December 08, 2020

Magma Fincorp Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long Term Bank Lines	2,056.67	1,711.05	[ICRA] AA- (Negative); Reaffirmed
Total	2,056.7	1,711.05	

**Instrument details are provided in Annexure-1*

Rationale

To arrive at Magma Fincorp'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 geographic presence through 298 branches across 21 states, mostly in semi-urban and rural areas. The rating also factors in the Group's comfortable capitalisation levels (CRAR of 27.0% and a consolidated net worth of Rs. 2,830 crore as on September 30, 2020), well-diversified portfolio mix and adequate liquidity buffers 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. Magma also has adequate financial flexibility as reflected from its good banking relationships and diversified borrowing profile. Also, a sizeable part of its loan book qualifies for priority sector lending, thus making securitisation an additional funding option for the Group.

However, the credit strengths are partly offset by the Group's moderate profitability owing to rising delinquencies and hence elevated credit costs. The Group's portfolio has high proportion of borrowers with relatively moderate credit profiles (first-time buyers, small entrepreneurs, self-employed and non-income proof category) and hence remain vulnerable, especially in the current challenging operating environment. Customers who have availed moratorium and have not paid a single instalment till end of October 2020, stood at ~Rs 595 crore, or 3.8% of AUM as on September 30, 2020. The Group's ability to control fresh slippages especially from the stressed pool and recover from already delinquent accounts (gross stage 3 assets % of 5.1% as on September 30, 2020), especially in a current environment, would be a determinant of its credit profile over the medium term.

The Negative outlook on the Group reflects the expected pressure on the asset quality indicators and the resultant high credit costs and consequently subdued profitability metrics of the Group. Given the current uncertainty, the portfolio quality could remain volatile, especially in the asset backed finance business. ICRA has also taken note of the proposed change in the portfolio mix of the company, to focus on relatively better yielding segments such as used vehicles, affordable housing, tractor and unsecured SME segment, the impact of the same on profitability would only be visible over the medium term. Overall, 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 298 branches across 21 states, mostly in semi-urban and rural areas. The Group's managed assets under management (AUM) stood at Rs 15,571 crore, as on September 30, 2020. Vehicle loans continued to dominate the portfolio mix at 64% followed by mortgage (27%) and SME (10%). In terms of geography, rural and the semi-urban markets account for 69% of Magma's portfolio.

Adequate capitalisation profile – The Group's capitalisation profile is adequate for the current scale of operations with a CRAR of 27.0% and a consolidated net worth of Rs. 2,830 crore as on September 30, 2020. The gearing stood at 4.1 times as on September 30, 2020 (4.4 times as on March 31, 2020 and 4.9 times as on March 31, 2019). Despite the modest internal capital generation, the capitalisation has remained adequate over the past few years due to muted business growth. Magma's assets under management contracted by 5.3% yoy in FY2020 to Rs 15,922 crore and portfolio is largely expected to remain stable in FY2021.

On a consolidated basis, the solvency ratio (net Stage 3 asset/net worth) stood at 15.5%, as on September 30, 2020. 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

Moderate portfolio vulnerability – The Group's portfolio vulnerability remains elevated, especially in the current challenging operating environment. Magma's portfolio is characterised by 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 which are quite vulnerable to weak economic activity. Also, a substantial portion of Group's borrowers opted for moratorium, reflecting possibly a higher impact on the business operations of the underlying borrowers of the current operating environment. The Group's ability to control fresh slippages and maintain a high collection efficiency in the near to medium term would remain a key rating monitorable.

Modest asset quality indicators – The Group's asset quality indicators deteriorated in FY2020, with rise in gross stage 3 assets ratio to 6.4% as on March 31, 2020 (vs. 4.8% as on March 31, 2019) and net stage 3 assets ratio to 4.2% (vs. 3.0% as on March 31, 2019). Deterioration mainly came from the CV and the SME segment. In H1FY2021, however, gross stage 3 assets reduced in absolute terms from Rs 914 cr to Rs 710 cr supported by both write offs and recoveries. Also, due to standstill on bucket movements, there was marginal roll forward to 90+ bucket. Decline in gross stage 3 assets correspondingly lead to improvement in gross stage 3 assets ratio from 6.4% to 5.1% and net NPA from 4.2% to 3.2% in H1FY2021.

Though the collection efficiencies are showing an improving trend, the vulnerability of the portfolio remains high. Customers who have availed moratorium and have not paid a singly instalment till end of October 2020, stood at ~Rs 595 crore, or 3.8% of AUM as on September 30, 2020. The Group's ability to control fresh slippages especially from the stressed pool and recover from already delinquent accounts (gross stage 3 asset % of 5.1% as on September 30, 2020), especially in a current environment, would be a determinant of its credit profile over the medium term.

Moderate profitability indicators, due to high credit costs – Yields of the company improved in FY2020, with rising share of high yielding assets in the portfolio mix. However, higher cost of funds led to contraction in spreads and correspondingly in NIMs to 6.4% in FY2020 (from 6.9% in FY2019). NIMs improved to 7.0% in H1FY2021 with moderation in cost of funds and lower slippages (with majority of portfolio being in moratorium).

