

January 13, 2016

Facilities	Amount (Rs. Crore)	Ratings	Rating Action
Term Loans	25.00	SMERA A-/Stable	Reaffirmed
Term Loans	219.12	SMERA A-/Stable	Assigned
Cash Credit	46.50	SMERA A-/Stable	Assigned
Letter of Credit	4.00	SMERA A2+	Assigned
Short/Long Term Bank Facilities (Proposed)	80.38	SMERA A-/Stable/SMERA A2+	Assigned
Total	375.00		

SMERA has reaffirmed the long-term rating of '**SMERA A-**' (read as SMERA single A minus) to the Rs.25.00 crore bank facilities of Electronica Finance Limited (EFL). SMERA has also assigned the long-term rating of '**SMERA A-**' and short-term rating of '**SMERA A2+**' (read as SMERA A two plus) to the Rs.350.00 crore bank facilities of EFL. The outlook is '**Stable**'.

The rating derives comfort from the EFL's long track record in machinery financing business, its experienced management, sound asset quality on account of good credit appraisal and monitoring systems, and adequate capitalisation and profitability metrics. The ratings are also supported by EFL's diversified resource profile and geographical diversity. However, the ratings are constrained by the subdued operational performance in the past two years and some deterioration in the asset quality indicators of the company. The ratings are also constrained due to EFL's business exposure towards MSME borrowers, which are highly vulnerable to economic slowdown. The rating also factors that the company's business risk profile is exposed to regulatory risks inherent in the asset financing industry.

EFL has track record of over two decades in the asset financing industry. The company's management has good understanding which helps them to effectively manage the risk involved in the machinery financing business. The promoters of the company also have machinery manufacturing units in Pune, which helps to understand the sector better. The board of EFL consists of eight directors with three promoter directors and five independent directors. The senior management is also experienced and being associated with the company for over a decade. EFL also has adequate risk management and information technology systems and processes in place. The credit approval is centralised in Pune.

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EFL is comfortably capitalised for its current scale of operations. The company's networth stood at Rs.77.87 crore as on March 31, 2015, as compared to Rs.65.07 crore in the previous year. EFL's gearing stood at 6.89 times (excluding security deposits the gearing stood at 3.70 times) as on March 31, 2015, which improved from 7.62 times as on March 31, 2013. The capital adequacy of the company stood at 19.17% as on March 31, 2015 as compared to 25.19% as on March 31, 2013. The company intends to raise capital over the next 18-24 months, which would support its capitalisation levels to an extent.

EFL's interest spread has improved in FY2014-15 (5.44% in FY 2015 as compared to 4.54% in FY 2014), as the company was able to source cheaper source of finance by way of security deposits from customers. The net interest margin also improved on SIDBI funding arrangement and securitisation portfolio (5.40% in FY2014-15 as compared to 5.19% earlier). Nevertheless, the improvement in spread was offset by the rise in operating expenses (4.49% of Average Managed Assets (AMA) FY2014-15 as compared to 4.22% in FY2013-14) and increase in write-off and provision from Rs.1.29 crore to Rs.2.63 crore, resulting in reduction in ROE (17.71% in FY2014-15 as compared to 21.55% in FY2013-14). The increase in opex was on account of branch expansion undertaken by company in FY2013-14 and FY2014-15, by adding branches primarily by venturing into newer geographies. SMERA expects the operating costs to moderate going ahead, as EFL expands its portfolio by leveraging on its branch set-up. Going forward, EFL's ability to maintain asset quality indicators, to moderate its operating expenses by leveraging on the branch set-up and to further reduce cost of funds would have a bearing on its profitability profile.

EFL has developed funding relationships with a large number of lenders. Additionally the company has also raised funds through SIDBI arrangement and securitization transactions. EFL has also raised funds through Security Deposits (SD) from customers which comprise significant proportion (around 46%) of EFL's resource profile. EFL takes security deposit (25-40% of asset value) from customer, on which it pays interest of ~6-8%. While the cost of funds from banks is in the range of 12% to 13%, on account of low cost funding in the form of SD, the overall cost of funds was lower at about 9.5% for FY2015. EFL has also raised Tier-II capital of Rs.15.00 crore from Syndicate Bank and IDBI Bank. The company has also raised Subordinated debt from third party and the same is repayable after May 2019.

EFL has entered in a financial arrangement with SIDBI wherein EFL originates the loan, provides the services with respect of document collection, payment collection and providing other services to customers. SIDBI does the credit appraisal and borrower receives the finance. As the loans are financed by SIDBI, they do not appear in EFL's book, and the company's exposure is only to the extent of the credit loss guarantee provided against these exposures. Under this arrangement, EFL enjoys a sanctioned limit of Rs.75.00 crore and earns a gross interest spread of around 4% (fixed).

EFL's operations are diversified across 13 states. However top 5 states (Maharashtra, Tamil Nadu, Haryana, Gujarat and Karnataka) where the MSME cluster exists contribute around ~74 per cent of its managed portfolio as on September 30, 2015.

The muted operating environment during FY2014-15 and FY2013-14 led to a slowdown in demand and tightening of Credit Norms by the company, which in turn resulted in subdued credit growth. As a result, the pace of growth of EFL's disbursements slowed down to 2.52% growth in FY2014-15 as compared to 1.80% in FY2013-14. The disbursements of the company were Rs.347 crore in FY2014-15 as compared to Rs.339 crore in the previous year. Nevertheless, the growth was supported by a geographical expansion; with EFL opening branches in Kolkata and Kerala.

EFL has been able to maintain sound asset quality indicators in the past; however there has been a rise in the delinquency numbers in H1FY2015-16, primarily on account of stress in the operating environment impacting the repayment ability of the MSME borrowers. The 90+ DPD (days past due) for EFL deteriorated to 5.18% of total managed portfolio as on September 30, 2015 from 3.47% as on March 2015. Nevertheless, SMERA acknowledges EFL's good credit appraisal and monitoring processes and also unique lending structure wherein borrowers' margin money remains with the company as a security deposit and results in faster build-up of borrowers' equity, which provides a comfort in this regard.

EFL's business is exposed to modest borrower profile, which comprise of small and medium industrial units engaged in engineering, auto ancillary, printing, plastic industries among others. The MSME borrower segment is fundamentally susceptible to slowdown in economic activity which adversely impact the financial profile of SMEs/MSMEs and in turn their repayment ability.

Rating Sensitivity Factors

- Increase in provisioning as per new norms
- Improvement in capitalization and asset quality indicators
- Diversification of income profile

Outlook: Stable

SMERA believes EFL will maintain its adequate capitalisation and sound asset quality and will continue to benefit over the medium term from its experienced management. The outlook may be revised to 'Positive' if EFL scales up and diversifies its loan portfolio significantly, while maintaining capital position, asset quality, and profitability. Conversely, the outlook may be revised to 'Negative' in case there is deterioration in the asset quality indicators. Decline in EFL's profitability, resulting in stress on capital position, or substantial increase in provisioning of bad assets, may also lead to outlook revision to 'Negative'.

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About the Company

Electronica Finance Limited (EFL), formerly known as Electronica Leasing and Finance Limited, is a Non-Banking Finance Company (NBFC) incorporated in the year 1990 to provide machinery loans to the MSME sector. EFL majorly deals with micro, small and medium industrial units, engaged mainly in engineering, auto ancillary, printing, plastic industries and among others. The company has a network of about 35 branches across India for its financing activities.

For FY2014-15, EFL reported profit after tax (PAT) of Rs.12.66 crore on a managed loan portfolio of Rs.743.29 crore, as compared to PAT of Rs.12.66 crore on a managed loan portfolio of Rs.654.44 crore in the previous year. In H1FY2015-16, EFL reported profit after tax (PAT) of Rs.5.35 crore on a managed loan portfolio of Rs.746.86 crore. The company's networth stood at Rs.77.87 crore as on March 31, 2015, as compared to Rs.65.07 crore in the previous year.

Contact List:

Media / Business Development	Analytical Contacts	Rating Desk
Antony Jose Vice President – Business Development Tel: +91-22-6714 1191 Email: antony.jose@smera.in Web: www.smera.in	Vinay Chhawchharia Associate Vice President – Corporate Ratings Tel: +91-22-6714 1156 Email: vinay.chhawchharia@smera.in	Tel: +91-22-6714 1184 Email: ratingdesk@smera.in