SE/2022-23/32

Utkarsh Small Finance Bank

The BSE Limited
Phiroze Jeejeebhoy Towers
Dalal Street, Fort
Mumbai – 400001
Maharashtra

September 29, 2022

Sub: Intimation pursuant to Regulation 51 and other applicable regulations, if any, of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

Scrip Code: 949694

Pursuant to Regulation 51, 55 and other applicable regulations, if any, read with Schedule III Part B of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, please find attached rationale letter dated September, 29, 2022 informing revision in rating as per details given below:

Credit Rating Agency	Rated Instrument	Existing	Revised
CARE Ratings Limited	Non Convertible Debentures	CARE A (Stable)	CARE A (Positive)

Request to kindly take the above on record.

Thanking You

Yours faithfully

For Utkarsh Small Finance Bank Limited

Muthiah Ganapathy
Digitally signed by Muthiah Ganapathy
Date: 2022.09.29 19:21:11 +05'30'

Muthiah Ganapathy
Company Secretary & Compliance Officer

CareEdge RATINGS

Utkarsh Small Finance Bank Limited

September 29, 2022

Rating

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Bonds	40.00	CARE A; Positive (Single A; Outlook: Positive)	Reaffirmed; Outlook revised from Stable
Tier-II Bonds	-	-	Withdrawn
Total long-term instruments	**40.00 (₹ Forty crore only)**		

Details of instruments/facilities in Annexure-1.

Detailed rationale and key rating drivers

The reaffirmation of the rating assigned to the bonds of Utkarsh Small Finance Bank Limited (USFBL) derives strength from the bank's long track record of operations in microfinance lending, experienced management team for managing the various banking operations, along with its growing scale of operations.

The rating also factors in significant mobilisation of deposits with increasing share of the retail and current account saving account (CASA) deposits and access to diverse funding sources since commencement of operations as small finance bank resulting in comfortable liquidity position of the bank. The rating also draws comfort from diversified institutional equity investors' base at the holding company level and comfortable capitalisation levels of USFBL given the substantial capital raised, which has allowed USFBL to grow its loan book. CARE Ratings Limited (CARE Ratings) notes that the bank is planning to raise around ₹500 crore through its initial public offering (IPO).

The rating, however, continues to be constrained by the geographic concentration in Uttar Pradesh and Bihar, significant (though declining) concentration to micro finance lending, lack of diversity in earnings profile, short track record in non-microfinance lending (MSME, home loans and wholesale lending portfolio), and the inherent risk involved in the microfinance segment, including socio-political intervention risk and unsecured lending.

Rating sensitivities

Positive factors – Factors that could lead to positive rating action/upgrade:

- Sustained growth in the loan book whilst ensuring comfortable credit profile of the overall loan portfolio.
- Improvement in profitability metrics with return on total assets (ROTA) above 1.5% on a sustained basis.

Negative factors – Factors that could lead to negative rating action/downgrade:

- Significant weakening of asset quality leading to decline in profitability metrics with ROTA below 0.5% over medium term.
- Further deterioration in asset quality with gross non-performing assets (GNPA) escalating above 7%.

Outlook: Positive

The revision in the rating outlook to Positive factors in the increased scale of the loan book along with improving collection efficiency trend, which is likely to result in lower slippages and improving profitability metrics going forward. In Q1FY23, the bank reported a ROTA of 2.37% against 0.45% in FY22 (refers to the period April 1 to March 31) as per CARE calculation, due to improvement in net interest margin(NIMs), other income and reduced credit costs. The GNPA and net non-performing assets (NNPA) ratio also improved in Q1FY23 to 5.73% and 1.66%, respectively, from GNPA and NNPA of 6.10% and 2.31% as on March 31, 2022.

Capitalisation position is expected to further improve post the IPO which is expected to provide the company sufficient headroom to achieve the envisaged growth. USFBL's ability to maintain its asset quality, along with growth in the scale of operations, will be a key rating monitorable.

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

Detailed description of the key rating drivers

Key rating strengths

Diversified investor base and comfortable capital adequacy: USFBL is a subsidiary of Utkarsh CoreInvest Limited (UCL). UCL has a strong investor base with British International Investment, the development financial institution of UK Government, being the key foreign investor besides NMI Frontier Fund KS, Responsibility Participations Mauritius, Sarva Capital, Aavishkaar Goodwell India Microfinance Development Company and International Finance Corporation (IFC).

The operations of USFBL are headed by Govind Singh, who is the Managing Director and CEO of USFBL. He has an extensive experience of over 30 years in the banking and microfinance sector, including having founded Utkarsh Micro Finance Limited (UMFL) in 2009 for carrying out micro lending activities.

