March 22, 2022

Suryoday Small Finance Bank Limited: [ICRA]A1+ assigned for enhanced amount of certificate of deposit programme; 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
Certificate of deposit programme	130	130	[ICRA]A1+; reaffirmed
Certificate of deposit programme	-	200	[ICRA]A1+; assigned
Total	**255**	**455**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings factor in Suryoday Small Finance Bank Limited's (SSFB) experienced board and management team, which has helped it scale up its operations while gradually diversifying its product offerings. The ratings also consider the bank's healthy capitalisation profile with a capital adequacy ratio (CAR) of 41.4% (Tier I: 37.8%) as on December 31, 2021. The current capitalisation profile is comfortable for the bank's near-term growth requirements. The ratings also factor in the healthy traction in SSFB's deposit mobilisation, with deposits comprising 58% of its total borrowings as on December 31, 2021. Moreover, the bank has reduced the share of bulk deposits and is gradually establishing a stable retail depositor base. The share of current account savings accounts (CASA) also improved to ~19% as on December 31, 2021 from 15% as on March 31, 2021 (11% as on March 31, 2020), though it remains relatively low.

The ratings also factor in the bank's strong liquidity profile and financial flexibility. SSFB maintained high on-book liquidity in FY2021 and 9M FY2022. Also, its liquidity coverage ratio of 223% for the quarter ended December 31, 2021, was well above the regulatory requirement of 100%. SSFB has access to funding from financial institutions (FIs), which further supports its liquidity profile. It has also raised funds under the Reserve Bank of India's (RBI) Special Long-Term Repo Operations (SLTRO) scheme in 9M FY2022.

The ratings are, however, constrained by the significant deterioration in SSFB's profitability metrics, with the bank reporting losses in 9M FY2022, given the Covid-19 pandemic-induced challenges. The asset quality indicators have deteriorated with SSFB reporting gross non-performing assets (NPAs) of 10.5% and net NPAs of 5.6% as on December 31, 2021. SSFB has also restructured 15.8% of its advances (standard is 11.9% and 3.9% is part of NPAs) as on December 31, 2021. The profitability indicators are in breach of the negative triggers as specified by ICRA. However, ICRA estimates that the bank has upfronted a significant part of the credit cost and is expected to witness an improvement in its profitability metrics in FY2023; this would remain a monitorable. Moreover, despite losses, its healthy capitalisation profile and strong liquidity profile would help SSFB meet its stated growth plans in the near term.

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 67% as on December 31, 2021 (69% as on March 31, 2021) exposing it to 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. 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 and would see an improvement in its profitability aided by the experienced management team, strong capitalisation profile, healthy traction in deposits and financial flexibility.

Key rating drivers and their description

Credit strengths

Strong capitalisation profile – The bank's capital adequacy ratio of 41.4% (Tier I: 37.8%) as on December 31, 2021 was well above the regulatory requirement of 15.0% (Tier I: 7.5%). The gearing remained low at 3.5 times as on December 31, 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 initial public offer (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 58% of its total borrowings as on December 31, 2021. Consequently, the cost of funds has been declining over the years and was reported at 6.8% in 9M 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 88% as on December 31, 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 December 31, 2021, funding from FIs comprised 23% of the total borrowings. The bank has also raised funds under the RBI's SLTRO scheme.

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. The liquidity coverage ratio was healthy at 220% for the quarter ended March 31, 2021 and 223% for the quarter ended December 31, 2021 on a daily average basis for the respective quarters. The liquidity profile is also supported by the availability of lines from FIs as well as the large share of non-callable bulk deposits.

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 9M FY2022 – The bank's profitability indicators remained subdued in 9M FY2022 as in FY2021 because of elevated credit costs and operational expenses. Credit costs remained elevated at 5.3% in 9M FY2022 (2.8% in FY2021) due to the deterioration in the asset quality.

The bank reported a net loss of Rs. 44.9 crore in 9M FY2022, translating into a return of -0.86% on average managed assets (AMA) and -3.86% on average net worth compared to 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). As the asset quality is expected to remain volatile in the near term, SSFB's ability to control slippages and credit costs would be important from a profitability perspective.

Deterioration in asset quality; performance remains monitorable – The bank's gross NPAs increased to 10.5% in 9M FY2022 from 9.4% as on March 31, 2021. The net NPAs stood at 5.6% as on December 31, 2021 (4.7% as on March 31, 2021). SSFB has also restructured 15.8% of its advances (standard is 11.9% and 3.9% is part of NPAs) as on December 31, 2021 (3.3% as on March 31, 2021). On an overall basis, the book under stress stands at 22.4% (gross NPAs + standard restructured book), the performance of and recovery from which would remain monitorable.

The bank's ability to navigate through the adversity of Covid-19 and manage the impact on its business growth, client retention and asset quality would remain critical from a rating perspective, going forward.

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 it has been scaling up its newer products, microfinance continues to account for a large share of the portfolio at 67% as on December 31, 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. Despite improving, the share of CASA remains low and stood at 19% as on December 31, 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 (67% as on December 31, 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 223% for the quarter ended December 31, 2021 (220% 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, 2021 did not show any cumulative mismatches for a period of one year, even under the stressed scenario of 80% collection efficiency on advances. As on December 31, 2021, SSFB was carrying free on-book liquidity of Rs. 651 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 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	[Rating Methodology for Non-Banking Finance Companies](#) [Rating Methodology for Banks](#)
Parent/Group Support	Not Applicable
Consolidation/Standalone	Standalone

About the company

Suryoday Small Finance Bank Limited (SSFB), 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. SSFB received a licence from the 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, 2021, the bank was operating in 13 states and Union Territories across India through 564 banking outlets, with a strong presence in Maharashtra, Tamil Nadu and Odisha. As on December 31, 2021, SSFB had 18.5 lakh clients and a portfolio of Rs. 4,872 crore.

Key financial indicators (audited)

Suryoday Small Finance Bank Limited	FY2020	FY2021	9M FY2022
Accounting as per	IGAAP	IGAAP	IGAAP
Net interest income	487	359	357
Profit before tax	154	12	(63)
Profit after tax	111	12	(45)
Net advances	3,532	3,983	4,620
Total managed assets	5,454	6,712	7,296
% Tier I	34.3%	47.2%	37.8%
% CRAR	35.4%	51.5%	41.4%
% Net interest margin	10.3%	5.9%	6.8%
% PAT / AMA	2.4%	0.2%	-0.9%
% Return on average net worth	11.4%	0.9%	-3.8%
% Gross NPAs	2.8%	9.4%	10.5%
% Net NPAs	0.6%	4.7%	5.6%

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 February 28, 2022 (Rs. crore)	Date & Rating in FY2022		Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019			
					Mar 22, 2022	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)	[ICRA]A- (Stable)	[ICRA]A- (Stable)
2	Certificate of deposit programme	Short term	130.00	0.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1	[ICRA]A1	[ICRA]A1
3	Certificate of deposit programme	Short term	200.00	0.00	[ICRA]A1+							

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: 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
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+
NA	Certificate of Deposit Programme – Yet to be Issued	NA	NA	7-365 days	200.00	[ICRA]A1+

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis – Not applicable

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