SMALL FINANCE BANKS

Buoyant growth and improving asset quality to drive profitability; Outlook remains Stable

DECEMBER 2023

List of abbreviations

ARC	Asset reconstruction company
ATA	Average total assets
AUM	Assets under management
Bps	Basis points
CAGR	Compound annual growth rate
CASA	Current accounts savings accounts
CET	Common equity tier I capital
CRAR	Capital-to-risk weighted assets ratio
GNPAs	Gross non-performing assets
LAP	Loan against property
NIM	Net interest margin
NNPAs	Net non-performing assets
NPAs	Non-performing assets
Opex	Operating expenses
RoA	Return on assets
SFBs	Small finance banks

SFBs included for consolidation of financials

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For the analysis in this note, ICRA has used the data of the following entities

Sl. No.	SFBs included for consolidation of financials	Legend used
1	AU Small Finance Bank Limited	AU SFB
2	Capital Small Finance Bank Limited	Capital SFB
3	Equitas Small Finance Bank Limited	Equitas SFB
4	ESAF Small Finance Bank Limited	ESAF SFB
5	Fincare Small Finance Bank Limited	Fincare SFB
6	Jana Small Finance Bank Limited	Jana SFB
7	North East Small Finance Bank Limited	NESFB
8	Suryoday Small Finance Bank Limited	Suryoday SFB
9	Ujjivan Small Finance Bank Limited	Ujjivan SFB
10	Utkarsh Small Finance Bank Limited	Utkarsh SFB

Agenda

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1 Portfolio Growth

2 Asset Quality Trends

3 Funding and Liquidity

4 Capitalisation and Profitability

5 Industry Outlook

6 ICRA's Ratings in the Sector and Annexures

Highlights

Growth is expected to remain buoyant; ICRA estimates CAGR of 22-25% for FY2024-FY2026	▪ SFBs reported a stronger portfolio growth of 26% in FY2023, surpassing ICRA's estimate of 20-22%. The growth was driven by buoyant credit demand and improved product offerings by SFBs. ICRA expects the growth to remain steady thereafter, with a CAGR estimate of 22-25% for FY2024-FY2026.
ICRA expects further improvement in asset quality indicators in H2 FY2024; thereafter steady state GNPAs to be 1.8-2.2% in the near-term	▪ The gradual improvement in borrowers' cash flows, which led to recoveries, and sizeable write-offs helped the industry report better-than-envisaged asset quality indicators. The momentum continued in H1 FY2024 with SFBs reporting a decline of around 40 bps and around 20 bps in GNPAs and NNPAs, respectively.
	▪ ICRA expects the asset quality recovery trend to continue. This, along with write-offs/sale to ARCs, would lead to a further reduction in the GNPAs. ICRA estimates a reduction of 20-40 bps in the GNPAs in H2 FY2024. Thereafter, the industry is expected to report steady-state GNPAs in the range of 1.8-2.2% in the near term.
Adequate capital and liquidity support growth plans	▪ SFBs increased the share of deposits in the overall funding mix to 88% as of September 2023 with the same expected to improve further as SFBs continue to strengthen their deposit franchise. ICRA expects that the sector would require Rs. 1.8-1.9 lakh crore of additional funding (over and above the refinancing of existing deposit/debt maturities) during FY2024-FY2026 for the envisaged growth with the major part expected to be mobilised through deposits.
RoA expected to be in the range of 2.0-2.2% in FY2024-FY2025 compared to 1.8% in FY2023	▪ With the expected growth in the scale of operations, SFBs are likely to witness better operating efficiency. Moreover, credit costs are expected to remain range-bound, closer to the level seen in FY2023. Accordingly, ICRA estimates the RoA of the industry to improve to 2.0-2.2% in FY2024 (from 1.8% in FY2023) and to remain at similar level in FY2025-FY2026.

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Thank You!