

IPO Report

Choice

“SUBSCRIBE” to

Utkarsh Small Finance Bank

Attractively priced



Salient features of the IPO:

- **Utkarsh Small Finance Bank (USFB)** commenced banking operations in Jan'2017 after getting SFB licence from the RBI.
- Headquarter in Varanasi, the bank has a significant business presence in Uttar Pradesh and Bihar states which cumulatively held 57% share in the bank's gross loan portfolio as of FY23.
- USFB's gross loan book stood at Rs13,947 cr in FY23 of which 66% comprised by microfinance segment.
- USFB is coming out with initial public offering of Rs500 cr. The issue is pure fresh issue.
- Issue will open for subscription on July 12' 2023 and close on July 14' 2023.

Key competitive strengths:

- Sound understanding of microfinance segment and presence in rural and semi-urban areas
- Growing deposits with focus on retail deposits
- Diversified distribution network with significant cross-selling opportunities
- Focus on risk managements and effective operations
- Stable growth and cost efficient operational performance

Valuation: At the higher price band of Rs25, USFB's issue is priced at P/ABV of 1.1x on post issue Adj. BVPS which is available at discount of peer's average of P/ABV 1.8x.

Below are the key highlights of the company:

- USFB commenced banking operation in Jan'2017 after getting the banking licence from the RBI. The bank business is majorly dominated by microfinance loans given the legacy of its promoter Utkarsh CoreInvest which was a microfinancier. Utkarsh CoreInvest Limited, commenced its operations as a NBFC in Fiscal 2010 and was focused on providing microfinance to unserved and underserved segments and in particular in the states of Uttar Pradesh and Bihar. Subsequent to obtaining the banking licence on Nov'2016, Coreinvest transferred its microfinance business to bank.
- Share of microfinance book stood at 66% of the book, though it reduced from 82% in FY21 as the bank is diversifying book across housing, retail, CE/CV and wholesale segments. Headquarter in Varanasi, the bank has a significant exposure to Uttar Pradesh and Bihar states which cumulatively held 57% of the gross loan portfolio as of FY23. While the bank has extended its presence in 26 states and Union Territories with 830 banking outlets and 15,425 employees serving 3.59 mn customers majorly located in rural and semi-urban areas. 27% of the total banking outlets is located in the unbanked rural centres (URCs).
- On the business front, USFB's advances (net) book stood at Rs13,069 cr and deposits at Rs13,710 cr in FY23. Microfinance accounted for major portion of the book at 66% followed by retail at 11%, wholesale at 11%, housing at 3.7% and CE/CV at 4% among other.
- Gross loan portfolio of the bank grew at a CAGR of 31% over FY19-23 to Rs13,957 cr out of which 66% or Rs9,216 cr comprised by microfinance segment as of FY23. Leveraging the experience of JLG financing, the bank recognize the cross sell opportunity to individual by offering loans like affordable housing, PL based on the credit behavior of the customer in the group. While the share of non-micro book increasing (from 18% in FY21 to 34% in FY23, USFB emphasized to remain focused on micro lending.

Recommendation	Subscribe
Price Band	Rs23 - Rs25 per share
Face Value	Rs10 per share
Fresh Issue Size	Rs500 cr
Share for Fresh Issue	20 cr shares
OFS Issue Size	Nil
Total Issue Size	Rs500 cr
Bidding Date	Jul 12' 2023 - Jul 14' 2023
MCAP at Higher Price Band	Rs2,740 cr

Book Running Lead Manager ICICI Securities Limited, Kotak Mahindra Capital Company Limited

Registrar	Kfin Technologies Private Limited
Industry	Banking

Retail application money at higher cut-off price per lot

Number of shares per lot	600
Application Money	Rs15,000 per lot

Allocation Detail

Qualified Institutional Buyers (QIB)	75%
Non-Institutional Investors (NII)	15%
Retail Individual Investors (RIIs)	10%

Shareholding Pattern

	Pre-Issue	Post Issue
Promoter & promoter group	84.8%	69.3%
Public	15.2%	30.7%
Total	100.0%	100.0%
No. of Shares (cr)	90	110

Analyst

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Key highlights of the company (Contd...):

- The bank disburses micro loans primarily to women entrepreneurs under JLG model with a maturity of 12 to 48 months. In FY23, average ticket size of micro loans was Rs40,000 and yield on micro loans stood at ~22%. GNPA ratio of the microfinance sector remained higher at 4.1% in FY23 v/s retail at 1.36%, wholesale at 0.0% and housing at 5.1%.
- USFB's deposits book grew at a CAGR of 35.1% to Rs13,710 cr in FY21-23E as compared to net advances CAGR of 26% during the same period. C/D ratio stood at 95% below than the peer average of 100%. Contrary to USFB's disbursements focus on semi-urban and rural geographies, the bank relies on urban and metropolitan geographies to fund the growth as these together accounted for 93% of total deposits. Thereby deposits accumulation to remain challenge for the small finance banks including USFB amidst high competitions from the large banks.
- COF stood higher at 7.0% due to the low CASA share of 21% as the bank has to offer higher deposits rate to make a place in higher competition. Though the impact is offset by high yield on loans over >15%. NIM of the bank stood at 9.6% in FY23. C/I ratio at 54.2%, lower than peer avg. of 60%, seems better given the required higher employees expenses due to microfinance business model.
- GNPA/NNPA stood at 3.2%/0.4% in FY23 with PCR at 88%. Standard restructure advances reduced to 0.22% of loans (v/s 1.26% in FY22). Credit cost reduced to 2.6% in FY23 v/s 5.0% in FY22. Management expressed confidence of credit cost to remain around last fiscal level in the coming fiscals.
- In FY23, the bank reported PAT of Rs405 cr on the back of strong core PPOP and lower credit cost. ROE rose to 22.8% in FY23 from 4.1% in FY22. RoA rose to 2.4% in FY23 v/s 0.5% in FY22. Microfinance segment is highly correlated to economic situations and generates superb profitability during the stable macro-economic phase.
- Given the bank presences in low credit penetrated states Uttar Pradesh and Bihar which represents only 5% and 1% in overall country's credit outstanding, we expect USFB's loan growth to remain strong going forward. Further the prevailing economic situation indicates the strong profitability trend of SFBs to continue in the near to medium term. The bank proposed to raise Rs500 cr through the public issues to augment its Tier I capital to meet future capital requirements. With the fresh capital raise of Rs500 cr, bank tier I capital is expected to increase by 500 bps to ~23%. Bank's strategized to continue diversify assets portfolio, grow retail deposits mix across geographies and customers segments to build stable funding source, increase share of fee income and capitalize cross sell opportunities and enhance the use of technologies and digital offering.
- At the higher price band of Rs25, USFB's issue is priced at P/ABV of 1.1x on post issue Adj. BVPS which is available at discount of peer's average P/ABV of 1.8x. Given the strong growth prospect and expectation of stable credit cost trajectory, we assign 'Subscribe' rating to the issue.

Companies (Rs cr)	CMP (Rs/sh)	6M R%	12M R%	M Cap	P/ABV (x)	P/E (x)	NIM (%)	GNPA (%)	NNPA (%)	CAR (%)
Utkarsh SFB	25	-	-	2,740	1.1	6.8	9.6%	3.2%	0.4%	20.6%
Suryoday SFB	170	49%	104%	1,802	1.2	23.2	9.5%	3.1%	1.6%	33.7%
Equitas SFB	94	64%	134%	10,434	2.2	18.2	9.0%	2.8%	1.2%	23.8%
Ujjivan SFB	42	42%	158%	8,211	2.0	7.5	9.5%	2.9%	0.0%	25.8%

Companies (Rs cr)	RoE (%)	RoA (%)	C/I (%)	C/D (%)	CASA (%)	Net Worth	PAT TTM	Advances	Deposits	Total Assets
Utkarsh SFB	22.8%	2.4%	54.2%	95.3%	20.9%	2,500	405	13,069	13,710	19,618
Suryoday SFB	4.9%	0.8%	60.0%	116.4%	17.1%	1,585	78	6,015	5,167	9,861
Equitas SFB	11.1%	1.6%	63.4%	101.7%	42.3%	5,158	574	25,799	25,380	34,958
Ujjivan SFB	26.2%	3.3%	55.0%	83.4%	26.4%	4,206	1,100	21,290	25,538	3,332

