

Vakrangee (VKI IN)

King of Convenience Services

BUY

Share Price INR 732
12m Price Target INR 830 (+13%)

Highly scalable network & services

We initiate coverage of VKI with a BUY and INR830 TP, at 36x FY19E EPS. This implies a 0.83 PEG vs Indian consumer stocks' 2.1. VKI has evolved into an asset-light convenience-service chain. It provides government-to-citizen services, real-time banking services and assisted e-commerce, using franchisees. We forecast that its store or "kendra" revenue and EBITDA will triple over FY17-20E, from: a) a doubling of kendras to 75,461; b) Amazon's activation of services in 58% of its kendras; and c) an increase in mature stores to 75% from 45%. Catalysts are expected from the launch of new services such as lead generation for loans, visa services and reverse logistics.

More mileage from Amazon & other partners

From working on Government of India projects such as passports and elections, VKI has opportunistically transformed itself into a multiple-service kendra operator. It helps its bank partners save costs by eliminating the need to run rural branches. It also helps partners such as Amazon, insurers and logistics companies reach India's deep hinterlands. Of Amazon's 12k+ assisted e-commerce stores in India, 10k+ belong to VKI. We forecast that by FY20E, assisted e-commerce, insurance and logistics will form 49% of its kendra revenue, up from 14% in FY17.

No major challenger yet...

While providing one service is not profitable, VKI's gamut of offerings offers it an EBITDA margin of 18%. VKI can be likened to the ubiquitous convenience-store 7-Eleven in Asian markets. Most of its Indian peers are small and unlisted. We see barriers to entry from its: a) extensive brick-&-mortar franchisee network, which dwarfs competitors' scale; b) depth of reach, which makes it the preferred choice of its partners; and c) strong customer footfalls from its Amazon partnership.

... which should protect its high growth & ROEs

VKI's stock has risen 166% YTD, on the back of its earnings growth. Still, we believe there is steam left. While 7-Eleven's ASEAN partners trade at 31.7x FY19E EPS, we value VKI at 36x FY19E, implying a 0.83 PEG. This still represents a 62% discount to Indian consumer stocks' 2.1 PEG. Catalysts could include the launch of new services such as lead generation for loans, visa services and reverse logistics, in our view.

FYE Mar (INR m)	FY16A	FY17A	FY18E	FY19E	FY20E
Revenue	31,907	40,005	59,772	90,812	121,583
EBITDA	8,208	9,460	12,364	17,852	23,005
Core net profit	3,949	5,308	8,144	12,207	15,588
Core EPS (INR)	7	10	15	23	29
Core EPS growth (%)	16.7	34.4	53.4	49.9	27.7
Net DPS (INR)	1	2	4	7	9
Core P/E (x)	98.1	73.0	47.6	31.7	24.9
P/BV (x)	24.5	18.9	14.8	11.4	8.8
Net dividend yield (%)	0.2	0.3	0.5	0.9	1.2
ROAE (%)	28.4	29.2	34.8	40.5	40.0
ROAA (%)	19.2	24.3	32.7	39.1	38.5
EV/EBITDA (x)	12.9	17.9	30.4	21.0	16.1
Net gearing (%) (incl perps)	9.6	net cash	net cash	net cash	net cash
Consensus net profit	-	-	-	-	-
MKE vs. Consensus (%)	-	-	-	-	-

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Company Description

Vakrangee delivers real-time banking, insurance, e-Governance, e-Commerce and logistics services across India

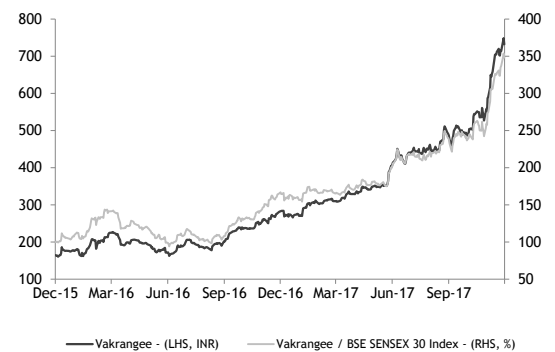
Statistics

52w high/low (INR)	749/266
3m avg turnover (USDm)	25.9
Free float (%)	55.6
Issued shares (m)	529
Market capitalisation	INR387.5B USD6.0B

Major shareholders:

Vakrangee Holdings Pvt Ltd	23.7%
Vakrangee Capital Pvt Ltd	12.3%
Life Insurance Corp. of India	6.6%

Price Performance



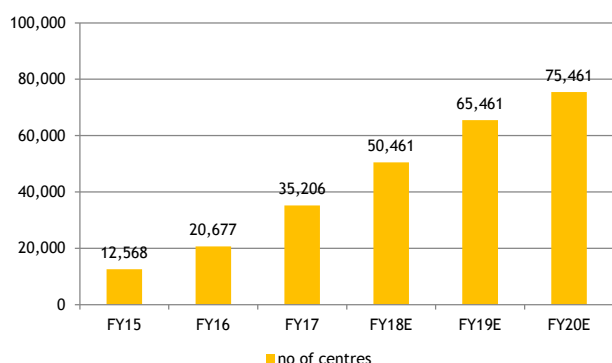
	-1M	-3M	-12M
Absolute (%)	33	49	160
Relative to index (%)	37	44	109

Source: FactSet

Value Proposition

- One-stop shop for government, banking, assisted e-commerce, logistics & other business-to-consumer services. dependence on capex-heavy e-governance as a contractor for government projects.
- Targets 2x increase in kendras to 75k by 2020, the bulk franchised.
- Leading distributor of Government of India's financial inclusion programme & major partner for Amazon's assisted e-commerce.
- Continues to add services such as visa filing, lead generation for finance companies and transport ticket bookings.
- By FY20, share of Amazon & assisted e-commerce, insurance and logistics services to rise to 49% from 14% in FY17.

No. of centres

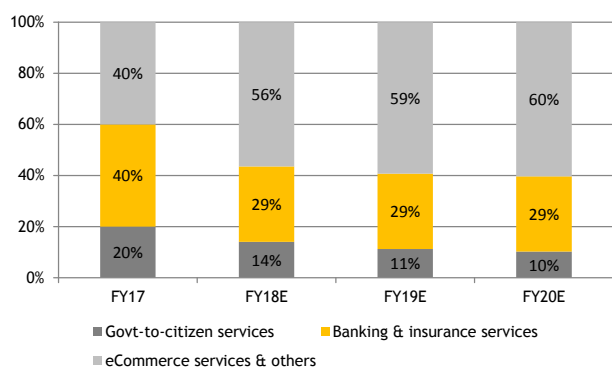


Source: Company, Maybank Kim Eng

Financial Metrics

- We forecast a 45% revenue CAGR & 43.2% EPS CAGR for FY18-20E, led by an increase in centres to 75,461 from 35,206 in FY17.
- Kendra revenue to touch 94.4% of total from 64.5%.
- EBITDA margins to decline to 18.9% from 23.6% in FY17 as franchisees' revenue share increases to 80% from 75%.
- High FCF as capex for kendra business is minimal.
- ROEs of 30%+. Cash could average 38% of net worth in FY18-20E.

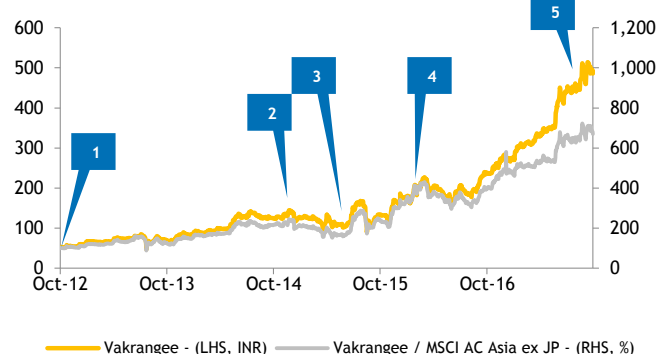
Revenue mix of kendra business



Source: Company, Maybank Kim Eng, FY17 indicative numbers given by co.

Price Drivers

Historical share price



Source: Company, Maybank Kim Eng, Factset

1. Selected as common banking correspondent for Rajasthan and Delhi for financial inclusion project.
2. Announced Vision 2020 to open 75k kendras by Mar 2020 from 12,568 in Mar 2015.
3. Partners Amazon to offer assisted e-commerce at its kendras.
4. Ties up with Indian Oil Corporation to set up kendras at more than 20,000 IOC outlets.
5. Announcement that over 10k of its centres will offer Amazon assisted e-commerce services, out of Amazon India's 12k centres offering this service.

Swing Factors

Upside

- 75k centres before 2020.
- Possible stake sale to a global e-commerce major.
- Reverse logistics business takes off.

Downside

- Delays in reaching its 75k-centre target.
- Amazon reduces reliance on VKI or ceases partnership.
- Delays in rollout of services.



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1. Investment Summary

1.1 Scalability to 2x current kendras

Working as a contractor of the government for government-to-citizen (G2C) services and a business correspondent for banks, VKI has set up kendras or stores across India. As of Sep 2017, it had 40,461 kendras in 18 Indian states. Of these, 71% was in rural India. The company has a target to increase this to 75k by FY20. Two-thirds will be in rural areas and the balance, in more than 650 urban centres, up from 365 in FY17. It aims to cover more than 19,000 postal codes by then, from 5,000 in FY17. We believe this is achievable, considering: a) its average quarterly rollout of 2,750 kendras in the last eight quarters; and b) its partnership with Indian Oil Corporation (IOC), which allows it to set up kendras at IOC's more than 20,000 fuelling stations. So far, only 200+ have been opened.

1.2 More mileage for services...

To monetise its penetration of rural and semi-urban India, VKI has tied up with businesses to deliver services to India's hinterlands. Operating via franchisees, it offers a gamut of services. These range from G2C services such as Aadhar enrolment and government fee collection. Banking services are also offered, such as the opening of bank accounts, deposits & withdrawals. VKI also sells life and non-life insurance policies and is a lead generator for non-banking financial companies. On top of Amazon-assisted e-commerce, it offers courier-booking services; direct-to-home top-ups; bus-booking services; railway-booking services; Reliance Jio top-ups and mobile sales. Based on a planned 2x increase in stores to 75,461 by FY20E and expectations of higher revenue per store after the activation of all services, we forecast that its kendra revenue will increase to 94.4% of its total by FY20E, from 64.5% in FY17. Non-kendra revenue primarily comes from e-governance project work.

1.3 ...& partnerships, particularly with Amazon

In a 2016 study, the Reserve Bank of India estimates the cost of a bank-branch transaction at INR59. This towers above VKI's INR29. For most services, VKI does not charge its customers directly; its partners pay VKI fees and commissions. For Amazon, insurance and other businesses, it provides reach and the opportunity to monetise the footfalls it gets for its other services.

Amazon India has over 12,000 stores in India providing assisted e-commerce services. Of these, more than 10,000 are VKI's kendras. Amazon has already reported strong traction in this segment which it dubs 'Project Udaan'. In a recently-concluded festive-season sale, Amazon reported a 29x YoY jump in its average daily number of customers and a 12x leap in its sales. We believe that by FY20E, Amazon services would be activated in at least 58% of VKI's kendras, or 44k.

VKI has opened 50-60m bank accounts for Indians, out of the 280m opened under the government's financial-inclusion scheme from 2013 to 2017. In the first four months of FY18, the government has already transferred INR337b to Indians through 314 schemes. One of the ways was direct cash transfers to the bank accounts of beneficiaries.

VKI sells insurance policies for nine life and non-life companies. India's life and non-life penetration, as measured by premiums to GDP, was 3.4% in FY16. At almost half the global average of 6.2%, this implies growth opportunities. Overall, we forecast that the share of new services such as

Amazon-assisted e-commerce, insurance and logistics will increase to 49% of its kendra revenue by FY20E, from 14% in FY17.

1.4 Barriers to entry

While providing one service is not profitable, VKI's gamut of offerings offers it an EBITDA margin of 18%. VKI can be likened to the ubiquitous convenience-store 7-Eleven in Asian markets. Most of its Indian peers are small and unlisted. We see barriers to entry from: a) its extensive brick-&-mortar franchisee network, which dwarfs competitors' scale; b) depth of reach, which makes it the preferred choice of its partners;; and c) strong customer footfalls from its Amazon partnership

1.5 Risks: changes in RBI rules, discontinued partnerships & delays

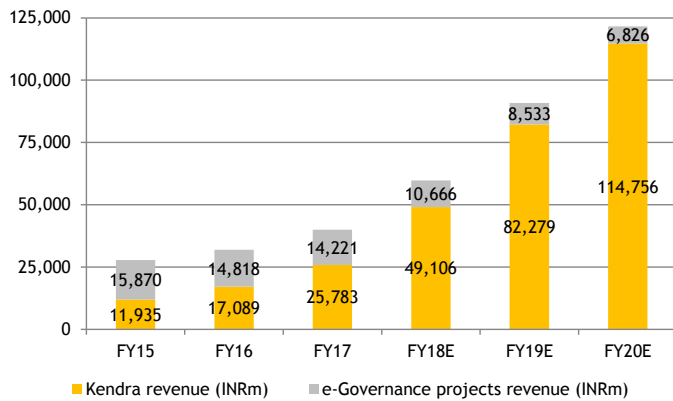
As a banking business correspondent, VKI is governed by RBI rules. Any unfavourable changes in these rules may affect its business. However, considering the RBI's impetus on financial inclusion, we do not foresee any immediate threat. Its Amazon partnership is also valid for five years. While change or discontinuation remains a risk, either seems unlikely in the foreseeable future, given their current service ramp-up. Delays in the activation of services may slow down VKI's revenue growth. To safeguard against this, it has appointed block leaders to oversee clusters of franchisees and train them to ensure timely and complete service rollout.

1.6 Premium valuations justified

VKI trades at 31.7x FY19E EPS, up from 21x a year ago as investors' confidence improves with a pick-up in its Amazon services and rollout of new services. It can be likened to 7-Eleven, whose partners in ASEAN trade at 30.7x FY19E EPS. Offline Indian retailers trade at 50x. We forecast an EPS CAGR of 43.2% for FY18-20E. A prospective FY18E ROE of 34.8% and cash at 42% of net worth arguably justify a P/E target of 36x. We initiate coverage with a BUY and INR830 TP, implying a 0.83 PEG. This is at a discount to the 2.1 for Indian consumer stocks. Catalysts are expected from a deepening of relations with Amazon, the launch of new services and any stake acquisition by Amazon.

