

Press Release

North East Small Finance Bank Limited (NESFBL)

06 March, 2018



Rating Assigned

Total facilities rated	Rs.1211.24 Cr.
Total Bank Facilities Rated	Rs. 1027.31 Cr.
Non-Convertible Debentures	Rs.183.93 Cr.
Long Term Rating	SMERA A-/ Stable (Assigned)

* Refer Annexure for details

Rating Rationale

SMERA has assigned the long term rating of '**SMERA A-**' (read as **SMERA A minus**) on the Rs. 1211.24 Cr. facilities of North East Small Finance Bank Limited (NESFBL). The outlook is '**Stable**'.

NESFB was incorporated in 2016 as a wholly owned subsidiary of RGVN Microfinance Limited (RGVN). RGVN, an NBFC-MFI was incorporated in 2008 to carry out microfinance and developmental activities in the north eastern states of Assam, Sikkim, Meghalaya, Arunachal Pradesh and Nagaland.

In September 2015, RGVN was awarded in principle approval from RBI to set up a small finance bank (SFB) and for this purpose NESFBL was incorporated and on successful completion of the various approval processes, the final license to commence operations as an SFB was granted in March 2017. Further in October 2017, RGVN's business of microfinance lending was transferred to NESFBL by way of a slump sale under a business agreement signed between the two entities. NESFBL is the only financial institution in North East India to have received a banking license.

NESFBL commenced its banking operations from October 2017 led by Ms. Rupali Kalita (Managing Director), an experienced development banker with an experience of more than three decades in the banking and financial sector. The bank has a current network of 147 branches in the North East of India (Assam, Sikkim, Meghalaya, Arunachal Pradesh and Nagaland) with Assets Under Management of Rs. 813 Cr. as on January 2017. Of this, only 8 are liability branches and the rest are asset branches extending micro finance which are likely to be brought under banking network by June 2018.

Key rating drivers

Strengths

SFB Conversion to strengthen business and funding profile over the medium term:

NESFBL has transferred RGVN's NBFC-MFI operations into the banking platform and is in the process of stabilising its banking operations. Given its status as the only small finance bank in the North east part of India, NESFBL would benefit from the government's initiatives and directives towards the

development of the latter region. NESFBL is likely to get new opportunities to lend to a diverse set of borrowers including MSMEs as against only microfinance borrowers in RGVN. Further, the banking platform is expected to improve the funding profile of NESFBL in a significant manner over the medium term with access to lower cost CASA deposits. While the development of retail liability franchise may take some time, the SFB is expected to garner whole sale deposits from corporate and Government bodies in the near term with relatively higher yield offerings. It is also likely to tap lines of credit from various commercial banks and the money markets once it achieves the status of a scheduled bank. However, any transition to a banking model may involve interim challenges in terms of mobilisation of CASA and maintenance of CRR and SLR requirements.

Nevertheless, SMERA believes that over the medium term, NESFBL will be able to leverage the inherent opportunities available in a banking platform in terms of access to lower cost funds and wider customer profile.

Healthy asset quality on back of seasoned portfolio

The underlying microfinance business of NESFBL has been inherited from RGVN under the business agreement signed between the two entities. The bank is expected to continue its focus on the microfinance segment. While the unsecured nature and the relatively weak profile of microfinance borrowers make the asset quality inherently vulnerable, it is largely offset given RGVN's track record in the microfinance business and borrower history through several lending cycles.

The asset quality of the bank is healthy reflected in greater than 90 days past due of Rs. 8.61 crore (1.16 per cent of total AUM) as on December 31, 2017. NESFBL has an average collection efficiency of 89.99 per cent for the period October to January 2018(i.e. since commencement of operations).

Going ahead, NESFBL's ability to maintain its asset quality while diversifying its portfolio with products namely SME, Retail loans, Vehicle loans etc. will be key to maintain a stable credit profile.

Adequate liquidity profile and strong capitalisation

NESFB's adequate liquidity profile is evident from the favourable asset-liability position as reflected in the positive mismatch in the near term buckets. The bank has a net worth of Rs. 295.44 Cr. along with comfortable gearing of 3.41x as on 31 December, 2017. The capital adequacy is strong at 37.31 per cent with Tier I CAR of 37.01 per cent as on 31st December 2017 vis-à-vis the regulatory requirement of 15 per cent. Strong capital position provides headroom for the bank to pursue balance sheet growth over the medium term.

