

Press Release

Sanghamithra Rural Financial Services

December 10, 2018



Rating Assigned

Total Bank Facilities Rated*	Rs. 160.00 Cr.
Long Term Rating	ACUITE BBB / Outlook: Stable

* Refer Annexure for details

Rating Rationale

Acuité has assigned long-term rating of '**ACUITE BBB** (read as **ACUITE triple B**) on the Rs. 160.00 cr. bank facilities of Sanghamithra Rural Financial Services. The outlook is '**Stable**'.

Sanghamithra Rural Financial Services (SRFS) is a Bangalore based 'Section 8' (under The Companies Act, 2013) not for Profit Company promoted by Mysore Rehabilitation and development agency (MYRADA). The company is engaged in extending credit through self-help groups (SHGs) model since 2000. Sanghamithra is led by Mr. Aloysius. P. Fernandez (founder and chairman) who has over three decades of experience in financial services sector. The company has presence in four states namely Karnataka, Tamil Nadu, Maharashtra and Madhya Pradesh and operates through a network of 112 branches.

The company has also initiated lending through joint liability group (JLG) model and farmers producers organization as a pilot initiative since January 2018. Sanghamithra had 1, 56,847 active members as on October 31, 2018.

Analytical Approach

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

Key Rating Drivers

Strengths

- **Long track record and strong presence in the SHG segment of the microfinance sector**

SRFS is a not for profit company promoted by MYRADA, a leading non-government organization (NGO) in Karnataka. The company was established in 1995 to promote rural development and started extending credit to SHGs since 2000 through SHG bank Linkage program introduced by RBI. In the initial years, the company primarily extended credit to SHGs promoted by MYRADA and has gradually empaneled 67 NGOs and 75 community managed resource centres (CMRCs).

SRFS's board comprises of 8 members led by Mr. Aloysius. P. Fernandez (founder and chairperson), who has over three decades of experience in the sector and has held managerial position in MYRADA, NABARD Financial services and Corporation Bank. The board of directors comprises of people with experience in social and financial services sectors and includes representation from MYRADA. Mr. R. D. Gadiyappanavar, CEO, has more than three decades of banking experience and is supported by an experienced team heading the various departments.

SRFS benefits from MYRADA's established presence in the sphere of social development which enables association with international organizations and mobilisation of grants. The company has received grants from Micro Credit for Mothers, Netherlands, M/s Water Org. (a US based organization) for WASH Program (Watsan Program), Canadian international Development agency, Sir Dorabji Tata Trust, Hope International Development agency amongst others.

SRFS's loan portfolio was at Rs. 173.40 Cr. as on September 30, 2018. The company operates through a network of 112 branches across 4 states.

Acuité believes that SRFS will continue to be a key player in the microfinance sector primarily operating through the SHG model backed by its strong promoter background and the experienced management team.

- **Comfortable profitability**

SRFS has comfortable profitability as reflected in its reported return on average assets (RoAA) of 4.4 percent in FY2018 as against 4.7 percent in the previous year. The company's profitability is driven by its ability to maintain competitive borrowing costs which results in adequate net interest margin - 10.1 percent in FY2018 and 10.2 percent in FY2017. The profitability is also supported by its moderate operating expenses to earning assets ratio of 5.0 percent in FY2018 as against 5.5 percent in FY2017. The company also benefits from exemption from payment of income tax, on account of being a section 8 'not for profit' company.

Furthermore, being a Section 8 company, provisions are considered as appropriation items and hence not adjusted while arriving at the reported profits by the company. While the provision for NPAs increased to Rs. 2.75 Cr in FY2018 from Rs. 1.17 Cr in FY2017, its impact on the profitability remained moderate. The adjusted profitability (RoAA adjusted for provisions for NPAs) was at 2.80 percent in FY2018 (3.93 percent in FY2017).

Acuité believes that SRFS will maintain comfortable profitability over the medium term supported by its comfortable net interest margin and moderate operating expenses. The provision for NPAs are also expected to moderate from the higher levels in the previous year, which will also support the overall earnings profile.

- **Adequate asset quality**

SRFS primarily focuses on lending to SHGs which are formed and trained by the empaneled NGOs and CMRCs. The company has built strong relationships with these partners and undertakes detailed evaluation of the NGOs and CMRCs before empaneling them. A detailed annual review of the performance of the NGOs and CMRCs is also done by the company. This enables the company to regularly assess the quality and performance of the NGOs and CMRCs and the SHGs associated with them. The incentive paid to the NGOs is partly linked to the recovery which also supports the company's asset quality.