* - BVPS, Net Worth on post issue basis

Source: Choice Equity Broking

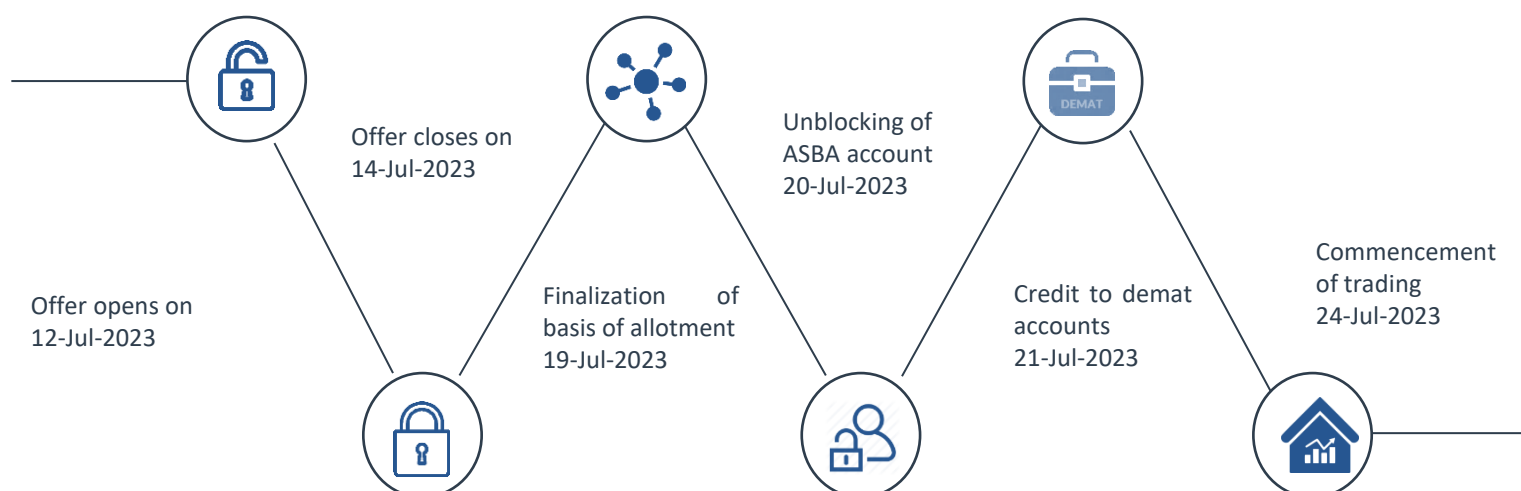
About the issue:

- Utkarsh Small Finance Bank (USFB) is coming out with initial public offering of Rs500 cr.
- The issue is pure fresh issue. Existing shareholders are not participating in the issue.
- Issue price is fixed at Rs23 – Rs25 per share.
- At the higher price band of Rs25, the issue offers 20 cr of fresh issue shares.
- The net proceed from the issue is proposed to be utilized towards augmentation of Bank's Tier I capital base to meet bank's future capital requirements.
- Fresh issue of 20 cr of shares will lead to 18% dilution in post issue paid up capital of the bank.
- Issue will open for subscription on July 12' 2023 and close on July 14' 2023.
- Not less than 75% of the net offer shall be available for allocation on a proportional basis to qualified institutional Investors (QIIs).
- Further not more than 15% shall be available for allocation on a proportional to non-institutional investors (NIIs) and not more than 10% of net offer shall be available for allocation to Retail Institutional Investors (RIIs).
- Anchor book allocation will be done on July 11' 2023.
- Stake of promoter and promoter group will reduce to 69.3% post-issue from 84.8% pre-issue level.
- The average cost of acquisition of equity shares of promoter is Rs10.5 per equity share.

Pre and post-issue shareholding pattern (%)		
	Pre-issue	Post-issue (at higher price band)
Promoter & promoter group	84.8%	69.3%
Public	15.2%	30.7%

Source: Choice Equity Broking

Indicative IPO process time line:



Company Introduction and Business Overview

USFB, headquarter in Varanasi, Uttar Pradesh, received the RBI In-Principle approval to establish SFB in Oct'2015 following which Utkarsh CoreInvest, the promoter of bank, transferred its business of providing microfinance to bank, which commenced banking operations in Jan'2017. The bank has now presence in 26 states and Union Territories with 830 banking outlets and 15,425 employees as of Mar' 2023. 27% of the total banking outlets are located in unbanked rural centres (URCs). As of Mar'2023, the bank has 3.59 mn customers majorly located in rural and semi-urban areas primarily in the states of Bihar and Uttar Pradesh that are among the states in FY22 which reflects best assets but with low and moderate credit penetration. These states constituted 31% and 26% of gross loan portfolio of total gross loan portfolio as of Mar'2023. Taking legacy of promoter as a NBFC, microfinance is a focused business segment of bank.

Bank's assets products include microfinance loans, retail loans which includes unsecured loans such as business & personal loans and secured loans such as loan against property, wholesale lending, housing loans, commercial vehicles/ construction loans and gold loans. 56% of the book related to rural and semi-urban area and 78% of the book qualified as the priority sector lending in FY23. Share of microfinance segment stood at 66% of gross loan portfolio in FY23 which reduced from 75% in the previous fiscal. The share of other segments include housing loans at 3.7% of book, retail at 11%, wholesale at 11%, BC at 2.7%, CE/CV at 4% and others at 1.5% of the loan book. As of FY23, advances (net) book stood at Rs13,069 cr and deposits at Rs13,710 cr with credit/deposits ratio at 95%. CASA ratio stood at 21% of total deposits while retail term deposits comprises 41% of total deposits. The bank reported PAT of Rs405 cr in FY23 v/s Rs61 cr in FY22. RoE improved to 22.8% in FY23 as compared to 4.1% in FY22 and 10.0% in FY21. Assets quality remained stable with GNPA/NNPA at 3.23%/0.39% with PCR at 88%.

Particulars (Rs cr)	FY21	FY22	FY23
Gross loan portfolio	8,416	10,631	13,957
Disbursements	5,914	9,046	12,443
Deposits	7,508	10,074	13,710
C/D (%)	109.5%	101.5%	95.3%
Capital & Reserves	1,368	1,572	2,000
Net Interest Income	839	1,061	1,529
Net Interest Margin	8.2%	8.8%	9.6%
PAT	112	61	405
RoE (%)	10.0%	4.1%	22.8%
RoA (%)	1.1%	0.5%	2.4%
Avg. Yield (%)	15.5%	15.2%	15.7%
CoF	8.3%	7.5%	7.0%
CASA + Retail Term Deposits share	57.5%	59.6%	61.6%
CASA	17.7%	22.4%	20.9%
Cost to Income	56.5%	58.9%	54.2%
GNPA	3.75%	6.10%	3.23%
NNPA	1.33%	2.31%	0.39%
PCR	65.5%	63.6%	88.3%
CRAR	21.9%	21.6%	20.6%

Source – RHP, Choice Equity Broking



Competitive strengths:

- Sound understanding of microfinance segment and presence in rural and semi-urban areas
- Growing deposits with focus on retail deposits
- Diversified distribution network with significant cross-selling opportunities
- Focus on risk managements and effective operations
- Stable growth and cost efficient operational performance

Business strategy:

- Continue diversify retail assets portfolio
- Grow retail deposits mix across geographies and customers segments to build stable funding source
- Increasing share of fee income and capitalize on cross selling opportunities
- Increasing use of technology and digital offerings for the last mile delivery of customers



Risk and concerns:

- Large microfinance exposure to Bihar and Uttar Pradesh
- Business is more sensitive to macro risk given >65% share of microloan in book
- Increasing competition for deposits accumulation can impact growth
- Higher operating cost due to legacy of microfinance business

Financial statements:

Rs crore

Profit And Loss Statement

Particulars	FY21	FY22	FY23
Interest Earned	1,581	1,849	2,505
Growth (%)		16.9%	35.5%
Interest Expended	742	788	976
Growth (%)		6.2%	23.9%
Net Interest Income	839	1,061	1,529
Net Interest Margin	8.2%	8.8%	9.6%
Other Income	125	185	299
% of Interest Income	7.9%	10.0%	11.9%
Total Income	964	1,246	1,828
Growth (%)		29.2%	46.8%
Operating & Other expenses	545	734	990
Pre-Prov. Operating Profit	419	512	838
Provisions and contingencies	268	432	303
P&C % of Advances		4.2%	2.3%
Operating Profit before Tax	151	80	536
Growth (%)		-47.4%	572.2%
Pre-tax Margin %	15.7%	6.4%	29.3%
Tax	39.6	18.3	131.3
% of PBT	26.2%	22.9%	24.5%
Reported PAT	112	61	405
Net Profit Margin %	11.6%	4.9%	22.1%
Extrordinary Income			
Adjusted PAT	112	61	405
Growth (%)		-45.0%	558.1%

Balance Sheet

Particulars	FY21	FY22	FY23
Cash and balance with RBI	1,105	1,798	1,192
Balances with banks and money at call and short notice	65	74	1,324
Investments	2,314	2,348	2,859
Advances	8,217	10,228	13,069
Fixed assets	181	287	303
Other assets	256	330	370
TOTAL ASSETS	12,138	15,064	19,118
Capital	848	896	896
Reserves and Surplus	520	677	1,104
Deposits	7,508	10,074	13,710
Borrowings	2,608	2,572	2,349
Other liabilities and provisions	654	845	1,058
TOTAL CAPITAL AND LIABILITIES	12,138	15,064	19,118

Financial Ratios

Particulars	FY21	FY22	FY23
Return / Profitability Ratios (%)			
Net interest margin (NIM)	8.2%	8.8%	9.6%
Yield on advances	15.5%	15.2%	15.7%
Yield on investments	6.4%	6.6%	7.7%
EPS (Diluted) (Rs)	1.0	0.6	3.7
RoA	1.1%	0.5%	2.4%
RoE	10.0%	4.1%	22.8%
Cost of Deposits	6.4%	6.5%	8.8%
Operating ratios (%)			
Credit to Deposit (C/D)	109.4%	101.5%	95.3%
Cost-to-income (C/I)	56.5%	58.9%	54.1%
CASA (share)	17.7%	22.4%	20.9%
Investment / Deposit (I/D)	30.8%	23.3%	20.9%
Non interest income / Total income	12.9%	14.8%	16.4%
Capitalization Ratios (%)			
CET	20.0%	18.1%	18.3%
Tier-1	20.0%	18.1%	18.3%
Tier-2	1.9%	3.5%	2.4%
CAR (Basel III)	21.9%	21.6%	20.6%
Equity / Assets	11.3%	10.4%	10.5%
Loans / Assets	67.7%	67.9%	68.4%
Investments / Assets	19.1%	15.6%	15.0%
Asset Quality ratios (%)			
GNPA	3.8%	6.1%	3.2%
NNPA	1.3%	2.3%	0.4%
Coverage Ratio	65.5%	63.6%	88.3%
Per Share Data (Rs)			
EPS (Diluted)	1.0	0.6	3.7
BVPS	12.5	14.3	22.8
Adjusted BVPS	11.5	12.2	17.8
Valuation ratios (x)			
P/E (x)	24.5	44.6	6.8
P/BV (x)	2.0	1.7	1.1
P/ABV (x)	2.2	2.0	1.4
Growth ratios (%)			
Advances		24.5%	27.8%
Deposits		34.2%	36.1%
Net interest income		26.4%	44.1%
Interest Earned		16.9%	35.5%
PAT		-45.0%	558.1%

Note: Pre-IPO financials; Source: Choice Equity Broking

IPO rating rationale

Subscribe: An IPO with strong growth prospects and valuation comfort.

Subscribe with Caution: Relatively better growth prospects but with valuation discomfort.

Avoid: Concerns on both fundamentals and demanded valuation.

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