Initiating Coverage

Sector	Ratings
NBFC	BUY
Current Price	**Target**
Rs.269	Rs.344
Potential upside	**Holding**
28%	12 months

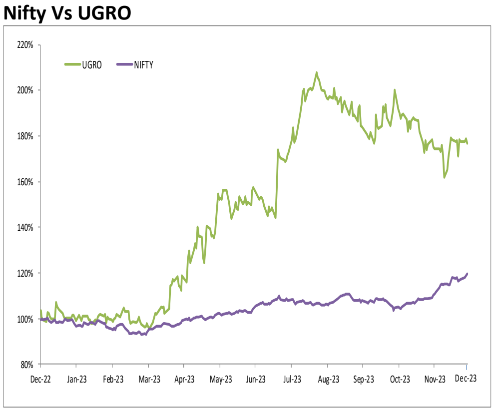
Stock Information	
Sensex/Nifty	72,410/21,779
Bloomberg	UGRO:IN
Equity shares (Cr)	9.25
52-wk High/Low (Rs)	319.85/144.00
Face value (Rs)	10
M-Cap (Rs Cr)	2,488
2-wk Avg Volume (Qty)	328,368

Financial Summary (Rs.cr.)

Year Ended	FY23	FY24E	FY25E	FY26E
NII	190	388	546	791
NIM (%)	8.6	7.8	7.2	7.2
PPOP	141	282	413	667
PAT	40	122	176	317
BV (Rs.)	142	182	194	230
PBV (x)	1.91	1.49	1.40	1.18
ROE (%)	4.08	9.14	9.25	13.62
ROA (%)	1.11	2.44	2.62	3.44
GNPA (x)	2.51	2.68	2.78	2.70
NNPA (x)	1.31	1.15	0.99	0.89

Shareholding Pattern (%)	Mar-23	Jun-23	Sept-23
Promoter	2.9	2.2	2.2
Public	95.4	96.5	96.4
Others	1.8	1.3	1.3

Nifty Vs UGRO



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Ugro Capital Ltd (UGROCAP)

29th December 2023

UGRO Capital Limited is a Data Tech Lending platform addressing the small business credit gap in India. It offers term loan programs, including secured and unsecured loans for MSMEs.

Our positive stance is supported by the rational a) Large total addressable market due to focus on lending to evolving MSME sector, b) Unique Process for underwriting using data analytics, AI and ML models to ensure robust asset quality c) Leveraging the Co-lending / Co-origination business model to increase the scalability and capital efficiency by transitioning from being a traditional NBFC to Lending as a service business model.

We expect AUM/PAT to grow at CAGR of 47%/100% respectively from FY23-26E and ROA and ROE for FY26E to be 3.4% and 13.6% respectively. We initiate coverage on UGRO Capital Ltd with a BUY recommendation and a Target price of Rs 344 / share based on 1.5x P/B of FY26E, offering an upside of 28%.

UGRO's Tech-Driven Triumph: Seizing the MSME Credit Gap

UGRO strategically targets the Rs. 85 trillion MSME credit gap through a tech-driven approach, leveraging data and technology for low-risk underwriting. The model adeptly exploits digitalization and regulatory frameworks, ensuring robustness with minimal human intervention. Delinquency rates align with GRO Scores, and UGRO's expansion from 34 to 104 branches, along with co-origination agreements, resulted in a Rs. 7,592 Crs AUM growth over three years.

Strategic Co-lending/Co-origination Model: Fueling Financial Resilience and Impressive Growth Targets

UGRO's Co-lending/Co-origination strategy, balancing on-book and off-book AUM at 50:50, strengthens its financial resilience. This approach allows UGRO to competitively offer medium-yield loans through off-book agreements and high-yielding loans from its own book. Collaborations with major financial institutions helps to secure cost-effective and accommodate diverse risk classes. With a targeted 3x increase in FY23 AUM to Rs. ~19,200 crs by FY26E, we anticipates a reduced cost-to-income ratio from 64% to 44%, driving RoE and RoA expansion from 4.1% to 13.6% and 1.1% to 3.4%, respectively. This strategic model positions UGRO for an impressive 71% EPS CAGR over FY23-26E.

Data analytics, AI and ML models to ensure the asset quality

Utilizing advanced data analytics, machine learning, and artificial intelligence, UGRO Capital has transformed the accessibility of financial support for MSMEs. Their robust credit evaluation framework and data-centric solutions facilitate swift assessment of creditworthiness, allowing for tailored financial products that cater to specific needs and expediting the loan processing for quicker approvals. The company's underwriting model, GRO Score 3.0, uses CIBIL score, GST data and bank statement for filtering out customers. The default rates for disbursals approved by GRO Score are only one-third of those observed in non-disbursed cases, showcasing the effectiveness of its analytical capabilities. Due to this the company has been able to maintain its stage 2 and stage 3 assets around 5% for the past few quarters.

Key risks

1. Regulatory changes may impact UGRO's Co-Lending model.
2. Economic shocks could slow growth and raise credit costs.
3. Changes in capital availability may affect UGRO's funding.
4. Potential delay in reducing repo rates could affect NIMs and overall profitability.

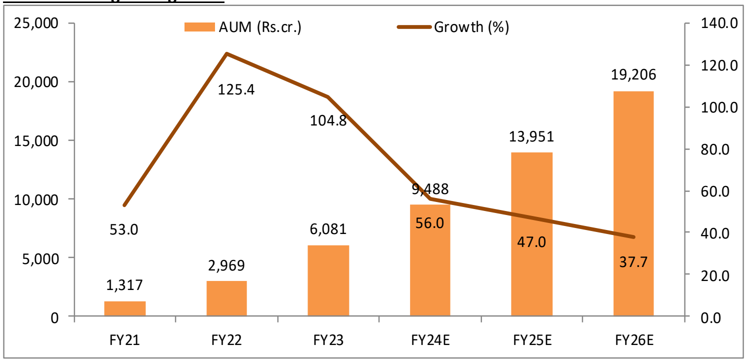
Investors are advised to refer disclosures made at the end of the research report.

Investment Rational

Robust growth trajectory: Targets ~Rs. 19,000 crs AUM by FY26E through strategic co-lending model

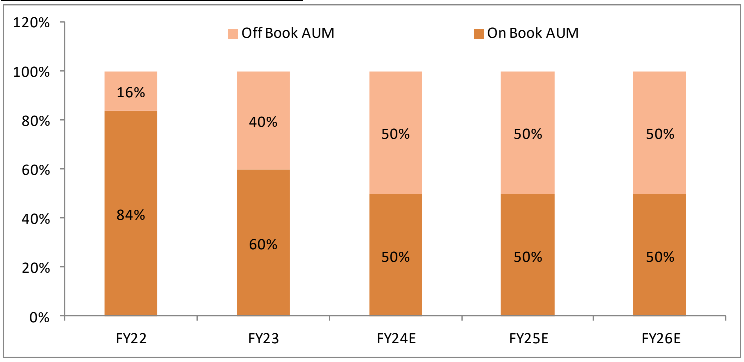
The company has consistently achieved 21% double-digit growth over the past nine quarters, with a robust Q2FY24 AUM of Rs. 7,592 Crs. Strategically, 55% of the financial standing is On Book and 45% Off Book, establishing a stable foundation. With an ambitious target, the company aims for a Rs. ~19,000 Crs AUM by FY26E, reflecting a remarkable 47% CAGR from FY23 to FY26E. The Co-lending and Co-origination model is key, with a goal for Off Book AUM to constitute 50% of the total AUM, providing capital efficiency and appealing collaboration for banks, especially advantageous for public sector and smaller private banks in SME financing.

Exibit: 1 Strong AUM growth



Source: Company, Systematix PCG Research

Exibit: 2 On Book – Off Book AUM Split

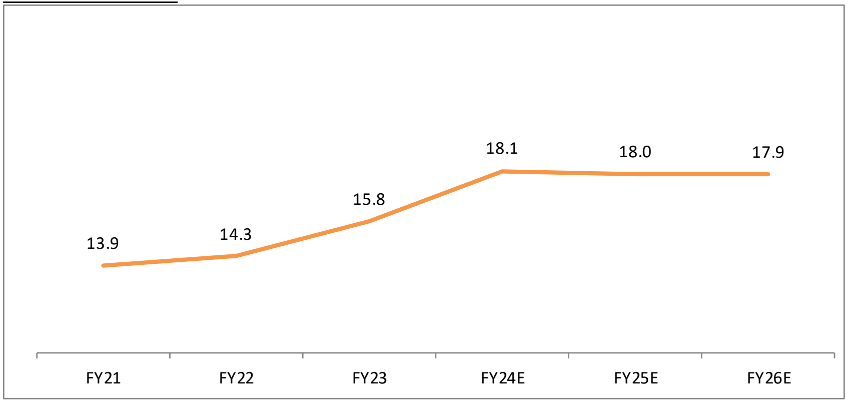


Source: Company, Systematix PCG Research

AUM mix focused towards high yield products

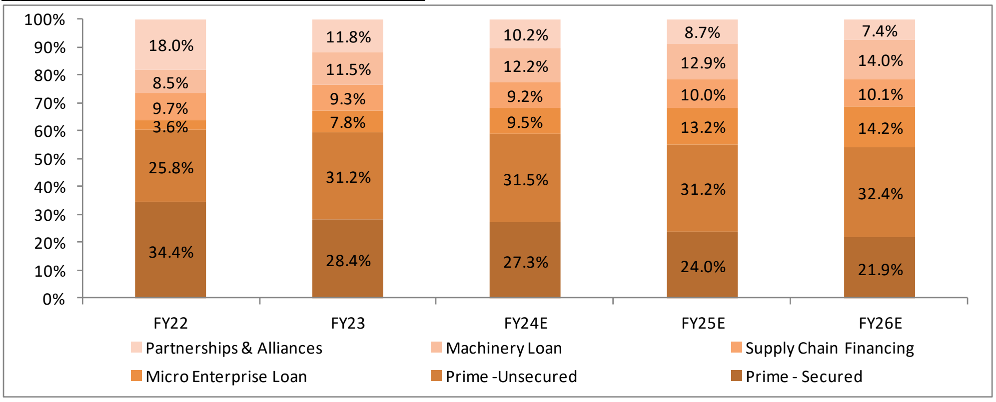
The company is strategically positioned to capitalize on every conceivable opportunity, honing its focus on high-yielding products. A pivotal component of this strategic vision involves the establishment of 100 micro branches within the next 2 years. Notably, these micro branches are designed to operate with optimized efficiency, boasting lower running costs and breaking even typically within an expedited timeframe of approximately 18 months. UGRO will be focused on small ticket sized loans against property which would be in the range of Rs 8-10 lakhs in the micro enterprise segment. The target is to grow this segment to ~Rs 2,500-3,000 crs over the next 3 years, also the company is planning to grow more into retail segment into machinery and supply chain financing which will again have higher yield this will help the company maintain its yield around 18%, while the cost of borrowing will be low ~11%.

Exibit: 3 Yield on loans



Source: Company, Systematix PCG Research

Exibit: 4 AUM mix focused towards high yield products



Source: Company, Systematix PCG Research

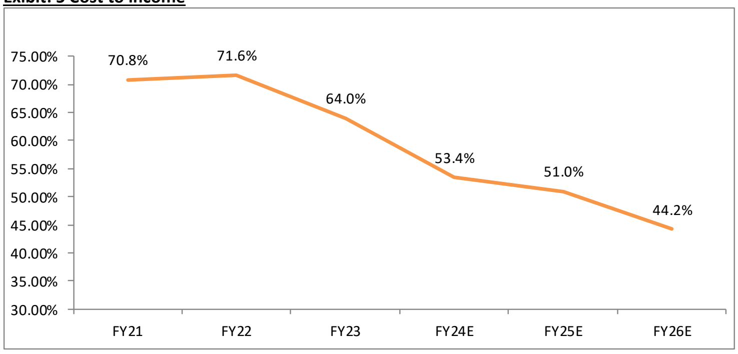
Strategic outlook: Cost of funds reduction and NIM enhancement

Anticipation of reduction in the Cost of Funds, aligned with the Reserve Bank of India's shift to a dovish stance. This strategic alignment, coupled with an expected decline in interest rates, positions the company to borrow funds at more favorable rates, particularly with the anticipated escalation in Off Book AUM.

In terms of NIM, UGRO has a multifaceted strategy for progressive enhancement. This includes the addition of micro branches to elevate the proportion of high-yielding micro loans in the on-book portfolio, contributing to overall revenue streams. Additionally, the growth of the Co-lending/Co-origination book is expected to substantially contribute to growth and related fee income. The strategic implementation of a corporate agent for insurance is poised to amplify fee income through cross-selling. This comprehensive approach reflects UGRO's commitment to sustained financial excellence and growth.

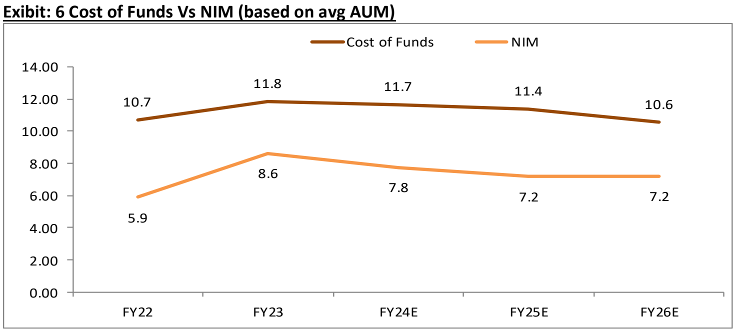
Going ahead, we envisage a prospective reduction in the cost of funds, with an expected decline to 10.6% by FY26E, down from 11.85% recorded in FY23. Concurrently, NIMs based on average AUM are anticipated to go from 8.63% in FY23 to 7.20% by FY26E, complemented by a concomitant reduction in spreads.

Exibit: 5 Cost to income



Source: Company, Systematix PCG Research

Exibit: 6 Cost of Funds Vs NIM (based on avg AUM)



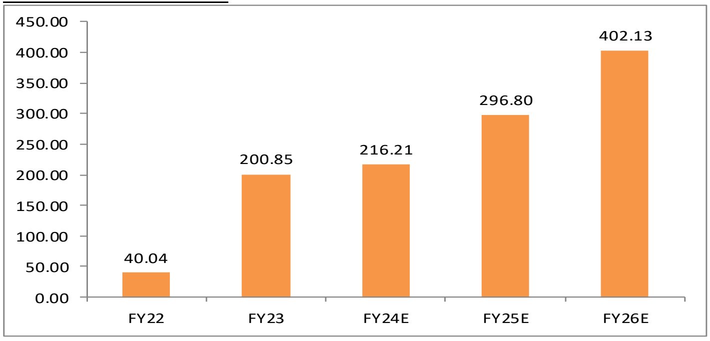
Source: Company, Systematix PCG Research

Substantial growth in non-interest income, fueled by diverse revenue streams

The company foresees a substantial uptick in non-interest income driven by three key sources. Firstly, fees from loan originations; secondly, income from foreclosures, accounting for around 1% of prime secured loans monthly, with fees ranging from 2-3%; and thirdly, insurance commissions, with majority of loans having life insurance of borrowers. This commission income is expected to rise along with the AUM growth.

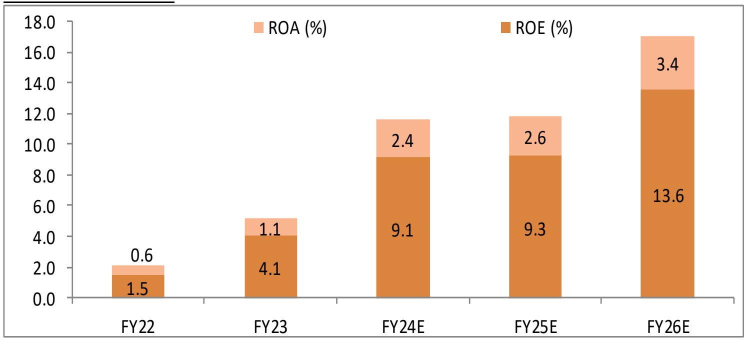
In FY23, non-interest income stood at approximately Rs 201 crs. Anticipating a twofold growth in AUM, we project a CAGR of 26%, resulting in non-interest income reaching Rs. 402 crs by FY26E. This forecast implies that non-interest income will constitute 34% of the total income, reflecting a robust and sustained expansion in our diverse revenue streams. This will also drive RoE and RoA expansion from 4.1% to 13.6% and 1.1% to 3.4%, respectively, from FY23 to FY26E.

Exibit: 7 Non Interest Income



Source: Company, Systematix PCG Research

Exibit: 8 ROE and ROA



Source: Company, Systematix PCG Research

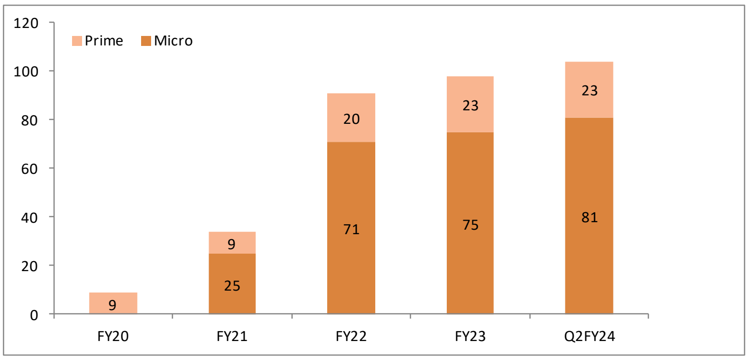
Strategic expansion: Target for 250 branches, emphasizing micro branch efficiency and geographic diversification

The company is strategically focused on a comprehensive branch expansion initiative, targeting a total count of 250 branches within the next 2 to 3 years, a significant increase from the current 104 branches. Currently, 78% of branches are dedicated as micro branches. The company plans to add another 100 micro branches, strategically positioned for higher yields.

These micro branches are engineered for optimized efficiency, boasting lower operational costs and a commendable track record of breaking even within an expedited timeframe of approximately 18 months. This cost-effective approach enhances overall operational efficiency and financial performance.

Furthermore, the company maintains a diversified geographic presence by implementing a policy where no single state contributes more than 20% to its branch network. This strategic geographical diversification mitigates concentration risk and reinforces the company's resilience in the face of regional economic variations or uncertainties.

Exibit: 9 Branch Addition



Source: Company, Systematix PCG Research

Exibit: 10 AUM Mix as Per Branch as on Q2FY24

State Wise	AUM Mix	Branches	
		Micro	Prime
Tamil Nadu	15%	20	1
Rajasthan	9%	15	2
Gujarat	12%	15	1
Karnataka	9%	15	1
AP & Telangana	12%	12	3
Maharashtra	15%	-	6
West Bengal	6%	-	4
NCR	17%	-	-
Rest of India	5%	4	5
Total	100%	81	23

Source: Company, Systematix PCG Research

Unique Process for underwriting using data analytics, AI and ML models to ensure the asset quality

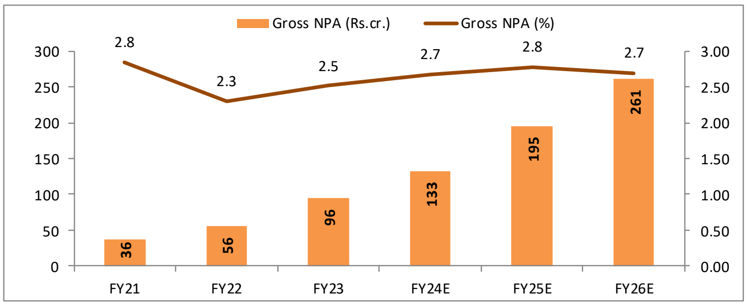
UGRO prioritizes maintaining exemplary asset quality by leveraging advanced AI/ML models. These models meticulously assess customers using criteria such as CIBIL score, GST data, and bank statements. This discerning approach allows UGRO to filter out underserved customers while prudently avoiding those new to credit who may be unserved. This strategic implementation instills high confidence in the company's ability to uphold superior asset quality.

Nearly 88% of UGRO's AUM caters to borrowers holding a CIBIL score exceeding 700. When analyzed based on the Commercial Bureau Score, only approximately 19% of the AUM falls within the CMR-7 band or lower. This meticulous filtering of customers based on high standards should alleviate any apprehensions regarding customer quality.

The process for monitoring the credit profile of a borrower is continued until the loan is repaid and if the borrowers rating decline the early warning system (EWS) alerts them, so the company tries to recover the loans early, so around 30-40% of the foreclosures done are initiated by the company due to drop in borrowers credit capacity. This helps them maintain the asset quality and lower the NPA profiles. Also the company is focused only lending in geogrpahy where it has physical presence due to better collection efficency.

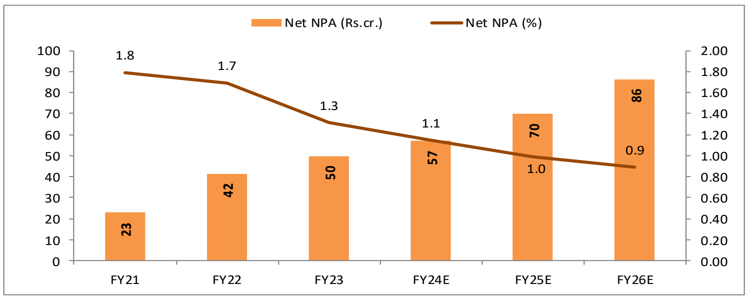
Going forward we anticipates UGRO to have a GNPA of Rs 261 crs by FY26E and NNPA of Rs 86 crs by FY26E with GNPA of 2.7% NNPA of 0.9%.

Exibit: 11 Trend of Asset Quality (GNPA)



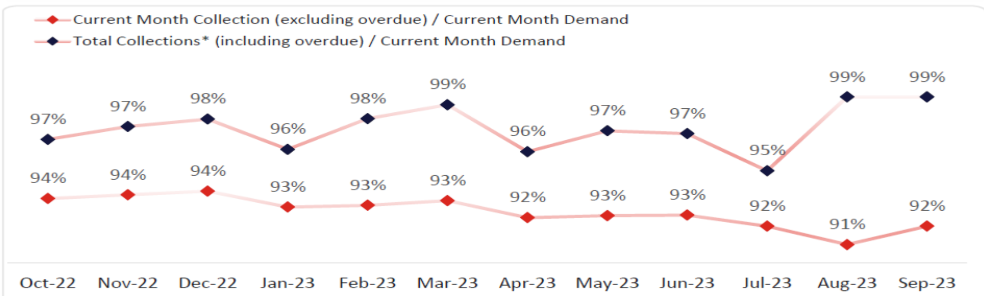
Source: Company, Systematix PCG Research

Exibit: 12 Trend of Asset Quality (NNPA)



Source: Company, Systematix PCG Research

Exibit: 13 Collection efficency



Source: Company, Systematix PCG Research

Exibit: 14 Trend of Asset Quality (GNPA) (Q2FY24)

Product Wise GNPA		
Product Category	**GNPA (%)**	**AUM (Rs. Crs)**
a) Prime - Secured	1.20%	2,164
b) Prime - Unsecured	3.50%	2,380
c) Micro Enterprise Loan	1.70%	636
d) Supply Chain Financing	2.60%	670
e) Machinery Loan	0.50%	893
f) Partnerships & Alliances	0.00%	849
Grand Total	**1.90%**	**7,592**

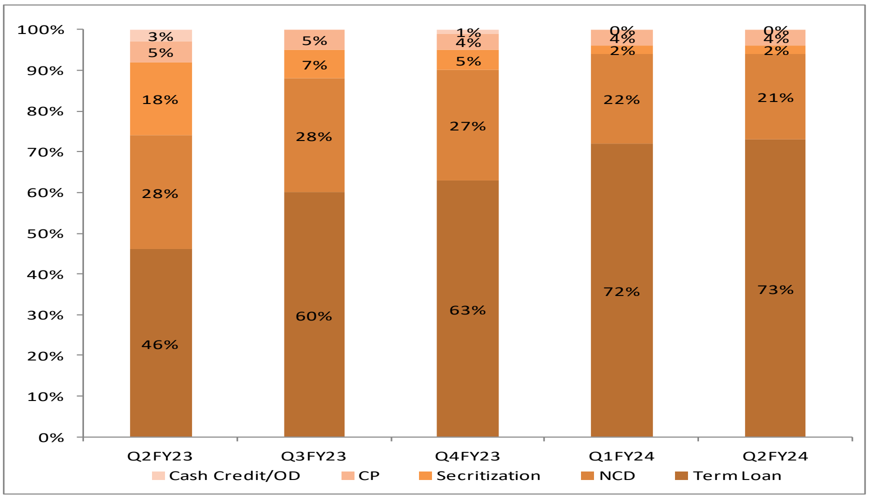
Source: Company, Systematix PCG Research

Three-part liability strategy: Diversified lending base, securitization, and development finance partnerships

UGRO adopts a comprehensive liability strategy, involving on-balance-sheet borrowings, co-origination partnerships, and loan securitization. The company has forged partnerships with various banks, NBFCs, and institutions to diversify its lending base. Utilizing products like term loans, NCDs, MLDs, and CPs, UGRO manages its on-balance-sheet loans. The securitization of a portion of the loan portfolio minimizes long-term asset-liability mismatch while maximizing liquidity. Additionally, UGRO facilitates impact financing in sectors like WASH, Climate Mitigation, Affordable and Clean Energy, Health, Education, Sustainable Cities, and Zero Hunger.

As of Q2FY24, the liability mix comprises 73% term loans, 21% NCDs, 2% securitization, 4% CP, and around 1% from cash credit/OD. In FY23, the company raised RS 2,400 crs across various products, adding 10+ new lenders and securing debt from three development finance institutions. The blended liability interest cost was 10.6%, with total debt reaching Rs 3,798 crs as of September 2023. With over 60 lenders, UGRO aims to streamline operations, increase funding per lender, and reduce borrowing costs. The debt level is projected to reach around Rs 7,900 crs by FY26E.

Exibit: 15 UGRO's target sector and credit exposure, as of Q2FY24



Source: Company, Systematix PCG Research

Financial Analysis

Financial Summary (Rs.cr.)				
Year Ended	FY23	FY24E	FY25E	FY26E
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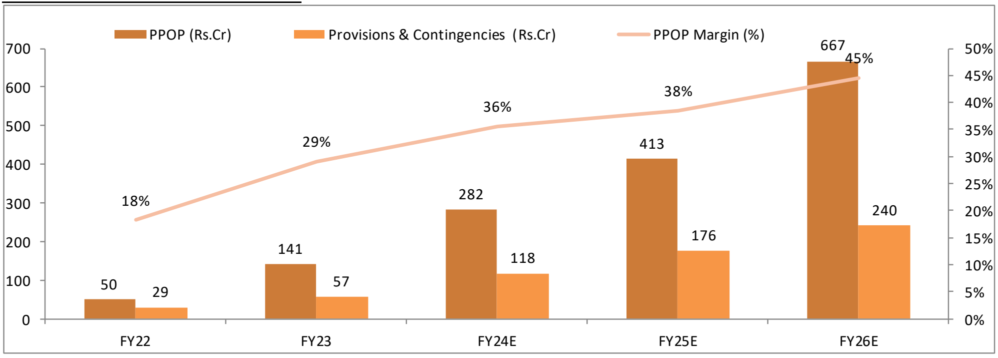
ROA (%)	1.11	2.44	2.62	3.44
GNPA (x)	2.51	2.68	2.78	2.70
NNPA (x)	1.31	1.15	0.99	0.89

UGRO's focused towards growth in AUM of ~3x between FY23-26E to~ Rs 19,200 crs which will eventually drive their NII from Rs 190 crs to Rs 791 crs by FY26E. The company is expected to maintain stable cost of funds which is expected to decline 10.6% by the FY26E, down from 11.85% recorded in FY23.

UGRO, acknowledging its substantial reliance on Artificial Intelligence (AI) and Machine Learning (ML) models for customer filtration, places a paramount emphasis on upholding exemplary asset quality standards. Leveraging advanced AI/ML algorithms, the company employs a meticulous evaluation process that incorporates key parameters such as CIBIL score, GST data, and bank statements. This discerning approach enables UGRO to selectively extend credit to high-quality customers while prudently excluding underserved individuals and those new to credit. The result is a proactive risk mitigation strategy, contributing to a reduced need for provisions compared to industry peers. In line with this risk-averse methodology, we anticipate a notable improvement in the Pre-Provision Operating Profit (PPOP), rising from Rs 141 crs in FY23 to an estimated value of Rs 667 crs by FY26E showing a CAGR growth of 68%.

Benefiting from a robust topline performance and a conservative approach to underwriting, the company effectively translates its strong revenue figures to the bottom line. Consequently, we anticipate a noteworthy CAGR of 100% in PAT from FY23 to FY26E, culminating in a projected PAT of Rs. 317 crs.

Exibit: 16 UGRO's PPOP and Provisions



Source: Company, Systematix PCG Research

Valuation

UGRO Capital Limited is a Data Tech Lending platform addressing the small business credit gap in India. It offers term loan programs, including secured and unsecured loans for MSMEs.

Our positive stance is supported by the rational a) Large total addressable market due to focus on lending to evolving MSME sector, b) Unique Process for underwriting using data analytics, AI and ML models to ensure robust asset quality c) Leveraging the Co-lending / Co-origination business model to increase the scalability and capital efficiency by transitioning from being a traditional NBFC to Lending as a service business model.

We expect AUM/PAT to grow at CAGR of 47%/100% respectively from FY23-26E and ROA and ROE for FY26E to be 3.4% and 13.6% respectively. We initiate coverage on UGRO Capital Ltd with a BUY recommendation and a Target price of Rs 344 / share based on 1.5x P/B of FY26E, offering an upside of 28%.

About the Company

U GRO Capital Limited stands at the forefront of innovation, revolutionizing the landscape of MSME lending in India. Leveraging cutting-edge Data Tech methodologies, their term loan programs, tailored for MSMEs, offer unmatched flexibility. Partnering with industry leaders, end-to-end solutions, including secured and unsecured loans, cater to diverse needs.

Company's Supply Chain program goes beyond conventional financing, providing comprehensive solutions for both demand and supply sides, with a special focus on Micro companies. The backbone of their success lies in robust Data Analytics and Technology architecture, delivering customized platforms like GRO Plus, GRO Chain, and GRO Xstream.

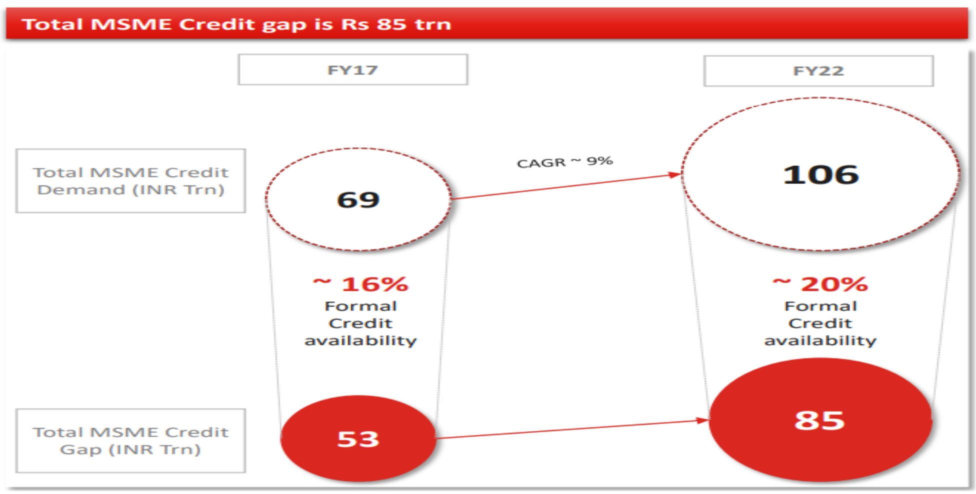
GRO Score (3.0), AI/ML-driven credit scoring model, is transforming MSME credit with on-tap financing akin to consumer financing. Pioneering the "Lending as a Service" model, Company has forged impactful co-lending relationships with major institutions, solidifying a substantial LaaS book through the GRO Xstream platform.

Backed by substantial equity capital from marquee investors, including RS 900+ Crs in 2018 and RS 340 Crs in 2023, U GRO Capital aspires to capture a significant 1% market share in the next three years.

