# Ujjivan Small Finance Bank Limited

July 06, 2018

**Ratings**

| Facilities | Amount (Rs. crore) | Ratings[1] | Rating Action |
|---|---|---|---|
| Long-term Bank Facilities | 4250 (reduced fro, Rs.6000 crore) | **CARE A+; Stable (Single A Plus; Outlook: Stable** | Reaffirmed |
| Non- Convertible Debentures- (NCD V) | 40 | **CARE A+; Stable (Single A Plus; Outlook: Stable** | Reaffirmed |
| Non- Convertible Debentures- (NCD VI) | 60 | **CARE A+; Stable (Single A Plus; Outlook: Stable)** | Reaffirmed |
| Non- Convertible Debentures- NCD IX | 100 | **CARE A+; Stable (Single A Plus; Outlook: Stable** | Reaffirmed |
| **Total Facilities** | **4450 (Rupees Four Thousand Four Hundred Fifty crore only)** | | |

*Details of instruments/facilities in Annexure-1*

**Detailed Rationale & Key Rating Drivers**

The rating assigned to the bank facilities of Ujjivan Small Finance Bank Limited (USFB) continue to factor in the successful commencement of banking operations, with bank increasing its branch network, launching various products under liabilities and asset side, and mobilizing considerable amount of deposits (majorly in form of term deposits and certificate of deposits) to repay the high cost bank loans. The rating also continue to derive strength from bank's experienced promoter group with seasoned management, comfortable liquidity position, adequate capitalization levels and inheritance of geographically well-diversified client portfolio and well-developed portfolio management systems from Ujjivan Financial Services Limited(UFSL).

The rating takes into account limited fresh delinquencies with consistently high collection efficiency on loans disbursed post demonetisation, substantial reduction in net NPA level from 2.30% as on June 30, 2017 to 0.70% as on March 31, 2018, following improvement in collections and substantial provisioning/ write-offs done in FY18 (Rs.311 crore which was around 5.3% of last year's gross advances). The significant credit cost of Rs.311 crore and high operational cost of transformation to small finance bank has led to moderation of profitability levels during FY18. The rating, continues to remain constrained due to USFB's foray into newer area of general banking business which is characterized by intense competition and impact on the near term profitability arising on account of staffing, regulatory compliance and technology and infrastructure spending. Going forward the ability of the bank to maintain its asset quality, while achieving growth in the advances, ramping up its retail liabilities base to fund the growth in portfolio, and improving its profitability indicators will be key rating sensitivities.

**Detailed description of the key rating drivers**

**Key Rating Strengths**

***Experienced promoter group with seasoned management:*** The present senior management team of USFB is largely stable and highly experienced in financial sector. The Managing Director (MD) and Chief Executive Officer (CEO), Mr. Samit Ghosh is a veteran banker with over three decades of experience. USFB has five Independent Directors with diverse experience, who bring valuable expertise to the Bank. While the existing senior management team continues to handle their respective portfolio on the asset side, the bank has hired people in leadership position for new asset verticals of MSME & Housing, treasury, risk and liability departments.

***Transition to SFB, and setup/conversion of bank branches, and launch of products under liability and asset:*** USFB had commenced its operation from February 01, 2017, post compliance of various SFB guidelines issued by RBI including raising adequate funds to comply with the CRR and SLR requirements. USFB has been able to scale up its operations and branch network, over last year, with bank closing the year with 187 branches (including 47 unbanked rural centres) as against 15 bank branches at the beginning of the year although the pace was moderate as the bank focused on addressing asset quality issues post demonetisation. Also with the commencement of banking operations, USFB has

[1]*Complete definition of the ratings assigned are available at www.careratings.com and other CARE publications*

introduced various deposits products under liability side and witnessed growth in new products like home loan, loans against property, secured and unsecured loans to Micro, small and medium enterprises.

***Geographically well-diversified client portfolio:*** USFB's net loan portfolio Rs.7335 crore is spread across 24 states and UTs as on March 31, 2018, with active borrowers of 37.10 lac (PY: 35.60 lacs). However top four states of Karnataka, West Bengal, Tamil Nadu and Maharashtra contributed to approximately 53.56% of the overall portfolio as on March 2018 (55.60% of the overall portfolio as on March 2017), the single State concentration had effectively reduced to 14.08% as on March 2018 (15.42% as on March 2017) from 16.08% as on March 2016. The portfolio of the bank is still concentrated to MFI; however the share of non-MFI portfolio (from housing and MSME segment) has improved from 2.4% as Mar'17 to 7.2% as on Mar'18. Presently the non-MFI portfolio includes a mix of secured and unsecured portfolio.

