India Ratings Places IIFL Samasta Finance’s NCDs on Rating Watch with Negative Implications

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India Ratings and Research (Ind-Ra) has placed IIFL Samasta Finance Limited’s (IIFL Samasta) non-convertible debentures’ (NCDs) rating on Rating Watch with Negative Implications as follows:

Details of Instruments

Instrument Type	Date of Issuance	Coupon Rate	Maturity Date	Size of Issue (million)	Rating assigned along with Outlook/ Watch	Rating Action
NCDs*	-	-	-	INR5,000	IND AA/Rating Watch with Negative Implications	Placed on Rating Watch with Negative Implications

*Yet to be issued

Analytical Approach

Ind-Ra has taken a consolidated view of the business and financial risk profiles of IIFL Finance Limited (debt rated ‘IND AA’/Rating Watch with Negative Implications) and its subsidiaries - IIFL Home Finance Ltd (80% stake; debt rated ‘IND AA’/Rating Watch with Negative Implications) and IIFL Samasta (99.56%), collectively referred to as the IIFL Finance group, while arriving at the rating. This is because of the significant operational, financial and managerial integration among the entities. Also, all the entities operate under a common brand.

The micro finance business (IIFL Samasta) is a key focus area for the IIFL group, and it has a close oversight from the group’s top management, although its present share in the consolidated balance sheet and the profitability of the ultimate parent and the group is modest. Also, the rating factor in the strategic importance of IIFL Samasta to IIFL Finance and the common brand name, which strengthens Ind-Ra’s expectation that IIFL Samasta is likely to receive timely and adequate support from IIFL Finance.

Detailed Rationale of the Rating Action

The Rating Watch with Negative Implications reflects the recent regulatory developments, wherein the Reserve Bank of India (RBI) has imposed restrictions on IIFL from sanctioning/disbursing or assigning/securitising gold loans due to material supervisory concerns. The RBI’s main concerns were related to deviations in certifying the purity and net weight of the gold at the time of sanction of loans and at the time of auction upon default; breaches in the loan-to-value ratio; cash collection and disbursements over the statutory limit; and non-compliance with the standard auction process. Ind-Ra would monitor the developments on this front and will resolve the Rating Watch with Negative Implications post the resolution of concerns raised by the RBI and normalisation of operations.

List of Key Rating Drivers

Strengths

- Significant player in major segments, but regulatory issue would impact franchisee growth
- Adequate capitalisation
- Stable Outlook on NBFC-MFIs

Weaknesses

- Profitability under pressure due to regulatory overhang
- Evolving funding profile
- Ability to maintain asset quality performance and control credit losses remains key monitorable

Detailed Description of Key Rating Drivers

Significant Player in Major Segments, but Regulatory Issue Would Impact Franchisee Growth: IIFL Finance's consolidated asset under management (AUM) stood at INR774 billion at end-3QFY24 (FY23: INR646.4 billion), growing at a CAGR of 18.27% over FY19-3QFY24. This was largely driven by retail orientation of the book which has increased to 95.6% of AUM (FY19: 83.6%) and increasing geographical presence to 4,679 branches (FY19: 1,977 branches). Gold (31.9% of AUM) and microfinance (MFI, 15.6%) loans primarily led with 35.3% and 43.9% CAGRs during FY19-3QFY24; however, home loans (33% of AUM) grew at a CAGR of 16.2% during the period. Due to the restriction on incremental disbursement of gold loans, Ind-Ra expects a rundown of the gold portfolio, which is a shorter tenure book. Although the other segments would continue their normal operations, there would be an impact on overall AUM growth.

IIFL Finance has created a sizeable presence in segments with MFI and gold finance, being among the top two players in these segments. IIFL Home Finance is the largest player in the affordable housing segment with AUM of INR255 billion (at end-3QFY24) in an industry with AUM of INR920 billion-950 billion. Also, it has created substantial physical infrastructure, comprising 2,721 branches for the gold loan business, 1,572 branches for MFI loans and 386 network points for the housing finance business. IIFL has also created a presence in the unsecured business and personal loan segment through the digital mode. IIFL intends to reduce wholesale exposure (3QFY24: 3.7%; FY19: 14.5%) further in the medium term.

