Saurashtra Gramin Bank

January 08, 2021

Ratings

Facilities	Amount (Rs. crore)	Ratings[1]	Rating Action
Tier I Perpetual Debt Instrument (PDI)	200.00 (Rs. Two Hundred crore only)	CARE A+; Stable (Single A Plus; Outlook: Stable)	Reaffirmed

Details of instruments/facilities in Annexure-1

The rated Tier I Perpetual Debt Instrument (PDI) have specific features including a lock-in clause, whereby the servicing of the bonds (coupon and repayment) is linked to the bank meeting the regulatory norms on capitalisation and reported profitability and the coupon on the bonds is not cumulative. In case the bank does not meet the regulatory norm, the servicing of the bonds would be subject to approval from Reserve Bank of India (RBI).

The rating factors in the additional risk arising due to the existence of the lock in clause in hybrid instruments. Any delay in payment of interest/principal (as the case may be) following the invocation of the lock-in-clause, would constitute as an event of default as per CARE's definition of default and as such these instruments may exhibit a somewhat sharper migration of rating compared to conventional subordinated debt instruments.

Detailed Rationale & Key Rating Drivers

The rating assigned to the proposed Tier I Perpetual Debt Instrument (PDI) issue of Saurashtra Gramin Bank (SGB) factors in its constitution as a Regional Rural Bank (RRB) with majority shareholding held by Government of India (GOI, holding 50%), the sponsor bank – State Bank of India (SBI; rated 'CARE AAA; Stable', holding 35%) and Government of Gujarat (GOG, holding 15%), managerial, operational and technology support from SBI. The rating also factors in the bank's robust deposit franchise, moderate asset quality, adequate capitalization and liquidity profile.

The rating remains constrained on account of moderate profitability and impact on account of pension liability, high geographical concentration resulting due to its mandate of operating in a specific region and exposure to relatively riskier segments like agriculture and allied sectors and economically weaker borrowers.

Continued support from the sponsor bank (SBI) in terms of operations and management, capital support from the majority shareholders (GOI and SBI), capitalization levels, asset quality and profitability are the key rating sensitivities.

<u>Rating Sensitivities</u>

Positive Factors - Factors that could lead to positive rating action/upgrade:

- Improvement in the asset quality with GNPA of less than 1% on a sustained basis
- Improvement in the profitability with Return on Total Assets (ROTA) exceeding 1.5% on a sustained basis
- Increase in size of operations

Negative Factors- Factors that could lead to negative rating action/downgrade:

- Material dilution in shareholding from major shareholders and moderation in expected support from SBI
- Deterioration in capital adequacy ratio to less than 9.5%
- Deterioration in the asset quality with GNPA above 4% on a sustained basis

Covid-19 impact

The bank has provided blanket moratorium to all its customers. The bank has minimum COVID-19 impact as it has 67% exposure to Agricultural sector which has been least impacted due to normal agricultural produce. The bank has 21% exposure to MSME and have started to perform better as the pent up demand continues. Out of the total MSME exposure, ~53% is towards Ceramic Industry, the ceramic industry cluster in Morbi has started to perform better due to increased demand from foreign countries. The bank has very limited exposure of 0.55% of total outstanding loans to infrastructure (hotels, school and real estate) sector and the hotel industry in Gujarat is yet to pick-up demand. The bank made Covid-19 related provisioning of Rs.17.20 crore during Q4FY20 and Q1FY21 in accordance with RBI's regulatory package guidelines. Also, the bank has reported a provisions for bad and doubtful debts of Rs.139.55 crore as on September 30, 2020 for a GNPA Rs.73.86 crore.

Detailed description of the key rating drivers

Key Rating Strengths

Shareholding by GOI, SBI and GOG

SGB is a regional bank (RRB) with operations in the state of Gujarat and majority of the shareholding is by GOI (50%) while State Bank of India (SBI; rated 'CARE AAA; Stable') which is the sponsor bank holds 35% shareholding in SGB, while the

[1]*Complete definitions of the ratings assigned are available at www.careratings.com and in other CARE publications.*

remaining 15% shareholding is held by GOG. As per The Regional Rural Banks (Amendment) Act, 2015, RRBs can raise equity capital from sources other than GOI, sponsor bank and state government; provided that the shareholding of GOI and the sponsor bank remains above fifty-one percent.
In line with the regulations, the majority shareholding of SGB would be continued to be held by GOI and SBI together. The ratings factors in expected capital support from GOI and SBI is in case of requirement and is a key rating sensitivity.

Managerial, operational and technology support from SBI
SBI being the sponsor bank, the operational and management training and control of SGB is done by SBI. In addition, RRBs are under the supervision of National Bank for Agriculture and Rural Development (NABARD; rated 'CARE AAA; Stable') which has a Board for Supervision for RRBs to provide directions and guidance on matters related to supervision and inspection.
The management of SGB is headed by its Board of Directors having seven members out of which three are nominees of SBI, two nominees of GOG, one nominee of Reserve Bank of India (RBI) and one nominee of NABARD. The Board of Directors is headed by Mr. Manoj Kumar Kalamthekar (Chairman) who holds the rank of Deputy General Manager (DGM) in SBI and has been deputed by SBI. In addition, SBI has deputed senior personnel to look after key functions at SGB.
SBI also provides operational, technology and systems support to SGB. SGB follows the rating / grading model for loans and advances as per the guidelines followed by SBI. SGB has implemented its Risk Focused Internal Audit Report System as suggested by SBI.
The audit committee of the bank consists of one SBI nominated-director as chairman and nominee directors of NABARD, RBI and GOI. The AGM, deputed from SBI as Chief Vigilance Officer, is handling the vigilance administration of the bank.

Adequate capitalization parameters
The capitalization levels of SGB were moderate and the bank reported overall Capital Adequacy Ratio (CAR) (under Basel I) of 10.27% (Tier I CAR: 8.91%) as on March 31, 2020 as compared to CAR of 10.70% (Tier I CAR: 9.31%) as on March 31, 2019 which was above the minimum requirement of 9.00% for RRBs.
The bank reported increase in net profit during H1FY21 (refers to period from April 01 to September 30) which helped SGB report increase in CAR to 10.88% (Tier I CAR: 9.64%) as on September 30, 2020. The bank plans to maintain CAR in excess of 9.5% on an ongoing basis.
The recent regulations allow RRBs to raise Perpetual Debt Instruments (PDI) – Tier I Bonds which would be computed towards capital in computation of CAR. In case the bank is unable raise capital by way of PDI, CARE expects GOI, GOG and SBI to infuse capital in case of requirement towards maintaining capitalization levels.

Robust deposit franchise and high CASA deposit base
SGB being a RRB has a strong regional presence and has built a robust deposit base. Its 259 branches spread across the 11 districts of Gujarat state has helped in garnering a healthy deposit base. The bank also has a stable Current Account Savings Account (CASA) deposit base that grew at a 5 year CAGR of 23.14% till FY20. The CASA deposits constituted 44.32% of the total deposits as on March 31, 2020 (P.Y.: 47.63%) and 42.77% as on September 30, 2020.
Stable growth in deposits and advances
The total business (advances + deposits) of SGB stood at Rs.10,827 crore as on March 31, 2020 as compared to Rs.9,768 crore as on March 31, 2019. The bank's deposit increased by 9.50% during FY20 to Rs.6,186 crore, whereas the advances of SGB increased by 12.69% to Rs.4,641 crore as on March 31, 2020 due to which the net interest income was up by 6.92% for FY20.
As mandated by the RRB Act, majority of the advances of SGB constituted lending to the agriculture and allied activities segment (largely comprising exposure by way of Kisan Credit Cards (KCC)) stood at 65.29% of total advances while lending to SMEs constituted 22.74% as on March 31, 2020.
As on September 30, 2020, advances stood at Rs.4,972 crore constituting 67% of agriculture and related activities and 21% SME lending.
Healthy asset quality parameters
SGB has been reporting asset quality parameters which have been relatively better compared to other RRBs. SGB reported Gross NPA Ratio of 1.56% as on March 31, 2020 which increased from 0.97% as on March 31, 2019 due to stress in MSME sector. The bank has been entirely providing for the NPAs resulting in Nil Net NPA Ratio.
During H1FY21, the bank reported GNPA at 1.48% as there has been only minor additional slippages due to moratorium being placed, recovery and up-gradation in overdue accounts and 7.14% growth in gross advances over March 31, 2020. The bank has a total provisioning of Rs.156.75 crore for NPA, bad and doubtful debts and 10% Additional COVID-19 provisioning as stipulated by RBI for GNPA of Rs.73.86 crore as on September 30, 2020.
For agricultural loans, the bank recognizes NPA for short duration loans, where instalment of principal or interest remains overdue for two crop seasons and for long duration loans, where instalment of principal or interest remains overdue for one crop season.

Key Rating Weaknesses

Moderate profitability and impact on account of pension liability

The bank's interest income increased by 10.10% to Rs.579 crore supported by increase in advances as the yield on advances declined by 90 bps to 9.97% during FY20 (refers to period from April 01 to March 31) as compare to the previous year. The total income increased by 12.29% to Rs.645 crore during FY20 supported by increase in interest income and increase in non-interest income largely because of increase in commission and brokerage income.

The bank earns from other income sources such as commission income of Rs.2 crore during FY20 by cross-selling SBI life and general insurance policies. They also earn by trading "Priority Sector Lending Certificates" through CBS e-Kuber portal and have accordingly sold net surplus of Rs.1,790 crore of Small & Marginal Farmers and Agri Lending under priority sector and in process earned Rs.29.54 crore in FY20.

The bank's interest expense increased by 12.77% to Rs.323.10 crore resulting in net interest income growth of 6.92% during the year. As a result, the bank's net interest margin has declined marginally from 3.87% for FY19 to 3.70 % for FY20.

The operating expense decreased by 13.85% to Rs.201.63 crore as the bank had made Rs.120 crore pension provisioning during FY19 as against Rs.65.69 crore (Rs.18.55 crore – provisions and Rs.47.14 crore – expenses) during FY20. The bank's provisioning cost has increased majorly due to 155.56% increase in provisioning for bad and doubtful debts to Rs.66.34 crore. Accordingly, the bank has reported Profit After Tax (PAT) of Rs.33.92 crore as against Rs.30.55 crore during FY19, registering 11% growth.

The bank has done complete provisioning for its pension liabilities of Rs.196.13 crore as on March 31, 2020.

During H1FY21, the bank reported PAT of Rs.67.24 crore on a total income of Rs.374.85 crore as against Rs.12.37 crore on a total income of Rs.329.27 crore during H1FY20. The PAT has improved due to significant decline in provisioning for bad and doubtful debts to Rs.13.60 crore.

Geographical concentration

The bank being an RRB is confined to a very small area which covers only about 11 districts of Gujarat in the limited geographical area. The bank faces immense competition from well-established PSU's as well as private sector banks. The geographical concentration and heavy dependence on agriculture and allied activities in a single region exposes the bank's asset quality and profitability to concentration risk.

Large exposure to agriculture and related activities with some diversification in SME and retail lending

As per the regulatory norms for RRBs, the bank is mandated to extend at least 75% of its total advances to the priority sector. As such, the bank has been lending to Agricultural segment (65%), MSME (23%) and Personal segment (12%). As such, the borrower's ability to service the debt remains vulnerable to the vagaries of nature. While the exposure to MSME segment is 20.95% and majority of such loans are advanced to ceramic sector which has high presence in the region.

Exposure to relative weaker economic segment of borrowers

The bank's purpose of existence is to serve the rural areas and uplift the low income grouped people and provide people with low interest loans. Accordingly, the bank's weaker section loans stood at Rs.1,513.22 crore which forms 32.42% of the total lending as on March 31, 2020. The Bank's PSL lending constitutes 90% of the portfolio in FY20.

Moderate size of operations as compared to commercial banks

The bank has a deposits of Rs.6,611 crore and a loan book of Rs.4,972 crore as on September 30, 2020 and therefore a modest business size of Rs.11,583 crore which is comparatively smaller than commercial bank. Also, scaling up business is difficult for RRBs due to limitations of majority lending being towards agriculture and related activities, limited geographical spread and competition from other banks in the area.

Liquidity: Adequate

The asset liability maturity (ALM) profile of Bank as on 30th September 2020 was comfortable up to the period of one year with a positive cumulative mismatch of around 38% which shows a healthy short term liquidity of the bank. The bank also maintained the SLR requirements over and above the mandate requirements throughout their term of operations. As on September 30, 2020, the bank had SLR investments of Rs.1,214 crore which was above the regulatory requirement of Rs.1,196 crore.

Analytical approach:

CARE has considered the standalone business and financial profile of Saurashtra Gramin Bank along with factoring in benefits on account of its ownership of GOI and SBI and support from the sponsor bank (SBI).

Applicable Criteria
[Criteria on assigning Outlook and Creditwatch to Credit Ratings]
[CARE Policy on Default Recognition]
[CARE's Rating Methodology For Banks]
[Bank - Rating framework for Basel III instruments (Tier I & Tier II)]
[Financial ratios - Financial Sector]
[Rating Methodology: Consolidation and Factoring Linkages in Ratings]

About the Bank
Saurashtra Gramin Bank (SGB) is a Regional Rural Bank (RRB) based in Rajkot (Gujarat), India and is sponsored by State Bank of India (SBI; rated CARE AAA; Stable) was formed by an amalgamation of three banks namely Jamnagar Rajkot Gramin Bank, Junagadh Amreli Gramin Bank & Surendra Bhavnagar Gramin Bank, prompted by SBS (now SBI) and is one of the leading RRB in India in many financial parameters specially maintaining NPAs at a low level. The Bank has its presence through 259 branches spread in 11 districts of Gujarat named as Rajkot, Jamnagar, Surendranagar, Junagadh, Amreli, Porbandar, Bhavnagar, Gir Somnath, Botad, Morbi, Dev Bhumi Dwarka. The bank had a total staff (excluding sponsor bank staff) of 956 employees as on March 31, 2020.

As per RBI regulation, the RRBs mandate is to lend at least 75% of their advances to the Priority Sector. As a result, SGB lends to small and marginal farmers, micro enterprises and weaker sections of society. The bank also offers all government sponsored schemes. The Deposits accepted by RRBs are covered by the DICGC scheme. The operations of SGB are regulated by the RBI and it is supervised by NABARD while the management and operations are largely handled by the sponsor bank (SBI). The bank has varying credit portfolio with significant presence in agriculture & allied activities, SME & Personal lending segment loan in bank's area of operation.

Brief Financials (Rs. crore)	FY19 (A)	FY20 (A)
Total income	574.95	645.61
PAT	30.55	33.92
Total Assets	6,676.58	7,149.94
Net NPA (%)	0.00	0.00
ROTA (%)	0.49	0.49

A: Audited

About Regional Rural Banks (RRBs) were formed under the RRB Act, 1976 with the objective of providing credit and related banking facilities to small farmers, agricultural labourers, artisans, and other rural poor. In line with their mandate, the emphasis of RRBs' lending remains on the priority sector. Total Deposits of 45 RRBs increased from to Rs.4,78,547 crore with CASA of 53 in FY20 whereas Loans and Advances to Rs.2,98,256 crore in FY20 whereas profits of the RRBs increased to Rs.2,203 crore in FY20.

Status of non-cooperation with previous CRA: Not Applicable
Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2
Complexity level of various instruments rated for this company: Annexure 3
Annexure-1: Details of Instruments/Facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Tier I Perpetual Debt Instrument	-	-	-	-	**200.00**	**CARE A+; Stable**

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1	Tier I Perpetual Debt Instrument	LT	200.00	CARE A+; Stable	-	1) CARE A+; Stable (17-Mar-2020)	-	-

Annexure 3: Complexity level of various instruments rated for this company

Sr. No.	Name of instrument	Complexity level
1	Tier I Perpetual Debt Instrument	Highly Complex

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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