Ujjivan Small Finance Bank Limited

January 03, 2024

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long Term Bank Facilities	500.00	CARE AA-; Stable	Revised from CARE A+; Positive
Subordinated Non-Convertible Debentures	500.00	CARE AA-; Stable	Revised from CARE A+; Positive

Details of instruments/facilities in Annexure-1

Rationale and key rating drivers

The revision in the ratings assigned to the bank facilities and debt instruments of Ujjivan Small Finance Bank Limited (USFB) factors in the sustenance of improved profitability, good growth in business over last few years, wherein advances have seen significant growth and comfortable capitalisation levels with bank raising capital regularly including the recent equity infusion ₹475 crore in FY23. The bank witnessed healthy profitability in all quarters of FY23, which continued in both quarters of H1FY24. The bank reported PAT of ₹324 crore in Q1FY24 and ₹328 crore in Q2FY24. During H1FY24 (refers to the period April 01 to September 30), bank reported ROTA of 3.6% as against 3.8% in FY23 (refers to the period April 01 to March 31). Total CAR stood at 25.19% as on September 30, 2023 as against 25.81% as on March 31, 2023. The total business witnessed 14% growth in H1FY24 to ₹53,464 crore as on September 30, 2023 as against ₹46,827 crore as on March 31, 2023 with advances and deposits grow by 14% each in H1FY24. The ratings continue to derive strength from the long track record of operations with seasoned management, improving resource profile of the bank with improvement in deposit franchise and the geographically well-diversified loan portfolio.

The rating also takes note of the improvement in the asset quality of the bank, with a decline in the overall stressed asset portfolio and a resultant improvement in the profitability indicators. The gross non-performing assets (GNPA) and net non-performing assets (NNPA) ratios improved from 7.34% and 0.61% as on March 31, 2022, to 2.88% and 0.04% as on March 31, 2023, and further to 2.35% and 0.09% as on September 30, 2023.

The rating continues to remain constrained by the lack of diversity in income profile with the unsecured micro-banking-joint liability group (JLG) segment continuing to constitute 57% of the loan portfolio as on September 30, 2023. In addition, individual loans under micro-banking stood at 15% as on September 30, 2023. The rating also remains constrained due to the exposure to the inherent risk associated with the marginal borrower profile of customers, with the majority of USFB's customers being from the economically-weaker section (EWS) and low-income group (LIG) segments. While the bank has been able to improve its deposit base in recent years, the current account savings account (CASA) ratio continues to be relatively moderate with a CASA of 24% as on September 30, 2023 (26% as on March 31, 2023).

Rating sensitivities : Factors likely to lead to rating actions

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

- Scale up of the total business along with diversification into a secured asset class comprising 50% of portfolio.
- Continuous improvement in the CASA proportion on a sustained basis.

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

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

- Significant deterioration in the profitability with ROTA below 1%.
- Material deterioration in the asset quality.
- Decline in the total CAR below 18%.

Analytical approach: Standalone

Outlook: Stable

The stable outlook reflects the likely continuation of steady growth in advances with comfortable capitalisation levels and healthy profitability levels while maintaining stable asset quality.

Detailed description of the key rating drivers

Key strengths

Established track record of the bank

USFB, incorporated in 2016, is a subsidiary of Ujjivan Financial Services Limited (UFSL). UFSL was a Bengaluru-based microfinance company registered as a non-banking financial company-microfinance institution (NBFC-MFI) with the Reserve Bank of India (RBI). The entity has a long track record in the microfinance segment since 2005. Subsequently, the RBI granted the license to carry out the banking business. USFB commenced operations in 2017. The present senior management team of USFB is highly experienced in the financial sector. Ittira Davis is the current Managing Director (MD) and Chief Executive Officer (CEO), who has an experience of over 40 years in the banking industry. USFB's board comprises eight directors, which includes the MD, a non-executive director, and six independent directors with diverse experience, who bring valuable expertise to the bank. The bank's operations are ably supported by the senior management team.

Comfortable capitalisation levels

On account of the losses reported and loan book growth of 20% in FY22, USFB's CAR% and Tier-I CAR witnessed moderation from 26.44% and 25.06%, respectively, as on March 31, 2021, to 18.99% and 17.70%, respectively, as on March 31, 2022, however, the bank's CAR and Tier-I CAR witnessed improvement on account of the equity raised by the bank aggregating to ₹475 crore in H1FY23 by way of QIP and was further aided by healthy profits reported by the bank in FY23. Additionally, the bank had also raised subordinated debt (Tier-II bonds) of ₹300 crore, which had shored up its capital levels and has remained comfortably above the regulatory requirements with the CAR at 25.81% and Tier-I CAR at 22.68% as on March 31, 2023. Supported by strong internal accruals, capital adequacy continues to remain comfortable with Total CAR and Tier-I CAR at 25.19% and 22.50% as on September 30, 2023 despite the growth in advances of 14% during H1FY24. CARE Ratings Limited (CARE Ratings) expects the CAR levels to remain comfortable and is expected to support the growth over the medium term.

Improved deposit funding, however, CASA remains moderate

Deposits as a percentage of the total liabilities has increased to 87.7% as on March 31, 2023 (FY22: 87.9% and FY21: 76.5%) and remains at 86% as on September 30, 2023. The term loans from the RBI and financial institutions formed the remaining portion of the resource profile. The granularity of the deposit base too reflected an improvement, with retail deposits constituting 66% of the total deposits as on March 31, 2023 and 65% as on September 30, 2023

However, the low-cost CASA deposits remain relatively moderate at 26.4% as on March 31, 2023, and further witnessed moderation to 24.1% as on September 30, 2023. Thus, an improvement in the CASA proportion on a sustained basis along with an improvement in the quality of the CASA will be key rating monitorable.

Geographically well-diversified loan portfolio

USFB has full-fledged banking branches of 629 as on March 31, 2023 and 700 as on September 30, 2023. The bank's advances witnessed a growth of 31% during FY23 from ₹16,303 crore as on March 31, 2022, to ₹21,290 crore as on March 31, 2023 and further 14% growth in H1FY24 to ₹24,325 crore as on September 30, 2023, spread across 26 states and Union Territories (UTs) with an active customer base of 79 lakh. The top five states of Karnataka, West Bengal, Tamil Nadu, Maharashtra, and Gujarat contributed to 57.9% of the overall portfolio as on March 31, 2023 (60.3% of the overall portfolio as on March 31, 2022) and 57.0% of overall portfolio as on September 30, 2023, with the top state Tamil Nadu contributing to 15.5% of the loan portfolio as on March 31, 2023 (PY: 15.5% as on March 31, 2022) and 14.6% as on September 30, 2023. CARE Ratings expects the geographical diversification of advances to continue in the medium term.

Significant improvement in profitability in FY23 and profitability sustained in H1FY24

The bank's profitability was impacted in FY21 and FY22, with interest reversals due to higher slippages on account of the COVID-19-induced pandemic, which resulted in higher credit costs. However, with an improvement in collections, reduced slippages and improved recoveries, the profitability witnessed improvement in FY23. The NIM improved during FY23 to 9.5% from 8.1% in FY22, supported by improved yields. The operating expenses/average total assets declined to 6.3% in FY23 from 6.8% in FY22. The cost-to-income witnessed an improvement to 54.8% in FY23 from 71.7% in FY22.

Thus, the bank reported a pre-provision operating profit (PPOP) of ₹1,485 crore in FY23 as against ₹637 crore in FY22. The credit cost reduced significantly to 0.1% in FY23 from 5.4% in FY22. Thus, the bank reported a PAT of ₹1,100 crore in FY23 as against a loss of ₹415 crore in FY22. The bank reported ROTA of 3.9% in FY23.

During H1FY24, NIM witnessed moderation to 8.9% on account of increase in cost of funds. Operating expenses/average total assets declined to 5.8% and the cost-to-income witnessed an improvement to 52.5% in H1FY24. The bank reported PPOP of ₹941 crore in H1FY24. The credit cost witnessed moderation to 0.4% in H1FY24, however, the bank reported stable ROTA of 3.6% in H1FY24. CARE Ratings expects the profitability to remain stable over the medium term.