SRFS also undertakes detailed due diligence of the SHGs members. The initial loan amount is linked to the savings of the group and the repayment track record of the existing loans by the members. The subsequent loan amount is linked to the earlier loan cycles and the repayment track record therein. A detailed assessment of the borrowers is undertaken including a visit to the borrowers to assess their eligibility. Most of the loan portfolio is towards income generating activities and a small proportion of the portfolio is towards housing and sanitation loans.

The company has recently started JLG lending model and undertakes detailed due diligence of the borrowers including monitoring end use of the borrowed funds.

The company reported gross NPA of 2.90 percent as on September 30, 2018 as against 2.70 percent as on March 31, 2018 and 3.03 percent as on March 31, 2017. The company had been impacted during the post demonetisation period which resulted in increase in NPAs. Nevertheless, the incremental asset quality remains adequate and is supported by the company's focus on portfolio monitoring and recovery from NPAs. The company has demonstrated healthy collection efficiency with a track record of over 100 percent collection for the six months ended October 31, 2018 primarily due to pre-payments by the borrowers.

Acuité believes that Sanghamithra will maintain adequate asset quality over the medium term supported by its SHG business model, risk management systems and processes. Given the high reliance on NGOs and CRMCs, any significant dilution in the processes such as formation or training of the group or lapses in the recovery process will adversely impact the company's asset quality. Also, its ability to maintain asset quality in the newer segments such as JLG model or housing loans will remain a key monitorable.

Weaknesses

- **Ability to scale-up operations**

SRFS's loan portfolio grew at a 3 year compound annual growth rate of 8.25 percent to Rs. 178.19 Cr. as on March 31, 2018 from Rs. 140.47 Cr. as on March 31, 2015. The growth was higher (25.63%) in FY2018 on account of the slower growth in second half of FY2017 due to demonetization. The loan portfolio has declined to Rs. 173.40 Cr as on September 30, 2018 on account of the migration to the new IT system which reduced focus on disbursement during the period and further due to higher loan pre-payments. Given the company's business model that hinges on NGOs and CMRCs, the growth through the SHG model is expected to remain moderate over the medium term.

The company has launched new products like JLG loans and housing loans to mitigate the growth-related challenges associated with the SHG model. While the proportion of such loans is very small currently, it will increase gradually over the medium term and help scale-up the operations.

However, the overall growth is expected to remain moderate and hence the scale is expected to remain small as compared to MFIs. Being a section 8 non-profit company, SRFS's ability to scale-up its operations is restricted to the internal accruals and grants received. The company reported net worth of Rs. 46.30 Cr. as on March 31, 2018 as against Rs. 41.97 Cr. as on March 31, 2017, mainly supported by healthy internal accruals. Gearing was comfortable at 3.0 times as on March 31, 2018 as against 2.50 times as on March 31, 2017. The gearing is expected to remain at around 5 times over the medium term, which will continue to support the company's overall credit risk profile.

SRFS has maintained adequate capitalization levels at 29.46 percent as on September 30, 2018 as against 29.59 percent and 23.67 percent as on March 31, 2018 and March 31, 2017 respectively. Acuité believes that the company's growth strategies are likely to be impinged by the limitation on its capital structure.

- **Geographically concentrated operations**

SRFS has geographically concentrated operations with 2 states - Karnataka and Tamil Nadu - constituting around 86 percent of the portfolio as on September 30, 2018. Thus, 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.

Acuité believes that SRFS's operations will remain concentrated in the 2 southern states, despite expanding to newer states such as Maharashtra and Madhya Pradesh, and its plans to further geographically diversify its operations over the medium term.

- **Exposure to inherent socio-political risk in MFI segment**

SRFS primarily extends microfinance loans wherein the borrowers' credit profile is weak. The microfinance sector has witnessed two major events in the past decade which has resulted in volatility in the income flow of the borrowers thereby impacting their cash flows and impinged upon their repayment ability. These events have demonstrated the vulnerability of microfinance sector to regulatory and legislative risk.

Liquidity Position

SRFS manages its liquidity through an internal committee which monitors the liquidity position in the context of disbursement plan and the upcoming debt repayments. However, it is not mandatorily required to prepare asset liability management (ALM) statement. The company has undrawn bank lines of Rs. 35.00 Cr. as on September 30, 2018 to support the business need or in case of any future mismatches. A large proportion of the company's borrowing is in the form of cash credit facility. The company has a sizeable loan repayment of around Rs. 10 Cr. coming up for repayment in July 2019 and its ability to manage the repayment of the same will be critical.

