September 08, 2020

Suryoday Small Finance Bank Limited: [ICRA]A(Stable) assigned to Rs. 100-crore subordinated debt programme

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Subordinated debt programme	-	100.00	[ICRA]A(Stable); assigned
Non-convertible debenture programme	5.00	5.00	[ICRA]A(Stable); outstanding
Subordinated debt programme	50.00	50.00	[ICRA]A(Stable); outstanding
Certificates of deposit programme	130.00	130.00	[ICRA]A1+; outstanding
Total	**185.00**	**285.00**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings take into account Suryoday Small Finance Bank Limited's (SSFB) comfortable capitalisation profile, supported by regular equity infusions (~Rs. 62 crore in Q1 FY2021, ~Rs. 70 crore in FY2020 and ~Rs. 253 crore in FY2019). The ratings also consider SSFB's healthy profitability profile, supported by a moderation in its operating expenses and healthy income from treasury operations, and the good traction in deposit mobilisation. SSFB reported a net profit of Rs. 110.94 crore in FY2020 (Rs. 86.60 crore in FY2019), translating into a return of 2.35% on the average managed assets (AMA; 2.76% in FY2019) and 11.40% on the average net worth (12.19% in FY2019). The ratings also factor in the bank's experienced board and management team. SSFB has been able to scale up its operations over the past few years and reported a managed portfolio of Rs. 3,593 crore as on June 30, 2020, supported by good systems and processes. SSFB's operations are geographically diversified with 477 branches spread across 13 states/union territories serving over 15 lakh customers. The ratings also factor in the bank's comfortable liquidity profile and financial flexibility, supported by healthy deposit mobilisation, the maintenance of considerable on-book liquidity, and the availability of funding lines from financial institutions.

The microfinance industry is facing many challenges following the spread of the Covid-19 pandemic throughout the country. These include the continuity of business operations on the field and the possible adverse impact on the asset quality as the borrowers' cash flows and economic activity have slowed down. The bank's ability to navigate through the adversity and manage the impact on business growth, client retention, asset quality and profitability would remain critical from a rating perspective, going forward.

The ratings are, however, constrained by the high reliance on bulk deposits. The top 20 deposits comprised 35% of the total deposits held by the bank as on June 30, 2020 (39% as on March 31, 2020; 45% as on March 31, 2019). However, most of the bulk deposits are non-callable in nature. SSFB commenced banking operations in January 2017 and introduced new products like home loans, commercial vehicle (CV) loans, loan against property (LAP) and loans to micro, small and medium enterprises (MSMEs), etc. The share of new products on the asset side stood at 26% as on June 30, 2020 (19% as on March 31, 2019) and the bank's ability to successfully scale up its operations while diversifying its product profile will be important from a credit perspective. The ratings are also constrained by the limited seasoning of the non-microfinance portfolio. SSFB reported a deterioration in its asset quality with gross and net non-performing assets (NPAs) of 2.79% and 0.57%, respectively, as on March 31, 2020 (1.81% and 0.44%, respectively, as on March 31, 2019). This was on account of the livelihood being affected in certain states by natural calamities and the weaker performance of some of the new products.

The ratings continue to factor in the bank's focus on unsecured lending, the political and operational risks associated with microlending, and the marginal profile of the borrowers, which may lead to high volatility in the asset quality indicators. Going forward, SSFB's ability to improve its asset quality indicators, diversify the asset mix and reduce the concentration in the deposit profile while scaling up its operations and diversifying its product profile will be important from a credit perspective.

The Stable outlook on the [ICRA]A rating reflects ICRA's opinion that SSFB will continue to benefit from its experienced management team, adequate systems and processes, and comfortable capitalisation and liquidity profile.

Key rating drivers and their description

Credit strengths

Comfortable capitalisation profile supported by regular capital infusions – The bank's capital adequacy is comfortable with a capital to risk weighted assets ratio (CRAR) of 29.57% (Tier I: 28.61%) as on March 31, 2020 in relation to the regulatory requirement of 15% (Tier I: 7.5%) while the gearing remained low at 3.88 times (3.12 times as on March 31, 2019). This was largely because of regular equity infusions (~Rs. 70 crore in FY2020 and ~Rs. 253 crore in FY2019) by the promoters and investors. The bank raised Rs. 62 crore of equity capital in Q1 FY2021 and equity infusions are likely to continue at regular intervals to support the growth plans. The gearing is not expected to exceed 4 times in the near to medium term.

