Capital Small Finance Bank Limited

March 13, 2023

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Lower Tier II Bonds	25.00	CARE A; Stable	Assigned
Upper Tier II Bonds@	25.00	CARE A-; Stable	Assigned
Upper Tier II Bonds@	15.00	CARE A-; Stable	Reaffirmed; Outlook revised from Positive

Details of instruments/facilities in Annexure-1.

@CARE Ratings Limited (CARE Ratings) has rated the aforesaid Upper Tier II Bonds after taking into consideration their increased sensitivity to Capital Small Finance Bank's (CSFBL) Capital Adequacy Ratio (CAR), capital-raising ability and profitability during the long tenure of the instruments. The rating factors in the additional risk arising due to the existence of the lock-in clause in hybrid instruments. Any delay in payment of interest/principal (as the case may be) following invocation of the lock-in clause, would constitute as an event of default as per CARE Ratings' definition of default and as such these instruments may exhibit a somewhat sharper migration of the rating compared with conventional subordinated debt instruments.

Rationale and key rating drivers

The rating assigned to CSFBL derives strength from the bank's established track record of operations in lending business, experienced management team along with diversified institutional equity investors base. The rating also factors in significant mobilisation of deposits with increasing share of the retail and current account saving account (CASA) deposits and access to diverse funding sources since commencement of operations as small finance bank resulting in comfortable liquidity position of the bank.

The rating, however, continues to be constrained by relatively modest scale, geographic concentration in Punjab and modest capitalisation ratios.

Rating sensitivities: Factors likely to lead to rating actions

Positive factors- Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Improvement in capitalisation and gearing level by way of significant fresh equity infusion.
- Significant growth in the loan book whilst ensuring comfortable credit profile of the overall loan portfolio.
- Improvement in asset quality profile with gross stressed assets remaining below 2% on a sustained basis whilst ensuring controlled credit costs.

Negative factors- Factors that could, individually or collectively, lead to negative rating action/downgrade

- Significant deterioration in asset quality.
- Decline in profitability metrics with return on total assets (ROTA) below 0.5% on a sustained basis.

Analytical approach: Standalone

Outlook: Stable

The stable outlook factors in CARE Ratings' expectation that CSFBL will be able to continue to maintain its asset quality, along with growth in the scale of operations.

Key strengths

Established track record in lending business

CSFBL started in the year 2000 as a local area bank. Since then, it is extending agriculture loans, housing loans and Micro, Small and Medium Enterprise (MSME) loans. In 2016, it was converted to small finance bank, and was the first one to enter in this space with 47 branches.

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

The operations of CSFBL are headed by Sarvjit Singh Samra, who is the Managing Director and CEO of CSFBL. Most of the members of board are founding members, who have been with the bank since its inception.

The assets under management (AUM) of CSFBL stood at ₹5,089 crore as on December 31, 2022, with the company growing at annual compounded annual growth rate (CAGR) of 22% over the past three years. The bank has been able to keep its asset quality under control with gross non-performing assets (GNPA) ratio remaining below 3.00% over the past five years, with minimal write offs.

Good asset quality backed by secured lending

CSFBL predominantly focuses towards extending kisan credit card to mid-sized agriculturalists, other retail asset loans including MSME loans, and housing loans (HL) to the borrowers. The bank's asset quality remained good with GNPA ratio at 2.96% and net NPA (NNPA) at 1.60% as on December 31, 2022. The restructured portfolio also stood small at 2.42% of the total loan portfolio of ₹5,089 crore as on December 31, 2022.

CARE Ratings notes that around 99% of the portfolio is secured, limiting the loss on default. For agri loans, collateral of 200% of the registered value of the land is taken. Going forward too, with improving collection efficiency, CARE Ratings expects GNPA to remain under control.

Low cost of funds with high CASA ratio and rollover rate for term deposits

The bank's liability mix has undergone substantial change with significant deposits (including CDs) being raised post conversion into bank from ₹3,667 crore as on March 31, 2019, to ₹6,700 crore as on December 31, 2022. The bank has been gradually focusing on building its retail deposits book, and consequently, CASA grew by 22% Y-o-Y to ₹2,549 crore as on March 31, 2022, from ₹2,093 crore as on March 31, 2021. Of the total deposits of ₹6,700 crore, 44% was towards CASA and the remaining was towards term deposits (mainly retail term deposits) that constituted the remaining 56%. The CASA ratio of 44% is one of the highest among the small finance bank (SFB) peers. The retail term deposits constituted 97% of the overall term deposits. The rollover rate for term deposits hovered around 90% since the past eight quarters. It stood at 92% as on September 30, 2022.

Due to high share of CASA, cost of funds for the bank was 5.22% as on March 31, 2022, which is one of the lowest among the SFB peers. It further reduced to 5.04% for the nine months ended December 31, 2022.

Moderate, albeit improving profitability

Driven by relatively lower yields and high gearing, the bank's profitability has been moderate, albeit on an improving trend over the last four years. It reported ROTA of 0.51% for FY19, 0.53% for FY20, 0.70% for FY21 and 0.93% for FY22. The bank's net interest margin (NIM) increased slightly from 3.39% in FY21 to 3.77% in FY22 due to low cost of funds. The operating expenses/average assets ratio remained stable at 2.9%, in line with the bank's cost-optimisation measures. Driven by high collection efficiency, credit costs continued to remain low (0.42% of average assets).

In 9MFY23, with further improvement in NIM and lower credit costs, profit after tax (PAT) improved to ₹69.35 crore, which led to ROTA of 1.23% on annualised basis. The bank's ability to control further slippages and improve its profitability will be a key monitorable.

Key weaknesses

Geographical concentration of loan portfolio

The bank has 161 branches spread across 35 districts, 3 states and 2 union territories of the country, namely, Punjab, Haryana, Rajasthan, Delhi, and Chandigarh as on March 31, 2022. However, geographical concentration exists with Punjab alone constituting around 86% of total loan portfolio as on March 31, 2022 as against 88% of the loan portfolio as on March 31, 2021. The bank is reducing geographical concentration post conversion into a small finance bank. The bank recently opened a new branch in Himachal Pradesh. It intends to leverage its branch network to drive greater and deeper penetration in the western and northern states of India, in which it operates, focusing on middle-income individuals and farmers, who have limited or no access to formal banking and finance channels, spanning rural, semi-urban and urban markets.

Relatively smaller in size as compared to other peers

CSFBL predominantly focuses towards extending kisan credit card to mid-sized agriculturalists, other retail asset loans including MSME loans, HL to borrowers. The AUM of CSFBL stood at ₹4,689 crore as on March 31, 2022 (as against ₹3,763 crore on March 31, 2021) with overall 6.5 lakh customers. It further increased to ₹5,089 crore as on December 31, 2022. Agriculture lending continues to be mainstay for the bank with nearly 38% of the AUM of the company as on March 31, 2022, being agriculture loans in the form of kisan credit card and term loan. The average ticket size for agri loans is ₹12 lakh and lending rate is 12%. The share of MSME loans, i.e., secured, and unsecured business loans (MSME – 23.3% of AUM) with average ticket size of ₹18 lakh and lending rate of 10.19%, housing loans (24.07% of AUM) with average ticket size of ₹11 lakh and lending rate of 10.95% and others (14.65% of AUM) with average ticket size of ₹9 lakh and lending rate of 10% as on March 31, 2022, contributes to rest of the gross portfolio.

Modest capitalisation ratios: The capital adequacy of CSFBL was adequate with capital adequacy ratio (CAR) and Tier-I capital being 18.63% and 13.21% as on March 2022 as against 19.80% and 14.27% as on March 2021. CAR further improved to 19% as on December 31, 2022. The CAR of 19% is above the regulatory requirement of 15% for small finance banks. Tangible Net worth of the bank stood at ₹586 crore as on December 31, 2022. CSFBL had filed the Draft Red Herring Prospectus (DRHP) dated October 30, 2021, with SEBI. It then filed addendum to DRHP dated September 12, 2022.

Liquidity: Adequate

As per statement of structural liquidity of CSFBL as on December 31, 2022, the liquidity profile remains comfortable with no cumulative mismatch in any of the time buckets on account of comfortable capital structure. CSFBL has also been maintaining adequate liquidity over and above the regulatory requirement. The liquidity coverage ratio stood at 229% as on December 31, 2022. The bank has also been maintaining excess Statutory Liquidity Ratio (SLR) of around 10%.

Assumptions/Covenants

CRAR should not be below minimum regulatory requirement prescribed by RBI

Applicable criteria

Policy on default recognition
Financial Ratios - Financial Sector
Rating Outlook and Credit Watch
Rating Basel III - Hybrid Capital Instruments issued by Banks
Bank
Policy on Withdrawal of Ratings

About the company and Industry

Industry classification

Macro Economic Indicator	Sector	Industry	Basic Industry
Financial Services	Financial Services	Banks	Other Bank

CSFBL started operations as India's first small finance bank on April 24, 2016, after conversion from Capital Local Area Bank. Prior to conversion to a small finance bank, Capital Local Area Bank was operating as India's largest local area bank since January 14, 2000. The bank transitioned from a local area bank to small finance bank with 47 branches. At present, it has total 161 branches-145 in Punjab, 11 in Haryana, 3 in New Delhi and 2 in Rajasthan. The bank’s focus is on retail segment for both loans and deposits. Retail advances form 72% of the total gross advances, whereas retail deposits form 97% of the total deposits. Average roll over is 90% for term deposits. The target segment is the middle-income group salaried people and farmers for both loans and deposits. Around 99% of the loan portfolio is secured. 70% of its business is in rural and semi-urban areas. Its focus is to be the primary banker of the customer. Sarvjit Singh Samra is the Managing Director (MD) and CEO of CSFBL. He has over 35 years of experience in the banking and financial industry spread over various roles and has been associated with the bank since its inception. He has been instrumental in the conversion of bank from a local area bank to an SFB.

Brief Financials (₹ crore)	March 31, 2021 (A)	March 31, 2022 (A)	9MFY23(UA)
Total operating income	557.28	632.40	531.39
PAT	40.79	62.57	69.35
Interest coverage (times)	1.17	1.26	1.80
Total Assets	6,371.24	7,153.92	7,882.87
Net NPA (%)	1.13	1.36	1.60
ROTA (%)	0.70	0.93	1.23

A: Audited UA: Unaudited Note: 'the above results are latest financial results available'

Status of non-cooperation with previous CRA: Not Applicable
Any other information: Not Applicable
Rating history for the last three years: Please refer Annexure-2

Covenants of the rated instruments/facilities: Detailed explanation of the covenants of the rated instruments/facilities is given in Annexure-3

Complexity level of the various instruments rated: Annexure-4

Lender details: Annexure-5

Annexure-1: Details of instruments/facilities

<table>
<tr><th>Name of the Instrument</th><th>ISIN</th><th>Date of Issuance (DD-MM-YYYY)</th><th>Coupon Rate (%)</th><th>Maturity Date (DD-MM-YYYY)</th><th>Size of the Issue (₹ crore)</th><th>Rating Assigned along with Rating Outlook</th></tr>
<tr><td rowspan="2">Bonds-Upper Tier II Bonds</td><td>INE646H08012</td><td>31-03-2015</td><td>11.75</td><td>31-03-2030</td><td>14.00</td><td rowspan="2">CARE A-; Stable</td></tr>
<tr><td colspan="4">Proposed</td><td>1.00</td></tr>
<tr><td>Bonds-Upper Tier II Bonds</td><td>INE646H08020</td><td>30-03-2016</td><td>11.75</td><td>30-03-2031</td><td>25.00</td><td>CARE A-; Stable</td></tr>
<tr><td rowspan="2">Bonds-Lower Tier II</td><td>INE646H08129</td><td>31-03-2019</td><td>10.00</td><td>31-03-2029</td><td>22.50</td><td rowspan="2">CARE A; Stable</td></tr>
<tr><td colspan="4">Proposed</td><td>2.50</td></tr>
</table>

Annexure-2: Rating history for the last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021	Date(s) and Rating(s) assigned in 2019-2020
1	Bonds-Upper Tier II	LT	15.00	CARE A-; Stable	1)CARE A-; Positive (30-Jan-23)	-	-	-
2	Bonds-Upper Tier II	LT	25.00	CARE A-; Stable				
3	Bonds-Lower Tier II	LT	25.00	CARE A; Stable				

*Long term

Annexure-3: Detailed explanation of the covenants of the rated instruments/facilities : Not Applicable

Annexure-4: Complexity level of the various instruments rated

Sr. No.	Name of the Instrument	Complexity Level
1	Bonds-Lower Tier II	Complex
2	Bonds-Upper Tier II	Highly Complex

Annexure-5: Lender details

To view the lender wise details of bank facilities please click here

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

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About us:
Established in 1993, CARE Ratings is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India, it has been acknowledged as an External Credit Assessment Institution by the RBI. With an equitable position in the Indian capital market, CARE Ratings provides a wide array of credit rating services that help corporates raise capital and enable investors to make informed decisions. With an established track record of rating companies over almost three decades, CARE Ratings follows a robust and transparent rating process that leverages its domain and analytical expertise, backed by the methodologies congruent with the international best practices. CARE Ratings has played a pivotal role in developing bank debt and capital market instruments, including commercial papers, corporate bonds and debentures, and structured credit.

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