

June 06, 2024

## Utkarsh Small Finance Bank Limited: Ratings reaffirmed; [ICRA]A+ (Stable) assigned to subordinated debt programme

### Summary of rating action

| Instrument*             | Previous Rated Amount<br>(Rs. crore) | Current Rated Amount<br>(Rs. crore) | Rating Action                 |
|-------------------------|--------------------------------------|-------------------------------------|-------------------------------|
| Subordinated debt       | 200.0                                | 200.0                               | [ICRA]A+ (Stable); reaffirmed |
| Subordinated debt       | 0.0                                  | 200.0                               | [ICRA]A+ (Stable); assigned   |
| Certificates of deposit | 1,000.0                              | 1,000.0                             | [ICRA]A1+; reaffirmed         |
| <b>Total</b>            | <b>1,200.0</b>                       | <b>1,400.0</b>                      |                               |

\*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 a growth of ~31% in its scale in FY2024 with the gross loan portfolio reaching Rs. 18,299 crore as on March 31, 2024. Utkarsh's asset quality remains comfortable with gross non-performing assets (NPAs) and net NPAs of 2.5% and 0.03%, respectively, as on March 31, 2024 (3.2% and 0.4%, respectively, as on March 31, 2023). The bank carried a healthy provision cover of ~99% (including management overlay/floating provision) on the gross NPAs as on March 31, 2024, which helped it report low net NPAs and solvency ratio (Net NPA/Net worth of 0.2% as on March 31, 2024). ICRA notes that the bank has been creating a floating provision to provide a cushion against asset quality risk for unforeseen events, which is currently being utilised against the gross NPAs.

Utkarsh reported a return of 2.3% on average total assets (RoA) in FY2024 compared to 2.4% in FY2023. 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 22.6%, as of March 2024, was well above the regulatory requirement of 15%.

The ratings, however, remain constrained by the geographically concentrated portfolio with micro-banking accounting for a high share. ICRA notes that the share of micro-banking has been declining gradually (62% as on March 31, 2024 vis-à-vis 66% as on March 31, 2023) and expects the trend to continue. Given the high share of micro-banking, the ratings continue to factor in the risks associated with the unsecured nature of micro-banking loans, the marginal borrower profile, which is susceptible to income shocks, and the political and operational risks inherent in the micro-banking business.

Although 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. The share of CASA in Utkarsh's total deposits stood at ~21% as on March 31, 2024, similar to the March 2023 level. Nonetheless, ICRA notes that the share of retail deposits (retail term deposits + CASA) increased to ~66% in March 2024 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.

## 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 2.5% and net NPAs of 0.03% as on March 31, 2024 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 micro-banking (~62% as of March 2024) and the limited seasoning of the non-micro-banking portfolio. ICRA notes that the bank has been creating a floating provision to provide cushion against asset quality risk for unforeseen events, which is currently being utilised against gross NPAs.

Utkarsh’s earnings profile remains comfortable, supported by the stable net interest margin (NIM). The bank was able to maintain its NIM at 8.8% of average total assets (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, the operating expenses rose to 6.0% of ATA in FY2024 from 5.8% in FY2023 (5.4% in FY2022) due to capacity-building and increasing administrative costs. With stable margins and decline in credit costs in comparison to FY2023, the overall profitability indicators remained comfortable in FY2024 as Utkarsh reported a net profit of Rs. 498 crore, translating into a return of 2.3% on ATA and 16.7% on the closing 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 22.6% (Tier I of 21.0%), as on March 31, 2024 (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 6.5 times as on March 31, 2024 (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 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 micro-banking** – Utkarsh reported an AUM of Rs. 18,299 crore as on March 31, 2024, spread across 26 states and Union Territories (UTs). However, the share of Bihar and Uttar Pradesh (UP) remained high with ~24% of the branches in Bihar and ~20% in UP as on March 31, 2024 (share in total AUM stood at 29% and 25%, respectively, as on December 31, 2023). Further, the share of micro-banking remained high at 62%, as on March 31, 2024, despite declining.

Over the years, Utkarsh launched various products such as loans to micro, small and medium enterprises (MSMEs), housing loans, construction equipment (CE) and commercial vehicles (CVs), 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 micro-banking, as it scales up its operations, will remain important from a credit perspective.

**Improving granularity of deposits and increasing share of CASA key monitorables** – Utkarsh has successfully built a large deposit base, constituting 90% of its total borrowings as on March 31, 2024, up from 85% as on March 31, 2023. The overall deposit base increased to Rs. 17,473 crore as on March 31, 2024 from Rs. 13,710 crore as on March 31, 2023. However, the share of CASA remained relatively low at 21% as on March 31, 2024 (21% as on March 31, 2023). ICRA takes note of the gradually improving granularity of deposits with CASA + retail TD increasing to 66% as on March 31, 2024 (~68% as of 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 March 31, 2024 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.

## Liquidity position: Strong

The liquidity coverage ratio was healthy at 160% on a daily average basis for the quarter ended March 31, 2024. The bank's structural liquidity statement, as on March 31, 2024, 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 94%, as on March 31, 2024, 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 their 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 | <a href="#">ICRA's credit rating methodology for banks and financial institutions</a> |
| 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 March 31, 2024, Utkarsh offers deposits, micro-banking loans, micro, small and medium enterprise (MSME) loans, affordable housing loans and corporate loans, among other products. It had a portfolio of Rs. 18,299 crore, as on March 31, 2024, with micro-banking loans (excluding micro-banking loans sourced by business correspondents) comprising 62% (66% as on March 31,

2023) of the same. As for liabilities, the bank had a deposit base of Rs. 17,473 crore as on March 31, 2024, with term deposits accounting for 80% (79% as on March 31, 2023).

#### Key financial indicators (audited)

| Utkarsh Small Finance Bank Limited | FY2022 | FY2023 | FY2024 |
|------------------------------------|--------|--------|--------|
| Total income                       | 2,034  | 2,804  | 3,579  |
| PAT                                | 61     | 405    | 498    |
| Total assets                       | 15,064 | 19,118 | 23,903 |
| CET I                              | 18.1%  | 18.3%  | 21.0%  |
| CRAR                               | 21.6%  | 20.6%  | 22.6%  |
| PAT/ATA                            | 0.5%   | 2.4%   | 2.3%   |
| Gross NPAs                         | 6.1%   | 3.2%   | 2.5%   |
| Net NPAs                           | 2.3%   | 0.4%   | 0.03%  |

Source: Company, ICRA Research; 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                        | Type       | Current rating (FY2025)  |                                                   |                         |                   | Chronology of rating history for the past 3 years |                         |                         |
|---|-----------------------------------|------------|--------------------------|---------------------------------------------------|-------------------------|-------------------|---------------------------------------------------|-------------------------|-------------------------|
|   |                                   |            | Amount rated (Rs. crore) | Amount outstanding as of Mar 31, 2024 (Rs. crore) | Date & rating in FY2025 |                   | Date & rating in FY2024                           | Date & rating in FY2023 | Date & rating in FY2022 |
|   |                                   |            |                          |                                                   | Jun 06, 2024            | Apr 1, 2024       |                                                   |                         |                         |
| 1 | Subordinated debt programme       | Long term  | 200.00                   | 195.00                                            | [ICRA]A+ (Stable)       | [ICRA]A+ (Stable) | [ICRA]A+ (Stable)                                 | [ICRA]A (Positive)      | [ICRA]A (Stable)        |
| 2 | Certificates of deposit programme | Short term | 1,000.00                 | 665.00                                            | [ICRA]A1+               | [ICRA]A1+         | [ICRA]A1+                                         | [ICRA]A1+               | [ICRA]A1+               |
| 3 | Subordinated debt programme       | Long term  | 200.00                   | 0.00                                              | [ICRA]A+ (Stable)       | -                 | -                                                 | -                       | -                       |

