Arman Financial Services Limited

June 01, 2022

Ratings

Facilities	Amount (₹ crore)	Rating[1]	Rating Action
Long-term bank facilities	6.80 (Reduced from 35.47)^	CARE BBB+; Stable (Triple B Plus; Outlook: Stable)	**Reaffirmed**
Total facilities	**6.80 (₹ Six crore and eighty lakh only)**		
Non-convertible debentures	39.00	CARE BBB+; Stable (Triple B Plus; Outlook: Stable)	Assigned
Non-convertible debentures	37.80	CARE BBB+; Stable (Triple B Plus; Outlook: Stable)	Reaffirmed
Non-convertible debentures	-*	-	Withdrawn
Total long-term instruments	**76.80 (₹ Seventy-six crore and eighty lakh only)**		

Details of instruments/facilities in Annexure-1.
*CARE Ratings has withdrawn the rating assigned to the NCD with immediate effect, as the company has redeemed the NCD issue and there is no amount outstanding under the said issue, as on date.

Detailed rationale and key rating drivers

For arriving at the ratings of Arman Financial Services Limited (AFSL), CARE Ratings has taken a consolidated view of AFSL, which includes its wholly-owned subsidiary – Namra Finance Limited (NFL), engaged in microfinance lending, apart from the standalone financing business of AFSL. This is on account of the operational, managerial, and financial linkages between the two entities. Together the entities are referred to as the 'group'.

The ratings are assigned and reaffirmed for the bank facilities and non-convertible debentures (NCDs) of AFSL deriving strength from the group's established track record of operations in the financing business; the experienced and professional management; the diversified operations across three different loan segments – micro-finance, vehicle finance, and micro, small and medium enterprise (MSME) lending; and adequate internal control systems. The ratings also factor in the growth in the loan portfolio over the past few years along with the improvement in profitability in 9MFY22 due to reduced credit costs. The ratings further derive strength from the increasing geographical diversification of the group's operations, adequate liquidity profile, adequate capitalisation, and moderate asset quality.

The ratings, however, are constrained on account of the moderate loan book with a limited track record of operations in new geographies and products, risks associated with unsecured lending in microfinance and MSME loans, and its presence in a highly competitive financing industry along with regulatory risks pertaining to the microfinance business. Furthermore, the ratings also take note of the increase in credit cost in FY21 and the resulting moderation in profitability due to COVID-19-led operational disruptions throughout the economies, although the company has reported an improvement in asset quality in 9MFY22, leading to improved profitability with reduced credit costs in 9MFY22.

Rating sensitivities

Positive Factors – Factors that could individually or collectively lead to positive rating action/upgrade:

- Significant growth in the total income, driven by the expansion of the loan portfolio while maintaining the net interest margin (NIM) above 12% along with containment of gross non-performing assets (GNPA) levels at below 1% on a sustained basis.
- Significant capital addition, improving the overall gearing and capital adequacy ratio (CAR) of the company on a sustained basis.

Negative Factors – Factors that could individually or collectively lead to negative rating action/downgrade:

- Deterioration of profitability with return on total assets (ROTA) falling below 3% on a sustained basis.
- Significant increase in the GNPA, going forward.
- Deterioration in the capital structure, with the overall gearing increasing to 6x or higher.

Detailed description of the key rating drivers

Key rating strengths

Established Track record and promoters experience: AFSL is engaged in the financing business since 1992 and has demonstrated a long track record of operations through various business cycles. The company is promoted by Mr. Jayendra Patel, Managing Director, who has a wide industry experience of more than two decades, and his son, Mr. Aalok Patel, who is also on

[1]Complete definitions of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications.

the board of the company and is actively involved in the business. Furthermore, Mr. Alok Prasad, the present Chairman on the board of AFSL, Mr. Prasad has more than 35 years of experience in regulatory, banking, and financial services.

Apart from the parent-subsidiary relationship, AFSL and NFL share benefits from synergies due to operating in the same line of business, such as its shared branch network, operational support, and support in accessing various avenues for debt tie-up as well as capital. AFSL and NFL also have common board members.

