April 16, 2021

Indostar Capital Finance Limited: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Commercial Paper	1,250	1,250	[ICRA]A1+; Reaffirmed

**Instrument details are provided in Annexure-1*

Rationale

While arriving at the rating, ICRA has taken a consolidated view of the credit profiles of Indostar Capital Finance Limited (Indostar) and its wholly-owned subsidiary – Indostar Home Finance Private Limited (IHFPL), referred to as the Group or Indostar, owing to the common management, shared infrastructure, as well as the strategic importance of IHFPL to the Group.

The rating reaffirmation considers Indostar's strong capitalisation with a consolidated gearing of 1.9x and standalone capital adequacy of 35.3% as on December 31, 2020. Further, the rating draws comfort from the strong liquidity profile with the management's stated intention of maintaining ~15% of the net worth in liquid investments and undrawn bank lines at all times. The rating also factors in the experienced management team, the strong institutional investors, and the diversified product portfolio with the increasing share of the retail loan book (75% in December 2020 compared to 61% in March 2019) and the steady decline in the wholesale loan book, though the track record in retail lending is limited.

The aforesaid strengths are, however, partially offset by the asset quality challenges and subdued profitability trajectory. Given the Covid-19-induced disruptions, the Group's portfolio vulnerability stands augmented as reflected by the uptick in the delinquencies in the softer buckets. While the reported proforma asset quality indicators were comfortable as of December 31, 2020 (consolidated proforma gross NPA% of 2.8%), it is noted that these have been supported by the sizeable sale of non-performing accounts (gross value of Rs. 161 crore; 1.8% of the loan book), write-offs and restructuring support to eligible customers (3.66% of the retail loan book as of December 31, 2020). This, in turn, has kept the profitability indicators under pressure with a consolidated return on assets (RoA) and return on equity (RoE) of 1.3% and 4.5%, respectively, in 9M FY2021 following the net loss reported in FY2020. In this regard, the Group's ability to scale up the loan book over the medium term by leveraging the existing infrastructure network and partnerships while maintaining prudent underwriting standards and hence good control over incremental slippages will remain a key determinant of the profitability trajectory.

Also, while the Group has established relationships over the years with banks and investors to diversify its lender base, ICRA notes that its dependence on incremental borrowings from banks, mutual funds and other domestic investors has remained limited in the recent past due to sizeable equity infusion and curtailed portfolio growth. Going forward, given the growth plans, it would be imperative to leverage and demonstrate the relationship network to re-establish financial flexibility and to borrow sizeable funds for a prudent tenure at competitive rates from diverse sources.

Key rating drivers and their description

Credit strengths

Strong capitalisation – Indostar's capitalisation strengthened following the capital raise in Q1 FY2021. As of December 31, 2020, the consolidated net worth (net of goodwill) stood at Rs. 3,704 crore with a consolidated gearing of 1.9x, strong standalone capital adequacy of 35.3% and comfortable consolidated solvency (proforma net stage 3/net worth) of 3.8%. Nonetheless, while the leverage has eased post March 2019 due to the sizeable capital raise and the tepid portfolio trajectory thereafter, ICRA expects the gearing to increase considerably from the current level with the growth in the retail portfolio over the medium term. The company is, however, expected to maintain a prudent capitalisation level commensurate with the underlying portfolio mix and comfort is drawn from its flexibility to raise equity funds from capital markets. In May 2020, Indostar had raised capital from BCP V Multiple Holdings Pte Ltd (Brookfield), a private equity fund managed by Brookfield Business Partners. Brookfield infused about Rs, 1,225 crore in Indostar by way of equity shares and compulsorily convertible preference shares (CCPS).

The Group's liquidity position is strong with the management's stated intention of maintaining ~15% of the net worth in liquid investments and undrawn bank lines at all times. