June 15, 2020

Utkarsh Small Finance Bank Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Subordinated debt programme	200	200	[ICRA]A(Stable); reaffirmed
Certificate of deposit programme	1,000	1,000	[ICRA]A1+; reaffirmed
Total	**1,200**	**1,200**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings factor in Utkarsh Small Finance Bank Limited's (USFB) experienced management team, strong investor base and adequate systems and processes, which have helped it scale up its operations. As on March 31, 2020, USFB was catering to more than 25 lakh borrowers through a network of 510 banking outlets spread 11 states while managing a portfolio of Rs. 6,660 crore. The bank's profitability improved in FY2020 with an increase in the scale of operations, an improvement in the net interest margin and the comfortable asset quality. USFB reported a net profit of Rs. 186.75 crore in FY2020 translating into a return of 2.39% on the average managed assets (AMA) and 20.84% on the average net worth (Rs. 93.89 crore, 1.73% and 15.85% respectively in FY2019). Further, USFB has been able to maintain adequate capitalisation with CRAR reported at 22.19% (Tier I: 19.41%) as on March 31, 2020, though the leverage increased as the bank focused on increasing its on-book liquidity. ICRA takes note of the bank's plans to raise equity capital in FY2021, which would help maintain capitalisation and cushion the possible credit losses in the aftermath of the Covid-19 pandemic while supporting the bank's growth plans. USFB's ability to raise equity capital in a timely manner would be important from a growth and credit perspective. In addition, the bank has been successfully diversifying its borrowing profile while increasing the share of funds raised from financial institutions (FIs) through long term refinance lines and deposits. The total deposits increased by 38% in FY2020 to Rs. 5,235 crore as on March 31, 2020 (Rs. 5,262 crore as on April 30, 2020). The ratings also factor in USFB's comfortable liquidity profile and the availability of funding lines from FIs and other banks.

The ratings, however, factor in the limited share of the non-microfinance portfolio (10% as on March 31, 2020; 13% as on March 31, 2019) and the geographically concentrated microfinance operations. Share of microfinance portfolio in Bihar and Uttar Pradesh remained high at 47% and 28% respectively as on March 31, 2020 (48% and 29%, respectively as on March 31, 2019). Further, there is scope for improvement in the district-level portfolio diversification as the top 10 and top 20 districts comprised 29% and 47%, respectively, of the microfinance portfolio and 171% and 275%, respectively, of the net worth as on March 31, 2020. Further, the ratings take into consideration USFB's high reliance on bulk[1] (48% of total term deposits as on April 30, 2020) though these are largely non-callable (~95%) in nature. The ratings also factor in the risks associated with unsecured lending to marginal borrowers with limited ability to absorb income shocks. USFB's ability to onboard borrowers with a good credit history, recruit and retain employees and improve the geographical diversity of its operations would be key for managing high growth rates.

The microfinance industry is facing many challenges following the spread of Covid-19 throughout the country. These include the continuity of business operations on the field and the possible adverse impact on the asset quality. The bank's ability to manage the adverse impact of the pandemic on its asset quality and profitability as well as to maintain

[1] *Deposit size greater than Rs. 2 crore*

prudent capitalisation and raise capital in a timely manner to absorb expected credit losses and support growth will be important from a credit perspective.

The Stable outlook on the [ICRA]A rating reflects ICRA's opinion that USFB will continue to benefit from its experienced management team, strong investor base, diversified borrowing profile and financial flexibility.

Key rating drivers and their description

Credit strengths

Experienced management team; strong investor profile – Most of the functional heads (core team members) in the senior management team have been associated with the bank since inception. USFB has developed a good second and third line of management for its operations. The team was strengthened with fresh recruitment at the senior level in key areas like liabilities, information technology, risk, operations, compliance and treasury among others. USFB is wholly-owned by Utkarsh CoreInvest Limited (formerly Utkarsh Micro Finance Limited). CDC Group (formerly Commonwealth Development Corporation) is Utkarsh CoreInvest Limited's largest shareholder followed by Faering Capital and RBL Bank. Other shareholders include International Finance Corporation, Aavishkaar Goodwell, Norwegian Microfinance Initiative and ResponsAbility.

Improved profitability profile – USFB reported a net profit of Rs. 186.75 crore in FY2020 translating into a return of 2.39% on AMA and 20.84% on the average net worth (Rs. 93.89 crore, 1.73% and 15.85% respectively in FY2019). The net interest margin improved by 22 bps to 9.67% in FY2020 with the increase in yields outpacing the increase in the cost of average interest-bearing funds. The bank also earns a healthy fee income from the sale of priority sector lending certificates (PSLCs). Income from this source stood at Rs. 45.27 crore in FY2020 (Rs. 24.28 crore in FY2019). The operating expenses moderated to 6.09% of AMA in FY2020 from 6.29% in FY2019 as USFB scaled up its operations while the costs related to its transformation into an SFB had been incurred in the previous years. The bank made an additional provision of Rs. 49.96 crore in FY2020 in light of the pandemic and the expected slippages in the near term. Despite the additional provision, the credit costs remained comfortable at 1.28% of AMA in FY2020 (1.30% in FY2019) owing to the comfortable asset quality.

Diversified funding mix with good traction in deposit mobilisation – The total deposits increased by 38% in FY2020 to Rs. 5,235 crore as on March 31, 2020 (Rs. 5,262 crore as on April 30, 2020). The concentration of deposits has improved as the top 20 deposits comprised 34% of the total deposits held by the bank as on April 30, 2020 (46% as on March 31, 2019). The share of funding from FIs (NABARD and SIDBI) through refinancing lines increased to 29% of total borrowings as on March 31, 2020 from 15% as on March 31, 2019 with significant funds raised from the institutions in Q4 FY2020. The bank raised Rs. 1,400 crore of refinance from NABARD and SIDBI together in Q4 FY2020 and Rs. 300 crore of refinance from SIDBI in May 2020. The bank has been successfully diversifying its borrowing profile while increasing its deposits, which comprised 67% of the total borrowings as on March 31, 2020 (72% as on March 31, 2019).

Comfortable liquidity position and financial flexibility – The bank's liquidity profile is supported by its borrowing ability on account of its 'scheduled' status and the large portion of relatively shorter-tenor assets. USFB held Rs. 1,608 crore of liquid assets over and above regulatory minimum requirement of CRR and SLR as on May 29, 2020, which is adequate to meet its scheduled debt obligations till August 31, 2020. The liquidity profile is also supported by the availability of funding lines from Fis and other banks as well as the large share of non-callable deposits.

Credit challenges

Ability to manage adverse impact of Covid-19 pandemic on asset quality and profitability – The microfinance industry is facing many challenges following the spread of the Covid-19 pandemic throughout the country. These include the continuity of business operations on the field and the possible adverse impact on the asset quality the borrowers' cash flows and economic activity have slowed down. Moreover, incremental business growth has been hindered with disbursements being muted in Q1 FY2021. The bank's ability to navigate through the adversity and manage the impact on business growth, client retention and asset quality would remain critical from a rating perspective, going forward.

Ability to develop retail depositor base and diversify the product mix – The ratings factor in USFB's high reliance on bulk[2] (48% of total term deposits as on April 30, 2020). However, the bulk deposits are largely non-callable (~95%) in nature. The share of new products on the asset side stood at 10% as on March 31, 2020 (13% as on March 31, 2019) and the bank's ability to successfully scale up its operations while diversifying its product profile will be important from a credit perspective. The ratings are also constrained by the limited seasoning of the non-microfinance portfolio.

Geographically concentrated microfinance operations – USFB's microfinance business had a presence in 11 states and 136 districts through a network of 404 branches as on March 31, 2020. However, the share of the microfinance portfolio in Bihar and Uttar Pradesh remained high at 47% and 28%, respectively, as on March 31, 2020 (48% and 29%, respectively as on March 31, 2019). Further, the top 10 and top 20 districts comprised 29% and 47%, respectively, of the microfinance portfolio outstanding as on March 31, 2020 (31% and 50%, respectively as on March 31, 2019) and represented 171% and 275%, respectively, of the net worth as on March 31, 2020 (168% and 266%, respectively, as on March 31, 2019). Going forward, the bank's ability to diversify its operations geographically as it scales up its operations will remain important from a credit perspective.

Maintaining prudent capitalisation and raising equity capital in a timely manner – While the bank's capital adequacy ratio of 22.19% (Tier I: 19.41%) as on March 31, 2020 was well above the regulatory requirement of 15%, the higher pace of growth vis-à-vis the internal capital generation led to a moderation in the capitalisation profile with the net worth, as a proportion of advances, declining to 15.3% as on March 31, 2020 from 16.3% as on March 31, 2019. It will be important for USFB to maintain a prudent capitalisation profile and raise capital in a timely manner to absorb expected credit losses and support growth. Further, the bank is required to list itself on the stock exchanges by June 2021 and reduce the promoter shareholding to less than 40% (99.9% as on March 31, 2020) by January 2022. ICRA notes that the bank raised Rs. 60 crore equity capital through rights issue in September 2019 and it plans to further raise equity capital in FY2021 to support growth. The planned equity capital and the proposed change in the shareholding structure of the bank will facilitate meeting regulatory requirements.

Ability to manage political, communal and other risks, given the marginal borrower profile – As a large portion of the bank's portfolio continues to comprise microfinance (90% as on March 31, 2020), the portfolio remains vulnerable to asset quality shocks as witnessed post demonetisation. 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. USFB's ability to onboard borrowers with a good credit history and recruit and retain employees while scaling up the operations would be key for managing high growth rates.

---

[2] *Deposit size greater than Rs. 2 crore*

Liquidity position: Adequate

USFB held Rs. 1,608 crore of liquid assets as on May 29, 2020 which is adequate to meet its scheduled debt obligations till August 31, 2020. The liquidity coverage ratio (provisional) remained comfortable at 280% for the fortnight ended April 10, 2020 (180% for the fortnight ended February 28, 2020, 221% for the fortnight ended January 03, 2020). The bank's liquidity profile is supported by its enhanced borrowing ability on account of 'scheduled' status and its large portion of relatively shorter-tenor assets. The liquidity profile is also supported by the availability of lines from financial institutions.

Rating sensitivities

Positive triggers – ICRA could revise the outlook or upgrade the long-term rating if USFB is able to diversify its asset mix on a sustained basis while maintaining the asset quality and a prudent capitalisation profile and improving its retail deposit franchise.

Negative triggers – Pressure on the bank's ratings could arise if there is a deterioration in the asset quality or operational efficiencies, which could affect its profitability with the return on AMA falling below 1.5% on a sustained basis. A deterioration in the capitalisation profile or the weakening of the liquidity profile could also exert pressure on the ratings.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA's Credit Rating Methodology for Non-Banking Finance Companies Rating Methodology for Banks
Parent/Group Support	Not applicable
Consolidation/Standalone	Standalone

About the company

Incorporated in 2009, Utkarsh Micro Finance Limited received a small finance bank (SFB) licence from the Reserve Bank of India (RBI) in November 2016 and completed its conversion to a bank in January 2017. The bank is promoted by Mr. Govind Singh, who was earlier the business head of micro banking at ICICI Bank. Operating in 16 states as on April 30, 2020, the bank offers deposits, microfinance loans, MSME loans, affordable housing loans and corporate loans. USFB had a portfolio of Rs. 6,625 crore as on April 30, 2020, with microfinance loans accounting for 90% of the same. As for liabilities, USFB had a deposit base of Rs. 5,262 crore as on April 30, 2020, with term deposits accounting for 82% of the same.

Key financial indicators (audited)

As per For the period ended	IGAAP FY2019	IGAAP FY2020
Net interest income	513.86	756.67
Profit after tax	93.89	186.75
Net worth	772.76	1,019.50
Assets under management	4,323.09	6,659.95
% PAT / Average managed assets	1.73%	2.39%
% PAT / Average net worth	15.85%	20.84%
% Gross NPAs	1.39%	0.71%
% Net NPAs	0.12%	0.18%
% Net NPA / Net worth	0.72%	1.09%
% Capital adequacy ratio	24.14%	22.19%
Gearing (reported)	6.93	7.99

Amounts in Rs. crore; Source: USFB & ICRA research; Gearing=(Total borrowings including deposits)/Net worth; All ratios are as per ICRA calculations

Status of non-cooperation with previous CRA: None

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)				Chronology of Rating History for the Past 3 Years						
						FY2020		FY2019		FY2018		
		Type	Rated Amount	Amount Outstanding	15-Jun-20	15-May-19	11-Apr-19	14-Dec-18	12-Sep-18	08-Feb-18	17-Jan-18	08-Jan-18
1	Subordinated debt programme	Long term	200	-	[ICRA]A (Stable)	[ICRA]A (Stable)				-	-	-
2	CD programme	Short term	1,000	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1	[ICRA]A1	[ICRA]A1	-	-
3	NCD programme	Long term	-	-	-	-	-	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)

Amounts in Rs. crore

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN	Instrument	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	Subordinated Debt*	-	-	-	200	[ICRA]A(Stable)
-	Certificates of Deposit Programme	-	-	7 – 365 days	1,000	[ICRA]A1+

** Yet to be issued; Source: USFB*

Analyst Contacts

Karthik Srinivasan
+91 22 6114 3444
karthiks@icraindia.com

Supreeta Nijjar
+91 124 4545 324
supreetan@icraindia.com

Sachin Sachdeva
+91 124 4545 307
sachin.sachdeva@icraindia.com

Prateek Mittal
+91 33 71501132
prateek.mittal@icraindia.com

Deeksha Agarwal
+91 124 4545 833
deeksha.agarwal@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

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata	+ (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore	+ (91 80) 2559 7401/4049
Ahmedabad	+ (91 79) 2658 4924/5049/2008
Hyderabad	+ (91 40) 2373 5061/7251
Pune	+ (91 20) 2556 0194/ 6606 9999

ICRA ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. ICRA ratings are subject to a process of surveillance, which may lead to revision in ratings. An ICRA rating is a symbolic indicator of ICRA's current opinion on the relative capability of the issuer concerned to timely service debts and obligations, with reference to the instrument rated. Please visit our website www.icra.in or contact any ICRA office for the latest information on ICRA ratings outstanding. All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable, including the rated issuer. ICRA however has not conducted any audit of the rated issuer or of the information provided by it. While reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. Also, ICRA or any of its group companies may have provided services other than rating to the issuer rated. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents