Arman Financial Services Limited (Revised)

April 05, 2023

Ratings

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Non-convertible debentures	37.80	CARE BBB+; Stable	Reaffirmed
Non-convertible debentures	39.00	CARE BBB+; Stable	Reaffirmed
Non-convertible debentures	58.50	CARE BBB+; Stable	Assigned

Details of instruments/facilities in Annexure-1.

Rationale and key rating drivers

For arriving at the ratings of Arman Financial Services Limited (AFSL), CARE Ratings Limited (CARE Ratings) has taken a consolidated view for 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 Non-convertible debentures (NCDs) of AFSL are reaffirmed deriving strength from the group's established track record of operations in the financing business with growing loan book, the diversified operations across microfinance, micro, small and medium enterprises (MSME) and two-wheeler segment. The rating also factors in moderate profitability indicators, albeit improving with rising margins and normalization of credit costs post Covid. CARE notes that while the asset quality deteriorated significantly in FY21 due to challenging operating environment, gross stressed assets have been adequately provided for and are on a declining trend since then. The ratings further derive strength from adequate liquidity profile, adequate capitalization profile from the capital infusion in Q2FY23.

These rating strengths are offset by relatively high gearing as compared to peers (though improved in 9MFY23, with capital infusion of Rs 115 crore in Q2FY23), limited track record of operations in new geographies, 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: Factors likely to lead to rating actions

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

- Sizeable equity raise leading to improvement in net worth and improved gearing.
- Significant growth in the loan book portfolio whilst ensuring lower geographical concentration.

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

- Significant rise in gross non- performing assets (GNPA) % leading to deterioration in profitability profile with reduction in return on total assets (RoTA) below 2%
- Deterioration in the capital structure, with the overall gearing increasing to 6x or higher.

Analytical approach: Consolidated

Consolidated with NFL, wholly owned subsidiary of AFSL.

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.

Outlook: Stable

CARE Ratings expects sustained growth in the AUM, while improving the asset quality and addressing the stress on the restructured book.

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

Key strengths

Established track record of operations with growing loan book

Incorporated in 1992, the group is engaged in lending business for three decades and has established itself in various business cycles. Starting its operations with two-wheeler financing and later foraying in to microfinance lending and MSME lending, AFSL has reached to an asset under management (AUM) of Rs. 1,223 crore as on March 31, 2022, increased by 51% y-o-y at three years compounded annual growth rate (CAGR) of 13% till FY22. The AUM has further increased to Rs. 1,642 crore as on December 31, 2022. The microfinance lending is provided through AFSL's wholly owned subsidiary, NFL and two-wheeler financing and MSME lending is carried out by AFSL on standalone basis.

With change in regulations for microfinance institutions by Reserve bank of India, along with group's strategy, CARE Ratings expects the proportion in MSME lending will gradually grow although, the microfinance lending will continue to be in majority. Furthermore, with rising delinquencies in the two-wheeler financing for the group and reduced demand in the two-wheeler industry, CARE Ratings expects the two-wheeler financing segment will remain on lower front for the group.

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.

Diversified operations with three product segments

Starting its operations with two-wheeler financing and microfinance lending, the share of the two products dominated the AUM of the group with 35% and 63%, respectively, as on March 31, 2017 and as SME lending started in 2017, its share remained low in the AUM. As on March 31, 2022, the microfinance segment continued to be in majority with proportion rising to 83% of AUM, followed by SME lending with 13% of AUM and balance is contributed by two-wheeler financing. The share of two-wheeler financing in the group's AUM is on a reducing trend owing to high delinquencies reported in the segment. As on December 31, 2022, the proportion of all the products remain similar as it was as on March 31, 2022.

In FY22, the group has piloted with individual business loan under the segment with intention to provide higher ticket size loans to micro finance customers.

