October 31, 2019

Muthoot Vehicle & Asset Finance Limited: Ratings reaffirmed; Outlook revised to Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long term (LT) – Fund based	100.00	100.00	[ICRA]BBB+ (Negative); reaffirmed, Outlook revised to Negative from Stable
Short term (ST) – Interchangeable#	22.50	22.50	[ICRA]A2; reaffirmed
Fixed deposit programme	-	-	MA (Negative); reaffirmed, Outlook revised to Negative from Stable
Total	**100.00**	**100.00**	

** Instrument details are provided in Annexure-1*

 # Short-term facilities are interchangeable with long-term facilities; total rated limit is Rs. 100.00 crore

Rationale

The revision in the outlook considers the weakening in Muthoot Vehicle & Asset Finance Limited's (MVFL) asset quality and the expected pressure on profitability in the near term. The company's 90+ dpd increased sharply to 4.6% in September 2019 from 1.5% in March 2019 (0.9% in March 2018) as slippages increased. This was due to the subdued operating environment, further aggravated by some senior management exits in the collection and recovery verticals, which impacted resolutions. The company's net profitability (profit after tax/average managed asset) moderated to 2.5% in FY2019 from 3.0% in FY2018, as credit costs increased on a YoY basis. The credit costs could increase further due to the high provisioning requirement (provision cover stood at 19% in FY2019 and 21% in FY2018) unless there is a meaningful improvement in loan recoveries. MVFL was faced with the closure of certain bank credit facilities in H1 FY2020 as the funding environment for non-banking finance companies (NBFCs), especially for mid/small sized NBFCs, remained muted. Its liquidity, however, was supported by the promoters and associate entities in the form of unsecured loans/inter-corporate deposits. Currently, MVFL envisages raising about Rs. 200 crore through the public issuance of debentures in Q3 FY2020. The company's ability to raise external funds would be critical for maintaining an adequate liquidity profile while pursuing its envisaged business growth plans.

The ratings reaffirmation continues to factor in the benefits derived by virtue of being a part of the Muthoot Finance Group. The Group's flagship company, Muthoot Finance Limited (MFL), is rated [ICRA]AA(Stable)/[ICRA]A1+.The ratings take into account the management, operational and financial support received from the Group and the promoters. The ratings also consider MVFL's adequate capitalisation profile, characterised by a gearing of 3.7x as of March 2019 (3.6x as of March 2018). The ratings also factor in the company's moderate scale (Rs. 439.8 crore as on September 30, 2019) and the geographically concentrated operations with its presence largely confined to Kerala.

Key rating drivers and their description

Credit strengths

Part of Muthoot Finance Group – Being a part of the Muthoot Finance Group, MVFL derives management, operational and financial support from the Group. The Group has an established presence across businesses including gold loans, vehicle finance, home finance, foreign exchange, insurance, hospitals, educational institutions and real estate. The company leverages the Group's established brand and franchise in Kerala for business growth and for mobilising retail deposits. MVFL's board and shareholders largely comprise the promoters of the Muthoot Finance Group. Mr. George Alexander Muthoot (Managing Director of Muthoot Finance Limited) is the Managing Director of MVFL. The company has received financial support in the form of inter-corporate deposits to the tune of Rs. 49.8 crore in H1 FY2020, apart from unsecured loans from promoters (outstanding at Rs. 60 crore as of September 2019), which currently uphold its liquidity profile.

Adequate capitalisation profile – MVFL has an adequate capitalisation profile with a gearing of 3.7x as of March 2019 (3.6x as of March 2018). The gearing remained stable as the internal generation was sufficient to meet the portfolio growth (11% in FY2019). ICRA notes that the company would require about Rs. 20-25 crore to achieve portfolio growth in the range of 25-30% (CAGR) over the next three years, assuming the gearing is maintained under 5x. ICRA expects timely capital support from the promoters and the Group, if required.

Credit challenges

Weakening asset quality indicators – MVFL's gross NPA increased to 4.6% in September 2019 from 1.5% in March 2019 (0.9% in March 2018; 2.1% in March 2017) led by slippages in the passenger vehicle segment (88% of the total portfolio in September 2019) and certain high value exposures in the SME segment (4% of the total portfolio). The company's collections were also impacted by attrition in the collection & recovery functions. Within the passenger vehicle segment, the company has been increasing its focus on the used vehicle segment, with the share of disbursements increasing to 49% in H1 FY2020 from 24% in FY2019 (11% in FY2018). As the borrowers are predominantly self-employed, the company would remain exposed to income shocks. ICRA notes that MVFL has amended its credit policy by tightening the lending norms, basis the income profile of the borrowers, and restricting loan tenors. While the impact of these measures is likely to be seen over the medium to long term, its ability to strengthen collections would be critical to improve the asset quality in the near term and would be a key rating monitorable.

Expected pressure on profitability – MVFL's core profitability (operating profit/average managed asset) remained stable at 3.4% in FY2019 (3.4% in FY2018) as margins and operating costs remained stable. However, the net profitability moderated to 2.5% in FY2019 from 3.0% in FY2018 as credit costs inched up. While the credit costs remained negative during FY2016-2018 due to higher recoveries from the written-off accounts, the company witnessed higher write-offs vis-à-vis recoveries in FY2019. ICRA takes note of the increase in delinquencies in H1 FY2020, which is expected to exert pressure on the earnings profile during the current fiscal. ICRA also notes that the company has scope to improve efficiency as its operating costs stood at 4.1% in FY2019 (4.7% in FY2018). Therefore, going forward, MFVL's ability to tie up funds at competitive rates and keep the operating and credit costs under control would be critical.

Moderate scale of operations – MVFL's loan book grew by 11% in FY2019 to Rs. 428.1 crore as on March 31, 2019 (Rs. 439.8 crore as on September 30, 2019) as disbursements fell sharply by about 39% to Rs. 161.4 crore in FY2019 due to lower demand for passenger vehicles, natural calamities in Kerala and funding constraints. The company's portfolio predominantly comprises passenger cars (88%) with the rest being commercial vehicles (CVs), two-wheelers, construction equipment (CE), business loans and trade advances. Within the passenger vehicle portfolio, new and used cars constituted 79% and 21%, respectively, as of September 2019. Going forward, the company is expected to focus on used car financing.

Geographically concentrated operations – MVFL operates predominantly in Kerala, with 22 of its branches (25 branches overall) located in the state as of March 2019. The company has one branch each in Tamil Nadu, Karnataka and Delhi.

While MVFL intends to gradually expand its presence in other southern states, Kerala is likely to remain the key market over the medium term.

Liquidity position: Adequate

As on September 30, 2019, MVFL's asset liability maturity (ALM) profile was characterised by a cumulative negative mismatch of 9% (of total assets) in the <1-year bracket. This was due to the relatively longer tenor of the assets (maximum tenor of a passenger vehicle loan is seven years) vis-à-vis liabilities, which largely consist of cash credit/working capital demand loans, promoter/Group company loans (tenor of about 1-2 years) and public deposits (with maturity of 1-2 years). Excluding the maturities of the promoter and Group company loans, the cumulative mismatch in the <1-year bucket would be positive though there are mismatches in some of the sub-buckets. The company has taken steps to reduce the tenure of new/used car loans and is aiming to increase the share of term loans (instead of cash credit) to reduce the ALM mismatch.

ICRA notes that MVFL faced the closure of some of the bank facilities (Rs. 65 crore) in H1 FY2020, which were higher than the fresh sanctions (Rs. 10 crore) availed during this period. While ICRA takes comfort from the Group support, as observed in the past, it would be crucial for the company to get external funding. MVFL expects the public issuance of Rs. 200-crore NCDs in the near term and is also expecting credit lines from a few banks, which are currently in various stages of approval. As of September 30, 2019, the borrowing profile consisted of funding from banks (30%), fixed deposits (35%), unsecured loans from promoters, relatives & inter-corporate deposits (29%) and debentures (6%).

Rating sensitivities

Positive triggers – Given the Negative outlook, a rating upgrade in the near term is less likely. The outlook could be revised to Stable if the company improves its asset liability maturity profile considerably and achieves portfolio growth while maintaining adequate profitability (above 2.5%) and keeping the 90+dpd under 2.5% on a sustained basis.

Negative triggers – ICRA could downgrade MVFL's ratings if the 90+dpd exceeds 5% on a sustained basis and if the liquidity profile is adversely impacted by sub-optimal external funding or lower-than-required Group support. Increase in the managed gearing beyond 5x, on a sustained basis, is also a negative trigger.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA's Credit Rating Methodology for Non-Banking Finance Companies
Parent/Group Support	The ratings assigned to MVFL factor in the high likelihood of support from the Muthoot Finance Group. MVFL shares a common name with the Muthoot Finance Group, which, in ICRA's opinion, would persuade the Group and promoters to provide financial support to MVFL to protect its reputation from the consequences of a group entity's distress
Consolidation/Standalone	The ratings are based on the standalone financials of MVFL

About the company

Muthoot Vehicle & Asset Finance Limited (MVFL) is a non-banking finance company (NBFC), classified as a deposit accepting asset finance company, headquartered in Kochi. MVFL is primarily engaged in new and used vehicle financing. The company currently has 23 branches in Kerala. MVFL is a part of the Muthoot Finance Group, which has diversified lines of business including gold loans, vehicle finance, home finance, micro finance, foreign exchange, insurance, hospitals, schools, and real estate among others.

The company achieved a net profit of Rs. 11.2 crore on a managed asset base of Rs. 428.1 crore in FY2019 compared to a net profit of Rs. 10.2 crore on a managed asset base of Rs. 384.3 crore in FY2018.

Key financial indicators – MVFL

	FY2018	FY2019
Total Income	50.2	68.0
Net Profit	10.2	11.2
Net Worth	89.5	98.9
Total Managed Portfolio	384.3	428.1
Total Managed Assets	428.7	482.3
Return on Managed Assets	3.0%	2.5%
Return on Net Worth	11.8%	11.9%
Gearing (times)	3.6	3.7
Gross NPA%	0.9%	1.5%
Net NPA%	0.7%	1.2%
Net NPA/Net Worth	3.2%	5.3%
CRAR %	22.6%	22.5%

Source: MVFL and ICRA research; Amounts in Rs. crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Current Rating (FY2020)				Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding	Rating 31-Oct-19	FY2019 06-Jul-18	FY2018 08-Aug-17	FY2017 24-May-16
1	Long term (LT) – Fund based	Long Term	100.00	100.00	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)
2	Short term – Interchangeable	Short Term	22.50*	22.50*	[ICRA]A2	[ICRA]A2	[ICRA]A3+	[ICRA]A3+
3	Fixed deposit programme	Medium Term	-	-	MA (Negative)	MA (Stable)	MA (Stable)	MA (Stable)

**Short-term facilities are interchangeable with long-term facilities; total rated limit is Rs. 100.00 crore*
Amount in Rs. crore

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	Long term (LT) – Fund based	NA	NA	NA	100	[ICRA]BBB+ (Negative)
-	Short term – Interchangeable	NA	NA	NA	22.5	[ICRA]A2
-	Fixed deposit	NA	NA	NA	-	MA (Negative)

Source: MVFL

Annexure-2: List of entities considered for consolidated analysis: Not applicable

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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