October 08, 2021

SBFC Finance Private Limited: Rating reaffirmed; outlook revised to Positive

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term fund-based bank lines	2,865.60	2,865.60	[ICRA]A reaffirmed; Outlook revised to Positive from Stable
Non-convertible debentures	50.00	50.00	[ICRA]A reaffirmed; Outlook revised to Positive from Stable
Non-convertible debentures	200.00	200.00	[ICRA]A reaffirmed; Outlook revised to Positive from Stable
Total	**3,115.60**	**3,115.60**	

**Instrument details are provided in Annexure-1*

Rationale

ICRA has reaffirmed the rating for SBFC Finance Private Limited's (SBFC) instruments at [ICRA]A. The outlook has been revised to Positive from Stable. The revision in the outlook considers the improvement in SBFC's profitability and capital levels. SBFC witnessed an improvement in its return ratios with the return on assets (RoA) and the return on equity (RoE) rising to 2.0% and 7.7%, respectively, in FY2021 from 1.2% and 3.7%, respectively, in FY2020. The improvement in the return ratios was mainly due to operating efficiency as reflected by the reduction in the cost-to-income ratio to 46.2% in FY2021 from 54.6% in FY2020.

Further, the company's adjusted gearing[1] improved to 3.1 times as on March 31, 2021 from 4.1 times as on March 31, 2020. It improved further to 2.9 times as on June 30, 2021. The improvement was supported by internal accruals and a capital infusion of Rs. 100 crore in FY2021. This also supported the capitalisation profile with the capital to risk weighted assets (CRAR) ratio rising to 26.25% in FY2021 (27.08% in Q1 FY2022) from 21.89% in FY2020. SBFC plans to infuse equity of Rs. 250 crore in FY2022, which will further augment the Tier I capital ratio by 7.1% of the risk-weighted assets.

ICRA also notes the induction of SBFC's senior management team with significant experience in the retail lending business, post the acquisition of the lending business from Karvy Financial Services Limited (KFSL). Moreover, ICRA notes the acquisition of a loan pool from Dewan Housing Finance Corporation Limited (DHFL) by way of a pass-through certificate (PTC) transaction. The transaction was fully funded by equity, long-term bank lines and NCDs at competitive rates. The DHFL pool had a first loss cover of 79% as on September 9, 2021, up from 40% as of September 2020.

The rating remains constrained by the relatively lower vintage of the SBFC-originated loans coupled with the comparatively lower ability of the end borrowers to withstand local economic shocks. SBFC's asset quality deteriorated due to the second wave of the Covid-19 pandemic, which impacted the cashflows of the businesses. This led to a rise in the 90+ days past due (dpd) to 4.9% as on June 30, 2021 from 3.1% as on March 31, 2021. However, the company managed to reduce this to 3.7% in September 2021 through improved collections, asset reconstruction company (ARC) sale of Rs. 39.5 crore and write-off of Rs. 4.9 crore. Moreover, ICRA notes that SBFC has tightened its underwriting norms in terms of customer segmentation with a lower ticket size (below Rs. 30 lakh) in the micro-enterprise segment, which is expected to improve the asset quality in the

[1] *Adjusted for goodwill of Rs. 260.4 crore acquired during the acquisition of lending business from KFSL*

near term. SBFC's ability to maintain the collection efficiency at the pre-Covid levels and grow its loan book amid a tougher operating environment will remain a key monitorable.

Key rating drivers and their description

Credit strengths

Retail ME book; relatively low average ticket size and LTV with adequate seasoning – As of June 2021, the loan book originated by SBFC and the portfolios acquired from KFSL and DHFL formed 64%, 6% and 30%, respectively, of the portfolio compared to 39%, 7% and 54%, respectively, as of June 2020. The share of loans with a ticket size of Rs. 25 lakh and below in the ME + SME portfolio increased significantly to 73% as on June 30, 2021 from 56% as on March 31, 2018. The company plans to increase the share of the <Rs. 30-lakh segment to ~90%+ of the ME assets under management (AUM) in the near term, given its relatively better delinquency performance compared to higher ticket size loans.

