August 31, 2020

Sonata Finance Private Limited: Rating assigned, reaffirmed and withdrawn for various debt programmes

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debenture programme	-	25.00	[ICRA]BBB(Stable); assigned
Non-convertible debenture programme	235.00	235.00	[ICRA]BBB(Stable); reaffirmed
Non-convertible debenture programme	98.00	-	[ICRA]BBB(Stable); reaffirmed and simultaneously withdrawn
Long-term bank line	500.00	500.00	[ICRA]BBB(Stable); outstanding
Subordinated debt programme	15.00	15.00	[ICRA]BBB(Stable); outstanding
Total	**848.00**	**775.00**	

**Instrument details are provided in Annexure-1*

Rationale

ICRA has withdrawn the rating of [ICRA]BBB(Stable) for Sonata Finance Private Limited's (SFPL) Rs. 98-crore non-convertible debenture (NCD) programme as there is no amount outstanding against the rated instrument. The rating withdrawal is in accordance with ICRA's policy on the withdrawal and suspension of credit ratings.

The rating factors in the company's experienced management team and board of directors. The senior management team and board of directors have rich experience in microlending, banking, financial services, and insurance (BFSI) operations, social transformation, advisory services and developmental funding. The rating also factors in SFPL's good systems and processes. The rating is supported by the company's adequate capitalisation profile with a comfortable capital adequacy ratio of 23.01% (Tier I: 17.02%) and moderate adjusted gearing[1] of 5.44 times as on March 31, 2020 (25.95%, 22.51% and 4.80 times, respectively, as on March 31, 2019). As on June 30, 2020, the capital adequacy ratio stood at 20.27% (Tier I: 17.56%) with adjusted gearing[1] of 5.36 times.

The rating is, however, constrained by the geographically concentrated operations as the company remains exposed to regional risks with a high share of its portfolio in the top 3 states of Uttar Pradesh (50%), Bihar (24%) and Madhya Pradesh (17%) as on March 31, 2020. While the overall asset quality indicators have improved with gross non-performing assets (NPAs) of 1.41% and nil net NPAs as on June 30, 2020 (1.54% and nil, respectively, as on March 31, 2020) from 3.34% and 2.70%, respectively, as on March 31, 2019, the company's ability to maintain the asset quality indicators amid the current scenario will be a key rating monitorable. The rating is also constrained by the decline in SFPL's profitability profile as it reported a return of 0.70% on the average managed assets (AMA) and 5.32% on the average net worth in FY2020 compared to 1.87% and 15.13%, respectively, in FY2019, which further declined to 0.33% and 2.42%, respectively, in Q1 FY2021. This can be attributed to the increased provisioning on account of the Covid-19 pandemic. The rating continues to factor in the risks associated with the unsecured nature of microfinance loans, the marginal borrower profile which is susceptible to income

[1] *(Total debt + pass-through certificates)/(net worth less FLDG/cash collateral for managed portfolio)*

shocks, the rising borrower leverage levels owing to an increase in multiple lending, and the political and operational risks inherent in the microfinance business.

The microfinance industry is facing many challenges following the spread of Covid-19 throughout the country. These include the continuity of business operations on the field and the possible adverse impact on the asset quality. Though there has been a gradual increase in the collection efficiency post the lifting of the lockdown in several parts of the country, the overall pace of economic recovery and collection efficiency once the lockdown is fully lifted remains to be seen. The company's ability to manage the adverse impact of the pandemic on its asset quality and profitability will be important from a credit perspective.

The Stable outlook on the [ICRA]BBB rating reflects ICRA's opinion that SFPL will continue to benefit from its experienced management team, good systems and processes, adequate capitalisation profile and improved earnings profile.

Key rating drivers and their description

Credit strengths

Experienced management team and board of directors – The senior management team has rich experience in microlending, BFSI operations, social transformation and advisory services. The board comprises 11 directors including 4 independent and 6 nominee directors with all members having diverse experience in BFSI, social initiatives and developmental funding. The investors, namely Creation Investments Social Ventures (Creation), Societe De Promotion Et De Participation Pour La Cooperation Economique (Proparco), Triodos Custody B.V. (Triodos), SIDBI and Caspian Impact Investments, have representatives on the board.

Good systems and processes – The company uses an integrated loan origination and management system, which integrates the core operations, accounting, human resources and learning and development modules. It has invested significantly in technology to ensure the real-time availability of data, verification of customer details and cashless disbursements. SFPL has deployed a separate team for the appraisal of individual loans. The scope and frequency of internal audit is in line with the industry. The company follows the code of responsible lending launched by the self-regulatory organisations of the microfinance industry.

