August 02, 2022

Kotak Infrastructure Debt Fund Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debenture programme	1,000	1,000	[ICRA]AAA (Stable); reaffirmed
Commercial paper programme	50	50	[ICRA]A1+; reaffirmed
Total	**1,050**	**1,050**	

**Instrument details are provided in Annexure I*

Rationale

The ratings reflect the strength of Kotak Infrastructure Debt Fund Limited's (KIDF) sponsors, the relatively tighter regulatory framework necessitating investments only in operational infrastructure projects, and the favourable liquidity position supported by regulatory restrictions on the proportion of short-term debt in the overall borrowing mix. The ratings also consider the company's good capitalisation profile, stringent underwriting norms reflected in the good asset quality indicators, good risk mitigants and healthy profitability indicators. KIDF's promoter/sponsor, Kotak Mahindra Bank Limited {KMBL; rated [ICRA]AAA (Stable)}, held a 30% stake in the company as on June 30, 2022 with the rest held by the bank's subsidiaries. Any dilution in the expected level of support from the Kotak Group to KIDF or a change in the credit profile of KMBL would be a key rating sensitivity.

ICRA has taken note of the moderation in KIDF's loan book in FY2022 following the higher-than expected prepayments on some loan accounts and the company's cautious approach towards new business growth. Further, the inherent nature of infrastructure financing entails concentrated exposure to a few sectors, making the portfolios vulnerable to asset quality shocks. ICRA, however, draws comfort from the company's prudent underwriting and risk management systems. Going forward, KIDF's ability to grow its loan book while maintaining prudent capitalisation levels and strict underwriting standards would be a key monitorable.

Key rating drivers and their description

Credit strengths

Strong parentage and experienced management team – KMBL held a 30% stake in KIDF as on June 30, 2022, while the balance is held by KMBL's subsidiaries, i.e. Kotak Securities Limited, Kotak Investment Advisors Limited and Kotak Mahindra Capital Company Limited. Consequently, KIDF enjoys strong financial and operational support from the Kotak Group, including access to capital, operational synergies, management and systems, and supervision by the board. The company's board of directors includes representation from KMBL's board. In addition to capital support, the Group has supported KIDF by investing in its debt issuances.

Regulatory framework necessitates lending to operational projects, supporting overall business risk – The regulatory framework for infra debt funds (IDFs) necessitates lending/investment only in infrastructure projects with at least one year of satisfactory commercial operations. Hence, construction and execution risks are nil and operating risk is low, given the track record of operations, though ICRA notes that the absence of tripartite agreements (post widening of scope in FY2016) would expose the IDFs to the risk associated with the project in the event of termination. Nevertheless, the asset quality of these operational projects (including projects without tripartite agreements) is expected to be stable, given the lower risks compared to non-operational projects.

KIDF's portfolio declined by 16% year-on-year (YoY) to Rs. 618 crore as on March 31, 2022 from Rs. 735 crore as on March 31, 2021 owing to high prepayments. In line with the industry trend, the solar renewable energy segment had the highest share of 57% in the portfolio as on March 31, 2022, followed by the wind segment (32%) and others (transmission and hydro power; the balance).

Good capitalisation profile for current scale of operations – The company reported a comfortable capital adequacy ratio (capital-to-risk weighted assets ratio; CRAR) of 69.9% (Tier I of 69.6%) as on March 31, 2022. The gearing, as on March 31, 2022, stood low at 1.2 times. However, with incremental business likely to be funded out of fresh borrowings, the gearing would increase from the current level and is expected to be around 2-3 times over the medium term. Notwithstanding the expected increase in the leverage, the company's capitalisation profile is expected to remain comfortable with low incremental capital requirement. In ICRA's opinion, a prudent capitalisation level is one of the key risk mitigants and a monitorable for a portfolio that has a relatively high concentration risk.

Profitability supported by tax exemption status enjoyed by IDFs – The company reported a profit after tax (PAT) of Rs. 30 crore in FY2022 {3.1% of average total assets (ATA)} compared to Rs. 35 crore in FY2021 (3.8% of ATA). The net interest margin (NIM) declined to 3.0% in FY2022 from 4.0% in FY2021 due to the decline in the loan book and some moderation in the overall yields, given the negative carry on account of the higher level of on-book liquidity maintained in FY2022. Due to the wholesale nature of its operations, the company's operating expenses were low at 0.9% of ATA in FY2022, but higher than the peer set owing to the relatively modest scale of operations. As on March 31, 2022, the company had nil stage 3 assets and the credit costs consequently remained low.

Going forward, KIDF's profitability indicators are expected to improve with the improvement in the scale of operations, which would lead to better operating efficiency. Subject to compliance with the conditions stipulated by the Central Board of Direct Taxes (CBDT), an IDF-non-banking financial company's (IDF-NBFC) income is exempt from tax, which supports its overall profitability. ICRA notes that any changes in these regulations could have an adverse impact on the profitability.

Credit challenges

Moderation in loan book and relatively high concentration risk – The inherent nature of the infrastructure financing business means that the company is exposed to project risks and the exposures are concentrated. Hence, KIDF's portfolio would remain vulnerable to asset quality shocks in case of slippages in a few key exposures, which may adversely affect the profitability. Further, with the decline in the portfolio in FY2022, the concentration risk has increased with the top 10 borrowers accounting for ~76% of the total portfolio and ~105% of the net worth as on March 31, 2022 (~72% and 128%, respectively, as on March 31, 2021). Going forward, the company's ability to maintain strict underwriting standards while growing the portfolio would be a monitorable.

Liquidity position: Strong

KIDF, in line with the regulations for IDF-NBFCs, can raise resources only through the issuance of bonds of minimum five years' maturity, in line with the maturity profile of the assets. Shorter-tenure bonds and commercial papers are not allowed beyond 10% of the outstanding debt. Further, since IDF-NBFCs can only invest in projects that have completed at least one year of commercial operations, loan repayments also start immediately after disbursement, auguring well for the ALM profile. The company's ALM, as on May 31, 2022, reflects positive cumulative mismatches across all buckets.

As of May 31, 2022, the company had available liquidity in the form of cash and liquid investments up to ~Rs. 436 crore, providing comfortable liquidity cover over the debt repayments of Rs. 265 crore which are due over the next one year. Further, liquidity is supported by the expected cash inflow of ~Rs. 60 crore from advances during the above-mentioned period. ICRA also derives comfort from the good financial flexibility of the company and the expectation of support from the sponsors if required.

Rating sensitivities

Positive factors – Not applicable

Negative factors – Any significant change in the regulatory framework, leading to an increase in the portfolio vulnerability, and/or a change in the likelihood of support from the sponsors or key shareholders or a deterioration in the credit profile of the sponsors or key shareholders could warrant a rating revision for the company. Pressure on KIDF's ratings could emerge on the weakening of the capitalisation profile (gearing > 9 times) on a sustained basis and/or of the asset quality, leading to a deterioration in the solvency on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	ICRA's Credit Rating Methodology for Non-banking Finance Companies Rating Approach - Implicit Support from Parent or Group
Parent/Group support	KMBL holds a 30% stake in KIDF, while the balance is held by its subsidiaries – Kotak Securities Limited, Kotak Investment Advisors Limited and Kotak Mahindra Capital Company Limited. Consequently, KIDF enjoys strong financial and operational support from the Kotak Group, including access to capital, management and systems, and supervision by the board. ICRA expects the company to maintain prudent capitalisation and expects that support from the sponsors would be forthcoming as and when required.
Consolidation/Standalone	Standalone

About the company

Kotak Infrastructure Debt Fund Limited (KIDF) was formerly known as Kotak Forex Brokerage Limited and was in the foreign exchange related business. The company planned to foray into the infrastructure debt fund business and had applied for a licence from the Reserve Bank of India (RBI) in October 2016. It received the licence in April 2017. The company is fully owned by KMBL and its subsidiaries.

KIDF had a assets under management (AUM) of Rs. 618 crore as on March 31, 2022 with exposure to the renewable energy generation and transmission projects. For the year ended March 31, 2022, KIDF reported a PAT of Rs. 30 crore on a total asset base of Rs. 967 crore compared to Rs. 35 crore and Rs. 936 crore, respectively, as on March 31, 2021.

Key financial indicators (audited)

Kotak Infrastructure Debt Fund Limited (Rs. crore)	FY2020	FY2021	FY2022
	Ind AS	Ind AS	Ind AS
Net interest income	37.2	37.1	28.5
Operating expenses	7.5	8.3	8.5
Profit before tax	30.5	34.9	29.8
Profit after tax	30.5	34.9	29.8
Assets under management (AUM)	785	735	618
Net worth	380.2	415.6	445.7
Tier I	43.2%	74.9%	69.6%
CRAR	43.6%	75.3%	69.9%
Gearing (times)	1.4	1.2	1.2
Net profit/Average total assets	3.6%	3.8%	3.1%
Return on net worth	8.3%	8.8%	6.9%
Gross stage 3	0%	0%	0%
Net stage 3	0%	0%	0%
Net stage 3/Net worth	0%	0%	0%

Source: Company, ICRA Research; All ratios as per ICRA's calculations

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 (Rs. crore)	Date and rating in FY2023	Date and rating in FY2022	Date and rating in FY2021	Date and rating in FY2020
					Aug-2-22	Aug-27-21	Aug-28-20	Jul-29-19
1	Non-convertible debenture programme	Long term	1,000.00	500.00	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)
2	Commercial paper programme	Short term	50.00	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

Source: Company data

Complexity level of the rated instrument

Instrument	Complexity Indicator
Non-convertible debenture programme	Simple
Commercial paper programme	Very 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 I: Instrument details as on March 31, 2022

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate (%)	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE905Y07019	Non-convertible debenture	Dec-5-2017	7.85%	Dec-5-2022	100	[ICRA]AAA (Stable)
INE905Y07027	Non-convertible debenture	Jan-19-2018	(1 year T-Bill +1.71%)	Feb-17-2023	150	[ICRA]AAA (Stable)
INE905Y07035	Non-convertible debenture	Jun-29-2018	(1 year T-Bill +1.46%)	Jul-28-2023	150	[ICRA]AAA (Stable)
INE905Y07043	Non-convertible debenture	May-30-2019	9.15%	Jun-28-2024	100	[ICRA]AAA (Stable)
NA^	Non-convertible debenture	NA	NA	NA	500	[ICRA]AAA (Stable)
NA^	Commercial paper	NA	NA	7-365 days	50	[ICRA]A1+

Source: Company; ^Yet to be placed/unutilised

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.

For more information, visit www.icra.in

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