March 17, 2023 (Revised)

# STCI Finance Limited: Ratings reaffirmed; outlook revised to Stable

## Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| **Long-term bank lines** | 1,700.00 | 1,700.00 | [ICRA]AA-; reaffirmed and outlook revised to Stable from Negative |
| **Non-convertible debentures programme** | 350.00 | 350.00 | [ICRA]AA-; reaffirmed and outlook revised to Stable from Negative |
| **Commercial paper programme** | 300.00 | 300.00 | [ICRA]A1+; reaffirmed |
| **Total** | **2,350.00** | **2,350.00** | |

**Instrument details are provided in Annexure I*

## Rationale

The revision in the outlook on STCI Finance Limited's (STCI Finance) long-term rating to Stable factors in the improved asset quality and outlook on the profitability. The outlook had been revised to Negative in December 2019, given the deterioration in the company's asset quality and the consequent increase in the credit costs, which impacted the profitability. The loan book of the company was declining, further constricting the profitability. The company subsequently made significant provisions for its stressed assets and the net stage 3 (NS3) stands at 1.5% of net advances as on December 31, 2022 while NS3/adjusted net worth[1] remained comfortable at 2.2%.

With credit costs expected to remain moderate, the improvement in the profitability witnessed in FY2022 and 9M FY2023 is likely to sustain. The company's core return on average assets (core RoAA[2]) improved to 7.3% and 6.4%, respectively, in FY2022 and 9M FY2023 compared to the negative core return in FY2020 and FY2021. The loan book growth has improved with assets under management (AUM) of Rs. 1,985 crore as on December 31, 2022 (YoY growth of ~36%) with the growth expected to sustain in the medium term, given the improved credit growth environment.

The ratings factor in the support from the company's largest shareholder, i.e. Bank of India [BoI; rated AA+ (Stable)], holding a 29.96% stake, and the presence of two nominee directors on its board. The ratings are also supported by the comfortable capitalisation with a net worth of Rs. 1,797 crore (adjusted net worth of Rs. 1,251 crore) as on December 31, 2022 (adjusted gearing of 0.53 times). ICRA expects the existing capitalisation coupled with internal capital generation to be comfortable to meet the growth plans in the medium term.

The ratings are, however, constrained by the company's concentrated loan portfolio, comprising wholesale products. Loan against share (LAS) accounted for 52% of the portfolio, followed by real estate (22%), corporate loans (21%) and lending to non-banking financial companies (NBFCs; 6%). As LAS is a capital market exposure, its high share in the overall loan book constrains the financial flexibility to avail bank funding against such exposures. The top 10 exposures accounted for 74% of the total loan book and ~80% of the total adjusted net worth as on September 30, 2022. The ratings take note of the vulnerability of the asset quality to the inherent volatility in the capital markets and its exposure to the relatively riskier real estate financing.

The Stable outlook on the long-term rating is driven by the expectation of support from BoI, if required, and that the company will maintain stable asset quality and steady profitability while improving its AUM.

*[1] Adjusted net worth excludes investment in STCI Primary Dealer Limited (STCI PD) and The Clearing Corporation of India Limited (CCIL)*
*[2] Core RoAA is the profitability excluding dividend income from the investee companies*

## Key rating drivers and their description

### Credit strengths

**Support from largest shareholder** – The ratings consider the support from BoI, which is the largest shareholder in the company. Apart from BOI, Other public sector banks hold 39.74%, public insurance companies hold 8.32% while the balance is held by other banks and financial institutions. BoI has board oversight on the operations of STCI Finance with two nominee directors and BOI also includes STCI in its consolidated financial reporting. ICRA expects support from BoI to be forthcoming if required. BoI has extended funding support to STCI Finance in the past and is also one of the lenders to the company.

**Comfortable capitalisation with satisfactory core profitability** – STCI Finance has a comfortable capitalisation level with a reported net worth of Rs. 1,797 crore and an adjusted net worth of Rs. 1,251 crore as of December 31, 2022 (as a sizeable portion of its net worth is deployed towards investments in subsidiary (STCI PD) and CCIL). Despite this, STCI Finance had a capital-to-risk weighted assets ratio (CRAR) and a Tier I ratio of 70.98% and 70.16%, respectively, as on December 31, 2022 and the adjusted gearing remains modest and stood at 0.53 times as on December 31, 2022. With expectations of an improvement in the scale of the AUM, ICRA expects the company's borrowings to increase in the near to medium term. However, its reported as well as adjusted gearing is expected to remain below 2.5 times. As the company largely funds its LAS portfolio through its net worth, any increase in the loan book beyond 2.0 times of the adjusted gearing will require it to scale down its LAS portfolio to free up net worth for growing the non-LAS product segments.

The reported profitability remains modest with return on equity (RoE) of 8.5% in 9M FY2023. However, adjusting for capital deployed towards investments, the core profitability is satisfactory with the core RoE at 10.0% in 9M FY2023. STCI Finance's wholly-owned subsidiary, STCI PD, is comfortably capitalised with a net worth of Rs. 777 crore as on March 31, 2022. Given the comfortable capitalisation and profitability, ICRA does not expect any capital requirement towards STCI PD.

### Credit challenges

**Asset quality exposed to concentration in loan book and exposure to real estate segment** – STCI Finance's AUM had been on a declining trend (Rs. 3,542 crore as of March 2018 to Rs. 1,189 crore as of September 2021) as it faced asset quality issues in the real estate as well as corporate loan segments. The asset quality deteriorated with the sharp rise in gross stage 3 assets and the shrinking AUM in FY2021 and peaked at 22.3% as on September 30, 2021. Supported by limited slippages, improved recoveries as well as write-offs, the reported asset quality improved in FY2022 and 9M FY2023 with gross and net stage 3 of 8.7% and 1.5%, respectively, as on December 31, 2022 (10.4% and 4.4% respectively as Mach 31, 2020). With the improvement in the asset quality, the AUM has been on an increasing trend since Q2 FY2022. It increased to Rs. 1,985 crore as on December 31, 2022 (YoY growth of 36%), though it is yet to reach the previous highs.

Given the high share of LAS at 52% and real estate at 22% of the overall loan book, the portfolio remains exposed to the inherent volatility in the capital markets and to the relatively riskier real estate financing. Further, the exposures are concentrated, with the top 10 exposures accounting for 74% of the total loan book and ~80% of the total adjusted net worth as on September 30, 2022. Given the concentration, the company's asset quality remains exposed to lumpy slippages, and this is unlikely to change materially in the medium term. The risks into real estate sector lending are partially mitigated by its exposure being largely against completed inventory and to projects in advanced stages of construction.

**Borrowing profile remains concentrated** – The company's borrowings are entirely through term loans from banks. ICRA notes that the LAS exposure is funded by net worth as these are classified as capital market exposures, thereby constraining the company's ability to avail bank funding against these exposures. Incrementally, as the growth is likely to be driven by non-LAS exposures, the borrowing requirement is likely to increase and STCI Finance's ability to tie up additional bank funding will be critical for growth in the AUM. Further, given the growth plans, the company's ability to diversify its funding profile, which will also enhance its financial flexibility, remains to be seen.

## Liquidity position: Adequate

STCI Finance had free cash and cash equivalents of Rs. 59 crore and undrawn sanctioned bank lines of Rs. 57 crore as on December 31, 2022 which is adequate in meeting its debt obligations, including operating expenses, for the next six months. Given the low leverage, as of now, and the sizeable share of LAS exposure with put/call options, the company has positive cumulative mismatches in the Statement of Structural Liquidity.

## Rating sensitivities

**Positive factors –** ICRA could revise the outlook to Positive or upgrade the rating if the company reports a substantial and sustained improvement in its AUM, with diversification in the borrowing profile and accompanied with improvement in the profitability and asset quality.

**Negative factors –** ICRA could downgrade the ratings or change the outlook to Negative if there is a material deterioration in the credit profile of BoI or a reduction in linkages with BoI. The ratings could also be revised if there is a material weakening in the asset quality or a deterioration in the profitability or a substantial increase in the leverage on a sustained basis.

## Analytical approach

| Analytical Approach | Comments |
|---|---|
| **Applicable rating methodologies** | Non-banking Finance Companies<br>Impact of Parent or Group Support on an Issuer's Credit Rating<br>Rating approach – Consolidation |
| **Parent/Group support** | ICRA has factored in the support of STCI Finance's largest shareholder, i.e. Bank of India. ICRA expects support from BoI to be forthcoming, if required. |
| **Consolidation/Standalone** | To arrive at the ratings, ICRA has considered the standalone financials of STCI Finance. However, in line with ICRA's limited consolidation approach, the capital requirement of STCI Finance's wholly-owned subsidiary (STCI PD), going forward, has been factored in. *Details mentioned in Annexure II.* |

## About the company

STCI Finance Limited is a systemically important non-deposit taking NBFC providing loans against shares, corporate loans, real estate loans and loans to NBFCs. Bank of India is the largest shareholder with an equity stake of 29.96% in the company as on December 31, 2022. The rest of the shareholding is distributed among State Bank of India, IDFC First Bank Limited, Punjab National Bank, Life Insurance Corporation of India and other financial institutions and public sector banks. STCI Finance has a wholly-owned subsidiary – STCI Primary Dealer Limited.

### Key financial indicators (audited) – Standalone

| | FY2021 | FY2022 | 9M FY2023* |
|---|---|---|---|
| **Total income** | 318 | 213 | 201 |
| **Profit after tax** | 107 | 190 | 113 |
| **Net worth** | 1,531 | 1,727 | 1,797 |
| **Adjusted net worth** | 1,020 | 1,177 | 1,251 |
| **Loan book** | 1,426 | 1,705 | 1,985 |
| **Total assets** | 2,323 | 2,365 | 2,528 |
| **Core return on assets** | -1.1% | 7.3% | 6.4% |
| **Core return on net worth** | -2.1% | 12.1% | 10.0% |
| **Return on assets** | 4.5% | 8.1% | 6.2% |
| **Return on net worth** | 7.3% | 11.6% | 8.5% |
| **Adjusted gearing (times)** | 0.75 | 0.49 | 0.53 |
| **Gross stage 3** | 19.7% | 10.5% | 8.7% |
| **Net stage 3** | 3.5% | 1.7% | 1.5% |
| **Solvency (Net stage 3/Adjusted net worth)** | 4.0% | 2.1% | 2.2% |
| **CRAR** | 86.3% | 78.4% | 70.9% |

*Source: STCI Finance Limited, ICRA Research; All ratios as per ICRA's calculations; Amount in Rs. crore*

**Status of non-cooperation with previous CRA: Not applicable**

**Any other information: None**

## Rating history for past three years

| | Instrument | Current rating (FY2023) | | | | Chronology of rating history for the past 3 years | | |
|---|---|---|---|---|---|---|---|---|
| | | Type | Amount rated (Rs. crore) | Amount outstanding as of Feb 28, 2023 (Rs. crore) | Date & rating in FY2023 | Date & rating in FY2022 | Date & rating in FY2021 | Date & rating in FY2020 |
| | | | | | Mar 17, 2023 | Mar 10, 2022 | Mar 26, 2021<br>Mar 15, 2021 | Dec 26, 2019 |
| 1 | Long-term bank lines | Long term | 1,700.00 | 669.27 | [ICRA]AA- (Stable) | [ICRA]AA- (Negative) | [ICRA]AA- (Negative) | [ICRA]AA- (Negative) |
| 2 | Non-convertible debenture programme | Long term | 350.00 | - | [ICRA]AA- (Stable) | [ICRA]AA- (Negative) | [ICRA]AA- (Negative) | [ICRA]AA- (Negative) |
| 3 | Commercial paper programme | Short term | 300.00 | - | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1+ |

## Complexity level of the rated instruments

| Instrument | Complexity Indicator |
|---|---|
| Commercial paper programme | Very Simple |
| Non-convertible debentures programme | Very Simple* |
| Long-term bank lines | Simple |

** The complexity indicator mentioned here is subject to change when the terms will be finalised*

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: Click Here

## Annexure I: Instrument details

| ISIN | Instrument Name | Date of Issuance | Coupon Rate | Maturity | Amount Rated (Rs. crore) | Current Rating and Outlook |
|---|---|---|---|---|---|---|
| **NA** | **Long-term bank lines** | - | NA | FY2024 | 1,700.00 | [ICRA]AA- (Stable) |
| **Yet to be placed** | **Non-convertible debentures programme** | NA | NA | NA | 350.00 | [ICRA]AA- (Stable) |
| **Yet to be placed** | **Commercial paper programme** | NA | NA | NA | 300.00 | [ICRA]A1+ |

*Source: STCI Finance Limited*

*Please click here to view details of lender-wise facilities rated by ICRA*

## Annexure II: List of entities considered for consolidated analysis

| Company Name | Ownership | Consolidation Approach |
|---|---|---|
| **STCI Primary Dealer Limited (STCI PD)** | 100% | Limited consolidation |

## Corrigendum

Updated the link for "Rating Approach - Consolidation" in the analytical approach section on page 3 on the document dated March 17, 2023.

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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.

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