Ujjivan Small Finance Bank

July 03, 2019

Ratings

Facilities	**Amount (Rs. crore)**	**Rating1**	**Rating Action**
Long term Bank Facilities	1459.06 (reduced from 4250.00)	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Non- Convertible Debentures- (NCD VI)@	-	-	Withdrawn
Total Facilities	**1499.06 (Rs. One thousand ninety nine crore and six lakhs only)**		

Details of instruments/facilities in Annexure-1|@ Rating withdrawn post payment confirmation from USFB and Debenture Trustee

Detailed Rationale & 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, 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 also continues to factor in the successful expansion 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 albeit traction in CASA and secured non-MFI portfolio buildup has been slow. The rating also takes into account increase in cost to income ratio of Bank during FY19 which led to decline in operating profits of USFB despite increase in net increase income of the bank by 28.45%. However, owing to lower provisions in FY19, net profit of the Bank improved significantly. The rating also takes notes of improvement in asset quality ratios of Bank with improvement in GNPA%, NNPA% and reduction in PAR>0 (Portfolio at risk) as well as provision coverage ratio continues to remain high as on March 31, 2019. The rating, continues to remain constrained by lack of diversity in income profile with unsecured MFI portfolio continuing to constitute more than 85% 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 branch expansion, staffing, regulatory compliance and technology and infrastructure spending as witnessed in significant rise in cost to income ratio of the bank. Further, performance of unseasoned non-MFI portfolio remains to be seen. Going forward the ability of the bank to maintain its asset quality, while achieving growth in diverse asset classes, 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. As part of succession planning, company has appointed Mr. Nitin Chugh as MD&CEO of the bank with effect from December 01, 2019 who has experience of 25 years in banking industry.

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 and has been able to scale up its operations and branch network, over last year, with bank closing FY19 with 474 full-fledged banking branches (including 120 unbanked rural centers) as against 187 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. Bank is planning to introduce two wheeler and three wheeler vehicle loan during FY20.

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

Geographically well-diversified client portfolio but slow traction in secured non-MFI portfolio buildup: USFB's loan portfolio Rs.10,623 crore is spread across 24 states and UTs as on March 31, 2019, with active borrowers of 40.2 lacs (PY: 37.1 lacs). However top four states of Karnataka, West Bengal, Tamil Nadu and Maharashtra contributed to approximately 54.09% of the overall portfolio as on March 2019 (53.56% of the overall portfolio as on March 2018), the single State concentration had effectively increased to 16.74% as on March 2019 (15.13% as on March 2018). 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 7.3% as Mar'18 to 15.3% as on Mar'19. Presently the non-MFI portfolio includes a mix of secured and unsecured portfolio. Bank has a wholesale book portfolio of Rs.225 crore as on March 31, 2019.

Improvement in the asset quality, but risks associated with marginal borrower profile remains: Bank as a concentrated effort had suspended new customer acquisition in areas, where delinquency level was high, though repeat loans to customers with good credit history continued. This along with satisfactory performance of fresh disbursement had resulted in reduction in Portfolio at Risk (PAR>0) from 4.0% as on March 31, 2018 to 1.6% as on March 31, 2019. USFB has taken prudent write-off of around Rs.177.8 crore and made adequate provisions leading to credit cost of around Rs.231.7 crore, which has helped the bank to improve its asset quality, with GNPA and NNPA at 0.92% & 0.26% as on March 31, 2019 as against the GNPA and NNPA of 3.65% & 0.69% respectively as on March 31, 2018. The collection efficiency of the MFI portfolio improved from 93.56% in FY18 to 98.2% in FY19. Provision coverage continues to remain high at around 71.84% (Mar'18:81.52%). Bank's Net NPA to Networth was around 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. With significant share of advances continuing to remain exposed to the marginal borrower profile, USFB will continue to face the challenge of risks associated with such segment including political and operational. USFB follows accelerated provisioning against regulatory requirement, which helps the bank to gradually account for substandard assets. Going forward, the ability of Bank to maintain its asset quality while achieving growth in diverse asset classes will be key rating sensitivities.

