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India Ratings Assigns Nabsamruddhi Finance’s Bank Loans ‘IND AA’/Stable

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By Jindal Haria

India Ratings and Research (Ind-Ra) has assigned Nabsamruddhi Finance Limited’s (Nabsamruddhi) bank loans a rating of ‘IND AA’ with a Stable Outlook, as follows:

Instrument Type	Date of Issuance	Coupon Rate	Maturity Date	Size of Issue (million)	Rating/Outlook	Rating Action
Bank loans	-	-	-	INR1,500	IND AA/Stable	Assigned

Analytical Approach: To assign the ratings, Ind-Ra has factored in the expectations of continued availability of support to Nabsamruddhi from its majority shareholder (90.68%) National Bank for Agriculture and Rural Development (NABARD; ‘IND AAA’/Stable) towards capital, liquidity, operations, supervision etc.

KEY RATING DRIVERS

Support from Parent: NABARD maintains an oversight on Nabsamruddhi’s board of directors and has four board seats to which it has deputed senior and experienced officials. The chairman of the board is the deputy managing director of NABARD. In addition, senior NABARD officials have been deputed for the positions of managing director, chief financial officer and chief operating officer. NABARD has been supporting Nabsamruddhi, which is a non-banking finance company (NBFC), through regular capital infusions; in FY20, NABARD infused INR745 million in the NBFC. NABARD has also been providing funding support through funding lines and term loans. As the sole lender, NABARD had provided loans of INR4,544 million to Nabsamruddhi as on 31 March 2020. NABARD has delegated the decision-making powers regarding equity infusions and liquidity support to its NBFC to Nabsamruddhi’s chairman, and hence, funds could be made available at a short notice if needed. NABARD also bears some of the NBFC’s employee costs, and charges nominal rentals if any. The NBFC also benefits from NABARD’s information technology (IT) systems and does not incur material costs on that account.

Nevertheless, Ind-Ra has considered the fact that Nabsamruddhi's role in fulfilling NABARD's stated objectives would be limited in the medium term in view of its relatively small scale and overall contribution to NABARD. While Nabsamruddhi is likely to play a role in NABARD's mission of rural development, the former's presence or absence would not cause any material change in the latter's business and operational profiles. However, NABARD is critical to Nabsamruddhi's survival, at least until it attains a critical size so as to be able to sustain financially even without NABARD's assistance. Furthermore, NABARD might dilute its stake in the subsidiary but will continue to hold the majority stake and the board seats; in such a scenario, the NBFC could evaluate the option of bringing in a strategic investor over the medium term.

Adequate Capitalisation for Scale of Operations: Nabsamruddhi's tier 1 CAR stood at 29.08% at end-FY20 (FY19: 18.72%; FY18: 14.98%) post the capital infusion of INR745 million made over FY20. The management plans to operate at a leverage of around 4x on a steady-state basis (leverage at end-FY20: 2.6x; FY19:4.58x). Ind-Ra would expect the increase in leverage to be gradual and calibrated, given the unseasoned nature of its book and the prevailing macro-economic environment. Considering the scale of operations, the capitalisation is adequate; however, in a stress scenario, Ind-Ra would expect Nabsamruddhi to receive capital support from the parent. The parent has articulated that Nabsamruddhi is strategically important to NABARD and it would continue to support Nabsamruddhi through equity and liquidity injections, if required for stress tolerance, in the medium term.

Liquidity Indicator- Adequate: At end-FY20, the company's asset liability management statement had a cumulative surplus of 27.2% (without considering the unutilised refinance lines) across the short-term maturity buckets. The liability profile is also supported by on-call refinance lines from the parent; in FY20, the NBFC utilised only half of the budgeted refinance lines from the parent. While the nature of lending is wholesale, the exposure is spread across more than 70 entities, and hence, the loan book is relatively granular; this also reduces the concentration risk and its impact on the asset liability management. In the first phase of moratorium, exposures of about INR4 billion, spread across 41 entities, were granted moratorium. This declined to INR0.5 billion, spread across six entities, in the second phase of moratorium. In the immediate short term (June-August), even if the agency considers nil repayments by its borrowers, Nabsamruddhi has over two months of balance sheet liquidity.

Ongoing Diversification of Funding Sources: Nabsamruddhi's entire funding is from NABARD. However, the company plans to diversify its funding portfolio over FY21. Towards this purpose, it intends to begin raising funds from public sector banks at rates that are at least comparable to NABARD's refinance rates. Nabsamruddhi also plans to approach capital markets in the medium term.

Post-COVID-19 Environment Could Stress Asset Quality: Nabsamruddhi has managed to maintain its non-performing assets (NPAs) over FY20, with a gross non-performing assets ratio of 2.94% in FY20 (FY19: 2.66%). Until FY19, most of the gross non-performing assets had been from legacy originations (operations that the NBFC wanted to run down); however, in FY20, INR100 million of exposures to financial institutions slipped to NPAs. Over FY21, Ind-Ra expects small NBFCs and microfinance institutions to face issues with respect to collections, with a ramp-up to over 90% seeming uncertain as the economy opens up post the COVID-19-led lockdown, as well as the continued challenges associated with the raising of debt funding. The pressure on asset quality could increase significantly, if some of these financial institutions commit a default.

Profitability Under Pressure: Compared to some NBFCs that are in the business of funding smaller NBFCs, Nabsamruddhi's yields are lower by 1.5%-2% for similar borrower profiles. The profitability matrices of the company were modest in FY20, with a return on average assets of 2.8% (FY19: 2.8%) and return on average equity of 11.92% (15.93%). The return on average equity declined due to the substantial equity infusion in FY20. The cost-to-income ratio was significantly low at 7.53% for FY20 (FY19: 9.52%), as some of the cost, including staff-related expenditure, is borne by NABARD. Also, there are substantial savings on rental costs and the IT infrastructure, as the company's office is located in NABARD's premises. Over FY21, the pressure on asset quality could result in elevated credit costs for Nabsamruddhi. Furthermore, while the NBFC has written off assets worth almost INR90 million in FY20, its provision cover is still less than 15%; Ind-Ra believes the provision cover also needs to be ramped up over FY21. Hence, credit costs are likely to be the key driver of profitability in FY21 and, in the worse-case scenario, FY22.

Systems and Processes, IT Infrastructure Evolving: As mentioned above, Nabsamruddhi has benefited significantly from NABARD's experience with NBFCs and the comprehensive support provided by the parent in terms of employees and IT infrastructure. However, Nabsamruddhi has begun to independently recruit personnel from the market and has started to build its own strength. Nabsamruddhi has had three-to-four years of experience in lending to NBFCs and has been developing capabilities in understanding products such as pass-through certificates and off-balance sheet products. In the agency's opinion, as the portfolio expands, Nabsamruddhi would also need to adopt a portfolio-based risk approach. In addition, the company is bolstering its technical infrastructure to enable better monitoring, systems-based management of treasury functions, etc.

RATING SENSITIVITIES

Positive: There could be a positive rating action if in the opinion of the agency, the NBFC achieves a critical scale that is sustainable even on a standalone basis with enhanced systems and processes and commensurate IT infrastructure without material dilution of support from NABARD's ecosystem.

Negative: Any weakening in the credit profile of the parent is likely to reflect upon Nabsamruddhi's rating. Any assessment of a decline in NABARD's support expectation could lead to a rating downgrade. This could be in the form of dilution of the majority ownership below 51%, reduced operational oversight or lower importance of Nabsamruddhi to the parent. Lack of timely support from the parent in terms of equity, such that the leverage increases materially above 5x and the equity buffers deteriorate, or a decline in the liquidity support would also be negative for the rating.

COMPANY PROFILE

Nabsamruddhi was incorporated under the Companies Act, 1956, on 17 February 1997 under the name of Agri Business Finance Limited and registered as a non-banking financial company with the Reserve Bank of India. It is promoted with equity participation from NABARD, Andhra Bank, Canara Bank ('IND AAA'/RWN), Government of Andhra Pradesh, Government of Telangana, Andhra Pradesh State Cooperative Bank, Telangana State Cooperative Apex Bank and a few industrial houses / individuals. Nabsamruddhi was initially focussed on providing credit facilities to individuals and legal entities engaged in activities including microfinance, micro small and medium enterprises, housing, education, transport, etc. In FY17, the NBFC changed its strategic direction to financing small NBFCs and microfinance institutions and performing a strategic function for NABARD.

FINANCIAL SUMMARY

Particulars	FY20	FY19	FY18
Total tangible assets (INR million)	6,488	4,930	2,977
Total tangible net worth (INR million)	1,768	904	441
Net income (INR million)	159	107	32
Return on average tangible assets (%)	2.83	2.77	1.52
Tier 1 capital ratio (%)	29.08	18.72	14.98
Source: Nabsamruddhi, Ind-Ra			

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Applicable Criteria

Financial Institutions Rating Criteria

Non-Bank Finance Companies Criteria
Rating FI Subsidiaries and Holding Companies

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