Press Release

Sonata Finance Private Limited

August 25, 2021

Rating Assigned

Term Loan Facilities Rated*	Rs. 10.00 Cr
Long Term Rating	ACUITE A-(CE)/ Stable (Assigned; Converted to Final from Provisional rating)

Rating Rationale

Acuité has converted the provisional rating to final long term rating of **'ACUITE A-(CE)' (read as ACUITE A minus (Credit Enhancement))** on the Rs.10.00 Cr. partially credit enhanced loan facilities of Sonata Finance Private Limited (SFPL). The outlook is **'Stable'**.

The transaction has Partial Credit Enhancement (PCE) in the form of unconditional, irrevocable, payable on demand guarantee by Northern Arc (Credit Enhancer/ Guarantor) covering 18% of the initial principal value of the facility amount. The level of guarantee as a percentage of the aggregate outstanding principal of the facility is capped at 24%. Additionally, the facility has security in the form of exclusive first charge on identified book debts and receivables with 110% margin (qualifying under priority sector) in favour of the bank. SFPL shall make payments of interest and principal amounts due along with all other obligations (if any) under the Facility Documents by T-3 business days. In case of non-payment by Sonata Finance Private Limited (SFPL), the Guarantors shall be severally and jointly liable to make the payments by the due date.

The investor is SBM Bank India Limited.

The final rating is assigned based on the fulfilment of the structure, terms and covenants detailed in the executed term loan agreement, deed of guarantee, master credit facility agreement, agreement for hypothecation of receivables, collection and payment agreement and other documents relevant to the transaction.

About Sonata Finance Private Limited

Uttar Pradesh based SFPL is an NBFC- MFI engaged in providing microcredit to women borrowers via Joint Liability Group (JLG) model. SFPL also provides individual, utility and sanitation financing. SFPL commenced its operations in 2006 and is promoted by Mr. Anup Kumar Singh. Mr. Anup Kumar Singh has over two decades of experience in micro finance segment. SFPL operates through its network of 448 branches spread across 9 states as on November 30, 2020. The latest rationale of SFPL can be found here: https://www.acuite.in/documents/ratings/revised/142-RR-20210211.pdf

SFPL's networth grew to Rs. 279.14 Cr as on March 31, 2021 from Rs. 272.69 Cr as on March 31, 2020. The company's Profit After Tax (PAT) reduced to Rs. 4.93 Cr as on March 31, 2021 from Rs. 14.09 Cr as on March 31, 2021. SFPL's AUM as on November 30, 2020 stood at Rs. 1,276.99 cr. (Rs. 1,750.26 cr. as March 31, 2020 and Rs. 1,441.08 cr. as on March 31, 2019) The AUM comprised of owned portfolio of Rs. 986.28 cr. (77 percent of AUM) and off-book exposure of Rs. 290.71 cr. (23 percent of AUM) as on November 30, 2020. The company takes off-book exposure through Business Correspondence model, Direct Assignment and Pass Through Certificates. SFPL is in talks to commence Co-lending model.

About Northern Arc Capital Limited ("Northern Arc")

Northern Arc, previously known as IFMR Capital Finance Ltd., is a Non-Deposit taking Non-Banking Financial Company (ND-NBFC) incorporated in 1989. It is involved in the placement (arranging funding for its clients via loan syndication, securitisation and assignment among others) and lending business. The company acts as a link between mainstream capital markets investors and high-quality last mile lending institutions and businesses. The company's debt portfolio is diversified across 29 states and 540 districts of India. The company's business is categorized as finance sector exposure, i.e., microfinance, affordable housing finance, commercial vehicle finance, consumer finance, agri finance and small business loans, and non-finance sector exposure, i.e., mid-market finance and corporates.

