Ujjivan Small Finance Bank Limited

July 07, 2020

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long term Bank Facilities	407.63 (reduced from Rs.1,386.31 crore)	**CARE A+; Stable (Single A Plus; Outlook: Stable)**	**Reaffirmed**
Long term Bank Facilities-Proposed	- (reduced from Rs.72.75 crore)	**-**	**Withdrawn@**
Total	**407.63 (Rs. Four hundred seven crore and sixty three lakhs only)**		

Details of instruments/facilities in Annexure-1 |@ rating is withdrawn as company has not raised proposed facility.

Detailed Rationale and Key Rating Drivers

The rating assigned to the bank facilities of Ujjivan Small Finance Bank Limited (USFB) continues to derive strength from bank's experienced promoter group with seasoned management, comfortable capitalization profile post equity raised by way of IPO and inheritance of geographically well-diversified client portfolio and well-developed portfolio management systems from Ujjivan Financial Services Limited (UFSL). The rating also continues to factor in the expansion of banking operations albeit portfolio still being largely microfinance focused, with bank increasing its branch network, launching various products under liabilities and asset side, and diversified resource profile with mobilizing considerable amount of deposits (majorly in form of term deposits) to repay the high cost bank loans albeit traction in CASA and secured non-MFI portfolio buildup has been slow. The rating also takes into account bank's consistent profitability aided by improvement in operational efficiency as witnessed in improvement in cost to income ratio of bank during FY20, however the same continues to remain high. The rating also derives strength from moderate asset quality ratios of bank with stable GNPA% and NNPA% although there was marginal increase in PAR>0 (Portfolio at risk). Bank's provision coverage ratio continues to remain high as on March 31, 2020. The rating, continues to remain constrained by lack of diversity in income profile with unsecured MFI portfolio continuing to constitute 77.3% of asset base, exposure to inherent risk associated with marginal borrower profile and 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 banking transition including branch expansion, staffing, regulatory compliance and technology and infrastructure spending. Further, performance of unseasoned non-MFI portfolio also remains to be seen. Weaker economic environment post the outbreak of COVID has elevated the credit risk for the bank. At the same time, bank's loss absorption capacity is satisfactory with strong pre-provisioning profits and healthy Tier I capital. The liquidity coverage ratio of bank also remained comfortable at 253.92% as on March 31, 2020 as against the regulatory requirement of 90%.

Rating Sensitivities

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

- Scale up of its business with sustained diversification in secured asset class while maintaining asset quality on a reasonably seasoned portfolio.

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

- Delay in ramp up in collections to pre-pandemic levels.
- Material deterioration in asset quality impacting earnings profile of the bank.

Detailed description of the key rating drivers

Key Rating Strengths

Comfortable capitalization profile post equity raised by way of IPO: USFB reports capital ratios as per BASEL II guideline, as per which, USFB's overall CAR and Tier-1 capital have improved from 18.95% and 18.39% as on March 31, 2019 to 28.82% and 28.00% respectively as on March 31, 2020 and the same remains comfortably above regulatory requirement of 15% and 7.5% respectively. Improvement in CAR and Tier-I CAR is on account of equity raised by bank through IPO and employee stock option scheme amounting to Rs.1045 crore as well as aided by profit accretion during FY20.

Experienced promoter group with seasoned management: The present senior management team of USFB is largely stable and highly experienced in financial sector. Mr. Nitin Chugh is the current Managing Director (MD) and Chief Executive Officer (CEO) who replaced founder-director Mr. Samit Gosh w.e.f. December 1, 2019. He has experience of 25 years in banking industry. USFB's Board comprises of 10 directors which includes MD, 3 Non-Executive directors and six Independent Directors with

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

diverse experience, who bring valuable expertise to the Bank. Bank has further strengthened senior management team and had brought in new Head of credit, Head of digital banking, Head of MSE and Head of liabilities.

Strong growth in business and geographically well-diversified client portfolio: USFB had commenced its operation from February 01, 2017 and has been able to scale up its operations and branch network, over last year, with bank closing the year with 575 full-fledged banking branches (including 144 unbanked rural centers) as against 524 bank branches at the beginning of the year. Also with the commencement of banking operations, USFB has introduced new products like home loan, loans against property, secured and unsecured loans to Micro, small and medium enterprises, under assets side, and various deposits products under liability side.

USFB's gross loan portfolio stood at Rs.14,153 crore spread across 24 states and UTs as on March 31, 2020, with active borrowers of 43.5 lac (PY: 40.2 lacs). Top five states of Karnataka, West Bengal, Tamil Nadu, Maharashtra and Gujarat contributed to remain high at 61.98% of the overall portfolio as on March 2020 (60.93% of the overall portfolio as on March 31, 2019).

Moderate asset quality levels: Bank's asset quality parameters continue to remain moderate with GNPA% and NNPA% at 0.97% and 0.20% as on March 31, 2020 as against 0.92% and 0.26% respectively as on March 31, 2019. USFB has taken prudent write-off of around Rs.64.1 crore and made provisions of Rs.109.7 crore, which has helped the bank to contain GNPA and NNPA ratios. Provision coverage continues to remain high at 79.95% (Mar'19:71.84%). Bank's asset quality is also attributable to high share of repeat loans to customers with good credit history. 64% of loan disbursements in MFI segment during FY20 were extended towards existing customers. This along with satisfactory performance of fresh disbursement had resulted in maintaining asset quality. However bank's Portfolio at Risk (PAR>0) has marginally increased from 1.6% as on March 31, 2019 to 2.01% as on March 31, 2020. Bank's Net NPA to Networth also witnessed improvement and stood at 0.86% as on March 31, 2020 as against 1.91% as on March 31, 2019. 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. Going forward, the ability of Bank to maintain its asset quality while achieving growth in diverse asset classes will be key rating sensitivities.

Traction in deposit raising: Post the receipt of scheduled bank status from RBI, USFB has focused on mobilizing sizeable wholesale and retail deposits and certificate of deposits to retire high cost grandfathered borrowings, which has helped the bank to reduce its average cost of borrowings. Deposits as a percentage of total liabilities has increased from 53.7% as on March 31, 2019 to 58.5% as on March 31, 2020. Out of the total deposits outstanding of Rs.10,780 crore as on March 31, 2020, certificate of deposits constituted 7.86%, term deposits from institutional investors formed 46.77%, term deposits from retail investor constituted 31.84% and CASA proportion also increased from 10.62% of overall deposits as on March 31, 2019 to 13.53% as on March 31, 2020. Going forward, bank plans to scale up 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. With increase in share of Deposits, deposits funded 76.1% of advances (PY: 69.4%).

Consistent profitability albeit high cost to income ratio of the bank: USFB's AUM grew by 33.2% from Rs.10,623 crore in FY19 to Rs.14,153 crore in FY20. During FY20, bank's total income witnessed increase of 48.5% and stood at Rs.3026 crore (FY19:Rs.2038 crore) aided by healthy increase in interest income of 47.6% and non-interest income by 56.3%. Bank's Net Interest Income (NII) increased by 47.7% and stood at Rs.322 crore (FY19:Rs.206 crore) in line with growth in interest income. NIM has improved to 10.16% in FY20 as against 9.53% in FY19 aided by decrease in average cost of funds which stood at 7.88% during FY20 as against 8.40% in FY19, mainly owing to bank replacing high cost debt with lower cost term deposits. Yield on advances also improved from 19.32% in FY19 to 20.75% in FY20 aided by higher yield achieved by bank in MFI segment. Bank's operational efficiency also witnessed improvement with cost to income ratio of the bank declining from 76.45% in FY19 to 67.42% in FY20, however the same continues to remain high compared to its peers. However bank is taking measures to control the increasing operational expenses and targets further improvement going forward.

With improvement in NII and improvement in operational efficiency, bank reported Pre Provisioning Operating Profit (PPOP) of Rs.637 crore in FY20 as against Rs.309 crore in FY19. Owing to the same, despite higher provisioning cost of Rs.171 crore in FY20 as against Rs.41 crore in FY19, USFB recorded net profit of Rs.350 crore in FY20 as against Rs.199 crore in FY19. Consequently, USFB's ROTA also improved to 2.18x in FY20 (FY19:1.72x).

Key Rating Weaknesses
Low retail deposit base and lower CASA deposits than its comparable peers: USFB's share of retail deposits has been gradually increasing, although it still remains fairly moderate at 40.5% of total term deposits as on March 31, 2020. CASA was also low at 13.53% of total deposits as on March 31, 2020, lower compared to peer banks.

