Utkarsh Small Finance Bank

February 08, 2018

Summary of rated instruments

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Certificate of Deposit Programme	500.00	[ICRA]A1; Assigned
Non-Convertible Debenture Programme	117.00	[ICRA]A- (Stable); outstanding
Total	**617.00**	

Rating action

ICRA has assigned a short-term rating of [ICRA]A1 (pronounced ICRA A one) to the Rs. 500.00 crore certificate of deposit (CD) programme of Utkarsh Small Finance Bank (USFB). ICRA also has long term rating of [ICRA]A- ((pronounced ICRA A minus) with stable outlook outstanding for 117.00 crore Non-Convertible Debenture Programme of Utkarsh Small Finance Bank.

Rationale

The ratings take into account the strong investor profile, the bank's comfortable capitalisation, its adequate liquidity profile, diversification of resource mix and raising substantial funds through term deposits, and the strengthened management team with the transformation into a small finance bank (SFB) in January 2017. Given the increased 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 Micro Finance Limited) 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.

The rating remains constrained by the bank's relatively high delinquencies, especially in the harder buckets (90+ and 180+ dpd of 8% and 7% as on December 31, 2017), which is expected to result in increased credit costs during FY2018, high geographic concentration in Bihar and Uttar Pradesh (41% and 35% of the portfolio as on December 31, 2017), low share of retail deposits and reliance on joint liability group (JLG) loans (which formed 92% of the portfolio as on December 31, 2017) and the risks thereof. Going forward USFB's 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 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 – USFB is wholly-owned by Utkarsh Micro Finance Limited (UMFL), which has Commonwealth Development Corporation as the largest shareholder with a 14.14% stake. UMFL raised Rs. 150 crore equity through a rights issue in November 2017 with the largest investors being Commonwealth Development Corporation, RBL Bank and Faering Capital. Post infusion, USFB's foreign shareholding fell to 39.4% from 42.1%. Other shareholders include International Finance Corporation, Aavishkar Goodwell, Norwegian Microfinance Initiative and Sarva Capital among others.

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 (holding company) mobilised 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 December 31, 2017, the JLG portfolio accounted for 92% of the bank's overall portfolio. Other segments included Micro Small and Medium Enterprise (MSME) loans (4%), wholesale lending book (4%) 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 to 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 (76% of the portfolio outstanding as on December 31, 2017) – USFB was present in 10 states across 110 districts through 403 branches as on December 31, 2017. However, the share of Uttar Pradesh and Bihar remains high at 41% and 35% respectively with top five states accounting for 91% of the portfolio and top three accounting for 82% as on December 31, 2017. The top five and top ten districts accounted for 23% and 37% of the overall portfolio and 72% and 115% of net worth as on December 31, 2017 respectively. However, the bank is looking to penetrate deeper in existing geographies which is expected to bring down concentration risk gradually.

Weak asset quality indicators (90+ of 8.3% and Net NPA/net worth of 16% as on December 31, 2017); albeit improvement has been seen in the past months – UMFL (holding company) had negligible NPAs prior to demonetisation and was adversely affected by the event which impacted the entire industry as a whole. Overall asset quality indicators have improved gradually with 0+ of 28% as of December 31, 2016 to 11% as of December 31, 2017. USFB reported 90+ dpd of 8.3% (Rs. 206 crore in absolute terms) as of December 31, 2017. The company's on balance sheet provision for NPAs stood at Rs. 76 crore while net NPA as a percentage of net worth stood at 16% as of December 31, 2017. While the asset quality indicators were weak, ICRA takes comfort from the recent capital raise of Rs. 150 crore in November 2017 by UMFL, which would support USFBs capitalization and solvency indicators going forward.

Ability to garner retail deposit base – As of December 31, 2017, the bank had a deposit base of Rs. 1,377 crore, majority of which were institutional deposits, and accounted for 46% 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. USFB is wholly-owned by USFB and Mr. Govind Singh serves as the Managing Director and CEO of the SFB. He has earlier served as 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 23.6 crore on a managed asset base of 3,727.8 crore in 9M 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%*

Amounts in Rs. crore
Source: ICRA Research and company
**taking into account RBI dispensation*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Type	Current Rating (FY2018) Amount Rated (Rs. crore)	Amount Outstanding (Rs Crore)	Date & Rating February 2018	December 2017	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	117.00	**117.00**	**[ICRA]A- (Stable)**	**[ICRA]A- (Stable)**	-	-	-
2	Certificate of deposit programme	Short term	500.00	**500.00**	**[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: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
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)
NA	CD	NA	NA	7-365 days	500.00	[ICRA]A1

Source: Utkarsh Small Finance Bank

ANALYST CONTACTS

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

Supreeta Nijjar
+91 124 4545 324
supreetan@icraindia.com

Saagar Malhotra
+91 124 4545 308
saagar.malhotra@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

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

Helpline for business queries:

+91-124-2866928 (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

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata	+ (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore	+ (91 80) 2559 7401/4049
Ahmedabad	+ (91 79) 2658 4924/5049/2008
Hyderabad	+ (91 40) 2373 5061/7251
Pune	+ (91 20) 6606 9999