***Improvement in the asset quality, with company providing for /write-off of substandard assets:*** USFB's asset quality ratios, which was impacted significantly due to demonetization, has improved with satisfactory performance of fresh disbursement and bank taking a one-time credit cost hit. In FY18, Bank had suspended new customer acquisition in areas, where delinquency level (in form of PAR>0) was more than 5%, though repeat loans to customers with good credit history continued. The bank has also setup specialized team collection team to collect from hard buckets (PAR>90) and recover from written off loans. The bank has seen quarterly traction from the hard buckets of around 30%, and has been collecting on an average Rs.9 crore every month, and is expecting further recovery from these accounts. USFB has taken prudent write-off of around Rs.177 crore and made adequate provisions leading to one-time credit cost of around Rs.311 crore, which has helped the bank to contain its asset quality, with GNPA and NNPA at 3.65% & 0.69% as on March 31, 2018 as against the peak GNPA and NNPA of 6.16% & 2.30% respectively as on June 30, 2017. The collection efficiency of all the loans post demonetization (Jan-17 onwards), has been comfortable at 99.7%. With bank providing for majority of provision for non-performing assets, provision coverage was high at around 81.54%. Bank's Net NPA to Networth was around 3.09% as on March 31, 2018. The performance of the unseasoned non-MFI portfolio remains to be seen, and its performance will be critical for bank to maintain its asset quality in future. However USFB follows accelerated provisioning against regulatory requirement, which helps the bank to gradually account for substandard assets. Going forward the ability of the bank to maintain its asset quality, while achieving growth in the advances will be key rating sensitivity.

**Diversified resource profile, with bank repaying high cost bank loans with wholesale deposits:** Post the receipt of scheduled bank status from RBI, USFB has mobilized sizeable wholesale deposits and certificate of deposits to retire around 60% (Rs.3664 crore) high cost grandfathered borrowings, which has helped the bank to reduce its average cost of borrowings. Out of the total deposits outstanding of Rs.3772 crore as on March 31, 2018, certificate of deposits constituted majority of around 57.42%, term deposits from institutional investors formed 31.26%, term deposits from retail investor formed 7.66% and CASA proportion formed 3.66% of overall deposits. Going forward with the scaling up of existing bank branches and conversion of existing asset centres into bank branches, USFB is targeting to increase the share of low cost CASA deposits to fund the growth in the portfolio.

**Key Rating Weaknesses**

***Moderation in profitability, due to elevated credit cost and high operational cost for the setup of new branches:*** It is to be noted that the assets and liabilities were transferred from UFSL to USFB on Feb 01, 2017, and for major part of year operations were at UFSL, as a result consolidated view at UFSL is taken for FY17 for comparison purpose.

Interest yield has decreased from 20.39% in FY17 to 18.87% in FY18 on a comparable basis, primarily on account of interest reversal for substandard assets, reduction in high yield MFI segment, and diversification into secured asset classes such as housing, and MSME, where the yield are relatively lower compared to microfinance. After the conversion into SFB, interest expense to averaged borrowed funds have decreased from 10.11% in FY17 to 8.69% in FY18, mainly owing to bank replacing high cost debt with lower cost term deposits. NIM moderated from 10.12% in FY17 to 9.61% in FY18 because of moderation in yield.

Moreover with bank incurring high operational cost for the setup of new branches in the form of rentals, employee cost, and IT related expense, bank's cost to income ratio deteriorated further from 53.55% in FY17 to 67.05% in FY18. Due to one-time credit cost of Rs.311 crore and high operating expense incurred post the transition to SFB, USFB's net profitability has taken a hit, with net profits remaining minuscule at Rs.6.86 crore as against Rs.207.67 crore in FY17. Bank is planning to convert all its asset centres (around 277 as on March 2018) into full-fledged bank branches in FY19, which will keep the cost to income ratio high over the medium term, until the benefits of expansion positively impact the earnings.

**Industry prospects:**
The banking sector is reeling under asset quality pressure thereby impacting profitability. The asset quality review conducted by RBI led to build up of non-performing assets. Credit growth has been subdued due to slowdown in the economy and capital constraints especially in the case of PSU banks. Going forward, asset quality stress is expected to continue and profitability will be subdued. Only with the turnaround in the economy and resolution of NPAs, the banking sector would embark on a growth trajectory. Though GOI has announced the plan for recapitalization of public sector banks which is a positive for the industry, the implementation of the same is yet to be seen.