Magma's operating expenses to total assets ratio has traditionally remained greater than 4%. It stood at 4.2% in FY2020. In H1FY2021, however, it moderated to 3.5% with reduction in both employee and administrative expenses. At the same time, credit costs remained elevated at 2.9% of Average Total Asset in FY2020 due to substantial write offs as well as due to excess covid-19 provision of Rs. 109 crore made in Q4FY2020. Overall, lower NIMs and higher provisioning lead to decline in RoA to 0.2% in FY2020 from 1.8% in FY2019. However, the overall profitability improved in H1FY2021 due to improved NIMs and decline in operating costs.

ICRA has also taken note of the proposed change in the portfolio mix of the company, to focus on relatively better yielding segments such as used vehicles, affordable housing and unsecured SME segment, the impact of the same on profitability would only be visible over the medium term. Also, though the company has made incremental provisions due to the pandemic, the profitability indicators are expected to remain subdued in FY2021 as incremental slippages may remain elevated.

Liquidity position: Adequate

Magma's liquidity position stands adequate. On a standalone basis, MFL has Rs 333 crore bank balances and Rs 799 crore sanctioned but unutilized working capital bank lines (capped based on drawing power availability) as on September 30, 2020, which are sufficient to take care of its debt obligations and operating expenses till February 2021. Also, MHFL on a standalone basis, has Rs 275 crore of bank balances and Rs 298 crore sanctioned but unutilized working capital bank lines (capped based on drawing power availability), which are sufficient to take care of its debt obligations and operating expenses for this financial year.

The Group's borrowing mix consist of working capital lines (29%), securitisation (25%), NCDs (10%), term loans (29%) and perpetual & subordinated debt (7%) as on September 30, 2020. Reliance on banks remain high with 80% of the company's funding, as on September 30, 2020 being generated through banks.

Rating sensitivities

Positive triggers

The Group's ability to improve its asset quality and profitability profile 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

Further deterioration in the asset quality indicators from current levels along with inability to maintain profitability with a return on average assets of over 1.0% 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](#) [ICRA's Credit Rating Methodology for Housing Finance Companies](#) [Impact of Parent or Group Support on an Issuer's Credit Rating](#)
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. Magma is primarily engaged in financing of Commercial Vehicles, Construction Equipment, Passenger Cars, used assets, tractors, SME and mortgage assets.

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 FY2020, Magma recorded a consolidated profit after tax of Rs. 27 crore on a total consolidated asset base of Rs. 15,852 crore compared with a consolidated profit after tax of Rs. 304 crore on a total consolidated asset base of Rs. 17,346 crore in FY2019. In HY 1FY2021, Magma reported consolidated profit after tax of Rs. 76 crore on a total consolidated asset base of Rs. 15696 crore.

Magma reported assets under management of Rs 15,571 crore, as on September 30, 2020. Vehicle loans continued to dominate the portfolio mix at 64% followed by mortgage (27%) and SME (10%). Gross Stage 3 Asset ratio stood at 5.1% as on September 30, 2020 (vs. 6.4% as on March 31, 2020) and net Stage 3 asset ratio at 3.2% as on September 30, 2020 (vs. 4.2% as on March 31, 2020).

Key financial indicators (audited)

	FY2018 Ind-AS	FY2019 Ind-AS	FY2020 Ind-AS	H1FY2021 Ind-AS
Total income	2,307	2,495	2562	1,179
Profit after tax	237	304	27	76
Net worth	1,972	2,744	2,748	2,830
Total assets	15,682	17346	15852	15696
Total managed assets	16,819	18730	17738	17362
Return on average assets	1.6%	1.8%	0.2%	1.0%
Return on average equity	11.4%	12.9%	1.0%	5.4%
Gearing (times)	6.1	4.8	4.4	4.1
% CRAR (standalone)	20.7%	24.9%	25.9%	27.0%
% Gross Stage 3 Assets (on-book)	8.6%	4.8%	6.4%	5.1%
% Net Stage 3 assets (on-book)	4.5%	3.1%	4.2%	3.2%
% Net Stage 3 assets/ Net worth	31.7%	17.2%	21.1%	15.5%

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

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Current Rating (FY2021)			Chronology of Rating History for the Past 3 Years								
	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in FY2021		Date & Rating in FY2020				Date & Rating in FY2019		Date & Rating in FY2018
				8-Dec-20	13-Apr-20	16-Dec-19	24-Oct-19	06-Aug-19	22-Jul-19	25-Jul-18	20-Apr-18	24-Jul-17
1 Term Loans (banks)	Long Term	1,711.05	1411.05*	[ICRA]AA- (Negative)	[ICRA]AA- (Negative)	[ICRA]AA- (Negative)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Negative)
2 NCD	Long Term	-	-		Rating Withdrawn	[ICRA]AA- (Negative)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Negative)

*Amount in Rs. Crore * Proposed Bank Limits: Rs 300 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 click here

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Long term Bank lines	29-Dec-15 to 31-Dec-19	NA	28-Dec-20 to 30-Mar-26	1711.05	[ICRA]AA-(Negative)

Source: Magma

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Magma Fincorp Limited	100.00%	Full Consolidation
Magma Housing Finance Limited	100.00%	Full Consolidation

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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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