December 16, 2019

Magma Fincorp Limited: Rating reaffirmed; Outlook revised to Negative from Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loans (bank)	2,056.67	2,056.67	[ICRA]AA- (Negative); reaffirmed, outlook revised to Negative from Stable
Non-convertible Debenture Programme	335.00	335.00	[ICRA]AA- (Negative); reaffirmed, outlook revised to Negative from Stable
Total	**2,391.67**	**2,391.67**	

**Instrument details are provided in Annexure-1*

Rationale

To arrive at Magma Fincorp Limited's (MFL) rating, ICRA has taken a consolidated view of the credit profiles of MFL and Magma Housing Finance Limited (MHFL; together referred to as the Magma Group) owing to their common management and shared infrastructure.

The rating factors in the Group's strong presence in the retail asset finance business with a wide geographical presence through 310 branches across 21 states. The rating also factors in the Group's comfortable capitalisation levels (CRAR – 27.6% for MFL, CRAR – 33.8% for MHFL as on September 30, 2019), well-diversified portfolio mix and adequate liquidity buffer in the form of unutilised drawable bank lines and unencumbered cash and liquid investments. In ICRA's opinion, prudent capitalisation is a key mitigant against delinquencies and other credit risks associated with the Group's business. The Group's retail loan book supports its asset liability management (ALM) profile and since a sizeable part of its loan book qualifies for priority sector lending, down-selling is an important funding option for the Group.

The revision in the outlook on the Group's rating factors in the deterioration in the asset quality indicators following the reduced collection efficiencies in certain geographies and loan segments (commercial vehicles - CVs and construction equipment - CE). Consequently, the credit costs were high and adversely impacted the profitability metrics of the Group. While there could be some recovery in H2 FY2020, ICRA expects the Group's profitability to remain subdued over the medium term. Moreover, ICRA expects the Group to continue having relatively weaker asset quality indicators compared to the peer set. Given the relatively moderate borrower credit profiles (first-time buyers, small entrepreneurs, self-employed and non-income proof category), the Group's ability to profitably grow its business while improving the asset quality from the current levels and maintaining prudent capitalisation would be a key rating sensitivity.

Key rating drivers and their description

Credit strengths

Established player in retail asset finance business – Incorporated in 1988, the Magma Group is a significant player in the retail asset finance space with an experienced management team and a wide geographical presence through 310 branches across 21 states, mostly in semi-urban and rural areas. The Group's managed assets under management (AUM) stood stable at Rs. 16,463 crore as on September 30, 2019 on a consolidated basis. It has a well-diversified managed portfolio mix comprising cars and utility vehicles (19%), CVs (10%), CE (7%), used assets (21%), tractors (10%), SME (12%) and mortgage (22%) as on September 30, 2019. The Group's retail loan book supports its ALM profile. Moreover, as a large part of the portfolio qualifies for priority sector lending, the ability to down-sell loans remains high.

Adequate capitalisation profile – The Group's capitalisation profile is adequate for the current scale of operations with a CRAR of 27.6% (MFL) and 33.8% (MHFL) and a net worth of Rs. 2,752 crore as on September 30, 2019. The managed gearing remained stable at 4.5 times as on September 30, 2019 (4.8 times as on March 31, 2019). Despite the muted internal capital generation, the capitalisation has remained adequate due to modest business growth with the disbursements declining by 54% in Q2FY2020 (declined by 24% in H1 FY2020) on a YoY basis. On a consolidated basis, the solvency ratio (net NPA/net worth) improved to 21.77% (as per Ind-AS) as on September 30, 2019 from 24.46% as on September 30, 2018, supported by the significant write-off of loans (~Rs. 410 crore in FY2019 and Rs. 205 crore in H1 FY2020). According to ICRA, prudent capitalisation is a key mitigant against delinquencies and other credit risks associated with Magma's business and ICRA expects the Group to maintain prudent capitalisation going forward as well.

Credit challenges

Modest asset quality indicators – The Group's asset quality indicators deteriorated with the gross stage 3% and net stage 3% rising to 6.4% and 4.2%, respectively, as on September 30, 2019 from 4.8% and 3.1%, respectively, as on March 31, 2019 (as per Ind-AS), despite the write off of loans worth Rs. 205 crore in H1 FY2020. The rise in delinquencies was majorly attributable to reduced collections in the CV and CE segments in Q2 FY2020 (accounted for ~70% of the increase in slippages) and in certain geographies such as Uttar Pradesh, West Bengal, Andhra Pradesh and Bihar (accounted for ~60% of the increase in slippages). Though the collection efficiencies improved to an extent in October and November, the vulnerability of the portfolio remains high. The asset quality indicators remain weaker than peers and the Group's ability to control fresh slippages and recover from delinquent accounts, especially in a challenging operating environment, would be a key monitorable.