Weaknesses:

Bank's profitability likely to remain a challenge over the medium term

The transition to a banking business model may pose challenges for NESFBL in the near term as they need to make significant investments to upgrade to the core banking platform and set up branch banking infrastructure in remote areas. Additionally, the bank needs to invest in CRR and SLR as per the regulatory requirements which is likely to constrain the gross spreads. While focus on microfinance will support higher lending yields, the overall profitability is expected to remain under pressure over the medium term. The benefits of low cost CASA deposits, however, will accrue gradually and strengthen the bank's profitability over the longer term.

Analytical approach:

SMERA has considered the standalone business and financial risk profiles of NESFBL to arrive at the rating.

Outlook – Stable

SMERA believes NESFBL will maintain a stable outlook given its comfortable capitalization and healthy asset quality. The outlook may be revised to 'Positive' in case the bank is able to diversify its resources profile by attracting retail deposits and scale up operations while maintaining profitability. The outlook may be revised to negative in case of significant deterioration in asset quality or in case of any sharp decline in profitability.

About the Rated Entity - Key Financials- Not applicable as the entity has commenced operations in FY2018.

Status of non-cooperation with previous CRA (if applicable):

None

Any other information: Not Applicable

Applicable Criteria

- Default Recognition - <https://www.smera.in/criteria-default.htm>
- Financial Ratios And Adjustments - <https://www.smera.in/criteria-fin-ratios.htm>

Note on complexity levels of the rated instrument

<https://www.smera.in/criteria-complexity-levels.htm>

Rating History (Up to last three years)

Not Applicable

Annexure – Details of instruments rated

Name of the Facilities	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. Crore)	Ratings/Outlook
Term loans	Not Applicable	Not Applicable	Not Applicable	28.13	SMERA A-/ Stable
Term loans	Not Applicable	Not Applicable	Not Applicable	56.90	SMERA A-/ Stable
Term loans	Not Applicable	Not Applicable	Not Applicable	19.52	SMERA A-/ Stable
Term loans	Not Applicable	Not Applicable	Not Applicable	1.61	SMERA A-/ Stable
Term loans	Not Applicable	Not Applicable	Not Applicable	67.87	SMERA A-/ Stable
Term loans	Not Applicable	Not Applicable	Not Applicable	9.74	SMERA A-/ Stable
Term loans	Not Applicable	Not Applicable	Not Applicable	36.27	SMERA A-/ Stable
Term loans	Not Applicable	Not Applicable	Not Applicable	4.11	SMERA A-/ Stable

Term loans	Not Applicable	Not Applicable	Not Applicable	68.93	SMERA A-/ Stable
Term loans	Not Applicable	Not Applicable	Not Applicable	13.33	SMERA A-/ Stable
Term loans	Not Applicable	Not Applicable	Not Applicable	34.11	SMERA A-/ Stable
Term loans	Not Applicable	Not Applicable	Not Applicable	2.17	SMERA A-/ Stable
Term loans	Not Applicable	Not Applicable	Not Applicable	37.50	SMERA A-/ Stable
Term loans	Not Applicable	Not Applicable	Not Applicable	78.26	SMERA A-/ Stable
Term loans	Not Applicable	Not Applicable	Not Applicable	8.33	SMERA A-/ Stable
Term loans	Not Applicable	Not Applicable	Not Applicable	43.75	SMERA A-/ Stable
Term loans	Not Applicable	Not Applicable	Not Applicable	47.38	SMERA A-/ Stable
Term loans	Not Applicable	Not Applicable	Not Applicable	10.86	SMERA A-/ Stable
Term loans	Not Applicable	Not Applicable	Not Applicable	7.67	SMERA A-/ Stable
Term loans	Not Applicable	Not Applicable	Not Applicable	42.63	SMERA A-/ Stable
Term loans	Not Applicable	Not Applicable	Not Applicable	44.10	SMERA A-/ Stable
Proposed bank facility	Not Applicable	Not Applicable	Not Applicable	364.14	SMERA A-/ Stable
Secured Redeemable Non- convertible Debentures	July 14,2015	13.91 %	July 14, 2020	16.00	SMERA A-/ Stable
Secured Redeemable Non- convertible Debentures	July 17,2015	14.50%	Nov 13,2020	33.26	SMERA A-/ Stable
Secured redeemable non-convertible debentures	June 10, 2016	13.25%	Jun 30, 2019	15.00	SMERA A-/ Stable
Unsecured senior redeemable non-convertible debentures	Aug 29, 2017	11%	Aug 29, 2020	36.67	SMERA A-/ Stable
Secured redeemable non-convertible debentures	Aug 09,2017	11 %	Aug 09, 2020	58.00	SMERA A-/ Stable
Secured redeemable non-convertible debentures	Jun 09, 2016	13.25%	Jun 09,2022	25.00	SMERA A-/ Stable

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ABOUT SMERA

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