

Utkarsh Small Finance Bank Limited

April 11, 2019

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+; Upgraded from [ICRA]A1
Non-convertible Debenture Programme	50.00	-	[ICRA]A (Stable); Withdrawn
Total	1,050.00	1,000.00	

*Instrument details are provided in Annexure-1

Rationale

ICRA has upgraded the short-term rating for the Rs. 1,000-crore¹ certificate of deposit programme of Utkarsh Small Finance Bank Limited (USFB)² to [ICRA]A1+ (pronounced ICRA A one plus) from [ICRA]A1 (pronounced ICRA A one). ICRA has also withdrawn the long-term rating of [ICRA]A (Stable) (pronounced ICRA A with a Stable outlook) on USFB's Rs. 50.00-crore non-convertible debenture programme. The rating was withdrawn in accordance with ICRA's policy on withdrawal and suspension as there is no amount outstanding against the rated instrument.

The rating upgrade factors in USFB's stable liquidity profile, supported by healthy deposit mobilisation, long-term funding lines from financial institutions (NABARD and SIDBI) and its excess SLR investments and interbank lines. The bank's traction on deposit mobilisation has been healthy with Rs. 3,278 crore of deposits till February 28, 2019, with the share of retail deposits increasing to 27% from 10% as on March 31, 2018. Being a scheduled bank, USFB's deposits are also covered by deposit insurance in accordance with the Reserve Bank of India's (RBI) regulations.

The rating continues to factor in the bank's established track record in the microfinance industry, experienced senior management team and good progress on product diversification. USFB commenced banking operations in January 2017 and has introduced new products like home loans, loan against property (LAP), loans to micro, small and medium enterprises (MSMEs) and wholesale lending, which comprised 12% of the assets under management (AUM) as on December 31, 2018. The rating continues to factor in USFB's strong investor profile and comfortable capitalisation. It also considers the bank's good financial flexibility, resulting from its diversified funding mix, strong investor base and robust management and information systems (MIS) as well as the effective internal audit and monitoring systems.

The rating remains constrained by the bank's high geographic concentration in Bihar and Uttar Pradesh (44% and 28% of the portfolio, respectively, as on March 31, 2019), low share of retail deposits at 27%, reliance on microfinance loans (which formed 88% of the portfolio as on March 31, 2019) and the risks thereof, and the high credit costs incurred post demonetisation. Even though the asset quality numbers have improved post demonetisation, 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.

¹ 100 lakh = 1 crore = 10 million

² For complete rating scale and definitions, please refer to ICRA's website (www.icraindia.com) or other ICRA rating publications

Outlook: Not applicable

Key rating drivers

Credit strengths

Experienced and professional management team – The bank is headed by Mr. Govind Singh. 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.

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 followed by Faering Capital and RBL Bank. Other shareholders include International Finance Corporation, Aavishkaar Goodwell, Norwegian Microfinance Initiative and ResponsAbility.

Good capitalisation profile supported by equity infusion – Despite its high pace of growth, USFB has been able to maintain good capitalisation indicators supported by regular capital infusion. The net worth, as a percentage of the managed portfolio, as on December 31, 2018, was 22% while the capital to risk weighted assets ratio (CRAR) was 28.12% (Tier 1: 23.73%) against the regulatory requirement of 15% (Tier 1: 7.5%). The gearing remained moderate at 5.05 times as on December 31, 2018. 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 good traction in deposit mobilisation (deposits of Rs. 3,278 crore as on February 28, 2019), with most of the term deposits being non-callable. Further, the bank has funding support from SIDBI, NABARD, MUDRA and access to interbank lines. USFB's liquidity profile is further supported by its enhanced borrowing ability on account of receiving Scheduled status and its relatively shorter-tenor assets.

Credit challenges

High exposure in Uttar Pradesh and Bihar – USFB was present in 11 states across 136 districts through 438 branches as on March 31, 2019. However, the share of Uttar Pradesh and Bihar remained high at 28% and 44%, respectively, with the top 5 and top 3 states accounting for 87% and 77% of the portfolio, respectively, as on March 31, 2019. While the bank is exploring new geographies for its liability base, it does not plan on aggressive diversification of the asset-side portfolio. However, USFB plans to bring down the concentration in Uttar Pradesh and Bihar and expand in Jharkhand, Chhattisgarh and West Bengal.

Asset quality improved, post write-off of demonetisation losses, though it remains a key monitorable – USFB's asset quality profile remained comfortable with gross and net NPA ratios of 2.51% and 0.74%, respectively, as on December 31, 2018 against 1.85% and 1.09%, respectively, as on March 31, 2018. The increase in gross NPA was due to a Rs. 40-crore exposure to an infrastructure company, which was classified as an NPA in Q3 FY2019. However, the bank had already created a provision of Rs. 20 crore against the exposure till December 31, 2018. The asset quality of the microfinance book, which accounted for 88% of the overall portfolio as on March 31, 2019 improved marginally with 0+

and 90+ of 1.83% and 1.30%, respectively, as on December 31, 2018 against 2.88% and 1.83%, respectively, as on March 31, 2018. Given the risks associated with the marginal borrower profile and unsecured lending business, the portfolio remains vulnerable to asset quality shocks as witnessed post demonetisation. USFB's comfortable capitalisation profile and good collection efficiency for post-demonetisation disbursements provide comfort, in this regard. The rating factors in the risks associated with the marginal borrower profile, unsecured lending business, political risks, and operational risks arising out of cash handling, along with the challenges associated with the high pace of growth and significant attrition rate.