Moderate profitability; albeit improving

The profitability of the group was negatively impacted due to COVID-19 in FY21 due to steep rise in credit costs. Yields for the group declined in FY21 and FY22, due to downward interest rate scenario coupled with rising share of relatively low yielding microfinance loans in the book (average yield on MSME stands at 33%, two-wheeler at 32% and Microfinance at 23%). Consequently, the spreads moderated in FY21 and FY22. In 9MFY23, with the reversing of interest rate cycle, along with removal of interest rate cap on microfinance loans, the yields for the group have increased. Although, parallel rise in cost of funds, in line with the rising interest rate environment, has led to muted rise in margins to 12.36% in 9MFY23 from 12.19% in FY22. The credit costs as a percentage of average total assets significantly rose to 5.9% in FY21 owing to significant slippages in NPA owing to COVID. With lower slippages and improving collection efficiency, the credit costs% came down in FY22 to 3.5% and further to 2.6% 9MFY23. With this, RoTA improved to 2.95% in FY22 from 1.14% as in FY21 and further to 4.76% in 9MFY23.

Going forward, profitability is expected to improve driven by expected rise in net interest margins (NIMs) and controlled credit costs.

Improving asset quality, though, concern remains for rising slippages in restructured portfolio

The asset quality of the group had suffered during COVID-19, with rise in GNPA% in FY21. With significant write offs along with lower slippages and sizable loan book growth, the group has been able to reduce its GNPA% to 4.76% as on March 31, 2022 from 5.12% as on March 31, 2021. The asset quality continued to improve with reduction in GNPA% to 3.4% and NNPA% to 0.17% as on December 31, 2022.

The days past due (dpd) wise analysis shows improvement in overall 30+ and 90+ dpd with 8% and 5%, respectively, as on March 31, 2022 from 10% and 5%, respectively, as on March 31, 2021 and further to 5% and 3%, respectively as on December 31, 2022.

The group's restructured book stands lower as compared to most of the other MFI entities. With COVID-19, the group restructured only in microfinance segment with 3.69% of gross advances as on March 31, 2021 which further rose to 4.18% as on March 31, 2022. However, as on December 31, 2022, the share of restructured portfolio in gross advances reduced to 1.06%, against which the group has created 95% of provisions. CARE notes that the group has adequately provided for its restructured assets.

Diversified resource base
The group has a diversified resource profile with borrowings from banks, small finance banks (SFBs), non- banking finance companies (NBFCs), financial institutions (FIs), development FIs (DFIs), in form of term loan, external commercial borrowings (ECBs), direct assignments (DA), securitisation and non- convertible debenture (NCDs). As on December 31, 2022, majority of the borrowings are from banks and SFBs, comprising of 30% of the borrowings, followed by 24% of the borrowings from NBFCs/FIs, 16% of borrowings through securitization and through NCDs, each and remaining through DA, DFIs and ECBs. The CARE Ratings calculated cost of funds remained in the range of 10-11%.

Key weaknesses

Relatively high gearing, though improved with recent capital infusion
The overall gearing levels for the group has increased to 5.1x as on March 31, 2022 from 4.2x as on March 31, 2021 driven by rapid loan book expansion. In Q2FY23, the group received funds from non-promoter group to the tune of Rs. 115 crore in form of Compulsory Convertible Debenture (CCD) of Rs. 77 crore and Optionally Convertible Redeemable Preference Shares (OCRPS) of Rs. 38 crore. The infusion was received from the non-promoter group which includes some marquee investors like Sixteenth Street Capital and Seven Canyon Advisors. The capital raising has led to improvement in gearing ratio to 5.23x as on December 31, 2022. If we adjust the debt for overdraft against fixed deposits and CCDs, the gearing levels stands at 4.57x. Going forward, CARE expects gearing levels to remain below 5x.

Limited track record of operations in new geographies
The group operates in eight states with majority exposure in Gujarat, being its home state, with 33% of AUM as on March 31, 2022. The group has been able to diversify its operations across states with reducing its exposure in Gujarat to 29% of AUM as on December 31, 2022. The group has forayed in two new states, namely, Haryana and Bihar in FY21 and FY22, respectively, which aggregately amounts to 10% of the AUM as on December 31, 2022. CARE notes that currently 99% of the portfolio in Haryana and Bihar are on time as on December 31, 2022, however, track record is yet to be established. Group's ability to scale up its loan book to new geographies remain key monitorable factor.

Regulatory and inherent risks associated with unsecured lending: The group operates in a business segment that is unsecured in nature, exposing itself to credit risk. However, with strong underwriting mechanism, the NNPA% have remained controlled. Furthermore, the company is also exposed to regulatory risks associated with any adverse changes in the regulations guiding such NBFCs, along with event-based risks associated with microfinancing.

