BUY

CMP: **INR 54** Target Price: **INR 70** ▲ 30%

ICICI Securities Limited is the author and distributor of this report

01 January 2024

India | Equity Research | Initiating Coverage

Utkarsh Small Finance Bank

Financial Services

Decade-long exposure to high growth states, a bankable asset in sustainability/profitability

We initiate on Utkarsh SFB (Utkarsh) with **BUY** and a TP of INR 70, valuing at 2x FY25E BVPS. We see Utkarsh's deep presence in under-penetrated states, enhanced product offering, proven track record of managing asset quality better than peers (write-offs during covid at 12% vs. 15-20% at other MFI players) and its rapidly evolving liability franchise (steady decline in cost of funds) ensuring sustainability of >18% RoE and >25% growth over FY24-26E. Utkarsh kicked-off its lending journey in the states of UP and Bihar – collectively, the region is perceived to be the toughest lending market in India. Hence, since inception, it has embarked on a calibrated growth journey emphasising on risk management and portfolio quality.

Utkarsh delivered 34% AUM CAGR between FY18-23 by diversifying its asset mix. As on Sep'23, non-MFI book contributes 38% of total AUM. Undisrupted growth, tight control on cost (C/I ratio at 56.5% vs. 65% for Equitas vs. 60% for Suryoday vs. 57% for ESAF) and stable asset quality helped Utkarsh deliver industry-leading profitability – average RoE between FY21-22-23 stood at 12% vs. 11% for Equitas vs. 6% for Ujjivan and 0.03% for Suryoday.

Proven track record of managing growth with pristine asset quality

Utkarsh is amongst the very SFBs who have successfully transitioned from their erstwhile NBFC avatars to SFBs without materially impacting cost and growth. Its superior execution reflects in robust 34% AUM CAGR between FY18-23, effective cost management with average cost-assets at 5.6% vs. industry average of >6% and average credit cost at 2.8%. A combination of the above enabled it in delivering average 15% RoE between FY18-23 vs. 9% for Ujjivan vs. 10% for Equitas and 5% for Suryoday.

Renish Bhuva
renish.bhuva@icicisecurities.com
+91 22 6807 7465
Vaibhav Arora
vaibhav.arora@icicisecurities.com

Market Data

Market Cap (INR)	59bn
Market Cap (USD)	711mn
Bloomberg Code	UTKARSHB IN
Reuters Code	UTKR.BO
52-week Range (INR)	62 /37
Free Float (%)	15.0
ADTV-3M (mn) (USD)	4.6

Price Performance (%)	3m	6m	12m
Absolute	5.1	-	-
Relative to Sensex	(4.7)	-	-

Financial Summary

Y/E March	FY23A	FY24E	FY25E	FY26E
NII (INR bn)	15.3	18.6	23.5	28.8
Op. profit (INR bn)	8.4	9.6	12.5	15.6
Net Profit (INR bn)	4.0	4.7	6.3	7.8
EPS (INR)	4.5	4.5	6.0	7.4
EPS % change YoY	545.7	(1.0)	33.6	23.9
P/E (x)	11.9	12.0	9.0	7.3
P/BV (x)	2.4	1.9	1.6	1.3
GNPA (%)	3.2	2.5	2.0	1.9
RoA (%)	2.4	2.1	2.2	2.2
RoE (%)	22.6	18.9	19.1	19.5

Deep presence/understating of underserved markets – UP and Bihar – augurs well for growth sustainability

Utkarsh started its lending journey in Varanasi, UP in FY10 with MFI lending. For the next ten years it remained committed in establishing a strong niche in UP and Bihar before gradually expanding operations in neighbouring states. Utkarsh has clawed overall credit market share in both these states – rising from 0.7% and 0.2%, respectively in FY18, to 1.7% and 0.6% as of FY23 – and we believe it is still nascent. Further, Utkarsh's branch distribution in these two states ranks among the top-five banks, especially in rural and semi-urban markets. Further, the company has enhanced its asset offering by entering 2W, gold loans, mortgage, MSME, CV/CE etc. which will help Utkarsh leverage its general branch banking network of >250 branches as on Sep'23.

Valuation

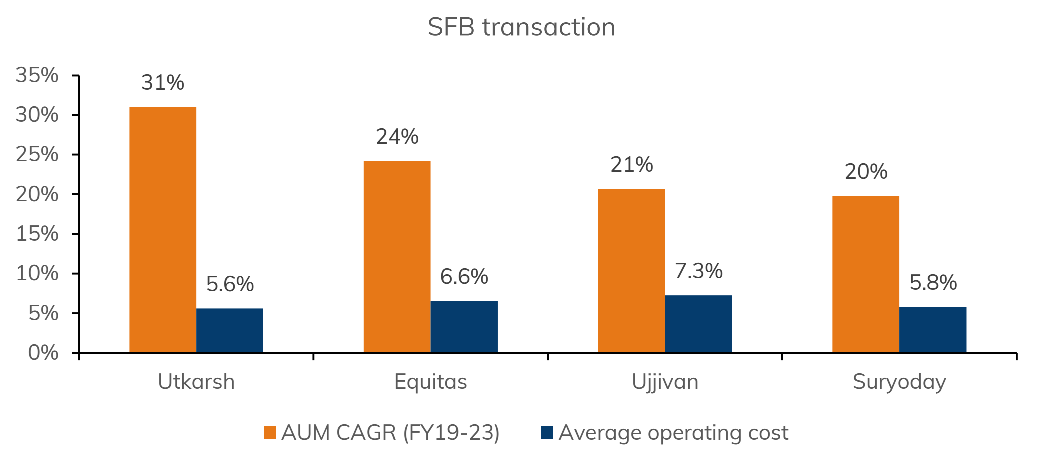
The transition phase, from being an NBFC to a SFB, for Utkarsh has been well-executed. This is evident in its: 1) sustainably growing in the under-penetrated markets of UP and Bihar, whilst a market share at 1.7% and 0.6% in the respective states; 2) robust 34% AUM CAGR growth over FY18-FY23 while successfully increasing the share of its secured portfolio to 34% in Sep'23, from 9% in FY18; and 3) maintenance of higher efficiencies with one of the lowest cost to income ratio amongst SFBs at 54% in FY23, despite consistent efforts to build its franchise through continuous branch expansion (3-year CAGR of 18%) and investments for building digital capabilities.

Even as the bank remained focused on pursuing its long-term asset strategy of building secured retail assets, the average credit costs for the last 5-6 years have also remained comfortable at ~270 bps, despite the pandemic.

On the liability side, the increasing share of retail deposits to 41% in FY23, from 21% in FY19, speaks of its better execution on building a granular liability base.

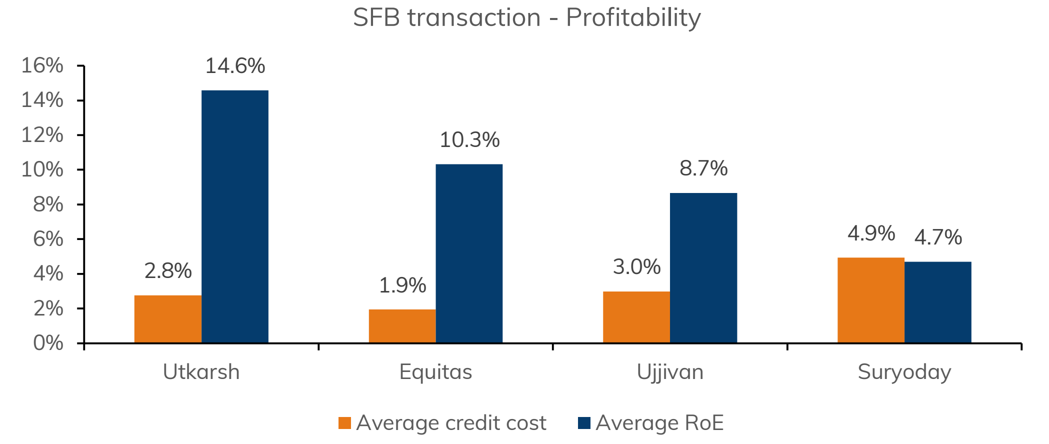
We initiate coverage on Utkarsh with a BUY rating and a target price of INR 70, valuing it at 2.0x FY25E P/ABV. Our target multiple of 2.0x FY25E P/ABV is dictated by a) successful transition from NBFC to SFB model as compared to other SFB, and b) thoughtful strategy to build contingency provision to bring sustainability to P&L – we expect RoA trajectory of >2% in FY24-FY26E and >25% AuM growth over the same period.

Exhibit 1: Utkarsh delivered robust 31% AUM CAGR between FY19-23 with tight control on cost as reflect in lowest average cost-asset at 5.6% even while transition



Source: I-Sec research, Company data

Exhibit 2: Average RoE (FY19-23) for Utkarsh remained highest at ~15% vs <10% for other SFB



Source: Company data, I-Sec research

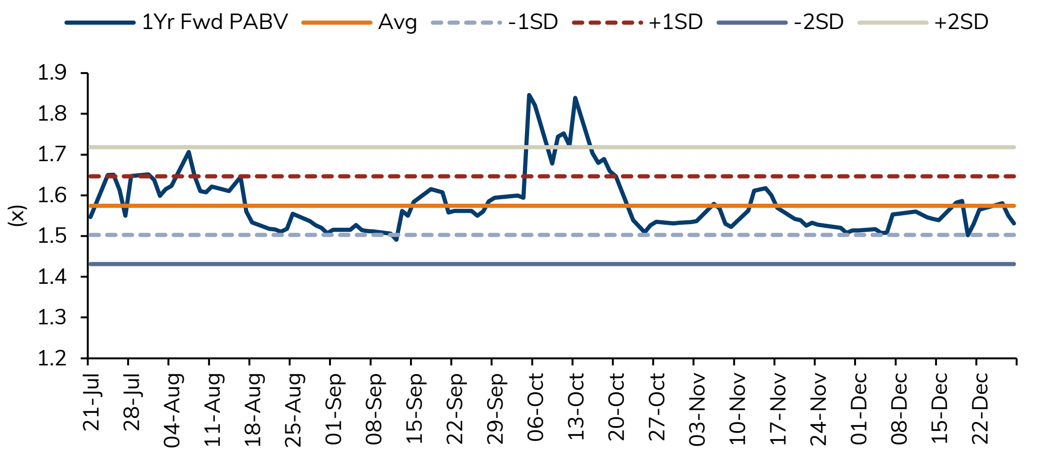
Key risks: 1) Sharper margin deterioration due to stiff competition in secured lending; and 2) higher-than-expected credit costs.

Exhibit 3: Peer valuation

Particulars	CMP	P/E			P/BV			EPS			BV			RoAA			RoAE		
		FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E
SFBs																			
Equitas	107	20.7	15.6	12.3	2.3	2.0	1.7	5	7	9	46	53	62	1.9	1.9	2.0	12.2	13.7	15.1
Suryoday	156	21.4	8.9	5.3	1.0	0.9	0.8	7	18	29	149	167	196	0.9	1.8	2.4	5.0	11.5	16.2
AU SFB	790	37.9	28.0	28.0	4.7	4.2	3.6	21	28	28	169	190	221	1.7	1.9	1.9	14.4	15.4	15.4
Ujjivan	57	10.1	9.1	8.1	2.8	2.1	1.7	6	6	7	21	27	34	3.9	3.3	3.1	31.4	25.3	22.4
NBFC-MFIs																			
Credit Access	1,590	30.6	19.0	15.1	4.9	3.9	3.1	52	84	105	321	405	511	4.2	5.3	5.4	18.2	23.0	23.0
Spandana	1,100	629.5	15.2	10.8	2.5	2.2	1.8	2	73	102	437	509	611	0.2	5.1	5.4	0.4	15.4	18.2
Fusion	564	14.6	10.8	8.1	2.4	2.0	1.6	39	52	70	231	284	353	4.6	4.7	4.8	21.2	20.3	21.9

Source: I-Sec research

Exhibit 4: PBV (1-year forward)



Source: Bloomberg, I-Sec research

Table of Contents

Utkarsh's differentiator over other SFBs 6

Strong brand name, market leadership in under-penetrated states – UP/Bihar 6

Focus on JLG, tight control on process and stable management team helped build its strong microfinance business 10

In an early stage of leveraging leadership position in high growth states; carefully building retail asset portfolio 14

Pristine asset quality; lowest pandemic write-offs vs. peers 19

Liability franchise – focusing on top-100 deposit centres 22

Deposits build up across the years... 24

Deep distribution, comprehensive product suite creates cross-sell opportunities .. 27

Cost efficient operational performance 29

Financial Outlook 32

Deep presence in underserved UP/Bihar, extensive distribution network and diversified asset mix to drive >25% AUM CAGR over FY23-FY26E 32

Increasing secured mix to put pressure on yields; however, the same is expected to be offset by improving liability profile 33

Increasing secured book and inherently strong good customer behaviour in UP/Bihar to ensure better asset quality and lower credit costs 33

Tech initiatives to drive productivity improvement 35

RoA likely to be >2% in FY24-FY26E, with RoE at 18-20%; contingency provision policy to provide cushion during challenging times 36

Utkarsh's differentiator over other SFBs

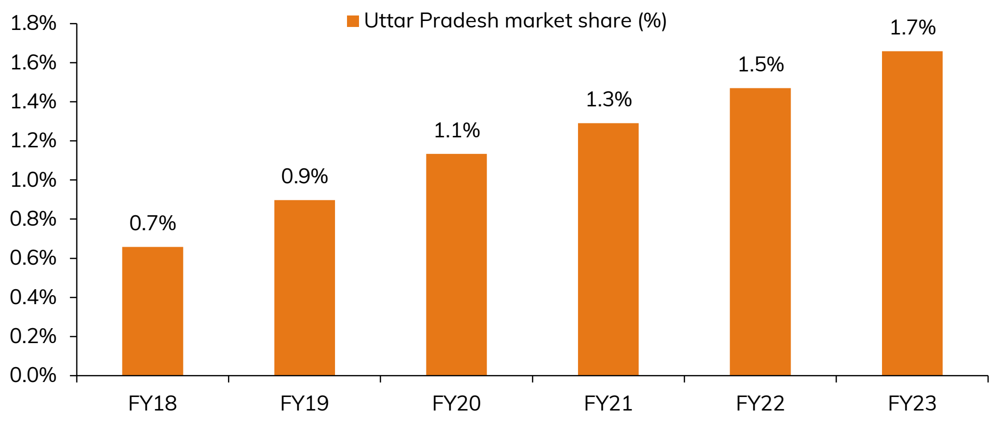
Strong brand name, market leadership in under-penetrated states – UP/Bihar

Utkarsh started its lending journey in UP in FY10 and hence it possesses a rich experience (more than a decade) of operating in one of the fastest growing credit markets. As on Sep'23, Utkarsh has 178 banking outlets in UP and 214 in Bihar, cumulatively representing ~45% of its total banking outlet.

Credit penetration in UP and Bihar has been increasing at a swift pace – five-year (FY18-23) loan CAGR at 12% for UP and 13% for Bihar vs. 11% for systemic credit. During the same time, Utkarsh delivered 34% loan CAGR, reflecting its strong position in the core market. While credit penetration is improving in UP, it is still significantly lower than Maharashtra (27%), Delhi (12%) and Tamil Nadu (9%), implying strong growth momentum shall sustain going forward.

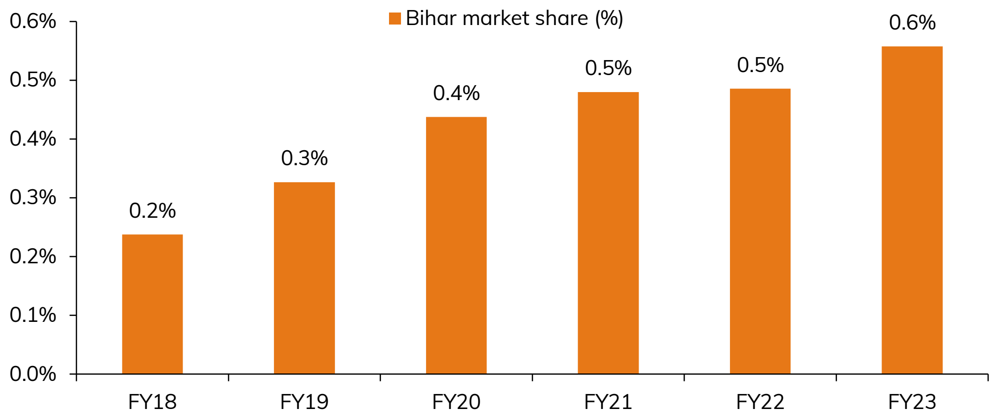
If we go further deep into the SFBs and NBFC-MFIs, who are operating in UP and Bihar, Utkarsh has, in its corner, the highest market share and remains amongst the top-three players in both UP and Bihar. Utkarsh's first-mover advantage in these states has helped its cause.

Exhibit 5: Utkarsh's market share in UP increased to 1.7% in FY23 from 0.7% in FY18…



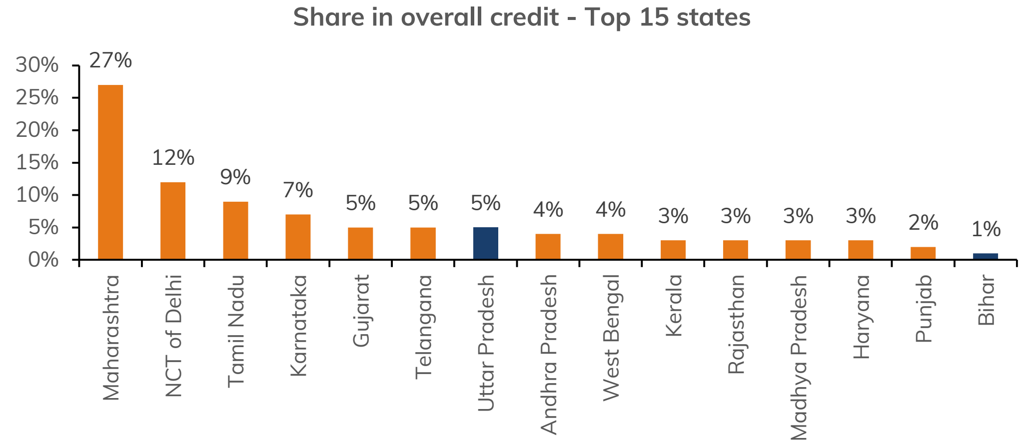
Source: Company data, I-Sec research

Exhibit 6: …similar trend visible in Bihar



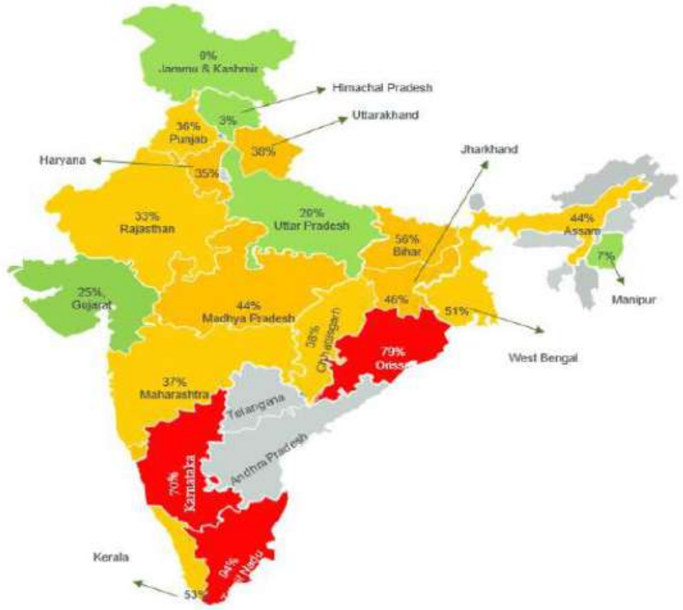
Source: Company data, I-Sec research

Exhibit 7: Low penetration in UP (5%) and Bihar (1%) in the overall credit indicates huge growth potential



Source: RBI, CRISIL MI&A

Exhibit 8: Within microfinance, UP and Bihar remain low/moderately penetrated at 20% and 56% (Mar'22), respectively



Source: CRIF Highmark, CRISIL MI&A

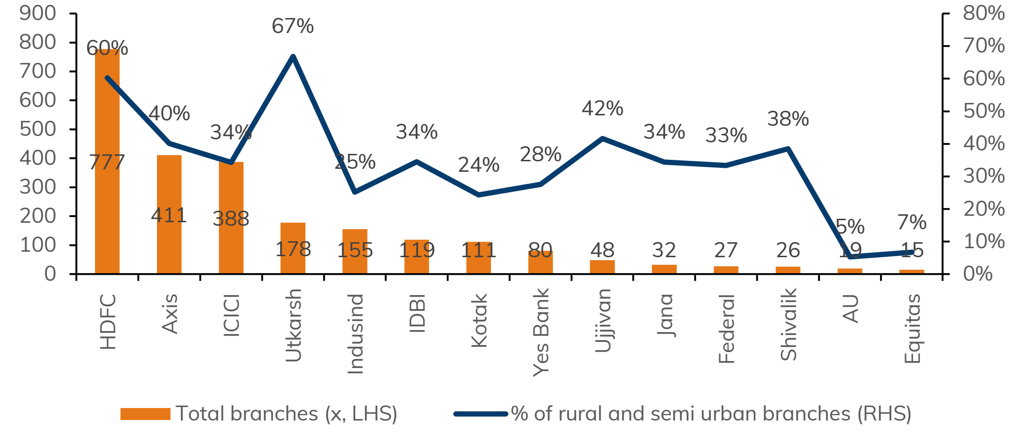
Note: Includes – SFBs, Banks lending through JLG, NBFC-MFIs, other NBFCs and non-profit MFIs

Deep distribution network especially in rural and semi-urban markets

Utkarsh started its operations as an NBFC in Sep'09 in UP to ride on significant credit under-penetration in the state. It started its journey by offering microfinance loans to unserved/underserved segments in rural and semi-urban areas. With more than ten years of operating history in UP and Bihar, Utkarsh has since established a strong brand name and market leadership position in these states.

Over the last decade, Utkarsh, through its extensive expansion in distribution, has built a robust presence in the states of UP and Bihar. In both states, together constituting 55% of its overall MB branches, the bank remained the market leader among SFBs (in terms of branch network), taking 56% and 63% of respective market shares in UP and Bihar (in terms of overall SFB branches in the states). Furthermore, in terms of number of branches, Utkarsh ranked among the top-five banks and even remained ahead of a few of the large private sector banks such as Indusind, Kotak, Yes etc.

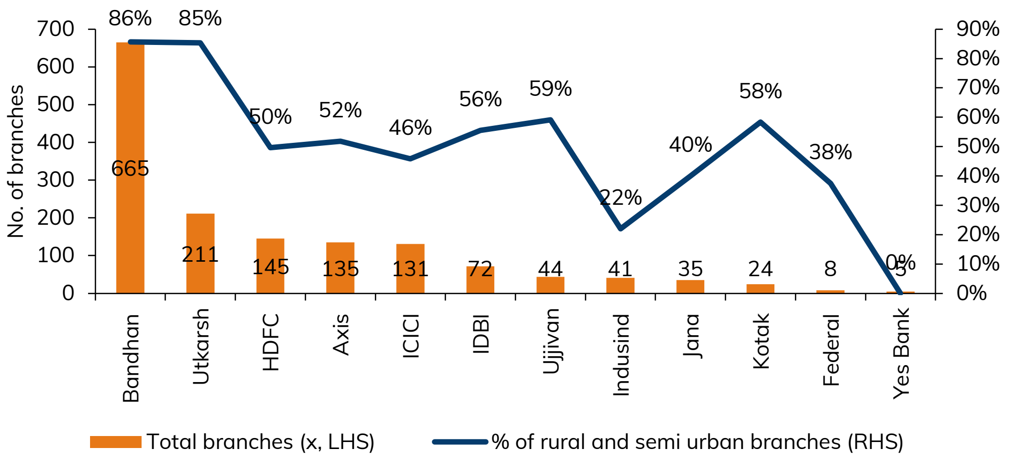
Exhibit 9: Barring HDFC, Axis and ICICI, Utkarsh's branch presence in UP is at par or well-above SFBs and private sector banks (Sep'23)



Source: State Level Bankers' Committee (UP)

Utkarsh has strategically focused on rural and semi-urban areas due to the relatively lower competition as compared to urban and metro markets. Hence, over the past decade, it built strong deep distribution in these markets – evident in Utkarsh's branch presence in rural and semi-urban segment being second-highest with 211 branches in Bihar, much higher than the large private sector banks such as HDFC, Axis, Kotak etc.

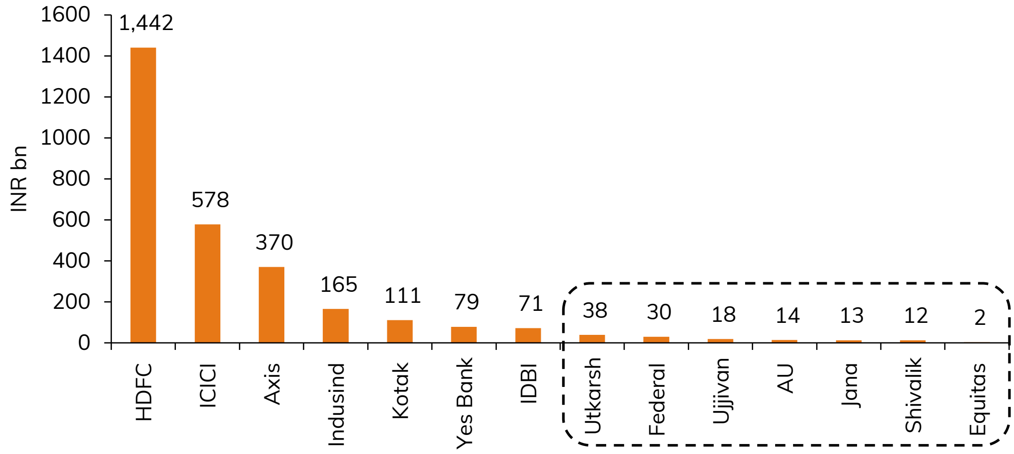
Exhibit 10: In Bihar, the bank had the second-highest branch network amongst private banks and SFBs (Jun'23) (similar chart for Bihar)



Source: State Level Bankers' Committee (Bihar)

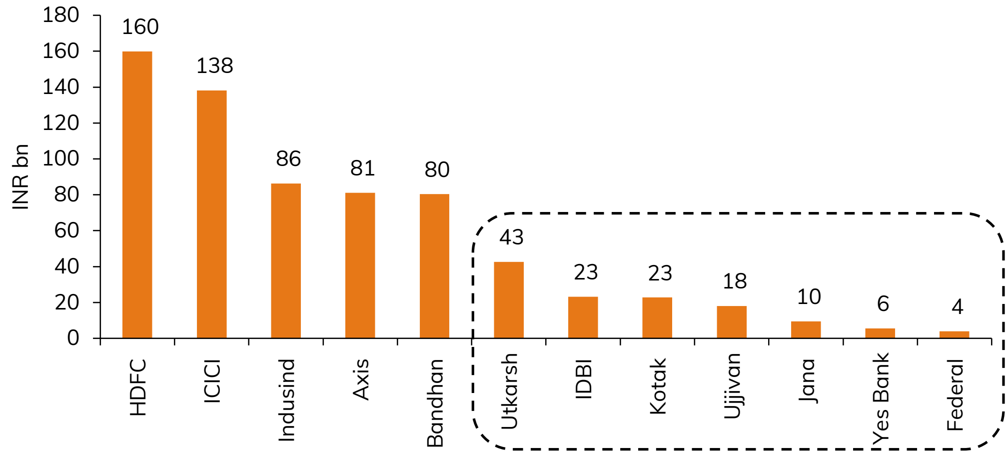
Utkarsh's strong presence in UP and Bihar also reflects in its gross loan portfolio, which shows a similar trend, wherein Utkarsh remains ahead of all SFBs in both states.

Exhibit 11: Loan portfolio of SFBs and private sector banks in UP (Sep'23)



Source: State Level Bankers' Committee (UP)

Exhibit 12: Loan portfolio of SFBs and private sector banks in Bihar (Jun'23)

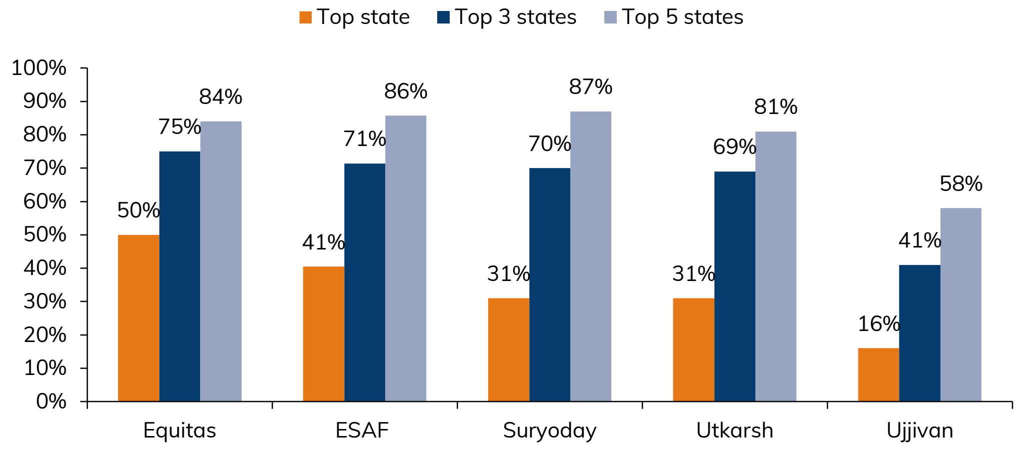


Source: State Level Bankers' Committee (Bihar)

While UP and Bihar, together, constitute 57% of Utkarsh's overall book, in order to tackle the concentration risk, the bank has been contiguously increasing its geographical presence in other states. Over the last three years, the share of UP and Bihar has reduced from 66% in FY21 to 57% in FY23, as the bank has been expanding its book in other low/moderately-penetrated states such as Jharkhand, Haryana, Madhya Pradesh and Orissa.

Notably, barring Ujjivan, Utkarsh's geographical concentration remains at par with other listed peers – MFI being their primary offering in the SFB space.

Exhibit 13: Utkarsh had the second-lowest geographical concentration among SFB peers with MFI as the primary offering



Source: Company data, I-Sec research

In case of microfinance lending, the bank's strategy to move into newer states revolves around its understanding and ground-level knowledge of a particular state and operating environment/local issues. At present, the bank only targets the Hindi-speaking states. Accordingly, it does not target southern Indian states, where Utkarsh's local connect/understanding is not at par with its core geographies.

Additionally, whenever it enters a new state, it sends an experienced staff member to set up the network, post which, it eventually hires local staff who have better field knowledge. Over the medium term, the bank will grow its portfolio in the existing states of Jharkhand, Orissa and Rajasthan. Furthermore, it is at the early discussion stage to enter western-UP, which remains unexplored at present for Utkarsh. The given factors would help in further reduction of geographical concentration.

Focus on JLG, tight control on process and stable management team helped build its strong microfinance business

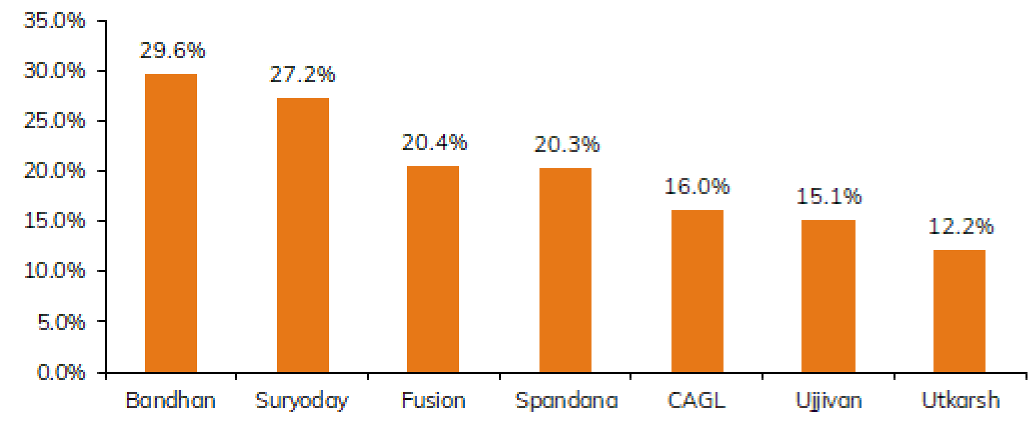
Utkarsh's lending journey began in FY10 with it getting into micro finance loans. Back then the MFI industry was at its nascent stage and there was no historical evidence providing meaningful rationale to which particular model to follow – rural or urban-focused MFI. However, Utkarsh's management team was sure about following the rural MFI model and since then it has always focused on going deeper in the geography with continued focus on rural/semi-urban market.

Over the past ten years, many players have tweaked their MFI business models – moving from JLG to individual loans, cutting out time for CGT or GRT test to save on cost, entering new states without having deep understanding of local economics etc. However, Utkarsh remained steadfast in the JLG concept and the company sticks to basics of MFI business. Below are some of Utkarsh's key MFI policies, which we believe make the company a key differentiator with its lowest write-offs curing covid –

- Focus on JLG-led growth and extremely stringent criteria for individual loans.
- ~85% rural and semi-urban based MFI portfolio.
- Maximum ticket size largely capped at INR 75,000, much lower than industry average of INR 100,000.
- Bi-weekly collection model.
- Very selective about top-up loans.

- Offer only one product at a time; not following multiple product strategy.
- Loan utilisation check: Post-disbursement, the bank checks whether the loan amount is used for income generation or consumption. As a policy, within 30 days of disbursement a credit officer (CO) should conduct a utilisation check and branch manager/supervisors will also cross-check 20% of loans on sample-basis.
- Geographical expansion: Follow contagious expansion plan, but avoided western UP.
- Incentive is designed in a manner that ensures checks on over leveraging and quality customer on-boarding – no incentives for growth if driven by ticket size increase. Maximum incentives are for better customer service; to ensure this the bank has capped maximum borrower per loan officers at 600-650.

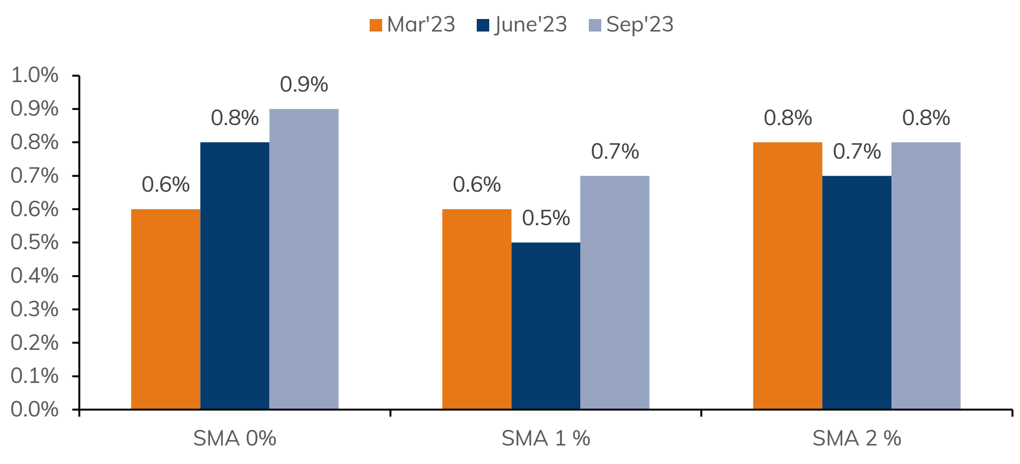
Exhibit 14: One of the lowest write-offs amongst MFI players in last 3 years



Source: Company data, I-Sec research

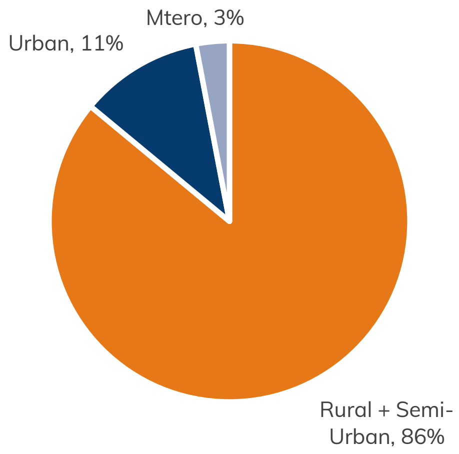
Note: Cumulative write-offs of FY21, FY22 and FY23 calculated as a % of FY23 micro-banking AUM

Exhibit 15: One of the lowest stress pool as on Sep'23



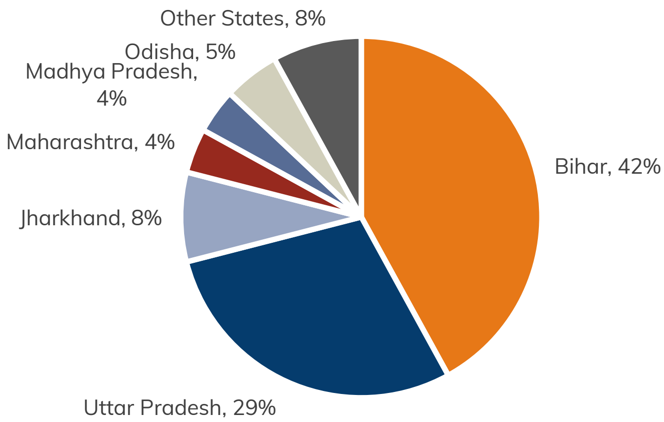
Source: Company data, I-Sec research

Exhibit 16: ~86% of its MB outlets are in rural and semi-urban areas as on Sep'23



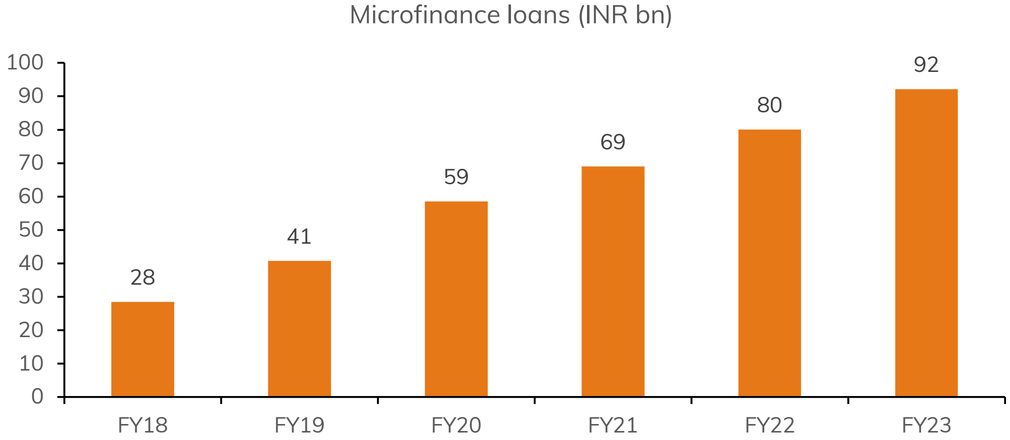
Source: Company data, I-Sec research

Exhibit 17: Geographical Split of MB Portfolio – gradually expanding its presence in other states as well



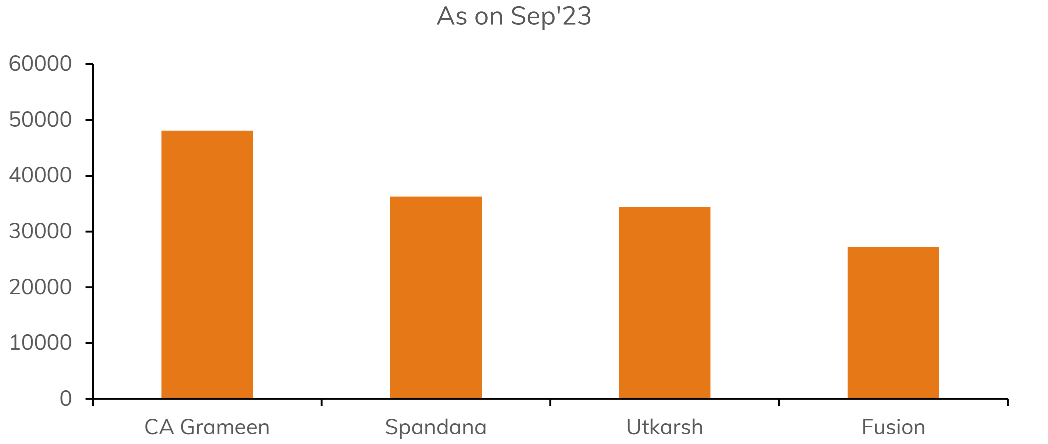
Source: Company data, I-Sec research

Exhibit 18: Utkarsh delivered strong 27% AUM CAGR over past 5 years in microfinance



Source: Company data, I-Sec research

Exhibit 19: ... as reflect in outstanding per borrower as on Sep'23 is amongst one of the lowest



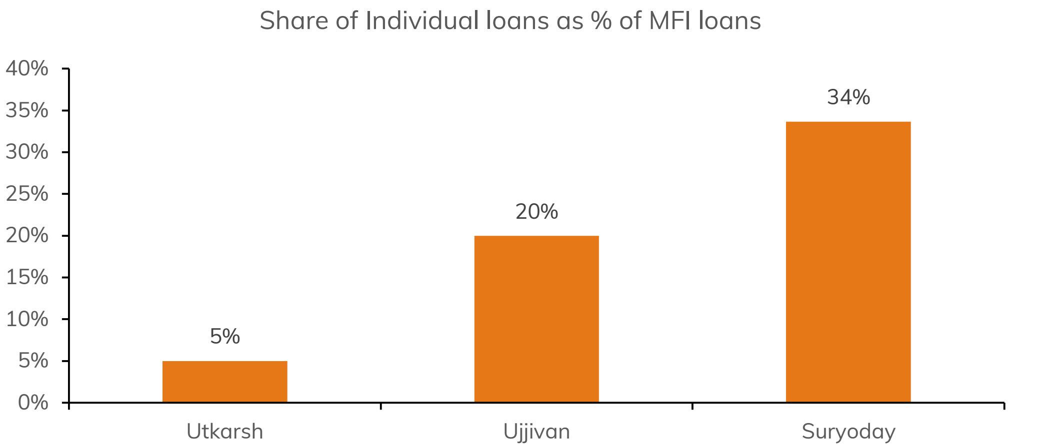
Source: Company data, I-Sec research

While Utkarsh continued to strongly emphasise on JLG led MFI loans, to leverage its existing customer pool, especially the ones who have demonstrated robust credit behaviour, it entered the individual MFI loan segment in FY20. However, it has been very selective in extending individual loans to its existing customer base – total MBIL portfolio at INR4.7bn, as on Sep'23, contributing only 5% of total MFI book.

Key credit policies for MBIL loans

- Separate credit team
- Maximum ticket size capped at INR2.5 lakhs but average ticket size is INR1.2L.
- Minimum vintage of 18 months with Utkarsh
- Majority of loans are pre-approved for customer who have demonstrated good credit behaviour across cycles
- Customer has to be current (<0+ DPD) at the time of disbursements, while any customer who have crossed 30+ DPD during entire tenure of all its past loans will not be eligible for MBIL.
- NPL at around <0.5%

Exhibit 20: Utkarsh's Individual loan share as % of total MFI exposure is lowest at 5% vs. 20% for Ujjivan and 34% for Suryoday



Source: Company data, I-Sec research

In an early stage of leveraging leadership position in high growth states; carefully building retail asset portfolio

Carefully building non-MFI book to ensure sustainability and predictability

Post-conversion to SFB in 2017, Utkarsh has carefully started crafting its secured retail book in order to build a sustainable business with controlled asset quality metrics. Unlike Equitas and AU (which already had a diversified mix), the bank had to build its retail book, along with the liability franchise from scratch.

Like its MFI business, Utkarsh is building its retail asset portfolio very carefully and does not intend to overboard growth for the sake of asset diversification. Further, considering the retail asset business requires a completely different approach than MFI business, Utkarsh is following verticalized approach – each retail product has a separate underwriting and sourcing team. It has also set-up a separate risk department that oversees retail assets as well as overall risk management functions of the bank.

<u>Retail assets expansion strategy</u>

- Start with core geographies like Varanasi and then expand contiguously. Target market is tier-2/3 cities (e.g. Varanasi, Patna, Muzaffarpur) or outskirt of big cities like Thane or Navi Mumbai etc. Average ticket size with INR2.0-2.5 mn.
- Separate credit team: Absolutely independent from the beginning.
- Separate collection team: 100+ collection officers for HL and MSME. Bucket size collection.
- Sourcing: MFI branches will source MFI, individual loans and micro-LAP/retail assets selectively. While General Banking Branch (heart of the city) will do all other retail assets (will not do MFI loans) as well as liability products. All the branches of the bank are CBS enabled, customers can transact from any of the branches.
- Product pipeline – Micro LAP, Gold loan and credit card.

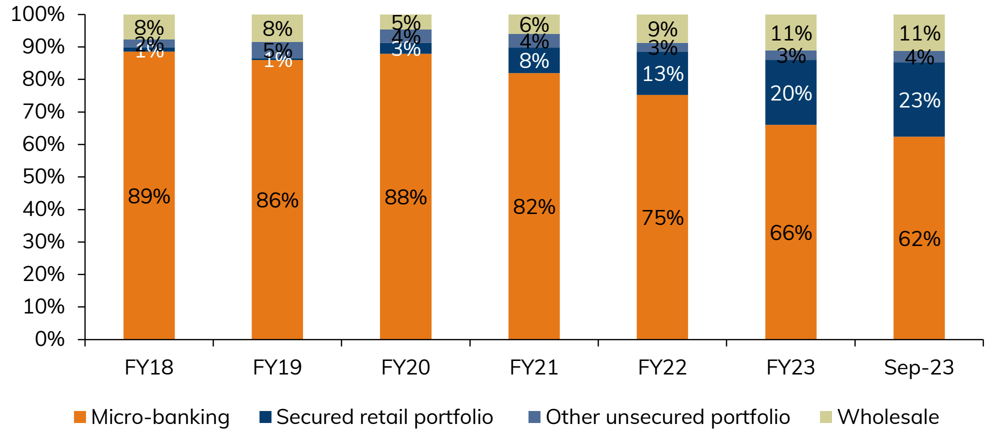
The bank forayed into Retail lending with MSME loans in FY16 and then gradually expanded its product portfolio by introducing affordable home loans, CV/CE loans, OD against FD, Gold loans etc. Consequently, the bank's retail secured book increased from 1% in FY18 to 23% in Sep'23. In addition to the retail book, the bank also does wholesale lending, which constituted 11% of the overall book, taking the overall secured portfolio to 34% as of Sep'23.

The bank is incrementally focuses on leveraging it leadership position in UP and Bihar via its extensive branch network of microfinance and also putting more emphasis on leveraging its General Branch distribution outside Up & Bihar. As on Sep'23 its MB outlets stands at 602 and GB at 269.

Over the next three years, the bank –

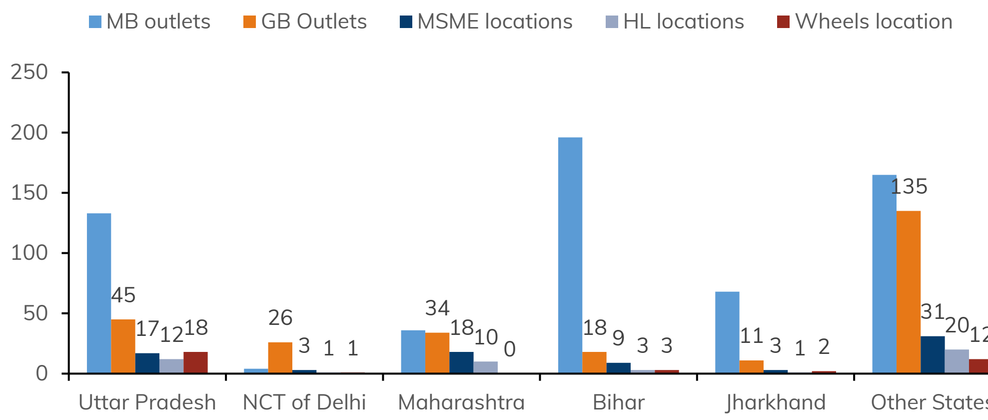
- envisages a 45:55 secured vs. unsecured mix with MFI contributing 50%, followed by MSME at 15-20%, home loans at 6-10%, wheels at 6-10%, wholesale at 12-14%; balance with other products i.e. ODFD, gold, loans through BC channel etc.
- will have higher focus on MBIL within micro-banking and consequently JLG share will decrease. As per the bank, potential for MBIL is large as 20% of JLG customers could be eligible for MBIL loan; so far only 2.5% of the customers have been covered by the bank.

Exhibit 21: Share of secured loans increased to 34% in Sep'23



Source: Company data, I-Sec research

Exhibit 22: Significant headroom to leverage existing distribution network



Source: I-Sec research, Company data

Product-wise highlights

MSME lending: It currently offers three products under its MSME vertical – 1) LAP; 2) Unsecured business loans (~4% of total MSME book); and 3) Micro-LAP and overdraft (OD). Average disbursement yields stands at 11.5%.

As on Sep'23, it is offering MSME product (small business segment) through only 81 branches, leaving significant headroom to expand within existing branches.

Exhibit 23: Product features of MSME loans

Segment	MSME loans
Ticket size	INR 2.0-2.5mn
Tenure	3-15 years
Disbursement yield (%, Sep-23)	11.6%
Loan book (INR bn, Sep-23)	20

Source: Company data, I-Sec research

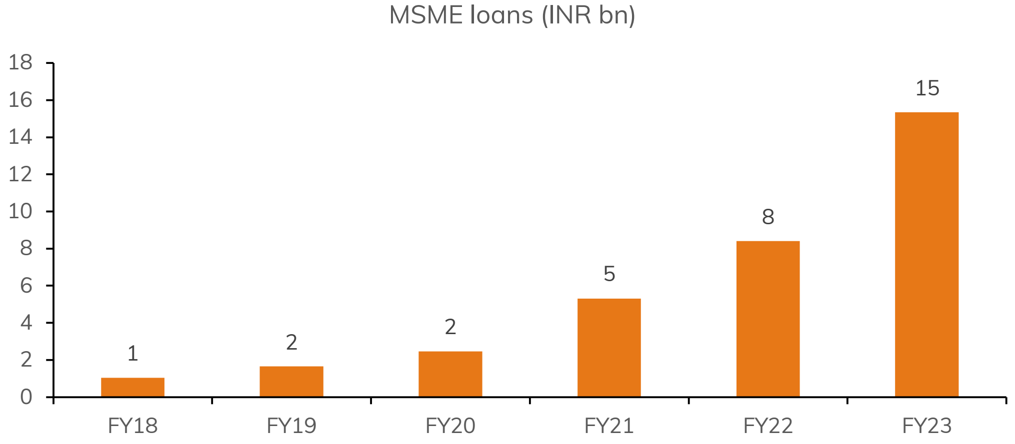
Unsecured business loans are targeted mainly at small businesses with an average ticket size of INR 0.5-0.8mn.

