

Press Release

S.M.I.L.E MICROFINANCE LIMITED – Northern Arc 2020 MFI Caissa

April 19, 2021

Rating Assigned



Pass through Certificate*	Rs. 18.14 Cr
Long Term Rating	ACUITE BBB+(SO) (Assigned: Converted to Final from Provisional rating)

*Refer annexure for further details

Rating Rationale

Acuite has converted the provisional rating of '**ACUITE BBB+(SO)**' (read as **ACUITE triple B (Structured Obligation)**) to the Pass Through Certificates (PTCs) issued by Northern Arc 2020 MFI Caissa (The trust) to final rating under a securitisation transaction originated by S.M.I.L.E. Microfinance Limited (SMFL) (The Originator). The PTCs are backed by a pool of loans provided to MFI borrowers with original PTC amount Rs. 18.14 Cr. As of March 2021 payout, the PTCs outstanding is Rs. 2.04 Cr and the pool principal is Rs. 3.5 Cr.

The final rating is based on the strength of cash flows from the selected pool of contracts; the credit enhancement is available in the form of

- (i) Over collateralisation of 4.00% of the pool principal
- (ii) Unfunded First Loss Credit Enhancement of 15.00% of the pool principal provided by the originator
- (iii) Excess Interest Spread; as per the waterfall mechanism, after adjustment for any past overdues and other repayments, the surplus will be utilised to prepay the principal portion on month on month basis

The final rating addresses the timely payment of interest on monthly payment dates and the ultimate payment of principal by the final maturity date, in accordance with the transaction documentation.

The final rating is assigned based on the fulfilment of the structure, terms and covenants detailed in the executed trust deed, servicing agreement, legal opinion, accounts agreement, assignment agreement and other documents relevant to the transaction.

About the Originator

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. For the latest rating rationale, refer to <https://www.acuite.in/documents/ratings/revised/18861-RR-20210323.pdf>

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.

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.

Assessment of the pool:

As per initial rating

The current pool being securitised comprises ~3% of the total loan exposures. The current pool comprises of microfinance loans extended to 12,973 individual borrowers for income generation purposed. The an initial portfolio of ~Rs. 31 Cr (original amount) are unsecured and are repayable fortnightly. The original maturities of these loans range between 12-40 fortnights. The loans have fixed interest rate of 23.50%.

As on the pool cut-off date, August 31, 2020, the pool was 60.94% amortised with an aggregate principal outstanding balance of Rs. 18.89 Cr. The average outstanding loan balance was ~Rs. 14,500. The weighted average seasoning of the pool is ~11 fortnights, with maximum seasoning of 20 fortnights and minimum seasoning of 5 fortnights. As on the pool cut-off date of August 31, 2020, there were no overdues from the designated loans of the pool.

Adequacy of Credit Enhancement and impact of COVID19

During the pandemic, business disruptions occurred to varying degrees in the economy and collections in the NBFC industry had got impacted both due to lockdowns and loan moratorium. Acuite anticipates a probable deterioration in asset quality across all industries due to COVID19, which it has accounted for in its analysis. For this transaction, Acuite expects the external Credit Enhancement to be sufficient over the remaining tenure.

Credit Enhancements (CE)

The transaction is supported in the form of

- (i) Over collateralisation of 4.00% of the pool principal
- (ii) Unfunded First Loss Credit Enhancement of 15.00% of the pool principal provided by the originator
- (iv) Excess Interest Spread; as per the waterfall mechanism, after adjustment for any past overdues and other repayments, the surplus will be utilised to prepay the principal portion on month on month basis

The final rating addresses the timely payment of interest on monthly payment dates and the ultimate payment of principal by the final maturity date, in accordance with the transaction documentation.

Transaction Structure

The transaction is structured at par. Collections of a particular month will be utilized to make promised interest and expected principal payouts to Series A1 PTCs and expected interest payment to Series A1 PTCs. In case of shortfall in payment to Series A1 PTCs, cash collateral will be utilized for making principal payouts. The payouts under Series A1 PTCs are expected to end by May 2021.

