March 08, 2024

Pahal Financial Services Pvt. Ltd.: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debentures	60.90	60.90	[ICRA]BBB- (Stable); reaffirmed
Non-convertible debentures	113.70	0.00	[ICRA]BBB- (Stable); reaffirmed and withdrawn
Long-term fund based – Term loan	50.00	50.00	[ICRA]BBB- (Stable); reaffirmed
Total	**224.60**	**110.90**	

**Instrument details are provided in Annexure I*

Rationale

The rating reaffirmation factors in Pahal Financial Services Pvt. Ltd.'s (PFSPL) established track record of operations in the microfinance sector, increasing scale of operations and adequately diversified funding profile. The company's disbursements picked up in FY2023 and 9M FY2024, driven by branch expansion and the addition of new locations and borrowers. Its assets under management (AUM) grew by 34% (annualised) to Rs. 1,883 crore as on December 31, 2023. The rating also factors in the company's adequately diversified funding profile comprising a mix of loans from public sector banks, private banks, non-banking financial companies (NBFCs) and financial institutions (FIs).

The rating is, however, constrained by the geographically concentrated operations, given the high share of AUM in Gujarat (32%) and Bihar (28%) as on December 31, 2023. Its profitability profile has improved with the revision in the lending rates, though the same remains moderate due to high operating expenses and elevated credit costs. The asset quality deteriorated in 9M FY2024, leading to an increase in the credit costs. Further, the leverage (managed gearing[1] of 7.9 times as on December 31, 2023) has been increasing owing to the high pace of growth and the delay in equity infusion. ICRA takes note of the company's plans to raise sizeable equity capital in the coming few months to improve its capitalisation profile and support its growth plans. The timely raise of equity capital and improvement in the capitalisation profile shall remain key rating monitorables.

The rating continues to factor in the risks associated with the unsecured nature of microfinance loans, the marginal borrower profile, which is susceptible to income shocks, and the political and operational risks inherent in the microfinance business.

The Stable outlook takes into consideration the steps taken by the company to strengthen its capital profile in the near term, which shall support its overall credit profile. The outlook also factors in ICRA's expectation of a steady increase in the scale of operations and an improvement in the earnings profile from the current level.

ICRA has reaffirmed and simultaneously withdrawn the rating outstanding on the Rs. 113.7-crore non-convertible debenture (NCD) programme as the instrument has matured/been repaid by the company with no amount outstanding against the same. The rating has been withdrawn in accordance with ICRA's policy on the withdrawal of credit ratings.

[1] Managed gearing = (on-book debt + off-book portfolio) / net worth

Key rating drivers and their description

Credit strengths

Established track record in microfinance sector – Since commencing operations in 2011 under microfinance lending, PFSPL has a track record of over a decade in the sector. As on December 31, 2023, the company was operating through a network of 342 branches spreads across 145 districts in 10 states/Union Territories (UTs) while managing a portfolio of Rs. 1,883 crore. It is promoted by Mr. Kartik Mehta and Ms. Purvi Bhavsar, who have experience in the banking and microfinance sectors. PFSPL's existing investors include Base of Pyramid Asia (BoPA) Pte. Ltd., Dia Vikas Capital Private Limited (an impact investor) and GAWA Capital Pte. Ltd.

Adequately diversified funding profile – PFSPL's funding mix is adequately diversified with the company having relationships with various lenders including NBFCs, FIs, public sector banks and private banks. The borrowing profile comprised loans from banks (36%), NBFCs/FIs (33%), NCDs (25%) and subordinated debt (6%) as on December 31, 2023. The company raised Rs. 1,209-crore debt funds (including securitisation) in 9M FY2024 and had a healthy pipeline of funding to support its growth plans. Nevertheless, it is important for PFSPL to reduce its cost of funds and further diversify its funding profile as it continues to scale up its operations.

Credit challenges

High geographical concentration – As on December 31, 2023, the company had operations in 10 states/UTs, though the AUM remains concentrated in Gujarat and Bihar. The top 3 states comprised 72% of the AUM as on December 31, 2023 with a high share in Gujarat (32%) and Bihar (28%). However, ICRA notes that the concentration in top-3 states has declined from 75% as on March 31, 2023. Further, there is scope for improving the district-level diversification of the AUM. ICRA takes note of PFSPL's efforts to gradually reduce portfolio concentration, which will remain important from a credit perspective.

High leverage – Company's reported capital adequacy ratio of 19.50% (Tier I: 15.9%), as on December 31, 2023, was above the regulatory requirement of 15%, however, gearing remains high. The gearing has been increasing owing to the high pace of growth, moderate profitability and delay in equity infusion. The on-book gearing and managed gearing increased to 6.2 times and 7.9 times, respectively, as on December 31, 2023, from 5.1 times and 6.5 times, respectively, as on March 31, 2023. PFSPL has been in breach of the ICRA-stipulated rating sensitivities on managed gearing for the past few quarters. ICRA takes note of the company's plans to raise sizeable equity capital in the coming months to improve its capitalisation profile and support its growth plans. The timely raise of equity capital and improvement in the capitalisation profile shall remain key rating monitorables.

Moderate profitability and asset quality indicators – The company reported a return on average managed assets (RoMA) and a return on equity (RoE) of 1.8% and 15.8%, respectively, in 9M FY2024 (0.9% and 7.5%, respectively, in FY2023). While the overall profitability improved in 9M FY2024 due to the higher margins, it remained moderate due to high operating expenses and elevated credit costs. PFSPL is in expansion mode with continuous branch expansion and manpower recruitment, leading to high operating expenses. Further, credit costs increased in 9M FY2024 due to the deterioration in the asset quality indicators. The gross stage 3 (GS-3) increased to 2.5% as on December 31, 2023 from 2.0% as on March 31, 2023 (4.3% as on March 31, 2022). Moreover, the company has sold some assets to an asset reconstruction company (ARC) and held security receipts against the same (1.7% as on December 31, 2023). Going forward, PFSPL's ability to control further slippages and recover from delinquent accounts will be a key monitorable.

Political, communal and other risks in microfinance sector, given the marginal borrower profile – Microfinance remains susceptible to 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. Further, political and operational risks associated with microfinance may result in high volatility in the asset quality indicators. The microfinance industry is prone to socio-political, climatic and operational risks, which could negatively impact its operations. PFSPL's ability to onboard borrowers with a good credit history, recruit and retain employees as well as improve the geographical diversity of its operations would be key for managing high growth rates while maintaining its credit profile.

Liquidity position: Adequate

As on December 31, 2023, the company had a free cash and bank balance of Rs. 272 crore and scheduled inflows from advances of Rs. 793 crore against scheduled debt repayments of Rs. 718 crore during January 1, 2024 to December 31, 2024. Factoring in the expected collections from advances, the liquidity profile is expected to remain adequate to meet the debt obligations in a timely manner. Nevertheless, PFSPL would require additional funding to support its envisaged disbursements, given its growth plans. It also has Rs. 95 crore as margin money deposits placed to avail term loans from banks and other lenders and as cash collateral in connection with the securitisation and business correspondent transactions.

Rating sensitivities

Positive factors – ICRA could upgrade the rating if PFSPL improves its earnings profile on a sustained basis while expanding its scale of operations and is able to improve its capitalisation level with a managed gearing of less than 6 times on a sustained basis.

Negative factors – Pressure on the rating could arise on further deterioration in the asset quality, which could affect the profitability. Weakening of the capitalisation profile, with a managed gearing of more than 7 times on a sustained basis, could also exert pressure on the rating.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Rating Methodology for Non-banking Finance Companies ICRA Policy on Withdrawal of Credit Ratings
Parent/Group support	Not applicable
Consolidation/Standalone	Standalone

About the company

PFSPL is an Ahmedabad-based non-banking financial company-microfinance institution (NBFC-MFI) registered with the Reserve Bank of India. It commenced operations in March 2011 by acquiring the existing operations of Lok Vikas Nidhi, a trust operational in Gujarat for over 25 years. The current promoters acquired the portfolio of Rs. 2.6 crore spread over 15 branches, along with the field staff of Lok Vikas, and subsequently transferred the acquired portfolio to an NBFC along with an equity contribution of Rs. 2 crore. The NBFC was renamed Pahal Financial Services Pvt. Ltd. PFSPL lends to poor women primarily in the rural and semi-urban areas of Gujarat, Rajasthan, Madhya Pradesh, Bihar, Tamil Nadu, Uttar Pradesh, Chhattisgarh, Haryana, Maharashtra and Puducherry.

PFSPL reported a profit after tax (PAT) of Rs. 28.8 crore in 9M FY2024 on AUM of Rs. 1,883 crore as on December 31, 2023 against a profit of Rs. 15.1 crore in FY2023 on AUM of Rs. 1,509 crore as on March 31, 2023.

Key financial indicators

PFSPL	FY2022	FY2023	9M FY2024
	Audited	Audited	Limited Review
Accounting as per	Ind-AS	Ind-AS	Ind-AS
Total income	184.5	279.3	327.3
Profit after tax	1.0	15.1	28.8
Total managed assets (grossed up for provisions)	1,375.0	1,795.9	2,339.6
Return on average managed assets	0.1%	0.9%	1.8%
Gearing (managed; times)	6.6	6.5	7.9
Gross stage 3 assets	4.3%	2.0%	2.5%
CRAR	21.3%	23.7%	19.5%

Source: Company, ICRA Research; All ratios as per ICRA's calculations; Amount in Rs. crore
Managed gearing = (on-book debt + off-book portfolio) / net worth

Status of non-cooperation with previous CRA: Not applicable

Any other information:

ICRA notes that PFSPL also faces prepayment risk, given the possibility of debt acceleration upon the breach of covenants, including financial, operating and rating-linked covenants. Upon failure to meet the covenants, if the company is unable to get waivers from the lenders/investors or the lenders/investors do not provide it with adequate time to arrange for alternative funding to pay off the accelerated loans, the rating would face pressure. Nevertheless, ICRA notes that PFSPL has been able to raise fresh funds despite covenant breaches in the last two to three years. The management has guided that PFSPL has requested for waivers from lenders/investors for such breaches and no negative comments/adverse actions have been taken for the same.

Rating history for past three years

	Instrument	Current Rating (FY2024)				Chronology of Rating History for the Past 3 Years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Dec 31, 2023 (Rs. crore)	Date & Rating in FY2024	Date & Rating in FY2023	Date & Rating in FY2022	Date & Rating in FY2021		
					Mar-8-24	Mar-10-23	Mar-17-22	Mar-18-21	Feb-22-21	Dec-15-20
1	NCD	Long term	9.1	-	[ICRA]BBB- (Stable), withdrawn	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	-
2	NCD	Long term	5.9	-	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	-
3	NCD	Long term	39.6	-	[ICRA]BBB- (Stable), withdrawn	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)
4	NCD	Long term	65.0	-	[ICRA]BBB- (Stable), withdrawn	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)
5	NCD	Long term	-	-	-	[ICRA]BBB- (Stable), withdrawn	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)
6	NCD	Long term	-	-	-	[ICRA]BBB- (Stable), withdrawn	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)
7	NCD	Long term	-	-	-	[ICRA]BBB- (Stable), withdrawn	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)
8	NCD	Long term	55.0	43.13	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	-	-
9	Bank lines	Long term	50.0	50.00	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)
10	NCD	Long term	-	-	-	-	[ICRA]BBB- (Stable); withdrawn	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)
11	NCD	Long term	-	-	-	-	[ICRA]BBB- (Stable); withdrawn	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)

Complexity level of the rated instrument

Instrument	Complexity Indicator
Non-convertible debentures	Simple
Bank facilities	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: Click Here

Annexure I: Instrument details

ISIN	Name of instrument	Date of Issuance	Coupon Rate	Maturity Date	Rated Amount (Rs. crore)	Current Rating and Outlook
INE514Q07155	**NCD**	Mar-28-2020	13.15%	Mar-31-2023	28.20	[ICRA]BBB- (Stable); withdrawn
INE514Q07106	**NCD**	Jul-12-2018	14.20%	Mar-30-2023	15.00	[ICRA]BBB- (Stable); withdrawn
INE514Q07221	**NCD**	Mar-15-2021	14.50%	Mar-30-2023	15.00	[ICRA]BBB- (Stable); withdrawn
INE514Q07189	**NCD**	Nov-3-2020	11.72%	Nov-03-2023	13.40	[ICRA]BBB- (Stable); withdrawn
INE514Q07205	**NCD**	Jan-12-2021	11.63%	Jan-12-2024	17.10	[ICRA]BBB- (Stable); withdrawn
INE514Q07197	**NCD**	Dec-18-2020	14.50%	Dec-18-2023	25.00	[ICRA]BBB- (Stable); withdrawn
INE514Q08021	**NCD**	Mar-16-2020	16.50%	Jun-16-2025	15.00	[ICRA]BBB- (Stable)
INE514Q07239	**NCD**	Apr-23-2021	12.30%	Apr-30-2025	37.50	[ICRA]BBB- (Stable)
Unallocated	**NCD**	-	-	-	8.40	[ICRA]BBB- (Stable)
NA	**Bank lines**	Mar 2023	MCLR + 2.85%	Mar 2026	50.00	[ICRA]BBB- (Stable)

