ESAF Small Finance Bank Limited

July 04, 2023

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Tier-II Bonds (Basel III)-I	80.00 (Reduced from 125.00)	CARE A; Stable	Reaffirmed; Outlook revised from Negative
Tier-II Bonds (Basel III)-II	300.00	CARE A; Stable	Reaffirmed; Outlook revised from Negative
Certificate Of Deposit	500.00	CARE A1+	Reaffirmed

Details of instruments/facilities in Annexure-1

Tier-II bonds under Basel-III are characterised by a 'point of non-viability' (PONV) trigger due to which the investor may suffer a loss of principal. The PONV will be determined by the Reserve Bank of India (RBI) and is a point at which the bank may no longer remain a going concern on its own unless appropriate measures are taken to revive its operations, and thus, enable it to continue as a going concern. In addition, the difficulties faced by a bank should be such that these are likely to result in financial losses and raising the Common Equity Tier-I capital of the bank should be considered the most appropriate way to prevent the bank from turning nonviable.

Rationale and key rating drivers

The ratings assigned to the debt instruments of ESAF Small Finance Bank Limited (ESAF SFB) continue to factor in the established track record of the bank in the lending business especially in microfinance business, adequate capitalisation levels and adequate liquidity profile. The ratings are, however, constrained by regionally concentrated nature of business, limited diversification in loan portfolio, which mainly consists of micro finance loans. The ratings factors in the improvement in asset quality indicators with improved collections and higher write-offs. Gross stress assets stood at 3.17% as on March 31, 2023, as against 12.48% as on March 31, 2022 with rundown of restructured book. The ratings also take note of improvement in profitability indicators with return on total assets (ROTA) of 1.60% in FY23 as against 0.37% in FY22. The company is in the process of filing draft red herring prospect (DRHP) with Securities and Exchange Board of India (SEBI). Timely mobilisation of equity capital is critical for strengthening the capital adequacy ratio (CAR) levels and absorb increase in the credit cost, if any, due to event risks.

Rating sensitivities

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

- Increase in the scale of operations along with improvement in the capital adequacy levels.
- Improvement in geographical diversification and product diversification.

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

- Fall in overall CAR below 18%.
- Weakening of asset quality performance with stressed assets of above 10% of advances.

Analytical approach: Standalone

Outlook: Stable

The revision in the outlook from negative factors in the improvement in asset quality performance of the bank with significant reduction in stressed assets from 12.48% as on March 31, 2022 to 3.17% as on March 31, 2023. The stable outlook factors in the CARE Ratings' expectation that ESAF SFB will be able to sustain profitability while maintaining adequate capitalisation levels.

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

Detailed description of the key rating drivers

Key strengths

Established track record of bank

ESAF SFB promoted by Mr. K Paul Thomas, who is the promoter of the Kerala-based ESAF group operating in microfinance space from 1995 (ESAF Microfinance started its operations as an NGO as Evangelical Social Action Forum) and set up ESAF Microfinance & investments Pvt. Limited (EMFIL) in 2007. EMFIL subsequently got SFB license and started its banking operations from March 2017 onwards. Mr. K Paul Thomas holds 6.94% stake in ESAF SFB as on March 31, 2023. He has over 34 years of industry experience, of which more than 25 years are in the microfinance sector. He is supported by well-qualified and experienced management team having rich experience in the banking and financial services sector. As on March 31, 2023, the bank's board consisted of nine directors, including seven independent directors who have rich experience in the banking and financial services industry.

Adequate capitalisation levels

With moderate growth of 16% in advances and supported by internal accruals, the total CAR and Tier-I CAR improved to 19.83% and 18.12%, respectively, as on March 31, 2023, as against 18.64% and 16.16%, respectively, as on March 31, 2022, however, the same remains above the regulatory requirements (minimum regulatory requirement of 15% and 7.5%). The bank's tangible net worth (TNW) stood at ₹1,677 crore as on March 31, 2023, as against ₹1,347 crore as on March 31, 2022. CARE Ratings notes that, the bank is in the process of filing DRHP. CARE Ratings expects the CAR levels to remain adequate, as the bank is expected to remain profitable in the medium term with reduction in stressed assets.

Moderate growth in advances in FY23; however, share of MFI loans continues to be high

ESAF SFB's gross advances grew by 16% during FY23 and stood at ₹14,118 crore as on March 31, 2023 (PY: ₹12,130 crore as on March 31, 2022). The bank ventured into non-MFI products like gold loan, loan against property (LAP), business loans, corporate loans, agri loan, etc, however the microfinance loan book continues to remain high at 73% as on March 31, 2023 as against 83% of the advances as on March 31, 2022. Next to MFI loans, gold loans stood at ₹2,054 crore as on March 31, 2023 (13% of AUM). CARE Ratings expects the proportion of MFI loans to remain high in the medium term.

