

June 14, 2022 ^(Revised)

Fincare Small Finance Bank Limited: Rating reaffirmed; Migration of the rating on the medium-term rating scale to the long-term rating scale

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Bank lines (Long term – Term loan)	800	800	[ICRA]A (Stable); reaffirmed
Bank lines (Long Term – Fund based/non-fund based)	75	75	[ICRA]A (Stable); reaffirmed
Tier-II Bonds	100	100	[ICRA]A (Stable); reaffirmed
Fixed deposit	50	50	[ICRA]A (Stable); reaffirmed and migrated from MA+ (Stable)
Total	1,025	1,025	

*Instrument details are provided in Annexure-1

Rationale

The rating reaffirmation factors in Fincare Small Finance Bank Limited's experienced board and management team, its adequate systems and processes, and its strong liquidity profile. The rating also takes into consideration the healthy growth in the scale of operations as reflected by the growth of ~25% in FY2022 with closing assets under management (AUM) of Rs. 7,599 crore and the compound annual growth rate (CAGR) of ~37% from an AUM of Rs. 2,154 crore as on March 31, 2018. Fincare's liquidity profile remains strong with refinancing ability in the form of lines available from National Bank for Agriculture and Rural Development (NABARD) and Small Industries Development Bank of India (SIDBI).

Further, Fincare's funding profile remains diversified with good traction in deposit mobilisation in FY2022. The share of current account and savings account (CASA) deposits also increased to ~34% as on December 31, 2021 from ~12% as on March 31, 2020. The rating also factors in Fincare's comfortable capitalisation profile with a reported capital adequacy ratio (CAR) of 22.3% as on March 31, 2022 compared to the regulatory requirement of 15%. Fincare is in the process of listing its shares to meet regulatory requirements and to raise Rs. 1,330 crore (including Rs. 330-crore primary issuance) of equity. However, ICRA takes note of the delay in completing the same and will continue to monitor further developments.

The rating is, however, constrained by the significant deterioration in Fincare's profitability metrics, with the bank reporting a marginal profit in FY2022, given the Covid-19 pandemic-induced challenges. The asset quality indicators had deteriorated in H1 FY2022. Though the same improved thereafter, it still remains high with reported gross non-performing assets (GNPAs) of 7.8% and net NPAs (NNPAs) of 3.5% as on March 31, 2022. Fincare's standard restructured advances are also estimated at 1.8% of its AUM as on March 31, 2022. ICRA estimates that the bank has borne a significant part of the pandemic-related credit costs because of the pandemic and is expected to witness an improvement in its profitability metrics in FY2023; ICRA will continue to monitor the same.

While the bank has been scaling up its newer products like affordable housing loans (AHL), loan against property (LAP), loan against gold (LAG), etc., the microfinance segment continues to account for a large share of its portfolio (78% as on December 31, 2021; 80% as on March 31, 2021) exposing it to the risks associated with unsecured lending. The rating also continues to factor in the political and operational risks associated with microlending, and the marginal profile of the borrowers, which may lead to high volatility in the asset quality indicators. Going forward, Fincare's ability to improve its asset quality indicators, further diversify the asset mix and increase the share of CASA in the deposit profile while scaling up its operations will be important from a credit perspective.

The Stable outlook reflects ICRA's expectation that the bank would continue to maintain its credit profile over the medium term and would see an improvement in its profitability aided by the experienced management team, strong capitalisation profile, healthy traction in deposits and financial flexibility.

In compliance with the circular [SEBI/HO/MIRSD/MIRSD_CRADT/P/CIR/2021/594] issued by the Securities and Exchange Board of India (SEBI) on July 16, 2021 and the subsequent circular (SEBI/HO/MIRSD/MIRSD_CRADT /P/CIR/2022/43) of April 1, 2022, for standardising the rating scales used by credit rating agencies, ICRA has discontinued the medium-term rating scale which was being used to assign ratings to the fixed deposit programmes of entities.

