

CARE/KRO/RR/2017-18/1265

Shri Manoj Nambiar
Managing Director
Arohan Financial Services Pvt. Ltd.
PTI Building, 4th Floor, West wing,
DP Block, Sector-V, Salt Lake,
Kolkata – 700 091.

August 22, 2017

Dear Sir,

Credit rating of Arohan Financial Services Private Limited

Please refer to our letters dated August 18, 2017 on the above subject.

2. The rationale for the ratings is attached as an **Annexure-I**.
3. We request you to peruse the annexed documents and offer your comments, if any. We are doing this as a matter of courtesy to our clients and with a view to ensure that no factual inaccuracies have inadvertently crept in. Kindly revert as early as possible. In any case, if we do not hear from you by August 24, 2017, we will proceed on the basis that you have no comments to offer.

If you have any further clarifications, you are welcome to approach us.

Thanking you,

Yours faithfully,

Bagaria
Richa Bagaria
Senior Manager

Encl.: As above

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CARE Ratings Limited
(Formerly known as Credit Analysis & Research Limited)

Annexure- I
Rating Rationale
Arohan Financial Services Private Ltd

Ratings

Facilities	Amount (Rs. crore)	Ratings ¹	Rating Action
Long term Bank Facilities	921.07 (enhanced from Rs.592.11 crore)	CARE A-; Stable (Single A Minus; Outlook: Stable)	Reaffirmed
Total Facilities	921.07 (Rupees Nine hundred Twenty One crore and Seven Lakhs only)		

Rating Rationale

The ratings continue to draw comfort from experienced promoters, experienced board of directors with professional management team, adequate risk management system with adequate IT infrastructure, continuous infusion of funds leading to comfortable CAR, diversified funding profile, and improvement in the financial performance of the company in FY17 (refers to the period April 01 to March 31). However, the above ratings continue to be constrained by moderate geographical concentration of portfolio base, low seasoning of loan portfolio, deterioration in asset quality post demonetisation, inherent risks in the micro finance industry including unsecured lending, regulatory risks & socio-political intervention like farm loan waiver across various States in India and operational risks related to cash based transaction.

The ability of the company to increase its scale of operation while maintaining healthy CAR and improvement in the collection efficiency going forward, and tapping new States to further reduce the geographical concentration risk remains the key rating sensitivities. The ability to derive envisaged benefits out of the proposed merger with Intellecash would also remain one of the key rating sensitivities.

Background

Arohan Financial Services Private Ltd (Arohan), incorporated in 2006, is a (Non-Deposit taking) Non-Banking Financial Company – Micro Finance Institution (NBFC-MFI) registered with Reserve Bank of India (RBI). Arohan is engaged in the business of micro lending to individual women borrowers and operates on a mix of both Joint Liability Group (JLG) model and Centre Liability lending model. It manages an asset under management (AUM) of Rs.1013.84 crore as on March 31, 2017 (Rs.667.56 crore as on March 31, 2016) through a network of 271 branches in 93 districts spanning across seven states viz. West Bengal (39% of AUM), Assam (24%), Bihar (17%), Jharkhand (4%), Odisha (15%), Meghalaya (0.4%) and Chhattisgarh (0.7%). The company has total workforce strength of over 2,400 employees as on March 31, 2017.

The company has recently announced its merger with Intellecash Microfinance Network Company Private Limited (Intellecash), one of its associate companies. Intellecash provides

¹Complete definition of the ratings assigned are available at www.careratings.com and other CARE publications

working capital and business loans to MSME in the range of Rs. 2.5 lakh-Rs. 75 lakh. Intellectcash had an outstanding AUM of Rs. 8.5 crore as on March 31, 2016.

Credit Risk Assessment

Experienced promoters

In Sep 2012, the Intellegroup (promoted by Mr. Vineet Rai) acquired around 56% stake in Arohan from previous promoters i.e. Mr. Subhankar Sengupta and other institutional investors. Mr. Vineet Rai has around two decades of experience in early stage investing, small business incubation and microfinance business.

Experienced and professional management team

Arohan's board comprises ten members, having rich experience in the banking and financial sectors. The board is headed by Mr. Manoj Nambiar (Managing Director), having 28 years of experience in consumer finance & retail banking. Prior to joining Arohan, he worked as an MD & CEO of IntellectCash. He is also a member of the governing board at Micro Finance Institutions Network (MFIN), the microfinance Self-Regulatory Organisation, since Jan'13 and was former President of MFIN. Mr. Nambiar is also well supported by a team of experienced professionals. The other BoD includes Mr. Sumantra Banerjee (Ex-MD of CESC Ltd), Ms. Matangi Gowrishankar (Director of global Leadership academy & Head of Capability Development), Mr. Kailash Chand Vaid (Regional Head of SIDBI, Kolkata), Mr. Rajat Mohan Nag (Ex-Managing Director General of Asian Development Bank), Mr. Anurag Agarwal, Mr Vineet Rai, Mr Piyush Goenka (Nominee Director), Mr. Wim Van Der Beek (Nominee Director) and Mr. Kasper Svarrer (Nominee Director).

Adequate risk management system with strong IT infrastructure

In July 2017, Arohan has migrated from earlier its Core Banking System called 'Omni' to a more sophisticated and equipped Core Banking System called 'Profile' provided by FIS, a financial technology solution company. This will allow Arohan to provide a wide range of financial services to its existing and new customers.

Arohan has provided smart tablets to its field staff. The tablets are powered by 'Gravity', an application developed by Esthenos for front end work.

In January 2017, Arohan has setup a Central IT HUB in Kolkata, for centralized file processing.

Diversified funding profile

Arohan has a diversified funding profile as it has raised equity from various institutional investors (Rs.27 crore in FY14, Rs.22.1 crore in FY15, Rs.60.0 crore in FY16, Rs. 189 crore (includes tier II capital from Bank of Maharashtra and IFMR) in FY17) and debt from private & public sectors banks, NBFCs and institutional investors in the past.

Consistent growth in scale of operations

In the last 3 years (FY15-FY17), AUM of Arohan has increased at a CAGR of around 63% and stood at Rs.1013.84 crore as on March 31, 2017 vis-à-vis Rs. 667.56 crore as on March 31, 2016 (Rs. 383.57 crore as on March 31, 2015). The increase in AUM was on account of increase in own portfolio (from Rs.586.02 crore as on Mar.31, 2016 to Rs.909.81 crore as on Mar.31, 2017) as well as increase in securitized and business correspondence (BC) portfolio (from Rs.81.54 crore as on Mar.31, 2016 to Rs.104.03 crore as on Mar.31, 2017).

Improvement in financial performance in FY17 though moderation witnessed in asset quality

Interest income of Arohan increased by around 61% in FY17 vis-à-vis FY16 on the back of increase in interest income on account of higher disbursement from Arohan during FY16 & FY17 (increase in loan portfolio was around 55% in FY17 vis-à-vis FY16). Arohan's NIM remained stable at 8.60% in FY17 vis-à-vis 8.70% in FY16.

Operating expense/Avg. total assets slightly increased from 5.70% in FY16 to 6.93% in FY17 mainly due to significant increase in branches (from 180 in Mar'16 to 272 in Mar'17). Provisioning expense / Avg. total assets increased from 0.46% in FY16 to 0.83% in FY17 on account of additional provision of Rs. 3.26 crore made by the company towards NPA during FY17 (FY16- nil). The amount is over and above the amount required to be created in accordance with RBI guidelines. Overall, ROTA deteriorated from 3.47% in FY16 to 2.83% in FY17 due to lower NIM coupled with higher provisioning cost.

PAR> 30 days & PAR> 90 days deteriorated to 5.12% & 0.52% of AUM as on March 31, 2017 vis-à-vis 0.50% & 0.37% of AUM as on March 31, 2016. The deterioration was mainly on account of deterioration in asset quality in few of the branches in West Bengal, Bihar & Jharkhand due to demonetisation effect.

Marked improvement in CAR

Arohan's CAR improved from 25.02% as on March 31, 2016 to 39.35% as on March 31, 2017 on account of infusion of equity of around Rs. 154 crore from new and existing investors. The company also received Rs.35 crore from Bank of Maharashtra and IFMR as unsecured term loan and debentures. On an adjusted basis (for off-book assets), CAR improved from 22.19% in FY16 to 35.11% in FY17.

Moderate geographic concentration of portfolio and low seasoning of loan portfolio

Arohan's portfolio concentration in West Bengal area has reduced from 48% (of AUM as on March 31, 2016) to 39% (of AUM as on March 31, 2017). Though on absolute levels, the loan portfolio has increased in almost all its covered states (except Jharkhand), the concentration risk has reduced and dispersed among the states.

In order to diversify its portfolio base, the company is expected to start its operations in Uttar Pradesh and Tripura in FY18.

Further, as on Mar.31, 2017, 44% of the Loan AUM (47% of Loan AUM as on Mar.31, 2016) is in first loan cycle indicating the lack of seasoning of loan portfolio to an extent.

Increasing competition

Arohan faces competition from large MFIs who have better and cheaper access to resources and enjoy the economies of large scale operations. Further, banks and NBFC's are also trying to increase their direct presence in rural areas to meet the priority sector lending requirement.

Industry outlook

On account of various events post demonetisation, collection efficiency of the MFIs has deteriorated. This has impacted the asset quality of the MFIs leading to increase in credit costs. It is expected that the loss on account of this event is likely to be in the range of 5-10% of the total loan portfolio of different MFIs. Given the current situation and any further deterioration in the situation from hereon, the profitability of the MFIs are expected to take a severe hit in FY18 on account of higher provisioning costs. Overall FY18 is expected to be a challenging year for the sector with growth expected to moderate on the back of demonetisation as the MFIs will primarily concentrate on overhaul of entire operations to minimise future losses. CARE expects the portfolio growth to be around 25 to 30% y-o-y in FY18 as compared to 50-60% y-o-y growth achieved in the past few years. However given the market potential, the sector is likely to continue its high growth post normalisation of situation with MFIs continuing to attract funds and improving operational efficiencies to maintain profitability.

Prospects

Ability of the company to increase its scale of operation while maintaining CAR and improvement in the collection efficiency going forward, improvement in the asset quality post demonetisation and tapping new states to further reduces the geographical concentration risk remains the key rating sensitivities. The financial performance of Arohan post-merger with Intellectash would also remain one of the key rating sensitivities.

Financial Performance

(Rs. Cr)

Y.E/As on March 31	2015	2016	2017
	(12m, A)	(12m, A)	(12m, A)
<u>Working Results</u>			
Interest income	64.88	113.41	182.10
Securitization income	2.15	4.70	14.17
Other operating income	7.53	12.66	18.71
Total income	74.56	130.77	214.98
Interest expenses	35.56	59.09	98.78
Operating Expenses (Incl. Depreciation)	20.84	35.62	67.14
Provision & write-offs	2.40	2.88	8.03
PAT	10.90	21.65	27.46
<u>Financial Position</u>			
Tangible network	137.55	159.69	338.83
Total Borrowings	365.34	539.51	813.55
Total Loan Portfolio	364.54	586.02	909.81
Total Assets	516.96	731.28	1207.10

Y/E/As on March 31	2015	2016	2017
	(12m, A)	(12m, A)	(12m, A)
Loan Asset Under Management (AUM)	383.57	667.56	1013.84
Key Ratios			
Profitability			
Net Interest Margin (NIM)	7.86	8.70	8.60
Return on total assets	2.92	3.47	2.83
Op. Exp. (before prov. & w/off) / Avg. Total Assets (%)	5.59	5.71	6.93
Solvency			
Overall Gearing (times)	2.66	3.38	2.40
Capital Adequacy Ratio (CAR) (%)	35.88	25.02	39.35
Tier I CAR (%)	35.88	25.02	35.62
Interest Coverage	1.45	1.58	1.43
Asset Quality			
Gross NPA to Gross Advances	0.27	0.41	0.36
Net NPA to Net Advances	0.01	0.06	0.00
Net NPA to Tangible Network	0.04	0.22	0.00

Details of Rated Facilities

1. Long-term facilities

1.A. Secured rupee term loans

Sr. No.	Lender	Rated Amount (Rs. Crore)	Remarks
1.	Andhra Bank	10.00	Outstanding
2.	Axis Bank	7.20	Outstanding
3.	Bank of Baroda	9.20	Outstanding
4.	Bank of Baroda	30.50	Outstanding
5.	Bank of India	20.00	Outstanding
6.	Bank of India	20.00	Outstanding
7.	Bank of Maharashtra	25.00	Outstanding
8.	BNP Paribas	9.38	Outstanding
9.	BNP Paribas	0.63	Outstanding
10.	BNP Paribas	1.56	Outstanding
11.	Capital First	15.00	Outstanding
12.	Capital First	25.00	Outstanding
13.	Citi Bank	3.00	Outstanding
14.	Citi Bank	5.00	Outstanding
15.	Citi Bank	5.00	Outstanding
16.	Citi Bank	8.00	Outstanding
17.	Citi Bank	7.00	Outstanding
18.	Corporation Bank	3.13	Outstanding
19.	DCB	3.64	Outstanding
20.	DCB	2.00	Outstanding
21.	DCB	4.88	Outstanding
22.	Federal Bank	1.67	Outstanding
23.	Federal Bank	4.28	Outstanding

24.	FWWB	0.79	Outstanding
25.	HDFC LTD	0.45	Outstanding
26.	HDFC LTD	12.22	Outstanding
27.	HERO Fincorp Ltd.	7.36	Outstanding
28.	IDBI Bank	3.81	Outstanding
29.	IDBI Bank	45.00	Outstanding
30.	IDBI Bank	20.95	Outstanding
31.	IDFC Bank	0.47	Outstanding
32.	IDFC Bank	1.43	Outstanding
33.	IDFC Bank	2.86	Outstanding
34.	IDFC Bank	3.12	Outstanding
35.	IDFC Bank	2.92	Outstanding
36.	IDFC Bank	3.33	Outstanding
37.	IFMR Capital	7.04	Outstanding
38.	IFMR Capital	7.65	Outstanding
39.	IFMR Capital	7.65	Outstanding
40.	Indian Bank	4.55	Outstanding
41.	Indian Bank	15.00	Outstanding
42.	Kotak Mahindra Bank	1.67	Outstanding
43.	L&T Finance	6.00	Outstanding
44.	L&T Finance	10.00	Outstanding
45.	L&T Finance	7.33	Outstanding
46.	L&T Finance	0.56	Outstanding
47.	L&T Finance	0.79	Outstanding
48.	MUDRA	10.85	Outstanding
49.	NABARD	70.00	Outstanding
50.	Oiko Credit	15.00	Outstanding
51.	RBL Bank	2.14	Outstanding
52.	RBL Bank	2.14	Outstanding
53.	RBL Bank	10.71	Outstanding
54.	RBL Bank	12.86	Outstanding
55.	SBI	4.19	Outstanding
56.	SBI	1.00	Outstanding
57.	SBM	3.71	Outstanding
58.	SBM	2.67	Outstanding
59.	SBM	5.00	Outstanding
60.	SBM	5.00	Outstanding
61.	SIDBI	5.19	Outstanding
62.	SIDBI	20.83	Outstanding
63.	SIDBI	12.50	Outstanding
64.	SIDBI	1.20	Outstanding
65.	South Indian Bank	4.67	Outstanding
66.	South Indian Bank	6.67	Outstanding
67.	Standard Chartered Bank	3.00	Outstanding

68.	Standard Chartered Bank	3.00	Outstanding
69.	Standard Chartered Bank	7.50	Outstanding
70.	Tata Capital	9.50	Outstanding
71.	Union Bank Of India	2.78	Outstanding
72.	Union Bank Of India	13.94	Outstanding
73.	United Bank of India	6.67	Outstanding
74.	Vijaya Bank	3.50	Outstanding
75.	YES Bank	2.00	Outstanding
76.	YES Bank	1.33	Outstanding
77.	YES Bank	1.33	Outstanding
78.	YES Bank	6.25	Outstanding
79.	Proposed	264.92	Outstanding
	Total	921.07	

Disclaimer

CARE's ratings are opinions on credit quality and are not recommendations to sanction, renew, disburse or recall the concerned bank facilities or to buy, sell or hold any security. CARE has based its ratings/outlooks on information obtained from sources believed by it to be accurate and reliable. CARE does not, however, guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. Most entities whose bank facilities/instruments are rated by CARE have paid a credit rating fee, based on the amount and type of bank facilities/instruments.

In case of partnership/proprietary concerns, the rating /outlook assigned by CARE is based on the capital deployed by the partners/proprietor and the financial strength of the firm at present. The rating/outlook may undergo change in case of withdrawal of capital or the unsecured loans brought in by the partners/proprietor in addition to the financial performance and other relevant factors.

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