Assessment of Adequacy of Credit Enhancement:

Acuite has arrived at a base case delinquency estimate of 1.20 – 3.00% in respect of the loan assets being securitised. It has applied appropriate stress factors to the base case parameters to arrive at the final loss estimates and consequently the extent of credit enhancement required. The stress factors also factor in the likelihood of elevated slippages due to current subdued environment caused by the environment. The final loss estimates also consider the risk profile of the particular asset class, i.e. unsecured loans, the borrower strata and economic risks. Acuite has accounted for the probable impact of COVID19 in the transaction for its analysis.

Legal Assessment:

The final rating is assigned based on the fulfilment of the structure, terms and covenants detailed in the executed trust deed, servicing agreement, legal opinion, accounts agreement, assignment agreement and other documents relevant to the transaction.

Key Risks

- **Counterparty Risks:**

The loans are essentially unsecured microfinance loans with ticket sizes ranging between Rs. 5,000 to Rs. 30,000. Entire pool has an interest rate range between 23-25%. Considering the vulnerable credit profile of the borrowers, the risk of delinquencies/defaults are elevated. These risks of delinquencies are partly mitigated, considering the efficacy of SMFL's originating and monitoring policies coupled with the systems

and process put in place for post disbursement monitoring.

- **Concentration Risks:**

Since the pool is entirely granular, i.e. underlying assets in the pool are in nature of unsecured income generating loans to 12,973 individual borrowers; hence, the risk is significantly mitigated. Geographically, the pool is concentrated in the state of Tamil Nadu with ~89% of the pool followed by Chhattisgarh at ~8%, the remaining pool was spread across two other states.

- **Prepayment Risk:**

The pool is subject to prepayment risks since the rate of interest is significantly high and borrowers may be inclined to shift to low cost options (based on availability). In case of significant prepayments, the PTC holders will be exposed to interest rate risks, since the cash flows from prepayment may have to be deployed at lower interest rates.

- **Servicing Risk**

Since the current pool of borrowers in the transaction is retail in nature, there are significant requirements in terms of monitoring, collections and servicing the payouts. The on-going restrictions on the movement of people and infrastructural challenges could result in logistical challenges in servicing of the pool transaction. SMFL has been undertaking Direct Assignment and PTC Transactions since 2018 and hence there is moderate track record available for servicing of PTC's.

- **Commingling Risk**

The transaction is subject to commingling risk since there is a time gap between last collection date and transfer to payout account.

- **Regulatory Risk**

In the event of government or RBI announcing changes in the regulatory framework, applicable to MFIs, it could have implications on the performance of the pool. In the event of any leniency in the regulatory framework towards delinquent borrowers, ensuring timely payments from the borrowers could be a challenging task.

Liquidity Position – Adequate

The liquidity position in the transaction is adequate. Excess collections by way of EIS shall be utilised to make the prepayments will be utilised towards prepayments of principal. The PTC payouts will also be supported by an internal credit enhancement in the form of over collateralisation which should help in providing liquidity support in the event of a shortfall in collections and unfunded first loss credit enhancement by the originator.

Key Rating sensitivity

- Sharp increase in delinquencies in two consecutive months.
- Decline in credit quality of originator which could impact the servicing of the PTC, in the opinion of the rating agency.

**Necessary data to be provided by the originator or trustee on a monthly basis*

Material Covenants

The following covenant is included in the transaction structure: The collection in month M will be deposited into the Collection and Payout Account (CPA) in the month (M+1).

Key Financials – Originator

	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

**Preparation of Financial Statements under IndAS became mandatory for SMFL from FY20*

Any other information

Not Applicable

Applicable Criteria

- Default Recognition - <https://www.acuite.in/view-rating-criteria-52.htm>
- Securitised transactions - <https://www.acuite.in/view-rating-criteria-48.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 the Instruments/ Facilities	Term	Amount (Rs. Cr.)*	Ratings/Outlook
October 05, 2020	Pass through Certificate	Long term	18.89	ACUITE PROVISIONAL BBB+(SO) (Assigned)

*Includes PTCs and overcollateralisation amounts

*Annexure – Details of instruments rated

Name of the Facilities	Date of Issuance	Coupon Rate	Size of the Issue (Rs. Cr.)	Ratings/Outlook
Series A1 PTC	September 29, 2020	12.00	18.14	ACUITE BBB+(SO) (Assigned: Converted to Final from Provisional rating)

Contacts

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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.

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