ICRA

June 28, 2017

Sambandh Finserve Private Limited

Summary of rated instruments

Instrument*	Rated Amount (in Rs. crore)	Rating Action
Term Loans	44.92	[ICRA]BB-(stable); watch with negative implications removed and a stable rating outlook assigned
Un-allocated	0.08	

*Instrument details are provided in Annexure-1

Rating action

ICRA has removed 'watch with negative implications' from [ICRA]BB- (pronounced ICRA double B minus) rating to the Rs. 45 crore[1] long term bank lines of Sambandh Finserve Private Limited (SFPL)[2] and a "stable" outlook has been assigned.

Rationale

The rating has been removed from watch, following the company's strong collection efficiency (average of 99.21% during December 2016 to April 2017) and stable disbursements post demonetisation. The company has continued to receive funding from lenders even after demonetisation which enabled it to expand its portfolio to Rs 128.76 crore as on April 30, 2017 from Rs. 96.93 crore as on March 31, 2016. Given the large share of SFPL's portfolio in Odisha, where collections were not materially impacted by demonetisation, the company's asset quality indicators were less affected than that of peer MFIs. SFPL's 0+ dpd stood at 0.67% as on April 30, 2017. The rating also takes into account the management team's experience in microfinance industry and the company's adequate internal audit processes for its current scale of operations.

The ratings are however constrained by SFPL's moderate scale (managed portfolio size of Rs. 128.76 crore as on April 30, 2017) and geographically concentrated operations (~82% of portfolio in two districts of Odisha) and its evolving systems and processes. The rating also factors in the company's weak capitalisation profile (net worth/average managed advances of 11.24% as on March 31, 2017[3]), limited financial flexibility, and moderate profitability indicators (ROE of 9.4% as on March 31, 2017[3]). However, ICRA takes note of the conversion of Rs. 1.5 crore optionally convertible preference shares by SIDBI and the expected infusion of Rs. 2.5 crore of compulsorily convertible preference shares by Dia Vikas Capital Private Limited in Q1FY2018, which would improve the company's capitalisation profile. ICRA also takes note of the management's plans to upgrade to a core banking solution in the near term.

Key rating drivers

Credit strengths

- Moderate track record of operations
- Adequate term loan origination and risk management systems for the current scale of operations
- Healthy asset quality indicators, with limited impact of demonetisation
- Diversified funding profile; however, high dependence on NBFCs

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[1] 100 lakh = 1 crore = 10 million

[2] For complete rating scale and definitions, please refer to ICRA's website (www.icra.in) or other ICRA rating publications

[3] Provisional results

Credit weaknesses

- High geographical concentration risk, with ~82% of the portfolio being concentrated in two districts of Odisha
- Weak capitalisation indicators with net worth/managed advances of 11.24% as on March 31, 2017
- To recruit and train personnel to manage the growth and attrition
- To manage industry specific risks including political, communal and other risks in the areas of operation

Description of key rating drivers:

SFPL currently operates through its 30 branches across the three states of Odisha, Chhattisgarh and Jharkhand. However, its geographical concentration risk is very high with ~82% of the total portfolio as on March 31, 2017 being concentrated in two districts in Odisha. To increase the geographic diversity of its portfolio, the company plans to expand its operations to new districts in Chhattisgarh and Jharkhand going forward. The company registered a portfolio growth of 34% in FY2017 supported by an expansion in branch network and an increase in its client base and ticket sizes. The management aims to grow the portfolio at a CAGR of 45-50% over the next two years. ICRA notes that while the company is operating in areas with low microfinance penetration and good growth potential, as it expands into less penetrated geographies, it would be important to maintain credit discipline and systems, so as to maintain good asset quality.

SFPL has an experienced management team with functional heads supervising the key areas and operations of the company. Given the limitations of the company's current software, the management is in the process of upgrading to a core banking module. The company is registered with two credit bureaus and all loan sanctions are made after a credit bureau check. As mandated by the RBI, SFPL caps the total indebtedness of a borrower at Rs. 100,000. For its own portfolio, the company follows a two lender policy, while for its BC portfolio it extends loans as a third lender.

SFPL has demonstrated good collection efficiency even after the cash shortage following the Government of India's demonetisation action in November 2016. Its average collection efficiency during December 2016 to April 2017 stood at 99.21%. The company also continued to receive funding from lenders which enabled it to maintain disbursement levels. Supported by good collection efficiency, SFPL reported good asset quality indicators with 0+ dpd of around 0.67% as on April 30, 2017.

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 of 2009. 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 rating also factors in the company's weak capitalisation profile (networth/average managed advances of 11.24% as on March 31, 2017), limited financial flexibility, and moderate profitability indicators (ROE of 12.7%). ICRA also takes note of the conversion of Rs. 1.5 crore optionally convertible preference shares by SIDBI and the infusion of Rs. 2.5 crore of compulsorily convertible preference shares by Dia Vikas Capital Private Limited in Q1FY2018, which would improve the company's capitalisation profile. As on March 31, 2017, 75% of the company's on-book borrowings were from financial institutions while its off-balance sheet borrowings accounted for 25% of the total. SFPL's average cost of borrowings was high at 14.79% in FY2017. 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. SFPL provides loans at an interest rate of 23-26% along with 1% processing fee. Its yields on average loans and cost of average interest bearing funds were at 24.53% and 13.48% respectively during FY2017 as compared with 27.28% and 16.10% respectively during FY2016. This translated into net interest margins of 9.0% in FY2017 and 10.0% in FY2016. The company's operating expenses as a % of AMA marginally increased to 7.7% during FY2017 from 7.3% during FY2015. The decline in net interest margins coupled with the increase in operational expenses led to a lower ROE of 9.4% in FY2017[4] in comparison with 12.7% in FY2016.

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.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria

https://www.icra.in/Rating/ShowMethodologyReport/?id=401&Title=Microfinance%20Institutions&Report=Microfinance%20Institutions,%20Grading%20Methodology,%202015.pdf

About the company

SFPL (erstwhile Modline Build-cap Private Limited) was incorporated in July 1996. The microfinance activities were started by the promoters of SAMBANDH in the year 2006 as a project under Regional Rural Development Centre (RRDC), one of the reputed NGOs in Odisha. It 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. It also offers loans under the Water and Sanitation Program. SFPL operates through its network of 30 branches, spread over 16 districts of Odisha, Chattisgarh and Jharkhand. The company acts as a business correspondent for IDBI Bank and Yes Bank.

SFPL reported a provisional profit after tax of Rs. 1.19 crore during FY2017 (Rs. 1.10 crore in FY2016) with total advances (managed and own) of Rs. 130.30 crore as on March 31, 2017 (Rs. 96.93 crore as on March 31, 2016).

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

[4] Provisional results

Rating history for last three years:
Table:

S. No.	Instrument	Current Rating (FY 2018)			Chronology of Rating History for the past 3 years	
		Type	Amount Rated (Rs. crore)	June 2017	FY2017	
					December 2016	November 2016
1	Term Loan	Long Term	44.92	[ICRA]BB-(stable)	[ICRA]BB-@	[ICRA]BB-(stable)
2	Unallocated	Long Term	0.08	[ICRA]BB-(stable)	[ICRA]BB-@	[ICRA]BB-(stable)

@Rating placed on watch with negative implications

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

Instrument	Date of Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
Term Loans		-	August 14, 2018	44.92	[ICRA]BB-(stable)
Unallocated		-	-	0.08	[ICRA]BB-(stable)

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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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