UTKARSH SMALL FINANCE BANK LIMITED
IPO Note
Date: 11.07.2023

Utkarsh SFB is one of the leading small finance banking with 830 branches across 26 states majorly concentrated in eastern UP and Bihar. There is huge demand of loan for micro business/enterprises among such under penetrated and largely populated states of India like UP and Bihar.

Company is available at P/BVPS of 1.12x, which is lower as compared to peer competitors; however performance of Net interest margin in future as it could see pressure due to increase in cost of funds. Hence, we recommend to subscribe the issue for Listing gains.

Issue details

Price Band (Rs in per share)	23-25
Issue size (Rs in Crore)	500.00
Fresh Issue size (Rs in Crore)	500.00
OFS Issue size (Rs in Crore)	NA
Issue open date	12-07-2023
Issue close date	14-07-2023
Tentative date of Allotment	19-07-2023
Tentative date of Listing	24-07-2023
Total number of shares (lakhs)	2173.91-2000.00
No. of shares for QIBs (75%) (lakhs)	1614.13-1485.00
No. of shares for NII (15%) (lakhs)	322.83-297.00
No. of shares for retail investors (10%) (lakhs)	215.22-198.00
No. of shares for employees (lakhs)	21.74-20.00
Minimum order quantity	600
Face value (in Rs)	10
Amount for retail investors (1 lot)	13800-15000
Maximum number of shares for Retail investors at lower Band	8400(14 Lots)
Maximum number of shares for Retail investors at upper band	7800(13 lots)
Maximum amount for retail investors at lower Band- upper band (in Rs)	193200-195000
Exchanges to be listed on	BSE, NSE

About the Company:

Utkarsh Small Finance Bank Ltd 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 ₹ 60 billion. Promoter, 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. Bank have headquarters located in Varanasi, Uttar Pradesh and have over the years expanded SFB operations strategically in States where bank have been able to leverage the prior microfinance experience of Utkarsh CoreInvest Limited.

RESEARCH ANALYST

Sankita V
sankita@canmoney.in | Tel 022-43603863
canmoney.in
A route to making money online

Promoters

Utkarsh CoreInvest Limited

Objective of the Offer

- To augment its Tier-1 capital base to meet its future capital requirements
- To meet the expenses in relation to issue.

Financials

Brief Financials			
Particulars (Rs. Cr)*	**FY23**	**FY22**	**FY21**
Share Capital	895.91	895.52	848.33
Net Worth	2000.32	1572.30	1368.35
Interest Earned	2504.98	1848.81	1580.99
Net Profit	404.50	61.46	111.82
Net Interest Margin (%)	8.20%	8.75%	9.57%
Gross NPAs (%)	3.75%	6.10%	3.23%
Net NPAs (%)	1.33%	2.31%	0.39%
Basic EPS	4.52	0.70	1.46
Net Asset Value (Rs)	22.33	17.56	16.13
P/E#	5.53	NA	NA
P/B #	1.12	NA	NA

*Source: RHP # Calculated at the upper price band, * Restated summary*

Industry Review:

GLOBAL ECONOMIC OVERVIEW

The global economy is witnessing tightening of monetary conditions in most regions. As per the IMF (World Economic Outlook Update – April 2023), global growth prospects are estimated to fall from 3.4% in 2022 to 2.8% in 2023 and then witness an increase in 2024 to 3.0%, the impact of which is expected to be witnessed in the Indian economy as well. Global trade is estimated to have reached a record level of approximately US$ 32 trillion in 2022, but its growth had turned negative during the second half of 2022. The trade outlook for 2023 is expected to be negatively impacted because of geopolitical frictions, persisting inflation and lower global demand. Further, deceleration in domestic growth could lead to some reduction in imports.

CRISIL MI&A expects growth outlook for Fiscal 2024 to be fettered with multiple risks, including sluggish exports and lagged impact of rate hikes manifested fully into the economy. Nevertheless, India is expected to remain the fastest growing economy in the world with GDP growth of 6.0% projected in Fiscal 2024 as per CRISIL MI&A. The IMF too estimates India's GDP to have grown by 6.8% in 2022 due to its broad range of fiscal, monetary and health responses. The IMF projects the growth to slow down to 5.9% in 2023, before picking up to 6.3% in 2024.

There is a wide variation across states and within various districts in the same state as well in terms of credit, which indicates latent opportunity for providing banking services to unserved or underserved customers.

State-wise rural credit accounts in banks and top five districts concentration (Fiscal 2022)

State	No. of districts	% share in overall population in India	Share in overall credit	Credit to Deposit ratio	Concentration of credit in top 5 districts	% of credit in rural areas	Concentration of credit accounts in top 5 districts*	% credit accounts in rural areas
Maharashtra	36	9%	27%	92%	90%	2%	77%	7%
NCT of Delhi	11	1%	12%	93%	100%	0%	100%	0%
Tamil Nadu	38	6%	9%	99%	62%	11%	44%	27%
Karnataka	31	5%	7%	58%	75%	8%	50%	28%
Gujarat	33	5%	5%	69%	72%	6%	49%	18%
Telangana	33	3%	5%	92%	79%	6%	48%	22%
Uttar Pradesh	75	17%	5%	40%	38%	17%	23%	37%
Andhra Pradesh	26	4%	4%	128%	64%	15%	49%	29%

State	No. of districts	% share in overall population in India	Share in overall credit	Credit to Deposit ratio	Concentration of credit in top 5 districts	% of credit in rural areas	Concentration of credit accounts in top 5 districts*	% credit accounts in rural areas
West Bengal	23	8%	4%	45%	73%	14%	47%	45%
Kerala	14	3%	3%	59%	66%	2%	52%	4%
Rajasthan	33	6%	3%	73%	53%	14%	40%	30%
Madhya Pradesh	52	6%	3%	65%	54%	12%	33%	25%
Haryana	22	2%	3%	53%	62%	8%	44%	19%
Punjab	23	2%	2%	52%	61%	19%	46%	28%
Bihar	38	9%	1%	38%	46%	22%	36%	48%
Odisha	30	3%	1%	39%	61%	19%	47%	51%
Chhattisgarh	28	2%	1%	64%	73%	8%	52%	22%
Assam	34	3%	1%	46%	50%	23%	37%	43%
Jharkhand	24	3%	1%	29%	68%	18%	53%	49%
Chandigarh	1	0%	1%	90%	100%	0%	100%	1%
Jammu & Kashmir	20	1%	1%	49%	60%	35%	50%	50%
Uttarakhand	13	1%	1%	34%	89%	21%	82%	32%
Himachal Pradesh	12	1%	0%	30%	74%	58%	68%	69%
Goa	2	0%	0%	24%	100%	17%	100%	31%
Puducherry	4	0%	0%	60%	100%	10%	100%	15%
Tripura	8	0%	0%	33%	87%	30%	83%	37%
Meghalaya	12	0%	0%	29%	93%	36%	88%	44%
Manipur	16	0%	0%	59%	83%	29%	82%	28%
Nagaland	12	0%	0%	43%	84%	23%	81%	27%
Arunachal Pradesh	25	0%	0%	23%	72%	27%	65%	33%

Note: Arranged in descending order of share in overall credit outstanding of banks, (*) As of Fiscal 2021.
Source: RBI, CRISIL MI&A.

With high focus on retail loans, NBFCs and NBFC-MFIs driving financial inclusion

While banks are the primary institutions for banking in India, retail loan portfolio forms only 31% of the overall banking credit. Other focus areas for banks are wholesale lending to large corporates, credit to services sector and agriculture sector. Lower presence of banks in the retail space has created an opportunity for NBFCs and NBFCMFIs to penetrate the segment, which has also led to greater financial inclusion as NBFCs, and NBFC-MFIs cater to riskier customer profiles with lower income. Compared to that of banks, NBFC credit to retail segment forms more than 60% of its portfolio and NBFC-MFI exclusively into retail indicating larger focus on retail customers.