IIFL Samasta is one of the largest microfinance players in India among non-banking finance company-microfinance institutions (NBFC-MFIs) and is well positioned to capture growth opportunities. IIFL Samasta delivered three-year AUM CAGR of 46% in FY20-FY23 with MFI share of 93% for FY23. The AUM stood at INR130 billion at end-December 2023. At end-December 2023, it had 1,572 dedicated MFI branches covering 22 states and 387 districts. The MFI operations are a bit concentrated with states namely Bihar, Tamil Nadu and Karnataka accounting for around 50% of the book.

Adequate Capitalisation : IIFL Finance's consolidated capitalisation remained adequate with a net worth of INR117.8 billion as of 3QFY24 (FY23: INR102.0 billion; FY22: INR64.7 billion). The improvement in networth was complemented by an improving return on assets profile (9MFY24: around 3.8%; FY20: around 1.5%), augmented by a capital raise of INR22.0 billion in IIFL Home Finance in FY23 and earlier capital infusions by Fairfax and Capital group. The gross leverage improved to 3.65x at end-December 2023 (FY21: 6x). The group's capitalisation is further supported by the increasing share of the off-balance sheet portfolio of 39% at end-3QFY24 (FY21: 24.8%). This leads to optimum utilisation of capital and better return ratios. Furthermore, the group is planning to raise equity capital of up to INR30 billion by early FY25 which could bolster the capital position and provide additional levers to grow the franchisee. Given the business strategy of growth with an orientation towards asset-light model, capitalisation should remain comfortable over the medium term for the projected scale of operations.

IIFL Finance has 99.51% stake in IIFL Samasta, and the rating factors in Ind-Ra's expectation that the parent will provide timely financial support to the MFI business as it is strategically important, helps diversify the financial product suite of the parent and expands its presence in the financial inclusion space. IIFL Finance has regularly infused equity totalling INR 9.4 billion since acquisition in 2016, with latest in November 2023. IIFL Samasta's gross leverage (debt/equity) stood at 4.6x in end-3QFY24 (FY23: 5.5x, FY22: 5.3x) and IIFL Samasta could raise equity by early FY25 which would further enhance the capital position. Furthermore, the senior management of IIFL Finance is actively involved in managing the treasury, risk management functions of IIFL Samasta. Hence, Ind-Ra believes IIFL Finance would continue to provide timely support to IIFL Samasta, as and when required.

IIFL Samasta's capitalisation remained adequate with a tier 1 ratio of 18.46% in end-3QFY24, largely supported by improved profitability (9MFY24 PAT: INR3.8 billion; FY23 PAT: INR1.3 billion) and equity infusion of INR 2 billion each in February 2023 and November 2023. The parent remains committed to making regular capital infusions in IIFL Samasta to support its growth plans and current higher gross leverage remains a key monitorable. In Ind-Ra's opinion with the capital raising plans in near term, IIFL Samasta's capitalisation is expected to remain adequate over the medium term in the normal course of business. Given the regulatory overhang and continuous payment/collections from gold loan customers, there would be higher liquidity in the medium term, which would ultimately lead to a reduction in leverage for the group.

Stable Outlook on NBFC-MFIs: Ind-Ra has maintained an neutral outlook on the microfinance sector while keeping the rating Outlook at Stable for FY25. Ind-Ra expects the participants to maintain growth momentum at similar levels of FY24. Delinquency levels continue to improve on a yoy basis. The slight uptick in 3QFY24 was mainly due to the stress in Punjab and Haryana amid the ongoing farmer protest in the region and a mild increase in early delinquencies in some of the districts of Tamil Nadu due to floods. The agency opines this will only have a moderate impact on delinquencies for one or two quarters. Thus, Ind-Ra expects continued normalised delinquencies in FY25, in the absence of any major negative event playing out. There were no major disruptions in operations in FY24, despite some of the major state facing elections during the year. However, Ind-Ra remains cautious of the ongoing farmer protest in Punjab and the cascading effect of that in other states till the general elections.

Profitability Under Pressure due to Regulatory Overhang : Gold loans constitute a significant proportion of the AUM, and it was a high yielding (around 19% yield) book; therefore, restrictions on making incremental disbursements would have an impact on the group's profitability. However, IIFL reported comfortable return on assets of 3.3% in FY23. The earnings were supported by an increase in assignment income, which meaningfully improved to INR5.1 billion in FY23 (FY21: INR1.3 billion), and a decline in credit cost to 2.35% (3.77%).IIFL is one of the few big NBFCs to have an asset-light model, as reflected in its reliance on off-book (including direct assignment and co-lending portfolios). The proportion of off-book portfolio rose to 39% as of 3QFY24 (FY21: 24.8%). Within the off-book portfolio, assignment contributed 24.08% and co-lending 14.96% as of 3QFY24. The asset-light model has benefitted liquidity while keeping borrowing costs under control at 9.07% in 3QFY24 (4QFY22: 8.6%). Consequently, spreads improved to 8.1% in 3QFY24 (FY22: 6%). As a result, IIFL Finance was able to invest in scaling up the infrastructure to 4,679 branches in 3QFY24 (FY19: 1,947 branches) which will lead to significant operating leverage going ahead as major part of capex is already done.

Largely due to the Reserve Bank of India guidelines in April 2022, where in the interest margin cap (of 10%) was discontinued, MFIs have been going in for risk-based pricing by increasing their yields. Specifically for IIFL Samasta, spreads have increased to 19.04% in 9MFY24 vs 12% in FY21/FY22; however, higher opex at around 7.95% and elevated credit cost at 5.31% have led to its profitability remaining lower than comparable peers'. Its return on assets and return on managed assets (on annualised basis) improved to 5.21% and 4.7% in 9MFY24 from 1.9% and 1.6% for FY21, largely due to an improvement in spreads and cost to income ratio falling to 40.02% from 50.2%.

Evolving Funding Profile: As of 3QFY24 on a consolidated basis, excluding securitisation , the borrowings were largely driven by term loans (54%) and refinance (18%); 24% of funding is through debentures and remaining through commercial papers (4%) and securitization (1%). Further during 2QFY24, IIFL Finance was able to borrow USD50 million from US International Development Financial Corporation for financing affordable housing loans, USD100 million from IFC World Bank and INR25 billion from National Housing Bank (IND AAA/Stable), which has supported the overall funding cost. The share of capital market funding in the borrowing profile remains limited and is a rating monitorable in the medium term. Further, the impact of the regulatory development on the ability of mobilising funding will be a key monitorable.

IIFL Samasta has significantly diversified its resource profile since its acquisition by IIFL Finance. As of 3QFY24, the overall borrowing comprised bank funding (55%), direct assignment (22%), financial Institutions (13%), NCD (9%) and commercial papers (1%). The marginal cost of borrowings, however, increased due to the increase in policy rates and increasing share of longer-tenor liabilities to 11.04% in 9MFYFY24 (FY23: 9.98%). Ind-Ra does not see any major challenge for the company to raise funds incrementally at competitive rates.

Ability to Maintain Asset Quality performance and Control Credit Losses remains key monitorable: IIFL Finance's consolidated gross NPAs and net NPAs were 1.7% and 0.9%, respectively, during 3QFY24 (FY23: 1.8%/1.1% and FY22: 3.2%/1.8%). The provision coverage ratio for 3QFY24 stood at 49.7% while the total provisions coverage ratio (including standard asset provisioning) was 151%. Also, gold (31.9% of AUM as of 3QFY24) and home finance (33% of AUM) are larger segments of business, primarily secured and have shown a resilient performance even during the COVID-19 pandemic with less volatility in terms of asset quality.

As of 3QFY24, IIFL Samasta 's 1+ and 90+ days past due (dpd) stood at 3.7% and 2.1%, respectively, vs 11.7% and 2.8% for FY22, largely driven by improves collection efficiency of 96.0% in 3QFY24 (FY22 : 90.3%), as well as higher write-offs and sale to an asset reconstruction company. As of September 2023, IIFL Samasta had adequately provided for stress with provision coverage of 73% and restructured assets worth INR0.53 billion which is around 0.7% of the loan book. Considering the pace of growth, the company's ability to sustain collection efficiency and eventually reach the pre-pandemic levels of over 99% on a steady-state basis will be a key monitorable.

Liquidity

Adequate

At 3QFYE24, IIFL Finance on consolidated basis had the cumulative surplus of 21.0% of assets until one year, and as on 5 March 2024, there was an additional cushion of unutilised bank lines of INR66.45 billion against scheduled debt obligations of INR70.97 billion during December 2023 - June 2024. Furthermore, IIFL has received a credit line of USD200 million from Fairfax India, which provides additional comfort. The tenure of MFI and gold loans (47.5% of AUM) is largely shorter than that of the borrowed funds, while the asset-liability maturity profile remains comfortable.

As of 3QFY24, IIFL Samasta had the cumulative surplus of 16.4% of assets till one year against scheduled debt obligations of INR11.79 billion till March 2024. Furthermore, even on stressed basis, the asset liability profile seems reasonable. As MFI loans are largely shorter tenure than the tenure of borrowed funds, the asset-liability maturity profile remains comfortable.

Rating Sensitivities

The Rating Watch with Negative Implications indicates that the ratings may be either downgraded or affirmed. The agency will continue to monitor the impact of the restriction on gold loan sanctioning/disbursing or assigning/securitising in the medium term. The agency will resolve the Rating Watch with Negative Implications post the removal of the regulatory overhang on IIFL's operations.

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 IIFL Samasta, due to either 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.

About the Company

IIFL Samasta began its microfinance operations in 2008 and was later acquired by IIFL group in 2016. It had a portfolio of INR122.0 billion and 1,485 dedicated MFI branches covering 22 states and 387 districts as of 3QFY24.

KEY FINANCIAL INDICATORS - CONSOLIDATED

Parameters	9MFY24	FY23	FY22
Assets (INR billion)	590	530	459.1
Equity (INR billion)	117	102.0	64.7
Profit after tax (INR billion)	15.4	16.1	11.9
Return on average assets	3.8*	3.25	2.74
Return on managed assets	2.5*	2.78	2.48
Equity/ assets (%)	19.97	19.25	14.09
Source: Ind-Ra, IIFL Finance * Annualised			

KEY FINANCIAL INDICATORS - STANDALONE

Parameters	9MFY24	FY23	FY22
Assets (INR billion)	104.5	89.0	63.9
Equity (INR billion)	18.2	13.2	10.0

Profit after tax (INR billion)	3.8	1.3	0.5
Equity/ assets (%)	17.4	14.85	15.63
Tier 1 capital (%)	18.46	13.49	15.85
Return on average assets	5.21*	1.7	0.9
Return on Managed Assets	4.7*	1.5	0.9
Source: Ind-Ra, IIFL Samasta * Annualised			

Status of Non-Cooperation with previous rating agency

Not applicable

Rating History

Instrument Type	Current Rating /Rating Watch			Historical Rating /Outlook
	Rating Type	Rated Limits (millions)	Rating	16 January 2024
NCDs	Long-Term	INR5,000	IND AA/Rating Watch with Negative Implications	IND AA/Positive

Complexity Level of the Instruments

Instrument Type	Complexity Indicator
NCDs	Low

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

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APPLICABLE CRITERIA

Non-Bank Finance Companies Criteria

Evaluating Corporate Governance

Policy for Placing Ratings on Rating Watch

The Rating Process

Financial Institutions Rating Criteria