Press Release

Midland Microfin Limited

June 17, 2021

Ratings Reaffirmed and Assigned

Total Term Loan Facilities Rated*	Rs. 25.00 Cr
Long Term Rating	ACUITE BBB+/ Positive (Reaffirmed)
Total Term Loan Facilities Rated*	Rs. 10.00 Cr
Long Term Rating	ACUITE PROVISIONAL A-(CE)/ Stable (Assigned)

Rating Rationale

Acuité has reaffirmed the long term rating of **'ACUITE BBB+' (read as ACUITE BBB+)** to the Rs. 25.00 Cr bank facilities of Midland Microfin Limited (MML). The outlook is **'Positive'**.

Acuité has assigned a long term rating of **'ACUITE PROVISIONAL A-(CE)/ Stable' (read as ACUITE PROVISIONAL A minus (Credit Enhancement))** on the Rs.10.00 Cr. partially credit enhanced proposed loan facilities of Midland Microfin Limited (MML). The outlook is **'Stable'**.

The rating factors in company's established presence in the areas of operations, experienced management and representation of institutional investors on the MML's board. The rating takes into account the demonstrated ability of promoters to infuse the capital at regular intervals, which has helped Midland Microfin Limited to grow its AUM from Rs. 549.12 Cr as on March 31, 2019 to Rs. 799.17 Cr as on March 31, 2021. The rating considers the company's adequate capitalisation profile with capital adequacy ratio (CAR) at 28.43 percent as on March 31, 2021. The rating also considers the efficient risk management systems and collection process adopted by the company.

The rating is constrained by the relatively high leveraged capital structure with a gearing of 5.05 times as on March 31, 2021 (7.10 times as on March 31, 2020). The company's GNPA increased to 1.69 percent as on March 31, 2021 from 0.57 percent as on March 31, 2020 and it made Estimated Credit Loss (ECL) provisions of Rs. 12.37 Cr during FY2021. The increase in provision due to asset quality pressure was attributable for decline in RoAA to 1.41% as on March 31, 2021 from 2.13% as on March 31, 2020. Also, MML is exposed to geographical concentration risks since Bihar and Punjab constitute 33.95% and 32.23% respectively of the total outstanding portfolio as on March 31, 2021.

Acuité takes note of MML's funding plan through capital infusion for Q2 FY2022, which would help the company in bringing down it's leverage. The rating is also constrained by inherent risks associated with lending in this segment.

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. MML 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 MML, the Guarantors shall be severally and jointly liable to make the payments by the due date.

The rating on facilities is provisional and the final rating is subject to execution of following documents:

1. Debenture Trusteeship Agreement;
2. Debenture Trust Deed
3. Deed of Hypothecation

About Midland Microfin Limited

Punjab based, Midland Microfin Limited (MML) is an NBFC-MFI engaged in providing microcredit to women borrowers via Joint Liability Group (JLG) model. The company is promoted by Mr. Amardeep Singh Samra who acquired an existing NBFC - Sajan Hire Purchase Private Limited in 2010 and re-named it to Midland Microfin Limited. The company commenced its operation in Jalandhar Punjab in 2011 and since then has expanded its presence in 7 states across the northern region. MML currently operates through a branch network of 218 branches as on April 30, 2021.
The latest rationale of MML can be found in https://www.acuite.in/documents/ratings/revised/24935-RR-20201218.pdf

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 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 MML, the rating of MML (ACUITE BBB+/ Positive), 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 Rs. 10.00 Cr 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.

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 MML 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 percentage 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 MML becomes A- at a standalone level, the Credit Enhancement percentage shall completely fall off. This will be subject to rating of the facility being maintained at A- post the guarantee fall off.

MML 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 MML, the Guarantors shall be severally and jointly liable to make the payments due.

In case of downgrade of MML'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, MML 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 MML 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 transaction might be susceptible to commingling risks due to the absence of a ring-fencing arrangement of the hypothecated pool.

Acuité believes that the proposed 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 proposed terms and conditions.

- **Established presence in the areas of operations**

MML commenced its microfinance operations in 2011, extending micro-credit to women borrowers engaged in income generating activities under Joint Liability Group (JLG) model. The company caters to rural and semi-urban areas where the borrowers are mainly engaged in agri and agri allied activities and providing essential services. MML commenced its operations in Punjab and over the years has expanded its presence in other states namely Bihar, Rajasthan, Haryana, Uttar Pradesh, Jharkhand and Himachal Pradesh. The company has a presence 218 branches with an asset under management (AUM) of Rs. 731.19 Cr as on March 31, 2021.

MML is promoted by Mr. Amardeep Singh Samra (Managing Director) who has been previously engaged in asset financing, hire-purchase and leasing businesses. Mr. Samra purchased an existing NBFC - Sajan Hire Purchase Private Limited in 2010 and re-named it to Midland Microfin Limited. The company is led by Mr. Samra who is supported by other members on the board which comprise Mr. Vijay Kumar Bhandari, ex-GM Central Bank of India, having around three decades of experience in banking, Mrs. Kamna Aggarwalla, ex-Chairperson of the Confederation of Indian Industry (CII), Punjab amongst others. Private equity investor Kitara Capital have board representation and MML benefits from their expertise. Mr. Sachin Kamath founder member of Kitara Capital International Limited is on the board of MML.

Acuité believes that MML will continue to benefit from its established presence and experience of the promoters in microfinance segment.

- **Demonstrated fund raising ability**

MML's networth stood at Rs. 176.81 Cr as on March 31, 2021 as compared to Rs. 118 Cr as on March 31, 2020. The company has demonstrated fund raising ability by raising funds from private equity investor and promoter group. In FY 2019 the company raised Rs. 39.43 Cr via private placement and right issue. The company also raised Rs. 18.61 Cr in FY2019-20 from its existing shareholders comprising of promoter group and existing investors. The company in FY2021 raised equity capital to the tune of Rs. 45.00 Cr. MML has demonstrated itsfund raising ability with access to funds from Banks, NBFC/FI's, External commercial borrowings, NCD's and also securitization.

Acuité believes that the company's growth prospectus will be supported by promoter's experience in the industry, along with their demonstrated track record of resource raising ability.

- **Healthy growth in AUM while maintaining asset quality**

MML's AUM stood at 799.17 Cr as of March 31, 2021 as compared to Rs. 777.71 Cr as on March 31, 2020 and Rs. 549.12 Cr in March 31, 2019. The company has reported growth while maintaining healthy asset quality with on-time portfolio at 95.84 percent as on March 31, 2021. The company's gross non-performing asset (GNPA) was 0.83 percent as on September 30, 2020 (provisional) as compared to 0.57 percent as on March 31, 2020. The company has demonstrated and maintained healthy asset quality despite increase in loan book. The company's AUM comprises mix of on-book and off book exposure. The AUM of Rs. 799.17 Cr comprises own portfolio of Rs. 764.59 Cr and off-book exposure of Rs. 34.58 Cr as on March 31, 2021.

MML takes off book exposure through securitized transactions like Pass through Certificates (PTC) and Direct Assignments. However, the company saw a deterioration in its earning profile with return on average assets (RoAA) at 1.41 percent as on March 31, 2021 as compared to 2.13 percent as on March 31, 2020. The company's net interest margin (NIM) dropped slightly to 11.86 percent as on March 31, 2021 from 13 percent as on March 31, 2020. The operating expense to earning assets ratio stood at 7.57 percent as on March 31, 2021.

The company's overall growth in AUM has been as a result of expansion in newer geographies and thereby also reducing its overall geographical concentration. The increase in scale of operations during FY2021 was attributable to its expansion in its network of branches to 218 branches as on March 31, 2021 from 197 branches as on March 31, 2020. MML disbursed loans amounting to Rs. 688.82 Cr during FY2021, down from Rs. 1034.6 Cr during FY2020 because of disruption in economic activities due to COVID19 1.0. Also, as a result of COVID19 2.0, the company could disburse Rs 84.52 Cr in April 2021 and May 2021.

Acuité expects MML to improve the growth momentum in a sustainable manner while diversifying its geographical reach.

Weaknesses

- **Leveraged capital Structure**

MML is engaged in microfinance lending providing short term loans up to 12 - 36 months. The company extends micro-credit through the Joint Liability Group (JLG) model. The company's networth stood at Rs. 176.81 Cr as on March 31, 2021 as compared to Rs. 118 Cr as on March 31, 2020. MML's AUM stood at 799.17 Cr as of March 31, 2021 as compared to Rs. 777.71 Cr as on March 31, 2020 and Rs. 549.12 Cr in March 31, 2019. MML's gearing stood at 5.05 times as on March 31, 2021 as compared to 7.10 times as on March 31, 2020. While in a steady operating environment, it becomes relatively easy for NBFC's like MML to raise additional debt. However, in the current environment, the company could face challenges in raising further debt to support its future business growth considering its existing levels. Hence, the promoters may have to go for additional equity infusion to support its future growth and to maintain the gearing at an optimal level. The approach of the banks has become more stringent, especially after certain credit events. Also, the pandemic has resulted in economic disruptions. Hence, considering the already leveraged capital structure, the promoters may be required to infuse additional equity to support any future business growth.