Outlook: Stable

Acuité believes that SRFS will maintain a 'Stable' outlook over the medium term supported by its established presence in the microfinance segment along with demonstrated ability to maintain asset quality and profitability. The outlook may be revised to 'Positive' in case of significant growth in loan portfolio while maintaining asset quality, profitability, and capitalization. The outlook may be revised to 'Negative' in case of any headwinds faced in scaling up of operations or in case of significant deterioration in asset quality and profitability metrics.

About the Rated Entity - Key Financials

	Unit	FY18 (Actual)	FY17 (Actual)	FY16 (Actual)
Total Assets	Rs. Cr.	188.9	150.4	155.8
Total Income*	Rs. Cr.	16.5	15.0	15.3
PAT **	Rs. Cr.	7.5	7.2	8.5
Net Worth	Rs. Cr.	46.3	42.0	35.1
Return on Average Assets (RoAA) ^	(%)	4.4	4.7	5.7
Return on Average Net Worth (RoNW) ^	(%)	17.0	18.6	27.0
Total Debt/Tangible Net Worth (Gearing)	Times	3.0	2.5	3.3
Gross NPA	(%)	2.7	3.0	1.0
Net NPA #	(%)	0.8	0.6	0.0

*Total income equals to Total Income net off interest expense

** Provision for NPAs are appropriated from the reported PAT and not accounted for while arriving at the PAT

^ Based on reported PAT

Being a section 8 Company, provisioning norms for NBFC-MFIs are not applicable. The company reports loss assets as net NPAs

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

Not Applicable

Any other information

Not Applicable

Applicable Criteria

- Default Recognition - <https://www.acuite.in/criteria-default.htm>
- Non - Banking Financing Entities - <https://www.acuite.in/view-rating-criteria-10.htm>
- Financial Ratios And Adjustments - <https://www.acuite.in/view-rating-criteria-20.htm>

Note on complexity levels of the rated instrument

<https://www.acuite.in/criteria-complexity-levels.htm>

Rating History (Upto last three years)

Not Applicable

*Annexure – Details of instruments rated

Name of the Facilities	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. Cr.)	Ratings/Outlook
Cash Credit	Not Applicable	Not Applicable	Not Applicable	22.00	ACUITE BBB /Stable (Assigned)
Cash Credit	Not Applicable	Not Applicable	Not Applicable	15.00	ACUITE BBB /Stable (Assigned)
Cash Credit	Not Applicable	Not Applicable	Not Applicable	20.00	ACUITE BBB /Stable (Assigned)
Cash Credit	Not Applicable	Not Applicable	Not Applicable	25.00	ACUITE BBB /Stable (Assigned)
Term loans	Not Applicable	Not Applicable	Not Applicable	6.00	ACUITE BBB /Stable (Assigned)
Term loans	Not Applicable	Not Applicable	Not Applicable	6.50	ACUITE BBB /Stable (Assigned)
Term loans	Not Applicable	Not Applicable	Not Applicable	5.00	ACUITE BBB /Stable (Assigned)

Cash Credit	Not Applicable	Not Applicable	Not Applicable	5.00	ACUITE BBB /Stable (Assigned)
Cash Credit	Not Applicable	Not Applicable	Not Applicable	10.00	ACUITE BBB /Stable (Assigned)
Term loans	Not Applicable	Not Applicable	Not Applicable	5.00	ACUITE BBB /Stable (Assigned)
Cash Credit	Not Applicable	Not Applicable	Not Applicable	10.00	ACUITE BBB /Stable (Assigned)
Term loans	Not Applicable	Not Applicable	Not Applicable	10.00	ACUITE BBB /Stable (Assigned)
Term loans	Not Applicable	Not Applicable	Not Applicable	10.00	ACUITE BBB /Stable (Assigned)
Subordinated debt	Not Applicable	Not Applicable	Not Applicable	5.00	ACUITE BBB/Stable (Assigned)
Proposed Long Term Bank Facility	Not Applicable	Not Applicable	Not Applicable	1.50	ACUITE BBB/Stable (Assigned)
Term loans	Not Applicable	Not Applicable	Not Applicable	4.00	ACUITE BBB/Stable (Assigned)

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About Acuité Ratings & Research:

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