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.

Canara Bank Securities Ltd

Comparison of different business models

	Scheduled commercial banks	SFBs	MFIs
Priority sector lending			
Targeted lending to sectors	• 40% of their adjusted net bank credit (“**ANBC**”) or equivalent off-balance sheet exposure (whichever is higher) for priority sector lending • 18% of ANBC to agriculture • 7.5% of ANBC to micro-enterprises • 10% of ANBC to weaker sections	• 75% of their ANBC for priority sector lending • 18% of ANBC to agriculture • 7.5% of ANBC to micro-enterprises • 12% of ANBC to weaker sections • At least 50% of loan portfolio should constitute loans and advances of up to ₹ 2.5 million	• 75% of total assets should be qualifying micro-finance loans • Income generation loans greater than 50% of total loans
Prudential norms			
Capital adequacy framework	• Minimum Tier-I capital: 7% • Minimum capital adequacy ratio: 9%	• Minimum Tier-I capital: 7.5%(Tier-II capital cannot be more than 100% of Tier-I capital) • Minimum capital adequacy ratio: 15%	• Tier-I capital more than Tier-II capital • Minimum capital adequacy ratio: 15%
CRR / SLR	• Maintenance of CRR/SLR ratio mandatory • CRR – 3%, 3.5% begin. March 27, 2021, 4% beginning May 22, 2021, 4.5% beginning May 21, 2022 • SLR – 18%	• Maintenance of CRR/SLR ratio mandatory • CRR – 3%, 3.5% begin. March 27, 2021, 4% beginning May 22, 2021, 4.5% beginning May 21, 2022 • SLR – 18%	• No such requirement
Leverage ratio	• Minimum leverage ratio of 4%	• Minimum leverage ratio of 4%	• No such requirement
LCR (liquidity coverage ratio)/ NSFR (net stable funding ratio)	• Mandatory requirement to maintain liquidity coverage ratio • NSFR applicable to scheduled commercial banks	• Minimum liquidity coverage ratio of 100% by April 1, 2021 • NSFR will be applicable to SFBs on par with scheduled commercial banks as and when finalised	• No such requirement
Funding			
Deposits	• Primarily rely on deposits, CASA and term deposits, for funding requirements	• Primarily rely on deposits, CASA and term deposits, for funding requirements • Deposit ramp-up will require time	• Cannot accept deposits
Bank loans / market funding	• Access to broader array of market borrowings	• Access to bank loans and broader array of market borrowings (including refinance from NABARD, among others)	• Diversified funding sources, including bank loans, short-term and long-term market borrowings. Funding from NABARD, MUDRA loans etc.
Products			
Products offered	• Full spectrum of banking, savings, investment and insurance products	• Can offer savings and investment products apart from credit products / loans • Can act as corporate agent to offer insurance products • Cannot act as business correspondent to other banks	• Can act as business correspondent to another bank and offer savings, deposits, credit and investment products • Can act as corporate agent to offer insurance products

Source: RBI, CRISIL MI&A.

Profitability of players in Fiscal 2023

Players	Yield on advances (%)	Cost of borrowing (%)*	NIMs (%)	Opex (%)	Cost to income (%)	Credit cost (%)	RoE (%)	RoA (%)
SFBs								
AU SFB	13.10%	5.63%	5.56%	4.32%	63.01%	0.19%	15.44%	1.79%
Equitas SFB	16.67%	6.48%	8.22%	6.59%	63.41%	1.32%	12.20%	1.85%
Ujjivan SFB	19.73%	6.08%	9.48%	6.33%	54.82%	0.06%	31.37%	3.86%
Jana SFB	19.99%	6.96%	7.24%	5.61%	56.22%	3.25%	17.08%	1.12%
ESAF SFB	19.81%	6.02%	9.68%	6.49%	57.94%	2.57%	19.37%	1.59%
Utkarsh SFB	**19.56%**	**6.80%**	**8.95%**	**5.79%**	**54.15%**	**1.77%**	**22.64%**	**2.37%**
Fincare SFB	20.19%	6.47%	9.33%	7.48%	66.13%	2.68%	8.26%	0.89%
Suryoday SFB	19.04%	6.10%	8.28%	5.62%	60.02%	2.62%	5.03%	0.86%
Microfinance								
Credit Access	19.39%	8.30%	10.75%	4.22%	37.40%	2.04%	17.81%	4.20%
Spandana	19.24%	12.86%	9.96%	5.55%	51.01%	6.07%	0.40%	0.15%
Fusion	22.92%	10.24%	11.50%	5.34%	38.44%	2.41%	21.16%	4.65%
Universal banks								
Bandhan Bank	13.9%	5.3%	6.3%	3.1%	39.5%	2.8%	11.9%	1.5%

