6,270)**
Pre-provision Operating Profit	1,406	2,950	4,546	7,290	10,780
Total Provision Charges	**(568)**	**(1,163)**	**(1,819)**	**(2,581)**	**(3,820)**
Operating Profit After Provisions	838	1,788	2,727	4,710	6,960
Pretax Income/(Loss) from Assoc.					
Operating EBIT (incl Associates)	838	1,788	2,727	4,710	6,960
Non-Operating Income/(Expense)					
Profit Before Tax (pre-EI)	838	1,788	2,727	4,710	6,960
Exceptional Items					
Pre-tax Profit	838	1,788	2,727	4,710	6,960
Taxation	(441)	(594)	(818)	(1,413)	(2,088)
Consolidation Adjustments & Others					
Exceptional Income - post-tax					
Profit After Tax	398	1,193	1,909	3,297	4,872
Minority Interests					
Pref. & Special Div					
FX And Other Adj.					
Net Profit	398	1,193	1,909	3,297	4,872
Recurring Net Profit					

Balance Sheet Employment

(Rsm)	Mar-23A	Mar-24A	Mar-25F	Mar-26F	Mar-27F
Gross Loans/Cust Deposits					
Avg Loans/Avg Deposits					
Avg Liquid Assets/Avg Assets					
Avg Liquid Assets/Avg IEAs	**106.4%**	**107.2%**	**103.7%**	**106.4%**	**107.7%**
Net Cust Loans/Assets					
Net Cust Loans/Broad Deposits					
Equity & Provns/Gross Cust Loans					
Asset Risk Weighting					
Provision Charge/Avg Cust Loans					
Provision Charge/Avg Assets					
Total Write Offs/Average Assets					

SOURCE: INCRED RESEARCH, COMPANY REPORTS

BY THE NUMBERS…cont'd

Balance Sheet

(Rsm)	Mar-23A	Mar-24A	Mar-25F	Mar-26F	Mar-27F
Total Gross Loans	**38,064**	**54,322**	**71,822**	**92,178**	**120,379**
Liquid Assets & Invst. (Current)					
Other Int. Earning Assets					
Total Gross Int. Earning Assets	38,064	54,322	71,822	92,178	120,379
Total Provisions/Loan Loss Reserve					
Total Net Interest Earning Assets	38,064	54,322	71,822	92,178	120,379
Intangible Assets					
Other Non-Interest Earning Assets	**1,644**	**2,785**	**4,177**	**5,848**	**7,603**
Total Non-Interest Earning Assets	**2,018**	**3,307**	**4,804**	**6,569**	**8,396**
Cash And Marketable Securities	2,118	4,549	119	10,300	6,109
Long-term Investments					
Total Assets					
Customer Interest-Bearing Liabilities					
Bank Deposits					
Interest Bearing Liabilities: Others	31,489	46,532	58,361	74,059	94,318
Total Interest-Bearing Liabilities	31,489	46,532	58,361	74,059	94,318
Banks Liabilities Under Acceptances					
Total Non-Interest Bearing Liabilities	1,726	1,884	2,690	3,353	4,065
Total Liabilities	33,215	48,416	61,051	77,412	98,383
Shareholders Equity	9,840	14,384	16,292	32,239	37,111
Minority Interests					
Total Equity					

Key Ratios

	Mar-23A	Mar-24A	Mar-25F	Mar-26F	Mar-27F
Total Income Growth	38.6%	39.0%	48.7%	43.8%	39.8%
Operating Profit Growth	183.2%	109.8%	54.1%	60.4%	47.9%
Pretax Profit Growth	315%	113%	53%	73%	48%
Net Interest To Total Income	48.6%	41.3%	44.3%	45.0%	46.2%
Cost Of Funds	11.85%	11.35%	11.00%	10.70%	10.40%
Return On Interest Earning Assets	15.4%	15.3%	15.4%	15.5%	15.7%
Net Interest Spread	3.59%	3.94%	4.36%	4.81%	5.25%
Net Interest Margin (Avg Deposits)					
Net Interest Margin (Avg RWA)					
Provisions to Pre Prov. Operating Profit	40%	39%	40%	35%	35%
Interest Return On Average Assets					
Effective Tax Rate	52.5%	33.2%	30.0%	30.0%	30.0%
Net Dividend Payout Ratio					
Return On Average Assets					

SOURCE: INCRED RESEARCH, COMPANY REPORTS

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Stock Ratings	Definition:
Add	The stock's total return is expected to exceed 10% over the next 12 months.
Hold	The stock's total return is expected to be between 0% and positive 10% over the next 12 months.
Reduce	The stock's total return is expected to fall below 0% or more over the next 12 months.

The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

Sector Ratings	Definition:
Overweight	An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
Neutral	A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
Underweight	An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

Country Ratings	Definition:
Overweight	An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
Neutral	A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
Underweight	An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.