**Analytical approach:** Standalone. It is to be noted that the assets and liabilities were transferred from UFSL to USFB on Feb 01, 2017, and for major part of year operations were at UFSL, as a result consolidated view at UFSL is taken for FY17 for comparison purpose.

**Applicable Criteria**
CARE's Criteria on assigning Outlook to Credit Ratings
CARE's Policy on Default Recognition
Financial ratios – Financial sector
CARE Methodology for Non-Banking Financial Companies
CARE's Rating Methodology for Banks

**About the Company**

USFB, incorporated on July 04, 2016 is a wholly owned subsidiary of Ujjivan Financial Services Limited (UFSL). UFSL was a Bangalore based Microfinance Company registered as NBFC-MFI with RBI. It has been in microfinance lending since 2005 and has operated through joint liability group (JLG) model in urban and semi urban areas and target customers who are salaried as well as self-employed women. UFSL was one of the ten entities to be granted "in-principle" approval by Reserve Bank of India (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 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 with Business Transfer Agreement (BTA) effective from February 1, 2017 entered between UFSL and USBL, the entire assets/liabilities of UFSL had been transferred to USBL.
As on March 31, 2018, the bank has 187 branches (including 47 Unbanked Rural Centres) and 277 Asset centres. Further the bank has 146 biometric ATMs as on March 31, 2018. The bank has presence across 24 the States and Union Territories of India, and with an overall portfolio of around Rs.7,335 crore as on March 31, 2018.

| Brief Financials (Rs. crore) | FY17 (A)^ | FY18 (A)^^ |
|---|---|---|
| Total operating income | 1398 | 1579 |
| PAT | 208 | 7 |
| Interest coverage (times) | 1.59 | 1.52 |
| Total Assets | 8,367 | 9,473 |
| Net NPA (%) | 0.03 | 0.69 |
| ROTA (%) | 2.95 | 0.08 |

*A: Audited*; ^: Consolidated financials of UFSL; ^^: Standalone financials of USFB

**Status of non-cooperation with previous CRA:** Not Applicable

**Any other information:** Not Applicable

**Rating History for last three years:** Please refer Annexure-2

***Note on complexity levels of the rated instrument:*** *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

**Analyst Contact:**
Name: Mr Karthik Raj K
Tel: 080 - 46625566
Mobile: +91 9980562244
Email: karthik.raj@careratings.com

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**Annexure-1: Details of Instruments/Facilities**

| Name of the Instrument | Date of Issuance | Coupon Rate | Maturity Date | Size of the Issue (Rs. crore) | Rating assigned along with Rating Outlook |
|---|---|---|---|---|---|
| Fund-based - LT-Term Loan | - | - | July 31, 2022 | 1195.17 | CARE A+; Stable |
| Fund-based-Long Term | - | - | July 31, 2022 | 3054.83 | CARE A+; Stable |
| Debentures-Non Convertible Debentures | July 01, 2014 | 12.60% | May 28, 2019 | 60.00 | CARE A+; Stable |
| Debentures-Non Convertible Debentures | July 30, 2013 | 12.75% | July 30, 2019 | 40.00 | CARE A+; Stable |
| Debentures-Non Convertible Debentures | July 23, 2015 | 12.35% | August 05, 2021 | 100.00 | 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 (Rs. crore) | Rating | Date(s) & Rating(s) assigned in 2018-2019 | Date(s) & Rating(s) assigned in 2017-2018 | Date(s) & Rating(s) assigned in 2016-2017 | Date(s) & Rating(s) assigned in 2015-2016 |
| 1. | Fund-based - LT-Term Loan | LT | 1195.17 | CARE A+; Stable | - | 1)CARE A+; Stable (06-Sep-17)<br>2)CARE A+; Stable (12-Apr-17) | - | - |
| 2. | Debentures-Non Convertible Debentures | LT | - | - | - | 1)Withdrawn (06-Sep-17)<br>2)CARE A+; Stable (12-Apr-17) | - | - |
| 3. | Debentures-Non Convertible Debentures | LT | 40.00 | CARE A+; Stable | - | 1)CARE A+; Stable (06-Sep-17)<br>2)CARE A+; Stable (12-Apr-17) | - | - |
| 4. | Debentures-Non Convertible Debentures | LT | - | - | - | 1)Withdrawn (06-Sep-17)<br>2)CARE A+; Stable (12-Apr-17) | - | - |
| 5. | Debentures-Non Convertible Debentures | LT | 100.00 | CARE A+; Stable | - | 1)CARE A+; Stable (06-Sep-17)<br>2)CARE A+; Stable (12-Apr-17) | - | - |
| 6. | Fund-based-Long Term | LT | 3054.83 | CARE A+; Stable | - | 1)CARE A+; Stable (06-Sep-17)<br>2)CARE A+; Stable (12-Apr-17) | - | - |
| 7. | Debentures-Non Convertible Debentures | LT | 60.00 | CARE A+; Stable | - | 1)CARE A+; Stable (06-Sep-17)<br>2)CARE A+; Stable (12-Apr-17) | - | - |

