

September 02, 2021

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 | 125 | 125 | [ICRA]A (Stable); reaffirmed |
| Subordinated debt programme | 25 | - | [ICRA]A (Stable); reaffirmed and simultaneously withdrawn |
| Non-convertible debenture Programme | 5 | - | [ICRA]A (Stable); reaffirmed and simultaneously withdrawn |
| Certificate of deposit programme | 130 | 130 | [ICRA]A1+; reaffirmed |
| Total | 285 | 255 | |

*Instrument details are provided in Annexure-1

Rationale

The ratings take into account Suryoday Small Finance Bank Limited's (SSFB) strong capitalisation profile with a capital adequacy ratio of 52.1% (Tier I: 47.6%) as on June 30, 2021, supported by regular capital raising (~Rs. 522 crore in FY2021; ~Rs. 66 crore in FY2020). In FY2021, the bank launched its initial public offering (IPO), which has bolstered its capitalisation profile, making it well capitalised to absorb Covid-19-related losses and support its growth plans. The ratings also factor in SSFB's experienced board and management team, which has helped it scale up its operations while gradually diversifying its product offerings.

SSFB has successfully built a large deposit base, which comprised 67% of its total borrowings as on June 30, 2021. The bank has reduced the share of bulk deposits and is gradually establishing a stable retail depositor base. Nevertheless, the share of current accounts – savings accounts (CASA) remains low, albeit improving, at 16% as on June 30, 2021 (15% as on March 31, 2021 and 11% as on March 31, 2020).

The ratings also factor in the bank's strong liquidity profile and financial flexibility. SSFB maintained high on-book liquidity in FY2021 and Q1 FY2022. Also, its liquidity coverage ratio of 260% for the quarter ended June 30, 2021, was well above the regulatory requirement of 100%. The bank has access to funding from financial institutions (FIs), which further supports its liquidity profile.

The ratings, however, are constrained by SSFB's weakening profitability in FY2021, given the Covid-19 pandemic-induced challenges. The bank reported a net profit of Rs. 12 crore in FY2021, translating into a return of 0.2% on average managed assets (AMA) and 0.9% on average net worth (Rs. 111 crore, 2.4% and 11.4%, respectively, in FY2020). The profitability indicators remained subdued in Q1 FY2022 with the bank creating significant provisions during the quarter {credit costs of 6.6% on AMA (annualised)} and it consequently reported a loss of Rs. 48 crore. The asset quality indicators have deteriorated, given the impact of the pandemic, with the bank reporting gross non-performing assets (NPAs) of 9.5% and net NPAs of 4.5% as on June 30, 2021. SSFB has also restructured a significant portion of its advances (10.5%) as on June 30, 2021.

While the bank has been scaling up its newer products like housing loans, loans to micro, small and medium enterprises (MSMEs), etc., microfinance continues to account for a large share of its portfolio at 68% as on June 30, 2021 (69% as on March 31, 2021; 75% as on June 30, 2020). SSFB's ability to successfully scale up its operations while further diversifying its product profile will be important from a credit perspective.

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, further diversify the asset mix 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 aided by an experienced management team, strong capitalisation profile, healthy traction in deposits and financial flexibility.

ICRA has reaffirmed and simultaneously withdrawn the rating outstanding for Rs. 25 crore subordinated debt programme and Rs. 5 crore non-convertible debenture programme as the instruments have been repaid by the company and there is no amount outstanding against the rated instrument. The rating has been withdrawn in accordance with ICRA's policy on withdrawal of credit ratings.

Key rating drivers and their description

Credit strengths

Strong capitalisation profile – The bank's capital adequacy ratio of 52.1% (Tier I: 47.6%) as on June 30, 2021 was well above the regulatory requirement of 15.0% (Tier I: 7.5%). The gearing remained low at 3.2 times as on June 30, 2021 (3.1 times as on March 31, 2021; 3.9 times as on March 31, 2020) despite the excess liquidity being carried by the bank. While the pace of growth has been higher than the internal capital generation, SSFB has been regularly raising equity capital to maintain its capitalisation profile. In FY2021, the bank launched its IPO, which has bolstered its capitalisation profile, making it well capitalised to absorb Covid-19-related losses and support its growth plans. The bank raised ~Rs. 522 crore of equity capital in FY2021 (through IPO and private placement) compared to ~Rs. 64 crore in FY2020 (~Rs. 248 crore in FY2019). Going forward, ICRA expects SSFB's capitalisation profile to remain strong.

Diversified funding mix with good traction in deposit mobilisation – SSFB has successfully built a large deposit base, which comprised 67% of its total borrowings as on June 30, 2021 (66% as on March 31, 2021; 69% as on March 31, 2020). Consequently, the cost of funds has been declining over the years and was reported at 7.4% in Q1 FY2022 (8.1% in FY2021).

