

## Small Business FinCredit India Private Limited

April 22, 2019

### Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Bank Lines Programme	200.00	500.00	[ICRA]A(stable); / reaffirmed
Non-convertible Debenture Programme	400.00	400.00	[ICRA]A(stable); reaffirmed
<b>Total</b>	<b>600.00</b>	<b>900.00</b>	

\*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, coupled with the revamping of the risk management systems and processes and the company's efforts to source leads and collect payments in-house within the indicated timelines. The rating also factors in the significant upfront equity infusion of Rs. 845 crore by Lyra Partners and Arpwood Partners Investment Advisors LLP for the acquisition of the retail lending book and existing infrastructure, branch network and employee team of Karvy Financial Services Limited (KFSL). This equity infusion and the Rs. 400-crore non-convertible debentures helped SBFC acquire the Rs. 807-crore loan assets from KFSL.

The retail lending portfolio consists of small ticket micro enterprise (ME) loans, medium ticket small and medium enterprise (SME) loans, loan against gold (LAG) and small commercial vehicle (SCV) loans. The rating also factors in the moderate seasoning of the ME and SME loans, which were acquired as a part of the KFSL deal and the stable asset quality of this portfolio, post the settlement of the 10% first loss cover in March 2019. ICRA also notes the moderate delinquency levels of the portfolio originated by the new team under the new processes. The rating also factors in 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, and the long-term nature of the borrowings.

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 and the acquired infrastructure from KFSL. 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, thereby impacting the company's profitability.

### Key rating drivers

### Credit strengths

**Granular book with retail focus; low average ticket size and LTV with adequate seasoning** – As of December 2018, ME, SME, LAG, SCV and unsecured personal loans formed 64%, 11%, 22%, 1% and 2%, respectively, of the portfolio. Around 67% of the ME portfolio and 59% of the SME portfolio had a loan-to-value (LTV) ratio of less than 50%, indicating adequate collateral coverage, while 70% of the ME portfolio had a ticket size of less than Rs. 40 lakh. Meanwhile, 90% of the LAG portfolio had a ticket size of less than Rs. 5 lakh, which imparts granularity to the overall assets under management (AUM). While acquiring KFSL's lending business in September 2017, SBFC ensured that only the seasoned portfolio was acquired with no new loan disbursements (except LAG) between June 2016 and September 2017 and with average seasoning of over 25 months (except LAG). Only the performing portfolio (current and 0-30 for the ME book) was acquired. Gold loans, with mark-to-market LTV of less than 90%, were acquired. Moreover, the settlement of the 10% first loss cover for the loan assets, which defaulted in the first year of operations till September 2018, helped in a further clean-up of the acquired book with minimal impact on the company's bottom line.

**Comfortable capitalisation profile on equity infusion by new shareholders** – 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. SBFC's gearing stood at a comfortable level of ~0.87 times as of December 2018, with an adjusted net worth of Rs. 619.5 crore (adjusted for goodwill of Rs. 42.8 crore) and a capital adequacy of 52%. In FY2020, another Rs. 100 crore will be infused by Arpwood on the conversion of share warrants. Supported by the upfront capital infusion, the company's capital structure is expected to be adequate to meet its growth targets for the next three years.

**Senior management team with experience in retail lending business; collection framework revamped** – SBFC has on-boarded Mr. Aseem Dhru (as Chief Executive Officer), Mr. Mahesh Dayani (as Chief Business Officer), Mr. Narayan Barasia (as Chief Financial Officer) and other officials with a proven track record in the banking/NBFC sector. The senior management team is supported by a strong zonal leadership team, with experience ranging from 11 to 18 years. This team was on-boarded over the last 12 months for the business, credit and collection verticals. SBFC would leverage their experience in ramping up the retail loan book, maintaining strong 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, 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. 356 crore as on February 28, 2019), on seasoning, remains to be seen. The freshly originated loans under the ME, SME and personal loan segments witnessed moderate delinquencies, as of date. However, LAG, which has almost been churned completely over the last 12 months, has slightly higher delinquencies. The adequate security cover, the lender's focus on margin call and the liquid nature of the collateral, however, 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.

**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. Pre-goodwill amortisation, the company had earned a profit before tax of Rs. 2.05 crore in FY2018 and Rs. 33.31 crore in 9M FY2019 (based on India GAAP accounting standards). The accounting of goodwill as per Ind AS may differ and the amount will be tested for impairment. SBFC's ability to contain operating expenses, as it scales up its operations, would also be a key rating monitorable.

## Liquidity position

As on February 28, 2019, SBFC had Rs. 13 crore of debt maturing by August 2019, against which it had adequate cash and liquid assets of Rs. 205 crore and scheduled inflows of Rs. 168 crore. Further cushion is available through unutilised bank lines. Hence, the liquidity position is adequate to meet the debt maturities in the near term.

## Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	<a href="#">ICRA's Credit Rating Methodology for Non-Banking Finance Companies</a>
Parent/Group Support	ICRA factors in the significant upfront equity infusion by the Group to finance the acquisition of KFSL's lending business. The largest promoter, Lyra Partners and its investor, has adequate financial flexibility to infuse equity into SBFC, as and when needed. The rating also factors in the induction of the senior management team, with significant experience in the retail lending business, for the scaling up of its business
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. SBFC reported a net loss of Rs. 97.98 crore on total assets of Rs. 1,267.66 crore in 9M FY2019 compared to a net loss of Rs. 84.75 crore on total assets of Rs. 1,303.29 crore in FY2018.

### Key financial indicators (audited)

	<b>FY2018</b>	<b>9M FY2019</b>
Net interest income	43.46	84.56
Operating income	53.55	96.83
Profit before tax	(84.75)	(97.98)
Profit after tax	(84.75)	(97.98)
Total portfolio	781.39	1,066.00*
Net worth	760.22	662.25
Goodwill	173.59	42.80
Total assets	1,303.29	1,267.66
% Tier 1	55.46%	50.95%
% CRAR	55.95%	51.55%
Gearing (adjusted)	0.83	0.87
% Net profit/average total assets (annualised)	(12.91%)	(10.16%)
% Return on net worth	(22.22%)	(18.37%)
% Gross NPAs	1.41%	0.41%*
% Net NPAs	1.17%	0.36%*
Net NPA/Net worth	1.20%	0.60%*

*\*Adjusted for amount settled by first loss cover in March 2019*

**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)	Apr-19	FY2019	FY2018		FY2017
						Sep-18	Dec-17	Sep-17	-
1	Bank Lines Programme	Long Term	500.00	287.50	[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)	-

### 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](http://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	2021-22	287.50	[ICRA]A (stable)
NA	Long-term Bank Lines - Proposed	NA	NA	NA	212.50	[ICRA]A (stable)

Source: Small Business FinCredit India Private Limited

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