Moderate profitability – In H1 FY2020, the Group's profitability was significantly impacted (RoA of 0.48% and RoE of 2.92%) by higher credit costs of Rs. 251 crore (2.97% of average assets) compared to Rs. 171 crore (2.11% of average assets) in H1 FY2019. The increase in credit costs was mostly attributable to the incremental provisions on loan write offs and the loss on the sale of repossessed assets. ICRA notes that though the Group's focus on product segments such as CVs, used assets, SME finance and mortgage (combined share of 65% of the overall portfolio as on September 30, 2019 compared to 56% as on September 30, 2018) could improve its risk-adjusted returns, its profitability is expected to remain subdued in the medium term due to elevated credit costs. The Group's ability to control fresh slippages and recover from delinquent accounts and hence report an improvement in the profitability indicators would be a key rating sensitivity.

Moderate portfolio vulnerability – The Group's portfolio remains vulnerable given the high proportion of borrowers with relatively moderate credit profiles (first-time buyers, small entrepreneurs, self-employed and non-income proof category). The customer segment includes small fleet operators, farmers, small traders, factory owners, shop owners and other borrowers with informal income wherein ~68% of the Group's portfolio was spread across semi-urban and rural areas as on September 30, 2019. The Group also provides unsecured loans to business enterprises as a part of its SME loan book. As on September 30, 2019, about two-third of the mortgage (including loan against property (LAP) and home loans) portfolio exposure was towards the self-employed borrower category (37% formal, 34% informal), while the rest was towards the salaried segment. The Group's ability to control fresh slippages and maintain a high collection efficiency in the near term would remain a key rating monitorable.

Liquidity position: Adequate

The Group's liquidity profile is adequate on a consolidated basis, supported by unencumbered cash and liquid investments of Rs. 233 crore and positive cumulative mismatches till the 6-month ALM maturity buckets as on September 30, 2019. However, as ~30% of the total borrowings are via working capital lines from banks, a positive mismatch in the 6-12-month maturity bucket will depend on the timely renewal of these lines.

The Group expects inflows of Rs. 3,538 crore compared to repayments of Rs. 1,719 crore in the next 6 months on a consolidated basis as on September 30, 2019. Moreover, it had Rs. 1,352 crore of unutilised sanctioned bank lines as on September 30, 2019, which supports its liquidity profile. Also, a large part of its portfolio is eligible for securitisation which provides an additional source of funding for the Group and hence supports the overall liquidity.

Rating sensitivities

Positive triggers – The Group's ability to improve its asset quality with a reduction in the 90+ dpd (including write-offs) to less than 6.5% of AUM on a sustained basis, while maintaining the gearing at the current level on a sustained basis, would lead to a revision in the rating outlook. Given the Negative outlook, a credit rating upgrade is unlikely in the near term.

Negative triggers – The Group's inability to improve its asset quality by reducing the 90+ dpd (including write-offs) to less than 6.5% of AUM along with its inability to maintain profitability with a return on average managed assets of over 1.5% on a sustained basis would lead to a revision in the credit ratings.

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	Consolidated view of the credit profiles of MFL and MHFL (together referred to as the Magma Group) owing to their common management and shared infrastructure

About the company

Magma Fincorp Limited (formerly MFL Leasing Limited and MFL Shrachi Finance Limited) was incorporated in 1988 and is registered with the Reserve Bank of India (RBI) as an asset-financing NBFC. The portfolio growth remained stagnant in H1FY2020 with the managed AUM at Rs. 16,463 crore as on September 30, 2019 compared to Rs. 16,526 crore as on September 30, 2018. The portfolio mix remained largely stable, with vehicle financing, SME and mortgage constituting 66%, 12% and 22%, respectively, of the portfolio. There has been an increased focus on the financing of CVs, used assets, SME and mortgage, the total share of which increased to 65% of the portfolio as on September 30, 2019 from 53% as on March 31, 2018. While MFL has a long track record in asset-based product financing (CVs, CE, cars, tractors), its SME business gained volume only from FY2014. The company entered mortgage financing in February 2013 and general insurance through a joint venture in October 2012.

In FY2019, MFL recorded a consolidated profit after tax of Rs. 304 crore on a total consolidated asset base of Rs. 16,789 crore compared with a consolidated profit after tax of Rs. 237 crore on a total consolidated asset base of Rs. 14,894 crore in FY2018. On a standalone basis, MFL reported a profit after tax of Rs. 275 crore on an asset base of Rs. 14,991 crore in FY2019 compared to a profit after tax of Rs. 202 crore on an asset base of Rs. 13,568 crore in FY2018.

In H1 FY2020, MFL recorded a consolidated profit after tax of Rs. 40 crore on a total consolidated asset base of Rs. 15,857 crore compared with a consolidated profit after tax of Rs. 145 crore on a total consolidated asset base of Rs. 15,457 crore in H1 FY2019. On a standalone basis, MFL reported a profit after tax of Rs. 20 crore on an asset base of Rs. 13,865 crore in H1 FY2020 compared to a profit after tax of Rs. 122 crore on an asset base of Rs. 13,955 crore in H1 FY2019. On a consolidated basis, the company's borrowing mix consisted of working capital lines (31%), securitisation (34%), non-convertible debentures (NCDs; 5%), term loans (22%) and perpetual & subordinated debt (8%) as on September 30, 2019. About two-third of the funding was generated through banks.

Key financial indicators (consolidated)

	FY2018 Ind-AS	FY2019 Ind-AS	H1 FY2020 Ind-AS
Profit after tax	237	304	40
Net worth	1,972	2,744	2,752
AUM	15,801	17,029	16,463
On-book portfolio	14,644	15,645	14,581
Return on average assets	1.6%	1.8%	0.5%
Return on average equity	11.4%	12.9%	2.9%
Gearing (times)	6.1	4.8	4.5
% CRAR (MFL standalone)	17.3%	24.9%	27.6%
% Gross stage 3 (on-book)	8.6%	4.8%	6.4%
% Net stage 3 (on-book)	4.5%	3.1%	4.2%
% Net stage 3/ Net worth	31.7%	17.2%	21.8%

Source: Magma, ICRA research; Amount in Rs. crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Current Rating (FY2020)							Chronology of Rating History for the Past 3 Years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in FY2020				Date & Rating in FY2019		Date & Rating in FY2018	Date & Rating in FY2017
					16-Dec-19	24-Oct-19	06-Aug-19	22-Jul-19	25-Jul-18	20-Apr-18	24-Jul-17	01-Feb-17
1	Term Loans (banks)	Long Term	2,056.67	2,056.67	[ICRA]AA-(Negative)	[ICRA] AA-(Stable)	[ICRA] AA-(Stable)	[ICRA] AA-(Stable)	[ICRA]AA-(Stable)	[ICRA] AA-(Stable)	[ICRA]AA-(Negative)	[ICRA]AA-(Negative)
2	NCD	Long Term	335	60.00*	[ICRA]AA-(Negative)	[ICRA] AA-(Stable)	[ICRA] AA-(Stable)	[ICRA] AA-(Stable)	[ICRA]AA-(Stable)	[ICRA] AA-(Stable)	[ICRA]AA-(Negative)	[ICRA]AA-(Negative)

Source: ICRA research, Magma

**Rs. 275 crore of yet-to-be placed NCDs*

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
INE511C07607	Secured NCD	18-Aug-2017	8.99%	19-Aug-2019	60	[ICRA]AA- (Negative)
NA	NCD (yet to be placed)	NA	NA	NA	275	[ICRA]AA- (Negative)
NA	Term Loan 1	29-Dec-2015	9.40%	31-Dec-2020	75	[ICRA]AA- (Negative)
NA	Term Loan 2	29-Dec-2015	9.10%	28-Dec-2020	63.75	[ICRA]AA- (Negative)
NA	Term Loan 3	26-Feb-2016	9.45%	31-Dec-2020	37.5	[ICRA]AA- (Negative)
NA	Term Loan 4	26-Sep-2017	9.90%	30-Sep-2022	162.5	[ICRA]AA- (Negative)
NA	Term Loan 5	31-Oct-2017	8.95%	30-Sep-2022	65.63	[ICRA]AA- (Negative)
NA	Term Loan 6	29-Jun-2016	10.60%	29-Jun-2021	35.29	[ICRA]AA- (Negative)
NA	Term Loan 7	31-Dec-2018	10.00%	31-Dec-2023	500	[ICRA]AA- (Negative)
NA	Term Loan 8	30-Mar-2019	10.50%	30-Mar-2024	150	[ICRA]AA- (Negative)
NA	Term Loan 9	30-Mar-2019	9.75%	31-Mar-2024	100	[ICRA]AA- (Negative)
NA	Term Loan 10	27-May-2019	9.80%	27-May-2023	392	[ICRA]AA- (Negative)
NA	Term Loan 11	28-Jun-2019	9.15%	27-Jun-2024	75	[ICRA]AA- (Negative)
NA	Term Loan 12	30-Mar-2019	12.50%	30-Mar-2026	100	[ICRA]AA- (Negative)
NA	Term Loan 13 (yet to be placed)	-	-	-	300	[ICRA]AA- (Negative)

Source: Magma

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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.

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