Arman Financial Services Limited (Revised)

September 19, 2022

Ratings

Facilities	Amount (₹ crore)	Rating[1]	Rating Action
Non-convertible debentures	39.00	CARE BBB+; Stable (Triple B Plus; Outlook: Stable)	Reaffirmed
Non-convertible debentures	37.80	CARE BBB+; Stable (Triple B Plus; Outlook: Stable)	Reaffirmed
Total long-term instruments	**76.80 (₹ Seventy-six crore and eighty lakh only)**		
Long term Bank Facilities	0.00*	-	Reaffirmed at CARE BBB+; Stable (Triple B Plus; Outlook: Stable) and Withdrawn
Total Facilities	**0.00**		

Details of instruments/facilities in Annexure-1

*CARE Ratings has withdrawn the rating assigned to the Bank Facilities with immediate effect, as per the request of Arman Financial Services Limited and 'No Objection Certificate' received from the banks that have extended the facilities rated by CARE Ratings.

Detailed Rationale & 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 for the non-convertible debentures (NCDs) of AFSL are reaffirmed 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. 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 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.

Rating Sensitivities

Positive Factors - Factors that could 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 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.

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

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 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 84%, and MSME and two-wheeler form the remaining proportion as on June 30, 2022.

Growing loan portfolio and healthy profitability: On a consolidated basis, AFSL's AUM has grown at a three-year CAGR of 13% as on March 31, 2022, with yearly rise by 51% to ₹ 1,233 crore. The AUM has further risen as on June 30, 2022 with ₹ 1,388 crore (+13% ytd).

On a consolidated basis, in FY22, AFSL reported a net profit of ₹ 32 crore, up by around two folds underpinned by rise in loan book by 32% y-o-y and reduction in provisioning expenses by 32% y-o-y. The total income increased to ₹ 235 crore in FY22 by 22% y-o-y. With this, the ROTA as on March 31, 2022 improved to 2.95% from 1.14% as on March 31, 2021. In Q1FY23, the company reported net profit of ₹ 16 crore, up by around three-fold on yearly basis, on account of rise in loan book by 58% y-o-y, however, net profit in Q1FY23 declined by 3% on quarterly basis due to rise in provisions by 10% q-o-q, despite 16% ytd rise in loan book. The ROTA in Q1FY23 improved significantly to 4.92%

Increasing geographical diversification: AFSL, on a consolidated basis, operates across eight states, with majority exposure towards Uttar Pradesh (25% of AUM), followed by Gujarat (22% of AUM) and Madhya Pradesh (20% of AUM) as on June 30, 2022. Till FY21, Gujarat had maximum exposure with 39% of AUM.

Adequate capitalisation and diversified resource base: 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 March 31, 2022 increased to 5.04x from 4.16x as on March 31, 2021. The gearing levels further slightly increased to 5.08x as on June 30, 2022. 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.

Improvement 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. With reduced fresh additions, increased recoveries coupled with increased write offs in FY22, the asset quality has improved with reduction in GNPA% to 4.76% and NNPA% to 0.82%. The GNPA% and NNPA% have further improved with 3.86% and 0.34%, respectively as on June 30, 2022. The collection efficiency for the group has improved to 99% in the month of June 2022 from 98% in the month of May 2022 and 88% in the month of June 2021.

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.

Key Rating Weaknesses

L**imited track record of operations in new geographies:** AFSL commenced microfinance lending operations in Rajasthan and Uttarakhand only during the past four 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 ₹ 76 crore cash/bank balance, liquid investments, and undrawn cash credit (CC) limits as on June 30, 2022.

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
Policy on Default Recognition
Financial Ratios – Financial Sector
Criteria on Assigning 'Outlook' or 'Credit Watch' to Credit Ratings
Policy on Withdrawal of Ratings
Rating Methodology - Services Sector Rating Methodology - Non Banking Finance Companies

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 110 districts through a network of 308 branches as on June 30, 2022.

Consolidated Brief Financials (₹ crore)	31-03-2021 (A)	31-03-2022 (A)	Q1FY23 (UA)
Total operating income	193.26	235.01	78.90
PAT	10.62	31.73	15.72
Interest coverage (times)	1.15	1.51	1.70
Total Assets	926.70	1,224.79	1,331.42
Net NPA (%)	0.80	0.82	0.34
ROTA (%)	1.14	2.95	6.26

A: Audited, UA: Unaudited

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

Covenants of rated instrument / facility: 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	-	-	-	-	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

Annexure-2: Rating History of 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	-	-	1)CARE BBB+; Stable (01-Jun-22)	1)CARE BBB+; Stable (03-Jan-22) 2)CARE BBB+; Stable (22-Nov-21)	1)CARE BBB+; Stable (07-Oct-20)	1)CARE BBB+; Stable (13-Sep-19)
2	Debentures-Non Convertible Debentures	LT	-	-	1)Withdrawn (01-Jun-22)	1)CARE BBB+; Stable (03-Jan-22) 2)CARE BBB+; Stable (22-Nov-21)	1)CARE BBB+; Stable (07-Oct-20)	1)CARE BBB+; Stable (13-Sep-19)
3	Fund-based - LT-Term Loan	LT	-	-	1)CARE BBB+; Stable (01-Jun-22) 2)Withdrawn (01-Jun-22)	1)CARE BBB+; Stable (03-Jan-22) 2)CARE BBB+; Stable (22-Nov-21)	1)CARE BBB+; Stable (07-Oct-20)	1)CARE BBB+; Stable (13-Sep-19)
4	Fund-based - ST-Others	ST	-	-	-	1)Withdrawn (03-Jan-22) 2)CARE A2 (22-Nov-21)	1)CARE A2 (07-Oct-20)	1)CARE A2 (13-Sep-19)
5	Debentures-Non Convertible Debentures	LT	37.80	CARE BBB+; Stable	1)CARE BBB+; Stable (01-Jun-22)	1)CARE BBB+; Stable (03-Jan-22) 2)CARE BBB+; Stable (22-Nov-21)	1)CARE BBB+; Stable (07-Oct-20)	1)CARE BBB+; Stable (27-Feb-20)
6	Debentures-Non Convertible Debentures	LT	39.00	CARE BBB+; Stable	1)CARE BBB+; Stable (01-Jun-22)	-	-	-

LT: Long Term/ ST: Short Term

Annexure-3: Detailed explanation of covenants of the rated instrument / 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

Note on complexity levels of the rated instrument: CARE Ratings Ltd. 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.

Annexure 5: Bank Lender Details for this Company
To view the lender wise details of bank facilities please click here

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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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