IPO Note

July 11, 2023

Utkarsh Small Finance Bank Limited

Issue Snapshot:

Issue Open: July 12 – July 14, 2023

Price Band: Rs. 23 – 25

*Issue Size: Rs 500 Cr (Including Employee Reservation of 1%)

Reservation for:

QIB	atleast	75% eq sh
Non-Institutional	upto	15% eq sh
((including 1/3rd for applications between Rs.2 lakhs to Rs.10 lakhs))		
Retail	upto	10% eq sh

Face Value: Rs 10

Book value: Rs 22.33 (March 31, 2023)

Bid size: - 600 equity shares and in multiples thereof

100% Book built Issue

Capital Structure:

Pre Issue Equity:	Rs.	895.90 cr
*Post issue Equity:	Rs.	1095.90 cr

Listing: BSE & NSE

Book Running Lead Managers: ICICI Securities Limited, Kotak Mahindra Capital Company Limited

Sponsor Bank: Axis Bank Ltd & ICICI Bank Ltd

Registrar to issue: KFin Technologies Limited

Shareholding Pattern

Shareholding Pattern	**Pre issue %**	**Post issue %**
Promoter and Promoter Group	84.75	69.28
Public & Employee	15.25	30.72
Total	100.0	100.0

*=assuming issue subscribed at higher band

Source for this Note: RHP

Background & Operations:

Utkarsh Small Finance Bank Limited (USFBL) is a SFB in India and recorded the third fastest Gross Loan Portfolio growth between Fiscal 2019 and Fiscal 2023 among SFBs with Gross Loan Portfolio of more than Rs. 60 billion. It has its headquarters located in Varanasi, Uttar Pradesh and has over the years expanded its SFB operations strategically in States where it has been able to leverage the prior microfinance experience of Utkarsh CoreInvest Limited.

USFBL's operations are spread across India and are present in 26 States and Union Territories with 830 Banking Outlets and 15,424 employees, as of March 31, 2023. As of March 31, 2023, 27.35% of its Banking Outlets were located in Unbanked Rural Centres ("URCs") as against the regulatory requirement of 25% of banking outlets of SFBs to be located in URCs. Its operations are focused in rural and semi-urban areas and as of March 31, 2023, it had 3.59 million customers (both deposit and credit) majorly located in rural and semi-urban areas primarily in the states of Bihar and Uttar Pradesh that, in Fiscal 2022, are among the states with the best asset quality but with low and moderate credit penetration. As of March 31, 2023, these states constituted 30.88% and 25.98% of its total Gross Loan Portfolio (based on location of the Banking Outlet), respectively. It is also focused on further strengthening its presence in newer geographies in addition to existing states where USFBL operates by entering into arrangements with business correspondents ("BCs") and direct selling agents ("DSAs") and as of March 31, 2023, it had tie-ups with 13 BCs to source customers and 321 DSAs to grow its asset portfolio.

Given the legacy of Utkarsh CoreInvest Limited as a non-banking finance company-microfinance institutions ("NBFC-MFI"), microfinance remains a focused business segment for its Bank. USFBL has been diversifying its product portfolio to include non-micro banking loans allowing it to reduce dependence on its microfinance business and grow its secured loan portfolio. It offers a range of financial products and services that address the specific requirements of its customer segments while assessing factors including income profile and the type of security available. Its asset products include (i) microbanking loans that include joint liability group loans, and individual loans; (ii) retail loans that includes unsecured loans, such as business loans and personal loans, and secured loans, such as loans against property ("LAP") (iii) wholesale lending that includes short term and longterm loan facilities to SMEs, mid and large corporate and institutional clients; (iv) housing loans with a focus on affordable housing; (v) commercial vehicle / construction equipment loans; and (vi) gold loans that was launched in Fiscal 2022. On the liabilities side, it offers savings accounts, current accounts and a variety of term and recurring deposit accounts. In addition, it also provides non-credit offerings comprising ATM-cum-debit cards, bill payment system and distribute third party point of sales terminals, mutual funds and insurance products.

USFBL's Bank leverages the use of technology to provide transactional ease through internet and mobile banking and on-boarding convenience through digital on-boarding of customers with the use of handheld devices and as of March 31, 2023, 15,797 employees used handheld devices/ digital services for onboarding 573,619 savings account customers.

Its endeavour is to be a retail focused bank with the aim to provide financial services that offer quality products and solutions. It intends to develop and offer a comprehensive suite of assets and liabilities products that will help it attract new customers and deepen its relationship with its existing customer base. It intends to continue to grow its asset portfolio by offering new products that cater to all customer segments. It also intends to scale up its liabilities franchise by focussing on newer geographies including targeting the top 100 cities in terms of overall deposits, in addition to tapping metropolitan and urban areas by promoting its savings accounts along with other deposit products.

Objects of Issue:

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

Competitive Strengths

Sound understanding of microfinance segment and presence in rural and semi-urban areas: Utkarsh CoreInvest Limited, originally commenced operations as a NBFC in Fiscal 2010 and later converted to a NBFC – MFI. It has a history of serving customers in the microfinance segment with a particular focus on financial inclusion for unserved and underserved customer segments in rural/ semi-urban areas of Uttar Pradesh, Bihar, Jharkhand, Madhya Pradesh, Chhattisgarh and Uttarakhand. Utkarsh CoreInvest Limited also offered micro enterprise loans to the economically poor segments. Following the commencement of its SFB operations, it has further strengthened its engagement with borrowers by continuing to focus on microfinance and by diversifying its product offerings to include savings accounts, deposit products and other loan products.

As of March 31, 2021, 2022 and 2023, Bank's microbanking portfolio constituted 81.98%, 75.28% and 66.03% of its total Gross Loan Portfolio and were to its microbanking loan customers primarily present in rural and semi-urban areas across 159 districts, as of March 31, 2023. Its total customers (both deposit and credit) have been continuously increasing and its customer base grew from 2.90 million customers as of March 31, 2021 to 3.14 million customers as of March 31, 2022 and further to 3.59 million customers as of March 31, 2023. As of March 31, 2021, 2022 and 2023, it generated 68.47%, 63.23% and 56.42% of its Gross Loan Portfolio from rural and semi-urban areas, respectively. Its focus on the microbanking segment is also reflected in its lending towards 'priority sectors'. As of March 31, 2021, 2022 and 2023, 86.15%, 83.04% and 78.38% of its advances qualified as 'priority sector lending', as compared to the regulatory requirement of 75% for SFBs. Bank also stand to benefit from the re-classification norms prescribed by the RBI pursuant to which, from 2022 onwards, or incremental priority sector credit to certain districts (where the credit flow is comparatively lower) is eligible for a PSL weightage of 125% and 100%, respectively. As of March 31, 2023, these districts accounted for 50.81% and 40.56% of its JLG portfolio, respectively.

Growing deposits with focus on retail deposits: USFBL offers a variety of demand and time deposit products along with other services through which its customers can address their savings and transactional needs. Its product suite includes a range of deposit products including saving accounts, salary accounts, current accounts, recurring and fixed deposits (with callable and non-callable options) and locker facilities. It offers diversified liabilities products at competitive rates targeted primarily at retail customers from all segments led by senior citizens, middle-class individuals and self-employed and salaried individuals.

Its total deposits have grown from Rs. 75,075.68 million as of March 31, 2021, to Rs. 100,741.83 million as of March 31, 2022, and further to Rs. 137,101.40 million as of March 31, 2023, while its deposit-only customers have increased from 0.38 million as of March 31, 2021, to 0.65 million as of March 31, 2022 and further to 0.86 million as of March 31, 2023. Its CASA franchise has increased from Rs. 13,269.92 million as of March 31, 2021 to Rs. 22,532.85 million as of March 31, 2022 and further to Rs. 28,637.35 million as of March 31, 2023. CASA to total deposits ratio was 17.68% as of March 31, 2021, increased to 22.37% as of March 31, 2022, and further to 20.89% as of March 31, 2023. Its CASA ratio and large percentage of retail deposits provides it with stable access to low cost funding and longer tenure resources profile

A continuous growth in Bank's customer base has led to diversification of its deposit franchise and its retail deposit base has grown from Rs. 29,905.18 million as of March 31, 2021 to Rs. 37,553.56 million as of March 31, 2022 and further to Rs. 55,751.33 million as of March 31, 2023. The ratio of its retail term deposits to total deposits, as of March 31, 2021, 2022 and 2023 was 39.83%, 37.28% and 40.66%, respectively. Retail deposits offers greater opportunities for cross-selling and up-selling a variety of products which includes assets and third-party products, therefore meeting the life cycle of its customer requirements. Its deposit base comprises customers across segments and geographies. As of March 31, 2023, 54.97%, 39.28%, 3.06% and 2.69% of its total deposit base were in metropolitan, urban, semi-urban and rural areas, respectively, based on the location of its Banking Outlets.

As of March 31, 2021, USFBL's deposit base was spread across 18 States and Union Territories in India, with 58.74%, 14.60%, 1.16% and 25.50% of its deposits in the Northern, Eastern, Southern, and Western regions of India, respectively. Further, as of March 31, 2023, its deposit base was spread across 26 States and Union Territories in India, with 58.76%, 17.38%, 5.25% and 18.61% of its deposits in the Northern, Eastern, Southern, and Western regions of India, respectively. It had the second lowest share of deposits from top state in overall deposits among SFBs with Gross Loan Portfolio of more than Rs. 60 billion in Fiscal 2023.

Diversified distribution network with significant cross-selling opportunities: USFBL has an extensive physical network of Banking Outlets and as of March 31, 2023, it had 830 Banking Outlets across 26 States and Union Territories covering 253 districts in India of which 522 Banking Outlets were located in rural and semi-urban areas (combined). Its network of Banking Outlets allows it to service its existing customers and attract new customers as a result of relationships cultivated through proximity and frequent interaction by its employees. Its network aims to reduce reliance on a particular region in India and allows it to replicate best practices developed in one region to other regions.

As of March 31, 2023, 62.89% of USFBL's total Banking Outlets were located in rural and semi-urban areas. In order to further increase the financial inclusion and provide comprehensive financial services to the underserved and unserved customer segments, it has also opened Banking Outlets that have been classified by the RBI as Unbanked Rural Centres ("URCs) in 69 districts. Its Banking Outlets has grown from 558 Banking Outlets as of March 31, 2021 to 686 Banking Outlets as of March 31, 2022 and further to 830 Banking Outlets as of March 31, 2023. Of its 830 Banking Outlets, as of March 31, 2023, it has internally classified 579 Banking Outlets to focus on growing its microbanking portfolio. Its footprint in the states of Uttar Pradesh and Bihar has enabled it to build a significant microbanking franchise in these states. Bank have also leveraged BCs and DSAs and their network to grow its asset portfolio. As of March 31, 2023, it has arrangements with 13 BCs to grow its asset portfolio and had tie-ups with 321 DSAs to primarily source retail loan against properties across various locations.

Besides Banking Outlets, USFBL's multi-channel delivery includes ATMs, micro-ATMs, mobile and internet banking, corporate internet banking services. As of March 31, 2023, it had a network of 280 on-site and seven off-site ATMs. As of March 31, 2023, it haslso set-up 546 micro-ATMs. To facilitate ease of transaction for account holders, it offers a range of transaction and payment channels that include domestic and international ATM cum debit cards (RuPay and Mastercard), payment gateways, integrated bill payment system facility, money transfer service scheme and door-step banking services.

Focus on risk management and effective operations: Risk management is at the core of USFBL's operations, and it has over the years focused on robust and comprehensive credit assessment and risk management framework. Its framework identifies, monitors and manages risks inherent in its operations and in particular manages credit, market, liquidity, IT and operational risks. Its risk function has a system of measuring, monitoring and implementing risk parameters including real time monitoring of regulatory updates and trends in national and international markets, framing guidelines, policies and products in accordance with industry practices, defining admissible portfolio at risk for each product, an early warning system to provide signals for sector performance and limits on extending funds to a particular industry. It continually uses technology and data analytics to manage credit risks and follow a risk-based lending approach where it has developed a credit application scorecard to identify the credit worthiness of customers and make informed decisions on lending. 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 which are comprised and supported by members of its senior management team. Its risk management policies and conservative provisioning policy has helped its successfully navigate through industry wide one-off events such as demonetization and COVID-19.

Stable growth with cost efficient operational performance: USFBL's Gross Loan Portfolio has grown from Rs. 84,156.60 million as of March 31, 2021 to Rs. 106,307.25 million as of March 31, 2022 and further to Rs. 139,571.08 million as of March 31, 2023. It recorded the third fastest Gross Loan Portfolio growth of 31.0% CAGR between Fiscal 2019 and Fiscal 2023 among SFBs with Gross Loan Portfolio of more than Rs.60 billion. Its disbursements increased from Rs. 59,140.08 million in Fiscal 2021 to Rs. 90,462.79 million in Fiscal 2022, and was Rs. 124,428.94 million in Fiscal 2023. Deposits have also grown consistently and were Rs. 75,075.68 million as of March 31, 2021, Rs. 100,741.83 million as of March 31, 2022 and Rs. 137,101.40 million as of March 31, 2023. It has a comfortable liquidity profile that is backed by shorter tenure microbanking lending and sufficient liquidity buffer and as of March 31, 2023, its Liquidity Coverage Ratio ("LCR") was 375.82% as against regulatory requirement of maintaining LCR of 90%. It is well above the regulatory capital requirements, having a SLR, CRR and CAR of 31.53%, 5.33% and 20.64%, respectively, as of March 31, 2023. USFBL's interest earned has been consistently growing and grew from Rs. 15,809.87 million in Fiscal 2021 to Rs. 18,488.13 million in Fiscal 2022 and further to Rs. 25,049.80 million in Fiscal 2023.

Bank's ability to provide its products and services in a cost-efficient manner is among its core strengths and its cost-to-income ratio was the lowest among SFBs with Gross Loan Portfolio of more than Rs.60 billion in Fiscal 2023. Its cost-efficient operations are attributable to its automation and digitization of various processes including disbursements of loans in the microbanking business. Its cost-to income ratio was 56.54% in Fiscal 2021, 58.90% in Fiscal 2022, and 54.15% in Fiscal 2023 and provision coverage ratio (including technical write off) was 80.42%, 78.14% and 95.78% in Fiscal 2021, 2022 and 2023.

Leadership complementing strengths: USFBL's Promoter, Utkarsh CoreInvest Limited, has a number of institutional investors. It has management team comprising of qualified and experienced professionals. Its Managing Director and chief executive officer, Govind Singh, has over 25 years of experience in the banking and financial services sector and in particular the microfinance industry. He has been associated with leading financial services organizations in India including ICICI Bank Limited, Surya Fincap Limited, UTI Bank Limited, Bank Internasional Indonesia, Allahabad Bank and State Bank of Patiala in various capacities. Its Board comprises of individuals from various fields with varied and diverse experience. The experience of its Independent Directors helps to ensure transparency and accountability in its operations across diverse functional aspects and their inputs enhance quality of its operations. Bank is also led by a professional senior management team each of whom has significant experience in the banking and financial services industry.

Business Strategy:

Continue diversifying retail asset portfolio*:* USFBL's primary focus will be to continue to diversify its asset portfolio. It intends to leverage its wide base of existing customers in the unserved and underserved segments by developing a range of asset products based on their vintage and credit worthiness to create sustainable livelihood. Therefore, it intends to extend the offering from JLG loans to individual loans to micro enterprise loans, affordable housing loans and other new products. It will also seek to increase visibility and penetration of its other assets products to achieve a well-diversified lending book along with a continued focus on financial inclusion.

Grow retail deposits mix across geographies and customer segments to build stable funding source: USFBL intends to strengthen its liability franchise by continuing its focus on CASA and retail deposit base in a steady manner. Retail term deposits raised were 48.39%, 48.02% and 51.40% of total term deposits as of March 31, 2021, 2022 and 2023, respectively. As a result of its continued diversification of deposits across geographies and customer segments, the average cost (interest expense divided by the average of balance for the relevant period) of savings bank deposits was 6.04%, 5.87% and 5.88%, respectively, and the average cost of term deposits was 8.39%, 7.30% and 7.10%, respectively, each as of March 31, 2021, 2022 and 2023. It intends to undertake the expansion of its deposit base through its Banking Outlets and its digital offerings. Its focus will be to continue to develop the physical infrastructure by opening additional Banking Outlets in existing and newer geographies, including top 100 cities to grow its deposit base

In order to grow bank's retail deposits, it intends to focus on client acquisition through its existing and new Banking Outlets besides deepening relationships with its existing customers. It intends to follow a two-pronged strategy to expand its footprint (i) further penetration in the existing geographies; and (ii) expand its reach into newer states in Western and Southern India. USFBL will expand its presence in a calibrated manner in new geographies through additional Banking Outlets in top 100 cities in terms of overall deposits, where it is not extensively present. It will expand its presence in a calibrated manner in new geographies through additional Banking Outlets and BC partnerships and in particular in rural and semi-urban areas where it is not extensively present. It also intends to cross-sell liabilities products to its retail asset and JLG customer base by assisting them with opening of current and savings accounts and inculcating savings behavior by promoting its recurring deposits, fixed deposits and other products. USFBL intends to grow its deposit base by entering into arrangements with corporates and institutions by providing an array of services to meet their payment, collection and savings requirement besides offering salary accounts for their employees

