Ujjivan Small Finance Bank Ltd.

Issue Snapshot:

Issue Open: December 02 – December 04, 2019

Price Band: Rs. 36 –37 (Discount of Rs 2 per share for eligible UFSL shareholders bidding in shareholders' reservation portion)

Issue Size: 202,702,703 eq shares *
(Inculding UFSL shareholder reservation)

Issue Size: Rs. 750.0 crs

QIB	atleast 75% eq sh
Non Institutional	upto 15% eq sh
Retail	upto 10% eq sh

Face Value: Rs 10

Book value: Rs 13.84 (Sept 30, 2019)

Bid size: - 400 equity shares and in multiples thereof

100% Book built Issue

Capital Structure:

Pre Issue Equity:	Rs. 1525.5 cr
Post issue Equity:	Rs. 1728.2 cr

Listing: BSE & NSE

Book Running Lead Manager: Kotak Mahindra Capital Company Limited, IIFL Securities Limited, JM Financial Limited

Registrar to issue: Karvy Fintech Private Limited

Shareholding Pattern

Shareholding Pattern	Pre issue %	Post issue %
Promoter and Promoter Group	94.40	83.32
Public & Employee	5.60	16.68
Total	100.0	100.0

Source for this Note: RHP
*= assuming pricing at higher end of band

Background & Operations:

Ujjivan Small Finance Bank Ltd is a mass market focused SFB in India, catering to unserved and underserved segments and committed to building financial inclusion in the country. Its Promoter, Ujjivan Financial Servces Ltd (UFSL) commenced operations as an NBFC in 2005 with the mission to provide a full range of financial services to the 'economically active poor' who were not adequately served by financial institutions. UFSL's erstwhile business was primarily based on the joint liability group-lending model for providing collateral-free, small ticket-size loans to economically active poor women. Among the leading SFBs in India, Ujjivan Bank had the most diversified portfolio, spread across 24 states and union territories as of March 31, 2019 (*Source: CRISIL Report*). As of September 30, 2019, it served 4.94 million customers and operated from 552 Banking Outlets that included 141 Banking Outlets in Unbanked Rural Centres ("**URCs**") (of which seven were business correspondent centres) and additionally operated four Asset Centres. In Fiscal 2019 alone, it operationalized 287 Banking Outlets. As of September 30, 2019, it had a network of 441 ATMs (including 18 ACRs), two 24/7 phone banking units based in Bengaluru and Pune that service customers in 11 languages, and a mobile banking application that is accessible in five languages as well as internet banking facility for individual and corporate customers.

Its portfolio of products and services includes various asset and liability products and services. Its asset products comprise: (i) loans to its micro banking customers that include group loans and individual loans, (ii) agriculture and allied loans, (iii) MSE loans, (iv) affordable housing loans, (v) financial institutions group loans, (vi) personal loans, and (vii) vehicle loans. On the liability side, it offers savings accounts, current accounts and a variety of deposit accounts. In addition, it also provide non-credit offerings comprising ATM-cum-debit cards, Aadhaar enrolment services, distribute third party insurance products and point of sales ("**POS**") terminals. It offers its customers with various digital platforms including internet banking, mobile banking, SMS banking, bill payments, biometric ATMs and RuPay Platinum debit cards. It has a tablet-based loan origination system for both group and individual loans to bring down loan origination turn-around time for its customers. The credit processing for these loans is also digitised and an automated collection receipt system has also been launched to enable seamless collection from customers. USFBL's customers are also able to register savings bank accounts on UPI based mobile applications. It also provides customers the ability to repay loans in a cashless manner through digital wallets and payment gateways. It also has a robust back-end operating system supported by its core banking system, customer relationship management system and document management system.

USFBL has grown in a sustainable manner. Its Gross Advances (including securitization/ IBPC) has grown from Rs 63,839.77 million as of March 31, 2017 to Rs 110,485.91 million as of March 31, 2019 and were Rs 128,636.45 million as of September 30, 2019. Its deposits has increased from Rs 2,064.05 million as of March 31, 2017 to Rs 73,794.40 million as of March 31, 2019 and were Rs 101,298.49 million as of September 30, 2019. As of September 30, 2019, its percentage of gross NPAs to gross advances was 0.85% while its percentage of net NPAs to Net Advances was 0.33%. Its profit after tax as restated for Fiscal 2018 and 2019 was Rs 68.63 million and Rs 1,992.18 million, respectively while for the six months ended September 30, 2019, its profit after tax as restated was Rs 1,871.10 million.

Objects of Issue:

USFBL proposes to utilize the Net Proceeds from the Issue towards augmenting its Bank's Tier – 1 capital base to meet Bank's future capital requirements. Further, the proceeds from the Issue will also be used towards meeting the expenses in relation to the Issue. USFBL expects to receive the benefits of listing the Equity Shares on the Stock Exchanges.

Competitive Strengths

Deep understanding of mass market serving unserved and underserved segments: USFBL is an SFB providing a variety of banking services in mass market customer segments with a focus on serving the financially unserved and underserved segments in India. A large section of the Indian population lacks access to formal banking services or is served by informal providers. Its SFB operations are focused on serving the financially unserved and underserved segments in India. As of September 30, 2019, it operated 235 Banking Outlets located in 107 districts classified by the RBI as under-banked districts as per the Census 2011. In addition, its focus on the financially unserved and underserved segments enables it to comply with RBI's requirements that: (i) small finance banks locate at least 25% of their banking outlets in URCs, and (ii) at least 75% of adjusted net bank credit ("**ANBC**") be made to "priority sectors", which includes micro loans and were able to comply with such guidelines within the first year of its operations. USFBL undertakes constant research on various segments within the mass market to understand the financing requirements of potential customers and accordingly, are able to customize and develop products and services to address their needs. For instance, it has introduced a differentiated current account product for traders, overdraft facility for MSEs, loans for agriculture and allied activities, corporate internet banking for non-individual customers with current accounts and fund transfers in an open loop system through UPI.

Customer centric organization with multiple delivery channels: USFBL served 4.94 million customers as of September 30, 2019, and consider its customers to be the most significant stakeholder at the core of its operations. Customers prefer one source for multiple financial products and services and that its spectrum of products and services and allocating each customer with a relationship officer helps in customer acquisition and retention. It launched "Sampoorna Banking" in April 2019 that extends full banking services including education loans, vehicle loans, deposits, funds transfer facilities and distribution of insurance to families of its existing micro banking customers. On the liability side, it offers a variety of demand deposits and other services so that its customers can realise their savings goals. Customer satisfaction scores of its Banking Outlets has improved from 77.11% in Fiscal 2018 to 78.53% in Fiscal 2019. Besides Banking Outlets and Asset Centres, its delivery channels also include ATMs, ACRs, mobile and internet banking services. As of September 30, 2019, it had a network of 441 ATMs that accept RuPay, Visa and MasterCard. As of September 30, 2019, its two 24/7 phone banking units based in Bengaluru and Pune service customers in 11 languages while its mobile banking application is accessible in five languages. USFBL offers 'missed call' and SMS banking services.

Pan-India presence: As of March 31, 2019, USFBL was among the leading SFBs in terms of branch count and geographical spread across India. As of September 30, 2019 it was present in 24 states and union territories encompassing 232 districts in India. As of September 30, 2019, it operated from 552 Banking Outlets that included 141 Banking Outlets in URCs (of which seven were business correspondent centres) and additionally operated four Asset Centres. Its diversified operations also allow to de-risk its business by mitigating political and state-specific risks. As of September 30, 2019, it operated 131, 167, 173 and 81 Banking Outlets (including in URCs) in the North, South, East and West regions, respectively. In Fiscal 2019 alone, it operationalized 287 Banking Outlets. Its operations are well-diversified and in Fiscal 2019, no single state constituted more than 18.00% of its overall loan portfolio. As a result of USFBL's geographic spread, it has been able to reduce its concentration risk and diversify its loan portfolio. The penetration of its distribution network has enabled it to develop the expertise to understand and differentiate customers on the basis of their specific requirements. Its established distribution network and relationships with its customers allows it to offer them with differentiated and customized products that include micro loans, agriculture and allied loans, MSE loans, financial institutions group loans, personal loans, housing finance and vehicle finance. It also distribute third party insurance products from various insurance companies to its customers. Its diversified operations and understanding of customers' requirements has enabled to establish a strong liability franchise.

Technology driven operating model with advanced digital platform: USFBL's leverage technology to serve its customers better, identify opportunities, deliver innovative products and services and advance on its goal of facilitating financial inclusion in India. It manage the entire life cycle of its customers' banking transactions, from onboarding to customer management, through various technology platforms. Over the years, its use of technology has improved work place engagement and governance, increased the accessibility of products to the customers and enabled to rapidly scale up its operations in a secure and efficient manner. The number of banking transactions through digital channels were 0.60% and 8.31% of its overall transactions in Fiscal 2018 and 2019, respectively and such transactions accounted for 18.29% of its overall transactions in the six months ended September 30, 2019. USFBL aims to encourage and empower customers to conduct their banking operations through digital channels including through internet, phone and mobile banking. With its digital platform, it has enabled paperless and handheld device based loan origination and cashless disbursements for its customers with remittances directly to their accounts. It has an automated backend, supported by a robust core banking system, customer relationship management system, collection management system and document management system that has helped improve efficiency and minimize turn-around time. USFBL continues to leverage technology for underwriting and creating credit models to ascertain credit behaviour of various customer segments to ensure diversification of its product portfolio.

Robust risk management framework: USFBL has an established risk management framework to identify, measure, monitor and manage credit, market, liquidity, IT and operational risks. Its risk management framework is driven actively by its Board through its Risk Management Committee and at the management level by the Asset and Liability and Market Risk Management Committee and Credit Risk Management Committee, Operational Risk Management Committee and the Information Security and Business Continuity Management Committee which are comprised and supported by members of its senior management team. Its Risk Management Committee is responsible for the review of prudential risks while its Credit Risk Management Committee is responsible for overseeing implementation of credit risk management framework across the Bank. It has implemented credit management models such as decentralized loan sanctioning and stringent credit history checks. It continually use technology and data analytics to manage credit risks and its in-house analytics team has developed a credit application scorecard to make informed decisions on lending. USFBL has implemented SaaS for measuring capital adequacy, asset liability management and preventing money laundering. Its credit risk monitoring policies seeks to monitor and control performance of both its loan assets at account and portfolio levels, with account monitoring designed to identify and facilitate corrective action for weak accounts, and portfolio monitoring aimed at identifying credit stress in specific sectors and geographies. Its risk management framework has been recognized and it has been awarded 'Best IT Risk Management and Cyber Security Initiative' under the small bank category at Indian Banks' Association at the Banking Technology Conference, Expo and Awards in 2019 and were awarded 'ERM Strategy of the Year' award at the ERM World Summit and Awards 2019 by RSA.

Strong track record of financial performance: USFBL has maintained strong growth credentials since its inception through high rates of customer retention, geographical expansion, operationalization of Banking Outlets, improved productivity, lower credit cost and growth in customer base. Its operational efficiencies, low turn-around time and network of Banking Outlets has resulted in the rise in profitability. Gross Advances (including securitization/ IBPC) have grown from Rs 63,839.77 million as of March 31, 2017 to Rs 110,485.91 million as of March 31, 2019 and were Rs 128,636.45 million as of September 30, 2019. Of its Gross Advances (including securitization/ IBPC), secured advances constituted 1.83% as of March 31, 2017 and increased to 13.59% as of March 31, 2019 and further increased to 19.39% as of September 30, 2019. Net Interest Income in Fiscal 2018 and 2019 was Rs 8,610.11 million and Rs 11,064.11 million, respectively, and was Rs 7,404.21 million in the six months ended September 30, 2019. It's Net Interest Margins in Fiscal 2018 and 2019 were 10.31% and 10.93%, respectively, and was 10.64% in the six months ended September 30, 2019. USFBL has grown in a sustainable manner and accordingly has been able to maintain its asset quality. USFBL was ranked second in terms of provision coverage ratio among the small finance banks in India, as of March 31, 2019. Its profit after tax for Fiscal 2018 and 2019 was Rs 68.63 million and Rs 1,992.18 million, respectively and was Rs 1,871.10 million in the six months ended September 30, 2019. As a result of its performance, its return on average assets and return on average equity was 1.72% and 11.49%, respectively, as of and for the year ended March 31, 2019 and was 2.51% and 19.57%, respectively, as of and for the six months ended September 30, 2019. USFBL was ranked fourth among the small finance banks in India as of March 31, 2019.

Professional management, experienced leadership with focus on employee welfare: USFBL is professionally managed and its senior management team has a diversified track record in the financial services industry. Its Board consists of Directors with a diverse mix of experience in various sectors, in particular, the financial services industry and technology. the experience of its independent Directors, who constitute a majority of its Board, ensures transparency and accountability in its operations while the heads of functional groups, such as finance, financial planning and analysis, risk and human resources, enhance the quality of its management with their specific and extensive industry experience. As a performance driven organization, USFBL has undertaken a number of measures towards employee welfare, including introduction of specific programmes to address role specific regulatory requirements and build a culture of governance. SWAYAM, its learning application, was introduced in October 2018, which allowed its foray into technology-enabled, self-paced learning. Employees are educated on products, processes, compliance and basic banking knowledge with the help of SWAYAM across all regions.

Business Strategy:

Diversify product offerings to enable multiple customer relationships: USFBL's endeavour is to be a one-stop-shop for financial services, delivering quality products and solutions, along with a personalized customer experience to a diversified customer base. It intends to develop and offer a comprehensive suite of asset and liability products that will help it to attract new customers and deepen its relationship with its existing customer base. USFBL also intends to expand its range of third party products and services in order to serve its customers better. Currently, its group loan customers with positive repayment track record graduate to becoming individual loan customers. It proposes to capitalize on this trend by increasing the penetration of its individual loan products, and by innovating and designing need-specific products and services. In order to help its customers to meet their housing needs, USFBL has an affordable housing finance program with products ranging from small ticket size home improvement loan to larger loans for purchase of ready housing units. It intends to collaborate with State Housing Boards for properties built by them for providing housing loans to the beneficiaries of such housing projects, as well as online aggregators to reach out to a larger potential customer base. In addition to the various loan products and the deposit products that it offers, it intends to expand its range of third party products and services such as life insurance, general insurance, cash management, POS terminals, debit cards and fee collection solutions for educational institutions. By expanding its range of products and services and by using multiple delivery channels, it endeavours to meet the financial needs of its customers and will be able to develop a stronger relationship with them.

Continue to focus on technology and data analytics to grow operations: The optimum use of advanced, cost-effective technology has significantly driven USFBL's operations, and going forward, it intends to strategically invest its resources for further integration of technology into its operations. By furthering USFBL's digital and technology platform, its endeavour is to empower the customers to access various products and services on their own, reduce its operating costs and increase efficiencies. It intends to automate the operational processes by adopting robotic processes in order to become faster and efficient. It is currently exploring the use of robotic process automation technology for reconciliation of ATMs and UPI transactions. It intends to work further on developing various digital platforms in order to establish ourselves as a modern technology enabled bank. Going forward, it intends to work with fintech companies for programmes focused at specific customer segments. It intends to move from person-to-person services to providing technology assisted services using handheld devices and phone banking services to entirely self-service model through the use internet and mobile banking. USFBL intends to facilitate this with establishment of digital and neo banking services, where full range of financial services are available. Its Board currently comprises Independent Directors with significant experience in the technology space which it believes is critical to achieving its mission of creating a technology focused mass market bank.

Strengthen liability franchise and focus on increasing retail base: Currently USFBL has a strong customer base and as of September 30, 2019, it served 4.94 million customers. It intends to strengthen its liability franchise with a focus on growing its retail deposit base to provide it with a stable, low-cost source of funding. It intends to further expand its retail deposit base through measured expansion of its Banking Outlets and offer digital savings and deposit products through internet and mobile banking to acquire new customers and also providing its existing customers with a convenient banking experience to meet the needs of their particular demographics. This shift will enable it to access diversified, short term, low cost funds. Since becoming a scheduled commercial bank in July 2017, USFBL also has focused on increasing its institutional deposit base. It has identified the key retail and institutional customer segments and put together a range of saving accounts, current accounts, recurring and fixed deposits along with services such as bill pay, UPI based money transfer, e-NACH, cash management and POS terminals. It offers a variety of debit and ATM cards to its customers and also make banking services available through its mobile banking application and internet banking platform. In addition to expanding its Banking Outlet network, it also intends to develop products and services designed for its rural and urban mass retail customers, specifically digital savings products for younger customers who has entered or are entering into banking channels, as well as by continuing to actively promote its accounts and deposits. It will focus on mass acquisition of deposit customers through programs such as corporate salary accounts in order to grow its customer base. It intends to launch additional products and services designed for non-resident Indians and introduce foreign currency remittances, in order to increase its business with the Indian diaspora.

Expand distribution network to increase customer penetration*:* USFBL intends to expand its Banking Outlets and infrastructure by focusing on rural and semi-urban areas. These areas represent a significant opportunity for its continued growth as it expand banking services to those areas which has traditionally been underserved. It intends to operationalize additional Banking Outlets, convert its existing Asset Centres to Banking Outlets, expand its ATM network and business correspondent agent network to grow its advances and deposits. It also intends to deploy ACRs for the convenience of its customers. While USFBL will selectively open additional Banking Outlets, it also intends to strengthen its alternate delivery channels and increase their adoption by encouraging customers to move from less cash to a cashless environment. Its focus will be to target new-to-bank customers through its digital acquisition channels such as mobile banking platforms and offer them digital banking products. It also intends to explore strategic partnerships with fintech companies to increase customer acquisition, lower processing and on-boarding costs, reduce turnaround time and improve overall customer experience. Its plan is to use the right combination of physical and digital channels and partnerships to expand its reach and deliver value to its customers.

Focus on developing responsible banking behavior for unserved and underserved segments: Basic education on financial products and services can help individuals and MSEs access the right financial solutions and develop better financial behaviour. USFBL's focus will continue to remain on serving the unserved and underserved segments to build responsible banking behavior by educating potential customers and increasing financial literacy. The experience of its Promoter, UFSL, in the microfinance industry provides it with a deep understanding of the needs and behaviour of mass market customers. It has helped USFBL to understand the complexities of lending to the financially unserved and underserved segments in India. It intends to continue to train and educate its customers to ensure avoidance of over-indebtedness and multiple borrowing, and the benefits of putting their savings in a bank apart from the use of insurance products for risk mitigation. A majority of USFBL's customers still use cash for their transactions and the adoption of digital banking and payment gateways is minimal. It intends to take a number of initiatives to promote the use of bank accounts, UPI and digital payment gateways among such customers. These initiatives will help to reduce its cost of operation and increase the usage of its products and services by its existing customers as well as help USFBL to acquire more customers.

Diversify revenue streams: An important strategic focus for USFBL is to diversify its fee and non-fund based revenues. It intends to leverage on its Banking Outlet network, digital channels and its increasingly diversified product and service portfolio to develop fee and commission-based business. For MSE customers, USFBL aims to market fee and non-fund based products such as letters of credit, bank guarantees, foreign exchange remittance services and third-party insurance products. It also intends to offer POS terminals to MSE customers in partnership with third party providers. For its retail customers, it intends to follow a relationship based approach by providing and expanding its third-party product offerings including insurance products, mutual funds, wealth management services, money transfer and foreign exchange services. It intends to pursue strategic relationships with corporate entities and the GoI and state governments to provide its products to their employees and customers. It intends to grow its income from fee-based services by introducing new products and services and by cross-selling its offerings to its existing customers. The inherent nature of USFBL's assets business gives it an opportunity to build priority sector advances in surplus of the targets mandated by the RBI.

Industry

Small Finance Banking Industry
In order to promote financial inclusion, the Indian banking industry has seen several changes in recent years. NBFCs such as, Bandhan and IDFC, received permission to set up universal banks. Further, a few microfinance companies, local area banks and NBFCs have received permission to set up SFBs. SFBs are allowed to take deposits, which provide them an edge of having lower cost of funds in comparison with NBFCs. MFIs turned into SFBs are now diversifying their advances mix, and focusing on other retail and corporate lending business.

Evolution of SFBs
Despite various measures taken by the Government to increase financial penetration in India, a significant percentage of India's population does not have access to basic financial services. In 2013, the RBI constituted a committee that recommended differential licensing in the form of payment bank and SFB. Accordingly, on November 27, 2014, the RBI released guidelines for a new class of banking entity, 'small finance banks', to cater to the diverse needs of the low income group. Further, on September 16, 2015, the RBI awarded SFB licenses to 10 players on account of the Government's focus towards financial inclusion and inclusive banking. Out of the 10 SFBs, there were eight microfinance players, one local area bank and one NBFC. The objective of SFB's is to extend banking services to the underserved and unserved population through savings instruments, and providing credit to small business units, small and marginal farmers, micro and small industries, and other unorganized sector.

The operations of SFBs is technologically driven in order to reduce the cost of operations and also ensure faster reach to the untapped market. According to World Bank's Global Findex Database 2017, India's financial inclusion level has improved significantly with the adult population's bank accounts rising from 53% in 2014 to 80% in 2017 on account of various Government initiatives, institution support and increase in usage of mobile phones as a medium for distributing financial services. As per CRISIL Inclusix, the index that measures the financial inclusion across 666 districts in India, reported a financial inclusion score of 58.0 in Fiscal 2016, having increased from a score of 50.1 and 35.4 in 2013 and 2009, respectively. The overall improvement of the financial inclusion score is primarily driven the 'JAM' trinity, *i.e. Jan Dhan Yojana*, *Aadhaar* and mobile. Technology improvements help in financial penetration, however, the primary challenge for SFBs is still the ability to generate low cost deposits. While there exists a significant opportunity, SFBs will need to innovative further in terms of introducing customized and flexible offerings to target the untapped market and move toward becoming universal banks.

Growth drivers
Sizeable market opportunity and credit at affordable rates
Due to the size of India's population and the lack of formal banking services for a significant section of India's population, driving financial inclusion has been a key priority for the Government. The banking system and PSL have been the most popular channels to bring the majority of India's population under formal credit institutions. Financial inclusion is a comprehensive exercise that constitutes several products and services, such as provision bank accounts, insurance facilities, payment and remittance mechanisms, financial counselling and affordable credit. Further, various initiatives have been undertaken by the Government, which have been implemented by NABARD and through entities such as regional rural banks, cooperatives and commercial banks. In addition, in 1970s, such lending institutions achieved significant reach and increasing number of individuals did avail of credit facilities. However, major delinquencies in repayment severely impaired the financial health of such lending institutions and entities. Further, despite the rapid expansion in the scale of the institutions, several households continued to face difficulties in accessing credit facilities. Within the large range of products and services under financial inclusion, such players have a major role to play in the provision of credit. The key growth drivers for SFB include the size of the India market in terms of financially unserved and underserved households and a business model that offers sustainable credit to the poor at affordable rates.

Customized products aided by technology and better availability of information

Increase in the use of technology has enabled lenders to provide customized product offerings to their target customer segments at much lower turnaround times. Further, availability of multiple data points facilitates lending decisions by firms within a few minutes by using data-driven automated lending models. These models help in the supply of credit to small business units and the unorganized sector at low cost. The increase in use of technology is expected to also enable such players in expanding their reach to under penetrated population and areas at a lower operating cost. To support the high volume business and to meet security and compliance requirements of different regulatory authorities, SFBs require strong and secure systems at the core. Further, various SFBs have tied up with the large IT companies in order to improve their IT infrastructure.

Availability of funds at cheaper rates

The ability to accept deposits through CASA and other retail deposits would provide SFBs cheap source of funding which would help them in competing with the NBFCs. Further, with the low cost of funds, SFBs would aim to expand their product portfolio and provide competitive rates in the market. In addition, with further expansion of SFBs in the underserved regions, the deposit base is expected to further increase and will help in expanding their asset side portfolio. Accordingly, SFBs will hold an advantage over NBFCs.

Target audience

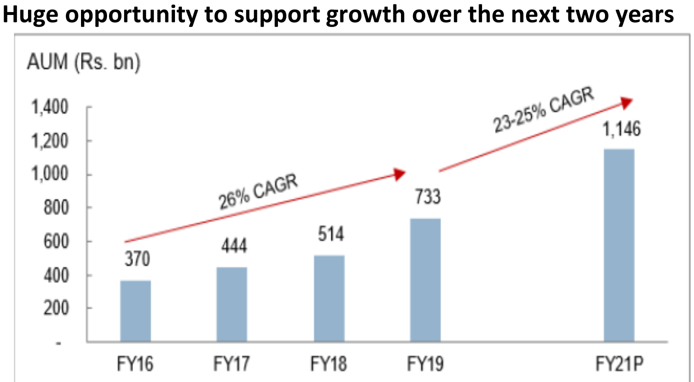
SFB's aim to cater to the low-income segment and have an opportunity to offer them with various products and services. Further, deeper penetration of SFBs into semi-urban and rural areas will help them to cater unserved and underserved rural population and with competitive advantage in relation to cost of funds in comparison with the local NBFCs, SFBs will be considered as the most suitable choice among mass population having requirements of lower ticket size loans. In addition, the knowledge of local areas enables SFBs to understand the needs of the customers better.

Further, unlike NBFCs which expand horizontally with special focus product, SFBs have the chance to expand vertically and deep which will enable them to have a good range of medium and low value customers and as a result, help in increasing their business. In addition, factors, such as, lack of awareness of financial services, illiteracy and poverty will result in a challenge for SFBs from the demand side. Further, the SFB will have to face the challenges of building trust in the minds of relatively lower income segments in order to compete with the public sector banks. Although SFBs will fare better in terms of product and service quality due to their focused approach, SFBs will have to create convenient touch points to initiate customers into saving regularly and also invest in human capital to equip their staff into mobilizing savings.

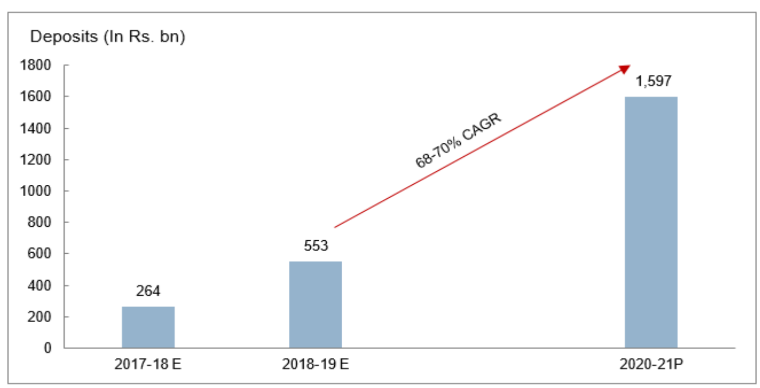
South India is one of the regions that had the highest literacy rate and which is reinforced by the region's leadership in financial penetration in comparison with other regions. Further, as other regions continue to grow and with the Government's focus on rural rejuvenation, there exists a significant potential in east India and north-east India.

Industry growth and outlook

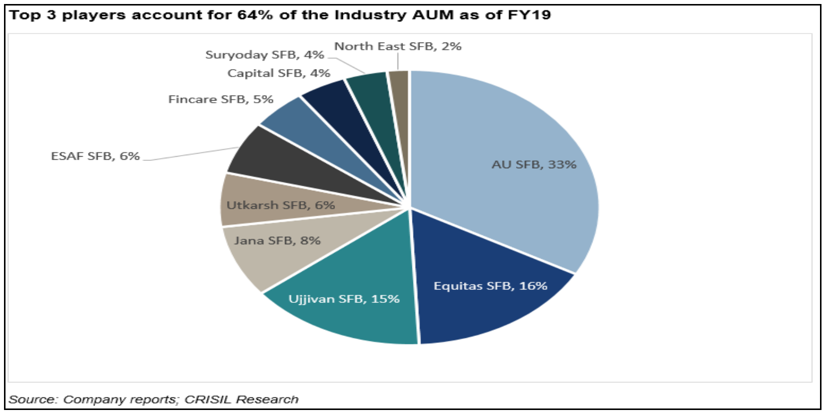
Huge opportunity to support growth over the next two years



Note: 1) Above industry sizing only includes SFBs.
2) For Jana SFB, Utkarsh SFB and Suryoday SFB, advances have been considered.
Source: Company reports, CRISIL Research



Note: 1) Above deposit sizing includes all SFBs, excluding North East SFB.
Source: Company reports, CRISIL Research



SFBs have grown at a CAGR of 26% from Fiscal 2016 to Fiscal 2019, in terms of assets under management (AUM). Top three SFBs accounted for 64% of the total SFB AUM in Fiscal 2019, compared to 53% in Fiscal 2016. These top three SFBs recorded a CAGR of 34% from Fiscal 2016 to Fiscal 2019.

Further, it is expected the loan portfolio of SFBs will grow at a CAGR of approximately 25% in the near term due to support from (i) significant market opportunity especially in the rural segment; (ii) presence of high informal credit channels; (iii) geographic diversification; (iv) ability to understand local markets, (v) access to low cost funds, and (vi) loan recovery and control on NPAs. In the next couple of years, SFBs are expected to focus on gradually building up their banking business and complying with more stringent regulatory norms. On the other hand, access to stable and granular public deposits over the long run will bring down their cost of funds. However, SFBs are expected to face near-term challenges in increasing deposits amid intense competition and maintaining profitability in the initial few years after transformation.

Over the next couple of years, SFBs are expected to focus on gradually building up their banking business and complying with tougher regulatory norms. On the other hand, transformation into SFBs will provide them access to stable and granular public deposits over the long run, which will bring down their cost of funds. However, SFBs are expected to face near-term challenges in increasing deposits amid intense competition and maintaining profitability in the initial few years after transformation.

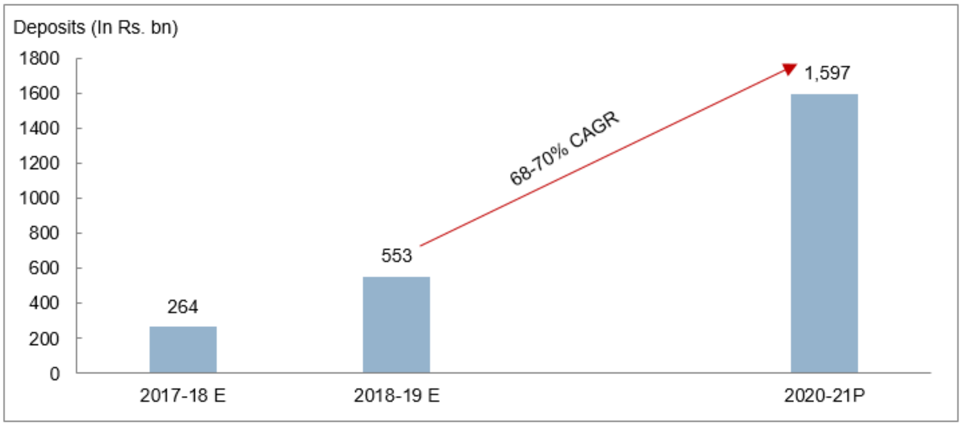
In the last three years, SFB players have shifted their focus from microfinance to other products, but the core customer focus is not likely to change much because of the regulatory norms. Going forward, SFBs will have to focus on small ticket size lending to financially under-served and un-served segments (loans below Rs. 2.5 million will have to form at least 50% of loan book).

Microfinance segment accounted for 39% of overall business of SFBs in Fiscal 2019. The MFIs that converted into SFBs are expected to further diversify and expand their loan book beyond microfinance loans by focusing on allied segment loans such as MSME loans, affordable housing finance, gold loans, commercial vehicle / non-commercial vehicle loans and two-wheeler loans.

SFBs have a sizeable growth opportunity as most of them were functioning as NBFCs/MFIs previously. In the last one year, all SFBs have focused on increasing their deposit base immediately after commencement of their operation. Overall deposit base of SFBs has grown by 109% to around Rs. 555 billion in the Fiscal 2019. However, the CASA deposit has reduced from 24% to 20%.

However, SFBs will face stiff competition from public sector and private sector banks as these banks enjoy high trust among the customers in the rural region. Cost of accepting deposits will also be high in the initial years of operation due to high interest rates offering in order to attract the customers. Also, the average deposit per customer is the rural region is low. In the long run, with customer centric approach, usage of technology, stability of business model, and improved reach it is expected the cost of acquisition and interest paid to come down.

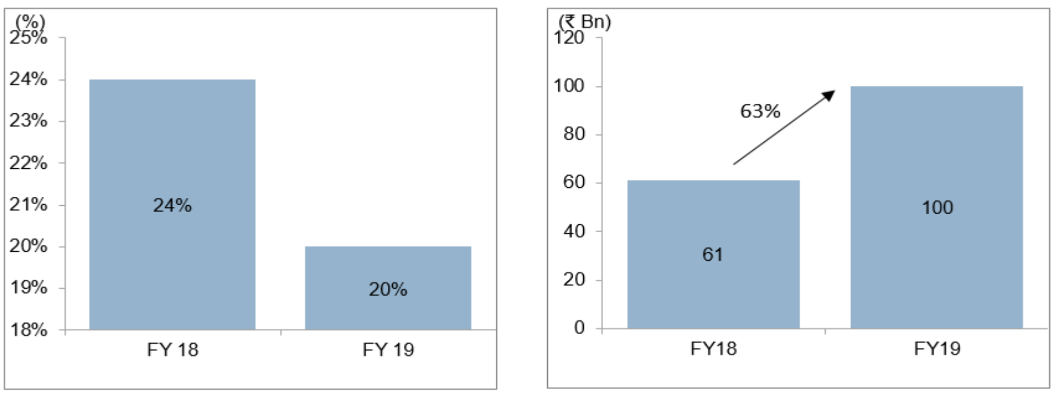
Going forward, deposits are expected to grow at 68-70% CAGR between Fiscal 2019 to Fiscal 2021 as players focus on popularising convenient banking habits so that banking reaches the last mile and enhances financial inclusion. In addition, players are also looking at capital injections not only to grow asset size but also to help them deepen their penetration in untapped geographies by increasing their number of branches/banking outlets.



Note: 1) Above deposit sizing includes all SFBs, excluding North East SFB

Source: Company reports, CRISIL Research

CASA ratio **CASA grew at 63% in FY 2019 (in Rs. Billion)**



Note: 1) Data for CASA includes aggregate of AU SFB, Capital SFB, Equitas SFB, ESAF SFB, Fincare SFB, North East SFB, Suryoday SFB, Utkarsh SFB and Ujjivan SFB

2) CASA ratio is calculated based on overall deposits excluding Certificate of Deposits (CoD).

Source: Company reports, CRISIL Research

Over the next couple of years, SFBs are expected to focus on gradually building up their banking business and complying with tougher regulatory norms. In addition, transformation into SFBs will provide access to stable and granular public deposits over the long run, which will bring down their cost of funds. However, SFBs are expected to face near-term challenges in getting deposits amid intense competition and maintaining profitability in the initial few years after transformation.

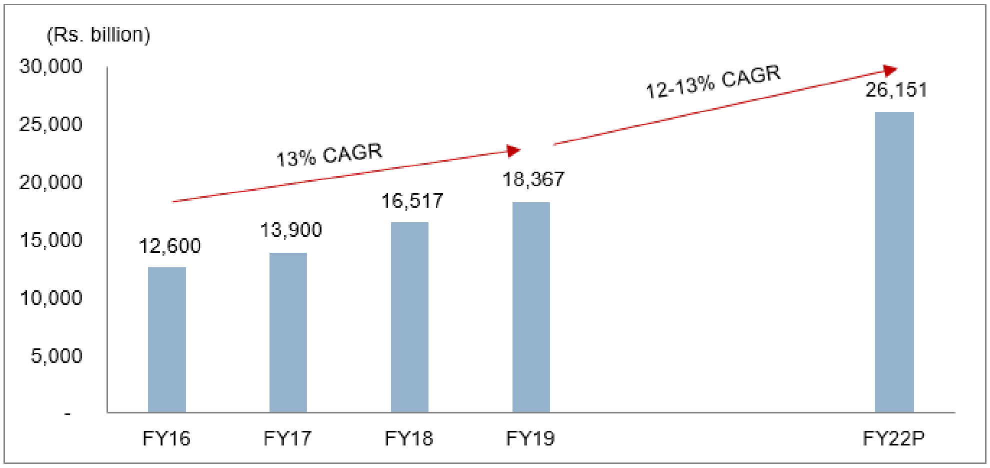
Analysis of Various segments:

MSME Finance

MSME financing market is expected to grow at approximately 12% to 13% until Fiscal 2023 due to definite Government focus and initiatives

MSME financing along with LAP loans that are secured, and other loans, such as, overdrafts and cash credit as well as secured non-LAP loans and unsecured MSME loans, have a significant outstanding amount of approximately Rs. 18 trillion as of March 31, 2019. This outstanding amount grew by 11% year-on-year, and was approximately Rs. 16.5 trillion as of March 31, 2018. To complement this growth, the number of user accounts have grown at a CAGR of approximately 10% from 12.9 million as of March 31, 2018 to 14.3 million as of March 31, 2019. With increased focus on easing the loan process for MSMEs and more focus on reporting transactions and reforms including GST, the lending through formal channels is expected to grow further and accordingly, the loan outstanding amount is expected to reach approximately Rs. 26 trillion as of March 31, 2022.