Ability to diversify product mix and increase share of retail deposits – As of December 31, 2018, the JLG portfolio accounted for 88% of the bank's overall portfolio. Other segments include MSME loans (4%), wholesale lending book (6%), business correspondent (BC) loans (1%) and housing loans (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.

USFB had a deposit base of Rs. 3,278 crore and AUM of Rs. 4,202 crore as on February 28, 2019. The share of current account and savings account (CASA) and retail deposits has been improving and stood at 8.7% and 27%, respectively, as on February 28, 2019, compared to 3.4% and 10.8%, respectively, as on December 31, 2017. The bank has been able to gain good traction in its deposit base, given its nascent stage of operations. However, its ability to build its CASA and retail fixed deposits base would be important from a credit perspective.

Liquidity position

USFB's ALM profile remains comfortable owing to its conservative liquidity policy, mobilisation of deposits and high share of shorter-tenure JLG loans. The bank had healthy cash and cash equivalents of Rs. 1,283 crore as on December 31, 2018 (includes liquid mutual fund investments, reverse repo and a Rs. 500-crore NABARD sanction) and its treasury department has a policy of maintaining sufficient liquidity (including repayments and disbursements). Out of its bulk deposits, around 90% do not have a prematurity option and the bank is currently considering institutional deposits with a minimum tenure of 1 year. The liquidity is also supported by access to refinance limits from NABARD, SIDBI and MUDRA (overall limits of Rs. 852.5 crore as on March 31, 2019) and interbank lines of Rs. 525 crore. The bank has also been able to raise funds through CDs, which provide better liquidity. The current CD utilisation rate is ~30%.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	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 USFB and the parent, Utkarsh CoreInvest Limited

About the company

Incorporated in 2009, Utkarsh CoreInvest Limited received a final small finance bank (SFB) licence from the RBI in November 2016 and completed the conversion to a bank in January 2017. The bank is headed by Mr. Govind Singh, who was earlier the business head of micro banking at ICICI Bank. USFB is promoted by Utkarsh CoreInvest Limited, which is a non-banking finance company – core investment company (NBFC-CIC).

USFB has operations in 11 states through 438 branches in 136 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, affordable housing and wholesale lending segments. USFB had a portfolio of Rs. 4,202 crore as on February 28, 2019 with 88% of

the portfolio comprising microfinance loans. As for liabilities, USFB had deposits of Rs. 3,278 crore as on February 28, 2019 with retail deposits accounting for 27%. The gross and net NPA ratios stood at 2.51% and 0.74%, respectively, as on December 31, 2018.

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. 83.54 crore on a managed asset base of Rs. 5,337 crore in 9M FY2019 (consolidated, unaudited).

Key financial indicators (consolidated; audited)

	FY2017	FY2018	9M FY2019 (provisional)
Net Interest Income	214.23	280.06	361.78
Profit before Tax	52.90	(91.30)	122.01
Profit after Tax	34.36	(60.99)	83.54
Managed Advances	1,613.61	3,210.05	3,757.75
Total Assets	2,651.19	4,566.07	5,307.13
Net Worth	675.39	765.52	850.60
Borrowings (excluding deposits)	1,901.83	1,519.89	1,185.61
Deposits	10.57	2,171.17	2,988.64
% Tier 1	17.15%	12.95%	23.73%
% CRAR	25.87%	17.40%	28.12%
Gearing	2.86	4.84	5.05
% Net Profit / Average Managed Assets	1.5%	(1.6%)	2.26%
% Return on Net Worth	7.40%	(8.46%)	13.78%
% Gross NPA	0.00%*	1.85%	2.51%
% Net NPA	0.00%*	1.09%	0.74%
Net NPA / Net Worth	0.00%*	4.40%	3.63%

Amounts in Rs. crore

Source: ICRA research and company

* Considering RBI dispensation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

Current Rating (FY2020)						Chronology of Rating History for the Past 3 Years				
Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating		Date & Rating in FY2019		Date & Rating in FY2018		Date & Rating in FY2017
				April 2019	December 2018	September 2018	February 2018	January 2018	-	-
1 NCD	Long Term	50.00	0.00	-	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	-	-
2 Certificate of deposit programme	Short Term	1,000.00	285.55	[ICRA]A1+	[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	50.00	[ICRA]A (Stable); withdrawn
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	99.99%	Full consolidation

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