The capital adequacy of USFBL was comfortable with capital adequacy ratio (CAR) and Tier-I capital being 21.59% and 18.08% as on March 2022 as against 21.88% and 19.98% as on March 2021. During FY22, the bank has raised equity worth ₹150 crore and ₹240 crore in FY21. USFBL has filed the Draft Red Herring Prospectus (DRHP) with SEBI on July 30, 2022, to raise ₹500 crore through the prospective IPO. The issue consists of only fresh equity shares with a face value of ₹10 each. With planned IPO, capitalisation is expected to further improve giving headroom for loan growth.

Growth in the loan portfolio: The bank registered a 26% growth in the gross loan portfolio during FY22 to ₹10,631 crore as on March 31, 2022, from ₹8,416 crore as on March 31, 2021. The loan book further increased to ₹10,951 crore as on June 30, 2022. Majority of the portfolio continues to be microfinance loans, though its share is gradually decreasing y-o-y basis from 95% in FY17 to 75% in FY22. Going forward, while the bank intends to continuously grow microfinance portfolio at healthy pace, other lending verticals (being smaller in size) are expected to grow faster than microfinance business and hence the share of micro finance loans in Bank's overall loan book is expected to reduce further.

Diversified funding mix: The bank's liability mix has undergone substantial change with significant deposits (including CDs) being raised post conversion into bank from ₹2,194 crore as on March 31, 2018, to ₹10,074 crore as on March 31, 2022. The bank has been gradually focusing on building its retail deposits book, and consequently, CASA grew by 70% Y-o-Y to ₹2,253.28 crore as on March 31, 2022, from ₹1,326.98 crore as on March 31, 2021.

The bank has been working on expanding its resource profile and especially improving its low-cost, stickier CASA deposits. USFBL has also raised refinance loans from NABARD and SIDBI, and term money borrowings from banks post conversion into the bank. USFBL can also access call money market and raise borrowings under MSS and LAF from the RBI, thereby getting access to diverse set of resources.

During fiscal 2022, the bank mobilised deposits of ₹2,566.71 crore translating into annual growth of 34.19% of the total deposits of ₹10,074.18 crore, 22.37% was from CASA, 37.34% from retail term deposits, and remaining 40.36% from wholesale term deposits. The bulk term deposits constituted relatively high 40% of the overall deposits.

Key rating weaknesses

Geographical concentration of loan portfolio: The bank has 686 banking outlets spread across 224 districts and 22 states & union territories (UTs) of the country as on March 31, 2022. The top two states- Bihar and UP, constitute around 61% of POS on March 2022 as against 66% of the loan portfolio as on March 2021. The geographical concentration is, however, improving with the opening of new branches. During FY22, the bank expanded into the state of Rajasthan**.** Currently, it has presence in 12 states for micro finance portfolio. Diversification in product mix and consequently reduction in micro finance loan book as well as reduction in the geographical concentration would be critical for its credit profile.

Weak, albeit improving asset quality: The bank's asset quality deteriorated in FY22 with rise in the GNPA ratio from 3.75% to 6.10% in FY22. Driven by improved collection efficiency, it improved to 5.73%, as on June 30, 2022. Standard restructured assets stood small at 1.31%, as on March 31, 2022.

CARE notes that the bank has provided adequate provisioning. The provision coverage on non-performing loans and standard restructured assets stood at 72% and 18%, respectively as on June 30, 2022. The bank has not provided moratorium on any of its JLG restructured portfolio. Along with it, the bank has made additional contingency provisions of ₹65 crore (0.6% of gross loan portfolio.

Moderate profitability due to high provisioning: The bank's profitability remained weak with significant rise in the credit costs. The net profits declined by 45% Y-o-Y in FY22 due to high provisions, even after a growth in the total income by 19% during the year. The bank's net interest margin (NIM) in FY22 remained stable at 7.82% as per CARE calculation. The operating expenses/average assets ratio improved to 5.43%, in line with the bank's cost optimisation measures. However, sizable credit costs (3% of average assets) continued to put a drag on the profitability.

With Covid impact receding, PAT improved in Q1FY23 to ₹89 crore. The bank's ability to control further slippages and improve its profitability will be a key monitorable.

Socio-political and regulatory risks inherent in the micro finance industry: Microfinance lending continues to be the key lending segment for the bank, which continues to be impacted by the inherent risk involved, viz., socio-political intervention risk and the risks emanating from unsecured lending.

Liquidity: Adequate

The liquidity position of the bank was comfortable as reflected by well-matched asset-liability management (ALM) as on March 31, 2022. It has strengthened post formation of the bank, given the access to diverse funding resources, including inter-bank borrowing limits, unavailed refinance lines and the ability to borrow from the Reserve Bank of India (RBI) under MSS/LAF window and from call money market against the excess liquidity maintained over and above the regulatory requirement of statutory liquidity ratio (SLR) of 18%. The liquidity coverage ratio (LCR) of USFBL stood at 173% as on March 2022 as against the regulatory requirement of 100%. As of March 31, 2022, the Bank maintained excess liquidity of ₹ 1,813 crore in addition to mandatory SLR and CRR requirement and deployed primarily in 'Liquidity Adjustment Facility' with RBI, SLR securities and other liquid and marketable (non-SLR) securities.

Analytical approach: Standalone

Applicable criteria

Policy on default recognition

Financial Ratios - Financial Sector

Rating Outlook and Credit Watch

Bank

Policy on Withdrawal of Ratings

About the company

Utkarsh Small Finance Bank Limited (USFBL), based out of Varanasi is a subsidiary of Utkarsh CoreInvest Limited (UCL). The company commenced banking operations on January 23, 2017, upon receipt of license from RBI on November 25, 2016, and subsequent transfer of business from UCL, which was carrying on the micro lending operations since September 2009.

USFBL extends microfinance loans based on the joint-liability group (JLG) model to individuals, which constitute nearly 75% of the gross loan portfolio of the company as on March 31, 2022. The bank also extends wholesale loans, MSME loans and housing loans to the borrowers. USFBL provides microfinance loans through Business Correspondence activities as well. Gross loan portfolio of USFBL stood at ₹10,951 crore as on June 30, 2022. The operations of the bank are currently spread across 22 states/2 UTs, i.e., Uttar Pradesh, Bihar, Madhya Pradesh, Haryana, Uttarakhand, Maharashtra, Himachal Pradesh, Chhattisgarh, Jharkhand, West Bengal, Odisha, Rajasthan, Gujarat, Telangana, Delhi, Chandigarh, Punjab, Assam, Andhra Pradesh, Kerela, Karnataka, and Tamil Nadu.

Brief Financials (₹ crore)	March 31, 2021 (A)	March 31, 2022 (A)	Q1FY23
Total operating income	1,705.84	2,033.65	639.57
PAT	111.82	61.47	89.50
Interest coverage (times)	1.20	1.10	1.50
Total assets	12,137.91	15,063.77	15,202.00
Net NPA (%)	1.33	2.31	1.66
ROTA (%)	1.04	0.45	2.37

A: Audited

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for the last three years: Please refer Annexure-2

Covenants of the rated instruments/facilities: Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3

Complexity level of various instruments rated for this company: Annexure-4

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Bonds *	INE735W08012	09-07-2018	10.58%	09-07-2025	25.00	CARE A; Positive
	INE735W08020	31-08-2018	10.58%	30-08-2025	15.00	CARE A; Positive
Bonds-Tier-II Bonds	INE396P08066					Withdrawn

*Against the rated amount of ₹40 crore (2 NCDs of ₹25 crore and ₹15 crore)

Annexure-2: Rating history for the last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021	Date(s) and Rating(s) assigned in 2019-2020
1	Debentures-Non-convertible debentures	LT	-	-	-	-	-	1)Withdrawn (23-Dec-19)
2	Fund-based - LT-Term loan	LT	-	-	-	-	1)Withdrawn (22-Dec-20)	1)CARE A; Stable (23-Dec-19)
3	Debentures-Non-convertible debentures	LT	-	-	-	-	1)Withdrawn (22-Dec-20)	1)CARE A; Stable (23-Dec-19)
4	Bonds-Tier-II Bonds	LT	-	-	-	1)CARE A; Stable (20-Dec-21)	1)CARE A; Stable (22-Dec-20)	1)CARE A; Stable (23-Dec-19)
5	Debentures-Non-convertible debentures	LT	-	-	-	-	1)Withdrawn (22-Dec-20)	1)CARE A; Stable (23-Dec-19)
6	Debentures-Non-convertible debentures	LT	-	-	-	-	1)Withdrawn (22-Dec-20)	1)CARE A; Stable (23-Dec-19)
7	Debentures-Non-convertible debentures	LT	-	-	-	-	1)Withdrawn (22-Dec-20)	1)CARE A; Stable (23-Dec-19)
8	Bonds	LT	40.00	CARE A; Positive	-	1)CARE A; Stable (20-Dec-21)	1)CARE A; Stable (22-Dec-20)	1)CARE A; Stable (23-Dec-19)

Annexure-3: Detailed explanation of the covenants of the rated instruments/facilities: NA

Annexure-4: Complexity level of various instruments rated for this company

Sr. No.	Name of Instrument	Complexity Level
1	Bonds-Tier-II Bonds	Complex
2	Bonds	Simple

Annexure-5: Bank lender details for this company

To view the lender-wise details of bank facilities please click here

Note on complexity levels of the rated instruments: CARE Ratings has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

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About us:
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