

Press Release

S.M.I.L.E. Microfinance Limited - Northern Arc 2020 MFI Solstice

April 19, 2021

Rating Assigned



Pass Through Certificates (PTCs)*	Rs. 20.0 Cr
Long Term Rating	ACUITE BBB+(SO) (Assigned; Converted to Final from Provisional Rating)

*Refer annexure for details

Rating Rationale

Acuite has converted the provisional rating of '**ACUITE BBB+(SO)**' (read as **ACUITE triple B plus (Structured Obligation)**) to the Pass Through Certificates (PTCs) issued by Northern Arc 2020 MFI Solstice (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 Microfinance Institutions (MFIs) with principal outstanding of Rs. 20.0 Cr. As per the March 2021 payout, the PTCs outstanding amount is Rs. 7.73 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) Fixed deposit First Loss Credit Enhancement of 5.0% of the pool principal, and
- (ii) Unfunded First Loss Credit Enhancement of 15.0% of the pool principal
- (iii) Excess Interest Spread (EIS); after adjustment for any shortfall, the surplus will be utilised to prepay the principal portion on month on month basis.

The final rating of Northern Arc 2020 MFI Solstice addresses the timely payment of interest on monthly payment dates and the ultimate payment of principal by the final maturity date of September 2021, in accordance with the transaction documentation. Acuite has taken into account the potential impact of the Covid-19 pandemic on the collections.

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:

The current pool comprises of microfinance loans extended to 22,154 individual borrowers for income generation purposes. The pool of Rs. 20.0 Cr is unsecured and is repayable fortnightly and 4-weekly.

As on the pool cut-off date, December 07, 2020, the pool was 50.35% amortised with an aggregate principal outstanding balance of Rs. 20.0 Cr. The average outstanding loan balance stood at Rs. 9,028. The weighted average seasoning of the pool is 16.03 fortnights, with maximum seasoning of 48 fortnights and minimum seasoning of 4 fortnights. As on the pool cut-off date, there were no overdues from the designated loans of the pool. The average ticket size is Rs. 18,182, minimum ticket size is Rs. 2,380. and maximum ticket size is Rs. 48,400. The pool has weighted average original tenure of 27.85 fortnights, and 69.40% of the borrowers belong to Loan Cycle 2 and above.

Adequacy of Credit Enhancement and impact of COVID19

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

Credit Enhancements (CE)

The transaction is supported in the form of

- (i) Fixed deposit First Loss Credit Enhancement of 5.0% of the pool principal. The fixed deposit would be placed by SMFL with the bank approved by the Trustee, the right, title and interest of which shall be assigned in favour of the Trustee in order to make it available for utilization by the Trustee to meet any shortfall in making payouts to the PTC holders as per the Waterfall Mechanism on each Payout Date in accordance with the terms of the Trust Deed and other Transaction Documents.
- (ii) Unfunded First Loss Credit Enhancement of 15.0% of the pool principal
- (iii) Excess Interest Spread (EIS). After adjustment for any shortfall, the EIS will be utilised to prepay the principal portion on month on month basis.

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 1 PTCs and expected interest payment to Series 1 PTCs.

On every payin Date, the Trustee will determine the adequacy of the funds lying in the Collection and Payout Account to make the payouts to the PTC holders as per the waterfall mechanism. In the event the funds in the Collection and Payout Account on any payin date is inadequate or insufficient to make such payouts to the PTC holders as contemplated under the waterfall mechanism on the corresponding payout date, the Trustee will utilise the external Credit Enhancement in the manner provided in the Trust Deed and the transaction documents to make good such shortfall. Any external Credit Enhancement utilised by the Trustee as aforesaid shall be replenished as per the waterfall mechanism.

The EIS will be utilised to prepay the principal portion on month on month basis.

Brief Methodology:

Acuite has arrived at average base case delinquency estimate in respect of the microfinance loan assets being securitised ranging between 2.0%-3.6%. Acuite has applied appropriate stress factors to the base estimates to arrive at the possible delinquencies and estimate of the credit enhancement required.

Legal Assessment:

The provisional rating is based on draft term sheet, the conversion of rating from provisional to final, shall include, besides other documents, the legal opinion to the satisfaction of Acuite. The legal opinion shall cover, adherence to RBI guidelines, true sale, constitution of the trust, bankruptcy remoteness and other related aspects.

Key Risks

- **Counterparty Risks:**

The loans are essentially MFI loans with ticket sizes ranging between Rs. 2,380 to Rs. 48,400. The entire pool has interest rate ranging between 23-24.5%. Considering the unsecured nature of the loans, the risk of delinquencies/defaults remain. 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 MFI loans to 22,154 individual borrowers, the risk is significantly mitigated. Geographically, the pool is concentrated across 40 districts, the concentration risks remain minimal and have been addressed through suitable cushion on base loss estimates.

- **Prepayment Risk:**

The pool is subject to prepayment risks since 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. The prepayment risks are partially mitigated considering the relatively small size of the loans.

- **Servicing Risk**

Considering the limited size of the pool, and relative ease in servicing, any operational risks related to servicing of the pool are significantly mitigated.

- **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 regulatory framework, applicable to NBFCs, it could have implications on the performance of 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. The cash collateral first loss credit enhancement available in the transaction amounts to 5.0% of the pool principal and unfunded first loss credit enhancement of 15.0% of the principal.

Key Rating sensitivity

- Collection performance of the underlying pool
- Credit quality of the underlying borrowers
- Decrease in cover available for PTC payouts from the credit enhancement

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

Material Covenant

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), two days prior to the relevant payout date.

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

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

None

Any other information

None

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
January 06, 2021	Pass through Certificate	Long term	20.00	ACUITE PROVISIONAL BBB+(SO) (Assigned)

*Annexure – Details of instruments rated

Name of the Facilities	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of the Issue (Rs. Cr.)	Ratings/Outlook
Pass Through Certificates	December 31, 2020	11.00	September 27, 2021	20.00	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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