October 12, 2020

InCred Financial Services Limited: [ICRA]A1 assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Short-term Bank Limits – Unallocated	100.00	[ICRA]A1; assigned
Total	**100.00**	

**Instrument details are provided in Annexure-1*

Rationale

The assigned rating factors in InCred Financial Services Limited's (IFSL) experienced management team and healthy capitalisation profile backed by reputable investors. Since commencing active operations in FY2017, IFSL has raised Rs. 1,008.5 crore from a diverse set of investors. This has helped it maintain a health capitalisation profile with a capital-to-risk-weighted assets ratio (CRAR) of 45.4% and a gearing of 1.4 times as on June 30, 2020. The rating also considers the company's diversified product portfolio, which is spread across consumer loans (personal loans and two-wheeler loans), education loans (student loans and secured school financing and micro, small and medium enterprise (MSME) loans (anchor-backed business loans, non-anchor-backed business loans and lending to financial institutions (FIs) and escrow backed lending). Moreover, the portfolio is backed by adequate underwriting and risk management systems. While the company utilises a technology-based system (artificial intelligence-based algorithm) for underwriting personal loans, it uses traditional underwriting for the other business segments. The rating also factors in IFSL's demonstrated ability to raise long-term debts from a diversified lender base. The company raised Rs. 535.8 crore of debt from diversified sources in Q1 FY2021, with ~75% in the form of long term debt (tenure of more than one year).

The rating is, however, constrained by the moderate scale of operations and the subdued profitability level owing to the elevated operating expenses amid the expansion phase. The rating is also constrained by the limited seasoning of a large share of the portfolio, the long product tenure specially for the education loan segment (41% of the book) and the moderate asset quality. The impact of the ongoing Covid-19 pandemic on the economy has constrained the lending operations and is likely to weaken the asset quality in the near term, in line with the impact expected on the industry. As on August 31, 2020, ~35% of the loan book was under moratorium compared to ~52% as on May 31, 2020, indicating the improving sentiments of the borrowers towards recovery. With the moratorium ending in August 2020, IFSL's ability to improve the collections and contain the resulting delinquencies would remain critical over the near term. ICRA notes that the collection efficiency, which stood at ~70% in July and August 2020, improved significantly in September 2020 (~76% as on September 20, 2020; management's expectation of 85-90% for September 2020). The adequate liquidity profile, supported by the moderate collections and the sizeable fund raising in the past two quarters, provides comfort. The rating does not factor in any inorganic growth. In case of any merger and/or acquisitions, ICRA will review the rating on a case-to-case basis.

Key rating drivers and their description

Credit strengths

Well capitalised for medium-term growth requirements; demonstrated ability to raise capital from existing and new investors – IFSL is well capitalised with a net worth of Rs. 1,035.8 crore as on June 30, 2020. Its gearing was low at 1.4

times and the CRAR was comfortable at 45.4% as on June 30, 2020. The capitalisation profile is supported by the equity infusion of Rs. 1,008.5 crore since inception (Rs. 581.3 crore between FY2017 and FY2019 and Rs. 427.1 crore in FY2020) following the takeover of the company by the current promoter group. IFSL's shareholders include reputable private equity/investment companies like FMO (a Netherlands-based entrepreneurial development bank), OAKS Asset Management and Associates (formerly Alpha Capital), Investcorp (IDFC Private Equity Fund), Moore Strategic Ventures, Dalmia Enterprise Holdings, Elevar Equity, Paragon Partners and Ranjan Pai (Manipal Group). Going forward, the company's gearing is expected to increase considering the envisaged growth in the loan book. The management's plan to maintain the gearing below 4 times provides comfort. The current capitalisation provides the company with adequate headroom to grow over the near to medium term (IFSL plans to grow its loan book at a CAGR of ~30% over the next three years).

Experienced senior management team – IFSL's board of directors consists of eight members with diverse and considerable experience in the financial services industry. The board has three independent directors and three representatives of the private equity investors apart from the CEO (promoter) and the CFO. The board is advised by the former co-CEO of Deutsche Bank. ICRA also takes note of the experience of the promoter and the senior management team in banking and financial services. The key business functions, including product-wise credit and underwriting, risk and data analytics, technology, treasury and human resources, are headed by personnel with adequate experience (~18-25 years) in these fields.

Diversified product mix supports business risk profile – IFSL has a diversified loan book comprising personal loans (21% of the loan book as on June 30, 2020), two-wheeler loans (4%), student loans (18%), school finance (23%), anchor-backed business loans (11%), non-anchor-backed business loans (9%) and lending to FIs and escrow-backed lending (13%). The mix between the secured and unsecured loan book was 46:54 as on June 30, 2020. As on August 31, 2020, ~27% of the non-anchor-backed loan book was covered under the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) scheme.

Credit challenges

Moderate scale of operations with limited seasoning of sizeable part of portfolio – IFSL started operations in FY2017 and FY2018 was the first full year of operations. Though products with a short tenure like personal loans and anchor-backed business loans have seen seasoning, a significant portion of the total portfolio is in the first cycle and the credit quality is yet to be established, especially in the education loan segment that has a long tenure with a moratorium. As on June 30, 2020, 24% of the total book had a tenure of more than 10 years while 16% had a tenure ranging from 5 years to 10 years and 60% had a tenure of less than 5 years.

Moderation in asset quality in recent quarters; ability to contain the same amid general recovery from pandemic remains to be seen – With the gradual seasoning of the portfolio, the company witnessed a moderation in its asset quality in FY2020 with its gross non-performing assets (GNPAs) and net non-performing assets (NNPAs) increasing to 2.86% and 1.34%, respectively, as on March 31, 2020 from 1.80% and 0.71%, respectively, as on March 31, 2019. As on June 30, 2020, the GNPAs and NNPAs were 2.93% and 1.36%, respectively. A significant portion of the NPAs pertains to the MSME segment (GNPAs of 4.98% as on June 30, 2020), largely due to the now-discontinued automobile supply chain lending segment. IFSL currently focuses only on information technology (IT) supply chain lending as a part of its anchor-backed business loans, in addition to the anchor-backed two-wheeler loans and other anchor-backed business loans.

With the disruption in economic activities over the past six months due to the pandemic-related nationwide lockdown, the credit profile of a section of the borrowers was impacted and these borrowers availed the moratorium benefit offered by the COVID-19 – Regulatory Package of the Reserve Bank of India (RBI). As on August 31, 2020, ~35% of the portfolio was under moratorium with a major portion of secured school loan, personal loan and unsecured business loan borrowers availing the moratorium. Though ~27% of the non-anchor-backed loan book is guaranteed under the CGTMSE scheme and IFSL maintains sufficient security cover against the school finance portfolio, its ability to maintain the asset quality, especially with the moratorium ending in August 2020, would be a key monitorable.

Moderate profitability though expected to improve with an increase in scale of operations – IFSL's total income increased at a CAGR of ~9% over the last three years. Despite the liquidity tightening in the market, the cost of funds (CoF) improved to 9.8% in FY2020 from 10.5% in FY2019. This supported an improvement in the net interest margin (NIM) to 9.3% in FY2020 from 8.5% in FY2019. IFSL's cost-to-income ratio remains high, albeit with some improvement in the past, which is typical of the early stage of operations with the entity being in expansion mode. This, coupled with the high credit costs, resulted in a moderate profitability level. The credit cost was high at 2.68% of the average total assets in FY2020 (1.46% in FY2019) as the company increased the expected credit loss (ECL) allowance to provide for the estimated impact of the pandemic on the business. The Covid-19 related provisions stood at ~Rs. 5 crore in FY2020. In FY2020, IFSL reported a profit after tax (PAT) of Rs. 4.3 crore (return on assets (RoA) of 0.2%) compared to Rs. 3.8 crore in FY2019 (RoA of 0.2%). In FY2020, the PAT was also impacted by an exceptional loss of Rs. 6.2 crore due to the impairment of IFSL's investment in its housing finance subsidiary[1]. If the exceptional loss and the Covid-19 related provisions were to be excluded, the PAT would have been Rs. 15.5 crore (RoA of 0.75%) in FY2020. The return on average net worth (RoNW) was 0.5% in FY2020 compared to 0.7% in FY2019. Going forward, the company's ability to scale up its operations while keeping the credit cost under control will remain critical from a credit perspective.

Liquidity position: Adequate

IFSL had total liquidity of Rs. 362.7 crore as on June 30, 2020, comprising Rs. 31.7-crore cash and bank balances and Rs. 331 crore in the form of mutual fund investments and fixed deposits. In addition, the company had unutilised bank lines of ~Rs. -60 crore as on June 30, 2020. In Q1 FY2021, IFSL raised funds aggregating Rs. 535.8 crore through multiple sources including schemes like Targeted Long Term Repo Operations (TLTRO), Partial Credit Guarantee Scheme (PCGS) and Special Liquidity Scheme (SLS).

