Fincare Small Finance Bank Limited

July 04, 2022

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Proposed-Long term Bank Facilities	**125.00**	**CARE A; Stable (Single A; Outlook: Stable)**	**Reaffirmed**
Lower Tier-II bonds	**100.00**	**CARE A; Stable (Single A; Outlook: Stable)**	**Reaffirmed**
Lower Tier-II bonds	**100.00**	**CARE A; Stable (Single A; Outlook: Stable)**	**Reaffirmed**

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The rating assigned to the proposed bank facility and lower tier-II bond issues of Fincare Small Finance Bank (FSFB) continues to derive strength from its experienced management team, adequate capitilisation levels, high growth in AUM post transition to SFB which helped to improve diversification in loan book, improving CASA proportion & granularity of deposit and resultant improvement in cost of funds. The rating also takes note of fresh equity infusion of Rs.169.7 crore in FY22.

The ratings are however continues to be constrained by high concentration in MFI portfolio, high geographic concentration, moderation in asset quality parameters with increase in stressed assts during the year FY22, marginal borrower profile and the inherent risk involved in the microfinance segment including socio-political intervention risk and unsecured nature of lending.

Rating Sensitivities

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

- Scale up of its business with sustained product and geographic diversification with increase in secured asset class on a reasonably seasoned portfolio.
- Improvement in earnings profile with ROTA above 2% on a sustained basis.

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

- Delay in ramp up in collections to pre-pandemic levels.
- Material deterioration in asset quality impacting earnings profile of the bank with GNPA above 10%.
- Continued weak earnings profile with credit cost above 4%.

Detailed description of the key rating drivers

Key Rating Strengths

Experienced management team: FSFB is professionally managed under the overall guidance of the bank's Board of Directors (BoD). The BoD of the bank is headed by Mr. Pramod Kabra (Chairman) who has over 30 years of experience in multiple sectors including logistics, cables, financial services and radio taxi services. The operations of the bank are led by Mr. Rajeev Yadav (MD & CEO), who has over 25 years of diversified experience in financial services across NBFCs and HFC. Prior to this, he was the India CEO at GE Money, which included an NBFC and HFC business across diversified retail products. He is assisted by senior management team having rich experience in the financial services and microfinance sector. Further, there has been induction of senior management team with extensive experience in banking and finance for implementing the banking functions.

High growth in AUM: FSFB had commenced its operations on July 21, 2017, post compliance of various SFB guidelines issued by RBI including raising adequate funds to comply with the CRR and SLR requirements. Also, with the commencement of banking operations, FSFB has introduced new products like Loan against Property, gold loans, institutional finance (loans to Micro, small and medium enterprises, NBFCs, and NBFC-MFIs), two-wheeler vehicle loan and affordable housing loan under assets side, and various deposits products under liability side. The bank's AUM increased from Rs. 6,019 crore as on March 31, 2021 to Rs. 7,541 crore as on March 31, 2022, witnessing a growth of 25.3%. The number of branches as on March 31, 2022 stood at 919 spread across 16 states and 1UT.

Adequate capitalisation levels: FSFB has a diversified investor base with True North, which holds around 16.50% through Fincare Business Services Ltd (holding company with 78.58% stake), and 2.34% directly in FSFB as on March 31, 2022. The investors of FBSL include several marquee names such as TA Associates, Leapfrog Investments, SIDBI, Kotak Mahindra Life, Edelweiss Tokio Life, etc. The investors had demonstrated continued support by infusing funds through FBSL into the bank with latest infusion of Rs.170 crore raised through rights issue during May 2021. On account of advances growth of 32.7% in FY22, bank's CAR and Tier-1 CAR has witnessed moderation to 22.32% and 19.48% respectively as on March 31, 2022 as against 29.56% and 24.91% as on March 31, 2021, however, the capitalization remains above the regulatory requirements of 15%. Tier 2 capital stood at Rs.157 crore as on March 31, 2022. Out of the total borrowings of Rs.2900 crore outstanding as on March 31, 2022, bank has rating related trigger clauses on borrowings amounting Rs.100 crore (0.92% of total liabilities) of subordinated debt which is included in Tier 2 capital. These instruments have optional accelerated redemption based on rating related trigger. However, same is subject to regulatory approvals. Bank had filed DRHP during May 2021 and planned to raise Rs.1330 crore

