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CARE/KRO/RR/2015-16/1073

Shri Manoj Nambiar
Managing Director
Arohan Financial Services P. Ltd.
PTI Building, 4th Floor, West Wing,
DP Block, DP-9, Sector-V, Salt Lake
Kolkata - 700091

June 30, 2015

Confidential

Dear Sir,

Credit rating of bank facilities/NCDs for Rs.482.69 crore

Please refer to our letter dated Jun 23, 2015 on the captioned subject.

1. As per the discussion, the revised rationale & brief rationale for the captioned rating is enclosed as **Annexure I** & **Annexure II** respectively to this letter.

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

Thanking you,

Yours faithfully,

Punit Singhania
(Punit Singhania)
Dy. Manager

(Utkarsh Nopany)
Manager

Encl: As above

June 30, 2015

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CIN-L67190MH1993PLC071691

Annexure I
Rating Rationale
Arohan Financial Services Pvt Ltd

Ratings

Facilities	Amount (Rs. crore)	Ratings[1]	Remarks
Long-term Bank Facilities	388.64 (enhanced from 230.02)	'CARE BBB+' (Triple B Plus)	Revised from 'CARE BBB' (Triple B)
Total Facilities	**388.64**		
Non-Convertible Debenture (Series I & II)	44.05	'CARE BBB+' (Triple B Plus)	Revised from 'CARE BBB' (Triple B)
Proposed Non-Convertible Debenture	5.95	'CARE BBB+' (Triple B Plus)	Revised from 'CARE BBB' (Triple B)
Proposed Non-Convertible Debenture	44.05	'CARE BBB+' (Triple B Plus)	Assigned
Total Facilities/Instruments	**482.69**		

Rating rationale

The revision in rating is on account of significant increase in scale of operation while maintaining the CAR at satisfactory levels on account of fund infusion of Rs.60.0 crore by a private equity investor in March 2015. The financial performance of the company also improved in FY15 with higher return ratios and comfortable asset quality. The rating continues to draw comfort from experienced promoters, experienced Board of directors with professional management team, adequate risk management system with strong IT infrastructure and diversified funding profile. However, the rating continues to be constrained on account of moderate track record of operation, moderate scale of operation, geographical concentration of portfolio base (mainly in West Bengal), increasing competition, lack of seasoning of loan portfolio and operational risks due to cash transactions. Furthermore, the rating continues to be constrained by inherent risks in the microfinance industry including socio-political intervention risk and regulatory uncertainty. Deterioration in asset quality & CAR and significant regulatory change in the industry are the key rating sensitivities.

Background

Arohan Financial Services Pvt Ltd (Arohan), incorporated in 2006, is registered as an NBFC-MFI based in Kolkata. Arohan is engaged in the microfinance activity and manages

[1] *Complete definitions of the ratings assigned are available at www.careratings.com and in other CARE publications.*

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AUM of Rs.384 crore as on March 31, 2015 (Rs.190 crore as on March 31, 2014) through a network of 104 branches in 38 districts spanning across four states viz. West Bengal (56% of AUM), Bihar (26%), Assam (16%), Jharkhand (2%). Arohan has also started its operation in Odisha in May 2015. It operates on a mix of both JLG group based lending model (64.6% as on Mar 31, 2015) & individual lending model (35.4% as on Mar 31, 2015). The company has total workforce strength of 880 employees as on Mar 31, 2015.

Credit Risk Assessment

Experienced promoters

Arohan is promoted by Intellecash Microfinance Network Company Pvt Ltd [Intellecash; subsidiary of Intellectual Capital Advisory Services Pvt Ltd] and Aavishkaar Goodwell India Microfinance Development Company II Ltd. Mr. Vineet Rai is the founder member of both the companies and has around two decades of experience in early stage investing, small business incubation and microfinance.

Experienced Board of Directors

Arohan's board comprises ten members, having rich experience in the banking and financial sectors. The BoD includes three independent directors viz. Mr. Bhaskar Sen (Ex CMD of United Bank of India); Mr. Rajat Mohan Nag (Ex-Managing Director General of Asian Development Bank) and Mr. Sumanta Banerjee (Ex-MD of CESC Ltd). Furthermore, the Board has 6 sub-committees which include Audit, Risk Management, HR, Nomination & Remuneration, Corporate Social Responsibility & Corporate Governance. All these sub-committees are chaired by independent directors.

Professional management

Arohan's management team is headed by Mr. Manoj Nambiar (Managing Director). He has a work experience of close to two and a half decades in marketing, consumer finance, retail banking and microfinance. Prior to joining Arohan, he had been working as the MD & CEO of IntelleCash. He is also a member of the board of MFIN (Micro Finance Institutions Network).

Shubhankar Sengupta is the CEO of Arohan. He has over 17 years of experience in micro-finance industry. Shubhankar is a founding board member of MFIN and is actively involved in new Credit Bureau Initiatives. Mr. Nambiar and Mr. Sengupta are well-supported by a team of experienced professionals.

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Moderate track record of operation

Arohan commenced micro-finance operations from 2006. The company witnessed a sharp decline in AUM during the AP crisis. However, the scale of operation has significantly increased post taken over by the new management in Sep 2012.

Adequate risk management system with strong IT infrastructure

Arohan has been supporting its operations through IT enabled services to keep pace with its growing scale of operations. It uses a Core Banking Solution software, named Omni developed by Infrasoft Technologies, which provides branches with real-time central server connectivity. The software provides all levels of management access to the central server, thereby improving supervision, control and decision making.

Further, incorporation of features like automated Credit Bureau enquiry has improved operational as well as supervisory capabilities. The company has also outsourced its server hosting to a third-party vendor (Nelco - a TATA group company in Mumbai) to ensure efficient functioning, maintenance and disaster management.

Arohan has set up a separate risk management department in FY14. The head of this department reports directly to the Chairman of the Risk Management Committee.

Diversified funding profile

Arohan has a diversified funding profile as it has raised equity from various institutional investors and debt from various lenders including - private banks, public sector banks, NBFCs, NCD holders and development finance institutions. In FY15, the company has raised fund of Rs.60.0 crore from a new private equity investor, Tano Capital, and debt of Rs.101.5 crore by issuing NCDs to various institutional investors.

Increase in scale of operations, but the scale continues to remain at a moderate level

Arohan's asset under management (AUM) increased from Rs.190.3 crore as on March 31, 2014 to Rs.383.6 crore as on March 31, 2015 mainly due to higher disbursement of own portfolio. However, the scale of operations continues to remain at a moderate level in comparison to other players operating in this industry.

Improvement in financial performance in FY15 with comfortable asset quality

Interest spread improved from 10.79% in FY14 to 11.10% in FY15 on account of access to funds at a slightly lower cost. Operating expense (excluding provision & write-off) / Avg. capital employed fell from 8.55% in FY14 to 5.72% in FY15 mainly due to averaging

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effect on account of sharp increase in loan portfolio in Q4FY15. Provisioning expense (including write-offs) decreased from 1.39% in FY14 to 0.92% in FY15 on account of one-time higher provisioning charges made in FY14 due to change in provisioning requirement from 0.25% to 1% on standard asset. As a result, ROTA improved from 1.83% in FY14 to 2.93% in FY15.

Asset quality continued to remain at comfortable levels, with PAR>30 days having improved from 0.55% as on March 31, 2014 to 0.37% as on March 31, 2015.

Satisfactory CAR

Despite significant increase in AUM, Arohan's CAR slightly declined from 37.1% as on March 31, 2014 to 35.9% as on March 31, 2015 and remained at satisfactory levels on the back of equity infusion of Rs.60 crore in Mar 2015.

Geographic concentration of portfolio

Though Arohan's portfolio continues to remain concentrated in West Bengal area, the company has diversified the portfolio by entering into new states (Jharkhand in June 2014) and increasing its portfolio in Bihar & Assam. As a result, exposure to West Bengal has reduced from 62.2% as a percentage of AUM as on March 31, 2014 to 56.1% as on March 31, 2015. The company has also started its operation in Odisha from May 2015 and plans to enter Uttar Pradesh, Chhattisgarh, Madhya Pradesh, Tripura and Meghalaya in the next few years for further geographic diversification of its portfolio base.

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.

Lack of seasoning of loan portfolio

As on March 31, 2015, 46.3% of asset under management (including managed portfolio) are in first loan-cycle whose repayment track record needs to be observed closely.

Operational risks due to cash transactions

Transactions in micro-financing operations are generally cash in nature as disbursements and collections are made in cash. This exposes companies to high degree

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of operational risks. To mitigate this risk, Arohan operates only one account each for disbursements and collections. Disbursements are made from head office to the banking branch nearest to the MFI branch one day prior to disbursement to the clients, while collections made from the clients are deposited in the bank account on the same day. Further, Arohan has taken insurance cover for all its employees for infidelity, cash-in-transit and cash-in-safe.

Outlook

Post the AP crisis and regulatory intervention by RBI, the microfinance sector has seen growth in loan portfolio on account of improving funding profile, control in operating expenses, improving margins post removal of interest rate cap and moderate leverage levels. Current focus of the microfinance sector is mainly on micro-credit with other products still evolving. Going forward, MFIs are likely to expand their client base and reach out to more underserved areas of the country.

The stabilization of the regulatory regime has led to a renewed interest from both domestic and foreign funds in the sector. In recent past the sector has witnessed strong capital inflows.

Also post upward revision in loan ticket-size, household income and indebtedness by RBI would aid in the growth of the loan portfolio of MFIs as it widens the base of borrowers and significantly increases the addressable market size. Furthermore, resources are not seen as a major constraint given the significant capital infusion in recent times. If MFIs manage to control the asset quality of their portfolio while adhering to new guidelines, the profitability of the sector is expected to improve with the benefits of operating leverage. Credit view will continue to factor in risks associated with unsecured lending, socio-political intervention, geographic concentration and operational risks related to cash based transaction.

Financial Results

(Rs. crore)

Y.E/As on March 31	2013	2014	2015
	(12m, A)	(12m, A)	(12m, A)
Working Results			
Interest income	10.76	27.99	64.88
Securitization income	1.54	2.42	1.75

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Y.E/As on March 31	2013	2014	2015
	(12m, A)	(12m, A)	(12m, A)
Other operating income	2.14	4.31	7.92
Total operating income	14.45	34.73	74.56
Interest expenses	4.18	14.85	35.56
Operating Expenses (Incl. Depreciation)	9.81	13.93	20.84
Provision & write-offs	0.34	1.55	2.40
PAT	0.05	3.06	10.90
Financial Position			
Tangible networth	42.03	67.35	136.73
Total Borrowings	61.30	146.67	365.34
Total Loan Portfolio	68.67	154.62	364.54
Total Assets	106.01	228.82	516.15
Asset Under Management (AUM)	90.43	190.26	383.56
Key Ratios			
Profitability			
Net Interest Margin (NIM)	12.41	11.77	11.30
Return on total assets	0.07	1.83	2.93
Op. Exp. (before prov. & w/off) / Avg. CE (%)	12.50	8.54	5.72
Solvency			
Overall Gearing (times)	1.46	2.18	2.67
Capital Adequacy Ratio (CAR) (%)	51.30	37.10	35.88
Tier I CAR (%)	50.40	37.10	35.88
Interest Coverage	1.17	1.43	1.52
Asset Quality			
Gross NPA to Gross Advances	0.58	0.25	0.27
Net NPA to Net Advances	0.47	0.25	0.00
Net NPA to Tangible Networth	1.02	0.58	0.71

Details of Rated Facilities as at May 31, 2015

Long-Term Facilities

1.A.Term Loan

Sr. No.	Banker / lender	Rated Amount (Rs. crore)	Remarks
1.	Development Credit Bank	11.33	Outstanding
2.	Axis Bank	7.60	Outstanding
3.	Axis Bank	10.00	Sanctioned
4.	HDFC Bank	7.21	Outstanding

