Capital Small Finance Bank Limited (Revised)

March 12, 2024

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Lower Tier-II Bonds	25.00	CARE A; Stable	Reaffirmed
Upper Tier II Bonds#	25.00	CARE A-; Stable	Reaffirmed
Upper Tier II Bonds#	15.00	CARE A-; Stable	Reaffirmed

Details of instruments 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 reaffirmation of the ratings assigned to the debt instruments of Capital Small Finance Bank Limited (CSFBL) derive strength from the bank's established track record of operations in lending business, robust liability franchise with stable Current Account Savings Account (CASA) deposits and experienced management team. The rating also factors in the strengthened capital base post the equity capital raised in February 2024 through initial public offer (IPO) of equity shares and access to diverse funding sources since commencement of operations as small finance bank resulting in comfortable liquidity position of the bank.

The ratings are constrained due to relatively smaller scale and high geographic concentration in the state of Punjab.

Rating sensitivities: Factors likely to lead to rating actions

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

- Significant increase in size of operations along with geographical diversification of the loan book and comfortable credit profile of the overall loan portfolio.
- Improvement in asset quality profile with gross stressed assets remaining below 2% of advances on a sustained basis whilst ensuring controlled credit costs.

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

- Significant deterioration in asset quality with Net NPA ratio exceeding 3% on sustained basis.
- Decline in profitability metrics with return on total assets (ROTA) below 0.5% on a sustained basis.

Analytical approach: Standalone

CARE Ratings Limited (CARE Ratings) has considered the standalone business and financial profile of CSFBL

Outlook: Stable

The stable outlook is on account of CARE Ratings' expectations of stable growth in the bank's advances over the next few years supported by comfortable capitalisation levels augmented by recent fresh equity infusion with stable profitability and asset quality parameters.

[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 in lending business and experienced management team

CSFBL started in the year 2000 as a local area bank (LAB). Since then, it is extending agriculture loans, housing loans and Micro, Small and Medium Enterprise (MSME) loans to middle income individuals. In 2016, it was converted to an SFB and was the first one to enter this space with 47 branches. Since then, the bank has grown its branch network steadily to 175 branches as on December 31, 2023, spread across 4 states and 2 UTs in northern India.

The operations of CSFBL are headed by Mr. Sarvjit Singh Samra, who is the promoter and Managing Director and CEO (MD & CEO) of CSFBL who along with promoter group held 18% stake as on February 14, 2024.

The Bank has an experienced and well diversified board of directors. The bank has a team of experienced professionals handling several functions of the bank. Most of the members of the senior management team are the founding members, who have been with the bank since its inception.

The advances book of the bank has demonstrated a CAGR of 20% over FY19-FY23 and stood at ₹5,634 crore as on December 31, 2023. CARE Ratings expects the bank to grow its advances with higher penetration in the existing states as well as expansion in other states.

Good asset quality backed by secured lending

CSFBL predominantly focuses on agriculturalists including kisan credit card (KCC) loans, MSME loans, and mortgage loans to middle income groups with minimal focus on microlending. More than 99% of the bank's advances are secured due to which the bank has been able to keep its asset quality under control with gross non-performing assets (GNPA) ratio remaining below 3% over the last five years, with minimal write-offs.

The bank's asset quality parameters have remained good with GNPA ratio at 2.97% as on December 31, 2023 (March 31, 2023: 2.77%) as compared to 2.50% as on March 31, 2022. The deterioration in the GNPA levels is due to higher slippages in the retail and agriculture segment during FY23. The net NPA (NNPA) ratio as on December 31, 2023, stood at 1.53% (March 31, 2023: 1.36%) as compared to 1.36% as on March 31, 2022. The bank's provision coverage ratio (PCR) stood at around 50% as on March 31, 2023 and September 30, 2023.

The bank had restructured advances in line with the RBI framework during the Covid-19 pandemic and the bank's restructured accounts have declined from 2.74% as on March 31, 2022, to 1.48% of total advances as on September 30, 2023 (March 31, 2023: 1.77%).

CARE Ratings notes that more than 99% of the portfolio is secured, therefore 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 has a stable depositor base due to its long track record in the geographies it is present. The bank's liability mix has undergone substantial growth with significant deposits (including CDs) being raised post conversion into bank from ₹3,667 crore as on March 31, 2019, to ₹7,482 crore as on December 31, 2023. The bank has been gradually focusing on building its retail deposits book, and consequently, its CASA ratio is one of the best in the entire small finance banks industry at 42% as on March 31, 2023. However, due to an increase in term deposit interest rates, the CASA deposits of the bank witnessed a slower growth of 8% during 9MFY24 to stand at 40% of total deposits as on December 31, 2023, as compared to 42% as on March 31, 2023.

The retail term deposits constituted 93% of the overall term deposits with a high rollover rate. Due to such a robust liability franchise along with a high proportion of low-cost CASA deposits, CARE Ratings expects the bank to maintain its cost of deposits at around 5%-5.5% in the medium term.

Comfortable Capitalisation levels augmented by the recent equity infusion

The bank has raised funds from diverse investors such as include Amicus Capital Partners, Oman India Joint Investment Fund, HDFC Life, SIDBI, ICICI Prudential, PI Ventures and Max Life Insurance Ltd. As of December 31, 2023, the Net-worth of the bank stood at ₹743 crore as compared to ₹516 crore as on March 31, 2022. Max Life Insurance Ltd infused a capital of ₹50 crore in the month of June 2023 thereby improving the bank's capital adequacy ratio from 18.63% (Tier 1: 13.21%) as on March 31, 2022, to 20.72% (Tier 1: 15.26%) as on September 30, 2023. The bank's capital adequacy ratio stood at 20.06% (Tier 1: 15.00%) as on December 31, 2023. In

addition to this, the bank has recently concluded the Initial Public Offering sized at ₹523 crore of which ₹450 crore was the fresh issue.
The proceeds from IPO are expected to boost the capitalisation levels even further. CARE Ratings expects that because of the availability of enough capital at the bank's disposal, the bank is set to grow its advances in the medium term.

Key weaknesses

Geographical concentration of loan portfolio

The bank has 175 branches spread across 4 states and 2 union territories of the country, namely, Punjab, Haryana, Rajasthan, Himachal Pradesh, Delhi, and Chandigarh as on December 31, 2023, However, geographical concentration exists with Punjab alone constituting around 84% of total loan portfolio as on September 30, 2023, as against 86% of the loan portfolio as on March 31, 2022. The bank is making conscious efforts to reduce the geographical concentration post conversion into a small finance bank as evident from its recent foray into the other states of north India.
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.

Agriculture dominant loan book along with relatively smaller in size as compared to peers

The advances book of the bank stood at ₹5,634 crore with a deposit base of ₹7,482 crore as on December 31, 2023, indicating that the size of bank is relatively smaller as compared to other SFB peers.
CSFBL mainly focusses on providing credit to the middle-income groups of society including agriculturalists and MSME business owners along with mortgage loans to borrowers. The advances book of CSFBL stood at ₹5,634 crore as on December 31, 2023 (March 31, 2023: ₹5429 crore) with overall 40,000 customers. Agriculture lending continues to be mainstay for the bank with nearly 37% of the advances of the bank as on December 31, 2023, being in the form of KCC and term loan.
The average ticket size for agricultural loans is ₹12 lakh and lending rate is 12%. Rest of the loan portfolio consists of MSME loans with an average ticket size of ₹18 lakhs and lending rate of 11% contributing 20% to the bank's loan portfolio along with Mortgage Loans contributing 27% to bank's advances having an average ticket size of ₹12 lakhs with lending rate of around 12%.

Liquidity: Adequate

The bank's liquidity profile is supported by the bank's strong retail and CASA depositor base. The asset liability maturity (ALM) profile as on September 30, 2023, had no negative cumulative mismatches in any of the time buckets up to one year. The average LCR for the quarter ended September 30, 2023, was at 246%, well above the present prescribed minimum requirement of 100%. Comfort can be drawn from the excess statutory liquidity ratio (SLR) maintained by CSFBL at 6% of net demand and time liabilities as on September 30, 2023.

Applicable criteria

Analytical Treatment of Restructuring - COVID
Definition of Default
Rating Outlook and Rating Watch
Bank
Financial Ratios - Financial Sector
Rating Basel III - Hybrid Capital Instruments issued by Banks

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. As of December 31, 2023, it has total 175 branches spread across Punjab, Haryana, Chandigarh, Himachal Pradesh, New Delhi and Rajasthan. The bank’s focus is on retail segment for both loans and deposits. Retail advances form 74% 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. More than 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.

CSFBL Financials

Brief Financials (₹ crore)	31-03-2021 (A)	31-03-2022 (A)	31-03-2023 (A)	31-12-2023 (UA)
Total income	557.30	632.40	725.48	637.67
PAT	40.78	62.56	93.59	83.32
Total assets	6,371	7,154	7,991	8,850
Net NPA (%)	1.13	1.36	1.36	1.53
ROTA (%)	0.70	0.93	1.24	1.32

A: Audited UA: Unaudited; Note: ‘the above results are latest financial results available’
All ratios are as per CareEdge Calculations

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-Lower Tier II	INE646H08129	31-03-2019	10.00%	31-03-2029	25.00	CARE A; Stable
Bonds-Upper Tier II	INE646H08012	31-03-2015	11.75%	31-03-2030	15.00	CARE A-; Stable
Bonds-Upper Tier II	INE646H08020	30-03-2016	11.75%	30-03-2031	25.00	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	Bonds-Upper Tier II	LT	15.00	CARE A-; Stable	-	1)CARE A-; Stable (13-Mar-23) 2)CARE A-; Positive (30-Jan-23)	-	-
2	Bonds-Upper Tier II	LT	25.00	CARE A-; Stable	-	1)CARE A-; Stable (13-Mar-23)	-	-
3	Bonds-Lower Tier II	LT	25.00	CARE A; Stable	-	1)CARE A; Stable (13-Mar-23)	-	-

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-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 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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