Healthy profitability indicators although impact expected on account of Covid-19 – The bank's profitability indicators moderated with an increase in the credit costs. Its net interest margin moderated to 10.30% of AMA in FY2020 (11.14% in FY2019) with the decline in yields outpacing the decline in the cost of funds. The operating expenses moderated to 5.76% of AMA in FY2020 from 6.24% in FY2019 as SSFB scaled up its operations. The major costs related to its transformation into a small finance bank (SFB) had already been incurred in the past few years. The credit costs increased to 3.21% of AMA in FY2020 from 2.35% in FY2019 on account of Covid-19-related provisions and a deterioration in the asset quality. The bank made additional provisions of Rs. 65.92 crore (1.39% of AMA) in FY2020 on account of Covid-19. Its profitability profile is supported by income from treasury operations (Rs. 59.95 crore in FY2020; Rs. 37.70 crore in FY2019). The overall profitability indicators remain healthy with a net profit of Rs. 110.94 crore in FY2020 (Rs. 86.60 crore in FY2019), translating into a return of 2.35% on AMA (2.76% in FY2019) and 11.40% on average net worth (12.19% in FY2019). Given the expected slippages due to the pandemic, the credit costs are likely to increase in FY2021, affecting the profitability of the bank.

Experienced board and management team; good systems and processes – SSFB has a nine-member board including five independent directors. Currently, the board has sub-committees including committees for audit, risk management, credit, customer service, information technology (IT) strategy, corporate social responsibility, etc. These committees meet periodically or as and when required. Furthermore, the bank has an experienced senior and middle management team to manage the operations. SSFB has hired extensively at the senior and middle management levels in key areas like liabilities, IT, risk, operations, compliance and treasury among others. The bank ensures credit bureau checks for all its customers and has capped the overall indebtedness of a borrower at Rs. 80,000 (including the proposed loan) for its microfinance portfolio. SSFB has set up a credit committee for its non-microfinance portfolio along with internal credit scoring models. Quarterly audits are conducted at each branch. Monthly audits are also done on a sample basis by a separate team for internal quality and process control.

Comfortable liquidity position and financial flexibility – The bank's liquidity profile is supported by its enhanced borrowing ability on account of receiving 'scheduled' status and the large portion of relatively shorter-tenor assets. SSFB held Rs. 1,458 crore of liquid assets as on July 31, 2020, which is adequate to meet its scheduled debt obligations for at least 6 months i.e. till January 31, 2021. The liquidity profile is also supported by the availability of lines from financial institutions. The liquidity coverage ratio (provisional) remained comfortable at 259% for the fortnight ended August 14, 2020 (177% for the quarter ended June 30, 2020, 154% for the quarter ended March 31, 2020 and 152% for the quarter ended December 31, 2019).

Credit challenges

Ability to manage adverse impact of pandemic on operations and asset quality – The bank reported a deterioration in its asset quality with gross NPAs of 2.79% as on March 31, 2020 compared to 1.81% as on March 31, 2019. The deterioration resulted from the livelihood being affected in certain states by natural calamities and the weaker performance of new products. The microfinance industry is facing many challenges following the spread of the Covid-19 pandemic throughout the country. These include the continuity of business operations on the field and the possible adverse impact on the asset quality as the borrowers' cash flows and economic activity have slowed down. Moreover, incremental business growth has been hindered with disbursements being muted in Q1 FY2021. With regular capital infusions, SSFB has been able to provide for delinquent assets and has improved its loss-absorption capacity. Consequently, the net NPA remained comfortable at 0.57% as on March 31, 2020 (0.44% as on March 31, 2019). The bank's ability to navigate through the adversity and manage the impact on business growth, client retention and asset quality would remain critical from a rating perspective, going forward.

Ability to develop retail depositor base and diversify the product mix – The ratings factor in SSFB's high reliance on bulk deposits. The top 20 deposits comprised 35% of the total deposits held by the bank as on June 30, 2020 (39% as on March 31, 2020; 45% as on March 31, 2019). However, most of the bulk deposits are non-callable in nature. The share of new products on the asset side stood at 26% as on March 31, 2020 (19% as on March 31, 2019) and the bank's ability to successfully scale up its operations while diversifying its product profile will be important from a credit perspective. The ratings are also constrained by the limited seasoning of the non-microfinance portfolio.

Ability to manage political and communal risks and the marginal borrower profile – As a large portion of the bank's portfolio continues to comprise microfinance (74% as on June 30, 2020), the portfolio remains vulnerable to asset quality shocks as witnessed post demonetisation. The ratings factor in the risks associated with unsecured lending to marginal borrowers with limited ability to absorb income shocks and the rising borrower leverage levels owing to an increase in multiple lending in the areas of operations. The microfinance industry is prone to socio-political, climatic and operational risks, which could negatively impact the bank's operations, and thus its financial position. SSFB's strong capitalisation and geographically diversified operations provide comfort in this regard. Its ability to onboard borrowers with a good credit history and recruit and retain employees while scaling up the operations would be key for managing high growth rates.

Liquidity position: Adequate

SSFB held Rs. 1,458 crore of liquid assets as on July 31, 2020, which is adequate to meet its scheduled debt obligations for at least 6 months i.e. till January 31, 2021. The liquidity profile is also supported by the availability of lines from financial institutions. The liquidity coverage ratio (provisional) remained comfortable at 259% for the fortnight ended August 14, 2020 (177% for the quarter ended June 30, 2020, 154% for the quarter ended March 31, 2020 and 152% for the quarter ended December 31, 2019). While the present liquidity profile is adequate, SSFB's ability to maintain its deposit base as well as develop a retail deposit base will be critical from a liquidity perspective.

Rating sensitivities

Positive triggers – ICRA could revise the outlook or upgrade the long-term rating if SSFB is able to stabilise the diversification of its asset mix and develop a retail deposit franchise while maintaining a prudent capitalisation profile and improving its asset quality.

Negative triggers – Pressure on the bank's ratings could arise if there is a deterioration in the asset quality, which could affect its profitability with the return on managed assets falling below 1.5% on a sustained basis. A deterioration in the capitalisation profile or weakening of the liquidity profile could also exert pressure on the ratings.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA's Credit Rating Methodology for Non-Banking Finance Companies Rating Methodology for Banks
Parent/Group Support	Not applicable
Consolidation/Standalone	Standalone

About the bank

Suryoday Small Finance Bank Limited (SSFB), started as Suryoday Micro Finance Limited, was set up in October 2008 as a non-banking financial company (NBFC) with the concept of providing loans to women in urban and semi-urban areas using the joint liability group (JLG) lending model. SSFB received a licence from the Reserve Bank of India (RBI) in FY2016 to commence operations as a small finance bank. It commenced operations as a small finance bank on January 23, 2017. As on June 30, 2020, SSFB's assets under management (AUM) stood at Rs. 3,593 crore and it had a presence in 13 states, catering to more than 15 lakh borrowers.

Key financial indicators (audited)

As per For the period ended	IGAAP FY2019	IGAAP FY2020
Net interest income	349.91	486.88
Profit after tax	86.60	110.94
Net worth	880.62	1,066.23
Managed assets	4,000.78	5,454.40
% PAT / Average managed assets	2.76%	2.35%
% PAT / Average net worth	12.19%	11.40%
% Gross NPAs	1.81%	2.79%
% Net NPAs	0.44%	0.57%
% Net NPA / Net worth	2.37%	1.91%
% Capital adequacy ratio	35.98%	29.57%
Gearing (Reported)	3.12	3.88

All ratios are as per ICRA calculations; Amounts in Rs. crore; Source: SSFB & ICRA research

Status of non-cooperation with previous CRA: None

Any other information: None

Rating history for past three years

	Instrument	Current rating			Rating history for the past 3 years								
		Type	Amount rated	Amount outstanding	FY2021 08-Sep-20	11-May-20	FY2020 27-Mar-20	FY2019 01-Mar-19	14-Sep-18	31-May-18	07-May-18	FY2018 27-Mar-18	23-Feb-18
1	CD programme	Short term	130.00	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	-
2	Subordinated debt programme	Long term	100.00	-	[ICRA]A (Stable); assigned	-	-	-	-	-	-	-	-
3	NCD programme	Long term	5.00	5.00	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)
4	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)	[ICRA]A- (Stable)	[ICRA]A- (Stable)

Amounts in Rs. crore

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	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE428Q07083	Non-convertible Debenture	06-04-2015	14.90%P.A.	18-12-2020	5.00	[ICRA]A (Stable)
INE428Q08016	Subordinated Debt Programme	31-03-2015	17.50% P.A.	18-12-2020	10.00	[ICRA]A (Stable)
INE428Q08024	Subordinated Debt Programme	22-09-2015	15.85% P.A.	23-04-2021	15.00	[ICRA]A (Stable)
INE428Q08032	Subordinated Debt Programme	21-09-2016	12.70% P.A.	26-07-2022	25.00	[ICRA]A (Stable)
NA	Certificates of Deposit Programme	NA	NA	7-365 days	130.00	[ICRA]A1+
NA	Subordinated Debt Programme – Proposed	NA	NA	NA	100.00	[ICRA]A (Stable); assigned

Source: SSFB

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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