September 27, 2022

Electronica Finance Limited: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debentures	33.75	33.75	[ICRA]A- (Stable); reaffirmed
Subordinated debt programme	25.00	-	[ICRA]A- (Stable); reaffirmed and simultaneously withdrawn
Total	58.75	33.75	

**Instrument details are provided in Annexure I*

Rationale

The rating factors in Electronica Finance Limited's (EFL) established track record of more than three decades in the asset financing business, its experienced management team and adequate systems and processes. The company has been able to scale up its portfolio consistently (5-year CAGR[1] of 14% till March 31, 2022) despite the disruptions caused by the Covid-19 pandemic and it reported assets under management (AUM) of Rs. 1,990 crore as on March 31, 2022 (Rs. 2,200 crore as on June 30, 2022; Rs. 1,591 crore as on March 31, 2021). The increase in the scale of operations has been aided by the adequate systems and processes installed by the management and timely fund-raising, both equity and debt. In addition, the growth has been aided by the company's gradual expansion in the micro loan against property (LAP) segment and the rooftop solar loan segment. The share of these segments increased collectively to 13% as on March 31, 2022 from 3% as on March 31, 2020.

The company has a diversified borrowing profile comprising funding relationships with more than 25 lenders as on June 30, 2022 with a good mix of private sector banks, public sector banks, non-banking financial companies (NBFCs) and financial institutions (FIs). The company raised Rs. 107 crore through compulsorily convertible preference shares (CCPS) and equity in FY2020, which helped improve its capitalisation profile while supporting its growth plans. The managed gearing (including cash collateral from customers as borrowings)[2] though has been increasing and was reported at 5.6 times as on March 31, 2022 (4.5 times as on March 31, 2021) due to the scaling up of portfolio. In ICRA's opinion, EFL would require regular equity infusions to support the envisaged growth over the medium term, while maintaining a prudent capitalisation profile.

The rating though is constrained by the inherent risks associated with the target borrower segment of small and medium industrial units that are susceptible to economic shocks. This can bring asset quality challenges on the portfolio.. However, with strong underwriting norms, the company has been able to navigate through various macro-economic events in the past, including the pandemic. Despite the pandemic, EFL witnessed an improvement in its asset quality indicators in FY2021 and FY2022. It reported gross non-performing assets (NPAs) of 2.0% as on March 31, 2022 compared to 2.2% as on March 31, 2021 (2.8% as on March 31, 2020). The improvement was driven by the company's strong recovery mechanisms and good ability to sell repossessed assets with limited loss. Nevertheless, the company's ability to keep its asset quality under control, especially in the relatively newer product segments, namely micro-LAP and rooftop solar loans, would be important.

The rating also remains constrained by the company's moderate, albeit gradually improving, earnings profile. EFL's ability to improve its operating efficiency while managing the credit costs as its scales up the portfolio will be important from a credit perspective. The Stable outlook on the [ICRA]A- rating reflects ICRA's opinion that EFL will continue to benefit from its experienced management team, adequate systems and processes and diversified borrowing profile, while increasing its scale of operations.

[1] Compound annual growth rate

[2] (On-book borrowings + Securitised/assigned loan assets + Cash collateral from customers)/(Net worth including CCPS)

ICRA has reaffirmed and simultaneously withdrawn the rating outstanding on the company's Rs. 25-crore subordinated debt programme as the instrument has matured and no amount is outstanding against the same. The rating has been withdrawn in accordance with ICRA's policy on the withdrawal of credit ratings.

Key rating drivers and their description

Credit strengths

Established track record of operations in asset finance; experienced management team – EFL started its operations in machine financing in 1990, given the background of its parent group of equipment manufacturers. It draws competitive advantage, in terms of critical know-how of machine usage and resale, by leveraging the operational and management experience of its promoter group entities. Moreover, the company takes higher exposures only in case of repeat borrowers with a successful repayment track record or in case of adequate group entity comfort and/or with sufficient collateral to support the loan. Supported by the diverse experience of its senior management and its track record of over 30 years, EFL was managing an AUM of Rs. 1,990 crore (Rs. 2,200 crore as on June 30, 2022) through 119 branches spread across 16 states as on March 31, 2022.

