December 14, 2021

Unity Small Finance Bank Limited: [ICRA]A1/[ICRA]A- assigned; ratings on Watch with Developing Implications

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Certificate of Deposit	25.00	[ICRA]A1 &; assigned
Non Convertible Debenture	25.00	[ICRA]A- &; assigned
Total	**50.00**	

*&- Under rating watch with developing implications *Instrument details are provided in Annexure-1*

Rationale

The ratings take into account the established presence of Unity Small Finance Bank Limited's (Unity SFB or the bank) promoter group in the financial services industry space, Unity SFB's healthy upfront capitalisation and its favourable liquidity profile supported by the staggered proposed pay-out schedule. Unity SFB has been promoted by Centrum Group (the Group) in partnership with Resilient Innovations Private Limited (Resilient or BharatPe) with upfront capital of ~Rs. 1,105 crore. It marks the transition of Centrum Group's lending business, which has hitherto been housed under non-banking financial companies {NBFCs, namely Centrum Financial Services Limited (CFSL) and Centrum Microcredit Limited (CML)}, to the banking model.

While assigning the ratings ICRA has also taken note of the proposed merger of Unity SFB with Punjab and Maharashtra Cooperative Bank (PMC Bank). The draft scheme of amalgamation[1] as released by the Reserve Bank of India (RBI) provides for the fair valuation of the assets and liabilities which would ensure a matched balance sheet and comfortable asset liability management profile. The treatment of uninsured deposits and certain other liabilities as capital instruments is expected to be accretive for the Unity SFB's capital adequacy. While deposits up to Rs. 5 lakh to all eligible depositors would be paid upfront, in-turn funded by Deposit Insurance and Credit Guarantee Corporation (DICGC), the scheme proposes a staggered pay-out schedule for the remaining deposits thereby limiting the near-term cash outflows for the bank and supporting its liquidity profile. Given its nascent stages, coupled with any possible overhang or reputational sensitivity owing to PMC Bank, Unity SFB's ability to build a granular deposit profile remains to be seen. However, the healthy on-balance sheet liquidity, coupled with favourable liabilities maturity schedule in accordance with the draft scheme of amalgamation, provides the ability to fund growth over the near term while the bank builds its deposit franchise.

While assigning the ratings, ICRA has taken note of the expectation of losses for the bank over the medium term given the high operating expenses in early stages, the costs on account of the merger with PMC Bank, and incremental credit costs if required. The accounting treatment on fair valuation impact of assets and liabilities of the erstwhile PMC Bank would have a further bearing on the reported profitability. The ratings also consider, the relatively moderate scale of the Group's lending operations (CFSL and CML taken together) with stagnant assets under management (AUM) over the past few years and high geographical concentration. Given the large scale of PMC Bank in relation to the existing operations of Unity SFB, seamless integration of operations would remain critical over near to medium term. The ratings also factor in the risks associated with the unsecured nature of microfinance loans (~35% of overall book), the marginal borrower profile, which is susceptible to income shocks, and the political and operational risks inherent in the microfinance business. While the reported asset quality remains healthy (estimated gross non-performing assets (GNPAs) of 1.4% of advances and NNPA of 0.5% as of September 2021), the restructured assets remain high at ~9%. Going forward, Unity SFB's ability to develop a granular deposit base and thus improve

[1] Draft Punjab and Maharashtra Co-operative Bank Ltd. (Amalgamation with Unity Small Finance Bank Limited) Scheme, 2021 released by the RBI on November 22, 2021

its liability profile and scale up its operations while maintaining a healthy asset quality would remain critical from a credit perspective.

The rating watch with developing implications factors in the proposed amalgamation of Unity SFB with PMC Bank. The draft scheme of amalgamation was placed in the public domain by the RBI on November 22, 2021 inviting suggestions and objections, if any by December 10, 2021. Post this, the RBI is expected to take a final view and thereafter would be subject to regulatory and Government of India (GoI) approval. ICRA will continue to closely monitor developments and take suitable rating action based on the final implementation of the scheme of amalgamation.

Key rating drivers and their description

Credit strengths

Established presence of promoters in financial services industry – The Centrum Group comprising Centrum Capital Limited (CCL), the holding company for the Group and its subsidiaries, is a diversified financial services provider with a presence in fee-based businesses such as investment banking, broking, wealth management, insurance broking and asset management. The Group has an established position in debt capital markets with a clientele across public sector units, banks, state-level undertakings, private corporates and various provident funds. It ventured into the distribution of insurance products and the asset management business in FY2018. It also has a small equity broking operation under Centrum Broking Limited. In FY2019, the Group shifted its focus to grow the fund-based businesses and set up an NBFC (CFSL), a housing finance company (Centrum Housing Finance Limited; CHFL) and a microfinance institution (CML). RIPL/ BharatPe (49% stake in Unity SFB) is a fintech company that provides services like payment solutions and financing solutions to small merchants and kirana store owners. It is expected to bring in technology support to aid with setting up the platform for Unity SFB's digital bank plans.

Comfortable capital profile – Unity SFB is promoted by the consortium of Centrum Group and RIPL. The RBI granted in-principle approval to CFSL, to set up a small finance bank (SFB), under the general guidelines for the on-tap licensing of SFBs in the private sector, as a part of the revival/reconstruction of PMC Bank in June 2021; the licence to set up the SFB was issued in October 2021. As a part of this transaction, the entire business (assets and liabilities) of CFSL and CML was transferred to Unity SFB via a slump sale. BharatPe would acquire a 49% stake in Unity SFB (for Rs. 745 crore) while CFSL would hold a 51% stake. Thus, Unity SFB will comprise the already existing small and medium enterprise (SME)/micro, small and medium enterprise (MSME)/supply chain/micro finance asset base of CFSL and CML along with the digital platform and technology support from BharatPe.

Unity SFB commenced active operations from November 1, 2021 with an upfront equity base of ~Rs. 1,105 crore. In addition to this, the promoters have committed to infuse Rs. 1,900 crore of capital in the bank over the next few years as and when required. ICRA notes that PMC Bank is proposed to be amalgamated with Unity SFB over the near term in accordance with the RBI's scheme for the recovery/resolution for the same. The draft scheme of amalgamation was placed in the public domain by the RBI on November 22, 2021 inviting suggestions and objections, if, any by December 10, 2021. Post this, the RBI is expected to take a final view and thereafter would be subject to regulatory and GoI approval. Based on the draft scheme, the fair valuation of the assets and liabilities would ensure a matched balance sheet and asset liability management profile and may be accretive from a capital adequacy perspective. Going forward, Unity SFB's capitalisation profile, post the amalgamation with PMC Bank would be a key monitorable.

Favourable liquidity profile supported by staggered pay-out schedule– The depositor's settlement plan is to stagger the liabilities over a 10-year period, which helps support the asset-liability management (ALM) profile of the bank. As per the draft scheme of amalgamation released by the RBI, deposits up to Rs. 5 lakh to all eligible depositors would be paid upfront and will be funded through the proceeds from DICGC. Unity SFB is not expected to have cash outflow towards deposits on an immediate basis, till the first 2 years of operations (following the immediate payable through DICGC proceeds). The pay-out to DICGC is to be made over a 20-year period; this long maturity profile gives Unity SFB the flexibility to plan and phase the payments as per cash accruals. On a pro forma basis, Unity SFB had an unencumbered cash and bank balance of Rs. 1,020 crore and total debt outstanding of Rs. 1,334 crore as on November 1, 2021, of which Rs. 353 crore and Rs 794 crore are due for repayment in the next 6 and 12 months, respectively. PMC Bank had a cash and bank balance of Rs. 532 crore and investments of Rs. 2,350 crore as of March 31, 2021. This is expected to have remained stable as there were no further disbursements and is expected to add to the liquidity buffer of Unity SFB.

Credit challenges

Modest scale of operations; expansion under new business model while maintaining healthy asset quality would remain critical – Unity SBF's loan book is estimated at Rs. 1,264 crore as on November 1, 2021 with micro finance loans forming ~35% of the overall book while the rest includes SME/MSME and supply chain finance loans. The geographical concentration is high with Maharashtra accounting for ~53% of the overall loans as of September 30, 2021. Going forward, the bank would be focusing on loan against property, unsecured business loans, supply chain finance, digital finance and working capital lines. BharatPe is also expected to play a transactional role in Unity SFB, which would help the bank scale up its loans and deposits. While the reported asset quality (for the existing CML and CFSL portfolio) remains healthy (estimated GNPAs of 1.4% of advances as of September 2021), the restructured assets remain high at ~9%. The bank's ability to maintain healthy asset quality in the existing CFSL and CML portfolio as well as manage the stress from PMC Bank's portfolio and keep the credit costs under control would be critical. Unity SFB's ability to grow as well as diversify its portfolio and reduce geographical concentration while maintaining the asset quality would be a key monitorable for its credit profile.

Profitability expected to remain subdued in the near to medium term – In FY2021, CFSL and CML combined, posted a profit after tax (PAT) of ~Rs. 3 crore (Return on average assets (RoAA) of ~0.2%) compared to a PAT of ~Rs. 14 crore (RoAA of ~0.8%) in FY2020. The decline in the PAT was attributable to higher credit costs (~Rs. 11 crore in FY2021 compared to ~Rs. 1 crore in FY2020) because of the stress in the asset quality due to the Covid-19 pandemic. The earnings profile further moderated in the current fiscal with CFSL and CML reporting a loss of ~Rs. 2 crore on a consolidated basis in H1 FY2022 owing to lower income and higher operating expenses. Unity SFB is expected to report losses over the medium term given the high operating expenses typical in early stages, costs on account of the merger with PMC Bank, and incremental credit costs if required. The accounting treatment on fair valuation impact of assets and liabilities of the erstwhile PMC Bank would have a further bearing on the reported profitability.

Ability to develop granular deposit base and achieve sustained improvement in liability profile would be key for future growth plans– Unity SFB started its operations from November 1, 2021. Currently, Unity SFB does not have deposit base and is reliant on capital market borrowings and bank lines. As of November 1, 2021, Unity SFB had total borrowings of Rs. 1,334 crore. As of September 30, 2021, debt securities formed ~61% of the combined borrowings of CFSL and CML, followed by bank borrowings of 38% and subordinated liabilities of 1%. Unity SFB's ability to build its current account and savings account deposits (CASA) and retail fixed deposits base would be critical to realise its expansion plans and would thus remain important from a credit perspective.

Ability to manage political, communal and other risks in microfinance sector, given the marginal borrower profile with high susceptibility to income shocks – As a large portion of Unity SFB's portfolio continues to comprise microfinance loans (35% as on November 1, 2021), the portfolio remains vulnerable to asset quality shocks as witnessed after demonetisation and during the pandemic. The ratings factor in the risks associated with unsecured lending to marginal borrowers with limited ability to absorb income shocks and the rising borrower leverage levels owing to an increase in multiple lending in the areas of operations. The microfinance industry is prone to socio-political, climatic and operational risks, which could negatively impact the bank's operations and thus its financial position. Unity SFB's ability to onboard borrowers with a good credit history and recruit and retain employees while scaling up its operations would be key for managing high growth rates.

Liquidity position: Strong

On pro forma basis, Unity SFB had an unencumbered cash and bank balance of Rs. 1,020 crore and a total debt outstanding of Rs. 1,334 crore as on November 1, 2021 of which Rs. 353 crore and Rs. 794 crore are due for repayment in the next 6 and 12 months, respectively. ICRA also notes that as per the draft RBI scheme for the PMC Bank amalgamation, PMC Bank's deposit liabilities are expected to stagger over a period of 10/20 year, with no cash outflows from Unity SFB's on-balance sheet liquidity in the initial 24 months of operations, which alleviates pressure on the ALM profile. PMC Bank had a cash and bank balance of Rs. 532 crore and investments of Rs. 2,350 crore as of March 31, 2021. This is expected to have remained stable as there were no further disbursements which is expected to add to the liquidity buffer of Unity SFB.

Rating sensitivities

Positive/Negative factors – ICRA will continue to closely monitor the developments and take suitable rating action based on the terms of the final approved scheme of amalgamation.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA's Credit Rating Methodology for Non-banking Finance Companies Rating Methodology of Banks Consolidation and Rating Approach
Parent/Group Support	Not applicable
Consolidation/Standalone	To arrive at the ratings, ICRA has considered the financial profile of CFSL and CML and the capital infusion from RIPL.

About the company

Unity SFB is promoted by the consortium of Centrum Group and RIPL (or BharatPe, a fintech company). The RBI granted in-principle approval to CFSL to set up an SFB, under the general guidelines for the on-tap licensing of SFBs in the private sector, as a part of the revival/reconstruction of PMC Bank in June 2021; the licence to set up the SFB was issued in October 2021.

BharatPe would acquire a 49% stake in Unity SFB (for Rs. 745 crore) while CFSL would hold 51%. Thus, Unity SFB will comprise the already existing SME/MSME/supply chain/microfinance asset base of CFSL and CML along with the digital platform and technology support of BharatPe. Unity SFB commenced active operations from November 1, 2021 with an upfront equity base of Rs. 1,105 crore. PMC Bank is proposed to be amalgamated with Unity SFB over the near term in accordance with the RBI's scheme for the recovery/resolution for the same. The draft scheme of amalgamation was placed in the public domain by the RBI on November 22, 2021 inviting suggestions and objections, if any, by December 10, 2021. Post this, the RBI is expected to take a final view and thereafter would be subject to regulatory and GoI approval.

Key financial indicators (proforma)

Unity Small Finance Bank	FY2020	FY2021	Nov 1, 2021*
Total income	NA	NA	NA
Profit after tax	NA	NA	NA
Net worth	NA	NA	1,105
Loan assets	NA	NA	1,264
Total assets	NA	NA	2,477
Return on assets	NA	NA	NA
Return on equity	NA	NA	NA
Gearing (times)	NA	NA	1.21
Gross NPA (%)	NA	NA	NA
Net NPA (%)	NA	NA	NA
CRAR (%)	NA	NA	NA

Source: *Unity SFB, ICRA Research; All ratios as per ICRA calculations; * Based on entity's estimates*
Amount in Rs. crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					Dec 14, 2021	-	-	-
1	Certificate of Deposit	Short Term	25.00	0.00	[ICRA]A1 &; assigned	-	-	-
2	Non Convertible Debenture	Long Term	25.00	0.00	[ICRA]A- &; assigned	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Certificate of Deposit	Very Simple
Non Convertible Debenture	Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Certificate of Deposit – Proposed	NA	NA	NA	25	[ICRA]A1 &; assigned
NA	Non Convertible Debenture – Proposed	NA	NA	NA	25	[ICRA]A- &; assigned

Source: *Unity SFB*

Annexure-2: List of entities considered for consolidated analysis: Not applicable

ANALYST CONTACTS

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

Samriddhi Chowdhary
+91 22 6114 3462
samriddhi.chowdhary@icraindia.com

Sainath Chandrasekaran
+91 22 6114 3439
sainath.chandrasekaran@icraindia.com

Jatin Arora
+91 124 45 45 330
jatin.arora@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
communications@icraindia.com

Helpline for business queries

+91-9354738909 (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

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches