ESAF Small Finance Bank Limited

March 28, 2025

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Lower Tier II	500.00	CARE A; Negative	Assigned
Lower Tier II	150.00	CARE A; Negative	Reaffirmed
Lower Tier II	130.00	CARE A; Negative	Reaffirmed
Tier II Bonds	60.00	CARE A; Negative	Reaffirmed
Tier II Bonds	20.00	CARE A; Negative	Reaffirmed
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 it 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 its established track record in the lending business especially in microfinance business, adequate capitalisation levels, and adequate liquidity position. However, ratings are constrained by business's regional concentration and its limited loan portfolio diversification, predominantly comprising microfinance loans, despite showing a notable decrease in concentration in 9MFY25 with increase in share of gold loans. Ratings factor in moderate asset quality indicators, marked by sustained high slippages that led to losses in Q2FY25 and Q3FY25. Net loss in 9MFY25 stood at ₹338 crore against profit after tax (PAT) of ₹382 crore 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:

- Increasing scale of operations while maintaining adequate capitalisation levels.
- Improving asset quality with net stressed assets/net worth below 10% and improvement in profitability.
- Improving in geographical diversification and product diversification.

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

- Deteriorating capitalisation with overall capital adequacy ratio (CAR) below 18%.
- Weaking of earnings profile with continuation of losses.
- Weakening asset quality performance with gross stressed assets of above 7% of advances.

Analytical approach: Standalone

Outlook: Negative

The 'Negative' outlook is on account of the anticipated sustained pressure on asset quality, driven by stress in the microfinance segment, which has adversely impacted the company's profitability, resulting in losses in Q2FY25 and Q3FY25. Pre-provision Operating Profit (PPOP) also declined on a quarterly basis from ₹254 crore in Q1FY25 to ₹143 crore in Q2FY25 and further to ₹127 crore in Q3FY25. Also higher provisioning owing to increased slippage resulted in net losses in Q2FY25 and Q3FY25. Going forward, trend in PPOP would be a key rating monitorable. The continued high slippage is likely to lead to elevated provisioning requirements. CARE Ratings will continue to closely monitor the impact of this stress on the bank's performance. The outlook may be revised to 'Stable' if the company successfully raises substantial equity capital or demonstrates improved asset quality, characterised by a significant reduction in slippage while maintaining a comfortable capital adequacy buffer above regulatory requirements.

Detailed description of key rating drivers:

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

Key strengths

Established track record of the bank

ESAF SFB is promoted by K Paul Thomas, who is the promoter of the Kerala-based ESAF group, operating in the microfinance space since 1995 (ESAF Microfinance started its operations as an NGO as Evangelical Social Action Forum) and set up ESAF Microfinance & Investments Private 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 6.05% stake in ESAF SFB as on December 31, 2024. He has over 34 years' industry experience, of which, over 25 years are in the microfinance sector. He is supported by a well-qualified and experienced management team, having rich experience in the banking and financial services sector. As on December 31, 2024, the bank's board consisted of 11 directors, including five independent directors, two nominee directors and one non-executive director apart from chairman, MD and one executive director, having rich experience in the banking and financial services industry.

Adequate capitalisation levels

With completion of equity raise of ₹ 390.7 by way of IPO in November 2023, internal accruals and Tier-II capital raise of ₹280 crore in FY24, capital adequacy levels of bank improved in FY24 with capital adequacy ratio (CAR) and Tier I CAR at 23.27% and 19.70%, respectively, as on March 31, 2024, and stood adequately above the regulatory requirements. Despite the losses reported in 9MFY25, the bank's capital adequacy remained comfortably above regulatory requirements, with a CAR of 22.70% and a Tier I CAR of 18.68% as of December 31, 2024. This was supported by the bank's strategic focus on expanding its gold loan portfolio, which contributed to a reduction in risk-weighted assets. Given the anticipated earnings pressure in the near term, the maintenance of a sufficient capital adequacy buffer will remain a key rating monitorable.

Significant increase in the secured loan portfolio in 9MFY25, however proportion of MFI portfolio continues to remain high

The bank's loan book grew by 20.4% in FY24, increasing from ₹16,331 crore as on March 31, 2023, to ₹19,659 crore as on March 31, 2024. However, in 9MFY25, loan book experienced a marginal decline of 2.5%, reaching ₹19,161 crore as on December 31, 2024, primarily due to a reduction in the microfinance (MFI) portfolio. Outstanding MFI loans declined to ₹10,854 crore as on December 31, 2024, compared to ₹13,764 crore as on March 31, 2024.

To diversify its portfolio, the bank expanded in non-MFI segments, including gold loans, loans against property (LAP), business loans, corporate loans, and agricultural loans. As a result, the share of the secured loan portfolio increased significantly from 30.0% as on March 31, 2024, to 43.4% as on December 31, 2024, driven by the growth in the gold loan segment, which accounted for 25.0% of the total loan book as of December 31, 2024. Despite this diversification, the portfolio remains predominantly MFI-focused, with MFI loans constituting 56.6% total advances as on December 31, 2024, compared to 70.0% as on March 31, 2024. CARE Ratings anticipates MFI loans will continue to remain as major product in the medium term.

