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India Ratings Upgrades Aye Finance and its NCDs to 'IND A-'; Rates New NCDs & Bank Loan

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MAR 2020

By Jinay Gala

India Ratings and Research (Ind-Ra) has upgraded Aye Finance Private Limited's (Aye) Long-Term Issuer Rating to 'IND A-' from 'IND BBB+'. The Outlook is Stable. The instrument-wise rating actions are given below:

Instrument Type	Date of Issuance	Coupon Rate	Maturity Date	Size of Issue (million)	Rating/Outlook	Rating Action
Non-convertible debentures (NCDs)*	-	-	-	INR1,684	IND A-/Stable	Upgraded
NCDs*	-	-	-	INR6,450	IND A-/Stable	Assigned
Long-term bank loans	-	-	-	INR2,100	IND A-/Stable	Assigned
NCDs*	-	-	-	INR600	IND A-/Stable	Assigned

*Details are in Annexure table

The upgrade factors in Aye's increased capital base through the funds raised in March 2019; adequate scale of operations; retail granular loan book; fairly experienced co-founders in the micro-lending segment; moderate leverage; stable asset quality and funding profile along with focus on analytics to drive credit underwriting through a cluster-based lending approach. The ratings also factor in marquee investors providing strategic oversight, driving governance structure along with supporting operational efficiency by providing analytical and technological expertise to scale the business in the medium term.

The ratings, however, are constrained by the company's largely unseasoned loan book, since a major portion of the book has grown only in the last two years, and the inherent risks of unsecured micro lending. While its capital buffers along with technology-driven credit appraisal system should aid in scaling the business, Aye's ability to maintain its asset quality and business competitiveness while expanding the franchise would be a key monitorable.

KEY RATING DRIVERS

Capital Infusion Through Marquee Investors: Aye raised equity to the tune of INR2,300 million in March 2019, taking its franchise size in terms of assets under management (AUM) at INR15,950 million, along with the net worth, to INR5,400 million, as of 3QFY20. Aye is supported by strong private equity players, namely SAIF Partners, LGT, Capital G, Falcon Edge and Accion that provide it with long-term growth capital for the business. The company had, as of December 2019, witnessed four rounds of funding raising of total INR4,800 million. All the aforementioned investors have board representation, driving the business at the strategy level and providing support, as and when required. The board is well represented with three independent directors. Moreover, Aye's founding members have substantial experience in micro lending and it has established stable second line of management to drive business growth.

Widening of Franchise Across Geographies: Aye's asset under management grew at a CAGR of 167% over FY16-9MFY20 to INR15,950 million (FY19: INR10,460 million; FY18: INR4,960 million). The company increased its geographic presence and achieved pan-India presence over 9MFY20 by opening up branches across eastern and western India. Aye has a strong competitive advantage by catering to the underpenetrated customer segment in semi-urban and rural geographies, thereby enabling pricing capabilities. However, Ind-Ra believes borrower leverage on unsecured lending needs to be monitored periodically, as there could be a higher loss given default risk if the borrower's leverage remains uncontained.

Informal Borrowers Remain Key Target Segment: With no direct selling agents, Aye caters to businesses with an annual turnover of INR1 million-10 million. The company's loan book, as of 9MFY20, was segmented across small traders and retailers (39%), manufacturers (26%), livestock rearers (28%), etc. who require funding for working capital management or expansion of their business. The company's target ticket size is INR0.1 million-0.3 million, with an average tenor of around 25 months; the company lends at 26%-28% yields, largely to new-to-credit customers. Even though the book is well diversified across geographies, 70% of the portfolio is unsecured in nature, due to which the company's book remains susceptible to economic challenges. Further, the company's customers are a notch above microfinance customers having adequate vintage in their respective businesses; however, they tend to have improper property or collateral records, thereby making the recovery mechanism challenging. Thus, the focus and thrust on collection and initial assessment of borrower's credit profile remains paramount to control credit risk in the informal segment in medium to long term.

Well-Established System and Process for Scaling-up of Operations: Aye follows a paperless approach, and has a strong portfolio analytical system and monitoring process with the ability to capture the cash flows of micro enterprises in a digitised form. While the initial on-boarding for the disbursement process is completely digitised, the company has been focussing on the adding and building team of ground level staff to drive collections. Aye has segmented customer profiles based on the business clusters, with strong micro level understanding on business margins and assessing the cash flows of the borrower.

Diversified Funding Profile: Aye's funding is well diversified across 26 lenders, with lines from development finance institutions, banks and non-bank financing companies. Development finance institutions' contribution to the borrowing pool stands highest at 59% (INR7,470 million), as on 31 December 2019.

