April 01, 2024

Utkarsh Small Finance Bank Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Subordinated debt	200.0	200.0	[ICRA]A+ (Stable); reaffirmed
Certificates of deposit	1,000.0	1,000.0	[ICRA]A1+; reaffirmed
Total	**1,200.0**	**1,200.0**	

**Instrument details are provided in Annexure I*

Rationale

The ratings continue to factor in Utkarsh Small Finance Bank Limited's (Utkarsh) comfortable asset quality and earnings profile and adequate capitalisation. The bank reported an annualised growth of 24% (year-on-year (YoY) growth of ~31%) in its scale in 9M FY2024 with the assets under management (AUM) reaching Rs. 16,407 crore as on December 31, 2023. Utkarsh's asset quality remains comfortable with gross non-performing assets (NPAs) and net NPAs of 3.0% and 0.2%, respectively, as on December 31, 2023 (3.2% and 0.4%, respectively, as on March 31, 2023). The management carried a healthy provision cover of ~94% (including management overlay/ floating provision) on its GNPA as on December 31, 2023, which aided in reporting low Net NPA and solvency ratio (Net NPA/ Net worth of 1.0% as on December 31, 2023). ICRA notes the bank is creating floating provision to provide cushion against asset quality stress and is being utilised against gross NPA at present. The bank reported an annualised return of 2.3% on average total assets (RoA) in 9M FY2024 compared to 2.4% in FY2024. The primary capital of Rs. 500 crore raised in July 2023 via an initial public offering (IPO) has helped it maintain a prudent capitalisation profile while scaling up its operations. Utkarsh's reported capital-to-risk weighted assets (CRAR) of 23.2%, as of December 2023[1], was well above the regulatory requirement of 15%.

The ratings, however, remain constrained by the geographically concentrated portfolio with microfinance accounting for a high share. ICRA notes that the share of microfinance has been declining gradually (61% as on December 31, 2023 vis-à-vis 66% as on March 31, 2023) and expects the trend to continue. Given the high share of microfinance, the ratings continue to factor in the risks associated with the unsecured nature of microfinance loans, the marginal borrower profile, which is susceptible to income shocks, and the political and operational risks inherent in the microfinance business.

Further, while the bank has been able to garner sizeable deposits, it remains important for it to improve the granularity of its deposits while increasing the share of current account and savings account (CASA) deposits. Utkarsh's share of CASA in total deposits declined to ~20% as on December 31, 2023 from ~21% in March 2023. Nonetheless, ICRA notes that the share of retail deposits (retail term deposits + CASA) increased to ~68% in December 2023 from ~62% in March 2023. Going forward, the bank's ability to improve the granularity of its deposits further while increasing the share of the relatively lower-cost CASA deposits shall remain important.

The Stable outlook on the long-term rating reflects ICRA's expectation that Utkarsh would be able to sustain a steady credit profile, while expanding its scale of operations, by maintaining healthy profitability and adequate capitalisation.

[1] CRAR does not include profit after tax (PAT) for Q3 FY2024, as limited review was carried out for Q3 FY2024 financial results

Key rating drivers and their description

Credit strengths

Comfortable asset quality and earnings – The bank's overall asset quality metrics remain comfortable as it reported gross NPAs of 3.0% and net NPAs of 0.2% as on December 31, 2023 compared to 3.2% and 0.4%, respectively, as on March 31, 2023 (6.1% and 2.3%, respectively, in March 2022). Nevertheless, the asset quality remains a monitorable, given the high share of microfinance and the limited seasoning of the non-microfinance portfolio. ICRA notes the bank is creating floating provision to provide cushion against asset quality stress and is being utilised against gross NPA at present.

Utkarsh's earnings profile remains comfortable, supported by stable net interest margin (NIM). It was able to maintain its NIM at 9.0% of ATA compared to 8.9% in FY2023 as it increased its lending rates to compensate for the systemic rise in interest rates and was supported by the capital infusion. Nevertheless, operating expenses rose to 6.1% of ATA in 9M FY2024 from 5.8% in FY2023 (5.4% in FY2022) due to capacity building and increasing administrative costs. With the stable margin and credit costs, the overall profitability indicators remained comfortable in 9M FY2024 as Utkarsh reported a net profit of Rs. 338 crore, translating to a return of 2.3% on ATA and 16.0% on the net worth (Rs. 405 crore, 2.4% and 20.2%, respectively, in FY2023). ICRA expects the bank to continue maintaining a healthy earnings profile with a gradual improvement in the operating efficiency. However, keeping control on the credit costs shall remain key.