Diversified operations across three segments with microfinance comprising major share: The group is present in three segments – microfinancing, vehicle financing, and MSME lending, wherein, AFSL on a standalone basis undertakes vehicle financing and MSME lending, while the microfinance lending is done through NFL, its wholly-owned subsidiary. Microfinance forms the majority of the consolidated assets under management (AUM), with 82% of the AUM as on December 31, 2021, and MSME and two-wheeler form the remaining proportion of the consolidated AUM.

Growing loan portfolio and healthy profitability: On a consolidated basis, AFSL's AUM has grown at a three-year CAGR of 24% as on March 31, 2021, although down by 1% y-o-y. With improvement in economic conditions, the AUM has increased to ₹1,045 crore as on December 31, 2021, from ₹814 crore as on March 31, 2021 and ₹720 crore as on December 31, 2020, underpinned by improvement in disbursements to ₹685 crore as on December 31, 2021, from ₹513 crore as on March 31, 2021. Microfinance loans make up the majority of the portfolio (82% of the AUM), with MSME (13% of the AUM) and two-wheeler (5% of the AUM) making up the remaining as on December 31, 2021.

On a consolidated basis, as on December 31, 2021, AFSL reported a net profit of ₹15 crore, up from ₹11 crore as on March 31, 2021 and ₹10 crore as on December 31, 2020. With this, the ROTA as on December 31, 2021 improved to 2.0%, up from 1.1% as on March 31, 2021 and 1.6% as on December 31, 2020.

Increasing geographical diversification: AFSL, on a consolidated basis, operates across eight states, covering around 94 districts through a network of 262 branches as on December 31, 2021.

Adequate capitalisation and diversified resource base: AFSL's CAR, on a standalone basis, continued to be comfortable at 48.8% as on March 31, 2021, improving from 34.7% (as per IND-AS) as on March 31, 2020. Going forward, the timely infusion of equity will remain crucial for achieving growth in the business operations while maintaining the leverage and capitalisation levels. On a consolidated basis, the overall gearing as on December 31, 2021 increased to 5x, from 4x as on September 30, 2021. Furthermore, the group's resource base is diversified, with borrowings relationships across over 30 banks and other financial institutions, along with reputed foreign investors and private equity players. This apart, it also has the flexibility to raise funds from capital markets, being a listed entity. The borrowings consist of term loans, working capital, NCDs, external commercial borrowings (ECBs), and securitisation.

Key rating weaknesses

Moderation in asset quality: On a consolidated level, as on March 31, 2021, the asset quality was impacted due to COVID-19, with an increase in GNPA% and net non-performing assets (NNPA)% of 5% and 1%, respectively, from 1% and 0%, respectively, as on March 31, 2020. However, as on December 31, 2021, the company has shown improvement, with a reduced GNPA% of 5%, from 6% as on September 30, 2021, and a stable NNPA% of 1% as on December 31, 2021 and September 30, 2021.

The collections were impacted in the month of May 2021, post which, it started showing improvement. Higher collection efficiencies were aided by improvements in the cash flow position of the borrowers and the strengthened collection team on the ground. Collection efficiencies further improved in the month of January 2022 and stood at 94%.

The asset quality will remain vulnerable, given the fact that NFL caters to a customer segment with an inherently weaker credit profile and those who are more susceptible to economic vulnerabilities and socio-political risks, if any. Further developments in asset quality remain a key rating monitorable.

Moderate size of loan book; limited track record of operations in new geographies: The loan portfolio of the group witnessed healthy growth in the past three years, but moderated in FY21 to ₹814 crore, from ₹859 crore in FY20 due to the COVID-19 pandemic. However, the company's AUM increased to ₹1,044 crore as on December 31, 2021. Furthermore, it commenced microfinance lending operations in Rajasthan and Uttarakhand only during the past three years, along with operations in Haryana in FY21 and Bihar in Q4FY22; and thus, has a limited track record of exposure to these local economies and their dynamics, in light of the unsecured nature of lending. Also, AFSL commenced unsecured MSME lending only during the end of FY17, which scaled up sizably in the past three years. Collectively, both these translate into a limited track record for the group in new geographies and product segments. Furthermore, the seasoning of the loan portfolio is moderate due to the inherent short tenure loans. The company does not do mid-year top-ups.

