December 08, 2022

Unity Small Finance Bank Limited: Ratings reaffirmed; Ratings reaffirmed and withdrawn for matured/redeemed instruments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
Non-convertible Debenture	10.00	10.00	[ICRA]A- (Stable); reaffirmed
Bank Facilities (LT/ ST – Fund based)	133.10	133.10	[ICRA]A- (Stable)/[ICRA]A1; reaffirmed
Bank Facilities (LT/ ST – Fund based)	45.80	0.00	[ICRA]A- (Stable)/[ICRA]A1; reaffirmed and withdrawn
Certificate of Deposit	25.00	25.00	[ICRA]A1; reaffirmed
Total	**213.90**	**168.10**	

**Instrument details are provided in Annexure I*

Rationale

The rating action factors in the established presence of Unity Small Finance Bank Limited's (Unity SFB) promoter group in the financial services industry, the bank's healthy upfront capitalisation and favourable liquidity profile, supported by the staggered payout schedule for the deposits of the erstwhile PMC Bank and the relaxations provided by the Reserve Bank of India (RBI) on priority sector lending (PSL) norms, timeline for the initial public offering (IPO), etc. While reaffirming the ratings, ICRA continues to take cognisance 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. In this regard, the accounting treatment of the fair valuation of the assets and liabilities of the erstwhile PMC Bank would have a bearing on the future profitability and capitalisation.

Unity SFB's ability to build a healthy deposit franchise would be critical to realise its growth plans and would remain important for its earnings trajectory. Nonetheless, the healthy on-balance sheet liquidity, coupled with the favourable liability maturity profile, provides the bank with the ability to fund growth over the near term while it builds its deposit base. Its ability to scale up its operations while maintaining a healthy asset quality would remain critical from a credit perspective. The ratings also factor in the risks associated with the unsecured nature of microfinance loans, which is likely to remain a focus area for the bank for growth as well as to meet its priority sector lending (PSL) targets. ICRA also notes that the reported gross non-performing assets (GNPAs) and net NPAs (NNPAs) stood high, despite the high provisioning coverage ratio.

The Stable outlook on the long-term rating reflects ICRA's expectation that the bank will be able to grow its liability base, improve its scale of operations and report profitable operations after the next couple of years. The outlook also factors in the requisite capital-raising plans to offset the interim losses and to fund the growth.

The outstanding ratings on the Rs. 45.80-crore bank facilities have been reaffirmed and withdrawn as there is no amount outstanding against the said facility and in accordance with ICRA's policy on the withdrawal of credit ratings.

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 of 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 a non-banking financial company (NBFC; Centrum Financial Services Limited; CFSL), a housing finance company (Centrum Housing Finance Limited; CHFL) and a microfinance institution (Centrum Microcredit Limited; CML).

Resilient Innovations Private Limited (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 while CFSL holds a 51% stake.

Unity SFB commenced active operations from November 1, 2021 with an upfront equity base of Rs. 1,105.10 crore. Thereafter, PMC Bank was amalgamated with Unity SFB in accordance with the RBI's scheme for the recovery/resolution of 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. 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 already been settled to PMC Bank's depositors while the rest was retained as of July 07, 2022. Unity SFB has retained the same in the form of current account savings account (CASA) deposits or redeployed it in fixed deposits. 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.

The bank's liquidity coverage ratio was healthy at 677.9% as on September 30, 2022, with statutory liquidity ratio (SLR) investments of Rs. 1,860 crore and non-SLR investments of Rs. 845 crore. Its 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. 272 crore as of September 30, 2022.

Credit challenges

Modest scale of operations; expansion under new business model while maintaining healthy asset quality would remain critical – As of September 30, 2022, Unity SFB's gross loan book stood at Rs. 6,768 crore and the net loan book was Rs. 3,148 crore. Comparatively, its gross loan book was Rs. 5,996 crore, while the 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. 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 legacy loan book accounted for the balance. 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.

As of September 30, 2022, the GNPA ratio stood at 56.29% and the NNPA ratio stood at 5.95%. The bank's ability to incrementally maintain healthy asset quality in the existing CFSL and CML portfolios, 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. Unity SFB reported a net loss of Rs. 99 crore in H1 FY2023. It had reported a net loss of Rs. 150 crore during November 1, 2021 to March 31, 2022.

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. The fresh term deposit accretion is modest at approximately Rs. 720 crore as of October 30, 2022, raised during the last seven 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. It 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. Its 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 comprises 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 bank received funds aggregating Rs. 3,830 crore from DICGC, of which Rs. 2,590 crore has already been settled to PMC Bank's depositors while the rest was retained as of July 07, 2022. Unity SFB has retained the same in the form of CASA deposits or redeployed it in fixed deposits. 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.

The bank's liquidity coverage ratio was healthy at 677.9% as on September 30, 2022, with SLR investments of Rs. 1,860 crore and non-SLR investments of Rs. 845 crore. Its 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. 272 crore as of September 30, 2022.

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
Consolidation/Standalone	Standalone

About the company

Unity SFB is the 12th SFB in 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 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 of the same. This was completed on January 24, 2022.

Key financial indicators (proforma)

Unity Small Finance Bank	Mar 31, 2021	Nov 1, 2021	Mar 31, 2022	Q1 FY2023/Jun 30, 2022	Q2 FY2023/Sep 30, 2022
Total income	NA	NA	154	126	210
Profit after tax	NA	NA	(150)	(92)	(7)
Net worth (reported)	NA	1,105	1,914	1,813	1,797
Loan assets	NA	1,264	2,419	2,809	3,148
Total assets	NA	2,477	10,811	8,032	7,603
Return on assets	NA	NM	NM	NM	NM

Unity Small Finance Bank	Mar 31, 2021	Nov 1, 2021	Mar 31, 2022	Q1 FY2023/Jun 30, 2022	Q2 FY2023/Sep 30, 2022
Return on equity	NA	NM	NM	NM	NM
Gearing (including deposits; times)*	NA	1.21	2.57	1.21	1.03
Gross NPA	NA	NA	62.94%	59.40%	56.29%
Net NPA	NA	NA	8.14%	7.42%	5.95%
CRAR	NA	NA	63.71%	58.91%	62.75%

*Source: Unity SFB, ICRA Research; All ratios as per ICRA's calculations; NM – Not meaningful; NA – Not available; *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*
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 as of Dec 02, 2022 (Rs. crore)	Date & Rating			Date & Rating in FY2022			Date & Rating in FY2021	Date & Rating in FY2020
					Dec 08, 2022	Sep 09, 2022	Aug 05, 2022	Dec 29, 2021	Dec 17, 2021	Dec 14, 2021	-	-
1	Issuer Rating	Long Term	NA	NA	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- &	-	-	-	-
2	Non-convertible Debenture	Long Term	10	10	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- &	[ICRA]A- &	[ICRA]A- &	-	-
3	Bank Facilities (LT/ ST – Fund based)	Long/ Short Term	133.10	68	[ICRA]A- (Stable)/ [ICRA]A1	[ICRA]A- (Stable)/ [ICRA]A1	[ICRA]A- (Stable)/ [ICRA]A1	[ICRA]A- &/ [ICRA]A1 &	-	-	-	-
4	Bank Facilities (LT/ ST – Fund based)	Long/ Short Term	45.80	0	[ICRA]A- (Stable)/ [ICRA]A1; withdrawn	[ICRA]A- (Stable)/ [ICRA]A1	[ICRA]A- (Stable)/ [ICRA]A1	[ICRA]A- &/ [ICRA]A1 &	-	-	-	-
5	Certificate of Deposit	Short Term	25	0	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1 &	[ICRA]A1&	[ICRA]A1 &	-	-
6	Commercial Paper Programme	Short Term	-	-	-	-	-	[ICRA]A1+ (CE); withdrawn	[ICRA]A1+(CE)	-	-	-

& - Under rating Watch with Developing Implications; NA – Not applicable

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	Not applicable

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: Click Here

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)
NA	**Bank facilities – Term loan/ WCDL/OD**	Sep 12, 2021	Not available	Aug 01, 2024	38.97	[ICRA]A-(Stable)/[ICRA]A1
NA	**Bank facilities – Term loan/ WCDL/OD**	Aug 05, 2021	Not available	Aug 10, 2024	48.00	[ICRA]A-(Stable)/[ICRA]A1
NA	**Bank facilities – Term loan/ WCDL/OD**	Oct 08, 2021	Not available	Oct 21, 2023	45.83	[ICRA]A-(Stable)/[ICRA]A1
NA	**Bank facilities – Term loan/ WCDL/OD**	NA	NA	NA	45.80	[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; NA – Not applicable

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

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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.

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