August 29, 2019

Small Business FinCredit India Private Limited: [ICRA]A(Stable) assigned to enhanced bank lines

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Bank Lines Programme	500.00	2,865.60	[ICRA]A(stable); assigned / outstanding
Non-convertible Debenture Programme	400.00	400.00	[ICRA]A(stable); outstanding
Total	**900.00**	**3,265.60**	

**Instrument details are provided in Annexure-1*

Rationale

The assigned rating factors in the induction of Small Business FinCredit India Private Limited's (SBFC) senior management team, with significant experience in the retail lending business, post-acquisition of lending business from Karvy Financial Services. ICRA notes revamped risk management systems and processes and the company's efforts to source leads and collect payments in-house within the indicated timelines. ICRA also notes the acquisition of loan pool from Dewan Housing Finance Corporation Limited (DHFL), by way of a PTC transaction, which has more than tripled the AUM to Rs. 3,605 crore in June 2019, from Rs. 1,156 crore in March 2019. The transaction was fully funded by long term bank lines at competitive rates. The company has further strengthened its collections team to manage the new pool, however, the ability of the company to handle the operational issues during the transition period over the next few quarters will be a key monitorable. ICRA notes the moderate seasoning of the acquired pool. However, the rating takes comfort from the over collateralisation of the pool by way of a secondary pool held by DHFL. SBFC also acts as a collections service provider to the special purpose vehicle (SPV), which renders adequate control over the collection of payments.

The retail lending portfolio consists of small ticket micro enterprise (ME) loans, housing loans (HL), medium ticket small and medium enterprise (SME) loans, loan against gold (LAG) and small commercial vehicle (SCV) loans. The rating also factors in the adequate seasoning of the ME and SME loans, which were acquired as a part of the KFSL deal and the weakening asset quality of this portfolio, post the settlement of the first loss cover of up to Rs. 50 crore in March 2019. ICRA also notes the increase in delinquency levels of the portfolio originated by the new team with a moderate seasoning during Q1 FY2020. SBFC's adequate liquidity position, thanks to the sufficient cash and liquid investments on its book for meeting the debt repayments in the near term, long-term nature of the borrowings and equity infusion plans by promoters provides comfort.

The company's ability to keep the asset quality in check, as the portfolio seasons, would be a key rating sensitivity in the near to medium term. Going forward, SBFC's ability to improve its profitability by borrowing at competitive rates from banks and by controlling operating expenses would also be a key rating monitorable.

Outlook: Stable

ICRA believes that SBFC will continue to benefit from the upfront equity infusion along with the experienced senior management team. The outlook may be revised to Positive if the company is able to scale up while maintaining the sound asset quality of its loan book. The outlook would be revised to Negative if there is a material deterioration in the asset quality of the loan book, a marked deterioration in the collection efficiencies of the acquired pool, or any delay in the proposed capital infusion plan for FY2020.

Key rating drivers

Credit strengths

Granular book with retail focus; low average ticket size and LTV with adequate seasoning – As of June 2019, loan book originated by SBFC, and portfolios acquired from KFSL and DHFL formed 25.4%, 8.9% and 65.7% of the portfolio. ME, HL, SME, LAG, SCV and unsecured personal loans formed 46.8%, 40.6%, 2.7%, 7.7%, 0.1% and 2.2%, respectively, of the overall portfolio. Average LTV on the secured portfolio (ME, SME and HL) is around 60%, while average ticket size is about Rs. 30-40 lakhs. High ticket size SME loans are being run down. About 88% of the LAG portfolio had a ticket size of less than Rs. 5 lakh. The seasoning on the acquired portfolios from KFSL (except LAG) and DHFL is around 46 months and 18 months respectively. These factors impart adequate granularity to the portfolio. The deal with DHFL provides over collateralisation of the series A PTC of Rs. 2,365.6 crore held by SBFC by 25%, by way of series B PTC of Rs. 591.4 crore, provides comfort, since any short fall in collections from Series A can be recovered from the collections of Series B. The funds from series B will be transferred to DHFL will be carried out only once all the regulatory dues, collection fees is recovered and run down of series A is fully complete.

Senior management team with experience in retail lending business; collection framework revamped – SBFC has on-boarded a senior management team comprising officials with a proven track record in the banking/NBFC sector. The senior management team is supported by a zonal leadership team, with experience ranging from 11 to 18 years. This team was on-boarded over the last 15 months for the business, credit and collection verticals. SBFC would leverage their experience in ramping up the retail loan book, maintaining adequate underwriting practices and for technology adoption. It has also added KFSL's junior and middle management team along with the various branches of KFSL. SBFC has eliminated middle agencies for business sourcing and collections. The in-house debt management policy is expected to improve the monitoring of accounts, enable the triggering of pre-emptive measures and allow better follow-up of payment delays. SBFC also educates customers about the implications of defaults on their credit history and other measures like loan recall, litigation, etc.

Credit challenges

Ability to manage asset quality as portfolio seasons – SBFC's asset quality, at the time of the closing of the deal with KFSL, was healthy with the company largely acquiring only performing loan assets. In March 2019, the first loss cover up to Rs. 44.2 crore was utilised and settled by KFSL. Although the initial bad loans on the acquired book were settled in this transaction, the asset quality of the remaining loans in the acquired book (about Rs. 320 crore as on June 30, 2019), on seasoning, has weakened in Q1 FY2020. The freshly originated loans under the ME, SME and personal loan segments are also witnessing slippages. These could be attributable to the underlying stress in the operating environment of the borrowers. LAG, which has higher delinquencies, has almost been churned completely over the last 12 months. However, the adequate security cover, the lender's focus on margin call and the liquid nature of the collateral, minimise the credit risk to an extent. As the company ramps up its loan book and the existing loan book seasons, its ability to maintain the asset quality would remain a key rating monitorable. The ability to maintain strong underwriting practices in segments like ME loans would be a critical driver of the overall asset quality. The pool acquired from DHFL, which forms more than half of the overall portfolio, has a loss cover to the extent of up to 25%, which can be recovered from Series B PTC held by DHFL. Hence the losses to SBFC on account of the acquired pool is expected to be limited.

Weakening of capitalisation profile, and increase in leverage, driven by acquisition of portfolio – Arpwood and Lyra Partners infused Rs. 845 crore upfront into the company. This, along with the non-convertible debenture borrowings of Rs. 400 crore, helped SBFC acquire KFSL's retail assets worth ~Rs. 807 crore. In Q1 FY2020, the shares held by Lyra Partners was transferred to SBFC Holdings, which are both affiliates of the same investor group. SBFC's gearing (adjusted for goodwill of Rs. 260.39) increased to 4.9 in June 2019 from 1.4 in March 2019, while capital adequacy fell from 44.81% in March 2019 to 16.6% in June 2019. This was driven by long term borrowings, used to finance the acquisition of portfolio from DHFL. An equity infusion of Rs. 100 crore has been planned for current year, of which Rs. 25 crore has been raised in Q1 FY2020. Remaining amount is expected to be raised by December 2019. It is also in discussion to raise further equity. On a steady state, a gearing will be maintained below 4.5. ICRA notes the promoters' commitment to maintain adequate capitalisation of the entity, which is necessary to support the growth envisaged.

Ability to improve profitability by borrowing at attractive cost of funds and containing operating expenses – With the company expecting to ramp up its loan book going forward, its ability to borrow funds from banks at competitive rates would be important for improving its net interest margins. The amortisation of goodwill post the acquisition of KFSL's retail assets, dented SBFC's profitability in FY2018 based on India GAAP accounting standards. As per IGAAP accounting, the company was amortising the goodwill of Rs. 260.4 crore as on September 2017, resulting from the acquisition of business from KFSL. Rs. 86.8 crore was amortised in FY2018 (6 months of operation) and Rs. 173.6 crore was to be amortised in FY2019, leading to complete amortisation by March 2019. With the implementation of IndAS, the goodwill was tested for impairment and the amortisation was reversed. As a result, the company reported profits of Rs. 3.43 crore in FY2018 and Rs. 24.43 crore in FY2019 as per IndAS, as against loss of Rs. 84.75 crore in FY2018 (as per IndAS) and adjusted loss of Rs. 138.62 crore in FY2019. However, the profits of Q1 FY2020 would not have had any impact due to goodwill amortisation. The company posted a net profit of Rs. 4 crore in Q1 FY2020, as compared to a net profit of Rs. 24 crore in FY2019. Owing to the initial growth stage of operations, the operating expenses are high. In Q1 FY2020, higher credit costs and borrowing costs also impacted the profitability. Going forward, the higher interest income from the acquired pool and rationalization of costs is expected to improve the profitability, provided credit costs remain controlled, which would be a key monitorable.

Ability to facilitate a smooth transition of DHFL accounts – The acquired pool has increased the overall portfolio size of SBFC by 3 times in June 2019, which is expected to increase the required scale of operations manifold. SBFC also acts as the collections service provider to the SPV, which enables better control on the recovery process and transfer of funds. The ability of the company's existing operations to manage the higher volume of transactions, transfer of records and documents and servicing of the customers is expected to be a challenge in the near term, more so, since the support from DHFL is likely to be limited with depleted level of operations. However, ICRA notes that the collections team of SBFC has been further strengthened over the last three months to manage collections on Series A and Series B PTCs. The ability of the company to handle the sudden scale up of operations and prevent any adverse impact on the existing systems and processes is a key monitorable.

