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India Ratings Affirms Ashv Finance's Bank Loans and PP-MLDs at 'IND BBB'/Positive; Rates CP 'IND A2+' and NCDs 'IND BBB'/Positive

May 29, 2023 | Non Banking Financial Company (NBFC)

India Ratings and Research (Ind-Ra) has taken the following rating actions on Ashv Finance Limited's (AFL) debt instruments:

Instrument Type	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of Issue (million)	Rating/Outlook	Rating Action
Principal protected market-linked debenture (PP-MLD)	INE411R07087	29 June 2021	-	30 September 2024	INR200	IND PP-MLD BBB/Positive	Affirmed
PP-MLD	INE411R07079	23 June 2021	-	14 October 2022	INR250	WD	Withdrawn (paid in full)
Bank loans	-	-	-	-	INR500	IND BBB/Positive	Affirmed
Commercial paper (CP)^	-	-	-	-	INR500	IND A2+	Assigned
Non-convertible debentures (NCDs)^	-	-	-	-	INR700	IND BBB/Positive	Assigned

^ Yet to be issued

The Positive Outlook continues to reflect AFL's increasing franchise in the small ticket unsecured business loans segment with increasing diversification in its funding profile and addition of large public sector as well as private banks to its banking relationships. Furthermore, AFL is in the advanced stage of raising equity of about INR1.5 billion-2 billion by 2QFY24, which would be critical for growth capital and reducing the leverage (debt/tangible net worth) below 4x. With the growing scale, Ind-Ra expects the operating leverage to deliver the decent profitability metrics.

Key Rating Drivers

Continued Growth in New Small Ticket Business Loans (Unsecured): In line with AFL's stated strategy to grow small ticket business loans, its assets under management (AUM) increased 47% yoy to INR10.7 billion in FY23 with the share of small ticket business loans increasing to 95% (FY22: 87%, FY21: 53%) and the share of legacy and partnership book (emitting major stress historically) declining to 3% (13%, 47%). Under the small ticket business loans, AFL caters to businesses with an annual turnover of up to INR1 billion having a target average ticket size of INR1 million and an average tenor of around 24 months. The company provides loans at yields of 20%-26% on the basis of the product type. Incrementally, Ind-Ra expects small ticket business loans to be a focus area for AFL, of which 80%-85% is expected to be unsecured and 15%-20% as secured (about 1% of AUM) over the medium term. Considering the borrower profile in business loans, the focus and thrust on collections and the initial assessment of the borrower's credit profile remain of paramount importance for controlling credit risk in the medium-to-long term.

Advanced Stage of Capital Raise; Critical with Increasing Leverage: At FYE23, AFL's Tier-1 capital stood at 19.5% (FY22: 27.71%, FY21: 39.64%, FY20: 60%) with a tangible net worth of INR1,984.8 million. Since AFL plans to grow aggressively in the small ticket size business loans segment, it would require higher capital given the capital consumption, modest borrower profile, exposure to unsecured credit products and a relatively high credit cost. Ind-Ra expects AFL to maintain adequate capitalisation buffers to absorb asset quality pressures. At FYE23, AFL had leverage (debt/tangible net worth) of 3.9x (FY22: 2.56x, FY21: 1.43x). On a steady state basis, the management plans to operate below a threshold leverage of 4.0x. Furthermore, as the leverage continues to increase, AFL is in advanced stages to raise INR1.5 billion-2.0 billion by 2QFY24 to maintain leverage below 4.0x on a sustained basis. AFL also utilised direct assignments in FY23 to manage its capitalisation. Ind-Ra expects it to continue to utilise the same over the medium term and also continue to source business by way of off-book financing through business correspondence and co-lending partnerships.

Diversified Funding Profile Supports Cost of Funds: At FYE23, AFL had funding lines from 42 lenders with 15 new lenders being added during the year. The funding mix has improved with the share of cheaper term loans from banks increasing to 22.3% (FY22: 13%, FY21: 5%) and share of non-bank financial companies declining to 36% (36%, 65%) and NCDs to 31% (29%). With the increasing share of funding from banks, AFL was able to reduce its marginal cost of borrowings to 12.6% at FYE23 (FYE22: 12.95%, FYE21: 13.55%). AFL raised around INR9,250 million in FY23. Around 60% of the borrowings are variable rate loans. However, given the favourable change in the funding mix, Ind-Ra expects the cost of borrowings to increase only moderately in FY24.

Increasing Franchise Across Geographies: Over the last two-to-three years, the management had set up new policies, processes and revamped its IT systems in line with its strategy to become granular and enhance its credit monitoring systems required for small unsecured business loans. The company also increased its geographic presence by adding 12 new branches during FY21-FY23, thus taking the total branches to 36 and 182 spoke locations. AFL has presence across 20 states and union territories as of FY23 with top three states contributing 51% to the AUM. It has also hired employees across different geographies (FY23: 483, FY22: 406, FY21: 329, FY20: 153) while expanding its franchise to have its own origination, credit and collection team across branches for improved sales and better business oversight.

Liquidity Indicator - Adequate: As per the asset-liability statement, at FYE23, AFL had a cumulative surplus as a percentage of total assets of 5% in the less than one-year bucket. The management expects the surplus in the up to one-year bucket to be maintained on an ongoing basis and AFL's plans to maintain its on-balance sheet liquidity to meet repayments for the next two months even as the business scale continues to expand. At end-March 2023, AFL had debt obligations of INR1,108.8 million for the subsequent three months, as against the unencumbered cash and liquid investments of INR1114.6 million, which along with advances inflow provide adequate liquidity cover. AFL is planning to raise CP over the near term which is unlikely to be more than 5% of borrowings. AFL's billing efficiency improved to around 94.3% at FYE23 (FYE22: 92%).

Need for Credit Costs to Stabilise; Impact of Legacy Book to Wane by FYE24: At FYE23, AFL's gross non-performing assets (GNPA) stood at 3.5% (FY22: 4.01%, FY21: 3.15%, FY20: 2.4%). The company also maintained an adequate provision coverage of 81% in FY23 (FY22: 85%, FY21: 138%). However, AFL had written off INR400.7 million of loans in FY23 (FY22: INR122.7 million, FY21: INR100.3 million) as the stress from the legacy book and restructured pool was majorly consumed during the year. The legacy book/partnership book declined to around 4% of AUM at FYE23. The company expects an additional INR100 million of stress to come from this book. The restructured pool also declined to INR131 million (1% of portfolio; 36% of portfolio from legacy pool) from INR330 million in FY22 (4% of the portfolio) . The GNPA stood low for new small unsecured business loans at 2.65% at FYE23 (FYE22: 2%) and write-offs stood at 3% from the new business loans. The agency expects 4%-4.5% of slippages and 3%-3.5% of annual credit costs from its unsecured business loan portfolio over the medium term.

Profitability Remains Under Pressure, Although Expected to Improve with Growing Scale: Considering AFL's shift of focus towards small ticket size retail loans from large ticket size loans, the net interest margin improved (FY23: 10.2% FY22: 10.3%, FY21: 11.8%; FY20: 9.97%; FY19: 7.5%) on account of an increase in yield. However, AFL's profitability has been constrained by high operational (FY23 operating cost/average total assets: 7.9%, FY22: 7.3%, FY21: 6.5%, FY20: 6.1%, FY19:4.1%) and credit costs (6.6%, 2.2%, 4.12%, 3.5%, 3.8%). The agency expects the operating cost to moderate in the medium term as the company grows its AUM to around INR15 billion and operating leverage plays out as the company starts leveraging on its current infrastructure of hub & spoke model, which has been set up over the last few years with improving AUM/branch (FYE23 AUM/branch of INR297million). Furthermore, with AFL's legacy book reducing to around 4% of AUM and running down in the near term, incremental credit costs over the medium term are likely to be lower than in the recent past, which will be key for improving its profitability. At FYE23, the return on average assets stood modest at 0.62% (FYE22: 0.77%, FYE21: 1.43%, FYE20: 0.84%, FYE19: 0.61%) and the return on average equity was 2.7% (2.3%, 3.3%, 1.9%, 1.6%).

Rating Sensitivities

Positive: A demonstrated ability to profitably expand the franchise with a sustainable asset quality, while continuing to improve diversification of the funding profile, and maintaining adequate liquidity and capital buffers could lead to a positive rating action.

Negative: Weakened operating performance, dilution in the liquidity profile, continued delays in the planned raising of equity capital beyond 2QFY24, non-improvement in the asset quality or operating buffers and the leverage (debt/tangible net worth) increasing above 4.0x on a sustained basis, will result in a negative rating action.

ESG Issues

ESG Factors Minimally Relevant to Rating: Unless otherwise disclosed in this section, the ESG issues are credit neutral or have only a minimal credit impact on AFL, either due to their nature or the way in which they are being managed by the entity. For more information on Ind-Ra's ESG Relevance Disclosures, please click here. For answers to frequently asked questions regarding ESG Relevance Disclosures and their impact on ratings, please click here.

Company Profile

AFL is a non-bank financial company registered with the Reserve Bank of India. It started operations in 2012 as a venture debt financer and provides small ticket size loans to the micro, small and medium-sized enterprises.

FINANCIAL SUMMARY

Particulars	FY23 (Provisional)	FY22
Total assets (INR million)	10013	8933
Total tangible equity (INR million)	1,914.9	2,426.6
Net income (INR million)	69.2	54.7
Return on average assets (%)	0.62	0.73
Tier-I capital adequacy ratio (%)	19.5	27.71
Equity/assets (%)	19.1	27.2
Source: AFL, Ind-Ra		

Solicitation Disclosures

Additional information is available at www.indiaratings.co.in. The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings has been compensated for the provision of the ratings.

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Rating History

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook			
	Rating Type	Rated Limits (million)	Rating	24 June 2022	25 June 2021	18 June 2021	23 March 2021
Bank loans	Long-term	INR500	IND BBB/Positive	IND BBB/Positive	IND BBB/Stable	IND BBB/Stable	IND BBB/Stable
PP-MLD	Long-term	INR200	IND PP-MLD BBB/Positive	IND PP-MLD BBB/Positive	IND PP-MLD BBBemr/Stable	IND PP-MLD BBB emr/Stable	-
CP	Short-term	INR500	IND A2+	-	-	-	-
NCDs	Long-term	INR700	IND BBB/Positive	-	-	-	

Bank wise Facilities Details

Click here to see the details

Complexity Level of Instruments

Instrument Type	Complexity Level
Bank loans	Low
PP-MLD	High
CP	Low
NCDs	Low

For details on the complexity level of the instruments, please visit https://www.indiaratings.co.in/complexity-indicators.

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APPLICABLE CRITERIA

Financial Institutions Rating Criteria

Non-Bank Finance Companies Criteria

Evaluating Corporate Governance

The Rating Process

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