Structural reforms and better access to credit to drive MSME loan growth

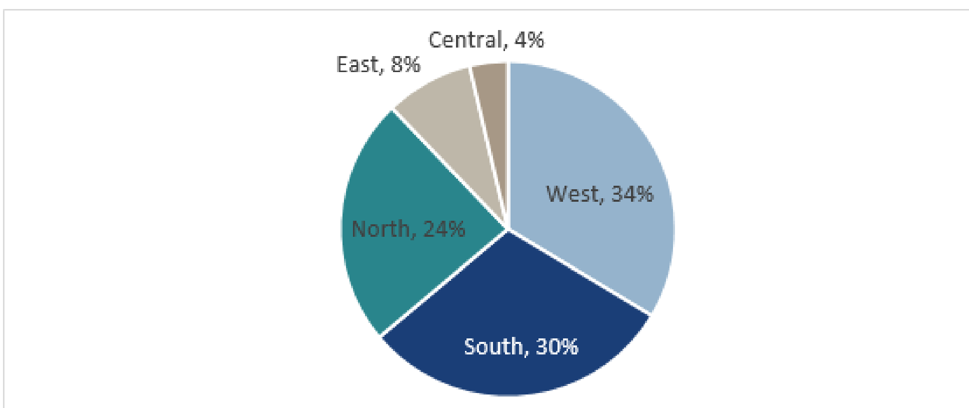


Note: Above industry sizing include MSME and LAP portfolio for banks and NBFCs
Source: CRISIL Research

Region wise split of MSME segment

Eastern and central regions of India are underpenetrated and account for only 12% share, while southern and western regions of India account for approximately two-third of outstanding loans in the MSME segment, primarily due to organised nature of the MSMEs present in these regions.

Western and Southern region account for the lion share in MSME segment



Source: CRISIL Research

Share of NBFCs is expected to increase vis-à-vis banks

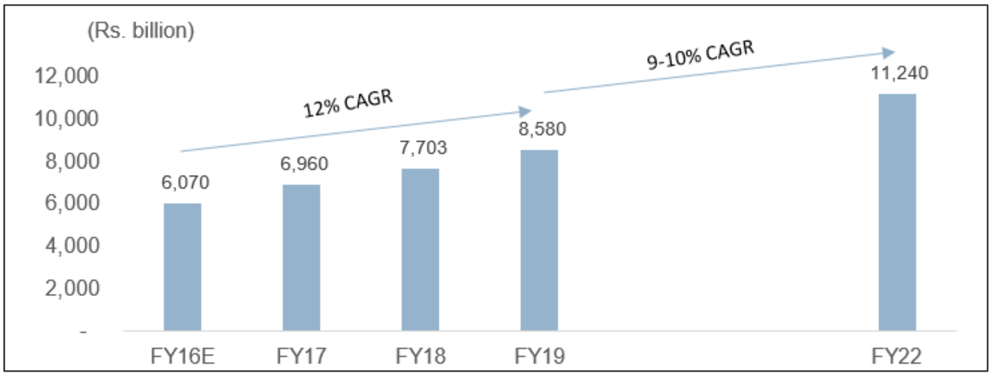
The MSME segment has traditionally been dominated by the public sector banks due to their large presence and the higher addressable customer base. However, their share has been on a constant decline since the last few years. With better means of appraisal, private banks, SFBs, and particularly, NBFCs and HFCs have started focusing more on this segment. While banks still dominate the large ticket size and MSME working capital loans, the LAP segment has been an important segment for NBFCs. Even SFBs are targeting the micro and small segment of borrowers and are direct competitors for NBFCs. However, despite the competition, NBFCs have been able to increase their market share to reach 23% in Fiscal 2019 from 18% in Fiscal 2017. The share of the NBFCs is expected to increase particularly in the unsecured space of MSME lending with solutions being offered to smaller SMEs and targeting of underpenetrated cities along with that of SFBs.

Affordable housing loan (Ticket size < Rs 2.5 million)

Affordable Housing Loan is expected to increase at a CAGR of approximately 9% to 10% till Fiscal 2022

The affordable housing loan segment has grown at a CAGR of 12% from Fiscal 2016 to Fiscal 2019. As of March 31, 2019, the outstanding loans was approximately Rs. 8.5 trillion, having grown from 11% from approximately Rs. 7.7 trillion as of March 31, 2018. The affordable housing loan is further expected to increase by approximately 9% to 10% until Fiscal 2022. Loans with ticket sizes from Rs. 1 million to Rs. 2.5 million are expected to grow faster than the low cost housing finance loans below Rs. 1 million.

Growth to be range bound in the medium term as in the past three fiscals



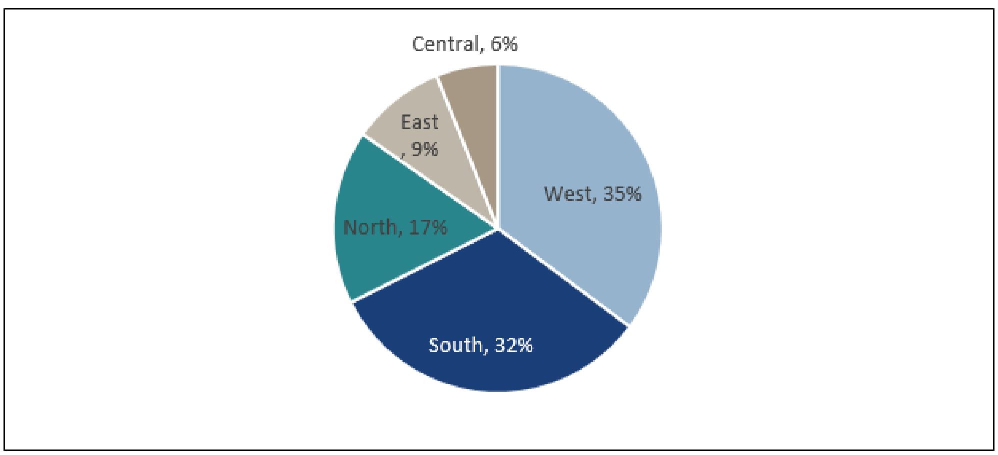
Source: Industry, CRISIL Research

The number of accounts for affordable housing loans have grown from 11 million to approximately 11.9 million as of March 31, 2019, at a CAGR of approximately 8%.

Western and southern markets account for two-thirds of the outstanding loans

With the high influx of affordable housing finance players in lower Tier cities, the growth in the affordable housing space that has been there in such smaller regions and is expected to continue with the major housing markets remaining to be saturated. The focus of buyers on these low cost options in low cost and affordable segment has spread across the regions, which was traditionally focused in the southern and western regions of India. However, these two regions combined account for approximately 68% of the total affordable housing loans outstanding in Fiscal 2019.

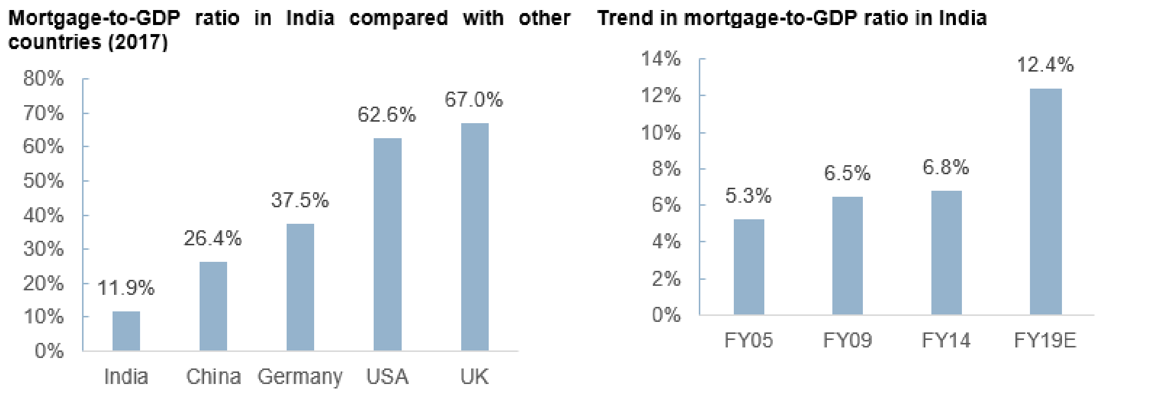
Region wise share in affordable housing loans



Source: Industry, CRISIL Research

Low mortgage penetration and increasing lender interest to lead growth

While the mortgage-to-GDP ratio in India is very low at 12.4% as of March 31, 2019, mortgage penetration in affordable housing is considered to be even smaller. Due to the burgeoning traditional mortgage finance market, a few commercial banks have entered the affordable housing market. These banks tend to offer long-term mortgage loans, which extend to 20 years and require down payment between 10% and 30% of the home value, pay slips, and legal title to property. Even at such levels, affordable housing loan penetration in India is expected to remain lower than in developed markets, such as, the United States and developing countries, such as, China.



Source – HOFINET, Peoples Bank of China, CRISIL Research

Source – NHB, RBI, Industry, World Bank, HOFINET, CRISIL Research

Key Concerns:

USFBL is subject to stringent regulatory requirements and prudential norms*:* The RBI Final Approval, SFB Licensing Guidelines and SFB Operating Guidelines require USFBL to comply with certain conditions in order to operate its business. Further, currently the RBI does not require SFBs to provide any capital charge for operational risk or market risk weighted assets, however, there can be no assurance that RBI will not require SFBs, including it, to provide capital charge for such risk in the future. It is also regulated under the Banking Regulation Act and has to comply with circulars and directives issued by the RBI that apply to scheduled commercial banks. It is required to comply with prudential norms specified in respect of market discipline, classification, valuation and operation of its investment portfolio, income recognition, asset classification and provisioning pertaining to advances (including restructuring of credit facilities), RBI directives on permissible loans and advances, maintenance of regulatory ratios (such as CRR and SLR), authorization of Banking Outlets, permissible exposures, requisite disclosures in financial statements, fraud classification and reporting, and periodic disclosure requirements (including in presentation of financial information and financial statements). Further, uncertainty in the applicability, interpretation or implementation of the governing law, specifically due to the absence of administrative or judicial precedent may be time consuming as well as costly for it to resolve. To ensure compliance with the regulatory framework applicable to SFBs, USFBL may need to allocate additional resources, which may increase its regulatory compliance costs and divert management attention. Its inability to comply with laws and regulations applicable to an SFB may have an adverse effect on its business, results of operations, financial condition and cash flows.

Significantly depends on micro banking business, particularly group loans: USFBL's loan portfolio contains significant advances towards its micro banking segment, particularly through group loans. Consequently, its financial performance significantly depends on its micro banking business, which in turn depends on various factors, including the ability of its borrowers to repay their loan, the results of operations of such borrowers and their business, changes in regulations and policies, natural disasters, calamities, political and social risks, including any adverse publicity or litigation relating to the microfinance sector (such as a public interest litigation filed against all microfinance institutions in Maharashtra), public criticism of the microfinance sector and religious beliefs relating to loans and interest payments. Further, in its microfinance business, USFBL rely primarily on non-traditional guarantee mechanisms rather than any tangible assets such as collateral, such as the joint liability group model. There can however be no assurance that such joint liability arrangements will ensure repayment by the other members of a joint liability group in the event of default by any one of them. Any decline in sales of, or in demand for its micro banking products could adversely affect its business, results of operations, financial condition and cash flows.

Limited operating history as an SFB: USFBL was incorporated on July 4, 2016 and began operations on February 1, 2017 when UFSL, its Promoter, transferred its business to it pursuant to the Business Transfer Agreement and it simultaneously commenced general banking activities. As a result of its limited operating history as an SFB, there is limited historical financial and operational information available to help prospective investors to evaluate its past performance as a commercial banking entity. Its business in each sector and its business overall is growing and the results and amounts set forth in its financial statements may not provide a reliable indication of its future performance. Accordingly, investors should evaluate its business and prospects in light of the risks, uncertainties and difficulties frequently encountered by both high growth companies and banks that are in the early stages of development. USFBL's failure to mitigate these risks and uncertainties successfully could materially adversely affect its business and operating results, and consequently result in a decline in the trading price of the Equity Shares.

USFBL has a continuous requirement of funds and its inability to access sources of funds would adversely impact the results of operations and financial condition: Historically, as an NBFC-MFI, UFSL raised majority of its funding requirements through a combination of term loans from banks and financial institutions and issuance of non-convertible debentures. However, post transitioning into an SFB, USFBL's primary source of funding has been deposits. Considering the growth of the business, it will have a continuous requirement of funds for expanding its outreach and enhancing its loan portfolio. Its ability to continue to meet customer demand for new loans will depend primarily on its ability to raise funds through deposits and refinance from NABARD and SIDBI on suitable interest rates and terms, and in a timely manner. USFBL's ability to raise such funds on competitive terms in the future will depend on various factors including its credit ratings, macroeconomic factors, the regulatory environment and policy initiatives in India, developments in the international markets affecting the Indian economy, investors' and/or lenders' perception of demand for debt and equity securities of SFBs, and its current and future results of operations and financial condition. USFBL has to also compete with other banks by offering attractive interest rates, and may be unable to raise sufficient funds, including funds through deposits at existing or higher interest cost. It also face certain restrictions on its ability to incur debt from international markets, which may further constrain its ability to raise funds at attractive rates. Consequently, its inability to raise sufficient funds in a timely manner, or at all, may have an adverse effect on the business, results of operations, financial condition and cash flows.

The Indian banking industry is very competitive and growth strategy depends on the ability to compete effectively: USFBL has a limited operating history as an SFB and the success of its banking operations depends on a number of factors, including the demand for its services and its ability to compete with other banks and financial institutions effectively. The banking and financing sector in India is highly competitive and USFBL face competition in all its principal areas of business. It face its most significant organized competition from other small finance banks, NBFCs, microfinance institutions, cooperative banks which has significant presence in rural areas, public sector banks, private sector banks, housing finance companies and other financial services companies in India. In addition, many of its potential customers in economically weaker segments do not have access to any form of organized institutional lending, and rely on loans from informal sources, especially moneylenders, landlords, local shopkeepers and traders, at much higher rates. In the organized sector, its competitors may have a better brand recognition, greater business experience, more diversified operations, greater customer and depositor base, larger Banking Outlets network and better access to, and lower costs of funding than USFBL do. Its inability to compete effectively may adversely affect its business, results of operations financial condition and cash flows.

If USFBL is not able to control the level of non-performing assets in its portfolio or any increase in RBI mandated provisioning requirements could adversely affect the business, financial conditions and results of operations: USFBL's NPAs (net of provisions) in its MSE and affordable housing segment has continued to increase in the three months ended June 30, 2019 and in the three months ended September 30, 2019. Its NPAs may increase in the future, due to several factors, including increased competition, adverse effect on the business and results of operations of its borrowers, a rise in unemployment, a sharp and sustained rise in interest rate, slow industrial and business growth, changes in customer behaviour and demographic patterns, central and state government decisions (including agricultural loan waivers that may affect its agricultural portfolio in the short term) and changes in regulations. Further, the expansion of its business may cause USFBL's NPAs to increase and the overall quality of its loan portfolio to deteriorate. While USFBL has already made provisions for NPAs, there can be no assurance that the transition to Ind AS, which would result in computing provisions on the basis of the expected credit loss method as against the current method for incurred credit loss, will not further increase its provisioning requirements in the future. Accordingly, any significant increase in its NPAs may have a material adverse effect on its financial condition and results of operations and as a result, its return ratios may not be consistent with USFBL's previous performance.

Micro banking loan portfolio, personal loans, and certain categories of MSE loans are not supported by any collateral: USFBL's micro banking loans are offered through its micro banking business. Certain categories of its personal loans and MSE loans are at higher credit risk than secured loan portfolios because they may not be supported by realisable collateral that could help ensure an adequate source of repayment for the loan. It may be unable to collect in part or at all in the event of non-payment by a borrower. Further, any increase in delinquency in its micro banking loan portfolio, personal loans portfolio or MSE loan portfolio could require USFBL's to increase its provision for credit losses, which would decrease its earnings.

Recently introduced several new products and services and it cannot be assured that such products and services will be profitable in the future: USFBL has introduced several new products and services, such as personal loans, vehicle, agriculture loans and certain products of MSE loans and affordable housing loans. It has incurred substantial costs to expand its range of products and services and it cannot be assured that such products and services will be successful, whether due to factors within or outside of its control, such as general economic conditions, a failure to understand customer demand and market requirements or management focus on these new products. It has limited experience in offering personal loans, agriculture loans and vehicle loans as well as in certain products of MSE loans and affordable housing loans, and certain of its competitors may have a longer operating history and more experience as compared to it in these businesses. Further, USFBL requires approval from regulatory authorities before it commence offering certain services. If it fails to obtain such approvals, or to develop and launch such products and services successfully, it may lose a part or all of the costs incurred in the development of such offerings, or discontinue these offerings, which could in turn adversely affect its business and results of operations. Further, new businesses will require significant capital investment and commitment of time from its senior management. There also can be no assurance that its management will be able to develop the skills necessary to successfully manage these new business areas. Its inability to effectively manage any of these issues could materially and adversely affect the business and impact its future financial performance and/ or cash flows.