Liquidity position

As on July 31, 2019, SBFC had Rs. 87 crore of debt maturing by January 2020, against which it had adequate cash and liquid assets of Rs. 203 crore and scheduled inflows of Rs. 130 crore. Hence, the liquidity position is adequate to meet the debt maturities in the near term.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA's Credit Rating Methodology for Non-Banking Finance Companies
Parent/Group Support	Not applicable.
Consolidation/Standalone	The rating is based on the standalone financial statements of the issuer

About the company

Small Business FinCredit India Private Limited (SBFC) is a non-banking finance company that provides loans against property, gold loans and personal loans. Backed by Lyra Partners and Arpwood Partners Investment Advisors LLP, the company commenced operations in September 2017 after acquiring the performing loans in KFSL's retail portfolio. At the time of closing the deal in September 2017, the company had a net worth of ~Rs. 590 crore (net of goodwill) and a loan book of Rs. 807 crore, which stood at Rs. 597 crore and Rs. 871 crore, respectively, as on June 30, 2018. Following the acquisition, SBFC focussed on building adequate systems and processes and on the on-boarding of experienced professionals in the management team before rebooting the lending business. It leverages technology and analytics to provide customers with easy access to credit and to assess their credit behaviour through their digital footprints. In June 2019, the company acquired a pool of Rs. 2,365.6 crore via a PTC transaction in Q1 FY2020. The total pool in the structure was of Rs. 2,957.02 crore, of which Series A PTC of Rs. 2,365.6 crore was issued to SBFC, wholly financed by long term borrowings. While DHFL holds Series B PTC of remaining amount of Rs. 591.4 crore (20% of Series A PTC in line with RBI's guidelines pertaining to minimum retention).

SBFC reported a net profit of Rs. 24.43 crore in FY2019 on total assets of Rs. 1,792.99 crore in March 2019 compared to a net profit of Rs. 3.14 crore in FY2018 on total assets of Rs. 1,382.14 crore in March 2018. In Q1 FY2020, the company posted a net profit of Rs. 4.09 crore on a total asset base of Rs. 4,140.51 crore in June 2019.

Key financial indicators (audited)

	FY2018	FY2019	Q1 FY2020
Net interest income	58.17	123.97	36.20
Operating income	58.49	125.72	36.68
Profit before tax	5.45	34.98	5.99
Profit after tax	3.14	24.43	4.09
Total portfolio	778	1,156	3,605
Net worth	848.43	880.24	913.18
Goodwill	260.39	260.39	260.39
Total assets	1,382.14	1,792.99	4,140.51
% Tier 1	55.46%	44.26%	16.41%
% CRAR	55.95%	44.81%	16.63%
Gearing (adjusted)	0.82	1.43	4.92
% Net profit/average total assets (annualised)	0.45%	1.54%	0.55%
% Return on net worth	0.74%	2.83%	1.82%
% Gross NPAs	1.40%	0.43%	1.28%
% Net NPAs	1.17%	0.39%	1.00%
Net NPA/Net worth	1.30%	0.51%	1.35%

Note: All numbers are based on IndAS reporting. Q1 FY2020 numbers are unaudited.

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Current Rating (FY2020)				Chronology of Rating History for the Past 3 Years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Aug-19	FY2020	FY2019	FY2018		FY2017
						Apr-19	Sep-18	Dec-17	Sep-17	-
1	Bank Lines Programme	Long Term	2,865.60	2,646.85	[ICRA]A (stable)	[ICRA]A (stable)	[ICRA]A (stable)	[ICRA]A (stable)	-	-
2	Non-convertible Debenture programme	Long Term	400.00	400.00	[ICRA]A (stable)	[ICRA]A (stable)	[ICRA]A (stable)	[ICRA]A (stable)	[ICRA]A (stable)	-

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 No.	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE423Y07013	Non-convertible Debenture	28-Sep-17	9.40%	28-Sep-20	400.00	[ICRA]A (stable)
NA	Long-term Bank Lines	2018-19	NA	2021-27	2,646.85	[ICRA]A (stable)
NA	Long-term Bank Lines - Proposed	NA	NA	NA	218.75	[ICRA]A (stable)

Source: Small Business FinCredit India Private Limited

ANALYST CONTACTS

Karthik Srinivasan
+91 22 61143444
karthiks@icraindia.com

Sahil Udani
+91 22 61143429
sahil.udani@icraindia.com

Parvathy S
+91 22 6114 3428
parvathy.s@icraindia.com

Sudham Shingade
+91 22 6114 3425
sudam.shingade@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+ 91 9845022459
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries:

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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.

For more information, visit www.icra.in

ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata	+ (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore	+ (91 80) 2559 7401/4049
Ahmedabad	+ (91 79) 2658 4924/5049/2008
Hyderabad	+ (91 40) 2373 5061/7251
Pune	+ (91 20) 2556 0194/ 6606 9999