The company's leverage (debt/equity) stood at 1.9x as on 31 December 2019 (31 December 2018:1.8x), post the latest round of equity infusion. However, the agency expects Aye to operate at a steady state leverage of 4x-5x in the medium term-to-long term. In the long run, as the company grows, Ind-Ra expects it to increasingly diversify funding further through banking channels and capital market instruments.

Liquidity Indicator- Adequate: Aye's asset liability tenor is well matched in the short-term less than one-year buckets, since the funding duration is on higher side of around three years, while the assets-side duration stands at two-and-a-half-years (largely working capital funding). Ind-Ra expects Aye to maintain a liquidity policy focusing on stable funding lines or on-balance sheet liquidity, covering three months of immediate debt repayments. As on 3QFY20, Aye had an on-balance sheet liquidity to the tune of INR2,200 million.

Operating Leverage to Drive Profitability with Scale: Aye's profitability has been constrained by the higher operational and manpower cost, which the agency believes will improve with scaling up of operations. Since the company still in expansionary mode, the operating cost accounted for 11.9% of the earning assets, as on 30 September 2018. At end-9MFY20, the return on average assets was 4.4% (FY19: 2.9%; FY18: 0.7%) and return on average equity was 12.1% (FY19: 8.69%; FY18: 2.62%).

Asset Quality Stable, but Needs to be Monitored for Seasoning: Aye has maintained reasonable control over its asset quality, with the gross non-performing assets (NPAs) at 1.8% (FY19: 1.88%, FY18: 1.54%) and the net NPAs at 0.1% (FY19: 0.4%, FY18: 1.0%) in 9MFY20 and one-year lagged non-performing assets at 4%. The company's net NPA-to-equity has remained miniscule since commencement of operations and was 0.1% in 9MFY20 (FY19: 0.39%, FY18: 0.89%). Since a large part of the book has been disbursed in the last one year, softer delinquencies needs to be monitored, with further scaling up of operations and seasoning of the book Ind-Ra opines credit costs could be volatile in the self-employed segment in current operating environment.

RATING SENSITIVITIES

Positive: Expansion of the franchise's size and scale, increased diversification along funding sources across banks, with sustained asset quality metrics and benefit of operating leverage improving profitability buffers along with maintaining capital buffers will be key triggers for rating upgrade.

Negative: Non- availability of external funding or growth capital and a weakening liquidity position; a significant deterioration in the asset quality, and weakened operating performance could lead to a negative rating action. The quantitative triggers on which rating remains monitorable are:

- - gross NPAs moving above 5% on one-year lagged basis or
- - net NPA-to-equity rising above 10% or gross leverage rising above 5x on a sustained basis.

COMPANY PROFILE

Aye is a non-banking finance company that commenced operations in 2014 by Sanjay Sharma and Vikram Jetley, with an objective to tap the underpenetrated segment of micro and small businesses. They have a cluster-based approach, with 173 branches across 18 states of northern and southern India, and cater to about 1,13,000 customers. The company has notable names such as SAIF Partners, Capital G, Falcon Edge, Accion and LGT on their investors list.

FINANCIAL SUMMARY

Particulars	FY19	FY18
Total tangible assets (INR million)	12,432.9	5,099.6
Total tangible equity (INR million)	4,876.8	893.6
Net profit/loss (INR million)	250.8	23.0
Tangible equity/assets (%)	39.2	17.5
Gross non-performing assets (%)	1.88	1.54

Debt-to-equity	1.49	4.53
Tier-1 ratio	44.13	19.5
Source: Aye		

RATING HISTORY

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook	
	Rating Type	Rated Limits (million)	Rating	20 November 2019	25 February 2019
Issuer rating	Long-term	-	IND A-Stable	IND BBB+/Stable	IND BBB+/Stable
NCDs	Long-term	INR8734	IND A-/Stable	IND BBB+/Stable	IND BBB+/Stable
Long-term bank loans	Long-term	INR2,100	IND A-/Stable	-	-

ANNEXURE

ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (million)	Rating/Outlook
INE501X08032	6 March 2019	12.14	6 March 2024	INR200	IND A-/Stable
INE501X07166	8 November 2019	12.50	8 November 2024	INR414	IND A-/Stable
INE501X07174	29 November 2019	12.90	29 November 2022	INR1,070	IND A-/Stable
Limit utilised				**INR1,684**	
Limit unutilised				INR7050	
Total				**INR8734**	

COMPLEXITY LEVEL OF INSTRUMENTS

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

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Applicable Criteria

Financial Institutions Rating Criteria
Non-Bank Finance Companies Criteria

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