USFBL relies extensively on and continuously upgrade its information technology systems and any disruptions in such systems, or breach of data, could adversely affect the operations and reputation: USFBL's information technology systems are a critical part of its business that help to manage, among other things, its risk management, financial controls, transaction processing, deposit servicing and loan origination functions, as well as its increasing portfolio of products and services. USFBL's front end, data processing, and back-end operations are automated. As a result, any disruption, breach or failure in its technology infrastructure may have significant consequences on its business operations. It's hardware and software systems are subject to both potential internal and external disruptions such as damage or incapacitation by human error, natural disasters, power loss, nation/region-wide interruptions in the infrastructure, sabotage, computer viruses and similar events or the loss of support services from third-parties such as internet backbone providers. Its systems are also potentially vulnerable to data security breaches, whether by employees, who may have a lack of experience with its newer information technology systems, or others, that may expose sensitive data to unauthorized persons. Failed security measures could have a material adverse effect on its business, its future financial performance and the trading price of the Equity Shares. Any such security breaches or compromises of technology systems could result in institution of legal proceedings against it and potential imposition of penalties, which may have an adverse effect on the business and reputation.

Business is dependent on operations in certain regions of India: While USFBL's operations are spread out in all four zones of the country, a large number of its Banking Outlets are located in the southern and eastern states of India, particularly, Karnataka, Tamil Nadu and West Bengal. Consequently, a majority of its advances are from customers in these states. In the event of a regional slowdown in the economic activity in Karnataka, Tamil Nadu or West Bengal, or any other developments including political unrest, disruption or sustained economic downturn in these regions that make its products in these states less beneficial, it may experience an adverse impact on its financial condition and results of operations, which are largely dependent on the performance, geo-political and other prevailing conditions affecting the economies of these states.

Depends on brand recognition, and failure to maintain and enhance awareness of its brand would adversely affect the ability to retain and expand base of customers: Any damage to the brand "*Ujjivan*" or to USFBL's reputation could substantially impair its ability to maintain or grow its business, or have a material adverse effect on its overall business, financial condition, results of operations and cash flows. In addition, any unauthorized or inappropriate use of its brand, trademarks and other related intellectual property rights by others in their corporate names or product brands or otherwise could harm its brand image, competitive advantages and business, and dilute or harm its reputation and brand recognition. USFBL may also be subject to claims by third parties, both inside and outside India, if it breaches their intellectual property rights by using taglines, names, designs, software or other such subjects, which are of a similar nature to the intellectual property these third parties may have registered. Any legal proceedings that result in a finding that it has breached third party intellectual property rights, or any settlements concerning such claims, may require it to provide financial compensation to such third parties or make changes to its marketing strategies or to the brand names of its products, which may have a materially adverse effect on its brand, business, prospects, financial condition and results of operations.

USFBL's operations involve handling significant amounts of cash, making susceptible to operational risks: USFBL's employees at its Banking Outlets are responsible for the collection and deposit of cash, thereby exposing it to the risks of loss, fraud, misappropriation, theft, assault and unauthorized transactions by its employees. While USFBL's strive to monitor, detect and prevent fraud or misappropriation by its employees, through various internal control measures and insurance coverage, it may be unable to adequately prevent or deter such activities in all cases. In addition, it may be subject to regulatory or other proceedings in connection with any such unauthorized transaction, fraud or misappropriation by its agents or employees, which could adversely affect the goodwill, business prospects and future financial performance.

Deposits depend on a limited number of customers: USFBL is dependent on a limited customers for a substantial portion of its deposits. Reduction or loss of such deposit accounts expose it to an increasing funding risk, which could in turn adversely affect the financial performance and results of operations. A reduction in the services it perform for such customers or the loss of such major customers could result in a significant reduction of its deposits portfolio. Factors that may result in a loss of a customer include its service performance, reduction in budgets due to macroeconomic factors or otherwise and shift in policies and political or economic factors. There is significant competition for the services USFBL provide and it is typically not an exclusive service provider to its large customers. These factors may not be predictable or under its control. Significant pricing or margin pressure exerted by its customers could also adversely affect the business, financial condition and results of operations.

Inability to expand Banking Outlets network, ATMs or manage infrastructure or if USFBL is unable to attract new customers may adversely affect the business, results of operations, financial condition and cash flows: USFBL has a large and diverse Banking Outlet and Asset Centre network across India. As of September 30, 2019, it operated in 552 Banking Outlets that included 141 in URCs of which seven were business correspondents and additionally operated four Asset Centres across 24 states and union territories in India. In Fiscal 2019, it operationalized 287 Banking Outlets in India including 150 Banking Outlets in URCs and rural and semi-urban areas. It intends to grow its network of Banking Outlets in its existing markets and new markets in India and attract new customers. USFBL has incurred substantial expenditure in setting up such Banking Outlets. To address these challenges, it may have to make significant investments that may not yield desired results or incur costs that it may not be able to recover. If it is unable to implement such growth strategies, its business, results of operations, financial condition and cash flows will be adversely affected.

The value of collateral may decrease or USFBL may experience delays in enforcing collateral when borrowers default on their obligations: USFBL disburse certain loans that are secured by assets and follow certain procedures to evaluate the credit profiles of its customers. However, the value of the collateral obtained by it may fluctuate or decline due to factors beyond its control, including deterioration in regional economic conditions or of asset values or as a result of adverse changes in the credit quality of its borrowers and counterparties or delays in foreclosure proceedings or defects or deficiencies in the perfection of collateral. In the event of a decline in any of these, some of its loans may exceed the value of their underlying collateral. Changes in asset prices may cause the value of its collateral to decline. In the event USFBL's borrowers default on the repayment of loans, it may not be able to realize the full value of the collateral due to various reasons, including a possible decline in the realizable value of the collateral, defective title or pledge of damaged items as security, prolonged legal proceedings and fraudulent actions by borrowers, or it may not be able to foreclose on collateral at all. Further, it may be required to increase its provision for loan losses in case of any decline in the value of the security, which could impair USFBL's ability to realize the secured assets upon any foreclosure

Business is particularly vulnerable to interest rate risk: USFBL's results of operations depend substantially on its Net Interest Income, which is the difference between its interest earned and interest expended. Interest rate risk depends upon the nature of gaps in rate sensitive assets and rate sensitive liabilities. Any change in interest rates or their volatility would affect the interest expense on its interest-bearing liabilities as well as its Net Interest Income and Net Interest Margins. Any increase in cost of funds may lead to a reduction in the Net Interest Margins, or require it to increase interest rates on loans disbursed to customers in the future to maintain its Net Interest Margins. It is also exposed to interest rate risk through treasury operations when it commence trading in securities. Any rise in interest rates or any greater interest rate volatility could adversely affect the income from treasury operations. In addition, any change in the volume of business in its treasury operations and profitability, could have an adverse impact on the overall profitability of the Bank.

Risk management measures may not be fully effective in mitigating risks in all market environments or against all types of risks, which may adversely affect the business and financial performance: USFBL's risk management functions are divided on the basis of principal risks defined under applicable Basel II guidelines, i.e., credit risk, market risk, operational risk, information technology risk and liquidity risk. It has a well-defined risk management governance framework that comprises of a risk management committee of its Board and management sub committees for management of credit, market, liquidity, information technology and operational risk, to the extent any of the instruments and strategies it use to hedge or otherwise manage its exposure to market or credit risk are not effective, USFBL may not be able to mitigate effectively its risk exposures, in particular to market environments or against particular types of risk. As it seeks to expand the scope of its operations, it also face the risk that it may not be able to develop risk management policies and procedures that are properly designed for new business areas or to manage the risks associated with the growth of its existing businesses effectively. Implementation and monitoring may prove particularly challenging with respect to businesses that it plans on developing. An inability to develop and implement effective risk management policies may materially and adversely affect its business, financial condition and results of operations.

Inability to grow CASA ratio may result in higher cost of deposits and impact the financial condition: As of March 31, 2019 and September 30, 2019, the share of CASA to total deposits ratio was at 10.63% and 11.87%, respectively. USFBL may not be able to grow its CASA deposits and ratio owing to the increased competition from other banks and lending institutions. In order to attract retail customers and increase its CASA deposits, it intends to introduce new products and promote its products through marketing campaigns. The interest rates that it must pay to attract customer deposits are determined by numerous factors such as the prevailing interest rate structure, competitive landscape, Indian monetary policy and inflation. However, there is no assurance that it will be successful in growing its CASA base. If it fails to grow its CASA ratio, its financial condition and cash flows may be materially and adversely affected.

An inability to renew or maintain statutory and regulatory permits and approvals required to operate the business may adversely impact the business, financial condition and results of operation: USFBL are required to obtain various statutory and regulatory permits and approvals to operate its business which requires USFBL to comply with certain terms and conditions to continue its banking operations. These include approvals from the RBI for various aspects of its banking operations (including for services such as NEFT, RTGS and foreign exchange dealing), approvals for providing internet and phone banking services and licenses from other regulatory authorities, such as the IRDAI and PFRDA, for distribution of insurance or pension products. Its RBI In-Principle Approval and RBI Final Approval also require USFBL to comply with certain terms and conditions. In the event that it is unable to comply with any or all of these terms and conditions, or seek waivers or extensions of time for complying with these terms and conditions, it is possible that the RBI may revoke this license or may place stringent restrictions on its operations. This may result in the interruption of all or some of its operations and may have a material adverse effect on the business, financial condition, results and cash flow.

