

July 14, 2022

Arohan Financial Services Limited: Change in limits

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term bank facilities – Fund-based term loan	25.00	25.00	[ICRA]A(CE)(Negative); outstanding
Long-term bank facilities – Fund based^	3,376.43	2,092.06	[ICRA]A- (Negative); outstanding
Non-convertible debentures	316.70	316.70	[ICRA]A- (Negative); outstanding
Non-convertible debentures	90.00	90.00	[ICRA]A- (Negative); outstanding
Non-convertible debentures	200.00	200.00	[ICRA]A- (Negative); outstanding
Total	4,008.13	2,723.76	

*Instrument details are provided in Annexure-1; ^Rated limits reduced to Rs. 2,092.06 crore from Rs. 3,376.43 crore

Rating without explicit credit enhancement	[ICRA]A-
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Note: The (CE) suffix mentioned alongside the (provisional) rating symbol indicates that the rated instrument/facility is to be backed by some form of explicit credit enhancement. This rating is specific to the rated instrument/facility, its terms and structure and does not represent ICRA's opinion on the general credit quality of the entity concerned. The above table also captures ICRA's opinion on (a) the rating if the pending actions/documents are not completed, and (b) the rating without factoring in the proposed explicit credit enhancement

Rationale

For the [ICRA]A- (Negative) rating

The rating factors in Arohan Financial Services Limited's (Arohan or AFSL) experienced management team and good systems and processes. Although the company has scaled up its operations over the last few years at a healthy pace, ICRA notes that it has witnessed a decline in its assets under management (AUM) in FY2022 because of the Covid-19 pandemic-induced disruptions. As on March 31, 2022, it reported AUM of Rs. 4,122 crore compared to Rs. 4,648 crore as on March 31, 2021 (Rs. 4,854 crore as on March 31, 2020).

The rating also considers the company's adequate capitalisation profile supported by regular capital infusions, given its strong investor and promoter base. Arohan had a capital adequacy ratio (CAR) of 34.6% as on March 31, 2022, which was well above the regulatory requirement of 15%, while the gearing (managed)¹ was reported at 4.1 times as on March 31, 2022 (4.7 times as on March 31, 2021). ICRA takes note of the company's plans to raise equity capital in FY2023, which would help support the growth plans while maintaining a prudent capitalisation profile. The borrowing profile remains fairly diversified with a good mix of private banks, public sector banks, financial institutions (FIs) and non-banking financial companies (NBFCs).

The rating remains constrained by the weak asset quality indicators, which moderated because of the disruptions caused by the pandemic. Arohan reported gross stage 3 (GS3) assets of 4.5% as on March 31, 2022 (11.2% as on March 31, 2021) compared to 2.3% as on March 31, 2020. ICRA notes that the GS3 had weakened significantly in FY2022, though it improved by March 31, 2022, driven by some recoveries and write-offs. Also, the company has restructured loans under the Reserve

¹ Adjusted gearing = (On-book borrowings + securitised/assigned loan assets)/(Net worth – cash collateral/first loss default guarantee (FLDG) for managed portfolio)

Bank of India's (RBI) Resolution Framework for Covid-19-related stress, and the share of the standard restructured portfolio was reported at 28% of the overall AUM as on March 31, 2022. A sizeable portion of the standard restructured portfolio is under moratorium and the performance of such loans, upon the lifting of the moratorium, remains a key monitorable. ICRA notes that Arohan has been receiving some payments from the restructured portfolio under moratorium.

With the deterioration in the asset quality and the elevated credit costs, the company's profitability remains subdued. It reported a profit of Rs. 61 crore, translating to a return of 1.0% on average managed assets (AMA) and 6.2% on average net worth in FY2022. ICRA expects asset quality pressures to persist in the near to medium term, which could possibly suppress the profitability indicators for FY2023.

The rating also factors in the risks associated with the unsecured nature of microfinance loans, the marginal borrower profile, which is susceptible to income shocks, and the political and operational risks inherent in the microfinance business. Further, there is scope for improvement in the geographical diversification of operations.

The outlook remains Negative, given the high delinquencies, the pressure on profitability and growth in light of the pandemic, and the continuing pandemic-related stress on the asset quality metrics. Arohan's ability to improve the asset quality and profitability and control the credit costs would remain a key rating monitorable.