Accordingly, ICRA has migrated the rating currently outstanding for Fincare's fixed deposit programme from the medium-term rating scale to the long-term rating scale. The medium-term rating scale of ICRA was a 14-point scale, while the long-term rating scale is a 20-point scale. The migration of the rating has resulted in a change in the rating symbol; however, this is to be construed only as a recalibration of the rating from one scale to another and not as a reflection of a change in the credit risk of the fixed deposit programme.

Key rating drivers and their description

Credit strengths

Diversified funding mix with good traction in deposit mobilisation – Fincare has been successful in building a large deposit base comprising ~78% of its total borrowings as on December 31, 2021. Further, ~15% of the funding was sourced through financial institutions (FIs) including NABARD, SIDBI, MUDRA and National Housing Bank (NHB). Consequently, the cost of funds has been declining over the years and was 7.1% in FY2022 against 8.6% in FY2021.

Fincare has been able to build its deposit franchise and a gradual increase in the share of CASA in total deposits is visible. As on December 31, 2021, CASA formed ~34% of the total deposit profile against ~24% in March 2021. While the bank builds a stable retail deposit franchise, lines from FIs are likely to support its funding requirement during the interim period.

Strong liquidity position and financial flexibility – The bank's liquidity profile is supported by its enhanced borrowing ability on account of its 'scheduled' status and the large portion of relatively shorter-tenor assets. The liquidity coverage ratio was healthy at 309% as on May 6, 2022 and 222% as on March 25, 2022. The bank's structural liquidity statement (SLS) as on March 31, 2022 did not have any cumulative mismatches for a period of one year, even under the stressed scenario of 90% collection efficiency on advances. The liquidity profile is also supported by the availability of lines from FIs.

Comfortable capitalisation profile for near-term growth requirements – The bank's capital adequacy ratio of 22.3% as on March 31, 2022 was well above the regulatory requirement of 15.00%. The net worth, in relation to the AUM, stood at ~16% as on March 31, 2022, marginally lower than ~17% as on March 31, 2021. Fincare has SEBI's approval to launch its initial public offer (IPO) to raise around Rs. 330 crore of primary equity capital (and Rs. 1,000 crore through offer for sale (OFS)); this would help bolster Fincare's capitalisation profile while supporting its growth plans.

Experienced board and professional management team; adequate portfolio monitoring system – As on May 31, 2022, Fincare's board comprised 11 members, including five independent directors. The bank has a strong senior-and-mid-level management with average work experience of around 30 years. 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 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 updates and report generation, allows the proactive assessment of risk.

Credit challenges

Deterioration in asset quality on account of the pandemic; performance remains monitorable – The bank's GNPA's increased to 8.9% on December 31, 2021 but declined to 7.8% as on March 31, 2022 (6.4% as on March 31, 2021) largely on account of the write-offs in Q4 FY2022. The NNPAs stood at 3.5% as on March 31, 2022 (2.8% as on March 31, 2021), with a provision coverage ratio (PCR) of ~56% on the GNPA's in March 2022 against ~58% in March 2021. Fincare also has a standard restructured book of 1.8% (estimated) of its AUM as on March 31, 2022. On an overall basis, the book under stress stands at 9.6% (GNPA's + standard restructured book). The performance of this book and recovery from the same would remain monitorable.

The bank's ability to make meaningful recoveries from its stressed book and arrest further slippages while growing its book would remain critical from a rating perspective, going forward.

Subdued profitability owing to higher credit costs and lower margins – The bank's profitability indicators remained subdued in FY2022 as in FY2021 because of higher credit costs, operating expenses and lower net interest margin (NIM). Credit costs, with respect to average managed assets (AMA), remained elevated at 4.2% in FY2022 (2.6% in FY2021) due to the deterioration in the asset quality on account of the second wave of the pandemic. Further, NIM/AMA declined to 8.7% in FY2022 from 9.2% in FY2021 primarily on account of the reversal of interest income on the elevated GNPA's.

The bank reported a net profit of Rs. 9 crore in FY2022, translating into a return of 0.1% on AMA and 0.8% on average net worth compared to a net profit of Rs. 113 crore in FY2021, translating into a return of 1.4% on AMA and 11.8% on average net worth (Rs. 143 crore, 2.3% and 18.3%, respectively, in FY2020). Fincare's ability to control slippages and credit costs and improve the margin would be important from a profitability perspective.

