ESAF Small Finance Bank Limited

February 22, 2024

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Tier-II bonds (Basel III)-I	80.00	CARE A; Stable	Reaffirmed
Tier-II bonds (Basel III)-II	20.00 (Reduced from 150.00)	CARE A; Stable	Reaffirmed
Lower Tier-II bonds (Basel II)-I	150.00	CARE A; Stable	Reaffirmed
Lower Tier-II bonds (Basel II)-II	130.00	CARE A; Stable	Assigned
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. 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, difficulties faced by a bank should be such that these are likely to result in financial losses, and raising bank's Common Equity Tier-I capital should be considered the most appropriate way to prevent the bank from turning nonviable.

Rationale and key rating drivers

Ratings assigned to debt instruments of ESAF Small Finance Bank Limited (ESAF SFB) continue to factor in bank's established track record in lending business, especially in microfinance business, adequate capitalisation levels and adequate liquidity. However, ratings are constrained by regionally concentrated nature of business, limited diversification in loan portfolio, which mainly consists of micro finance loans. Ratings factor in the improvement in asset quality indicators with improved collections and higher write-offs. Gross stressed assets stood at 3.68% as on March 31, 2023, as against 12.48% as on March 31, 2022, with rundown of restructured book.

Ratings also consider improvement in profitability indicators with return on total assets (ROTA) of 1.60% in FY23 as against 0.37% in FY22, which further improved to 2.29% (annualised) in 9MFY24.

Rating sensitivities: Factors likely to lead to rating actions

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 7% of advances.

Analytical approach: Standalone

Outlook: Stable

The 'Stable' outlook factors in CARE Ratings' expectation that ESAF SFB will be able to sustain profitability while maintaining adequate capitalisation levels.

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

Established track record of bank

ESAF SFB is promoted by K Paul Thomas, who is the promoter of the Kerala-based ESAF group operating in microfinance space since 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 small finance bank (SFB) license and started its banking operations from March 2017 onwards. K Paul Thomas holds 6.06% stake in ESAF SFB as on December 31, 2023. He has over 34 years of industry experience, of which more than 25 years are in microfinance sector. He is supported by well-qualified and experienced management team having rich experience in banking and financial services sector. As on December 31, 2023, the bank's board consisted of 10 directors, including five independent directors, two nominee directors and one non-executive director, having rich experience in banking and financial services industry.

Adequate capitalisation levels

With moderate growth of 16% in advances and supported by internal accruals, 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 regulatory requirements (minimum regulatory requirement of 15% and 7.5%). With completion of the initial public offer (IPO) process, the bank raised ₹390.7 crore through fresh issue of shares, thus, total CRAR and Tier-I CAR stood at 21.0% and 18.9% as on December 31, 2023.

CARE Ratings expects CAR levels to remain adequate, as the bank is expected to remain profitable in the medium term.

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

ESAF SFB's gross advances grew by 16% in 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, and agriculture loan, among others. However, microfinance loan book continues to remain high at 73% as on March 31, 2023, as against 83% as on March 31, 2022. Next to MFI loans, gold loans stood at ₹2,054 crore as on March 31, 2023 (13% of assets under management [AUM]).

Gross advances witnessed 21% growth during 9MFY24 and stood at ₹17,153 crore as on December 31, 2023 as against ₹14,118 crore as on March 31, 2023. Microfinance loan book continues to remain high at 70% as on December 31, 2023. Next to MFI loans, gold loans stood at ₹2,514 crore (15% of advances) as on December 31, 2023. CARE Ratings expects the proportion of MFI loans to remain high in the medium term.

Moderate growth in deposits in FY23

Bank's resource profile majorly consists of deposits (73% of total liabilities as on March 31, 2023) followed by borrowings. 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, which further improved by 29% during 9MFY24 and stood at ₹18,860 crore. In terms of granularity of deposits, 78% of total term deposits stood below the ticket size of ₹1.0 crore as on December 31, 2023. Bank's current account savings account (CASA; as percentage of total deposits) stood at 18.9% as on December 31, 2023, which has witnessed decline from 21.4% as on March 31, 2023 (PY: 22.8% as on March 31, 2022).

Significant improvement in profitability in FY23

In 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 Asset Reconstruction Company(ARC).

Consequently, bank's net interest income (NII) increased by 60% and stood at ₹1,836 crore (FY22: ₹1,147 crore). 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. Bank's pre-provisioning operating profit (PPOP) improved by 82% to ₹894 crore in FY23 from ₹492 crore in FY22. However, due to higher write-offs, credit cost remained at 2.58% in FY23 as against 2.79% in FY22. Bank reported improvement in profitability with profit-after-tax (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.

During 9MFY24, ESAF reported PAT of ₹382 crore in 9MFY24 and ROTA of 2.29% (annualised). 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.

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. Improvement in asset quality levels is on account of increased write-offs and sale of NPA to ARC. 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 end of FY23. In addition, bank has also sold technical written-off accounts aggregating to ₹487 crore to ARC. During 9MFY24, with higher slippages, GNPA and NNPA witnessed moderation and stood at 4.15% and 2.19%, respectively, as on December 31, 2023, as against 2.5% and 1.1% as on March 31, 2023. The bank has written-off ₹201 crore during 9MFY24.

