India Ratings & Research
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India Ratings Upgrades SBFC Finance's Bank Loans & NCDs to 'IND A+'; Outlook Stable

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India Ratings and Research (Ind-Ra) has taken the following rating actions on SBFC Finance Private Limited's (SBFC) debt instruments:

Instrument Type	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of Issue (billion)	Rating	Rating Action
Bank loans	-	-	-	-	INR29	IND A+/Stable	Upgraded
Non-convertible debentures (NCDs)*	-	-	-	-	INR2.5	IND A+/Stable	Upgraded

* Details in Annexure

KEY RATING DRIVERS

Secured Granular Loan Book with Increasing Franchise Presence: SBFC provides secured micro enterprise (ME) loans, gold loans, and unsecured personal and business loans. The branches have been scaled up in the last two years (2QFY22: 134, FY21: 124, FY20:113) along with a rise in its own originated book (68% of assets under management (AUM), 64%, 38%). The company's presence has increased in tier 2 and tier 3 cities with identified geographies, where exposure per state has been restricted to less than 15%, except Karnataka. SBFC has tweaked its target segment to less than INR3 million ticket size and is focusing on trader and retail segments with loan-to-value ratio of less than 70% and average ticket size of INR1 million. The company's AUM stood at INR32.6 billion in 2QFY22, comprising investments in pass-through certificates (PTCs) purchased from Dewan Housing Finance Corporation Limited (DHFL; 22.68% of AUM as of September 2021); book acquired by Karvy Financial Services Limited (KFSL; 6.4%), book originated through co-lending arrangement (3.5%) and self-originated book (68%). The product mix includes ME loan against property (LAP) (2QFY22: 67.6% of own book AUM), loan against gold (LAG; 22.9%) and unsecured loans (9.5%). The management's focus is on scaling ME LAP book, LAG and unsecured personal loans, with the secured business comprising 95% of the AUM in the long run. The acquired PTCs have run down earlier than Ind-Ra's expectation and are currently outstanding at INR7.4 billion with a first loss cover of 83.8%.

The gold loan book also stands comparable to peers in terms of efficiency with AUM per branch at INR41million in 2QFY22. The gold product exists across all branches, with incremental thrust on online gold loan business which has been contributing 10%-20% to monthly disbursements of gold loan.

The unsecured business loan portfolio is backed by 75% loss cover, under the credit guarantee fund trust for micro and small enterprise scheme; while in unsecured personal loans, there is a tilt towards borrowers employed with the government enterprises. The company's AUM is granular in nature with about 75% of loan book (excluding investments in DHFL's PTCs) having a ticket size of less than INR2.5 million as of September 2021. In Ind-Ra's opinion, the secured and granular nature of the book will support SBFC's credit profile in the long term.

Experienced Management: SBFC is headed by seasoned professionals who have a significant experience in retail lending. The second line of management also brings relevant experience. SBFC is backed by Clermont Group (September 2021: 73% shareholding), and private equity investor, Arpwood Partners (19.83%); the remaining is held by promoters and in employee stock ownership plans. The investors have a majority representation on the board, with the company planning more diversified and independent representation on the board in the near term.

Concentrated Funding Mix, However, Cost of Funds Benefits to Continue due to PTC Structure: SBFC has been able to raise funds from public and private sector banks, and small finance banks which together funded 91.6% of the borrowing as of September 2021. The largest lender accounted for 75.2% of the overall funding in 2QFY22 (2QFY21: 89%), as the company financed the acquisition of DHFL's PTCs through long-term borrowings for eight years with one-year moratorium from a single-largest public sector bank, where repayments are quarterly starting September 2020. The company has also raised funds through capital markets, which formed 7.5% of the total borrowing in 2QFY22. It has about 18 lender relationships across private and public sector banks to drive further borrowing. In Ind-Ra's opinion, as the company scales its franchise, its ability to maintain modest leverage and diversify its lender base will be critical.

Improved Capital Buffers: The company's tangible leverage (debt/equity) improved to 2.6x at 1HFYE22 (FYE21: 2.94x, FYE20: 4.08x) driven by an equity infusion of INR1 billion in 1QFY21 and internal accruals. In the medium term, the company plans to cap its leverage at 4.0x. SBFC also plans to further raise INR2.5 billion by end-FY22.

Liquidity Indicator - Adequate: SBFC had unencumbered cash and liquid investments of INR4.75 billion and undrawn sanction of INR3.25 billion at end-September 2021. As per the contractual asset-liability management statement as of September 2021, there is no negative cumulative mismatch in the up to three-year buckets. Also, as per Ind-Ra stress test, SBFC's cash inflow from receivables and asset-liability statement remained matched in the up to three years bucket. According to the management, the company's internal liquidity policy is to maintain at least a quarter's disbursements and debt repayments as on balance sheet liquidity. Ind-Ra expects SBFC to manage its liquidity prudently with staggered payments to avoid the possibility of bulk repayments.

Improved Profitability Buffers: SBFC's profitability matrix benefits from fee income generated on the co-lending agreement with a bank and the collection service business, which it extends to other special purpose vehicles. Furthermore, SBFC has been acting as a collections service provider for a special purpose vehicle with AUM of INR30 billion.

In 2QFY22, SBFC's return on assets improved to 1.9% (FY21: 2.1%, FY20: 1.3%) and return on tangible equity to 8.0% (10.0%, 5.2%), primarily due to normalised credit costs, as the company made majority of COVID-19 related provisioning of INR0.18 billion in 4QFY20 and 1HFY21. The cost-to-income ratio remained high at 52.4% in 2HFY22 (FY21: 45.8%, FY20: 57.05%, FY19: 71.60%), although, will normalise with scaling up of franchise. Also, it has no major branch expansion plans in the near term. Ind-Ra believes these costs are likely to be rationalised in the medium term, as the operating scale of the company expands in line with an increase in the AUM. The agency expects the return ratio to improve further with rundown of PTC investments yielding 11% and getting replaced with ME book yielding 14%-15% and LAG at 19%, provided credit cost remains in line with the historical trend.

Also, there has been a creation of goodwill of about INR2.69 billion due to KFSL acquisition of network, which remains subjected to half-yearly impairment test, could impact profitability in case of adverse outcome.

Reasonably Managed Asset Quality despite COVID-19 Pandemic: SBFC's borrowers are MEs engaged in small businesses, largely from trader and retailer segments, which are vulnerable to economic shocks. Although the operating environment remained conducive for borrowers from healthcare, grocery, and other essential services sectors, other sectors such as manufacturing, hospitality, textile, among others, experienced cashflow headwinds. SBFC has evaluated its strategy and incrementally plans to focus on sub INR3 million ticket size in the LAP segment and personal loans to government employees and business loans to professionals in the unsecured category. It would restrict its unsecured book to less than 5% with gold accounting for 20% of the AUM and remaining from ME loans.

The asset quality is largely impacted due to legacy KFSL ME book along with the challenges witnessed in lending business and personal loans to non-government employee segment. The collection efficiency in its ME segment has been on an improving trend post the second wave of Covid-19, which stood at 94% in September 2021 after recovering from April 2021 levels of 80% on billing-to-billing basis excluding overdues. The overall book collection efficiency also improved to 87.6% in September 2021, although still below pre-covid-19 levels, largely due to asset quality challenges seen in unsecured book. The proforma gross non-performing assets (GNPAs) increased to 3.3% in 2QFY22 (FY21: 3.1%, FY20:2.3%) on portfolio excluding PTC investments. The delinquencies improved in 2QFY22 from 1QFY22 due to asset sale of about INR0.39 billion. The delinquency levels are higher in some states, however, the fairly-diversified geographical presence with the top three states comprising 41% of the portfolio supports its credit profile. The LAG portfolio had higher auction due to moderation in gold price, along with borrower distress to bring in additional collateral or normalise the account. However, SBFC maintains a check on the loan-to-value ratio with a threshold of 85% including accrued interest to principal as point to initiate notice to the borrower. The secured nature of the product and lower loss given the default of gold provides comfort on recoverability. SBFC has improved the provision coverage ratio to 38.1% in 2QFY22 (FY21: 38.2%, FY20: 30.8%) and carried total expected credit loss provision stood at 2.3% in 2QFY22 (FY21: 2.1%, FY20: 1.4%). The restructured book stood at 3.2% of the own book in 2QFY22 and the book benefitted through emergency credit line guarantee scheme stood at 3.9%.

In Ind-Ra's stress-case scenario, wherein the GNPAs are stressed to include a spike in the softer-bucket delinquencies, the company's capitalisation levels stand adequate to absorb increased credit cost. Ind-Ra believes the asset quality will be a key monitorable over the medium term.

RATING SENSITIVITIES

Positive: A significant expansion of the franchise with the proven ability to manage asset quality and other operating matrices, increased lender and funding source diversification while maintaining adequate liquidity, all on a sustained basis, could lead to a positive rating action.

Negative: Any substantial decline in the operating profit buffers due to a rise in credit cost or competitive pressures on margins will lead to a negative rating action. Also, a weakened liquidity profile in the form of gaps in the asset-liability maturity profile without sufficient contingent liquidity buffers could result in a negative rating action. The GNPAs exceeding 5% on a sustained basis could result in a rating downgrade.

COMPANY PROFILE

SBFC is a systemically-important non-banking finance company registered with the Reserve Bank of India. It started operations in September 2017 after purchasing the secured retail portfolio from KFSL along with its branch infrastructure and staff. The company mainly provides ME loans, backed by property, LAG and unsecured personal and business loans. In 2QFY22, the company had 134 branches spread across 110 cities with more than 17,00 employees.

FINANCIAL SUMMARY

Particulars	FY21	FY20
Total assets (INR billion)	40.03	39.49
Tangible equity (INR billion)	9.45	7.51
Profit after tax (INR billion)	0.85	0.35
Return on average assets (%)	2.14	1.28
Tangible equity/assets (%)	25.2	20.4
GNPA on own book (%)	3.08	2.30
Source: SBFC, Ind Ra		

RATING HISTORY

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook					
	Rating Type	Rated Limits (billion)	Rating/Outlook	5 March 2021	17 September 2020	27 July 2020	17 July 2020	18 February 2020	25 October 2019
Bank loans	Long-term	INR29.00	IND A+/Stable	IND A/Stable	IND A/Stable	IND A/Stable	IND A/Stable	IND A/Stable	IND A/Stable

NCDs	Long-term	INR2.5	IND A+/Stable	IND A/Stable	IND A/Stable	IND A/Stable	IND A/Stable	IND A/Stable	IND A/Stable

ANNEXURE

Instrument Type	ISIN	Date of Issuance	Coupon (%)	Maturity Date	Amount (billion)	Rating/Outlook
NCDs	INE423Y07062	6 August 2021	8.57	6 August 2024	INR0.43	IND A+/Stable
NCDs	INE423Y07039	11 August 2020	9.25	11 February 2022	INR0.5	IND A+/Stable
NCDs	INE423Y07021	3 August 2020	9.25	3 February 2022	INR0.25	IND A+/Stable
NCDs	INE423Y07047	17 August 2020	9.3	17 February 2022	INR0.25	IND A+/Stable
NCDs	INE423Y07054	14 September 2020	9.25	14 March 2022	INR0.5	IND A+/Stable
Limit unutilised					**INR0.57**	
Total					**INR2.50**	

BANK WISE FACILITIES DETAILS

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COMPLEXITY LEVEL OF INSTRUMENTS

Instrument Type	Complexity
NCDs	Low
Bank loans	Low

For details on the complexity level of the instruments, please visit https://www.indiaratings.co.in/complexity-indicators.

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Applicable Criteria

Financial Institutions Rating Criteria
Non-Bank Finance Companies Criteria

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