

August 04, 2020

Fincare Small Finance Bank Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Tier-II bonds programme	100.00	100.00	[ICRA]A (Stable) Reaffirmed
Long-term fund-based facilities	800.00	800.00	[ICRA]A (Stable) Reaffirmed
Long-term bank facilities	75.00	75.00	[ICRA]A (Stable) Reaffirmed
Fixed deposit programme	50.00	50.00	MA+ (Stable) Reaffirmed
Total	1,025.00	1,025.00	

*Instrument details are provided in Annexure-1

Rationale

The ratings factor in Fincare Small Finance Bank Limited's (Fincare) comfortable capitalisation position for its near-term growth requirements, support from the investors and the experienced senior management team, and the adequate monitoring and control systems. With a track record of timely capital infusions, the bank has remained adequately capitalised with a capital adequacy ratio of 29% as on March 31, 2020 and a net worth, in relation to managed advances, of 17%. The net worth, as on March 31, 2020, was Rs. 903.77 crore (Rs. 943.42 crore as on June 30, 2020, as per provisional unaudited financials), up from Rs. 666.00 crore as on March 31, 2019. The increase was on the back of a capital infusion of Rs. 90 crore by way of a rights issue and improved profitability. ICRA expects Fincare to remain well capitalised in the near-to-medium term, given its moderate growth targets and timely capital infusions. A prospective Rs. 500-crore rights issue is slated for FY2021 and the bank is due for an initial public offering (IPO) by September 2021, as per the regulatory guidelines.

The ratings also factor in Fincare's improved earnings profile and expanded deposit base. With a robust YoY growth of 78% in the net interest income, supported by non-interest income of 2.97% (as a percentage of average managed assets; AMA), and a moderation in the operating expenses due to the improved scale of operations, the bank delivered a return on average net worth of 18.28% in FY2020 (20.32% in FY2019) and a return on AMA (RoMA) of 2.44% (2.85% in FY2019). This was despite an increase in the credit costs on account of the additional provisioning due to the Covid-19 pandemic. ICRA notes that Fincare has been able to grow its deposit base significantly within a short time period with increased focus on retail deposits. The bank witnessed a deposit growth of 130% YoY as the deposits increased to Rs. 4,653.93 crore as on March 31, 2020 (76% of overall outstanding borrowings) and further to Rs. 5,204.10 crore as on June 30, 2020 (79% of overall outstanding borrowings) from Rs. 2,043.21 crore as on March 31, 2019 (55% of overall funding). The increase in deposits and the share of retail deposits and current and savings accounts (CASA) would remain a monitorable from a funding standpoint.

Fincare's ratings are, however, constrained by its ability to diversify its asset mix while scaling up as well as its ability to manage the adverse impact of the pandemic on its asset quality and business growth. The bulk of its exposure is towards unsecured microfinance loans where its borrower profile remains vulnerable to socio-political influences while remaining susceptible to income shocks. As on March 31, 2020, 80% of the assets under management (AUM) comprised microfinance loans followed by loans against property (LAP) at 10% and institutional finance (loans to non-banking financial companies; NBFCs) at 5%. 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. While the bank's collection efficiency has shown a month-on-month improvement in Q1 FY2021, its ability to manage the adverse impact of the pandemic on its asset quality and profitability as well as scale up the retail deposit base and maintain a prudent capitalisation profile will be important from a credit perspective.

The Stable outlook on the [ICRA]A rating reflects ICRA's opinion that Fincare will continue to benefit from its experienced management team, the timely capital support from the investors, its diversified borrowing profile and financial flexibility.

Key rating drivers and their description

Credit strengths

Comfortable capitalisation profile for near-term growth requirements on the back of capital support from investors –

With a track record of timely capital infusions, Fincare has remained adequately capitalised with a capital adequacy ratio of 29% as on March 31, 2020 and a net worth, in relation to managed advances, of 17%. The net worth, as on March 31, 2020, was Rs. 903.77 crore (Rs. 943.42 crore as on June 30, 2020, as per provisional unaudited financials), up from Rs. 666.00 crore as on March 31, 2019. The increase was on the back of a capital infusion of Rs. 90 crore by way of a rights issue and improved profitability. ICRA expects the bank to remain well capitalised in the near-to-medium term, given its moderate growth targets and timely capital infusions. A prospective Rs. 500-crore rights issue is slated for FY2021 and the bank is due for an IPO by September 2021, as per the regulatory guidelines.

