Ujjivan Financial Services Limited

Ratings

Facilities	Amount (Rs. crore)	Ratings1	Remarks
Long-term Bank Facilities	4,500	CARE A+ (Single A Plus)	Revised from CARE A (Single A)
NCD V	40	CARE A+ (Single A Plus)	Revised from CARE A (Single A)
NCD VI	60	CARE A+ (Single A Plus)	Revised from CARE A (Single A)
NCD VII	100	CARE A+ (Single A Plus)	Revised from CARE A (Single A)
NCD VIII	100	CARE A+ (Single A Plus)	Revised from CARE A (Single A)
NCD IX	100	CARE A+ (Single A Plus)	Revised from CARE A (Single A)
Total Facilities	**4,900 (Rupees Four Thousand Nine Hundred crore only)**		

**Rating on NCD amounting to Rs.50 crore has been withdrawn as the NCD hasbeen fully redeemed by the company.*

Rating Rationale

The revision in the rating factors in the healthy improvement in business and earnings profile during FY16 (refers to the period April 1 to March 31) and significant equity infusion to the tune of Rs.650 crore received by Ujjivan Financial Services Limited (Rs.292 crore during Q4FY16 and Rs.358 crore through IPO), which has bolstered the capitalization levels and expected to supportthe business expansion and portfolio growth. The rating also continues to reflect UFSL's healthy profitability, geographically well-diversified client portfolio with good asset quality, experienced management and well-developed portfolio management systems. The rating also takes note of the structural changes in its operational framework including investments in employee and IT systems, UFSL is undertaking towards migration to Small Finance Bank (SFB).

The rating is, however, constrained by the increasing proportion of relatively riskier individual lending portfolio which is presently limited to 12.87% of the overall portfolio (as on March 31, 2016) and inherent risks associated with the microfinance industry including socio-political and regulatory risks.

The prospects of UFSL will be linked to the robustness of the MFI sector and how UFSL strategizes its transition from NBFC-MFI to Small Finance Bank (SFB) while maintaining profitability, liquidity, asset quality and capitalization at healthy levels which remains the key rating sensitivities.

Background

UFSL is a Bangalore-based Microfinance Company registered as NBFC-MFI with RBI. It has been in microfinance lending since 2005 and operates through joint liability group model in urban and semi-urban areas and target customers who are salaried as well as self-employed women. UFSL provides range of customized products to its customer like business loan, family loan, education loan, housing loan, etc. It has created a niche segment in the microfinance sector as an urban-based MFI. As on March 31, 2016, it has 469 branches in 24 states reaching out to 30.50 lakh customers as compared with 423 branches in 24 states reaching out to more than 22 lakh customers as on March 31, 2015.

Credit Risk Assessment

Healthy improvement in business and income profile in FY16 backed by equity infusion

During FY15, UFSL witnessed robust improvement in business, with disbursement of Rs.6619.1 crore (FY14: Rs.4,328.4 crore) and portfolio outstanding increased to Rs.5,388.6 crore as on March 31, 2016, from Rs.3,274.1 crore as on March 31, 2015. The strong business growth translated to improvement in income profile with total income increasing by 68.21% to Rs.1,029.3 crore in FY15 from Rs.611.9 crore in FY15. The PAT also witnessed a substantial growth of 133.83% to Rs.133.7 crore in FY16 from Rs.75.8 crore in FY15. As a result of monetary easing by RBI, cost of funds declined during FY16, leading to decline in average cost of borrowing for UFSL to 12.18% and with margin cap of 10% as mandated by RBI, the interest rates on microfinance loans declined to 22% in FY16 (FY15: 23.6%), housing (15.75%) and MSE lending (20%). During FY16, net interest margin (NIM) improved to 10.7% from 9.5% in FY15 and ROTA improved to 3.67% in FY16 from 2.51% in FY15. The improvement in business prospect was ably support by a substantial equity investment of Rs.292 crore by existing and new investors which supported the capitalization levels and enabled strong business growth.

[1]Complete definitions of the ratings assigned are available at www.careratings.com and other CARE publications

Increasing scale of operations and efficiency

The growth in business and profitability was commensurate with UFSL increase in the scale of operations. There was substantial increase in borrowers to 30.5 lakh as on March 2016 from 22.0 lakh as on March 2015. The outreach in terms of branches increased to 469 in FY16 from 423 in FY15. The geographical diversification remained similar at 24 states in FY16. The top four states of Karnataka, West Bengal, Tamil Nadu and Maharashtra contributed to approximately 56.3% of the overall portfolio growth in FY16 from 57% in FY15, the single State concentration had effectively reduced to 16.08% in FY16 from 16.52% in FY15. The average loan outstanding per branch has also been growing over the years along with improvement in number of borrowersserviced per employee. UFSL's emphasis to improve operating efficiency has contributed greatly to enhance its profitability further, this has alsoensured customer retention rate of 86% during FY16 from 87% in FY15.

Good asset quality

The cautious approach and thorough research under taken before every business expansion and growth measures have helped UFSL maintain a good asset quality. UFSL makes continuous improvement in risk management systems. It has separate credit committee for group lending (GL) and IL with well-defined lending policies for each loan product. This is reflected in Gross NPA% of 0.15% as on March 31, 2016 (0.07% as on March 31, 2015). Also, the Net NPA% has been negligible at 0.04% as on March 31, 2016 (0.02% as on March 31, 2015). UFSL also enhanced its individual lending (IL) portfolio to Rs.693.81 crore as on March 31, 2016 constituting 12.87% of the overall portfolio from Rs.342.8 crore as on March 31, 2015 constituting 10.47% of the total portfolio. UFSL is also promoting individual lending but more than 90% of the individual loan borrowers have completed at-least three cycles of GL before being eligible for availing IL. Thus, UFSL has an established credit history for major part of the IL borrowers to maintain asset quality at adequate levels. Majority of the IL portfolio is largely unsecured lending, thus UFSL is maintaining provision of 2% on the IL portfolio (Additional 1% over the RBI mandated norms). Though individual lending pertains to a relatively riskier segment, UFSL has maintained an overall collection efficiency of over 99.8% in FY16. The average ticket size of IL as on March 31, 2016, stands at Rs.65,000 with a range between Rs.50,000 and Rs.2.0 lakh. The ticket size is tailored based on repayment ability and credit requirement of the borrower. The tenor is normally 24 months except higher education loan with a tenor upto 60 months.

Comfortable capital adequacy

UFSL has a track record of regular equity infusion in the past with demonstrated ability to raise capital. During FY16, UFSL raised Rs.292 crore of capital, which bolstered the capitalization levels. Furthermore, during Q1FY17, the company raised Rs.358 crore via IPO. The CAR marginally declined to 24.14% as on March 31, 2016, from 24.24% as on March 31, 2015 due to 57.5% increase in risk-weighted assets; however, the same was marginally offset by equity infusion.

Transition of UFSL from NBFC-MFI to Small Finance Bank

UFSL received in-principle approval from RBI for setting up a Small Finance Bank (SFB) in September 2015. The company is in the process of implementing structural changes towards migration to SFB. UFSL has proposed to float a wholly owned subsidiary named Ujjivan Small Finance Bank (USFB). The entire business of UFSL would then be transferred to USFB through a slump sale and UFSL will continue to be the holding company. The company has complied with RBI regulation regarding reduction in foreign investors holding to 49% (48.68% as on May 20, 2016). As on March 2016, UFSL had 469 branches of which 200 branches are planned to be converted into Small Finance Banks branches and the balance will continue as customer service points. Additionally, the company is expected to open 80 UBRB branches in rural areas in the next 8 to 9 months.

The company has tied-up with Infosys for implementing their Core-Banking Solution 'Finacle'. It has also tied-up with other vendors for implementation of credit & risk management functions. The company is also working towards hiring and training its employees. The company plans to raise additional capital by way of Commercial Paper (CP), securitization, proceeds of which will be utilized towards heightened regulatory capital requirement and meeting other costs towards migration to SFB.The company plans to launch SFB operations from January 2017.