For the [ICRA]A(CE) (Negative) rating

The rating is based on the strength of an unconditional and irrevocable guarantee provided by Northern Arc Capital Limited (NACL; rated [ICRA]A+ (Stable)/[ICRA]A1+).

Adequacy of credit enhancement

ICRA has assessed the attributes of the partial guarantee issued by NACL in favour of the said instrument. While the guarantee is legally enforceable, irrevocable, unconditional, covers the entire tenor of the rated facility, and has a well-defined invocation and payment mechanism, it does not cover the entire rated amount. The guarantee is 27.69% of the initial loan amount, guaranteeing the repayment of the principal and the payment of the interest amount in relation to the facility for six months. NACL has waived off all the suretyship rights available under the Indian Contract Act, 1872. However, the credit enhancement provided in the guarantee shall cease to be available to the Lender if any modifications are done, without the prior approval of NACL, to the terms of the facility which adversely impact NACL's obligations.

Taking cognisance of the above credit enhancement, ICRA had assigned a rating of [ICRA]A(CE) (Negative) to the said facility against the unsupported rating of [ICRA]A- (and in relation to the guarantor's rating of [ICRA]A+ (Stable)/[ICRA]A1+). In case the ratings of the guarantor or the unsupported rating of Arohan change in future, the same would have a bearing on the rating of the aforesaid facility as well.

Salient covenants of the rated facility

- » The tenure of the facility is 24 months with equated monthly interest and principal repayment.
- » The guarantee amount shall remain stable in absolute terms till it is reset. It can be reduced, subject to the confirmation/affirmation of the rating agency.
- » In addition to the partial guarantee, Arohan will maintain a pool of loan receivables, which would be at least 1.10 times the outstanding amount of the facility. In case of a downgrade in Arohan's senior secured long-term rating to below BBB+, non-maintenance of security cover, non-payment by Arohan, and cross default of Arohan, then Arohan shall make equal weekly repayments and shall transfer the collections from the Hypothecated Property to the Collection and Payment Account on a weekly basis.
- » The security cover shall be met only with Receivables that do not have any principal, interest, additional interest, fee or any other expected payments overdue. For this purpose, Arohan shall, with the consent of the Lender, replace any Receivables constituting the Hypothecated Property that has one or more instalments of principal, interest, additional interest, fee or any other expected payments overdue for more than 90 (ninety) days with Performing Loans that meet the Eligibility Criteria. Such replacement shall be done on or before the 15th of any calendar month.

» Arohan shall report/file such list of assets, comprising the Hypothecated Assets, with the concerned Registrar of Companies (ROC) and the Central Registry of Securitisation Asset Reconstruction and Security Interest of India in relation thereto as soon as practicable and no later than 30 (thirty) days.

» In case of a downgrade in the Arohan's senior secured long-term rating to below BBB+, Arohan will ensure that the percentage of the outstanding principal value of the portfolio at risk (PAR) > 0 loans in the Hypothecated Property does not exceed 10% of the outstanding principal value of the Hypothecated Property.

Please refer to the following link for the previous detailed rationale that captures key rating drivers and their description, liquidity position, rating sensitivities, key financial indicators: [Click here](#)

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Rating Methodology for Non-banking Finance Companies Rating Methodology for Partially Guaranteed Debt
Parent/Group Support	Not Applicable
Consolidation/Standalone	Not Applicable

About the company

Arohan Financial Services Limited (Arohan) is a Kolkata-headquartered NBFC-MFI. It was incorporated on September 27, 1991. Arohan is engaged in the business of microlending mainly to women borrowers and operates on the joint liability group (JLG) model. It was set up through the acquisition of an existing NBFC, ANG Resources Ltd, with the support of Bellwether Microfinance Fund. The company's name was changed to Arohan Financial Services Limited in March 2008. Arohan became a part of the Aavishkar Group in September 2012. As on March 31, 2022, it was catering to 16.8 lakh borrowers through a network of 749 branches spread across 224 districts and 14 states while managing a portfolio of Rs. 4,122 crore.

Northern Arc Capital Limited (NACL; support provider)

Chennai-based NACL is a systemically important NBFC. It acts as a platform in the financial services sector with the objective of catering to the diverse credit requirements of under-served households and businesses by providing access to debt finance. This is done either through direct lending and investments or by providing syndication and structuring services. The company commenced its business by targeting MFIs and has diversified into other sectors including MSME finance, vehicle finance (includes commercial vehicle and two-wheeler finance), consumer finance, affordable housing finance and agricultural supply chain finance. NACL has steadily diversified, over the years, across products, geographies, and borrower segments as well. Nimbus, NACL's proprietary technology system, forms the backbone of its growth as a platform and enables the scaling up of business operations with execution and functional efficiencies and data analytics.

As of December 2021, IIFL Special Opportunities Fund was the largest shareholder with a stake of 26.1% on a diluted basis. Other large shareholders included Leapfrog Financial Inclusion India II Limited (23.0%), Augusta Investments II Pte Ltd (18.1%), Eight Roads Investments (Mauritius) (II) Limited (10.5%), Dvara Trust (9.9%), Accion Africa Asia Investment Company (5.9%), and SMBC (5.4%).

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)							Chronology of Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Jun 30, 2022 (Rs. crore)*	Date & Rating in FY2023				Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020
					Jul 14, 2022	Jul 01, 2022	Jun 21, 2022	Apr 06, 2022			
									Mar 25, 2022 Oct 05, 2021 Jul 20, 2021	Oct 05, 2020 Aug 05, 2020 Jul 28, 2020	-
1	Long-term Bank Facilities – Fund Based	Long Term	2,092.06	2,092.06	[ICRA]A-(Negative)	[ICRA]A-(Negative)	[ICRA]A-(Negative)	[ICRA]A-(Negative)	[ICRA]A-(Negative)	[ICRA]A-(Stable)	-
2	NCDs	Long Term	90.00	81.70	[ICRA]A-(Negative)	[ICRA]A-(Negative)	[ICRA]A-(Negative)	[ICRA]A-(Negative)	[ICRA]A-(Negative)	[ICRA]A-(Stable)	-
3	NCDs	Long Term	316.70	300.00	[ICRA]A-(Negative)	[ICRA]A-(Negative)	[ICRA]A-(Negative)	-	-	-	-
4	NCDs	Long Term	200.00	200.00	[ICRA]A-(Negative)	[ICRA]A-(Negative)	[ICRA]A-(Negative)	[ICRA]A-(Negative)	-	-	-
5	Long-term Bank Facilities – Fund-based Term Loan	Long Term	25.00	22.14	[ICRA]A(CE) (Negative)	[ICRA]A(CE) (Negative)	Provisional [ICRA]A(CE) (Negative)	Provisional [ICRA]A(CE) (Negative)	-	-	-

*Source: Company

Complexity level of the rated instruments

Instrument	Complexity Indicator
NCD	Simple
Long-term Bank Facilities – Fund Based	Simple
Long-term Bank Facilities – Fund-based Term Loan	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's 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
INE808K07162	NCD	Jul-29-2020	11.00%	Jul-29-2023	25	[ICRA]A- (Negative)
INE808K07246	NCD	Dec-14-2020	11.40%	Jun-14-2024	65	[ICRA]A- (Negative)
INE808K08079	NCD	Mar-31-2022	13.65%	Jun-30-2027	200	[ICRA]A- (Negative)
INE808K07261	NCD	Jun-26-2022	11.86%	Jun-29-2027	115	[ICRA]A- (Negative)
INE808K07139	NCD	Jun-19-2020	11.00%	Jun-16-2023	25	[ICRA]A- (Negative)
INE808K08061	NCD	Oct-25-2019	12.85%	Oct-25-2026	25	[ICRA]A- (Negative)
INE808K08046	NCD	Mar-29-2018	13.25%	Apr-28-2025	65	[ICRA]A- (Negative)
INE808K08053	NCD	Aug-14-2018	13.25%	Sep-30-2025	35	[ICRA]A- (Negative)
INE808K08012	NCD	Sep-20-2016	14.25%	Sep-20-2022	10	[ICRA]A- (Negative)
INE808K07147	NCD	Jul-10-2020	11.50%	Jul-10-2023	25	[ICRA]A- (Negative)
NA	NCD – Yet to be issued	NA	NA	NA	17	[ICRA]A- (Negative)
NA	Long-term Bank Facilities – Fund Based	Aug-03-2017 to Mar-31-2022	NA	Jul-10-2022 to Mar-31-2026	2,092.06	[ICRA]A- (Negative)
NA	Long-term Bank Facilities – Fund-based Term loan	Mar-31-22	NA	Mar-31-24	25	[ICRA]A(CE)(Negative)

Source: Company

[Please click here to view details of lender-wise facilities rated by ICRA](#)

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

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Branches



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