



SMALL FINANCE BANKS MARCH 2019

Good progress; enhancement of retail
deposit franchise key success factor

Karthik Srinivasan
+91 22 6114 3444
karthiks@icraindia.com

Supreet Nijjar
+91 124 4545 324
supreetan@icraindia.com

Prateek Mittal
+91 33 7150 1132
prateek.mittal@icraindia.com

CONTENTS

1. Executive Summary	03
2. Overview	05
3. Outlook	06
4. Industry Trends	07
Portfolio growth picks up in 9M FY2019	08
Diversification in process; however, portfolios of most SFBs focussed on unsecured segments	09
Improving asset quality indicators as demonetisation impact absorbed	10
Good traction in bulk deposit mobilisation	11
Liquidity supported by favourable asset mix and long-term funding from FIs	13
Regular capital infusions support capitalisation profile	14
Improvement in profitability supported by stabilisation of operations and lower credit costs	15
Key credit factors and outlook	16
5. Competitive Positioning of SFBs and MFIs	17
6. Annexure	18
Annexure 1: Comparison of key guidelines of new universal banks, SFBs and NBFC-MFIs	19
Annexure 2: Consolidated financials	21
Annexure 3: List of entities used for consolidation of financials	22
Annexure 4: List of SFBs rated by ICRA as on March 10, 2019	23



Executive Summary



HIGHLIGHTS

- SFBs reported annualised growth of 33% in assets under management in 9M FY2019 to Rs. 64,325 crore as on December 31, 2018 (17% growth in FY2018)
- Asset quality indicators improved with gross NPA at 5.8% as on December 31, 2018 (2.1% as on December 31, 2018, excluding one large player)
- Good progress on deposit mobilisation with deposits—mostly bulk—accounting for 54% of the borrowings, as on September 30, 2018
- Cost of funds has reduced despite the rate offered on deposits being 100-150 bps higher than that offered by other full-service banks
- Good liquidity profile supported by shorter-tenor assets and high share of non-callable long-term deposits from FIs like NABARD, SIDBI and MUDRA
- Good capitalisation indicators
- Several SFBs are owned through holding company structures; as per RBI guidelines, they will have to be listed before completion of three years of commencing operations
- Setting up and upgradation of existing branches, systems upgradation, and hiring of manpower has kept the operating expense ratios high; however, some signs of moderation are visible with marginal reduction seen in 9M FY2019

OVERVIEW

SFBs reported annualised growth of 33% in the assets under management (AUM) in 9M FY2019 to Rs. 64,325 crore as on December 31, 2018 (17% growth in FY2018). The pace of growth has picked up as operations have stabilised and most SFBs have made considerable progress on branch stabilisation. SFBs have also been able to diversify their product mix, which has led to a decline in the share of microfinance as an asset class to 44% of AUM as on December 31, 2018 from 60% as on March 31, 2017.

The asset quality indicators of SFBs improved with gross NPA at 5.8% as on December 31, 2018 (9.0% as on March 31, 2018). However, if we were to exclude one large player, an outlier in terms of asset quality, the overall gross NPA was lower at 2.1% as on December 31, 2018 (3.1% as on March 31, 2018).

The overall capitalisation levels of SFBs have been good, supported by regular capital infusions into most of the entities. However, since several SFBs are owned through holding company structures, as per RBI guidelines, they will have to be listed before the completion of three years of operations. This would have to be worked out as some SFBs are approaching the three-year timeline in FY2020. Moreover, the promoters' stake would have to be brought down to 40% or lower, within five years of operations, so that would also need to be worked out.

SFBs have made good progress on deposit mobilisation with deposits accounting for 54% of the borrowings, as on September 30, 2018. Nevertheless, most of these are bulk deposits and certificates of deposits, as developing the retail franchise will take longer. The cost of funds for SFBs declined, supported by the higher share of funding from financial institutions (FIs) and deposits, despite the rate offered on deposits being 100-150 bps higher than that offered by other full-service banks.

On the liquidity front, SFBs have been able to maintain a favourable asset liability maturity profile supported by shorter-tenor assets and high share of non-callable deposits raised by them. Further, like other scheduled commercial banks (SCBs), SFBs are eligible for additional liquidity support including interbank limits and have access to the call money market as well. While these factors support the near-term liquidity position, ability to develop a strong franchise and hence, a retail deposit base is critical from a long-term perspective. All SFBs are eligible for deposit insurance, which enhances their ability to mobilise retail deposits as this provides more confidence to retail depositors and can help maintain stability of retail deposits.