Adequate systems and processes; strong recovery mechanism – EFL has a stringent appraisal and risk management framework, which includes multiple site visits, know your customer (KYC) verification, credit bureau checks and financial due diligence wherein the focus remains on assessing the debt repaying ability of the borrower based on his existing scale of business. While the relationship managers remain responsible for the respective accounts, the company also has a separate collection team for follow-ups/personal visits in case of delays. It has a strong recovery process as well and has, over the years, demonstrated its ability to sell repossessed assets with limited loss.

Diversified borrowing profile – The company has a diversified borrowing profile comprising funding relationships with more than 25 lenders as on June 30, 2022 and a good mix of private sector banks, public sector banks, NBFCs and FIs. The borrowing profile comprised bank facilities (40%), non-convertible debentures (10%), term loans from NBFCs/FIs (6%), and a securitised/assigned portfolio (23%) as on June 30, 2022. EFL also takes a cash collateral as a security deposit from its clients, which is a major source of funding (20%). Cash collateral from customers is a source of low-cost funds, wherein the company provides a loyalty bonus to its borrowers, contingent on meeting certain conditions. EFL raised Rs. 809 crore of debt funds in FY2022 from more than 20 different lenders followed by Rs. 145 crore of debt funds in Q1 FY2023 and continues to maintain a healthy pipeline of funds to support its growth plans.

Credit challenges

Moderate profitability profile – The net interest margin improved to 5.4% of average managed assets (AMA) in FY2022 from 5.2% in FY2021 owing to the decline in the cost of funds led by the systemic softening of interest rates. However, operating expenses increased to 3.7% of AMA in FY2022 from 3.1% in FY2021 due to higher employee and administrative expenses. The company continues to open new branches and hire personnel to support its envisaged growth plans. Credit costs were low with overall comfortable asset quality indicators and were reported at 0.4% of AMA in FY2022 compared to 0.6% in FY2021. With the improvement in margins and low credit costs, EFL's profitability profile has improved marginally, though it remains moderate. The company reported a net profit of Rs. 29 crore, translating into a return of 1.5% on AMA and 9.4% on average net worth in FY2022 (Rs. 22 crore, 1.4% and 7.9%, respectively, in FY2021). EFL's ability to improve its operating efficiency while managing the credit costs as its scales up the portfolio will be important from a credit perspective.

Ability to manage asset quality, given the marginal borrower profile – The portfolio is prone to asset quality challenges on account of lending to small-and-medium industrial units that are susceptible to economic shocks. However, with strong underwriting norms, the company has been able to navigate through various macro-economic events in the past, including the pandemic. Despite the pandemic, EFL witnessed an improvement in its asset quality indicators in FY2021 and FY2022. It reported gross NPAs of 2.0% as on March 31, 2022 compared to 2.2% as on March 31, 2021 (2.8% as on March 31, 2020). The improvement was driven by the company's strong recovery mechanisms and good ability to sell repossessed assets with limited loss. Going forward, the company's ability to maintain its asset quality at reasonable levels while growing its loan book would be a key rating monitorable.

Liquidity position: Adequate

EFL's liquidity profile is adequate given the free on-book liquidity of Rs. 160 crore (including short-term fixed deposit with banks) as on March 31, 2022, expected inflows from advances and the availability of sanctioned unutilised lines of Rs. 224 crore. As per the structural liquidity statement as on March 31, 2022, the company had scheduled inflows of Rs. 580 crore against scheduled outflows of Rs. 387 crore till March 31, 2023. However, given its growth plans, EFL would require additional funding to support the projected growth in business.

Rating sensitivities

Positive factors – ICRA could revise the outlook to Positive or upgrade the rating if the company is able to sustainably scale up its portfolio while maintaining the asset quality and capitalisation profile and improving its earnings profile.

Negative factors – Pressure on the company's rating could arise if there is a deterioration in the asset quality, which could affect its profitability. The weakening of the capitalisation profile with the managed gearing exceeding 6 times on a sustained basis or a stretch in the liquidity could also exert pressure on the rating.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Rating Methodology for Non-banking Finance Companies Policy on Withdrawal of Credit Ratings
Parent/Group support	Not Applicable
Consolidation/Standalone	Standalone

About the company

Electronica Finance Limited (EFL), formerly known as Electronica Leasing and Finance Limited, is a non-banking financial company (NBFC) incorporated in 1990 and is a part of SRP Electronica Group (Group). At present, EFL provides financial assistance to small-and-medium industrial (SME) units (mostly tier II, tier III and tier IV ancillary units) engaged mainly in the engineering, auto ancillary and plastic industries. The company reported an AUM of Rs. 1,990 crore (Rs. 2,200 crore as on June 30, 2022), which is being managed through 119 branches spread across 16 states as on March 31, 2022.

The origin of the SRP Electronica Group was that of a manufacturing company started by a group of first-generation technocrats. With the experience of starting a new business also came the realisation about the challenges, especially of financing, that a typical SME business faces. Having the manufacturing background and understanding of machines and engineering equipment, EFL had a leverage in starting machine financing, which at that time was a pioneering effort. This understanding was also used to start other innovative services like doorstep finance and assessment-based financing. Very soon, EFL started machine financing of other manufacturers in the machine tool as well as other industries. EFL's products, services and last mile connectivity were also recognised by Small Industries Development Bank of India (SIDBI), which resulted in a partnership of 15+ years.

Key financial indicators (audited)

Electronica Finance Limited	FY2021	FY2022
As per	Ind-AS	Ind-AS
Total income	172	212
Profit after tax	22	29
Net worth (including CCPS)	293	321
Gross loan portfolio	1,591	1,990
Total managed assets	1,675	2,225
Return on average managed assets	1.4%	1.5%
Return on average net worth	7.9%	9.4%
Gearing (including cash collateral as borrowings; times)	3.5	4.5
Managed gearing (times)	4.5	5.6
Gross stage 3 assets	2.8%	2.6%
Net stage 3 assets	1.3%	1.3%
Solvency (Net stage 3 assets /Net worth)	4.2%	5.2%
Capital to risk weighted assets ratio	24.2%	21.9%

Total managed assets = (Total assets + Impairment allowance + Assigned portfolio); Managed gearing = (On-book borrowings + Securitised/assigned loan assets + Cash collateral from customers)/(Net worth); Source: Company, ICRA Research; All ratios as per ICRA's calculations; Amount in Rs. crore

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 on Sep-20-2022* (Rs. crore)	Date & Rating in FY2023	Date & Rating in FY2022		Date & Rating in FY2021	Date & Rating in FY2020
					Sep-27-2022	Sep-28-2021	Aug-09-2021	Aug-10-2020	Jun-24-2019
1	Non-convertible debt programme	Long term	33.75	33.75	[ICRA]A- (Stable)	[ICRA]A- (Stable)	-	-	-
2	Subordinated debt programme	Long term	25.00	-	[ICRA]A- (Stable); reaffirmed and simultaneously withdrawn	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Positive)

**Source: Company*

Complexity level of the rated instruments

Instrument	Complexity Indicator
Non-convertible debentures	Very Simple
Subordinated debt	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 I: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE612U07068	Non-convertible debentures	Sep-27-2021	10.30%	Mar-13-2026	33.75	[ICRA]A- (Stable)
INE612U08017	Subordinated debt*	Mar-30-2017	14.50%	Sep-30-2021	25.00	[ICRA]A- (Stable); reaffirmed and simultaneously withdrawn

**Instrument matured and redeemed; Source: Company*

Annexure II: 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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