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India Ratings Affirms Mahasemam Trust's Bank Loans at 'IND BBB-'; Outlook Stable

11
JUL 2019

By Janet Thomas

India Ratings and Research (Ind-Ra) has undertaken the following rating actions on Mahasemam Trust's (MT) bank loans:

Instrument Type	Date of Issuance	Coupon Rate	Maturity Date	Size of Issue (million)	Rating/Outlook	Rating Action
Bank loans	-	-	-	INR949.39	IND BBB-/Stable	Affirmed

The ratings continue to be supported by MT's 20 years of experience in the microfinance industry (MFI) and healthy asset quality. The ratings continue to be constrained by MT's trust form which limits loan book growth and profitability, modest capitalisation, low geographical diversification, weak capital buffers led by dependence only on internal accruals, small size in MFI, and the high credit risk inherent in unsecured MFI lending.

KEY RATING DRIVERS

Stable Asset Quality: The loan portfolio performance remained stable in FY19 with Portfolio at Risk (PAR 0) at 0.08% (FY18: 0.15%; FY17: 0.26%). The trust continues to demonstrate its ability to manage asset quality and expects the credit costs to remain low.

Moderate Liquidity: The trust maintained a minimum cumulative asset surplus over liabilities of 16% (as a percentage of total assets) in its less than one year maturity buckets at end-March 2019. Ind-Ra believes the trust's liquidity is adequate for its current scale of operations and that it will maintain the required liquidity supported by its inherent business profile of providing shorter tenure microloans. The trust had sanctioned lines of about INR700 million at end-June 2019.

Funding Source Concentration: MT's funding profile remains moderate with bank term loans constituting 69% of its total funding and thrift deposits comprising the rest at FYE19. Ind-Ra expects some pressure on funding considering the trust has stopped accepting thrift deposits since January 2018 which may mature in the next two-to-three years; banks would then become the sole source of funding for MT. While the trust is exposed to funding risk, the agency also notes that it has been able to renew its majority bank lines on a continual basis. The trust was able to secure INR800 million bank lines in the six months ended March 2019.

The finance cost (including interest on thrift deposits) remained somewhat steady in FY19 at 10.95% (FY18: 11.0%; FY17: 11.6%) mainly due to MT's low-cost deposits with average interest rates of 6%; the average cost of bank funding was 12.4% at FYE19 (FYE18: 12.3%; FYE17: 13.3%). Ind-Ra expects the funding costs to tick upwards in FY20 between 12% and 13% with the increase in the proportion of bank loans and a simultaneous reduction in thrift deposits.

Modest Capitalisation: MT's Tier 1 capital adequacy ratio improved to 18.96% in FY19 (FY18: 15.70%; FY17: 17.0%) led by internal accruals of 18.9% (FY18: 17.2%, FY17: 25.4%). While the trust is not covered under the Reserve Bank of India's regulations and thus it is not required to maintain any regulatory level capital buffers unlike other non-banking financial companies, it still plans to maintain equity capitalisation above 15% in the near-to-medium term. However maintaining adequate capital buffers is a key rating driver and any material decrease in its Tier 1 to advances ratio or equity to advances ratio could result in a negative rating action.

Reasonable Leverage: MT's leverage (debt and thrift deposits/equity) was 5.6x in FY19 (FY18: 7.0x; FY17: 6.3x) and adjusted leverage (debt/equity, excluding thrift deposits) was 3.9x (FY18: 4.9x). MT also expects single digit loan book growth and improved capital levels aided by income profile in FY20 that will enable it to at least maintain its leverage in the near-to-medium term. The increase in leverage levels (absolute as well as adjusted) will remain a key rating monitorable. Given the funding situation and the fact that thrift deposits will gradually decline, Ind-Ra expects the leverage to further increase.

Geographic Concentration and Early Borrower Cycle Risks: MT added one more branch in FY19, increasing the branch count to 48 (FY18: 47; FY17: 46; FY16: 41). The portfolio, however, remains concentrated in Tamil Nadu, exposing it to geographical concentration risk. Also, the trust does not intend to expand the portfolio out of Tamil Nadu in the near term. The trust has tied up arrangement with Kiara Micro Credit Private Limited, a commercial Non-Banking Financial Corporation Micro Finance Institution (NBFC-MFI) where the higher cycle borrowers who may require higher ticket sizes loans may be transferred. This keeps the trust exposed to earlier cycle borrowers to a larger extent than other MFIs of its size. Ind-Ra will continue to monitor its asset performance for deviations.

Elevated Expenditure Ratio - Typical of Non-profit Entities: MT's return on average managed loan assets improved slightly in FY19 to 2.4% (FY18: 2.0%). The trust's social activities include rewarding poor borrowers without a record of default, and improving their standard of living by giving monetary gifts in case of special occasions in borrowers' households. MT plans to keep its social spends such that its return on assets remains in the range of 2.0%-3.0% over the medium term. Although its social activities, combined with its weekly collection model, increase the operating costs, they also result in an increase in borrower engagement and provide greater access to borrower's cash flow.

Growth Constraints: While commercial NBFC-MFIs have the option to adequately leverage their balance sheets and use equity funding to drive growth, capital funding to MT can only be in the form of donation. This exerts pressure on its balance sheet expansion thus restraining its profitability.

RATING SENSITIVITIES

Positive: The ratings could be upgraded if the trust is able to significantly expand and diversify the franchise, scale-up operations while maintaining adequate short-term liquidity, higher capital buffers and lower leverage while maintaining asset quality.

Negative: Deterioration in the trust's profitability and capital impairment arising from a possible increase in non-performing loans (NPLs) that could impact its asset quality, inability to secure funding from financial institutions, increase in funding costs by over 150 basis points from FY19 levels and the inability to at least maintain capital buffers and decrease its leverage could result in a rating downgrade.

COMPANY PROFILE

MT is a Madurai-based trust engaged in microfinance activity. The trust provides personal unsecured loans to its members across six districts (Madurai, Tirunelveli, Kanyakumari, Tuticorin, Virudhunagar and Ramanathpuram) in Tamil Nadu. The trust operates through 48 branches in six districts.

Over 99% of the trust's loan portfolio consists of women self-help group (SHG) loans. SHGs operate on the joint liability group model with the joint guarantee signed by the groups. The trust also provides maternity loans, education loans, marriage loans, and sanitation loans to aid and cover the entire life cycle of SHG members.

FINANCIAL SUMMARY

Particulars	**FY19**	**FY18**
Total assets (INR million)	1,770.3	1,805.0
Total equity (INR million)	265.0	223.4
Net income (INR million)	42.2	32.8
Return on average assets (%)	2.36	2.05
Equity/assets (%)	15.0	12.4
Capital adequacy ratio (%)	18.96	15.70
Source: Company annual report		

RATING HISTORY

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook		
	Rating Type	Rated Limits (million)	Rating	11 July 2018	10 May 2017	19 January 2016
Bank loans	Long-term	INR949.39	IND BBB-/Stable	IND BBB-/Stable	IND BBB-/Stable	IND BBB-/Stable

COMPLEXITY LEVEL OF INSTRUMENTS

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

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Ind-Ra currently maintains coverage of corporate issuers, financial institutions (including banks and insurance companies), finance and leasing companies, managed funds, urban local bodies and project finance companies.

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Applicable Criteria

Financial Institutions Rating Criteria

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