

Press Release

Sonata Finance Private Limited

June 03, 2022



Rating Assigned and Reaffirmed

Product	Quantum (Rs. Cr)	Long Term Rating	Short Term Rating
Bank Loan Ratings	10.00	ACUITE A- CE Stable Reaffirmed	-
Bank Loan Ratings	10.00	Provisional ACUITE A- CE Stable Assigned	-
Bank Loan Ratings	250.00	ACUITE BBB+ Stable Reaffirmed	-
Non Convertible Debentures (NCD)	170.00	ACUITE BBB+ Stable Reaffirmed	-
Non Convertible Debentures (NCD)	25.00	PP-MLD ACUITE BBB+ Stable Reaffirmed	-
Total Outstanding Quantum (Rs. Cr)	465.00	-	-
Total Withdrawn Quantum (Rs. Cr)	0.00	-	-

Rating Rationale

Acuite has assigned a long term rating of '**ACUITE PROVISIONAL A-(CE)**' (read as **ACUITE PROVISIONAL A minus (Credit Enhancement)**) on the Rs.10.00 Cr. partially credit enhanced proposed loan facilities of Sonata Finance Private Limited (SFPL). The outlook is '**Stable**'.

Acuite has reaffirmed a 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**'.

Acuite has reaffirmed a long term rating of '**ACUITE BBB+**' (read as **ACUITE triple B plus**) to Rs. 170.00 crore non-convertible debentures of Sonata Finance Private Limited. The outlook is '**Stable**'.

Acuite has reaffirmed a long term rating of '**ACUITE BBB+**' (read as **ACUITE triple B plus**) to Rs. 250.00 crore bank facilities of Sonata Finance Private Limited. The outlook is '**Stable**'.

Acuite has reaffirmed the long term rating of '**ACUITE PP-MLD BBB+**' (read as **ACUITE Principal Protected Market Linked Debentures triple B plus**) to the Rs. 25.00 cr. proposed principal protected market linked non-convertible debentures of Sonata Finance Private Limited. The outlook is '**Stable**'.

The rating continues to factor in SFPL's track record of operations, experienced management & institutional support. SFPL has a comfortable capital structure with Capital Adequacy Ratio (CAR) of ~24.24 percent as on June 30, 2021 and gearing of 4.61 times as on December 31,

2021. The rating further factors in SFPL's diverse lender base and demonstrated ability to attract funding from banks and financial institutions. Acuité understands that improvement in capitalization buffers is aided by healthy internal accruals coupled with moderation in AUM during the period. SFPL has reported uptick in disbursement in H2 FY2022 after slowdown on account of pandemic induced lockdowns in H1 FY2022.

These strengths are partially offset by moderate asset quality with on-time portfolio at 65.75 percent and GNPA at 10.77 percent as on June 30, 2021 which have impacted the profitability metrics. While the company has reported improvement in monthly collection efficiencies since September 21, sustained collections and asset quality improvement in a key monitorable. On-time portfolio saw an improvement in the month of March 2022 at 85.79 percent vis a vis 65.75 percent as on June 30, 2021. The rating also considers the moderate geographical concentration in states of Uttar Pradesh, Bihar and Madhya Pradesh which comprised ~91 percent of the AUM as on March 31, 2022. Going forward, the ability of the company to scale up its operations and movement of delinquencies across different time buckets and resultant impact on profitability would remain key monitorables.

The Rs 10.00 Cr transaction has a PCE in the form of unconditional, irrevocable, payable on demand guarantee by Northern Arc covering 18 percent of the issue size of debentures. The level of guarantee as a percentage of the aggregate outstanding principal of the debentures is, however, capped at 24 percent.

If due to the amortization of the debentures, the credit enhancement percent exceeds 24 percent of the aggregate outstanding principal of the debentures, the Guarantee Cap shall be reduced to 24 percent of the aggregate outstanding principal of the debentures (Revised Guarantee Cap).

The rating on the Rs. 10.00 Cr proposed term loan (partial credit guarantee) is provisional and the final rating is subject to execution of following documents:

1. Debenture Trusteeship Agreement/CPA Agreement
2. Deed of Guarantee
3. Deed of Hypothecation

About SFPL

Uttar Pradesh based Sonata Finance Private Limited (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 450 branches spread across 9 states as on March 31, 2022.

About Northern Arc Capital Limited ("Northern Arc")

Northern Arc, previously known as IFMR Capital Finance Ltd., is a Non-Deposit taking NonBanking 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 highquality last mile lending institutions and businesses. 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. 6874 Cr. as on March 31, 2022 as against Rs. 5,220.87 Cr. as on March 31, 2021. Northern Arc's asset quality improved with GNPA (90+dpd) at 0.51% as on March 31, 2022 as against 2.23% as on March 31, 2021. The company's Profit After Tax (PAT) stood at Rs. 163.73 Cr for the period ending FY2022 (Rs. 67.51 Cr as of FY2021). The company's debt/equity ratio was 2.53 times as on March 31, 2021 as compared to 1.96 times as on March 31, 2020. However, the debt/equity ratio increased to 3.50 times as on March 31, 2022.