Experienced Management

The company has been in microfinance activity since 2005 and has gained reasonable experience in carrying out microfinance activities. It has established its presence in urban and semi urban areas and created a niche segment in the microfinance sector as urban-based microfinance institutions (MFI). UFSL has experienced management which has rich experience in the financial services sector. The Managing Director (MD) and Chief Executive Officer (CEO), Mr Samit Ghosh is a veteran banker with over three decades of experience. UFSL has also been inducting Independent Directors with diverse experience, who bring valuable expertise to the company. The core team managing the day-to-day operations has more than a decade experience in retail banking. The second tier management handling key functions including internal audit, finance & accounts, management information system have rich domain experience. The experience of the management has helped in creating strong appraisal and monitoring systems. Above this the retention of core management team since inception also adds to the strength.

Moderately diversified resource profile

As on March 31, 2015, major source of external funding has been term loans from banks and FIs. It has mobilized borrowings from over 44 banks and FIs. Amongst banks; it has good mix of both private sector and public sector banks. UFSL also raised NCD issues during FY16.

Industry outlook and prospects

Post the AP crisis and regulatory intervention by RBI, the microfinance sector has seen strong growth in loan portfolio on account of improving funding profile, control over operating expenses, improving margins and moderate leverage levels.

RBI has revised the lending norms for the MFI sector, post Andhra Pradesh (AP) crisis in 2010 and Malegam Committee Report on NBFC-MFI in 2011. The sector has evolved with the advent of credit bureaus in the sector and subsequent control over asset quality. MFI sector saw 30+ days past due (DPD) of around 0.33% as on March 31, 2016. As on the same date, aggregate gross loan outstanding for the sector was Rs.53,233 crore, registering 84% Y-o-Y growth from Rs.28,940 crore as on March 31, 2015. (Source: MFIN) The stabilization of the regulatory regime has led to a renewed interest from both domestic and foreign funds in the sector. In the recent past, the sector has witnessed strong capital inflows.

Also, post upward revision in loan ticket-size (from Rs.35,000 to Rs.60,000 for 1st cycle and from Rs.50,000 to Rs.100,000 for subsequent cycle), household income (from Rs.60,000 to Rs.100,000 for rural region and from Rs.120,000 to Rs.160,000 for urban & semi-urban region) and borrowing limit for individual borrower (from Rs.50,000 to Rs.100,000) by RBI would aid in the growth of the loan portfolio of MFIs as it widens the base of borrowers and significantly increases the addressable market size. Furthermore, resources are not seen as a major constraint given the significant capital infusion in recent times. If MFIs manage to control the asset quality of their portfolio while adhering to new guidelines, the profitability of the sector is expected to improve with the benefits of operating leverage. Credit view will continue to factor in risks associated with unsecured lending, socio-political intervention, geographic concentration and operational risks related to cash based transaction.

Financial Performance (Rs. Cr)

As on / Year ended March 31	2014 (12m, A)	2015 (12m, A)	2016 (12m, A)
Working Results			
Interest Income	328.9	557.6	939.8
Loan Processing Fees	22.4	47.3	70.8
Other income	6.4	7.0	18.7
Total Income	357.7	611.9	1029.3
Operating Expenses	117.5	197.9	297.9
Total Provision / Write offs	8.6	21.3	27.9
Depreciation	3.2	6.7	8.0
Interest	144.9	271.4	423.5
PBT	83.8	114.5	272.0
PAT	55.0	75.8	177.2
Financial Position			
Tangible Net worth	362.8	717.5	1166.2
Total Borrowings	1650.0	3121.8	4338.0
Total Loan Portfolio	1617.3	3218.7	5064.4
Total Assets	2069.0	3957.3	5695.8
Asset under Management (AUM)	1617.3	3274.1	5388.6
Key Ratios (%)			
Solvency			
Overall Gearing (times)	4.58	4.38	3.76
Capital Adequacy Ratio (CAR) (%)	22.73	24.24	24.14
Tier I CAR (%)	21.81	21.70	22.37
Interest Coverage (times)	1.58	1.42	1.64
Profitability			
Net Interest Margin	10.77	9.50	10.70
Return on Total Assets (ROTA)	3.22	2.52	3.67
Operating expenses to Total Assets	7.05	6.79	6.34
Asset Quality			
Gross NPA Ratio	0.07	0.07	0.15
Net NPA Ratio	0.01	0.02	0.04
Net NPA to Net worth (%)	0.06	0.08	0.17

