

August 05, 2020

## Arohan Financial Services Limited: [ICRA]A-(Stable) assigned

### Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debenture programme	-	1,000.00	[ICRA]A-(Stable); assigned
Non-convertible debenture programme	25.00	25.00	[ICRA]A-(Stable); outstanding
Long-term bank lines	100.00	100.00	[ICRA]A-(Stable); outstanding
<b>Total</b>	<b>125.00</b>	<b>1,125.00</b>	

\*Instrument details are provided in Annexure-1

### Rationale

The rating factors in Arohan Financial Services Limited's (Arohan) experienced management team and good systems and processes, which have helped the company scale up its operations at a healthy pace. As on March 31, 2020, Arohan was catering to more than 22 lakh borrowers through a network of 711 branches spread across 229 districts and 14 states while managing a portfolio of Rs. 4,854 crore (Rs. 4,862 crore as on June 30, 2020). The rating also takes into account the company's adequate capitalisation profile supported by healthy internal accrual generation and regular capital infusion, given its strong investor and promoter base. The company had a capital adequacy ratio (CAR) of 24.80%<sup>1</sup>, as on March 31, 2020, which was well above the regulatory requirement of 15%, while the gearing (adjusted)<sup>2</sup> was reported at 4.38 times as on March 31, 2020 (4.37 times as on March 31, 2019). ICRA takes note of the company's plans to raise equity capital by FY2021, which would help cushion the possible credit losses in the aftermath of the Covid-19 pandemic and support the company's growth plans.

The rating also factors in the company's healthy profitability indicators despite a decline in FY2020 on account of a moderation in the net interest margin (NIM) and an increase in the credit costs. Arohan reported a net profit of Rs. 126.80 crore in FY2020, translating into a return of 2.53% on average managed assets (AMA) and 15.28% on average net worth (Rs. 127.64 crore, 3.79% and 23.66%, respectively, in FY2019). The higher credit costs in FY2020 included an additional provision of Rs. 45.25 crore (0.90% of AMA) in light of the pandemic. Given the expected slippages in light of the pandemic, the credit costs are likely to remain elevated in FY2021, affecting Arohan's profitability. The rating also factors in the diversity in the funding mix comprising a good mix of private banks, public sector banks, financial institutions (FIs) and non-banking financial companies (NBFCs). As on March 31, 2020, Arohan had funding relationships with 44 lenders and its funding profile comprised bank loans (70%), FIs/NBFCs (25%), subordinated debt (5%) and pass-through certificates (PTCs).

The rating is, however, constrained by Arohan's geographically concentrated operations with the top 3 states comprising 67% of the microfinance institution (MFI) portfolio as on June 30, 2020 (66% as on March 31, 2019). Further, there is scope for district-level diversification of the portfolio as the top 5, 10 and 20 districts comprised 13%, 22% and 35%, respectively, of the MFI portfolio as on March 31, 2020 (13%, 22% and 37%, respectively, as on March 31, 2019) and 61%, 103% and 166%, respectively, of the net worth as on March 31, 2020 (71%, 118% and 197%, respectively, as on March 31, 2019). Going forward, the company's ability to improve its geographical diversification while scaling up its operations remains important from a credit perspective. ICRA takes note of the deterioration in the asset quality

<sup>1</sup> Audited

<sup>2</sup> Adjusted gearing = (on-book borrowings + PTCs)/(net worth – credit enhancement for business correspondent portfolio)

indicators in FY2020. While the gross non-performing assets (NPAs) increased to 2.15% as on June 30, 2020 from 0.66% as on March 31, 2019, the net NPA remained nil. The company's asset quality remains a key rating monitorable. The rating also factors in the risks associated with unsecured lending to marginal borrowers with limited ability to absorb income shocks. Arohan's ability to onboard borrowers with a good credit history, recruit and retain employees and improve the geographical diversity of its operations would be key for managing high growth rates.

The microfinance industry is facing many challenges following the spread of Covid-19 throughout the country. These include the continuity of business operations on the field and the possible adverse impact on the asset quality. The company's ability to manage the adverse impact of the pandemic on its asset quality and profitability will be important from a credit perspective.

The Stable outlook on the [ICRA]A- rating reflects ICRA's opinion that Arohan will continue to benefit from its experienced management team, strong investor base, good systems and processes and diversified borrowing profile.

## Key rating drivers and their description

### Credit strengths

**Good scale of operations** – Arohan is one of the largest NBFC-MFIs in India by assets under management (AUM). The company has an established track record of more than 13 years in the microfinance space. It reported an AUM of Rs. 4,862 crore with a presence in 229 districts across 14 states through a network of 711 branches while catering to more than 22 lakh borrowers as on June 30, 2020. Apart from microfinance, the company had a small MSME portfolio (4%) and corporate loan book (2%) as on June 30, 2020.