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 proposed 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 rating – (SFPL)

ACUITE BBB+/ Stable

Key Rating Drivers

Strength

Strength of underlying structure

The Rs 10.00 Cr transaction has a PCE in the form of unconditional, irrevocable, payable on demand guarantee by Northern Arc covering 18 percent of the issue size of debentures. The level of guarantee as a percentage of the aggregate outstanding principal of the debentures is, however, capped at 24 percent.

If due to the amortization of the debentures, the credit enhancement percent exceeds 24 percent of the aggregate outstanding principal of the debentures, the Guarantee Cap shall be reduced to 24 percent of the aggregate outstanding principal of the debentures (Revised Guarantee Cap).

SFPL shall make payments of interest and principal amounts due along with all other obligations (if any) under the Transaction Document on T-3 business days. In the event of failure of the Issuer to comply, on T-3 Business Days, the Trustee shall invoke the PCE and the credit enhancement shall be dipped on T-1 Business days.

The Debentures shall be secured by way of a first ranking, exclusive and continuing charge on identified receivables. The Hypothecated Receivables shall at all times be equal to the value of 1.1 times the outstanding amounts of the facility. In case of Issuer rating (as per Rating Agency's view) downgrade to below BBB-, the Borrower will ensure that the percentage of outstanding principal value of PAR > 0 loans in the hypothecated pool does not exceed 15 percent of the outstanding principal value of the hypothecated pool.

Acuité believes that the structure provides adequate covenants to safeguard the interest of the investors.

Experienced management supported by diverse and reputed investors

SFPL commenced its microfinance operations in 2006, 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 132 districts with a network of 450 branches with an asset under management (AUM) of Rs. 1,786.46 Cr. as on March 31, 2022.

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 instrumental in raising funds from 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.

SFPL's AUM as on March 31, 2022 stood at Rs. 1,786.46 Cr. (Rs. 1,494.19 Cr. as March 31, 2021 and Rs. 1,768.06 Cr. as on March 31, 2020) The AUM comprised of owned portfolio of Rs. ~1,300 Cr. (~73 percent of AUM) and off-book exposure of Rs. ~450 Cr. (~27 percent of AUM) as on March 31, 2022. The company takes offbook exposure through Business Correspondence model, Direct Assignment and Pass Through Certificates.

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.

Comfortable capital structure with diversified funding mix

SFPL's networth stood at Rs. 288.13 Cr. as on December 31, 2021. The company's leverage indicators stood at 4.61 times as on December 31, 2021 (4.23 times as on March 31, 2021 and 4.49 times as on March 31, 2020). SFPL's capital adequacy ratio (CAR) improved to 24.24 percent as on June 30, 2021 as compared to 22.05 percent as on March 31, 2021 on account of healthy internal accruals coupled with moderation in AUM. The company has a strong lender profile comprising Banks and Financial Institutions, with total debt of Rs. 1,308.04 Cr. as on December 31, 2021. SFPL's borrowing profile comprised Term loans (~51 percent), Sub-debt (~5 percent), ECB's (~12 percent) and NCD's (~32 percent) as on December 31, 2021. 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.

Acuite 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

The MFI lending segment entails providing loans to the lower economic strata of the society. The inherent risks of microfinance industry including exposure to marginalised borrowers have been exacerbated by localised lockdowns and economic disruptions in the wake of second wave of Covid-19. The intermittent lockdowns and relaxations had resulted in volatility in collection efficiency.

SFPL's operations are moderately concentrated with Uttar Pradesh accounting for ~46 per cent of its AUM as on March 31, 2022 followed by Bihar at ~26 percent and Madhya Pradesh at ~19 percent. While the company is gradually expanding into other neighbouring states, there is an overall concentration of the lending business with the above three states comprising ~91 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.

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

Moderation in asset quality and profitability metrics

While SFPL has demonstrated healthy asset quality in the past with low Gross Non-Performing Assets (GNPA), the company's asset quality has deteriorated on account of Covid-19 induced lockdowns and disruptions. During FY2021 and Q1FY2022 SFPL has witnessed significant deterioration in asset quality with on-time portfolio declining to 65.75 percent and GNPA at 10.77 percent as on June 30, 2021 as compared to ontime portfolio of 86.15 percent and GNPA of 6.15 percent as on March 31, 2021. While Acuite takes cognizance of asset quality stress in the MFI sector due to ongoing pandemic, some MFIs have been more affected due to diverse factors like geographic presence and disruption in economic activities therein, customer profile, rural urban mix etc.

With the lifting of lockdowns, the ontime portfolio saw an improvement in March 2022 with 85.79 percent vis a vis 65.75 percent as on June 30, 2021. SFPL's collection efficiency for current month due also improved to ~99 percent for the month of February and March 2022 from 68.67 percent as on May 31, 2021.

The lockdowns and economic disruptions had slowed down the process of scaling up of operations, thereby, affecting the return metrics. SFPL's profitability metrics were subdued marked by Return on Average Assets (RoAA) at 0.29 percent as on March 31, 2021 (0.94 percent as on March 31, 2020). Decline in Net Interest Margin (NIM) was also seen at 7.81 percent as on March 31, 2021 as compared to 11.80 percent as on March 31, 2020. Acuite

believes that SFPL's ability to improve its overall collection efficiency while containing elevated stress in asset quality will be key monitorable.

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Assessment of 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.

ESG Factors Relevant for Rating

Sonata Finance Private Limited (SFPL) belongs to the NBFC-MFI sector which facilitates lending to the unbanked population. Some of the material governance issues for the financial services sector are policies and practices with regard to business ethics, board diversity and independence, compensation structure for board and KMPs, role of the audit committee and shareholders' rights. On the social aspect, some of the critical issues for the sector are the contributions to financial inclusion and community development, responsible financing including environmentally friendly projects and policies around data privacy. The industry, by nature has a low exposure to environmental risks. The entity maintains adequate transparency in its business ethics practices as can be inferred from the entity's disclosures regarding related party transactions, vigil mechanism and whistle blower policy. The board of directors of the company comprise of 9 directors out of which 3 are independent directors and 5 are nominee directors. The audit committee is with the objective to monitor and provide an unbiased supervision of the management's financial reporting process. SFPL also maintains transparency in terms of disclosures pertaining to interest rate policy and its adherence to Fair Practice Code as disseminated by Reserve Bank of India's circular. SFPL aims to empower women by providing micro loans to help them generate additional income opportunities, hence making an economic contribution by way of financial inclusion. It continues to work on several community development initiatives and has also worked on empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centers and such other facilities for senior citizen and measures for reducing inequalities faced by socially and economically backward groups.

Rating Sensitivity

- Continued investor support
- Movement in collection efficiency and asset quality
- Movement in profitability metrics
- Movement in liquidity buffers
- Changes in regulatory environment

Material Covenants

SFPL is subject to covenants stipulated by its lenders/investors in respect of various parameters like capital structure, asset quality, among others. As per confirmation received from the client the company is adhering to all terms and conditions stipulated as covenants by all its lenders/investors.

Liquidity Position: Adequate

SFPL's overall liquidity profile remains adequate with no negative cumulative mismatches in near to medium term as per ALM dated March 31, 2022. The company has maintained unencumbered cash and bank balances of ~Rs. 367.28 Cr. as on December 31, 2021. The borrowing profile of SFPL of Rs. 1,308.04 Cr. as on December 31, 2021 comprised Term loans (~51 percent), Subdebt (~5 percent), ECB's (~12 percent) and NCD's (~32 percent) from Banks and NBFC/FIs. The company has undrawn sanctions of around Rs. ~280 Cr. and is in talks in raising additional fundings from banks.

Outlook : Stable

Acuité believes that the SFPL will maintain a 'Stable' outlook over the medium term supported by its established presence in the microfinance segment and capital structure. The outlook may be revised to 'Positive' in case of significant and sustainable growth in its AUM while maintaining profitability, asset quality and capitalization indicators. Conversely, the outlook may be revised to 'Negative' in case of challenges in attaining optimal collection efficiency or significantly higher than expected pressure on asset quality or profitability margins

Other Factors affecting Rating

Not Applicable

Key Financials - Standalone / Originator

Particulars	Unit	FY21 (Actual)	FY20 (Actual)
Total Assets	Rs. Cr.	1491.55	1522.62
Total Income*	Rs. Cr.	111.91	163.83
PAT	Rs. Cr.	4.39	14.09
Networth	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	4.23	4.49
Gross NPA's	(%)	6.15	0.98
Net NPA's	(%)	1.17	0.31

* Total income equals to Net interest income plus other income

Status of non-cooperation with previous CRA (if applicable):

Not Applicable

Any other information

Supplementary disclosures for Provisional Ratings Risks associated with the provisional nature of the credit rating

In case there are material changes in the terms of the transaction after the initial assignment of the provisional rating and post the completion of the issuance (corresponding to the part that has been issued) Acuité will withdraw the existing provisional rating and concurrently assign a fresh final rating in the same press release, basis the revised terms of the transaction.

Rating that would have been assigned in absence of the pending steps/documentation

The structure would have become null and void for the instrument. The rating of the instrument would have been equated to the standalone rating of the issuer (ACUITE BBB+/Stable).

