Utkarsh Small Finance Bank Limited

June 12, 2025

Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Tier-II Bonds	15.00	CARE A+; Negative	Reaffirmed; Outlook revised from Stable
Tier-II Bonds	200.00	CARE A+; Negative	Reaffirmed; Outlook revised from Stable

Details of instruments in Annexure-1.

Rationale and key rating drivers

CARE Ratings Limited (CareEdge Ratings) has revised the outlook on the long-term rating of Utkarsh Small Finance Bank Limited (USFBL) considering persistent stress in its microfinance portfolio, which weakened its asset quality and profitability in FY25, and which is expected to continue in H1FY26. While the bank is actively diversifying its portfolio towards secured loans, profitability is expected to remain under pressure due to elevated credit costs in the microfinance segment and a shift to lower-yielding segments.

USFBL's asset quality weakened significantly in FY25 with gross non-performing assets (GNPA) increasing sharply from 2.51% as on March 31, 2024 to 9.43% as on March 31, 2025. This was primarily due to slippages in the microfinance segment, which accounted for a sizable portion of the loan book (50% as on March 31, 2025). While CareEdge Ratings takes note of the quarter-on-quarter improvement in X-bucket collection efficiency and in SMA (0,1 and 2) indicating a slowdown in fresh accretion, overall asset quality remains a key concern. The net NPA (NNPA) to net worth ratio also increased to 30.98% in FY25 from 0.16% in FY24. The bank has already taken shareholders' approval pursuant to which the bank is planning to raise the equity capital upto ₹750 crore by H1FY26 to strengthen the capitalisation levels, which would help the bank in absorbing additional stress from the microfinance book. Any further weakening of asset quality resulting in capital erosion and/or delay in the proposed equity infusion, would be a credit negative.

USFBL's advances growth moderated in FY25, as the bank calibrated its microfinance disbursements following stricter regulatory guardrails and sectoral stress, but reported strong growth in non-microfinance retail segments improving the advances mix in favour of secured portfolio, which will bring down the yields from current level. The microfinance exposure reduced from 62% of the loan book to 50% and secured book has increased from 34% to 43% between March 2024 and March 2025. While the bank expanded its deposit base in the recent years, its current account savings account (CASA) ratio still remained relatively low at 21.8% as on March 31, 2025.

The bank reported modest profit after tax (PAT) of ₹24 crore for FY25 (FY24: ₹498 crore) due to elevated credit costs and interest reversals linked to asset quality pressures. Going forward, profit margins are expected to remain under pressure due to continued stress in the microfinance sector and change in product mix in favour of lower yielding secured loans.

CareEdge Ratings will closely monitor the bank's asset quality trends and profitability trajectory in FY26. The bank's ability to contain further slippages, improve collection efficiency, and maintain earnings momentum while strengthening its secured lending base and maintaining capitalisation will be key rating sensitivities going forward.

Rating sensitivities: Factors likely to lead to rating actions

Positive factors: Factors that could individually or collectively lead to positive rating actions/upgrade:

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

Negative factors: Factors that could individually or collectively lead to negative rating actions/downgrade:

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

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

Analytical approach: Standalone

Outlook: Negative

Revision in the outlook reflects the continued stress in the micro finance segment affecting USFBL's asset quality and profitability, which is expected to continue even in H1FY26. The outlook may be revised to stable if the asset quality parameters show sustained improvement, resulting in better profitability, while maintaining healthy capitalisation levels.

Detailed description of key rating drivers:

Key strengths

Adequate, although declining, capitalisation levels

The bank continues to be adequately capitalised by maintaining sufficient cushion over the minimum regulatory requirement of 15% (Tier-I: 7.5%). However, CareEdge Ratings notes that USFBL's capitalisation level moderated in FY25 with capital adequacy ratio (CAR) at 20.93% and Tier-I at 17.88% as on March 31, 2025 from 22.57% and 20.95% levels, respectively, as on March 31, 2024. The bank is in the process of raising upto ₹750 crore by H1FY26. The equity raise will aid in maintaining capital buffers to support growth while providing for the deterioration in the asset quality. Any delay in raising the additional capital could weaken the capitalisation profile in case of a continued asset quality deterioration in the microfinance book, and hence remains a key rating monitorable.

