March 21, 2023

Suryoday Small Finance Bank Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Subordinated debt programme	100.00	100.00	[ICRA]A (Stable); reaffirmed
Subordinated debt programme	25.00	0.00	[ICRA]A (Stable); reaffirmed and withdrawn
Certificate of deposit programme	330.00	330.00	[ICRA]A1+; reaffirmed
Total	**455.00**	**430.00**	

**Instrument details are provided in Annexure I*

Rationale

The ratings reaffirmation factors in the steady growth in Suryoday Small Finance Bank Limited's (Suryoday) scale of operations, with the gradual diversification of its product offerings. The ratings also take into consideration its comfortable capitalisation profile with a capital adequacy ratio (CAR) of 36.4% (Tier I: 33.5%) as on December 31, 2022, well above the regulatory requirement of 15.0% (Tier I: 7.5%). The current capitalisation profile is comfortable for the bank's near-term growth requirements. The ratings also derive comfort from the healthy traction in Suryoday's deposit mobilisation over the last few years. Deposits comprised 67% of its borrowings as on December 31, 2022. The share of retail deposits has also been increasing over the years and stood at 78% as on December 31, 2022.

ICRA notes that Suryoday witnessed an improvement in its asset quality and profitability metrics in 9M FY2023, which had deteriorated in FY2021 and FY2022 because of the Covid-19 pandemic-induced disruptions. However, the same remains subdued, continuing to constrain the ratings. Gross non-performing assets (GNPA) declined to 4.2% as on December 31, 2022 from 11.8% as on March 31, 2022 due to recoveries, write-offs and the sale of the portfolio to an asset reconstruction company (ARC) in Q3 FY2023. ICRA notes that, after witnessing subdued profitability in FY2022 on account of low margins and high credit costs, the bank reported an improvement in its earnings profile in 9M FY2023 because of higher margins and lower credit costs. ICRA expects the bank to witness further improvement in its profitability, going forward, driven by lower credit costs. Suryoday's ability to arrest further slippages and recover from its restructured and delinquent portfolio would remain a key monitorable from a credit perspective.

While the bank has been scaling up its newer products like housing loans, financial intermediary group, commercial vehicles, loans to micro, small and medium enterprises (MSMEs), etc, microfinance continues to account for a large share of its portfolio at 61% as on December 31, 2022 (67% as on March 31, 2022), exposing it to the risks associated with unsecured lending. The ratings also continue to factor in 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. Moreover, the share of current account savings account (CASA) remains low and declined further to 14% as on December 31, 2022 from 18% as on March 31, 2022. Going forward, Suryoday's ability to improve its asset quality indicators, diversify the asset mix further and improve the share of CASA in the deposit profile while scaling up its operations will be important from a credit perspective.

The Stable outlook reflects ICRA's expectation that the bank would continue to maintain its credit profile over the medium term and would see an improvement in its profitability and asset quality along with a comfortable capitalisation profile and healthy traction in its deposits.

ICRA has reaffirmed and simultaneously withdrawn the rating outstanding on the Rs. 25-crore subordinated debt programme as the instrument has been repaid by the bank with no amount outstanding against the same. The rating has been withdrawn in accordance with ICRA's policy on the withdrawal of credit ratings.

Key rating drivers and their description

Credit strengths

Comfortable capitalisation profile – The bank's capital adequacy ratio of 36.4% (Tier I: 33.5%) as on December 31, 2022 was well above the regulatory requirement of 15.0% (Tier I: 7.5%). Though the gearing increased to 4.6 times as on December 31, 2022 from 4.3 times as on March 31, 2022 (3.1 times as on March 31, 2021), it remains comfortable. In FY2021, the bank raised ~Rs. 522 crore of equity capital through IPO and private placement, compared to ~Rs. 64 crore in FY2020 (~Rs. 248 crore in FY2019). Going forward, ICRA expects Suryoday's capitalisation profile to remain comfortable.

Good traction in deposit mobilisation – Suryoday has successfully built a large deposit base, which comprised 67% of its total borrowings as on December 31, 2022, up from 60% as on March 31, 2022. The overall deposit base grew to Rs. 4,697 crore as on December 31, 2022 from Rs. 3,850 crore as on March 31, 2022. Consequently, the cost of funds has been declining over the years aided by low interest rates during the pandemic. Suryoday has been able to contain its cost of funds over the last few quarters despite the overall increase in interest rates in the market. It reported cost of funds at 6.3%[1] in 9M FY2023. The share of retail deposits was reported at 78% as on December 31, 2022 (78% as on March 31, 2022) compared to 54% as on March 31, 2020. ICRA takes note of Suryoday's plan to reduce the share of bulk deposits further and establish a stable retail depositor base.

Steady growth in scale of operations – Suryoday has been able to maintain a steady growth in its scale of operations over the last few years, aided by its experienced management team and good systems and processes. It increased its gross advances at a compound annual growth rate of 43% during FY2017 to FY2022. The growth rate moderated slightly to 9% (annualised) in 9M FY2023, given the sale of the portfolio to an ARC. However, the growth rate is expected to improve, going forward.

Credit challenges

Moderate asset quality and profitability – The bank's asset quality deteriorated in FY2022 owing to the pandemic. However, its GNPA declined to 4.2% as on December 31, 2022 from 11.8% as on March 31, 2022 due to write-offs and the sale of the portfolio to an ARC in Q3 FY2023. Moreover, its standard restructured portfolio declined to 1.6% of gross advances as on December 31, 2022 from 10.4% as on March 31, 2022 primarily on account of slippages. Going forward, Suryoday's ability to increase its collections further and recover from the restructured portfolio will help improve its asset quality indicators.

The bank also witnessed subdued profitability indicators in FY2022 due to lower margins on account of the reversal of interest income and increased credit costs as a result of higher write-offs. Suryoday reported negative return on average total assets (RoTA) and return on equity (RoE) of (1.2%) and (6.2%), respectively, in FY2022. The net interest margin improved in 9M FY2023 with Suryoday increasing its lending rates in the secured book and lending more under the Vikas loan segment, which carries a higher interest rate vis-à-vis joint liability group loans. Also, credit costs declined as the majority of the same was booked in FY2022. As a result, the bank's RoTA and RoE improved to 0.6% and 2.5%, respectively, in 9M FY2023, though they remain subdued with a meaningful improvement expected to take place by next year.

Ability to diversify product mix further and increase the share of CASA in deposits – With the commencement of banking operations, Suryoday introduced new products like housing loans, MSME loans, overdraft, commercial vehicle loans, financial intermediary group, etc. While it has been scaling up its newer products, microfinance continues to account for a large share of the portfolio at 61% as on December 31, 2022 (67% as on March 31, 2022; 70% as on March 31, 2021).

On the liabilities front, Suryoday has been successful in garnering a healthy amount of deposits and has been gradually focusing on building a stable retail deposit franchise. However, the share of CASA remains low and declined further to 14% as on December 31, 2022 from 18% as on March 31, 2022. The bank's ability to scale up its operations successfully while diversifying

[1] *As per ICRA's calculations and includes cost of deposits and borrowings*

its product profile further and increasing the share of CASA in deposits 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, communal and other risks, given the marginal borrower profile – As a large portion of the bank's portfolio continues to comprise microfinance (61% as on December 31, 2022), the portfolio remains vulnerable to asset quality shocks as witnessed after demonetisation and during the pandemic. 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. 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. Suryoday's ability to onboard borrowers with a good credit history and recruit and retain employees while scaling up its operations would be key for managing high growth rates.

Environmental and social risks

Environmental considerations – Given the service-oriented business of Suryoday, its direct exposure to environmental risks as well as those emanating from regulations or policy changes is not material. While the bank does not face material physical climate risks, it is exposed to environmental risks indirectly through its portfolio of assets. Further, the lending is usually short-to-medium term, which allows the bank to adapt while taking incremental exposures on less environmentally vulnerable businesses.

Social considerations – Data security and customer privacy are among the key sources of vulnerability for Suryoday as any material lapse could be detrimental to its reputation and could invite regulatory censure. Customer preference is increasingly shifting towards digital banking, which provides an opportunity to reduce the operating costs. However, the possibility of subpar execution of the information technology strategy, and thus the inability to adequately meet the customers' needs, could result in more costs than benefits. On the positive side, Suryoday contributes towards enhancing financial inclusion by providing several products and services that are specifically targeted towards the marginalised sections of society and attempts to address and cater to social concerns. Prudent lending to such under-served segments could create growth opportunities. However, such growth opportunities must be seen in conjuncture with asset quality risks that could impact the bank's credit quality.

Liquidity position: Strong

The liquidity coverage ratio was healthy at 150.36% for the quarter ended December 31, 2022 (208% for the quarter ended March 31, 2021) on a daily average basis for the respective quarter. The bank's asset-liability management statement as on December 31, 2022 did not show any cumulative mismatches for a period of one year, even under the stressed scenario of 80% collection efficiency on advances. Suryoday's liquidity profile is supported by its enhanced borrowing ability on account of its 'scheduled' status and the large portion of relatively shorter-tenor assets.

Rating sensitivities

Positive factors – ICRA could revise the outlook or upgrade the long-term rating if Suryoday is able to scale up its portfolio further, while diversifying its asset mix and improving the asset quality and maintaining a prudent capitalisation profile.

Negative factors – Pressure on the bank's ratings could arise if it is unable to improve its profitability metrics in the near term. 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 Rating Methodology for Banks and Financial Institutions ICRA Policy on Withdrawal of Credit Ratings
Parent/Group support	Not applicable
Consolidation/Standalone	The ratings are based on the standalone financial profile of the bank

About the company

Suryoday Small Finance Bank Limited (Suryoday), initially incorporated as Suryoday Micro Finance Limited, was set up in October 2008 as a non-banking financial company with the concept of providing loans to women in urban and semi-urban areas using the joint liability group (JLG) lending model. Suryoday 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 of December 31, 2022, the bank was operating in 14 states and Union Territories (UTs) across India through its 571 branches, with a strong presence in Maharashtra, Tamil Nadu and Odisha. Suryoday caters to 21.9 lakh clients and had a portfolio of Rs. 5,408 crore as on December 31, 2022.

Key financial indicators (audited)

Suryoday Small Finance Bank Limited	FY2021	FY2022	9M FY2023*
Accounting as per	IGAAP	IGAAP	IGAAP
Net interest income	410	585	537
Profit before tax	12	(127)	51
Profit after tax	12	(93)	39
Gross advances	4,206	5,063	5,408
Total managed assets	6,712	8,180	8,900
Tier I	47.2%	34.4%	33.5%
CRAR	51.5%	37.9%	36.4%
Net interest margin	6.8%	7.8%	8.4%
PAT / AMA	0.2%	(1.2) %	0.6%
Return on average net worth	0.7%	(6.2) %	2.5%
Gross NPAs	9.4%	11.8%	4.2%
Net NPAs	4.7%	6.0%	2.7%

*Source: Bank, ICRA Research; All ratios as per ICRA's calculations; *Limited review; Amount in Rs. crore*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Chronology of Rating History for the Past 3 Years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of February 28, 2023 (Rs. crore)	Date & Rating in FY2023	Date & Rating in FY2022		Date & Rating in FY2021		Date & Rating in FY2020
					Mar 21, 2023	Mar 22, 2022	Sep 02, 2021	Sep 08, 2020	May 11, 2020	Mar 27, 2020
1	**Certificate of deposit programme**	Short term	330.00	0.00	**[ICRA]A1+**	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
2	**Subordinated debt programme**	Long term	100.00	100.00	**[ICRA]A (Stable)**	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)
3	**Subordinated debt programme**	Long term	25.00	0.00	**[ICRA]A (Stable); withdrawn**	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)
4	**Subordinated debt programme**	Long term	0.00	0.00	-	-	[ICRA]A (Stable); withdrawn	[ICRA]A	[ICRA]A	[ICRA]A
5	**Non-convertible debenture**	Long term	0.00	0.00	-	-	[ICRA]A (Stable); withdrawn	[ICRA]A	[ICRA]A	[ICRA]A
6	**Fixed deposit programme**	Medium term	0.00	0.00	-	-	-	-	MA+ (Stable); withdrawn	MA+ (Stable)
7	**Non-convertible debenture**	Long term	0.00	0.00	-	-	-	-	-	[ICRA]A (Stable); withdrawn

Complexity level of the rated instruments

Instrument	Complexity Indicator
Subordinated debt programme	Simple
Certificate of deposit programme	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA’s website: Click Here

Annexure I: Instrument details

ISIN/Banker Name	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
INE428Q08032	**Subordinated debt programme**	Sep 21, 2016	12.70% p.a.	Jul 26, 2022	25.00	[ICRA]A (Stable); withdrawn
INE428Q08073	**Subordinated debt programme**	Sep 08, 2020	12.50% p.a.	Apr 07, 2027	100.00	[ICRA]A (Stable)
NA	**Certificate of deposit programme – Yet to be issued**	NA	NA	7-365 days	330.00	[ICRA]A1+

Annexure II: List of entities considered for consolidated analysis: Not applicable

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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.

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