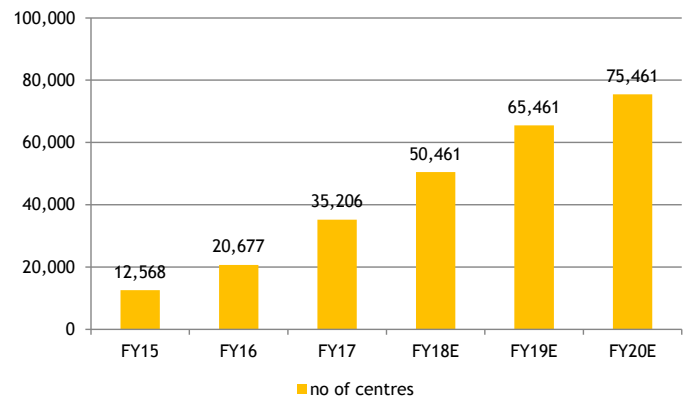
2. Focus Charts

Fig 1: Kendra business to form 94.4% of revenue by FY20E



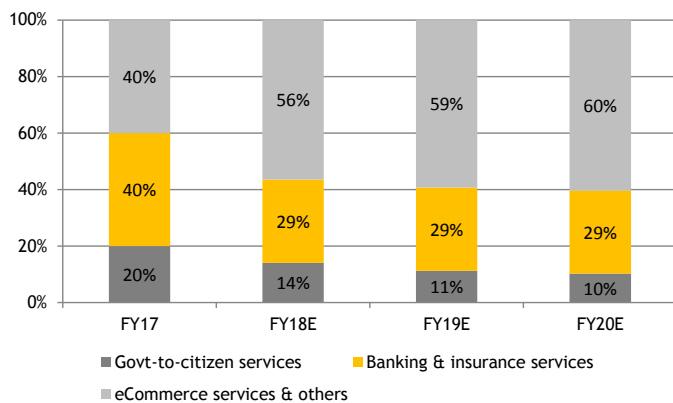
Source: Company, Maybank Kim Eng

Fig 2: No. of kendras to surpass 75,000 then



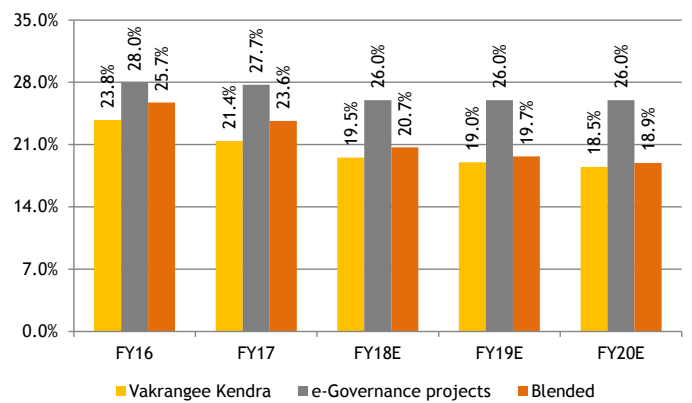
Source: Company, Maybank Kim Eng

Fig 3: Kendra revenue is increasingly coming from e-commerce



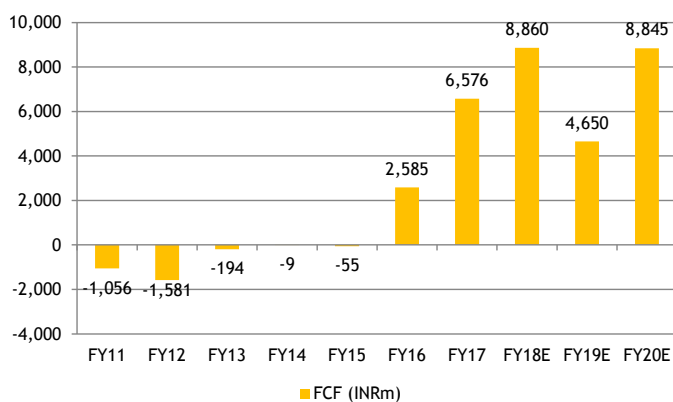
Source: Company, Maybank Kim Eng

Fig 4: EBITDA margins are declining as it has started awarding its franchisees 80% of revenue, up from 75%. The trade-off is a bigger scale, which could attract more partners and franchisees



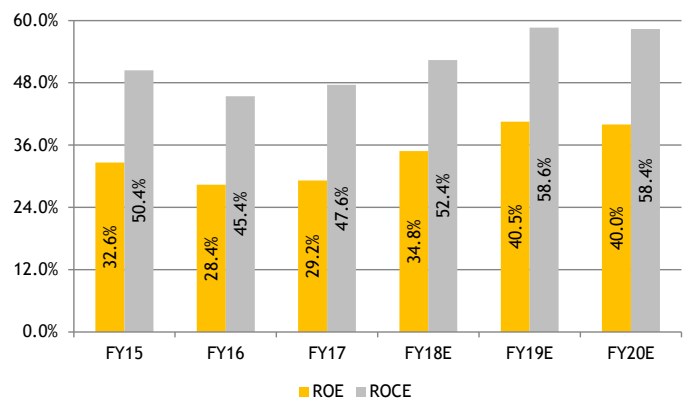
Source: Company, Maybank Kim Eng

Fig 5: Improving FCF



Source: Company, Maybank Kim Eng

Fig 6: Strong ROEs & ROCE



Source: Company, Maybank Kim Eng

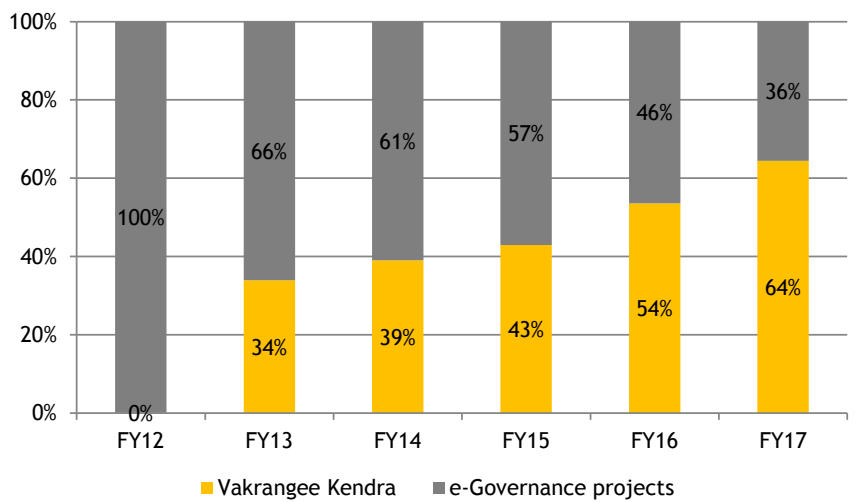
3. Corporate Information

3.1 From government contractor to one-stop shop

Back when it was founded in 1990, VKI was only a contractor and sub-contractor of the government. It computerised and digitised records for government departments, including the Election Commission of India, initially in Maharashtra and then in other states. The company continued to secure other government projects such as Sarva Shiksha Abhiyan, which issues Aadhar cards to all Indians under the auspices of the Unique Identification Development Authority of India (UIDAI).

Over time, VKI progressed from a sub-contractor to an independent bidder. Gaining experience from setting up centres and kiosks to provide government-to-citizen (G2C) services, it launched its Vakrangee kendra business in FY2012. These stores offer real-time banking, e-governance, insurance, e-commerce and logistics services to Indians who have no or limited access to banking and the Internet. Correspondingly, e-governance revenue decreased to 36% in FY17 from 100% in FY12. In the past few years, VKI also decided to cut its exposure to e-governance projects and not re-bid for them when they come up for renewal.

Fig 7: Revenue share from kendras is increasing



Source: Company

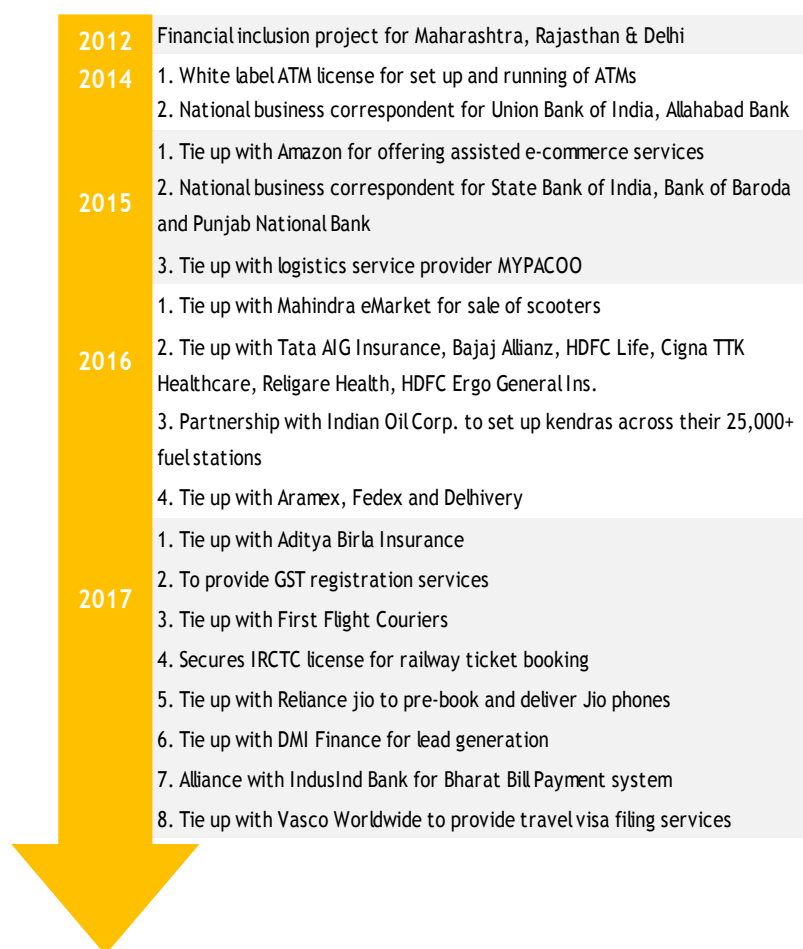
Fig 8: Its e-governance business in the past


Source: Company

3.2 Evolution of kendras

Its kendra business originated in 2012-13, after it secured a common banking-correspondent project from the states of Maharashtra, Rajasthan and Delhi. Later, VKI became the national business correspondent of nationalised banks such as the State Bank of India, Allahabad Bank, Bank of Baroda, Union Bank of India and Punjab National Bank. Their contracts required VKI to set up kendras in selected locations. VKI also secured a licence from the Reserve Bank of India to set up white-label ATMs across India. It is now a national business correspondent for eight state-owned banks and a common correspondent for 26 banks in Maharashtra and Rajasthan.

With a view to monetising its presence across rural India, the company approached Amazon in 2015 to offer assisted e-commerce at its kendras. It also tied up with insurance companies to offer life and non-life insurance products at its kendras. It further teamed up with logistics companies to facilitate the booking of couriers and parcels; non-banking financial institutions for the lead generation of loan products; and product companies like Reliance Jio for the pre-booking and sale of Jio phones.

Fig 9: Evolution of kendras

Source: Company

Fig 10: Services offered at its kendras

Major segments	Services offered	% of FY17 revenue
Banking, financial services and insurance	Bank A/C Opening - Savings, Current, Self-help groups (SHG), cash deposit, withdrawals, money transfer, fixed/recurring deposits, disbursement of money under direct benefit transfer, real time withdrawals through automated teller machines (ATM) Corporate agency tie up with private life and non-life insurance companies and micro insurance schemes under government pension and insurance programmes like Atal Pension Yojana, Jeevan Jyoti Bima Yojana and Pradhan Mantri Suraksha Bima Yojana Tie up with non-banking finance companies for lead generation	40%
e-governance services	Enrolment for Aadhar, issue of election cards, payment of electricity bills, government-to-citizen services for state of Rajasthan under e-Mitra scheme, railway ticket booking on IRCTC, GST registration and filing services	20%
e-commerce	Assisted e-commerce for Amazon, pick up point for Amazon parcels; alliance with Augmont for sale of gold products; alliance with Reliance Jio for sale of sim cards and mobile handsets; alliance with Redbus for offering bus ticketing services; alliance with Mahindra eMarket Limited for promoting and booking automobile products; mobile recharge, DTH subscription recharge	40%
Logistics	Alliance with Aramex India Private Limited, Delhivery Private Limited, FedEx Express and First Flight Couriers Limited for courier and logistics services both forward delivery and reverse pick up services	negligible
Others	Tie up with Vasco worldwide for travel visa services	NIL

Source: Company, Maybank Kim Eng

Fig 11: Drivers of various businesses and potential threats

Services offered	Drivers	Threats
Government-to-citizen services	<ul style="list-style-type: none"> - Correction/change request in Aadhar card - Making of plastic Aadhar card - GST enrolment, filing and payment services - Bharat Bill Pay Services for utility bill payment - Ticketing tie up with Indian Railways 	<ul style="list-style-type: none"> - New Aadhar card issuing to reduce - Shift from offline to online
Banking and financial services	<ul style="list-style-type: none"> - Direct benefit transfer into bank accounts and remittances - Increase in number of bank accounts driving more transactions - Lead generation fees to sell loan products from non-banking finance companies 	<ul style="list-style-type: none"> - Competition from fintech - Shift from offline to online. Mobile banking & new tech modes account for meagre 1.6% of country's electronic payments - Number of new account opening to taper
Insurance	<ul style="list-style-type: none"> - Sells only motor insurance in non-life insurance and in life insurance it sells standard small-ticket term or endowment plans - Kendras at IOC fuel filling stations to drive motor insurance - Low insurance penetration - Activation of services across more kendras - Touchpoint for claim redress gives confidence 	<ul style="list-style-type: none"> - require specific skills and knowledge to sell life insurance products. This risk is minimised as the product category is restricted - Competition from fintech
Amazon/assisted ecommerce	<ul style="list-style-type: none"> - Under-penetration of Amazon/e-commerce - Activation of services across more kendras - lack of mobile/internet literacy for e-commerce - Adding new product tie-ups for sale - Adding business-to-business (B2B) e-commerce 	<ul style="list-style-type: none"> - Addition of more partners by Amazon - Discontinuation of partnership - Shift from offline to online
Logistics services	<ul style="list-style-type: none"> - Under-penetration of last mile - Activation of services across more kendras - Addition of reverse logistics business 	<ul style="list-style-type: none"> - Competition from start-ups

Source: Company, Maybank Kim Eng Aadhar is a 12-digit unique identity number issued to all Indian residents based on their biometric and demographic data

3.3 India's answer to Alibaba's Rural Taobao

As of 31 Dec 2016, 590m Chinese resided in China's rural areas, according to the National Bureau of Statistics of China. Rural consumption is highly constrained by geographical and infrastructure limitations, as the cost of distribution to dispersed and remote locations, is prohibitively high. To overcome this and to tap anticipated rural demand, Alibaba launched its Rural Taobao programme in 2014. As of Mar 2017, it had penetrated 26,500 villages. Villagers can place orders at these service centres. Consumer goods such as electronic appliances and agricultural supplies can be ordered online for delivery to county-level stations, before their distribution by local couriers to village service centres for pick-up. Coordinated by Cainiao Network, its logistics arm, almost all packages can be delivered from county-level stations to village service centres the next day. VKI is replicating this set-up through its partnership with Amazon.