Continued diversification of loanbook

Advances growth moderated in FY25, primarily as the bank is calibrating its microfinance disbursements following stricter regulatory guardrails and sectoral stress while continuing strong growth in non-microfinance retail segments and improving the advances mix in favour of secured portfolio. The bank registered 8% growth in the gross loan portfolio year-on-year which stood at ₹19,666 crore as on March 31, 2025, with the microfinance segment degrowing by 17% while the secured book grew at the rate of 36%. The largest segment of the portfolio continues to be micro-banking loans; though its share has reported a decline from 62% of the loan book as on March 31, 2024 to 50% as on March 31, 2025. While the bank will continue to grow micro-banking loans, it is focusing on increasing other non-micro banking segments, especially secured loans whose proportion increased from 34% as on March 31, 2024 to 43% as on March 31, 2025. Going forward, other lending verticals (being smaller in size) are expected to grow even faster than micro-banking business and hence the share of micro-banking loans in overall loan book is expected to reduce further. The reduction in micro finance loan book and reduction in the geographical concentration remain key rating monitorable.

Key weaknesses

Deterioration of asset quality and weak profitability

USFBL's asset quality deteriorated materially in FY25, with the GNPA rising to 9.43% as on March 31, 2025 (March 31, 2024: 2.51%), and the NNPA to net worth ratio increasing sharply to 30.98% (March 31, 2024: 0.16%), which is relatively higher than the peers. This was primarily due to slippages in the microfinance segment, which accounted for a sizable portion of the loan book. The bank utilised the floating provisions in FY25 and maintained provision coverage ratio (PCR) of 51% on GNPA as on March 31, 2025, which is relatively lower than peer small finance banks. However, CareEdge Ratings notes that the X-bucket collection efficiency and the SMA (0/1/2) book showed quarter-on-quarter improvement, indicating a slowdown in fresh accretions. The bank reported a PAT of ₹24 crore in FY25 (FY24: ₹498 crore), affected by high credit costs and interest reversals. The profitability was partially supported by changes in fee recognition accounting policy. Going forward, profit margins are expected to remain under pressure due to continued stress in the microfinance sector and change in product mix in favour of lower yielding secured loans.

CareEdge Ratings observes, the bank's ability to manage asset quality and credit costs remain critical for stability of its profitability and return ratios going forward.

Geographical concentration of loan portfolio

The bank has 1,092 banking outlets spread across 27 states and union territories (UTs) as on March 31, 2025. The top two states - Bihar and UP, constitute ~46% of branches and 49% of gross loan portfolio (over 70% of microbanking loans) as on March 31, 2025. However, the geographical concentration is improving gradually with the opening of new branches outside of these two states.

The share of microfinance loans in the loan book remained dominant at 50% as on March 31, 2025, which exposes the bank to inherent risks associated with the industry such as socio-political intervention, regulatory uncertainties, and challenges of unsecured lending.

Relatively low CASA

The bank's liability mix has undergone substantial change as deposits as a percentage of total liabilities has been increasing with reduction in dependence on borrowings, which is evident from the improving credit to deposit ratio. USFBL's deposits have grown ~23% y-o-y and stood at ₹21,566 crore with CASA proportion remaining relatively modest, although improving marginally to 21.79% as on March 31, 2025 from 20.50% as on March 31, 2024. The bank's CASA proportion remains lower compared to its peers in the small finance banking industry. The bank has been focusing on building its granular retail deposits book and its CASA plus retail term deposits (upto ₹3 crore) constituted 71% as on March 31, 2025. Its dependence on wholesale term deposits remained high at 29%, although the same has been improving in the last few years. CareEdge Ratings expects the bank to focus on raising CASA deposits, which would provide the bank a stable depositor base and reduce cost of funding over the medium term.

Liquidity: Strong

Per the structural liquidity statement as on March 31, 2025, there were no negative cumulative mismatches for time buckets up to one year. The bank also maintained surplus liquidity of ~₹3,800 crore over and above regulatory requirements, which provides liquidity buffer. In addition, the bank has access to borrowing from Reserve Bank of India's (RBI's) liquidity adjustment facility (LAF) and marginal standing facility (MSF) and option to refinance from Small Industries Development Bank of India (SIDBI), National Housing Bank (NHB), and National Bank for Agriculture and Rural Development (NABARD) among others, and access to call money markets. The bank's liquidity coverage ratio was comfortable at 189% as on March 31, 2025, against the minimum regulatory requirement of 100%.