Regulatory and inherent risks associated with unsecured lending albeit adequate internal control systems: AFSL operates in a business segment that is unsecured in nature, however, the non-performing asset (NPA) levels have been restricted, underlining adequate internal control and risk management systems, followed by the management for loan disbursement and recoveries. Furthermore, the company is also exposed to regulatory risks associated with any adverse changes in the regulations guiding such non-banking financial companies (NBFCs), along with event-based risks associated with microfinancing.

Increasing competition in the industry: The group faces competition from larger microfinance institutions (MFIs), who have better access to resources and enjoy the economies of large-scale operations. Furthermore, banks are also trying to increase their direct presence in rural areas to meet the priority sector lending requirements. The sector has evolved with the advent of credit bureaus and the subsequent control over asset quality. Moreover, other models of microfinance, including non-governmental organisations (NGOs), co-operatives, and trusts, have also grown significantly in the recent years, adding to the competition in the sector, its growth potential notwithstanding. This apart, microfinance players also face competition from the unorganised lending sector, which still has a prevalence in large parts of the country.

Liquidity: Adequate
AFSL's consolidated liquidity remained adequate, with ₹126.4 crore in cash and bank balance, liquid investments, and undrawn cash credit (CC) limits as on December 31, 2021. Additionally, the company has ₹105 crore undrawn sanctions from existing lenders. Against this, the company has debt repayments of ₹256 crore over the next six months. Furthermore, in its asset-liability management (ALM) statement, as on December 31, 2021, there were no cumulative mismatches owing to the inherent shorter tenure lending than borrowing.

Analytical approach: Consolidated
A consolidated approach including AFSL and NFL has been considered for analysis due to the following:

- NFL is a wholly-owned subsidiary of AFSL.
- Both entities are engaged in the similar line of business.
- Both entities operate under a common management.
- The entities have cash flow fungibility among each other.

Applicable criteria

Rating methodology: Consolidation
Rating methodology: Notching by factoring linkages in ratings
CARE Ratings' policy on Default Recognition
Financial ratios: Financial sector
Criteria for assigning 'outlook' and 'credit watch' to credit ratings
Rating methodology: NBFCs
Policy on Withdrawal of Ratings

About the company
AFSL is a non-deposit-taking NBFC registered with the Reserve Bank of India (RBI), promoted by Jayendra Patel. Prior to May 2013, AFSL was engaged in the business of two-wheeler financing and microfinance lending business through the joint liability group model. However, NFL got an NBFC-Micro Finance Institution license from RBI on February 14, 2013, and since May 2013, the entire new microfinance lending is being carried out by NFL. In March 2017, AFSL also commenced the MSME lending business. The company, on a consolidated basis, operates across seven states – Gujarat, Madhya Pradesh, Maharashtra, Uttar Pradesh, Uttarakhand, Rajasthan, and Haryana, covering around 94 districts through a network of 262 branches as on December 31, 2021. Microfinance lending is presently the largest business segment of the group, which contributed 82% of its total AUM of ₹1,044 crore as on December 31, 2021, while the balance was from MSME loans (13%) and two-wheeler loans (5%).

AFSL (Consolidated)

Brief Financials (₹ crore)	March 31, 2020 (A)	March 31, 2021 (A)	December 31, 2021 (UA)
TOI	215.15	193.26	159.19
PAT	41.52	10.62	15.44
Interest coverage (times)	1.61	1.15	1.24
Total assets	936.83	940.07	1085.12
Net NPA (%)	0.21	0.8	1.1
ROTA (%)	4.7	1.08	2.03

A: Audited; UA: Unaudited.

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for the last three years: Please refer Annexure-2

Covenants of the rated instruments/facilities: Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3

Complexity level of various instruments rated for this company: Annexure-4

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Fund-based - LT-Cash Credit	-	-	-	NA	6.80	CARE BBB+; Stable
Fund-based - LT-Term Loan		-	-	-	0.00	Withdrawn
Debentures-Non-Convertible Debentures	INE109C07022	March 03, 2020	13.15%	March 03, 2025	37.80	CARE BBB+; Stable
Debentures-Non-Convertible Debentures (Proposed)	-	-	-	-	39.00	CARE BBB+; Stable
Debentures-Non-Convertible Debentures	-	-	-	-	0.00	Withdrawn

NA: Not available.

