

April 05, 2024

Asset Reconstruction Company (I) Limited: [ICRA]AA- (Stable) assigned to NCD programme; Rating reaffirmed

Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|--------------------------------------|-------------------------------------|--------------------------------|
| Non-convertible debenture (NCD) programme | 200.0 | 200.0 | [ICRA]AA- (Stable); reaffirmed |
| NCD programme | - | 100.0 | [ICRA]AA- (Stable); assigned |
| Bank lines long-term fund based – Others | 750.0 | 750.0 | [ICRA]AA- (Stable); reaffirmed |
| Total | 950.0 | 1,050.0 | |

*Instrument details are provided in Annexure I

Rationale

The rating continues to consider Asset Reconstruction Company (I) Limited's (ARCIL) established position in the asset reconstruction industry with an adequate track record of recovery from assets, healthy capitalisation, and backing of experienced sponsors. ARCIL is one of the largest asset reconstruction companies (ARCs) in the domestic market with gross assets under management (AUM) of Rs. 15,815 crore as of December 31, 2023. It is backed by experienced sponsors with Avenue India Resurgence Pte. Ltd. holding a 70% stake in the company, followed by State Bank of India (SBI; 20%)¹. ARCIL benefits from the expertise of its largest sponsor in the global distressed assets space and enjoys operational support from Avenue Capital Group.

ARCIL's capitalisation profile remains healthy with a net worth of Rs. 2,296 crore and a gearing of 0.1 times as on December 31, 2023. It is noted that the management intends to keep the financial leverage below 0.75 times in the medium term. The rating also considers the company's comfortable coverage metrics with average debt/average recoveries of less than 1.0 times in the last three years. ARCIL has demonstrated a track record of recoveries with the cumulative recoveries to cumulative acquisitions ratio remaining in the range of 61-65% over the last five years (FY2019 to 9M FY2024). With the modest moderation in fresh acquisitions and continued healthy recoveries, the cumulative recoveries to cumulative acquisitions ratio improved to 69% in 9M FY2024. Going forward, the company's ability to maintain the pace of resolutions and recoveries will remain a key driver of its cash flow and debt servicing ability.

The rating is, however, constrained by the volatile nature of the cash flows in the ARC industry. Further, the valuation of an ARC's assets and its management fee are linked to the recovery ratings of the security receipts (SRs), which can result in volatile profitability. Thus, any adverse movement in the recovery rating profile of the portfolio can have a bearing on the company's financial profile. Nonetheless, going forward, ARCIL's ability to generate healthy cash flows through timely resolutions will remain important from a credit perspective. Also, the asset reconstruction industry's prospects have remained susceptible to regulatory changes. In this backdrop, the company's ability to judiciously acquire new assets while maintaining a comfortable leverage will remain imperative for its credit profile.

¹ SBI's infrastructure bonds and fixed deposit facility are rated [ICRA]AAA (Stable) by ICRA

Key rating drivers and their description

Credit strengths

Established track record in ARC industry and backing of experienced sponsors – ARCIL was India's first ARC to commence the business of the resolution of stressed assets upon acquisitions from Indian banks and financial institutions. It continues to be one of the prominent players in the domestic ARC industry with an operational track record of almost two decades. Further, ARCIL is one of the largest ARCs in the domestic market; as of December 2023, it had issued cumulative SRs of Rs. 33,827 crore and the SRs outstanding (gross AUM) was Rs. 15,815 crore. ARCIL's own share in the AUM was Rs. 3,007 crore while the net asset value (NAV; reduced for provisions) stood at Rs. 2,252 crore as of December 31, 2023. The company has a pan-India setup with 15 branches and remains sector agnostic in terms of its asset acquisition policy.

ARCIL mainly used to operate in the corporate and small and medium-sized enterprise (SME) segment (~90% of AUM as on March 31, 2023), which is riskier than the retail segment on account of the comparatively larger ticket size, higher complexity involved in the transactions, and the protracted resolution process. However, the improving health of the corporate loan books of banks and the cyclically low gross non-performing assets (GNPAs) in the banking sector impacted the supply of stressed corporate assets in recent quarters. Further, increasing competition in the ARC industry makes it challenging to acquire fresh assets at the desired price. Accordingly, most private ARCs reported a shift towards retail assets in recent quarters.