Improved earnings profile supported by portfolio growth and moderation in operating costs with increase in scale¹ –

The bank's yield on average advances improved by ~150 bps in FY2020 (21.97% in FY2020 from 20.45% in FY2019) though the portfolio mix remained largely stable with microfinance loans accounting for ~80%. With the cost of funds (excluding IBPC) being largely stable at around 9%, Fincare maintained a lending spread of 12.33% in FY2020 vs 11.55% in FY2019. With a robust 78% YoY growth in the net interest income, the net interest margin (NIM), as a percentage of AMA (NIM/AMA), increased to 10.53% in FY2020 from 9.24% in FY2019. This was further supported by the non-interest income of 2.97% on AMA (vs 2.94% in FY2019). With the expansion in scale, the operating expenses moderated to 7.25% in FY2020 from 8.11% in FY2019, thereby yielding an increase in the operating profits (5.69% in FY2020 from 2.91% in FY2019). However, this was suppressed by the increase in the credit cost (2.26% in FY2020 from 0.98% in FY2019) on account of the Rs. 82.50-crore Covid-19 provisioning (in addition to the standard provisioning and write-offs). Resultantly, the RoMA was slightly lower at 2.44% (2.85% in FY2019). The return on average net worth remained comfortable though it declined to 18.28% in FY2020 from 20.32% in FY2019 due to a Rs. 90-crore rights issue. ICRA expects some compression in the profitability in FY2021 as the portfolio growth is expected to be lower and the credit costs are likely to be higher on account of the Covid-19 impact on the portfolio and the planned Rs. 82.50-crore Covid-19-related provisioning. The planned capital raise may further suppress the return on equity.

Experienced and professional management with good credit appraisal and portfolio monitoring processes –

The bank has a strong senior-and-middle-level management guided by a nine-member board of directors with average work experience of around 30 years. Fincare has good loan origination practices and prudent lending policies with centralised pre-disbursal checks. The bank has an adequate risk management framework with a quarterly portfolio review for microfinance loans and a credit committee review for any proposal exceeding Rs. 25 lakh in the non-micro finance institutions (non-MFI) advances. Fincare conducts risk-based internal audits of its branches, support functions and information technology (IT) systems. Further, it has a strong management information system (MIS) with a centralised internal data centre located at the head office and the branch network is well integrated with the bank's IT systems. The increasing digitisation of branch-and-centre-level functions, enabling real-time data update and report generation, allows the proactive assessment of risk.

Ability to scale up deposit base in a short time period though pickup in deposit traction and share of retail deposits remain a monitorable –

The bank has been able to grow its deposit base significantly in a short time period with increased focus on retail deposits. The deposits grew by 130% YoY to Rs. 4,653.93 crore as on March 31, 2020 (76% of overall outstanding borrowings) and further to Rs. 5,204.10 crore as on June 30, 2020 (79% of overall outstanding borrowings) from Rs. 2,043.21 crore as on March 31, 2019 (55% of overall funding). While retail deposits accounted for

¹ All ratios are as per ICRA calculations
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more than 60% of the deposits as on March 31, 2020, the CASA share was lower at 12%. ICRA notes that the management is envisaging a higher contribution of CASA, at around 25%, and the share of bulk deposits is likely to decline further, going forward. About 80-85% of the bulk depositors were cooperative banks, followed by trusts and other corporates which had parked their liquidity with the bank. The traction towards deposits and the share of retail deposits and CASA would remain a monitorable from a funding standpoint.

Credit challenges

Ability to manage adverse impact of pandemic on the asset quality and business growth – 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 as 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 profitably scale up non-microfinance products and improve geographical diversification – While the bank has diversified its asset-side offerings by introducing LAP, loan against gold, affordable housing loans, two-wheeler loans and institutional finance, the portfolio seasoning for these products remains low and the microfinance product continues to account for 80% of the overall mix. The bank's ability to scale up the non-microfinance book profitably while maintaining the asset quality remains a credit monitorable. Further, with three states (Gujarat, Karnataka and Tamil Nadu) accounting for 66% of the AUM as on March 31, 2020 and the top 10 and top 20 districts contributing 29% and 44%, respectively, to the on-book portfolio, the bank could improve its geographical diversification going forward, especially at the district level as it penetrates in the existing geographies while scaling up.

