Arman Financial Services Limited

October 07, 2020

Ratings

Facilities/ Instruments	Amount (Rs. crore)	Ratings[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 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 (Reduced from 38.00)	**CARE BBB+; Stable (Triple B Plus; Outlook: Stable)**	**Reaffirmed**
Total Instruments	**65.30 (Rs. Sixty-Five Crore and Thirty Lakhs Only)**		

Details of facilities / Instruments 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 healthy growth in the loan portfolio over the last three years alongwith improvement in profitability during FY20 (refers to period April 1 to March 31), despite additional provisioning in Q4FY20 for likely impact of COVID-19 outbreak.

The ratings further derive strength from increasing geographical diversification of group's operations, adequate liquidity profile, adequate capitalization and healthy 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 alongwith regulatory risks pertaining to the microfinance business. Further, the ratings also take note of likely increase in credit cost on account of impact of COVID-19 outbreak on the credit profile of its borrowers.

Moreover, CARE also takes note of the group availing moratorium granted by its lenders for first three months for its terms loans (March to May 2020) and for six months towards working capital limits (March to August 2020), as a COVID relief measure (as permitted by the Reserve Bank of India).

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% on a sustained basis
- Significant capital addition improving overall gearing and CAR of the company on a sustained basis

Negative factors

- Deterioration of profitability with Return on Total Assets (ROTA) falling below 3%
- Significant increase in GNPA going forward
- Deterioration in capital structure with overall gearing increasing to 6 times or higher

[1]*Complete definitions of the ratings assigned are available at www.careratings.com and in 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 Microfinance lending continued to be the largest segment for the group constituting 72% of its total AUM as on March 31, 2020.

Growth in loan portfolio and improvement in profitability in FY20, however, down in Q1FY21 due to high credit cost: 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.
The group's profitability improved in FY20 owing to growth of higher margin MSME segment during the year. The NIM improved by 107 bps y-o-y to 13.72% (PY 12.65%) and ROTA improved by 58 bps y-o-y to 4.85% in FY20 from 4.27% in FY19 as a result of improvement in NIM. However, the profitability deteriorated during Q1FY21, due to significant increase in credit cost mainly on account of additional COVID-specific provisioning made during the quarter.

Increasing geographical diversification: The group expanded its operations to Rajasthan where it has registered healthy growth in last two years ended FY20; 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 (43.5% in FY20; 49% in FY19). As on March 31, 2020, the group had presence across more than 78 districts in these six states with a network of 211 branches.

Adequate capitalization and diversified resource base: AFSL's capital adequacy ratio (CAR) on a standalone level continued to be comfortable at 34.70% as on March 31, 2020, improved from 32.09% (as per IND-AS) as on March 31, 2019. The overall gearing of the group on a consolidated basis also improved from 5.06x as on March 31, 2019 to 4.17x as on March 31, 2020. 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 presence of 21 banks and 14 non-banking financial companies (NBFCs); alongwith reputed foreign investors and private equity players. This apart, it also has flexibility to raise funds from capital markets, being a listed entity.

Healthy asset quality: 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. The net NPA to networth reduced during the year from 2.49% as on March 31, 2019 to 1.02% as on March 31, 2020. The collection efficiency for the combined loan portfolio of AFSL and NFL remained healthy at 98% during 11MFY20; before deteriorating from March 2020 onwards due to moratorium extended by group to its borrowers within RBI guidelines and disruptions caused by outbreak of COVID-19 pandemic. Although the collection efficiency has incrementally improved from June 2020 onwards, uncertainty with respect to achieving normalcy persists in the near to medium term.

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.858.19 crore as on March 31, 2020. Furthermore, it commenced microfinance lending operations in Rajasthan and Uttarakhand only during the last three 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. Moreover, delinquencies by borrowers in second - fourth loan cycles are greater than delinquency rate of borrowers in first cycle.

Regulatory and inherent risks associated with unsecured lending; albeit adequate internal control systems: Around 89% of the outstanding loan portfolio of the group as on March 31, 2020 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. This 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.120 crore as on September 15, 2020 which is largely equivalent to three months of debt servicing obligations (principal + interest) alongwith low utilization of working capital limits averaging 37% during the 12 months ended July 2020 with adequate undrawn limits.
Further there were no cumulative mismatches in its asset liability management (ALM) statement 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 (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
Criteria for Short Term Instruments
Rating Methodology: Consolidation and 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 more than 78 districts through a network 211 branches as on March 31, 2020. Microfinance lending is presently the largest business segment of the group, which contributed 72% of its total assets under management (AUM) of Rs.858.19 crore (consolidated) as on March 31, 2020, while the balance was from two-wheeler loans (11%) and MSME loans (16%).

Brief consolidated financials of AFSL are tabulated below:

Brief Financials (Rs. crore)	FY19 (A)	FY20 (A)
Total operating income	139.58	215.15
PAT	26.43	41.52
Interest coverage (times)	1.61	1.61
Total Assets	774.68	936.83
Net NPA (%)	0.44	0.21
ROTA (%)	4.27	4.85

A: Audited

In Q1FY21, the AFSL (Consolidated) reported total income of Rs.49.39 crore and PAT of Rs.5.31 crore against total income of Rs.48.20 crore and PAT of Rs.12.11 crore in Q1FY20 (Consolidated).

Brief standalone financials of AFSL are tabulated below:

Brief Financials (Rs. crore)	FY19 (A)	FY20 (A)
Total operating income	48.38	70.10
PAT	12.36	18.24
Interest coverage (times)	1.97	2.02
Total Assets	274.10	312.07
Net NPA (%)	1.43	0.75
ROTA (%)	5.88	6.22

A: Audited

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History (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: Please refer 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	-	-	-	-	33.80	CARE BBB+; Stable
Fund-based - LT-Term Loan	-	-	-	February 2022	33.74	CARE BBB+; Stable
Fund-based - ST-Others	-	-	-	-	5.00	CARE A2
Debentures-Non Convertible Debentures	INE109C07014	Sept. 19, 2018	12.60%	March 19, 2022	27.50	CARE BBB+; Stable
Debentures-Non Convertible Debentures	INE109C07022	March 03, 2020	13.15%	March 03, 2025	37.80	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 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Fund-based - LT-Cash Credit	LT	33.80	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)
2.	Fund-based - LT-Term Loan	LT	33.74	CARE BBB+; Stable	-	1)CARE BBB+; Stable (13-Sep-19)	1)CARE BBB+; Stable (27-Sep-18)	-
3.	Fund-based - ST-Others	ST	5.00	CARE A2	-	1)CARE A2 (13-Sep-19)	-	-
4.	Debentures-Non Convertible Debentures (INE109C07014)	LT	27.50	CARE BBB+; Stable	-	1)CARE BBB+; Stable (13-Sep-19)	1)CARE BBB+; Stable (14-Sep-18)	-
5.	Debentures-Non Convertible Debentures (INE109C07022)	LT	37.80	CARE BBB+; Stable	-	1)CARE BBB+; Stable (27-Feb-20)	-	-

Annexure-3: Key covenants of outstanding rated NCDs

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 the 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

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.*

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About CARE Ratings:
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