Adequate capitalisation – The bank's capital adequacy ratio of 23.2%[2] (Tier I of 21.5%[2]), as on December 31, 2023 (20.6% (Tier I: 18.3%) as on March 31, 2023), was well above the regulatory requirement of 15% (Tier I: 7.5%). Its gearing (including deposits) declined to 6.0 times as on December 31, 2023 from 8.0 times as on March 31, 2023, aided by the capital raise of Rs. 500 crore in 9M FY2024, via an IPO, along with internal accruals. ICRA expects the bank to remain adequately capitalised while maintaining sufficient buffer over the regulatory requirements as it continues to scale up its operations.

Credit challenges

Geographically concentrated portfolio and high share of microfinance – Utkarsh reported an AUM of Rs. 16,407 crore as on December 31, 2023, spread across 26 states and Union Territories (UTs). However, the share of Bihar and Uttar Pradesh remained high at 29% and 25%, respectively, as on December 31, 2023. Further, the share of microfinance remained high at 61%, as on December 31, 2023, despite declining.

Over the years, Utkarsh launched various products such as loans to micro, small and medium enterprises (MSMEs), housing loans, construction equipment and commercial vehicles (CE/CV), etc., and plans to increase their share in the portfolio. Going forward, the bank's ability to diversify its operations geographically and reduce the share of microfinance, as it scales up its operations, will remain important from a credit perspective.

Improving granularity of deposits and increasing share of CASA key monitorables, going forward – Utkarsh has successfully built a large deposit base, constituting 90% of its total borrowings as on December 31, 2023, up from 85% as on March 31, 2023. The overall deposit base increased to Rs. 15,111 crore as on December 31, 2023 from Rs. 13,710 crore as on March 31, 2023. However, the share of CASA remained relatively low at 20% as on December 31, 2023 (21% as on March 31, 2023). ICRA takes note of the gradually improving granularity of deposits with CASA + retail TD increasing to 68% as on December 31, 2023 from 62% as on March 31, 2023. The share of the top 20 depositors has also been reducing and stood at 18% as on December 31, 2023 compared to 21% as on March 31, 2023. Nevertheless, improving the granularity of deposits further while sustainably increasing the share of CASA will be important from a credit perspective.

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[2] CRAR and Tier I does not include profit after tax (PAT) for Q3 FY2024, as limited review was carried out for Q3 FY2024 financial results

Liquidity position: Strong

The liquidity coverage ratio was healthy at 181% on a daily average basis for the quarter ended December 31, 2023. The bank's structural liquidity statement, as on December 31, 2023, did not show any negative cumulative mismatches for a period of at least one year. Utkarsh's liquidity profile is supported by its strong borrowing ability on account of its 'scheduled' status and the large portion of relatively shorter-tenor assets. It reported a credit-to-deposit (CD) ratio of 99%, as on December 31, 2023, as against 95% in March 2023. The liquidity profile is also supported by the availability of funding lines from financial institutions (FIs).

Environmental and social risks

Environmental considerations – Given Utkarsh's service-oriented nature of business, its direct exposure to environmental risks as well as those stemming from regulations or policy changes is not material. While the bank is not materially exposed to physical climate risks, it indirectly encounters environmental risks through its portfolio of assets. Further, its lending typically involves short-to-medium-term durations, enabling it to adjust and incrementally invest in less environmentally vulnerable businesses.

Social considerations – Data security and customer privacy are among the key sources of vulnerability for banks, including Utkarsh, as any material lapse could be detrimental to its reputation and could invite regulatory censure. Customer preference is increasingly shifting towards digital banking, which provides an opportunity for the banks to reduce the operating costs. However, subpar execution of information technology strategies and the inability to meet the customers' requirements adequately may result in more costs than benefits. On the positive side, Utkarsh contributes towards enhancing financial inclusion by providing several products and services that are specifically targeted towards the marginalised sections of society and attempts to address and cater to social concerns. Prudent lending to such under-served segments could create growth opportunities. However, such growth opportunities must be seen in conjuncture with asset quality risks that could impact the bank's credit quality.

Rating sensitivities

Positive factors – A significant scale-up in the operations with diversification in the asset mix and a sustainable improvement in deposit granularity, while maintaining healthy profitability and prudent capitalisation, could positively impact the rating.