**Experienced management, good systems and processes** – Arohan has an experienced management team comprising seasoned professionals with adequate domain experience and expertise. A second line of management has been developed by the company to cope with the increasing scale of operations. Arohan has good systems and processes and it uses a core banking software to manage its operations. Further, the entire disbursement process is paperless and cashless. The company has also tied up with various partners to manage its cash at the field level and is working towards making cashless collections at the borrower level. It has signed the code for responsible lending (CRL) launched by the self-regulatory organisations (SROs) of the industry.

**Adequate capitalisation profile** – The company's capitalisation profile is supported by healthy internal capital generation and regular equity infusions. It reported a CAR of 24.80% as on March 31, 2020, which was well above the regulatory requirement of 15%. The management plans to maintain the CAR well above 20% over the medium term. Arohan last raised equity capital of Rs. 130 crore in FY2020 and plans to raise Rs. 200-500 crore of equity capital in the current fiscal.

**Diversified borrowing profile though high share of funding from banks** – The company's funding base is well diversified with a good mix of private banks, public sector banks, FIs and NBFCs. As on March 31, 2020, Arohan had funding relationships with 44 lenders. The funding profile is diversified and comprised bank loans (70%), FIs/NBFCs (25%), subordinated debt (5%) and PTCs as on March 31, 2020. The company raised Rs. 3,554 of debt funds (including securitisation) from 31 different lenders in FY2020. Arohan's refinancing ability is good and it has been able to raise funds from FIs and under targeted long-term repo operations (TLTRO) in Q1 FY2021.

**Healthy profitability indicators but moderation expected on account of Covid-19** – The company reported a net profit of Rs. 126.80 crore in FY2020, translating into a return of 15.28% on average net worth (Rs. 127.64 crore and 23.66%, respectively, in FY2019). The NIM moderated to 10.49% of AMA in FY2020 from 11.14% in FY2019. The operating

expenses moderated to 4.57% of AMA in FY2020 from 5.43% in FY2019 as the company scaled up its operations. The credit costs increased to 3.12% of AMA in FY2020 from 1.09% in FY2019 due to a deterioration in the asset quality and an additional provision of Rs. 45.25 crore (0.90% of AMA) for the expected losses in light of the Covid-19 pandemic. With the moderation in the NIM and the increase in the credit costs, the return on AMA (before other comprehensive income) moderated to 2.53% in FY2020 from 3.79% in FY2019. Given the expected slippages in light of the pandemic, the credit costs are likely to remain elevated in FY2021, affecting the profitability of the company.

## Credit challenges

**Limited diversification of revenue stream and relatively risky asset class** – As the portfolio loans in microfinance are unsecured and only supported by a group-based social security, the asset class of Arohan's portfolio is relatively risky. Further, given the monoline nature of the business with interest income from the microfinance portfolio comprising the majority of the total income earned in FY2020, there is limited diversification in terms of the revenue stream and the asset class.

**Ability to improve geographical diversification of operations** – The company had a presence in 229 districts across 14 states through a network of 711 branches as on June 30, 2020. However, West Bengal's share in the portfolio remained high at 26% as on June 30, 2020. The top 3 states comprised 67% of the MFI portfolio as on June 30, 2020 (66% as on March 31, 2019). Further, there is scope for district-level diversification of the portfolio as the top 5, 10 and 20 districts comprised 13%, 22% and 35%, respectively, of the MFI portfolio as on March 31, 2020 (13%, 22% and 37%, respectively, as on March 31, 2019) and 61%, 103% and 166%, respectively, of the net worth as on March 31, 2020 (71%, 118% and 197%, respectively, as on March 31, 2019). Going forward, the company's ability to improve its geographical diversification while scaling up its operations remains important from a credit perspective.

**Deterioration in asset quality in FY2020 with further impact expected on account of Covid-19** – The company reported a deterioration in its asset quality, largely owing to the weaker performance of its microfinance portfolio. While the gross NPA increased to 2.15% as on June 30, 2020 from 0.66% as on March 31, 2019, the net NPA remained nil. Arohan has reported nil net NPAs for the last five years. The microfinance industry is facing many challenges following the spread of Covid-19 throughout the country. These include the continuity of business operations on the field and the possible adverse impact on the asset quality as the cash flows of microfinance borrowers and economic activity have undergone a slowdown. Moreover, incremental business growth has been hindered with disbursements being muted in Q1 FY2021. The company's ability to navigate through the adversity and manage the impact on business growth, client retention and asset quality while maintaining the profitability indicators would be important from a rating perspective.