Diversified resource profile, with bank repaying high cost bank loans with wholesale deposits: Post the receipt of scheduled bank status from RBI, USFB has focused on mobilizing sizeable wholesale 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 49% as on March 31, 2018 to 62% as on March 31, 2019. Out of the total deposits outstanding of Rs.7379 crore as on March 31, 2019, certificate of deposits constituted around 13.31%, term deposits from institutional investors formed 49.57%, term deposits from retail investor increased from 7.66% as on March 31, 2018 to 26.49% as on March 31, 2019 and CASA proportion also increased from 3.66% of overall deposits as on March 31, 2018 to 10.62% as on March 31, 2019. Going forward, bank plans to scaling up of existing bank branches and with introducing family banking segment targeting family members of already existing customers, USFB is targeting to increase the share of low cost CASA deposits. .

Improvement in profitability owing to lower credit cost: USFB's AUM grew by 44.8% from Rs.7,335 crore in FY18 to Rs.10,623 crore in FY19. Interest yield on advances has decreased from 19.89% in FY18 to 19.32% in FY18, primarily on account of 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. NIM remained stable at 9.53% in FY19 to 9.62% in FY19.
Net Interest income of the bank had grown by 28.45% from Rs.861 crore in FY18 to Rs.1106 crore in FY19 and along with lower credit cost of Rs. 231.7 crore during FY19 as against Rs.386.9 crore during FY18 bank's net profits improved to Rs.199.22 crore as against Rs.6.86 crore in FY18.

Key Rating Weaknesses

Significant rise in cost to income with high operational cost for the setup of new branches: On account of bank incurring high operational cost for the setup of new branches in the form of rentals, employee cost, and IT related expense, bank's operating profit slightly moderated from Rs.320 crore in FY18 to Rs.309 crore in FY19 and cost to income ratio deteriorated further from 67.13% in FY18 to 76.45% in FY19. Bank is planning to convert all of its remaining asset branches into full-fledged bank branches in FY20, which is expected to keep the cost to income ratio high. However bank is taking measures to control the increasing operational expenses and has targeted to achieve cost to income ratio of 72% for FY20.

Low retail deposit base and lower CASA deposits than its comparable peers: Post transition to bank in February 2017, most of fiscal 2018 was spent in overcoming demonetization related challenges. USFB's share of retail deposits has been gradually increasing, although it still remains fairly small at 37.1% of total deposits as on March 31, 2019. CASA was also low at 10.62% of total deposits as on March 31, 2019, lower compared to peer banks.

Industry prospects: Transformation from NBFC to SFB offers various benefits including ability to offer wider range of products both on assets and liability side, reduce cost of funds, increased regulatory supervision and support. UFSB is working towards stabilization of its banking operations including diversifying its asset portfolio and increasing the share of low cost retail deposits.

Adequate liquidity position: According to the bank's structural liquidity statement (SLS) as on March 31, 2019, liquidity profile is comfortable with no cumulative negative mismatches in any of the time buckets. The liquidity coverage ratio of bank remained comfortable at 186.54% as on Mar'19. Moreover, Bank had excess SLR of Rs. 575 crore as on Mar'19 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. 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 Financials 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, 2019, the bank has 474 branches (including 120 Unbanked Rural Centres). Further the bank has 385 biometric ATMs as on March 31, 2019. The bank has presence across 24 the States and Union Territories of India, and with an overall portfolio of around Rs.11,049 crore as on March 31, 2019

Brief Financials (Rs. crore)	FY18 (A)	FY19 (A)
Total operating income	1579	2038
PAT	7	199
Interest coverage (times)	1.53	1.43
Total Assets	9473	13742
Net NPA (%)	0.69	0.26
ROTA (%)	0.08	1.72

A: Audited
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	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Term Loan- Proposed	-	-	-	72.75	CARE A+; Stable
Fund-based-Long Term	-	-	August 05, 2021	1386.31	CARE A+; Stable
Debentures-Non Convertible Debentures	July 01, 2014	12.60%	May 28, 2019	0.00	Withdrawn
Debentures-Non Convertible Debentures	July 30, 2013	10.95%	July 30, 2019	40.00	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 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Fund-based - LT-Term Loan- Proposed	LT	72.75	CARE A+; Stable	-	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	40.00	CARE A+; Stable	-	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	1386.31	CARE A+; Stable	-	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)CARE A+; Stable (06-Jul-18)	1)CARE A+; Stable (06-Sep-17) 2)CARE A+; Stable (12-Apr-17)	-

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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