

March 27, 2020

Suryoday Small Finance Bank Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debenture programme	5.00	5.00	[ICRA]A(Stable); reaffirmed
Subordinated debt programme	50.00	50.00	[ICRA]A(Stable); reaffirmed
Certificate of deposit programme	130.00	130.00	[ICRA]A1+; reaffirmed
Fixed deposit programme	500.00	500.00	MA+(Stable); put on notice of withdrawal for one month
Non-convertible debenture programme	55.00	-	[ICRA]A(Stable); withdrawn
Total	740.00	685.00	

*Instrument details are provided in Annexure-1

Rationale

ICRA has reaffirmed the long-term rating of [ICRA]A (pronounced as ICRA A) for the Rs. 5-crore non-convertible debenture (NCD) and Rs. 50-crore subordinated debt programmes of Suryoday Small Finance Bank Limited (SSFB). The outlook on the long-term rating is Stable. ICRA has also reaffirmed the short-term rating of [ICRA]A1+ (pronounced as ICRA A one plus) for the Rs. 130-crore certificate of deposit (CD) programme of the bank. ICRA has withdrawn the rating of [ICRA]A (Stable) for the Rs. 55-crore NCD programme as there is no amount outstanding against the rated instrument. ICRA has also put the rating of MA+(Stable) (pronounced as M A plus) for the Rs. 500-crore fixed deposit (FD) programme on notice of withdrawal for one month 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 9M 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 interbank lines and long-term 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 – SSFB's liquidity position remains comfortable owing to its 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 and it reported deposits of Rs. 2,491 crore as of December 31, 2019. 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. As a large portion of the advances

comprise relatively shorter-tenure microfinance loans, the asset liability maturity profile remains comfortable with no absolute mismatches, even at 90% collection efficiency, for a period of up to 1 year, as per the structural liquidity statement as on December 31, 2019. The bank held Rs. 381.46 crore of liquid assets (including Rs. 270.71 crore of excess SLR investments) as on December 31, 2019. The liquidity profile is also supported by the availability of lines from financial institutions and interbank lines. The liquidity coverage ratio remained comfortable at 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

As a large portion of the advances continue to comprise relatively shorter-tenure microfinance loans, SSFB’s asset liability maturity profile remains comfortable. The bank did not have any absolute mismatches, even at 90% collection efficiency, for a period of up to 1 year as per the structural liquidity statement as on December 31, 2019. Further, there were no cumulative mismatches, even at 90% collection efficiency, for a period of up to 5 years as per the aforementioned structural liquidity statement. SSFB held Rs. 381.46 crore of liquid assets (including Rs. 270.71 crore of excess SLR investments) as on December 31, 2019. The liquidity profile is also supported by the availability of lines from financial institutions and interbank lines. The liquidity coverage ratio remained comfortable at 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).

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	ICRA's Credit Rating Methodology for Non-Banking Finance Companies ICRA's Policy on Withdrawal and Suspension of Credit Rating
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	IGAAP	IGAAP	IGAAP
For the period ended	FY2018	FY2019	9M FY2020*
Net interest income	167.41	349.91	358.24
Non-interest income/ Fee income ¹	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

¹ 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	FY2020 27-Mar-20	FY2019 01-Mar-19	14-Sep-18	31-May-18	07-May-18	FY2018 27-Mar-18	23-Feb-18	FY2017 27-Oct-16	28-Sep-16	26-Aug-16	17-May-16	
1	CD programme	Short term	130.00	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	-	-	-	-	-
2	FD programme	Medium term	500.00	-	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)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]BBB+ (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)	[ICRA]A- (Stable)	[ICRA]BBB+ (Stable)
5	NCD programme	Long term	55.00	-	[ICRA]A (Stable); withdrawn	[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)	[ICRA]BBB+ (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
INE428Q07059	Non-convertible Debenture*	23-06-2014	13.5 -14% P.A.	28-05-2019	35.00	[ICRA]A (Stable); withdrawn
INE428Q07083	Non-convertible Debenture	06-04-2015	14.90%P.A.	18-12-2020	5.00	[ICRA]A (Stable)
INE428Q08040	Non-convertible Debenture*	27-10-2016	11.55% P.A.	28-10-2019	20.00	[ICRA]A (Stable); withdrawn
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); put on notice of withdrawal for one month

*instrument matured / redeemed, and rating withdrawn; Source: SSFB

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