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 (78% as on December 31, 2021), the portfolio remains vulnerable to asset quality shocks as witnessed after demonetisation and during the pandemic. The rating factors 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 its operations would be key for managing high growth rates.

Liquidity position: Strong

The liquidity coverage ratio was healthy at 309% as on May 6, 2022. The bank's SLS (provisional), as on March 31, 2022, did not have negative cumulative mismatches for any bucket for up to one year, even under the stressed scenario of 90% collection efficiency on advances. As on March 31, 2022, Fincare was carrying on-book liquidity (including mandatory investments) of Rs. 2,570 crore. The bank's liquidity profile is supported by its enhanced borrowing ability on account of its 'scheduled' status and the large portion of relatively shorter-tenor assets. The liquidity profile is also supported by the availability of lines from FIs.

Rating sensitivities

Positive factors – 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 maintaining a prudent capitalisation profile and improving its asset quality.

Negative factors – Pressure on the bank's rating could arise if it is unable to improve its profitability metrics in the near term. A deterioration in the capitalisation profile or the weakening of the liquidity profile could also exert pressure on the rating.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Rating Methodology for Banks Rating Methodology for Non-Banking Finance Companies (NBFCs) Migration of Ratings to the Long-Term Rating Scale from the Medium-Term Rating Scale
Parent/Group Support	Not Applicable
Consolidation/Standalone	Standalone

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), a private equity fund, funded FFSPL and Disha.

FFSPL's operations were adversely impacted during the Andhra Pradesh microfinance crisis and FFSPL along with Disha came under the brand name, Fincare. 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 the merger of FFSPL with Fincare Business Services Limited, which is the holding company, while Disha Microfin converted into Fincare Small Finance Bank Limited. Fincare received scheduled bank status in 2019.

As on March 31, 2022, Fincare had operations in 17 states and Union Territories spanning 251 districts through 919 branches serving a customer base of 25.4 lakh. In FY2022, Fincare reported a net profit of Rs. 9 crore on an AUM of Rs. 7,599 crore as on March 31, 2022 against a net profit of Rs. 113 crore in FY2021 on an AUM of Rs. 6,072 crore as on March 31, 2021.

Key financial indicators (audited)

Fincare Small Finance Bank Limited	FY2020	FY2021	FY2022
Accounting as per	IGAAP	IGAAP	IGAAP
Net interest income	587	701	875
Profit before tax	203	146	6
Profit after tax	143	113	9
Gross advances (Rs. crore)	4,841	5,490	7,346
Total managed assets (Rs. crore)	7,643	8,754	11,415
% Tier I	23.5%	24.9%	NA
% CRAR	29.3%	29.6%	22.3%
% Net interest margin/ AMA	9.3%	9.2%	8.7%
% PAT / AMA	2.3%	1.4%	0.1%
% Return on net worth	18.3%	11.8%	0.8%
% Gross NPAs	0.9%	6.4%	7.8%
% Net NPAs	0.4%	2.8%	3.5%
% Provision coverage excl. technical write-offs	55.8%	58.0%	56.4%

% Net NPA/ Net worth	2.2%	14.6%	20.8%
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Note: Amount in Rs. crore; All calculations are as per ICRA Research

Source: Fincare, ICRA Research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Chronology of Rating History for the Past 3 Years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Dec 31, 2021 (Rs. crore)	Date & Rating	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020	
					Jun 14, 2022	Jul 26, 2021	Aug 04, 2020	Oct 03, 2019	
1	Bank lines (Long term – Term loan)	Long term	800	800	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	
2	Bank lines (Long term – Fund based/non-fund based)	Long term	75	75	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	
3	Tier-II Bonds	Long term	100	100	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	
4	Fixed deposit	Long term	50	NA	[ICRA]A (Stable)	MA+ (Stable)	MA+ (Stable)	MA+ (Stable)	