Also, MML's GNPA increased to 1.69 percent as on March 31, 2021 from 0.57 percent as on March 31, 2020. The company's NNPA increased to 0.34 percent as on March 31, 2021 from 0.05 percent as on

March 31, 2020.

Acuité believes that leveraged companies like MML could face challenges in raising additional debt due to a very selective and cautious approach adopted by Banks and FIs.

- **Inherent risk in microfinance segment**

The company mostly focuses on rural areas which were less impacted by the COVID19 1.0. Even so, the COVID19 2.0 caused disruptions in the businesses in rural areas. Also, 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. Future lockdowns and economic disruptions may slow down the process of scaling up of operations, thereby, affecting the return metrics. Although MML has demonstrated healthy asset quality in the past, 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 crucial.

Rating Sensitivity

- Timely infusion of capital
- Impact of natural calamities like Covid-19 on ongoing operations
- Movement in collection efficiency and asset quality
- Movement in liquidity buffers
- Movement in profitability metric
- Changes in the regulatory environment

Assessment for Adequacy of Credit Enhancement

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%.

Liquidity: Adequate

MML's overall liquidity profile remains adequate with no negative cumulative mismatches in near to medium term as per ALM dated March 31, 2021. The company's liquidity is supported by recent capital infusion by investors. The company has maintained unencumbered cash and bank balances of Rs. 235.17 Cr as on March 31, 2021. The borrowing profile of MML of Rs. 811.24 Cr as on March 31, 2021 mainly comprised Term loans from Banks (49.08 percent), NBFC/ FIs and ECB (30.19 percent) and NCDs and Inter Corporate Loans (20.73 percent). The borrowings of MML have an average maturity of 24 to 48 months for its term loans. While the average lending tenure is of ~12 to 24 months. Hence, there is inherent financial flexibility in the company. MML's collections during March, April and May 2021 were around Rs. 83 Cr, Rs. 81 Cr and Rs. 63 Cr respectively. The collections are currently subdued and any improvement in collections are expected to be gradual.

Acuité believes that the company's liquidity profile will continue to benefit from funding support from its promoters.

Material Covenants

The following covenant is included in the structure: the maximum permissible ratio of PAR90 net off Loan Loss Provisions (on the Borrower's entire portfolio including receivables sold or discounted on a non-recourse basis) shall be 5.00%.

Outlook:

Acuité believes that the rating on the Rs. 25.00 Cr loan facility will maintain a 'Positive' outlook.

Also, Acuité believes that the rating on the Rs. 10.00 Cr PCE loan facility will maintain a 'Stable' outlook over the near to medium owing to the structure of the transaction, with Northern Arc as guarantor.

Acuité believes that MML's credit profile will benefit from the buoyancy in the environment once the economic revival is demonstrated on a sustainable basis. The rating could be upgraded if the company is able to demonstrate sustained growth in AUM while maintaining capital structure, asset quality and profitability metrics at healthy levels. Conversely, the outlook may be revised to stable if the company faces higher than expected asset quality pressures or deterioration in capital structure parameters.

About the Rated Entity - Financials

	Unit	FY21 (Actual)	FY20 (Actual)
Total Assets	Rs. Cr.	1095.65	978.01
Total Income*	Rs. Cr.	88.64	84.65
PAT	Rs. Cr.	14.63	18.73
Net-worth	Rs. Cr.	176.81	118.59
Return on Average Assets (RoAA)	(%)	1.41	2.13
Return on Net Worth (RoNW)	(%)	9.90	18.55
Total Debt/Tangible Net Worth (Gearing)	Times	5.05	7.10
Gross NPA's	(%)	1.69	0.57
Net NPA's	(%)	0.34	0.05

** 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

Supplementary disclosures for Provisional Ratings

A. 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.

B. 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+/ Positive).

C. 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

- 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 Instrument/ Facilities	Term	Amount (Rs. Cr.)	Ratings/Outlook
December 18, 2020	Proposed Bank Facility	Long term	25.00	ACUITE BBB+/ Positive (Assigned)

Annexure- Details of Instruments rated

ISIN	Name of Facilities	Date of Issuance	Coupon Rate	Maturity Date	Size of Issue (Rs. Cr.)	Ratings/Outlook
-	Proposed Bank Facility	Not Applicable	Not Applicable	Not Applicable	25.00	ACUITE BBB+/ Positive (Reaffirmed)
-	Proposed Bank Facility	-	-	-	10.00	ACUITE PROVISIONAL A-(CE)/ Stable (Assigned)

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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.