ARCIL issued SRs aggregating Rs. 1,716 crore in 9M FY2024, with 90% of the SRs representing retail assets, compared to SRs of Rs. 4,289 crore issued in FY2023 of which 86% were from the corporate sector. Going forward, ARCIL plans to remain focused on acquiring SME and retail assets. Nonetheless, the share of retail assets is expected to remain modest in the near to medium term, given the relatively smaller asset size and the shorter time for such resolutions. As of December 31, 2023, the share of retail and SME assets was 33% of the gross AUM. ICRA notes that incremental growth in the gross AUM in the near and medium term may be impacted by the relative smaller deal sizes in the SME and retail segments vis-à-vis the corporate segment. The top 10 gross exposures accounted for 37% of the gross AUM as of December 31, 2023 compared to 39% as of March 31, 2023. On NAV basis, the top 10 exposures accounted for 29% of ARCIL's NAV as on December 31, 2023.

Avenue India Resurgence Pte. Ltd., a part of Avenue Capital Group, acquired an additional 44.4% stake in ARCIL from the other sponsors in FY2022 and FY2023, taking its total shareholding to 69.7%. Avenue Capital Group is a global distressed debt management fund with an established presence in the United States (US), Europe and Asia. Further, ARCIL enjoys operational support from the sponsor, Avenue India Resurgence Pte. Ltd. ICRA notes that the partnership between the two entities remains non-exclusive. ARCIL's other key sponsors include SBI (20%) and Lathe Investments Pte. Ltd. (5%), among others. ARCIL also benefits from managerial supervision through its adequately diversified board, comprising three Sponsor Directors and four Independent Directors.

Adequate track record of recovery from assets – ARCIL's cumulative recoveries to cumulative acquisitions has remained in the range of 61-65% over the last five years (FY2019 to FY2023). With the modest moderation in fresh acquisitions and continued healthy recoveries, the cumulative recoveries to cumulative acquisitions ratio improved to 69% in 9M FY2024. The NAV of the higher rated SRs (with expected recovery of more than 75%) formed 77% of the AUM² as of December 31, 2023, while ARCIL's own share in higher rated SRs was 63%. ICRA notes that a sizeable portion of the assets acquired in FY2016 and FY2017, which would have become due for write-off after eight years, were provided for in the preceding years. Thus, ICRA expects the near-term impact of the incremental downward revision in the fair valuation of these assets, if any, on the profitability of the company, to be modest. The incremental write-offs in FY2024 and FY2025, basis the vintage of the SRs outstanding, is expected to be low at ~Rs. 51 crore (net of provisioning). Although ARCIL has demonstrated its ability to

²14% of the AUM was unrated, while 31% of the SRs held by ARCIL were unrated as on December 31, 2023. Unrated SRs primarily comprise of recently issued SRs. ARCs are required to get SRs rated within 6 months from issuance

maintain the pace of resolutions and recoveries, including recoveries from the written-off pool, while shortening the time to recovery, the same remains a monitorable.

Healthy capitalisation and recoveries provide good coverage for debt servicing – ARCIL’s capitalisation remains healthy with a net worth of Rs. 2,296 crore (vis-à-vis the minimum regulatory requirement of Rs. 300 crore), gearing of 0.1 times and CRAR of 81% as on December 31, 2023. In this regard, considering its ambitious growth target and its intent to acquire a higher share in SRs in the SME and retail segments, the possibility of an increase in the leverage cannot be ruled out. Further, the accretion to reserves is expected to be limited by the regular dividend payouts. Hence, the reported financial leverage is likely to increase in the medium term. Nevertheless, comfort is drawn from the management’s stated intent of keeping the leverage below 0.75 times over the medium term. Additionally, it is noted that ARCIL’s average debt to average recoveries ratio has remained below 1.0 times in the last three years, providing good coverage against debt. Further, in the corporate segment, the company plans to pursue the co-investment model and cash deals, wherein its share in the issued SRs can be as low as 2.5% (thereby reducing ARCIL’s potential on-balance sheet borrowings), as per the amended regulatory framework for ARCs. The share of acquisitions with a co-investor in the gross AUM was 10% in 9M FY2024 compared to 4% in FY2019.