SSFB is gradually reducing the share of bulk deposits and establishing a stable retail depositor base. The share of retail deposits was reported at 86% as on June 30, 2021 (80% as on March 31, 2021) compared to 54% as on March 31, 2020. While the bank builds a stable retail deposit franchise, lines from FIs are likely to support its funding requirement during the interim period. As on June 30, 2021, funding from FIs comprised 27% of the total borrowings.

Strong liquidity position and financial flexibility – The bank'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. As on June 30, 2021, SSFB was carrying free on-book liquidity of Rs. 1,596 crore, which is adequate to meet its scheduled debt obligations for at least six months, i.e. till December 30, 2021. The liquidity profile is also supported by the availability of lines from FIs. The bank was also able to raise subordinated debt of Rs. 100 crore in FY2021 despite the challenging operating environment.

Experienced board and management team – 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 adequately tenured people at the senior and middle management levels in key areas like liabilities, IT, risk, operations, compliance and treasury among others.

Credit challenges

Weakening profitability in FY2021 and Q1 FY2022 – The bank's profitability indicators were subdued in FY2021 with elevated credit costs and reversal of interest income on NPAs. The net interest margin declined to 5.9% in FY2021 from 10.3% in FY2020 due to interest reversal on account of NPAs and the excess on-book liquidity being maintained by the bank in light of the pandemic. Credit costs remained elevated at 2.8% in FY2021 (3.2% in FY2020) due to the deterioration in the asset quality.

SSFB reported a net profit of Rs. 12 crore in FY2021, translating into a return of 0.2% on AMA and 0.9% on average net worth (Rs. 111 crore, 2.4% and 11.4%, respectively, in FY2020). The profitability indicators remained subdued in Q1 FY2022 with the

bank creating significant provisions during the quarter {credit costs of 6.6% on AMA (annualised)} and it consequently reported a loss of Rs. 48 crore.

Deterioration in asset quality; further impact expected because of Covid-19 second wave – The bank's gross NPAs increased in FY2021 and were reported at 9.4% as on March 31, 2021 compared to 2.8% as on March 31, 2020. The net NPAs stood at 4.7% as on March 31, 2021 (0.6% as on March 31, 2020). SSFB's asset quality indicators were further impacted in Q1 FY2022 owing to the second wave of the pandemic and it reported an increase in gross NPAs to 9.5% as on June 30, 2021. The bank has also restructured loans amounting to 10.5% of its loan portfolio as on June 30, 2021 (3.3% as on March 31, 2021).

As the borrowers' cash flows and economic activity have slowed down, the asset quality indicators are expected to deteriorate further in the near term. While ICRA takes comfort from the bank's strong capitalisation profile and loss-absorbing capacity, its ability to arrest slippages and recover from delinquent accounts remains a key rating monitorable.

Ability to further diversify the product mix and increase the share of CASA in deposits – With the commencement of banking operations, SSFB introduced new products like housing loans, MSME loans, overdraft, commercial vehicle loans, deposits, etc. While the bank has been scaling up its newer products, microfinance continues to account for a large share of the portfolio at 68% as on June 30, 2021 (69% as on March 31, 2021; 75% as on June 30, 2020).

On the liabilities front, SSFB has been successful in garnering a healthy amount of deposits and has been gradually focusing on building a stable retail deposit franchise. Nevertheless, the share of CASA remains low, albeit improving, at 16% as on June 30, 2021 (15% as on March 31, 2021 and 11% as on March 31, 2020). The bank's ability to successfully scale up its operations while further 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, communal and other risks, given the marginal borrower profile – As a large portion of the bank's portfolio continues to comprise microfinance (68% as on June 30, 2021), 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 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 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.

Liquidity position: Strong

The liquidity coverage ratio was healthy at 261% for the quarter ended June 30, 2021 (220% for the quarter ended March 31, 2021) on a daily average basis for the respective quarter. The bank's structural liquidity statement as on March 31, 2021 did not have any cumulative mismatches for a period of one year, even under the stressed scenario of 80% collection efficiency on advances. As on June 30, 2021, SSFB was carrying free on-book liquidity of Rs. 1,596 crore. The bank'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. The liquidity profile is also supported by the availability of lines from FIs.

Rating sensitivities

Positive factors – ICRA could revise the outlook or upgrade the long-term rating if SSFB is able to further scale up its portfolio, 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 there is a further 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 | Rating Methodology for Non-Banking Finance Companies Rating Methodology for Banks Policy on Withdrawal of Credit Ratings |
| Parent/Group Support | Not Applicable |
| Consolidation/Standalone | Standalone |

About the company

Suryoday Small Finance Bank (SSFB), initially incorporated as Suryoday Micro Finance Limited, was set up in October 2008 as a non-banking finance company 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 in FY2016 to commence operations as a small finance bank. It commenced operations as a small finance bank on January 23, 2017.

As of June 30, 2021, the bank was operating in 13 states and Union Territories across India through 555 banking outlets, with a strong presence in Maharashtra, Tamil Nadu and Odisha. As on June 30, 2021, SSFB was catering to more than 15 lakh clients while managing a portfolio of Rs. 4,004 crore.

Key financial indicators (audited)

| Suryoday Small Finance Bank Limited | FY2020 | FY2021 | Q1 FY2022 |
|-------------------------------------|--------|--------|-----------|
| Accounting as per | IGAAP | IGAAP | IGAAP |
| Net interest income | 487 | 359 | 99 |
| Profit before tax | 154 | 12 | (57) |
| Profit after tax | 111 | 12 | (48) |
| Net advances | 3,532 | 3,983 | 3,793 |
| Total managed assets | 5,454 | 6,712 | 6,753 |
| % Tier I | 34.3% | 47.2% | 47.6% |
| % CRAR | 35.4% | 51.5% | 52.1% |
| % Net interest margin | 10.3% | 5.9% | 5.9% |
| % PAT / AMA | 2.4% | 0.2% | (2.8%) |
| % Return on average net worth | 11.4% | 0.9% | (12.1%) |
| % Gross NPAs | 2.8% | 9.4% | 9.5% |
| % Net NPAs | 0.6% | 4.7% | 4.5% |

Note: Amount in Rs. crore; All calculations are as per ICRA

Source: SSFB, ICRA Research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

| Instrument | Current Rating (FY2022) | | | | Chronology of Rating History for the Past 3 Years | | | | | |
|------------|-------------------------------------|--------------------------|--|-------------------------|---|-------------------------|-------------------------|------------------|------------------------------|-------------------|
| | Type | Amount Rated (Rs. crore) | Amount Outstanding as of August 31, 2021 (Rs. crore) | Date & Rating in FY2022 | Date & Rating in FY2021 | Date & Rating in FY2020 | Date & Rating in FY2019 | | | |
| | | | | Sep 02, 2021 | Sep 08, 2020 May 11, 2020 | Mar 27, 2020 | Mar 01, 2019 | Sep 14, 2018 | May 31, 2018 May 07, 2018 | |
| 1 | Subordinated debt programme | Long term | 125.00 | 125.00 | [ICRA]A (Stable) | [ICRA]A (Stable) | [ICRA]A (Stable) | [ICRA]A (Stable) | [ICRA]A (Stable) | [ICRA]A- (Stable) |
| 2 | Subordinated debt programme | Long term | 25.00 | 0.00 | [ICRA]A (Stable); reaffirmed and simultaneously withdrawn | [ICRA]A (Stable) | [ICRA]A (Stable) | [ICRA]A (Stable) | [ICRA]A (Stable) | [ICRA]A- (Stable) |
| 3 | Non-convertible debenture programme | Long term | 5.00 | 0.00 | [ICRA]A (Stable); reaffirmed and simultaneously withdrawn | [ICRA]A (Stable) | [ICRA]A (Stable) | [ICRA]A (Stable) | [ICRA]A (Stable) | [ICRA]A- (Stable) |
| 4 | Certificate of deposit programme | Short term | 130.00 | 0.00 | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1 | [ICRA]A1 |

Complexity level of the rated instruments

| Instrument | Complexity Indicator |
|-------------------------------------|----------------------|
| Subordinated debt programme | Simple |
| Non-convertible debenture 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: www.icra.in

Annexure-1: Instrument details

| ISIN/Banker Name | Instrument Name | Date of Issuance | Coupon Rate | Maturity | Amount Rated (Rs. crore) | Current Rating and Outlook |
|------------------|---|------------------|-------------|--------------|--------------------------|---|
| INE428Q07083 | Non-convertible Debenture | Apr 06, 2015 | 14.90% p.a. | Dec 18, 2020 | 5.00 | [ICRA]A (Stable); reaffirmed and simultaneously withdrawn |
| INE428Q08016 | Subordinated Debt Programme | Mar 31, 2015 | 17.50% p.a. | Dec 18, 2020 | 10.00 | [ICRA]A (Stable); reaffirmed and simultaneously withdrawn |
| INE428Q08024 | Subordinated Debt Programme | Sep 22, 2015 | 15.85% p.a. | Apr 23, 2021 | 15.00 | [ICRA]A (Stable); reaffirmed and simultaneously withdrawn |
| INE428Q08032 | Subordinated Debt Programme | Sep 21, 2016 | 12.70% p.a. | Jul 26, 2022 | 25.00 | [ICRA]A (Stable) |
| 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 | 130.00 | [ICRA]A1+ |

Source: Company

Annexure-2: 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.

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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