# Ujjivan Small Finance Bank Limited

**July 05, 2018**

## Summary of rated instruments

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| Non Convertible Debenture Programme | 400.00 | 400.00 | [ICRA]A+ (Stable) / Reaffirmed |
| Non Convertible Debenture Programme | 43.75 | - | [ICRA]A+ (Stable) / Withdrawn |
| Certificate of Deposits | 1,000.00 | 1,000.00 | [ICRA]A1+ / Reaffirmed |
| Short-term Fixed Deposits | 1,000.00 | 1,000.00 | [ICRA]A1+ / Reaffirmed |
| **Total** | **2,443.75** | **2,400.00** | |

## Rating action

ICRA has reaffirmed the long-term rating of [ICRA]A+ (pronounced ICRA A plus) to the Rs.400.00 crore[1] non-convertible debenture (NCD) programme of Ujjivan Small Finance Bank Limited (USFB). The outlook on the long-term rating is 'Stable'. ICRA has also reaffirmed the short-term rating of [ICRA]A1+ (pronounced ICRA A one plus) to the Rs.1,000.00 crore Certificate of Deposits and the Rs.1,000.00 crore Short-term Fixed Deposits programme of the bank.

ICRA has withdrawn the rating of [ICRA]A+ (pronounced ICRA A plus) on the Rs.43.75 crore NCD programme of the bank as the same have been fully redeemed and there is no amount outstanding against the same.

## Rationale

The ratings reaffirmation takes into account the bank's track record of operations, strong board, management team's experience in the field of microfinance and retail lending and its adequate internal control and monitoring systems. The bank reported a portfolio growth of 18.5% in FY2018 taking its total advances to Rs.7,560 crore as on March 31, 2018. USFB' portfolio is reasonably diversified across 24 states with top three states accounting for 43.1% of its portfolio as on March 31, 2018. The ratings continue to take into account USFB's financial profile characterized by adequate capitalization, and solvency profile. The bank's profitability was however impacted in FY2018 owing to sizeable provisioning of Rs.134.3 crore and write-offs to the extent of Rs.176.5 crore pertaining to large delinquencies post demonetization. USFB reported modest return on assets (RoA) of 0.1% and return on equity (RoE) of 0.4% in FY2018 as compared to RoA of 2.9% and RoE of 14.1% in FY2017. Given its comfortable provisioning cover of 81.6% as in March 2018 and improved collection efficiencies in the portfolio generated post January 2017, USFB's credit cost is likely to reduce going forward thereby supporting its incremental profitability.

ICRA also takes note of the initiatives taken by the bank to augment its senior management bandwidth to support the envisaged growth in the new product verticals including: affordable housing advances, loans for micro and small enterprises (MSE) and deposits. ICRA takes note of the comfortable liquidity position presently; however ability to scale up its retail deposit base would be crucial going forward as the business expands. The rating continues to factor in the risks associated with the unsecured nature of microfinance loans, credit risk emerging from the marginal borrower profile and other socio-political and operational risks inherent to the microfinance and MSE businesses.

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[1] *100 lakh = 1 crore = 10 million*

## Outlook: Stable

ICRA expects the bank to report business expansion and product diversification while maintaining a comfortable capital structure. The outlook may be revised to 'Positive' if USFB is able to keep asset quality under control, significantly enhance its deposit profile and report healthy business scale up while maintaining adequate capitalization. The outlook may be revised to 'Negative' if the asset quality, earnings and capital profile deteriorates significantly.

## Key rating drivers

## Credit strengths

**Experienced senior management team; good governance structure with a professional Board:** The bank has a diverse Board profile and a seasoned senior management team with experience in their respective functional domains. USFB's Board comprises nine members with majority of independent directors headed by a non-executive independent chairman. Further, the bank's management team comprises experienced personnel from the field of financial services, banking, marketing, retail, microfinance, and corporate laws. Having a management team with good understanding of the banking and microfinance sector enables USFB to frame and maintain robust lending and monitoring systems. The bank's senior management team has an average work experience of 15-20 years. However, given its current geographic spread and the current slower than expected scale up in new products, ICRA believes that the bank would have to further strengthen its middle level management team to support the envisioned growth.