# CONTACT

**Head Office Mumbai**

**Ms. Meenal Sikchi**
Cell: + 91 98190 09839
E-mail: meenal.sikchi@careratings.com

**Ms. Rashmi Narvankar**
Cell: + 91 99675 70636
E-mail: rashmi.narvankar@careratings.com

**Mr. Ankur Sachdeva**
Cell: + 91 98196 98985
E-mail: ankur.sachdeva@careratings.com

**Mr. Saikat Roy**
Cell: + 91 98209 98779
E-mail: saikat.roy@careratings.com

**CARE Ratings Limited**

**(Formerly known as Credit Analysis & Research Ltd.)**

Corporate Office: 4th Floor, Godrej Coliseum, Somaiya Hospital Road, Off Eastern Express Highway, Sion (East), Mumbai - 400 022
Tel: +91-22-6754 3456 | Fax: +91-22-6754 3457 | E-mail: care@careratings.com

**AHMEDABAD**
**Mr. Deepak Prajapati**
32, Titanium, Prahaladnagar Corporate Road,
Satellite, Ahmedabad - 380 015
Cell: +91-9099028864
Tel: +91-79-4026 5656
E-mail: deepak.prajapati@careratings.com

**BENGALURU**
**Mr. V Pradeep Kumar**
Unit No. 1101-1102, 11th Floor, Prestige Meridian II,
No. 30, M.G. Road, Bangalore - 560 001.
Cell: +91 98407 54521
Tel: +91-80-4115 0445, 4165 4529
Email: pradeep.kumar@careratings.com

**CHANDIGARH**
**Mr. Anand Jha**
SCF No. 54-55,
First Floor, Phase 11,
Sector 65, Mohali - 160062
Chandigarh
Cell: +91 85111-53511/99251-42264
Tel: +91- 0172-490-4000/01
Email: anand.jha@careratings.com

**CHENNAI**
**Mr. V Pradeep Kumar**
Unit No. O-509/C, Spencer Plaza, 5th Floor,
No. 769, Anna Salai, Chennai - 600 002.
Cell: +91 98407 54521
Tel: +91-44-2849 7812 / 0811
Email: pradeep.kumar@careratings.com

**COIMBATORE**
**Mr. V Pradeep Kumar**
T-3, 3rd Floor, Manchester Square
Puliakulam Road, Coimbatore - 641 037.
Tel: +91-422-4332399 / 4502399
Email: pradeep.kumar@careratings.com

**HYDERABAD**
**Mr. Ramesh Bob**
401, Ashoka Scintilla, 3-6-502, Himayat Nagar,
Hyderabad - 500 029.
Cell : + 91 90520 00521
Tel: +91-40-4010 2030
E-mail: ramesh.bob@careratings.com

**JAIPUR**
**Mr. Nikhil Soni**
304, Pashupati Akshat Heights, Plot No. D-91,
Madho Singh Road, Near Collectorate Circle,
Bani Park, Jaipur - 302 016.
Cell: +91 – 95490 33222
Tel: +91-141-402 0213 / 14
E-mail: nikhil.soni@careratings.com

**KOLKATA**
**Ms. Priti Agarwal**
3rd Floor, Prasad Chambers, (Shagun Mall Bldg.)
10A, Shakespeare Sarani, Kolkata - 700 071.
Cell: +91-98319 67110
Tel: +91-33- 4018 1600
E-mail: priti.agarwal@careratings.com

**NEW DELHI**
**Ms. Swati Agrawal**
13th Floor, E-1 Block, Videocon Tower,
Jhandewalan Extension, New Delhi - 110 055.
Cell: +91-98117 45677
Tel: +91-11-4533 3200
E-mail: swati.agrawal@careratings.com

**PUNE**
**Mr.Pratim Banerjee**
9th Floor, Pride Kumar Senate,
Plot No. 970, Bhamburda, Senapati Bapat Road,
Shivaji Nagar, Pune - 411 015.
Cell: +91-98361 07331
Tel: +91-20- 4000 9000
E-mail: pratim.banerjee@careratings.com

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