Adequate capitalisation profile – The capitalisation profile is adequate, supported by regular capital infusions with the company receiving equity of Rs. 77.23 crore in FY2019 (Rs. 75 crore in the form of compulsory convertible preference shares (CCPS), which got converted into equity in FY2020). The capital adequacy ratio was comfortable at 23.01% (Tier I: 17.02%) as on March 31, 2020 (25.95% and 22.51%, respectively, as on March 31, 2019). The gearing was moderate at 5.44 times as on March 31, 2020 (4.80 times as on March 31, 2019). As on June 30, 2020, the capital adequacy ratio stood at 20.27% (Tier I: 17.56%) with adjusted gearing of 5.36 times. Given its growth plans and gearing target, it would be important for the company to raise equity capital in a timely manner to maintain its capitalisation profile.

Credit challenges

Geographically concentrated operations – SFPL remains exposed to regional risks with the top 3 states of Uttar Pradesh (50%), Bihar (24%) and Madhya Pradesh (17%) accounting for a high share of the portfolio as on March 31, 2020. Further, the top 10 and top 20 districts comprised 25% and 40%, respectively, of the portfolio outstanding and 151% and 241%, respectively, of the net worth as on March 31, 2020. ICRA notes the company's efforts to diversify its operations geographically at the state as well as district level and the same would be important from a credit perspective.

Ability to maintain asset quality indicators – The overall asset quality indicators have improved with gross NPAs of 1.54% and nil net NPAs as on March 31, 2020 from 3.34% and 2.70%, respectively, as on March 31, 2019 on account of write-offs and recoveries. The asset quality improved further in Q1 FY2021 as the company reported gross NPAs of 1.41% and nil net NPAs as on June 30, 2020. SFPL reported 0+ and 90+ dpd of 2.83% and 1.44%, respectively, as on March 31, 2020 (5.61% and 2.64%, respectively, as on March 31, 2019) and 2.70% and 1.27%, respectively, as on June 30, 2020. However, given the disruptions caused by the pandemic, the asset quality of the industry (including SFPL) is expected to weaken and the company's ability to contain the deterioration and absorb the likely losses will be a key rating monitorable.

Ability to manage political and communal risks, given the marginal borrower profile – The rating factors in 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 the company's operations, and thus its financial position. SFPL's ability to onboard borrowers with a good credit history, recruit and retain employees and improve the geographical diversity of its operations would be key for managing high growth rates.

Moderation in profitability – SFPL's net interest margin declined to 6.95% of AMA in FY2020 from 7.41% in FY2019. The operating expenses declined marginally to 4.44% of AMA in FY2020 from 4.51% in FY2019 as the company scaled up its operations. The credit costs increased to 3.45% of AMA (Rs. 69.40 crore) in FY2020 from 1.00% in FY2019 (Rs. 17.55 crore) as the company adjusted its expected credit loss (ECL) model in anticipation of Covid-19-related losses. This led to a reduction in its profitability in FY2020 as SFPL reported PAT/AMA of 0.70% in FY2020 compared to 1.87% in FY2019 and a return on net worth of 5.32% in FY2020 compared to 15.13% in FY2019. In Q1 FY2021, the company reported PAT/AMA of 0.33% and a return on net worth of 2.42%. The moderation in the profitability was on account of the increase in the provisioning due to Covid-19.

Liquidity position: Adequate

As the advances comprise relatively shorter-tenure microfinance loans compared to the tenure of the borrowed funds, the asset liability maturity (ALM) profile remains comfortable. The company had adequate liquidity in the form of unencumbered cash and liquid balances of ~Rs. 275 crore as on August 21, 2020. Additionally, it had Rs. 20 crore of sanctioned unutilised funding lines from two lenders as on August 21, 2020. While ICRA expects SFPL to meet its debt obligations in a timely manner, it would be important for the company to maintain its collection efficiency while ensuring a regular flow of funds to meet its internal growth projections.

Rating sensitivities

Positive triggers – ICRA could revise the outlook to Positive or upgrade the rating if there is a sustained improvement in the company's profitability indicators with a return on managed assets of more than 2.5% on a sustainable basis, an improvement in the scale and geographical diversification while maintaining the asset quality, and prudent capitalisation with the adjusted gearing being below 5 times on a sustained basis.

