ICRA

February 14, 2020

# SBFC Finance Private Limited: [ICRA]A(Stable) assigned to Rs. 50-crore non-convertible debenture programme

## Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| Non-convertible Debenture Programme | - | 50 | [ICRA]A(stable); assigned |
| Non-convertible Debenture Programme | 400.00 | 400.00 | [ICRA]A(stable); outstanding |
| Long-term Bank Lines Programme | 2,865.60 | 2,865.60 | [ICRA]A(stable); outstanding |
| **Total** | **3,265.60** | **3,315.60** | |

**Instrument details are provided in Annexure-1*

## Rationale

The assigned rating factors in the induction of SBFC Finance Private Limited's (SBFC) senior management team, with significant experience in the retail lending business, post the acquisition of the lending business from Karvy Financial Services (KFS). ICRA notes the 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 a loan pool from Dewan Housing Finance Corporation Limited (DHFL), by way of a pass-through certificate (PTC) transaction, which more than tripled the assets under management (AUM) in June 2019. The transaction was fully funded by long-term bank lines at competitive rates, which implies minimal impact on the company's asset liability management profile and controlled cost of borrowings. SBFC has further strengthened its collections team to manage the new pool though its ability 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 a special purpose vehicle (SPV), which renders adequate control over the collection of payments.

The retail lending portfolio consists of small ticket microenterprise (ME) loans, housing loans (HLs), 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 subsequent weakening asset quality of this portfolio, post the settlement of the 10% first loss cover in March 2019. As on December 31, 2019, the KFSL portfolio had a GNPA of 4.55%. SBFC's liquidity position is adequate, led by the cash and liquid investments on its books for meeting the debt repayments in the near term, the long-term nature of the borrowings and the equity infusion plans of the promoters, thereby providing 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.

## Key rating drivers and their description

## Credit strengths

**Retail book; relatively low average ticket size and LTV with adequate seasoning** – As of December 2019, the loan book originated by SBFC and the portfolios acquired from KFSL and DHFL formed 35%, 8% and 58%, respectively, of the portfolio. The average LTV of the secured portfolio (ME, SME and HL) is around 60% while the average ticket size is about Rs. 30-40 lakh. Disbursals on high ticket size ME (ticket size above Rs. 50 lakh) and SME loans are reducing. The seasoning on the acquired portfolios from KFSL (except LAG) and DHFL is around 52 months and 24 months, respectively. These factors impart adequate granularity to the portfolio. The transaction with DHFL provides over-collateralisation of the Series A PTCs of Rs. 2,365.6 crore held by SBFC, by 25%, by way of Series B PTCs of Rs. 591.4 crore. This provides comfort as any shortfall in collections from Series A PTCs can be recovered from collections from Series B PTCs. The funds from Series B PTCs will be transferred to DHFL only after all the regulatory dues and collection fees are recovered and the rundown of Series A PTCs 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 the team's 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 the better follow-up of payment delays.

## Credit challenges

**Ability to manage asset quality as portfolio seasons** – SBFC's asset quality, at the time of the closing the deal, 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. 280 crore as on December 31, 2019), on seasoning, weakened in Q3 FY2020. The freshly originated loans under the ME loan segment are also witnessing higher slippages. These are attributable to the underlying stress in the operating environment of the borrowers. LAG, which has higher delinquencies (in 30+ and 60+ dpd buckets), has almost been churned completely over the last 12 months. However, the adequate security cover, the lender's focus on margin calls and the liquid nature of the collateral minimise the credit risk to an extent. The pool acquired from DHFL, which forms more than half of the overall portfolio, has a loss cover up to 25%, which can be recovered from the Series B PTCs held by DHFL. Hence, SBFC's losses on account of the acquired pool are expected to be limited. The monthly collection efficiency on this pool of assets has exceeded 98% since June 2019.

**Weakening of capitalisation profile and increase in leverage owing to acquisition of portfolio** – Arpwood Partners Investment Advisors LLP and Lyra Partners infused Rs. 845 crore upfront in 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 were transferred to SBFC Holdings, which are both affiliates of the same investor group. SBFC's gearing (adjusted for goodwill of Rs. 260.39 crore) increased to 4.1 times in December 2019 (4.9 times in June 2019) from 1.4 times in March 2019, while the capital adequacy fell to 19.48% in December 2019 (16.64% in June 2019) from 44.81% in March 2019. This was on account of the long-term borrowings that were used to finance the acquisition of the portfolio from DHFL. The company raised equity of Rs. 87 crore in 9M FY2020 and is planning to raise equity in the range of Rs. 200-350 crore by May 2020 from existing as well as new investors. On a steady state basis, the gearing will be maintained below 4.5 times. ICRA notes the promoters' commitment to maintain adequate capitalisation, which is necessary to support the envisaged growth.

**Ability to improve profitability by borrowing at attractive cost 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 Indian GAAP (IGAAP) accounting standards. As per IGAAP accounting, the company was amortising the goodwill of Rs. 260.4 crore as of September 2017, resulting from the acquisition of the business from KFSL. While Rs. 86.8 crore was amortised in FY2018 (six months of operations), Rs. 173.6 crore was to be amortised in FY2019, leading to the complete amortisation by March 2019. With the implementation of Ind-AS, the goodwill was tested for impairment and the amortisation was reversed. As a result, SBFC reported a profit of Rs. 3.14 crore in FY2018 and Rs. 24.43 crore in FY2019, as per Ind-AS, against a loss of Rs. 84.75 crore in FY2018 (as per IGAAP) and an adjusted loss of Rs. 138.62 crore in FY2019. However, the profits for the first three quarters of FY2020 would not have been impacted by the goodwill amortisation. SBFC posted a net profit of Rs. 39 crore in Q3 FY2020 compared to a net profit of Rs. 24 crore in FY2019 on account of the lower cost-to-income ratio. In Q3 FY2020, the higher credit costs and borrowing costs also took a toll on the company's net interest income. Going forward, the higher interest income from the acquired pool and rationalisation of costs are expected to improve the profitability, provided the credit costs remain under control, which would be a key monitorable.

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

## Liquidity position

As on December 31, 2019, SBFC had Rs. 57 crore of debt maturing by June 2020, against which it had adequate cash and liquid assets of Rs. 192 crore and scheduled inflows of Rs. 300 crore. Hence, the liquidity position is adequate to meet the debt maturities in the near term. ICRA notes a bullet repayment of Rs. 400 crore scheduled in September 2020.

## Rating sensitivities

**Positive triggers** – ICRA could upgrade the rating if the company shows a track record of profitable growth in the near to medium term while improving the asset quality.

**Negative triggers** – Pressure on SBFC's rating could arise if there is a continued deterioration in the asset quality from the current levels or an increase in the adjusted gearing[1] over 5 times on a sustained basis.

## 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

SBFC Finance 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 footprint. 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 Rs. 2,957.02 crore, of which Series A PTCs of Rs. 2,365.6 crore were issued to SBFC, wholly financed by long-term borrowings. DHFL holds the Series B PTCs of the remaining amount of Rs. 591.4 crore (20% of Series A PTCs; in line with the 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.

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*Total borrowings / (Total net worth – goodwill)*

## Key financial indicators (audited)

| | FY2018 | FY2019 | 9M FY2020 |
|---|---|---|---|
| Net interest income | 58.17 | 123.97 | 122.80 |
| Operating income | 58.49 | 125.72 | 138.28 |
| Profit before tax | 5.45 | 34.98 | 55.24 |
| Profit after tax | 3.14 | 24.43 | 39.43 |
| | | | |
| Total AUM | 778.00 | 1,156.00 | 3,566.90 |
| Net worth | 848.43 | 880.24 | 1,014.91 |
| Goodwill | 260.39 | 260.39 | 260.40 |
| Total assets | 1,382.14 | 1,792.99 | 4,235.64 |
| | | | 0 |
| % Tier 1 | 55.46% | 44.26% | 19.17% |
| % CRAR | 55.95% | 44.81% | 19.48% |
| Gearing (adjusted) | 0.82 | 1.43 | 4.11 |
| | | | 0 |
| % Net profit/average total assets (annualised) | 0.45% | 1.54% | 1.74% |
| % Return on net worth | 0.74% | 2.83% | 5.55% |
| % Gross NPAs | 1.40% | 0.43% | 1.98% |
| % Net NPAs | 1.17% | 0.39% | 1.42% |
| Net NPA/Net worth | 1.30% | 0.51% | 2.11% |

*Note: All numbers are based on Ind-AS reporting; 9M 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) | 14-Feb-20 | 29-Aug-19 | FY2020 | FY2019 | FY2018 | | FY2017 |
| | | | | | | | 22-Apr-19 | 28-Sep-18 | 19-Dec-17 | 15-Sep-17 | - |
| 1 | Bank Lines Programme | Long Term | 2,865.60 | 2,683.94 | [ICRA]A (stable) | [ICRA]A (stable) | [ICRA]A (stable) | [ICRA]A (stable) | [ICRA]A (stable) | - | - |
| 2 | Non-convertible Debenture Programme | Long Term | 400 | 400 | [ICRA]A (stable) | [ICRA]A (stable) | [ICRA]A (stable) | [ICRA]A (stable) | [ICRA]A (stable) | [ICRA]A (stable) | - |
| 3 | Non-convertible Debenture Programme | Long Term | 50 | 0 | [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 | Instrument Name | Date of Issuance / Sanction | Coupon Rate | Maturity Date | Amount Rated (Rs. crore) | Current Rating and Outlook |
|---|---|---|---|---|---|---|
| INE423Y07013 | Non-convertible Debentures | 28-Sep-17 | 9.40% | 28-Sep-20 | 400.00 | [ICRA]A (stable) |
| - | Non-convertible Debentures* | - | 9.50% | - | 50 | [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: SBFC Finance Private Limited; yet to be issued*

## Analyst Contacts

**Karthik Srinivasan**
+91 22 61143444
karthiks@icraindia.com

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

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

**Parvathy S**
+91 22 6114 3428
parvathy.s@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 |