Northern Arc reported Assets Under Management (AUM) of Rs. 4,953.7 Cr. (provisional) as on March 31, 2021 as against Rs. 4,484 Cr. as on March 31, 2020. Northern Arc's asset quality moderated with GNPA (90+dpd) at 2.28% (provisional) as on March 31, 2021 as against 0.5% as on March 31, 2020. The company's Profit After Tax (PAT) stood at Rs. 56.05 Cr (provisional) as on March 31, 2021 (Rs. 89.62 Cr as on March 31, 2020). The company's debt/equity ratio was 1.96 times as on March 31, 2020 as compared to 2.55 times as on March 31, 2019. However, the debt/equity ratio increased to 2.53 times as on March 31, 2021.

Analytical Approach

Acuité has considered the standalone business and financial risk profile of SFPL, the rating of SFPL (ACUITE BBB+/ Stable), and has further factored in the credit enhancement arising from the structure. The suffix (CE) indicates credit enhancement arising from the PCE in the form of unconditional, irrevocable, payable on demand guarantee covering 18% of the initial principal value of the facility amount. The strength of the underlying structure and continued adherence to the same is central to the rating. Accounting for the Partial Credit Enhancement, the agency has enhanced the rating of the facility to ACUITE A- (CE)/ Stable. The Credit Enhancement (CE) in the rating is solely for the rated issue and its terms and structure.

The notched up rating of the loan facility incorporates the PCE in the form of guarantee by Northern Arc Capital Limited ("Northern Arc"), acting as the Credit Enhancer/ Guarantor.

Standalone/Unsupported – (SFPL)

Acuite BBB+/Stable

Key Rating Drivers

Strengths

- **Strength of underlying structure**:

The transaction has PCE in the form of unconditional, irrevocable, payable on demand guarantee by Northern Arc covering 18% of the initial principal value of the facility amount. The level of guarantee as a percentage of the aggregate outstanding principal of the facility is, however, capped at 24%.

The Credit Enhancer shall provide PCE, favouring SFPL in the form of an unconditional, irrevocable guarantee that covers 18% to the extent of Guarantee Cap guaranteeing the repayment of principal and payment of interest amounts in relation to the facility.

If due to the amortisation of the facility, the credit enhancement % becomes greater than 24% of the aggregate outstanding principal of the facility, the Guarantee Cap shall be reduced to 24% of the aggregate outstanding principal of the facility (Revised Guarantee Cap).

The structure envisages that if the rating of SFPL becomes A- at a standalone level, the Credit Enhancement % shall completely fall off. This will be subject to rating of the facility being maintained at A- post the guarantee fall off.

SFPL shall make payments of interest and principal amounts due along with all other obligations (if any) under the Facility Documents on T-3 business days. In case of non-payment by SFPL, the Guarantors shall be severally and jointly liable to make the payments due.

In case of downgrade of SFPL's senior secured long term rating (as per Acuité's view) to below BBB-, non-maintenance of security cover, non-payment by Borrower, and cross default of the borrower, SFPL and the Guarantor shall be jointly and severally liable to also transfer the collections from the security pool to the lender by on T-3 business days. These collections would be used by the lender for prepayment of principal and repayment of interest on the facility.

In the event of failure of SFPL and the Guarantor to comply with the terms above, on T-2 Business Days, the lender shall invoke the PCE and send a notice of 1 business day to the Credit Enhancer to make payments. The Credit Enhancer shall make payment on T-1 business days.

The facility and all interest, additional interest, further interest, liquidated damages, commitment charges, indemnification payments, fees, costs, expenses and other monies owing by, and all other present and future obligations and liabilities are further secured by a first and exclusive charge by way of hypothecation over identified receivables. The facility has security in the form of exclusive 1st charge on identified book debts and receivables with 110% margin (qualifying under priority sector) arising out of banks funding in favour of the bank.

The security cover will be met from the date of disbursal of the facility. In case of SFPL senior secured long term rating (as per Acuité view) downgrade to below BBB-, SFPL will ensure that the % of outstanding principal value of PAR > 0 loans in the hypothecated property does not exceed 15% of the outstanding principal value of the hypothecated property.

The transaction might be susceptible to commingling risks due to the absence of a ring-fencing arrangement of the hypothecated pool.

Acuité believes that the structure provides for adequate covenants to safeguard the interest of the lender. The lender has enough buffers available to initiate corrective action and mitigate the risks arising out of non-adherence to the terms and conditions.

- **Experienced management supported by diverse and reputed investors**

SFPL commenced its microfinance operations in 2011, extending micro-credit to women borrowers engaged in income generating activities under Joint Liability Group (JLG) model. SFPL commenced its operations in Uttar Pradesh and over the years has expanded its presence in other states, namely Bihar, Madhya Pradesh, Haryana, Rajasthan, Uttarakhand, Punjab, Maharashtra and Jharkhand. The company has a presence in 131 districts with a network of 448 branches with an asset under management (AUM) of Rs. 1,276.99 cr. as on November 30, 2020.

SFPL is promoted by Mr. Anup Kumar Singh (MD & CEO), who has an experience of over two decades in micro finance segment. Mr. Anup Kumar Singh has been able to bring on board marquee institutional investors like Caspian Impact Investment, SIDBI, Creation Investments Social Ventures, India Financial Inclusion Fund, Michael & Susan Dell Foundation, Societe De Promotion Et De Participation Pour La Cooperation Economique, Triodos, amongst others with representation on the board. Mr. Anup Kumar Singh is supported by seasoned and experienced professionals in managing the operations of the company.

Acuite believes that SFPL's business and credit profile will be supported by an established presence in its area of operations and expectation of continued support from the existing investors over the near term.

- **Adequate financial position with diversified funding mix**

SFPL's net-worth stood at Rs. 279.66 cr. as on September 30, 2020 and reported a healthy capital adequacy ratio (CAR) of 26.70 percent comprising Tier 1 capital at 21.80 percent and Tier II capital at 7.15 percent. The company's leverage indicators stood at 4.33 times as on September 30, 2020 (4.49 times as on March 31, 2020 and 4.69 times as on March 31, 2019). SFPL's capital adequacy ratio (CAR) improved to 26.70 percent as on September 30, 2020 as compared to 23.07 percent as on March 31, 2020. Further, healthy internal accruals coupled with moderation in AUM improved CAR to 28.95 percent as on November 30, 2020. SFPL's total debt stood at Rs. 1212.28 cr. as on September 30, 2020. The company has a strong lender profile comprising Banks and Financial Institutions, with total debt of Rs. 1,212.28 cr. outstanding as on September 30, 2020. SFPL's borrowing profile comprised Term loans (59 percent), Sub-debt (8 percent), ECB's (14 percent) and NCD's (19 percent) as on September 30, 2020. The ability to raise debt by microfinance companies remains challenging due to a very selective and cautious approach adopted by Banks and NBFC/FIs. However, SFPL has demonstrated access to funding from both banks and large NBFC/FIs.

Acuité believes, going forward, the ability of the company to mobilise additional lower cost funding through debt/ sub debt and its ability to deploy the funds profitably will be a key rating monitorable.

Weakness

- **Moderate geographic concentration; susceptibility to risks inherent to microfinance segment**

SFPL's operations are moderately concentrated with Uttar Pradesh accounting for 50 per cent of its AUM as on November 30, 2020 followed by Bihar at 24 percent and Madhya Pradesh at 17 percent. While the company is gradually expanding into other neighboring states, there is an overall concentration of the lending business with the above three states comprising 90 percent of AUM. Generally, the risk profile of a microfinance company with a geographically diversified portfolio is more resilient compared to that of an entity with a geographically concentrated portfolio. The company's performance is expected to remain exposed to the occurrence of events such as natural calamities, which may adversely impact the credit profile of the borrowers. Besides geography, the company will be exposed to any changes in the regulatory framework. The current lockdowns and economic disruptions may slow down the process of scaling up of operations, thereby, affecting the return metrics. SFPL has demonstrated healthy asset quality in the past with low Gross Non-Performing Assets (GNPA) at 0.89 percent as on March 31, 2020 (1.75 percent as on November 30, 2020), the company has made adequate provisions in case of any increase in slippages. However, rise in delinquency is expected due to impact of COVID-19 as the credit profiles of some of the borrowers could be impaired for a much longer time.