Credit challenges

Volatile cash flows and earnings due to inherent nature of the business – The resolution process for stressed assets, especially corporate assets, involves a protracted recovery process with low recoveries in the initial years. ICRA notes that the cash flows and profitability of the entities operating in this segment remain volatile, given the inherent nature of the asset reconstruction business. Further, the valuation of an ARC’s assets and its management fee are linked to the recovery ratings of the SRs. Thus, any adverse movement in the recovery rating profile of the portfolio can have a bearing on the company’s financial profile. It is to be noted that the recovery proceeds are first used for the payment of management fees and other expenses and dues, while the balance is used for the redemption of the SRs. Thus, the SR redemption ratio trails behind the recovery ratio.

ARCIL’s reported return on assets (RoA) has been volatile and ranged between -3.7% and 9.7% in the last five years (FY2019 to FY2023). The 4-year average return on net worth (RoE) was sub-optimal at 3.1% between FY2019 and FY2022. Subsequently, recoveries from the SRs written off in earlier years and healthy fee income supported ARCIL’s profitability and the RoE improved to 11.2% in FY2023. The RoE was 8.1% in 9M FY2024. Going forward, ARCIL’s ability to achieve timely resolutions and healthy recoveries from its assets will remain important from a credit perspective.

Evolving nature of the industry with challenges in acquiring assets at reasonable prices – The asset reconstruction industry’s prospects remain susceptible to regulatory changes. Nonetheless, the amended regulatory framework, requiring a higher capitalisation level for undertaking ARC operations besides allowing lower investment requirement for acquisitions and the option to participate as a resolution applicant under the Insolvency and Bankruptcy Code (IBC), is expected to benefit established ARCs. Nevertheless, ARCIL’s ability to judiciously acquire new assets while maintaining a comfortable capital structure and competitive borrowing costs remains imperative. Moreover, the developments related to the securitisation of stressed assets and the commencement of National Asset Reconstruction Company Limited, and their impact on the private players in the industry will remain monitorable.

Liquidity position: Adequate

As on December 31, 2023, ARCIL had on-balance sheet liquidity of Rs. 115 crore, besides enjoying sanctioned bank lines of Rs. 570 crore with minimal utilisation in the recent past. The company has remained largely debt-free except for the occasional drawdown of working capital facilities in the past few years. Further, ICRA believes that the key sponsor company, Avenue India Resurgence Pte. Ltd., will extend funding/liquidity support (in the form of intercorporate deposits (ICDs)/loans) in case of contingencies. The sponsor has demonstrated its support to ARCIL by participating as a co-investor in certain full cash deals and the trend is expected to continue.

Rating sensitivities

Positive factors – A significant increase in the scale of operations and a sustained improvement in recoveries while maintaining strong capitalisation, achieving a diversified portfolio, and delivering healthy profitability and cash flows on a sustained basis will be credit positives.

Negative factors – The rating may come under pressure if the company's profitability or the trajectory of its recoveries weakens significantly on a sustained basis. Moreover, a sharp increase in the leverage with a gearing of over 0.75 times may also be credit negative.

Analytical approach

| Analytical Approach | Comments |
|---------------------------------|--|
| Applicable rating methodologies | Rating Methodology – Non-banking Finance Companies (NBFCs) |
| Parent/Group support | Not applicable |
| Consolidation/Standalone | Standalone |

About the company

Incorporated in 2002, Asset Reconstruction Company (India) Limited (ARCIL) is India's first asset reconstruction company to commence the business of resolution of the non-performing assets (NPAs) acquired from Indian banks and financial institutions. It is sponsored by US-based Avenue Capital Group (largest shareholder with 69.7% stake as of December 2023). The company is also sponsored by leading Indian banks including SBI, Karnataka Bank, The South Indian Bank and Federal Bank. These banks together hold 25.1% of the equity capital. Over the last few years, other sponsor banks like Punjab National Bank, IDBI Bank and ICICI Bank Limited sold off their shareholding to Avenue Capital Group.

