

October 03, 2022

SBFC Finance Private Limited: Rating upgraded to [ICRA]A+; outlook revised to Stable; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term loan	2,865.60	3,500.00	[ICRA]A+ upgraded from [ICRA]A; Outlook revised to Stable from Positive; assigned for enhanced limits
Non-convertible debentures	100.00	100.00	[ICRA]A+ upgraded from [ICRA]A; Outlook revised to Stable from Positive
Non-convertible debentures	50.00	-	[ICRA]A+ upgraded from [ICRA]A; Outlook revised to Stable from Positive; withdrawn
Non-convertible debentures	100.00	-	[ICRA]A+ upgraded from [ICRA]A; Outlook revised to Stable from Positive; withdrawn
Total	3,115.60	3,600.00	

*Instrument details are provided in Annexure I

Rationale

The rating upgrade considers SBFC Finance Private Limited's (SBFC) improved capitalisation and gearing levels, following the Rs. 250-crore capital infusion in Q1 FY2023. ICRA also notes that the company plans to complete its initial public offering (IPO) in Q1 FY2024, which is likely to support its capitalisation profile further while it pursues its growth plans.

While the reported profitability in FY2022 remained lower compared to the previous fiscal due to higher operating expenses and credit costs, it improved in Q1 FY2023. ICRA expects that as SBFC increases its assets under management and achieves a scale of ~Rs. 5,500-6,000 crore (AUM; Rs. 4,081 crore as on June 30, 2022), it is likely to benefit from economies of scale, and achieve a return on assets (RoA) of more than 3.0% on a sustained basis.

The rating remains constrained by the relatively lower vintage of the SBFC-originated loans and the comparatively lower ability of the end borrowers to withstand the ongoing macro-economic shocks and uncertainty. ICRA, however, notes that SBFC was able to contain its asset quality despite the tougher macro-economic environment. SBFC's asset quality improved with a decline in the gross stage 3 (GS3) to 2.68% of gross advances as on June 30, 2022 from 3.12% as on March 31, 2021. This was driven by the improvement in the collection efficiency as well as from some write-offs and the sale of impaired assets to an asset reconstruction company (ARC) in FY2022.

The stable outlook factors in ICRA's expectations that SFBC will continue to improve its scale while maintaining its asset quality and leverage by generating healthy internal capital for growth.

There is no amount outstanding against the Rs. 150-crore non-convertible debentures as the rated instruments were redeemed on maturity. Hence, the rating on the non-convertible debentures has been upgraded and withdrawn as per ICRA's rating withdrawal policy.

Key rating drivers and their description

Credit strengths

Retail ME book; relatively low average ticket size and LTV; however, book is yet to season sufficiently – As of June 2022, the loan book originated by SBFC and the portfolios acquired from Karvy Financial Services Limited (KFSL) and Dewan Housing

Finance Limited¹ (DHFL) formed 85%, 4% and 12%, respectively, of the portfolio compared to 64%, 6% and 30%, respectively, as of June 2021. The share of loans with a ticket size of Rs. 25 lakh and below in the micro enterprise (ME) and small and medium-sized enterprises (SME) portfolio increased significantly to 86% as on June 30, 2022 from 49% as on March 31, 2019. The company plans to increase the share of the <Rs. 30-lakh segment to >90% of the ME AUM in the near term, given its relatively better delinquency performance compared to higher ticket size loans. Around 79% of the ME + SME portfolio had a loan-to-value (LTV) ratio of less than and equal to 60% as of June 2022. SBFC's core focus is on providing loans with a ticket size of Rs. 8-15 lakh and preferably below Rs. 30 lakh in the ME segment, with better pricing ability. This resulted in the company witnessing higher ME yields in FY2022. SBFC's strategy is to achieve a portfolio mix of ME (75%), loan against gold (LAG; 20%) and other loans (5%) compared to the mix of 72.6%, 20.9% and 6.5%, respectively, as of June 2022.

For DHFL's loan book, which was acquired as a pass-through certificate (PTC) structure, the over-collateralisation available on the Series A PTCs (senior tranche held by SBFC) of Rs. 428 crore held by SBFC increased to 151%² (over-collateralisation is available by way of collections on Series B PTCs – subordinate tranche held by DHFL) as of July 2022. This provides comfort as any shortfall in collections from the Series A PTCs can be recovered from the collections from the Series B PTCs. The funds from the Series B PTCs will be transferred to DHFL only after all the regulatory dues and collection fees have been recovered and the rundown of the Series A PTCs is complete. DHFL's PTC book is expected to run down by FY2024.