Negative triggers – Pressure on the company's rating could arise if there is a deterioration in the asset quality which, in turn, could affect its profitability with the return on managed assets falling below 2%. An increase in the adjusted gearing beyond 6 times or a weakening in the liquidity could also exert pressure on the rating.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	[ICRA's Credit Rating Methodology for Non-Banking Finance Companies] [ICRA's Policy on Withdrawal and Suspension of Credit Rating]
Parent/Group Support	Not applicable
Consolidation/Standalone	Standalone

About the company

SFPL is a non-banking finance company – microfinance institution (NBFC-MFI) registered with the Reserve Bank of India (RBI). The company was incorporated in 1995 and its microfinance operations commenced in 2006. SFPL's registered office is in Lucknow. It offers credit to economically-backward women engaged in income-generating activities like processing and manufacturing activities, service activities and animal husbandry. While the company offers a gamut of loans including loans for home improvement, utility, sanitation, etc, its focus product is income-generating group loan (IGL) using the joint liability group lending (JLG) model. As on June 30, 2020, the company was managing a portfolio of Rs. 1,645 crore through a network of 443 branches spread across 130 districts in 8 states.

Key financial indicators (audited)

	Ind-AS FY2019	Ind-AS FY2020	Ind-AS Q1 FY2021^
Total income	301.71	334.60	80.32
Net interest income	123.75	139.75	43.31
Profit after tax (PAT)	32.99	14.09	1.66
Net worth	256.85*	272.69	274.73
Gross loan portfolio	1,441.08	1,768.06	1,644.73
% PAT / Average managed assets	1.87%	0.70%	0.33%
% PAT / Average net worth	15.13%	5.32%	2.42%
% Gross NPAs	3.34%	1.54%	1.41%
% Net NPAs	2.70%	0.00%	0.00%
% Net NPA / Net worth	14.25%	-	-
% Capital adequacy ratio	25.95%	23.01%	20.27%
Gearing (reported)	4.69	4.59	4.53
Gearing (adjusted)	4.80	5.44	5.36

*Amounts in Rs. crore; * CCPS of Rs. 75 crore considered as part of the net worth; ^ Unaudited*

Status of non-cooperation with previous CRA: CRISIL, October 2016

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	Rating	FY2020	FY2019					FY2018		
				31-Aug-20	02-Mar-20	06-Feb-19	03-Jan-19	10-Dec-18	31-Oct-18	20-Sept-18	29-Jan-18	19-Jun-17
Bank lines	Long term	500.00	311.29	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB (Stable)
NCD programme	Long term	235.00	185.50	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB (Stable)
Subordinated debt programme	Long term	15.00	15.00	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB (Stable)
NCD programme	Long term	25.00	-	[ICRA]BBB (Stable)	-	-	-	-	-	-	-	-
NCD programme*	Long term	98.00	0.00	withdrawn	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB (Stable)

**Instrument matured and rating withdrawn; 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 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
INE509M07196^	NCD	30-Jun-2015	14.70%	30-Sep-2020	30.00	[ICRA]BBB(Stable)
INE509M07121	NCD	03-Mar-2016	14.00%	15-Apr-2022	10.00	[ICRA]BBB(Stable)
INE509M07147	NCD	26-Oct-2016	12.77%	26-Oct-2021	67.00	[ICRA]BBB(Stable)
INE509M07204#	NCD	31-Jul-2017	12.53%	31-Jul-2022	78.00	[ICRA]BBB(Stable)
INE509M07170	NCD	07-Dec-2018	14.20%	31-Mar-2023	20.00	[ICRA]BBB(Stable)
INE509M07097	NCD	06-Apr-2015	14.75%	18-Dec-2020	15.00	[ICRA]BBB(Stable)
Unallocated/Proposed	NCD	-	-	-	40.00	[ICRA]BBB(Stable)
INE509M07139	NCD*	22-Jun-2016	14.00%	22-Jun-2022	68.00	Withdrawn
INE509M07154	NCD*	21-Mar-2017	12.17%	23-Mar-2020	30.00	Withdrawn
INE509M08012	Subordinated debt	02-Mar-2016	16.25%	15-Apr-2022	15.00	[ICRA]BBB(Stable)
NA	Term loans	28-Sep-2016 to 31-12-2019	10.60% - 13.50%	25-03-2020 to 13-03-2022	311.29	[ICRA]BBB(Stable)
NA	Long-term bank lines – Unallocated	NA	NA	NA	188.71	[ICRA]BBB(Stable)

**Instrument matured and rating withdrawn; Source: Company*

^ This instrument has been restructured with a new maturity date of September 30, 2020 and the revised ISIN is INE509M07196; the earlier maturity date was June 30, 2020 and ISIN was INE509M07105

 # This instrument has been restructured with a new coupon rate of 12.5266% and the revised ISIN is INE509M07204; the earlier coupon rate was 12.77% and ISIN was INE509M07162

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