Exhibit 24: Product features of other unsecured loans

Segment	Unsecured products	
Product	**Business loans**	**Business loans plus**
Ticket size	INR 0.3-1mn	INR 1-2mn
Tenure	12-48 months	12-60 months
Interest rates (%)	17%-22% per annum	15%-22% per annum
ATS (Q4FY23)		
Loan book (INR bn, Sep-23)	6	

Source: Company data, I-Sec research

Exhibit 25: MSME loans grew at 5-year CAGR of 71%



Source: Company data, I-Sec research

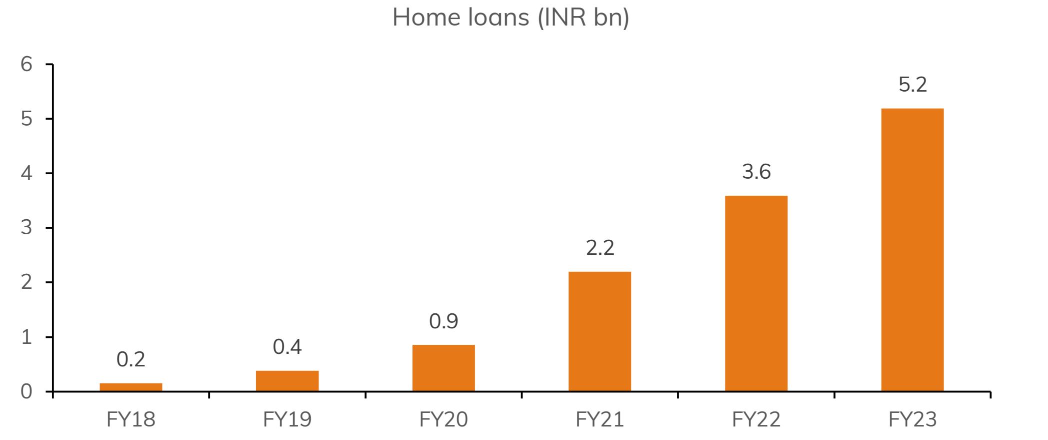
<u>Housing loans (HL):</u> It currently offers two products under the housing vertical – 1) retail HL; and 2) affordable HL. Housing loans up to INR 3.5mn account for ~70% of total housing loan portfolio with average ticket size of the book at INR 2-2.5mn as on Sep'23. Average disbursement yields stands at ~10-10.5%. As on Sep'23, it is offering housing loans through only 47 locations.

Exhibit 26: Product features of housing loans

Segment	Housing loans
Ticket size	INR 2.0-2.5mn
Tenure	3-20 years
Disbursement yield (%, Sep)	10.4%
Loan book (INR bn)	6

Source: Company data, I-Sec research

Exhibit 27: Home loans grew at 5-year CAGR of 103%



Source: Company data, I-Sec research

CE and CV loans: Utkarsh entered the vehicle financing space in FY21. It currently offers three products under the CE/CV verticals – 1) New CV (90% of the total book); 2) New CE (~6% of the total book); and 3) Used CV/CE (~4% of the total book). It primarily caters to small fleet operators in its core geographies with an average ticket size at INR 3-3.5mn.

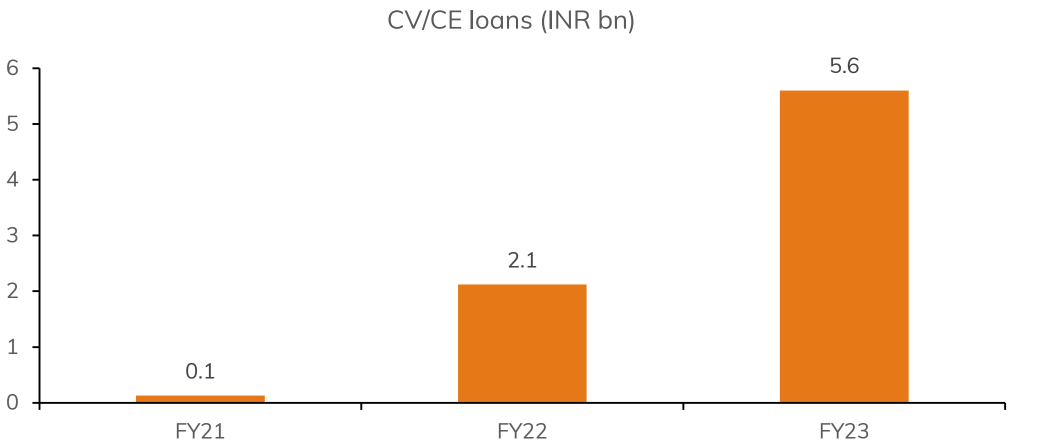
Currently, Utkarsh offers CE and CV products through 36 branches with significant headroom to expand within existing branches.

Exhibit 28: Product features of CV/CE loans

Segment	CV/CE loans
Ticket size	INR 3.0-3.5mn
Tenure	12-60 months
Disbursement yield (%, Sep)	11.9%
Loan book (INR bn)	7.4

Source: Company data, I-Sec research

Exhibit 29: CV/CE book stood at INR 5.6bn in FY23



Source: Company data, I-Sec research

Wholesale lending

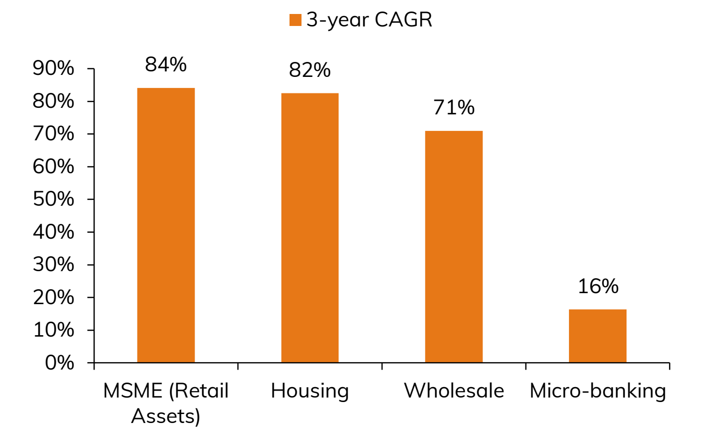
The bank's wholesale book primarily caters to small and mid-sized corporates (SME segment – Business Banking Group) and institutional clients (WSL FI lending). The loans are provided to meet on-lending, working capital and business expansion requirements.

Exhibit 30: Product features of wholesale loans

Segment	Business Banking Group	WSL FI lending
Ticket size	~INR 40mn	INR 150-200mn
Tenure	Upto 10 years (~3 years for WSL FI lending)	
Disbursement yield (%, Sep-23)	11%	
Loan book (INR bn, Sep-23)	5	12

Source: Company data, I-Sec research

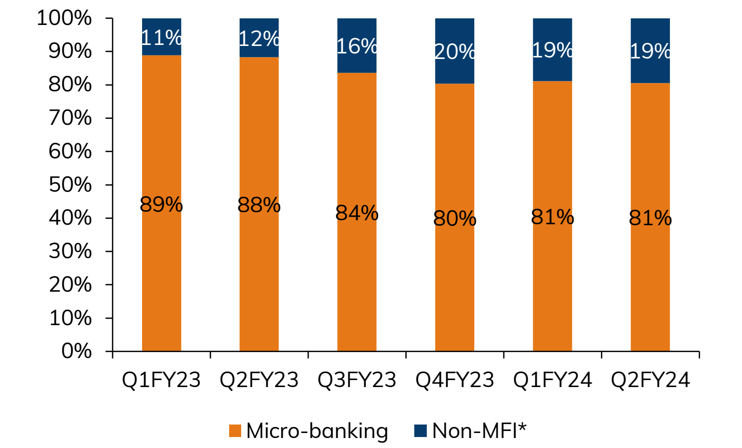
Exhibit 31: Incremental growth largely driven by non-MFI loans; with calibrated growth in MFI segment



Source: Company data, I-Sec research

*Wheels segment – which started in FY21 had a 2-year CAGR 562%

Exhibit 32: Strong disbursement traction in non-MFI loans likely to continue



Source: Company data, I-Sec research

*Includes – MSME, Housing and CV/CE; Excludes – Wholesale and other retail loans

Pristine asset quality; lowest pandemic write-offs vs. peers

Stringent risk management practices; robust underwriting and collection mechanisms…

While the strong presence in UP and Bihar does play an important role in Utkarsh's pristine asset quality, given the better customer behaviour being observed – lowest PAR>90 at ~6% during past 2.5 years vs. 7%-18% for other states. However, this is also complemented by the bank's strong credit assessment practices built over the past ten years.

While Utkarsh incrementally emphasises on scaling its non-MFI book (wheels, MSME, housing and wholesale), it remains focused on maintaining pristine asset quality in the non-MFI book, similar to its MFI book.

As the customer segment in the non-MFI segment is very different from that of MFI customers, the bank has created three separate credit teams – MFI, non-MFI and wholesale. All three teams report to the Chief Credit Officer. Additional layer of a strong risk management team led by Chief Risk Officer of the bank is also in place. Independent credit evaluation of different asset classes has helped the bank manage its portfolio risk levels fairly well – gross NPAs of MFI book at 3.6% and non-MFI book at 1.2%, as of Sep'23.

Key credit assessment highlights

- Careful geographical selection: Bank enters the states using the contiguous strategy. It only targets areas that it can understand well. The bank has strategy of entering on Hindi-speaking states as it helps in tackling the language barriers and in better understanding of the customer segment/local issues in MFI segment.
- Granular book with low ticket size: Maximum ticket size for JLG book is largely INR 75,000 and Micro-Banking Individual Loans (MBIL) is INR 0.25mn
- Separate credit team for MBIL: The loan is only offered to existing JLG customers with at least three years of vintage and up to PAR 30 dpd. However, the customer needs to be current for the latest six months. MBIL portfolio had a GNPA of <0.5%, as of Sep'23.
- Regular loan utilisation checks: 100% of loans checked by credit officer and 20% are checked by branch manager/supervisor.
- Non-MFI products primarily offered at liability branches where the customer profile is relatively less vulnerable; non-MFI NPA were at 1.2%, as of Sep'23.
- Wholesale book: Loans to small and mid-size corporates (SME) secured by collateral of immovable properties; whereas, institutional lending is only done to investment grade or above entities, with >70% of book having 'A' or higher rating by external credit agencies. Wholesale book had 'nil' NPAs, as of Sep'23.

The bank has a credit team of 400+ people as of Sep'23. Management highlighted that it has built a strong credit team and with the existing team structure, the bank can comfortably double its loan book. Further, management mentioned its plans to gradually move towards the hub-and-spoke model, wherein, the credit team will be placed at the hub branch, thereby leading to better efficiencies.

On the collections front, one thing that stands out for Utkarsh is the fortnightly collection model vs. the monthly collection model in other SFBs. 93% of the JLG loans had a fortnightly collection cycle; the remaining have a monthly collection cycle. As of Sep'23, the micro-banking collections stood at 97%.

The bank has been taking major initiatives to further strengthen its collection structure in the near term. These initiatives include:

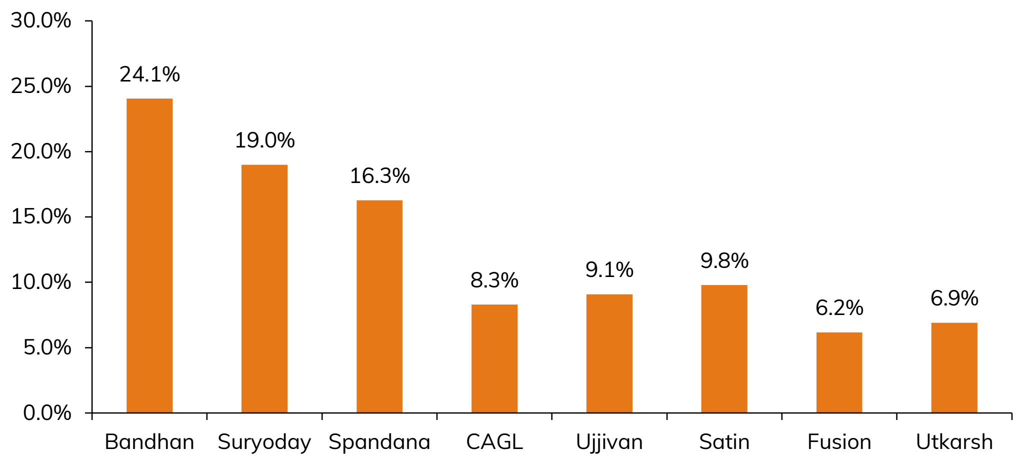
- Higher automation through borrower specific QR codes/UPI; 8% of micro-banking customers paid one or more instalment through digital mode in Q2FY24, with MBIL collections being completely digital.
- Plans to strengthen its collections team for non-micro-banking portfolio by hiring collection agency. At present, the bank has an in-house collections team of 196+.
- Bucketing of the collections team, with each individual being responsible for a different bucket.

...with superior asset quality performance – despite the pandemic

High presence in the relatively better performing UP and Bihar, gradual geographical diversification to tackle concentration risk, increased focus towards asset diversification with incremental growth stemming from secured loans and continued calibrated growth in the MFI segment has helped Utkarsh maintain best-in-class asset quality metrics.

The bank's gross NPA stood at 2.8% in Sep'23, after peaking during the pandemic at 6.1%. Interestingly, while NPA levels remain at par with other players in the industry, the write-offs for Utkarsh remained lowest amongst the SFBs and NBFC-MFIs.

Exhibit 33: One of the lowest write-offs amongst MFI players in last 3 years



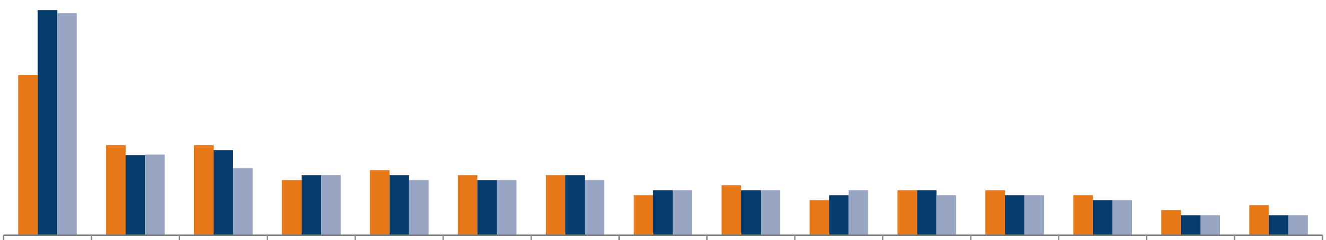
Source: Company data, I-Sec research

Note: Cumulative write-offs of FY21, FY22 and FY23 calculated as a % of FY23 micro-banking AUM

Inherently good customer behaviour in UP and Bihar

Unlike other states where the PAR>90 stood in the range of 7%-18% (barring Assam having PAR>90 between 32%-45%), in UP and Bihar, the same remained <6% in last 2.5 years, thereby showcasing better borrower behaviour in these two states.

Exhibit 34: Resilient customer segment in UP and Bihar; PAR>90 remained <6% in last 2.5 years

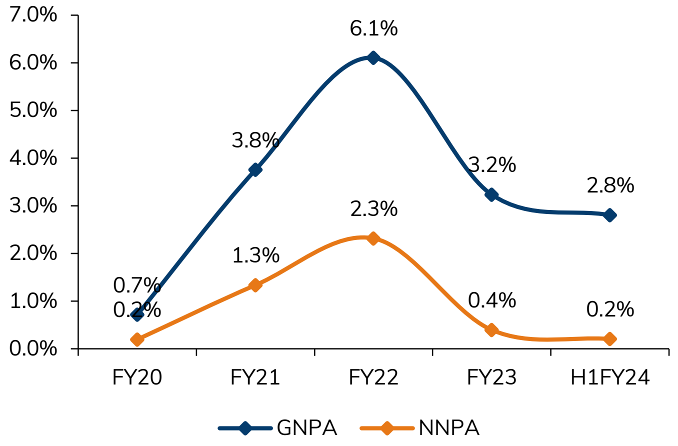


	Assam	West Bengal	Maharashtra	Orissa	Madhya Pradesh	Kerala	Chandigarh	Rajasthan	Gujarat	Haryana	Tamil Nadu	Karnataka	Jharkhand	Bihar	Uttar Pradesh
FY22	32%	18%	18%	11%	13%	12%	12%	8%	10%	7%	9%	9%	8%	5%	6%
FY23	45%	16%	17%	12%	12%	11%	12%	9%	9%	8%	9%	8%	7%	4%	4%
Q1FY24	44%	16%	13%	12%	11%	11%	11%	9%	9%	9%	8%	8%	7%	4%	4%

Source: CRISIL MI&A

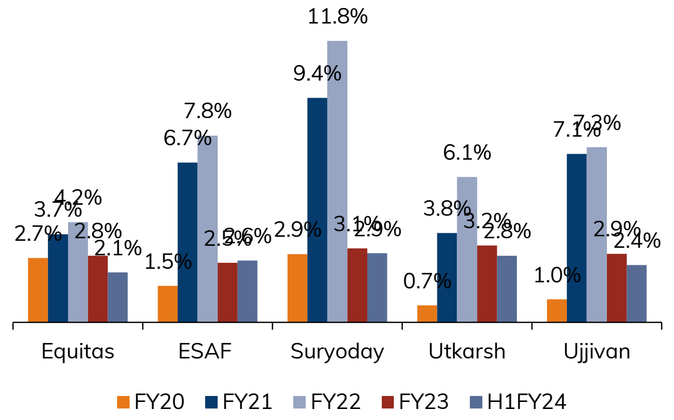
Note: Includes – Banks' lending through joint liability group (JLG), SFBs, NBFC-MFIs, other NBFCs and non-profit MFIs

Exhibit 35: While GNPA reached its peak in pandemic at 6.1%...



Source: Company data, I-Sec research

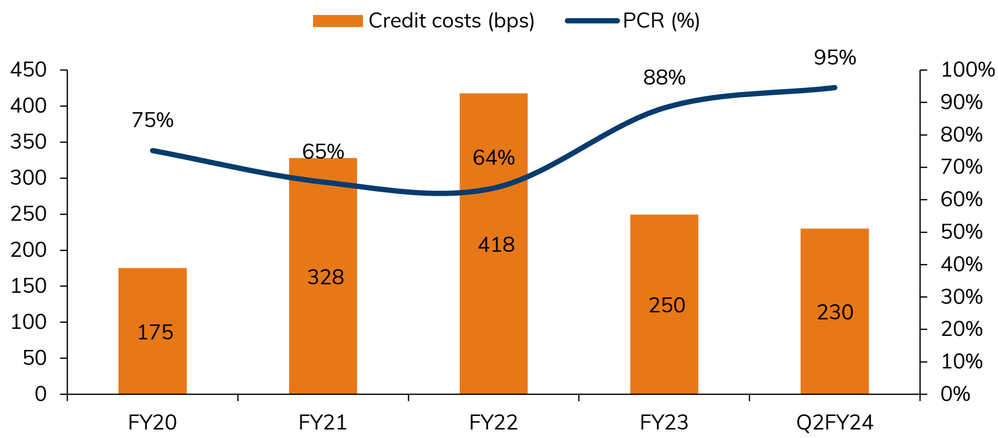
Exhibit 36: ...it remained at par with the peers



Source: Company data, I-Sec research

Owing to low GNPA levels and low write-offs, barring the pandemic period, the bank maintained credit costs at <250bps over the years despite the five-year average provision coverage ratio of 77%. The bank has also built a floating provision over last 3 years to ensure resiliency, which stood at INR 1.2bn as of Sep'23

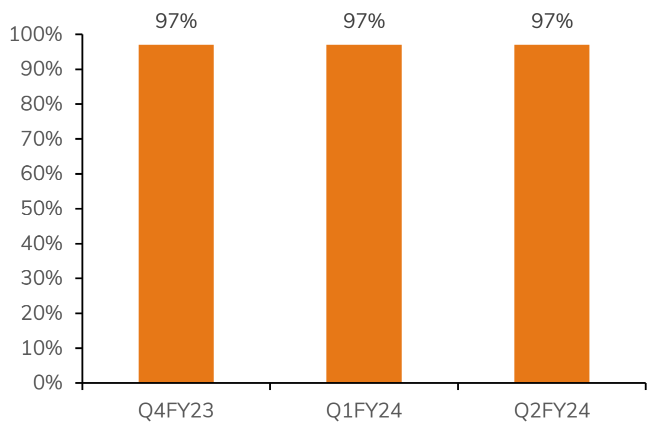
Exhibit 37: Credit costs <250bps in non-pandemic period; average PCR of 77%



Source: Company data, I-Sec research

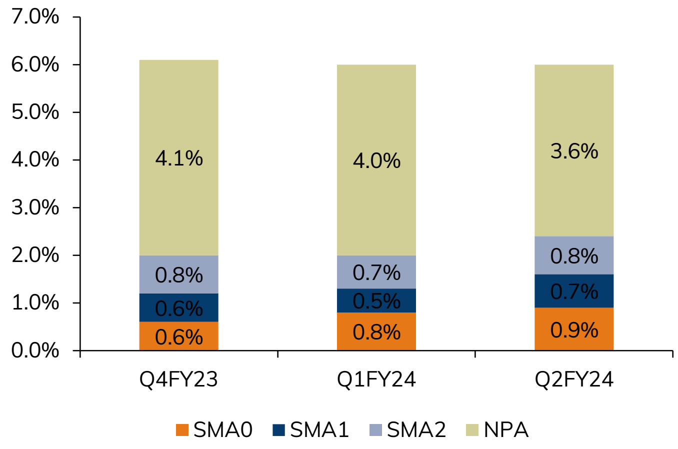
The MFI book, which constitutes 62% of the overall portfolio, is supported by strong collections at 97% (ex-prepayments), resulting in lower delinquency levels across buckets. The bank's SMA0, SMA1 and SMA 2 together formed about 2.4% of the portfolio. This, coupled with the GNPL of 3.6% in the MFI book, kept the 0+ at 6.1%.

Exhibit 38: 97% collections for the micro-banking portfolio ...



Source: Company data, I-Sec research

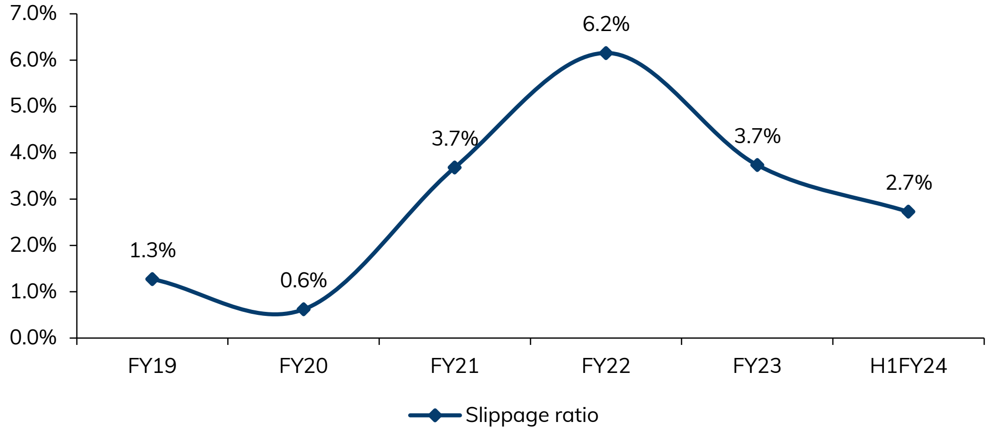
Exhibit 39: ...with comfortable delinquency levels



Source: Company data, I-Sec research

The bank's ability to manage its portfolio is also evident in the slippage ratio gradually receding post-peaking during covid. As of Sep'23, the slippage ratio dropped to 2.7%, from 6.2% in FY22.

Exhibit 40: Downward trend in slippage ratio poses well for asset quality going forward



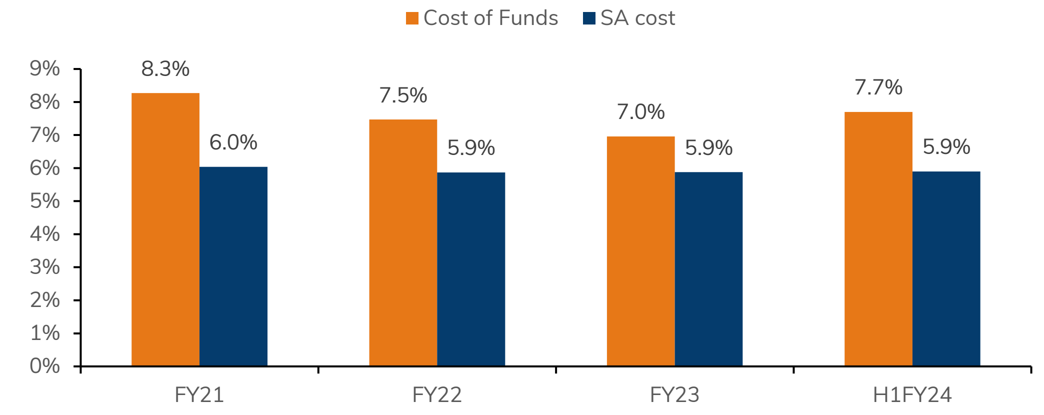
Source: Company data, I-Sec research

Liability franchise – focusing on top-100 deposit centres

After transitioning into an SFB, Utkarsh has consistently focused on fortifying its liability franchise, particularly in the realms of retail and CASA deposits, which remains a reliable and cost effective funding source. The bank's early adoption of targeting the top-100 deposit centres and focussing on high-value customers from metro/tier-1/tier-2 cities, coupled with extensive digital offerings, the bank has built a robust deposit base across geographies, spread across 26 states/UTs.

Successful execution of its liability strategy reflects in steady decline in cost of fund during the past three years despite the rising rate cycle. Its cost of funds fell to 7% by FY23 from 8.3% in FY21, improvement of ~130bps. While its CoF increased to 7.7% for H1FY24 due to repricing of deposit at higher rates, it is still lower than FY21 level.

Exhibit 41: Steady decline in cost of funds, despite rising rate cycle



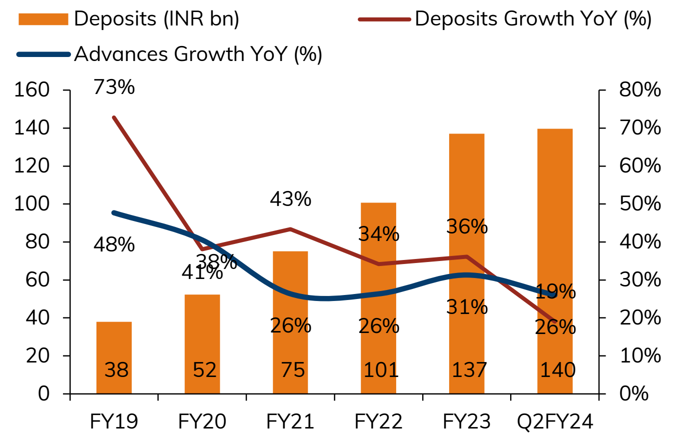
Source: Company data, I-Sec research

Some of the key noteworthy initiatives taken by the bank in last 4-5 years in order to expand its deposit base are as follows –

- Significant expansion in deposit branch: Number of general banking outlets grew 4x to 269 in Sep'23 vs. 61 in FY19.
- Targeting top 100 cities to grow the deposit franchise; 95% of the overall deposits came from metro/urban cities.
- Digital on-boarding of customers; 0.2 mn CASA accounts opened in Q2FY24, of which 94% on-boarded digitally.
- Tie ups with Fintech platforms to drive retail term deposits growth; the platform helps in opening fixed deposits with the bank digitally.
- Digital sourcing through bank's website – Instant SA &TD account opening though website using video KYC.
- Inter-operable card-less cash withdrawal from deposit account.
- AEPS/Micro-ATM
- Innovative product offerings across savings, current and term deposits in order to increase the customer stickiness –
    - *Premium Savings Account*: Unlimited free domestic transactions at any ATM; Platinum Rupay Debit Card; accidental insurance policy; interest calculated on daily basis with credit on quarterly basis,
    - *Gen-Nex Savings Account*: Savings account for minors; average quarterly balance of INR 2,500 to be maintained.
    - *UPI Easy Account*: Virtual address/UPI ID created for merchants to transact with no need for net-banking ID/password; nil average quarterly balance; unlimited credit transaction through the UPI application and unlimited free RTGS/NEFT.
    - *Business plus:* Customers can earn savings bank interest on their current account balance, over and above minimum balance requirement. Along with a current account, a linked virtual savings account is opened in the name of the individual/ proprietor. Day-end balance above INR 50,000 (for metropolitan an urban branches) and above INR 25,000 (for semi-urban and rural branches) in the current account will be automatically swept into the linked virtual savings account, thereby creating liquidity with higher interest returns on surplus funds, offering high returns to customers.

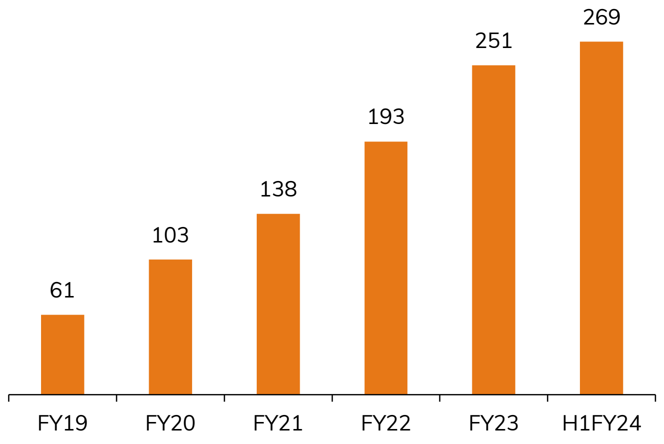
Deposits build up across the years…

Exhibit 42: Robust deposit growth at 4-year CAGR of 38% vs. 31% growth in advances



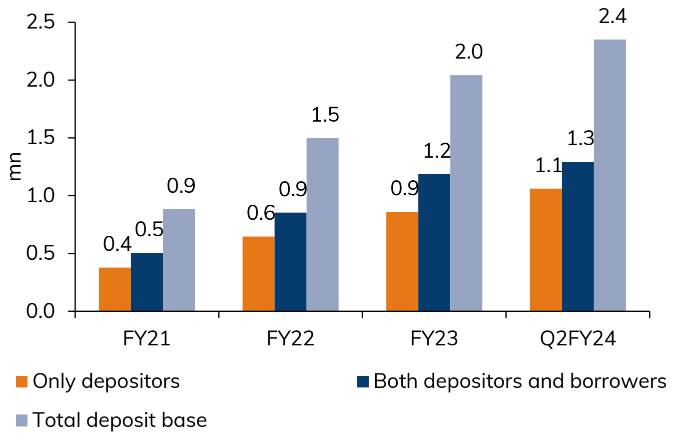
Source: Company data, I-Sec research

Exhibit 43: Deposit branches became 4x in last 5 years



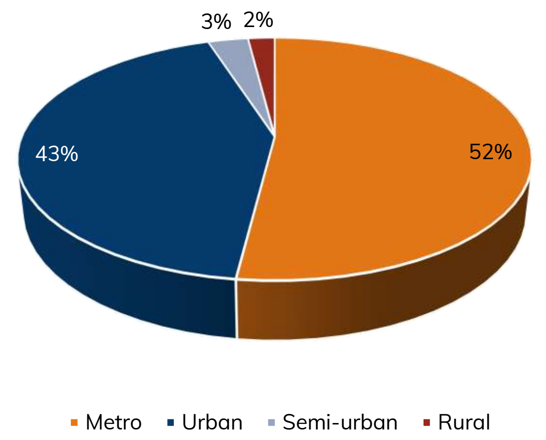
Source: Company data, I-Sec research

Exhibit 44: Strong customer acquisitions shaped up the deposit franchise



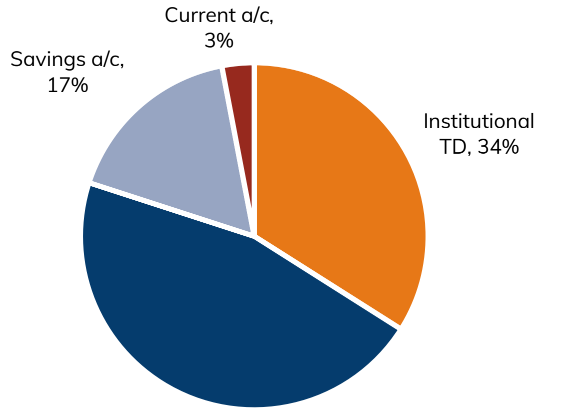
Source: Company data, I-Sec research

Exhibit 45: 95% of deposits were from metro/urban cities



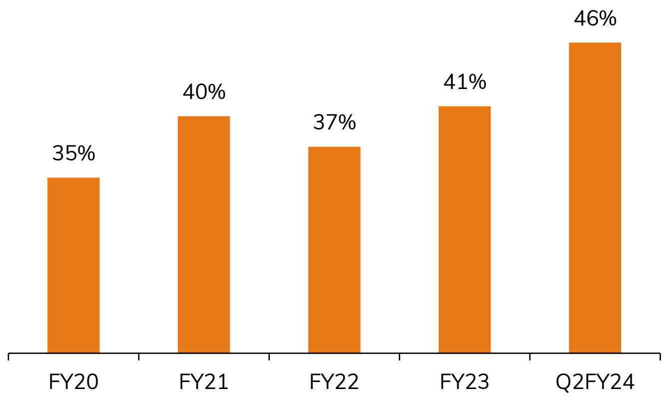
Source: Company data, I-Sec research

Exhibit 46: Retail TD taking the largest share in the overall deposits pie



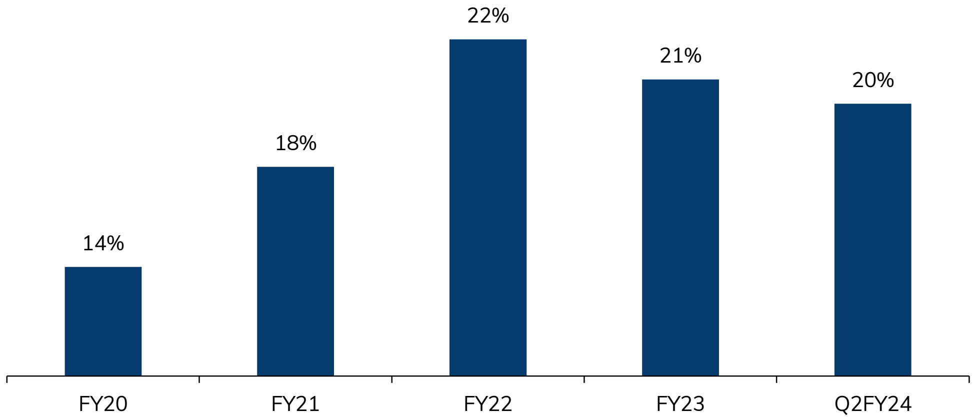
Source: Company data, I-Sec research

Exhibit 47: Retail deposit share increased to 46% in Sep'23 vs. 35% in FY20…



Source: Company data, I-Sec research

Exhibit 48: …with steady growth in CASA, which reached 20% vs. 13.5% in FY20



Source: Company data, I-Sec research

In order to build a stable funding source, the bank intends to grow its liability franchise by continued focus towards CASA and retail deposits. Growth in the deposit base will primarily rely on the general branch expansion and differentiated digital offerings.