Moderate growth in deposits in FY23

The bank's resource profile majorly consists of deposits (73% of total liabilities as on March 31, 2023) followed by borrowings. The total deposits grew by 14% during FY23 and stood at ₹14,666 crore as on March 31, 2023 as against ₹12,815 crore as on March 31, 2022. In terms of granularity of deposits, 77% of the total deposits stood below the ticket size of ₹1.0 crore as on March 31, 2023. The bank's current account savings account (CASA; as percentage of total deposits) stood at 21.4% as on March 31, 2023, as against 22.8% as on March 31, 2022.

Significant improvement in profitability in FY23

In the last two years ending March 31, 2022, bank's profitability was impacted due to COVID-19-induced pandemic, with higher credit cost, and lower yields; however, with recovery in the economy the profitability witnessed improvement in FY23. During FY23, the bank's total income witnessed growth of 46% and stood at ₹3,142 crore (FY22: ₹2,148 crore) aided by healthy increase in the interest income of 47% and in non-interest income by 39% aided by pick-up in disbursements and recovery from written-off accounts and income from sale of technical write-off accounts to ARC.

Consequently, bank's net interest income (NII) has increased by 60% and stood at ₹1,836 crore (FY22: ₹1,147 crore). The bank's net interest margin (NIM) witnessed improvement to 9.71% in FY23 from 7.66% in FY22. The bank's operational expenses/ average total assets increased to 6.51% in FY23 from 5.76% in FY22. The bank's Pre-Provisioning Operating Profit (PPOP) improved by 82% to ₹894 crore in FY23 from ₹492 crore in FY22. However, on account of higher write-offs, credit cost remained at 2.58% in FY23 as against 2.79% in FY22. The bank reported improvement in profitability with PAT of ₹302 crore in FY23 as against ₹55 crore in FY22. Thus, ROTA improved to 1.60% in FY23 as against 0.37% in FY22. The ability of the bank to limit incremental slippages remains critical to maintaining the earnings profile. CARE Ratings expects the profitability to remain relatively stable with stable asset quality levels.

Key weaknesses

Asset quality witnessed improvement in FY23 although the same continues to remain moderate

The asset quality parameters of the bank improved with gross non-performing assets (GNPA)% and net non-performing assets (NNPA)% at 2.49% and 1.13% as on March 31, 2023 as against 7.83% and 3.92%, respectively, as on March 31, 2022. The improvement in asset quality levels is on account of increased write-offs and sale of NPA to ARC. The bank has written-off ₹495 crore and has sold ₹588 crore of NPA to ARC, further improved collections and reduced slippages resulted in lower NPA levels at the end of FY23. In addition, bank has also sold Technical Written-off accounts aggregating to ₹487 crore to ARC.

Gross stressed assets (GNPA+ Standard Restructured advances) stood at 3.17% as on March 31, 2023, as against 12.48% as on March 31, 2022, due to decline in outstanding restructured advances with rundown in restructured book (0.82% of advances as on March 31, 2023; PY: 6.06%). Net stressed assets/Net worth stood at 14.59% as on March 31, 2023 (71.54% as on March 31, 2021). Furthermore, the bank had also disbursed relief loans to its borrowers who were impacted by COVID-19 pandemic in order to support their income generation capability until June 2022, post which the bank has stopped disbursement. Relief loans outstanding reduced and stood at ₹2,271 crore (16.08% of advances as on March 31, 2023) as against ₹4,197 crore (34.6% of advances as on March 31, 2022) on which the delinquencies are relatively higher compared to the micro banking loan book. CARE Ratings notes that 85% of the relief loan book is non delinquent, and NPA in the corresponding book has reduced during the year. Going forward, the ability of the bank to limit incremental slippages from relief loan portfolio would be critical. At the same time, the bank's loss absorption capacity with adequate pre-provisioning income is satisfactory.

Regional concentration of loan portfolio with improvement in single state concentration

ESAF SFB's AUM continues to remain concentrated in Kerala at 42% as on March 31, 2023 (46% as on March 31, 2022). The top three states constitute 73% of overall portfolio as on March 31, 2023. The bank has its presence in 23 states across 700 branches as on March 31, 2023.

Liquidity: Strong

As per the structural liquidity statement of the bank as on March 31, 2023, the bank does not have negative cumulative mismatches up to one-year time bucket. Also, the liquidity coverage ratio (LCR) stood comfortable at 132.97% as on March 31, 2023. In addition, the bank consistently maintains excess SLR investments which provide cushion to the bank's liquidity profile.