3.4 Kendras are franchised

Kendras are opened by franchisees who incur all the capex and opex. VKI shares the commissions it receives for its services with its franchisees. Of its 40,461 operating kendras as at end-Sep 2017, just 22 were owned by VKI. From awarding 75% of its kendra revenue to its franchisees, it has started awarding 80%, keeping 20%. This is to increase the attractiveness of its kendras to franchisees.

In most cases such as banking, insurance and e-governance, money is directly received by VKI. VKI keeps its share and transfers the balance to its franchisees. For changes in Aadhar, the making of plastic Aadhar cards and Amazon services, money is received by the franchisees directly.

Franchisee selection

Franchisee selection is reasonably stringent and has been fine-tuned over time. As its franchisees act as banks' business correspondents, their final selection is done by the banks. VKI advertises in the areas where it wants to set up kendras. It shortlists a few candidates and sends them to bank branch managers for their final selection. A basic know-your-customer form is filled, an aptitude test taken and police / credit / referral checks made. This is followed by GST registration and verification of the franchisees' PAN / Aadhar cards. The franchisees would also need to clear a few basic exams. For e-governance, there is the NSE IT UIDAI exam. For banking, there is the Indian Institute of Banking & Finance (IIBF) exam. Thereafter, basic training on various products and services is given to the franchisees.

Economics for a franchisee: urban & rural

Franchisees need to at least pass their higher secondary certificate examination or 12th standard. This is the basic requirement for the IIBF examination. VKI does not fund any part of the capex or working capital of its franchisees.

In urban areas, its franchisees could be ex-bankers, accountants, insurance agents or potential entrepreneurs. They usually have some capital and the capacity to secure small loans. Typically, they need to invest INR1.2-2m. The amount could be lower, depending on the requirements of the corresponding bank. One-time capex is INR0.5-0.8m. The balance INR0.7-1.2m is for working capital to maintain balances with the corresponding banks.

In rural areas, its franchisees could be persons of repute in the localities or aspiring entrepreneurs already running a shop or with space to set up one. They have to invest INR385k, of which one-time capex is INR85k and the balance INR0.3m used to maintain balances with the corresponding banks. Here again, they usually have some capital. Their balance funding could come from loans from MUDRA or the Micro Units Development & Refinance Agency Ltd. Launched in Apr 2015, MUDRA was set up by the Government of India to develop and refinance micro enterprises. It offers loans of up to INR1m. To date, it has disbursed INR4,167b.

Fig 12: Capex requirements for franchisees

INR	Urban	Rural
Capex - one time		
Hardware	500k	85k
ATM	300k	300k
Working capital		
excl ATM	700k	300k
for ATM	500k	100k

Source: Company

Fig 13: Franchise economics

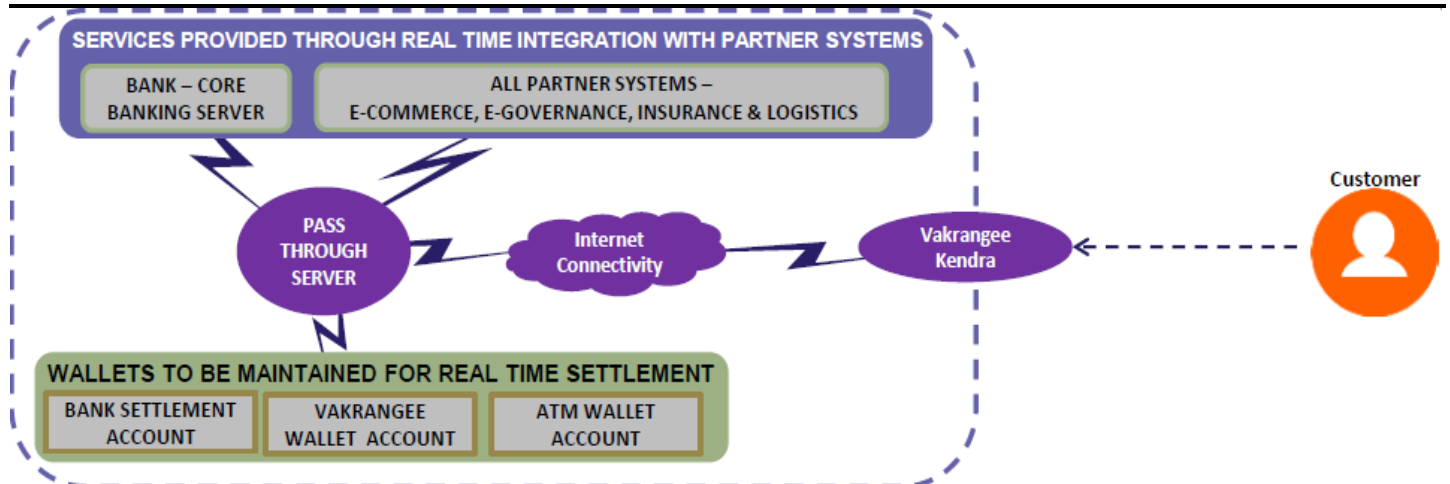
INR	Urban	Rural
Capex + WC		
incl ATM	2,000,000	
excl ATM	1,200,000	385,000
Operating costs per month		
Operator salary (INR10k/person)	30,000	10,000
Manager salary	20,000	
Rent	25,000	1,000
Office expenses	15,000	10,000
Marketing costs	10,000	4,000
Total	100,000	25,000
Avg. revenue per kendra per month		
incl ATM	200,000	
excl ATM	168,750	62,500
Revenue per kendra per year		
incl ATM	2,400,000	
excl ATM	2,025,000	750,000
Franchisee share of revenue		
incl ATM	1,920,000	
excl ATM	1,620,000	600,000
Net earning for franchisee		
incl ATM	720,000	
excl ATM	420,000	300,000
Payback period (years)		
incl ATM	2.8	
excl ATM	2.9	1.3

Source: Company, Maybank Kim Eng

Internet-based platform

VKI's entire franchise operation is paperless. Customer verification is done through its unique-identity Aadhar facility. VKI has also developed an Internet-based technology platform called the Vakrangee Kendra Management System on which all its services are activated. It employs 1,000 block coordinators to supervise 35-45 kendras each. These coordinators report to district-level officers who in turn report to state-level officers. The block co-ordinators must ensure services are active and train franchisees to provide all the services activated.

Fig 14: The kendra model



Source: Company

Fig 15: How kendras generate revenue

Services offered	Rate	Paid by	Recd. by
Government-to-citizen services			
Issue of new Aadhar	INR35	UIDAI	VKI
Correction/change in Aadhar	INR25	Customer	Franchisee
Making of Aadhar PVC card	INR30	Customer	Franchisee
G2C services (Rajasthan)	diff. rates for diff. services	Govt of India / Customer	Franchisee
Banking services			
Overall	fixed monthly fee	Bank	VKI
Account opening	INR20-50	Bank	VKI
Cash deposit/withdrawal	0.35-0.5%	Bank	VKI
ATM - financial transaction	INR15	Bank	VKI
ATM - non-financial transaction	INR5	Bank	VKI
Insurance			
Sale of insurance policies	10-20% of premium as per IRDA rules	Insurance company	VKI
e-commerce services			
DTH/mobile recharges	3-6%	Company	VKI
Amazon/assisted e-commerce, Reliance Jio, Augmont Jewellery	4-15% of bill amount	Company	VKI
Courier services	20-25% of courier charges	Company	VKI
Bus ticket booking services	5-7% of booking fee	Company	VKI

Source: Company

Training is crucial: dedicated teams from partners

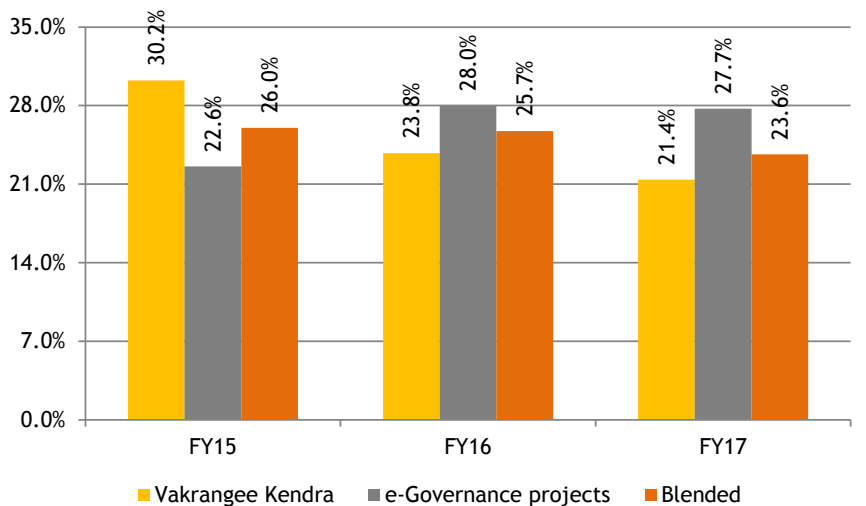
Training is crucial for the growth of its kendra business, especially as the number of its kendras explodes. Franchisees have some knowledge of banking and G2C services once they pass their IIBF and NSE IT UIDAI examinations. Further training is given at the time of setting up hardware systems. VKI's block managers may also collaborate with its partners to set up camps in various regions to train franchisees. With its growing operations, VKI has approached its partners to secure dedicated training teams from them. This should further aid its training programme. VKI has also set up a call centre with 80-100 staff to provide technical support to its franchisees.

3.5 Kendra EBITDA margins may trend down

Revenue-sharing has moved from 65:35 to 75:25 for franchisees / VKI. VKI is in the midst of further improving it to 80:20, to increase the attractiveness of its franchise and build scale. This brought its EBITDA margins down to 21.4% in FY17 from 30.2% in FY15.

E-governance EBITDA margins have been 23-28% in the last four years. Management guides for a more or less stable 25-30%. Blended EBITDA margins are expected to stabilise at around 18%.

Fig 16: EBITDA margins of the two businesses



Source: Company

Fig 17: Top management

Name	Position	Remarks
Dinesh Nandwana	Managing Director & CEO	Promoter, a certified chartered accountant by qualification
Dr Nishikant Hayatnagarkar	Director - R&D	24 years experience in the IT sector. Holds a Doctorate in Computer Science from the Indian Institute of Technology, Mumbai
Sumit Jain	CEO - e-commerce	Has worked with Barclays, Credit Suisse and Intel Corporation. Holds an MBA from Stern School of Business at New York University and B.Tech in computer science from Indian institute of Technology, Bombay
Rajeev Ranjan	CEO - e-governance	Earlier was CEO of Vakrangee's Philippines business. He has worked with the Tata group and has vast experience delivering simultaneous National level, large scale and mission-critical projects
Rahul Dev Pal	CEO - banking business	Has 26 years experience in the field of sales and marketing. He has in-depth knowledge of the banking vertical. Starting his career with HCL he worked with companies like Xerox, Pertech Computers , BPL and Godrej. His last assignment in Godrej was as a National Head
Nitin Sharma	CEO - ATM business	Over 17 years of cross-cultural experience in Operations, Implementation, Retail and Project Management. Was COO of Vakrangee's Philippines business. Holds an executive MBA from IIM Kolkata and Masters in operations, IR and social work from Premier Institute, Udaipur
Subhash Singhania	Chief Finance Officer	Qualified chartered accountant with vast experience in accounts and taxation

Source: Company

4. Scalability to 2x current kendras

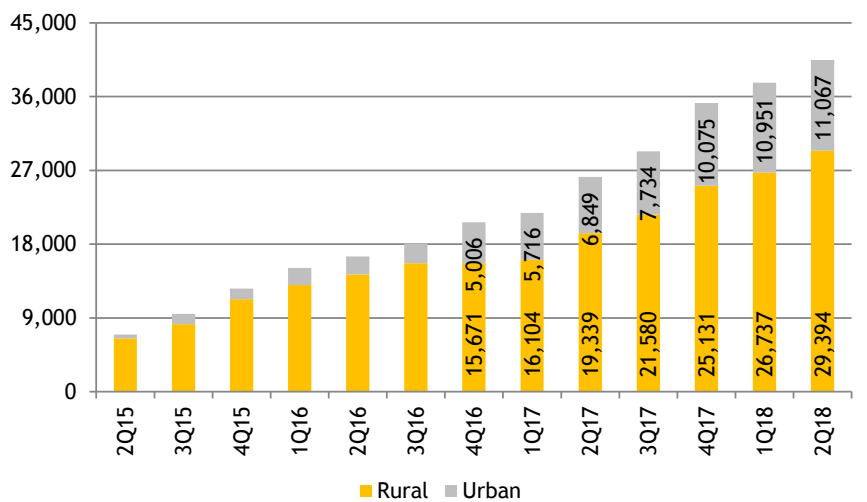
4.1 Strong execution

VKI has a record of working on mission-mode projects for the Government of India. These include data collection and data management for the Election Commission of India in the last 25 years. It has moved up the value chain from sub-contractor to independent bidder for large government projects. For the issuance of Aadhar cards, it received a T3F4 licence from UIDAI, the highest for any provider.

As of Sep 2017, VKI had 40,461 kendras in 18 Indian states. Of these, 71% were in rural India where agriculture is the main source of income. It wants to double this to 75,000 at least by 2020. Two-thirds will be in rural areas and the rest in more than 650 urban districts, up from 365 in FY17. With this expansion, it hopes to cover more than 19,000 postal codes, dramatically up from 5,000 in FY17.

We don't think its target is unrealistic, considering: a) its average quarterly rollout of 2,750 kendras in the last eight quarters; and b) its partnership with IOC, which allows it to set up kendras at IOC's more than 20,000 fuelling stations. As only 200+ have been opened so far, there is room to open at least another 19,800.

Fig 18: Kendras are multiplying



Source: Company

Of its 40,461 kendras as at Sep 2017, 91% were located in the three states of Rajasthan, Maharashtra and Uttar Pradesh. When it opens more and more kendras, management thinks this geographical concentration may come down to 70-75%.

Fig 19: 2Q18 kendras in rural and urban areas by state

States	Rural	Urban	Total	Amazon #
Bihar	433	109	542	27
Chandigarh	2	12	14	12
Chhattisgarh	67	20	87	21
Dadra & Nagar Haveli		1	1	
Delhi	21	125	146	89
Goa	31	27	58	57
Gujarat	245	212	457	165
Haryana	102	158	260	240
HP	15	12	27	11
Jharkhand	193	90	283	
Karnataka	10	4	14	8
MP	656	361	1,017	292
Maharashtra	7,815	2,729	10,544	3,259
Odisha	75	45	120	28
Punjab	110	235	345	227
Rajasthan	10,821	3,066	13,887	2,534
UP	8,746	3,824	12,570	2,980
Uttarakhand	52	37	89	50
Total	29,394	11,067	40,461	10,000

Source: Company
As of 28 Nov 2017

4.2 More mileage for Amazon

In retailing, VKI has partnered Reliance Jio, Augmont Jewellery, Mahindra eMarket and Amazon. For Reliance Jio, VKI enables the pre-booking of its Jio phones as well as mobile top-ups. The Jio phones were launched in Aug 2017. In May 2015, it started offering Amazon-assisted e-commerce services, namely marketing, promotions and pick-up services, at its kendras. Via their 5-year agreement which will expire in Jul 2020, Amazon India hopes to piggyback on VKI's network to reach India's deep hinterlands. Amazon doubled its 'Project Udaan' or assisted-shopping stores from 6,000 to 12,000+ in the last four weeks leading to its big festival sale in Sep 2017. Of these, over 10,000 were VKI's kendras.

Amazon has similar tie-ups with Smart Buy, Rajasthan Government's eMitra project, Connect India and Store King, all unlisted. Under Project Udaan, Amazon appoints offline associates at retail points such as kirana stores, medical stores and mobile-phone retail shops. It provides them with PC-based websites. The store owners are trained to help customers find and buy products, earning a commission in the process. Amazon then delivers the products to the customers' doorsteps or to the centres and accepts cash on delivery.

Their ramp-up will depend on how fast Amazon India can set up fulfilment centres and warehouses across the country. Amazon has a target of 41 fulfilment centres in 13 Indian states for this year. The states are Maharashtra, Gujarat, Rajasthan, Uttar Pradesh, Delhi, Punjab, Haryana, Karnataka, Andhra Pradesh, Telangana, Tamil Nadu, West Bengal and Madhya Pradesh.

Amazon also provides customers with the option to get their parcels delivered to any of its designated pick-up locations in 45 cities. This service is free for customers, while Amazon pays INR15 per package to its designated pick-up stores.

The Indian Brand Equity Foundation estimates that India’s retail market will reach USD1.3t by 2020 from USD672m in 2016. Organised retailing’s share will reach 19% from 9%. Online retailing is expected to touch USD60b by 2020, 4x 2016’s USD14.5b. Amazon launched its online marketplace in India on 5 Jun 2013. To date, it has invested USD2.5-3b, with a commitment to increasing this to USD5b.

Amazon is gaining momentum in India. During its ‘Great Indian Festival Sale’ during 21-24 Sep 2017, its gross merchandise sales, excluding returns, were up 4.5x from normal times. About 86% of its new customers came from small towns. Daily transactions under Project Udaan ballooned 29x YoY while sales leapt 12x. As a result, Amazon amassed a customer market share of 44% and transaction share of 42% in online retailing during its sale, according to a Kantar IMRB survey.

Fig 20: A VKI-Amazon advertisement in *Economic Times* on 5 Oct 2017

Fig 21: Another in *Rajasthan Patrika* on 23 Sep 2017

Source: Company

Source: Company

VKI dishes out incentives to its franchisees regularly to push sales higher. Its latest was a INR15,500 cash incentive for franchisees to enrol for its Amazon services.

Fig 22: Incentives offered by VKI

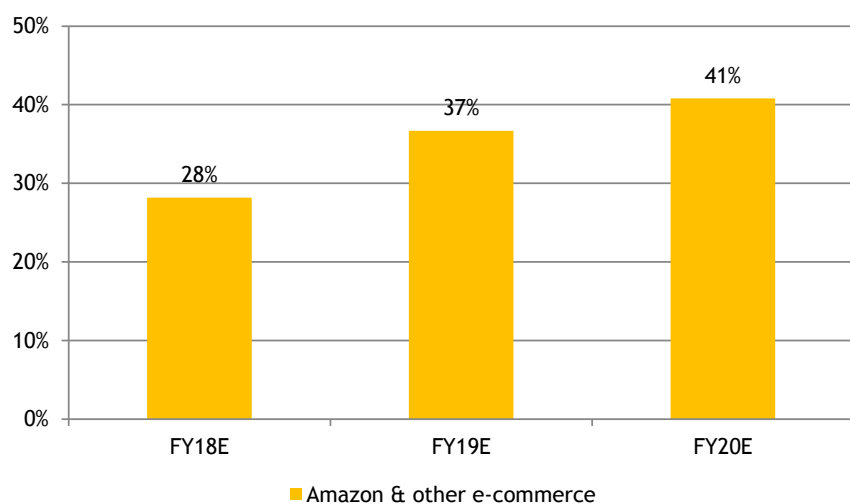
	INR
Amazon business opportunity	
Create 100 customer accounts in a month and earn	3,500
Sell 30 mobile phones of average price of INR5,000 in a month and earn	4,000
Sell 10 pair of shoes/shirts/pants/sarees/of an average price of INR1,000 in a month and earn	1,000
Get 100 customers to order home/kitchen products (mixer/cooker, oil, toothpaste, detergent powder, soaps) worth INR1,000 per month and earn	7,000
Total	15,500

Source: Company

To take its business to another level, VKI is also considering business-to-business (B2B) retailing. It is in discussions with leading retailers, including Amazon.

Benefits of Amazon partnership

From its Amazon partnership, VKI earns: 1) commissions of 4-15% on the GMV of products sold; and 2) INR15 for each package picked up at its kendras. Out of Amazon India's 12,000+ stores offering assisted e-commerce, 10,000+ belong to VKI. After a slow ramp-up in the first couple of years, from zero to 2,000+, Amazon's subsequent ramp-up was very strong, to 10,000+ in six months. We believe that by FY20E, at least 58% of VKI's kendras will offer assisted e-commerce services. We forecast that the share of Amazon and other assisted e-commerce services will form 41% of kendra revenue by then, up from an estimated 10% in FY17.

Fig 23: Share of assisted e-commerce revenue set to jump

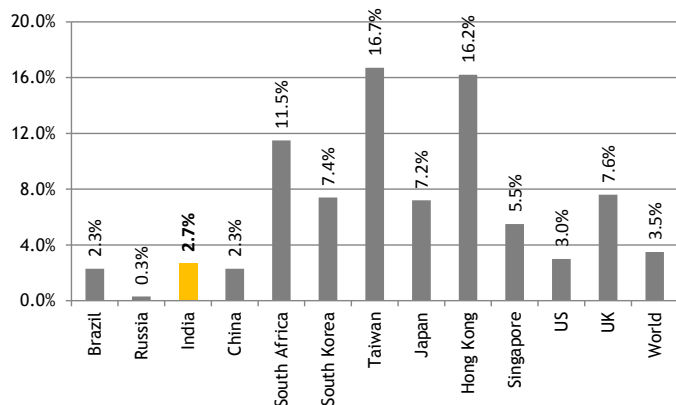
Source: Maybank Kim Eng

4.3 Insurance: penetration weak but improving

India's life and non-life penetration, as measured by premiums to GDP, was 3.4% in FY16. At almost half the global average of 6.2%, we see growth opportunities. VKI has partnered nine life and non-life companies: Life Insurance Corporation (LIC), HDFC Life Insurance, Bajaj Allianz, Tata AIG Insurance, Aditya Birla Health Insurance, Cigna TTK Health Insurance, Religare Health Insurance, Reliance General Insurance and HDFC Ergo General Insurance. In non-life insurance, it only sells motor insurance. In life, it sells either term insurance or endowment policies. Companies like HDFC Life have launched sub-INR1,000-premium policies for rural India.

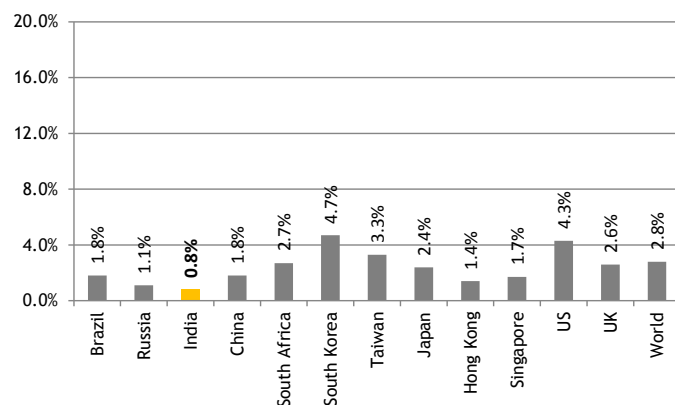
Its tie-up with IOC to open kendras at fuelling stations should provide an avenue for selling vehicle-insurance products. VKI adds value to its insurance partners by providing reach at negligible customer acquisition costs. Consumers also seem to prefer brick-&-mortar kendras for claim reporting and redress.

Fig 24: India's life-insurance penetration is below the world average



Source: IRDA

Fig 25: Its non-life insurance penetration is at the bottom of the pack



Source: IRDA

The typical commission allowed by the regulators for selling motor insurance is 15%. In life insurance, commissions are 5-20%. VKI commands 10-20%. Its typical volumes are five life policies and 10-15 motor insurance per month per mature franchisee. Corporate agents like VKI were responsible for 8.4-8.8% of non-life distribution in the last three years and 1.3-1.4% of life distribution.

Fig 26: How non-life insurance is distributed in India...

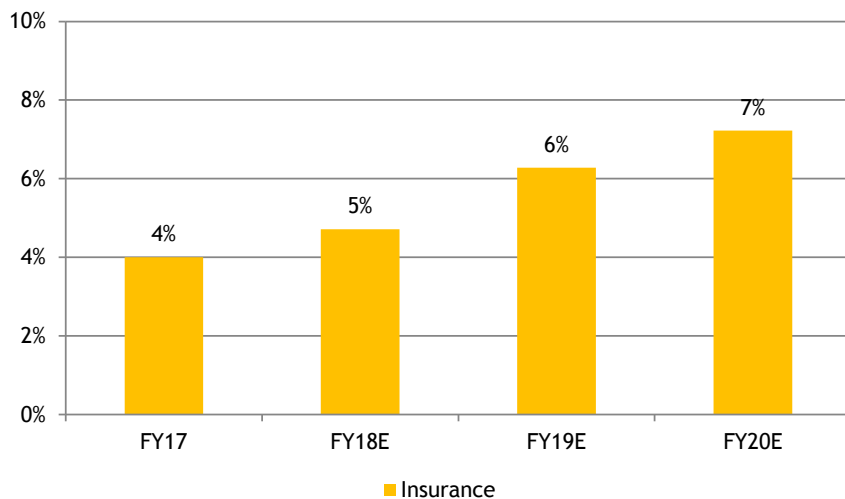
Distribution mix	2012	2013	2014	2015	2016	2017
Brokers	23.1%	29.3%	29.4%	25.2%	30.3%	28.8%
Corporate agents - banks	11.4%	11.6%	11.7%	13.2%	12.5%	10.4%
Corporate agents - others	3.1%	3.8%	5.5%	8.4%	8.9%	8.8%
Direct business	42.9%	33.3%	31.2%	29.1%	26.4%	35.7%
Individual agents	19.1%	21.7%	22.0%	21.3%	20.3%	16.1%
All others	0.5%	0.2%	0.1%	2.6%	1.6%	0.2%

Source: ICICI Lombard RHP

Fig 27: ... and life

Distribution mix	FY12	FY13	FY14	FY15	FY16
Brokers	1.8%	1.7%	1.6%	1.8%	1.6%
Corporate agents - banks	15.0%	16.2%	15.6%	20.8%	23.8%
Corporate agents - others	2.7%	2.1%	1.3%	1.4%	1.4%
Direct business	1.9%	2.6%	3.1%	4.4%	4.4%
Individual agents	78.7%	77.5%	78.4%	71.4%	68.3%
All others	0.0%	0.0%	0.0%	0.0%	0.6%

Source: IRDA annual reports

Fig 28: VKI's insurance revenue to reach 7% of its total by FY20E


Source: Maybank Kim Eng

4.4 Opportunities from financial inclusion, Aadhar & direct transfers

The Government of India has a financial inclusion programme to bank the unbanked. This is on top of its mandate to issue 12-digit unique-identity Aadhar numbers and cards to all Indian residents. Eventually, it hopes to link these numbers to bank accounts to enable the direct transfer of funds under various social-welfare schemes.

VKI is present across this value chain. In 2012, it secured financial-inclusion projects from the states of Maharashtra, Rajasthan and Delhi. Later, it was selected as the national business correspondent of the State Bank of India, Bank of Baroda, Allahabad Bank, Union Bank of India and Punjab National Bank.