Consistent growth in deposits; however, current account savings account (CASA) proportion still remains moderate

The bank's resource profile majorly consists of deposits (83.8% of total liabilities as on December 31, 2024) followed by borrowings. The bank's total deposits grew by 12.8% in 9MFY25 and stood at ₹22,415 crore as on December 31, 2024, against ₹19,868 crore as on March 31, 2024. The bank's CASA (as a percentage of total deposits) stood at 24.95% as on December 31, 2024, against 18.89% as on December 31, 2023.

Key weaknesses

Losses reported in 9MFY25

The bank demonstrated an improvement in profitability in FY24, reporting a profit after tax (PAT) of ₹426 crore, compared to ₹302 crore in FY23. Return on total assets (ROTA) also improved from 1.60% in FY23 to 1.84% in FY24. However, continued high slippage resulted in elevated provisioning requirements, leading to a net loss of ₹338 crore in 9MFY25, in contrast to a PAT of ₹382 crore in 9MFY24.

The bank's net interest margin (NIM) declined to 8.16% in 9MFY25 from 10.25% in FY24, primarily due to interest income reversals of ₹93 crore in Q2FY25 and ₹76 crore in Q3FY25, following asset quality deterioration. The share of higher-yielding microfinance (MFI) portfolio declined from 70.0% as on March 31, 2024, to 56.6% as on December 31, 2024. Credit costs increased to 4.64% in 9MFY25 from 2.56% in FY24. CARE Ratings also notes increase in credit cost is considering the higher provisioning done by the bank over and above the bank policy. Overlay provisions stood at ₹472 crore as on December 31, 2024. The bank's ability to limit incremental slippages remains critical to maintain its earnings profile.

Moderate asset quality with continued high slippages

In FY24, the bank's asset quality deteriorated, with gross non-performing assets (GNPA) and net non-performing assets (NNPA) increasing to 4.76% and 2.26%, respectively, as on March 31, 2024, compared to 2.49% and 1.13% as on March 31, 2023. Similarly, the bank's NNPA to net worth ratio moderated from 9.42% as on March 31, 2023, to 16.92% as on March 31, 2024.

iIn 9MFY25, with increased slippages, GNPA and NNPA further deteriorated to 6.96% and 2.97%, respectively, as on December 31, 2024, up from 4.76% and 2.26% as on March 31, 2024. The bank wrote off ₹880 crore in 9MFY25, significantly higher than the ₹306 crore written off in FY24. As on December 31, 2024, standard restructured advances stood at ₹11.89 crore, representing 0.07%gross advances.

Gross stressed assets (as a percentage of advances) increased to 7.03% as on December 31, 2024, from 4.84% as on March 31, 2024, remaining at the same level as of September 30, 2024. Net stressed assets (as a percentage of advances) stood at 3.03%

as on December 31, 2024, compared to 3.39% as on September 30, 2024, and 2.34% as on March 31, 2024. Given the ongoing stress in the microfinance (MFI) segment, slippages are expected to remain elevated in the near term, posing continued pressure on the bank's profitability.

Regional concentration of loan portfolio with improvement in single state concentration
ESAF SFB continues to be concentrated majorly in Kerala, followed by Tamil Nadu and Madhya Pradesh. The concentration in top three states of Kerala, Tamil Nadu and Madhya Pradesh continues to remain high at 67.6% as on December 31, 2024 (68.8% as on March 31, 2024). But bank has reduced the top state concentration significantly over the last three years. Kerala constitutes 34.8% portfolio as on December 31, 2024 (March 31, 2024: 36.1%, March 31, 2023: 42.1%, March 31, 2022: 45.6%). The bank has its presence in 24 states and two UTs across 770 branches as on December 31, 2024.

Liquidity: Adequate
Per the bank's structural liquidity statement as on December 31, 2024, it does not have negative cumulative mismatches up to one year time bucket. Liquidity coverage ratio (LCR) stood comfortable at 152% as on December 31, 2024. In addition, the bank consistently maintains excess SLR investments, which provides cushion to its liquidity. Excess SLR as on December 31, 2024, stood at ₹2,319 crore.