*Note: *Cost of borrowing is calculated on total borrowings (borrowing + deposits), Credit costs is calculated as provisions on average assets, Opex is calculated as operating expense on average assets.*

Source: Company reports, CRISIL MI&A

Profitability of players in Fiscal 2022

Players	Yield on advances (%)	Cost of borrowing (%)*	NIMs (%)	Opex (%)	Cost to income (%)	Credit cost (%)	RoE (%)	RoA (%)
SFBs								
AU SFB	12.10%	5.29%	5.36%	4.00%	57.07%	0.60%	16.56%	1.87%
Equitas SFB	17.33%	6.75%	7.89%	6.60%	66.12%	1.91%	7.35%	1.09%
Ujjivan SFB	16.73%	5.70%	8.07%	6.80%	71.68%	5.19%	-13.97%	-1.89%
Jana SFB	22.15%**	7.58%	7.08%	5.80%	66.46%	2.90%	0.46%	0.03%
ESAF SFB	19.59%**	5.99%	7.64%	5.74%	63.69%	2.78%	3.97%	0.36%
Utkarsh SFB	**17.85%**	**6.92%**	**7.80%**	**5.41%**	**59.11%**	**3.04%**	**4.18%**	**0.45%**
Fincare SFB	21.45%	7.07%	9.28%	6.85%	60.01%	4.51%	0.80%	0.09%
Suryoday SFB	18.72%	6.31%	7.85%	5.55%	60.93%	5.26%	-6.00%	-1.25%
Microfinance								
Credit Access	19.16%	8.18%	9.72%	3.93%	35.38%	3.27%	10.09%	2.78%
Spandana	21.47%	11.86%	12.12%	4.76%	38.56%	6.31%	2.39%	0.92%
Fusion	20.71%	9.83%	8.66%	4.75%	45.81%	5.62%	1.68%	0.33%
Universal banks								

Asset Quality and Liquidity ratios for players in Fiscal 2023

Players	Provision Coverage Ratio (%)	Liquidity Coverage Ratio (%)	GNPA (%)	NNPA (%)
SFBs				
AU SFB	75.00%	128.00%	1.66%	0.42%
Equitas SFB	56.90%	186.28%	2.60%	1.14%
Ujjivan SFB	98.00%	NA	2.60%	0.04%
Jana SFB	NA	NA	NA	NA
ESAF SFB	55.11%	138.79%	2.49%	1.13%
Utkarsh SFB	**88.29%**	**375.82%**	**3.23%**	**0.39%**
Fincare SFB	60.82%	NA	3.25%	1.30%
Suryoday SFB	51.43%	150.36%*	3.13%	1.55%
Microfinance				
Credit Access	71.58%	NA	1.21%	0.35%
Spandana	70.00%	NA	1.95%	0.58%
Fusion	75.50%	NA	3.46%	0.87%
Universal banks				
Bandhan Bank	76.82%	136.34%*	4.90%	1.20%

*Note: * As of December 31, 2022; NA – Not Available.*
Source: Company reports, CRISIL MI&A.