Environment, social, and governance (ESG) risks

Given USFBL's service-oriented nature of business, its direct exposure to environmental risks remains low. However, it faces implicit environmental risks through its portfolio of assets. The bank has targeted reduction in energy consumption, preserve water quality, and availability in addition to plantation of trees. Customer data privacy and security remain the key social risk-related vulnerabilities for USFBL as breaches could attract regulatory attention and damage the bank's reputation. While digital banking offers many benefits to the bank, poor execution of IT strategies and failure to adequately meet customer needs could lead high costs. On a positive note, USFBL is enhancing financial inclusion by offering products and services aimed at marginalised sections of society, addressing social concerns. Prudent lending to these underserved segments could create growth opportunities, which must be weighed in the context of asset quality risks, including borrower creditworthiness, economic vulnerabilities, and regulatory uncertainties.

Applicable criteria

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

Macroeconomic indicator	Sector	Industry	Basic industry
Financial services	Financial services	Banks	Other bank

Based out of Varanasi, USFBL is a subsidiary of Utkarsh CoreInvest Limited (UCL), a non-banking financial company non-deposit taking systemically important core investment company (NBFC-NDSI-CIC) with the RBI. 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 constituted nearly 50% of the gross loan portfolio of the company as on March 31, 2025. The bank also extends wholesale loans, MSME loans, and housing loans to the borrowers. USFBL provides microfinance loans through Business Correspondence activities as well. As on March 31, 2025, it had 1,092 banking outlets, 369 ATMs, and 761 micro-ATMs. The bank is headed by Govind Singh, MD & CEO, whose reappointment as MD & CEO has been approved by RBI for three years on September 21, 2024.

USFBL, vide announcement to the stock exchanges on September 20, 2024, informed the exchanges that its board of directors approved scheme of amalgamation of UCL, the holding company with USFBL, subject to the approval of shareholders, debenture holders, RBI, Stock exchanges, National Company Law Tribunal (NCLT) and other competent authority, as may be applicable. The scheme is subject to the expiry of the lock-in restriction on equity shares held by UCL in the USFBL, which expires on January 19, 2025. The amalgamation would be through share exchange ratio of 669 equity shares of face value of ₹10 each of USFBL, for every 100 equity shares of face value of ₹10 each of UCL. The Scheme would result in increase of public shareholding in USFBL from 30.98% as on June 30, 2024 to 100%. The scheme has received NOC from RBI and is awaiting Securities and Exchange Board of India (SEBI) approval, post which the bank will immediately file with the NCLT.

USFBL Financials

Brief Financials (₹ crore)	31-03-2024 (A)	31-03-2025 (A)
Total income	3,579	4,365
PAT	498	24
Total assets	23,798	28,016
Net NPA (%)	0.03	4.84
ROTA (%)	2.32	0.09

A: Audited; UA: Unaudited; Note: these are latest available financial results
All calculations per CARE Ratings

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

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+; Negative
Bonds-Tier-II Bonds	INE735W08061	27-Nov-2024	10.90	27-Nov-2031	105.00	CARE A+; Negative
Bonds-Tier-II Bonds	Proposed	-	-	-	95.00	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 2025-2026	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
1	Bonds-Tier-II Bonds	LT	-	-	-	-	-	1)Withdrawn (29-Sep-22)
2	Bonds	LT	15.00	CARE A+; Negative	-	1)CARE A+; Stable (31-Oct-24) 2)CARE A+; Stable (24-Sep-24)	1)CARE A+; Stable (26-Sep-23)	1)CARE A; Positive (29-Sep-22)
3	Bonds	LT	200.00	CARE A+; Negative	-	1)CARE A+; Stable (31-Oct-24)	-	-

LT: Long term; ST: Short term; LT/ST: Long term/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-Tier-II Bonds	Simple

Annexure-5: Lender details: Not applicable

Note on complexity levels of rated instruments: CareEdge 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, CareEdge 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 Reserve Bank of India. With an equitable position in the Indian capital market, CareEdge 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, CareEdge 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. CareEdge Ratings has played a pivotal role in developing bank debt and capital market instruments, including commercial papers, corporate bonds and debentures, and structured credit. For more information: www.careratings.com

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