

June 21, 2024

## Unity Small Finance Bank Limited: Long-term rating upgraded to [ICRA]A (Stable)

### Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Issuer rating	-	-	[ICRA]A (Stable); upgraded from [ICRA]A- (Stable)
Bank facilities (LT <sup>&amp;</sup> – Fund based)	37.09	37.09	[ICRA]A (Stable); upgraded from [ICRA]A- (Stable)
<b>Total</b>	<b>37.09</b>	<b>37.09</b>	

\*Instrument details are provided in Annexure I; <sup>&</sup>LT – Long term

### Rationale

The rating upgrade factors in the healthy growth in Unity Small Finance Bank Limited's (Unity SFB) scale of operations along with the improvement in its deposit base and profitability indicators. ICRA expects the bank to continue witnessing a robust pace of expansion, though this would depend on its ability to garner deposits. Its ability to maintain the profitability will continue to be driven by recoveries from written-off assets. The rating also continues to consider the established presence of the Bank's promoter group in the financial services industry, its healthy capitalisation indicators, its plan to raise capital in the near term, the relaxations provided by the Reserve Bank of India (RBI) on priority sector lending (PSL) norms, the timeline for the initial public offering (IPO), etc.

While the capital indicators remain healthy for the current scale, given the expansion plans, the Bank would need a fresh capital infusion in the medium term, which would be in line with the capital infusion commitment under the reconstruction scheme for PMC Bank. Further, the fair valuation of the liabilities of PMC Bank would continue to weigh down on capital build-up in the near to medium term. Thus, the promoters' ability to fund the required equity infusion or bring new investors on board would be critical for the planned growth.

ICRA also notes that the growth in advances has been retail focused, though this is offset by the risks associated with the unsecured nature of microfinance loans and the high-yield unsecured business loans in the micro, small and medium enterprise (MSME) segment. On the deposits front, higher deposit rates continue to be the key proposition to attract customers. Unity SFB's ability to continue building its deposit base, while increasing the granularity, would be important for its scale and profitability. Its ability to scale up its operations while maintaining healthy asset quality would remain important for improving its operating leverage and earnings profile. ICRA also notes that the Bank has largely written off the legacy non-performing assets (NPAs) of PMC Bank, which led to a decline in its reported gross NPAs (GNPAs). Nevertheless, its fresh NPA generation rate remains elevated and the earnings profile benefited significantly from the recoveries from the stressed assets of PMC Bank.

The Stable outlook on the long-term rating reflects ICRA's expectation that the Bank will be able to maintain a steady credit profile while expanding its scale and improving its liability franchise. The outlook also factors in Unity SFB's requisite capital-raising plans to offset the impact of the fair valuation of PMC Bank's liabilities on the capital and to fund growth.

### 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 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 its 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)<sup>1</sup> and a microfinance institution (Centrum Microcredit Limited; CML). Later, the lending portfolios of CFSL and CML were transferred to Unity SFB through a slump sale by the Centrum Group and CFSL became the promoter of Unity SFB with a 51% stake.

The balance is held by Resilient Innovations Private Limited (RIPL)/BharatPe, a fintech company that provides services like payment solutions and financing solutions to small merchants and kirana store owners.

**Comfortable capital position, though fresh infusion required to meet targeted growth** – 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 liabilities has been accretive from a capital adequacy perspective. As on March 31, 2024, Unity SFB had a comfortable capitalisation profile with a Tier I ratio of 19.92% (27.16% as on March 31, 2023), comfortably above the regulatory requirement. The overall capital adequacy, with a capital-to-risk weighted assets ratio (CRAR) of 36.46%, as on March 31, 2024, is supported by the relaxations provided by the RBI in terms of inclusion of certain restructured and fair-valued liabilities in the total CRAR. The liabilities will be marked up gradually to the face value over the coming years; consequently, the capital accretion will be lower than the Bank's profit for the year. Further, considering the envisaged portfolio growth and the impact of the fair valuation of liabilities, Unity SFB will need growth capital. In this regard, the shareholders have committed to infuse Rs. 1,900 crore by the end of eight years from the start of Unity SFB, i.e. by October 2029.

## Credit challenges

**Highly vulnerable asset quality** – As on March 31, 2024, Unity SFB's net loan book stood at Rs. 7,961 crore (net of Rs. 560 crore of inter-bank participatory certificates), up 78% YoY, with microfinance loans (microfinance institution (MFI); inclusive banking) forming 32% of the overall net loan book and MSME and supply chain finance loans (business banking) accounting for 52% and 13%, respectively. Unsecured business loans accounted for 38% of the loans in the MSME segment (20% of overall net loan book). PMC Bank's legacy loan book stood at 3% of overall advances as on March 31, 2024. As a sizeable portion of Unity SFB's portfolio comprises unsecured loans, the portfolio remains vulnerable to asset quality shocks. This could negatively impact its operations and financial position, given the marginal profile of the borrowers with limited ability to absorb income shocks.

**Profitability remains vulnerable to recoveries, given high cost of funds and elevated operating expenses** – Unity SFB's reported net profit improved significantly to Rs. 439 crore in FY2024 from Rs. 35 crore in FY2023. This translated into a return on assets (RoA) of 3.9% in FY2024 compared to 0.4% in FY2023. The performance was driven by healthy recoveries from the written-off assets of PMC Bank and the decline in the cost-to-income ratio (though the same remains elevated) with the increase in the scale of operations.

The Bank has a fair value charge (~Rs. 250 crore per annum) on restructured liabilities, which is charged directly to the reserves, limiting capital accretion in relation to the reported profit. Unity SFB's ability to generate sufficient profitability through core operations will be key for offsetting the adverse impact of these charges on the net worth and to support future growth. This would depend on the scale-up of the loan book and the ability to raise deposits at competitive rates, thereby improving its operating profitability while keeping slippages and credit costs at lower levels. Additionally, recoveries from legacy stressed assets would be a positive for the profitability and would remain a monitorable.

**Ability to ramp up deposit base while maintaining granularity and reducing costs** – Unity SFB commenced operations from November 1, 2021 and had 171 branches and 206 offices as on March 31, 2024. It witnessed meaningful traction in its deposits in FY2024, with the same growing to Rs. 6,505 crore as on March 31, 2024 from Rs. 2,685 crore as on March 31, 2023. To improve deposit traction, its interest rate proposition remains attractive for depositors. While this has helped build traction in

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<sup>1</sup> Currently, the Group is in the process of selling CHFL

the deposit base, the same mainly comprises fixed deposits, however, the growth in current and savings account (CASA) remains low. The share of CASA stood low at 17% of total deposits as on March 31, 2024. Unity SFB's ability to gradually improve the competitiveness of its funding and increase the share of CASA deposits would be critical for a sustained increase in its operating profitability.

### Liquidity position: Strong

As per the structural liquidity statement (SLS), as on March 31, 2024, the Bank did not have negative cumulative mismatches in any bucket for up to one year and the daily average liquidity coverage ratio for Q4 FY2024 was high at 463.3%. Its ability to maintain high granularity and renewal rates for deposits will be the driver of its liquidity profile. Unity SFB's liability profile is partly supported by the staggered repayment of the liabilities of PMC Bank.

### Rating sensitivities

**Positive factors** – ICRA could upgrade the rating if Unity SFB is able to sustain the build-up of the granular liability franchise while improving its funding cost and profitability. Diversifying the asset mix, while scaling up and maintaining the asset quality, and maintaining a prudent capitalisation profile will be positive factors.

**Negative factors** – The rating could be downgraded on a material weakening in the bank's capital and/or liquidity profile. The decline in profitability, with RoA of less than 1% on a sustained basis, would also be a negative factor.

### Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	<a href="#">ICRA's Rating Methodology for Banks and Financial Institutions</a>
Parent/Group support	Not applicable
Consolidation/Standalone	Standalone

### About the company

Unity SFB is the 12<sup>th</sup> small finance bank (SFB) in India, promoted by the consortium of the Centrum Group and Resilient Innovations Private Limited. 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 of Unity SFB with no other operations. Currently, Unity SFB primarily has the 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 (standalone)

Unity Small Finance Bank	FY2022	FY2023	FY2024
Total operating income <sup>^</sup>	47	628	1,225
Profit after tax	-150	35*	439*
Total assets	10,811	8,761	13,774
Return on average total assets	-1.39%	0.36%	3.90%
CET I	38.77%	27.16%	19.92%
CRAR	63.71%	49.40%	36.46%
Gross NPA	62.94%	45.83%	4.36%
Net NPA	8.14%	0.34%	0.63%

Source: Unity SFB, ICRA Research; All ratios as per ICRA's calculations; Amount in Rs. crore; \* Before fair value charges

<sup>^</sup> Includes net interest income and non-interest income

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

### Rating history for past three years

Instrument	Type	Current Rating (FY2025)		Chronology of Rating History for the Past 3 Years							
		Amount Rated	Amount Outstanding as of June 17, 2024	Date & Rating in FY2025	Date & Rating in FY2024	Date & Rating in FY2023			Date & Rating in FY2022		
		(Rs. crore)	(Rs. crore)	Jun 21, 2024	Aug 02, 2023	Dec 08, 2022	Sep 09, 2022	Aug 05, 2022	Dec 29, 2021	Dec 17, 2021	Dec 14, 2021
Issuer rating	Long term	-	-	[ICRA]A (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- &	-	-
Non-convertible debenture	Long term	-	-	-	[ICRA]A- (Stable); withdrawn	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- &	[ICRA]A- &	[ICRA]A- &
Bank facilities (LT – Fund based) <sup>^</sup>	Long term	37.09	4.30	[ICRA]A (Stable)	-	-	-	-	-	-	-
Bank facilities (LT/ST – Fund based)	Long/Short term	-	-	-	[ICRA]A- (Stable)/ [ICRA]A1; withdrawn	[ICRA]A- (Stable)/ [ICRA]A1	[ICRA]A- (Stable)/ [ICRA]A1	[ICRA]A- (Stable)/ [ICRA]A1	[ICRA]A- & [ICRA]A1	-	-
Certificates of deposit	Short term	-	-	-	[ICRA]A1; withdrawn	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1 &	[ICRA]A1 &	[ICRA]A1 &

<b>Commercial paper programme</b>	Short term	-	-	-	-	-	-	-	-	[ICRA]A1+ (CE); withdrawn	[ICRA]A1+ (CE)	-
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&- Under Rating Watch with Developing Implications; <sup>§</sup> Short term rating has been reaffirmed and withdrawn; <sup>^</sup>instrument was clubbed with LT/ST fund-based bank facilities in previous rating exercises.

### Complexity level of the rated instruments

Instrument	Complexity Indicator
Bank facilities (LT – 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
-	<b>Bank facilities (LT – Fund based)</b>	-	-	-	37.09	[ICRA]A (Stable)
-	<b>Issuer rating</b>	-	-	-	-	[ICRA]A (Stable)

Source: Unity SFB

*Please click here to view details of lender-wise facilities rated by ICRA*

**Annexure II: List of entities considered for consolidated analysis**

Not applicable

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