24th February 2023

BSE Limited
Phiroze Jeejeebhoy Towers,
Dalal Street, Mumbai- 400001

Scrip code: 511742

National Stock Exchange of India Limited
Exchange Plaza, 5th Floor, Plot No. C/1,
G Block, Bandra - Kurla Complex,
Bandra (E), Mumbai - 400 051

Symbol: UGROCAP

Sub: Credit Rating - Intimation under Regulation 30 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

Pursuant to Regulation 30 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, we wish to inform that the India Ratings & Research has assigned rating of IND A/Stable in respect of the Company's bank loans.

Instrument	Amount (Rs. In million)	Rating
Bank Loans	Rs. 5000	IND A/Stable

The rating letter received from India Ratings & Research is enclosed herewith.

This is for your information and record.

Thanking you,
For UGRO Capital Limited

NAMRATA SAJNANI Digitally signed by NAMRATA SAJNANI Date: 2023.02.24 19:40:44 +05'30'

Namrata Sajnani
Company Secretary and Compliance Officer

Encl: a/a

India Ratings Assigns UGRO Capital's Bank Loans 'IND A'/Stable

Feb 24, 2023 | Non Banking Financial Company (NBFC)

India Ratings and Research (Ind-Ra) has rated UGRO Capital Limited's (UGRO) bank loans as follows:

Instrument Type	Date of Issuance	ISIN	Coupon Rate (%)	Maturity Date	Size of Issue (million)	Rating/Outlook	Rating Action
Bank loans	-	-	-	-	INR5,000	IND A/Stable	Assigned

The rating reflects UGRO's wide product offering for the micro, small and medium enterprises (MSMEs), along with its geographic and end-segment diversification. Furthermore, UGRO's adequate capital base with modest leverage and a plan to further augment capital to support the growing franchise, along with the presence of marquee investors while maintaining adequate liquidity have also been factored in to the ratings. The ratings also consider UGRO's moderate-but-expanding scale and profitability, which is likely improve in FY24-FY25 as the operational leverage plays out and the seasoning of the book increases with a growing vintage of operations. While seasoning is low, 50% of the current assets under management (AUM) has been generated over the last 12 months, when the effect of the pandemic was waning.

Key Rating Drivers

Focused on Funding for MSMEs; Geographical and Sectoral Diversification: UGRO is a specialised non-banking financial company (NBFC) focused on providing funding across the MSME segment – secured against property as collateral, funding for purchase of machinery, supply chain financing and unsecured business loans. The average ticket size of products varies from INR0.6 million to INR11.5 million with the upper cap being INR50 million for secured products and INR2.5 million for unsecured products. Since coming into existence into 2019, the entity has built an AUM of INR50.9 billion even as a large part of this period was impacted by the pandemic. Furthermore, the entity operates out of 98 branches (23 prime and rest for micro enterprises) which are largely present across nine states while the customers are spread across twenty-four states with no single state accounting for more than 16% of the AUM. Furthermore, the AUM is also diversified across nine key sectors with the largest end-segment constituting 22.4% of AUM. The agency opines the product, geography and end-segment diversification bode well for UGRO given the volatility that the customer segment is known to face through economic cycles.

Enablers in Place to Drive Franchise Expansion: UGRO has invested in technology infrastructure, data analytics, human resources and systems and processes to expand its franchisee over the near-to-medium term. It follows a blend of physical and digital framework for sourcing, underwriting, disbursements and collections. UGRO uses a high-touch model where the sourcing is done through branch network, direct sales agents, anchors for dealer financing, original equipment manufacturers, co-origination partners and a soon-to-be-introduced completely digital channel. The company has developed a platform for lending and monitoring, which has a fully automated workflow and requires limited manual intervention. On the underwriting side, the company uses a data science-based credit decisioning model which underwrites loan proposals using bureau data, banking data and Goods and Services Tax data. Collections continue to be physical while integration with various payment gateways is available so as to keep cash handling at negligible levels.