#### 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)          |
| Yet to be issued | Subordinated debt       | NA               | NA          | NA          | 200.00                   | [ICRA]A+ (Stable)          |
| INE735W16510     | Certificates of deposit | Apr-17-2023      | 8.45%       | Apr-16-2024 | 50.00                    | [ICRA]A1+                  |
| INE735W16569     | Certificates of deposit | Oct-13-2023      | 8.00%       | Oct-11-2024 | 25.00                    | [ICRA]A1+                  |
| INE735W16577     | Certificates of deposit | Nov-24-2023      | 7.75%       | May-16-2024 | 25.00                    | [ICRA]A1+                  |
| INE735W16585     | Certificates of deposit | Feb-02-2024      | 8.50%       | Jan-31-2025 | 80.00                    | [ICRA]A1+                  |
| INE735W16593     | Certificates of deposit | Feb-23-2024      | 8.85%       | Feb-21-2025 | 300.00                   | [ICRA]A1+                  |
| INE735W16601     | Certificates of deposit | Mar-07-2024      | 8.85%       | Mar-07-2025 | 100.00                   | [ICRA]A1+                  |
| INE735W16619     | Certificates of deposit | Mar-19-2024      | 8.75%       | Mar-19-2025 | 85.00                    | [ICRA]A1+                  |
| Yet to be issued | Certificates of deposit | NA               | NA          | 7-365 days  | 335.00                   | [ICRA]A1+                  |

Source: Company

## Annexure II: List of entities considered for consolidated analysis

Not applicable

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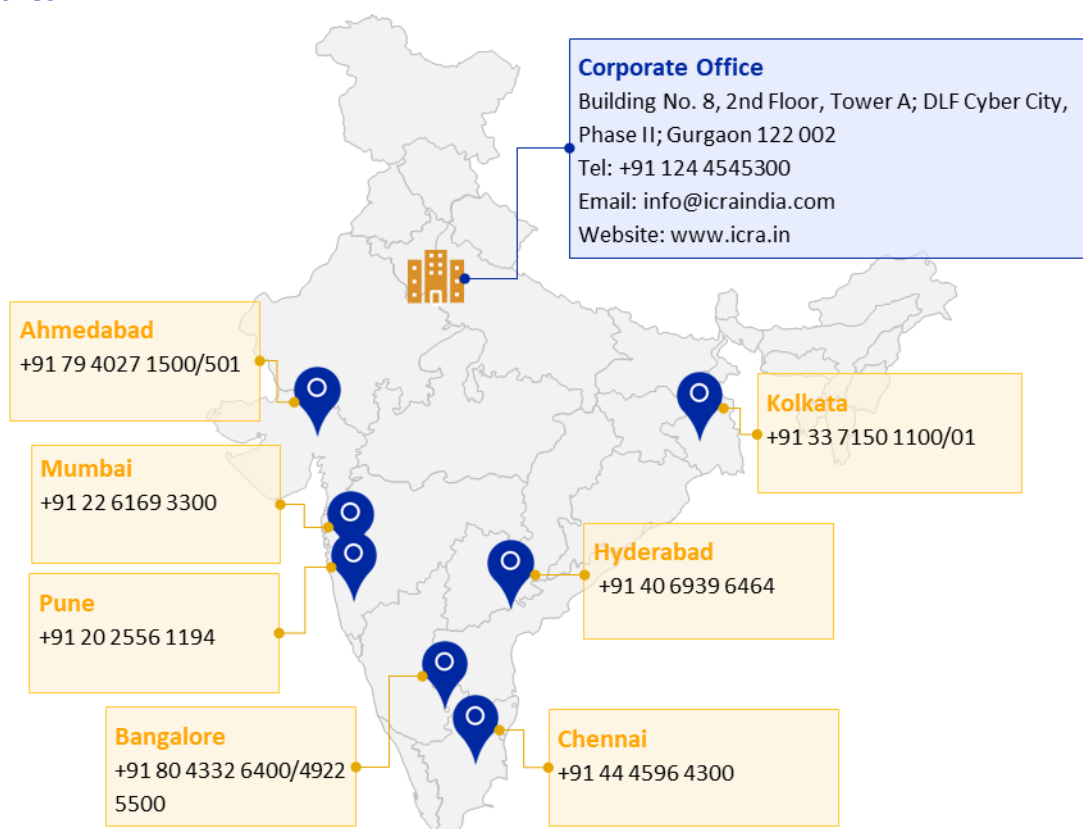


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