Utkarsh Small Finance Bank Limited

December 23, 2019

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long term Bank Facilities	13.64 (reduced from 109.26)	CARE A; Stable (Single A; Outlook: Stable)	Reaffirmed
Total	**13.64 (Rs. Thirteen Crore and sixty four lacs only)**		
Non-Convertible Debentures	- (reduced from 38.56)*	CARE A; Stable (Single A; Outlook: Stable)	Withdrawn
Non-Convertible Debentures	50# (reduced from 75) (Rs. Seventy Five Crore Only)	CARE A; Stable (Single A; Outlook: Stable)	Reaffirmed
Non-convertible debentures	77.50@ (reduced from 125.50) (Rs. Seventy Seven Crore Fifty lacs only)	CARE A; Stable (Single A; Outlook: Stable)	Reaffirmed
Non convertible debentures	135 (Rs. One Hundred Thirty Five Crore Only)	CARE A; Stable (Single A; Outlook: Stable)	Reaffirmed
Non convertible debentures	50 (Rs. Fifty Crore only)	CARE A; Stable (Single A; Outlook: Stable)	Reaffirmed
Long Term - Tier-II Bonds	150 (Rs. One Hundred Fifty Crore only)	CARE A; Stable (Single A; Outlook: Stable)	Reaffirmed
Long Term - Tier-II Bonds	40 (Rs. Forty Crore only)	CARE A; Stable (Single A; Outlook: Stable)	Reaffirmed

Details of instruments/facilities in Annexure-1

* Upon redemption of NCD (ISIN: INE396P07084) of Rs.38.56 crore

Upon Part payment of the NCD issue (ISIN: INE396P07118)

@ Upon Redemption of NCD (ISIN: INE396P08025) of issue size Rs.80 crore upon balance repayment of Rs.48 crore

Detailed Rationale & Key Rating Drivers

The rating assigned to the bank facilities and various instruments of Utkarsh Small Finance Bank Limited (USFBL) continue to derive strength from the bank's long track record of operations in microfinance lending, experienced managed team for managing the various banking operations, improved financial performance during FY19 and H1FY20 supported by strong growth in income and profitability in line with robust growth in AUM and incrementally lower delinquencies resulting in healthy asset quality, significant mobilization of deposits with increasing share of the retail and CASA deposits and access to diverse funding sources since commencement of operations as small finance bank resulting in the comfortable liquidity position of the bank. The ratings also continue to factor in the diversified institutional equity investors base at the holdco level and comfortable capitalization levels of USFBL given substantial capital raised (~Rs.550 crore since October 2016) which has allowed USFBL to grow its loan book and absorb the high credit costs following weakness in collections post demonetization.

The ratings however continue to be constrained by geographic concentration in Uttar Pradesh and Bihar (76% of retail book), significant concentration to micro finance lending (JLG loans forming 89% of AUM as on Sept-19), lack of diversity in earnings profile, short track record in non-microfinance lending (Micro Enterprise Loans and Home Loan portfolio) and the inherent risk involved in the microfinance segment including socio-political intervention risk and due to unsecured lending.

<u>Rating Sensitivities</u>

Positive Factors

- Successful listing on the exchange upon IPO in FY21
- Further diversification of product offering along with geographical diversification on sustained basis
- Increase its retail deposit base
- Improve profitability indicators on a sustained basis

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

Negative Factors

- Weakening of asset quality
- Weakening of liquidity levels
- Delay in IPO and capital raising plans and consequent deterioration in capital adequacy and ability to expand the operations due to statutory limitations

Detailed description of the key rating drivers

Key Rating Strengths

Experienced management team

The operations of USFBL are headed by Mr. Govind Singh who is the Managing Director and CEO of USFBL. He has an extensive experience of over 30 years in the Banking and Microfinance sector including having promoted Utkarsh Micro Finance Limited (UMFL) in 2009 for carrying out micro lending activities. The overall operations of the bank are governed by the Board of Directors consisting of eminent members from across banking, financial services, consulting and social sector. The operations (Lending, Treasury, Risk, IT, Legal & Compliance, Liability etc.) of the bank are managed by a senior management team having rich experience in the financial services, banking and microfinance sector. The bank has appointed Business heads for each of the product verticals as the product mix is expected to gradually move towards MSME and Affordable Housing loans although JLG loans would continue to contribute to the product mix majorly during the initial stages of operations of the SFB.

