Utkarsh Small Finance Bank Limited

December 14, 2018

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Certificate of Deposit Programme	1,000.00	1,000.00	[ICRA]A1; Outstanding
Non-convertible Debenture Programme	67.00	0.00	[ICRA]A (Stable); Withdrawn
Non-convertible Debenture Programme	50.00	50.00	[ICRA]A (Stable); Reaffirmed
Total	**1,117.00**	**1,050.00**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings continue to factor in Utkarsh Small Finance Bank's (USFB) progress on product diversification and deposit mobilisation post conversion into a small finance bank (SFB). The ratings also factor in USFB's strong investor profile, its comfortable capitalisation and adequate liquidity profile. The bank's liquidity profile is supported by its scheduled bank status and its relatively shorter-tenor assets and good traction in deposit mobilisation. The ratings continue to factor in USFB's good financial flexibility, resulting from its diversified funding mix, its strong investor base and good management and information systems (MIS) as well as effective internal audit and monitoring systems.

The ratings remain constrained by the bank's high geographic concentration in Bihar and Uttar Pradesh (46% and 31% of the portfolio, respectively, as on September 30, 2018), low share of retail deposits, reliance on joint liability group (JLG) loans (which formed 88% of the portfolio as on September 30, 2018) and the risks thereof, and the high credit costs incurred post demonetisation. Even though the asset quality numbers have improved, the bank's ability to maintain the same would remain a key monitorable. Going forward, USFB's ability to diversify its product mix and depositor base and strengthen 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 profitability improves and the financial risk profile strengthens. The outlook may be revised to Negative in case of a deterioration in the bank's asset quality or its capitalisation and solvency profile.

Key rating drivers

Credit strengths

Experienced and professional management team – The bank's promoter, Mr. Govind Singh, was reinstated as the Managing Director and CEO in September 2018. The senior management comprises functional heads (core team members), most of whom have been associated with the bank since inception. USFB has developed a good second and third line of management for its operations. The team was strengthened with fresh recruitment at the senior level in key areas like liabilities, IT, risk, operations, compliance and treasury among others to smoothen the transition to an SFB.

Strong investor profile – USFB is wholly owned by Utkarsh Coreinvest Limited (formerly Utkarsh Micro Finance Limited). CDC Group (formerly Commonwealth Development Corporation) is Utkarsh Coreinvest Limited's largest shareholder with a 14.13% stake followed by RBL Bank at 9.99%. Other shareholders include International Finance Corporation, Aavishkaar Goodwell, Norwegian Microfinance Initiative and Sarva Capital.

Good capitalisation profile supported by equity infusion – Despite its high pace of growth, the bank has been able to maintain good capitalisation indicators supported by regular capital infusion. The net worth, as on September 30, 2018, was Rs. 738 crore (standalone) while the capital to risk weighted assets ratio (CRAR) was 27.53% (Tier 1: 23.02%) against the regulatory requirement of 15% (Tier 1: 7.5%). The gearing remained moderate at 5.36 times (standalone) as the promoters and investors infused capital worth Rs. 150 crore in FY2018. ICRA expects the bank to maintain good capitalisation indicators, going forward, given the investor support and regular capital infusion.

Comfortable liquidity position and financial flexibility; strong ability to raise funds from diverse sources – USFB's liquidity position remains comfortable owing to a conservative liquidity policy, high cash balances and continued funding from promoters and investors. Focus on expanding deposits as a source of funds has increased with the commencement of banking operations. However, developing a sizeable retail deposit base would take some time. The bank has funding support from SIDBI, NABARD, MUDRA and other banks to cushion liquidity while it garners sizeable retail deposits. The bank's liquidity profile is supported further by its enhanced borrowing ability, its scheduled bank status and its relatively shorter-tenor assets.

Credit challenges

Dependence on microfinance segment with high exposure in Uttar Pradesh and Bihar – As of September 30, 2018, the JLG portfolio accounted for 87% of the bank's overall portfolio. Other segments included micro, small & medium enterprises (MSME) loans (4%), wholesale lending book (8%) and housing and business correspondent book (1%). The bank intends to bring down the share of the JLG book in the medium term while expanding into other segments. USFB's ability to diversify its asset portfolio while maintaining the asset quality at a reasonable level will be important from a credit perspective.

The bank is largely concentrated in Uttar Pradesh and Bihar with a share of 31% and 46% of the overall portfolio, respectively, as on September 30, 2018. While USFB is exploring new geographies for its liability base, it does not plan aggressive diversification of the asset side portfolio. However, the bank does plan to bring down the concentration in Uttar Pradesh and Bihar and expand into other less penetrated states.

