Ujjivan Financial Services Limited

	Amount In Rs. Crore	Rating Action
Non Convertible Debentures (NCDs)	225.00	[ICRA]A+(Stable); assigned

ICRA has assigned a rating of [ICRA]A+ (pronounced ICRA A[1] plus) with a stable outlook to the Rs. 225 crore Non-Convertible Debenture Programme (NCD) of Ujjivan Financial Services Limited (Ujjivan/ the company). ICRA also has outstanding rating of [ICRA]A+(Stable) on the Rs. 302.5 crore NCD programme of the company and a rating of [ICRA]A1+ on the Rs. 100 crore Commercial Paper programme of the company.

The ratings factor in Ujjivan's strong capitalisation profile (managed gearing of 2.8 times as of June 2016) pursuant to the equity infusion of about Rs. 650 crore received by the company in Q1 FY16 (networth of Rs. 1,619 crore as in June 2016) and the expected improvement in Ujjivan's business risk profile post conversion into a small finance bank (SFB)[2]. Ujjivan has applied for the final SFB license and has made progress towards the transition into a SFB and is working towards broad basing the management team, hiring and training its employee base, upgrading existing branch infrastructure and identifying its new branch locations and, upgradation of its IT systems and processes. In ICRA's opinion, Ujjivan would be able to offer additional loan products, increase fee-based income as well as develop a reasonable retail deposit franchise over the medium term given its large active customer base, which could support its liability profile going forward. However, in the short term, Ujjivan's funding requirements would increase by around 20-25% owing to CRR and SLR requirements and, the company would have to rely on wholesale funding sources such as interbank lending/certificates of deposits, securitization, and capital market instruments for meeting its funding requirements. Overall, the ability of the company to diversify its product mix, develop a good retail deposit franchise and maintain asset quality indicators while managing the projected growth would have a bearing on the credit profile of the company. Additionally, the company's ability to fully meet the transition-related challenges to a SFB is a key development to be observed. The rating continues to factor in Ujjivan's sound management and diverse Board composition, good IT systems, prudent lending practices and, adequate internal control and monitoring processes, which have enabled it to scale-up its operations significantly while maintaining a low credit risk profile despite lending to marginal borrower profile customers and growing across geographies.

ICRA takes note of Ujjivan's ability to grow its portfolio (Portfolio of Rs 5,851 crore as on June 30, 2016) while keeping asset quality indicators under control (30+ delinquencies of 0.26% on overall portfolio as on June 30, 2016), and maintaining good profitability indicators (RoA[3] of 3.7% in FY2016 and 4.8% in Q1FY2017). ICRA also takes note of the geographical diversity of Ujjivan's operations (present in 24 states in India, with the top 3 states comprising 44% of portfolio as in June-16). While increase in ticket sizes may lead to overleveraging of the end borrowers of MFIs, including those of Ujjivan, mandatory use of credit bureaus and adopting lower ticket sizes (less than Rs. one lakh) should contain the overleveraging concerns; however, the company's ability to manage the credit quality while increasing share of individual loans (which have historically witnessed higher delinquencies for other players) going ahead, where the ticket size is also likely to be higher, will be an important monitorable. ICRA also takes note of the drop in the attendance level of members during centre meetings (largely in the urban locations), but there is no visible impact on the asset quality yet- it would be important for the company to closely monitor the credit discipline of its borrowers so as to continue to maintain a strong joint liability concept. Overall, the rating remains constrained on account of monoline nature of its business, marginal borrower profile, high operational risk inherent in the business, lack of diversification in earnings so far and challenges associated with high pace of growth. However, the conversion to SFB should address some of these issues including more diversified sources of earnings, reduced political risk with better regulatory supervision and, liquidity support from the RBI.

[1] For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications.
[2] For ICRA's view on RBI's in-principle approval for SFB license, please refer to ICRA's note on the same that is available on ICRA website.
[3] Return on Assets: Profit After Tax/ Average Total Assets

Though Ujjivan has funding lines from about 40 lenders, its reliance on term loans from banks and other financial institutions continues to remain high i.e. 87% as in Mar-16. The cost of funds for the company continues to be amongst the lowest in its peer group. Given that the spreads have been fixed by the RBI at 10%, the company has been able to offer relatively lower rates (22% on group loans, relatively low compared to most peers) owing to its low cost of funds. Going forward, the ability of the company to replace the bank borrowings in their liability mix through mobilisation of deposits and other borrowing sources remains to be seen. However, as a result of change in asset and liability mix, Net Interest Margin (NIM) of the company could decline from the current levels, at the same time leveraging levels are likely to increase. At present, the leveraging of the company is comfortable at about 2.8 times (in June 2016) which should be sufficient to meet their growth plans in the near term. However, the company would need sizeable increase in funding lines as well as large scale recruitment and training of employees to meet its growth plans. The liquidity position remains comfortable given that the residual tenure of liabilities is around 2-3 years, while that of the assets is around 1-2 year, resulting in a favourable ALM position. The company's ability to manage good liquidity while being able to tap funds from alternate sources (since term loans from banks and NBFCs would no longer be available), in view of the transition to an SFB, while registering optimal business growth would remain a key rating sensitivity.

Going ahead, while Ujjivan would benefit from growing its portfolio by leveraging on its branch network, it may need to improve the management bandwidth, upgrade their existing branch infrastructure, MIS systems as well as recruit and train personnel to deal with multiple products, in line with the Small Finance Bank requirements, which is likely to push the overall cost operations and have a bearing on the near term profitability indicators of the company. The company, given the good growth prospects and established relationships with investors and lenders, should be able to continue mobilizing funding and capital commensurate with the envisaged growth. In ICRA's opinion, ability of the company to raise retail deposits at competitive rates would have an important bearing on its liquidity profile, even as stronger liquidity support (post conversion to a bank) from the central bank would be a positive.

About the Company

Ujjivan Financial Services Limited (Ujjivan) is a Microfinance Institution (MFI) that was set up in October 2005 as an NBFC and became operational from January 2006. It was founded by Mr. Samit Ghosh, who is the CEO and Managing Director of the company at present. Ujjivan has its headquarters in Bangalore, with regional offices in New Delhi, Kolkata & Pune. Ujjivan's focus is to provide financial services to the economically backward women in urban and semi-urban areas. The company has was listed in the National Stock Exchange and Bombay Stock Exchange in May 2016, post the Initial Public Offer (IPO).

As of June 2016, Ujjivan operates in 24 states with a network of 469 branches, with the top 3 states i.e. Karnataka, West Bengal and Tamil Nadu accounting for 44% of the portfolio. It had a portfolio of Rs. 5,851 crore as on June 30, 2016 with a client base of about 34 lakh members. The company has been able to raise equity from multiple investors in different rounds of equity infusion as well as through an IPO in May 2016. The company has reported net profits of Rs. 177 crore (profitability of 3.7%) in FY2016 on a managed assets base of Rs. 6,052 crore as against profits of Rs. 76 crore (profitability of Rs. 2.5%) for FY2015 on a managed assets base of Rs. 4,032 crore. In Q1 FY2017, the company has reported net profit of Rs. 71 crore (profitability of 4.8%) on a managed asset base of Rs. 6.043 crore.

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