Targeting Strong Off-balance Growth; Efficacy of Co-Lending Yet to be Established: UGRO is targeting strong growth in the capital-light off-balance sheet product by increasing its lending under the co-lending and direct assignment along with co-origination segments. These segments together have grown rapidly from 4% of the total AUMs in FY22 to 35% of AUMs in 3QFY23, even as the AUMs grew 2.6x to INR50.9 billion during the quarter. While being less strenuous on the capital buffers, this growth is providing a steady source of income for UGRO. Ind-Ra believes that banks, in particular public sector banks, have become more amenable to take on assets on their balance sheet under the co-lending route as it helps them build a granular book while operational contours are left to the partner to manage. Furthermore, banks also get to lend directly to small-ticket customers rather than lending directly to non-banking financial companies. The effectiveness of the model is yet to be established given low seasoning and credit costs, which need to stabilise over a larger scale. These remain key monitorable and success factors that will determine whether UGRO will be able to further scale up the share of this segment to 50%, even as the AUMs continue their sharp growth trajectory.

Adequate Capital Buffers: UGRO has adequate capital buffers with Tier I capital of 21.18% and a capital adequacy ratio of 21.54% at end-3QFY23 (FYE22: 33.61, 34.37%; FYE21: 65.15%, 65.55%). The leverage (debt/equity) was at modest levels of 2.98x at end-3QFY23 (FYE22: 1.86x, FYE21: 0.82x) but has been rapidly increasing given the sharp build up in the scale in 9MFY23. The company is planning to raise about INR4 billion, which will increase its capital base to around INR14.0 billion over next six months by raising funds from new investors to support its aggressive growth plans. With the expected capital raise, the leverage will reduce in FY24 and build gradually thereafter to 4.5x over the medium term as the operations continue to scale up. The agency believes given the borrower dynamics in the segment, along with the high credit costs that the segment has been associated with, leverage, on a sustained basis, will be contained within 4.0x while keeping the proportion of lending to unsecured segment capped at 30% of the overall AUMs.

Diversified Funding Mix and Lender Base: UGRO has mobilised funds from 67 financiers, including some of the largest public sector and private sector banks. Term loans from banks, small finance banks and NBFCs stood at 33.4%, 7.3% and 16.9%, respectively, of the borrowings at end-3QFY23 with working capital loans constituting another 3.5%. Non-convertible debentures and market linked debentures constituted 19.7% and 9.7%, respectively, with commercial paper constituting 5.4% and external commercial borrowings 4.2%. Given the scale at which UGRO operates, the number of lending relations is adequate and the liability mix is diversified. UGRO's focus on co-lending with 10 partners also acts as an additional source of fund raising. The agency believes with the planned equity infusion and growth in AUM, UGRO will see a consolidation in its funding mix and an increase in its market presence over the near-to-medium term.

Liquidity Indicator - Adequate: At end-2QFY23, UGRO had a total liquidity of around INR6.3 billion combining unencumbered cash, liquid investments and unutilised bank lines, which cover its debt obligations for five months, without considering any inflows from collections. Furthermore, in the up to one-year bucket, UGRO maintained a surplus on a cumulative basis during 2QFY23. On a steady state basis, UGRO aims to keep at least two months of debt payments and operating expenses along with one month of disbursements as on-balance sheet liquidity. UGRO had about INR50.9 billion of AUM, of which, assets worth INR33.1 billion were on-balance sheet assets. The company has co-lending partners to fund borrowers for its offerings. UGRO expects the institutional co-lending model to generate significant opportunities for off-balance sheet assets with regards to liquidity and funding requirements on an ongoing basis.

Moderate Profitability; Likely to Improve as Operational Leverage Picks up: UGRO has been profitable since its first year of operations although the profitability during FY20-FY21 was aided by tax write-backs. However, the entity was reporting a positive profit before tax even though it was modest with high operating costs. The cost to income ratio came in at 63.9% in 3QFY23 (FY22: 71.8%, FY21: 70.8%). Even the operating cost-to-average-asset ratio was at 5.2%-5.5% over FY21-FY22, thus putting pressure on the profitability. The entity has made investments in its technology platform and the ground-level infrastructure which gives it the ability to scale up its disbursements by another 40% over the next couple of years with the same infrastructure. This, if achieved, will give the company a big fillip in terms of its return on asset which stood at 1.4% in 3QFY23 (FY22: 0.6%, FY21: 1.9%). That said, Ind-Ra opines UGRO will only be fully able to capitalise on its analytics-based credit model if it can keep its credit costs in check across multiple cycles and product lines.

Modest-but-growing Franchise; Limited Track Record; Asset Quality Seasoning needs to be Established: UGRO began operations in 2019 and has built an AUM of INR50.9 billion since then. While UGRO's portfolio has been growing strongly, the franchise size remains at a medium level. The seasoning in the portfolio is low as nearly 50% of the AUM has been generated in the last 12 months which however gives comfort that most of the recent generation has been done at a time when the effect of Covid was waning.

The gross stage 3 (GS3) for UGRO stood at 1.7% in 3QFY23 (FY22: 2.3%; FY21: 2.3%) with credit costs of less than 2.00% (on on-book AUM) during the same period. UGRO had also made sales of INR0.44 billion to asset reconstruction companies in FY22 (1.8% of FY22 on-book AUM). The GS3 provisions coverage stood at 38% on on-book AUM in 3QFY23 with total provisions at 1.5% on the AUM. In terms of the restructured portfolio also, the book remains small with an outstanding restructured book of INR0.8 billion (1.5% of the AUM) at 3QFY23 of which most is secured. However, given the limited seasoning of its business verticals, Ind-Ra believes control over softer bucket migration needs to be actively monitored with the rising scale and will thus be a key monitorable for the agency.

Rating Sensitivities

Positive: A profitable and a significant expansion of the franchisee while maintaining asset quality, geographical diversification and adequate liquidity could lead to a positive rating action.

Negative: Funding challenges, dilution in the liquidity profile, delays in the planned raising of equity capital beyond 2QFY24, deterioration in the asset quality eroding operating buffers and the leverage increasing above 4.0x on a sustained basis, will result in a negative rating action.

Company Profile

UGRO (erstwhile Chokhani Securities Limited) was acquired in 2018 by Shachindra Nath (Vice Chairman and Managing Director). UGRO focusses on lending to MSMEs by offering them multiple products with varying tenors and ticket sizes. The company operates through 98 branches (23 prime and 75 micro) across a wide geographic spread. The AUM of the entity (own and managed) stood at INR50.9 billion at end-3QFY23 with the off-book volumes constituting 35% of the overall AUM (split almost evenly between co-lending & direct assignment and co-origination. UGRO is a publicly listed entity on both the National Stock Exchange of India Limited and BSE.

FINANCIAL SUMMARY

Particulars	**9MFY23**	**FY22**	**FY21**
Total assets (INR billion)	50.9	28.5	17.5
Total equity (INR billion)	9.7	9.7	9.5
Net profit (INR billion)	0.26	0.15	0.29
Return on average assets (%)	0.5	0.6	1.9
Equity/assets (%)	19.0	33.9	54.3
Capital adequacy ratio (%)	21.54	34.37	65.55
Gross Stage 3 (%)	1.7	2.3	2.3
Source: Ind-Ra, UGRO			

Solicitation Disclosures

Additional information is available at www.indiaratings.co.in. The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings has been compensated for the provision of the ratings.

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Bank wise Facilities Details

Click here to see the details

Complexity Level of Instruments

Instrument Type	Complexity Indicator
Bank loans	Low

For details on the complexity level 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

The Rating Process

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