Asset quality improved post write-off of demonetisation losses though it remains a key monitorable – The overall asset quality indicators improved gradually with 0+ dpd of 3.54% as of September 30, 2018 compared to 13% as of November 2017 and 28% as of December 2016. The net NPA stood at 0.24% as on September 30, 2018. The bank wrote off portfolio worth Rs. 143 crore in FY2018 on account of demonetisation losses and showed an improvement in its asset quality indicators. It also has an exposure of Rs. 40 crore to the Infrastructure Leasing & Financial Services Group and was holding a provision of Rs. 4 crore for the same as on September 30, 2018. Overall, USFB's ability to maintain its asset quality indicators over the medium term will remain a key rating sensitivity.

Ability to develop retail deposit base – USFB had a deposit base of Rs. 2,607.4 crore as on September 30, 2018, which formed 60% of its overall borrowings. The bank has been able to gain good traction in its deposit base given that 80% of the total deposits came from corporations/financial institutions/the Government with the top 20 depositors accounting for 49% of the total deposits. However, its ability to build its current account and savings account (CASA) and fixed deposits base would be important from a credit perspective.

Marginal borrower profile with limited ability to absorb income shocks – The marginal borrower profile and political and operational risks associated with micro-lending may result in high volatility in the asset quality indicators. Political, communal, overleveraging and other risks in the company's portfolio and across geographies of operations will remain key sensitivities.

Liquidity position

USFB had negligible gaps in the up to 1-year bucket supported by shorter-tenure assets. Further, deposit renewal supports the bank's liquidity profile. The bank has funding support from SIDBI, NABARD, MUDRA and other banks to cushion liquidity while it develops its retail deposit base.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA's Credit Rating Methodology for Non-Banking Finance Companies Rating Methodology for Banks
Parent/Group Support	Not applicable
Consolidation / Standalone	The rating is based on the consolidated financial statements of Utkarsh Small Finance Bank and Utkarsh Coreinvest Limited (formerly Micro Finance Limited) (the parent)

About the company

Incorporated in 2009, Utkarsh Coreinvest Limited (formerly Utkarsh Micro Finance Limited) received a final small finance bank (SFB) licence from the Reserve Bank of India in November 2016 and completed the conversion to a bank in January 2017. The bank is promoted by Mr. Govind Singh, who was earlier the business head of micro banking at ICICI Bank.

USFB operates in 11 states through 438 branches in 120 districts with the largest states being Uttar Pradesh and Bihar, which together accounted for 77% of the portfolio. The bank offers loans in the microfinance, MSME, affordable housing and wholesale lending segments. USFB had a portfolio of Rs. 3,652 crore as on September 30, 2018 with 88% of the portfolio comprising microfinance loans. As for liabilities, USFB had deposits of Rs. 2,607 crore as on September 30, 2018 with fixed deposits accounting for 94%. The asset quality indicators improved with the 0+ dpd and 90+ dpd at 3.54% and 1.39%, respectively, as on September 30, 2018. The bank is expected to come out with an initial public offering (IPO) in FY2021.

USFB reported a net loss of Rs. 60.99 crore on a managed asset base of Rs. 4,669.85 crore in FY2018 (consolidated) vis-à-vis a profit after tax (PAT) of Rs. 34.36 crore on a managed asset base of Rs. 2,670.90 crore in FY2017 (consolidated). The bank reported PAT of Rs. 59.38 crore on a managed asset base of Rs. 4,939.17 crore in H1 FY2019 (standalone, unaudited).

Key financial indicators (audited)

	FY2017	FY2018	H1 FY2019
Net Interest Income	214.23	280.06	263.04
Profit before Tax	52.90	(91.30)	129.28
Profit after Tax	34.36	(60.99)	89.88
Managed Advances	1,613.61	3,210.05	3,656.32
Total Assets	2,651.19	4,566.07	4,800.77
% Tier 1	17.15%	12.95%	23.02%
% CRAR	25.87%	17.40%	27.53%
Gearing	2.86	4.84	4.70
% Net Profit / Average Managed Assets	1.5%	(1.6%)	3.75%
% Return on Net Worth	7.40%	(8.46%)	22.70%
% Gross NPA	0.00%*	1.85%	1.52%
% Net NPA	0.00%*	1.09%	0.24%
Net NPA / Net Worth	0.00%*	4.40%	1.19%

Source: Company's consolidated financials; Amounts in Rs. crore

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)	Date & Rating		Date & Rating in FY2018		Date & Rating in FY2017	Date & Rating in FY2016
					December 2018	September 2018	February 2018	January 2018	-	-
1	NCD	Long Term	50.00	50.00	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	-	-
2	Certificate of deposit programme	Short Term	1,000.00	238.78	[ICRA]A1	[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
INE396P07092	NCD	27-Nov-15	13.90%	27-Nov-21	67.00	[ICRA]A (Stable); withdrawn
INE396P07100	NCD	26-Feb-16	13.30%	24-Feb-21	50.00	[ICRA]A (Stable)
NA	CD	NA	NA	7-365 days	1,000.00	[ICRA]A1

Source: Utkarsh Small Finance Bank

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Utkarsh Coreinvest Limited (formerly Utkarsh Micro Finance Limited)	100.00%	Full Consolidation

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About ICRA Limited:

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