India Ratings Upgrades SBFC Finance’s NCDs and Bank Loans to ‘IND AA-’/Stable; Rates Additional NCDs and Bank Loans

Dec 15, 2023 | Non Banking Financial Company (NBFC)

India Ratings and Research (Ind-Ra) has taken upgraded SBFC Finance Limited’s (SBFC) debt instruments to ‘IND AA-’ from ‘IND A+’. The Outlook is Stable. The detailed rating actions are as follows:

Instrument Type	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of Issue (billion)	Rating/Outlook	Rating Action
Non-convertible debentures (NCDs)*	-	-	-	-	INR5	IND AA-/Stable	Assigned
Bank loans	-	-	-	-	INR10	IND AA-/Stable	Assigned
NCDs*	-	-	-	-	INR1	IND AA-/Stable	Upgraded
Bank loans	-	-	-	-	INR40	IND AA-/Stable	Upgraded

* Details in annexure

Analytical Approach: Ind-Ra continues to take a standalone view of SBFC to arrive at the rating.

The rating upgrade reflects Ind-Ra's expectation of SBFC's improved ability to grow its franchise, strengthened by its equity capital base through its public listing. The upgrade also reflects the agency's expectation of a further increase in the company's scale of operations over the medium term to drive operating leverage benefits along with maintained profitability and capital buffers. The ratings continue to be supported by the company's stable & experienced management profile demonstrating good governance and institutionalised approach, pan-India presence with less concentrated geographical presence along with maintained stable asset quality and improved profitability buffers.

Key Rating Drivers

Sizable Capital Raise provides Franchise Lever to Scale Up: SBFC's improved capital buffers post its public listing in August 2023, along with strong internal accruals, provide adequate impetus for it to scale up a franchise in the secured asset segment. The public listing also provides better governance and better visibility of the business over and above SBFC's strong core financial performance. The company's tangible net worth increased to INR23.4 billion at end-2QFY24 (2QFY23: INR13.5 billion). The leverage (debt/tangible equity) improved to 1.57x at end-September 2023 (FY23: 2.55x; FY22: 2.87x), post capital infusion (INR7.5 billion in 1HFY24) through equity raise through the initial public offering. Over the medium term, the company plans to cap its leverage at 4.0x.

Secured Granular Loan Book & Diversified Geographical Presence to Drive Franchise Growth: SBFC's loan portfolio remains granular in nature, and focuses on two key products i.e. secured micro enterprise (ME) loans and loans against gold (LAG). SBFC has 171 branches (FY23: 152; FY22: 135) present across 16 states and two union territories across India, where the top two states' concentration stood at 33.8% as a % of the asset under management (AUM) at end-2QFY24 thereby remaining adequately diversified. The incremental growth in branches would be limited, with the company continuing to focus on improving the AUM per branch, according to the management. The entity plans to expand its presence in tier-II and tier-III cities within identified geographies wherein exposure per state, except Karnataka, would be restricted to 20% in the ME segment.

At end-September 2023, about 93% of the ME loans were worth less than INR3 million. SBFC continues to focus on traders and retail customer profiles in its ME segment with ticket sizes less than INR3 million, loan to value of less than 70%, and an average ticket size of INR1 million. At end-September 2023, SBFC's AUM stood at INR58.0 billion (FY23: INR49.4 billion; FY22: INR31.9 billion), comprising a co-origination book of INR6.7 billion and own book of INR51.3 billion. At end-September 2023, ME (or loan against property (LAP) accounted for 83% of the own book (FY23: 79%; FY22: 73%), LAG constituted 15% (18%, 20%) and unsecured loan accounted for 2% (3%, 7%). Around 84.6% of the book is covered with residential properties as collateral. In FY23, SBFC managed the rundown in its acquired pass through certificate (PTC book) and Karvy book by driving its own origination of micro enterprise and gold loans through its expanded branch networks. As part of its strategy, the management plans to drive the scaling of ME (LAP) loans and affordable home loans by building presence on a pan-India basis. SBFC's gold loan book is comparable to those of peers in terms of efficiency, with an AUM of about INR61 million per branch at end-September 2023. The entity plans for LAG to account for around 15% of the AUM, and aims to achieve growth in this segment by increasing the AUM/branch in the existing LAG branches instead of adding new branches. The sourcing for SBFC remains completely inhouse, thereby driving better retention rates. It previously also provided unsecured personal and business loans but it has discontinued the same since September 2022.

Experienced Management Team: SBFC is headed by seasoned professionals who have significant experience in retail lending. The second line of management remains well established with relevant experience. SBFC is backed by the Clermont Group (58.5% stake at end-September 2023) and the Arpwood Group (5.5%). The investors have a majority representation on the board. SBFC's board of directors consists of eight members, comprising three independent directors with varied industry experience, four investor nominee directors and a managing director & chief executive officer.

Liquidity Indicator - Adequate: SBFC had unencumbered cash and liquid investments of INR8.4 billion at end-September 2023. As per the contractual asset-liability management statement at end-September 2023, there were no negative cumulative mismatches in the up-to-one-year bucket. Also, as per Ind-Ra's stress test, SBFC's asset-liability statement remained matched in the up-to-one-year buckets. According to the management, the company intends to maintain 6% of its total liabilities as on balance sheet liquidity. Ind-Ra expects SBFC to manage its liquidity prudently with staggered payments to avoid the possibility of bulk repayments. The company also had unutilised bank lines of INR3.45 billion at end-September 2023.

Improved Profitability Buffers: SBFC's return on average tangible assets (as per Ind-Ra's calculation methodology) stood at 3.5% in 1HFY24 (annualised; FY23: 3.1%; FY22: 1.5%) and its return on tangible equity was at 10.8% (annualised; 12.0%; 6.5%). The improvement in the profitability over the last 18 months was driven by a favourable change in the AUM mix in favour of the relatively higher-yielding medium-sized enterprise (ME) and gold loans. Also, the company has been able to pass on the increase in cost of funds, given that 98.5% of the ME loan book is on floating rates of interest. The cost-to-income ratio also moderated to 48.3% in 2QFY24 (FY23: 49.7%; FY22: 57.0%); the same is likely to decline with the scaling up of the franchise. Out of the total branch network of 171, 40 branches have vintage lower than 12 months, indicating a potential for improvement in the operating leverage. SBFC is in the process of further enhancing its LOS and LMS and it is likely to witness better productivity in FY25. SBFC's profitability matrix also benefits from the fee income generated on the co-origination agreement with a bank and the collection service business, which it extends to other special purpose vehicles.

SBFC carries a goodwill of about INR2.60 billion due to the acquisition of Karvy Financial Services Limited's network in FY18, and the same remains subject to impairment every year. Any adverse outcome in this regard could impact profitability.

Stable Asset Quality with improved Provision Coverage Ratio: ME loans continue to be the main focus area for SBFC; the company has been running down its unsecured loans segment. Moreover, over FY20-1HFY24, the proportion of customers based on their internal grading showing controlled delinquencies lower than the headline gross non-performing assets (GNPA) increased to 56% in 1HFY24 from 20% in FY20, which is likely to augur well in terms of asset quality outcome over the near term. At end-September 2023, about 83.6% of the customers had a CIBIL score of more than 700. With the ME segment, SBFC continues to focus on the sub-INR3 million ticket size. SBFC's GNPA improved to 2.37% at end-September 2023 (FY23: 2.57%, FY22: 2.91%, FY21: 3.37%). While the GNPA remains higher in the legacy ME portfolio (11.95%) and unsecured loans (8.67%) portfolio, they continue to rundown. This elevates the GNPAs for the respective segments due to denominator effect. The delinquency levels are higher in some states; however, SBFC's fairly-diversified geographical presence, with the top three states comprising 47.4% of the portfolio, reduces the overall concentration risk. In the gold loan segment, SBFC maintains a check on the loan to value threshold of 85%, including accrued interest to principal, as the point to initiate the auction notice to the borrower. The secured nature of the product and lower loss given default for gold provides comfort on the company’s ability to recover its dues; however, a seasoning-led movement in harder bucket remains monitorable.

SBFC collected 96.3% of its collections demand (excluding overdues) in the secured portfolio at end-September 2023. SBFC’s provision coverage ratio stood at 44.6% at end-September 2023, improved from 39.3% in FY23. Its credit cost on average advances (as per Ind-Ra’s calculation methodology) stood at 0.96% in 1HFY24 (FY23: 0.87%; FY22: 1.42%, FY21: 1.84%).

Borrowing Skewed Towards Banks, but Lender Base remains Well-diversified: SBFC raised funds from private sector banks (41.2%), financial institutions (10.3%), public sector banks (15.7%), securitisation (8.3%), foreign banks (0.7%), foreign currency non-resident (FCNR-B) loans (22.6%), NCDs (1.2%) at end-September 2023. However, the funds raised from capital markets constituting only 1.2% of the total borrowing. The largest lender accounted for 38% of the overall funding at end-September 2023, down from 61.2% in March 2022. At end-September 2023, the company had diversified its lender base across private and public sector banks to drive further borrowings, and it has relationships with around 23 lenders. In Ind-Ra’s opinion, as the company scales its franchise, its ability to diversify through capital market borrowings as well as widening its lender base will be critical.

Rating Sensitivities

Positive: A significant expansion of the franchise comparable to similar rated peers’, demonstrating leadership in new product or market segments, over and above continuous demonstration of ability to manage asset quality through the cycle and profitability buffers will be positive for the ratings.

From the liability side, strong access to funding from diversified sources while maintaining superior liquidity, and the institutionalisation of ownership and management, all on a sustained basis, could also lead to a positive rating action.

Negative: Events that could, individually or collectively, lead to a negative rating action are:

- any substantial decline in the operating profit buffers due to a rise in credit cost or competitive pressures on margins
- a weakened liquidity profile in the form of gaps in the asset-liability maturity profile without sufficient contingent liquidity buffers
- the leverage exceeding 4.0x on a sustained basis over the medium term
- GNPAs exceeding 4% on a sustained basis
- perceptible changes in business owing to managerial instability or deterioration in business environment in a meaningful way

ESG Issues

ESG Factors Minimally Relevant to Rating: Unless otherwise disclosed in this section, the ESG issues are credit neutral or have only a minimal credit impact on SBFC, due to either their nature or the way in which they are being managed by the entity. For more information on Ind-Ra's ESG Relevance Disclosures, please click here. For answers to frequently asked questions regarding ESG Relevance Disclosures and their impact on ratings, please click here.

Company Profile

SBFC is a non-deposit taking systemically important non-banking financial company registered with the Reserve Bank of India. It started operations in September 2017 after purchasing the secured retail portfolio from Karvy Financial Services along with its branch infrastructure and staff. The company mainly provides secured MSME loans (LAP), and LAG. At end-September 2023, the entity had 171 branches spread across 16 states and two union territories.

The company has changed its name from SBFC Finance Private Limited to SBFC Finance Limited with effect from 30 September 2022. It has also set up a wholly owned subsidiary under the name of SBFC Home Finance Private Limited and is in the process of filling the application for registration with Reserve Bank of India to carry on the business of housing finance as its principal business.

FINANCIAL SUMMARY

Particulars	1HFY24	FY23	FY22
Total assets (INR billion)	65.81	57.46	45.15
Net worth (INR billion)	25.99	17.27	12.87
Net profit/loss (INR billion)	1.00	1.50	0.64
Return on average tangible assets (%)	3.51	3.08	1.56
Equity/Assets (%)	37.0	26.7	28.51
GNPA (%)	2.37	2.57	2.91
CRAR (%)	45.04	31.90	26.21
Source: SBFC, Ind-Ra Note: As per Ind-Ra’s calculation methodology			

Non-Cooperation with previous rating agency

Not applicable

Solicitation Disclosures

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Rating History

Instrument Type	Current Rating/Outlook			Historical Ra			
	Rating Type	Rated Limits (billion)	Rating/Outlook	19 April 2023	15 July 2022	20 December 2021	5 Ma 20
Bank loans	Long-term	INR50.0	IND AA-/Stable	IND A+/Stable	IND A+/Stable	IND A+/Stable	IN A/St
NCDs	Long-term	INR6.0	IND AA-/Stable	IND A+/Stable	IND A+/Stable	IND A+/Stable	IN A/St

Annexure

Instrument Type	ISIN	Date of Issuance	Coupon (%)	Maturity Date	Amoun
NCDs	INE423Y07062	6 August 2021	8.57	6 August 2024	IN
Limit unutilised					**IN**
Total					**IN**

Bank wise Facilities Details

Click here to see the details

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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Ind-Ra currently maintains coverage of corporate issuers, financial institutions (including banks and insurance companies), finance and leasing companies, managed funds, urban local bodies and project finance companies.

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APPLICABLE CRITERIA

Financial Institutions Rating Criteria

Non-Bank Finance Companies Criteria

Evaluating Corporate Governance

The Rating Process