March 10, 2023 (Revised)

Pahal Financial Services Pvt. Ltd.: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debentures	174.60	174.60	[ICRA]BBB- (Stable); reaffirmed
Non-convertible debentures	89.00	-	[ICRA]BBB- (Stable); reaffirmed and withdrawn
Bank facilities	50.00	50.00	[ICRA]BBB- (Stable); reaffirmed
Total	**313.60**	**224.60**	

**Instrument details are provided in Annexure I*

Rationale

The rating reaffirmation factors in Pahal Financial Services Pvt. Ltd.'s (PFSPL) established track record of operations in the microfinance industry and its experienced promoters and management team, which has helped it register a healthy growth in its scale of operations. The company saw a pickup in disbursements in Q4 FY2022 and 9M FY2023, driven by branch expansion and penetration in the existing locations, with the trend expected to continue going forward. The rating also factors in its adequately diversified funding profile and the capital raise from GAWA Capital Pte. Ltd. in the form of compulsory convertible preference shares (CCPS) of Rs. 50.0 crore in Q4 FY2022 and Rs. 21.6 crore in Q3 FY2023.

The rating is, however, constrained by PFSPL's geographically concentrated portfolio with the top 3 states, namely Gujarat, Bihar and Rajasthan, accounting for around 78% of its assets under management (AUM) as on December 31, 2022, though the same has reduced from 82% as on March 31, 2022. The rating also takes into consideration the high managed gearing[1], which stood at 6.3 times as on December 31, 2022 (6.6 times as on March 31, 2022). PFSPL's ability to improve and maintain a prudent capitalisation profile while scaling up its operations shall remain a key monitorable.

The rating is also constrained by PFSPL's moderate asset quality indicators owing to the disruptions caused by the Covid-19 pandemic and the corresponding impact on its profitability. The company's asset quality deteriorated in FY2022 owing to the pandemic and it reported gross stage 3 (GS-3)[2] of 4.3% as on March 31, 2022 compared to 3.2% as on March 31, 2021. Its GS-3 declined to 1.2% as on December 31, 2022 due to write-offs and the sale of the portfolio to an asset reconstruction company (ARC) in Q3 FY2023. However, recoveries from security receipts (SRs), which were 1.8% of its AUM[2] as on December 31, 2022, would remain monitorable.

ICRA notes that, after witnessing subdued profitability in FY2022, the company reported an improvement in its earnings profile in 9M FY2023 because of the increase in its margins, though the same remains moderate. PFSPL's ability to arrest further slippages and recover from its delinquent portfolio would remain a key monitorable from a credit perspective. The rating also factors in the marginal borrower profile, focus on unsecured lending, the political and operational risks associated with microlending, and the rising ticket sizes and borrower leverage in the industry.

The Stable outlook on the [ICRA]BBB- rating reflects ICRA's opinion that the company will be able to maintain a steady credit profile, while expanding its scale of operations and improving its profitability supported by its experienced management team.

---

[1] *Managed gearing = (on-book debt + off-book portfolio) / net worth*

[2] *Calculated on AUM less business correspondent portfolio*

ICRA has reaffirmed the rating while simultaneously withdrawing the rating outstanding for the Rs. 89-crore non-convertible debenture (NCD) programme as the instrument has been repaid by the company with no amount 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 in microfinance sector and experienced management team – Since commencing operations in 2011 under microfinance lending, PFSPL has a track record of over a decade. The company is promoted by Mr. Kartik Mehta and Ms. Purvi Bhavsar, who have experience in the banking and microfinance sectors. The board consists of six members including three independent directors and one nominee director, who are from diverse backgrounds, while the senior management team has experience in microlending operations. PFSPL's existing investors include Base of Pyramid Asia (BoPA) Pte. Ltd., Dia Vikas Capital Private Limited (an impact investor) and GAWA Capital Pte. Ltd., which support the capital base.

Adequately diversified funding profile – PFSPL's funding mix is adequately diversified with the company having relationships with various lenders comprising a mix of non-banking financial companies (NBFCs)/financial institutions (FIs), small finance banks and banks. Borrowings comprised around 39% from banks, 35% from non-convertible debentures (NCDs), 22% from NBFCs/FIs and 5% in the form of subordinated debt as on December 31, 2022. Given its target growth plans, the company will have to increase the share of bank funding in the overall funding mix as the same is relatively scalable and cost competitive.

Credit challenges

High geographical concentration – ICRA notes the improvement in the scale of operations with the AUM increasing to Rs. 1,259 crore as on December 31, 2022 from Rs. 1,001 crore as on March 31, 2022 (Rs. 773 crore as on March 31, 2021). The company has operations in 8 states with Gujarat accounting for ~37% of the AUM, followed by Bihar (~28%), Rajasthan (13%), Uttar Pradesh (~11%), Madhya Pradesh (~8%), and Chhattisgarh, Maharashtra and Haryana accounting for the rest as on December 31, 2022. Although ICRA notes a reduction in the geographical concentration in Gujarat to 37% as on December 31, 2022 from ~43% as on March 31, 2022, the contribution of the top 3 states remained at 78% as on December 31, 2022 compared to 82% as on March 31, 2022 due to the increase in the portfolio share in Bihar. Going forward, PFSPL's ability to diversify its operations geographically will remain important from a credit perspective.