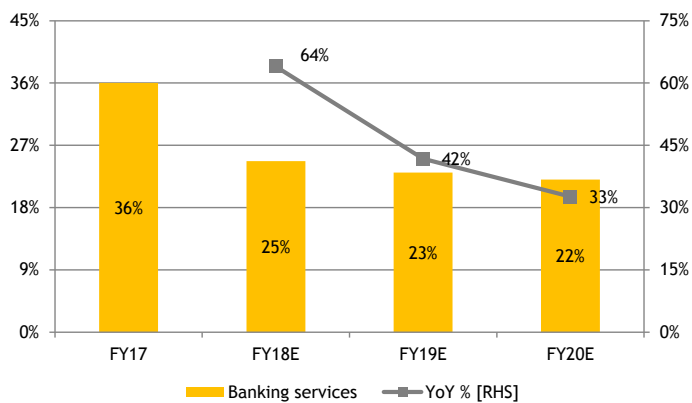
It holds T3F4 licences for the issue of Aadhar numbers and cards. Direct transfers of benefits to the accounts of beneficiaries mean higher transaction values. VKI has opened 50-60m of the 280m bank accounts created by the financial-inclusion programme since 2012. It has issued close to 70m Aadhar cards of the 1.1b total.

VKI helps banks avoid the cost of running rural branches and servicing footfalls in urban branches. A 2016 Reserve Bank of India study estimates the cost of a branch transaction at INR59 vs INR29 for business correspondents. This keeps banks interested in working with correspondents like VKI.

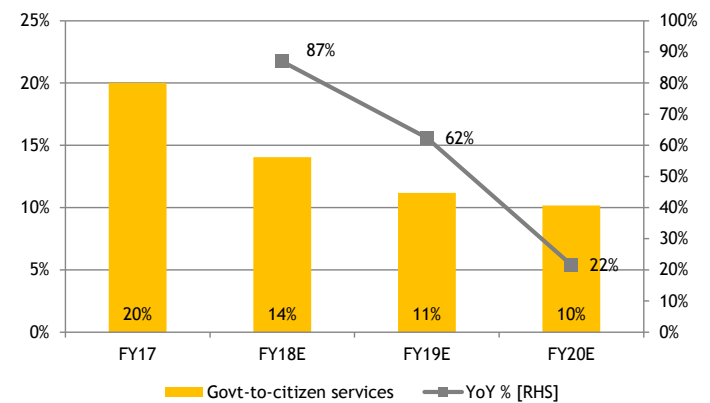
In banking services, VKI earns a fixed monthly fee from the banks, a commission of 0.35-0.5% on the amount of deposits or withdrawals made and INR20-50 per account opening. It also earns a small fee for successfully soliciting each bank deposit.

In G2C services, VKI is paid INR35 by UIDAI for issuing a new Aadhar number. For subsequent changes, the customer pays INR25 and INR30 for printing an Aadhar PVC card. Charges for other G2C services vary from state to state.

We forecast that banking and G2C revenue will continue to grow, albeit at a slower clip than e-commerce and insurance services, as the former are more mature businesses.

Fig 29: Banking-service revenue to grow by 46% on average a year


Source: Maybank Kim Eng

Fig 30: G2C's revenue share to decline


Source: Maybank Kim Eng

Size of unbanked market

The government first attempted to cover villages with populations of more than 2,000 in 2010. A total of 74,414 villages were identified and allocated to public-sector, private-sector and regional rural banks. All the identified villages have been provided banking services since, via branches, business correspondents or other modes such as ATMs and mobile vans. In Jun 2012, another attempt was made to provide banking services to unbanked villages with populations of less than 2,000. A total of 491,825 villages were allocated to various banks. As of 31 Mar 2017, 96% or 472,136 had been covered. Of these, 19,875 villages had brick-&-mortar branches, 431,359 had business correspondents and 20,902, other modes. Convenor banks have been advised to review and identify unbanked rural centres in villages with populations of above 5,000 and ensure that such centres have core-banking-system-enabled outlets by 31 Dec 2017.

As of Mar 2017, 534m new savings accounts had been opened by bank branches and business correspondents. Of this number, 52% was opened by business correspondents.

Fig 31: Financial Inclusion Plan's progress report

Note the high percentage of villages served by correspondents and their average transaction values

Particulars	Mar-10	Mar-11	Mar-12	Mar-13	Mar-14	Mar-15	Mar-16	Mar-17
Banking Outlets in Villages -Total	67,694	116,208	181,753	268,454	383,804	553,713	586,307	598,093
Branches	33,378	34,811	37,471	40,837	46,126	49,571	51,830	50,860
Branchless mode	34,316	81,397	144,282	227,617	337,678	504,142	534,477	547,233
Other Modes	142	595	3,146	6,276	4,678	4,142	3,248	3,761
BCs	34,174	80,802	141,136	221,341	333,000	500,000	531,229	543,472
Villages>2000-BCs	8,390	na	na	na	na	na	98,958	105,402
Villages<2000- BCs	25,784	na	na	na	na	na	432,271	438,070
Urban Locations covered through BCs	447	3,771	5,891	27,143	60,730	96,847	102,552	102,865
No of bank accounts - Total (m)	73	105	139	182	243	398	469	534
through branches (m)	60	73	81	101	126	210	238	254
through BCs (m)	13	32	57	81	117	188	231	280
Account balance - Total (INRb)	55	76	120	183	312	440	638	976
through branches (INRb)	44	58	110	165	273	365	474	691
through BCs (INRb)	11	18	11	18	39	75	164	285

Source: Reserve Bank of India

Direct transfers reduce pilferage & reach beneficiaries

To cut pilferage, the Government of India has been transferring funds under its public-welfare programmes directly to the bank accounts of their intended beneficiaries. This increases the number of withdrawal transactions for business correspondents like VKI. As of Aug 2017, 314 schemes had been brought under direct transfers, up from 140 in FY17. Funds transferred totalled INR337b in the first five fiscal months of FY17. Also, the share of Aadhar-based payments increased to 49% from 40% YoY, indicating increasing usage of this mode of payment. This is positive for banking correspondents like VKI.

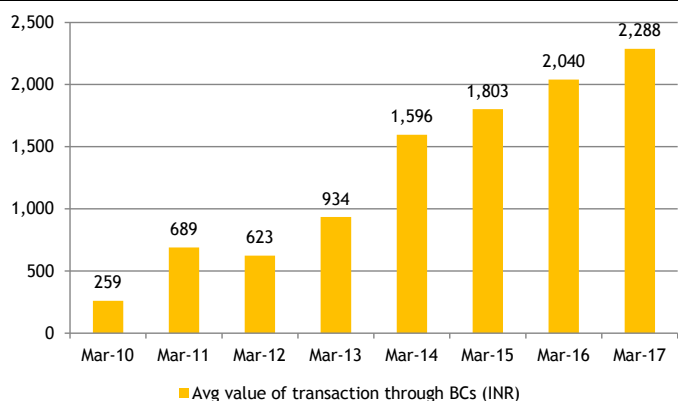
Fig 32: Funds transferred directly to beneficiaries (INRm)

Government schemes	FY14	FY15	FY16	FY17	FY18
PAHAL (cooking gas subsidy)	53,949	93,844	214,210	158,765	72,526
MGNREGS (employment guarantee)	0	200,101	258,618	373,119	160,858
NSAP (social assistance)	9,062	60,494	83,647	54,100	9,633
Scholarship schemes	0	0	51,199	128,596	33,028
Others	10,666	34,823	10,570	31,495	61,708
Total	73,677	389,262	618,243	746,076	337,751
No of schemes using DBT	28	34	59	140	314

Source: Government of India

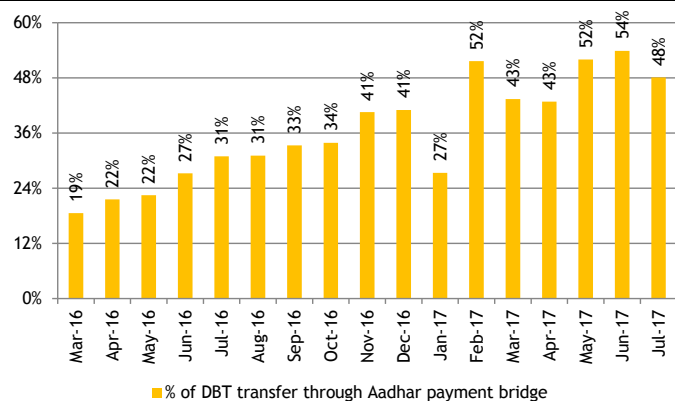
Two data points we will be monitoring are: a) the average value of transactions; and b) Aadhar payments directly transferred. Our channel checks suggest an average banking value per day of INR200-250k for a mature kendra. This includes deposits, withdrawals and fund transfers. In FY17, the government disbursed INR746b through direct transfers. This should increase to INR810b in FY18E, from annualised 5-month data. If so, it implies a big addressable market. Balances in bank accounts opened by business correspondents amounted to INR285b as at end-FY17, according to RBI.

Fig 33: Average value of transactions through business correspondents (INR)



Source: Ministry of Finance

Fig 34: % of direct transfers through the Aadhar payment gateway



Source: Ministry of Finance

Threat from electronic payments?

The world is inexorably moving towards mobile banking. As per the telecom regulatory authority of India (TRAI), India’s wireless penetration is 92%: urban 168% and rural 57%. Its government is hoping to improve broadband penetration to the last mile via its BharatNet project, which also envisages improving broadband speeds from 512 Mbps to 2 Gbps by Mar 2019. New modes of payment - like mobile banking, unstructured supplementary service data (USSD) for making payments by text messages,

prepaid payment instructions via e-wallets and unified payment interface for instant real-time payments through applications - account for just 1.6% of all electronic payments. Their monthly value is INR115.7t.

But although mobile payments could rise, we do not foresee any immediate threat to VKI. This is because: a) outside the metropolises and excluding millennials, many Indians still gravitate towards touchpoints; b) we think the size of the industry would allow for multiple channels; and c) China's 4G penetration is already 67% whereas India's 3G/4G broadband penetration is only 20-25%. India's adoption of mobile payments is much slower than China's.

Also, we believe that branch banking will be supported by:

- Its low penetration in India, at 13.5 commercial branches per 100k adults vs 28.2 in the US and 27.5 in the EU in 2015, according to the World Bank.
- The low penetration of banking products. Only 13% of farm households in the income bracket of less than USD1,000 has access to bank loans.

Even in the US, the Federal Deposit Insurance Corp estimates that US banks scaled back their branches by only 6% from 2009 to 2016. As the number of FDIC-insured banks also declined 25% over the same period, their culling seems even smaller. We also believe that with the cost advantage offered by business correspondents, there might actually be an increase in the number of correspondent centres in India.

Fig 35: New technology payment systems account for only 1.6% of electronic banking, indicating no immediate threat from mobile payments

Modes of electronic payment systems	Nov-16	Dec-16	Jan-17	Feb-17	Mar-17	Apr-17	May-17	Jun-17	Jul-17	Aug-17	Sep-17	Oct-17
Real time gross settlement (RTGS)	82.4%	79.8%	78.9%	79.2%	81.7%	79.7%	79.8%	80.5%	80.4%	80.4%	81.3%	79.6%
National electronic fund transfer (NEFT)	9.2%	10.9%	11.6%	11.6%	10.8%	10.9%	11.0%	11.0%	11.1%	11.3%	11.3%	12.0%
Cheque truncating system (CTS)	5.7%	6.5%	6.7%	6.4%	5.3%	6.3%	6.0%	5.6%	5.9%	5.6%	5.0%	5.5%
Immediate payment service (IMPS)	0.3%	0.4%	0.5%	0.5%	0.4%	0.5%	0.5%	0.5%	0.6%	0.6%	0.6%	0.6%
National automated clearing house (NACH)	0.6%	0.6%	0.6%	0.6%	0.5%	0.8%	0.6%	0.6%	0.7%	0.7%	0.5%	0.8%
Unified payment interface (UPI)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%
Unstructured supplementary service data (USSD)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Debit/Credit card & point of sale (POS)	0.4%	0.5%	0.5%	0.4%	0.3%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.5%
Prepaid payment instruction (PPI)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Mobile banking	1.3%	1.3%	1.2%	1.2%	1.0%	1.3%	1.7%	1.4%	0.9%	0.9%	0.9%	1.0%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Total (INRt)	95.2	105.4	98.2	93.7	151.1	111.0	113.0	115.3	108.4	110.9	125.8	115.7
Traditional payment systems (RTGS to NACH)	98.3%	98.2%	98.2%	98.4%	98.7%	98.3%	97.8%	98.2%	98.6%	98.6%	98.7%	98.4%
New payment systems (UPI to Mobile banking)	1.7%	1.8%	1.8%	1.6%	1.3%	1.7%	2.2%	1.8%	1.4%	1.4%	1.3%	1.6%

Source: Maybank Kim Eng

4.5 Logistics: high potential but time & money needed

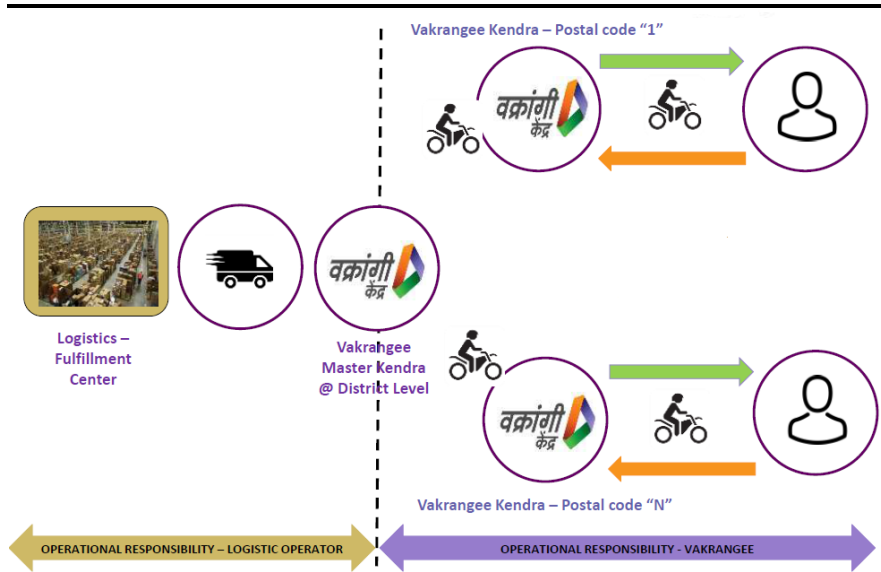
VKI has a much bigger plan for logistics services. It has signed on Fedex Express, Aramex India, Delhivery and First Flight Couriers to offer courier-booking services in 16 states. It serves 852 postal codes out of its 5,200 reach. In the medium term, it is eyeing last-mile delivery and reverse logistics. It has started pilot-testing 69 postal codes and completed the pick-up and delivery of more than 220k packages.

