Ujjivan Small Finance Bank Limited

August 05, 2021

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long Term Bank Facilities	**23.19 (Reduced from 407.63)**	**CARE A+; Stable (Single A Plus; Outlook: Stable)**	**Reaffirmed**
Total Facilities	**23.19 (Rs. Twenty-Three Crore and Nineteen Lakhs Only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The rating assigned to the bank facilities of Ujjivan Small Finance Bank Limited (USFB) continues to derive strength from adequate capitalization profile of the bank post equity raised by way of IPO which provides required financial support required, improving resource profile of the bank with improvement in deposit funding with increase in CASA & retail deposit share, inheritance of geographically well-diversified client portfolio from Ujjivan Financial Services Limited (UFSL) and bank's experienced promoter group with seasoned management. The rating also continues to factor in the expansion of banking operations albeit portfolio still being largely microfinance focused and improvement in operational efficiency as witnessed in improvement in cost to income ratio of bank during FY21 leading to increase in pre-provisioning operating profit.

The rating continues to remain constrained by lack of diversity in income profile with unsecured MFI portfolio continuing to constitute 71.8% of loan portfolio. Further, performance of unseasoned non-MFI portfolio also remains to be seen. Ratings also remain constrained due to exposure to inherent risk associated with marginal borrower profile of customers with majority of USFB customers being from the economically weaker section and low-income segments of the Indian economy which may be vulnerable to economic downturns as witnessed in decline in collection efficiencies during the COVID-19 affected period. The rating also takes note of the moderation in asset quality parameters post COVID and impact of the same on near term profitability arising on account of weaker economic environment post the outbreak of COVID which has elevated the credit risk for the bank. At the same time, bank's loss absorption capacity is satisfactory with strong pre-provisioning profits and healthy Tier I capital.

Rating Sensitivities

Positive factors-Factors that could lead to positive rating action/upgrade

- Scale up of its business with sustained diversification in secured asset class while improving asset quality on a reasonably seasoned portfolio.

Negative factors-Factors that could lead to negative rating action/downgrade

- Delay in ramp up in collections to pre-pandemic levels.
- Material deterioration in asset quality impacting earnings profile of the bank.

Detailed description of the key rating drivers

Key Rating Strengths

Adequate capital headroom provides required financial support: USFB had shored up its capital levels since its Initial Public Offering (IPO) in December 2019 with Basel II regulatory capital ratios increasing in FY20 over FY19. As at March 31, 2021, USFB continued to maintain Capital Adequacy Ratio (CAR) and Tier 1 ratio at FY20 levels at 26.44% (FY20: 28.82%) and 25.07% (FY20: 28.01%) respectively and remains comfortable above the regulatory requirements. This provides the bank with sufficient cushion to absorb elevated provisioning costs, especially considering capital levels will likely not be aided by internal accruals in the near term.

Improving deposit funding: USFB's reliance on non-deposit funding has exhibited a steady decline in the last couple of years. Deposits as a percentage of total liabilities has increased to 64.4% in FY21 (FYE19: 53.7%; FYE20: 58.5%) while deposits/advances improved to 90.6% (FYE20: 76.7%; FYE19: 69.9%). Additionally, low-cost CASA deposits gradually rose to 20.55% from 13.54% at FYE20 and 10.62% at FYE19, although it remains lower than its peers. The granularity of the deposit base too reflected an improvement with retail deposits now constituting 48% of the total deposits at FYE21 (FYE20: 44%). CARE Ratings understand that the bank has increased its range of deposit products to widen its customer base. Additionally, the higher-than-banks interest rates will also help USFB to garner further retail deposits.

Geographically Well-diversified Loan Portfolio: USFB has full-fledged banking branches of 575 (incl. 144 in unbanked rural centres) by the end of FY21. USFB's gross loan portfolio stood at Rs.15,140 crore on March 31, 2021 spread across 24 states and UTs with active customer base of 59.2 lakhs (PY: 52.5 lakhs). Top five states of Karnataka, West Bengal, Tamil Nadu,

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

Maharashtra, and Gujarat contributed to remain high at 61.30% of the overall portfolio as of March 2021 (61.98% of the overall portfolio as on March 31, 2020).

Experienced promoter group with seasoned management: The present senior management team of USFB is largely stable and highly experienced in financial sector. Mr. Nitin Chugh is the current Managing Director (MD) and Chief Executive Officer (CEO) who replaced founder-director Mr. Samit Gosh w.e.f. December 1, 2019. He has experience of over 25 years in banking industry. USFB's Board comprises of 9 directors which includes MD, three Non-Executive directors and five Independent Directors with diverse experience, who bring valuable expertise to the Bank. Bank's operations are ably supported by the senior management team.

Key Rating Weaknesses

Moderation in asset quality post-COVID: Asset quality performance was impacted by the COVID-19 led pandemic with GNPA deteriorating to 7.07% on March 31, 2021 from 0.97% on March 31, 2020. Provision coverage ratio also moderated to 60.34% as on March 31, 2021 as against 79.96% as on March 31, 2020. The loan amount under One-Time Restructuring amounted to Rs. 878 crores. The bank has provided Rs. 955 crores as provisions and has Rs. 172 crores in excess provisions. Collection efficiency weakened to ~78% during Jun-21 (March-21: ~94%). CARE Ratings understands that USFB has ramped up its collection efforts and has subsequently not undertaken significant write-offs. Write-offs remained at moderate levels at Rs. 73.8 crores (FY20: Rs. 64.1 crores). This will likely lead to further elevated GNPA levels in the near term with a concurrent rise in credit costs.

Earnings Under Pressure Led by High Provisioning: Profitability was affected by high credit costs, although Pre-Provision Operating Profit (PPOP) increased 27% during FY21 to Rs. 809.3 crores. Albeit decline in cost of funds from 8.14% in FY20 to 6.93% in FY21, bank's Net Interest Margin witnessed decline from 10.16% in FY20 to 8.91% in FY21 owing to decline in yield on advances from 20.75% in FY20 to 18.22% in FY21 with about 77% of disbursements made during H2FY21, hence full extent of interest income is not recognized during the year. Further bank also made interest income reversal of Rs.75 crore during the year. Increase in PPOP was also aided by improvement in Bank's operational efficiency as witnessed with cost to income ratio of the bank declining from 67.42% in FY20 to 60.32% in FY21. However, on account of higher credit cost on account of additional provisioning made by the bank for possible impact in asset quality on account of Covid-19, the bank reported lower profit of Rs.8.3 crore in FY21 as against Rs.349.9 crore in FY20. Going forward, Bank's ability to maintain asset quality limiting credit cost thereby protecting earnings profile would be a key rating monitorable.

Exposure to Inherent Socio-Economic and Geo-Political Risks of The Microfinance Sector: Increase in the non-MFI portfolio has led to a steady reduction in the composition of microfinance loan portfolio. Presently the non-MFI portfolio majorly comprises of housing loan segment (13.5% of the total loan portfolio), loans to MSE segment (8.5% of total loan portfolio) and loans to financial institution (FIG) segments. However, microfinance still comprises a larger share of the loan book at 72% (FY20: 77%) which exposes the bank to the inherent risks associated with the industry. The borrower base remains vulnerable to economic downturns and political events which affects their repayment capacity. CARE Ratings understands that the bank will be eventually able to manage the resultant risk as the growth in the non-MFI portfolio gains traction. However, near term risks will be closely monitored.

Liquidity position: Adequate

According to the bank's structural liquidity statement (SLS) as on March 31, 2021, liquidity profile is comfortable with no cumulative negative mismatches in any of the time buckets. The liquidity coverage ratio of bank remained comfortable at 116.13% for quarter ended March 31, 2021 as against the regulatory requirement of 100%. Moreover, Bank has excess SLR of Rs. 1274 crore as on April 30, 2021 over the regulatory requirements. Liquidity is also supported by the refinance lines available to it from SIDBI & NABARD and through sale of PSL certificate to other banks which are short of PSL targets.

Analytical approach: Standalone

Applicable Criteria

Financial Ratios – Financial Sector
Rating Methodology – Banks
Criteria on assigning 'outlook' and 'credit watch' to Credit Ratings
CARE's Policy on Default Recognition

About the Company

USFB, incorporated on July 04, 2016 is a subsidiary of Ujjivan Financial Services Limited (UFSL). UFSL was a Bangalore based Microfinance Company registered as NBFC-MFI with RBI. It has been in microfinance lending since 2005 and has operated through joint liability group (JLG) model in urban and semi urban areas and target customers who are salaried as well as self-employed women. UFSL was one of the ten entities to be granted "in-principle" approval by Reserve Bank of India (RBI) on September 16, 2015 to set up a bank under the "Guidelines for Licensing of Small Finance Banks in the private sector" (Guidelines) issued by the RBI on November 27, 2014. Subsequently, on November 11, 2016 RBI granted the license to USFB to carry out the banking business in India. Accordingly, USFB formally commenced its operations on February 1, 2017

whereby in line with the terms with Business Transfer Agreement (BTA) effective from February 1, 2017 entered between UFSL and USFB, the entire assets/liabilities of UFSL had been transferred to USFB. As per the listing norms requirement of RBI for SFBs, Bank concluded its IPO process and got listed on NSE and BSE on December 12, 2019. Post IPO, UFSL's shareholding stands at 83.32% in USFB.
As on March 31, 2021, the bank has a branch network of 575 branches and has 491 biometric ATMs. The bank has presence across 24 States and Union Territories of India, and with an overall portfolio of around Rs.15,140 crore as on March 31, 2021.

Brief Financials (Rs. crore)	FY20 (A)	FY21 (A)
Total operating income	3025.81	3116.89
PAT	349.92	8.30
Interest coverage (times)	1.60	1.75
Total Assets	18411.23	20380.45
Net NPA (%)	0.20	2.93
ROTA (%)	2.18	0.04

A: Audited

Status of non-cooperation with previous CRA: Not Applicable
Any other information: Not Applicable
Rating History for last three years: Please refer Annexure-2
Covenants of rated instrument / facility: *Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3*
Complexity level of various instruments rated for this company: Annexure 4

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based-Long Term	-	-	-	Jan 2022	23.19	CARE A+; Stable

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2021-2022	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019
1.	Fund-based - LT-Term Loan	LT	-	-	-	1)Withdrawn (07-Jul-20)	1)CARE A+; Stable (03-Jul-19)	1)CARE A+; Stable (06-Jul-18)
2.	Debentures-Non-Convertible Debentures	LT	-	-	-	-	1)Withdrawn (30-Aug-19) 2)CARE A+; Stable (03-Jul-19)	1)CARE A+; Stable (06-Jul-18)
3.	Debentures-Non-Convertible Debentures	LT	-	-	-	-	-	1)Withdrawn (19-Sep-18) 2)CARE A+; Stable (06-Jul-18)
4.	Fund-based-Long Term	LT	23.19	CARE A+; Stable	-	1)CARE A+; Stable (07-Jul-20)	1)CARE A+; Stable (03-Jul-19)	1)CARE A+; Stable (06-Jul-18)
5.	Debentures-Non-Convertible Debentures	LT	-	-	-	-	1)Withdrawn (03-Jul-19)	1)CARE A+; Stable (06-Jul-18)

Annexure-3: Detailed explanation of covenants of the rated instrument / facilities

Long Term Bank Facilities	Detailed explanation
A. Financial covenants	
I. CAR above 15%	Bank shall always maintain CAR above 15%
II. Tier I CAR above 7.5%	Bank shall always maintain Tier-I CAR above 7.5%

Annexure 4: Complexity level of various instruments rated for this company

Sr. No.	Name of the Instrument	Complexity Level
1.	Fund-based-Long Term	Simple

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

Contact us

Media Contact
Mradul Mishra
Contact no. – +91-22-6754 3573
Email ID – mradul.mishra@careratings.com

Analyst Contact
Ms. Janet Thomas
Contact no.- +91 98331 61236
Email ID- janet.thomas@careratings.com

Mr. Sudhakar Prakasam
Contact no. 044 -2850 1013
Email ID- p.sudhakar@careratings.com

Relationship Contact
Mr. Nitin Dalmia
Contact no.: 080-46625555
Email ID: nitin.dalmia@careratings.com

About CARE Ratings:
CARE Ratings commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

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