Environment, social, and governance (ESG) risks
ESAF SFB provides financial access to the unbanked and rural population. With a focus on financial inclusion, the bank aims to reach more rural geographies and extend financial deepening through customised products and services. The bank has adopted a CSR Policy, which contributes an average of up to 5% bank's total net profit in the last three fiscal years to carry out social initiatives. The bank recognises the importance of being socially responsible and contributing to uplift the poor, marginalised and needy segments of the society. Given the bank's business, 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
Banks
Financial Ratios - Financial Sector
Short Term Instruments
Rating Basel III - Hybrid Capital Instruments issued by Banks

About the company and industry

Industry classification

Macroeconomic indicator	Sector	Industry	Basic industry
Financial Services	Financial Services	Banks	Other Bank

ESAF SFB is a Kerala-based small finance bank (SFB), which commenced banking operations on March 10, 2017. The bank was promoted by K Paul Thomas who is part 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 Private Limited (EMFIL) in 2007. EMFIL subsequently received SFB license and started banking operations from March 2017 onwards. ESAF SFB is currently focused on 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 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.
ESAF Small Finance Bank completed the process of IPO in November 2023 and raised ₹390.70 crore through fresh issue of shares. As on December 31, 2024, ESAF Financial Holdings Private Limited held 52.91% of the shareholding in ESAF SFB, while Paul Thomas held 6.05%, ESAF Swasraya Multi State Agro Co-operative Society Limited held 4.35%, Muthoot Finance Limited held 3.63%, Bajaj Allianz Life Insurance Company held 2.03%, PI Ventures held 1.70%, Edelweiss Life Insurance Company Limited held 1.89% and others (including NRI, FPI among others) stood at 27.44%. As on December 31, 2024, the bank's total deposits stood at ₹22,415 crore and gross advances stood at ₹ 18,291 crore.

Brief Financials (₹ crore)- Standalone	31-03-2023 (A)	31-03-2024 (A)	31-12-2024 (UA)
Total operating income	3,142	4,260	3,293
PAT	302	426	-338
Interest coverage (times)	1.40	1.39	0.67
Total Assets	20,185	26,040	26,748
Net NPA (%)	1.13	2.26	2.97
ROTA (%)	1.60	1.84	-1.71

A: Audited UA: Unaudited; Note: these are latest available financial results

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years: Annexure-2

Detailed explanation of covenants of rated instrument / facility: Annexure-3

Complexity level of 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
Tier II Bonds (Basel III) -I	INE818W08024	March 28, 2018	11.50%	March 28, 2025	20.00	CARE A; Negative
Tier II Bonds (Basel III) -I	INE818W08032	June 1, 2018	11.50%	June 1, 2025	40.00	CARE A; Negative
Tier II Bonds (Basel III)- II	INE818W08081	March 31, 2022	11.25%	April 30, 2032	20.00	CARE A; Negative
Lower Tier-II bonds (Basel II)	INE818W08099	September 04, 2023	11.25%	May 04, 2029	85.00	CARE A; Negative
Lower Tier-II bonds (Basel II)	INE818W08107	February 29, 2024	11.10%	February 28, 2034	60.00	CARE A; Negative
Lower Tier-II bonds (Basel II)	INE818W08123	March 20, 2024	11.00%	April 20, 2030	85.00	CARE A; Negative
Lower Tier-II bonds (Basel II)	INE818W08115	March 20, 2024	11.10%	April 20, 2031	50.00	CARE A; Negative
Certificate Of Deposit	Proposed	-	-	-	500.00	CARE A1+
Lower Tier-II bonds (Basel II)	Proposed	-	-	-	500.00	CARE A; Negative

Annexure-2: Rating history for 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 2024-2025	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
1	Bonds-Tier II Bonds	LT	60.00	CARE A; Negative	1)CARE A; Negative	1)CARE A; Stable	1)CARE A; Negative	1)CARE A; Negative

						(17-Mar-25) 2)CARE A; Stable (04-Jul-24)	(22-Feb-24) 2)CARE A; Stable (01-Aug-23) 3)CARE A; Stable (04-Jul-23)	(27-Dec-22)	(07-Jan-22)
2	Certificate Of Deposit	ST	500.00	CARE A1+		1)CARE A1+ (17-Mar-25) 2)CARE A1+ (04-Jul-24)	1)CARE A1+ (22-Feb-24) 2)CARE A1+ (01-Aug-23) 3)CARE A1+ (04-Jul-23)	1)CARE A1+ (27-Dec-22)	1)CARE A1+ (07-Jan-22)
3	Bonds-Tier II Bonds	LT	20.00	CARE A; Negative		1)CARE A; Negative (17-Mar-25) 2)CARE A; Stable (04-Jul-24)	1)CARE A; Stable (22-Feb-24) 2)CARE A; Stable (01-Aug-23) 3)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; Negative		1)CARE A; Negative (17-Mar-25) 2)CARE A; Stable (04-Jul-24)	1)CARE A; Stable (22-Feb-24) 2)CARE A; Stable (01-Aug-23)	-	-
5	Bonds-Lower Tier II	LT	130.00	CARE A; Negative		1)CARE A; Negative (17-Mar-25) 2)CARE A; Stable	1)CARE A; Stable (22-Feb-24)	-	-

					(04-Jul-24)			
6	Bonds-Lower Tier II	LT	500.00	CARE A; Negative				

LT: Long term; ST: Short term

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

Annexure-4: Complexity level of instruments rated

Sr. No.	Name of the Instrument	Complexity Level
1	Bonds-Lower Tier II	Simple
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 complexity levels of rated instruments: CARE Ratings has classified instruments rated by it based on complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for 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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