Competitive Strengths

Sound understanding of microfinance segment and presence in rural and semi-urban areas

Uttar Pradesh and Bihar are the most populous states in India, accounting for 17% and 9% respectively of overall population in India, but their share in overall credit outstanding is only 5% and 1% respectively shows large variation in credit. There is a wide variation across states and within various districts in the same state as well in terms of credit, which indicates latent opportunity for providing banking services to unserved or underserved customers. Further, in Fiscal 2023, Bihar, Uttar Pradesh, and Jharkhand have the best asset quality amongst the other states and have portfolio at risk greater than 30 days and portfolio at risk greater than 90 days lower than that at a pan-India level.

Growing deposits with focus on retail deposits

CASA franchise has increased from ₹ 13,269.92 million as of March 31, 2021 to ₹ 22,532.85 million as of March 31, 2022 and further to ₹ 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. CASA ratio and large percentage of retail deposits provide them with stable access to low cost funding and longer tenure resources profile. As a result, Cost of Funds has reduced from 8.27% in Fiscal 2021 to 7.47% in Fiscal 2022 and further to 6.96% in Fiscal 2023.

Diversified distribution network with significant cross-selling opportunities

Bank have an extensive physical network of Banking Outlets and as of March 31, 2023, bank 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).

Relationship with micro banking customers presents significant opportunities to cross sell other asset products that cater to the entire customer lifecycle. For instance, in Fiscal 2020 bank launched individual loans for such customers. Bank have also launched a loan product that is customized specifically to address the financial requirements of street vendors. Bank offer graduating customers with a variety of asset products including individual loans, and micro-enterprise loans. Given large base of micro banking customers, bank have initiated opening of savings accounts for these customers as a result of which, as of March 31, 2021, 2022 and 2023, 21.10%, 35.16% and 44.74% of JLG loan accounts had savings accounts with Bank, respectively. This helps inculcate savings behavior through the savings products bank offer, including recurring deposits and fixed deposits.

Stable growth with cost efficient operational performance

Bank have a comfortable liquidity profile that is backed by shorter tenure micro banking lending and sufficient liquidity buffer and as of March 31, 2023, Liquidity Coverage Ratio ("LCR") was 375.82% as against regulatory requirement of maintaining LCR of 90%. Bank are 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. Bank believe that capital base positions them well to grow business. Policy for provisioning follows more conservative norms than those prescribed by the RBI.

Interest earned has been consistently growing and grew from ₹ 15,809.87 million in Fiscal 2021 to ₹ 18,488.13 million in Fiscal 2022 and further to ₹ 25,049.80 million in Fiscal 2023. Net Interest Income in Fiscal 2021, 2022 and 2023 was ₹ 8,392.46 million, ₹ 10,608.51 million and ₹ 15,290.31 million, respectively. Net Interest Margin in Fiscal 2021, 2022 and 2023 was 8.20%, 8.75% and 9.57%, respectively. net profit for the year, as restated, for Fiscal 2021, 2022 and 2023 was ₹ 1,118.15 million, ₹ 614.62 million and ₹ 4,045.02 million, respectively. As a result of performance, return on total average assets was 1.05%, 0.48% and 2.42%, as of March 31, 2021, 2022 and 2023, respectively, while return on average equity was 9.99%, 4.14% and 22.84%, respectively.

Risk Factors

Non-compliance with RBI inspection

During the RBI inspection conducted in January 2020, pursuant to Section 35 of the Banking Regulation Act, RBI has made certain observations regarding business and operations including, amongst others, reduce concentration in JLG loan portfolio and submit a quarterly monitorable plan from the quarter ended September 30, 2020 onwards, ensuring 100% coverage of PAN as part of customer information forms for retail and MSME borrowers and that core banking solutions has inbuilt cross referencing with the NSDL database, implement two-factor authentication for critical applications like core banking solution and treasury, reduction of concentration in wholesale lending portfolio to 25 NBFC borrowers, inability of treasury module to support trades in TREPS and over the counter trades were not executed over recorded lines, valuations were not carried out correctly for the HTM portfolio and the valuations and portfolio holdings were prepared by the front office dealer and the backoffice was not aware of the valuation process or how to arrive at the total portfolio holdings and information technology risk was not considered in the scope of risk committee charter.

Bank operate in a regulated market with evolving laws and regulations, which change over time. Certain of these laws and regulations governing business are relatively new, and thus their interpretation and enforcement may involve uncertainties.

Statutory Auditors have been debarred by the Reserve Bank of India

Haribhakti & Co. LLP, Chartered Accountants, have audited financial statements as at and for the years ended March 31, 2020, 2021 and 2022. The RBI has pursuant to its order dated September 23, 2021, debarred erstwhile statutory auditors, Haribhakti & Co. LLP, Chartered Accountants, from undertaking any type of audit assignments for entities regulated by the RBI for a period of two years with effect from April 1, 2022. According to the RBI, this action has been taken on account of a failure on part of Haribhakti & Co. LLP, Chartered Accountants, to comply with a specific direction issued by the RBI with respect to their statutory audit of a systemically important NBFC.

Risk of Concentration

A large number of Banking Outlets are located in the states of Bihar and Uttar Pradesh. As of March 31, 2023, 374 out of 830 Banking Outlets were located in these two States. Consequently, a majority of advances are towards customers in Bihar and Uttar Pradesh. As of March 31, 2023, advances towards customers in Bihar was ₹ 43,093.10 million, represented 30.88% of Gross Loan Portfolio, while advances towards customers in Uttar Pradesh was ₹ 36,265.42 million, and represented 25.98% of Gross Loan Portfolio.

Peer Comparison

Company	Total Income (in crs)	FV	EPS	NAV	P/E*	P/B*	RoNW (%)
Utkarsh Small Finance Bank Ltd	2804.29	10	4.52	22.33	5.53	1.12	20.22%
Equitas Small Finance Bank	4831.46	10	4.71	46.44	19.94	2.02	11.12%
Ujjivan Small Finance Bank Ltd	4754.19	10	5.88	20.25	7.08	2.06	27.79%
Credit Access Grameen Ltd	3550.79	10	52.04	326.89	24.63	3.92	16.18%
Spandana Sphoorty Financial Ltd	1477.03	10	1.74	436.58	409.80	1.63	0.40%
Bandhan Bank Ltd	18373.25	10	13.62	121.58	16.92	1.90	11.21%
AU Small Finance Bank Ltd	9239.87	10	21.86	164.64	34.81	4.62	13.01%
Suryoday Small Finance Bank	1281.10	10	7.32	149.28	23.48	1.15	4.90%
Fusion Micro Finance Ltd	1799.97	10	43.29	230.74	13.50	2.53	16.67%

**P/E & P/B ratio based on closing market price as on July 07th, 2023, At the upper price band of IPO, financial details consolidated audited results as on FY23*

OUR VIEWS

Utkarsh SFB is one of the leading small finance banking with 830 branches across 26 states majorly concentrated in eastern UP and Bihar. There is huge demand of loan for micro business/enterprises among such under penetrated and largely populated states of India like UP and Bihar.

Company is available at P/BVPS of 1.12x, which is lower as compared to peer competitors; however performance of Net interest margin in future as it could see pressure due to increase in cost of funds. Hence, we recommend to subscribe the issue for Listing gains.

Analyst Certification

We/I, Sankita V, MBA, Mcom Research Analysts, authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer (s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation (s) or view (s) in this report. It is also confirmed that above mentioned Analysts of this report have not received any compensation from the companies mentioned in the report in the preceding twelve months and do not serve as an officer, director or employee of the companies mentioned in the report.

Disclosures and Disclaimers

Research Desk
Canara Bank Securities Ltd
SEBI: RESEARCH ANALYST REGISTRATION: INH000001253
BSE: INB 011280238, BSE F&O: INF 011280238
NSE: INB 23180232, F&O: INF 231280232, CDS: 231280232
Maker Chambers III, 7th floor,
Nariman Point, Mumbai 400021
Contact No. : 1800220369/18001031369, 022 - 22802441/42, 43603841/42

Email id: researchdesk@canmoney.in Website: www.canmoney.in