Profitability metrics expected to improve with scale-up and change in product mix – SBFC's operating profit declined to Rs. 133.5 crore (2.8% of average total assets - ATA) in FY2022 from Rs. 143.8 crore (3.4%) in FY2021 due to the increase in operating expenses. Operating expenses increased mainly due to higher employee expenses, given the company's growth plans and the consequent addition of 2-3 additional employees at every location over and above its earlier plan of 5 employees per location. Further, SBFC added 11 branches in FY2022, which resulted in higher employee expenses apart from other administrative expenses. This resulted in a high cost-to-income ratio of 56.2% in FY2022 against 46.2% in FY2021. However, ICRA notes that SBFC's operating profit improved to 4.1% of ATA in Q1 FY2023 from 3.5% in Q1 FY2022, with the improving product mix driving better net interest margin and fee income. The operating expenses remained elevated at 4.4% of ATA in Q1 FY2023 compared to 3.9% in FY2022. The credit cost declined to 0.6% of ATA in Q1 FY2023 from 1.1% in FY2022 and 0.8% in FY2021, though the sustainability of the same, in the backdrop of the weakening macro-economic environment, remains a monitorable. Further, the company's profitability remains susceptible to goodwill impairment (when determined).

With the moderation in the operating profitability, SBFC's net profit declined to Rs. 64.2 crore (RoA of 1.5%) in FY2022 from Rs. 85.2 crore (2.0%) in FY2021. However, the RoA improved to 2.8% in Q1 FY2023 supported by the higher operating profit and the relatively lower credit costs even as the cost-to-income ratio remained elevated. ICRA estimates that as the company achieves an AUM of ~Rs. 5,500-6,000 crore, the improved economies of scale shall support higher return ratios.

Improved gearing and capitalisation levels mainly driven by equity infusion and internal accruals – SBFC's gearing (net of goodwill of Rs. 260.4 crore) declined to 2.2 times as on June 30, 2022 from 2.8 times as on June 30, 2021, while the Tier I capital adequacy ratio increased to 31.6% as on June 30, 2022 from 26.6% as on June 30, 2021. The improvement was mainly driven by the equity infusion of Rs. 250 crore in Q1 FY2023 and steady internal accruals with a reduction in the absolute debt levels.

SBFC plans to complete its IPO in Q1 FY2024. The capital infusion will keep the leverage under control while the company pursues its growth plans. ICRA expects SBFC to report a leverage below 3.0 times in the next couple of years.

Senior management team with experience in retail lending business – SBFC has onboarded a senior management team comprising officials with a proven track record in the banking/non-banking financial company (NBFC) sector. The senior management team is supported by a zonal leadership team with experience ranging from 11-18 years. This team was onboarded over the last couple of years for the business, credit, finance and collection verticals.

SBFC will leverage the team's experience for ramping up the retail loan book, maintaining adequate underwriting practices and for technology adoption. It has also added KFSL's junior and middle management team along with its various branches.

¹ Now Piramal Capital and Housing Finance Limited

² Principal outstanding (POS) of Series B PTCs / POS of Series A PTCs

The in-house debt management policy is expected to improve the monitoring of accounts, enable the triggering of preemptive measures and allow the better follow-up of payment delays.

Credit challenges

Ability to manage asset quality while scaling up the business – SBFC’s asset quality improved as the GS3 declined to 2.68% as on June 30, 2022 from 2.74% as on March 31, 2022 and the high of 3.12% as on March 31, 2021. ICRA notes that the improvement in the asset quality profile was driven by the improvement in the collection efficiency, the asset sale of Rs. 39.5 crore (1.9% of opening loan book) to an ARC and the subsequent write-off of Rs. 20.0 crore (0.9%) in FY2022. SBFC undertook asset sales to the ARC and the write-off in the unsecured segment in FY2022. The collection efficiency of the unsecured segment has improved gradually but remains lower than the pre-Covid-19 pandemic level. SBFC made an expected credit loss (ECL) provision of 80% for the non-performing loans in the unsecured loan segment as of June 2022. ICRA notes that the company discontinued the personal loan segment from September 2022 to focus on the secured segments.