ICRA notes that the increase in the ME loan book to Rs. 1,366 crore as on June 30, 2021 from Rs. 735 crore as on March 31, 2019 was largely due to higher volume (new ME customers) while the average ticket size of ME loans declined to Rs. 10.1 lakh in Q1 FY2022 from Rs. 13.7 lakh in Q1 FY2020. Around 72% of the ME+SME portfolio has a loan-to-value (LTV) of less than and equal to 60 as of June 2021. Further, the ME yields had been increasing during the same period. The company's core focus is to lend in a ticket size of Rs. 10-12 lakh in the ME segment. SBFC's strategy is to achieve a portfolio mix of ME (75%), loan against gold (LAG; 20%) and personal loans (PLs; 5%) compared to the mix of 64%, 26% and 10%, respectively, as of June 2021.

As of June 2021, the over-collateralisation available on the Series A PTCs of Rs. 740 crore held by SBFC increased to 79%[2] (over-collateralisation is available by way of collections on Series B PTCs of Rs. 591.4 crore). This provides comfort as any shortfall in collections from the Series A PTCs can be recovered from the collections from the Series B PTCs. The funds from the Series B PTCs will be transferred to DHFL only after all the regulatory dues and collection fees have been recovered and the rundown of the Series A PTCs is complete. SBFC plans to run down the DHFL PTC book by FY2023.

Improvement in profitability metrics – SBFC witnessed a consistent improvement in its operating efficiency with the cost-to-income ratio falling to 49.0% in Q1 FY2022 from 82.7% in FY2018. As a result, the operating profit to average total assets (ATA) increased to 3.5% in Q1 FY2022 from 1.5% in FY2018. Further, it made Covid provisions of ~Rs. 6 crore and utilised ~Rs. 2 crore in FY2021 compared to a Covid provision of ~Rs. 15 crore in FY2020. The company had a Covid provision of ~Rs. 19 crore or 0.89% of net advances as on June 30, 2021.

In FY2021, the fresh slippages in the acquired and the originated book along with Covid-19-related provisions pushed up the credit costs. The company posted a net profit of Rs. 22.7 crore in Q1 FY2022 (Rs. 85.1 crore in FY2021). Its return ratios have increased with RoA and RoE of 2.1% and 7.7%, respectively, in Q1 FY2022 compared to 0.5% and 0.7%, respectively, in FY2018. ICRA notes that the DHFL portfolio purchased by SBFC had an average interest rate of ~11% while the average yield on its ME portfolio was 14.5% in FY2021. The DHFL portfolio rundown is likely to be utilised to originate the book at a higher yield. The profitability will be susceptible to the goodwill impairment (when determined).

Adequate capitalisation with improved leverage – SBFC's gearing (adjusted for goodwill of Rs. 260.4 crore) declined to 2.9 times as on June 30, 2021 from 3.5 times as on June 30, 2020, while the capital adequacy ratio increased to 27.08% as on June 30, 2021 from 26.52% as on June 30, 2020. The improvement was driven by the equity infusion of Rs. 100 crore in FY2021, heathy internal accruals with RoA of 2.0% and 2.1% in FY2021 and Q1 FY2022, respectively, and reduction in the absolute debt levels.

SBFC plans to infuse equity of Rs. 250 crore in FY2022, which is likely to augment the Tier I capital ratio by 7.1% of the risk-weighted assets as on June 30, 2021 and will further improve the gearing levels. ICRA notes that the current gearing level

[2] *POS of Series B PTCs / POS of Series A PTCs*

would increase once the company starts growing its AUM. In the long term, SBFC expects to maintain a leverage of 3.5-4.0 times.

Senior management team with experience in retail lending business – SBFC has on-boarded a senior management team comprising officials with a proven track record in the banking/non-banking financial company (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 couple of years for the business, credit, finance and collection verticals.

SBFC will leverage the team's experience for 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. 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 while maintaining book growth – The asset quality deteriorated with the gross stage 3 ratio increasing to 4.94% as on June 30, 2021 from 3.05% as on March 31, 2021. The deterioration was in line with the industry trend as the company witnessed high slippages of Rs. 88.7 crore in Q1 FY2022 due to the second wave of the pandemic, which impacted the cashflows of the businesses. The expected credit loss (ECL) provision of the overall loan book was 2.3% while the ECL provision for stage 3 assets was 33.9% as on June 30, 2021.

SBFC reported write-offs of Rs. 5.5 crore in FY2021 and Rs. 4.0 crore in FY2020. It managed to reduce the 90+dpd to 3.7% in September 2021 through improved collections, ARC sale of Rs. 39.5 crore and write-off of Rs. 4.9 crore. As on June 30, 2021, the company reported a restructured loan book of Rs. 66.3 crore or 3.0% of advances. The restructured loan book is classified as stage 2 assets with a provision cover of more than 15%. As on August 31, 2021, the company maintained a Covid provision of Rs. 10 crore.

The collection efficiency of SBFC's largest ME segment improved to ~93% in August 2021, which is largely in line with the pre-Covid level. While unsecured loans witnessed an improving trend in the last few months at 85.1% in August 2021, this is still lower than the pre-Covid level of ~98%. The unsecured portfolio reported higher delinquencies, given the job losses during the pandemic. Within the unsecured segment, the collection efficiency of the PL segment (7.6% of total portfolio as on June 30, 2021) was better at an average of ~89% during March 2021 to August 2021 while the business loan segment (2.5% of total portfolio as on June 30, 2021) reported an average collection efficiency of ~76% during this period.

Modest credit profile of target customer segment – SBFC predominantly provides small-to-medium-size ticket loans to self-employed borrowers except for unsecured PLs where around 48% of the borrowers are government employees. Considering the borrowers' business and income profiles, their credit profiles are expected to be modest and vulnerable to income shocks induced by events such as the Covid-19 pandemic. However, these risks are mitigated to an extent by the company's prudent underwriting norms. Most (93%) of the ME + SME loans were backed by self-occupied (residential or commercial) properties as of June 2021.

Liquidity position: Adequate

The company's liquidity profile is adequate. As on August 31, 2021, it had Rs. 495 crore of cash and liquid investments, which would be sufficient to cover the near-term debt obligations of Rs. 341 crore (principal + interest) till December 2021. It reported positive cumulative mismatches across all the buckets in the asset-liability management (ALM) statement as on June 30, 2021.

Rating sensitivities

Positive factors – ICRA could upgrade the rating if the company shows a track record of profitable growth with a return on managed assets of more than 3% on a sustained basis while improving the asset quality.

Negative factors – Pressure on SBFC's rating could arise if there is a continued deterioration in the asset quality with the 90+dpd increasing beyond 5.0% (on loan book) or an increase in the adjusted managed gearing[3] to 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 the Clermont Group and the Arpwood Group, the company commenced operations in September 2017 after acquiring the performing loans in KFSL's retail portfolio. 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. 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 Reserve Bank of India's (RBI) guidelines pertaining to minimum retention).

SBFC reported a profit after tax (PAT) of Rs. 22.7 crore on total assets of Rs. 4,171 crore in Q1 FY2022 compared to a PAT of Rs. 24.1 crore on total assets of Rs. 4,342 crore in Q1 FY2021. In FY2021, the company witnessed a PAT of Rs. 85.1 crore on total assets of Rs. 4,266 crore compared to a PAT of Rs. 35.4 crore on total assets of Rs. 4,208 crore in FY2020.

[3] *Adjusted for goodwill of Rs. 260.4 crore*

Key financial indicators (audited)

SBFC Finance Private Limited	FY2020	FY2021	Q1 FY2021	Q1 FY2022
Total income (Rs. crore)	445	511	126	127
Profit after tax (Rs. crore)	35	85	24	23
Net worth (Rs. crore)	1,012	1,205	1,138	1,228
Loan book (Rs. crore)	1,548	2,106	1,530	2,167
Total assets (Rs. crore)	4,208	4,266	4,342	4,171
Return on assets (%)	1.18%	2.01%	2.28%	2.14%
Return on net worth (%)	3.74%	7.68%	9.41%	7.69%
Gross gearing – adjusted (times)*	4.06	3.06	3.53	2.90
Gross Stage 3 (%)	2.28%	3.05%	2.24%	4.94%
Net Stage 3 (%)	1.60%	2.01%	1.49%	3.35%
Solvency (Net stage 3/ adjusted Net worth)	3.28%	4.36%	2.59%	7.45%
CRAR (%)	21.89%	26.25%	26.52%	27.08%

Source: Company, ICRA Research
Note: Amount in Rs. crore; All calculations are as per 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 Oct 1, 2021 (Rs. crore)	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020			Date & Rating in FY2019
					Oct 8, 2021	Oct 16, 2020	Feb 14, 2020	Aug 29, 2019	Apr 22, 2019	Sep 28, 2018
1	Bank Lines Programme	Long Term	2,865.60	2,479.00	**[ICRA]A (Positive)**	[ICRA]A (stable)	[ICRA]A (stable)	[ICRA]A (stable)	[ICRA]A (stable)	[ICRA]A (stable)
2	Non-convertible Debenture Programme	Long Term	50.00	50.00	**[ICRA]A (Positive)**	[ICRA]A (stable)	[ICRA]A (stable)	-	-	-
3	Non-convertible Debenture Programme	Long Term	200.00	143.00	**[ICRA]A (Positive)**	[ICRA]A (stable)	[ICRA]A (stable)	[ICRA]A (stable)	[ICRA]A (stable)	[ICRA]A (stable)
4	Non-convertible Debenture Programme	Long Term	-	-	-	[ICRA]A (stable)	[ICRA]A (stable)	[ICRA]A (stable)	[ICRA]A (stable)	[ICRA]A (stable)

Complexity level of the rated instruments

Instrument	Complexity Indicator
Bank Lines Programme	Simple
Non-convertible Debenture Programme	Simple
Non-convertible Debenture Programme	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
-	Term Loan 1	Sep 2017	7.90%	Sep 2022	16.00	[ICRA]A (Positive)
-	Term Loan 2	Sep 2018	8.10%	Sep 2022	16.00	[ICRA]A (Positive)
-	Term Loan 3	Jul 2021	8.16%	Aug 2025	50.00	[ICRA]A (Positive)
-	Term Loan 1	Oct 2018	8.20%	Oct 2021	20.00	[ICRA]A (Positive)
-	Term Loan 2	Sep 2020	8.35%	Dec 2023	25.00	[ICRA]A (Positive)
-	Term Loan 1	Dec 2018	8.27%	Jun 2022	31.00	[ICRA]A (Positive)
-	Term Loan 2	Jan 2021	7.90%	Jan 2024	83.00	[ICRA]A (Positive)
-	Term Loan	Jun 2019	7.45%	Jun 2027	2,027.00	[ICRA]A (Positive)
-	Term Loan	Aug 2020	7.75%	Aug 2022	31.00	[ICRA]A (Positive)
-	Term Loan 1	Dec 2020	7.70%	Jan 2026	24.00	[ICRA]A (Positive)
-	Term Loan 2	Dec 2020	8.10%	Jul 2024	5.00	[ICRA]A (Positive)
-	Term Loan	Jan 2021	7.00%	Mar 2024	50.00	[ICRA]A (Positive)
-	Term Loan	Mar 2021	7.00%	Mar 2024	47.00	[ICRA]A (Positive)
-	Term Loan	Mar 2021	8.00%	Mar 2024	26.00	[ICRA]A (Positive)
-	Term Loan	Jun 2021	8.25%	Jun 2023	28.00	[ICRA]A (Positive)
NA	Unallocated	-	-	-	386.60	[ICRA]A (Positive)
INE423Y07039	Non-convertible Debentures	Aug 11, 2020	9.25%	Feb 11, 2022	50.00	[ICRA]A (Positive)
INE423Y07021	Non-convertible Debentures	Aug 3, 2020	9.25%	Feb 3, 2022	25.00	[ICRA]A (Positive)
INE423Y07047	Non-convertible Debentures	Aug 17, 2020	9.30%	Feb 17, 2022	25.00	[ICRA]A (Positive)
INE423Y07054	Non-convertible Debentures	Sep 14, 2020	9.25%	Mar 14, 2022	50.00	[ICRA]A (Positive)
INE423Y07062	Non-convertible Debentures	Aug 6, 2021	8.57%	Aug 6, 2024	43.00	[ICRA]A (Positive)
-	Non-convertible Debentures*	-	-	-	57.00	[ICRA]A (Positive)

Source: *Company; *Proposed*

Annexure-2: List of entities considered for consolidated analysis

Not Applicable

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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.

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