Gross stressed assets (GNPA + Standard Restructured advances + SR) stood at 3.68% 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). As on December 31, 2023, gross stressed assets stood at 4.69% and net stressed assets/net worth stood at 19.57%. 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), which has reduced further and stood at ₹1,043 crore as on December 31, 2023 (corresponding to 6.08% of advances) on which the delinquencies are relatively higher compared to the micro banking loan book. Going forward, bank's ability 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 39% as on December 31, 2023, as against 42% as on March 31, 2023 (46% as on March 31, 2022). Top three states constitute 73% of overall portfolio as on March 31, 2023 and December 31, 2023. Bank has its presence in 21 states and 2 UTs across 731 branches as on December 31, 2023.

Liquidity: Adequate

As per bank's structural liquidity statement as on December 31, 2023, it does not have negative cumulative mismatches up to one-year time bucket. Also, liquidity coverage ratio (LCR) stood comfortable at 148% as on December 31, 2023. In addition, bank consistently maintains excess SLR investments which provide cushion to bank's liquidity.

Environment, social, and governance (ESG) risks:

ESAF SFB provides financial access to the unbanked and rural population. With a focus on financial inclusion, bank aims to reach more rural geographies and extend financial deepening through customised products and services. Bank has adopted a CSR Policy which contributes an average of up to 5% of the bank's total net profit in the last three fiscal years to carry out social initiatives. Bank recognises the importance of being socially responsible and contributing to the upliftment of the poor, marginalised and needy segments of the society. Given the nature of bank's business, the consumption of resources is limited. With the Green Protocol, Environment Policy and ESG Policy in place, the bank makes the best effort to procure energy-efficient products. Greater adoption of digital platforms has brought in increased efficiencies of operations and additionally ensures substantially reduced dependency on paper. In FY22-23, the bank adopted an E-Signature process for disbursing micro loans.

Applicable criteria

Definition of Default
Rating Outlook and Rating Watch
Bank
Financial Ratios - Financial Sector
Withdrawal Policy
Rating Basel III - Hybrid Capital Instruments issued by Banks
Short Term Instruments

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 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, 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 Reserve bank of India (RBI) on December 27, 2018. The bank completed the IPO in November 2023 and raised ₹390.70 crore through fresh issue of shares. As on December 31, 2023, ESAF Financial Holdings Private Limited held 52.94% of the shareholding in ESAF SFB, while Paul Thomas held 6.06%, ESAF Swasraya Multi State Agro Co-operative Society Ltd held 4.35%, PNB Metlife India Insurance held 3.74%, Muthoot Finance Ltd held 3.64%, Bajaj Allianz Life Insurance Company held 3.06%, PI Ventures held 1.70%, ICICI Lombard General Insurance Company held 1.21% and others (including NRI, FPI, etc.) stood at 23.3%. As on December 31, 2023, bank's total deposits stood at ₹18,860 crore and gross advances stood at ₹ 17,153 crore.

Brief Financials (₹ crore)	31-03-2022 (A)	31-03-2023(A)	31-12-2023(UA)
Total operating income	2,148	3,142	3,108
PAT	55	302	382
Total assets	17,643	20,185	24,300
Net NPA (%)	3.92	1.13	2.19
ROTA (%)	0.37	1.60	2.29

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 to 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
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*	-	-	-	-	Withdrawn
Bonds-Lower Tier-II Bonds-I	INE818W08099	04-09-2023	11.25%	04-05-2029	85.00	CARE A; Stable
Bonds-Lower Tier-II Bonds-I	Proposed	-	-	-	65.00	CARE A; Stable
Bonds-Lower Tier-II Bonds-II	Proposed	-	-	-	130.00	CARE A; Stable
Certificate of deposit	Proposed	-	-	-	500.00	CARE A1+

*Withdrawn at bank's request, as bank has not utilised the ratings assigned by CARE Ratings 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; Stable (01-Aug-23) 2)CARE A; Stable (04-Jul-23)	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+ (01-Aug-23) 2)CARE A1+ (04-Jul-23)	1)CARE A1+ (27-Dec-22)	1)CARE A1+ (07-Jan-22)	1)CARE A1+ (05-Mar-21)
3	Bonds-Tier-II bonds	LT	20.00	CARE A; Stable	1)CARE A; Stable (01-Aug-23) 2)CARE A; Stable (04-Jul-23)	1)CARE A; Negative (27-Dec-22)	1)CARE A; Negative (25-Feb-22)	-
4	Bonds-Lower Tier-II	LT	150.00	CARE A; Stable	1)CARE A; Stable (01-Aug-23)	-	-	-
5	Bonds-Lower Tier-II	LT	130.00	CARE A; Stable				

LT- Long term / ST- Short term

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

Annexure-4: Complexity level of various instruments rated

Sr. No.	Name of the Instrument	Complexity Level
1	Bonds-Lower Tier-II	Simple
2	Bonds-Tier-II bonds	Complex
3	Bonds-Tier-II bonds	Simple
4	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:
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