Operations depend on the accuracy and completeness of information about customers and counterparties: USFBL business involves lending money to smaller, relatively low income entrepreneurs and individuals who may not have any credit history and as a result it is more vulnerable to customer default risks including default or delay in repayment of principal or interest on its loans. Some lines of business, such as vehicle loans, principally focuses on first time users who have limited access to capital through formal banking channels and housing finance focuses on relatively small ticket loans and the affordable housing segment. Further, MSE advances are eligible to be classified as PSL loans only if requisite documentation is provided by the borrower to attest to its investment in plant and machinery, and if such documents are not submitted, MSE loans cannot be classified as PSL compliant. A significant majority of its customers belong to the low income group and may not have any credit history supported by tax returns, credit card statements, statements of previous loan exposures or other related documents. They may also have limited formal education, and generally are able to furnish very limited information for it to be able to assess their creditworthiness accurately. In addition, USFBL may not receive updated information regarding any change in the financial condition of its customers or may receive inaccurate or incomplete information. Failure to maintain sufficient credit assessment policies, particularly for individual borrowers, could adversely affect its credit portfolio, which could have a material and adverse effect on the results of operations, financial condition and cash flows.

USFBL undertakes certain fee and commission-based activities and its financial performance may be adversely affected by an inability to generate income from such activities: USFBL has expanded its operations from undertaking banking activities to providing certain fee and commission-based services. Further, as part of its growth strategy, it intends to focus on increasing its non-interest income by focusing on bancassurance, fee and processing charges from loan and advances, foreign exchange business, credit and debit card business. New initiatives, products and services entail a number of risks and challenges, including risks relating to execution, the failure to identify new segments, the inability to attract customers and the inability to make competitive offerings. If USFBL is unable to successfully diversify its products and services while managing the related risks and challenges, returns on such products and services may be less than anticipated, which may materially and adversely affect the business, financial condition and results of operations.

The success of the business operations is dependent on senior management team and key management personnel as well as its ability to attract, train and retain such employees: The continued success of USFBL's business operations is attributable to its senior management team and key managerial personnel. The inputs and experience of its senior management, in particular, and other key personnel are valuable for the development of its business and operations and the strategic directions taken by the Bank. Its ability to sustain USFBL's growth depends upon its ability to attract and retain key personnel, developing managerial experience to address emerging business and operating challenges and ensuring a high standard of customer service. It cannot be assured that these individuals or any other member of its senior management team will not leave it or join a competitor or that it will be able to retain such personnel or find adequate replacements in a timely manner, or at all. It may also be required to increase its levels of employee compensation more rapidly than in the past to remain competitive in attracting employees that its business requires. The loss of the services of such persons may have an adverse effect on its business, results of operations, financial condition and cash flows.

Weakness or failures of internal control system may cause significant operational errors, which may in turn materially and adversely affect the business: Banks and financial institutions are generally exposed to many types of operational risks, including the risk of fraud or other misconduct by employees or outsiders, unauthorized transactions by employees and third parties (including violation of regulations for prevention of corrupt practices, and other regulations governing its business activities), or operational errors, including clerical or record keeping errors or errors resulting from faulty computer or telecommunications systems. Given the high volume of transactions that USFBL handle on a day to day basis, certain errors may be repeated or compounded before they are discovered and successfully rectified. In addition, its dependence upon automated systems to record and process transactions may further increase the risk that technical system flaws or employee tampering or manipulation of those systems will result in losses that are difficult to detect. It also face the risk that the design of its controls and procedures may prove inadequate, or are circumvented, thereby causing delays in detection or errors in information. While USFBL periodically test and update, as necessary, its internal control systems, it is exposed to operational risks arising from the potential inadequacy or failure of internal processes or systems, and its actions may not be sufficient to guarantee effective internal controls in all circumstances.

Any downgrade of debt ratings could adversely affect the business: USFBL's debt is rated by various agencies, including by CRISIL Limited and CARE Ratings Limited. Its long term bank facilities have been rated CARE A+; Stable by CARE Ratings Limited, its certificate of deposits have been rated CRISIL A1+ by CRISIL Limited. Any downgrade in its credit ratings may increase interest rates for refinancing its outstanding debt, which would increase financing costs, and adversely affect the future issuances of debt and USFBL's ability to raise new capital on a competitive basis, which may adversely affect its profitability and future growth. There can be no assurance that these ratings will not be further revised or changed by the above rating agencies which may materially and adversely affect the business, financial condition and results of operations.

The rise of digital platforms and payment solutions may adversely impact the fees, and there may be disintermediation in the loan market by fintech companies: Through USFBL electronically linked Banking Outlets network and centralized processing, it effectively provide a nationwide collection, disbursement and payment systems for its customers. Disruption from digital platforms could have an adverse effect on the fees that it has traditionally received on such services. USFBL also face threat to its loan market from newer business models, including partnering with fintech companies that leverage technology to bring together savers and borrowers. Over a period, it may not be competitive in facing up to the challenges from such newer entrants. This may, accordingly, have an adverse impact on its business and growth strategy.

Any deterioration in the general economic conditions in India and globally could adversely affect the business and results of operations: USFBL's performance and the growth of its business are necessarily dependent on the health of the overall Indian economy. Any slowdown in the Indian economy or future volatility in global commodity prices could adversely affect its business. Additionally, an increase in trade deficit, a downgrading in India's sovereign debt rating or a decline in India's foreign exchange reserves could negatively affect interest rates and liquidity, which could adversely affect the Indian economy and its business. Any downturn in the macroeconomic environment in India could also adversely affect the business, results of operations, financial condition and the trading price of the Equity Shares.

Banking is a heavily regulated industry and material changes in the regulations which govern the Bank, may adversely affect the business: Banks in India are subject to detailed supervision and regulation by the RBI. In addition, the financial condition and results of operations of banks are susceptible to material change pursuant to changes in law, as well as to changes in regulations, government policies and accounting principles. Any such changes may adversely affect USFBL's Bank's business, future financial performance and the price of the Equity Shares.

India's existing credit information infrastructure may cause increased risks of loan defaults: All of USFBL's business is located in India. India's existing credit information infrastructure may pose problems and difficulties in running a robust credit check on its borrowers. USFBL may also face difficulties in the due diligence process relating to its clients or to any security or collateral it take in relation to its loans. It may not be able to run comprehensive searches relating to the security and there are no assurances that any searches it undertake will be accurate or reliable. Hence, its overall credit analysis could be less robust as compared to similar transactions in more developed economies. Any inability to undertake a comprehensive due diligence or credit check might result in an increase in NPAs and it may have to increase its provisions correspondingly. Any of the foregoing may have a material adverse effect on the business, financial condition and results of operations.

The ability of small finance banks to raise borrowings in foreign currencies may be constrained by Indian law: As a small finance bank, USFBL is subject to exchange controls that regulate borrowing in foreign currencies, including those specified under FEMA. Such regulatory restrictions limit its financing sources and hence could constrain its ability to obtain financing on competitive terms and refinance existing indebtedness. In addition, it cannot be assured that any required approvals for borrowing in foreign currency will be granted to it without onerous conditions, or at all. Such, and other, limitations on raising foreign capital may adversely affect the business growth, results of operations, and financial condition.

Profit & Loss — Rs in million

Particulars	H1FY20	FY19	FY18	FY17
INCOME				
Interest Earned	12597.0	18316.1	14678.8	2170.1
Other Income	1,751.58	2,059.64	1,114.80	68.64
Total Income	**14348.6**	**20375.8**	**15793.6**	**2238.7**
EXPENDITURE				
Interest Expended	5,192.78	7,251.99	6,068.64	1,093.58
Operating Expenses	6,129.56	10,033.54	6,528.70	1,091.90
Provisions and Contingencies	1,155.13	1,098.04	3,127.58	52.91
Total Expenditure	**12,477.47**	**18,383.57**	**15,724.92**	**2,238.39**
Net Profit/ (Loss) for the period/year	**1871.1**	**1992.2**	**68.6**	**0.3**
EPS	1.1	1.2	0.0	0.0

Balance Sheet: — Rs in million

Particulars	As at September 30, 2019	FY19	FY18	FY17
Capital	16,400.37	16,400.37	16,400.37	16,400.37
Share Application Money Pending Allotment	359.24	0	0	0
Employees Stock Options and Purchase Outstanding	107.01	0	0	0

Reserves and Surplus	3,534.43	1,795.94	68.98	0.35
Deposits	101298.49	73,794.40	37,725.18	2,064.05
Borrowings	34,701.70	41,660.90	38,528.45	62,914.04
Other Liabilities and Provisions	4,677.72	3,770.54	2,005.75	2,980.24
TOTAL	161,078.96	137,422.15	94,728.73	84,359.05
ASSETS				
Cash and Balances with Reserve Bank of India	4,872.54	4,464.64	2,496.34	2,609.29
Balances with Banks and Money at Call and Short Notice	2,220.63	6,479.96	2,452.01	5,018.92
Investments	20,183.90	15,266.22	12,324.79	14,466.77
Advances	127803.9	105524.55	73,362.11	58,610.45
Fixed Assets	2,962.09	2,844.50	1,983.45	1,397.69
Other Assets	3,035.81	2,842.28	2,110.03	2,255.93
TOTAL	161,078.87	137,422.15	94,728.73	84,359.05
Contingent Liabilities	255.92	308.96	195.09	283.36

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