Increase share of fee income and capitalize on cross-selling opportunities: In order to create a robust revenue stream, USFBL intends to further diversify its fee and non-interest based revenues. It intends to achieve this by generating fee income from its own products and cross-selling third-party products such as distribution of mutual funds, life insurance and general insurance products, Atal Pension Yojana, National Pension Scheme, micro-insurance and by introducing newer products and services. It intends to grow its revenue from individual retail customers to be generated primarily from distribution of third-party products in addition to debit card fees and loans to individuals and remittances. Bank intends to provide various payment solutions through mobile and internet banking to increase the fee income generated from debit cards, bill payments, and money transfers. It proposes to focus on bancassurance channels to distribute various types of insurance products to existing customers. It has seven bancassurance relationships including with insurance companies offering general insurance, life insurance and health insurance products. It intends to capitalize on these relationships to diversify and distribute its products by leveraging on its existing network of Banking Outlets to promote newer products to multiple customers

On the liability side, USFBL will continue to engage with customers in urban and metropolitan locations to promote its wealth management services such as mutual fund investments and strengthen distribution of such products to its existing customer base. It seeks to engage actively with its customer base to drive debit card and online spending behaviour through active promotions, in order to drive growth of its transaction fee income.

Increasing use of technology and digital offerings for last mile delivery to customers: 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 leveraging technology for efficient operations as it scale up. By furthering its digital and technology platform, its endeavour is to reduce its operating costs, increase efficiencies as well as encourage customers to migrate from an assisted model to a self-service delivery model. It therefore intends to continue to invest in technology as a means of improving its customer experience and offer them a range of bespoke financial products in accordance with their financial requirements. It intends to retain its focus on the unserved and underserved segment by focusing on introducing customized digital channels across all its product segments. These include launching tab-based account opening for savings account customers and installing micro-ATMs in its key markets. Greater adoption of its digital service delivery mechanisms will enable it to be more efficient and customer friendly. It shall focus on leveraging data analytics for targeting specific customer profiles, and develop customized and tailor-made products to suit the diverse requirements of its customers and improve customer satisfaction.

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. Also, a few microfinance companies, local area banks and an NBFC as well as one urban co-operative bank have received permission to set up small finance banks ("**SFBs**"). As of March 2023, the RBI has awarded SFB licences to 12 players keeping in with the government's focus on financial inclusion and inclusive banking.

GROWTH DRIVERS FOR SMALL FINANCE BANKS

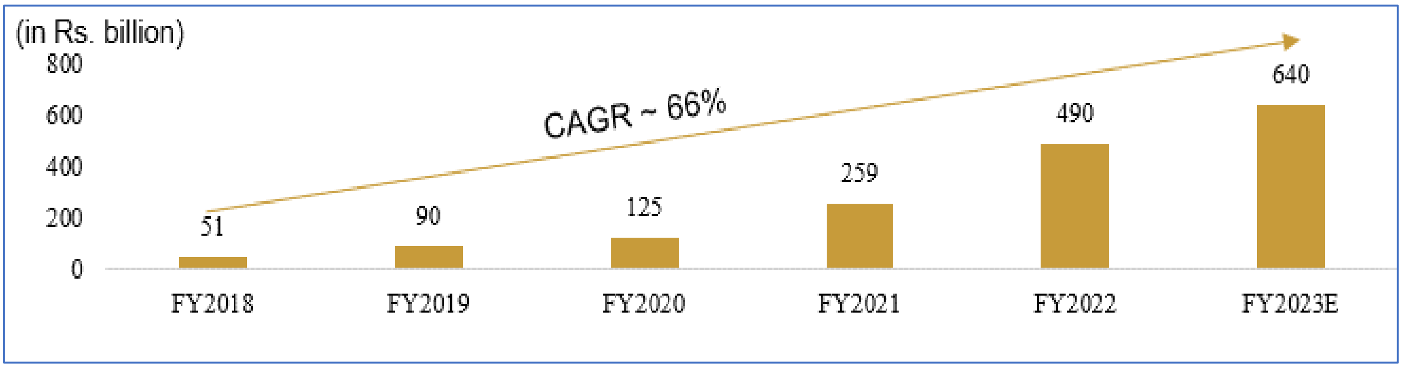
Customized products aided by technology and information availability

Greater use of technology is enabling lenders to provide customised products, that too at much lower turnaround time. Multiple data points are available for lenders that is facilitating quick decision making. In fact, they can take lending decisions within minutes using data-driven automated models. These models would help in supply of credit to small business units and the unorganised sector at low cost. Technology also helps these players expand their reach to under penetrated population in remote areas at a lower operating cost.

Availability of funds at cheaper rates

CASA and other retail deposits are a cheap source of funds for SFBs, which help them expand their product portfolio. They can provide lower rates in the market to compete with NBFCs. With SFBs expanding in the underserved regions further, their deposit base is expected to further widen. The CASA deposits for SFBs is estimated to have grown at 66% CAGR from Fiscal 2018 to Fiscal 2023. This will give them an advantage over NBFCs and help expand their asset book.

CASA deposits for SFBs is estimated to reach Rs.640 billion at the end of Fiscal 2023

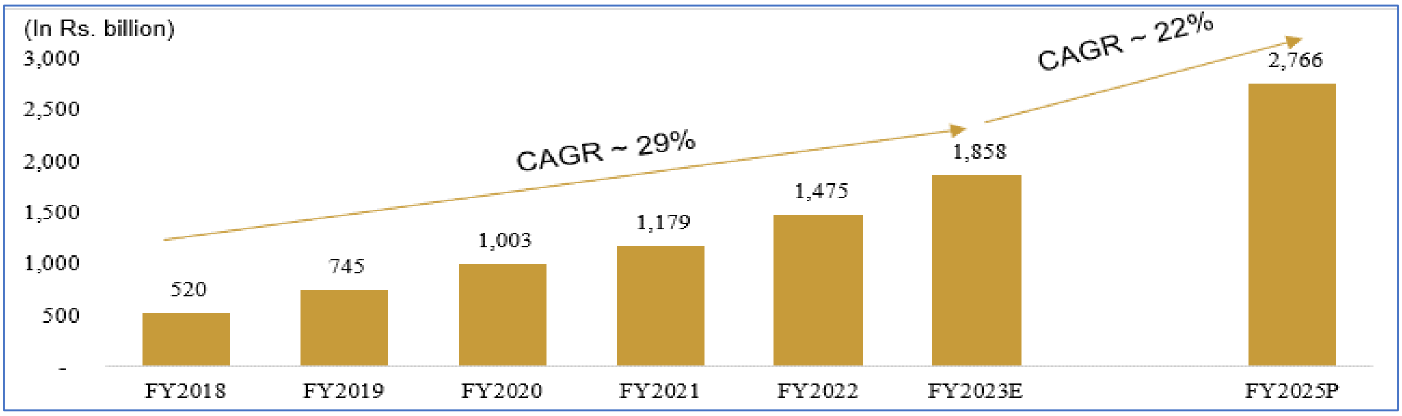


Large Target audience

SFBs' target audience is the low-income segment, who can be wooed with a sachet level product suite. Unlike NBFCs, which expand horizontally with a special focus product, SFBs have a chance to expand vertically and horizontally. This will enable them to have a good mix of medium and low-value customers. Also, rural and microfinance borrowers have low credit penetration and migrate less from one player to another. This will enable SFBs to build longer and loyal customer relationships.

INDUSTRY GROWTH AND OUTLOOK

Huge opportunity to support growth over next two years ("AUM")



SFBs' AUM is estimated to have clocked 29% CAGR from Fiscal 2018 to Fiscal 2023. CRISIL MI&A estimates that the top three SFBs accounted for approximately 62% of the aggregate AUM as of Fiscal 2023, compared to 55% as of Fiscal 2017, indicating the rising concentration and expansion of the top three players within the SFBs. CRISIL MI&A also estimates that the top six players accounted for approximately 89% of the market share as of Fiscal 2023. In Fiscal 2021 and Fiscal 2022, new loan origination remained low as SFBs turned cautious andselective in disbursals due to the pandemic. However, as the economy revived and business operations normalised, SFBs' AUM witnessed strong growth following the pandemic. As of Fiscal 2023, SFBs' AUM is estimated to have crossed Rs.1,800, billion growing at 26% - 27% year-on-year. CRISIL MI&A expects SFBs' loan portfolio to see a strong CAGR of approximately 22% between Fiscal 2023 and Fiscal 2025, as most SFBs have completed the transition phase and are likely to benefit from the operating leverage.

Growth in SFBs' AUM is likely to be driven by the following factors:

Huge market opportunity in the rural segment – Despite its larger contribution to GDP of 47%, the rural segment's share in credit remains fairly low at approximately 9-10% of the overall credit outstanding as of Fiscal 2022. This provides a huge market opportunity for SFBs and other players present in the segment

Presence of informal credit channels – In remote areas, informal credit channels have a major presence. In other words, there is a huge section of unbanked population. SFBs have an opportunity to tap this Market

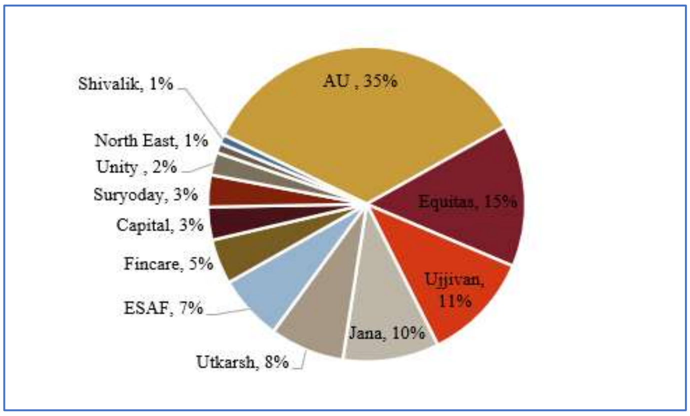
Geographic diversification – With increased focus on diversifying their portfolio and expanding their reach, SFBs are expected to log higher growth as they tap newer geographies

Loan recovery and control on aging NPAs – SFBs are experienced in collection and monitoring of default risk. This will help them keep asset quality under check

Ability to manage local stakeholders – With their microfinance experience, SFBs have the ability to manage local stakeholders and maintain operational efficiency

Access to low-cost funds & huge cross sell opportunity– SFBs' cost of funds is low substantially as they are allowed to raise CASA deposits. This will also help them lend at more reasonable rates to its customers, hence enhancing their cross-sell opportunity in terms of asset products, insurance etc.

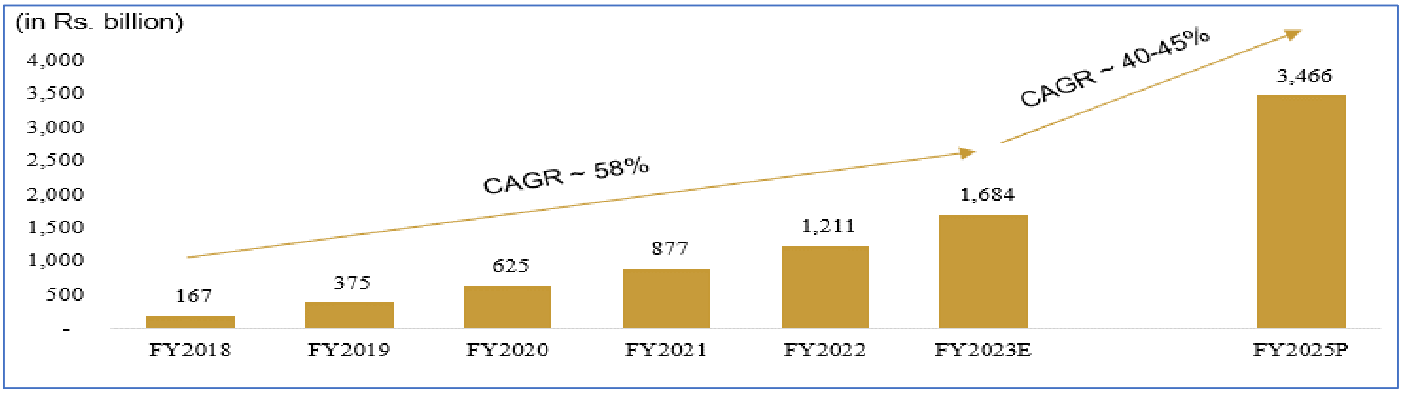
Top six players estimated for 84% of industry advances as of December 31, 2022



