

May 11, 2020

## Suryoday Small Finance Bank Limited: Rating withdrawn for fixed deposit programme

### Summary of rating action

| Instrument*                         | Previous Rated Amount<br>(Rs. crore) | Current Rated Amount<br>(Rs. crore) | Rating Action  |
|-------------------------------------|--------------------------------------|-------------------------------------|--|
| Fixed deposit programme             | 500.00                               | -                                   | MA+(Stable); reaffirmed and simultaneously withdrawn |
| Non-convertible debenture programme | 5.00                                 | 5.00                                | [ICRA]A(Stable); outstanding                         |
| Subordinated debt programme         | 50.00                                | 50.00                               | [ICRA]A(Stable); outstanding                         |
| Certificate of deposit programme    | 130.00                               | 130.00                              | [ICRA]A1+; outstanding                               |
| <b>Total</b>                        | <b>685.00</b>                        | <b>185.00</b>                       |  |

\*Instrument details are provided in Annexure-1

### Rationale

ICRA has reaffirmed and simultaneously withdrawn the rating of MA+(Stable) (pronounced as M A plus) for the Rs. 500-crore fixed deposit (FD) programme. The rating has been withdrawn at the bank's request. This is in accordance with ICRA's policy on the withdrawal and suspension of credit ratings.

The ratings take into account the bank's comfortable capitalisation profile, supported by regular equity infusions (~Rs. 68 crore in FY2020 and ~Rs. 254 crore in FY2019). The ratings also consider SSFB's improved profitability profile, supported by a moderation in the operating expenses and credit costs and healthy income from treasury operations, and the good traction in deposit mobilisation. SSFB reported a net profit of Rs. 126.42 crore in 9M FY2020 (Rs. 86.60 crore in FY2019), translating into an annualised return of 3.85% on the average managed assets (AMA; 2.76% in FY2019) and 17.24% 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. 3,614 crore as on December 31, 2019, supported by good systems and processes. SSFB's operations are geographically diversified with 439 branches spread across 12 states 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 ratings are, however, constrained by the high reliance on bulk deposits. The top 20 deposits comprised 40% of the total deposits held by the bank as on December 31, 2019 (45% as on March 31, 2019). However, 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 December 31, 2019 (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 NPAs of 2.78% and 0.52%, respectively, as on December 31, 2019 (1.81% and 0.77%, respectively, as on March 31, 2019) on account of the livelihood being affected in certain states owing to 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 adequate 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 29.22% (Tier I: 28.39%) as on December 31, 2019 in relation to the regulatory requirement of 15% (Tier I: 7.5%) while the gearing remained low at 3.16 times (3.12 times as on March 31, 2019). This was largely because of regular equity infusions (~Rs. 68 crore in 9M FY2020 and ~Rs. 254 crore in FY2019) by the promoters and investors. The equity infusions are likely to continue at regular intervals to support the growth plans, and the gearing is not expected to exceed 4 times in the near to medium term.

**Improved profitability profile** – The bank's profitability indicators improved with a moderation in the operating expenses and credit costs, and healthy income from treasury operations. Its net interest margin moderated to 10.90% of AMA in 9M FY2020 (11.14% in FY2019) with the decline in yields outpacing the decline in the cost of funds. The operating expenses moderated to 5.85% of AMA in 9M FY2020 from 6.24% in FY2019 as SSFB scaled up its operations and the major costs related to its transformation into a small finance bank had already been incurred in the past few years. The credit costs also moderated to 1.75% of AMA in 9M FY2020 from 2.35% in FY2019 though they remained slightly elevated. The bank's profitability profile was also supported by income from treasury operations (Rs. 69.69 crore in 9M FY2020; Rs. 58.25 crore in FY2019). It reported a net profit of Rs. 126.42 crore in 9M FY2020 (Rs. 86.60 crore in FY2019), translating into an annualised return of 3.85% on AMA (2.76% in FY2019) and 17.24% on average net worth (12.19% in FY2019).

**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 its large portion of relatively shorter-tenor assets. The bank held Rs. 748.87 crore of liquid assets as on March 27, 2020. The liquidity profile is also supported by the availability of lines from financial institutions. The liquidity coverage ratio (provisional) remained comfortable at 175% for the fortnight ended April 10, 2020 (153% for the quarter ended December 31, 2019, 189% for the quarter ended September 30, 2019 and 135% for the quarter ended March 31, 2019).

### Credit challenges

**Ability to garner retail deposits and diversify the product mix** – The ratings are constrained by SSFB's high reliance on bulk deposits. The top 20 deposits comprised 40% of the total deposits held by the bank as on December 31, 2019 (45% as on March 31, 2019). However, the bulk deposits are non-callable in nature. The share of new products on the asset side stood at 26% as on December 31, 2019 (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.

**Deterioration in asset quality** – The bank reported a deterioration in its asset quality with gross and net NPAs of 2.78% and 0.52%, respectively, as on December 31, 2019 (1.81% and 0.77%, respectively as on March 31, 2019). The deterioration was on account of the livelihood being affected in certain states owing to natural calamities and the weaker performance of new products. Going forward, SSFB’s ability to improve and maintain its asset quality indicators while scaling up its operations and diversifying its product profile will be important from a credit perspective.

**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 December 31, 2019), 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

The bank held Rs. 748.87 crore of liquid assets as on March 27, 2020. The liquidity profile is also supported by the availability of lines from financial institutions. The liquidity coverage ratio (provisional) remained comfortable at 175% for the fortnight ended April 10, 2020 (153% for the quarter ended December 31, 2019, 189% for the quarter ended September 30, 2019 and 135% for the quarter ended March 31, 2019). While the present liquidity profile is adequate, ability of the bank 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 the 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 2% 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 | <a href="#">ICRA's Credit Rating Methodology for Non-Banking Finance Companies</a><br><a href="#">ICRA's Policy on Withdrawal and Suspension of Credit Rating</a> |
| Parent/Group Support            | Not applicable  |
| Consolidation/Standalone        | Standalone  |

### About the company

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 December 31, 2019, the reported assets under management (AUM) stood at Rs. 3,614 crore with a presence in 12 states, catering to more than 15 lakh borrowers.

### Key financial indicators (audited)

| As per<br>For the period ended               | IGAAP<br>FY2018 | IGAAP<br>FY2019 | IGAAP<br>9M FY2020* |
|--|-----------------|-----------------|---------------------|
| Net interest income                          | 167.41          | 349.91          | 358.24              |
| Non-interest income/ Fee income <sup>1</sup> | 34.36           | 58.25           | 69.69               |
| Profit after tax                             | 10.13           | 86.60           | 126.42              |
| Net worth                                    | 539.76          | 880.62          | 1,075.32            |
| Managed assets                               | 2,282.79        | 4,000.78        | 4,764.77            |
| % PAT / Average managed assets               | 0.50%           | 2.76%           | 3.85%               |
| % PAT / Average net worth                    | 1.95%           | 12.19%          | 17.24%              |
| % Gross NPAs                                 | 3.54%           | 1.81%           | 2.78%               |
| % Net NPAs                                   | 2.25%           | 0.77%           | 0.52%               |
| % Net NPA / Net worth                        | 6.58%           | 2.37%           | 1.64%               |
| % Capital adequacy ratio                     | 37.94%          | 35.98%          | 29.22%              |
| Gearing (Reported)                           | 2.74            | 3.12            | 3.16                |

\*Unaudited; 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

<sup>1</sup> Including profit from sale of investments

### Rating history for past three years

| Instrument                    | Current rating |              |                    | Chronology of rating history for the past 3 years     |   |                     |                  |                   |                   |                     |                   |  |
|-------------------------------|----------------|--------------|--------------------|---|---|---------------------|------------------|-------------------|-------------------|---------------------|-------------------|--|
|                               | Type           | Amount rated | Amount outstanding | FY2021<br>11-May-20                                   | FY2020<br>27-Mar-20                                     | FY2019<br>01-Mar-19 | 14-Sep-18        | 31-May-18         | 07-May-18         | FY2018<br>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            | -                 |  |
| 2 FD programme                | Medium term    | 500.00       | -                  | MA+ (Stable); reaffirmed and simultaneously withdrawn | MA+ (Stable); put on notice of withdrawal for one month | MA+ (Stable)        | MA+ (Stable)     | MA (Stable)       | MA (Stable)       | MA (Stable)         | MA (Stable)       |  |
| 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) |  |
| 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) |  |

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](http://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           | Certificate of Deposit Programme | NA                          | NA          | 7-365 days    | 130.00                   | [ICRA]A1+   |
| NA           | Fixed Deposit Programme          | NA                          | NA          | NA            | 500.00                   | MA+ (Stable); reaffirmed and simultaneously withdrawn |

Source: SSFB

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