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Sr. No.	Banker / lender	Rated Amount (Rs. crore)	Remarks
5.	HDFC Bank	5.00	Sanctioned
6.	IDBI Bank	8.57	Outstanding
7.	IDBI Bank	15.00	Sanctioned
8.	Kotak Mahindra Bank	10.00	Outstanding
9.	Ratnakar Bank	20.43	Outstanding
10.	South Indian Bank	7.50	Outstanding
11.	BNP Paribas	8.75	Outstanding
12.	Bank of Maharashtra	6.86	Outstanding
13.	Standard Chartered	15.75	Outstanding
14.	UCO Bank	3.97	Outstanding
15.	Yes Bank	11.80	Outstanding
16.	Yes Bank	15.00	Sanctioned
17.	Union Bank of India	10.00	Outstanding
18.	SIDBI	5.41	Outstanding
19.	SIDBI	20.00	Sanctioned
20.	Ananya Finance	0.12	Outstanding
21.	Bellwether	5.15	Outstanding
22.	Capital First	14.17	Outstanding
23.	IFMR Capital	9.35	Outstanding
24.	L&T Finance	13.33	Outstanding
25.	OIKO Credit	10.83	Outstanding
26.	MAS Financial	15.83	Outstanding
27.	Reliance Capital	17.68	Outstanding
28.	Bhartiya Mahila Bank	2.00	Sanctioned
29.	Proposed	100.00	-
	Total LT facilities	**388.64**	

Long-Term Instruments

2.A. Outstanding Secured Non-Convertible Debentures

Particulars	Issued	
Instrument	NCD (Series – I)	NCD (Series – II)
Size (Rs. Cr)	15.0	29.05
Interest (%)	15.00, (semi-annual)	14.75, (semi-annual)
Tenure	36 months	53 months
Date of issue	Jul 18, 2014	Jul 2, 2014
Redemption	Bullet repayment at the end of 36 months (i.e.	*

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Particulars	Issued	
	June 2017) with put/call option at the end of 18 months from the date of allotment (i.e. Dec 2015)	

** Condition for redemption is as tabulated below:*

NCD (Series – II)	Condition for Redemption
Option 1	25% on 13th May 2016 & 99.99 % of outstanding principal on 13th Nov 2016 & 0.01% of outstanding principal on maturity
Option 2	25% on 13th May 2017 & 99.99 % of outstanding principal on 13th Nov 2017 & 0.01% of outstanding principal on maturity
Option 3	25% on 13th May 2018 & 100 % of outstanding principal on 13th Nov 2018 i.e maturity date

2.B. Proposed Secured Non-Convertible Debentures

Particulars	Proposed
Instrument	NCD
Size (Rs. Cr)	50.00
Interest (%)	15.00 (semi-annual)
Tenure	48 months
Redemption	Bullet repayment at the end of 48 months with put/call option at the end of 36 months from the date of allotment

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Annexure II

Brief Rationale

CARE revises the rating assigned to the long-term bank facilities/instrument and assigns 'CARE BBB+' rating to Proposed Non-Convertible Debenture issue of Arohan Financial Services Pvt Ltd.

Ratings

Facilities	Amount (Rs. crore)	Ratings[1]	Remarks
Long-term Bank Facilities	388.64 (enhanced from 230.02)	'CARE BBB+' (Triple B Plus)	Revised from 'CARE BBB' (Triple B)
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Total Facilities/Instruments	**482.69**		

Rating rationale

The revision in rating is on account of significant increase in scale of operation while maintaining the CAR at satisfactory levels on account of fund infusion of Rs.60.0 crore by a private equity investor in March 2015. The financial performance of the company also improved in FY15 with higher return ratios and comfortable asset quality. The rating continues to draw comfort from experienced promoters, experienced Board of directors with professional management team, adequate risk management system with strong IT infrastructure and diversified funding profile. However, the rating continues to be constrained on account of moderate track record of operation, moderate scale of operation, geographical concentration of portfolio base (mainly in West Bengal), increasing competition, lack of seasoning of loan portfolio and operational risks due to cash transactions. Furthermore, the rating continues to be constrained by inherent risks in the microfinance industry including socio-political intervention risk and regulatory

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uncertainty. Deterioration in asset quality & CAR and significant regulatory change in the industry are the key rating sensitivities.

Background

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