Negative factors – Deterioration in the asset quality or profitability (RoA below 1%) on a sustained basis could negatively impact the ratings. Significant deterioration in the capitalisation profile could also exert pressure on the ratings.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	ICRA's credit rating methodology for banks and financial institutions
Parent/Group support	Not applicable
Consolidation/Standalone	Standalone

About the company

Incorporated in 2009, Utkarsh Micro Finance Limited received a small finance bank (SFB) licence from the Reserve Bank of India (RBI) in November 2016 and completed the conversion to an SFB in January 2017. The bank is headed by Mr. Govind Singh, who was earlier the business head of micro banking at ICICI Bank Limited. Operating in 26 states/UTs as on December 31, 2023, Utkarsh offers deposits, microfinance loans, micro, small and medium enterprise (MSME) loans, affordable housing loans and corporate loans, among other products. It had a portfolio of Rs. 16,407 crore, as on December 31, 2023, with microfinance loans (including microfinance loans sourced by business correspondents) comprising 61% (66% as on March 31, 2023) of the same. As for liabilities, the bank had a deposit base of Rs. 15,111 crore as on December 31, 2023, with term deposits accounting for 80% (79% as on March 31, 2023).

Key financial indicators (audited)

Utkarsh Small Finance Bank Limited	FY2022	FY2023	9M FY2024*
Total income	2,034	2,804	2,563
PAT	61	405	338
Total assets	15,064	19,118	20,874
CET-I	18.1%	18.3%	21.5%
CRAR	21.6%	20.6%	23.2%
PAT/ATA	0.5%	2.4%	2.3%
Gross NPAs	6.1%	3.2%	3.0%
Net NPAs	2.3%	0.4%	0.2%

*Source: Company, ICRA Research; * Provisional numbers; All ratios as per ICRA's calculations; Amount in Rs. crore*
Note: Total assets exclude revaluation reserves

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2025)				Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as of Feb 29, 2024 (Rs. crore)	Date & rating in FY2025	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022
					Apr 1, 2024	Apr 13, 2023	Jun 28, 2022	Jun 29, 2021
1	Subordinated debt programme	Long term	200.00	195	**[ICRA]A+ (Stable)**	**[ICRA]A+ (Stable)**	**[ICRA]A (Positive)**	**[ICRA]A (Stable)**
2	Certificates of deposit programme	Short term	1,000.00	300^	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**

^Outstanding as on December 31, 2024

Complexity level of the rated instruments

Instrument	Complexity Indicator
Subordinated debt programme	Simple
Certificates of deposit programme	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
INE735W08038	Subordinated debt	Jun-26-20	12.50%	Jun-26-27	195.00	[ICRA]A+ (Stable)
Yet to be issued	Subordinated debt	NA	NA	NA	5.00	[ICRA]A+ (Stable)
INE735W16494	Certificates of deposit	Mar-12-2023	8.75%	365 days	75.00	[ICRA]A1+
INE735W16510	Certificates of deposit	Apr-17-2023	8.45%	365 days	50.00	[ICRA]A1+
INE735W16544	Certificates of deposit	Jun-28-2023	8.15%	208 days	25.00	[ICRA]A1+
INE735W16551	Certificates of deposit	Jul-18-2023	8.20%	175 days	50.00	[ICRA]A1+
INE735W16569	Certificates of deposit	Oct-13-2023	8.00%	364 days	25.00	[ICRA]A1+
INE735W16577	Certificates of deposit	Nov-24-2023	7.75%	174 days	75.00	[ICRA]A1+
Yet to be issued	Certificates of deposit	NA	NA	7-365 days	700.00	[ICRA]A1+

Source: Company

Annexure II: List of entities considered for consolidated analysis

Not applicable

ANALYST CONTACTS

Karthik Srinivasan
+91 22 6114 3444
karthiks@icraindia.com

A M Karthik
+91 44 4596 4308
a.karthik@icraindia.com

Prateek Mittal
+91 33 7150 1100
prateek.mittal@icraindia.com

Jatin Arora
+91 124 4545 846
jatin.arora@icraindia.com

Arpit Agarwal
+91 124 4545 873
arpit.agarwal@icraindia.com

RELATIONSHIP CONTACT

L. Shivakumar
+91 22 6114 3406
shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches