Utkarsh Small Finance Bank Revised

January 08, 2018

Summary of rated instruments

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible Debenture Programme	148.00	[ICRA]A- (Stable); Assigned
Total	**148.00**	

Rating action

ICRA has assigned a long -term rating of [ICRA]A- (pronounced ICRA A minus) to the Rs. 148.00-crore non-convertible debenture (NCD) programme of Utkarsh Small Finance Bank (USFB). The outlook on the long-term rating is Stable.

Rationale

The ratings take into account the strong investor profile, the bank's comfortable capitalisation, its adequate liquidity profile, given the sizeable deposits mobilised, post conversion, and the strengthened management team with the transformation into a small finance bank (SFB) in January 2017. Given the heightened delinquencies, post demonetisation, the bank is likely to make sizeable provisions during FY2018, which is expected to impact its profitability indicators for FY2018. However, the capital raised by the holding company (Utkarsh Microfinance) is likely to keep capitalisation levels comfortable. The ratings continue to factor USFB's good financial flexibility, arising out of its diversified funding mix, its strong investor base and good management and information systems (MIS) and effective internal audit and monitoring systems.

However, the ratings are constrained by the bank's relatively high delinquencies, especially in the harder buckets (90+ and 180+ dpd of 9% and 7% as on November 30, 2017), which is expected to result in increased credit costs during FY2018, high geographic concentration in Bihar and Uttar Pradesh (42% and 32% of the portfolio as on September 30, 2017), low share of retail deposits and reliance on joint liability group loans (which formed 94% of the portfolio as on September 30, 2017) and the risks thereof. Going forward USFBs ability to diversify its product mix and depositor base as well as strengthening the retail deposit franchise will be important from a credit perspective.

Outlook: Stable

ICRA believes USFB will continue to benefit from the extensive experience of its promoters and management. The outlook may be revised to 'Positive' if asset quality and profitability improves and strengthens the financial risk profile. The outlook may be revised to a 'Negative' in case of deterioration in capitalisation and the solvency profile of the bank.

Key rating drivers

Credit strengths

Experienced and professional management team – Mr. Govind Singh, the promoter, is the Managing Director and CEO, who is assisted by functional heads (core team members) associated with the company since its inception. The company has a good second and third line of management to manage its banking operations. The team was strengthened with fresh recruitments at the senior level in key areas like liabilities, IT, risk, operations, compliance and treasury amongst others to smoothen the transition to an SFB.

Strong investor profile – Utkarsh SFB is wholly-owned by Utkarsh Micro Finance Limited, which has Commonwealth Development Corporation as the largest shareholder with a 14.14% stake. Utkarsh Microfinance raised Rs. 150-crore equity through a rights issue in November 2017 from the Commonwealth Development Corporation, RBL Bank and Faering Capital. Post infusion, Utkarsh SFB's foreign shareholding fell to 39.8% from 42.1%. Other shareholders include International Finance Corporation, Aavishkar Goodwell, Norwegian Microfinance Initiative and Sarva Capital.

Good capitalisation profile supported by external equity infusion – Despite its high pace of growth, the bank has been able to maintain good capitalisation indicators supported by regular capital infusion. ICRA notes that UMFL has tied up Rs 150 crore of capital which will improve loss absorption capacity, given the high delinquencies faced, post demonetisation.

Credit challenges

Ability to diversify product mix – As of September 30, 2017, the JLG portfolio accounted for 94% of the banks' overall portfolio. Other segments included MSME loans (4%), wholesale lending book (2%) and housing loans (0.3%). The bank intends to bring down the share of JLG book in the medium term, while expanding into other segments. The bank's ability diversify its asset profile while maintaining asset quality at a reasonable level will be critical from a credit perspective.

High exposure to states of Uttar Pradesh and Bihar (72% of the portfolio outstanding as on September 30, 2017) – USFB was present in 10 states across 110 districts through 400 branches as on September 30, 2017. However, the share of Uttar Pradesh and Bihar remains high at 42% and 32% respectively with top five states accounting for 82% of the portfolio and top three accounting for 62% as on September 30, 2017. The top five districts and top 10 districts accounted for 21% and 35% of the overall portfolio as on September 30, 2017 respectively.

Weak asset quality indicators (90+ of 10% and NNPA/net worth of 20% as on September 30, 2017); albeit improvement has been seen in the past months - Overall asset quality indicators have improved gradually with 0+ of 28% as of December 2016 to 13% as of November 2017. USFB reported NPAs of Rs 208 crore as of November 2017. The company's on balance sheet provision for NPAs stood at Rs. 67 crore as of September 2017 while net NPA as a percentage of net worth stood at 20% as of September 2017. While the asset quality indicators were weak, ICRA takes comfort from USFBs hold co raising additional capital of Rs. 150 crore in November 2017, which would support USFBs capitalization and solvency indicators going forward.

Ability to garner retail deposit base – As of September 30, 2017, the bank had a deposit base of Rs. 581 crore, majority of which were institutional deposits, and accounted 25% of the overall borrowings of the bank. Ability of the bank to build its current account and savings account (CASA) and fixed deposits base would be critical from a credit perspective.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria:

Rating Methodology for Non-Banking Finance Companies

Rating Methodology for Banks

About the company:

Incorporated in 2009, Utkarsh Micro Finance Limited received the final Small Finance Bank (SFB) licence from the Reserve Bank of India in November 2016 and completed its conversion process in January 2017. The bank is promoted by Mr. Govind Singh, who was earlier the business head of microbanking at ICICI Bank. The bank operated in 10 states through 400 branches in 110 districts with the largest states being Uttar Pradesh and Bihar, which together accounted for 72% of the portfolio. The bank offers loans in the microfinance, MSME and the affordable housing segment. USFB had a portfolio of Rs. 2,089 crore as on September 30, 2017 with 94% of the portfolio comprising microfinance loans. As for liabilities, USFB had deposits of Rs. 581 crore as on September 30, 2017 with fixed deposits accounting for 97%. Asset quality indicators declined, post demonetisation and the bank had a 0+ and 90+ of 15% and 10% respectively. The bank is expected to come out with an IPO in FY2022.

USFB reported a profit after tax (PAT) of Rs. 34.4 crore on a managed asset base of Rs. 2669.6 crore in FY2017 (consolidated) vis-à-vis a PAT of Rs. 36.8 crore on a managed asset base of Rs. 1770.0 crore in FY2016 (consolidated). The bank reported a loss of Rs 29.6 crore on a managed asset base of 3,096.2 crore in H1 FY2018 (consolidated).

Key financial indicators (consolidated) (audited)

	FY 2016	FY 2017
Net Interest Income	123.35	214.23
Profit before Tax	61.11	52.90
Profit after Tax	36.81	34.36
Net Advances	1201.3	1593.9
Total Assets	1538.79	2651.19
% Tier 1	14.4%	17.15%
% CRAR	20.7%	25.87%
Gearing	4.88	2.86
% Net Profit / Average Managed Assets	2.6%	1.5%
% Return on Net Worth	15.80%	7.40%
% Gross NPA	0.17%	0.00%
% Net NPA	0.05%	0.00%
Net NPA / Net Worth	0.23%	0.00%

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2018) Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs Crore)	Date & Rating January 2018	Chronology of Rating History for the past 3 years: Date & Rating in FY2017	Date & Rating in FY2016	Date & Rating in FY2015
						-	-	-
1	NCD	Long Term	148.00	**148.00**	**[ICRA]A- (Stable)**	-	-	-

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: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE396P07035	NCD	10-Dec-13	14.80%	13-Nov-17	31.00	[ICRA]A- (Stable)
INE396P07100	NCD	26-Feb-16	13.30%	24-Feb-21	67.00	[ICRA]A- (Stable)
INE396P07092	NCD	27-Nov-15	13.90%	27-Nov-21	50.00	[ICRA]A- (Stable)

Source: Utkarsh Small Finance Bank

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About ICRA Limited:

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