Suryoday Small Finance Bank Limited

September 14, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fixed deposit programme	500.00	500.00	MA+ (Stable); upgraded from MA (Stable)
Long-term bank lines	105.12	105.12	[ICRA]A (Stable); upgraded from [ICRA]A- (Stable)
Non-convertible debenture	140.50	140.50	[ICRA]A (Stable); upgraded from [ICRA]A- (Stable)
Subordinated debt programme	50.00	50.00	[ICRA]A (Stable); upgraded from [ICRA]A- (Stable)
Certificate of deposit programme	130.00	130.00	[ICRA]A1; reaffirmed
Total	**925.62**	**925.62**	

**Instrument details are provided in Annexure-1*

Rating action

ICRA has upgraded the long-term rating on the Rs. 140.50-crore[1] non-convertible debenture programme, Rs. 50-crore subordinated debt programme and the Rs. 105.12-crore long-term bank lines programme of Suryoday Small Finance Bank Limited (SSFB)[2] to [ICRA]A (pronounced ICRA A) from [ICRA]A- (pronounced ICRA A minus). ICRA has also upgraded the medium-term rating on SSFB's Rs. 500-crore fixed deposit programme to MA+ (pronounced M A plus) from MA (pronounced M A). ICRA has reaffirmed the short-term rating of [ICRA]A1 (pronounced ICRA A one) for the bank's Rs. 130-crore certificate of deposit programme. The outlook on the long-term and medium-term ratings is Stable.

Rationale

The rating upgrade factors in SSFB's successful transition to a small finance bank (SFB), its established track record in the microfinance industry, good traction in management team expansion, systems upgradation, product diversification and deposit mobilisation. SSFB commenced banking operations in 2017 and has introduced new products like home loans, loan against property, loans to micro, small and medium enterprises (MSMEs) and deposits, which comprised 10% of the assets under management (AUM) as on June 30, 2018. Further, SSFB mobilised Rs. 855 crore of deposits as on June 30, 2018.

The ratings take into account the experienced board and management team and strong investor support, and the bank's comfortable capitalisation and liquidity profile supported by regular capital infusion by the investors and promoters. ICRA takes comfort from the capital infusion by the promoters and investors (Rs. 290 crore in FY2017 and Rs. 27 crore in FY2018) which has helped SSFB meet the increased operating expenses owing to conversion to a small finance bank and the elevated credit costs due to deterioration in the asset quality post demonetisation. SSFB was able to report an improvement in its asset quality indicators with gross non-performing assets (NPA) declining to 3.27% as on June 30, 2018 from 6.15% as on March 31, 2017 with continuous recovery efforts and write-offs, while the net NPA was lower at

[1] *100 lakh = 1 crore = 10 million*

[2] *For complete rating scale and definitions, please refer to ICRA's website (www.icraindia.com) or other ICRA rating publications*

0.79%. Further, SSFB's strong capitalisation and good collection efficiency for post-demonetisation disbursements provide comfort in this regard.

The ratings are, however, constrained by SSFB's low profitability indicators (return on average net worth (RoE) of 4.33% in FY2017 and 1.95% in FY2018) on account of high operating expenses and elevated credit costs. The ratings factor in the high attrition rates in the industry as well as the risks associated with unsecured lending, and the political and operational risks arising out of cash handling. Given the marginal profile of its borrowers and the risk of their overleveraging, the credit quality of the microfinance portfolio is fundamentally characterised by a high level of volatility. Going forward, SSFB's ability to grow while diversifying the product offering, increasing its retail deposit base and improving the profitability indicators would remain a key rating monitorable.

Outlook: Stable

ICRA believes SSFB will continue to benefit from the experienced board and strong management, comfortable capitalisation and liquidity position. The outlook may be revised to Negative if the asset quality or capitalisation indicators deteriorate sharply, or if there is a stretch in the bank's liquidity position.

Key rating drivers

Credit strengths

Geographically diversified portfolio – SSFB has a presence in eight states and one Union Territory covering major regions in the southern, western and eastern parts of the country. Initially focused on Maharashtra, SSFB has actively brought down the share of Maharashtra to 31% of the portfolio as on June 30, 2018 from 77% of the portfolio as on March 31, 2012 while focusing on new states and geographies. Over the past three years, SSFB has ventured into the states of Chhattisgarh, Puducherry and Madhya Pradesh, which together accounted for ~6% of the portfolio as on June 30, 2018. As on June 30, 2018, SSFB was operating through 219 banking outlets and 28 banking branches serving 8.6 lakh customers. Also, with the commencement of banking operations, SSFB has introduced new products like home loans, loan against property, loans to MSMEs and deposits. Consequently, the share of joint liability group (JLG) loans declined to 90% as on June 30, 2018 of AUM from 99% as on March 31, 2017.

Experienced board and management team and good systems enabled SSFB to scale up operations profitably – SSFB has a seven-member board with good representation by independent directors. The bank has an experienced senior management team and has developed strong second and third lines of management. SSFB has robust loan origination, monitoring and collection systems in place. Internal audits are conducted regularly, and the scope and coverage are in line with industry practices. The bank has a strong risk management team, which prepares the guidelines on credit risk, geographical concentration, introduction of cross-sell products, assessment of the various businesses and operating risks. SSFB has also recruited key managerial personnel with experience in the banking sector, to further strengthen its team.

Comfortable capitalisation and gearing level; regular capital infusion – SSFB's capital adequacy remains comfortable with a capital to risk weighted assets ratio (CRAR) of 37.94% (Tier I: 34.79%) as on March 31, 2018 compared to the regulatory requirement of 15% (Tier I: 7.5%). With regular equity infusion by the promoters and investors (Rs. 290 crore in FY2017 and Rs. 26 crore in FY2018), the gearing remained low at 3.21 times as on June 30, 2018. ICRA expects SSFB to maintain good capitalisation indicators, going forward, given the investor support and regular capital infusions.

Comfortable liquidity position and financial flexibility; strong ability to raise funds from diverse sources - SSFB's liquidity position remains comfortable owing to a conservative liquidity policy, high cash balances and continued funding from promoters and investors. Also, with the commencement of banking operations, SSFB has started raising funds through deposits. However, it would take some time for SSFB to garner a sizeable retail deposit base. Nevertheless, lines from SIDBI, NABARD and other banks are likely to support its liquidity profile in the interim period. The bank's liquidity profile is also supported by its enhanced borrowing ability on account of receiving 'scheduled' status and its relatively shorter tenor assets.

Credit challenges

Ability to diversify product mix and garner retail deposits – With the commencement of banking operations, SSFB has introduced new products like home loans, loan against property, MSME loans and deposits. While the share of the new products on the asset side stood at 10% of the portfolio as on June 30, 2018, the bank has been successful in raising deposits amounting to Rs. 855 crore against an AUM of Rs. 2,009 crore as of that date. However, a large portion of the deposits were of a wholesale nature. Going forward, SSFB's ability to successfully diversify its product mix and garner retail deposits while growing its portfolio remains a key rating monitorable.

Deterioration in asset quality post demonetisation – With the Government of India's demonetisation action leading to inadequate currency supply, political interference in some states, and disruption in borrower cash flows, SSFB witnessed a decline in collection efficiencies and a subsequent deterioration in its asset quality with gross NPA of 6.15% as on March 31, 2017. The elevated credit costs also impacted the bank's profitability with RoE of 4.33% in FY2017 and 1.95% in FY2018. However, with continuous collection efforts and write-offs, the gross and net NPA was 3.27% and 0.79%, respectively, as on June 30, 2018. Further, SSFB's strong capitalisation and good collection efficiency for post-demonetisation disbursements provide comfort in this regard.

Marginal borrower profile with limited ability to absorb income shocks – The ratings factor in the risks associated with the marginal borrower profile, unsecured lending business, political risks, and operational risks arising out of cash handling, along with the challenges associated with the high pace of growth and the significant attrition rate.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria:
[ICRA's Credit Rating Methodology for Non-Banking Finance Companies]

About the company

Suryoday Small Finance Bank (SSFB), which started as Suryoday Micro Finance Limited, was set up in October 2008 as a non-banking finance company (NBFC) for providing loans to women in urban and semi-urban areas under the Grameen Bank Joint Lending Model. During FY2016, SSFB received a licence from the Reserve Bank of India to commence operations as a small finance bank. Subsequently, it commenced operations as a small finance bank on January 23, 2017.

As of June 2018, SSFB had operations in eight states and one Union Territory, catering to a client base of 8.6 lakh customers through 219 banking outlets and 28 banking branches. During FY2018, SSFB reported a net profit of Rs. 10.13 crore on a total income of Rs. 324.93 crore vis-à-vis a net profit of Rs. 15.10 crore on a total income of Rs. 254.79 crore during FY2017. SSFB reported a return on managed assets (RoMA) of 0.50% FY2018 compared to 1.01% during FY2017. During Q1 FY2019, SSFB reported a net profit of Rs. 17.06 crore on a total income of Rs. 126 crore.

Key financial indicators (Audited)

In Rs. crore	FY2017	FY2018
Total income	254.79	324.93
Operating profit	37.80	75.99
Profit after tax (PAT)	15.10	10.13
Net interest margin / AMA	8.72%	8.33%
Operating profit / AMA	2.48%	3.66%
PAT / AMA	1.01%	0.50%
PAT / Average net worth	4.33%	1.95%
Net worth	500.57	539.76
Gearing	2.11	2.74
CAR	53.62%	37.94%
Gross NPA	6.15%	3.54%
Net NPA	3.80%	1.86%

AMA – Average managed assets; CAR – Capital adequacy ratio; NPA – Non-performing assets

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

Sl No	Instrument	Current Rating (FY2019) Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Sep-18	Chronology of Rating History for the past 3 years FY2109 May-18	FY2018 Mar-18	Feb-18	FY2017 Oct-16	Sep-16	Aug-16	May-16	FY2016 Oct-15	Jun-15	May-15	Apr-15
1	Certificate of Deposit Programme	Short Term	130.00	NA	[ICRA]A1;	[ICRA]A1	[ICRA]A1	-	-	-	-	-	-	-	-	-
2	Fixed deposit programme	Medium Term	500.00	NA	MA+ (Stable)	MA (Stable)	MA (Stable)	MA (Stable)	-	-	-	-	-	-	-	-
3	Long term bank lines	Long Term	105.12	105.12	[ICRA]A (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable); reallocated to long term with rating upgraded;	[ICRA]BBB+ (Stable) / [ICRA]A2	[ICRA]BBB+ (Stable) / [ICRA]A2; rating upgraded	[ICRA]BBB (Stable) / [ICRA]A3+	[ICRA]BBB (Stable) / [ICRA]A3+	[ICRA]BBB (Stable) / [ICRA]A3+
4	Non-convertible debenture	Long Term	140.50	140.50	[ICRA]A (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable); rating upgraded	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable); rating upgraded	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)
5	Subordinated debt programme	Long Term	50.00	50.00	[ICRA]A (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable); rating upgraded	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable); rating upgraded	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable); assigned

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fixed Deposit Programme	NA	NA	NA	500.00	MA+ (Stable)
NA	Long Term Bank Lines	2015-2016	NA	2018-2019	105.12	[ICRA]A (Stable)
INE428Q07059	Non-Convertible Debenture	6/23/2014	13.5 -14% P.A.	5/28/2019	35.00	[ICRA]A (Stable)
INE428Q07083	Non-Convertible Debenture	4/6/2015	14.90%P.A.	12/18/2020	5.00	[ICRA]A (Stable)
INE428Q07109	Non-Convertible Debenture*	6/1/2015	14.10% P.A.	7/13/2018	41.50	[ICRA]A (Stable)
INE428Q07117	Non-Convertible Debenture	9/30/2015	13.1011%P.A.	9/30/2020	39.00	[ICRA]A (Stable)
INE428Q08040	Non-Convertible Debenture	10/27/2016	11.55% P.A.	10/28/2019	20.00	[ICRA]A (Stable)
INE428Q08016	Subordinated Debt Programme	3/31/2015	17.50% P.A.	12/18/2020	10.00	[ICRA]A (Stable)
INE428Q08024	Subordinated Debt Programme	9/22/2015	15.85% P.A.	4/23/2021	15.00	[ICRA]A (Stable)
INE428Q08032	Subordinated Debt Programme	9/21/2016	12.70% P.A.	7/26/2022	25.00	[ICRA]A (Stable)
NA	Certificate of Deposit Programme	NA	NA	7-365 days	130.00	[ICRA]A1

**Instrument matured; Source: SSFB*

ANALYST CONTACTS

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

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

Prateek Mittal
+91 22 6114 3425
prateek.mittal@icraindia.com

Parvathy S
+91 22 6114 3428
Parvathy.s@icraindia.com

RELATIONSHIP CONTACT

L Shivakumar
+91 22 6114 3406
shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

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

Helpline for business queries:

+91-124-2866928 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

About ICRA Limited:

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For more information, visit www.icra.in

ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata	+ (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore	+ (91 80) 2559 7401/4049
Ahmedabad	+ (91 79) 2658 4924/5049/2008
Hyderabad	+ (91 40) 2373 5061/7251
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