

Utkarsh Small Finance Bank Limited

September 12, 2018

Summary of rated instruments

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Certificate of Deposit Programme	500.00	1,000.00	Reaffirmed at [ICRA]A1
Non-convertible Debenture Programme	117.00	117.00	Upgraded to [ICRA]A (Stable) from [ICRA]A- (Stable)
Total	617.00	1,117.00	

Rating action

ICRA has upgraded the long-term rating on the Rs. 117-crore non-convertible debenture (NCD) programme of Utkarsh Small Finance Bank Limited (USFB) to [ICRA]A (pronounced ICRA A) from [ICRA]A- (pronounced ICRA A minus). ICRA has also reaffirmed the short-term rating of [ICRA]A1 (pronounced ICRA A one) for the bank's Rs. 1,000-crore certificate of deposit programme (enhanced from Rs. 500 crore). The outlook on the long-term rating is Stable.

Rationale

The rating upgrade factors in USFB's ability to transition into a small finance bank (SFB) and its progress on product diversification, management team expansion, and deposit mobilisation.

The ratings continue to factor in USFB's strong investor profile, its comfortable capitalisation and adequate liquidity profile. The bank's liquidity profile is supported by its enhanced borrowing ability on account of receiving scheduled status and its relatively shorter-tenor assets and good traction in deposit mobilisation. The ratings continue to factor in USFB's good financial flexibility, resulting from its diversified funding mix, its strong investor base and good management and information systems (MIS) as well as effective internal audit and monitoring systems.

The ratings remain constrained by the bank's high geographic concentration in Bihar and Uttar Pradesh (46% and 33% of the portfolio, respectively, as on June 30, 2018), low share of retail deposits, reliance on joint liability group (JLG) loans (which formed 88% of the portfolio as on March 31, 2018) and the risks thereof, and the high credit costs incurred post demonetisation. Even though the asset quality numbers have improved post demonetisation, the company's ability to maintain the same would remain a key monitorable. Going forward, USFB's ability to diversify its product mix and depositor base and strengthen the retail deposit franchise will be important from a credit perspective.

Outlook: Stable

ICRA believes USFB will continue to benefit from the extensive experience of its promoters and management. The outlook may be revised to Positive if profitability improves and the financial risk profile strengthens. The outlook may be revised to Negative in case of deterioration in the bank's asset quality or its capitalisation and solvency profile.

Key rating drivers

Credit strengths

Experienced and professional management team – The bank’s promoter, Mr. Govind Singh, is currently serving as a Non-Executive Director. The senior management comprises functional heads (core team members), most of whom have been associated with the bank since inception. The bank 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, IT, risk, operations, compliance and treasury among others to smoothen the transition to an SFB.

Strong investor profile – USFB is wholly-owned by Utkarsh Micro Finance Limited. CDC Group (formerly Commonwealth Development Corporation) is Utkarsh Micro Finance Limited’s largest shareholder with a 14.13% stake followed by RBL Bank at 9.99%. Other shareholders include International Finance Corporation, Aavishkaar Goodwell, Norwegian Microfinance Initiative and Sarva Capital.

Good capitalisation profile supported by equity infusion – Despite its high pace of growth, the bank has been able to maintain good capitalisation indicators supported by regular capital infusion. The net worth, as on March 31, 2018, was Rs. 765 crore while the capital to risk weighted assets ratio (CRAR) was 17.40% (Tier 1 being 12.95%) against the regulatory requirement of 15% (Tier 1 being 7.5%). Gearing remained low at 4.84 times as the promoters and investors infused capital worth Rs. 150 crore during FY2018. ICRA expects the bank to maintain good capitalisation indicators, going forward, given the investor support and regular capital infusion.

Comfortable liquidity position and financial flexibility; strong ability to raise funding from diverse sources - USFB’s liquidity position remains comfortable owing to a conservative liquidity policy, high cash balances and continued funding from promoters and investors. Focus on expanding deposits as a source of funds has increased with commencement of banking operations. However, developing a sizeable retail deposit base would take some time. The bank has funding support from SIDBI, NABARD, MUDRA and other banks to cushion liquidity while the bank garners sizeable retail deposits. Moreover, the bank’s liquidity profile is further supported by its enhanced borrowing ability on account of receiving ‘Scheduled’ status and its relatively shorter tenor assets.

Credit Challenges

High exposure in Uttar Pradesh and Bihar- USFB was present in 11 states across 120 districts through 416 branches as on June 30, 2018. However, the share of Uttar Pradesh and Bihar remained high at 33% and 46%, respectively, with the top 5 and top 3 states accounting for 91% and 83% of the portfolio, respectively, as on June 30, 2018.

Asset quality improved post write-off of demonetisation losses though it remains a key monitorable – The overall asset quality indicators improved gradually with 0+ dpd of 2% as of June 2018 compared to 13% as of November 2017 and 28% as of December 2016. The bank wrote off portfolio worth Rs. 143 crore during FY2018 on account of demonetisation losses and showed an improvement in its asset quality indicators as on June 30, 2018. However, the bank’s ability to maintain its asset quality indicators remains to be seen.

Ability to diversify product mix – As of June 30, 2018, the JLG portfolio accounted for 88% of the bank’s overall portfolio. Other segments included Micro, Small & Medium Enterprises (MSME) loans (3%), wholesale lending book (8%) and housing loans (0.5%). The bank intends to bring down the share of the JLG book in the medium term, while expanding into other segments. The bank’s ability to diversify its asset portfolio while maintaining the asset quality at a reasonable level will be important from a credit perspective

Ability to develop retail deposit base – USFB had a deposit base of Rs. 2,282.67 crore as on June 30, 2018, which formed 59% of the bank’s overall borrowings. 80% of the total deposits came from corporations/financial institutions/ Government with the top 20 depositors accounting for 57% of the total deposits. The bank has been able to gain good traction in its deposit base given its nascent stage of operations. However, its ability to build its current account and savings account (CASA) and fixed deposits base would be important from a credit perspective.

Marginal borrower profile with limited ability to absorb income shocks – The marginal borrower profile and the political and operational risks associated with micro-lending may result in high volatility in the asset quality indicators. Political, communal, overleveraging and other risks in the company’s portfolio and across geographies of operations will remain key sensitivities.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria:

[Rating Methodology for Non-Banking Finance Companies](#)

[Rating Methodology for Banks](#)

About the company

Incorporated in 2009, Utkarsh Micro Finance Limited received final Small Finance Bank (SFB) license from Reserve Bank of India in November 2016 and completed the 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.

USFB operated in 11 states through 416 branches in 120 districts with the largest states being Uttar Pradesh and Bihar, which together accounted for 79% of the portfolio. The bank offers loans in the microfinance, MSME, affordable housing and wholesale lending segments. USFB had a portfolio of Rs. 3,331 crore as on June 30, 2018 with 88% of the portfolio comprising microfinance loans. As for liabilities, USFB had deposits of Rs. 2,282.67 crore as on June 30, 2018 with fixed deposits accounting for 97%. The asset quality indicators improved with 0+ dpd and 90+ dpd at 2% as on June 30, 2018. The bank is expected to come out with an Initial Public Offering (IPO) in FY2021.

USFB reported a net loss of Rs. 60.99 crore on a managed asset base of Rs. 4,669.85 crore in FY2018 (consolidated) vis-à-vis a profit after tax (PAT) of Rs. 34.36 crore on a managed asset base of Rs. 2,670.90 crore in FY2017 (consolidated). The bank reported PAT of Rs. 39.67 crore on a managed asset base of 4,806.10 crore in Q1 FY2019 (standalone, unaudited).

Key financial indicators (consolidated) (audited)

	FY 2017	FY 2018
Net Interest Income	214.23	280.06
Profit before Tax	52.90	(91.30)
Profit after Tax	34.36	(60.99)
Managed Advances	1,613.61	3,210.05
Total Assets	2,651.19	4,566.07
% Tier 1	17.15%	12.95%
% CRAR	25.87%	17.40%
Gearing	2.86	4.84
% Net Profit / Average Managed Assets	1.5%	(1.6%)
% Return on Net Worth	7.40%	(8.46%)
% Gross NPA	0.00%*	1.85%
% Net NPA	0.00%*	1.09%
Net NPA / Net Worth	0.00%*	4.40%

Amounts in Rs. crore

Source: ICRA research and company

* Considering RBI dispensation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

Instrument	Current Rating (FY2019)				Chronology of Rating History for the past 3 years			
	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating in FY2018		Date & Rating in FY2017	Date & Rating in FY2016
				September 2018	February 2018	January 2018		
1 NCD	Long Term	117.00	117.00	[ICRA]A (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	-	-
2 Certificate of deposit programme	Short Term	1,000.00	494.48	[ICRA]A1	[ICRA]A1	-	-	-

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 No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE396P07100	NCD	26-Feb-16	13.30%	24-Feb-21	67.00	[ICRA]A (Stable)
INE396P07092	NCD	27-Nov-15	13.90%	27-Nov-21	50.00	[ICRA]A (Stable)
NA	CD	NA	NA	7-365 days	1,000.00	[ICRA]A1

Source: Utkarsh Small Finance Bank Limited

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