Sambandh Finserve Private Limited

Instrument	Amount (In Rs. Crore)	Rating	Rating Action December 2016
Term Loans	45	[ICRA]BB-@	Rating placed on watch with negative implications

ICRA has placed the "[ICRA]BB-" (pronounced ICRA double B minus) rating to the Rs. 45 crore term loans of Sambandh Finserve Private Limited (SFPL) on watch with negative implications.

The rating action follows the likely adverse impact of recent demonetization on SFPL's liquidity and asset quality indicators. The risk of SFPL's credit quality deteriorating in the near to medium term is relatively high owing to its high leverage (total debt including off balance sheet book to net-worth to 8.51 times as on June 30, 2016). SFPL's collection efficiency has been impacted post demonetisation owing to limited currency supply, and disruption in borrowers' cash flows. The uncertainty on the likely near-term collection efficiency has been increased owing to a possible worsening of credit culture. In this regard, ICRA takes note of the steps undertaken by individual NBFC-MFIs as well as M-Fin (Microfinance Institutions Network, the Self-regulatory Organisation for NBFC-MFIs) to create awareness about the MFI's operations among the government administration as well to contain the contagion risk.

Nevertheless, unless the ground-level situation on the above mentioned issues improves, SFPL could face pressures on liquidity and asset quality front over the next 3-6 months even if incremental disbursements are significantly reduced. In ICRA's opinion, SFPL's ability to garner fresh funding, if required, would be critical for its operations over the short-term. ICRA will continue to closely monitor the company, more specifically the portfolio collection efficiency and access to funding and would take suitable rating action once more clarity emerges on these issues.

The rating also takes into account SFPL's moderate scale (managed portfolio size of Rs. 99.29 crore as on June 30, 2016) and geographically concentrated nature of operations (over 80% of portfolio in two districts of Odisha) and its evolving systems and processes. The rating also factors in the company's weak capitalisation profile (networth/ average managed advances of 11.31% as on June 30, 2016), limited financial flexibility, and moderate profitability indicators (ROE of 12.7%). The rating takes into account the reasonable experience of the management team, the company's adequate internal audit processes and its good asset quality indicators (0+ dpd at 0.35% as on June 30, 2016), albeit the high delinquencies in some pockets. ICRA also takes note of the proposed Rs. 1.5 crore of equity infusion from promoters, conversion of Rs. 1.8 crore optionally convertible preference shares by SIDBI and infusion of Rs. 2.5 crore of compulsorily convertible preference shares by Dia Vikas Capital Private Limited in Q4FY2017, which would improve the company's capitalisation profile. ICRA also takes note of the management's plans to upgrade to a core banking solution. Going forward, the company's ability to secure adequate debt and equity to achieve its targeted business growth, to improve its internal systems and control processes, and demonstrate control over asset quality with an increase in scale would be critical rating sensitivities.

The rating also factors in risks associated with unsecured lending, political and operational risks arising out of cash handling and high attrition rates. Given the marginal profile of its borrowers and the risk of their overleveraging, the credit quality of micro-loan portfolios is fundamentally characterised by a high level of volatility. The potential impact of political events (such as debt waivers), or natural calamities can be substantial as witnessed during the Andhra Pradesh crisis. While access to credit bureaus and the regulatory ceiling on borrower indebtedness are a positive, given the issues related to multiple identity proofs and incomplete information availability with the credit bureaus, rising competition with a large number of new entrants (especially through the business correspondent model), MFIs would need to carefully assess the debt repayment capacity of borrowers to limit the risk of overleveraging and the consequent threat to portfolio credit quality. ICRA takes comfort from the efforts at industry level to alleviate these concerns through standardization of KYC documents, digitization of SHG programme and the lower debt limit prescribed by MFIN.

The company aims to grow at a CAGR of 45-50% over the next three years; to meet the growth target, it would need to raise additional equity of Rs. 40-45 crore (around 400% of its current networth) over this period and tie-up adequate borrowings. Over the next three years, the company aims to expand into new districts in Jharkhand and Chattisgarh, and reduce its geographic concentration.

As on June 30, 2016, 84% of the company's on-book borrowings were from financial institutions and its off-balance sheet borrowings accounted for 31% of the total borrowings. SFPL's average cost of borrowings was high at ~15% in FY2016. ICRA notes that the company would need to diversify its resource profile and tie-up larger credit lines from banks at competitive rates to fund its proposed growth.

With a lending rate of around 23-26%, the interest spreads of the company in FY2016 were around 7%-10%. Consequently, the company reported healthy profitability indicators with RoE at 12.7% as on FY2016.

Company Profile

SFPL started operations in 2006 through a project under Regional Rural Development Centre (RRDC), and converted to an NBFC in 2009. In 2013, it secured an NBFC-MFI licence from the Reserve Bank of India. Its corporate and registered offices are located in Rajgangpur, Odisha. SFPL offers microfinance loans under both joint liability and self-help group models, for income generation. Loans are also offered under Water and Sanitation Program (WATSAN).

SFPL extends loans through its network of 22 branches, spread over 11 districts of Odisha, Chattisgarh and Jharkhand. The company acts as a business correspondent for IDBI Bank and Yes Bank Limited.

SFPL reported a provisional profit after tax of Rs. 0.70 crore during Q1FY2017 (Rs. 1.10 crore in FY2016) with total advances (managed + own) of Rs. 99.29 crore as on June 30, 2016 (Rs. 96.89 crore as on March 31, 2016).

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