Applicable criteria

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

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About the company and industry

Industry classification

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

ESAF SFB is a Kerala-based small finance bank (SFB), which has commenced its banking operations on March 10, 2017. The bank was promoted by K. Paul Thomas who is a part of the Kerala-based ESAF group operating in microfinance space from 1995. ESAF SFB is currently focused in retail banking business with presence in micro-finance, housing finance, business loans, loan against property (LAP), gold loans and providing financing solutions for marginal customers who lack access to the formal banking and financing channels while providing a comprehensive banking and digital platform for all. The bank received Scheduled status from RBI on December 27, 2018. As on March 31, 2023, ESAF Financial Holdings Private Limited held 62.46% of the shareholding in ESAF SFB, while Paul Thomas holding 6.94%, ESAF Swasraya Multi State Agro Co-operative Society Ltd holding 4.98%, PNB Metlife India Insurance holding 4.75%, Muthoot Finance Ltd holding 4.16%, Bajaj Allianz Life Insurance Company holding 3.89%, PI Ventures holding 1.94%, and ICICI Lombard General Insurance Company holding. As on March 31, 2023, the total deposits of the bank stood at ₹14,666 crore and AUM stood at ₹15,323 crore.

Brief Financials (Rs. crore)	31-03-2022 (A)	31-03-2023(A)
	Ind-AS	Ind-AS
Total operating income	2,148	3,142
PAT	55	302
Interest coverage (times)	1.62	1.88
Total Assets	17,643	20,185
Net NPA (%)	3.92	1.13
ROTA (%)	0.37	1.60

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

Status of non-cooperation with previous CRA: NA

Any other information: NA

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: Annexure-4

Lender details: Annexure-5

Annexure-1: Details of instruments / facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Bonds-Tier II Bonds-I	INE818W08016	30-12-2017	10.50%	30-12-2024	20.00	CARE A; Stable
Bonds-Tier II Bonds-I	INE818W08024	28-03-2018	11.50%	28-03-2025	20.00	CARE A; Stable
Bonds-Tier II Bonds-I	INE818W08032	01-06-2018	11.50%	01-06-2025	40.00	CARE A; Stable

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Bonds-Tier II Bonds-I (Proposed)*	Proposed	-	-	-	-	Withdrawn
Bonds-Tier II Bonds-II	INE818W08081	31-03-2022	11.25%	30-04-2032	20.00	CARE A; Stable
Bonds-Tier II Bonds-II	Proposed	-	-	-	280.00	CARE A; Stable
Certificate Of Deposit	Proposed	-	-	-	500.00	CARE A1+

*Withdrawn at the request of the bank, as bank has not utilised the ratings assigned by CARE for mobilising funds

Annexure-2: Rating history of 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 2023-2024	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
1	Bonds-Tier II Bonds	LT	80.00	CARE A; Stable	-	1)CARE A; Negative (27-Dec-22)	1)CARE A; Negative (07-Jan-22)	1)CARE A; Stable (05-Mar-21)
2	Certificate Of Deposit	ST	500.00	CARE A1+	-	1)CARE A1+ (27-Dec-22)	1)CARE A1+ (07-Jan-22)	1)CARE A1+ (05-Mar-21)
3	Bonds-Tier II Bonds	LT	300.00	CARE A; Stable	-	1)CARE A; Negative (27-Dec-22)	1)CARE A; Negative (25-Feb-22)	-

* Long term / Short term

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

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

Sr. No.	Name of the Instrument	Complexity Level
1	Bonds-Tier II Bonds	Complex
2	Bonds-Tier II Bonds	Simple
3	Certificate Of Deposit	Simple

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.

Contact Us

Media Contact	Analytical Contacts
Name: Mradul Mishra Director **CARE Ratings Limited** Phone: +91-22-6754 3596 E-mail: mradul.mishra@careedge.in **Relationship Contact** Name: Pradeep Kumar V Senior Director **CARE Ratings Limited** Phone: +91-2850-1001 E-mail: pradeep.kumar@careedge.in	Name: P Sudhakar Director **CARE Ratings Limited** Phone: +91-44-2850 1003 E-mail: p.sudhakar@careedge.in Name: Ravi Shankar R Associate Director **CARE Ratings Limited** Phone: +91-44-2850 1016 E-mail: ravi.s@careedge.in Name: Sakshi Arora Lead Analyst **CARE Ratings Limited** E-mail: sakshi.arora@careedge.in

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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