High leverage – ICRA notes that the company raised around Rs. 50.0 crore through CCPS in Q4 FY2022 and another Rs. 21.6 crore in Q3 FY2023 from GAWA Capital. PFSPL's reported capital adequacy ratio of 21.8%, as on December 31, 2022 (21.3% as on March 31, 2022), was above the regulatory requirement of 15%. However, its managed gearing was high at 6.3 times as on December 31, 2021 (6.6 times as on March 31, 2022), given the high share of the off-book portfolio. As the gearing remains relatively high, the company would require additional capital to maintain the managed gearing level at less than 6 times, given its growth plans. Going forward, ICRA expects PFSPL to raise equity capital in a timely manner to support its stated growth plans. Its ability to do so, while growing its book, will remain a monitorable.

Moderate asset quality indicators and profitability profile – The company's asset quality deteriorated in FY2022 owing to the pandemic and it reported GS-3 of 4.3% as on March 31, 2022 compared to 3.2% as on March 31, 2021. Its GS-3 declined to 1.2% as on December 31, 2022 due to write-offs and the sale of the portfolio to an ARC in Q3 FY2023. However, its GS3 and SRs together comprised 3% as on December 31, 2022 and the recovery from same shall remain a monitorable. Going forward, PFSPL's ability to increase its collections further and recover from delinquent accounts will help improve its asset quality indicators.

The company also witnessed subdued profitability indicators in FY2022 due to lower margins resulting from the reversal of interest income on account of higher GS-3. The company reported a return on average managed assets (RoMA) and a return on equity (RoE) of 0.1% and 0.7%, respectively, in FY2022. In 9M FY2023, the net interest margin improved with PFSPL increasing its lending rates. However, the increase in operating costs with the expansion of operations and higher credit costs due to increased provisioning negated the impact to some extent. PFSPL reported an improved RoMA and RoE of 0.9% and 6.6%, respectively, in 9M FY2023.

Ability to manage political, communal and other risks, given the marginal borrower profile – Microfinance remains susceptible to the risks associated with unsecured lending to marginal borrowers with limited ability to absorb income shocks and the rising borrower leverage levels owing to an increase in multiple lending in the areas of operations. Further, political and operational risks associated with microfinance may result in high volatility in the asset quality indicators. The microfinance industry is prone to socio-political, climatic and operational risks, which could negatively impact its operations. PFSPL's ability to onboard borrowers with a good credit history, recruit and retain employees as well as improve the geographical diversity of its operations would be the key rating sensitivity.

Liquidity position: Adequate

As on December 31, 2022, the company had an unencumbered cash and bank balance of Rs. 43 crore against scheduled debt obligations of Rs. 339 crore and scheduled collections of Rs. 347 crore till June 30, 2023. Factoring in the expected collections from advances, the liquidity profile is adequate for meeting the debt obligations in a timely manner. The company also has Rs. 160 crore as margin money deposits placed to avail term loans from banks and others and as cash collateral in connection with securitisation transactions.

Rating sensitivities

Positive factors – ICRA could revise the outlook or upgrade the rating if PFSPL improves its earnings profile on a sustained basis while expanding its scale of operations and is able to improve its capitalisation level with a managed gearing of less than 6 times on a sustained basis.

Negative factors – Pressure on the rating could arise if there is a further deterioration in the asset quality, which could affect the profitability. The weakening of the capitalisation profile with a managed gearing of more than 7 times could also exert pressure on the rating.

Analytical approach

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

About the company

PFSPL is an Ahmedabad-based NBFC-microfinance institution (NBFC-MFI) registered with the Reserve Bank of India. The company started its operations in March 2011 by acquiring the existing operations of Lok Vikas Nidhi, a trust operational in Gujarat for over 25 years. The current promoters acquired the portfolio of Rs. 2.6 crore spread over 15 branches, along with the field staff of Lok Vikas, and subsequently transferred the acquired portfolio to an NBFC along with an equity contribution of Rs. 2 crore. The NBFC was renamed Pahal Financial Services Pvt. Ltd. PFSPL lends to poor women primarily in the rural and semi-urban areas of Gujarat, Rajasthan, Madhya Pradesh, Bihar, Uttar Pradesh, Chhattisgarh, Haryana and Maharashtra.

PFSPL reported a profit after tax (PAT) of Rs. 9.5 crore in 9M FY2023 on AUM of Rs. 1,259 crore as on December 31, 2022 against a profit of Rs. 1.0 crore in FY2022 on AUM of Rs. 1,001 crore as on March 31, 2022.