Acuité believes that containing additional slippages while maintaining the growth in the loan portfolio will be key rating sensitivity.

Rating Sensitivity

- Movement in collection efficiency and asset quality
- Movement in profitability parameters
- Changes in regulatory environment

Assessment for Adequacy of Credit Enhancement

SFPL has significant experience in the MFI segment, and its adequate capital position has been bolstered by capital infusions. Thus, even after considering risks such as geographical concentration and possible asset quality deterioration during the pandemic, Acuité believes that the CE will stand adequate in all scenarios and in the event of any requirement, Northern Arc will provide the necessary support.

Liquidity: Adequate

The company had unencumbered cash and bank balance of Rs. 306.87 crore as on September 30, 2020. The transaction has PCE in the form of unconditional, irrevocable, payable on demand guarantee by Northern Arc covering 18% of the initial principal value of the facility amount. The level of guarantee as a percentage of the aggregate outstanding principal of the facility is capped at 24%.

Material Covenants

The following covenant is included in the structure: the maximum permissible ratio of Par > 90 net off Loan Loss Provisions (on SFPL's entire portfolio including receivables sold or discounted on a non-recourse basis) shall be 5.00%.

Outlook: Stable

Acuité believes that the rating on the loan facility will maintain a 'Stable' outlook over the near to medium owing to SFPL's presence in MFI business along with its capital position. The outlook may be revised to 'Positive' in case SFPL is able to demonstrate significant and sustainable growth in its scale of operations while mitigating the asset quality risks in its portfolio. Conversely, the outlook may be revised to 'Negative' in case of any sharp deterioration in its asset quality and profitability levels.

About the Rated Entity - Financials

	Unit	FY21 (Actual)	FY20 (Actual)
Total Assets	Rs. Cr.	1493.26	1522.62
Total Income*	Rs. Cr.	114.97	163.83
PAT	Rs. Cr.	4.39	14.09
Net-worth	Rs. Cr.	279.14	272.69
Return on Average Assets (RoAA)	(%)	0.29	0.94
Return on Net Worth (RoNW)	(%)	1.59	5.32
Total Debt/Tangible Net Worth (Gearing)	Times	4.24	4.49
Gross NPA	(%)	6.1	0.89
Net NPA	(%)	0.3	0.19

* *Total income equals to Net interest income plus other income*

Status of non-cooperation with previous CRA (if applicable)
None

Any other information
Not Applicable

Applicable Criteria
- Default Recognition - https://www.acuite.in/view-rating-criteria-52.htm
- Rating of Non-Banking Financing Entities - https://www.acuite.in/view-rating-criteria-44.htm
- Financial Ratios and Adjustments - https://www.acuite.in/view-rating-criteria-53.htm
- Explicit Credit Enhancements - https://www.acuite.in/view-rating-criteria-49.htm

Note on complexity levels of the rated instrument
https://www.acuite.in/view-rating-criteria-55.htm

Rating History (Upto last three years)

Date	Name of Facilities	Term	Size of Issue (Rs. Cr.)	Ratings/Outlook
March 22, 2021	Proposed Bank Facility	Long Term	10.00	ACUITE PROVISIONAL A-(CE)/ Stable (Assigned)

Annexure- Details of Instruments rated

Lender	Name of Facilities	Date of Issuance	Coupon Rate	Maturity Date	Size of Issue (Rs. Cr.)	Ratings/Outlook
SBM Bank India Limited	Term Loan	March 31, 2021	10.45%	March 31, 2023	10.00	ACUITE A-(CE)/ Stable (Assigned; converted to Final from Provisional rating)

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About Acuité Ratings & Research:
Acuité Ratings & Research Limited is a full-service Credit Rating Agency registered with the Securities and Exchange Board of India (SEBI). The company received RBI Accreditation as an External Credit Assessment Institution (ECAI), for Bank Loan Ratings under BASEL-II norms in the year 2012. Since then, it has assigned more than 6,000 credit ratings to various securities, debt instruments and bank facilities of entities spread across the country and across a wide cross section of industries. It has its Registered and Head Office in Mumbai.