October 05, 2020

Fusion Microfinance (Pvt.) Ltd.: [ICRA]A-(Stable) assigned

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible Debenture Programme	0.00	75.00	[ICRA]A-(Stable); assigned
Non-convertible Debenture Programme	683.50	683.50	[ICRA]A-(Stable); outstanding
Total	**683.50**	**758.50**	

**Instrument details are provided in Annexure-1*

Rationale

The rating factors in Fusion's good track record, its improved scale, and the geographical diversity of its operations with assets under management (AUM) of Rs. 3640.75 crore (incl. provision) as on March 31, 2020[1] (~37% YoY growth) (Rs. 3404.45 crore as on June 30, 2020 as per provisional IGAAP financials) spread across 18 states and 283 districts, with no state having a share of more than 20% in the portfolio. The rating also considers the company's improved and comfortable capitalisation profile with a net worth of Rs. 1,199 crore as on March 31, 2020 on the back of regular capital infusions. Fusion is backed by strong investors such as Warburg Pincus (48.6% stake as on March 31, 2020) and Creation Investments (~30% stake as on March 31, 2020), which participated in the Rs. 500-crore Series F funding round in Q3 FY2020. ICRA takes note of the improvement in the company's profitability with the return on managed assets (RoMA) increasing to 2.93%[2] in FY2020 (excluding the additional Covid-19 provisioning of Rs. 51.04 crore) from 1.72% in FY2019, driven by portfolio growth, calibrated spending with operating expenses as a percentage of average managed advances declining to 6.34% in FY2020 from 7.30% in FY2019 and contained credit costs of 0.95% of average managed assets (AMA) in FY2020 (2.19% including the additional provisioning on account of Covid-19). ICRA has also taken note of the gradual ramp up in monthly collection efficiency to ~83% in August 2020 from 29% in May 2020. ICRA takes comfort from Fusion's stable and experienced management and its infrastructure with good systems and risk monitoring processes.

The rating is, however, constrained by the relatively risky unsecured asset class and the marginal borrower profile, which is highly susceptible to income shocks. The rating is also constrained by the company's ability to manage the adverse impact of the ongoing Covid-19 pandemic on the asset quality and business growth and other risks in the microfinance sector, which would remain critical from a rating perspective.

The Stable outlook on the [ICRA]A- rating reflects ICRA's opinion that Fusion will continue to benefit from its established track record and the experience of its promoters and management.

[1] *As per audited Ind-AS financials of FY2020 (EIS adjusted)*

[2] *Factoring in the Covid-19 provisioning, the RoMA for FY2020 stands at 1.69%*

Key rating drivers and their description

Credit strengths

Comfortable capitalisation profile for near-term growth requirements on the back of timely capital support from strong investor base – Existing investors, Warburg Pincus and Creation Investments among others, participated in the Series F funding round of Rs. 500 crore in Q3 FY2020, raising the company's net worth to Rs. 1,199 crore as on March 31, 2020 (Rs. 626 crore as on March 31, 2019). Resultantly, the net worth increased to 33% of managed advances as of March 2020 from 24% as of March 2019. Fusion's capitalisation profile has remained comfortable, supported by regular capital infusions from its strong investor base. Further, the gearing levels declined to 2.5 times as on March 31, 2020 from 4.7 times as on March 31, 2019, leaving sufficient headroom for debt capital to support the near-term growth requirements. This, coupled with a moderation in the expected growth rates in the wake of the pandemic, will keep the company's incremental capital requirement low in the next couple of years. The capital to risk weighted assets ratio (CRAR) was 35.8% as on March 31, 2020 (26.9% as on March 31, 2019), well above the regulatory minimum requirement. ICRA expects Fusion to remain well capitalised over the medium term as well.

Established track record and improvement in scale and geographical diversity of operations – Over the past decade of its operations, Fusion has established itself as one of the top 10 players in the microfinance industry in India. The company's scale of operations and geographical footprint increased as the gross portfolio grew to Rs. 2,662.64 crore as of March 2019 (70% YoY growth) and further to Rs. 3,640.75 crore as of March 2020 (~37% YoY growth) from Rs. 1,555.60 crore as of March 2018[3]. The portfolio growth has coincided with the addition of new borrowers and a reduction in the concentration of the portfolio even at the district level, attributing granularity to the portfolio. In relation to the net worth as on March 31, 2020, the share of the top 5, top 10 and top 20 districts in the portfolio was 24%, 42% and 70%, respectively. While the portfolio growth is likely to remain muted in H1 FY2021 on account of the impact of Covid-19, ICRA expects the company to continue to improve on geographical diversity going forward as well.

Improved profitability supported by robust portfolio growth and contained operating costs, though supressed by elevated credit costs on account of additional Covid-19 provisioning – With the growth in the average asset base, the company's lending spreads shrunk to 10.1% in FY2020 from 12.1% in FY2019 despite the lack of a significant change in the lending rates and a 100-bps decline in the weighted average cost of borrowings to ~11% in FY2020 from ~12% in FY2019. As the net interest income increased by 53% YoY in absolute terms to Rs. 329 crore in FY2020 from Rs. 215 crore in FY2019, the net interest margin (NIM) as a percentage of AMA increased to 8.6% in FY2020 from 7.3% in FY2019. Additionally, Fusion earned another 0.93% as a percentage of AMA in non-interest income (including direct assignment income upfronted under Ind-AS) in FY2020 (vis-à-vis 0.23% in FY2019). While the company's calibrated spending (operating expenses declined to 4.85% of AMA in FY2020 from 5.22% in FY2019) supported profitability, the elevated credit cost of 2.19% in FY2020 (as compared to 0.61% in FY2019) due to additional Covid-19 provisioning resulted in suppressed net profitability with RoMA at 1.69% in FY2020 as compared to 1.72% in FY2019. The return on the average net worth declined to 7.6% in FY2020 from 11.5% in FY2019 primarily on account of the equity infusion during the year. ICRA takes note of the supressed profitability in Q1FY2021 (as per provisional IGAAP financials) on account of low disbursements and elevated credit costs due to additional provisioning. Going forward, while the improvement in the scale of operations over the medium term is likely to support the operating expense ratios further, leading to better net profitability assuming no significant deterioration in the credit costs, the profitability for FY2021 will largely be driven by Fusion's ability to contain the credit costs amid the prevailing pandemic-related disruptions.

[3] *Portfolio as on March 31, 2018 as per IGAAP*

Stable asset quality indicators supported by consistent collections and prudent provisioning – Fusion's reported asset quality indicators are stable with gross stage 3 assets (as a percentage of gross on-book portfolio) of 1.12% as on March 31, 2020 vis-à-vis 1.55% as on March 31, 2019. With a provision cover of 66% and 64% respectively, the net stage 3 as on March 31, 2020 stood at 0.38% and at 0.56% as on March 31, 2019. The company's dynamic delinquency indicators show an improving month-on-month trajectory over the last 24-month period. However, the improvement in the asset quality was partly supported by periodic write-offs of Rs. 29.11 crore in FY2019 and Rs. 35.21 crore in FY2020. Nevertheless, factors such as the management's focus on the asset quality, healthy contribution of 47% by borrowers who have completed at least one loan cycle with the company, implementation of lending norms which are well within the regulatory as well as SRO-prescribed limits, focussed collection efforts and constant portfolio monitoring are also at play. Though ICRA expects the long-term asset quality to remain range-bound as the microfinance industry has been adversely impacted by the spread of the pandemic and the consequent nationwide lockdown, an uptick in delinquencies is expected in the near term. The ability to recover multiple instalments from borrowers would remain critical for maintaining the delinquencies. ICRA takes note of the gradual ramp up in monthly collection efficiency to ~83% in August 2020 from 29% in May 2020.

Diversified funding profile; however, high share of funding from wholesale sources – Fusion's lender base, as on March 31, 2020, was fairly diversified with direct funding relationships with more than 50 distinct lenders including 6 public banks, 22 private banks (including SFBs and foreign banks), 9 NBFCs, and ~15 FIs/DFIs. Notwithstanding the benefit on account of the cost of funds, the company's dependence on wholesale funding is high with banks accounting for ~75% of the incremental funding in FY2020. Nonetheless, going forward, with an increase in the gearing levels, the funding profile is also expected to diversify with additional reliance on NCDs/ECBs and securitisation.

Experienced and professional management along with good credit appraisal and portfolio monitoring processes – Fusion, which has completed a decade in microfinance operations, draws upon the experience of its promoters and management personnel, some of whom have remained with the company for long, and upon the instituted policies, operational infrastructure and guidance therefrom. Fusion has robust, digitally-enabled credit appraisal and monitoring processes such that detailed daily data at the last mile level is available through its MIS. Also, the company has a strong recovery and internal audit team, which ensures the checks and balances regularly through surprise visits, employee rotation, and digital technology, affording accountability to all the employees.

Credit challenges

Limited diversification of revenue stream and relatively risky asset class – As the portfolio loans in microfinance are unsecured and are only supported by a group-based social security, the asset class of Fusion's portfolio is relatively risky. Further, given the monoline nature of business with interest income from the microfinance portfolio comprising 87% of the total income earned in FY2020, there is limited diversification in terms of the revenue stream and asset class. However, ICRA takes note of the company's ongoing pilot plan for lending to the MSME segment.

Ability to manage adverse impact of Covid-19 pandemic on the asset quality and business growth – The microfinance industry is facing many challenges following the spread of the Covid-19 pandemic throughout the country. These include the continuity of business operations on the field and the possible adverse impact on the asset quality as microfinance players will have to collect multiple EMIs from the borrowers whose cash flows and economic activity have undergone a slowdown. Moreover, incremental business growth has been hindered with disbursements being muted in Q1 FY2020. The company's ability to navigate through the adversity and manage the impact on business growth, client retention and asset quality would remain critical from a rating perspective, going forward.

Ability to manage political, communal and other risks in the microfinance sector, given the marginal borrower profile with high susceptibility to income shocks – Microfinance borrowers typically have a marginal income profile with lower financial literacy and banking habits. The borrowers, mostly dwelling in rural areas, are dependent on micro/small business activities like running small local eateries and grocery shops, tailoring, animal husbandry, artisan work, etc. Consequently, their susceptibility to income shocks is high. Also, the borrower segment is more vulnerable to political, communal and other influences, which have posed a risk to microfinance businesses historically. Fusion's ability to manage these risks and strengthen its processes to maintain the portfolio quality while expanding its footprint would continue to be critical for the rating, going forward.

Liquidity position: Adequate

Fusion's liquidity profile remains comfortable with no negative cumulative mismatches in any of the buckets, as per the reported liquidity statement, supported by the shorter tenure of the assets and the recent capital raise. As on August 31, 2020, the unencumbered on-balance sheet liquidity was at Rs. 860 crore while the repayment obligations (including operating expenses) for the next six months (September 2020 to February 2021) approximated to Rs. 1229 crore (after factoring in moratorium and revised repayment schedules). The on-balance sheet liquidity, un-availed lines and inflows from advances cover its repayment obligations for the next six months adequately.

Rating sensitivities

Positive triggers – ICRA could change the outlook to Positive or upgrade the rating if the company demonstrates sustained profitable growth (RoMA>2.5%) while maintaining comfortable capitalisation (managed gearing below 5 times) and asset quality.

Negative triggers – ICRA could change the outlook to Negative or downgrade the rating if the company's managed gearing increases to more than 6 times on a sustained basis or there is a significant deterioration in the asset quality or weakening of the profitability (RoMA<1.5%) on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA's Rating Methodology for Non-Banking Finance Companies
Parent/Group Support	Parent/Group Company: NA
Consolidation/Standalone	The rating is based on the standalone financial statements of the rated entity

About the company

Incorporated in 1994, Fusion Microfinance Private Limited started microfinance operations in 2010 and became a registered NBFC-MFI in 2014. The company is primarily engaged in microfinance lending activities, providing financial services (and educating borrowers on financial literacy) to poor women in India who are organised as joint liability groups (JLGs). The company provides small-value collateral-free loans up to Rs. 75,000. In addition to the core business of providing microcredit, Fusion uses its distribution channels to provide other financial products and services to members, primarily the purchase of productivity-enhancing products such as mobile phones, bicycles, emergency loans, etc.

As on March 31, 2020, Fusion had a presence in 283 districts across 18 states through 594 branches. Bihar, Uttar Pradesh, Odisha and Madhya Pradesh contributed 19%, 17%, 14% and 10%, respectively, to the company's portfolio of Rs. 3,605 crore as on March 31, 2020. As per its audited financial statements for FY2020, Fusion earned a profit after tax of Rs. 69.61 crore on a managed asset base of Rs. 4,537.68 crore as on March 31, 2020 vis-à-vis a profit after tax of Rs. 50.67 crore in FY2019 on a managed asset base of Rs. 3,701.14 crore as on March 31, 2019.

Key financial indicators (audited)

Period As per	FY2018 IGAAP	FY2019 Ind-AS	FY2020 Ind-AS
Net Interest Income	86.25	215.39	328.82
PAT	-33.64	50.67	69.61
Net Worth	254.69	625.87	1,198.81
Total Assets	1,968.46	3,652.61	4,338.14
Managed Portfolio	1,555.60	2,662.64	3,640.75
Gross NPA %/ Gross Stage 3 %	3.98%	1.55%	1.12%
Net NPA %/ Net Stage 3 %	0.16%	0.56%	0.38%
Gearing	6.31	4.72	2.50
PAT/AMA	-2.25%	1.72%	1.69%
PAT/Average Net Worth	-16.62%	11.51%	7.63%

Amount in Rs. crore; All ratios as per ICRA calculations

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)						Rating History for the Past 3 Years								
		Type	Amount Rated	Amount Outstanding	Current Rating	Earlier Rating		FY2020	FY2019						FY2018	
					05-Oct-2020	24-Aug-2020	11-May-2020	30-Aug-2019	04-Feb-2019	22-Oct-2018	25-Sep-2018	07-Sep-2018	27-Aug-2018	02-Aug-2018	15-Mar-2018	02-May-2017
1	NCD	Long Term	75.00	75.00	[ICRA]A-(Stable); assigned	[ICRA]A-(Stable)	[ICRA]A-(Stable); Assigned	-	-	-	-	-	-	-	-	-
2	NCD	Long Term	683.50	693.50	[ICRA]A-(Stable)	[ICRA]A-(Stable); Withdrawn	[ICRA]A-(Stable); Reaffirmed	[ICRA]A-(Stable); Rated amount enhanced	[ICRA]A-(Stable); Upgraded from [ICRA]BBB+(Stable)	[ICRA]BBB+(Stable); Rated amount enhanced	[ICRA]BBB+(Stable); Rated amount enhanced	[ICRA]BBB+(Stable); Rated amount reduced	[ICRA]BBB+(Stable); Upgraded from [ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable); Assigned

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 click here

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE139R07225	NCD	22-Oct-18	12.20%	22-Oct-21	35.00	[ICRA]A-(Stable)
INE139R07217	NCD	27-Sep-18	12.50%	27-Sep-21	25.00	[ICRA]A-(Stable)
INE139R08041	NCD	10-Sep-19	11.91%	09-Sep-25	35.00	[ICRA]A-(Stable)
INE139R07191	NCD	16-Mar-18	12.02%	16-Mar-24	63.00	[ICRA]A-(Stable)
INE139R07183	NCD	15-Mar-18	12.30%	15-Mar-21	19.00	[ICRA]A-(Stable)
INE139R08017	NCD	15-Mar-17	13.85%	30-Mar-23	50.00	[ICRA]A-(Stable)
INE139R08058	NCD	15-Sep-16	13.25%	15-Sep-25	55.00	[ICRA]A-(Stable)
INE139R07241	NCD	31-Aug-16	13.60%	31-Aug-21	47.00	[ICRA]A-(Stable)
INE139R07233	NCD	06-Feb-16	12.75%	16-May-22	53.00	[ICRA]A-(Stable)
INE139R07258	NCD	10-06-2020	11.90%	12-06-2023	10.00	[ICRA]A-(Stable)
INE139R07266	NCD	19-06-2020	11.40%	19-06-2023	30.00	[ICRA]A-(Stable)
INE139R07274	NCD	30-06-2020	11.25%	30-06-2023	20.00	[ICRA]A-(Stable)
INE139R07290	NCD	29-07-2020	11.50%	29-07-2023	20.00	[ICRA]A-(Stable)
INE139R08066	NCD	05-08-2020	11.96%	06-08-2021	15.00	[ICRA]A-(Stable)
INE139R07282	NCD	31-07-2020	11.25%	21-04-2023	25.00	[ICRA]A-(Stable)
INE139R07308	NCD	12-08-2020	10.50%	12-02-2022	50.00	[ICRA]A-(Stable)
Unallocated	NCD	-	-	-	206.50	[ICRA]A-(Stable)

Source: Fusion Microfinance Private Limited

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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