CARE/CRO/RL/2020-21/1234

Mr. Prabhakaran
Chief Financial Officer
S.M.I.L.E. Microfinance Limited
No.14/25, Chakrapani Street,
West Mambalam,
Chennai, Tamil Nadu 600033

July 28, 2020

Confidential

Dear Sir,

Credit rating for bank facilities

On the basis of recent developments including operational and financial performance of your company for FY20 (audited), our Rating Committee has reviewed the following ratings:

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long term Bank Facilities	250.00 **(Rs. Two Hundred and Fifty crore only)**	**CARE BBB-; Negative (Triple B Minus; Outlook: Negative)**	**Revised from CARE BBB; Negative (Triple B; Outlook: Negative)**

2. Refer **Annexure 1** for details of rated facilities.

3. The rationale for the rating will be communicated to you separately. A write-up (press release) on the above rating is proposed to be issued to the press shortly, a draft of which is enclosed for your perusal as **Annexure 2**. We request you to peruse the annexed document 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

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

inadvertently crept in. Kindly revert as early as possible. In any case, if we do not hear from you by July 30, 2020 we will proceed on the basis that you have no any comments to offer.

4. CARE reserves the right to undertake a surveillance/review of the rating from time to time, based on circumstances warranting such review, subject to at least one such review/surveillance every year.

5. CARE reserves the right to revise/reaffirm/withdraw the rating assigned as also revise the outlook, as a result of periodic review/surveillance, based on any event or information which in the opinion of CARE warrants such an action. In the event of failure on the part of the entity to furnish such information, material or clarifications as may be required by CARE so as to enable it to carry out continuous monitoring of the rating of the bank facilities, CARE shall carry out the review on the basis of best available information throughout the life time of such bank facilities. In such cases the credit rating symbol shall be accompanied by “ISSUER NOT COOPERATING”. CARE shall also be entitled to publicize/disseminate all the afore-mentioned rating actions in any manner considered appropriate by it, without reference to you.

6. CARE ratings do not take into account the sovereign risk, if any, attached to the foreign currency loans, and the ratings are applicable only to the rupee equivalent of these loans.

7. CARE’s ratings do not factor in any rating related trigger clauses as per the terms of the facility/instrument, which may involve acceleration of payments in case of rating downgrades. However, if any such clauses are introduced and if triggered, the ratings may see volatility and sharp downgrades.

8. Users of this rating may kindly refer our website www.careratings.com for latest update on the outstanding rating.

9. CARE ratings are **not** recommendations to sanction, renew, disburse or recall any bank facilities.

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If you need any clarification, you are welcome to approach us in this regard.

Thanking you,

Yours faithfully,

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Encl.: As above

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.
CARE's ratings do not factor in any rating related trigger clauses as per the terms of the facility/instrument, which may involve acceleration of payments in case of rating downgrades. However, if any such clauses are introduced and if triggered, the ratings may see volatility and sharp downgrades.

Annexure 1

Details of Rated Facilities

1.A. Rupee Term Loan

Sr. No.	Lender	Rated Amount (Rs. Crore)	Debt Repayment Terms
1.	CSB Bank Limited	8.88	Repayable in 24 monthly installments ending August 31, 2021
2	MUDRA	20.00	Repayable in 27 Monthly Installments ending June 10, 2022
	Total	**28.88**	

1. B. Fund Based limits

Sr. No.	Name of Bank	Type of facility	Rated Amount (Rs. Crore)
1.	Proposed	LT Fund Based	221.12
	TOTAL		**221.12**

Total long-term facilities (1.A+ 1.B) Rs. 250.00 crore

Annexure 2
Press Release
S.M.I.L.E. Microfinance Limited

Rating

Facilities	**Amount (Rs. crore)**	**Rating**[2]	**Rating Action**
Long-Term Bank Facilities	250.00 **(Rs. Two hundred and fifty crore only)**	**CARE BBB-; Negative (Triple B Minus; Outlook: Negative)**	**Revised from CARE BBB; Negative (Triple B; Outlook: Negative)**
Non-Convertible Debenture -I	38.70 **(Rs. Thirty eight crore seventy lakh only)**	**CARE BBB-; Negative (Triple B Minus; Outlook: Negative)**	**Revised from CARE BBB; Negative (Triple B; Outlook: Negative)**
Non-Convertible Debenture -II	25.80 **(Rs. Twenty five crore eighty lakh only)**	**CARE BBB-; Negative (Triple B Minus; Outlook: Negative)**	**Revised from CARE BBB; Negative (Triple B; Outlook: Negative)**
Non-Convertible Debenture -III	20.00 **(Rs. Twenty crore only)**	**CARE BBB-; Negative (Triple B Minus; Outlook: Negative)**	**Revised from CARE BBB; Negative (Triple B; Outlook: Negative)**
Non-Convertible Debenture (Proposed)	25.00 **(Rs. Twenty five crore only)**	**CARE BBB-; Negative (Triple B Minus; Outlook: Negative)**	**Revised from CARE BBB; Negative (Triple B; Outlook: Negative)**

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The revision in ratings assigned to the debt instruments and bank facilities of S.M.I.L.E. Microfinance Limited (SMFL) factors in the relatively low collection efficiency witnessed by SMFL in the month of June and July 2020 on account high concentration in top two districts namely Madurai & Chennai. Though collection efficiency in many of the states where SMILE has presence witnessed improvement in June and July 2020 and broadly in trend with industry, overall collection efficiency of the company stood relatively low on account of high concentration of its loan portfolio in top two districts. These two districts accounted for 27.27% of AUM as on March 31, 2020 have witnessed relatively low collection efficiency on account of extended period of lockdown.

With moratorium for the borrowers available till August 2020 and continuation of COVID-19 related restrictions in few parts of Tamil Nadu region which accounts for majority of portfolio for SMFL, the collection efficiency of SMFL is expected to remain relatively low. Further, with absence of disbursements in Q1FY21 and July 2020 (till date), AUM is likely to moderate going forward. In view of the same, maintenance of asset quality and improvement in profitability remains to be seen post the moratorium period. The rating also factors in the moderation in profitability during FY20 (refers to the period April 01 to March 31) with increase in operational expenses during the year majorly due to opening of new branches. The liquidity position of the company has improved since June 2020 on account of collections and moratorium provided by the lenders

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

during the period June 2020-August 2020. However, the ability of the company to improve its collection efficiency in the near term, while maintaining adequate liquidity will remain a key monitorable.

The rating, however, continues to derive strength from the established track record of operations, its experienced management team, adequate loan appraisal, MIS & risk management systems and comfortable capitalization levels. The rating continues to be constrained by moderate scale of operations with geographical concentration of its loan portfolio, moderately diversified funding profile and regulatory & political risks inherent in the microfinance industry.

As per the information on public domain, on July 06, 2020 CARE had become aware that the company filed a writ petition and received an Interim Injunction from Hon'ble High Court of Madras vide its order dated June 19, 2020. It is to be noted that same was not disclosed to CARE earlier.

Rating Sensitivities

Positive Factors:

- Improvement in geographical diversification while increasing the scale of operations
- Maintain good asset quality and improve profitability on a sustained basis

Negative Factors:

- Weakening of asset quality parameters
- Weakening of capital adequacy levels
- Continuation of relatively lower collection efficiency for a prolonged period

Outlook: Negative

The negative outlook reflects the relatively low collection efficiency levels and the expectation that the current lockdown due to outbreak of Covid-19 is likely to impact the asset quality of SMFL. Improvement witnessed in collections during June/July 2020 compared to May 2020 has aided the liquidity position of SMFL. However, with availability of moratorium to borrowers till August 2020 and COVID-19 related restrictions still persists in few of the geographies where the company operates, trend in collection remains key monitorable. The company is extending moratorium to its borrowers following Reserve Bank of India's circular, on the Covid-19 regulatory package. SMFL has also applied for moratorium from its lenders and approval for moratorium is pending from few of the lenders. It is expected that the lockdown is likely to impact the borrower segments of SMFL thereby impacting its collection efficiency & liquidity in the near term and asset quality & profitability in the medium term as bringing back the customers to regular repayments remains to be seen. The outlook may be revised to stable in the event that the liquidity position improves further and the asset quality parameters do not deteriorate.

Detailed description of the key rating drivers

Key Rating Strengths

Established track record and experienced management team

SMFL has an established track record of operations spanning over a decade in microfinance business primarily in the state of Tamil Nadu. The company is currently managed by Mr Murali Srinivas, who is the Managing Director & CEO of the company. He has 20 years of experience in Corporate & Development Sector, viz., Microfinance, Insurance, Bottled Water and Business Process Outsourcing. Mr Murali Srinivas is ably supported by an experienced management team in managing the day-to-day operations. The company has 7 directors in the board including Managing Director, 2 directors representing DWM Investments (Cyprus) Limited, 2 independent directors, 1 non-executive director and 1 director representing promoter.

Adequate loan appraisal, collection system & MIS

SMFL operates under the JLG lending model in which the groups undergo three-day training program (Compulsory Group Training-CGT) regarding loan process, product details, group formation and group liability. Field Development Officers (FDOs) complete the loan application process and submit the documentation to the branch manager along with KYC details. After verifying all the details, loan is sanctioned by Divisional Manager for loans upto Rs.30,000. If the loan amount exceeds Rs.30,000, then the loans are sanctioned by the Zonal Manager. Loan verification takes place at the branches where BM will verify the passbook of each member to make sure that the account number and IFSC code they provided are correct. These details are then sent to HO and the loan is disbursed to the client through NEFT. Every borrower is given with the repayment schedule indicating the due dates and the passbook for the loan account. The portfolio is monitored on an on-going basis by post disbursement verification of assets created out of loan amount. The repayment happens on fortnightly basis at the centers during center meetings. The internal audit team visits the branches every quarter. The company uses software BR.Net. Demand and collection reports, pending payment reports, etc., are generated from the software on a daily basis.

Comfortable capitalization levels

The company has maintained comfortable capital adequacy levels over the years. As on March 31, 2020, the company had networth of Rs.139 crore. CAR decreased to 23.64% as on March 31, 2020, as compared with 28.24% as on March 31, 2019 with increase in loan portfolio during FY20.

Moderation in profitability during FY20

Net Interest Margin (NIM) increased from 9.31% in FY19 to 9.86% in FY20 on account of reduction in the cost of borrowings. Opex to average total assets increased from 4.76% during FY19 to 6.80% during FY20. The increase in opex was majorly due to recruitment of new employees and opening of new branches in new and existing states during FY20. Also, the company has paid a one-time Non-Solicitation Payment of Rs. 5.50 crore during FY20. With increase in credit cost and opex, ROTA decreased from 3.55% in FY19 to 1.91% in FY20.

Good Asset Quality; However, impact of lockdown on asset quality remains to be seen

SMFL have maintained healthy asset quality over the years. The company follows 90 days DPD (days past due) as per RBI regulations. Gross NPA and Net NPA stood at 0.22% and Nil as on March 31, 2020 as against 0.26% and Nil as on March 31, 2019. 30+ DPD stood at 0.28% as on March 31, 2020 (excluding the customers who were given moratorium post imposition of lockdown) as against 0.42% as on March 31, 2019. The impact of lockdown on the asset quality remains to be seen post the moratorium period.

Key Rating Weaknesses:

Moderately diversified resource profile

The share of term loans from banks has decreased from 37% as on March 31, 2019 to 29% as on March 31, 2020, whereas share of term loans from financial institutions increased from 28% as on March 31, 2019 to 41% as on March 31, 2020. The share of NCDs decreased from 32% as on March 31, 2019 to 28% as on March 31, 2020. Going forward, SMFL needs to further diversify its funding source and look to borrow at cheaper rates in order to reduce the finance costs.

Moderate scale of operations with geographically concentrated loan portfolio

During FY20, SMFL has witnessed moderate growth in scale of operations. AUM has witnessed growth of 17% from Rs.516 crore in FY19 to Rs.606 crore in FY20. On-book loan portfolio (Ind AS) increased from Rs.506 crore as on March 31, 2019 to Rs.590 crore as on March 31, 2020. As on March 31, 2020, SMFL operates with 137 branches in 43 districts. The company is operating in 6 states and 1 union territory. The company has taken efforts to diversify during FY20 by opening new branches in Chattisgarh, Jharkhand, Karnataka and Madhya Pradesh. However, the portfolio is geographically concentrated with TN constituting 96% of AUM as on March 31, 2020. Although strong presence in a particular region helps the company to understand the dynamics of the particular region, it is exposed to geographical concentration risk. Single state exposure as percentage of tangible networth stood at 4.2x as on March 31, 2020 (PY: 3.9x). Top 3 districts accounted for 1.5x of tangible net worth and 35% of AUM as on March 31, 2020.

Industry outlook and prospects

Post the AP crisis and regulatory intervention by RBI, the microfinance sector has seen strong growth in loan portfolio on account of improving funding profile, control over operating expenses, improving margins and moderate leverage levels. The sector has evolved with the advent of credit bureaus in the sector and subsequent control over asset quality. However, it remains exposed to event based risks and marginal profile of borrowers. The recent outbreak of Covid-19 is likely to impact asset quality and credit costs. The ability to withstand event risks and avoid further deterioration in the asset quality leading to impact in the overall profitability will be the key considerations.

The 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.

Liquidity: Adequate

SMFL has cash and liquid investments of about Rs.38 crore as on July 23, 2020. The company has provided moratorium to all its borrowers till May 31, 2020 and decided to extend moratorium till August 31, 2020 to borrowers selectively. The company has also applied for moratorium from its lenders for the period June to August 2020. Some of the lenders have approved the moratorium, some are still processing the request and some have rejected it. Collections have improved from no collection in April 2020, to Rs.4.97 crore in May 2020 to Rs.27.78 crore in June 2020 and further to Rs.16.21 crore in July 2020 (till July 15, 2020). Scheduled repayment obligations for Aug 2020 and Sep 2020 (excluding PTCs/DAs) stood at Rs. 14.13 crore and Rs.27.73 crore. Considering the same, maintaining reasonable collection efficiency levels will be critical to meet its cash flow requirements in absence of any new funding.

Analytical approach: Standalone

Applicable Criteria:

Criteria on assigning Outlook and Credit watch to Credit Ratings
CARE’s Policy on Default Recognition
Financial Ratios-Financial Sector
CARE's Rating Methodology for Non Banking Finance Companies (NBFCs)

About the Company

S.M.I.L.E. Microfinance Limited (SMFL) is a Chennai-based Non-Deposit taking Non-Banking Finance Company (NBFC-ND) started as a private limited company in 2004 and converted to public limited company in November 2005. The company was reclassified as NBFC-MFI in May 2015. SMFL is engaged in the activity of extending loans to women for income generation purposes both in rural and urban areas. Mr Murali Srinivas is the Managing Director and CEO of the company. As on March 31, 2020, DWM Investments (Cyprus) Limited hold 66.64% stake, the promoters hold 18.57% stake and the remaining is held by Other Individual Shareholders (14.79%). As on March 31, 2020, the company is operating with 137 branches in 43 districts having presence in 6 states and 1 union territory with AUM of Rs.606 crore. During FY20 (IndAS), the company reported PAT of Rs.12.44 crore on a total income of Rs.129 crore as against PAT of Rs.21.45 crore on a total income of Rs.119 crore in FY19 (IndAS).

Brief Financials (Rs. crore)	FY19 (A)	FY20 (A)
Total operating income	119	129
PAT	22	12
Interest coverage (times)	1.47	1.32
Total Assets	623	681
Net NPA (%)	0.00	0.00
ROTA (%)	3.55	1.91

A: Audited

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based-Long Term	-	-	-	June, 2022	250.00	CARE BBB-; Negative
Debentures-Non Convertible Debentures (Proposed)	-	-	-	-	25.00	CARE BBB-; Negative
Debentures-Non Convertible Debentures	INE786V07050	October 05, 2017	12.96	October 05, 2022	38.70	CARE BBB-; Negative
Debentures-Non Convertible Debentures	INE786V07043	September 15, 2017	12.96	September 15, 2022	25.80	CARE BBB-; Negative
Debentures-Non Convertible Debentures	INE786V07068	December 18, 2017	13.00	December 18, 2020	20.00	CARE BBB-; Negative

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Debentures-Non Convertible Debentures	LT	38.70	CARE BBB-; Negative	1)CARE BBB; Negative (13-May-20)	1)CARE BBB; Stable (04-Oct-19)	1)CARE BBB; Stable (21-Aug-18)	1)CARE BBB; Stable (11-Sep-17)
2.	Debentures-Non	LT	25.80	CARE BBB-;	1)CARE BBB;	1)CARE BBB;	1)CARE BBB;	1)CARE BBB;

	Convertible Debentures			Negative	Negative (13-May-20)	Stable (04-Oct-19)	Stable (21-Aug-18)	Stable (11-Sep-17)
3.	Debentures-Non Convertible Debentures	LT	20.00	CARE BBB-; Negative	1)CARE BBB; Negative (13-May-20)	1)CARE BBB; Stable (04-Oct-19)	1)CARE BBB; Stable (21-Aug-18)	1)CARE BBB; Stable (01-Nov-17)
4.	Fund-based-Long Term	LT	250.00	CARE BBB-; Negative	1)CARE BBB; Negative (13-May-20)	1)CARE BBB; Stable (04-Oct-19)	1)CARE BBB; Stable (24-Aug-18)	-
5.	Debentures-Non Convertible Debentures	LT	25.00	CARE BBB-; Negative	1)CARE BBB; Negative (02-Jul-20)	-	-	-

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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