Source: Company

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

ANALYST CONTACTS

Karthik Srinivasan
+91 22 6114 3444
karthiks@icraindia.com

A M Karthik
+91 44 4596 4308
a.karthik@icraindia.com

Prateek Mittal
+91 33 7150 1132
prateek.mittal@icraindia.com

Arpit Agarwal
+91 124 4545 873
arpit.agarwal@icraindia.com

Arti Verma
+91 124 4545 313
arti.verma@icraindia.com

RELATIONSHIP CONTACT

L Shivakumar
+91 22 2433 1084
shivakumar@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.

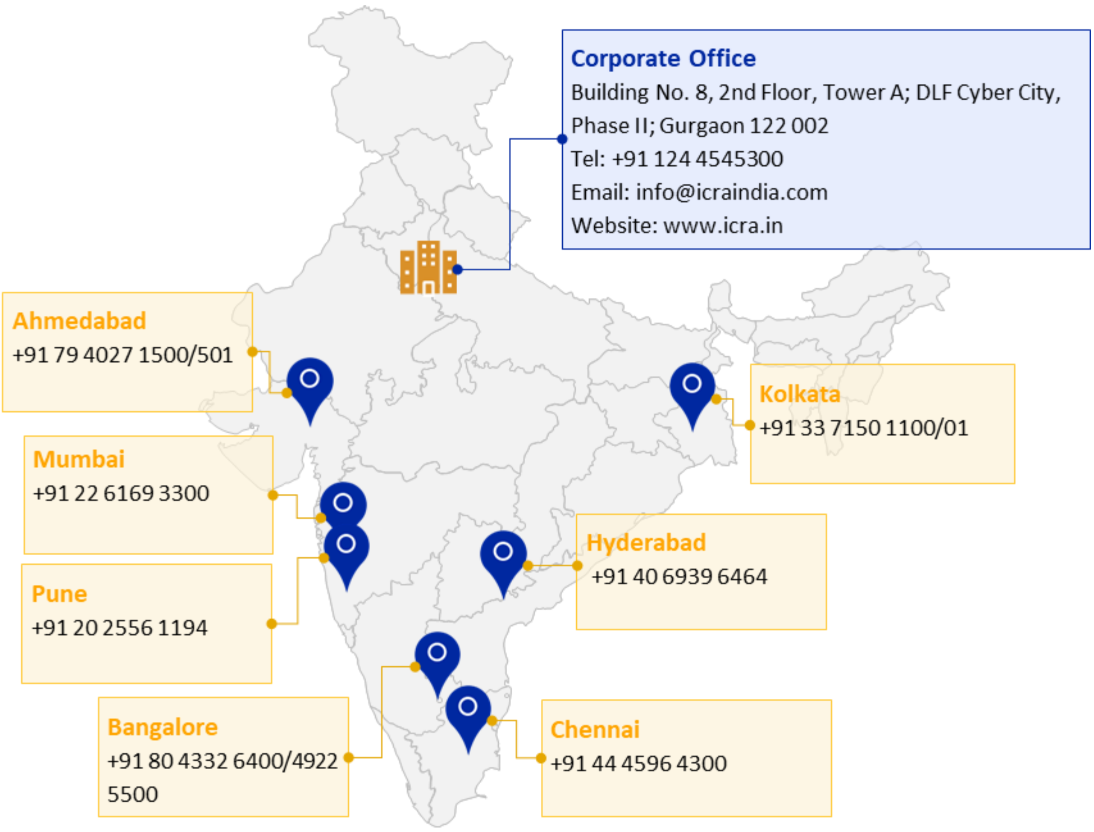
For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches



ICRA ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. ICRA ratings are subject to a process of surveillance, which may lead to revision in ratings. An ICRA rating is a symbolic indicator of ICRA's current opinion on the relative capability of the issuer concerned to timely service debts and obligations, with reference to the instrument rated. Please visit our website www.icra.in or contact any ICRA office for the latest information on ICRA ratings outstanding. All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable, including the rated issuer. ICRA however has not conducted any audit of the rated issuer or of the information provided by it. While reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. Also, ICRA or any of its group companies may have provided services other than rating to the issuer rated. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents.