

Press Release

S.M.I.L.E MICROFINANCE LIMITED

March 23, 2021

Rating Downgraded



Total Facilities Rated*	Rs. 250.00 Cr.
Long Term Rating	ACUITE BBB/ Outlook: Stable (Downgraded from ACUITE BBB+/Stable)
Total Non-Convertible Debenture	Rs. 50.00 Cr.
Long Term Rating	ACUITE BBB/ Outlook: Stable (Downgraded from ACUITE BBB+/Stable)

* Refer Annexure for details

Rating Rationale

Acuité has downgraded the long-term rating of '**ACUITE BBB+** (**read as ACUITE triple B plus**) to '**ACUITE BBB**' (**read as ACUITE triple B**) on the Rs. 250 Cr. bank facilities and Rs. 50 Cr. Non-Convertible Debenture programme of S.M.I.L.E. Microfinance Limited (SMFL). The outlook is '**Stable**'.

Reason for Rating Downgrade

The revision in the rating is primarily driven by asset quality stress and the expected impact on the credit profile. SMFL has reported sharp increase in delinquencies across different time buckets and the on-time collections have declined from 99.58 percent as on March 31, 2020 to 64.57 percent as on December 31, 2020. The elevated stress levels are reflected in softer buckets as well, delinquencies in 30+ to 90dpd bucket increased from 0.06 percent as on March 31, 2020 to 14.37 percent as on December 31, 2020. This in turn, is expected to result in sharp increase in the credit costs in the near term, thereby impacting profitability metrics. The rating is also constrained due geographically concentrated portfolio in the state of Tamil Nadu (93.92 percent as on December 31, 2020) and risks inherent to the microfinance sector. Thus, the movement of delinquencies across different time buckets and resultant impact on profitability due to higher provisioning requirements would remain key monitorables.

The rating continues to derive strength from SMFL's established track record of operations in the microfinance sector of over a decade along with the support of the experienced management team. The rating also derives strength from its adequate capitalisation levels and liquidity profile. The Capital Adequacy Ratio (CAR) stood at 31.94 percent as on December 31, 2020 and 23.64 percent as on March 31, 2020.

About the company

S.M.I.L.E. Microfinance Limited (SMFL) is a Tamil Nadu based Systemically Important Micro Finance Institution. It has obtained license from the Reserve Bank of India as 'Non-Banking Finance Company – Non-Deposit Taking Microfinance Institution (NBFC-MFI-ND) in January 2006. SMFL is engaged in extending of microfinance services to women in rural and urban areas for income generation purposes under the Joint Liability Group Model. As on December 31, 2020, the company's operations are spread across 6 States and 1 Union Territory, namely, Tamil Nadu, Kerala, Chhattisgarh, Karnataka, Jharkhand, Madhya Pradesh and Puducherry. It has a network of 137 branches across 45 Districts in these six States and one Union Territory. Till FY2019, the company's operations were restricted to the State of Tamil Nadu. To attain diversification, the company expanded its operations to 4 new States, namely Chhattisgarh, Jharkhand, Karnataka and Madhya Pradesh. Out of 137 branches as at December 31, 2020, 119 branches were located in the State of Tamil Nadu.

Analytical Approach

Acuité has considered the standalone financial and business risk profile of SMFL to arrive at the rating.

Key Rating Drivers

Strengths

- **Established Track Record of Operations**

SMFL commenced its microfinance activities since 2006. The company was founded by Dr. N. Sethuraman, a medical practitioner with an established practice in Madurai region of Tamil Nadu. Dr. Sethuraman initially commenced microfinance activities under the Mahasemam Trust, a not for profit organization in the 90's, thereafter in 2004, most of the operations of the trust were transferred to SMFL. In FY2010, Developing World Markets (DWM), a US based, social impact fund, invested Rs. 50 Cr for a 66.54 percent stake in the company and since then has been managing the operations of the company. Presently, the shareholding pattern constitute of DWM ~66.54 percent, Dr. S. Gurushankar (Son of Dr. N Sethuraman) having 15.59 percent stake while the remaining shareholders include ~11,000 women members of the public who were earlier associated with Mahasemam Trust.

At present, the company's operations are spread across 6 States and 1 Union Territory, namely, Tamil Nadu, Kerala, Chhattisgarh, Karnataka, Jharkhand, Madhya Pradesh and Puducherry. It has a network of 137 branches across 45 Districts in these six States and one Union Territory.

The company is in the process of strengthening its underwriting, monitoring, on boarding and collection systems, through introduction of technology. Over the years, the company built Assets under Management (AUM) of Rs 606 Cr as on March 31, 2020 which declined to Rs. 441.61 Crore as on December 31, 2020. The on-book exposure constitutes ~92 percent of the total AUM and off book (i.e. Direct assignment and pass through certificate) ~8 percent of the total AUM as on December 31, 2020.

At the helm of company affairs is Mr. Murali Srinivas, who is the Managing Director & CEO of the company. He has 20 years of experience in Corporate & Development Sector including Microfinance. The other board members who oversee the operations of the company time to time include two representative directors from DWM Investments (Cyprus) Limited and Mr. V. S. Padmanaban director representing promoter. Mr. Rajan Samuel and Mr. Suresh K. Krishna are Independent Directors on the board, Ms. Indrani Bhagwan Singh as non-executive director. The day to day operations are supported by an experienced team of personnel.

Acuité believes that the operations of SMFL's will be supported by established presence and experienced management.

- **Adequate Capital adequacy:**

SMFL's networth stood at Rs. 154.63 Cr. as on December 31, 2020 and reported adequate capital adequacy ratio (CAR) of 31.94 percent comprising Tier I Capital only. SMFL's overall CAR improved in December 2020 to 31.94 percent from 23.64 percent as on March 2020 due to moderation in AUM from Rs. 606.47 Cr. as on March 31, 2020 to Rs. 441.16 Cr. as on December 31, 2020.

Acuité believes that the company's adequate capitalization levels will support its growth plans over the near to medium term.

Weaknesses

- **Deteriorating Asset Quality:**

Due to the on-going pandemic, SMFL was required to grant moratorium to its borrowers and thus, the company granted blanket moratorium to all its borrowers. However, post the moratorium, the company has been facing challenges in improving its collection efficiency. The monthly collection efficiency (as against Scheduled Collections) post lifting of moratorium has been in the range of 70-75 percent. Due to subdued collection efficiency, there has been sharp increase in the softer delinquencies across different buckets; the on-time collection efficiency has declined from 99.58 percent as on March 31, 2020 to 64.58 percent as on December 31, 2020. The elevated stress levels are reflected in other buckets as well, GNPA increased from 0.06 percent as on March 31, 2020 to 7.67 percent as on December 31, 2020. Further, majority of incremental loans are towards the existing borrowers which is suggestive of borrower stress. SMFL has been recruiting staff for recovery across branches to improve their collections and thus avoid movements in the buckets. Asset quality deterioration and the resultant rise in credit provisions are expected to impact the credit profile of the company in the near term.

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

• Pressure on Profitability Metrics:

SMFL's net profit stood at Rs. 9.85 Cr. for nine month ended December 31, 2020 (Provisional) as compared to Rs. 12.44 Cr. for FY2020. The net profit of FY2020 was impacted due to increase in operating expenses on account of expansion to newer geographies and one-time non-solicitation payment to Mahasemam Trust. Though the Return on Average Assets (ROAA) improved to 2.01 percent(annualized) for 9MFY2021 (provisional) as compared to 1.91 percent for FY2020, the same is expected to be impacted in the near to medium term on account slower pace of disbursements and expected rise in the credit costs. Given the company has been augmenting its collection staff, the employee expenses are also expected to increase in the near term.

Acuité believes, that due to elevated stress on the asset quality SMFL's profitability would be impacted in the near term due to higher credit costs.

• Susceptibility of near term operating performance to the current challenging environment; geographically concentrated portfolio adds to the challenges:

The MFI lending segment entails providing loans to the lower economic strata of the society. The pandemic and the consequent disruptions have resulted in significant logistical challenges, affecting the movement of men and goods. This has impacted the credit profile of most of the borrowers and the impact has been more severe on the lower economic strata of the society who are already vulnerable. The logistical challenges in reaching out to the borrowers either for collections or disbursements have disrupted the operations of most of the MFIs. The intermittent lockdowns and relaxations have resulted in volatility in collection efficiency. Most of the decisions regarding lockdowns are currently taken at the state government and local authority's level. SMFL's portfolio is concentrated in the State of Tamil Nadu constituting 96percent of AUM as on March 31, 2020 which marginally has declined to ~94percent as on December 31, 2200. The top 10 districts amount to ~66percent of the AUM as on December 31,2020. SMFL has plans to diversify its portfolio by leveraging on the network of branches recently established in the States of Chhattisgarh, Jharkhand, Madhya Pradesh and Karnataka.

Acuité believes that SMFL's ability to maintain growth in AUM against the subdued economic scenario while managing its asset quality will determine the trajectory of its future credit profile.

Liquidity Position: Adequate

SMFL's liquidity buffers primarily depend on its cash inflows (collections from clients and loans from banks) vis. a vis. the cash outflows (disbursements, debt servicing commitments, operating expenses). The cash collections of the company were impacted by the lockdowns in its area of operations, however, post lifting moratorium the collections have remained subdued. The monthly collection efficiency of the company post moratorium has been in the range of 70 – 75 percent (amount collected as against scheduled collections). The company has obligations (Debt servicing obligations and operating expense) of ~Rs. 58.90 Cr. for the month of March, 2021. It had unencumbered cash and bank balances of ~Rs. 46.72 Cr as on February 28, 2021 and unavailed sanctions of Rs. 47 Cr. It has also augmented its resources through the securitization route to support its liquidity.

Rating Sensitivities

- Change in management & ownership
- Collection Efficiency and asset quality
- Movement in Liquidity Buffers
- Profitability and Capital Adequacy buffers
- Changes in regulatory environment

Material Covenants

SMFL is subject to covenants stipulated by its lenders in respect of various parameters. As per confirmation received from client, vide mail dated March 17, 2021. 'The company is complying with the material covenants imposed by its lenders'.

Outlook: Stable

Acuité believes that IMPL will benefit from its experienced promoters and management team and comfortable capitalisation buffers. The outlook may be revised to 'Positive' if there is significantly higher than expected growth in AUM while maintaining asset quality and improving profitability metrics. Conversely, the outlook may be revised to 'Negative' in case of significant deterioration in asset quality or profitability parameters.

About the Rated Entity - Key Financials

	Unit	FY20 (Actual)	FY19 (Actual)
Total Assets	Rs. Cr.	681.47	623.05
Total Income	Rs. Cr.	67.65	58.76
PAT	Rs. Cr.	12.44	21.47
Net Worth	Rs. Cr.	144.28	132.48
Return on Average Assets (RoAA)	(%)	1.91	3.62
Return on Average Net Worth (RoNW)	(%)	8.99	17.77
Debt/Equity	Times	3.62	3.69
Gross NPA	(%)	0.22	0.26
Net NPA	(%)	0.00	0.00

*Total income equals to Net Interest Income plus other income.

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

None

Any other information

None

Applicable Criteria

- Rating of Non-Banking Financing Entities - <https://www.acuite.in/view-rating-criteria-44.htm>
- Default Recognition - <https://www.acuite.in/view-rating-criteria-52.htm>
- Financial Ratios And Adjustments - <https://www.acuite.in/view-rating-criteria-53.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 Instrument/ Facilities	Term	Amount (Rs. Cr.)	Ratings/Outlook
September 11, 2020	Proposed Bank Facility	Long Term	250.00	ACUITE BBB+/Stable (Assigned)
	Proposed Non-Convertible Debentures	Long Term	50.00	ACUITE BBB+/Stable (Assigned)

*Annexure – Details of instruments rated

Name of the Facilities	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue	Ratings/Outlook
Term Loan	13.02.2021	11.90%	01.01.2023	9.88	ACUITE BBB/Stable (Downgraded from ACUITE BBB+/Stable)
Term Loan	27.02.2020	13.75%	01.07.2022	7.08	ACUITE BBB/Stable (Downgraded from ACUITE BBB+/Stable)

Term Loan	23.03.2020	13.50%	23.03.2022	5.74	ACUITE BBB/Stable (Downgraded from ACUITE BBB+/Stable)
Term Loan	31.10.2019	14.00%	21.02.2022	9.78	ACUITE BBB/Stable (Downgraded from ACUITE BBB+/Stable)
Term Loan	31.12.2018	11.30%	30.09.2022	5.38	ACUITE BBB/Stable (Downgraded from ACUITE BBB+/Stable)
Term Loan	30.03.2020	11.60%	01.06.2023	12.50	ACUITE BBB/Stable (Downgraded from ACUITE BBB+/Stable)
Term Loan	Not Available	12.95%	Not Available	10.00	ACUITE BBB/Stable (Downgraded from ACUITE BBB+/Stable)
Term Loan	Not Available	12.50%	Not Available	5.00	ACUITE BBB/Stable (Downgraded from ACUITE BBB+/Stable)
Cash Credit	Not Applicable	14.00%	Not Applicable	2.00	ACUITE BBB/Stable (Downgraded from ACUITE BBB+/Stable)
Proposed Bank Facility	Not Applicable	Not Applicable	Not Applicable	182.64	ACUITE BBB/Stable (Downgraded from ACUITE BBB+/Stable)

Non-Convertible Debentures

ISIN	Name of Facilities	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue	Ratings/Outlook
INE786V07100	Non-Convertible Debentures	18.12.2020	14.50%	20.12.2021	15.00	ACUITE BBB/Stable (Downgraded from ACUITE BBB+/Stable)
Not Applicable	Proposed Non-Convertible Debentures	Not Applicable	Not Applicable	Not Applicable	35.00	ACUITE BBB/Stable (Downgraded from ACUITE BBB+/Stable)

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About Acuité Ratings & Research:

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