Notably, the bank is making steady investment towards branch building and improving brand name. While the general branches have increased from 61 in FY19 to 269 in Sep'23, most of the branch expansion happened only in the last two-three years. Consequently, about 42% of liability branches had <2 years of vintage, thereby indicating potential opportunity yet to be tapped into from the existing branches itself.

Exhibit 49: 42% of branches are <2-year vintage

Branch vintage	GB branches	%
<1 year	60	22%
1-2 years	53	20%
2-3 years	29	11%
>3 years	127	47%
Total	**269**	**100%**

Source: Company data, I-Sec research

Branch expansion has been done keeping in mind the diversity to be maintained towards both geography and customer segments. In order to expand geographically, the bank has been following a two-pronged strategy: 1) further penetrating existing states; and 2) expanding reach into newer states in western and southern India.

As a result, over the years, the bank has been able to reduce its geographical concentration amongst deposits with top-five states contributing 60% of the deposits in FY23 vs. 73% in FY21.

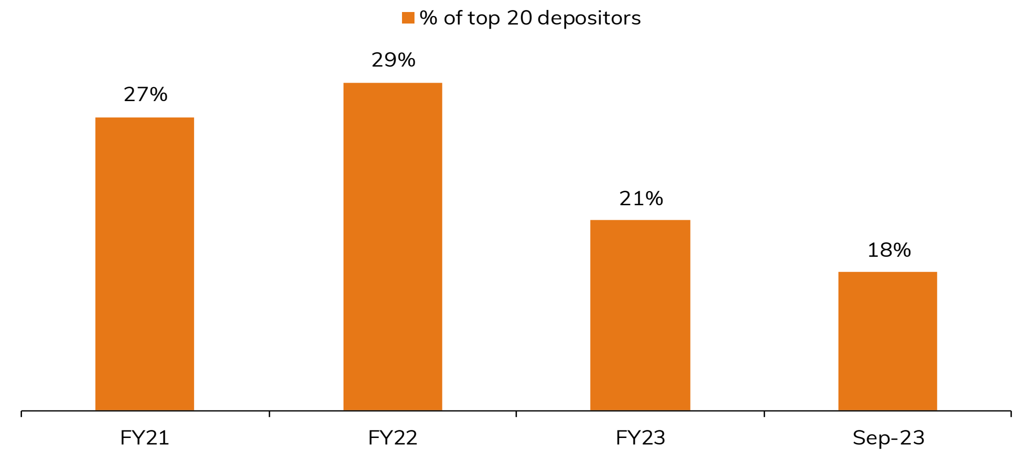
Exhibit 50: Deposit base expanded across 25+ states/UTs

	FY21	FY22	FY23
Uttar Pradesh	14%	15%	16%
NCT of Delhi	14%	15%	15%
Maharashtra	23%	17%	14%
Haryana	15%	11%	8%
Bihar	7%	7%	6%
Uttarakhand	9%	9%	6%
Jharkhand	5%	4%	5%
Punjab	1%	5%	4%
Gujarat	3%	4%	4%
West Bengal	2%	2%	3%
Rajasthan	1%	2%	3%
Tamil Nadu	0%	2%	3%
Odisha	1%	1%	2%
Madhya Pradesh	3%	2%	2%
Chandigarh	1%	1%	2%
Himachal Pradesh	0%	0%	1%
Karnataka	0%	1%	1%
Assam	1%	1%	1%
Chhattisgarh	1%	1%	1%
Telangana	1%	1%	1%
Kerala	0%	0%	0%
Puducherry	0%	0%	0%
Andhra Pradesh	0%	0%	0%
Jammu and Kashmir	0%	0%	0%
Goa	0%	0%	0%
Meghalaya	0%	0%	0%

Source: Company data, I-Sec research

As the deposit base expands through general branches being opened across geographies, the same is also reflective in the decline in the top 20 depositors to 18% in Sep'23 from 27% in FY21.

Exhibit 51: Decline in top-20 depositors %



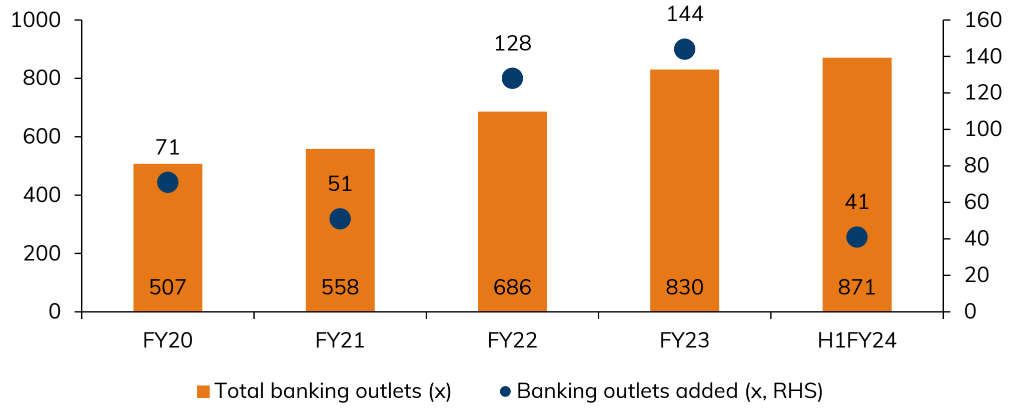
Source: Company data, I-Sec research

Deep distribution, comprehensive product suite creates cross-sell opportunities

Multi-channel strategy to attract and retain customers

Deep distribution network of 830 banking outlets spread across 26 states/UTs, covering 253 districts as of Mar'23 allows Utkarsh to service its existing customer base of 3.9mn as of Mar'23 and attract new customers. In addition to this, the bank has also tied up with business correspondents (BCs) and DSAs to expand its network in growing the asset portfolio. As of FY23, the bank had arrangements with 13 BCs and tie-ups with 321 DSAs to primarily source the LAP offering across various locations.

Exhibit 52: 871 banking outlets with consistent additions every year; 270+ branches added in FY22 and FY23



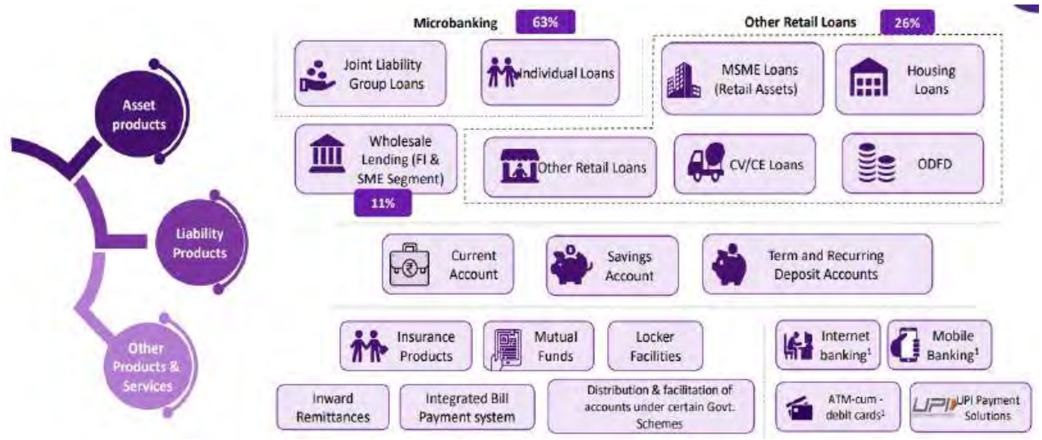
Source: Company data, I-Sec research

In addition to banking outlets, the other delivery channels include ATMs, micro-ATMs, mobile and internet banking and corporate internet banking services. As of FY23, Utkarsh had 280 on-site ATMs, seven off-site ATMs and 546 micro-ATMs. Furthermore, the bank also offers a range of transaction and payment channels through debit cards, payment gateways, IBPS, door-step banking services and UPI.

Comprehensive product offerings

Utkarsh has a well-curated product suite both on the asset as well as liability side, strategically designed for its target audiences in rural, semi-urban and urban areas. The bank has been constantly strengthening its product portfolio both on the asset-side (unsecured (MFI, personal loans) and secured loans (housing, wheels, wholesale MSME), as well as the liability-side (savings account, current account, term deposits (retail and bulk). Along with the given offerings, the bank also provides additional third-party products and services in the form of insurance and mutual funds, thereby creating a one-stop platform for increasing the customer lifecycle.

Exhibit 53: Diverse range of products and services



Source: Company data, I-Sec research

Building platform to cross-sell and up-sell

Given the diversified geographical presence and product suite, naturally, Utkarsh leverages its existing network to create cross-sell and up-sell opportunities.

Key cross-sell and upsell instances

- Of the 871 banking outlets, 602 outlets pertained to micro-banking and are primarily located in the rural and semi-urban areas. The bank leverage this network to offer individual and micro-enterprise loans to graduating customers.
- Savings account opening for JLG customers; 50% of JLG loan accounts had savings account with the bank.
- High retail deposit base with 95% of overall deposit presence in metro/urban areas, offer opportunities to sell other high-end asset products and third party products; except MFI, and individual loans, all the other products are primarily offered through 269 general (liability) branches.
- Customers can transact from any branch

Exhibit 54: Potential for retail assets cross-selling within existing branches

States	Total banking outlets	Micro-banking outlets	General banking outets	MSME locations	HL locations	Wheels locations
Bihar	214	196	18	9	3	3
Uttar Pradesh	178	133	45	17	12	18
Jharkhand	79	68	11	3	1	2
Maharashtra	70	36	34	18	10	0
NCT Of Delhi	30	4	26	3	1	1
Other States	300	165	135	31	20	12
Total	**871**	**602**	**269**	**81**	**47**	**36**

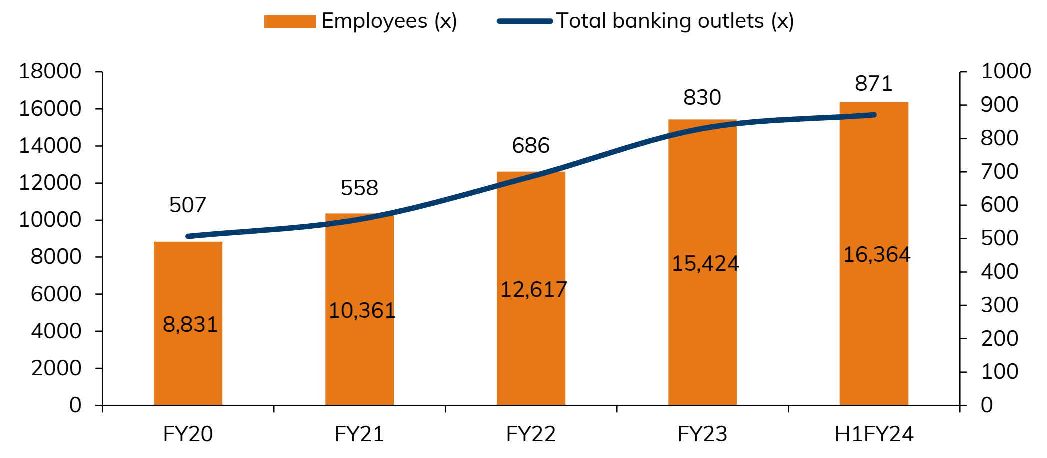
Source: Company data, I-Sec research

The well-curated product suite and multi-channel delivery mode aids in higher customer retention and reducing cost of customer acquisition.

Cost efficient operational performance

Since its SFB conversion, Utkarsh has regularly invested in its branch infrastructure and technology, in order to diversify and grow its asset book and build its deposit franchise along with enhanced digital offerings. Since FY20, the bank has significantly increased its network from 507 banking outlets to 871 banking outlets in Sep'23, which also resulted in the employee base growing to 16,364 in Sep'23, from 8,831 in FY20, keeping the branches with adequate manpower at 19 employees per branch.

Exhibit 55: Aggressive expansion in physical infrastructure; banking outlets increased to 871 from 507 in FY20



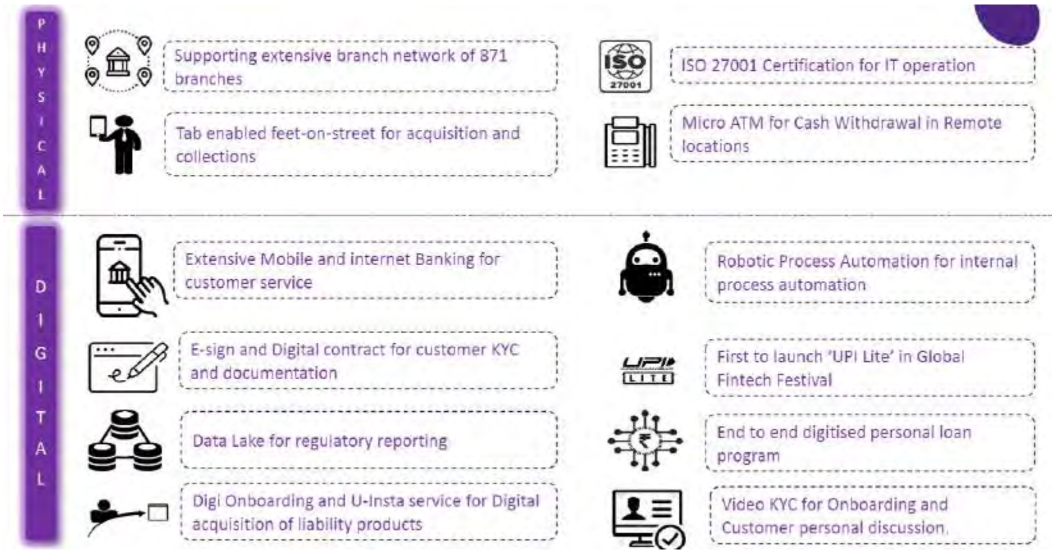
Source: Company data, I-Sec research

Utkarsh's growth story is well supported by its effective use of technology. In order to achieve the business growth, the bank is continuously working on enhancing its existing technology solutions and engaging with new technology/technology partners.

Over the last three years (FY21-FY23), the bank invested INR 941mn in building its tech infrastructure. This includes some of the key initiatives such as –

- Initiatives on the asset side
  - Tab-based digital on boarding; e-Sign and e-KYC introduced in current financial year (FY24).
  - Cash-less disbursements in JLG loans, coupled with cashless collections through QR code/UPI. At present, 8% of one or more instalments in micro-banking loans were done digitally, with 100% digital collections in the individual loans.
  - End-to-end digital personal loans.
  - Usage of technology and analytics to measure performance and manage credit risk through credit application score-card and risk-based lending.
- Initiatives on the liability side
  - Digital end-to-end on boarding with quick savings bank account opening with limited documentation through handheld devices.
  - Video KYC for on-boarding and customer personal discussion.
  - Instant SA &TD account opening though website.
  - Inter-operable card-less cash withdrawal from deposit account.

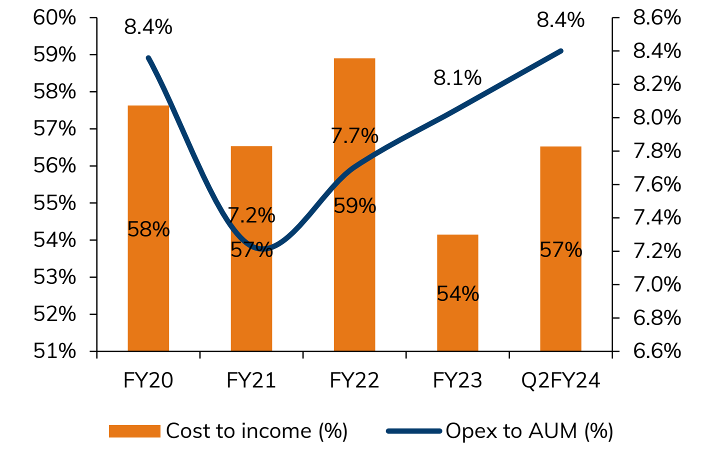
Exhibit 56: Tech initiatives supporting business growth



Source: Company data, I-Sec research

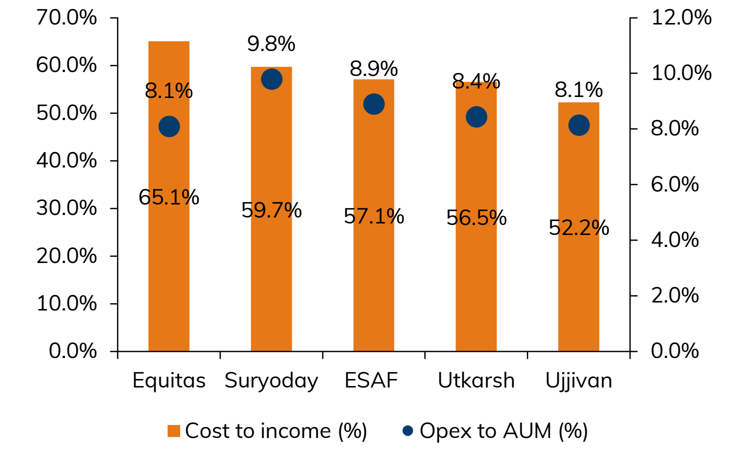
The above initiatives have helped Utkarsh in improving process efficiency, enabling it to provide its products and services in a cost efficient manner. This has allowed its cost of income to be at 57%, which despite being range-bound in the last 4-5 years has hovered between 57%-59% and has been one of the lowest among SFBs.

Exhibit 57: Cost to income range bound between 57%-59%; Opex to AUM at 8.4%



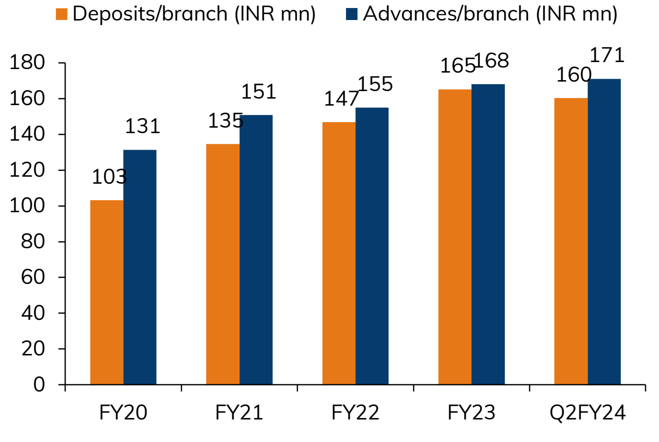
Source: Company data, I-Sec research

Exhibit 58: Operating expenses remained one of the lowest amongst SFBs (Sep'23)



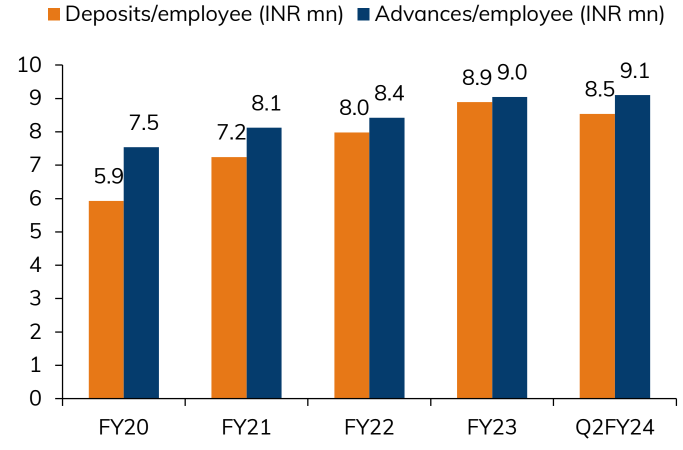
Source: Company data, I-Sec research

Exhibit 59: Improvement in branch productivity…



Source: Company data, I-Sec research

Exhibit 60: …as well as employee productivity



Source: Company data, I-Sec research

Financial Outlook

Deep presence in underserved UP/Bihar, extensive distribution network and diversified asset mix to drive >25% AUM CAGR over FY23-FY26E

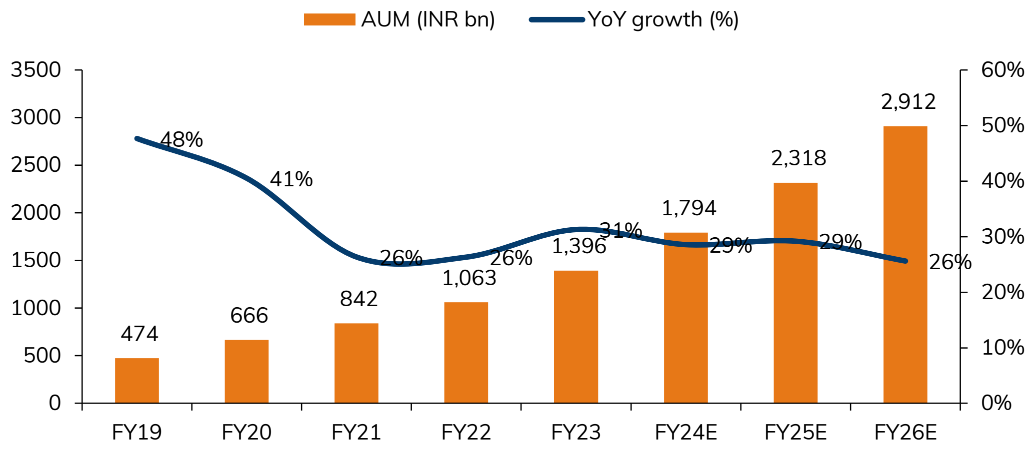
Utkarsh started its lending operations from UP and has been operating in the state for more than a decade. Despite the increasing credit penetration, evident in the 5-year (FY18-23) loan CAGR at 12% vs. 11% for systemic credit, penetration remained significantly lower than Maharashtra (27%), Delhi (12%) and Tamil Nadu (9%), thereby leaving ample opportunity to grow. The same also holds true for Utkarsh's second-largest contributing state, i.e. Bihar, which had a credit penetration of 1%.

As on Sep'23, Utkarsh has 178 banking outlets in UP and 214 in Bihar, cumulatively representing ~45% of its total banking outlet. While operating through these two primary states, the bank has reported 5-year CAGR of 33% reflecting its strong position in the core markets.

Notably, over the years, the bank has also expanded its operations and has created a pan-India presence in 26 states/UTs, with a network of 871 banking outlets, covering 253 districts, while also diversifying its asset mix, with its non-MFI portfolio increasing from 11% in FY18 to 38% in Sep'23. As MFI continued to grow in a calibrated manner at a 3-year CAGR of 16%, during the same time, the other product segments, such as MSME, housing and wholesale where the primary growth drivers growing at 84%, 82% and 71%, respectively. The bank also started with CV/CE financing in FY21, which, albeit on a lower base, has grown at 2-year CAGR of 562%.

Considering the vast untapped opportunity in its core markets – UP and Bihar – extensive distribution network of 871 banking outlets, 13 BCs and 321 DSAs (specifically for LAP product) and adequate capital adequacy at 21% shall support growth. We estimate >25% AUM CAGR over FY23-FY26E.

Exhibit 61: Expect AUM CAGR at >25% for FY23-FY26E



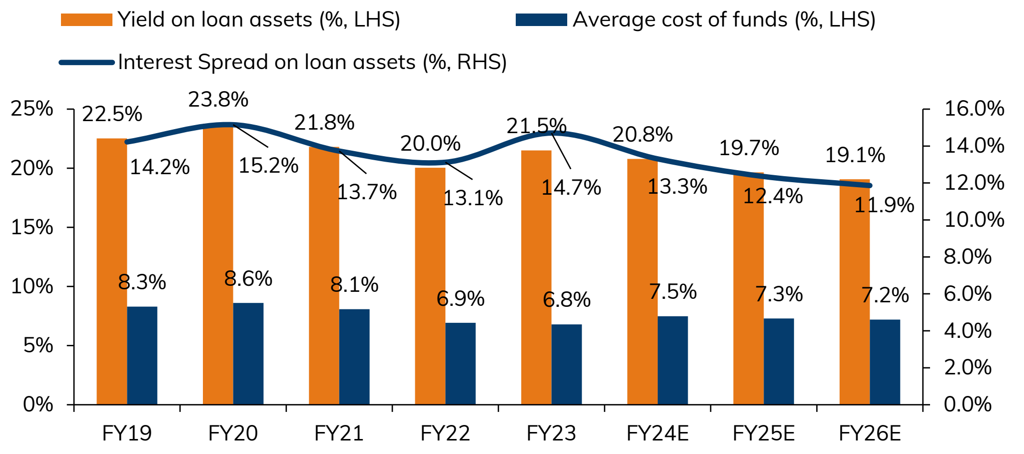
Source: Company data, I-Sec research

Increasing secured mix to put pressure on yields; however, the same is expected to be offset by improving liability profile

Subsequent to its conversion into a SFB in 2017, Utkarsh has been gradually diversifying its asset mix by focussing on the formal segment and secured product suite. The secured portfolio of the bank increased to 34% in Sep'23 from 9% in FY19. Going forward too, the bank plans to take the secured to unsecured mix to 45:55 in the next three years and plans to maintain this ratio on a steady-state-basis. As the bank increased its secured portfolio, the asset yields fell from 22.5% in FY19 to 21.5% in FY23. The impact however, was partially offset by the bank's consistent efforts towards improving its deposit profile, wherein the retail TD + CASA improved from 31% in FY19 to 62% in FY23, resulting in the subsequent reduction in the cost of borrowing from 8.3% in FY19 to 6.8% in FY23.

Going forward, we do expect a marginal yield impact as the secured portfolio grows further; however, the same is expected to be offset by the increasing share of retail deposits. We expect the spreads to remain between at ~12-13% in FY24E-FY26E.

Exhibit 62: Spreads to settle at 12-13% in FY24E-FY26E



Source: Company data, I-Sec research

Increasing secured book and inherently strong good customer behaviour in UP/Bihar to ensure better asset quality and lower credit costs

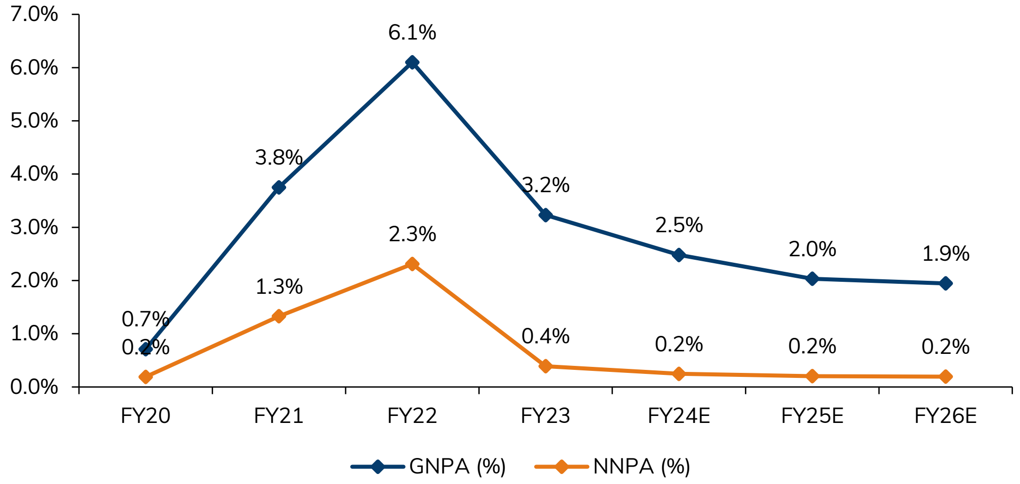
Strategic shift towards the secured book over the medium term is likely to result in better customer risk profile, which would in-turn work in favour of the overall asset quality metrics. Given a completely different customer segment from MFI, the bank has created three independent risk verticals – MFI, non-MFI (retail) and wholesale book – in order to better manage its asset quality. Consequently, for the existing non-MFI book (38% of the overall AUM) gross NPAs remained low, at 1.5% as of Sep'23.

The bank's asset quality also draws comfort from the highly resilient customer segment of its core markets, i.e. UP and Bihar, wherein, the 90+ dpd remained lowest amongst the top-15 MFI states at <6% in last 2.5 years, as compared to 8%-18% for the remaining states.

The effect of the same is also visible with the bank reporting one of the lowest write-offs amongst the MFI and SFBs at 12% (cumulative write-offs of FY21, FY22 and FY23 calculated as a % of FY23 micro-banking AUM) vs. the average of >15% for the Industry.

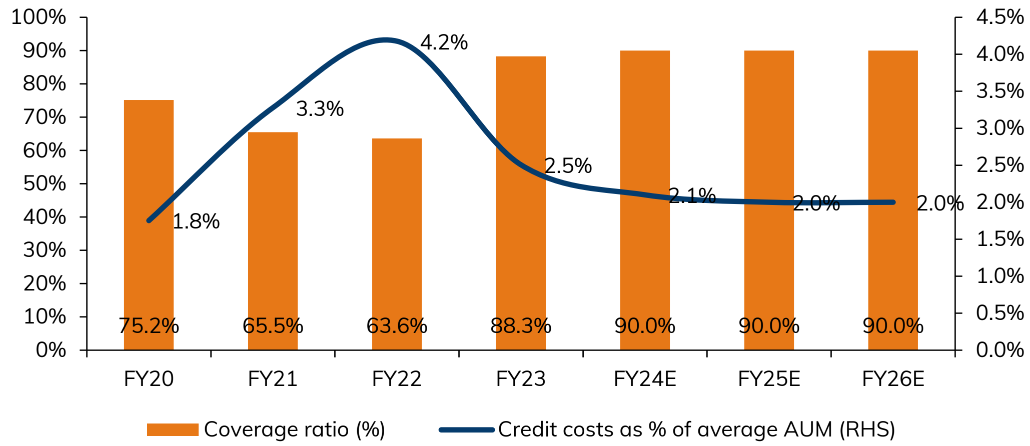
Going forward, we believe that the bank's asset quality metrics will benefit from an improving customer profile as it increases its share of the secured asset classes. This, coupled with the stringent underwriting practices and inherent good behaviour of UP and Bihar, will boost gross NPA improvement. We expect gross NPAs to fall to ~2% in FY25E/FY26E from 3.2% in FY23, with credit cost settling at ~200bps on a steady-state-basis, despite higher expected PCR of 90% during the same period.

Exhibit 63: GNPA improvement expected; to decline to 2% in FY26E vs. 3.2% in FY23



Source: Company data, I-Sec research

Exhibit 64: Credit costs to settle at ~200bps at a PCR of ~90%



Source: Company data, I-Sec research

Tech initiatives to drive productivity improvement

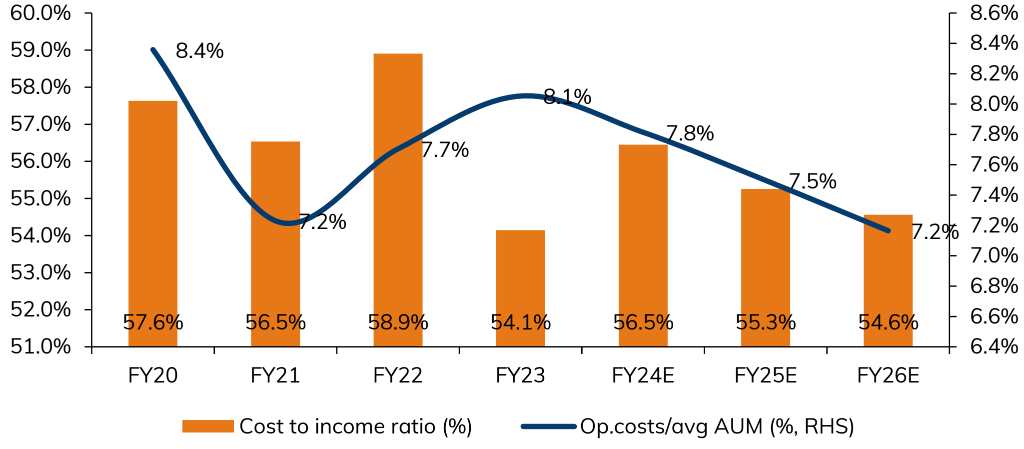
After transitioning into a SFB, in the last six years, Utkarsh has steadily invested in: 1) setting up pan-India presence backed by branch expansion; 2) deploying staff at the branch to cater to large area; and 3) advancing its IT systems and investments towards automation and tech-enabled platforms and tools. As a result, the bank's branch network grew at 3-year CAGR of 18% and employee base grew at 20% during the same period. Additionally, the bank has also invested about INR 941mn towards building its tech infrastructure, enabling paperless processes to complement both asset as well as liability side through digital on-boarding, scorecard-based underwriting, cashless collections and innovative digital offerings such as QR code/UPI.

During the same period, Utkarsh continued to report robust growth in its advances and deposits which grew at a 3-year CAGR of 28% and 38%, respectively. The same resulted in improving productivity with advances per branch and deposit per branch increased to INR 171mn and INR 160mn, respectively in Sep'23 vs. 131 and 103, respectively in FY20.

Despite its aggressive expansion efforts, the bank's cost to income has remained one of the lowest within the SFBs (C/I ratio at 56.5% vs. 65% for Equitas vs. 60% for Suryoday vs. 57% for ESAF).

With most of its branch expansion being executed in the last three years, we expect the bank to continue growing sustainably, as existing branches reach their full potential, while the calibrated investment towards tech advancements takes place over the years. Consequently, we expect the opex to AUM to improve from 8.1% in FY23 to 7.2%-7.5% in FY25E/FY26E

Exhibit 65: Opex to AUM to improve led by higher productivity



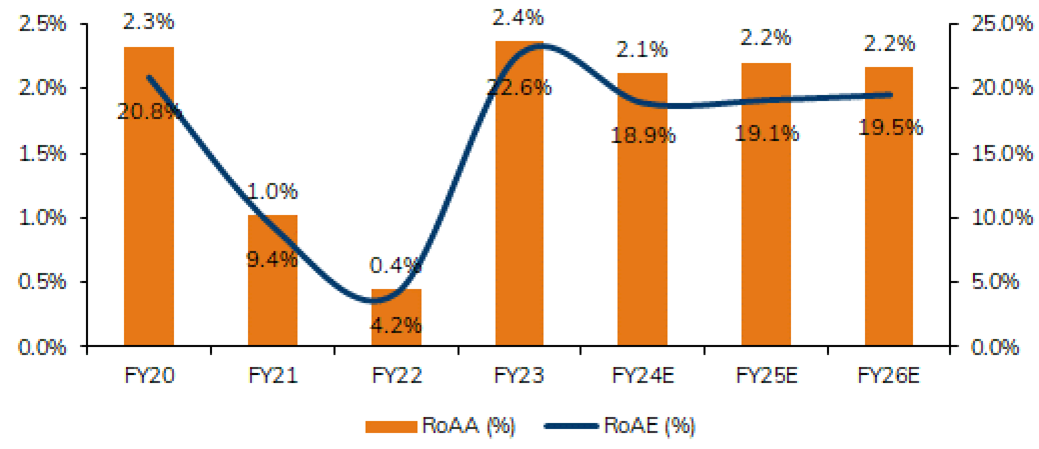
Source: Company data, I-Sec research

RoA likely to be >2% in FY24-FY26E, with RoE at 18-20%; contingency provision policy to provide cushion during challenging times

Utkarsh is likely to witness a steady RoA trajectory of >2% over FY23-26E vs. the last 5-year average of 1.6%. While RoA reached 2.4% in FY23, as the secured asset share further increases over the next couple of years, the same is likely to result in gradual decline in the yields. However, the improving liability profile and resultant improvement in the cost of borrowing will partially offset the NIM impact. Further, the increased secured portfolio will also ensure better asset quality and credit costs. Also, steady improvement in productivity and tech-enabled loan processes should drive operating leverage over FY23-26E. Overall, we expect RoA to remain >2% over FY24-FY26E and RoE at 18-20% during the same period.

Utkarsh is amongst very few MFI player, who is steadily building contingency buffer to make microfinance profitability more stable and sustainable. It is building floating provision in disciplined manner to absorb any challenging events like Demon, Covid etc. provide cushion to earnings during challenging times. Over the past six quarters management built floating provision from INR100mn in Mar'22 to INR1.2bn by Sep'23 (~1.4% of JLG book) and intend to build further going ahead. This may enable Utkarsh to remain relatively less vulnerable on profitability metrics during challenging events.

Exhibit 66: Steady RoA >2%, with RoE at 18-20%



Source: Company data, I-Sec research

Key Management Personnel

Name	Designation	Profile
Mr Govind Singh	Managing Director and CEO	Mr. Govind Singh is the Managing Director and Chief Executive Officer of the bank. He holds a bachelor's degree in commerce from Delhi University. He is a certified associate of the Indian Institute of Bankers. He was previously the Assistant General Manager at ICICI Bank Limited. He has received an award of excellence for Apy Big Believers (ABB) 4.0 by Pension Fund Regulatory and Development Authority in Fiscal 2022. He was the Managing Director and Chief Executive Officer of our Promoter - Utkarsh Core Invest. He has also been associated with Surya Fincap Limited, UTI Bank Limited, Allahabad Bank, State Bank of Patiala and Bank Internasional Indonesia.
Mr. Sarjukumar Pravin Simaria	Chief Financial Officer	He holds a bachelor's degree in commerce from University of Bombay and is a Chartered Accountant as an associate member of the Institute of Chartered Accountants of India (ICAI) He has received the 'CA CFO- for Large Corporates-BFSI Award' from the Committee for Members in Industry of Business (CMI&B), ICAI in the year 2022 and 'CFO Lifetime Achievement Award' at the CFO Vision & Innovation Summit & Awards in the year 2022. He has over 25 years of experience in the field of financial management and has previously worked at Canbank Investment Management services Ltd., SUN F&C Asset Management (I) Pvt. Ltd. as its CFO, HDFC Asset Management Company Limited, AIG Global Asset Management Company (India) Private Limited, American International Group, Inc., as its Head Operations, Edelweiss Capital Limited, Edelweiss Tokio Life Insurance Company Limited, Fino Payments Bank Limited as its CFO and , ECL Finance Limited and Edelweiss Financial Services Limited as its CFO.
Mr. Alok Pathak	Chief Risk Officer	He holds a bachelor's degree in science from Shri Shahu Ji Maharaj University, Kanpur, a diploma in information and systems management from Aptech. He has passed the Certified Banking Compliance Professional Examination and the CAIIB Examination conducted by the Indian Institute of Banking and Finance. He has experience in the fields of risk management and treasury management. He has previously worked at Yes Bank Limited as executive vice president – risk management, Axis Bank Limited as deputy vice president in the risk department and State Bank of Mysore as deputy manager (dealer in treasury).
Mr. Abhijeet Bhattacharjee	Chief Information Officer	He holds a bachelor's degree in science from University of Calcutta and a master's degree in information management from University of Mumbai, Maharashtra. He has experience in the field of information technology. He has previously worked at RBL Bank Limited as its head of digital channels, UTI Bank Limited as its deputy manager and Royal Bank of Scotland N.V. as its vice president.

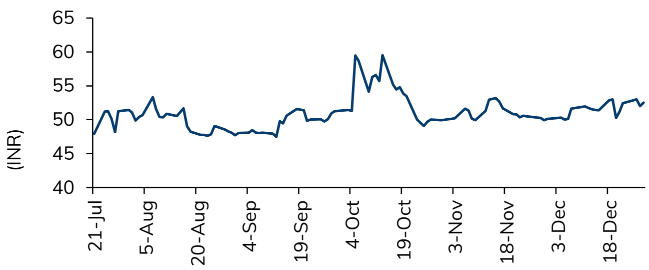
Source: Company data, I-Sec research

Exhibit 67: Shareholding pattern

%	Jul'23	Sep'23
Promoters	69.3	69.3
Institutional investors	15.9	15.1
MFs and others	6.9	8.9
FIs/Banks	1.5	0.0
Insurance	4.4	4.1
FIIs	3.1	2.1
Others	14.8	15.6

Source: Bloomberg

Exhibit 68: Price chart



Source: Bloomberg

Financial Summary

Exhibit 69: Profit & Loss

(INR mn, year ending March)

	FY23A	FY24E	FY25E	FY26E
Interest income	25,050	32,244	40,411	49,855
Interest expense	(9,759)	(13,691)	(16,955)	(21,092)
Net interest income	**15,290**	**18,553**	**23,456**	**28,763**
Non interest income	2,993	3,525	4,444	5,580
Operating income	**18,283**	**22,079**	**27,900**	**34,344**
Operating expense	(9,900)	(12,464)	(15,416)	(18,738)
- Staff expense	(5,701)	(7,326)	(8,991)	(10,789)
Pre-provisions profit	**8,383**	**9,615**	**12,484**	**15,605**
Core operating profit	**8,383**	**9,615**	**12,484**	**15,605**
Provisions & Contingencies	(3,081)	(3,350)	(4,113)	(5,230)
Pre-tax profit	**5,302**	**6,265**	**8,372**	**10,375**
Tax (current + deferred)	(1,257)	(1,579)	(2,110)	(2,615)
Net Profit	**4,045**	**4,686**	**6,262**	**7,761**
% Growth	**561.0**	**15.9**	**33.6**	**23.9**

Source Company data, I-Sec research

Exhibit 70: Balance sheet

(INR mn, year ending March)

	FY23A	FY24E	FY25E	FY26E
Capital	8,959	13,959	13,959	13,959
Reserve & surplus	11,044	15,730	21,992	29,753
Deposits	1,37,101	1,89,530	2,44,608	3,16,760
Borrowings	23,495	15,531	14,832	9,626
Other liabilities	10,576	17,058	22,015	28,508
Total equity and liabilities	**1,91,175**	**2,51,809**	**3,17,406**	**3,98,606**
Cash and Bank balance	25,164	24,607	25,944	32,639
Investments	28,594	39,801	51,368	66,520
Advances	1,39,571	1,79,446	2,31,821	2,91,207
Fixed assets	3,033	4,257	4,577	4,544
Other assets	3,697	3,697	3,697	3,697
Total assets	**1,91,175**	**2,51,809**	**3,17,406**	**3,98,606**
% Growth	26.9	31.7	26.1	25.6

Source Company data, I-Sec research

Exhibit 71: Key ratios

(Year ending March)

	FY23A	FY24E	FY25E	FY26E
No. of shares and per share data				
No. of shares (mn)	896	1,048	1,048	1,048
Adjusted EPS (INR)	4.5	4.5	6.0	7.4
Nominal Book Value per share (INR)	22	28	34	42
Adjusted BVPS (INR)	22	28	34	41
Valuation ratio				
PER (x)	11.9	12.0	9.0	7.3
Price/ Nominal Book (x)	2.4	1.9	1.6	1.3
Profitability ratio				
Yield on advances (%)	18.5	18.8	18.2	17.6
Yields on Assets	15.2	15.1	14.6	14.3
Cost of deposits (%)	6.6	7.2	7.1	7.1
Cost of funds	6.8	7.5	7.3	7.2
NIMs (%)	9.3	8.7	8.5	8.2
Cost/Income (%)	54.1	56.5	55.3	54.6
Dupont Analysis (as % of Avg Assets)				
Interest Income	14.7	14.6	14.2	13.9
Interest expended	(5.7)	(6.2)	(6.0)	(5.9)
Net Interest Income	8.9	8.4	8.2	8.0
Non-interest income	1.8	1.6	1.6	1.6
Total Income	**10.7**	**10.0**	**9.8**	**9.6**
Staff costs	(3.3)	(3.3)	(3.2)	(3.0)
Non-staff costs	-	-	-	-
Total Cost	**(5.8)**	**(5.6)**	**(5.4)**	**(5.2)**
PPoP	**4.9**	**4.3**	**4.4**	**4.4**
Non-tax Provisions	(1.8)	(1.5)	(1.4)	(1.5)
PBT	**3.1**	**2.8**	**2.9**	**2.9**
Tax Provisions	(0.7)	(0.7)	(0.7)	(0.7)
ROA (%)	**2.4**	**2.1**	**2.2**	**2.2**
Leverage (x)	9.6	8.9	8.7	9.0
ROE (%)	**22.6**	**18.9**	**19.1**	**19.5**
Asset quality ratios				
Gross NPLs (%)	3.2	2.5	2.0	1.9
Net NPLs (%)	0.4	0.2	0.2	0.2
PCR (%)	88.3	90.0	90.0	90.0
Gross Slippages (% of PY loans)	4.9	2.3	1.9	1.8
Credit cost as a % of AUM	0.0	0.0	0.0	0.0
Net NPLs / Networth (%)	2.5	1.5	1.3	1.3
Capitalisation ratios				
Core Equity Capital (%)	-	-	-	-
Tier I cap.adequacy (%)	18.3	20.7	19.6	19.1
Total cap.adequacy (%)	20.6	22.0	20.6	20.0

Source Company data, I-Sec research

This report may be distributed in Singapore by ICICI Securities, Inc. (Singapore branch). Any recipients of this report in Singapore should contact ICICI Securities, Inc. (Singapore branch) in respect of any matters arising from, or in connection with, this report. The contact details of ICICI Securities, Inc. (Singapore branch) are as follows: Address: 10 Collyer Quay, #40-92 Ocean Financial Tower, Singapore - 049315, Tel: +65 6232 2451 and email: navneet_babbar@icicisecuritiesinc.com, Rishi_agrawal@icicisecuritiesinc.com.

"In case of eligible investors based in Japan, charges for brokerage services on execution of transactions do not in substance constitute charge for research reports and no charges are levied for providing research reports to such investors."

New I-Sec investment ratings (all ratings based on absolute return; All ratings and target price refers to 12-month performance horizon, unless mentioned otherwise)
BUY: >15% return; ADD: 5% to 15% return; HOLD: Negative 5% to Positive 5% return; REDUCE: Negative 5% to Negative 15% return; SELL: < negative 15% return

ANALYST CERTIFICATION
I/We, Renish Bhuva, CFA (ICFAI); Vaibhav Arora, MBA; 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. Analysts are not registered as research analysts by FINRA and are not associated persons of the ICICI Securities Inc. 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.

Terms & conditions and other disclosures:
ICICI Securities Limited (ICICI Securities) is a full-service, integrated investment banking and is, inter alia, engaged in the business of stock brokering and distribution of financial products. Registered Office Address: ICICI Venture House, Appasaheb Marathe Marg, Prabhadevi, Mumbai - 400 025. CIN: L67120MH1995PLC086241, Tel: (91 22) 6807 7100. ICICI Securities is Sebi registered stock broker, merchant banker, investment adviser, portfolio manager, Research Analyst and Alternative Investment Fund. ICICI Securities is registered with Insurance Regulatory Development Authority of India Limited (IRDAI) as a composite corporate agent and with PFRDA as a Point of Presence. ICICI Securities Limited Research Analyst SEBI Registration Number – INH000000990. ICICI Securities Limited SEBI Registration is INZ000183631 for stock broker. ICICI Securities AIF Trust's SEBI Registration number is IN/AIF3/23-24/1292 ICICI Securities is a subsidiary of ICICI Bank which is India's largest private sector bank and has its various subsidiaries engaged in businesses of housing finance, asset management, life insurance, general insurance, venture capital fund management, etc. ("associates"), the details in respect of which are available on www.icicibank.com.

ICICI Securities is one of the leading merchant bankers/ underwriters of securities and participate in virtually all securities trading markets in India. We and our associates might have investment banking and other business relationship with a significant percentage of companies covered by our Investment Research Department. ICICI Securities and its analysts, persons reporting to analysts and their relatives are generally prohibited from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover.

Recommendation in reports based on technical and derivative analysis centre on studying charts of a stock's price movement, outstanding positions, trading volume etc as opposed to focusing on a company's fundamentals and, as such, may not match with the recommendation in fundamental reports. Investors may visit icicidirect.com to view the Fundamental and Technical Research Reports.

Our proprietary trading and investment businesses may make investment decisions that are inconsistent with the recommendations expressed herein.

ICICI Securities Limited has two independent equity research groups: Institutional Research and Retail Research. This report has been prepared by the Institutional Research. The views and opinions expressed in this document may or may not match or may be contrary with the views, estimates, rating, and target price of the Retail Research.

The information and opinions in this report have been prepared by ICICI Securities and are subject to change without any notice. The report and information contained herein is strictly confidential and meant solely for the selected recipient and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ICICI Securities. While we would endeavour to update the information herein on a reasonable basis, ICICI Securities is under no obligation to update or keep the information current. Also, there may be regulatory, compliance or other reasons that may prevent ICICI Securities from doing so. Non-rated securities indicate that rating on a particular security has been suspended temporarily and such suspension is in compliance with applicable regulations and/or ICICI Securities policies, in circumstances where ICICI Securities might be acting in an advisory capacity to this company, or in certain other circumstances.

This report is based on information obtained from public sources and sources believed to be reliable, but no independent verification has been made nor is its accuracy or completeness guaranteed. This report and information herein is solely for informational purpose and shall not be used or considered as an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ICICI Securities will not treat recipients as customers by virtue of their receiving this report. Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to your specific circumstances. The securities discussed and opinions expressed in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient. This may not be taken in substitution for the exercise of independent judgment by any recipient. The recipient should independently evaluate the investment risks. The value and return on investment may vary because of changes in interest rates, foreign exchange rates or any other reason. ICICI Securities accepts no liabilities whatsoever for any loss or damage of any kind arising out of the use of this report. Past performance is not necessarily a guide to future performance. Investors are advised to see Risk Disclosure Document to understand the risks associated before investing in the securities markets. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

ICICI Securities or its associates might have managed or co-managed public offering of securities for the subject company or might have been mandated by the subject company for any other assignment in the past twelve months.

ICICI Securities or its associates might have received any compensation from the companies mentioned in the report during the period preceding twelve months from the date of this report for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory service in a merger or specific transaction.

ICICI Securities or its associates might have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the companies mentioned in the report in the past twelve months.

ICICI Securities encourages independence in research report preparation and strives to minimize conflict in preparation of research report. ICICI Securities or its associates or its analysts did not receive any compensation or other benefits from the companies mentioned in the report or third party in connection with preparation of the research report. Accordingly, neither ICICI Securities nor Research Analysts and their relatives have any material conflict of interest at the time of publication of this report.

Compensation of our Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions.

ICICI Securities or its subsidiaries collectively or Research Analysts or their relatives do not own 1% or more of the equity securities of the Company mentioned in the report as of the last day of the month preceding the publication of the research report.

Since associates of ICICI Securities and ICICI Securities as a entity are engaged in various financial service businesses, they might have financial interests or actual/ beneficial ownership of one percent or more or other material conflict of interest in various companies including the subject company/companies mentioned in this report.

ICICI Securities may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report.

Neither the Research Analysts nor ICICI Securities have been engaged in market making activity for the companies mentioned in the report.

We submit that no material disciplinary action has been taken on ICICI Securities by any Regulatory Authority impacting Equity Research Analysis activities.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ICICI Securities and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

This report has not been prepared by ICICI Securities, Inc. However, ICICI Securities, Inc. has reviewed the report and, in so far as it includes current or historical information, it is believed to be reliable, although its accuracy and completeness cannot be guaranteed.