As per the asset-liability maturity statement as on June 30, 2020, IFSL has debt repayments aggregating ~Rs. 344.1 crore (including interest) due during July 2020 to December 2020. The available liquidity, as on June 30, 2020, fully covers the debt obligation for this period. The liquidity position is thus adequate.

Rating sensitivities

Positive triggers – The rating may be upgraded if IFSL profitably (RoA of at least 3% on a sustained basis) scales up its loan book while maintaining a healthy asset quality and a comfortable leverage level.

Negative triggers – Any deterioration in the asset quality (GNPAs including one-year write-offs of more than 5% on a sustained basis) could result in a rating downgrade. Pressure on the rating could also arise if IFSL fails to raise long-term debt funds to support its planned business growth over the medium term. The inability to raise equity capital to support

[1] *IFSL has discontinued the housing loan business carried out under its subsidiary, InCred Housing Finance Private Limited, which is in the process of surrendering its housing finance company (HFC) license.*

the long-term growth, resulting in an increase in the gearing to more than 4 times on a sustained basis, can also lead to pressure on the rating.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA's Credit Rating Methodology for Non-Banking Finance Companies
Parent/Group Support	Not applicable
Consolidation/Standalone	Standalone

About the company

InCred Financial Services Limited (IFSL) is registered with the RBI as a systematically important, non-deposit taking non-banking finance company (NBFC-ND-SI). It was incorporated in 1991 as Visu Leasing and Finance Private Limited and was rechristened IFSL following its acquisition by the current promoter (Mr. Bhupinder Singh, who was previously the co-head of the Investment Banking & Securities Division for the Asia Pacific region at Deutsche Bank) in FY2017. IFSL is currently backed by an investor base including Mr. Anshu Jain (former co-CEO of Deutsche Bank), Mr. Ranjan Pai of Manipal Group, FMO (a Netherlands-based entrepreneurial development bank), OAKS Asset Management and Associates, Investcorp, Moore Strategic Ventures, Dalmia Enterprise Holdings, Elevar Equity and Paragon Partners, among others. The company completed its first year of active operations under the present management in FY2018. It offers consumer loans, education loans and business loans to the MSME segment. IFSL had a presence in 17 cities in 10 states/Union Territories with ~650 employees as on June 30, 2020. The loan book (gross) stood at Rs. 1,912 crore (46% secured and 54% unsecured) as on June 30, 2020, comprising MSME loans (~32.9%), education loans (~41.3%) and consumer loans (~25.8%). Along with the traditional underwriting model, IFSL leverages the artificial intelligence-based digital underwriting model.

Key financial indicators

For the period	FY2019 IND-AS Audited	FY2020 IND-AS Audited	Q1 FY2021 IND-AS Provisional
Interest Income from Lending Portfolio	282.4	309.3	79.7
Net Interest Income	144.6	191.0	44.9
Profit before Tax (PBT)	5.6	12.3	8.0
Profit after Tax (PAT)	3.8	4.3	6.1
Net Worth	595.7	1,027.3	1,035.8
Total Debt	1,253.1	1,167.2	1,399.6
Loan Book (Gross)	1,733.1	2,041.7	1,911.8
Total Assets	1,877.5	2,250.0	2,498.0
PAT / Average Total Assets (RoA; %)	0.2%	0.2%	1.0%
Return on Average Net Worth (RoE; %)	0.7%	0.5%	2.4%
Total Debt / Net Worth (times)	2.1	1.1	1.4
CRAR (%)	29.6%	45.9%	45.4%
Gross Non-performing Assets [GNPA] (%)	1.8%	2.9%	2.9%
Net Non-performing Assets/Net Worth (%)	2.1%	2.7%	2.5%

Source: Company; All ratio as per ICRA calculation; Amount Rs. crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Current Rating (FY2021)				Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding*	12-Oct 20	FY2020	FY2019	FY2018
						-	-	-
1	Short-term Bank Limits - Unallocated	Short Term	100.00	-	[ICRA]A1; assigned	-	-	-

*Amount Rs. crore; *As on July 31, 2020*

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
-	Short-term Bank Limits - Unallocated	-	-	-	100.00	[ICRA]A1; assigned

Source: Company

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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