Timeline for conversion to Final Rating for a debt instrument proposed to be issued

The provisional rating shall be converted into a final rating within 90 days from the date of issuance of the proposed debt instrument. Under no circumstance shall the provisional rating continue upon the expiry of 180 days from the date of issuance of the proposed debt instrument.

Applicable Criteria

- Application Of Financial Ratios And Adjustments: <https://www.acuite.in/view-rating-criteria-53.htm>
- Banks And Financial Institutions: <https://www.acuite.in/view-rating-criteria-45.htm>
- Default Recognition: <https://www.acuite.in/view-rating-criteria-52.htm>
- Explicit Credit Enhancements: <https://www.acuite.in/view-rating-criteria-49.htm>
- Non-Banking Financing Entities: <https://www.acuite.in/view-rating-criteria-44.htm>

Note on complexity levels of the rated instrument

<https://www.acuite.in/view-rating-criteria-55.htm>

Rating History

Date	Name of Instruments/Facilities	Term	Amount (Rs. Cr)	Rating/Outlook
04 Oct 2021	Term Loan	Long Term	12.50	ACUITE BBB+ Stable (Reaffirmed)
	Proposed Bank Facility	Long Term	209.96	ACUITE BBB+ Stable (Reaffirmed)
	Proposed Non Convertible Debentures	Long Term	115.00	ACUITE BBB+ Stable (Assigned)
	Non Convertible Debentures	Long Term	22.00	ACUITE BBB+ Stable (Reaffirmed)
	Proposed Non Convertible Debentures	Long Term	3.00	ACUITE BBB+ Stable (Reaffirmed)
	Proposed Non Convertible Debentures	Long Term	25.00	ACUITE PP-MLD BBB+ Stable (Assigned)
	Non Convertible Debentures	Long Term	30.00	ACUITE BBB+ Stable (Reaffirmed)
	Term Loan	Long Term	27.54	ACUITE BBB+ Stable (Reaffirmed)
25 Aug 2021	Term Loan	Long Term	10.00	ACUITE A-(CE) Stable (Assigned)
22 Mar 2021	Proposed Bank Facility	Long Term	10.00	ACUITE Provisional A-(CE) Stable (Assigned)
11 Feb 2021	Proposed Bank Facility	Long Term	198.70	ACUITE BBB+ Stable (Assigned)
	Term Loan	Long Term	19.20	ACUITE BBB+ Stable (Assigned)
	Term Loan	Long Term	32.10	ACUITE BBB+ Stable (Assigned)
	Proposed Non Convertible Debentures	Long Term	55.00	ACUITE BBB+ Stable (Assigned)

Annexure - Details of instruments rated

Lender's Name	ISIN	Facilities	Date Of Issuance	Coupon Rate	Maturity Date	Quantum (Rs. Cr.)	Rating
Not Applicable	INE509M07246	Non-Convertible Debentures (NCD)	18-03-2021	11.63	18-03-2024	22.00	ACUITE BBB+ Stable Reaffirmed
Not Applicable	INE509M07253	Non-Convertible Debentures (NCD)	25-03-2021	11.63	25-03-2025	30.00	ACUITE BBB+ Stable Reaffirmed
Not Applicable	Not Applicable	Proposed Market Linked Debentures	Not Applicable	Not Applicable	Not Applicable	25.00	PP-MLD ACUITE BBB+ Stable Reaffirmed
Not Applicable	Not Applicable	Proposed Non Convertible Debentures	Not Applicable	Not Applicable	Not Applicable	3.00	ACUITE BBB+ Stable Reaffirmed
Not Applicable	Not Applicable	Proposed Non Convertible Debentures	Not Applicable	Not Applicable	Not Applicable	115.00	ACUITE BBB+ Stable Reaffirmed
Not Applicable	Not Applicable	Proposed Term Loan	Not Applicable	Not Applicable	Not Applicable	209.96	ACUITE BBB+ Stable Reaffirmed
Not Applicable	Not Applicable	Proposed Term Loan	Not Applicable	Not Applicable	Not Applicable	10.00	Provisional ACUITE A- CE Stable Assigned
State Bank of Mauritius Ltd	Not Applicable	Term Loan	31-03-2021	10.45	31-03-2023	10.00	ACUITE A- CE Stable Reaffirmed
Federal Bank	Not Applicable	Term Loan	21-10-2020	10.85	31-10-2023	27.54	ACUITE BBB+ Stable Reaffirmed
Utkarsh Small Finance Bank Ltd.	Not Applicable	Term Loan	29-09-2020	12.60	30-09-2022	12.50	ACUITE BBB+ Stable Reaffirmed

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About Acuité Ratings & Research

Acuité is a full-service Credit Rating Agency registered with the Securities & 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. Acuité has assigned 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 Kanjurmarg, Mumbai.

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