Slow traction in build-up of secured non-MFI portfolio and marginal borrower profile: The portfolio of the bank is still concentrated to MFI; however the share of non-MFI portfolio has improved from 15.3% as March 31, 2019 to 22.7% as on March 31, 2020. Presently the non-MFI portfolio majorly comprises of housing loan segment (10.76% of the total loan portfolio), loans to MSE segment (6.92% of total loan portfolio) and loans to financial institution (FIG) segments. While the asset quality parameters remain satisfactory, performance of the unseasoned non-MFI portfolio remains to be seen. Further, weaker economic environment post the coronavirus outbreak elevated the credit risk for the bank. At the same time, bank's loss absorption capacity with strong pre-provisioning income and strong Tier I capital is satisfactory.

Liquidity position: Adequate
According to the bank's structural liquidity statement (SLS) as on May 31, 2020, liquidity profile is comfortable with no cumulative negative mismatches in any of the time buckets. The liquidity coverage ratio of bank remained comfortable at 253.92% as on March 31, 2020 as against the regulatory requirement of 90%. Moreover, Bank has excess SLR of Rs. 1115.3 crore as on May 31, 2020 over the regulatory requirements. Liquidity is also supported by the refinance lines available to it from SIDBI & NABARD and also through sale of PSL certificate to other banks which are short of PSL targets.

Analytical approach: Standalone.

Applicable Criteria
Financial Ratios – Financial Sector
Criteria on assigning 'outlook' and 'credit watch' to Credit Ratings
CARE's Policy on Default Recognition
Rating Methodology – Banks

About the Company
USFB, incorporated on July 04, 2016 is a 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 USFB, the entire assets/liabilities of UFSL had been transferred to USFB. As per the listing norms requirement of RBI for SFBs, Bank concluded its IPO process and got listed on NSE and BSE on December 12, 2019. Post IPO, UFSL's shareholding stands at 83.32% in USFB.
As on March 31, 2020, the bank has a branch network of 575 branches and has 475 biometric ATMs. The bank has presence across 24 States and Union Territories of India, and with an overall portfolio of around Rs.14,153 crore as on March 31, 2020.

Brief Financials (Rs. crore)	FY19 (A)	FY20 (A)
Total operating income	2,038	3,026
PAT	199	350
Interest coverage (times)	1.43	1.60
Total Assets	13,742	18,411
Net NPA (%)	0.26	0.20
ROTA (%)	1.72	2.18

A: Audited

Covenants of rated instrument / facility: *Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3.*

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

Any other information: Not Applicable.

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

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	ISIN No.	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Term Loan	-	-	-	-	0.00	Withdrawn
Fund-based-Long Term	-	-	-	July 2022	407.63	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 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Fund-based - LT-Term Loan	LT	-	-	-	1)CARE A+; Stable (03-Jul-19)	1)CARE A+; Stable (06-Jul-18)	1)CARE A+; Stable (06-Sep-17) 2)CARE A+; Stable (12-Apr-17)
2.	Debentures-Non Convertible Debentures	LT	-	-	-	-	-	1)Withdrawn (06-Sep-17) 2)CARE A+; Stable (12-Apr-17)
3.	Debentures-Non Convertible Debentures	LT	-	-	-	1)Withdrawn (30-Aug-19) 2)CARE A+; Stable (03-Jul-19)	1)CARE A+; Stable (06-Jul-18)	1)CARE A+; Stable (06-Sep-17) 2)CARE A+; Stable (12-Apr-17)
4.	Debentures-Non Convertible Debentures	LT	-	-	-	-	-	1)Withdrawn (06-Sep-17) 2)CARE A+; Stable (12-Apr-17)
5.	Debentures-Non Convertible Debentures	LT	-	-	-	-	1)Withdrawn (19-Sep-18) 2)CARE A+; Stable (06-Jul-18)	1)CARE A+; Stable (06-Sep-17) 2)CARE A+; Stable (12-Apr-17)
6.	Fund-based-Long Term	LT	407.63	CARE A+; Stable	-	1)CARE A+; Stable (03-Jul-19)	1)CARE A+; Stable (06-Jul-18)	1)CARE A+; Stable (06-Sep-17) 2)CARE A+; Stable (12-Apr-17)

7.	Debentures-Non Convertible Debentures	LT	-	-	-	1)Withdrawn (03-Jul-19)	1)CARE A+; Stable (06-Jul-18)	1)CARE A+; Stable (06-Sep-17) 2)CARE A+; Stable (12-Apr-17)

Annexure-3: Detailed explanation of covenants of the rated instrument / facilities

Long term bank facilities	Detailed explanation
Financial covenants	
i. CAR above 15%	Bank shall maintain CAR above 15% at all times.
ii. Tier I CAR above 7.5%	Bank shall maintain Tier-I CAR above 7.5% at all times.

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.*

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