Strong and diversified investor base and comfortable capital adequacy albeit increasing gearing levels with the scale up loan book

USFBL is a subsidiary of Utkarsh CoreInvest Limited (UCL) formerly Utkarsh Micro Finance Limited (UMFL) registered as CIC-ND-SI with RBI. UCL had a strong investor base with CDC (Commonwealth Development Corporation) Group Plc, the development financial institution of UK Govt, being the key foreign investor in UCL holding 14.12% stake besides NMI Frontier Fund KS (7.92%), responsAbility Participations Mauritius (4.98%), Sarva Capital (3.05%), Aavishkaar Goodwell India Microfinance Development Company (4.12%) and International Finance Corporation (IFC, 2.87%) and sustainability finance holding 2.26% stake in the bank.

As one of the pre-requisites for formation of the Small Finance Bank by RBI was capping of the foreign shareholding in SFB to less than 49%, substantial capital of Rs.395 crore was raised in UMFL in Oct 2016 prior to receipt of license for commencement of operations as SFB from the domestic investors in with another round of equity infusion of Rs.150 crore at the holding company level through right issue in FY18. Major domestic investors in UCL as on June-19 are RBL Bank Ltd (9.98%), Faering Capital India Evolving Fund (9.98%), Hero Enterprise Partner Ventures (4.98%), Shriram Life Insurance Company Limited (4.96%), ICICI Prudential Life Insurance Ltd (4.27%), SIDBI (4.37%), Jhelum Investment Fund (3.29%), HDFC Standard Life Insurance Company Limited (3.20%).

The capital raised in UCL had been further fully invested in USFBL. USFBL's capitalization is comfortable as reflected by its CAR and Tier-I CAR of 24.97% and 21.9% as on Sept 30, 2019. However, the gearing levels have increased with the scale up loan book as well as excess liquidity being maintained by USFBL. The adjusted gearing of USFBL stood at 7.1x as on Sept-19 increased from 6.6x as on Mar-19 (5.5x as on Mar-18).

Bank is also planning to raise further equity funds into bank to provide the required growth capital to support its growing scale of operations including the proposed IPO issue in H2FY21 to meet the regulatory requirement for formation of the Small Finance Bank. USFBL also intends to raise Tier-II capital to meet its capital requirement.

Improvement in asset quality as a result of write-offs/provisioning and increase in collections post demonetization impact

The asset quality of USFBL remains stable with GNPA and NNPA being 1.39% and 0.12% as on Mar-19 as against 1.84% and 1.09% as on Mar-18. USFBL has reported GNPA and NNPA of 1.50% and 0.15% as on Sept-19.

USFBL's overall collection efficiency had dropped significantly following demonetization with major affected areas being Maharashtra, MP and Uttarakhand where recovery of loans was slow; however, the same has been restored as a result of improved collections and significant impact taken through write-offs/provisioning following the same. Consequently, USFBL made a lower provisioning for credit cost of 1.32% in FY19 (PY 4.75%) with majorly of the provision/write-off of Rs.71 crore during FY19 pertaining to an exposure of Rs.40 crore to IL&FS Financial services.

Overall given major portfolio of USFBL being JLG loans (the segment in which it has long standing presence), the asset quality of the company has been good (PAR 1 of 1.35% and PAR 90 of 0.55%), however, it has seen higher delinquencies in new segment (Individual MSME loans: PAR 1 of 12.8% and PAR 90 of 3.7%). Delinquencies in housing loan segment also have been controlled, however, these being longer tenure loans, the portfolio is yet to season fully.

Adequate risk management systems
USFBL has in place an efficient monitoring structure for overseeing its operations at various levels, at branch, area level, regional level and divisional levels. It has put in place risk management systems since inception viz. defined credit appraisal, collection and monitoring systems including profile of the clients and outer limit of loan size with risk monitoring matrix defined for measuring operational, market, liquidity and credit risks. Specialized software and user-level restrictions are in place to ensure a speedy access to the information with data security. Core banking Solution has also been implemented for undertaking banking operations.

Growth in loan portfolio
USFBL had registered a robust growth of 47% in its AUM from Rs.3,230 cr as on Mar-18 to Rs.4,758 cr as on Mar-19. The AUM has further grown by 10% to Rs.5254 crore as on Sept-19. Presently, the operations of the bank are spread across twelve states i.e. Uttar Pradesh, Bihar, Madhya Pradesh, Haryana, Uttarakhand, Maharashtra, Delhi, Himachal Pradesh, Chhattisgarh, Jharkhand and West Bengal. As on Sept-19, its AUM comprised MFI loans (89% of loan book), wholesale lending (6%), MSME loans (4%) and housing finance (1%). The bank is focusing to build its MSME and Affordable Housing Loan, leveraging its branch network and as a result, the share of these loan segments in USFBL's loan book is expected to increase going forward. However, these being new products and loan book being small, the track record of asset quality and profitability in these segments, is yet to be established.

Profitable operations during FY19 and H1FY20
USFBL's total operating income grew by 74% from Rs.562 crore during FY18 to Rs.939 crore during FY19 on the back of 47% growth in AUM during FY19. There was rationalization in operating expenses also seen during FY19 as reflected by reduction in Adj. Opex/ATA by 43bps to 6.05% in FY19 as against 6.48% in FY18. Also, with much of the impact of demonetization being absorbed by end of FY18, the credit cost was lower at 1.32% in FY19 as against 4.75% in FY19. Consequently, USFBL has reported PAT of Rs.94 crore in FY19 as against net loss of Rs.61 crore during FY18.

USFBL reported a PAT of Rs.115 crore in H1FY20 as against Rs.94 crore during FY19. The improvement in profitability was owing to the higher asset base, increase in yield resulting in higher Adj. NIM (9.73%) in H1FY20 as against 9.21% in FY19, higher other income (including income from sale of PSL certificates) of Rs.51 crore seen in H1FY20 (as against Rs.60 crore in FY19). Other income / Adj. ATA was 1.45% in H1FY20 as against 1.11% in FY19. As against increase in NIM and Other income, operating expenses remained stable at 6.0% in H1FY20 (as against 6.05% in FY19). Also, the credit cost declined from 1.32% in FY19 to 0.54% in H1FY20 as much of the credit cost was absorbed in FY18 and FY19. Consequently, ROTA improved from 1.74% in FY19 to 3.36% in H1FY20.

Improvement in resource base with significant mobilization of deposits
USFBL commenced operations as SFB in January 2017. With transition to banking operations, USFBL has raised significant funds through deposits which now constitute 75% of the borrowing mix as on Sept-19 as against just 1% as on Mar-17 which have helped in reducing the borrowing cost of the bank. USFBL has also raised funds in the form of Certificate of Deposits from Institutional Investors primarily Mutual Funds and Banks. Besides deposits, the bank has also raised refinance loans from SIDBI and NABARD and term borrowings from other Banks. The bank has been accorded the scheduled bank status by RBI and can thus access money market and also raise borrowings under MSS and LAF window from RBI in case of exigencies. USFBL has been running down its high cost secured borrowings (Term loans from Banks and NCDs raised from FIs/Investors). The legacy loans of USFBL viz. term loans from banks and NCDs i.e. secured borrowings raised as an MFI have been running down.

Key Rating Weaknesses
High reliance on bulk deposits albeit increase in retail deposit base with expansion of the general banking network
The bank has so far set up 77 general banking branches across the country, increased from 55 branches as on June-18. With the set-up of the branch network the deposit base of the bank has improved. The share of retail deposits (CASA and Retail Term deposits) has also been gradually increasing, although it still remains moderate at 42% (including CASA deposits of 10%) as on Sept 30, 2019.

Majority of the deposits of the banks are still bulk deposits (58% of the overall deposits as on Sept-19) largely raised from the Urban Co-operative Banks and Regional Rural Banks. The top 10 depositors constituted 31% of total deposits as on Aug-19. However, given that most of the bulk deposits are non-callable deposits, it insulates the bank against short term liquidity shocks.

Retail deposit buildup especially CASA buildup would take time as the bank expands its branch network, brand awareness and leverages the existing JLG borrower base to garner the retail deposits.

Geographical concentration and lack of diversity in product mix and earnings profile
While USFBL has presence in 12 states, currently a sizeable loan portfolio is concentrated in two states (Bihar and UP) which contributed 76% of the overall on-book retail loan portfolio as on Sept 30, 2019. Single largest state (Bihar) portfolio /Networth stood at 256% as on Sept 30, 2019. Going forward, the bank intends to further diversify its operations and plans to enter new territories thereby bringing down the concentration of the two states in the overall loan portfolio.

JLG loans formed nearly 89% of the total AUM as on Sept 30, 2019 with balance being contributed by Corporate loans, MSME Loans and Housing Loans. USFBL intends to grow its MSME and Housing Loan book while introducing new products and bring down the share of MFI loans in the overall loan portfolio over the medium term.

Diversification in product mix and consequently reduction in micro finance loan book as well as reduction in geographical concentration would be critical for its credit profile.

Inherent risks associated with micro lending
With significant share of advances continuing to be microfinance lending, USFBL will continue to face the challenge of risks associated with such segment viz. socio-political intervention risk and risks emanating from unsecured lending and marginal profile of borrowers who are vulnerable to economic downturns besides operational risks related to cash based transaction.

Liquidity: Strong
As per the bank's structural liquidity statement (SLS) as on Sept 30, 2019, liquidity profile is comfortable with no cumulative negative mismatches in any of the time buckets on account of comfortable capital structure and short-term nature of its loan assets as most loans are JLG loans having maximum tenure of up to 2 years.

The liquidity profile of USFBL is also supported by access to diverse funding sources including inter-bank borrowing limits, un-availed refinance lines and ability to borrow from RBI under MSS/LAF window and from call money market against the excess liquidity maintained over and above the regulatory requirement of SLR of 18.5%.
Liquidity Coverage Ratio (LCR) of USFBL stood at 528% as on Mar-19 as against the regulatory requirement of 80%. The bank also benefits from the rollover of deposits.

Analytical approach: Standalone. Combined view taken basis the consolidated financials of USFBL and UCL (formerly UMFL) till FY17, since the assets and liabilities of UMFL was acquired by USFBL through a slump sale concluded on January 21, 2017.

Applicable Criteria
Criteria on assigning Outlook to Credit Ratings
CARE's Policy on Default Recognition
Rating Methodology: Consolidation and Factoring Linkages in Ratings
CARE's Credit Rating Process: Policy on Withdrawal of ratings
CARE's Rating Methodology for Banks
CARE Methodology for Non-Banking Finance Companies
Financial Sector Ratios

About the Company
Utkarsh Small Finance Bank Ltd (USFBL) based out of Varanasi is a 99.99% subsidiary of Utkarsh CoreInvest Limited (UCL). The company commenced banking operations on January 23, 2017 upon receipt of license from RBI on Nov 25, 2016 and subsequent transfer of business from UMFL which was carrying on the micro lending operations since September 2009. USFBL extends microfinance loans based on JLG Model to individuals which constitutes nearly 89% of the Assets under Management (AUM) of the company as on September 30, 2019. The company also extends wholesale loans, MSME Loans and Housing Loans to borrowers. The AUM of USFBL stood at Rs.5,254 Crore as on Sept 30, 2019. The operations of the bank are currently spread across twelve states i.e. Uttar Pradesh, Bihar, Madhya Pradesh, Haryana, Uttarakhand, Maharashtra, Delhi, Himachal Pradesh, Chhattisgarh, Jharkhand, West Bengal and Odisha.

Brief Financials (Rs. Crore)	FY18 (A)	FY19 (A)
Total operating income	562	939
PAT	-63	94
Total Assets@	4528	6208
Net NPA (%)	1.09	0.15
Adj. ROTA (%)*	-1.72	1.74

A: Audited;

* Calculated based on opening and closing balance of total assets including off-book portfolio
@ Total Assets = Total Assets as per BS – DTA – Deferred Revenue Expenditure – Intangible Assets
@ Tangible Net-worth = Net-worth as per BS – DTA – Deferred Revenue Expenditure – Intangible Assets

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	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue rated (Rs. crore)	Rating assigned along with Rating Outlook
Bank Facilities-Term Loan	-	-	-	Dec-19	13.64	CARE A; Stable
Debentures-Non Convertible Debentures#	INE396P07118	17-Mar-16	12.50%	17-Mar-21	50.00	CARE A; Stable
Debentures-Non Convertible Debentures^	INE396P08041	29-Dec-16	10.80%	27-Dec-19	37.50	CARE A; Stable
Debentures-Non Convertible Debentures^	INE396P08058	30-Dec-16	11.00%	13-Dec-19	40.00	CARE A; Stable
Long Term Tier-II Bonds	INE396P08066	12-Jan-17	12.00%	30-Jun-22	150.00	CARE A; Stable
Debentures-Non Convertible Debentures	INE396P08074	12-Jan-17	11.70%	12-Jan-26	135.00	CARE A; Stable
Debentures-Non Convertible Debentures	INE396P08082	16-Jan-17	10.20%	16-Jan-20	50.00	CARE A; Stable
Long Term Tier-II Bonds/ Debentures $	INE735W08012	09-Jul-18	10.58%	09-Jul-25	25.00	CARE A; Stable
Long Term Tier-II Bonds/ Debentures (Proposed) $	INE735W08020	31-Aug-18	10.58%	30-Aug-25	15.00	CARE A; Stable

Upon Part payment of the NCD issue (ISIN: INE396P07118), reduced from Rs.75 crore
^Against the rated o/s amount of Rs.77.50 crore (2 NCDs of Rs.37.50 Cr and Rs.40 cr)
$ Against the rated amount of Rs.40 crore (2 NCDs of Rs.25 crore and Rs.15 crore)

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.	Debentures-Non Convertible Debentures	LT	-	-	-	1)CARE A; Stable (20-Sep-18)	1)CARE A; Stable (21-Jul-17)	1)CARE A; Stable (15-Dec-16)
2.	Fund-based - LT-Term Loan	LT	13.64	CARE A; Stable	-	1)CARE A; Stable (20-Sep-18)	1)CARE A; Stable (21-Jul-17)	1)CARE A; Stable (15-Dec-16)
3.	Commercial Paper	ST	-	-	-	-	1)Withdrawn (21-Jul-17)	1)CARE A1 (15-Dec-16) 2)CARE A1 (05-Aug-16)
4.	Debentures-Non Convertible Debentures	LT	50.00	CARE A; Stable	-	1)CARE A; Stable (20-Sep-18)	1)CARE A; Stable (21-Jul-17)	1)CARE A; Stable (15-Dec-16) 2)CARE A- (25-Apr-16)
5.	Bonds-Tier II Bonds	LT	150.00	CARE A; Stable	-	1)CARE A; Stable (20-Sep-18)	1)CARE A; Stable (21-Jul-17)	1)CARE A; Stable (15-Dec-16)
6.	Debentures-Non Convertible Debentures	LT	-	-	-	-	1)Withdrawn (21-Jul-17)	1)CARE A; Stable (15-Dec-16)
7.	Debentures-Non Convertible Debentures	LT	77.50	CARE A; Stable	-	1)CARE A; Stable (20-Sep-18)	1)CARE A; Stable (21-Jul-17)	1)CARE A; Stable (30-Dec-16)
8.	Debentures-Non Convertible Debentures	LT	135.00	CARE A; Stable	-	1)CARE A; Stable (20-Sep-18)	1)CARE A; Stable (21-Jul-17)	1)CARE A; Stable (25-Jan-17)
9.	Debentures-Non Convertible Debentures	LT	50.00	CARE A; Stable	-	1)CARE A; Stable (20-Sep-18)	1)CARE A; Stable (21-Jul-17)	1)CARE A; Stable (25-Jan-17)
10.	Bonds	LT	40.00	CARE A; Stable	-	1)CARE A; Stable (20-Sep-18) 2)CARE A; Stable (10-Jul-18)	-	-

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.

Contact us

Media Contact
Mradul Mishra
Contact no. – +91-22-6837 4424
Email ID – mradul.mishra@careratings.com

Analyst Contact
Mr. Gaurav Dixit
Contact no.- +91-11-45333235 (Tel); 09717070079 (Cell)
Email ID- gaurav.dixit@careratings.com

Relationship Contact
Ms. Swati Agrawal
Contact no.: +91-11-45333200 (Tel), 9811745677 (Cell)
Email ID: swati.agrawal@careratings.com

About CARE Ratings:
CARE Ratings commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

Disclaimer
CARE's ratings are opinions on the likelihood of timely payment of the obligations under the rated instrument and are not recommendations to sanction, renew, disburse or recall the concerned bank facilities or to buy, sell or hold any security. CARE's ratings do not convey suitability or price for the investor. CARE's ratings do not constitute an audit on the rated entity. CARE has based its ratings/outlooks on information obtained from sources believed by it to be accurate and reliable. CARE does not, however, guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. Most entities whose bank facilities/instruments are rated by CARE have paid a credit rating fee, based on the amount and type of bank facilities/instruments. CARE or its subsidiaries/associates may also have other commercial transactions with the entity. In case of partnership/proprietary concerns, the rating /outlook assigned by CARE is, inter-alia, based on the capital deployed by the partners/proprietor and the financial strength of the firm at present. The rating/outlook may undergo change in case of withdrawal of capital or the unsecured loans brought in by the partners/proprietor in addition to the financial performance and other relevant factors. CARE is not responsible for any errors and states that it has no financial liability whatsoever to the users of CARE's rating.

Our ratings do not factor in any rating related trigger clauses as per the terms of the facility/instrument, which may involve acceleration of payments in case of rating downgrades. However, if any such clauses are introduced and if triggered, the ratings may see volatility and sharp downgrades.

****For detailed Rationale Report and subscription information, please contact us at www.careratings.com**