**Geographically diversified presence:** As on March 31, 2018, USFB had a portfolio of Rs.7,560 crore spread 209 districts in 24 states with none of the states accounting for over 20% of its portfolio. Top three states comprised 43.1% of its portfolio while top 5 states accounted for 60.2% of its total advances. Its top 10 and top 20 districts however accounted for 22.9% and 36.7% of its portfolio respectively as on March 31, 2018. The bank had 464 branches as on March 31, 2018 of which 187 were full-fledged liability accepting banking outlets. For the current fiscal, the bank plans to continue to focus on converting the balance microfinance branches into banking outlets and branch addition is expected to gain pace post FY2019 upon conclusion of conversion of microfinance branches into banking outlets. Over the medium term, USFB has envisaged a portfolio growth of 20-25% per annum.

**Adequate internal control, monitoring, risk management and Information technology (IT) systems:** The bank's IT systems and internal controls were augmented for meeting the requirements of small finance bank and are currently adequate. USFB's IT infrastructure and software have been integrated with legacy systems for microfinance, MSE and Housing verticals. During FY2018, the bank has also introduced handheld devices for paperless and doorstep banking, ATMs with biometric facility, phone banking, mobile and internet banking.

**Adequate capitalization and comfortable liquidity profile:** USFB's capitalization profile remains comfortable with gearing of 4.4x and capital adequacy ratio of 23.0% as on March 31, 2018 as against regulatory requirement of 15%. Given that the entire capital is Tier-I at present, USFB has the flexibility of enhancing its capital base by way of Tier-II instruments. The bank's liquidity position remains supported by positive asset liability mismatch (ALM) given the shorter tenure of advances. However, given USFB's high dependence on relatively shorter tenure institutional deposit, ICRA notes that the bank would have to strengthen its retail deposit base which would be crucial from ALM standpoint, going forward, as portfolio expands. Nevertheless, refinancing lines from Small Industries Development Bank of India (SIDBI), National Bank for Agriculture & Rural Development (NABARD) and other banks are likely to support its liquidity profile in the interim period.

## Credit challenges

**Moderation in the asset quality profile post demonetization:** USFB's asset quality indicators deteriorated post demonetization with 90 days past dues (dpd) delinquencies peaking at 6.1% as during Q2 FY2018. Given that the recoveries from hard buckets have been low, the bank has written off Rs.176.5 crore during FY2018 and is carrying provisions to the extent of Rs.261.5 crore during as on March 31, 2018. However, as on March 31, 2018, USFB's gross non-performing assets (NPA) stood at 3.6% with a provision cover of 81.5% and net NPA / net worth of 2.9% providing comfort on solvency profile. With higher delinquencies being witnessed in the bank's micro and small enterprises (MSE) advances and expected increase in share of individual loans, the bank's ability to maintain good asset quality and contain credit costs would be crucial.

**Ability to diversify product mix and scale up retail deposit base:** With the commencement of banking operations, USFB has expanded its product profile across MSE, affordable housing and individual personal loans. However, the share of non-microfinance portfolio remains small accounting for 7% of the total portfolio as on March 31, 2018. The bank also offers range of liability products across its 187 branches. However, given that the roll out of new products is limited to full-fledged banking branches, the traction in new products has been slow. The bank had a total deposit base of Rs.3,772.0 crore – of which retail deposits was low at 11% (Rs.427 crore). Going forward, the bank's ability to scale up its new products, diversify its earnings profile and shore up retail deposit base would be key monitorable.

**Ability to improve profitability:** During FY2018, USFB's profitability was impacted on account of significantly higher credit costs of 3.4% as compared to 1.1% in FY2017 (0.5% in FY2016). The bank's profitability was also dragged down by increase in operating expenses attributed to transition related costs. USFB's cost to income ratio increased to 74.5% in FY2018 as compared to 55.5% in FY2017. Consequently, USFB's net profitability was low at 0.1% in FY2018 as compared to 2.9% in FY2017 (3.7% in FY2016). ICRA notes that with a comfortable provision cover of 81.5% as in March 2018, the bank's credit costs are likely to be lower going forward which is expected to support profitability. However, USFB's ability to improve operating efficiency and raise low cost deposits would be crucial in the face of costs arising out of maintaining regulatory cash and liquidity reserves which exert pressure on the net profitability.

**Marginal borrower profile:** The rating factors in the risks associated with marginal borrower profile, unsecured lending business, political risks, and operational risks arising out of cash handling, along with challenges associated with high pace of growth and high attrition rates. Additionally, in line with the industry, the bank would face challenges pertaining to reinstatement of field discipline, addressing the changes in borrower behaviour post demonetization and the risks pertaining to borrower overleveraging given their access to informal funding sources.

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

**Links to applicable criteria:**
ICRA's Credit Rating Methodology for Non-Banking Finance Companies
ICRA Rating Methodology for Banks

## About the company:

Ujjivan Small Finance Bank Limited (USFB / the bank) commenced operations on February 01, 2017, post transfer of assets and liabilities from Ujjivan Financial Services Limited (Ujjivan). The assets transferred included a portfolio of about Rs.5,900 crore. Ujjivan which operated as an NBFC-MFI, is the holding company of USFB and is listed on the National Stock Exchange and Bombay Stock Exchange.

USFB is a 100% subsidiary of Ujjivan Financial Services Limited and is included in the Second Schedule of the Reserve Bank of India Act, 1934. As on March 31, 2018, USFB's 464 branches was spread across 209 districts in 24 states. The bank had a total portfolio of Rs.7,560 crore and a deposit base of over Rs.3,700 crore.

## Key financial indicators (Ujjivan – Consolidated)

| Fiscal | FY 2016 (audited) | FY 2017 (audited) | FY2018 (audited) |
|---|---|---|---|
| Total Income | 1,027.6 | 1,397.6 | 1,581.7 |
| Profit after Tax | 177.2 | 207.7 | 7.3 |
| Net worth | 1,197.8 | 1,755.8 | 1,761.6 |
| Total Managed Portfolio | 5,388.6 | 6,379.5 | 7,560.0 |
| Total Managed Assets | 6,051.5 | 8,986.9 | 9,813.9 |
| | | | |
| Return on Average Managed Assets (%) | 3.5% | 2.8% | 0.1% |
| Return on Average Net worth (%) | 18.3% | 14.1% | 0.4% |
| | | | |
| Gross NPA (%) | 0.2% | 0.3% | 3.6% |
| Net NPA (%) | 0.0% | 0.0% | 0.7% |
| Net NPA / Net worth | 0.2% | 0.1% | 2.9% |
| | | | |
| Managed Gearing (times) | 3.9 | 4.0 | 4.4 |
| CRAR^ (%) | 24.1% | 18.3% | 23.0% |

*Note: Amounts in Rs. crore*
*Source: USFB, ICRA research*

## Status of non-cooperation with previous CRA: Not applicable

## Any other information: None

## Rating history for last three years:

| | Instrument | Current Rating (FY2019) | | | | Chronology of Rating History for the past 3 years | | |
|---|---|---|---|---|---|---|---|---|
| | | Type | Amount Rated (Rs. crore) | Amount Outstanding (Rs Crore) | FY2019 | FY2018 | FY2017 | FY2016 |
| | | | | | Jul 2018 | Apr 2017 | - | - |
| 1 | Non-convertible debenture | LT | 400.00 | 400.00 | [ICRA]A+ (Stable) | [ICRA]A+ (Stable) | - | - |
| 2 | Certificate of Deposits | ST | 1,000.00 | 1,000.00 | [ICRA]A1+ | [ICRA]A1+ | - | - |
| 3 | Short-term Fixed Deposits | ST | 1,000.00 | 1,000.00 | [ICRA]A1+ | [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 |
|---|---|---|---|---|---|---|
| INE334L08025 | NCD | 16-Nov-16 | 9.65% | 16-Nov-18 | 225.00 | [ICRA]A+ (Stable) |
| INE334L08017 | NCD | 07-Oct-16 | 9.74% | 07-Oct-18 | 175.00 | [ICRA]A+ (Stable) |
| - | Certificate of Deposits | - | - | - | 1,000.00 | [ICRA]A1+ |
| - | Short-term Fixed Deposits | - | - | - | 1,000.00 | [ICRA]A1+ |

*Source: USFB*

## ANALYST CONTACTS


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

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

**Ms. Swathi Hebbar**
+91 80 4332 6404
swathi.hebbar@icraindia.com

Mr. Anuprasanth
+91 80 4332 6416
anuprasanth@icraindia.com


## RELATIONSHIP CONTACT


**Mr. 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:

+91-124-2866928 (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 |




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