February 28, 2022

Indostar Capital Finance Limited: Provisional [ICRA]AAA(SO) assigned to PTCs backed by a pool of SME loan receivables issued by Sun SME Trust Feb 2022

Summary of rating action

Trust	Instruments*	Rated Amount (Rs. crore)	Rating Action
Sun SME Trust Feb 2022	PTC Series A	177.05	Provisional [ICRA]AAA(SO); Assigned

**Instrument details are provided in Annexure-1*

Rating in the absence of the pending actions/documents	No rating would have been assigned as it would not be meaningful

Rationale

ICRA has assigned a provisional rating to pass-through certificates (PTC) Series A issued by Sun SME Trust Feb 2022. The PTCs are backed loan receivables from a Rs. 186.37 crore pool (principal amount; receivables of Rs. 376.28 crore) of SME loan receivables originated by Indostar Capital Finance Limited (ICFL) (rated [ICRA]A1+).

The provisional rating is based on the strength of the cash flows from the selected pool of contracts, ICFL's track record as well as the credit enhancement (CE) available in the form of (i) a cash collateral (CC) of 11.00% of the pool principal to be provided by ICFL and (ii) the entire excess interest spread (EIS) in the structure. The rating is also based on the integrity of the legal structure. The rating is subject to the fulfilment of all the conditions under the structure and the review of the documentation pertaining to the transaction by ICRA.

Key rating drivers

Credit strengths

- Availability of credit enhancement in the form of EIS and cash collateral
- Absence of overdue contracts as on pool cut-off date; ~89% of the contracts in the pool have never been delinquent
- Average seasoning at ~15.5 months
- Low share (~6%) of contracts which have high IRR of greater than 13%

Credit challenges

- High geographical concentration (~74%) of the contracts in the pool from top 3 states
- While the PTC Yield is fixed while interest rate on the underlying loans is linked to ICFL's lending rate—which leads to an interest rate risk in the structure
- Pool's performance will remain exposed to any disruptions that may arise due to the Covid-19 pandemic

Description of key rating drivers highlighted above

According to the transaction structure, the loan pool receivables will be assigned at par to the PTC investors. The promised cash flow schedule for PTC Series A on a monthly basis will comprise the interest (at the predetermined yield) on the outstanding PTC principal and the principal to the extent of 100% of the billed pool principal on each payout date. The excess available after meeting the promised and expected payouts to the PTCs will be passed on to the originator every month. The pool amortisation schedule and the promised payouts to the PTC investors are subject to modification on account of prepayments.

The first line of support for PTC Series A in the transaction is in the form of an EIS of 43.5% of the pool principal. The residual EIS (after meeting the scheduled PTC payout and top-up of CC, if any, in any month) would leak out to the originator. Further support is available through the CC stipulated at 11.00% of the initial pool principal. The CC would be in the form of a fixed deposit maintained with a Designated Bank acceptable to ICRA. ICRA notes that a principal subordination of 5% is also available (PTC Series A principal is 95% of the pool principal). However, since 100% of the billed pool principal is promised every month to the PTC investor, the maturity date of the PTCs is co-terminus with 95% of the pool principal billing.

All the contracts in the pool are secured by immovable property with 95.0% of the pool secured by residential property. There are no overdues in the pool as on the cut-off date. While 88.6% of the contracts in the pool have never been delinquent in the past, the rest have never been delinquent for more than a month. The weighted average seasoning of the pool is moderate at 15.5 months as on the pool cut-off date (January 31, 2022). Further, the pool has a high share of loan contracts (75.8%) with a CIBIL score of more than 700. It has high geographical concentration with the top state (Maharashtra) contributing 35.8% to the initial pool principal amount. The PTC yield is fixed while the interest rate on the underlying loans is linked to ICFL's lending rate, which leads to interest rate risk in the structure. Also, the performance of the pool would remain exposed to disruptions caused by the pandemic.

Performance of past rated pools: This is the first SME pool of ICFL to be rated by ICRA.

Key rating assumptions

ICRA’s cash flow modelling for rating mortgage-backed securitisation (MBS) transactions involves the simulation of potential delinquencies, losses (shortfall in principal collection during the tenor of the pool) and prepayments in the pool. The assumptions for the loss and coefficient of variation (CoV) are arrived at after taking into account the past performance of the originator’s portfolio and the rated pools as well as the characteristics of the specific pool being evaluated. Additionally, the assumptions may be adjusted to factor in the current operating environment and any industry-specific factors that ICRA believes could impact the performance of the underlying pool of contracts.

After making these adjustments, the expected mean shortfall in principal collection during the tenure of the pool is estimated at 4.0-5.0%, with certain variability around it. The prepayment rate for the underlying pool is estimated in the range of 16.0-20.0% per annum.

Liquidity position: Superior

The liquidity of the rated transaction is expected to be superior, supported by the healthy collections expected from the pool of contracts and the presence of a CC amounting to 11% of the pool principal amount. Even assuming a monthly collection efficiency of only 50% in the underlying pool of contracts in a stress scenario, the CC would cover the shortfalls in the PTC payouts for 39 months.

Rating sensitivities

Positive factors – Not applicable

Negative factors - Sustained weak collection performance of the underlying pool of contracts (Monthly collection efficiency <90%) leading to higher than expected delinquency levels and CE utilization levels

Analytical approach

The rating action is based on the analysis of the performance of ICFL's portfolio till December 2021, the key characteristics and composition of the current pool, the performance expected over the balance tenure of the pool, and the CE cover available in the transaction.

Analytical Approach	
Applicable Rating Methodologies	Rating Methodology for Securitisation Transactions
Parent/Group Support	Not Applicable
Consolidation/Standalone	Not Applicable

Pending actions/documents required to be completed for conversion of the provisional rating into final

The assigned rating is provisional and would be converted into final upon the execution of:

1. Trust deed
2. Assignment agreement
3. Legal opinion
4. Trustee letter
5. Auditor's certificate
6. Any other documents executed for the transaction

Validity of the provisional rating

The Trust is expected to complete the pending actions/execute the pending documents in the near term. However, in case of continued pendency of the actions/documents beyond one year of this publication, the provisional rating would be withdrawn for the transaction even if the instrument has been issued.

Risks associated with the provisional rating

In case the issuance is completed, but the pending actions/documents are not completed for the transaction within one year (validity period) from the assignment of the rating, the provisional rating will be withdrawn in accordance with ICRA's Policy on Provisional Ratings available at www.icra.in.

About the company

Indostar Capital Finance Limited (ICFL) was originally incorporated as R V Vyapaar Private Ltd. in July 2009. Its name was changed to IndoStar Capital Finance Private Limited in November 2010 and to Indostar Capital Finance Limited in April 2014. ICFL is registered with the Reserve Bank of India (RBI) as a systemically important non-deposit accepting non-banking financial company. It is sponsored by a group of financial institutions including Everstone Capital, Goldman Sachs Group, Baer Capital Partners and ACPI Investment Managers.

As of December 31, 2021, Brookfield held a 56% stake in ICFL, followed by Indostar Capital Mauritius at 33% (including ECP II & ECP III). The Brookfield Group invested Rs. 1,225 crore in ICFL (through BCP V Multiple Holdings Pte Ltd) in May 2020 to become the largest shareholder and co-promoter of the company. ICFL was originally established by a group of financial institutions including Everstone Capital, Goldman Sachs, Baer Capital Partners, CDIB Capital and ACPI Investment Managers through Indostar Capital Mauritius with an initial capital of about Rs. 900 crore. The company got listed on stock exchanges in May 2018 and received a fresh equity infusion of Rs. 700 crore.

On a consolidated basis, ICFL reported a net loss of Rs. 214 crore in FY2021 on assets under management (AUM) of about Rs. 8,990 crore compared to a net loss of Rs. 325 crore on AUM of Rs. 9,690 crore in FY2020. In 9M FY2022, the company reported a profit after tax (PAT) of Rs. 17 crore against a PAT of Rs. 103 crore in 9M FY2021.

Key financial indicators

ICFL	FY2020 (audited)	FY2021 (audited)	9M FY2022 (provisional)
Total revenues (net)	738	581	436
Profit after tax	(325)	(214)	17
Assets under management (AUM)	9,690	8,990	9,236
Gross stage 3 (%)	4.8%	4.4%	4.3%
Net stage 3 (%)	3.8%	2.1%	2.3%

Source: *Company, ICRA Research; Amount in Rs. crore*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Trust	Current Rating (FY2022)				Chronology of Rating History for the Past 3 Years		
		Instruments	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					February 28, 2022	-	-	-
1	Sun SME Trust Feb 2022	PTC Series A	177.05	177.05	**Provisional [ICRA]AAA(SO)**	-	-	-

Complexity level of the rated instrument

Instrument	Complexity Indicator
PTC Series A	Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: www.icra.in

Annexure-1: Instrument details

Trust	Instruments	Date of Issuance / Sanction	Coupon Rate (p.a.p.m.)*	Maturity Date	Amount Rated (Rs. crore)	Current Rating
Sun SME Trust Feb 2022	PTC Series A	February 2022	7.78% p.a.p.m.	October 2035#	177.05	Provisional [ICRA]AAA(SO)

Source: *Company; *Per annum payable monthly*

 # Since 100% of the billed pool principal is promised every month to the PTC investors, the actual maturity date of the PTCs is co-terminus with 95% of the pool billing, i.e. October 2035

Annexure-2: List of entities considered for consolidated analysis

Not Applicable

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

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