Further, SBFC made an additional provision in March 2022 to align the stage 3 assets with the Reserve Bank of India’s (RBI) GNPA classification on a daily days past due (dpd) basis. It reported a restructured loan book of Rs. 108.6 crore or 3.2% of advances as on June 30, 2022. The restructured loan book is classified as stage 2 assets with a provision coverage of 19%. The company’s ability to maintain the asset quality indicators, while rapidly scaling up its AUM at a compound annual growth rate (CAGR) of ~30%+ in the next couple of years, will remain a monitorable.

Modest credit profile of target customer segment – SBFC predominantly provides small-to-medium-sized ticket loans to self-employed borrowers. Considering the borrowers’ business and income profiles, their credit profiles are expected to be modest and vulnerable to income shocks induced by events such as the pandemic, the ongoing inflation and the increase in interest rates. However, these risks are mitigated to an extent as most (93%) of the ME + SME loans were backed by self-occupied (residential or commercial) properties as of June 2022.

Liquidity position: Adequate

The company’s liquidity profile is adequate. As on July 31, 2022, it had Rs. 295 crore of cash and liquid investments. The company’s liquid investments are in mutual funds and fixed deposits. It reported positive cumulative mismatches in the up to 1-year buckets in the asset-liability management (ALM) statement as on June 30, 2022.

Rating sensitivities

Positive factors – ICRA could upgrade the rating if the company shows a significant track record of profitable growth with a return on assets of more than 3.5% on a sustained basis.

Negative factors – Pressure on SBFC’s rating could arise if there is a continued deterioration in the asset quality with the 90+dpd increasing beyond 4.0% (on loan book) or an increase in the gearing to over 4 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	ICRA’s Credit Rating Methodology for Non-banking Finance Companies Policy on Withdrawal of Credit Ratings
Parent/Group support	Not Applicable
Consolidation/Standalone	The rating is based on the standalone financial statements of the issuer

About the company

SBFC Finance Private Limited (SBFC) is a non-banking financial company that provides loans against property, gold loans and personal loans. Backed by the Clermont Group and the Arpwood Group, the company commenced operations in September 2017 after acquiring the performing loans in KFSL’s retail portfolio. Following the acquisition, SBFC focussed on building adequate systems and processes and on the onboarding of experienced professionals in the management team before

rebooting the lending business. It leverages technology and analytics to provide customers with easy access to credit and to assess their credit behaviour through their digital footprint.

SBFC reported a profit after tax (PAT) of Rs. 32.1 crore on total assets of Rs. 4,661 crore in Q1 FY2023 compared to a PAT of Rs. 22.7 crore on total assets of Rs. 4,171 crore in Q1 FY2022. In FY2021, the company witnessed a PAT of Rs. 64.2 crore on total assets of Rs. 4,515 crore compared to a PAT of Rs. 85.2 crore on total assets of Rs. 4,266 crore in FY2021.

Key financial indicators (audited)

SBFC Finance Private Limited	FY2021	FY2022	Q1 FY2022	Q1 FY2023
Total income	511	531	127	160
Profit after tax	85	64	23	32
Net worth	1,205	1,287	1,228	1,572
Loan book	2,107	2,982	2,166	3,363
Total assets	4,266	4,515	4,171	4,661
Return on assets	2.0%	1.5%	2.1%	2.8%
Return on net worth	7.7%	5.2%	7.7%	9.0%
Gross gearing – Adjusted (times)	2.9	2.9	2.8	2.2
Gross stage 3	3.1%	2.7%	4.9%	2.7%
Net stage 3	2.0%	1.7%	3.3%	1.6%
Solvency (Net stage 3/ adjusted Net worth)	4.4%	4.8%	7.4%	4.1%
CRAR	26.3%	26.2%	27.1%	32.0%

Source: Company, ICRA Research; Amount in Rs. crore; All ratios as per ICRA's calculations

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Type	Current Rating (FY2023)			Chronology of Rating History for the Past 3 Years					
		Amount Rated (Rs. crore)	Amount Outstanding as of August 31, 2022 (Rs. crore)	Date & Rating in FY2023 Oct 3, 2022	Date & Rating in FY2022 Oct 8, 2021	Date & Rating in FY2021		Date & Rating in FY2020		
						Oct 16, 2020	Feb 14, 2020	Aug 29, 2019	Apr 22, 2019	
1 Term loan	Long term	3,500.00	3,500.00	[ICRA]A+ (Stable)	[ICRA]A (Positive)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)
2 Non-convertible debenture programme	Long term	50.00	-	[ICRA]A+ (Stable); withdrawn	[ICRA]A (Positive)	[ICRA]A (Stable)	[ICRA]A (Stable)	-	-	-
3 Non-convertible debenture programme	Long term	100.00	-	[ICRA]A+ (Stable); withdrawn	[ICRA]A (Positive)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)
3 Non-convertible debenture programme	Long term	100.00	100.00	[ICRA]A+ (Stable)	[ICRA]A (Positive)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)
4 Non-convertible debenture programme	Long term	-	-	-	-	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)

Complexity level of the rated instruments

Instrument	Complexity Indicator
Term loan programme	Simple
Non-convertible debenture programme	Simple
Non-convertible debenture programme	Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: www.icra.in

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	TL	Jun-2019	8.25%	Jun-2027	1,604.80	[ICRA]A+ (Stable)
-	TL-2	Sep-2020	8.25%	Dec-2023	15.00	[ICRA]A+ (Stable)
-	TL -1	Dec-2020	7.60%	Jan-2026	18.42	[ICRA]A+ (Stable)
-	TL -2	Dec-2020	8.00%	Jul-2024	3.08	[ICRA]A+ (Stable)
-	TL	Jan-2021	7.80%	Mar-2024	30.00	[ICRA]A+ (Stable)
-	TL - 2	Jan-2021	8.60%	Jan-2024	50.00	[ICRA]A+ (Stable)
-	TL -1	Mar-2021	8.05%	Mar-2024	15.84	[ICRA]A+ (Stable)
-	TL	Mar-2021	8.05%	Mar-2024	28.80	[ICRA]A+ (Stable)
-	TL - 1	Jun-2021	9.85%	Sep-2025	18.75	[ICRA]A+ (Stable)
-	TL	Jun-2021	9.51%	Jun-2023	11.25	[ICRA]A+ (Stable)
-	TL - 3	Jul-2021	8.46%	Aug-2025	40.00	[ICRA]A+ (Stable)
-	TL	Nov-2021	8.50%	Nov-2024	40.90	[ICRA]A+ (Stable)
-	TL - 3	Dec-2021	8.25%	Feb-2025	200.00	[ICRA]A+ (Stable)
-	TL	Dec-2021	8.95%	Dec-2024	22.73	[ICRA]A+ (Stable)
-	TL - 3	Dec-2021	8.00%	Dec-2025	46.67	[ICRA]A+ (Stable)
-	TL - 2	Jan-2022	8.00%	Jan-2025	28.20	[ICRA]A+ (Stable)
-	TL-2	Jan-2022	6.76%	Mar-2025	50.00	[ICRA]A+ (Stable)
-	TL - 1	Jan-2022	8.00%	Jan-2025	42.41	[ICRA]A+ (Stable)
-	TL - 1 - Tranche I	Mar-2022	8.00%	Mar-2027	50.00	[ICRA]A+ (Stable)
-	TL - 4	Mar-2022	8.00%	Mar-2032	49.97	[ICRA]A+ (Stable)
-	TL - 3- Tranche - I	Mar-2022	8.40%	Mar-2025	45.83	[ICRA]A+ (Stable)
-	TL - 3- Tranche - II	Mar-2022	8.40%	Jun-2025	45.83	[ICRA]A+ (Stable)
-	TL - 2	Mar-2022	8.90%	Apr-2025	36.67	[ICRA]A+ (Stable)
-	TL - 2	Mar-2022	8.25%	Mar-2026	23.44	[ICRA]A+ (Stable)
-	TL	Jun-2022	8.50%	Dec-2026	25.00	[ICRA]A+ (Stable)
-	TL-2	Jun-2022	8.50%	Jul-2025	50.00	[ICRA]A+ (Stable)
-	TL - 5	Aug-2022	8.70%	Sep-2026	50.00	[ICRA]A+ (Stable)
-	TL - 4	Sep-2022	9.28%	Sep-2026	100.00	[ICRA]A+ (Stable)
-	TL - 2	Sep-2022	8.50%	Sep-2026	100.00	[ICRA]A+ (Stable)
-	TL	Sep-2022	9.10%	Sep-2026	75.00	[ICRA]A+ (Stable)
-	TL	Sep-2022	9.10%	Sep-2025	50.00	[ICRA]A+ (Stable)
-	TL - 1 - Tranche II	Sep-2022	8.75%	Sep-2027	50.00	[ICRA]A+ (Stable)
NA	Unallocated	-	-	-	481.41	[ICRA]A+ (Stable)
INE423Y07062	Non-convertible debentures	Aug-2021	8.57%	Aug-2024	43.00	[ICRA]A+ (Stable)
INE423Y07039	Non-convertible debentures	Aug-2020	9.25%	Feb-2022	50.00	[ICRA]A+ (Stable); withdrawn
INE423Y07021	Non-convertible debentures	Aug-2020	9.25%	Feb-2022	25.00	[ICRA]A+ (Stable); withdrawn
INE423Y07047	Non-convertible debentures	Aug-2020	9.30%	Feb-2022	25.00	[ICRA]A+ (Stable); withdrawn
INE423Y07054	Non-convertible debentures	Sep-2020	9.25%	Mar-2022	50.00	[ICRA]A+ (Stable); withdrawn

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	Non-convertible debentures*	-	-	-	57.00	[ICRA]A+ (Stable)

Source: Company; *Proposed

[Please click here to view details of lender-wise facilities rated by ICRA](#)

Annexure II: List of entities considered for consolidated analysis

Not Applicable

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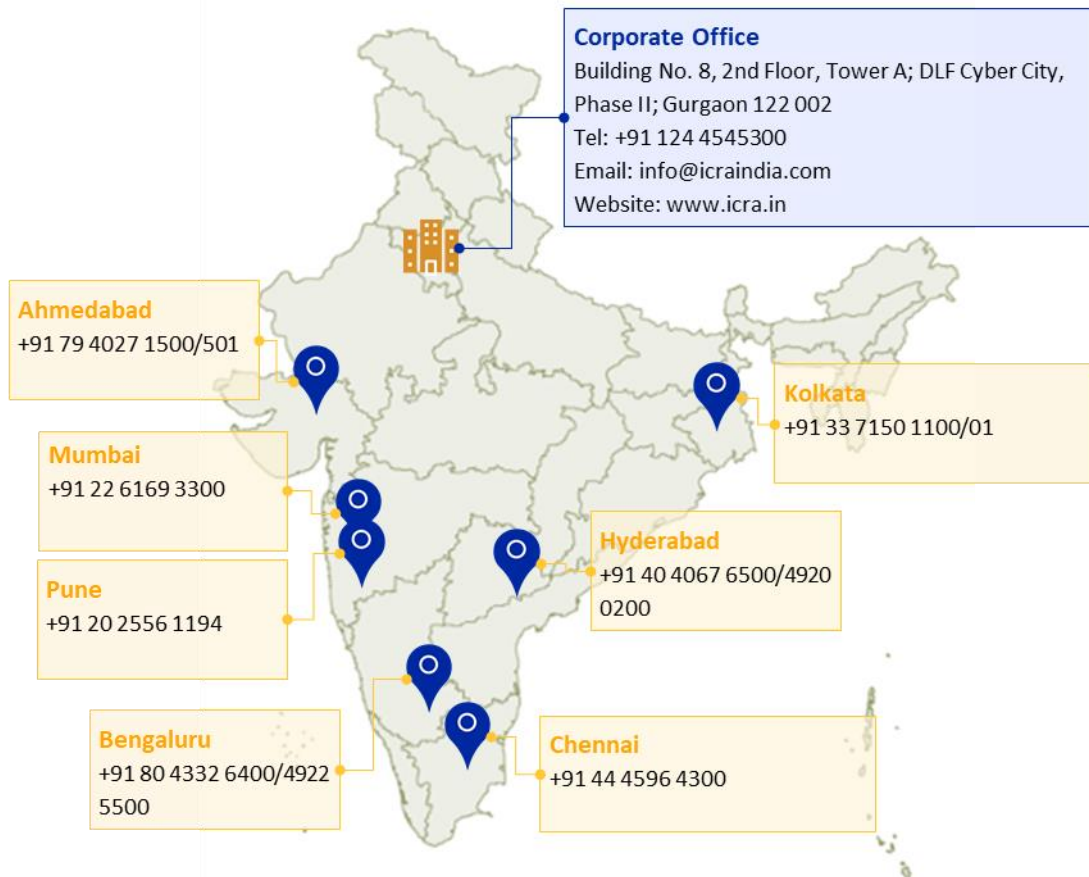
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