

August 05, 2022

Unity Small Finance Bank Limited: Ratings reaffirmed, removed from Watch with Developing Implications and Stable outlook assigned; Ratings withdrawn for matured/redeemed instruments

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Issuer Rating	-	-	[ICRA]A-(Stable) reaffirmed; removed from Watch with Developing Implications and Stable outlook assigned
Non-convertible Debenture	10.00	10.00	[ICRA]A-(Stable) reaffirmed; removed from Watch with Developing Implications and Stable outlook assigned
Non-convertible Debenture	180.00	0.00	[ICRA]A-(Stable) reaffirmed; removed from Watch with Developing Implications and Stable outlook assigned and withdrawn
Bank Facilities (LT/ ST – Fund based)	262.05	262.05	[ICRA]A-(Stable)/[ICRA]A1 reaffirmed; removed from Watch with Developing Implications and Stable outlook assigned
Bank Facilities (LT/ ST – Fund based)	77.95	0.00	[ICRA]A-(Stable)/[ICRA]A1 reaffirmed; removed from Watch with Developing Implications and Stable outlook assigned and withdrawn
Certificate of Deposit	25.00	25.00	[ICRA]A1 reaffirmed; removed from Watch with Developing Implications
Total	555.00	297.05	

*Instrument details are provided in Annexure I

Rationale

ICRA has reaffirmed the ratings for the borrowing programmes of Unity Small Finance Bank Limited (Unity SFB), has removed the rating Watch with Developing Implications and assigned a Stable outlook to the long-term rating. The rating action considers the final scheme for the amalgamation of Punjab and Maharashtra Cooperative Bank (PMC Bank), which has been approved by the Reserve Bank of India (RBI) and is largely in line with the draft scheme of amalgamation. It also factors in the completion of the merger of PMC Bank with Unity SFB. The Stable outlook on the long-term rating considers the bank's healthy upfront capitalisation and favourable liquidity profile, supported by the staggered proposed payout schedule and certain relaxations provided by the RBI on priority sector lending, timeline for the initial public offering, etc. The outlook also factors in the established presence of Unity SFB's promoter group in the financial services industry.

Unity SFB has been promoted by Centrum Group (the Group) in partnership with Resilient Innovations Private Limited (RIPL or BharatPe) with an upfront capital of Rs. 1,105.10 crore. It marks the transition of Centrum Group's lending business to a banking model with the transfer of the entire business (assets and liabilities) of the Group's non-banking financial companies (NBFCs), namely Centrum Financial Services Limited (CFSL) and Centrum Microcredit Limited (CML), to Unity SFB.

While reaffirming the ratings, ICRA has taken note of the expectation of losses for Unity SFB 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 of the fair valuation impact of the assets and liabilities of the erstwhile PMC Bank would have further bearing on the reported profitability. The ratings also consider the relatively moderate scale of the Group's lending operations. Given the large scale of PMC Bank in relation to the existing operations of Unity SFB, the seamless integration of operations would remain critical over the near to medium term.

The ratings also factor in the risks associated with the unsecured nature of microfinance loans, the marginal borrower profile, which is susceptible to income shocks, and the political and operational risks inherent in the microfinance business. ICRA notes that while the reported gross non-performing assets (GNPAs) were very high at Rs. 3,773 crore or 62.94% of the overall gross loan book, the net NPAs (NNPAs) stood at Rs. 197 crore or 8.14% of the net loan book, indicating a provisioning coverage ratio of 94.78% as of March 31, 2022. Going forward, Unity SFB's ability to scale up its operations while maintaining a healthy asset quality would remain critical from a credit perspective.

Currently, the fresh term deposit accretion is modest at Rs. 395 crore, as on July 31, 2022, raised during the last four months, as the bank is upgrading its information technology systems before launching a deposit mobilisation drive. It has 111 branches (110 PMC Bank branches and 1 non-PMC Bank branch) and 145 offices. In the next four years, the management aims to increase the number of branches to 288. The bank is focusing on various strategies to retain the existing depositors as well as attract new customers to enhance its deposit base. Unity SFB's ability to build its current account and savings account (CASA) deposits and retail fixed deposits base would be critical to realise its expansion plans and would thus remain important from a credit perspective. Nonetheless, the healthy on-balance sheet liquidity, coupled with the favourable liabilities maturity profile, provides the bank with the ability to fund growth over the near term while it builds its deposit franchise.

The outstanding ratings on Unity SFB's Rs. 180-crore non-convertible debenture (NCD) programme and Rs. 77.95-crore bank facilities have been withdrawn in accordance with ICRA's policy on the withdrawal and suspension of credit ratings and as requested by the company. The rated instruments were fully redeemed and there is no amount outstanding against the same.

Key rating drivers and their description

Credit strengths

Established presence of promoters in financial services industry – 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 help set up the platform for Unity SFB's digital bank plans.

Comfortable capital position – 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 acquired a 49% stake in Unity SFB (for Rs. 745 crore) while CFSL holds a 51% stake.

Unity SFB commenced active operations from November 1, 2021 with an upfront equity base of Rs. 1,105 crore. Thereafter, PMC Bank was amalgamated with Unity SFB in accordance with the RBI's scheme for the recovery/resolution for the same. ICRA notes that the fair valuation of the assets and liabilities has ensured a matched balance sheet and asset-liability management (ALM) profile and has been accretive from a capital adequacy perspective. As on March 31, 2022, Unity SFB had a comfortable capitalisation profile with a total capital-to-risk weighted assets ratio (CRAR) of 63.71% (Tier 1 ratio of 38.77%) against the regulatory requirement of 15%. However, it is noted that the capital adequacy is supported by the relaxations

provided by the RBI in terms of inclusion of certain restructured and fair valued liabilities in the total CRAR. Nonetheless, the Tier 1 ratio of 38.77% is comfortable, though the capitalisation level would be a key monitorable going forward considering the envisaged portfolio growth and the estimated losses in the initial years. ICRA notes that the promoters have committed to infuse Rs. 1,900 crore of capital in the bank over the next few years, as and when required.

Favourable liquidity profile supported by staggered payout schedule – The depositor's settlement plan has staggered the liabilities over a 10-year period, which supports the bank's ALM profile. As per the 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 Deposit Insurance and Credit Guarantee Corporation (DICGC). The bank received funds aggregating Rs. 3,830 crore from DICGC, of which Rs. 2,590 crore has been already settled to PMC Bank's depositors while the rest was retained as of July 07, 2022. The payout 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 provisional basis, the bank's structural liquidity statement (SLS) as on March 31, 2022 did not have negative cumulative mismatches in any bucket for up to one year, even under the stressed scenario of 90% collection efficiency on advances. As of March 31, 2022, it had grandfathered borrowings (excluding deposits) of Rs. 1,128 crore, which declined to Rs. 408 crore by July 2022. As on March 31, 2022, Unity SFB was carrying on-book statutory liquidity ratio (SLR) investments aggregating Rs. 2,735 crore. As of July 07, 2022, it had total cash and cash equivalents of Rs. 4,005 crore including Rs. 2,959 crore of SLR investments, Rs. 726 crore of non-SLR investments, Rs. 213 crore of cash reserve ratio (CRR) and Rs. 18 crore of other investments. ICRA notes that the liquidity coverage ratio was healthy at 661% as on May 31, 2022.

Credit challenges

Modest scale of operations; expansion under new business model while maintaining healthy asset quality would remain critical – Unity SFB's gross loan book stood at Rs. 5,996 crore and net loan book stood at Rs. 2,419 crore as on March 31, 2022 with microfinance loans (inclusive banking) forming 29% of the overall net loan book while the small and medium-sized enterprise (SME)/micro, small and medium enterprise (MSME) and supply chain finance loans (business banking) formed 47% of the overall net loan book. PMC Bank's loan book accounted for the rest. Going forward, the bank would be focusing on MSME lending, inclusive banking, loan against property, unsecured business loans, supply chain finance, digital finance and working capital loans. BharatPe is also expected to play a transactional role in Unity SFB, which would help it scale up its loans and deposits.

The GNPA's stood at Rs. 3,773 crore or 62.94% of the overall gross loan book while the NNPA's stood at Rs. 197 crore or 8.14% of the net loan book. 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 – 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 of the fair valuation impact of the assets and liabilities of the erstwhile PMC Bank would have further bearing on the reported profitability. During November 1, 2021 to March 31, 2022, the bank reported a net loss of Rs. 150 crore. ICRA note that Unity SFB has amortised goodwill of Rs. 92 crore and has taken a fair value charge of Rs. 46 crore pertaining to the amalgamation of PMC Bank in accordance with the scheme.

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, the fresh term deposit accretion is modest at Rs. 395 crore as of July 31, 2022, raised during the last four months, as the bank is upgrading its information technology systems before launching a deposit mobilisation drive. It has 111 branches at present (110 PMC Bank branches and 1 non-PMC

Bank branch) and 145 offices. In the next four years, the management aims to increase the number of branches to 288. Initially, the plan is to optimise/refurbish the existing branches. Following this, the bank would start adding branches in the existing locations and then in new locations.

Unity SFB is focusing on various strategies to retain the existing depositors as well as attract new customers to enhance its deposit base. It received scheduled bank status in July 2022 and has signed refinance agreements with National Bank for Agriculture and Rural Development (NABARD) and Small Industries Development Bank of India (SIDBI). However, it is yet to avail refinance lines from them due to excess liquidity. Unity SFB's ability to build its CASA deposits 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 sizeable portion of Unity SFB's portfolio continues to comprise microfinance loans, the portfolio remains vulnerable to asset quality shocks as witnessed after demonetisation and during the Covid-19 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

The depositor's settlement plan has staggered the liabilities over a 10-year period, which supports the bank's ALM profile. As per the 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. The payout 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 provisional basis, the bank's SLS as on March 31, 2022 did not have negative cumulative mismatches in any bucket for up to one year, even under the stressed scenario of 90% collection efficiency on advances. As on March 31, 2022, Unity SFB was carrying on-book SLR investments aggregating Rs. 2,735 crore. ICRA notes that the liquidity coverage ratio was healthy at 661% as on May 31, 2022. As of July 07, 2022, the bank had total cash and cash equivalents of Rs. 4,005 crore including Rs. 2,959 crore of SLR investments, Rs. 726 crore of non-SLR investments, Rs. 213 crore of CRR and Rs. 18 crore of other investments.

Rating sensitivities

Positive factors – ICRA could revise the outlook to Positive or upgrade the long-term rating if Unity SFB is able to build a granular liability franchise while improving its funding cost and profitability. Diversifying the asset mix while scaling up and maintaining the asset quality and a prudent capitalisation profile will remain imperative.

Negative factors – Pressure on the bank's ratings could arise on account of a longer-than-expected path to profitability, leading to pressure on the capitalisation profile. The weakening of the liquidity profile could also exert pressure on the ratings. Inability to demonstrate traction in the liability franchise will also be a credit negative.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	ICRA's Credit Rating Methodology for Non-banking Finance Companies Rating Methodology of Banks ICRA Policy on Withdrawal of Credit Ratings
Parent/Group support	Not applicable

Analytical Approach	Comments
Consolidation/Standalone	Standalone

About the company

Unity SFB is the 12th SFB of India promoted by the consortium of Centrum Group along with Resilient Innovations Private Limited (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 acquired a 49% stake in Unity SFB (for Rs. 745 crore) while CFSL holds 51%. Further, 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. CFSL serves as the holding company for Unity SFB with no other operations. Currently, Unity SFB primarily has the already existing SME/MSME/supply chain/microfinance asset base of CFSL and CML and receives 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. As the second leg of this transaction, PMC Bank was amalgamated with Unity SFB in accordance with the RBI's scheme for the recovery/resolution for the same. This was completed on January 24, 2022.

Key financial indicators (proforma)

Unity Small Finance Bank	Mar 31, 2020	Mar 31, 2021	Nov 1, 2021	Mar 31, 2022
Total income	NA	NA	NA	154
Profit after tax	NA	NA	NA	(150)
Net worth (reported) [@]	NA	NA	1,105	1,924
Loan assets	NA	NA	1,264	2,419
Total assets	NA	NA	2,477	10,811
Return on assets	NA	NA	NM	NM
Return on equity	NA	NA	NM	NM
Gearing (including deposits; times)	NA	NA	1.21	2.57*
Gross NPA	NA	NA	NA	62.94%
Net NPA	NA	NA	NA	8.14%
CRAR	NA	NA	NA	63.71%

Source: Unity SFB, ICRA Research; All ratios as per ICRA's calculations; NM – Not meaningful, * Gearing does not include the restructured deposit liabilities of Rs. 2,377 crore and interest accrued but not due of Rs. 126 crore as of March 31, 2022, [@] Capital and Reserves and Surplus 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 (FY2023)	Chronology of Rating History for the Past 3 Years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating in FY2022			Date & Rating in FY2021	Date & Rating in FY2020
						Aug 05, 2022	Dec 29, 2021	Dec 17, 2021	Dec 14, 2021	
1	Issuer Rating	Long Term	NA	NA	[ICRA]A-(Stable)	[ICRA]A- &	-	-	-	-
2	Non-convertible Debenture	Long Term	10	10	[ICRA]A-(Stable)	[ICRA]A- &	[ICRA]A- &	[ICRA]A- &	-	-
3	Non-convertible Debenture	Long Term	180	0	[ICRA]A-(Stable); withdrawn	[ICRA]A- &	[ICRA]A- &	[ICRA]A- &	-	-
4	Bank facilities (LT/ ST – Fund based)	Long/ Short Term	262.05	261.75	[ICRA]A-(Stable)/ [ICRA]A1	[ICRA]A- &/ [ICRA]A1 &	-	-	-	-
5	Bank facilities (LT/ ST – Fund based)	Long/ Short Term	77.95	0	[ICRA]A-(Stable)/ [ICRA]A1; withdrawn	[ICRA]A- &/ [ICRA]A1 &	-	-	-	-
6	Certificate of Deposit	Short Term	25	0	[ICRA]A1	[ICRA]A1 &	[ICRA]A1&	[ICRA]A1&	-	-
7	Commercial Paper Programme	Short Term	8.5	-	-	[ICRA]A1+ (CE); withdrawn	[ICRA]A1+(CE)	-	-	-

& - Under rating Watch with Developing Implications

Complexity level of the rated instruments

Instrument	Complexity Indicator
Certificate of Deposit	Very Simple
Non-convertible Debenture	Simple
Bank Facilities (LT/ ST – Fund based)	Simple
Issuer Rating	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 I: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
Not issued	Certificate of Deposit	NA	NA	NA	25.00	[ICRA]A1
INE0J1607016	NCD	Jun 29, 2020	10.60%	Jun 29, 2023	10.00	[ICRA]A-(Stable)
INE0J1607024	NCD	Jul 30, 2020	10.00%	Jan 30, 2022	50.00	[ICRA]A-(Stable);withdrawn
INE0J1607032	NCD	Sep 22, 2020	10.00%	Mar 22, 2022	25.00	[ICRA]A-(Stable);withdrawn
INE0J1607040	NCD	Nov 04, 2020	10.00%	May 04, 2022	25.00	[ICRA]A-(Stable);withdrawn
INE0J1607057	NCD	Dec 14, 2020	10.00%	Jun 14, 2022	18.75	[ICRA]A-(Stable);withdrawn
INE0J1607065	NCD	Dec 31, 2020	10.00%	Jun 30, 2022	50.00	[ICRA]A-(Stable);withdrawn
INE0J1607172	NCD	Dec 31, 2020	11.50%	Jun 30, 2022	11.25	[ICRA]A-(Stable);withdrawn
NA	Bank facilities-Term loan/WCDL/OD	NA	NA	NA	261.75	[ICRA]A-(Stable)/[ICRA]A1
NA	Bank facilities-Term loan/WCDL/OD	NA	NA	NA	77.95	[ICRA]A-(Stable)/[ICRA]A1; withdrawn
NA	Bank facilities-unallocated	NA	NA	NA	0.30	[ICRA]A-(Stable)/[ICRA]A1
NA	Issuer rating	NA	NA	NA	NA	[ICRA]A-(Stable)

Source: Unity SFB

Annexure II: List of entities considered for consolidated analysis: Not applicable

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About ICRA Limited:

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Branches



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