Note: Ratios have been computed based on average of annual opening and closing balances

NIM has been calculated as net interest income/ average annual total assets

Details of Rated Facilities

1.Long-term facilities

1.A. Secured rupee term loans

Banker/Lender	Rated Amount (Rs. Crore)	Remarks O/s as on May 31, 2016
A. Long Term Rupee Loan		
Axis Bank	342.86	Outstanding
SIDBI	185.38	Outstanding
SIDBI Sub Debt	50.00	Outstanding
HDFC Bank	284.24	Outstanding
Corporation Bank	33.33	Outstanding
Development Credit Bank	17.67	Outstanding
IDBI	363.55	Outstanding
Standard Chartered Bank	217.00	Outstanding
Ratnakar Bank	186.88	Outstanding
Bank of America	60.00	Outstanding
Andhra Bank	69.44	Outstanding
South Indian Bank	40.50	Outstanding
Yes Bank	256.96	Outstanding
Kotak Mahindra Bank	122.17	Outstanding
Dhanlaxmi Bank	37.50	Outstanding
HSBC	176.90	Outstanding
Union Bank of India	54.58	Outstanding
IndusInd Bank	183.79	Outstanding
ICICI Bank	28.13	Outstanding
Federal Bank	36.46	Outstanding
SocieteGenerale	16.89	Outstanding
Oriental Bank of Commerce	16.67	Outstanding
Vijaya Bank	5.63	Outstanding
Citi Bank	60.00	Outstanding
IFMR Capital	3.50	Outstanding
BNP Paribas	56.38	Outstanding
State Bank of India	21.44	Outstanding
State Bank of Patiala	33.99	Outstanding
NABARD	150.00	Outstanding
Capital First Limited	50.00	Outstanding
Dena Bank	12.50	Outstanding
Indian Overseas Bank	53.60	Outstanding
Tata Capital	8.33	Outstanding
L&T Fincorp Limited	21.74	Outstanding
State Bank of Hyderabad	60.39	Outstanding
Bank of Baroda	22.62	Outstanding
Hero Fincorp	19.07	Outstanding
Canara Bank	10.00	Outstanding
Bank of Maharashtra	46.86	Outstanding
SBER Bank	18.00	Outstanding
Abu Dhabi Commercial Bank	18.75	Outstanding
MUDRA	88.00	Outstanding
Bajaj Finserv	43.94	Outstanding
Tata Capital Housing Finance Ltd	4.87	Outstanding
Shinhan Bank	50.00	Outstanding

DBS Bank	75.00	Outstanding
CTBC Bank Co Ltd	25.00	Outstanding
Others	728.49	Outstanding
Total	4,469.00	

1.B. Fund-based limits sanctioned (Rs. Cr)

Sr. No.	Name of Bank	Fund-based Limits		
		CC*	Others (OD)	Total fund-based limits
1	HDFC Bank	1.00	-	1.00
2	Kotak Bank	5.00	-	5.00
3	Dhanlaxmi Bank	5.00	-	5.00
4	Yes Bank	-	20.00	20.00
	TOTAL	**11.00**	**20.00**	**31.00**

**CC=Cash credit; OD=Overdraft*

Total Long-term facilities (1.A + 1.B) Rs.4,500.0 crore

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(This follows our brief rationale for entity published on 11 July, 2016)

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