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

(Fresh issue: Rs.330 crore and Offer for sale: Rs. 1000 crore) through IPO. However, on account of weak economic environment post second wave of Covid-19 management decided to postpone the IPO issue. Bank plans to file revised DRHP and complete equity raise in FY23.

Traction in deposit raising: Post the transition to SFB, FSFB has raised deposits (majorly retail deposits) to repay high cost grandfathered loans, which has helped the bank to reduce its average cost of borrowings. The bank was accorded the scheduled bank status by RBI in March 2019, post which bank has built up significant low-cost deposits base. Out of total liabilities of Rs.9,704 crore, bank had total deposits outstanding of Rs.6,456 crore as on March 31, 2022, which forms 66.5% (PY:76.6%) of the total liabilities. CASA proportion has increased to 36.30% as on March 31, 2022 (March 31, 2021: 23.76%). Consequently, bank's cost of deposits has reduced from 8.34% in FY21 to 7.15% in FY22. Borrowings from refinance lines from NABARD, SIDBI, MUDRA and IBPC lines form the remaining resource profile. Going forward, with the scaling up of existing bank branches, setting up new bank branches and conversion of existing asset only bank outlets into full-fledged bank branches, FSFB is targeting to increase the share of retail deposits to fund the growth in the portfolio. Developing a strong retail deposit base and garnering low cost CASA deposit would remain key to its profitability.

Key Rating Weaknesses

Increase in PPOP, however PAT impacted due to high credit cost: During FY22, bank's total income witnessed growth of 19.5% and stood at Rs.1,648 crore (FY21: Rs.1,378 crore) aided by healthy increase in interest income of 15.6% and in non-interest income by 58.4% with pickup in disbursements. Supported by increase in CASA deposits the bank's cost of deposits improved to 7.15% during FY22 as against 8.34% during FY21. Consequently, Bank's Net Interest Income (NII) has increased by 25% and stood at Rs.876 crore (FY21: Rs. 701 crore) in trend with growth of advances. NIM has remained stable at 9.36% in FY22 (FY21: 9.36%) albeit decline in yield on advances from 22.70% in FY21 to 21.45% in FY22 aided by decline in cost of deposits. Decline in yield on advances is on account of lower proportion of MFI loan portfolio and interest reversals due to NPA.

Bank's operational efficiency parameters moderated with cost to income ratio of the bank at 60.0% in FY22 compared to 55.9% in FY21 on account of increased employee cost with additional personnel deployed for collection efforts for NPA and written off accounts starting from Q3FY22. Bank's operational expenses/ average total assets stood at 6.91% in FY20 compared to 6.19% in FY21. Bank's Pre-Provisioning Operating Profit (PPOP) improved by 18% to Rs. 431 crore in FY22 as against Rs.365 crore in FY21. However, on account of higher provisioning (excluding tax) of Rs. 425 crore in FY22 as against Rs.219 crore in FY21, the bank reported lower profit of Rs.9 crore in FY22 as against Rs.113 crore in FY21. Increase in provisioning cost is mainly on account of elevated slippages witnessed during FY22 post second wave of Covid-19 and additional provisioning made for the restructured portfolio. Bank has also made writeoffs of Rs.369 crore during FY22. Going forward, bank expects the profitability would be impacted during Q1FY23 with additional provisioning and writeoffs to be made as per ageing schedule. However, profitability is expected to be back to normal starting from Q2FY23. Bank's ability to maintain asset quality limiting credit cost thereby protecting earnings profile would be a key rating monitorable.

Moderation in asset quality parameters: FSFB's asset quality parameters witnessed moderation with increase in slippages due to Covid related disruption with impact on the livelihood of the borrowers leading to deterioration in GNPA ratio from 6.44% as on March 31, 2021 to 7.79% as on March 31, 2022 and NNPA ratio has deteriorated to 3.55% as on March 31, 2022 as against 2.80% as on March 31, 2021. During FY22, bank has written off Rs.369 crore of loans. Second wave of coronavirus outbreak had impacted the livelihood of the borrowers leading to higher delinquencies especially in Tamil Nadu and Karnataka where bank has significant presence. FSFB's high reliance on unsecured lending exposed it to an elevated asset quality issues. Bank's borrower profile being marginal are highly susceptible to event risk such as Covid-19 disruptions which impacted their earnings. Bank's outstanding restructured loans stood at Rs.360 crore (4.8% of AUM) as on March 31, 2022. Bank holds provision of Rs.145 crore for the said restructured portfolio. Gross stressed assets/ gross advances stood at 13.39% as on March 31, 2022 (FY21: 9.69%). Net stressed assets as a percentage of net worth stood at 55.97% (FY21: 32.66%). However, improvement in asset quality parameters is witnessed in March 31, 2022 after peaking in December 31, 2021.

High geographic concentration: Bank has operations in 16 states at present, bank continues to have high geographic concentration with concentration in top 5 states at 73.67% as on March 31, 2022 (March 31, 2021: 79.21%). The single state concentration (Tamil Nadu) have witnessed decline to 21.9% as on March 31, 2022 as against 25.5% on March 31, 2021.

Slow traction in build-up of secured non-MFI portfolio and marginal borrower profile: The portfolio of the bank is still concentrated in MFI, with the share of MFI portfolio continuing to remain high at around 75.7% (PY: 79.6%). Presently the non-MFI portfolio majorly comprises of Loan against property (12.0% of total loan portfolio), gold loan (5.5%), affordable housing loan (5.1%) and Institutional Finance (0.4%). Bank's asset quality parameters has witnessed moderation during FY22 and performance of the unseasoned non-MFI portfolio remains to be seen. FSFB will continue to face the challenge of risks associated with MFI segment including political and operational.

Liquidity: Adequate

The liquidity profile is adequate with no cumulative negative mismatches in the up to 1 year bucket as per the ALM submitted by the bank as on March 31, 2022. The liquidity coverage ratio of bank remained comfortable at 191.7% for quarter ended March 31, 2022 as against the regulatory requirement of 100%. Moreover, the Bank has excess SLR of Rs. 809 crore as on May 21, 2022. Liquidity is also supported by the refinance lines available to it from SIDBI, NABARD and MUDRA. Further, the bank having status of a SCB, has increased its resource raising ability by providing access to facilities like LAF, MSF and CD to meet any liquidity requirement.

Analytical approach: Standalone.

Applicable Criteria
Criteria on Assigning 'Outlook' or 'Credit Watch' to Credit Ratings
CARE's Policy on Default Recognition
Financial Ratios-Financial Sector
CARE's Rating Methodology for Banks

About the Company
Fincare Small Finance Bank Limited (FSFB) (erstwhile Disha Microfin Limited), is a small finance bank, which started it banking operations on July 21, 2017, post receipt of final license from RBI on May 12, 2017. Bank has been accorded the scheduled bank status in March 2019. As on March 31, 2022, FSFB operates in 16 states and one Union Territory with 912 branches, covering around more than 25.36 lakh active borrowers with asset under management (AUM) of Rs. 7541 crore

Brief Financials (Rs. crore)	31-03-2020 (A)	31-03-2021 (A)	31-03-2022 (A)
Total operating income	1,216	1,378	1,648
PAT	143	113	9
Total Assets	7,076	7,899	10,813
Net NPA (%)	0.41	2.80	3.55
ROTA (%)	2.55	1.51	0.09