Owing to the focus of SFBs on higher-yielding asset classes, portfolio yields and net interest margins continue to be higher than that of SCBs. Net interest margins have improved owing to high lending yields and reduction in cost of funds as share of deposits in overall borrowings has increased. The setting up and upgradation of existing branches, systems upgradation, and the hiring of manpower have kept the operating expense ratios high. However, signs of moderation were visible with a marginal reduction in 9M FY2019. The overall profitability of the SFBs improved (except for one player), supported by higher NIMs and lower credit costs.

ABOUT ICRA

ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange.

Alliance with Moody's Investors Service

The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder. The participation of Moody's is supported by a Technical Services Agreement, which entails Moody's providing certain high-value technical services to ICRA. Specifically, the agreement is aimed at benefiting ICRA's in-house research capabilities, and providing it with access to Moody's global research base. The agreement also envisages Moody's conducting regular training and business seminars for ICRA analysts on various subjects to help them better understand and manage concepts and issues relating to the development of the capital markets in India. Besides this formal training programme, the agreement provides for Moody's advising ICRA on Rating-products strategy, and the Ratings business in general.

The ICRA Factor

Our services are designed to

- Provide information and guidance to institutional and individual investors/creditors;
- Enhance the ability of borrowers/issuers to access the money market and the capital market for tapping a larger volume of resources from a wider range of the investing public;
- Assist the regulators in promoting transparency in the financial markets;
- Provide intermediaries with a tool to improve efficiency in the funds raising process.

Business Contacts

Mr. L. Shivakumar
E-mail: shivakumar@icraindia.com
Tel: +91 22 6114 3406 / +91 98210 86490

Mr. Jayanta Chatterjee
E-mail: jayantac@icraindia.com
Tel: +91 80 4332 6401/ +91 98450 22459

Media and Public Relations

Ms. Naznin Prodhani
E-mail: communications@icraindia.com
Tel: +91 124 4545 860

Registered Office:

1105, Kailash Building, 11th Floor,
26, Kasturba Gandhi Marg,
New Delhi - 110 001
Tel: + 91 11 2335 7940-45

Corporate Office:

Building No.8, 2nd Floor,
Tower A, DLF Cyber City Phase II,
Gurgaon- 122 002
Tel: +91 124 4545300

Ahmedabad

1809-1811, Shapath V,
Opposite Karnavati Club
S.G. Highway, Ahmedabad - 380015
Tel: +91 79 4027 1500/01

Bengaluru 1

'The Millenia', Tower- B, Unit No. 1004,
10th Floor, 1 & 2 Murphy Road,
Bengaluru - 560 008
Tel: +91 80 4332 6400

Bengaluru 2

2nd Floor, Vayudooth Chamber,
15-16, Trinity Circle, M.G. Road,
Bengaluru - 560 001
Tel: +91 80 4922 5500

Chennai

5th Floor, Karumuttu Centre,
634, Anna Salai, Nandanam
Chennai - 600 035
Tel: +91 44 4596 4300

Hyderabad 1

No. 7-1-58, 301, 3rd Floor, 'CONCOURSE',
Above SBI-HPS Branch, Ameerpet,
Hyderabad - 500 016
Tel: +91 40 4920 0200

Hyderabad 2

4A, 4th Floor, SHOBHAN,
6-3-927, A&B Somajiguda,
Raj Bhavan Road,
Hyderabad – 500082
Tel: +91 40 40676500

Kolkata

A-10 & 11, 3rd Floor,
FMC Fortuna 234/3A,
A.J.C. Bose Road,
Kolkata -700 020
Tel: +91 33 7150 1100/01

Mumbai

3rd Floor, Electric Mansion
Appasaheb Marathe Marg,
Prabhadevi,
Mumbai - 400 025
Tel: +91 22 6169 3300

Pune

5A, 5th Floor, Symphony,
S. No. 210 CTS 3202 Range Hills Road,
Shivajinagar, Pune - 411 020
Tel: +91 20 2556 0194, 020 6606 9999

Email: info@icraindia.com

Helpdesk: 9354738909

Website: www.icra.in/ www.icraresearch.in