April 21, 2017

Ujjivan Small Finance Bank Limited

Summary of Rated Instruments

Instruments*	Amount Rated (Rs. crore)	Rating Action
Non-Convertible Debentures	443.75^	[ICRA]A+(stable); assigned
Short Term Fixed Deposits	1,000.00	[ICRA]A1+; assigned
Certificate of Deposits	1,000.00	[ICRA]A1+; assigned

**Instrument details are provided in Annexure-1*

^ includes Rs.425.00 crore of NCDs transferred from Ujjivan Finance Services Limited

Rating action

ICRA has assigned an [ICRA]A+ (pronounced ICRA A plus)[1] rating to the Rs. 443.75 crore[2] non-convertible debentures (NCD) programme of Ujjivan Small Finance Bank Limited (USFB). The outlook on the rating is stable. ICRA has also assigned an [ICRA]A1+ rating to the Rs. 1,000.00 crore short term fixed deposit programme and the Rs.1,000.00 crore certificates of deposit programme of the company.

Detailed rationale

The ratings take into consideration USFB's experience in microfinance, its established borrower base (about 36 lakh as on December 31, 2016) and its diversified geographical presence. The ratings also take cognisance of the bank's strong management team, diverse Board composition, good IT systems, prudent lending practices and, adequate internal control and risk management systems. The bank's capitalisation profile is comfortable with gearing at about 4.2 times as on February 01, 2017. The gearing however would increase going forward; the bank is therefore expected to raise equity in FY2019/FY2020 to maintain the gearing at about 6-6.5 times over the period FY2018-FY2020.

The ratings however take note of the modest credit profile of the bank's customer base, who are vulnerable to adverse economic cycles. The asset quality of the loans transferred by Ujjivan Financial Services Limited (Ujjivan), as part of the business transfer arrangement, had deteriorated post demonetisation. ICRA however notes that the deterioration in asset quality has been relatively moderate in comparison with most of its peers. The bank's profitability indicators are likely to be subdued in FY2018 because of the expected increase in provisions and credit costs on the overdue loans, increase in operating expenses and the cost of maintaining the regulatory cash reserve ratio (CRR) and statutory liquidity ratio (SLR). In the near term, the bank's ability to control losses on the overdue loans would be crucial from a rating perspective. However, in the medium to long term, USFB's ability to diversify its product mix, develop a good retail deposit franchise and improve its operating efficiencies would be critical.

[1] For complete rating scale and definitions, please refer to ICRA's website (www.icra.in) or other ICRA rating publications
[2] 100 lakh = 1 crore = 10 million

Key rating drivers

Credit Strengths

- Geographically diversified presence across 24 states and union territories; large customer base of over 36 lakh as on December 31, 2016
- Experienced senior management team
- Good governance structure with a professional Board
- Adequate internal control, monitoring, risk management and MIS systems
- Comfortable capitalisation profile
- Strong liquidity profile; expected to improve further after receiving scheduled bank status

Credit Challenges

- Modest borrower profile leaves the bank vulnerable to economic cycles
- Asset quality related pressures post demonetisation; impact however is relatively moderate in comparison with most peers
- Ability to build a stable deposit base to support the lending book growth and meet reserve requirements; ability to secure funding from other sources, at competitive rates, till deposits scale-up
- Ability to diversify its product mix; limited track record in the new products, however target customer segment remains largely same
- Ability to maintain good profitability indicators considering the impact of demonetisation, higher operating costs and the SLR and CRR requirements

Detailed description of key rating drivers:

USFB commenced operations on February 01, 2017, following the transfer of assets and liabilities from Ujjivan. The asset transferred included a portfolio of about Rs.5,900 crore. Ujjivan had a gross portfolio of about Rs. 6,588 crore (including Rs. 541 crore of off-balance sheet assets) as on December 31, 2016, with a presence across 24 states and union territories and 209 districts through its 469 branches. About 86% of the Ujjivan' portfolio was in the form of microfinance loans while the remaining was accounted by individual loans. Going forward, USFB aims to grow its portfolio at a CAGR of about 30-33% during FY2018-FY2020 and also intends to reduce the share of microfinance loans to about 65% by March 2020, with corresponding increase in the share of individual loans, MSE loans and housing loans. The bank's ability to diversify its product mix going forward would be crucial for growth and for improving its earnings diversity (through fee income) and profitability.

The bank has a diverse Board profile and a seasoned senior management team with experience in their respective functional domains. The bank's IT systems and internal controls were augmented for meeting the SFB requirements and are currently adequate. ICRA however takes note that the bank's plan to steadily increase its branch network to support the envisaged growth while meeting the regulatory requirements is likely to result in lower operating efficiencies in the near term.

The asset quality of the microfinance loans and other individual loans offered by MFIs were impacted post demonetisation, with the collection efficiency declining because of the limited currency supply, disruption in borrower cash flows, and political intervention in some states. USFB' 90+dpd stood at about 1.96% in February 2017. ICRA however notes that the deterioration in USFB's asset quality has been relatively moderate in comparison with most peers. The bank's ability to improve collections and limit losses on overdues would be crucial in the near term. In the medium term, its ability to maintain asset quality in the individual loan segment, as its share increases going forward, would be key considering the modest credit profile of its target borrower segment.

USFB's near term profitability is expected to be subdued because of the expected losses on overdues and higher operating expenses for scaling up business. Further, the low yields from the SLR and CRR investments would exert pressure on USFB's profitability till the bank is able to scale-up its operations and diversify its income profile. Ujjivan reported a return on average managed assets of 2.9% for 9MFY2017. ICRA takes comfort from the adequate capital structure of the bank, with gearing of 4.2 times as on February 01, 2017. The ratings however note that the bank would need to raise capital over the next 18-24 months to maintain a comfortable risk-adjusted capital structure in relation to its envisaged business growth.

The bank's liquidity position remains comfortable given that shorter term nature of its assets in comparison with its liabilities, resulting in a favourable ALM position. As on February 28, 2017, about 87% of USFB's borrowings was from banks and financial institutions, while the remaining was through NCDs. Going forward, its ability to improve the liability mix through mobilisation of deposits and other borrowing sources remains to be seen. ICRA takes note of the challenges in building a retail deposit franchise given the competitive pressures; while the bank's established customer base imparts a favourable outlook for the long term, it would be dependent on refinance lines, bulk deposits and other wholesale funding sources till the retail deposits scale-up. ICRA nevertheless notes that, given the entity's favourable growth prospects and established relationships with investors and lenders, it should be able to continue to mobilising debt and equity commensurate with the envisaged growth.

Analytical approach: The rating takes into account the standalone financial and business performance of the rated entity.

Links to applicable criteria
http://www.icra.in/Files/Articles/Bank%20Rating%20Methodology_Feb2016.pdf

About the bank

Ujjivan Small Finance Bank Limited (USFB) commenced operations on February 01, 2017, post transfer of assets and liabilities from Ujjivan. The assets transferred included a portfolio of about Rs.5,900 crore. USFB has about 15 branches as on March 15, 2017 and is a 100% subsidiary of Ujjivan Financial Services Limited (Ujjivan). Ujjivan which operated as an NBFC-MFI, will be the holding company of USFB. Ujjivan was listed in the National Stock Exchange and Bombay Stock Exchange in May 2016, following its initial public offer.

Ujjivan reported net profits of Rs. 177 crore in FY2016 on a managed assets base of Rs. 6,052 crore as against net profits of Rs. 76 crore in FY2015 on a managed assets base of Rs. 4,032 crore. In 9MFY2017, Ujjivan reported net profits of Rs. 187 crore on a total managed asset base of Rs.7,765 crore.

Status of non-cooperation with previous CRA: Not Applicable.

Any other information: Not Applicable.

Rating History for last three years:

Table: Rating History

S. No.	Name of Instrument	Current Rating			Chronology of Rating History for the past 3 years		
		Type	**Rated amount (Rs. crore)**	**FY2018**	**FY2017**	**FY2016**	**FY2015**
1	Non-Convertible Debentures	Long term		**April 2017**	--	--	--
			443.75	[ICRA]A+ (Stable)	-	--	--
2	Short Term Fixed Deposits	Short term	1,000.00	[ICRA]A1+	--	--	--
3	Certificates of Deposit	Short term	1,000.00	[ICRA]A1+	--	--	--

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1
Details of Instruments

Name of the instrument	Date of issuance	Coupon rate	Maturity date	Size of the issue (Rs. crore)	Current Rating and Outlook
Non-Convertible Debentures	16-Nov 2016	9.65%	16-Nov 2018	225.00	[ICRA]A+(Stable)
Non-Convertible debentures	7-Oct 2016	9.74%	7-Oct 2018	175.00	[ICRA]A+(Stable)
Non-Convertible Debentures	26-Dec- 2014	13.25%	26-Dec-2017	25.00	[ICRA]A+(Stable)
Non-Convertible Debentures – Proposed	--	--	--	18.75	[ICRA]A+(Stable)
Short Term Fixed Deposits	--	--	--	1,000.00	[ICRA]A1+
Certificate of Deposits	--	--	--	1,000.00	[ICRA]A1+

Source: USFB

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