Large Total Addressable Market due to focus on lending to evolving MSME sector

MSMEs, which comprise a vital sector, contribute approximately 30% to the country's GDP (Gross Domestic Product), represent 45% of the manufacturing output, and serve as employers for a substantial portion, providing livelihoods to around 11 Crs of India's population. MSMEs play a crucial role in driving economic growth and fostering innovation but are often faced with challenges regarding availability of capital majorly due to being a part of the informal economy and heterogeneity of cash flows for different MSME sectors. UGRO Capital has recognized this opportunity and follows a data driven approach to address this effectively. The total credit gap in MSME sector was RS 85 trillion as on FY22 and this presents a large market opportunity and the demand for MSME loans has accelerated and has grown to about 1.7 times the demand of two years ago. During initial phases company worked with Crisil and carefully filtered out 9 sectors out of 200+ sub sectors based on homogeneity of cash flows among MSMEs. These sectors are Hospitality, Light Engineering, Auto Components, Chemicals, Food Processing, Education, Healthcare, Electrical Equipment & Components and Micro Enterprises.

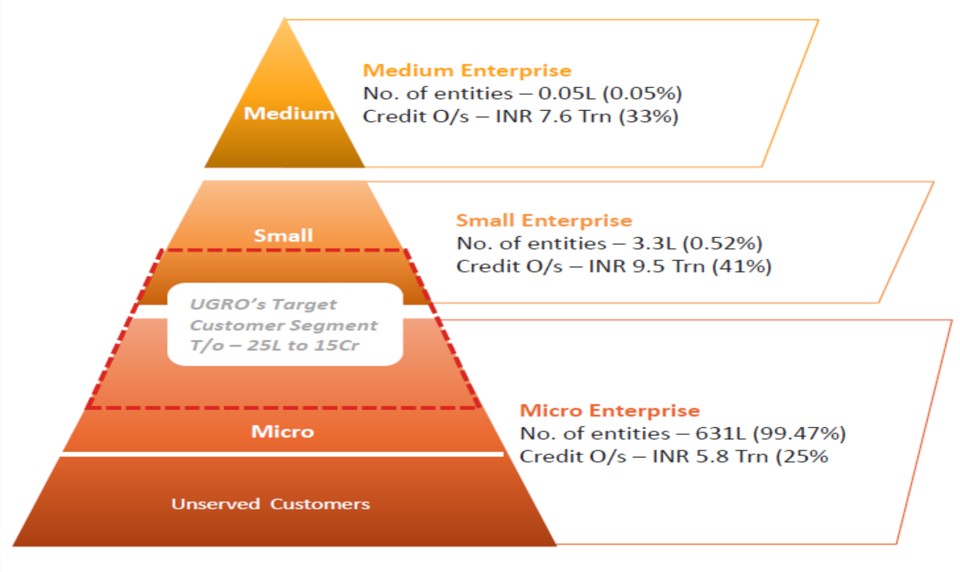
Exibit: 17 Credit GAP in MSME Sector



Source: Company, Systematix PCG Research

Credit Gap of customer segment constitutes 95%

Exibit: 18 Target Segment for UGRO



Source: Company, Systematix PCG Research

Brief on Company's selected sector.

In the contemporary fast-paced and intensely competitive business environment, Micro, Small, and Medium Enterprises (MSMEs) emerge as pivotal entities propelling economic growth and cultivating innovation. These agile enterprises stand as the backbone of our economy, making substantial contributions to employment generation, innovation, and overall economic development. MSMEs, which comprise a vital sector, contribute approximately 30% to the country's GDP (Gross Domestic Product), represent 45% of the manufacturing output, and serve as employers for a substantial portion, providing livelihoods to around 11 Crs of India's population.

Food Processing:

- FDI: $12.15 Bn by June 2023 (1.88% of total FDI). FY 2023: $0.896 Bn, total $12.35 Bn (2000-2023).
- Market: Projected $535 Bn by 2025.
- Consumer Spending: $6 Tn by 2030, boosting processed food demand.
- Exports: $51 Bn (2022-23), key destinations: USA, Bangladesh, UAE, Vietnam.
- Government Initiative: Aiming to make India the Global Hub for 'Shree Anna' (Millets).

Healthcare:

- Industry: $61.79 Bn (FY17) to $132 Bn by 2023, CAGR 16%-17%.
- Telemedicine: Projected $5.4 Bn by 2025, CAGR 31%.
- Blueprint: Aiming to unlock $200 Bn in economic value.
- Notable Scheme: Ayushman Bharat.
- Investment: RS 17,691.08 Cr in 157 new Medical Colleges since 2014.

Auto Components:

- Industry: Record $69.7 Bn turnover, 33% growth in FY 2022-23.
- FDI: $35.15 Bn (April 2000-June 2023), 100% FDI in automotive parts allowed.

Education:

- Sector: $117 Bn, projected $313 Bn by FY30.
- Pre-school: $7.35 Bn growth by 2028, 11.2% CAGR (2023-2028).
- K-12: 1.46 million schools, 230 million students.
- Higher Education: 45,000 degree colleges, 1000 universities, and 1500 top institutes.
- Ed-Tech: 7 out of 36 unicorn companies valued at $34.05 Bn (June 2022).
- Global Hub Prediction: Experts foresee India's rapid evolution.

Chemicals:

- Production: 26,570 MT (2022-23 up to September), 4.61% CAGR.
- Global Rankings: 11th in exports, 6th in imports.
- FDI: $21.48 Bn, employing over 2 million people.
- Notable Trend: Combined exports decreased to RS 17.88 Cr from RS 22.78 Cr (April-May 2023).

Hospitality:

- Significance: Drives job creation and development.
- Emphasis: Highlighted in 2023 Union Budget.
- Women Employment: A major employer backed by government initiatives.
- 'Visit India' Year: 2023 designated.
- FDI in Tourism: India allows 100%, including construction projects.
- Investment Opportunities: Explore in India's rich cultural tapestry and captivating destinations.

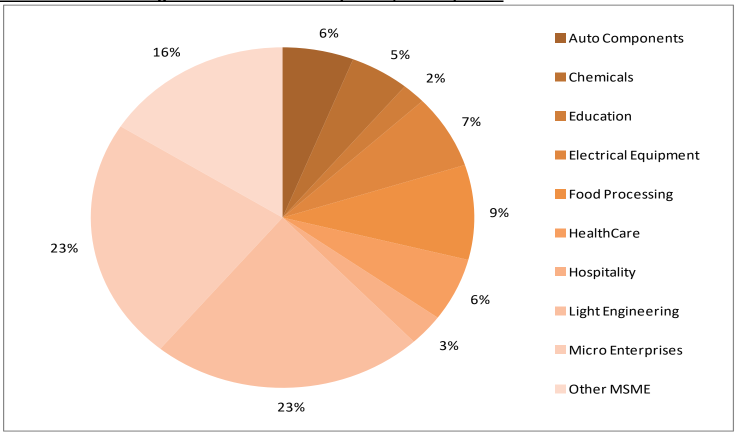
Electrical Equipment:

- Industry size: $50 Bn in FY21 and expected to grow to $72 Bn by 2025.
- Capital expenditure in plant, machinery, equipment, associated utilities and technology, including for Research & Development (R&D) will drive the growth.

Light Engineering:

- Major Products: Castings, forgings and fasteners
- Exports: Engineering goods exports stood at $111 Bn in FY22 with major countries being United States, Germany, Saudi Arabia, the United Kingdom, and Mexico.
- FDI: Upto 100% Foreign Direct Investment in the de-licensed engineering sector.

Exibit: 26 UGRO's target sector and credit exposure, as of Q2FY24



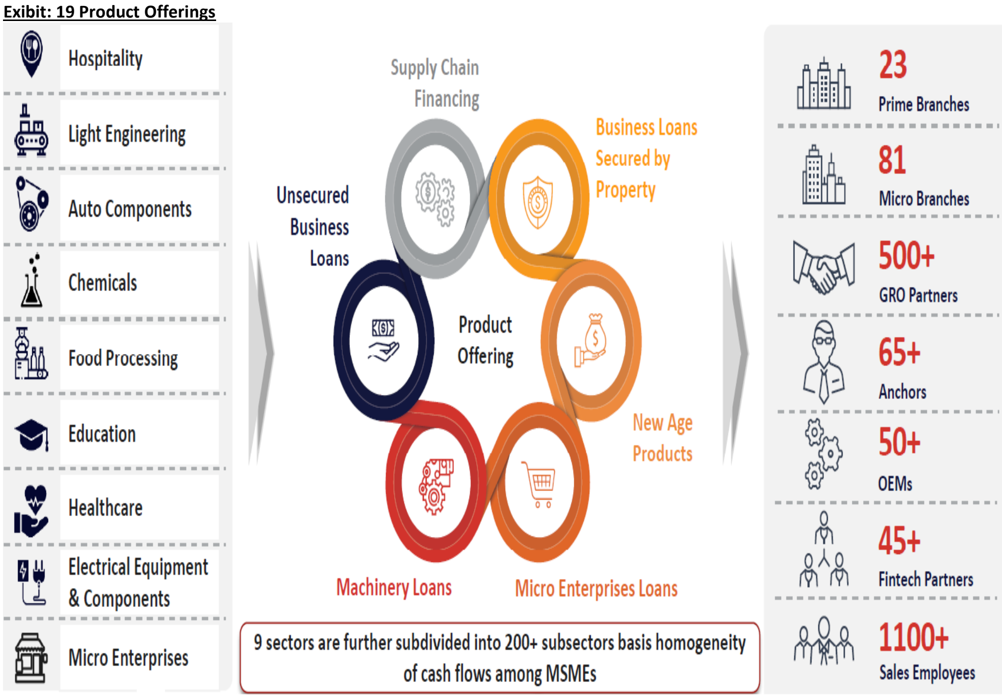
Source: Company, Systematix PCG Research

Sector focused approach, Multiple products and large distribution strength

UGRO Capital adopts a nuanced approach to MSME lending, recognizing the limitations of traditional definitions by GoI and regulators. In targeting 9 specific sectors out of 200, Company criteria prioritize stability against policy changes and reduced export dependency.

UGRO Capital is focused on lending to MSMEs having credit history but is unable to access credit from Banks and large NBFCs. UGRO adopts a sector-agnostic approach in the micro segment, prioritizing geographical clustering over sectoral considerations. This nuanced strategy ensures tailored lending practices, addressing unique sector-specific challenges and contributing to a more targeted and effective approach for serving diverse MSME needs. The major product offerings are Business Loans Secured by Property, New Age Products, Micro Enterprises Loans, Machinery Loans, Unsecured Business Loans, Supply Chain Financing.

Exibit: 19 Product Offerings



Source: Company, Systematix PCG Research

UGROs multi-pronged distribution channel includes:

Branch led channel which has a network of 95+ branches that includes 23 Prime loan branches majorly in metros and Tier 1/2 cities and 81 micro loan branches spread across 7 states majorly in Tier 3-6 cities.

Eco-system channel where the company is involved in supply chain financing and machinery financing through anchors and OEM partners.

Partnership & Alliances Channel which is a co-lending partnership with NBFCs/Fintech where these partners originate loans and provide 5-10% FLDG cover.

Direct Digital Channel which is a 100% digital sourcing which has the ability to dispense credit through UPI and other forms of payment

Exibit: 20 Average ticket size and yields

Product	Collateral	Cash flow Used	Sourcing	Customer Turnover	Average ticket size	Yield	Tenor	AUM Mix
Prime: Secured	Secured LAP	GST, Banking & Liquid income assessment	Intermediated	Rs 10 Mn – 15 Mn	Rs 7 Mn	13.8%	11 yrs	29%
Prime: Unsecured	Unsecured	GST, Banking & Liquid income assessment	Intermediated	Rs 10 Mn – 15 Mn	Rs 1.6 Mn	19.6%	3 yrs	31%
Eco system channel	Supply Chain Finance (SCF)	GST & Banking	Anchor & OEM partners	Rs 10 Mn – 100 Mn	Rs 4.9 Mn	13.3% (Net)	0.24 yrs	9%
Eco system channel	Machinery Finance	GST & Banking	Anchor & OEM partners	Rs10mn to Rs100mn	Rs 3.6 Mn	13.4%	4 yrs	12%
Micro: Loans	Secured LAP	Liquid income assessment	Internal Sourcing	< Rs 10 Mn	Rs 0.9 Mn	20.6%	8 yrs	8%
Micro: Loans	Unsecured	Liquid income assessment	Internal Sourcing	< Rs 10 Mn	Rs 0.3 Mn	25.3%	3 yrs	
Partnership & Alliances	FLDG from partner	Banking & liquid income assessment	Head Office led	< Rs 0.5 Mn	Rs 0.5 Mn	14.8% (net)	4 yrs	11%
Direct Digital	Unsecured	Banking	Digital Sourcing	< Rs 0.2 Mn	Rs 0.07 Mn	24%	1 yr	<1%

Source: Company, Systematix PCG Research

Unique Process for underwriting using data analytics, AI and ML models to ensure the asset quality

With the pace of formalization and digitization in the economy increasing along with increase in availability of data for MSME post 2016 due to demonetization and GST has paved the way for more innovative lending models like cash flow based lending models. UGRO has identified CIBIL score, GSTIN data and Bank statement as sources of data for customers within the chosen sectors which can be used to determine their homogeneity of cash flows and repayment behavior where past 3 years of credit history and 2 years of GST data is studied which act as inputs to their AI and ML models which help them to access the credit worthiness of the borrower.

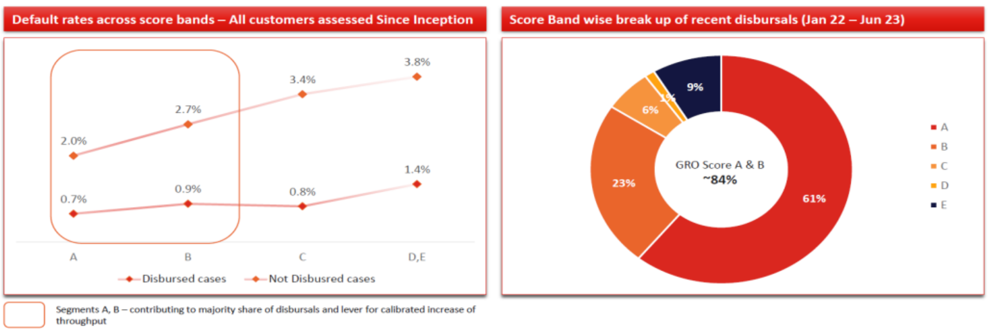
UGRO dedicated a 18 month period to scrutinize various MSME business models and ultimately came up with 8 sectors out of 200+ subsectors based upon their homogeneity of cash flows and less susceptibility to change in government policies and regulations. Additionally, they included small business loans in their selection criteria, emphasizing customer behavior influenced by geographical clustering and cash flow availability rather than broad trends within the sector. As a result, micro-enterprise loans emerged as the ninth sector in their analysis.

Utilizing advanced data analytics, machine learning, and artificial intelligence, UGRO Capital has transformed the accessibility of financial support for MSMEs. Their robust credit evaluation framework and data-centric solutions facilitate swift assessment of creditworthiness, allowing for tailored financial products that cater to specific needs and expediting the loan processing for quicker approvals. The company's underwriting model, GRO Score 3.0, represents advancement from their proprietary scoring model, GRO Score 2.0 which used credit bureau data and banking data. It conducts detailed analyses of approximately 20,000 applications, leveraging GST transaction reports to execute statistical model fitment and validation tests based on real loan repayment performances. The default rates for disbursals approved by GRO Score are only one-third of those observed in non-disbursed cases, showcasing the effectiveness of its analytical capabilities.

Over the past four years, UGRO Capital has served more than 48,000 customers across 4,000 different pin codes. Their operations involved analyzing over 93,000 bank statements, 34,000 GST records, and processing more than 63,000 GRO Score logins. By redirecting the focus from collateral to business fundamentals, UGRO Capital delivers timely and personalized credit solutions to MSMEs, empowering them to achieve their growth objectives. The machine generates 25,000+ data features from an applicant's bureau record and bank statement which are considered by the GRO score to categorise a particular customer across bands from A-E, with A being the best and E being the worst. Segments A, B contributes majority share of disbursals and from Jan 22 – June 23 around 84% of the disbursals were in these 2 bands.

GRO Score – Risk Bands Stacking up on historical portfolio

Exibit: 21 GRO Score



Source: Company, Systematix PCG Research

UGRO has a team of 40-50 people who are working on complex models where the machine generates around 25,000+ data features from an applicant's bureau record and bank statement and this model is used to filter out the customers and is refined on a daily basis as the availability of data increases and they have also filed a patent for this model. The model is used to provide the expected delinquencies by closely following the borrowers' business and his credit profile. Currently the company is focused only on lending to geographies where it has a physical presence for better recoveries.

Although the company uses data heavily for filtering out credit worthy customers based on cash flows, the final decision of lending is taken by the credit underwriter and even if the model approves a customer as high quality the credit underwriter may reject it based on his view so only around 40-50% of customers approved by the model are approved by the underwriter. The process for monitoring the credit profile of a customer is continued until the loan is repaid and if the borrowers rating decline the company tries to recover the loans early, so around 30-40% of the foreclosures done are initiated by the company due to drop in borrowers credit capacity. This helps them maintain the asset quality and lower the NPA profiles.

Transitioning from NBFC to Lending-as-a-Service via Co-lending for enhanced scalability and capital efficiency

RBI came up guidelines in 2018 for Co-origination of loans for banks and NBFCs for lending to priority sector to address the credit gaps within the sector. It was further updated in 2020 to allow greater flexibility for NBFCs to initiate loan sanctioning and disbursement, with subsequent transfer of the bank's co-lending share based on their assessment as per the Master Agreement.

In the dynamic landscape of SME financing, UGRO's co-lending and co-origination model doesn't just spell efficiency —it's a win-win for both. Picture this: a synergy of innovation and their longstanding credit expertise. For public sector banks and nimble private banks, this partnership isn't just about priority lending; it's about unlocking a more profitable future.

In Co-lending/Co-origination business UGRO partners with India's large banks and financial institutions to obtain quasi-liability at an attractive cost of debt. This value accretive model helps UGRO earns fee income and is able to cater to varying risk classes. The company is also leveraging co-lending model to gravitate from being a traditional NBFC to "lending as a service" business model. It also does Direct Assessment (DA) of loans; however that share is very low.

In the co-origination model, the originator must maintain a minimum 20% of the loan amount on its Balance Sheet. Both the originator and the partner participate in underwriting and funding the loan concurrently. The funding occurs via an escrow account, without any obligatory minimum holding period. In co-origination, if the partner is a bank, risk is shared equally, while the originator can offer First Loss Default Guarantee (FLDG) to the NBFC partner. Income from the spread is acknowledged throughout the loan's lifecycle.

In the co-lending model as per RBI norms, the originator is required to maintain a minimum 20% of the loan amount on its Balance Sheet. There is no specified minimum holding period for the originator. Risk is equally shared between the originator and the co-lending partner. The profit margin earned by the originator during co-lending is recognized upfront by the originator based on the Net Present Value (NPV).

In a Direct Assignment (DA), the originator can sell the portfolio after holding it for either 3 months (for tenure less than 2 years) or 6 months on its books. The originator must retain 5% of the loan's book value (for tenure less than 2 years) or 10% as a minimum retention requirement. If the buying partner conducts full due diligence, they may waive 5% of the book value for Residual MBS (Mortgage backed security). Risk is equally shared with the buying partner, and income recognition mirrors that of co-lending arrangements.

UGRO Capital reaps a myriad of benefits from its strategic approach:

- Higher ROA & ROE: Commitment to better leverage and a higher spread, in contrast to on-balance sheet lending, translates into superior Return on Assets (ROA) and Return on Equity (ROE), exemplifying financial prowess.
- High Growth with Lower Equity Capital: Company achieve high growth while optimizing equity capital, showcasing their ability to expand efficiently and effectively.
- Sizeable Sanction and On-Tap Capital: The availability of substantial sanctions and

on-tap capital ensures their agility in meeting market demands and capitalizing on growth opportunities.

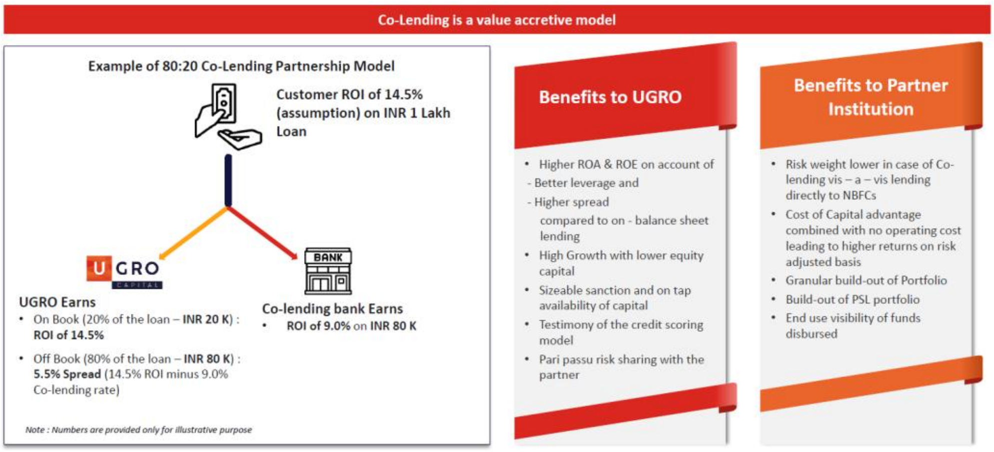
- Testimony of Credit Scoring Model: The success of credit scoring model serves as a powerful testament to their commitment to innovation and excellence in risk management.
- Pari Passu Risk Sharing: In partnerships, company embrace a pari passu risk-sharing model, creating a collaborative ecosystem where risks and rewards are shared equitably with their valued partners.

These elements collectively position UGRO Capital as a dynamic and resilient player in the financial landscape, where growth, efficiency, and prudent risk management converge for sustainable success.

Benefits to Partner Institution

- Lower risk weightage in case of Co-lending vis – a – vis lending directly to NBFCs
- Cost of Capital advantage combined with no operating cost leading to higher returns on risk adjusted basis
- Granular build-out of portfolio
- Build-out of priority sector lending portfolio
- End use visibility of funds disbursed

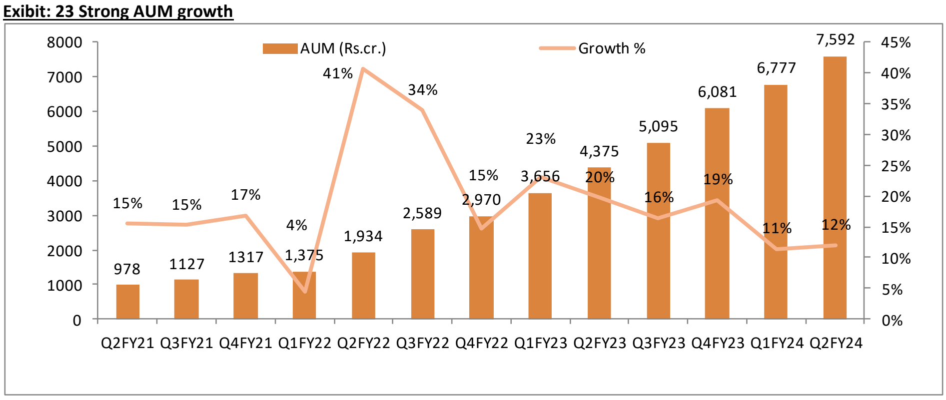
Exibit: 22 Co-lending benefits



Source: Company, Systematix PCG Research

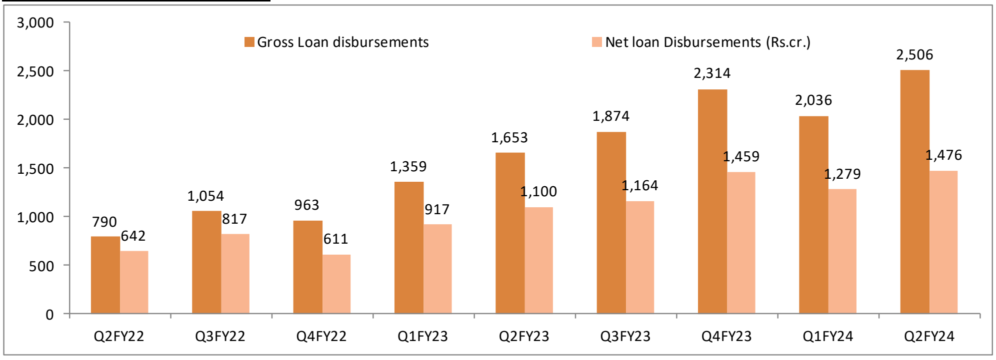
Due to these benefits the bank is continuously focusing to increase the off book AUM via Co-lending/Co-origination model, which stood at 16% of AUM in March 2022 and increased to 45% by September 2023. Going ahead UGRO aims to take the off book AUM to around 50%. This is also helps the company to reduce its expenses and bring the opex/income ratio which is around 52-53% to the long term target of around 45%.

Exibit: 23 Strong AUM growth



Source: Company, Systematix PCG Research

Exibit: 24 Gross loan disbursement



Source: Company, Systematix PCG Research

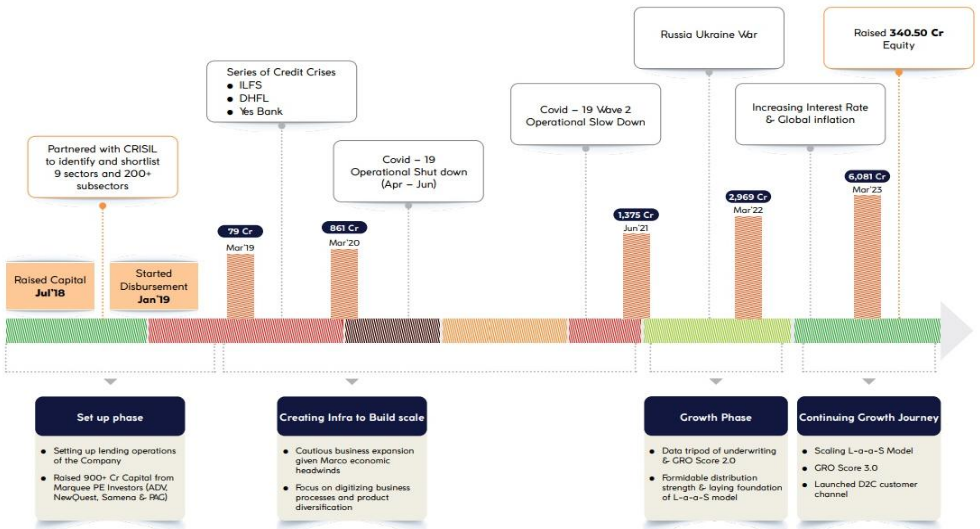
Business model is engineered for scale, with an unwavering focus on paramount asset quality.

UGRO has demonstrated substantial growth in AUM, rising from ~ Rs 1,300 crs in FY21 to ~ Rs 7,600 crs in H1FY24. This increase, viewed in terms of absolute growth, reflects the company's strategic evolution.

Established in 2017, UGRO's top management secured Rs 9,200 crs in equity by August 2018. External challenges, including the IL&FS/DHFL credit crisis and Covid-19, initially prompted cautious growth. By March 2021, with over three years of operations, UGRO expanded its branches from 34 to 104 and entered Co-origination agreements, adding Rs 7,600 crs in AUM over 2.5 years.

UGRO's resilience during Covid-19 disruptions allowed continued disbursements, enhancing underwriting capabilities. A focused approach and diversified strategy position the company well, instilling confidence in its ability to sustain asset quality amid growth.

Exibit: 25 Company History



Source: Company, Systematix PCG Research

Each of UGRO Capital's channels is powered by a proprietary technology module

GRO Plus: Designed for branch-led disbursement which has fully integrated every element of underwriting digitally (using all conventional parameters). The platform allows for GRO Partners (DSA network) to obtain in-principle approval within 60 minutes.

GRO Chain: GRO Chain is an end-to-end platform for supply chain financing that will cater to ecosystem anchors, vendor borrowers and dealer/distributor borrowers.

GRO Xstream: UGRO's pioneering FinTech Platform, "GRO XStream," represents an innovative industry-first marketplace for BFSI partners. This platform enables seamless API integrations with partners' systems, resulting in the achievement of exceptional

Turnaround Times (TATs). Its design is tailored to facilitate diverse transaction types among onboarded BFSIs, encompassing colending, onward lending, direct assignments, portfolio buyout, and securitization.

GRO X: GRO X App is a Direct Digital channel built to allow non-intermediated loan applications from eligible SMEs.

The current demand is coming from same geographies but from new customers, so to capitalize on this opportunity UGRO plans to add new branches and take the total count to 250 branches in the next few years.

FINANCIAL STATEMENT

Income Statement (Rs.cr.)	FY22	FY23	FY24E	FY25E	FY26E
Interest Income	272.08	482.91	793.71	1,076.11	1,497.88
Interest Expenses	137.26	293.27	405.81	530.42	706.48
Net Interest Income	134.82	189.64	387.90	545.69	791.40
Non Interest Income	40.04	200.85	216.21	296.80	402.13
Total Income	174.86	390.49	604.11	842.49	1,193.53
Growth (%)		123.3	54.7	39.5	41.7
Employee Cost	72.89	140.71	198.50	234.39	298.42
Other Expenses	52.37	109.15	123.95	195.09	228.56
Operating Expenses	**125.26**	**249.86**	**322.45**	**429.48**	**526.97**
PPOP	49.59	140.63	281.66	413.01	666.55
Provisions & Contingencies	29.42	56.80	117.55	175.79	240.39
PBT	20.18	83.83	164.11	237.22	426.16
Tax	5.63	44.05	42.18	60.96	109.52
PAT	14.55	39.78	121.94	176.25	316.64
Tax Rate (%)	27.9	52.6	25.7	25.7	25.7

Balance Sheet (Rs.cr.)	FY22	FY23	FY24E	FY25E	FY26E
Total Non-financial Assets	137.87	202.00	123.97	125.64	125.96
Investments	69.44	60.11	62.28	72.66	91.18
Loans & Advances	2,451.12	3,806.36	4,963.75	7,022.44	9,675.21
Cash and cash equivalents	188.35	211.81	496.19	537.07	673.62
Other assets	8.12	25.31	27.25	29.30	33.16
Total Assets	2,854.90	4,305.59	5,673.43	7,787.11	10,599.13
Equity Capital	70.56	69.32	92.55	109.80	109.80
Reserves & Surplus	896.00	914.72	1,590.52	2,016.85	2,411.58
Networth	966.56	984.04	1,683.07	2,126.65	2,521.38
Borrowings	1,802.25	3,148.93	3,817.75	5,487.85	7,905.15
Other liabilities	47.22	77.35	77.35	77.35	77.35
Total Liabilities	2,854.90	4,305.59	5,673.43	7,787.11	10,599.13

Basic Ratios (Rs.)	FY22	FY23	FY24E	FY25E	FY26E
EPS	2.1	5.7	13.2	16.1	28.8
Growth (%)	-49.4	178.2	129.6	21.8	79.6
Book Value	137.0	142.0	181.9	193.7	229.6
Growth (%)	1.4	3.6	28.1	6.5	18.6

Valuation Ratios	FY22	FY23	FY24E	FY25E	FY26E
P/E	131.4	47.2	20.6	16.9	9.4
P/BV	2.0	1.9	1.5	1.4	1.2
ROE (%)	1.5	4.1	9.1	9.3	13.6
ROA (%)	0.6	1.1	2.4	2.6	3.4
D/E (x)	0.8	1.9	3.2	2.3	2.6

Margin (%)	FY22	FY23	FY24E	FY25E	FY26E
PPOP Margin	18.2	29.1	35.5	38.4	44.5
PAT Margin	5.3	8.2	15.4	16.4	21.1

Spreads (%)	FY22	FY23	FY24E	FY25E	FY26E
Yield on Loans	14.3	15.8	18.1	18.0	17.9
Cost of Funds	10.7	11.8	11.7	11.4	10.6
Spread	3.6	4.0	6.5	6.6	7.4
NIM (on avg AUM)	5.9	8.6	7.8	7.2	7.2

Asset Quality	FY22	FY23	FY24E	FY25E	FY26E
Gross NPA (Rs.cr.)	56.4	95.7	132.8	195.3	261.2
Net NPA (Rs.cr.)	41.5	49.9	56.9	69.8	86.4
Gross NPA (%)	2.3	2.5	2.7	2.8	2.7
Net NPA (%)	1.7	1.3	1.1	1.0	0.9
AUM (Rs.cr.)	2,969	6,081	9,488	13,951	19,206
Growth (%)	125.4	104.8	56.0	47.0	37.7

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