Pahal Financial Services Pvt. Ltd.

January 24, 2019

Summary of rating action

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Bank lines	0.00	50.00	[ICRA]BBB-(Stable); assigned
NCD programme	28.00	28.00	[ICRA]BBB-(Stable); revised from [ICRA]BB+(Stable)
NCD programme	15.00	15.00	[ICRA]BBB-(Stable); revised from [ICRA]BB+(Stable)
NCD programme	40.00	40.00	[ICRA]BBB-(Stable); revised from [ICRA]BB+(Stable)
Total	**83.00**	**133.00**	

Rationale

The rating upgrade factors in the progress made by Pahal Financial Services Pvt. Ltd. (PFSPL) on scaling up its operations (managed portfolio of Rs. 387.68 crore, including the on-book portfolio of Rs. 331.38 crore as on November 30, 2018) while maintaining good asset quality indicators and improving geographical diversification with the share of Gujarat reducing to 55% as on November 30, 2018 from 74% as on March 31, 2018. The rating upgrade also factors in the company's ability to tie up both equity and debt to maintain capitalisation at adequate levels. The rating is constrained by PFSPL's moderate scale of operations, spread across 55 districts in five states. The rating continues to factor in the company's experienced promoters and senior management team, good loan origination, collection and monitoring systems, supported by an adequate management information system (MIS), a robust information technology (IT) system and a sound internal audit process.

The capital infusion of nearly Rs. 13 crore by Base of Pyramid Asia (BOPA) in September 2018 has supported the capitalisation profile. Further, ICRA notes that the company is in advanced stages of tying up equity capital to meet its growth plans for FY2020. The capital will be infused in stages every quarter based on business requirements to maintain capitalisation at adequate levels. As almost 44% of its borrowings were from non-banking finance companies (NBFCs)/financial institutions (FIs), the company's ability to diversify its funding base and secure funds in a timely manner will remain critical for business growth. PFSPL has adequate liquidity to service its debt obligations falling due over the next six months. The rating is constrained by moderate profitability indicators, a marginal borrower profile, the company's focus on unsecured lending and the political and operational risks associated with microlending that may lead to higher volatility in the asset quality indicators. Going forward, PFSPL's ability to grow profitably while maintaining the asset quality and capitalisation at adequate levels will be important for its credit profile.

Outlook: Stable

ICRA believes that PFSPL will continue to benefit from the experience of its management, good systems and processes. The outlook may be revised to Positive if the company is able to improve its capital structure and diversify its portfolio while maintaining its asset quality indicators as the portfolio expands. The outlook may be revised to Negative in the event of a weakened capitalisation profile or if PFSPL reports a material deterioration in its asset quality and earnings.

Key rating drivers

Credit strengths

Experienced management team and strong investor base - The company is promoted by Mr. Kartik Mehta and Ms. Purvi Bhavsar, who have experience in the banking and microfinance sectors. The company received funds in September 2018 from BOPA while Dia Vikas Capital is an existing investor. Apart from the investor representatives, the board consists of seven members including two independent directors and two nominee directors. In addition, the senior management team has experience in microlending operations.

Adequate internal control systems and prudent lending policy - The company's internal control processes and IT systems are commensurate with the current scale of operations. As per policy, loan appraisal and disbursement are centralised at the Head Office and 100% disbursal of loans is in the borrower's bank account. There are separate teams to address the appraisal and monitoring of joint liability group (JLG) and individual loans (ILs). PFSPL is in the process of streamlining operations with the introduction of new technology that would enable the tablet-based uploading of documents and a quick turnaround time. While the loan appraisal and sanction process remain at the Head Office, the branches are fully computerised and equipped with internet facility.

Improvement in geographical mix of the portfolio - With portfolio growth in M.P. and Rajasthan, the portfolio concentration in Gujarat declined to nearly 55% as on November 30, 2018 from 74% as on March 31, 2018, thereby reducing the regional risks associated with geographical concentration to some extent. While ICRA notes that the geographical concentration is reducing though the company's dependence on Gujarat remains high. Going forward, the planned portfolio growth in other states is likely to increase geographical diversity and further reduce the regional risks.

Good funding relationships and adequate liquidity profile - The company has a diverse funding profile with associations with 27 lenders comprising a mix of NBFCs/FIs, small finance banks and banks. As on December 31, 2018, the share of borrowings was nearly 44% from NBFCs/FIs, 25% from non-convertible debentures (NCDs), 19% through securitisation/assignment, 8% from banks and around 4% from others. The average cost of borrowing was 14.95% in 8M FY2019. The liquidity profile was adequate to support debt repayments owing to the shorter tenure of assets vis-à-vis liabilities, adequate cash balance and proceeds from borrowings in Q3 FY2019. However, the company would be required to tie up fresh funds to support business growth. Further diversification of the borrowing mix by reducing dependence on borrowings from NBFCs will be critical for maintaining an adequate funding profile.

Stable asset quality indicators - The company reported stable asset quality indicators with 0+ and 90+ overdues of 0.56% and 0.18%, respectively, as on November 30, 2018. This represented an improvement from 0.94% and 0.43%, respectively, as on March 31, 2018 owing to write-offs and the clean-up of demonetisation related losses and good collection efficiency of new portfolio originated. Going forward, PFSPL's ability to maintain the asset quality indicators while scaling up its operations in new and existing geographies will remain monitorable.

Credit challenges

Moderate scale of operations - The company had a moderate scale of operations with a managed portfolio of Rs. 387.68 crore as on November 30, 2018 (Rs. 223.02 crore as on March 31, 2018). The operations were spread in 55 districts in five states with Gujarat contributing nearly 55% to the managed portfolio as on November 30, 2018. Going forward, PFSPL's ability to tie up funds in a timely manner will remain important from a growth perspective.

Moderate capitalisation profile; capital infusion to provide support - The capital infusion of nearly Rs. 13 crore by BOPA in September 2018 supported the capitalisation profile for FY2019. ICRA notes that the company is in advanced stages of tying up further equity capital to meet its growth plans for FY2020. The funds will be infused in stages every quarter based on business requirements to maintain capitalisation at adequate levels. The timely infusion of capital to support the capitalisation profile will remain a key monitorable.

Moderate profitability profile - While the company returned to a profit in 8M FY2019 after reporting losses because of higher credit costs in FY2018, the profitability indicators were moderate on account of operating expenses incurred during the growth phase of operations. As a result, profit after tax in relation to managed advances and return on net worth were 1.77% and 13.07%, respectively, in 8M FY2019 (-2.93% and -19.19%, respectively, in FY2018). Going forward, the company's ability to contain credit costs and enhance its operating efficiencies would be crucial from a profitability perspective.

Marginal borrower profile - Unsecured lending to a marginal borrower profile and the political and operational risks associated with microlending may result in high volatility in the asset quality indicators. Political, communal, overleveraging and other risks associated with the borrower profile in the microfinance sector across geographies of operations will remain key rating sensitivities.

Ability to manage political, communal and other risks in the microfinance sector - The microfinance industry is prone to socio-political and operational risks, which could negatively impact its operations and thus its financial position. However, a geographically-diversified portfolio would mitigate these risks to some extent as these issues are largely region-specific so far. PFSPL's ability to on-board borrowers with good credit history, recruit and retain employees and maintain geographical diversity would be key for managing high growth rates.

Liquidity position

As on December 31, 2018, the company had an unencumbered cash and bank balance of nearly Rs. 29 crore. Given the well-matched tenor of its assets and liabilities, PFSPL expects repayments from customers of around Rs. 19-20 crore per month to be used for the repayment of debt maturities of around Rs. 12-13 crore per month over the next 3-4 months. The company raised funds through NCDs and securitisation in Q3 FY2019 and has unutilised lines and sanctions in the pipeline to support business growth. While PFSPL has adequate liquidity to service debt repayments, its ability to tie up for fresh sanctions will be crucial from a growth perspective.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	ICRA's Credit Rating Methodology for Non-Banking Finance Companies
Parent/Group support	NA
Consolidation/Standalone	The rating is based on the standalone financial profile of the company

About the company

PFSPL is an Ahmedabad-based NBFC-MFI registered with the Reserve Bank of India. The company started its operations in March 2011 by acquiring the existing operations of Lok Vikas Nidhi, a trust operational in Gujarat for over 25 years. The current promoters of Pahal acquired the portfolio of Rs. 2.6 crore spread over 15 branches, along with the field staff of Lok Vikas and subsequently transferred the acquired portfolio to an NBFC, along with an equity contribution of Rs. 2 crore. The NBFC was renamed Pahal Financial Services Private Limited. As on September 30, 2018, the company's operations were spread across 54 districts in four states - Gujarat (60%), Rajasthan (19%), Madhya Pradesh (18%) and Maharashtra (3%). The company commenced operations in Bihar in Q3 FY2019.

PFSPL reported a loss of Rs. 6.57 crore in FY2018 on a managed portfolio of Rs. 223.02 crore compared to a net profit of Rs. 1.88 crore on a managed portfolio of Rs. 127.48 crore in FY2017. The company reported a CRAR of 21.46% as on September 30, 2018. PFSPL reported a profit of Rs. 4.27 crore on a managed portfolio of Rs. 387.68 crore in 8M FY2019.

Key financial indicators (Audited)

	FY2017	FY2018	8M FY2019*
Total income (Rs. crore)	36.98	40.09	52.98
PAT (Rs. crore)	1.88	(6.57)	4.27
Net worth (Rs. crore)	28.66	39.77	58.36
Total managed portfolio (Rs. crore)	128.48	223.02	387.68
Return on managed assets (%)	1.11%	(2.93)%	1.77%
Return on equity (%)	8.45%	(19.19)%	13.07%
NIM/AMA	8.54%	6.60%	9.77%
Operating expenses/AMA	6.66%	6.40%	7.07%
Net worth/managed assets (%)	21.74%	17.82%	15.05%
Gearing (managed book; times)	5.21	5.56	6.26
CRAR	24.75%	24.05%	21.46%^

*PAT: Profit after tax; NIM: Net interest margin; AMA: Average managed assets; RoMA: Return on managed assets; RoE: Return on equity; All ratios as per ICRA calculations; *Provisional numbers; ^ As on September 30, 2018*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

		Current Rating							Chronology of Rating History for the Past 3 Years		
			Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	FY2019				FY18	FY17	FY16
	Instrument	Type			Jan-19	Oct-18	July-18	Jun-18	-	-	-
1	Bank Lines	Long Term	50.00	0.00	[ICRA]BBB- (Stable)	-	-	-	-	-	-
2	NCD Programme	Long Term	28.00	28.00	[ICRA]BBB- (Stable)	[ICRA]BB+ (Stable)	-	-	-	-	-
3	NCD Programme	Long Term	15.00	15.00	[ICRA]BBB- (Stable)	[ICRA]BB+ (Stable)	[ICRA]BB+ (Stable)	-	-	-	-
4	NCD Programme	Long Term	40.00	40.00	[ICRA]BBB- (Stable)	[ICRA]BB+ (Stable)	[ICRA]BB+ (Stable)	[ICRA]BB+ (Stable)	-	-	-
	Total		**133.00**	**83.00**							

Source: ICRA research

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

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE514Q07098	NCD Programme	29-Jun-2018	13.65%	29-Jun-2023	40.00	[ICRA]BBB-(Stable);
INE514Q07106	NCD Programme	12-Jul-2018	14.20%	30-Mar-2023	15.00	[ICRA]BBB-(Stable);
INE514Q07114	NCD Programme	23-Oct-2018	13.90%	22-Oct-2021	28.00	[ICRA]BBB-(Stable);
NA	Bank Lines (proposed)	-	-	-	50.00	[ICRA]BBB-(Stable);
Total					**133.00**	

Source: Company

ANALYST CONTACTS

Mr. Karthik Srinivasan
+91 22 61143444
karthiks@icraindia.com

Ms. Supreeta Nijjar
+91 124 4545324
supreetan@icraindia.com

Mr. Rajat Mehta
+91 124 4545377
rajat.mehta@icraindia.com

Ms. Deeksha Agarwal
+91 124 4545833
deeksha.agarwal@icraindia.com

RELATIONSHIP CONTACT

Mr. Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries:

+91-124-2866928 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata	+ (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore	+ (91 80) 2559 7401/4049
Ahmedabad	+ (91 79) 2658 4924/5049/2008
Hyderabad	+ (91 40) 2373 5061/7251
Pune	+ (91 20) 2556 0194/ 6606 9999