Arman Financial Services Limited

February 27, 2020

Rating

Instrument	Amount (Rs. crore)	Rating[1]	Rating Action
Proposed Non-Convertible Debenture issue (NCD-II)	38.00	**CARE BBB+; Stable (Triple B Plus; Outlook: Stable)**	**Assigned**
Total	**38.00 (Rupees Thirty Eight Crore Only)**		

Details of instrument in Annexure-1

Detailed Rationale & Key Rating Drivers

For arriving at the rating, CARE has taken a consolidated view of Arman Financial Services Limited (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 'group'.

The rating assigned to the Non-Convertible Debenture issue of NFL derives 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 rating also factors in robust growth in the loan portfolio over the last two years alongwith improvement in profitability during FY19 (refers to period from April 01 to March 31) and further in 9MFY20, though the loan book size remains moderate.

The rating further derives strength from increasing geographical diversification of group's operations, comfortable liquidity profile and collection efficiency, adequate capital adequacy and moderate asset quality with marginal deterioration in 9MFY20 after improvement during FY19.

The rating, however, continues to be constrained on account of limited track record of operations in new geographies and products, risks associated with unsecured lending in microfinance and MSME loans, presence in a highly competitive industry and regulatory risk pertaining to the microfinance business.

Rating Sensitivities:

Positive factors

- Significant growth in total income driven by expansion of loan portfolio while maintaining the Net Interest Margin (NIM) at 12% or above level alongwith containment of GNPA levels at below 1%
- Significant capital addition improving overall gearing and CAR of the company

Negative factors

- Dip in income to below Rs.150 crore with decline in loan portfolio to below Rs.500 crore
- Deterioration of profitability with ROTA falling below 3%
- Decline in asset quality with GNPA above 3%
- Deterioration in capital structure with overall gearing increasing to 6 times or higher

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, the present Vice Chairman and Managing Director of the company, 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 Directors of the company and is actively involved in the business. Further, in August 2018, Mr. Alok Prasad joined as the Chairman on the Board of Directors 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. All these three segments witnessed healthy growth in disbursements during FY19 and 9MFY20. Microfinance lending continued to be the largest segment for the group constituting 71% of its total AUM as on December 31, 2019.

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

Growth in loan portfolio and improvement in profitability in FY19 and 9MFY20: Group's AUM grew by around 94% CAGR over the last two years to Rs.684.70 crore during FY19, and further by 20% during 9MFY20 due to healthy growth witnessed in Micro financing and MSME lending and moderate growth in two-wheeler segment. The growth was largely driven by growth in the number of loans disbursed due to expansion in branch network and operational set-up; alongwith marginal increase in the ticket size. The AUM of the group stood at Rs.814.20 crore as on December 31, 2019.

Profitability:

The group's profitability, after witnessing a dip in FY18, improved in FY19 and 9MFY20 owing to improvement in asset quality post wearing-off of the impact of demonetization; alongwith growth of higher margin MSME segment during the period.

The Net Interest Margin (NIM) improved by 55 bps y-o-y to 12.14% (P.Y. 11.59%) and ROTA improved by 153 bps y-o-y during FY19 to 3.66% from 2.13% during FY18 as a result of improvement in NIM, lower operational cost due to established infrastructure and improvement in asset quality translating into lower provisions and write off expenses in proportion to the loan portfolio.

The NIM and ROTA further improved to 15.13% and 6.27%, respectively, during 9MFY20 due to healthy growth in income and stabilized operational expenses, despite increase in provisioning/write offs during this period on account of marginal deterioration in asset quality.

Increasing geographical diversification: The group expanded its operations to Uttarakhand and Rajasthan in last two years ended FY19; alongwith increasing its penetration in existing states of Madhya Pradesh, Uttar Pradesh and Maharashtra which has gradually resulted in reduced concentration of AUM in Gujarat (49% in FY19; 57% in FY18). As on December 31, 2019, the group had presence across more than 83 districts in these six states with a network of 223 branches.

***Diversified resource base*:** Company has moderately diversified resource profile with a mix of equity, long term loans, bank borrowings and debentures. The company has borrowings from over 29 banks and Non-banking financial companies (NBFCs). This apart, it also has flexibility to raise funds from capital markets, being a listed entity, alongwith reputed private equity players.

Comfortable collection efficiency with moderate asset quality and adequate capitalization:

Group's asset quality remained moderate with gross NPA of around 1.19% as on December 31, 2019, though marginally deteriorated from 0.99% at FY19 end mainly due to floods in select regions of Maharashtra and Gujarat.

The collection efficiency for the combined loan portfolio of AFSL and NFL remained healthy at 98.32% during past six months ended December 31, 2019, underlining its healthy cash flows.

AFSL's capital adequacy ratio (CAR) on a standalone level continued to be comfortable at 35.73% as on December 31, 2019, improved from 23.49% as on March 31, 2018 due to fund infusion in the form of compulsory convertible debentures (CCDs) in April 2018. Going forward, timely infusion of equity funds shall remain crucial for achieving growth in business operations while maintaining the leverage and capitalization levels.

Key Rating Weaknesses

Moderate loan book alongwith 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.814.20 crore as on December 31, 2019. Furthermore, it commenced microfinance lending operations in Uttar Pradesh, Maharashtra, Uttarakhand and Rajasthan only during the last two years 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 & products, hence its performance in terms of profitability and asset quality is yet to be established.

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

Risks associated with unsecured lending; albeit adequate internal control systems: Around 87% of the outstanding loan portfolio of the group as on December 31, 2019 was contributed by microfinance and MSME lending. The loans in both these business segments are unsecured in nature; exposing the company to probable losses in case of any delinquency as there is no asset which can be sold to recover the pending loan amounts. However, NPA's in these categories have been restricted, underlining adequate internal control and risk management systems followed by the management for loan disbursement and recoveries.

Presence in a competitive and highly regulated industry albeit healthy growth prospects: The NBFC-MFI segment has witnessed significant increase in the number players with the SHG – Bank Linkage Program (SBLP) launched in 1992 on a pilot basis having grown significantly as a full-fledged lending model across the country, enabling millions of poor

households get access to sustainable financial services from the banking system. 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. This apart, Micro-finance players also face competition from unorganized sector lending, which still has prevalence in large parts of the country. Furthermore, the company is also exposed to risks associated with any adverse changes in the regulatory policies guiding such NBFCs.
However, growth prospect of micro-finance business in India continues to remain good given the market potential.

Liquidity: Adequate
Liquidity of the group remained comfortable with no cumulative mismatches in its asset liability management (ALM) statement owing to inherent shorter tenure lending than borrowing, moderate utilization of working capital limits at around 50-60% resulting in unutilized bank lines and commencement of securitization of select loan portfolio, from FY19.
Moreover, company's policy of maintaining liquid balances equivalent to around one-two months of disbursement requirement also provided comfort from credit perspective. As on December 31, 2019 AFSL had free cash and bank balance of Rs.83.74 crore (consolidated) which is largely equivalent to one month's disbursement or two months of debt servicing obligations (principal + interest) of both the companies.

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 (lending)
- 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 – Factoring Linkages in Ratings
Rating Methodology - Non Banking Financial Companies
Financial Ratios-Financial Sector

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 six states i.e. Gujarat, Madhya Pradesh, Maharashtra, Uttar Pradesh, Uttarakhand and Rajasthan covering around 83 districts through a network 223 branches as on December 31, 2019. Microfinance lending is presently the largest business segment of the group, which contributed 71% of its total assets under management (AUM) of Rs.814.20 crore (consolidated) as on December 31, 2019, while the balance was from MSME loans and (16%) and two-wheeler loans (12%).
Brief consolidated financials of AFSL are tabulated below:

Brief Financials (Rs. crore)	FY18 (A)	FY19 (A)
Total operating income	80.03	141.06
PAT	7.30	21.33
Interest coverage (times)	1.27	1.49
Total Assets	470.42	696.57
Net NPA (%)	1.60	0.93
ROTA (%)	2.15	3.66

A: Audited
Brief standalone financials of AFSL are tabulated below:

Brief Financials (Rs. crore)	FY18 (A)	FY19 (A)
Total operating income	27.32	46.94
PAT	3.21	6.38
Interest coverage (times)	1.41	1.47
Total Assets	145.83	253.16
Net NPA (%)	1.14	1.86
ROTA (%)	2.74	3.20

A: Audited

Further, as per 9MFY20 (UA) results, AFSL on a consolidated basis reported TOI of Rs.159.60 crore and PAT of Rs.37.71 crore.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History (Last three years): Please refer Annexure-2

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Date of Issuance*	Coupon Rate*	Maturity Date*	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Debentures-Non Convertible Debentures (Proposed)	-	-	-	38.00	CARE BBB+; Stable

**Not applicable for proposed instruments*

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 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Fund-based - LT-Cash Credit	LT	34.00	CARE BBB+; Stable	1)CARE BBB+; Stable (13-Sep-19)	1)CARE BBB+; Stable (27-Sep-18) 2)CARE BBB+; Stable (14-Sep-18)	1)CARE BBB; Stable (05-Oct-17)	1)CARE BBB (29-Aug-16)
2.	Fund-based - LT-Term Loan	LT	-	-	-	-	-	1)Withdrawn (29-Aug-16)
3.	Debentures-Non Convertible Debentures	LT	27.50	CARE BBB+; Stable	1)CARE BBB+; Stable (13-Sep-19)	1)CARE BBB+; Stable (14-Sep-18)	-	-
4.	Fund-based - LT-Term Loan	LT	33.54	CARE BBB+; Stable	1)CARE BBB+; Stable (13-Sep-19)	1)CARE BBB+; Stable (27-Sep-18)	-	-
5.	Fund-based - ST-Others	ST	5.00	CARE A2	1)CARE A2 (13-Sep-19)	-	-	-
6.	Debentures-Non Convertible Debentures (Proposed)	LT	38.00	CARE BBB+; Stable	-	-	-	-

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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About CARE Ratings:
CARE Ratings commenced operations in April 1993 and over nearly two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

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