ICRA

September 15, 2017

Small Business Fincredit India Private Limited

Summary of rated instruments

Instrument *	Amount (in Rs. crore)	Rating Action
Non-Convertible Debenture programme	400.00	[ICRA]A(stable); Assigned
Total	**400.00**	

*Instrument details are provided in Annexure-1

Rating action

ICRA has assigned the rating of [ICRA]A (pronounced ICRA A) for the Rs. 400 crore non-convertible debenture programme of Small Business Fincredit India Private Limited (SBFC). The outlook on the long term rating is Stable.

Rationale

The rating derives significant strength from the proposed transaction structure (which is expected to get completed in September 2017) whereby SBFC will acquire the retail lending book along with the existing infrastructure, branch network and employee team from Karvy Financial Services Limited (KFSL). Retail lending portfolio consists of Small ticket micro enterprise (ME) loans, medium ticket small and medium enterprise (SME) loans, loan against gold (LAG) and small commercial vehicle (SCV) loans. The rating also factors in the moderate seasoning and stable asset quality (~98% of the loans have never been more than 30 days delinquent) of the ME and SME loans which will be acquired as part of the deal. The rating takes comfort from the significant upfront equity infusion of Rs. 845 crore committed by Lyra Partners and Arpwood Partners Investment Advisors LLP into the company. This equity infusion and the proposed Rs. 400 crore non-convertible debentures would fund the acquisition of the ~Rs. 900 crore of loan assets from KFSL. The rating also takes into account the senior management team who have significant experience in retail lending business in India. The rating is however constrained by the transition related challenges and the possible employee attrition in the near term after the transaction is completed. The company's ability to manage asset quality as the portfolio seasons would be a key rating sensitivity in the near to medium term. Going forward, the company's ability to improve its profitability by borrowing at competitive rates from banks and by containing operating expenses would also be a key rating monitorable.

Key rating drivers

Credit strengths

- **Moderately seasoned loan book with a track record of seven years; majority of the portfolio have never been more than 30 days delinquent –** The loan book to be acquired by SBFC include the ME loans, SME loans, LAG and SCV loans. KFSL's loan book has a large share of ME and SME loans (~75%) and LAG (~20%). The ME and SME loan book is moderately seasoned as these loans have been disbursed over the past seven years by KFSL. The portfolio acquired as part of transaction is moderately seasoned and majority of the portfolio for ME, SME and SCV (98% of the portfolio) have never been more than 30 days delinquent. The gold loan book is being acquired on account of the extensive branch network of KFSL which comes along with it. ICRA notes that the market risk associated with gold prices is mitigated by the adequate loan to value (LTV) cover and the company's ability to auction the assets in case the LTV reaches a threshold level. SBFC would have a credit enhancement from KFSL for any future non-performing assets (NPAs) up to Rs. 50 crore for a period of 12 months.

- **Granular book with retail focus and low average ticket size –** The existing ME and SME loan books have average ticket sizes of ~Rs. 12 lakh and ~Rs. 40 lakh respectively, which imparts granularity to the portfolio. For incremental disbursements, the company plans to focus on low ticket sizes micro enterprise loans upto Rs. 50 lakh. The average ticket size for the company is expected to be ~Rs. 25 lakh.
- **Capitalisation profile expected to improve significantly after equity infusion by new shareholders –** Lyra Partners and Arpwood Partners Investment Advisors LLP plan to infuse Rs. 845 crore upfront into the company which along with the non-convertible debenture borrowings would fund the acquisition of the proposed retail assets of ~Rs. 900 crore from KFSL. SBFC's gearing is expected to be ~0.67 time at the closing of the deal with an adjusted net worth of Rs. 590 crore (adjusted for goodwill). Supported by the upfront capital infusion, the company's capital structure is expected to be comfortable and enable it to meet its growth targets for the next three years.
- **Experienced senior management team –** SBFC is in process to bring on board Mr. Aseem Dhru (as Chief Executive Officer) and Mr. Mahesh Dayani (as Chief Business Officer) from leading private sector banks who have significant experience in retail lending. The company would leverage their experience in ramping up the retail loan book, maintaining strong underwriting practices and in technology adoption.

Credit weaknesses

- **Ability to ensure smooth transition of operations and contain employee attrition –** With the transaction in the pipeline for over a year, and no incremental disbursements during the period, there has been an increase in employee attrition in the last year. The company's ability to start disbursements soon would be critical for retaining key resources.
- **Ability to manage asset quality as portfolio seasons –** SBFC's asset quality at the time of closing of the deal is expected to remain healthy with the company largely acquiring only performing loan assets. However, as the company ramps up its loan book and the existing loan book seasons, its ability to maintain asset quality would remain a key rating monitorable. The company's ability to ensure strong underwriting practices in segments like ME loans would be critical driver of overall asset quality.
- **Ability to improve profitability by borrowing at attractive cost of funds and containing operating expenses –** With the company expecting to ramp up its loan book going forward, its ability to borrow funds from banks at competitive rates would be important for improving its net interest margins. FSBC's ability to contain operating expenses while investing in the required technology and infrastructure would also be important.

Analytical approach:

For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria:

ICRA's Credit Rating Methodology for Non-Banking Finance Companies

About the company

Small Business Fincredit India Private Limited (SBFC) is a non-banking finance company, which plans to acquire the retail assets of Karvy Financial Services Limited (KFSL). As a part of the transaction, the entire infrastructure, branches and employee team of KFSL would be transferred to SBFC. At the time of the closing of the deal, the company is expected to have a net worth of ~Rs. 590 crore (net of goodwill) and a loan book of ~Rs. 900 crore. Going forward, SBFC plans to focus the low ticket size business loans (secured by property) and loans against gold.

Key Financial Indicators (Consolidated for SBFC)

	At Deal Closing
Borrowings	400
Net worth	845
Loan Book	888
Fixed Assets	7
Liquid Assets	56
Goodwill	261
Total assets	1,245
Gearing (on adjusted net worth)	0.67

Amounts in Rs. crore
Provisional Financials based on proposed transaction
Source: Company and ICRA research

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years:
Table:

Sr. No.	Instrument	Current Rating (FY2018)			Chronology of Rating History for the past 3 years		
		Type	Rated amount (Rs. crore)	September 2017	FY2017	FY2016	FY2015
					-	-	-
1	Non-Convertible Debenture Programme	Long Term	400.00	[ICRA]A (stable)	-	-	-

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

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Annexure-1

Instrument Details

ISIN No.	Instrument	Date of Issuance/ Sanction	Coupon Rate	Maturity Date	Rated Amount (Rs. crore)	Current Rating and Outlook
-	Non Convertible Debenture Programme – Proposed	-	-	-	400.00	[ICRA]A (stable)

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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.

For more information, visit **www.icra.in**

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