February 21, 2023

Fino Payments Bank Limited: Ratings reaffirmed; Rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term/short-term fund based – Overdraft	150.00	294.54	[ICRA]BBB+ (Stable)/[ICRA]A2+; Reaffirmed and assigned for enhanced amount
Total	**150.00**	**294.54**	

**Instrument details are provided in Annexure I*

Rationale

The ratings continue to factor in the healthy expansion in Fino Payments Bank Limited's (FPBL) merchant network and scale of operations, as reflected in the increasing throughput volumes (gross value of transactions) and the growing number of current and saving accounts (CASA) deposits. This drives the bank's transactional and subscription-based fee income, supporting its profitability. The profitability is further aided by FPBL's improving net interest income (NII) from its treasury operations. Though the bank witnessed a decline in its net yield in H1 FY2023, the growth in volumes negated the impact to some extent and helped it maintain its profitability. The ratings also factor in FPBL's strong capitalisation profile vis-à-vis the regulatory requirement, supported by the capital raise in FY2022 and internal capital accretion.

Given the nature of its operations, the need for external funding is limited to short-term funding (typically overnight funding). However, with growing treasury operations, FPBL's borrowings increased in H1 FY2023 to fund its investments and earn additional NII. ICRA notes that this increases the asset-liability mismatch (ALM) risk and interest rate risk for the bank as the investments are in comparatively longer-tenure (< 1 year) instruments at a fixed rate, whereas the funding is in the form of short-term borrowings (0-7 days). Nevertheless, since the investments are only in Government securities, the high liquidity mitigates the risk to a great extent. The ratings also factor in FPBL's healthy product diversification, including third-party products. In addition, FPBL is in the process of launching a few more products to diversify its revenue stream further.

The ratings are, however, constrained by the high operational risk given the bank's external merchant/agent-driven model and the risks associated with high cash handling activities. ICRA takes note of FPBL's checks and systems, which help mitigate the risk to some extent. However, the aforementioned risks persist. Moreover, competition and the increasing digitisation of the payment infrastructure pose a challenge to FPBL for retaining and continuously adding merchants/agents and customers. In addition, despite registering robust growth, the overall scale of operations remains moderate. Also, the credit profile could be impacted by any adverse regulatory change.

The Stable outlook on the rating reflects ICRA's opinion that FPBL will be able to maintain its credit profile, while registering healthy growth in its scale, and maintain/improve its profitability further.

Key rating drivers and their description

Credit strengths

Healthy improvement in throughput volumes – FPBL, which provides products and services like micro-ATM (MATMs) services, business correspondence (BC) banking, remittance, CASA, insurance, loan referrals, etc, has displayed consistent growth in its throughput volumes over the past few years, despite operating on a relatively lower scale. FPBL reported throughput volumes of Rs. 1.87 lakh crore in 9M FY2023 against Rs. 1.34 lakh crore in 9M FY2022 (year-on-year (YoY) growth of ~40%). It increased its focus on opening CASA in 9M FY2023, which drives its subscription fee income and helps in retaining customers so that repeat business can be generated. The growth in CASA and throughput volume so generated was higher than the growth seen in other products/services. On an overall basis, the healthy growth in throughput volumes has helped FPBL maintain its profitability.

Improvement in profits, though net yield declined – The improvement in the throughput volumes helped FPBL grow its profitability. It reported a net profit of Rs. 42.7 crore in FY2022, translating into a return on average total assets (RoTA) of 3.2% and a return on net worth (RoNW) of 9.0% against a net profit of Rs. 20.5 crore in FY2021 with RoTA of 2.5% and RoNW of 13.6%. Further, FPBL reported a net profit of Rs. 23.9 crore in H1 FY2023 (Rs. 43.0 crore in 9M FY2023) with RoTA of 2.4% and RoNW of 9.4%. Though RoTA moderated in H1 FY2023, it is expected to improve going forward. The improvement in the profitability was also supported by the increase in the NII from treasury operations.

ICRA notes that FPBL's net yield (excluding NII) declined to 0.14% in H1 FY2023 from 0.18% in FY2022 due to the change in the revenue mix across the own and open banking channels. However, the higher increase in throughput volumes helped improve the profitability. ICRA expects the net yield to stabilise near the current level; this shall remain a key monitorable for FPBL's financial profile.

Healthy product diversification – FPBL provides a variety of products and services including MATMs, Aadhaar enabled payment system (AePS) transactions, BC banking for its banking partners, remittances, CASA, cash management services (CMS), and third-party products like insurance, loan referrals, etc, through merchants, BC agents and the application programming interface (API) channel. Its major source of net revenue in H1 FY2023 was CASA, which contributed around 31% to the total net revenue, followed by 26% from MATMs and AePS, 15% from NII and the remaining 28% from other products and services including BC, remittance, CMS, etc.

Credit challenges

Significant operational risk, given high cash handling activities and external merchant/agent-driven business model – FPBL operates through external merchants and agents, who are involved in cash handling activities like CMS, remittances, CASA, etc. The management has stated that the risk associated with the same is mitigated by taking security deposits from these external merchants/agents and capping their transactional limits up to the amount of such security deposit. However, ICRA believes such risk shall persist, given the nature of the operations, heavy dependence on external merchants, and the challenges in keeping a continuous check on the activities of all the merchants.

Ability to retain merchants/agents and customers amid high competition, increasing digitisation of payment infrastructure and expansion of services by other players – FPBL’s ability to retain its merchants/agents and customers, given the high competition and expanding space of digital infrastructure, shall be a key factor for its credit profile. It has taken steps to retain its merchants by increasing their share in revenues, hence reducing its own net revenue share. Further, the bank has been able to consistently add to its merchant network and has displayed the ability to grow so far. Its ability to retain them and expand the network further while being able to maintain the net revenues (hence profitability) shall remain a monitorable.

Risk of adverse regulatory changes – The financial inclusion industry is highly dependent on the regulatory policies framed by the Reserve Bank of India (RBI) and the Government of India (GoI). Hence, any adverse policy change by the RBI/GoI pertaining to payments banks and/or the financial inclusion industry/activities could impact the business of payments banks and entities operating in this space, including FPBL.

Environmental and social risks

Environmental – While payments banks like FPBL do not face material physical climate risks, they are exposed to environmental risks indirectly through their network of merchants operating in different geographies. If the merchant, with which such banks are operating with, faces livelihood disruption because of physical climate adversities, it could translate into operational risks for the bank. However, such risk is not material for FPBL as it benefits from adequate geographical diversification in its operations.

Social – With regard to social risks, data security and customer privacy are among the key sources of vulnerability for payments banks as any material lapse could be detrimental to their reputation and invite regulatory censure. FPBL has not faced such lapses over the years, which highlights its sensitivity to such risks. It is seen to be operating responsibly with no major instances of fines imposed in the near past by regulatory authorities because of misconduct. Further, FPBL contributes to promoting financial inclusion by operating largely in rural areas.

Liquidity position: Strong

As per FPBL's provisional structural liquidity statement (SLS) for September 2022, there are no negative cumulative mismatches in any buckets. FPBL's operations do not require long-term debt/borrowing. Hence, it only avails short-term working capital lines in the form of overdraft (OD) facilities, which are required to fund the short-term mismatches due to the difference in the settlement cycles for incoming and outgoing funds. FPBL increased its borrowing in H1 FY2023, which has been completely invested in Government securities to earn additional NII. As per the RBI's regulations for payments banks, FPBL is required to maintain at least 75% of its demand deposit balances (DDB) in Government securities on T+3 days and maximum 25% with other scheduled commercial banks (SCBs), which FPBL has been adhering to.

Rating sensitivities

Positive factors – The ratings and/or outlook could see an upward movement if the bank witnesses significant growth in its scale of operations with improved profitability on a sustained basis.

Negative factors – Pressure on the ratings and/or outlook could emerge if FPBL witnesses a decline in its throughput volumes, leading to the weakening of its profitability on a sustainable basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Rating methodology for non-banking finance companies
Parent/Group support	Not Applicable
Consolidation/Standalone	Standalone

About the company

FPBL is a 2017-licensed payments bank, which operates through 12.25 lakh merchant points, 109 customer service points (CSP) and 42 branches, as on September 30, 2022, across India. FPBL was granted scheduled commercial bank (SCB) status by the RBI in February 2021. It provides products and services including account opening, CASA deposits, insurance, remittance services, etc, to self and BC partners. In FY2022, it reported a net profit of Rs. 42.7 crore against a net profit of Rs. 20.5 crore in FY2021. It reported a net profit of Rs. 43.0 crore in 9M FY2023. FPBL targets the lower-income category in rural areas where financial inclusion is required, especially people with an annual income of Rs. 2-5 lakh.

Key financial indicators (audited)

FPBL (Rs. crore)	FY2020	FY2021	FY2022	H1 FY2023^	9M FY2023^
Operating income	681	782	994	573	873
Profit after tax (PAT)	-32	20	43	24	43
Net worth	130	151	477	508	527
Operating cost to operating income	105%	97%	96%	96%	95%
Return on average total assets	-4.9%	2.5%	3.2%	2.4%	NA
Return on net worth	-24.6%	13.6%	9.0%	9.4%	NA
Debt / net worth (times)	0.9	1.2	0.5	1.5	NA
Total CRAR	60.9%	56.3%	125.6%	100.5%	87.0%

Source: Company, ICRA Research; All ratios and values as per ICRA's calculations; ^ H1 FY2023 and 9M FY2023 values and ratios as per limited review financials
Operating income = Net interest income + other operating income (excluding revaluation gains, profit on sale of assets, etc)

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 Jan 31, 2023 (Rs. crore)	Date & Rating in FY2023		Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020
					Feb-21-23	Dec-30-22	Oct-01-21	Nov-25-2020	NA
1	Long-term fund based	Long term	-	-	-	-	-#	[ICRA]BBB- (Stable)	-
2	Long-term/short-term fund based – OD	Long term/short term	294.54	144.27^	[ICRA]BBB+ (Stable)/ [ICRA]A2+	[ICRA]BBB+ (Stable)/ [ICRA]A2+	[ICRA]BBB (Stable)/ [ICRA]A2#	-	-

^Sanctioned amount
#Change in limits

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term/short-term fund based – OD	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
NA	**Long-term/short-term fund based – Overdraft**	NA	NA	NA	294.54	[ICRA]BBB+ (Stable)/ [ICRA]A2+

Source: Company

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

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

ANALYST CONTACTS

Karthik Srinivasan
+91 124 6114 3444
karthiks@icraindia.com

Sachin Sachdeva
+91 124 4545 300
sachin.sachdeva@icraindia.com

Jatin Arora
+91 124 4545 846
jatin.arora@icraindia.com

Prateek Mittal
+91 33 7150 1132
prateek.mittal@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