Key financial indicators

PFSPL	FY2021	FY2022	9M FY2023
	Audited	Audited	Limited Review
Accounting as per	Ind-AS	Ind-AS	Ind-AS
Net interest income	76.9	66.5	82.1
Profit after tax	4.3	1.0	9.5
Net worth	124.4	175.5	206.1
Assets under management	773.3	1,001.3	1,258.9
PAT / Average managed assets	0.5%	0.1%	0.9%
PAT / Average net worth	3.6%	0.7%	6.6%
Gross stage 3	3.2%	4.3%	1.2%
Net stage 3	2.0%	3.4%	0.6%
SRs	-	-	1.8%
Gearing (reported; times)	5.1	5.5	4.6
Gearing (managed; times)	6.0	6.6	6.3

Source: Company, ICRA Research; All ratios as per ICRA's calculations; Amount in Rs. crore
Managed gearing = (on-book debt + off-book portfolio) / net worth

Status of non-cooperation with previous CRA: Not applicable

Any other information: PFSPL also faces prepayment risk, given the possibility of debt acceleration upon the breach of covenants, including financial, operating and rating-linked covenants. Upon its failure to meet the covenants, if the company is unable to get waivers from the lenders/investors or the lenders/investors do not provide it with adequate time to arrange for alternative funding to pay off the accelerated loans, the rating would face pressure. Nevertheless, ICRA notes that the company has been able to raise fresh funds despite the covenant breaches in the last 1-2 years.

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 Dec 31, 2022 (Rs. crore)	Date & Rating in FY2023	Date & Rating in FY2022	Date & Rating in FY2021			Date & Rating in FY2020				
					Mar-10-23	Mar-17-22	Mar-18-21	Feb-22-21	Dec-15-20	Mar-24-20	Dec-18-19	Dec-12-19	Jun-20-19
1	NCD	Long term	15	15	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)					
2	NCD	Long term	39.6	25.4	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)				
3	NCD	Long term	65	46.2	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)			
4	NCD	Long term	34	-	[ICRA]BBB- (Stable), withdrawn	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)		
5	NCD	Long term	15	-	[ICRA]BBB- (Stable), withdrawn	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)
6	NCD	Long term	40	-	[ICRA]BBB- (Stable), withdrawn	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)
7	NCD	Long term	55	52.5	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)						
8	Bank lines*	Long term	50	-	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)
9	NCD	Long term	-	-	-	[ICRA]BBB- (Stable); withdrawn	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)
10	NCD	Long term	-	-	-	[ICRA]BBB- (Stable); withdrawn	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)

** The rated bank facility is unallocated*

Complexity level of the rated instrument

Instrument	Complexity Indicator
Non-convertible debentures	Simple
Bank facilities	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: Click Here

Annexure I: Instrument details

ISIN	Name of instrument	Date of Issuance	Coupon Rate	Maturity Date	Rated Amount (Rs. crore)	Current Rating and Outlook
INE514Q07171	**NCD**	Dec-30-2019	13.90%	Dec-30-2022	34.00	[ICRA]BBB- (Stable) and withdrawn
INE514Q07130	**NCD**	Jun-23-2019	14.75%	Jun-30-2022	15.00	[ICRA]BBB- (Stable) and withdrawn
INE514Q07163	**NCD**	Jun-29-2018	13.65%	Jun-02-2022	40.00	[ICRA]BBB-(Stable) and withdrawn
INE514Q07155	**NCD**	Mar-28-2020	13.15%	Mar-31-2023	28.20	[ICRA]BBB- (Stable)
INE514Q07106	**NCD**	Jul-12-2018	14.20%	Mar-30-2023	15.00	[ICRA]BBB- (Stable)
INE514Q08021	**NCD**	Mar-16-2020	16.50%	Jun-16-2025	15.00	[ICRA]BBB- (Stable)
INE514Q07189	**NCD**	Nov-3-2020	11.72%	Nov-03-2023	13.40	[ICRA]BBB- (Stable)
INE514Q07205	**NCD**	Jan-12-2021	11.63%	Jan-12-2024	17.10	[ICRA]BBB- (Stable)
INE514Q07197	**NCD**	Dec-18-2020	14.50%	Dec-18-2023	25.00	[ICRA]BBB- (Stable)
INE514Q07221	**NCD**	Mar-15-2021	14.50%	Mar-30-2023	15.00	[ICRA]BBB- (Stable)
INE514Q07239	**NCD**	Apr-23-2021	12.30%	Apr-30-2025	37.50	[ICRA]BBB- (Stable)
Unallocated	**NCD**	-	-	-	8.40	[ICRA]BBB- (Stable)
NA	**Bank lines: Unallocated**	NA	NA	NA	50.00	[ICRA]BBB- (Stable)

Source: Company

Annexure II: List of entities considered for consolidated analysis – Not applicable

Corrigendum

Document dated March 10, 2023 has been corrected with revisions as detailed below:

- Link to ICRA policy on withdrawal of credit ratings has been updated to applicable rating methodologies in analytical approach on page number 3

ANALYST CONTACTS

Karthik Srinivasan
+91 22 6114 3444
karthiks@icraindia.com

Sachin Sachdeva
+91 124 4545307
sachin.sachdeva@icraindia.com

Arpit Agarwal
+91 124 4545 873
arpit.agarwal@icraindia.com

Jatin Arora
+91 124 4545 846
jatin.arora@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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

ICRA Limited

Registered Office

B-710, Statesman House, 148 Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches