August 11, 2023

Fincare Small Finance Bank Limited: Rating assigned; Rating reaffirmed and withdrawn for Bank lines

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Bank lines (Long term – Term loan)	800	-	[ICRA]A (Positive); reaffirmed and simultaneously withdrawn
Bank lines (Long term – Fund based/non-fund based)	75	-	[ICRA]A (Positive); reaffirmed and simultaneously withdrawn
Tier II bonds	100	100	[ICRA]A (Positive); outstanding
Lower Tier II bonds	200	200	[ICRA]A (Positive); outstanding
Lower Tier II bonds	-	60	[ICRA]A (Positive); assigned
Fixed deposits	50	50	[ICRA]A (Positive); outstanding
Total	**1,225**	**410**	

**Instrument details are provided in Annexure I*

Rationale

The rating continues to factor in the increase in Fincare Small Finance Bank Limited's (Fincare) scale of operations with the expectation that the trend will continue along with further improvement in the asset quality and profitability. The rating also factors in the adequate capitalisation profile with a capital adequacy ratio (CAR) of 20.0% (Tier I: 18.6%) as on March 31, 2023, above the regulatory requirement of 15.0% (Tier I: 7.5%). Nevertheless, ICRA believes that the bank will need to raise capital in the near term {including through the impending initial public offer (IPO)} to support its growth plans while maintaining an adequate capitalisation profile. The rating also derives comfort from the healthy traction in Fincare's deposit mobilisation over the last few years, with deposits comprising 68% of its borrowings {including securitisation and inter-bank participation certificates (IBPCs)} as on March 31, 2023.

ICRA notes that Fincare witnessed an improvement in its asset quality in FY2023, which had deteriorated in FY2021 and FY2022 because of the Covid-19 pandemic-induced disruptions. Fincare's gross non-performing assets (GNPAs) declined to 3.3% as on March 31, 2023 from 7.8% as on March 31, 2022 due to recoveries and write-offs in FY2023. Nonetheless, its ability to arrest incremental slippages and recover from its delinquent portfolio would remain a key monitorable from a credit perspective. Further, ICRA notes that the profitability indicators improved in FY2023, with the reduction in credit costs, though the same remains moderate. Going forward, Fincare's ability to control its credit cost and improve its operational efficiency will be important for improving its profitability profile and the same shall remain a monitorable.

While the bank has been scaling up its newer products, including affordable housing loans (AHL), loan against property (LAP), etc., the microfinance segment continues to constitute a large part of its portfolio with a 61% share as on March 31, 2023 (down from 77% as on March 31, 2022), exposing it to the risks associated with unsecured lending. Further, the portfolio under AHL and LAP has witnessed a robust growth in the past few years and remains unseasoned. The rating also continues to factor in the political and operational risks associated with microlending and the marginal profile of the borrowers, which may lead to high volatility in the asset quality indicators. Going forward, Fincare's ability to diversify the asset mix further and improve its asset quality indicators and profitability metrics while scaling up its operations will be important from a credit perspective.

The Positive outlook on the long-term rating factors in the expectation that Fincare will see a further increase in its scale of operations. Moreover, ICRA expects the bank's asset quality and profitability metrics to continue improving, while maintaining a prudent capitalisation profile and healthy traction in its deposits.

ICRA has reaffirmed and simultaneously withdrawn the ratings for the Rs. 875-crore Bank lines in accordance with ICRA's policy on the withdrawal of credit ratings.

Key rating drivers and their description

Credit strengths

Improvement in scale of operations – Fincare's assets under management (AUM) increased at a compound annual growth rate (CAGR) of 29% during FY2019 to FY2023, aided by the growing borrower base and diversification in the higher ticket size loan segments of AHL and LAP. The growth was moderate in H1 FY2023, given the write-offs during this period and the management's focus on recoveries. However, with higher disbursements in the second half of the fiscal, the bank witnessed an increase in its scale of operations. It reported an AUM of Rs. 9,911 crore as on March 31, 2023, registering a growth of ~30% in FY2023.

Good traction in deposit mobilisation – Fincare has been able to grow its deposit base, which comprised 68% of its total borrowings (including securitisation and IBPCs) as on March 31, 2023. The overall deposit base grew by 24% to Rs. 8,033 crore as on March 31, 2023 from Rs. 6,456 crore as on March 31, 2022. Moreover, the deposit base is granular with current and savings account (CASA) deposits at 33% and CASA + retail deposits at ~80% as on March 31, 2023. Though there was a slight decline in the share of CASA deposits in FY2023, in line with the industry, the bank is expected to witness an improvement in the same going forward, driven by its focus on expanding its retail depositor base. Fincare has also been able to contain its cost of funds over the last few quarters despite the overall increase in the interest rates in the market. It reported cost of average funding of 6.4% in FY2023 compared to 7.0% in FY2022.

Improvement in asset quality – The bank's overall asset quality indicators improved in FY2023, aided by write-offs, recoveries and gradually declining slippages. It reported GNPAs of 3.3% and net NPAs (NNPAs) of 1.3% as on March 31, 2023 compared to 7.8% and 3.6%, respectively, as on March 31, 2022. Further, the standard restructured portfolio declined substantially in FY2023. ICRA notes that Fincare increased its provision coverage ratio (PCR) on GNPAs to 62% as on March 31, 203 from 56% as of March 2022. The reduction in the NPAs along with the higher PCR led to an improvement in the bank's solvency (NNPA/Net worth) to 8.6% as on March 31, 2023 from 20.8% as on March 31, 2022. Nevertheless, the asset quality remains a monitorable, given the high share of microfinance and the limited seasoning of the non-microfinance portfolio.

Adequate capitalisation – The bank had an adequate capitalisation profile with a CAR of 20.0% as on March 31, 2023, which was well above the regulatory requirement of 15.0%. Fincare's net worth, in relation to the AUM, stood at ~13% as on March 31, 2023 compared to ~16% as on March 31, 2022. ICRA expects that the bank would maintain an adequate capitalisation profile while scaling up its operations through timely capital infusions, including the impending IPO. Fincare has filed a revised draft red herring prospectus (DRHP) with the Securities and Exchange Board of India (SEBI) and is awaiting its approval/comments.

Credit challenges

High, albeit declining, share of microfinance in the portfolio – The bank has increased its presence over the years in the secured loans segment and the share of mortgage lending (AHL and LAP) consequently increased to ~28% as on March 31, 2023 from ~17% as of March 2022, while the share of loan against gold (LAG) increased to ~9% from ~6% during this period. The share of microfinance lending declined to ~61% as on March 31, 2023 from ~77% as on March 31, 2022, though it continues to occupy a majority share in the bank's portfolio, exposing it to the risks associated with unsecured lending. Going forward, Fincare's ability to further diversify its product mix and reduce the share of the microfinance portfolio will remain important from a credit perspective.

Subdued profitability in FY2023, though expected to improve – The bank's profitability metrics improved in FY2023, driven by lower credit costs. It witnessed an improvement in its profitability in the last three quarters after absorbing sizeable credit costs in Q1 FY2023. Nonetheless, its overall profitability indicators remain subdued with a return on average assets (RoA) of

0.9% in FY2023 compared to 0.1% in FY2022 (1.5% in FY2021). ICRA expects that the operating efficiency would improve with the expected increase in the scale of operations. This, along with the expected reduction in the credit costs, is likely to improve the bank's overall profitability.

Political, communal and other risks, given the marginal borrower profile – As microfinance continues to account for a large portion of the bank's portfolio (61% as on March 31, 2023), the same remains vulnerable to asset quality shocks as witnessed after demonetisation and during the pandemic. The rating factors 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. Fincare'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 liquidity coverage ratio was healthy at 187% as on March 31, 2023. The bank's structural liquidity statement (SLS; provisional), as on March 31, 2023, did not have negative cumulative mismatches for any bucket for up to one year, even under the stressed scenario of 90% collection efficiency on advances. As on March 31, 2023, Fincare was carrying on-book liquidity (including mandatory investments) of Rs. 3,289 crore. The bank's liquidity profile is supported by its strong borrowing ability on account of its 'scheduled' status and the large portion of relatively shorter-tenor assets. The liquidity profile is also supported by the availability of lines from financial institutions (FIs).

Rating sensitivities

Positive factors – ICRA could upgrade the long-term rating if Fincare is able to scale up its portfolio further, while improving the asset quality and profitability and maintaining a prudent capitalisation profile.

Negative factors – Pressure on the bank's rating could arise if it is unable to improve its profitability metrics in the near term with the return on assets below 1% on a sustained basis. A deterioration in the capitalisation profile or asset quality or weakening of the liquidity profile could also exert pressure on the rating.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	ICRA Rating Methodology for Banks and Financial Institutions ICRA's Policy on Withdrawal of Credit Ratings
Parent/Group support	Not applicable
Consolidation/Standalone	The rating is based on the standalone financial profile of the bank

About the company

Fincare Small Finance Bank Limited (Fincare) converted into a small finance bank (SFB) in July 2017 from a microfinance institution (Disha Microfin Limited) registered as a non-deposit accepting, non-banking financial company (NBFC) with the Reserve Bank of India (RBI). In 2007, Mr. Reddy commenced the microfinance operations of Future Financial Services Private Limited (FFSPL) in South India. In 2009, Mr. Nanavati and three others commenced the microfinance operations of Disha Microfin in Gujarat. In October 2010, True North (erstwhile India Value Fund), a private equity fund, funded FFSPL and Disha.

FFSPL's operations were adversely impacted during the Andhra Pradesh microfinance crisis and FFSPL, along with Disha, came under the brand name, Fincare. The bank's transformation process began in 2016 after receiving in-principle approval from the RBI for its SFB licence. In 2017, the restructuring was completed with the merger of FFSPL with Fincare Business Services Limited, which is the holding company, while Disha Microfin converted into Fincare Small Finance Bank Limited. Fincare received scheduled bank status in 2019.

As on March 31, 2023, Fincare had operations in 22 states and Union Territories spanning 338 districts through 1,231 branches serving a customer base of 29.4 lakh. In FY2023, it reported a net profit of Rs. 103.6 crore on AUM of Rs. 9,911 crore as on March 31, 2023 against a net profit of Rs. 9 crore in FY2022 on AUM of Rs. 7,599 crore as on March 31, 2022.

Key financial indicators (audited)

Fincare SFB	FY2021	FY2022	FY2023
Accounting as per	IGAAP	IGAAP	IGAAP
Net interest income	701	879	1,090
Profit after tax (PAT)	113	9	104
Gross advances	5,506	7,360	8,878
Total assets	7,967	10,901	12,468
Tier I	24.91%	19.48%	18.64%
CRAR	29.56%	22.32%	20.04%
NIM / ATA	9.3%	9.3%	9.3%
PAT / ATA	1.5%	0.1%	0.9%
RoNW	13.2%	16.2%	17.7%
GNPA	6.4%	7.8%	3.3%
NNPA	2.8%	3.6%	1.3%

Source: Bank, ICRA Research; All ratios as per ICRA's calculations; 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 (FY2024)						Chronology of Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of July 31, 2023 (Rs. crore)	Date & Rating			Date & Rating in FY2023	Date & Rating in FY2022	Date & Rating in FY2021
					Aug 11, 2023	Jun 26, 2023	Jun 13, 2023	Jun 14, 2022	Jul 26, 2021	Aug 04, 2020
1	Bank lines (Long term – Term loan)	Long term	800	0	[ICRA]A (Positive); withdrawn	[ICRA]A (Positive)	[ICRA]A (Positive)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)
2	Bank lines (Long term – Fund based/non-fund based)	Long term	75	0	[ICRA]A (Positive); withdrawn	[ICRA]A (Positive)	[ICRA]A (Positive)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)
3	Tier II bonds	Long term	100	100	[ICRA]A (Positive)	[ICRA]A (Positive)	[ICRA]A (Positive)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)
4	Fixed deposit	Long term	50	NA	[ICRA]A (Positive)	[ICRA]A (Positive)	[ICRA]A (Positive)	[ICRA]A (Stable)	MA+ (Stable)	MA+ (Stable)
5	Lower Tier II Bonds	Long term	180	124	[ICRA]A (Positive)	[ICRA]A (Positive)	[ICRA]A (Positive)	-	-	-

	Instrument	Current Rating (FY2024)						Chronology of Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of July 31, 2023 (Rs. crore)	Date & Rating			Date & Rating in FY2023	Date & Rating in FY2022	Date & Rating in FY2021
					Aug 11, 2023	Jun 26, 2023	Jun 13, 2023	Jun 14, 2022	Jul 26, 2021	Aug 04, 2020
6	**Lower Tier II Bonds**	Long term	20	0	[ICRA]A (Positive)	[ICRA]A (Positive)	-	-	-	-
7	**Lower Tier II Bonds**	Long Term	60	0	[ICRA]A (Positive)	-	-	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Bank lines (Long term – Term loan)	Simple
Bank lines (Long term – Fund based/non-fund based)	Simple
Lower Tier II bonds	Highly complex
Tier II bonds	Highly complex
Fixed deposit	Very 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: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
INE519Q08152	**Tier II bonds**	Sep-30-2019	12.87%	Sep-30-2025	100.00	[ICRA]A (Positive)
NA	**Bank lines (Long term – Term loan)**	Aug 2016 to Oct 2021	NA	Jul 2021 to Feb 2026	800.00	[ICRA]A (Positive); withdrawn
NA	**Bank lines (Long term – Fund based/non-fund based)**				75.00	[ICRA]A (Positive); withdrawn
NA	**Fixed deposits**	NA	NA	NA	50.00	[ICRA]A (Positive)
INE519Q08160	**Lower Tier II bonds**	Jun-15-2023	10.75%	Dec-15-2028	49.00	[ICRA]A (Positive)
INE519Q08160	**Lower Tier II bonds**	Jul-5-2023	10.75%	Jan-5-2029	75.00	[ICRA]A (Positive)
To be issued	**Lower Tier II bonds**	NA	NA	NA	136.00	[ICRA]A (Positive)

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

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