A: Audited

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

Covenants of rated instrument / facility: 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
Term Loan-Long Term-Proposed	-	-	-	-	125.00	CARE A; Stable
Bonds-Tier II Bonds	INE519Q08152	September 30, 2019	12.87%	September 30, 2025	100.00	CARE A; Stable
Bonds-Lower Tier II	INE519Q08020	March 15, 2017	12.60%	November 29, 2022	25.00	CARE A; Stable
Bonds-Lower Tier II	INE519Q08137	March 22, 2018	11.30%	June 22, 2024	38.00	CARE A; Stable
Bonds-Lower Tier II	INE519Q08145	March 20, 2018	11.30%	June 20, 2024	37.00	CARE A; Stable

Annexure-2: Rating History of 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	Term Loan-Long Term	LT	125.00	CARE A; Stable	-	1)CARE A; Stable (05-Jul-21)	1)CARE A; Stable (06-Jul-20)	1)CARE A; Stable (01-Oct-19)
2	Debentures-Non Convertible Debentures	LT	-	-	-	-	1)Withdrawn (06-Jul-20)	1)CARE A; Stable (01-Oct-19)
3	Bonds-Tier II Bonds	LT	100.00	CARE A; Stable	-	1)CARE A; Stable (05-Jul-21)	1)CARE A; Stable (06-Jul-20)	1)CARE A; Stable (01-Oct-19)
4	Bonds-Lower Tier II	LT	100.00	CARE A; Stable	-	1)CARE A; Stable (06-Aug-21)	-	-

*Long Term / Short Term

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

Unsecured, Rated, Listed Redeemable Non-Convertible Subordinated Debentures (12.6%)	Detailed explanation
A. Financial covenants	Not Stipulated
B. Non-financial covenants	
I. Minimum credit rating	Credit rating of the issuer from any credit rating agency to remain at a minimum of 'BBB'. Subject to RBI approval and other applicable regulations, in case of breach of above-mentioned credit rating criteria, the debenture holders may require the company to redeem the debentures along with accrued interest and other charges (Optional accelerated redemption) within 30 days from date of such occurrence.
Unsecured, Rated, Listed Redeemable Non-Convertible Subordinated Debentures (11.3%)	**Detailed explanation**
A. Financial covenants	Not Stipulated
B. Non-financial covenants	
I. Minimum credit rating	Credit rating of the issuer from any credit rating agency to remain at a minimum of 'A-'. Subject to RBI approval and other applicable regulations, in case of breach of above-mentioned credit rating criteria, the debenture holders may require the company to redeem the debentures along with accrued interest and other charges (Optional accelerated redemption) within 30 days from date of such occurrence.
Lower Tier-II bonds	**Detailed explanation**
A. Financial covenants	Not Stipulated
B. Non-financial covenants	
I. Claims of dkebenture holders	The claims of debenture holders shall be: • Senior to the claims of investors in instruments eligible for inclusion in Tier I capital. • Subordinate to the claims of all the depositors, general creditors of the bank, but shall rank pari passu with other Tier II capital instruments of the bank. • Rank pari passu inter se the debenture holders, without preference amongst themselves.

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

Sr. No.	Name of Instrument	Complexity Level
1	Bonds-Lower Tier II	Complex
2	Bonds-Tier II Bonds	Complex
3	Term Loan-Long Term	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 instrument: CARE Ratings Ltd. 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 CARE Ratings Limited:
Established in 1993, CARE Ratings Ltd. is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India (SEBI), it has also been acknowledged as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). With an equitable position in the Indian capital market, CARE Ratings Limited provides a wide array of credit rating services that help corporates to raise capital and enable investors to make informed decisions backed by knowledge and assessment provided by the company.
With an established track record of rating companies over almost three decades, we follow a robust and transparent rating process that leverages our domain and analytical expertise backed by the methodologies congruent with the international best practices. CARE Ratings Limited has had a pivotal role to play in developing bank debt and capital market instruments including CPs, corporate bonds and debentures, and structured credit.

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