Liquidity: Adequate

As per ALM statement as on September 30, 2022, for AFSL and NFL, there are positive cumulative mismatches for all time buckets. The group has adequate inflow in form of advances of Rs. 801 crore for up to one year as against debt obligations of Rs. 729 crore for up to one year, as per ALM statement. The group has liquidity of Rs. 376 crore in form of cash/bank balance, liquid investments, and undrawn CC limits.

Environment, social, and governance (ESG) risks

Given that AFSL is engaged in the lending business, it is exposed to the environmental risks indirectly through their portfolio of assets. If the customers of AFSL face environmental risk or the sectors it operates in faces regulatory risk, it could translate into credit risks for AFSL.

Applicable criteria

Consolidation
Policy on default recognition
Financial Ratios - Financial Sector
Rating Outlook and Credit Watch
Non Banking Financial Companies

About the company and industry

Industry classification

Macro-Economic Indicator	Sector	Industry	Basic Industry
Financial Services	Financial Services	Finance	Non Banking Financial Company (NBFC)

Incorporated on November 26, 1992, AFSL is promoted by Mr. Jayendra Patel by the name of Arman Lease and Finance Limited. The group started its operations with two-wheeler financing and microfinance lending. On receiving licence for operations by NFL, in May 2013, the microfinance segment was carried by NFL. In March 2017, AFSL commenced lending under SME segment.

AFSL caters to the low income customers by providing lending services for two-wheeler financing, financing for MSME and to microfinance segment. AFSL is registered as a deposit taking NBFC and NFL is registered as a Non- Deposit taking Systemically Important Micro Finance Institution (NBFC-MFI-ND-SI) with RBI. The group operates with 313 branches in 111 districts of eight states catering to around 5 lakh customers.

Consolidated Brief Financials (₹ crore)	March 31, 2021 (A)	March 31, 2022 (A)	9MFY23 (UA)
Total operating income	193.26	235.01	274.59
PAT	10.62	31.73	57.61
Interest coverage (times)	1.15	1.51	1.70
Total Assets	926.70	1,224.79	2,003.10
Net NPA (%)*	0.66	0.82	0.17
ROTA (%)	1.14	2.95	4.76

A: Audited; UA: Unaudited
*CARE Ratings calculated
Note: 'the above results are latest financial results available'

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

Lender details: Annexure-5

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
Non-convertible debentures	INE109C07022	March 03, 2020	13.15%	March 03, 2025	37.80	CARE BBB+; Stable
Non-convertible debentures	INE109C07048	June 14, 2022	11.30%	June 16, 2027	28.67	CARE BBB+; Stable
Non-convertible debentures (Proposed)	-	-	-	-	68.83	CARE BBB+; Stable
Total					**135.30**	

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 2023-2024	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
1	Fund-based - LT-Cash Credit	LT	-	-	-	1)CARE BBB+; Stable (19-Sep-22) 2)Withdrawn (19-Sep-22) 3)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)
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)
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)
4	Fund-based - ST-Others	ST	-	-	-	-	1)Withdrawn (03-Jan-22) 2)CARE A2 (22-Nov-21)	1)CARE A2 (07-Oct-20)
5	Debentures-Non Convertible Debentures	LT	37.80	CARE BBB+; Stable	-	1)CARE BBB+; Stable (03-Jan-23) 2)CARE BBB+; Stable (19-Sep-22) 3)CARE BBB+;	1)CARE BBB+; Stable (03-Jan-22) 2)CARE BBB+; Stable (22-Nov-21)	1)CARE BBB+; Stable (07-Oct-20)

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2023-2024	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
						Stable (01-Jun-22)		
6	Debentures-Non Convertible Debentures	LT	39.00	CARE BBB+; Stable	-	1)CARE BBB+; Stable (03-Jan-23) 2)CARE BBB+; Stable (19-Sep-22) 3)CARE BBB+; Stable (01-Jun-22)	-	-
7	Debentures-Non Convertible Debentures	LT	58.50	CARE BBB+; Stable				

*Long term/Short term.

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

Not applicable

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

Sr. No.	Name of Instrument	Complexity Level
1	Debentures-Non Convertible Debentures	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 instruments: 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.

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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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