Healthy asset quality marked by low net stressed asset position with the bank maintaining a high provision coverage ratio (PCR)

The asset quality performance was impacted by the COVID-19-led pandemic, with the GNPA peaking at 11.80% as on September 30, 2021, from 7.07% on March 31, 2021. USFB had ramped up its collection efforts and the collections witnessed improvement from the month of July 2021 and has remained above 100% (including arrears). Consequently, the GNPA levels have witnessed an improvement to 7.34% as on March 31, 2022, and further to 2.88% as on March 31, 2023, aided by lower slippages, better recovery, and write-offs during FY23. The bank has written off loans aggregating to ₹483 crore in FY23 (PY: ₹789 crore). GNPA continues to improve and stood at 2.35% as on September 30, 2023. Additionally, the bank continues to make aggressive provisioning for the NPAs, thus the net NPA remains low at 0.04% as on March 31, 2023 (March 31, 2022: 0.61%) and remains stable at 0.09% as on September 30, 2023. The bank's PCR stood high at 98% as on March 31, 2023 (PY: 92%) and 96% as on September 30, 2023

Furthermore, with a rundown of restructured advances, the gross stressed assets (GNPA + Standard restructured advances) also declined to 3.17% as on March 31, 2023, as against 10.06% as on March 31, 2022. Gross stressed assets improved further and stood at 2.5% as on September 30, 2023. The total amount of standard restructured accounts outstanding stood at ₹65 crore (0.30% of the gross advances (Excluding IBPC/Securitisation) as on March 31, 2023, and at ₹39 crore as on September 30, 2023 (0.16% as on of gross advances (Excluding IBPC/Securitisation) as on September 30, 2023. The net stressed assets as a percentage of the net worth stood low at 1.60% as on March 31, 2023, as against 18.82% as on March 31, 2022 and continues to remain low at 0.46% as on September 30, 2023. However, higher delinquencies were also witnessed in the non-

MFI portfolio like mid-size enterprise (MSE) and vehicle loan with 90+DPD of 8.80% and 6.20%, respectively, as on March 31, 2023 (11.09% and 7.09%, respectively, as on March 31, 2022). 90+ DPD for MSE and Vehicle loans stood at 9.29% and 4.93% respectively as on September 30, 2023. CARE Ratings expects the asset quality to remain stable over the medium term.

Key weaknesses

Exposure to inherent socio-economic and geo-political risks of the microfinance sector

The share of micro-banking loans continues to form a larger share of the loan book at 72% with group loans (GL): 57% and individual loans (IL): 15% as on September 30, 2023, which exposes the bank to the inherent risks associated with the industry. The share of the borrower base remains vulnerable to economic downturns and political events, which affects their repayment capacity. The bank, over the years, has diversified its non-MFI portfolio, leading to a steady reduction in the composition of the microfinance loan portfolio. Whilst the overall share of microbanking continues to be at 72% as on September 30, 2023 and March 31, 2023, CARE Ratings notes that there is decline in proportion of group loans from 59% as on March 31, 2023 to 57% as on September 30, 2023 and increase in individuals loans from 13% as on March 31, 2023 to 15% as on September 30, 2023.

At present, the non-micro-banking portfolio mainly comprises the housing loan segment (14% of the total loan portfolio), loans to the MSE segment (7% of the total loan portfolio) and loans to the financial institution group (FIG) segments (5%) as on March 31, 2023. As on September 30, 2023, housing loan segment comprised 15% of total loan portfolio, loans to MSE segment comprised 5% and loans to FIG comprised 5% of total loan portfolio. However, 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.

Liquidity: Adequate

The liquidity profile of the bank stood comfortable, with no negative cumulative mismatches up to one year as per the ALM statement as on September 30, 2023. USFB's liquidity coverage ratio remained comfortable at 186% as on September 30, 2023, against the minimum regulatory requirement of 100%. USFB had excess statutory liquidity ratio (SLR) investments of ₹2,559 crore as on September 30, 2023 (11% of the NDTL requirement).

Environment, social, and governance (ESG) risks

With sustainability factoring to be a crucial aspect, the bank expects to expand the scope towards ESG, starting from banking products and services, operations and to all stakeholders. The ESG aspects are an integral part of the bank's core principles. Initiatives towards optimal resource utilisation in the bank's operations and digitalisation of its products and services are some of the key focus areas of the bank with respect to environment parameters. The bank follows responsible business practices during the procurement of goods, such as energy-efficient appliances across their offices, branches and ATMs pan-India.

USFB focusses on social uplifting of the people who aspire in the lower middle class and in the middle-class ladder. The bank focuses on improving customer satisfaction by providing seamless banking experience, doorstep services, benefits, financial literacy, etc. The bank carries out corporate social responsibility (CSR) activities to help in the progress of society, in terms of educational support, basic infrastructure facilities (water, sanitation and medical) and financial literacy. A defined policy, procedure and governance is established for safeguarding the risk. The bank has a comprehensive ERM framework along with environment and social risks integrated in risk assessment process and has protocols and governance mechanisms established across for the identified risks.

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

About the company and industry

Industry classification

Macro-economic Indicator	Sector	Industry	Basic Industry
Financial services	Financial Services	Banks	Other bank

USFB, incorporated on July 04, 2016, is a subsidiary of UFSL. UFSL was a Bengaluru-based microfinance company registered as an NBFC-MFI with the RBI. It has been involved in microfinance lending since 2005 and has operated through the JLGmodel in urban and semi urban areas and targets customers who are salaried as well as self-employed women. UFSL was one of the 10 entities to be granted 'in-principle' approval by the 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, the 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 of the Business Transfer Agreement (BTA) effective from February 1, 2017, entered between UFSL and USFB, the entire assets and liabilities of UFSL had been transferred to USFB. As per the listing norms requirement of RBI for small finance banks (SFBs), the bank concluded its initial public offering (IPO) process and got listed on the National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) on December 12, 2019. Post the IPO, UFSL's shareholding stands at 83.32% in USFB. The bank is currently in the process of reverse merger, and accordingly, USFL diluted its shareholding in USFB by way of QIP and had raised fresh equity of ₹475 crore on September 14, 2022, to meet the minimum public shareholding criteria of 25%. Post the QIP, USFL's shareholding stood at 73.7% as on March 31, 2023 and September 30, 2023
As on September 30, 2023, the bank has a branch network of 700 branches and has 554 biometric ATMs. The bank has a presence across 26 states and UTs in India and with an overall advance of around ₹26,575 crore as on September 30, 2023 (March 31, 2023: ₹24,085 crore), primarily spread across the micro-banking segment (GL: 57% and IL: 15%), retail housing (15%), MSE loan (5%), FIG (5%), and others (2%).

Brief Financials (₹ crore)	March 31, 2022 (A)	March 31, 2023(A)	September 30, 2023 (UA)
Total operating income	3,173	4,754	3,044
PAT	(415)	1,100	652
Total Assets	23,612	33,317	38,680
Net NPA (%)	0.61	0.04	0.09
ROTA (%)	NM	3.86	3.6

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

Status of non-cooperation with previous CRA: NA

Any other information: NA

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

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Fund-based-Long term	-	-	-	March 2025	500.00	CARE AA-; Stable
Debentures-Non - convertible debentures	INE551W08013	26-08-2022	11.95%	26-04-2028	300.00	CARE AA-; Stable
Debentures-Non - convertible debentures	Proposed	-	-	-	200.00	CARE AA-; Stable

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 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 (07-Jul-20)
2	Fund-based-Long term	LT	500.00	CARE AA-; Stable	1)CARE A+; Positive (03-Aug-23)	1)CARE A+; Stable (05-Jan-23) 2)CARE A+; Stable (05-Jul-22) 3)CARE A+; Stable (01-Apr-22)	1)CARE A+; Stable (05-Aug-21)	1)CARE A+; Stable (07-Jul-20)
3	Debentures-Non-convertible debentures	LT	500.00	CARE AA-; Stable	1)CARE A+; Positive (03-Aug-23)	1)CARE A+; Stable (05-Jan-23) 2)CARE A+; Stable (05-Jul-22)	-	-

*Long term/Short term.

Annexure-3: Detailed explanation of the 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	Debentures-Non-convertible debentures	Complex
2	Fund-based-Long term	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.

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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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