Complexity level of the rated instruments

Instrument	Complexity Indicator
Bank lines (Long term – Term loan)	Simple
Bank lines (Long term – Fund based/non-fund based)	Simple
Tier-II Bonds	Highly complex
Fixed deposit	Very simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
INE519Q08152	Tier-II Bonds	Sep-30-2019	12.87%	Sep-30-2025	100.00	[ICRA]A (Stable)
NA	Bank lines (Long term – Term loan)	Aug-16 to Oct-21	5.50-11.50%	Jul-21 to Feb-26	679.98	[ICRA]A (Stable)
NA	Bank lines (Long term – Fund based/non-fund based)				75.00	[ICRA]A (Stable)
NA	Bank lines (Long term – Term loan)	Jul-19 to Mar-20	8.25-9.00%	Oct-21 to Mar-23	120.02	[ICRA]A (Stable)
NA	Fixed Deposits	NA	NA	NA	50.00	[ICRA]A (Stable)

Source: Fincare

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

Corrigendum

Document dated June 14, 2022 has been corrected with revision as detailed below:

On page 1, 5 and 6 nomenclature of rated-instrument has been corrected to “Tier II bonds”.

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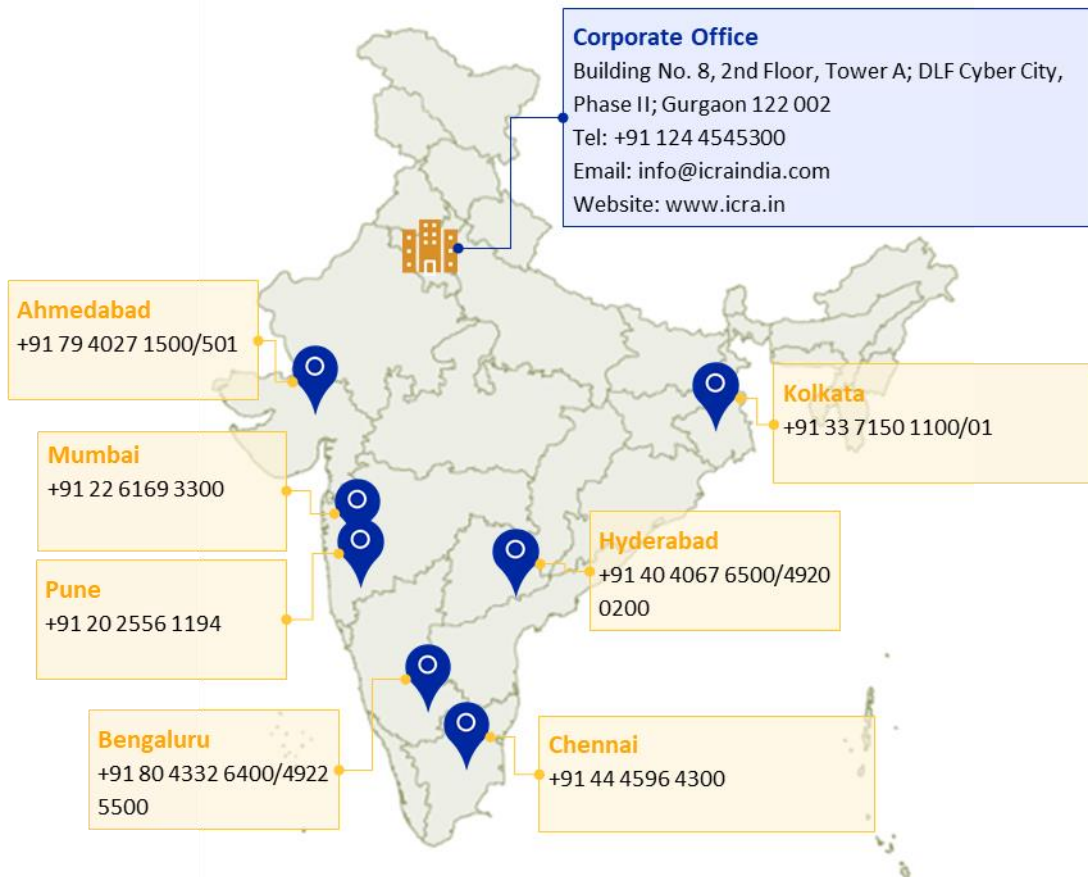
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