

Press Release

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

November 09, 2021

Rating Withdrawn



Pass Through Certificates (PTCs)*	Rs. 20.00 Cr
Long Term Rating	ACUITE BBB+(SO) (Withdrawn)

*Refer annexure for details

Rating Rationale

Acuité has withdrawn the rating of '**ACUITE BBB+(SO)**' (read as **ACUITE triple B (Structured Obligation)**) to the Pass Through Certificates (PTCs) issued by Northern Arc 2020 MFI Solstice (The trust) under a securitisation transaction originated by S.M.I.L.E. Microfinance Limited (SMFL) (The Originator). The PTCs were backed by a pool of loans provided to NBFCs with PTCs outstanding of NIL as of August 2021 payout month. The initial PTC amount was Rs. 20.0 Cr.

The transaction has been paid in full. All the contractual obligations and pay-outs to the investors have been duly completed. Hence, the rating is being withdrawn. The rating withdrawal is in accordance with Acuité's policy on withdrawal of rating and pursuant to a request received from the company in this regard.

The rating was based on the strength of cash flows from the selected pool of contracts; the credit enhancement, as per initial rating, was 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.

About the Originator

S.M.I.L.E. Microfinance Limited (SMFL) is a Tamil Nadu based Systemically Important Micro Finance Institution. Incorporated on 21st March 1995, it obtained license from the Reserve Bank of India as 'Non-Banking Finance Company – Non-Deposit Taking Microfinance Institution (NBFC-MFI-ND)' in May 2015. 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. 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 144 branches across 49 Districts as of March 31, 2021.

SMFL's networth stood at Rs. 136.11 Cr. as on March 31, 2021 and reported adequate capital adequacy ratio (CAR) of 27.23 percent as on March 31, 2021 as against 23.64 percent as on March 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:

Acuité has arrived at average base case delinquency estimate in respect of the microfinance loan assets being securitised ranging between 2.0%-3.6%. Acuité 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.

Outlook: Not Applicable

Key Financials – Originator

	Unit	FY21 (Provisional)	FY20 (Actual)
Total Assets	Rs. Cr.	526.31	681.47
Total Income	Rs. Cr.	57.84	67.65
PAT	Rs. Cr.	(8.88)	12.44
Net Worth	Rs. Cr.	136.11	144.28
Return on Average Assets (RoAA)	(%)	(1.47)	1.91

Return on Average Net Worth (RoNW)	(%)	(6.33)	8.99
Debt/Equity	Times	2.85	3.62
Gross NPA	(%)	9.41	0.22
Net NPA	(%)	2.28	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
April 19, 2021	Pass through Certificate	Long term	20.00	ACUITE BBB+(SO) (Assigned; converted to Final from Provisional rating)
January 06, 2021	Pass through Certificate	Long term	20.00	ACUITE PROVISIONAL BBB+(SO) (Assigned)

*Annexure – Details of instruments rated

Lender's Name	Name of the Facilities	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of the Issue (Rs. Cr.)	Ratings/Outlook
Not applicable	Pass Through Certificates	December 31, 2020	11.00	Not applicable	20.00	ACUITE BBB+(SO) (Withdrawn)

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About Acuité Ratings & Research:

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