Utkarsh Small Finance Bank (Revised)

September 26, 2023

Facilities/Instruments@	Amount (₹ crore)	Rating[1]	Rating Action
Tier II Bonds	15.00 (Reduced from ₹40.00 crore)*	CARE A+; Stable	Revised from CARE A; Positive

Details of instruments/facilities in Annexure-1.
*Reduced on account of redemption of bonds.

Rationale and key rating drivers

The rating assigned to the bonds of Utkarsh Small Finance Bank Limited (USFBL) factors in improvement in the financial risk profile with improvement in profitability and asset quality parameters which was impacted by Covid-19 induced stress. The bank continues to have comfortable capitalisation levels which have seen further enhancement as the bank has raised equity capital of Rs.500 crore through initial public offer (IPO) during July 2023 which would allow the bank to grow its book.

The rating continues to derive strength from the bank's long track record of operations in microfinance lending, experienced management team for managing the various banking operations, along with its rapidly growing scale of operations. The bank has demonstrated 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.

The rating, continues to be constrained by relatively moderate size as compared to private sector banks, geographic concentration of loan book in Uttar Pradesh and Bihar, significant (though declining) concentration of micro finance lending at 63% of total loan portfolio as on June 30, 2023, lack of diversity in earnings profile, limited track record in non-microfinance lending (MSME, home loans and wheels lending portfolio), and the inherent risk involved in the microfinance segment, including socio-political intervention risk and unsecured lending.

Rating sensitivities: Factors likely to lead to rating actions

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

- Significant increase in scale of operations with sustained improvement in asset quality while maintaining comfortable capitalisation levels
- Sustenance of profitability with return on total assets (ROTA) above 2.25%.
- Diversification in resource profile with continuous improvement in CASA proportion on a sustained basis

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

- Significant weakening of asset quality leading to decline in profitability metrics with ROTA below 0.5% over medium term
- Deterioration in asset quality with GNPA escalating above 4%.

Analytical approach: Standalone

CARE Ratings has considered the standalone business and financial profiles of USFBL and has factored in strong investors profile of its parent entity, Utkarsh CoreInvest Limited (UCL)

Outlook: Stable

The stable outlook is on account of improvement in profitability and comfortable capitalisation levels due to equity raised through IPO which will help the bank to grow its business.

Detailed description of the key rating drivers:

Key strengths

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

Comfortable capitalisation levels further enhanced post IPO of equity shares

USFBL is a subsidiary of Utkarsh CoreInvest Limited (UCL). UCL has a strong investor base with British International Investment, the development financial institution of UK Government, being the key investor besides RBL Bank Limited, NMI Frontier Fund KS, Faering Capital, Responsibility Participations Mauritius, Aavishkaar Goodwell India Microfinance Development Company, International Finance Corporation (IFC), HDFC Life Insurance, ICICI Prudential Life Insurance and Sarva Capital. The operations of USFBL are headed by Mr. Govind Singh, who is the Managing Director and Chief Executive Officer (MD & CEO) of USFBL. He has an experience of over 30 years in the banking and microfinance sector, including having founded Utkarsh Micro Finance Limited (UMFL) in 2009 for carrying out micro lending activities. The bank raised capital of ₹150 crore in FY22 by way of issue of fresh equity shares. The bank reported capital adequacy ratio (CAR) and Tier-I capital being 20.64% and 18.25% as on March 31, 2023, as against CAR of 21.59% and Tier I CAR of 18.08% as on March 31, 2022. During current financial year, the bank has raised equity capital (including share premium) of ₹500 crore (through IPO). With the capital raising through, capitalisation has increased to around 25% giving headroom for growth in loan book. Post the IPO, the shareholding of UCL stood at 69%.

Significant improvement in profitability in FY23 on the back of expansion in net interest margin (NIM) and reduction in credit costs

The bank's profitability metrics have improved significantly during FY23 and Q1FY24 after being under pressure during FY22 on account of significant rise in the credit costs due to effects of the Covid-19 pandemic. The bank saw increase in disbursements from second half of FY23 and the interest income of the bank increased by 35% from ₹1,849 in FY22 to ₹2,505 crore in FY23 while interest expense increased by 24% from ₹788 crore to ₹976 crore demonstrating a growth of 24% in the year FY23. As the bank was able to pass on its interest cost, its net interest margin (NIM) (based on year-end assets) increased to 8.99% for FY23 as compared to 7.84% for FY22. The non-interest income increased by 62% as the bank has been focusing on increasing fee-based income including distribution fees and has been tying up with insurance companies and other partners and recovery from written off accounts. The bank also earned by way of income through sale of priority sector lending certificates (PSLC). Going forward, the bank expects the non-interest income to be driven by fee-based activities.

The operating expenses of the Bank increased by 35% during FY23 primarily on account of significant expansion in franchise (144 new branches during FY23) and increase in employee base from 12,617 as on March 31, 2022, to 15,424 as on March 31, 2023. However, higher growth in income helped the bank's pre-provisioning operating profit (PPOP) increased by 65% year-on-year to ₹838 crore in FY23 as compared to ₹509 crore in FY22. With improvement in asset quality in FY23, the credit cost of the bank also reduced with provisions decreasing by 30% during FY23 from ₹430 crore in FY22 to ₹303 crore in FY23. The bank reported profit after tax (PAT) of ₹405 crore for FY23 as compared to PAT of ₹61 crore in FY22 witnessing a 558% growth in the year FY23 translating into return on total assets (ROTA) of 2.38% in FY23 as compared to 0.45% in FY22 (FY21: 1.04%).

During Q1FY24, the bank continued to see improvement in financial performance and reported PAT of ₹108 crore on total income of ₹812 crore translating into a ROTA of 2.24% in Q1FY24. CARE Ratings expects stabilisation in profitability along with an increase in the scale of operations in the coming quarters.

Sustained scaling up of operations and growth in the loan portfolio

The bank registered a 31% growth in the gross loan portfolio during FY23 to ₹13,957 crore as on March 31, 2023, from ₹10,631 crore as on March 31, 2022. The loan book further increased to ₹14,394 crore as on June 30, 2023. Majority of the portfolio continues to be microfinance loans, though its share is gradually decreasing y-o-y basis from 95% as on March 31, 2017, to 63% (excluding Business Correspondence) as on June 30, 2023. Going forward, while the bank intends to continuously grow microfinance portfolio at healthy pace, other lending verticals (being smaller in size) are expected to grow faster than microfinance business and hence the share of micro finance loans in Bank's overall loan book is expected to reduce further.

Diversified funding mix with scale up of deposits

The bank's liability mix has undergone substantial change with significant deposits (including Certificate of Deposits) being raised post conversion into bank from ₹2,194 crore as on March 31, 2018, to ₹13,710 crore as on March 31, 2023. The bank has been gradually focusing on building its retail deposits book, and consequently, CASA deposits grew by 27% in FY23 from ₹2,253 crore as on March 31, 2022, to ₹2,864 crore as on March 31, 2023. However, the bank's CASA proportion remains relatively lower as compared to its peers in the small finance banking industry. USFBL has also raised refinance loans from NABARD, NHB and SIDBI. During fiscal 2023, the bank mobilised deposits of ₹3,636 crore translating into annual growth of 36% in the total deposits to ₹13,710 crore. The CASA ratio for June 30, 2023, stood at 19% as compared to 22% as on March 31, 2022, due to depositors preferring term deposits on account of higher interest rates. Going forward, the bank is expected to focus on raising CASA deposits which would provide the bank a stable depositor base and reduce cost of funding over the medium term.

Key weaknesses

Geographical and product concentration of loan portfolio

The bank has 830 banking outlets spread across 253 districts and 22 states & 4 union territories (UTs) of the country as on March 31, 2023. Out of these 830 banking outlets, 522 are located in rural and semi-urban areas, validating USFBL's core vision of financial inclusion. The top two states- Bihar and UP, constitute around 57% of loan portfolio on March 31, 2023 as against 61% of the loan portfolio as on March 31, 2022. The geographical concentration is, however, improving with the opening of new branches. In the year FY23, the bank expanded to Goa, Jammu and Kashmir, Puducherry and Meghalaya. Currently, it has presence in 12 states for micro finance portfolio. Diversification in product mix and consequently reduction in micro finance loan book as well as reduction in the geographical concentration would be critical for its credit profile and is a key rating monitorable.

The bank's loan portfolio is currently dominated by relatively riskier unsecured lending towards Micro-Finance lending with its proportion in the total loan portfolio at 63% as on June 30, 2023, although having reduced from 75% as on March 31, 2022. Going forward, while the bank intends to continuously grow microfinance portfolio at healthy pace, other lending verticals (being smaller in size) are expected to grow faster than microfinance business and hence the share of micro finance loans in Bank's overall loan book is expected to reduce further.

Socio-political and regulatory risks inherent in the micro finance industry

Microfinance lending continues to be the key lending segment for the bank forming around 63% of the total loan portfolio as on June 30, 2023. The portfolio continues to be impacted by the inherent risk involved, viz., socio-political intervention risk and the risks emanating from unsecured lending. Also, since the bank is mandated to lend at least 75% of their loan portfolio to priority sectors, bank's exposure to agriculture and allied activities remains high at 45% of total gross loan portfolio and hence the borrower's ability to service the debt remains vulnerable to the vagaries of nature.

Liquidity: Adequate

As per the structural liquidity statement as on June 30, 2023, there are no negative cumulative mismatches for all the time buckets for up to 1 year. The bank also maintained the statutory liquidity ratio (SLR) requirements over and above the mandate requirements throughout their term of operations.

Environment, social, and governance (ESG) risks: USFBL envisions to be a trusted financial institution that creates a financially and socially inclusive environment for its customers through insightful, sustainable, and scalable technology enabled solutions. USFBL believes that its core values of persistence, diligence, responsible and ethical dealings, inclusiveness, and excellence will deliver 'best in class' experience for its valued customers and enable the Bank in achieving its vision. As a part of their ESG policy, the bank undertakes initiatives under themes such as Financial Awareness, Primary education, Health Camps, Health Awareness Programme, Skill development and Vocational Training, Supporting Orphanages and Support to Elderly Care.

Applicable criteria

Policy on default recognition
Factoring Linkages Parent Sub JV Group
Rating Basel III - Hybrid Capital Instruments issued by Banks
Financial Ratios - Financial Sector
Rating Outlook and Credit Watch
Bank

About the company and industry

Industry classification

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

Utkarsh Small Finance Bank Limited (USFBL), based out of Varanasi is a subsidiary of Utkarsh CoreInvest Limited (UCL). The company commenced banking operations on January 23, 2017, upon receipt of license from RBI on November 25, 2016, and subsequent transfer of business from UCL, which was carrying on the micro lending operations since September 2009. USFBL extends microfinance loans based on the joint-liability group (JLG) model to individuals, which constitute nearly 66% of the gross loan portfolio of the company as on March 31, 2023. The bank also extends wholesale loans, MSME loans and housing loans to the borrowers. USFBL provides microfinance loans through Business Correspondence activities as well. Gross loan portfolio of USFBL stood at ₹14,394 crore as on June 30, 2023. The operations of the bank are currently spread across 22 states & 4 UTs.

USFBL Financials

Brief Financials (₹ crore)	31-03-2021 (A)	31-03-2022 (A)	31-03-2023 (A)	30-06-2023 (UA)
Total income	1,706	2,034	2,804	812
PAT	112	61	405	108
Total assets	12,080	14,971	19,030	19,308
Net NPA (%)	1.33	2.31	0.39	0.33
ROTA (%)	1.04	0.45	2.38	2.24

A: Audited UA: Unaudited; Note: 'the above results are latest financial results available'
All calculations are as per CARE Ratings

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: Annexure-4

Lender details: Annexure-5

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance (DD-MM-YYYY)	Coupon Rate (%)	Maturity Date (DD-MM-YYYY)	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Bonds-Tier II Bonds	INE735W08020	31-Aug-2018	10.58%	30-Aug-2025	15.00	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 (₹ 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	Fund-based - LT-Term Loan*	LT	-	-	-	-	-	1)Withdrawn (22-Dec-20)

2	Debentures-Non Convertible Debentures	LT	-	-	-	-	-	1)Withdrawn (22-Dec-20)
3	Bonds-Tier II Bonds	LT	-	-	-	1)Withdrawn (29-Sep-22)	1)CARE A; Stable (20-Dec-21)	1)CARE A; Stable (22-Dec-20)
4	Debentures-Non Convertible Debentures	LT	-	-	-	-	-	1)Withdrawn (22-Dec-20)
5	Debentures-Non Convertible Debentures	LT	-	-	-	-	-	1)Withdrawn (22-Dec-20)
6	Debentures-Non Convertible Debentures	LT	-	-	-	-	-	1)Withdrawn (22-Dec-20)
7	Bonds-Tier II Bonds	LT	15.00	CARE A+; Stable	-	1)CARE A; Positive (29-Sep-22)	1)CARE A; Stable (20-Dec-21)	1)CARE A; Stable (22-Dec-20)

*LT-Long Term

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

Annexure-4: Complexity level of various instruments rated

Sr No	Name of the Instrument	Complexity Level
1	Bonds	Simple

Annexure-5: Lender details

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

Note on 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
Mradul Mishra Director **CARE Ratings Limited** Phone: +91-22-6754 3596 E-mail: mradul.mishra@careedge.in	Sudhakar Prakasam Director **CARE Ratings Limited** Phone: +91-044-2850 1003 E-mail: p.sudhakar@careedge.in
Relationship Contact Aakash Jain Director **CARE Ratings Limited** Phone: +91-020-4000 9001 E-mail: aakash.jain@careedge.in	Aditya R Acharekar Associate Director **CARE Ratings Limited** Phone: +91-022-6754 3528 E-mail: aditya.acharekar@careedge.in Raghav Bansal Rating Analyst **CARE Ratings Limited** Phone: +91-022-6754 1607 E-mail: raghav.bansal@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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