Annexure-2: Rating history for the last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021	Date(s) and Rating(s) assigned in 2019-2020
1	Fund-based - LT-Cash Credit	LT	6.80	CARE BBB+; Stable	-	1)CARE BBB+; Stable (January 03, 2022) 2)CARE BBB+; Stable (November 22, 2021)	1)CARE BBB+; Stable (October 07, 2020)	1)CARE BBB+; Stable (September 13, 2019)
2	Debentures-Non-Convertible Debentures	LT	-	-	-	1)CARE BBB+; Stable (January 03, 2022) 2)CARE BBB+; Stable (November 22, 2021)	1)CARE BBB+; Stable (October 07, 2020)	1)CARE BBB+; Stable (September 13, 2019)
3	Fund-based - LT-Term Loan	LT	-	-	-	1)CARE BBB+; Stable (January 03, 2022) 2)CARE BBB+; Stable (November 22, 2021)	1)CARE BBB+; Stable (October 07, 2020)	1)CARE BBB+; Stable (September 13, 2019)
4	Fund-based - ST-Others	ST	-	-	-	1)Withdrawn (January 03, 2022) 2)CARE A2 (November 22, 2021)	1)CARE A2 (October 07, 2020)	1)CARE A2 (September 13, 2019)
5	Debentures-Non-Convertible Debentures	LT	37.80	CARE BBB+; Stable	-	1)CARE BBB+; Stable (January 03, 2022) 2)CARE BBB+; Stable	1)CARE BBB+; Stable (October 07, 2020)	1)CARE BBB+; Stable (February 27, 2020)

						(November 22, 2021)		
6	Debentures-Non-Convertible Debentures	LT	39.00	CARE BBB+; Stable				

*Long term/Short term.

Annexure-3: Detailed explanation of covenants of the rated instruments/facilities

Non-Convertible Debentures*	Detailed Explanation
A. Financial covenants	
I. CAR of not less than 15%	NA
II. Ratio of total debt to total equity of not higher than 7x	'Total equity' will include subordinated debt to the extent that such can be accounted for as Tier-II capital in accordance with applicable regulations
III. Uncovered capital ratio below 15%	Defined as the PAR>90 days plus restructured portfolio minus loan loss provisions divided by equity
IV. Less than 5% of its liabilities and assets in non-INR denominated currency	NA
V. Ratio of outstanding off-balance sheet portfolio (including asset securitisation) to total assets less than 40%	
B. Non-financial covenants	
I. A rating will have been assigned to the NCD of not less than [BBB-] by any recognised rating agency approved by SEBI for carrying out debt ratings in India	NA

*As per indicative term sheet.
NA: Not available.

Annexure-4: Complexity level of various instruments rated for this company

Sr. No.	Name of Instrument	Complexity Level
1	Debentures-Non-Convertible Debentures	Simple
2	Fund-based - LT-Cash Credit	Simple
3	Fund-based - LT-Term Loan	Simple

Annexure-5: Bank lender details for this company
To view the lender-wise details of bank facilities, please click here.

Note on complexity levels of the rated instrument: CARE Ratings has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

Contact us

Media contact
Name – Mr. Mradul Mishra
Phone: +91-22-6754 3596
E-mail: mradul.mishra@careedge.in

Analyst contact
Name: Neha Kadiyan
Phone: +91-81303 40369
E-mail: Neha.Kadiyan@careedge.in

Relationship contact
Name: Swati Agrawal
Phone: +91-11-4533 3200
E-mail: swati.agrawal@careedge.in

About us:
Established in 1993, CARE Ratings is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India, it has been acknowledged as an External Credit Assessment Institution by the RBI. With an equitable position in the Indian capital market, CARE Ratings provides a wide array of credit rating services that help corporates raise capital and enable investors to make informed decisions. With an established track record of rating companies over almost three decades, CARE Ratings follows a robust and transparent rating process that leverages its domain and analytical expertise, backed by the methodologies congruent with the international best practices. CARE Ratings has played a pivotal role in developing bank debt and capital market instruments, including commercial papers, corporate bonds and debentures, and structured credit.

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