

The Case

Lendsmall, a financial services firm registered as an NBFC with RBI, lending to low income households for business and consumption has been in business for over 20 years. The founder, led by his vision to provide informal segments with access to formal financial services, has built a strong team over time and scaled the business of the firm. The management has been able to access equity from time to time to expand operations and enable leveraging to increase asset base, and has enjoyed the confidence of a diversified shareholder base through consistent performance and growth. Lenders to the firm include banks, domestic institutions, foreign institutions and high networth individuals. The firm has issued bonds which have seen subscription by mainstream capital markets investors (e.g. mutual funds, asset managers).

The firm lends to women who use the money to run their respective businesses, meet household expenses, meet extraordinary expenses (education, marriage, medical etc.), improve standards of living and reduce dependence on informal sources of borrowing that are exorbitant and mercilessly penal in the event of default. As part of the arrangement a group of women who have known each other over the years to the extent that they can vouch for each other's integrity and intent to repay, come together to borrow from the firm while guaranteeing each other's loan. This implies that a default in payment by one member of the group would call for other members to make good the shortfall. This lending is unsecured in nature. The firm offers 2 products:

- 12 month loan of INR 15,000 to first time borrowers
- 24 month loan of INR 35,000 to borrowers who have repaid one loan over 12 months exhibiting acceptable behaviour

The loan is offered an up front payout by the firm, to be repaid in equated monthly instalments. The firm's yield profile on loans is shown in exhibit V.

The firm has securitised some of its loan assets to banks and financial institutions to manage capital efficiently, and continues to service those assets while participating in their performance to the extent of 10% of such portfolio.

The firm was well on its way to achieve INR 100,000 Mn of assets under management (AUM) by March 2017 but fell short of its target closing the year at c.INR 71,535 Mn (Exhibit IV). Management attributed this shortfall and higher level of provision to demonetisation of high denomination notes that was announced on 8th November 2016, which, according to the management, 'crippled the cash and informal economy, impacted income levels and left borrowers with no cash to repay loans even if the borrower intended to'.

Exhibit I and II present the financial position and performance of the firm. As on date the firm operates in 15 states across the country (Exhibit IV) providing loans in small denominations for a variety of purposes (Exhibit III). Information about other firms in similar business is presented in Exhibit VI.

A reputed Indian credit rating agency had rated the firm 'BBB' in 2015, upgraded it to 'BBB+' in July 2016 and downgraded it to 'BBB' in February 2017. The latest rating rationale factored experience of promoters, track record of the firm, management's deep understanding of lending to informal segments and access to capital as strengths. It constrained its ratings on deterioration in asset quality, potential impact of demonetisation on capitalisation, high single-state concentration and risks inherent to unsecured microlending industry including political interference in specific regions. It counted Lendsmall's ability to improve collections, stay capitalised and diversify operations geographically among rating sensitivities.

Validating the confidence it enjoys with equity investors the firm was able to raise a round of equity after demonetisation was announced. However the management senses the need for additional equity in FY 2017-18 to absorb potential impact of demonetisation and maintain 15% of risk weighted assets in form of tier I and tier II capital to stay compliant with Reserve Bank of India's (RBI) norms for NBFCs.

Exhibit I – Balance sheet

	INR	INR
	31 March 2017	31 March 2016
Equity & Liabilities		
Shareholders' Funds		
- Share Capital	1,24,28,58,740	62,99,65,360
- Reserves & Surplus	12,00,15,23,714	5,85,01,55,000
Sub total: Shareholders' Funds	13,24,43,82,454	6,48,01,20,360
Non-current liabilities		
- Long term borrowings	40,40,24,14,364	26,66,99,14,786
- Long term provisions	15,51,98,590	5,77,18,752
Sub total: Non-current liabilities	40,55,76,12,954	26,72,76,33,538
Current liabilities		
- Short term borrowing	3,35,11,49,706	2,89,42,02,060
- Trade payable	18,47,88,136	26,15,49,528
- Other current liabilities	36,38,40,01,330	29,24,33,06,414
- Short term provision	1,24,59,84,192	46,17,24,214
Sub total: Current liabilities	41,16,59,23,364	32,86,07,82,216
Total Equity & Liabilities	94,96,79,18,772	66,06,85,36,114
Assets		
Non-current assets		
- Fixed assets	99,87,61,078	42,58,00,916
- Non-current investment	99,68,20,154	11,01,182
- Deferred tax assets (net)	45,37,00,552	17,49,61,970
- Long term loans & advances	16,45,24,15,100	10,83,92,12,848
- Other non-current assets	3,14,85,40,282	3,67,56,85,856
Sub total: Non-current assets	22,05,02,37,166	15,11,67,62,772
Current assets		
- Current investment	40,90,42,226	-
- Trade receivables	2,19,87,144	3,17,01,082
- Cash & bank balance	22,15,86,88,230	14,19,54,99,358
- Short term loans & advances	48,00,07,57,194	35,15,12,07,704
- Other current assets	2,32,72,06,812	1,57,33,65,198
Sub total: Current assets	72,91,76,81,606	50,95,17,73,342
Total Assets	94,96,79,18,772	66,06,85,36,114

Exhibit II – Profit & loss statement

	INR	INR
	31 March 2017	31 March 2016
Income		
- Revenue from operations	15,14,43,44,848	11,04,53,51,722
- Other income	38,89,85,868	12,50,73,412
Total	15,53,33,30,716	11,17,04,25,134
Expenses		
- Finance cost	8,70,26,61,190	5,79,71,59,526
- Employee benefits expenses	3,13,61,84,626	1,76,75,43,842
- Other expenses	2,81,68,91,722	1,78,72,94,354
- Depreciation & amortisation	11,25,66,278	5,76,44,702
Total	14,76,83,03,816	9,40,96,42,424
Net Revenue	76,50,26,900	1,76,07,82,710
Exceptional items	-	-
CSR expense	2,10,00,000	1,02,00,000
Extraordinary items	-	-
Profit Before tax	74,40,26,900	1,75,05,82,710
Tax expense		
- Current tax	53,27,81,380	66,00,75,200
- Deferred tax	27,87,38,582	6,83,02,794
Profit after tax	48,99,84,102	1,15,88,10,304

Exhibit III – AUM by economic activity

<u>Activity</u>	<u>Portfolio mix Mar'16</u>	<u>Portfolio mix Mar'17</u>
Agriculture / allied activities	63%	49%
Service / trade	29%	32%
Production	8%	5%
Other	0%	13%
Micro Enterprise	0%	1%
TOTAL	100%	100%

Exhibit IV – Portfolio quality by state

	#	INR Mn	INR Mn	#	#	INR Mn	INR Mn	INR Mn	INR Mn	INR Mn	INR Mn	INR Mn	INR Mn	INR Mn
State	No of loans	Total Principal Outstanding	Principal without overdue	No of loans in arrears	No of loans written off	Amount written off	Total PAR	0-30	31-60	61-90	91-120	121-180	181-365	>365
Tamil Nadu	10,55,200	13,745.26	13,541.90	18,734	8	0	203	127	32	15	11	13	6	0
Himachal Pradesh	70,080	933.18	875.98	4,776	0	0	57	19	8	8	10	9	3	0
Assam	14,960	187.5	134.74	4,844	0	0	53	21	10	6	6	7	3	0
Rajasthan	80,200	1,153.30	883.78	19,432	0	0	270	95	54	40	41	37	1	0
Bihar	1,73,120	2,794.34	1,727.14	66,656	56	0	1,067	334	196	153	185	190	10	0
Jharkhand	6,098	93.42	65.94	1,556	0	0	27	13	8	4	3	1	0	0
Chhattisgarh	5,218	68.1	65.68	154	4	0	2	2	0	0	0	0	0	0
Orissa	99,944	1,466.06	1,242.98	14,452	0	0	223	79	34	27	46	36	1	0
Kerala	8,12,348	11,347.84	7,687.38	2,97,164	20	0	3,660	1,211	563	419	682	708	73	3
Karnataka	1,14,566	1,933.84	331.46	90,008	0	0	1,602	90	85	113	646	664	4	0
West Bengal	5,99,474	8,022.40	4,673.04	2,46,112	322	0	3,349	1,013	655	574	645	456	7	0
Madhya Pradesh	1,68,342	2,696.60	1,898.36	55,300	258	0	798	249	150	118	133	142	7	0
Maharashtra	17,21,800	24,271.22	11,166.92	9,86,604	7,502	1	13,104	3,170	2,766	2,230	2,296	2,523	117	3
Uttar Pradesh	1,43,856	2,109.06	768.28	91,960	0	0	1,341	238	215	195	261	408	23	1
Punjab	44,010	713.7	708	516	0	0	6	4	1	1	0	0	0	0
Total*	51,09,216	71,535.84	45,771.60	18,98,268	8,170	2	25,764	6,665	4,775	3,902	4,966	5,195	254	8

Key

- * Total - refers to total assets under management (AUM), including portfolio that has been securitised to banks and financial institutions
- PAR: portfolio at risk.
- 0-30: portfolio overdue by less than 30 days

Exhibit V – Portfolio quality by lending yield

		INR Mn	INR Mn		INR Mn	INR Mn	INR Mn	INR Mn	INR Mn	INR Mn	INR Mn	INR Mn
Yield on lending	No of loans	Total Principal Outstanding	Principal without overdues	No of loans in arrears	Total PAR	0-30	31-60	61-90	91-120	121-180	181-365	>365
<15.0%	-	-	-	-	-	-	-	-	-	-	-	-
15 - 18%	-	-	-	-	-	-	-	-	-	-	-	-
18.01 - 21%	12	0.72	-	12	0.72	-	0.14	0.28	-	0.10	0.20	-
21.01-24%	13,46,362	23,681.10	21,047.02	2,04,742	2,634.06	807.28	579.58	449.72	409.28	382.56	5.64	-
24.01-27%	37,62,842	47,854.02	24,724.58	16,93,514	23,129.44	5,857.76	4,194.92	3,451.80	4,556.86	4,812.00	248.36	7.72
27.01-30%	-	-	-	-	-	-	-	-	-	-	-	-
30.01-33%	-	-	-	-	-	-	-	-	-	-	-	-
33.01-36%	-	-	-	-	-	-	-	-	-	-	-	-
36.01-39%	-	-	-	-	-	-	-	-	-	-	-	-
> 39%	-	-	-	-	-	-	-	-	-	-	-	-
Total	51,09,216	71,535.84	45,771.60	18,98,268	25,764.24	6,665.04	4,774.64	3,901.82	4,966.14	5,194.68	254.20	7.72

Exhibit VI – Excerpt from report of the industry association

Highlights:

- As of 31st March 2017, NBFC-MFIs provided microcredit t around 5.50 Crore clients, an increase of 30% over 31st March 2016.
- The aggregate gross loan portfolio (glp) of MFIs stood at Rs 93,694 Cr. This represents a yoy growth of 25% over FY 15-16 and 5% over the last quarter.
- Loan amount disbursed in FY 16-17 increased by 13% compared to FY 15-16 reaching to Rs 100,532 Cr.
- Total number of loans disbursed by NBFC-MFIs increased by 13% in FY 16-17 compared with FY 15-16 reaching to 5.66 Cr.
- Portfolio at Risk (PAR) 30 has increased considerably from 0.4% in FY 15-16 to 14.1% in FY 16- 17. This is directly attributed to the impact of demonetization.
- Average loan amount disbursed per account is reduced to Rs 17,779 in FY 16-17 from Rs 17,812 in FY 15-16.
- MFIs now cover 32 states/union territories.
- In terms of regional distribution of portfolio (GLP), south accounts for 31% of the total industry portfolio, north for 27%, west for 24%, and east for 18%. Top five top states, viz. Karnataka, Tamil Nadu, Uttar Pradesh, Maharashtra and Madhya Pradesh account for 56% of glp.

Performance of microfinance industry in FY 17 and FY 16:

<u>Parameter</u>	<u>31-Mar-17</u>	<u>31-Mar-16</u>
Branches	18,024	13,734
Employees	1,72,880	1,16,076
Clients (Crore)	5.50	4.24
Loan accounts (Crore)	6.14	4.96
Gross Loan Portfolio (INR Crore)	93,694	74,938
Loans disbursed (Crore)	5.66	4.98
Loan amount disbursed (INR Crore)	1,00,532	88,648

Questions

We would like you to present on the following to the team for 20 mins, which would be followed by 20 mins of Q&A:

1. For this section please **ONLY** use information provided in the case and exhibits.

Please present your analysis of the following:

- Viability of the business of this firm
- Capital structure
- Performance relative to FY 17

2. For this section please **ONLY** use information provided in the case and exhibits.

Please present your analysis of the following:

- Strengths, weaknesses, opportunities and threats (SWOT) analysis of the business of the company
 - Please list additional aspects of the firm that you would like to know about to refine your SWOT analysis
- Key risks you perceive in the business model

3. For this section please feel free to substantiate your views with research outside what is presented in the case.

Please present your analysis of the following:

- Performance of the firm's portfolio in various regions of the country
- List, with rationale, 5 firms that you would benchmark this firm's performance to
- Value the equity of the firm

4. Lendsmall has approached Vivriti Capital for a loan of INR 1000 Mn. Please advise the credit team of Vivriti Capital on whether to lend or not lend to Lendsmall with rationale.

Guidelines

We are evaluating your:

- Ability to assess a business, analyse financial statements and draw insights
- Ability to think strategically, and your eye for detail
- Ability to comprehend data, research publicly available information (for section 3) and draw inferences
- Presentation skills
- Ability to articulate your findings and stance clearly

We are **NOT** evaluating your ability to create a fancy presentation. Please add as much detail as you need to articulate your analysis and substantiate your argument but keep it functional