Ability to manage political, communal and other risks in the microfinance sector, given the marginal borrower profile with high susceptibility to income shocks – As a large portion of the bank's portfolio continues to comprise microfinance (80% 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. Fincare'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.

Liquidity position: Adequate

As on March 31, 2020, there were no negative cumulative mismatches in the reported liquidity profile. Adjusting the liquidity profile for a collection efficiency of 60%, there were no negative cumulative mismatches up to one year. The liquidity profile is further expected to remain supported by the planned rights issue of ~Rs. 500 crore in FY2021 in addition to access to interbank market and refinance limits (~Rs. 2,500 crore) from SIDBI, MUDRA and NABARD.

Rating sensitivities

Positive triggers – ICRA could revise the outlook or upgrade the long-term rating if Fincare is able to profitably diversify the asset mix while scaling up and develop a retail deposit franchise while maintaining a prudent capitalisation profile and improving its asset quality.

Negative triggers – Pressure on the bank's ratings could arise on a deterioration in the asset quality, which could affect its profitability with the RoMA 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	The ratings are based on the standalone financial statements of the rated entity

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 (IVFA)), a private equity fund, funded FFSPL and Disha. FFSPL's operations were adversely impacted during the Andhra Pradesh Microfinance crisis and the entity came under the brand name, Fincare, with Disha. 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 FFSPL being merged in Fincare Business Services Limited, which is the holding company, while Disha Microfin converted into Fincare Small Finance Bank. Fincare received a Scheduled Bank status in 2019. As on June 30, 2020, it had operations in 15 states and Union Territories spanning 182 districts through 711 branches serving a customer base of approximately 25 lakh.

Key financial indicators (audited)

	FY2019	FY2020	Q1 FY2021*
Net Interest Income	330.04	586.88	180.01
Total Income (incl. securitisation)	664.21	1,212.96	336.00
Profit after Tax	101.98	143.45	39.57
Net Worth	666.00	903.77	943.42
Gross Advances	3,528.00	5,342.03	5,342.55
Total Managed Assets	4,547.55	7,205.92	7,801.15
Gross NPA/ On-book Portfolio	1.13%	0.85%	0.61%
Net NPA/ Net Worth	1.42%	2.19%	1.69%
Gearing (times)	5.02	6.67	6.93
CRAR %	23.63%	29.28%	27.67%
Return on Average Net Worth %	20.32%	18.28%	17.14%
Return on Average Managed Assets %	2.85%	2.44%	2.11%

*As per provisional unaudited Q1 FY2021 financials

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)			Rating History for the Past 3 Years				
		Type	Amount Rated	Amount Outstanding	Rating	FY2020	FY2019		FY2018
					4-Aug-2020	3-Oct-2019	7-Jan-2019	14-Dec-2018	18-Sep-2017
1	Tier-II bonds programme	Long Term	100.00	100.00	[ICRA]A (Stable)	[ICRA]A (Stable)	-	-	-
2	Long-term fund-based facilities	Long Term	800.00	800.00	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	-	-
3	Long-term bank facilities	Long Term	75.00	75.00	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A- (Stable)
4	Fixed deposit programme	Medium Term	50.00	50.00	MA+ (Stable)	MA+ (Stable)	MA+ (Stable)	MA+ (Stable)	MA (Stable)

Amount 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 Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE519Q08152	Tier-II Bonds	30-Sep-2019	12.87%	30-Sep-2025	100.00	[ICRA]A (Stable)
	NABARD	13-Jul-2016 to 11-Mar-2020	8.25 - 11.25%	31-Jul-2021 to 31-Mar-2025	590.27	[ICRA]A (Stable)
NA	SIDBI	16-Mar-2017 to 23-Mar-2020	8.25% - 9.75%	10-Dec-2020 to 17-Mar-2023	264.13	[ICRA]A (Stable)
NA	MUDRA	19-Nov-2019	10.00%	1-Oct-2021	20.60	[ICRA]A (Stable)
NA	Fixed Deposit	NA	NA	NA	50.00	MA+ (Stable)

Source: Fincare Small Finance Bank Limited

Annexure-2: List of entities considered for consolidated analysis: Not applicable

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