Arman Financial Services Limited

November 22, 2021

Ratings

Facilities/Instruments	Amount (Rs. crore)	Rating[1]	Rating Action
Long Term Bank Facilities	67.54	CARE BBB+; Stable (Triple B Plus; Outlook: Stable)	Reaffirmed
Short Term Bank Facilities	5.00	CARE A2 (A Two)	Reaffirmed
Total Bank Facilities	**72.54 (Rs. Seventy-Two Crore and Fifty-Four Lakhs Only)**		
Non Convertible Debentures	27.50	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	**65.30 (Rs. Sixty-Five Crore and Thirty Lakhs Only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

For arriving at the ratings of Arman Financial Services Limited (AFSL), CARE has taken a consolidated view of AFSL, which includes its wholly owned subsidiary Namra Finance Limited (NFL) engaged in micro finance 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 a 'group'.

The ratings assigned to the bank facilities and instruments of AFSL continue to derive strength from group's established track record of operations in financing business, experienced & professional management, diversified operations across three different loan segments, viz. micro-finance, vehicle finance and Micro, Small and Medium Enterprise (MSME) lending and adequate internal control systems. The ratings also factor in growth in the loan portfolio over the last few years along with improvement in profitability, however, the same has moderated due to additional provisioning in FY21 due to impact of COVID-19 outbreak. The ratings further derive strength from increasing geographical diversification of group's operations, adequate liquidity profile, adequate capitalization and moderate asset quality.

The ratings, however, continue to be constrained on account of its moderate loan book with 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. Further, the ratings also take note of the increase in credit cost on account of impact of COVID-19 outbreak on the credit profile of its borrowers.

Rating Sensitivities

Positive Factors - Factors that could lead to positive rating action/upgrade:

- Significant growth in total income driven by expansion of loan portfolio while maintaining the Net Interest Margin (NIM) at 12% or above level along with containment of GNPA levels at below 1% on a sustained basis
- Significant capital addition improving overall gearing and 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 GNPA going forward
- Deterioration in capital structure with overall gearing increasing to 6 times or higher

[1]*Complete definition of the ratings assigned are available at www.careratings.com and other CARE publications*

Detailed description of the key rating drivers
Key Rating Strengths
Established track record of operations along-with experienced and professional management: 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. He is supported by Mr. Aalok Patel, son of Mr. Jayendra Patel, who is also on the Board of the company and is actively involved in the business. Further, Mr. Alok Prasad is the present Chairman on the Board of AFSL. Mr. Prasad has more than 35 years of experience in regulatory, banking and financial services.

Diversified operations across three segments with microfinance comprising major share: The group is present in three segments viz. Micro financing, 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 and MSME lending witnessed healthy growth in disbursements during FY20 while, the same declined in FY21 due to business de-growth. Microfinance lending continued to be the largest segment for the group constituting 79% of its total AUM as on March 31, 2021.

Growth in loan portfolio and improvement in profitability in last few years, however, decline in FY21 due to high credit cost: The group's AUM grew by around 14% y-o-y to Rs.858.19 crore as at FY20 end due to healthy growth witnessed in Micro financing and MSME lending. The growth was largely driven by growth in the number of loans disbursed due to expansion in branch network and operational set-up. However, several national and local lockdowns affected the business operations and the loan book de-grew by 5% in FY21. As on March 31, 2021, Arman's AUM on a consolidated basis stood at Rs. 814.38 cr.

On a consolidated level, Arman achieved a total income of Rs. 193.26 cr in FY21, lower by 10% y-o-y. The provisions and write-offs for the year stood at Rs. 54.59 cr, an increase of 173% y-o-y, leading to a credit cost on total assets at 5.82% in FY21 as against 2.34% in FY20. The NIM declined by 181 bps y-o-y to 11.91% (PY: 13.72%) and ROTA declined to 1.13% in FY21 as against 4.85% in FY20. In H1FY22, the company achieved a total income of Rs. 100.5 cr with net profit of Rs. 8.42 cr.

Increasing geographical diversification: As on June 30, 2021, the group had presence across more than 94 districts in 7 states with a network of 246 branches. In FY19, the group expanded its operations to Rajasthan where it has registered healthy growth in last two years. In FY21, it further expanded its footprints in Haryana where it held 1% of its portfolio. As on June 30, 2021, about 38% POS stood in Gujarat, followed by 22% in Madhya Pradesh, 15% each in Maharashtra and Uttar Pradesh and the remaining in Uttarakhand, Rajasthan and Haryana.

Adequate capitalization and diversified resource base: AFSL's capital adequacy ratio (CAR) continued to be comfortable at 48.8% as on March 31, 2021, improved from 34.7% (as per IND-AS) as on March 31, 2020. The overall gearing of the group on a consolidated basis stood at 4.17x as on March 31, 2021 (PY: 4.17x). Going forward, timely infusion of equity shall remain crucial for achieving growth in business operations while maintaining the leverage and capitalization levels.

Further, group's resource base is diversified with borrowings relationship across 30+ banks and other financial institutions, along with reputed foreign investors and private equity players. This apart, it also has flexibility to raise funds from capital markets, being a listed entity. The borrowings consist of term loans, working capital, NCDs, ECBs and securitisation.

Moderate asset quality: The group's asset quality remained healthy in FY20 with gross NPA of 1.13% and Net NPA of 0.21% as on March 31, 2020. However, the same has deteriorated in FY21 due to high covid-19 related provisioning. GNPA and Net NPA stood at 4.70% and 0.89% respectively on March 31, 2021. The same had further increased to 5.70% and 1.40% respectively on June 30, 2021. The collection efficiency for the combined loan portfolio of AFSL and NFL stood at 94.4% on March-21; however, it declined to 89.7% on Aug-21 due to disruptions caused by second wave of COVID-19 pandemic. Although the collection efficiency has incrementally improved in last few months, uncertainty with respect to achieving normalcy persists in the near to medium term.

Key Rating Weaknesses
Moderate loan book along with limited track record of operations in new geographies and products: Loan portfolio of the group witnessed healthy growth in last three years, however remained moderate with an AUM of around Rs.908.30 crore as on September 30, 2021. Furthermore, it commenced microfinance lending operations in Rajasthan and Uttarakhand only during the last three years, along with operations in Haryana in FY21 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 FY17 end, which scaled up sizably in last three years. Collectively, both these translates into a limited track record for the group in new geographies & product segments.

Furthermore, seasoning of the loan portfolio is moderate due to inherent short tenure loans with absence of any mid-year top-up.

Regulatory and inherent risks associated with unsecured lending; albeit adequate internal control systems: Around 80.4% of the outstanding loan portfolio of the group as on June 30, 2021 was contributed by microfinance and MSME lending. The loans in both these business segments are unsecured in nature, however, NPAs in these categories 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 NBFCs, alongwith event based risks associated with micro financing.

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

Liquidity: *Adequate*

Liquidity of the group remained adequate with unencumbered cash and bank balance and liquid investments of Rs.123.30 crore as on September 30, 20201 which is largely equivalent to three months of debt servicing obligations (principal + interest) alongwith low utilization of working capital limits and adequate undrawn limits of Rs.100 cr as on same date. Further, in its asset liability management (ALM) statement on June 30, 2021, there were no cumulative mismatches in its owing to 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 similar line of business
- Both entities operate under common management
- The entities have cash flow fungiblilty amongst each other

Applicable Criteria

Criteria on assigning 'outlook' and 'credit watch' to Credit Ratings
CARE's Policy on Default Recognition
Rating Methodology: Consolidation
Rating Methodology: Notching by factoring linkages in Ratings
Rating Methodology - Non Banking Financial Companies
Financial Ratios-Financial Sector
Criteria for Short Term Instruments

About the Company

Promoted by Mr. Jayendra Patel, AFSL is a Non-Deposit taking NBFC registered with Reserve Bank of India. Prior to May 2013, AFSL was engaged in the business of two-wheeler financing and microfinance lending business through Joint Liability Group (JLG) model. However, NFL got an NBFC – Micro Finance Institution license from RBI on February 14, 2013 and from May 2013, entire new microfinance lending is being carried out by NFL. In March 2017, AFSL also commenced MSME lending business.

AFSL, on a consolidated basis, operates across 7 states i.e. Gujarat, Madhya Pradesh, Maharashtra, Uttar Pradesh, Uttarakhand, Rajasthan and Haryana covering more than 94 districts through a network 246 branches as on June 30, 2021. Microfinance lending is presently the largest business segment of the group, which contributed 80.4% of its total assets under management (AUM) of Rs.784.77 crore (consolidated) as on June 30, 2021, while the balance was from two-wheeler loans (5.2%) and MSME loans (14.4%).

Brief Financials (Rs. crore) - consolidated	31-03-2020 (A)	31-03-2021 (A)	Q1FY22 (UA)
Total income	215.15	193.26	49.70
PAT	41.52	10.62	3.57
Interest coverage (times)	1.61	1.15	1.33
Total Assets	936.83	940.07	NA
Net NPA (%)	0.21	0.89	1.40
ROTA (%)	4.7	1.08	NA

A: Audited; NA: Not Available

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 (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Cash Credit		-	-	-	34.30	CARE BBB+; Stable
Fund-based - LT-Term Loan		-	-	-	33.24	CARE BBB+; Stable
Fund-based - ST-Others		-	-	-	5.00	CARE A2
Debentures-Non Convertible Debentures	INE109C07022	March 03, 2020	13.15%	March 03, 2025	37.80	CARE BBB+; Stable
Debentures-Non Convertible Debentures	INE109C07014	September 19, 2018	12.60%	March 19, 2022	27.50	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 (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2021-2022	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019
1	Fund-based - LT-Cash Credit	LT	34.30	CARE BBB+; Stable	-	1)CARE BBB+; Stable (07-Oct-20)	1)CARE BBB+; Stable (13-Sep-19)	1)CARE BBB+; Stable (27-Sep-18) 2)CARE BBB+; Stable (14-Sep-18)
2	Debentures-Non Convertible Debentures	LT	27.50	CARE BBB+; Stable	-	1)CARE BBB+; Stable (07-Oct-20)	1)CARE BBB+; Stable (13-Sep-19)	1)CARE BBB+; Stable (14-Sep-18)
3	Fund-based - LT-Term Loan	LT	33.24	CARE BBB+; Stable	-	1)CARE BBB+; Stable (07-Oct-20)	1)CARE BBB+; Stable (13-Sep-19)	1)CARE BBB+; Stable (27-Sep-18)
4	Fund-based - ST-Others	ST	5.00	CARE A2	-	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 (07-Oct-20)	1)CARE BBB+; Stable (27-Feb-20)	-

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

Particulars	Detailed explanation	
ISIN	INE109C07014	INE109C07022
A. Financial Covenants	• Maintain ratio of outstanding amount of this NCD to total assets not more than 15% • Maintain CAR of not less than 15% • Maintain Overall gearing of not higher than 7 times • Uncovered capital ratio below 15% (defined as PAR>90 days + restructured portfolio minus loan loss provisions divided by equity) • Maintain less than 5% of its liabilities and assets in non-INR denominated currency Maintain ratio of outstanding off-balance sheet portfolio to total assets less than 40%	• Maintain CAR of not less than 15% • Maintain Overall gearing of not higher than 7 times • Uncovered capital ratio below 15% (defined as PAR>90 days + restructured portfolio minus loan loss provisions divided by equity) • Maintain less than 5% of its liabilities and assets in non-INR denominated currency • Maintain ratio of outstanding off-balance sheet portfolio to total assets less than 40%
B. Non-financial Covenants	**Event of Default:** In the event of default, the NCD can be declared immediately repayable.	**Event of Default:** In the event of default, the NCD can be declared immediately repayable

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
4	Fund-based - ST-Others	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 has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

Contact us

Media Contact
Name: Mradul Mishra
Contact no.: +91-22-6754 3573
Email ID: mradul.mishra@careratings.com

Analyst Contact
Name: Gaurav Dixit
Contact no.: 011- 45333235
Email ID: gaurav.dixit@careratings.com

Relationship Contact
Name: Ms. Swati Agrawal
Contact no.: +91-11-4533 3200
Email ID: swati.agrawal@careratings.com

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