SFB deposits to grow faster than private and public-sector banks

SFBs have significant growth potential as most of them were functioning as NBFCs/MFIs previously. Immediately after commencement of their operation, all SFBs focused on increasing their deposit base. Their overall deposit base doubled to around Rs.375 billion as of Fiscal 2019. Further, proportion of CASA deposits has short up from nearly around 20% as of Fiscal 2020 to approximately 39% as of December 31, 2022. The increase could be attributed to the higher interest rates they offer and increase in their branch network. Deposit growth for SFBs continued to grow at a strong pace of 36% in the nine months ended December 31, 2022 year-on-year and is estimated to have reached Rs.1,684 billion at the end of Fiscal 2023. Going forward, CRISIL MI&A expects SFBs' deposit to grow at 40% - 45% CAGR over Fiscal 2023 – Fiscal 2025 as players focus on popularising convenient banking habits to cover the last mile and widen financial inclusion by deepening their penetration in untapped geographies.

SFB deposits to grow robustly

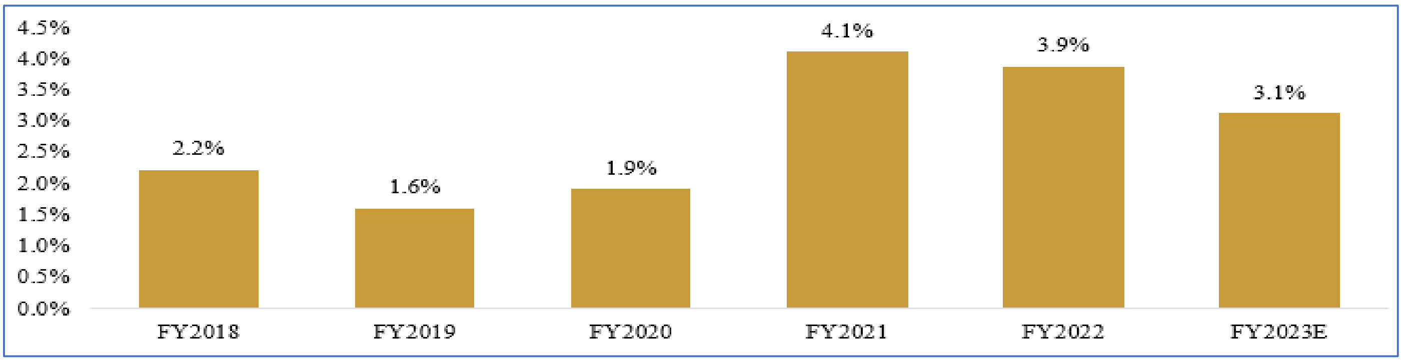


Asset quality for SFBs to marginally improve after pandemic-related stress

GNPA of SFBs improved to 1.6% as of Fiscal 2019 from 2.2% as of Fiscal 2018, which was significant impacted by demonetization and residual asset quality issues. This could be attributed to diversification of product mix into relatively less risky assets, write-off of legacy loans and reduction in microfinance loans due to better collection mechanism and deep understanding of their local geographies and customers. In Fiscal 2021, SFBs faced severe asset quality issues, as near-term collections saw disruptions on account of COVID-19. However, RBI in March 2020 announced the moratorium on term loans/ working capital for instalments falling due between March 1, 2020 and May 31, 2020. This was subsequently extended in May 2020 by another three months to August 31, 2020. A stand-still in asset classification for accounts availing the moratorium was provided from March 1, 2020 to August 31, 2020. For all accounts classified as standard as on February 29, 2020, even if overdue, the moratorium period, wherever granted, was to be excluded by the lending institutions from the number of days past-due for the purpose of asset classification. Recently, Government of India and RBI has announced various measures to support the stability of the financial service sector. These measures are likely to contain the impact of COVID-19 and economic slowdown.

Despite government measures, the lockdown impacted the low- and middle-income segments the most. They also happened to be the target audience of SFBs. While banks offered moratorium period to borrowers, SFBs' asset quality deteriorated due to difficulties faced by their borrowers. In Fiscal 2022, GNPAs improved marginally to 3.9%. In Fiscal 2023, the asset quality of SFBs improved on account of lower slippages, write-offs and improved collection efficiencies. GNPA for SFBs is estimated at 3.1% at the end of Fiscal 2023. The asset quality of SFBs is expected to improve further. However, it will vary depending on efficiency in credit underwriting, monitoring and collection over the long term.

GNPA trend of overall SFB Industry



ANALYSIS OF VARIOUS SEGMENTS

Microfinance

MFI Industry Gross Loan Portfolio witnessed robust year-on-year growth of 21.2% in Fiscal 2023; Rising penetration to support continued growth of the industry

Although India's household credit penetration on MFI loan has increased it is still on the lower side as only few states have higher penetration. There is huge untapped market available for MFI players. As at the end of March 2023, the microfinance industry had grown at a CAGR of 23% since Fiscal 2017. In Fiscal 2023, the industry grew by 21% year-on-year to reach Rs.3.4 trillion. The growth was driven by pent-up credit demand after the adverse impact of pandemic faded away, increased outreach to new customers, strong pick-up in disbursements across all lender groups, along with a growth in the average ticket size.

CRISIL MI&A expects the MFI loan portfolio to clock CAGR of 18% - 20% between Fiscal 2023 and Fiscal 2026. Key drivers behind superior growth outlook of the MFI industry include increasing presence of MFIs deep into the hinterland and expansion into newer states, faster growth in rural segments, expansion in average ticketsize, and support systems like Credit Bureaus. The presence of self-regulatory organisations ("**SRO**") like MFIN and Sa-Dhan is also expected to support sustainable growth of the industry going forward. Microfinance sector in India regulated by the RBI. The RBI's new regulatory regime for micro finance loans effective April 2022, which has done away with interest rate cap applicable on loans given by NBFC-MFIs, will also support growth by enabling players to calibrate pricing in line with customer risk.

Higher share of rural segment in MFI business to drive growth

CRISIL MI&A expects the share of rural segment in MFIs' business to remain higher, with burgeoning demand expected from this segment. With fewer branches and outlets in rural areas as compared with urban areas, the rural market in India is still under-penetrated, thereby opening up a huge opportunity for savings and loan products.

Over four years until Fiscal 2015, the share of the MFIs' urban clients rose sharply. According to Sa-dhan, share of urban borrowers increased due to rising focus of bigger lenders on urban clientele to achieve maximum operational efficiency and maintain profitability given the margin cap regulations. While only 33% of MFI clients were from rural areas in Fiscal 2015, with bigger players converting to SFBs and their exclusion, the share rose to 61% in Fiscal 2017. After Fiscal 2016, share of rural clientele has been higher and further increased to 75% in Fiscal 2022. Compared to banks, MFIs have higher focus on rural areas. CRISIL MI&A believes that establishing a good rapport with rural customers leads to longer and more loyal customer relationship, which can be further leveraged to cross-sell other products. With the government's focus on financial inclusion and increasing number of financial institutions opening up branches in the unbanked areas, CRISIL MI&A has seen that demand for loan is higher in rural areas. As of Fiscal 2022, the rural pie had accounted for 71% of the overall disbursement. Additionally, in terms of GLP, rural regions accounted for 75% of the overall portfolio of NBFC-MFIs, other NBFCs, and non-profit MFIs.

NBFCs outpace banks' MSME lending over Fiscals 2017 to 2023

NBFCs have managed to carve out a strong presence in MSME loans due to their focus on serving the needs of the customer segment, faster turnaround time, customer service provided and expansion in geographic reach. Over the years, the MSME portfolio of NBFCs has grown at a faster rate than the overall MSME portfolio at a systemic level. Under MSME lending, though banks account for a giant share, NBFCs gained approximately 4% of market share over Fiscal 2017 – Fiscal 2023, owing to their aggressive approach, higher risk-taking ability, and better leveraging of their property appraisal capabilities, despite slowing down post the IL&FS default. Banks are also losing share as some have triggered the RBI's 'prompt corrective action', which restricts lending. Moreover, inFiscal 2022 and Fiscal 2023, NBFCs increased their share as economic activity picked pace and collection efficiency improved.

Thus, the share of NBFCs in total credit to MSMEs is estimated to have increased to approximately 12% at the end of Fiscal 2023, from 8% as of Fiscal 2017. Going forward, CRISIL MI&A expects the competitive positioning of NBFCs to remain strong, given their strong target customer and product focus.

Key Concerns

- USFBL is subject to inspections by regulatory authorities, including by the RBI. Non-compliance with RBI inspection/ observations or other regulatory requirements or any adverse observations from such regulators may have a material adverse effect on its business, financial condition, results of operation or cash flows.

- A significant portion of advances in the microbanking segment are towards customers located in the states of Bihar and Uttar Pradesh, and any adverse changes in the conditions affecting the region can adversely impact the business, financial condition, results of operations and cash flows.

- Non-convertible debentures are listed on BSE and in the past, there were certain inadvertent delays by USFBL in making certain disclosures and regulatory filings to BSE under the Listing Regulations.

- USFBL has received a show cause notice from SEBI regarding alleged non-compliance of provisions of Companies Act 2013 and erstwhile SEBI (Issue and Listing of Debt Securities) Regulations, 2008 relating to public offering of securities which may result in penal actions.

- Bank is dependent on Key Managerial Personnel and Senior Management and the loss of, or inability to attract or retain, such persons could adversely affect the business, financial condition, results of operations and cash flows.

- Certain of the Directors, Key Managerial Personnel and Senior Management are interested in Bank in addition to the remuneration and reimbursement of expenses. Further, its Promoter is also interested in its Bank in addition to its shareholding.

- Deposits depend on a limited number of customers and a loss of such customers could materially and adversely affect the deposit portfolio, funding sources, financial condition, results of operations 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.

- Operations involve handling significant amounts of cash, making it susceptible to operational risks, including fraud, petty theft and embezzlement, which could harm its results of operations and financial position.

- Insurance coverage may be inadequate to cover claims. If it incurs substantial uninsured loss or loss that exceeds its insurance coverage, it could have a material adverse effect on its business, cash flows, results of operations and financial condition.

- A majority of advances, including its microbanking loan portfolio, are unsecured and are not supported by any collateral that could help ensure repayment of the loan. If USFBL is unable to recover such advances in a timely manner or at all, its financial condition, results of operations and cash flows may be adversely affected.

- USFBL is exposed to operational and credit risks which may result in NPAs.

- Bank and its Promoter are involved in certain legal proceedings, any adverse developments related to which could materially and adversely affect its business, reputation and cash flows.

- All Banking Outlets are on leased premises and it may enter into new lease arrangements for additional Banking Outlets. Any inability on its part to identify suitable premises or enter into or renew lease agreements on terms acceptable to it, may have an adverse effect on its operations.

- USFBL have certain contingent liabilities that have not been provided for in its financial statements, which, if they materialize, may adversely affect its results of operations, financial condition and cash flows.

- USFBL's operation depend on the accuracy and completeness of information about customers and counterparties which if inaccurate or materially misleading could adversely affect its business and results of operations.

- Bank is subject to stringent regulatory requirements and prudential norms of RBI and its inability to comply with such laws, regulations and norms may have an adverse effect on its business, results of operations, financial condition and cash flows.

- USFBL is currently significantly dependent on its microbanking segment, particularly joint liability group ("JLG") loans, and any adverse developments in this segment could adversely affect its business, results of operations, financial condition and cash flows

- Bank's business is vulnerable to interest rate risk, and any volatility in interest rates or inability to manage interest rate risk could adversely affect the Net Interest Margins, income from treasury operations, business, financial condition, results of operations and cash flows.

- The extent to which events such as the recent coronavirus (COVID-19) pandemic impacts Bank's business, cash flows, results of operations and financial condition will depend on future developments, which are highly uncertain and cannot be predicted.

- USFBL has a limited operating history as a SFB and its future financial and operational performance cannot be evaluated on account of its evolving and growing scale of operations.
- USFBL has a continuous requirement of funds and its inability to access sources of funds in an acceptable and timely manner or any disruption in the access to funds would adversely impact its results of operations, financial condition and cash flows.
- USFBL is required to comply with certain restrictive covenants under its financing agreements. Any non-compliance may lead to, amongst others, accelerated repayment schedule and suspension of further drawdowns, which may adversely affect the business, results of operations, financial condition and cash flows.
- The Bank undertakes certain fee and commission-based activities and its financial performance may be adversely affected by an inability to generate income from such activities.
- Operations could be adversely affected by strikes, work stoppages or increased wage demands by the employees or any other kind of disputes with its employees.
- USFBL experienced negative cash flow from operating activities in the past. If it does not maintain positive cash flow, it cannot assure you that it will be able to sustain its growth or achieve profitability in future periods.
- The value of collateral may decrease or it may experience delays in enforcing collateral when borrowers default on their obligations, which may result in failure to recover the expected value of collateral security exposing it to potential loss.
- Business relies extensively on information technology systems and any weakness, disruptions or failures in such systems, or breach of data, could adversely affect the operations and reputation.
- Inability to renew or maintain statutory and regulatory permits and approvals required to operate its business may adversely impact the business, financial condition and results of operation.
- USFBL has recently introduced new products and services and it cannot assure that such products and services will be profitable in the future. Further, it may not be able to successfully diversify its product portfolio or enter into new lines of business, which may materially and adversely affect its business prospects and impact its future financial performance.
- The Indian banking industry is very competitive and if USFBL is unable to compete effectively it would adversely affect its business, financial condition, results of operations and cash flows.
- The RBI may remove any employee, managerial personnel or may supersede Bank's Board of Directors in certain circumstances, which may materially affect its Bank's business, results of operations, and financial conditions.
- An inability to effectively manage growth and expansion may have a material adverse effect on the business prospects and future financial performance.
- Depends on brand recognition. Negative publicity, failure to maintain and enhance awareness of its brand would adversely affect its ability to retain and expand its base of customers.
- Any changes in the regulations that govern operations could have an adverse impact on the business, financial condition and results of operations.
- If risk management policies are ineffective, it could adversely affect the business, financial condition, results of operations and cash flows.
- Any adverse developments in the segments USFBL operates in, such as retail, wholesale, and housing, could adversely affect its business and results of operations.
- Inability to grow CASA deposits and CASA ratio may result in higher cost of deposits and impact its financial condition and cash flows.

- The SFB model is relatively new to India, and such operations pose various business and financial challenges.
- Bank may face asset liability mismatches, which could affect its liquidity and consequently may adversely affect its operations and profitability.
- Any downgrade of credit ratings could adversely affect the business
- USFBL utilizes the services of certain third parties for its operations. Any deficiency or interruption in their services could adversely affect the business and reputation.
- Business activities are subject to seasonality, which may contribute to fluctuations in results of operations and financial condition.
- Customers may engage in certain transactions in or with countries or persons that are subject to U.S. and other sanctions.
- If there is any change in laws or regulations, including taxation laws, or their interpretation, such changes may adversely affect the financial statements.
- Financial difficulty and other problems in certain financial and other non-banking financial institutions in India could materially adversely affect the business and the price of its Equity Shares.
- Fluctuation in the exchange rate between the Indian Rupee and foreign currencies may have an adverse effect on the value of Equity Shares, independent of its operating results.

Profit & Loss

Particulars (Rs in million)	FY23	FY22	FY21
INCOME			
Interest Earned	25049.8	18488.1	15809.9
Other Income	2993.1	1848.3	1248.5
Total	**28042.9**	**20336.5**	**17058.4**
EXPENDITURE			
Interest Expended	9759.5	7879.6	7417.4
Operating Expenses	9900.1	7337.5	5450.6
Provisions and Contingencies	4338.2	4504.7	3072.2
Total	**23997.8**	**19721.8**	**15940.2**
PROFIT/(LOSS)			
Net Profit / (Loss) for the period / year	**4045.0**	**614.6**	**1118.2**
EPS	4.5	0.7	1.5
FV	10.0	10.0	10.0

Balance Sheet

Particulars (Rs in million) As at	FY23	FY22	FY21
CAPITAL AND LIABILITIES			
Capital	8,959.1	8,955.2	8,483.3
Reserves and Surplus	11,044.2	6,767.8	5,200.2
Deposits	137,101.4	100,741.8	75,075.7
Borrowings	23,494.8	25,719.4	26,078.3
Other Liabilities and Provisions	10,576.1	8,453.6	6,541.7
Total	**191,175.4**	**150,637.7**	**121,379.1**
ASSETS			
Cash and balances with Reserve Bank of India	11,920.6	5,339.0	2,749.4
Balances with banks and money at call and short notice	13,243.1	13,377.5	8,948.8
Investments	28,594.2	23,479.2	23,139.4
Advances	130,687.7	102,281.5	82,168.6
Fixed Assets	3,033.2	2,865.3	1,811.7
Other Assets	3,696.7	3,295.2	2,561.3
Total	**191,175.4**	**150,637.7**	**121,379.1**
Contingent Liabilities	3,416.1	564.2	620.7
Bills for Collection	-	-	-

Source: RHP

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