Since inception, ARCIL has issued SRs totalling Rs. 33,827 crore. Gross SRs outstanding stood at Rs. 15,815 crore, of which SRs worth Rs. 8,460 crore were acquired in the last eight years. The NAV of the gross SRs acquired in the last eight years was Rs. 8,359 crore as of December 31, 2023. ARCIL's own share in gross SRs was Rs. 3,007 crore while the NAV (net of provision) of these SRs was Rs. 2,252 crore as of December 31, 2023. The company has a pan-India setup with 15 branches and employee strength of ~247 (including off-roll employees) as of December 2023.

ARCIL reported a profit after tax (PAT) of Rs. 137 crore in 9M FY2024 compared to a PAT of Rs. 239 crore in FY2023 (Rs. 143 crore in FY2022).

Key financial indicators (audited)

| ARCIL | FY2022 | FY2023 | 9M FY2024* |
|--|--------|--------|------------|
| Fee income | 244 | 173 | 122 |
| Interest income | 14 | 30 | 18 |
| Fair value changes – Realised^ | 368 | 255 | 94 |
| Fair value changes – Unrealised^^ | (97) | 244 | (8) |
| SRs written off (including provisions) | (227) | (249) | (2) |
| Other income | 2 | 2 | 3 |
| Total income | 304 | 456 | 226 |
| Profit after tax | 143 | 239 | 137 |
| Net worth | 2,034 | 2,240 | 2,296 |
| AUM / Total managed assets | 14,036 | 16,223 | 15,815 |
| Investment in SRs (at net asset value) | 1,406 | 1,809 | 2,252 |
| Total assets^^ | 2,344 | 2,524 | 2,781 |

| ARCIL | FY2022 | FY2023 | 9M FY2024* |
|-----------------------|--------|--------|------------|
| Return on assets | 6.1% | 9.7% | 6.8% |
| Gross gearing (times) | 0.1 | 0.1 | 0.1 |
| CRAR | 101% | 96% | 81% |
| GNPA | NA | NA | NA |

Source: Company, ICRA Research; All ratios as per ICRA's calculations; Amount in Rs. crore; *Provisional; ^^Based on net assets; ^ Largely recoveries from written-off accounts; ^^Largely provision write-backs

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for past three years

| Instrument | Type | Current Rating (FY2025) | | | Chronology of Rating History for the Past 3 Years | | | |
|----------------------------------|-----------|--------------------------|---|-------------------------|---|-------------------|-------------------------|-------------------------|
| | | Amount Rated (Rs. crore) | Amount Outstanding as of Mar 31, 2024 (Rs. crore) | Date & Rating in FY2025 | Date & Rating in FY2024 | | Date & Rating in FY2023 | Date & Rating in FY2022 |
| | | | | Apr 05, 2024 | Jul 12, 2023 | Apr 03, 2023 | - | - |
| 1 NCD programme | Long term | 300.0 | - | [ICRA]AA-(Stable) | [ICRA]AA-(Stable) | [ICRA]AA-(Stable) | - | - |
| 2 Bank lines fund based – Others | Long term | 750.0 | 670.0 | [ICRA]AA-(Stable) | [ICRA]AA-(Stable) | - | - | - |

Complexity level of the rated instruments

| Instrument | Complexity Indicator |
|--------------------------------|----------------------|
| NCD programme | Simple^ |
| Bank lines fund based – Others | Simple |

^ Subject to change based on terms of issuance

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 | NCD programme* | - | - | - | 300.0 | [ICRA]AA- (Stable) |
| NA | Bank lines fund based – Others | - | - | - | 750.0 | [ICRA]AA- (Stable) |

Source: Company; *Yet to be placed

[Please click here to view details of lender-wise facilities rated by ICRA](#)

Annexure II: List of entities considered for consolidated analysis

Not applicable

ANALYST CONTACTS

Karthik Srinivasan
+91 22 6114 3444
karthiks@icraindia.com

Anil Gupta
+91 124 4545 314
anilg@icraindia.com

Deep Inder Singh
+91 124 4545 830
deep.singh@icraindia.com

Kruti Jagad
+91 22 6114 3447
kruti.jagad@icraindia.com

Subhrajyoti Mohapatra
+91 80 4332 6406
subhrajyoti.mohapatra@icraindia.com

RELATIONSHIP CONTACT

L. Shivakumar
+91 22 6114 3406
shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)
info@icraindia.com

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ICRA Limited



Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45



Branches



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