**Ability to manage political, communal and other risks, given the marginal borrower profile** – Microfinance remains susceptible to the risks associated with unsecured lending to marginal borrowers with limited ability to absorb income shocks and the rising borrower leverage levels owing to an increase in multiple lending in the areas of operations. Further, political and operational risks associated with microfinance may result in high volatility in the asset quality indicators. The microfinance industry is prone to socio-political, climatic and operational risks, which could negatively impact Arohan's operations. This was recently observed in Assam with the company's 0+dpd and 90+dpd increasing to 6.53% and 2.37%, respectively, as on March 31, 2020, from 1.44% and 0.62%, respectively, as on September 30, 2019. Arohan's ability to onboard borrowers with a good credit history, recruit and retain employees and improve the geographical diversity of its operations would be key for managing high growth rates.

## Liquidity position: Adequate

As on July 22, 2020, the company had a cash and bank balance and liquid investments of Rs. 890 crore against scheduled debt obligations (including securitisation obligations) of Rs. 749 crore till September 30, 2020. It has also applied for a moratorium on its debt obligations and has received formal approval from some of its lenders, which further reduces its

debt obligations. Arohan raised Rs. 802 crore of debt funds in YTD FY2021, which supported its liquidity profile. The company has commenced its field activities and has started receiving collections, which also supports its liquidity profile. The ability to maintain and improve the collection efficiency and raise fresh funds in a timely manner will be important from a liquidity perspective.

## Rating sensitivities

**Positive triggers** – The maintenance of a prudent capitalisation profile with an adjusted gearing of less than 5 times and a healthy profitability indicator with a return on managed assets of more than 2.5% on a sustainable basis could positively impact the rating.

**Negative triggers** – Pressure on the company's rating could arise if there is a deterioration in the asset quality or operational efficiencies, which could affect its profitability with the return on managed assets falling below 1.5% on a sustained basis. A deterioration in the capitalisation profile with the adjusted gearing exceeding 6 times on a sustained basis or a stretch in the liquidity could exert pressure on the rating.

## Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	<a href="#">ICRA's Credit Rating Methodology for Non-Banking Finance Companies</a>
Parent/Group Support	Not applicable
Consolidation/Standalone	Standalone

## About the company

Arohan Financial Services Limited is a Kolkata-headquartered NBFC-MFI. It was incorporated on September 27, 1991. Arohan is engaged in the business of microlending mainly to women borrowers and operates on a joint liability group (JLG) model. It was set up through the acquisition of an existing NBFC, ANG Resources Ltd, with the support of Bellwether Microfinance Fund. The company's name was changed to Arohan Financial Services Limited in March 2008. Arohan became a part of the Aavishkar Group in September 2012. As on June 30, 2020, it was catering to more than 22 lakh borrowers through a network of 711 branches spread across 229 districts and 14 states while managing a portfolio of Rs. 4,862 crore.

## Key financial indicators (audited)

As per For the period ended	Ind-AS FY2019	Ind-AS FY2020
Net interest income	332.18	491.60
Profit after tax (PAT)	127.64	126.80
Net worth	697.16	962.63
Gross loan portfolio	4,044.88	4,854.02
% PAT / Average managed assets	3.79%	2.53%
% PAT / Average net worth	23.66%	15.28%
% Gross NPAs	0.66%	2.25%
% Net NPAs	-	-
% Net NPA / Net worth	-	-
% Capital adequacy ratio	20.05%	24.80%
Gearing (reported)	4.34	4.36
Gearing (adjusted)	4.37	4.38

Adjusted gearing = (on-book borrowings + PTCs)/(net worth – credit enhancement for business correspondent portfolio)

Amounts in Rs. crore; Source: Company & ICRA research

## Status of non-cooperation with previous CRA: None

## Any other information: None

## Rating history for past three years

Instrument	Current Rating (FY2021)				Chronology of Rating History for the Past 3 Years			
	Type	Rated Amount	Amount Outstanding	05-Aug-20	28-Jul-20	FY2020	FY2019	FY2018
1 Term Loans	Long Term	100.00	100.00	[ICRA]A-(Stable)	[ICRA]A-(Stable)	-	-	-
2 NCD Programme	Long Term	25.00	25.00	[ICRA]A-(Stable)	[ICRA]A-(Stable)	-	-	-
3 NCD Programme	Long Term	1,000.00	-	[ICRA]A-(Stable)	-	-	-	-

Amounts in Rs. crore

## Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website [www.icra.in](http://www.icra.in)

## Annexure-1: Instrument details

ISIN	Instrument	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan	28-Jul-2020	4.68%	10-Jul-2023	100.00	[ICRA]A-(Stable)
INE808K07162	NCD	29-Jul-2020	11.00%	29-Jul-2023	25.00	[ICRA]A-(Stable)
-	NCD – Proposed	-	-	-	1,000.00	[ICRA]A-(Stable)

Source: Company

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