Customers visit its kendras to book a courier and provide sender / recipient & shipment details. They pay consignment fees at the kendras. The franchisees will schedule pick-up by one of their employees. Courier

companies pick up the consignments according to schedule and the franchisees change the status of the consignments on their platforms to “picked”. VKI earns 20-25% of the courier charges.

VKI has set up a 100% subsidiary, Vakrangee Logistics Private Limited, to develop this business. Revenue in its first year of operations was INR9.3m, in FY17. Net loss was INR6.3m, which was negligible at the group level. The company has developed back-end technology for seamless reverse logistics. It is in discussions with partners. We believe reverse logistics will need a higher amount of franchisee co-operation and investments in manpower. For now, we have not factored in any revenue.

Fig 36: VKI’s reverse-logistics proposal



Source: Company

5. Competition

5.1 VKI's advantages: 100% bricks & mortar vs touchpoints; sheer scale

The RBI says that business correspondents currently operate 543,472 banking outlets in villages and 102,865 in urban centres. VKI operates 35,206 for a 5.5% market share. Our channel checks suggest it is different in several aspects: a) many of its competitors offer touchpoint, mobile or part-time services; b) their services are often restricted to banking or G2C; c) they have a much smaller presence in urban areas than VKI; d) they lack technology platforms; and e) their EBITDA margins are lower due to their restricted service offerings. VKI has brick-&-mortar stores which offer a gamut of services. Its Internet-based Vakrangee Kendra Management Systems also enables the quick activation of services and monitoring of franchisees. Finally, being present in 18 states gives VKI a head-start over the others.

Of the 199,375 touchpoints provided by CSC E-governance Services India Ltd (CSC), a company set up by the Ministry of Electronics and Information Technology, only about 11,900 offer banking services. All of VKI's 40,461 franchisees offer banking services. Also, CSC allocates 90% of its revenue to its franchisees, keeping 10%. This compares with VKI's evolving 80:20, explaining the difference in their margins.

Among its other rivals, FINO has been converted into a payment bank. But FINO's representatives only work on selected days at specific locations, which implies part-time services. Sahaj is part of the SREI Group (SREI IN, BUY, TP160), which provides only touchpoint services and that too, skewed towards G2C.

Fig 37: VKI is way ahead in size and financial performance

Parameters	VKI Kendra	CSC e-		FINO
		Sahaj	Governance	
centre/touchpoint	centres	touchpoints	touchpoints	touchpoints
no. of centres	37,688	65,251	199,375	30,000
as of	Mar-17	Mar-17	Mar-16	as per website
FY16 Revenue (INRm)	17,089	658	3,543	1,864
FY16 EBITDA (INRm)	4,060	-143	394	268

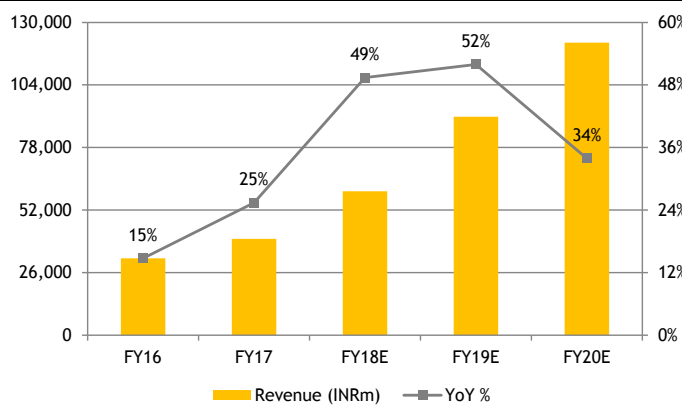
Source: Company filings on Ministry of Corporate Affairs (MCA) website

6. Financial Analysis

6.1 Forecast revenue growth of 3x from FY18E to FY20E

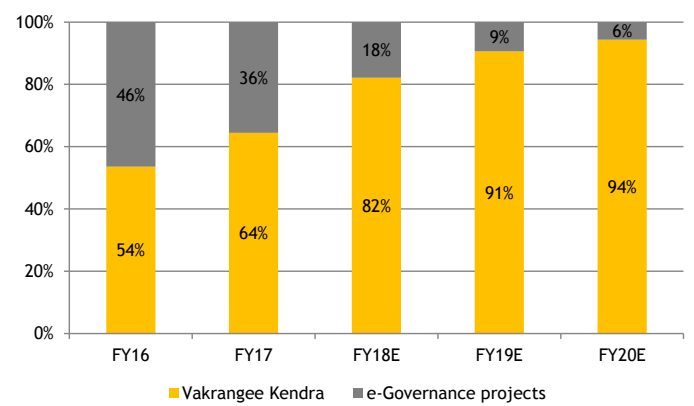
Assuming a 64.5% CAGR in kendra revenue, we forecast revenue increases to INR121.6b by FY20E from INR40b in FY17, for a 3x jump. Kendra's revenue share should rise to 94% from 64%, led by: a) a potential swelling in the number of centres to 75,461 from 35,206; b) more service activation; c) an increase in urban kendras' revenue share to 33% from 29%, which translates into higher revenue per kendra; and d) the maturing of 75% of its stores, up from 45% in FY17. A store becomes mature after operating for 12 months. We model average SSSG of 8% pa. We forecast that the share of new services such as assisted e-commerce, insurance and logistics will surge to 49% from 14% in FY17. Correspondingly, the share of G2C, banking and mobile/DTH top-up businesses should drop to 51% from 86%.

Fig 38: Revenue growth from FY18E



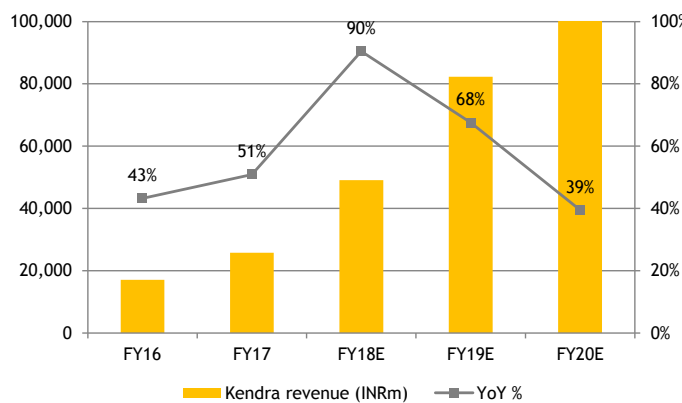
Source: Company, Maybank Kim Eng

Fig 39: Share of kendra business to reach 94%



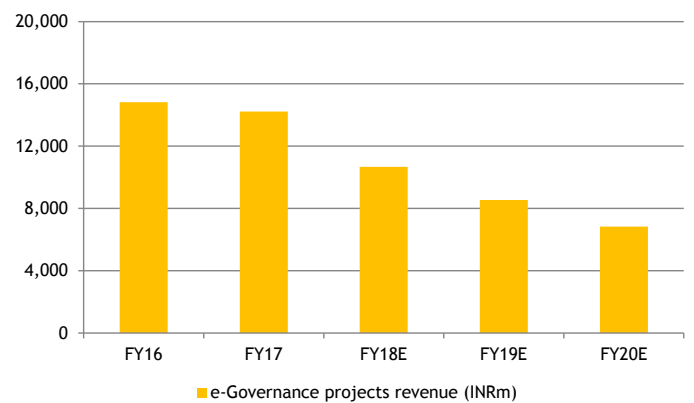
Source: Company, Maybank Kim Eng

Fig 40: Kendra revenue to grow at a 67% CAGR over FY18-20E



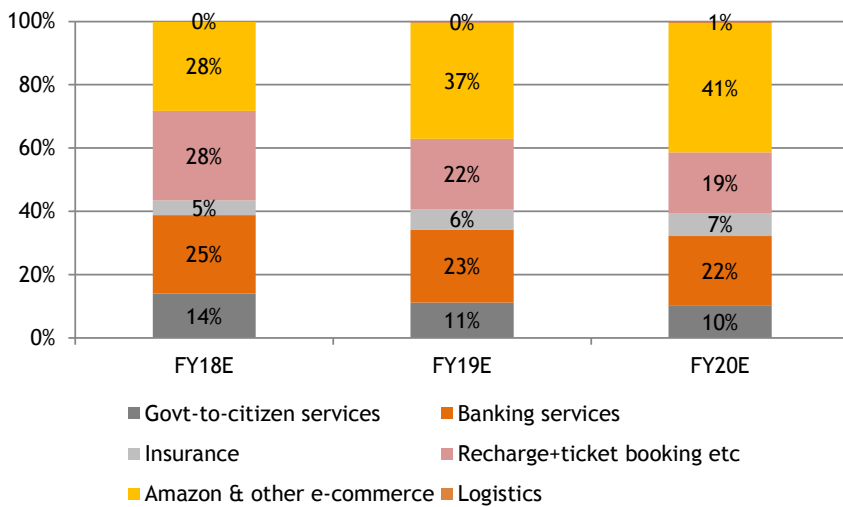
Source: Company, Maybank Kim Eng

Fig 41: E-governance contributions to decline



Source: Company, Maybank Kim Eng

Fig 42: Assisted e-commerce to form 41% of kendra revenue

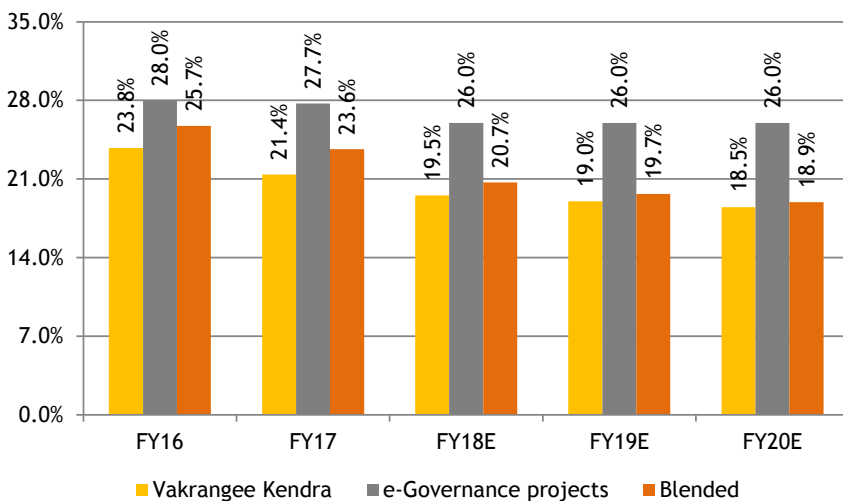


Source: Maybank Kim Eng

6.2 EBITDA margins to stabilise at 18%

For FY20E, we forecast that blended EBITDA margins will dip to 18.9% from 23.6% in FY17. Although e-governance margins have settled at 26% from a range of 23.2-28.4% in FY14-17, its contributions should steadily decrease. We forecast kendra EBITDA margins of 18.5% for FY20E, down from 21.4% in FY17. This would reflect higher revenue-sharing for its franchisees. When 100% of its revenue is kendra revenue eventually, we foresee EBITDA margins settling at 18%, with an optimal revenue-sharing ratio of 80:20 for franchisees:VKI.

Fig 43: EBITDA margins to be 18.9% in FY20E



Source: Company, Maybank Kim Eng

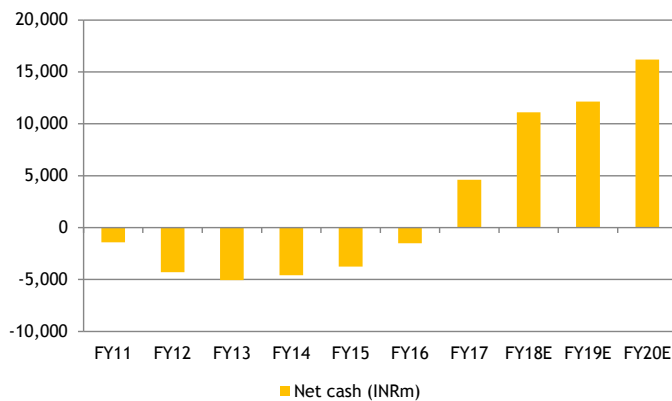
6.3 From net debt to net cash

From peak net debt of INR5b in FY13, the company turned net cash in FY17, with INR4.6b. FCF was INR6.6b, a reversal from peak outflows of INR1.6b. This was made possible by a shift to the kendra business from e-governance. The shift also helped to lift returns on invested capital to 52.2% in FY17 from 22.5% in FY13. We forecast further improvements to 87.6% in FY20E.

E-governance EBITDA margin is high but ROIC is lower due to high capex requirements and a long working-capital cycle. Receivable days range from 120 to 180. In contrast, kendra capex for VKI is about INR30k, with receivable days of around 60.

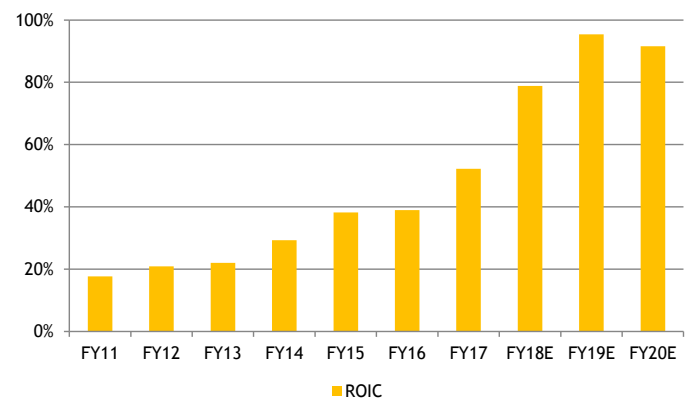
As its kendras' revenue share went from 34% in FY13 to 64.5% in FY17, VKI's receivable days dwindled from 128 days to 76. Net assets also shrank to INR287m in FY17 from INR4.2b in FY13 as the company completed capex-intensive e-governance projects and did not renew them.

Fig 44: From net debt to net cash in FY17



Source: Company, Maybank Kim Eng

Fig 45: ROIC could reach 92% by FY20E



Source: Company, Maybank Kim Eng

Fig 46: Profit & loss account

INRm	FY16	FY17	FY18E	FY19E	FY20E	Remarks
Revenue	31,907	40,005	59,772	90,812	121,583	Kendra business +64% CAGR, egov. project business -22% CAGR
YoY %	14.8%	25.4%	49.4%	51.9%	33.9%	
Cost of revenue	-23,207	-29,750	-46,213	-71,144	-96,146	Revenue share with franchisee currently being increased to
% of revenue	72.7%	74.4%	77.3%	78.3%	79.1%	80% from 70%
Employee costs	-253	-440	-598	-908	-1,216	Employee cost to remain steady at 1% of revenue as the
% of revenue	0.8%	1.1%	1.0%	1.0%	1.0%	employee addition will be in line with revenue increase
Other expenses	-239	-355	-598	-908	-1,216	Corporate expenses, business promotion and legal &
% of revenue	0.7%	0.9%	1.0%	1.0%	1.0%	professional fees will be in line with revenue increase
EBITDA	8,208	9,460	12,364	17,852	23,005	FY20 EBITDA: Kendra business 18.5%, egov. project business 26%
% of revenue	25.7%	23.6%	20.7%	19.7%	18.9%	
Depreciation & amortisation	-1,640	-734	-106	-162	-216	Low capex drive down depreciation charge
% of revenue	5.1%	1.8%	0.2%	0.2%	0.2%	
EBIT	6,567	8,726	12,259	17,689	22,789	
% of revenue	20.6%	21.8%	20.5%	19.5%	18.7%	
Other income	56	53	241	887	910	
Interest cost	-563	-501	-160	-80	-80	
Profit before tax	6,060	8,278	12,340	18,496	23,619	
Tax	-2,112	-2,970	-4,196	-6,289	-8,030	Effective tax rate of 34%
Minorities	0	0	0	0	0	
Net profit	3,949	5,308	8,144	12,207	15,588	
EPS (INR)	7.5	10.0	15.4	23.1	29.5	
No of shares (FV INR1)	529.2	529.2	529.2	529.2	529.2	

Source: Company, Maybank Kim Eng

Fig 47: Segmental performances

INRm	FY16	FY17	FY18E	FY19E	FY20E	Remarks
Segment revenue						
E-governance project business	14,818	14,221	10,666	8,533	6,826	CAGR of -21.7% over FY18-20 due to non-renewal of contracts
YoY %		-4.0%	-25.0%	-20.0%	-20.0%	
Vakrangee Kendra business	17,089	25,783	49,106	82,279	114,756	CAGR of +64.5% over FY18-20 driven by +29% CAGR in kendras and +18% in revenue per kendra
YoY %		50.9%	90.5%	67.6%	39.5%	
Total	31,907	40,005	59,772	90,812	121,583	
YoY %		25.4%	49.4%	51.9%	33.9%	
Segment EBITDA						
E-governance business	4,148	3,943	2,773	2,219	1,775	
Margin %	28.0%	27.7%	26.0%	26.0%	26.0%	
Vakrangee Kendra business	4,060	5,517	9,591	15,633	21,230	Revenue sharing with franchisee currently being increased to 80% from 70%
Margin %	23.8%	21.4%	19.5%	19.0%	18.5%	
Total	8,208	9,460	12,364	17,852	23,005	
Margin %	25.7%	23.6%	20.7%	19.7%	18.9%	

Source: Company, Maybank Kim Eng

Fig 48: Revenue mix

Over FY13-16, a higher share of kendra revenue came from e-governance services such as the issue of Aadhar numbers and election cards, plus banking services such as the opening of bank accounts. Amazon and insurance services were activated only in FY16-17.

Revenue break-up	FY17	FY18E	FY19E	FY20E	Remarks	
Government-to-citizen services	5,157	6,902	9,204	11,660	Driven by increase in number of kendras and requests for change/printing of Aadhar cards, new Aadhar issue will decline	
YoY %		33.9%	33.4%	26.7%		
Banking & insurance services	10,313	14,452	24,147	33,599	Driven by increase in number of kendras, higher remittances and increase in number of ATMs	
YoY %		40.1%	67.1%	39.1%		
Banking	9,282	12,139	18,982	25,312	Driven by activation of services across higher number of kendras	
YoY %		30.8%	56.4%	60.5%		
Insurance	1,031	2,313	5,164	8,287	Driven by activation of services across higher number of kendras	
YoY %		124.3%	123.3%	60.5%		
e-commerce services	10,313	27,752	48,929	69,497	Increase in revenue lower than increase in number of kendras as there is a shift to other modes of payment	
YoY %		169.1%	76.3%	42.0%		
Recharge business	na	13,878	18,432	21,984	Driven by activation of services across 58% of kendras by FY20 vs 6% in FY17	
YoY %			32.8%	19.3%		
Assisted e-commerce	na	13,832	30,184	46,816	Driven by activation of services across 47% of kendras by FY20 vs marginal number in FY17	
YoY %			118.2%	55.1%		
Logistics	na	42	313	698		
YoY %			643.1%	122.9%		
Total	25,783	49,106	82,279	114,756		
% of kendra revenue						
Government-to-citizen services	20%	14%	11%	10%		
Banking & insurance services	40%	29%	29%	29%		
Banking		25%	23%	22%		
Insurance		5%	6%	7%		
e-commerce services	40%	57%	59%	61%		
recharge business		28%	22%	19%		
Assisted e-commerce		28%	37%	41%		
Logistics		0%	0%	1%		
Total	100%	100%	100%	100%		

Source: Company, Maybank Kim Eng

Fig 49: Assumptions for Vakrangee Kendra business

Assumptions	FY16	FY17	FY18E	FY19E	FY20E
Vakrangee Kendra business					
Opening number of kendras	12,568	20,677	35,206	50,461	65,461
Addition during the year	8,109	14,529	16,445	16,683	12,078
Churn during the year	na	na	-1,190	-1,683	-2,078
Closing number of kendras	20,677	35,206	50,461	65,461	75,461
Rural kendras	76%	71%	71%	69%	67%
Urban kendras	24%	29%	29%	31%	33%
Avg. rev. per kendra pm (INR)	85,914	81,647	95,537	118,297	135,721
YoY %		-5.0%	17.0%	23.8%	14.7%

Source: Company, Maybank Kim Eng

Fig 50: Balance sheet

INRm	FY16	FY17	FY18E	FY19E	FY20E	Remarks
Cash & equivalents	1,672	6,038	11,088	12,138	16,184	
Receivables	8,595	8,244	12,287	18,162	23,641	Days to decline to 62 days for FY20 vs 116 days in FY16
Inventories	5,071	4,992	2,491	3,279	3,715	Decline due to de-focus from e-gov projects business
Other current assets	4,041	3,042	433	395	371	Declining due to de-focus in e-gov. projects business
Tangible assets (net)	1,322	287	775	1,213	1,560	
Other non-current assets	222	82	96	113	133	
Total assets	20,923	22,684	27,170	35,300	45,603	
Current liabilities	1,744	683	911	1,236	1,572	
Debt	3,199	1,440	0	0	0	
Deferred tax liabilities	130	0	0	0	0	
Other long term liabilities	18	23	28	34	40	
Shareholders' funds	15,831	20,538	26,231	34,031	43,991	
Total liabilities	20,923	22,684	27,170	35,300	45,603	

Source: Company, Maybank Kim Eng

Fig 51: Cash flow statement

INRm	FY16	FY17	FY18E	FY19E	FY20E	Remarks
Profit before tax	6,060	8,278	12,340	18,496	23,619	
Adjustments:						
Depreciation	1,640	734	106	162	216	
Tax paid	-2,922	-2,945	-4,196	-6,289	-8,030	
Interest paid/received	535	481	-81	-807	-830	
Other non-cash items	-49	66	0	0	0	
Change in working capital	-2,547	74	1,285	-6,312	-5,567	
Cash from operations	2,719	6,687	9,454	5,251	9,407	
Capex	-134	-112	-593	-600	-562	Largely driven by capex of INR30,000 per new centre
Others	43	648	241	887	910	
Cash from investing	-90	537	-352	286	348	
FCF	2,585	6,576	8,860	4,650	8,845	
Debt	-407	-122	-1,440	0	0	
Cash from equity raised	7	1	0	0	0	
Interest paid/received	-563	-501	-160	-80	-80	
Dividend paid incl tax	-159	-796	-2,451	-4,408	-5,629	Payout ratio of 25-30% in FY18-20
Others	0	0	0	0	0	
Cash from financing	-1,121	-1,419	-4,051	-4,488	-5,709	
Change in cash	1,507	5,806	5,051	1,049	4,046	

Source: Company, Maybank Kim Eng

7. Valuation

7.1 Growth justifies premium

VKI trades at 31.7x FY19E EPS vs 21x a year back when investors were still unconvinced about the potential of its kendra business. We believe a PEG of 0.83 is warranted, considering that its earnings are stepping up.

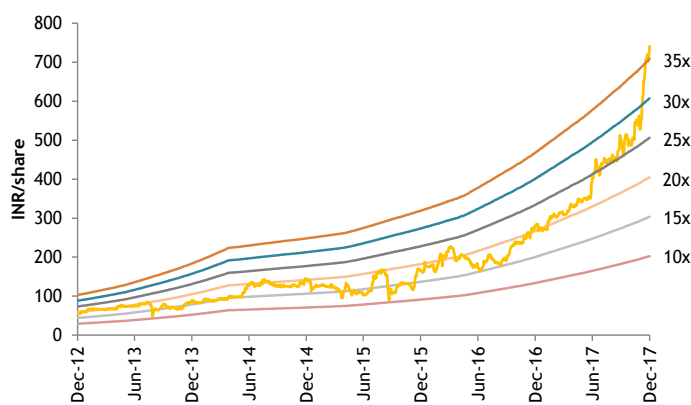
Most of its Indian peers are unlisted. We think VKI can be likened to 7-Eleven whose partners in ASEAN are trading at 30.7x FY19E EPS. Likewise, offline Indian retailers trade at 50x FY19E EPS. Indian consumer stocks trade at an average 44.3x for a PEG of 2.1x.

Recently, Amazon’s investment arm, Amazon NV Holdings LLC, acquired a 5% stake in unlisted Shoppers Stop, a departmental-store chain in India. The two will roll out “joint marketing” while Shoppers Stop will open Amazon Experience Centres where Amazon can showcase its brands.

We forecast an EPS CAGR of 43.2% for FY18-20E for VKI. Its prospective ROE of 35% and potential fast growth justify our target, in our view. We initiate coverage with a BUY and TP of INR830, set at 36x FY19E EPS. This implies a PEG of 0.83.

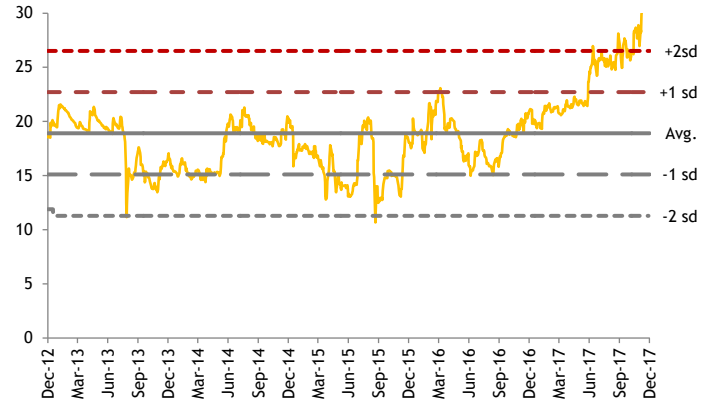
Catalysts are expected from: a) an activation of new services like reverse logistics and visa services; and b) any Amazon acquisition of a stake in the company. Visa services are currently centralised in major cities. Outbound travel has increased by 7-11% over the last five years to 21.9m in 2016. We think VKI’s wider reach to smaller cities and towns could be a differentiator from its smaller rivals. Reverse logistics can enable village reach for e-commerce, potentially triggering the activation of Amazon services at a higher number of kendras and a stickier partnership with Amazon.

Fig 52: 1-year forward P/E band



Source: Bloomberg, Maybank Kim Eng

Fig 53: 1-year forward P/E



Source: Bloomberg, Maybank Kim Eng

Fig 54: Peer comparisons

Company	Bbg code	M. cap USDm	Curr	CMP	Rating	TP	ROE	P/E (x)			PEG (x)
							FY18E	FY18E	FY19E	FY20E	
Vakrangee	VKI IN	6,006	INR	732	BUY	830	35%	47.6	31.7	24.9	0.7
Government-to-citizen service provider											
BLS International	BLSIN IN	363	INR	228	NR	NR	49%	22.1	18.6	NA	0.5
7-Eleven store operator											
7-Eleven Malaysia Holdings	SEM MK	473	MYR	1.56	SELL	1.24	99%	41.1	32.5	28.4	4.6
CP ALL PCL	CPALL TB	19,725	THB	74	NR	NR	32%	34.0	28.9	24.5	1.6
Average							66%	37.5	30.7	26.4	3.1
Offline retailers											
Shoppers Stop	SHOP IN	684	INR	528	NR	NR	5%	135.4	49.0	28.9	-0.2
Trent	TRENT IN	1,722	INR	334	NR	NR	8%	89.5	59.7	44.4	1.3
Future Retail	FRETAIL IN	4,010	INR	528	NR	NR	22%	41.9	25.2	22.2	0.5
Dmart	DMART IN	10,875	INR	1,124	NR	NR	18%	90.5	66.3	51.7	1.6
Vmart	VMART IN	382	INR	1,361	NR	NR	NA	NA	NA	NA	NA
Average							13%	89.3	50.0	36.8	1.1
Consumer-driven											
Colgate	CLGT IN	4,386	INR	1,040	NR	NR	47%	43.7	37.6	32.0	2.5
Dabur	DABUR IN	9,355	INR	343	NR	NR	27%	43.2	37.6	32.8	2.9
Glaxosmithkline	SKB IN	3,977	INR	6,099	NR	NR	21%	36.7	32.1	28.1	2.8
Godrej Consumer	GCPL IN	10,603	INR	1,004	NR	NR	25%	46.6	39.3	33.7	2.5
Hindustan Unilever	HUVR IN	42,806	INR	1,276	NR	NR	81%	54.0	45.8	38.9	2.8
ITC	ITC IN	47,543	INR	252	NR	NR	25%	26.9	23.5	21.0	1.9
Jubilant Foodworks	JUBI IN	1,745	INR	1,706	NR	NR	16%	81.1	60.1	46.0	1.0
Nestle	NEST IN	11,523	INR	7,709	NR	NR	39%	59.7	51.2	43.9	2.2
Tata Global Beverages	TGBL IN	2,690	INR	275	NR	NR	8%	32.6	29.3	24.3	1.5
United Breweries	UBBL IN	4,188	INR	1,022	NR	NR	15%	72.1	60.0	50.9	1.9
United Spirits	UNSP IN	7,570	INR	3,360	NR	NR	25%	89.1	62.1	48.9	0.5
Asian Paints	APNT IN	16,423	INR	1,104	NR	NR	27%	49.4	41.5	35.5	2.7
Titan	TTAN IN	10,648	INR	774	NR	NR	24%	60.3	47.7	39.4	1.4
Marico	MRCO IN	6,119	INR	306	NR	NR	35%	45.4	38.2	32.9	2.6
Page Industries	PAG IN	3,827	INR	22,128	NR	NR	44%	75.2	58.4	47.9	2.4
Average							30%	54.4	44.3	37.1	2.1

Source: Bloomberg, Maybank Kim Eng

8. Risks

8.1 Changes in RBI rules

Business correspondents for banks are governed by 'guidelines for engaging business correspondents' laid down by RBI. If there are any changes in the rules which are detrimental to them, VKI's business may be affected. However, considering RBI's impetus on financial inclusion, we do not foresee any immediate adverse changes. As at end-Mar 2017, 90% of banking outlets in villages was operated by correspondents, making them an integral part of the banking system. VKI's banking services contributed 37% to its FY17 revenue. This should dwindle to 25% by FY20E as other services gain prominence.

8.2 Breakdown in partnership with Amazon

We estimate that 45% of its incremental revenue over the next three years will stem from its Amazon partnership. Their current partnership is valid for five years, starting Jul 2015. Any slower-than-expected activation by Amazon of its services could affect VKI's growth rates. That said, over 10,000 of its kendras are now activated, up from 2,000 at the start of FY18. Based on their momentum, we forecast that at least 58% of its kendras will offer Amazon services by FY20E.

8.3 Delays in service activation or training

Delays in the activation of new services may slow down its revenue growth. To safeguard against this, the company has appointed block leaders to oversee its franchisees. They must ensure that adequate training is given and all services are offered by the franchisees to end-customers. If the latter is not met, a franchise may be shut down. Franchisees are also incentivised to bring in more business, reducing the risk of delays. As size increases, training all franchisees could become more and more difficult to execute. VKI is responding to this by roping in dedicated training executives from its partners to co-ordinate with its block managers. It collaborates with its partners to hold training camps continuously at different locations.

8.4 Competition

VKI's smaller competitors include Sahaj, FINO and CSC E-Governance. Its biggest differentiator is its 100% physical stores vs touchpoints or kiosks. A presence in 18 states also gives VKI a headstart over its competitors, in our view.

9. Appendix

Fig 55: VKI's partnerships



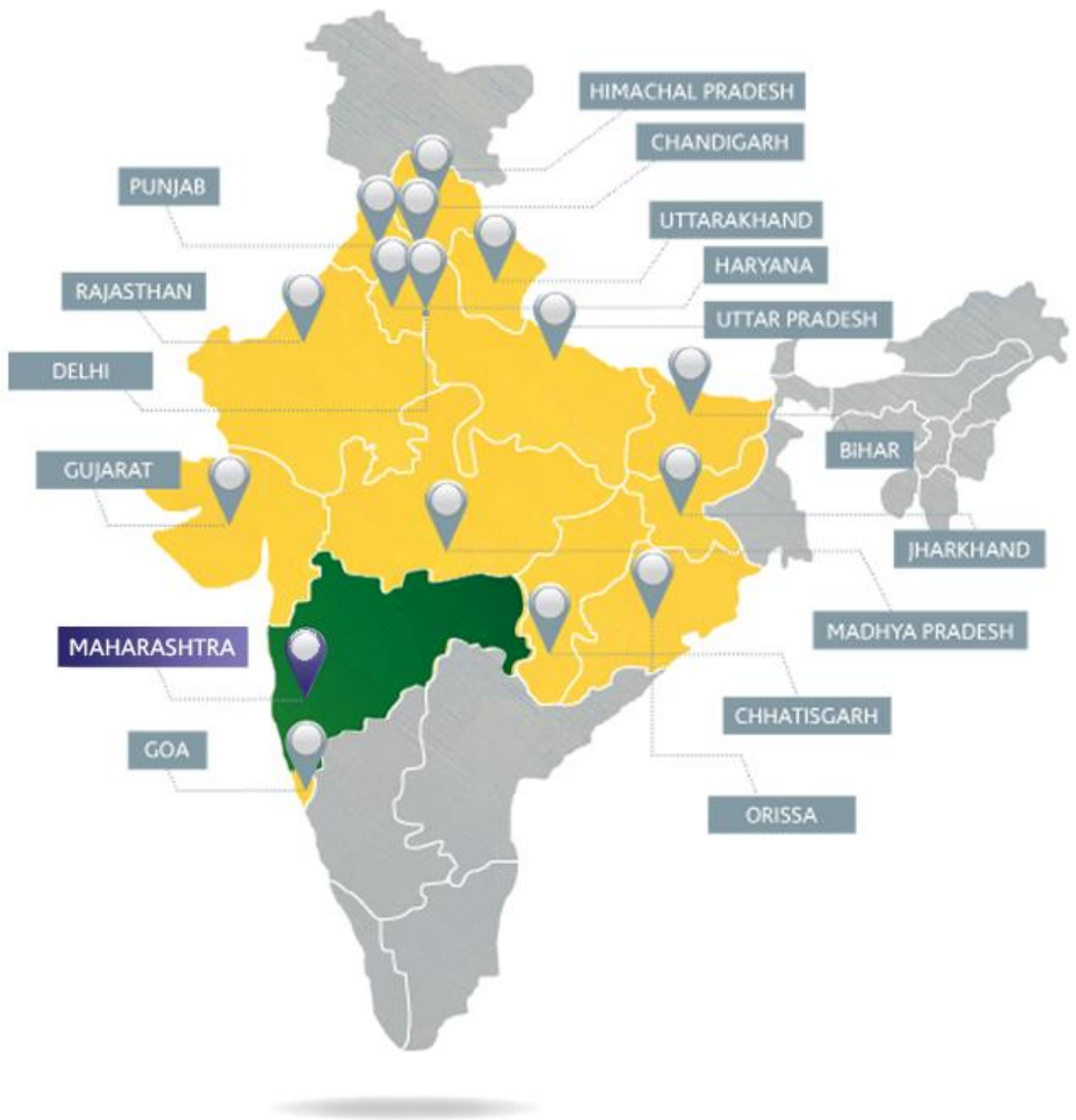
Source: Company

Fig 56: Selected kendras



Source: Company

Fig 57: Their spread



Source: Company

Video of Vakrangee Kendra

http://vakrangee.in/video_2.html

FYE 31 Mar	FY16A	FY17A	FY18E	FY19E	FY20E
Key Metrics					
P/E (reported) (x)	19.9	23.7	47.6	31.7	24.9
Core P/E (x)	98.1	73.0	47.6	31.7	24.9
P/BV (x)	24.5	18.9	14.8	11.4	8.8
P/NTA (x)	24.5	18.9	14.8	11.4	8.8
Net dividend yield (%)	0.2	0.3	0.5	0.9	1.2
FCF yield (%)	0.7	1.7	2.3	1.2	2.3
EV/EBITDA (x)	12.9	17.9	30.4	21.0	16.1
EV/EBIT (x)	16.2	19.4	30.7	21.2	16.3

INCOME STATEMENT (INR m)

Revenue	31,907.4	40,004.6	59,772.2	90,812.3	121,582.8
Gross profit	6,806.3	9,081.3	12,856.3	18,597.3	24,004.5
EBITDA	8,207.5	9,460.1	12,364.2	17,851.6	23,004.8
Depreciation	(1,640.4)	(733.9)	(105.5)	(162.4)	(216.1)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	6,567.1	8,726.2	12,258.6	17,689.2	22,788.7
Net interest income / (exp)	(506.8)	(448.1)	81.3	806.6	829.9
Associates & JV	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	6,060.3	8,278.1	12,339.9	18,495.8	23,618.6
Income tax	(2,111.8)	(2,970.2)	(4,195.6)	(6,288.6)	(8,030.3)
Minorities	0.0	0.0	0.0	0.0	0.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	3,948.6	5,308.0	8,144.3	12,207.3	15,588.3
Core net profit	3,948.6	5,308.0	8,144.3	12,207.3	15,588.3
Preferred Dividends	0.0	0.0	0.0	0.0	0.0

BALANCE SHEET (INR m)

Cash & Short Term Investments	1,672.0	6,037.6	11,088.4	12,137.7	16,183.9
Accounts receivable	8,595.2	8,243.6	12,286.5	18,162.5	23,641.1
Inventory	5,070.6	4,991.9	2,490.5	3,279.3	3,715.0
Property, Plant & Equip (net)	1,322.2	287.5	775.3	1,213.4	1,559.6
Intangible assets	0.0	0.0	0.0	0.0	0.0
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	4,262.9	3,123.9	529.5	507.5	503.7
Total assets	20,922.9	22,684.4	27,170.3	35,300.3	45,603.4
ST interest bearing debt	2,827.5	1,440.2	(0.0)	(0.0)	(0.0)
Accounts payable	916.3	306.8	475.0	731.2	988.2
LT interest bearing debt	371.6	0.0	0.0	0.0	0.0
Other liabilities	976.0	400.0	464.0	538.0	624.0
Total Liabilities	5,091.4	2,146.9	938.8	1,269.3	1,612.6
Shareholders Equity	15,831.5	20,537.5	26,231.4	34,031.0	43,990.8
Minority Interest	0.0	0.0	0.0	0.0	0.0
Total shareholder equity	15,831.5	20,537.5	26,231.4	34,031.0	43,990.8
Perpetual securities	0.0	0.0	0.0	0.0	0.0
Total liabilities and equity	20,922.9	22,684.4	27,170.3	35,300.3	45,603.4

CASH FLOW (INR m)

Pretax profit	6,060.3	8,278.1	12,339.9	18,495.8	23,618.6
Depreciation & amortisation	1,640.4	733.9	105.5	162.4	216.1
Adj net interest (income)/exp	534.6	480.8	(81.3)	(806.6)	(829.9)
Change in working capital	(2,546.6)	74.0	1,284.9	(6,312.2)	(5,567.2)
Cash taxes paid	(2,921.7)	(2,945.0)	(4,195.6)	(6,288.6)	(8,030.3)
Other operating cash flow	(48.5)	65.7	0.0	0.0	0.0
Cash flow from operations	2,718.5	6,687.5	9,453.5	5,250.8	9,407.2
Capex	(133.6)	(111.6)	(593.4)	(600.5)	(562.3)
Free cash flow	2,585.0	6,575.9	8,860.2	4,650.3	8,844.9
Dividends paid	(158.7)	(796.2)	(2,450.6)	(4,407.7)	(5,628.5)
Equity raised / (purchased)	7.4	0.7	0.2	0.0	0.0
Change in Debt	(406.5)	(122.2)	(1,440.2)	0.0	0.0
Other invest/financing cash flow	(520.0)	147.6	81.3	806.6	829.9
Effect of exch rate changes	(0.0)	(0.0)	0.0	0.0	0.0
Net cash flow	1,507.0	5,805.8	5,050.8	1,049.2	4,046.3

FYE 31 Mar	FY16A	FY17A	FY18E	FY19E	FY20E
Key Ratios					
Growth ratios (%)					
Revenue growth	14.8	25.4	49.4	51.9	33.9
EBITDA growth	13.5	15.3	30.7	44.4	28.9
EBIT growth	17.6	32.9	40.5	44.3	28.8
Pretax growth	23.8	36.6	49.1	49.9	27.7
Reported net profit growth	22.7	34.4	53.4	49.9	27.7
Core net profit growth	22.7	34.4	53.4	49.9	27.7
Profitability ratios (%)					
EBITDA margin	25.7	23.6	20.7	19.7	18.9
EBIT margin	20.6	21.8	20.5	19.5	18.7
Pretax profit margin	19.0	20.7	20.6	20.4	19.4
Payout ratio	16.8	19.9	25.0	30.0	30.0
DuPont analysis					
Net profit margin (%)	12.4	13.3	13.6	13.4	12.8
Revenue/Assets (x)	1.5	1.8	2.2	2.6	2.7
Assets/Equity (x)	1.3	1.1	1.0	1.0	1.0
ROAE (%)	28.4	29.2	34.8	40.5	40.0
ROAA (%)	19.2	24.3	32.7	39.1	38.5
Liquidity & Efficiency					
Cash conversion cycle	144.7	128.5	87.6	71.8	71.6
Days receivable outstanding	116.2	75.8	61.8	60.4	61.9
Days inventory outstanding	51.9	60.0	28.8	14.4	12.9
Days payables outstanding	23.4	7.3	3.0	3.0	3.2
Dividend cover (x)	6.0	5.0	4.0	3.3	3.3
Current ratio (x)	4.2	10.5	28.9	27.5	27.9
Leverage & Expense Analysis					
Asset/Liability (x)	4.1	nm	nm	nm	nm
Net gearing (%) (incl perps)	9.6	net cash	net cash	net cash	net cash
Net gearing (%) (excl. perps)	9.6	net cash	net cash	net cash	net cash
Net interest cover (x)	13.0	19.5	na	na	na
Debt/EBITDA (x)	0.4	0.2	nm	nm	nm
Capex/revenue (%)	0.4	0.3	1.0	0.7	0.5
Net debt/ (net cash)	1,527.1	(4,597.4)	(11,088.5)	(12,137.7)	(16,184.0)

Source: Company; Maybank

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