September 27, 2024

Unity Small Finance Bank Limited: Rating reaffirmed for PTCs backed by secured LAP loan receivables issued by Marathon

Summary of rating action

Trust name	Instrument*	Initial rated amount (Rs. crore)	Amount O/s after last surveillance (Rs. crore)	Amount O/s after Aug-24 payout (Rs. crore)	Rating Action
Marathon	Series A1 PTC	81.10	78.62	58.00	[ICRA]AA-(SO); Reaffirmed

Instrument details are provided in Annexure I

Rationale

The pass-through certificates (PTCs) are backed by loan against property (LAP) receivables originated by Unity Small Finance Bank Limited {Unity SFB; rated [ICRA]A(Stable)}.

The rating reaffirmation factors in the build-up of the credit enhancement cover over the future PTC payouts on account of healthy amortisation and pool performance being in line with the expectations. The rating also draws comfort from the fact that the breakeven collection efficiency is lower compared to the actual collection level observed in the pool till the August 2024 payout month.

Pool performance summary

Parameter	Marathon
Payout month	August 2024
Months post securitisation	13
Pool amortisation (as % of initial pool principal)	24.39%
Series A1 PTC amortisation (as % of initial PTC principal)	26.23%
Cumulative collection efficiency[1]	97.86%
Cumulative prepayment rate[2]	19.24%
Average Monthly prepayment rate	1.63%
Loss cum 0+ dpd (% of initial pool principal)[3]	13.40%
Loss cum 30+ dpd (% of initial pool principal)[4]	4.99%
Loss cum 90+ dpd (% of initial pool principal)[5]	2.41%
Breakeven collection efficiency[6]	66.87%
Cumulative cash collateral (CC) utilisation	0.00%
CC available (as % of balance pool)	3.97%
Excess interest spread (EIS) (as % of balance pool)[7]	42.97%
Principal subordination (% of balance pool principal)	9.26%

Transaction structure

As per the transaction structure, the monthly promised cash flows for Series A1 PTC will comprise the scheduled principal amount (which is 93% of the billed pool principal) and the interest payment to Series A1 PTC at the predetermined interest rate on the principal outstanding. The surplus, in relation to the principal portion of the pool's receivables along with any prepayment amount, would be used for the payment of Series A1 for faster amortisation. Following the payment of Series A1

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[1] *Cumulative collections / (Cumulative billings + opening overdue at the time of securitization)*
[2] *Principal outstanding at the time of prepayment of contracts prepaid till date/ initial pool principal*
[3] *Unbilled and Overdue Principal portion of contracts delinquent for more than 0 days, as a % of Initial Pool Principal*
[4] *Unbilled and Overdue Principal portion of contracts delinquent for more than 30 days, as a % of Initial Pool Principal*
[5] *Unbilled and Overdue Principal portion of contracts delinquent for more than 90 days, as a % of Initial Pool Principal*
[6] *(Balance Cash flows payable to investor – CC available) / Balance Pool Cash flows*
[7] *(Pool Cashflows till PTC maturity month– Cashflows to PTC A1 – originator's residual share)/ Pool Principal outstanding*

PTC in full, the principal for Series A2 PTC is to be paid monthly on expected basis (to the extent of billing). Further, the yield on Series A2 PTC is in the form of the EIS in the structure.

Further, the transaction has a liquidity facility amounting to 2.00% of the initial pool principal outstanding, maintained in the form of a fixed deposit (maintained with Axis Bank). In the event of a shortfall in meeting the promised PTC payouts during any month, the trustee will utilise the liquidity facility first followed by the cash collateral (CC) to meet the shortfall.

Key rating drivers and their description

Credit strengths

Significant credit enhancement available in the structure – The rating factors in the build-up in the credit enhancement with cash collateral increasing to 4.0% of the balance pool principal compared to 3.0% at time of securitisation. Internal credit support is also available through principal subordination of 9.3% and EIS of 43.0% of the balance pool principal.

Pool performance in line with the expectations – The performance of the pool has been in line with the expectations with cumulative collection efficiency of ~98% till August 2024 payout month. Though the pool has reported moderate softer bucket delinquencies with loss-cum-0+ days past due (dpd; as percentage of initial pool principal)) of 13.4%, the roll forward into harder buckets has remained limited with loss-cum-90+ dpd below 2.5%. However, the delinquencies in secured business banking portfolio have witnessed an uptick in Q1 FY2025 and remains a monitorable. The break-even collection efficiency of the pool has also declined to 67%. Further, there have been no instances of cash collateral utilisation for the pool till date owing to adequate collection performance and presence of EIS in the transaction.

Contracts backed by self-occupied residential properties – A major part of the pool (76% of its contracts in terms of the balance pool principal) is backed by self-occupied residential properties. This is expected to support the quality of the pool as it has been observed that borrowers tend to prioritise repayments towards such loans even during financial stress.

Credit challenges

High geographical concentration – The pool has high geographical concentration with the top 3 states, viz. Telangana, Gujarat and Uttar Pradesh, contributing 80% to the balance pool principal amount. The pool's performance would thus be exposed to any state-wide disruption that may occur due to natural calamities, political events, etc.

Exposed to interest rate risk – The transaction is exposed to interest rate risk as the underlying pool has fixed rate loans, whereas yield on PTCs is floating (linked to repo rate with quarterly reset).

Risks associated with lending business –The pool's performance would remain exposed to macro-economic shocks, business disruptions and natural calamities that may impact the income-generating capability of the borrowers and their ability to make timely repayments of their loans.

Key rating assumptions

ICRA's cash flow modelling for rating securitisation transactions involves the simulation of potential losses, delinquencies and prepayments in the pool. The losses and prepayments are assumed to follow a log-normal distribution. The assumptions for the losses and the coefficient of variation are considered on the basis of the values observed from the analysis of the past performance of the Originator's loan portfolio as well as the characteristics of the specific pool being evaluated. The resulting collections from the pool, after incorporating the impact of the losses and prepayments, are accounted for in ICRA's cash flow model, in accordance with the cash flow waterfall of the transaction.

For the current pool, ICRA has noted the high obligor concentration in the pool after the August 2024 payout month. Thus, the pool's performance is likely to get influenced by the performance of the large obligor. The variability of loss in case of a concentrated pool would be much higher than that of a regular granular pool. All loans pertaining to any borrower have been clubbed as one because if an entity defaults, it would most likely default on all its loans to a lender. ICRA's rating/credit assessment of the entity, along with the balance tenure of the loan given to the entity, has been taken into account to estimate the default probability for the loan. ICRA has also built in the assumptions on the quantum and timing of recovery post default. Further, a certain loss given default (LGD) has been assumed by factoring in the repossession and sale of the underlying asset. ICRA has assumed that the recovery, post the default by a borrower, would happen with a lag. Various possible scenarios are simulated and the incidences of default to the investor as well as the extent of losses are measured.

For the granular portion of the pool (~95% of the balance pool principal), ICRA has estimated the shortfall in the pool principal collection during its tenure at 6.50% with certain variability around it. The average prepayment rate for the underlying pool is modelled in the range of 6.0% to 20.0% per annum. Various possible scenarios have been simulated at stressed loss levels and prepayment rates for the granular portion. The cash flows of the granular as well as the concentrated portion are combined and the incidences of default to the investor as well as the extent of losses are measured after factoring in the credit enhancement to arrive at the final rating for the instrument.

Details of key counterparties

The key counterparties in the rated transaction are as follows:

Transaction Name	Marathon
Originator	Unity Small Finance Bank
Servicer	Unity Small Finance Bank
Trustee	Catalyst Trusteeship Limited
CC holding bank	Axis Bank Limited
Liquidity facility bank	Axis Bank Limited
Collection and payout account bank	Axis Bank Limited

Liquidity position: Strong

The liquidity for the PTC instrument is strong after factoring in the credit enhancement available to meet the promised payout to the investors. The total credit enhancement would be ~4.25 times the estimated loss in the pool.

Rating sensitivities

Positive factors – Sustained strong collection performance of the underlying pool of contracts, leading to lower-than-expected delinquency levels, and an increase in the cover available for future investor payouts from the credit enhancement would result in a rating upgrade

Negative factors – Sustained weak collection performance of the underlying pool of contracts, leading to higher-than-expected delinquency levels and higher credit enhancement utilisation levels, would result in a rating downgrade. Weakening in the credit profile of the servicer (Unity SFB) could also exert pressure on the rating.

Analytical approach

The rating action is based on the analysis of the performance of Unity SFB portfolio till August 2024, the key characteristics and composition of the current pool, the present delinquency levels, the performance expected over the balance tenure of the pool, and the credit enhancement cover available in the transaction.

Analytical Approach	Comments
Applicable rating methodologies	Rating Methodology for Securitisation Transactions
Parent/Group support	Not Applicable
Consolidation/Standalone	Not Applicable

About the originator

Unity SFB is the 12th small finance bank (SFB) in India, promoted by the consortium of the Centrum Group and Resilient Innovations Private Limited. The RBI granted in-principal approval to CFSL, to set up an SFB under the general guidelines for the on-tap licensing of SFBs in the private sector, as a part of the revival/reconstruction of PMC Bank in June 2021. The licence to set up the SFB was issued in October 2021.

BharatPe acquired a 49% stake in Unity SFB while CFSL holds 51%. Further, as a part of this transaction, the entire business (assets and liabilities) of CFSL and CML was transferred to Unity SFB via a slump sale. CFSL serves as the holding company of Unity SFB with no other operations. Currently, Unity SFB primarily has the existing SME/MSME/supply chain/microfinance asset base of CFSL and CML and receives digital platform and technology support from BharatPe. Unity SFB commenced active operations from November 1, 2021 with an upfront equity base of Rs. 1,105 crore. As the second leg of this transaction, PMC Bank was amalgamated with Unity SFB in accordance with the RBI's scheme for the recovery/resolution of the same. This was completed on January 24, 2022.

Key financial indicators

Unity SFB	FY2023	FY2024	Q1FY2025
Total operating income	628^	1,631	529
Profit after tax	35*	439	32
Total assets	8,761	13,773	14,915
Gross NPA	45.83%	4.36%	3.60%
Net NPA	0.34%	0.63%	0.90%
CRAR	49.40%	36.40%	29%

*Source: Company, ICRA Research; All ratios as per ICRA's calculations; Amount in Rs. Crore; *Before fair value changes*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

		Current Rating (FY2025)				Chronology of Rating History for the Past 3 Years			
S. No.	Trust Name	Instrument	Initial Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Date & Rating in FY2025	Date & Rating in FY2024		Date & Rating in FY2023	Date & Rating in FY2022
					Sep 27, 2024	Sep 25, 2023	July 18,2023	-	-
1	**Marathon**	Series A1 PTC	81.10	58.00	[ICRA]AA-(SO)	[ICRA]AA-(SO)	Provisional [ICRA]AA-(SO)	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Series A1 PTC	Moderately Complex

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

Trust Name	Instrument Type	Date of Issuance / Sanction	Coupon Rate (p.a.p.m.)	Maturity Date	Current Amount Rated (Rs. crore)	Current Rating
Marathon	Series A1 PTC	July 20, 2023	8.75%	November 20, 2037	58.00	[ICRA]AA-(SO)

Source: Company

Annexure II: 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.

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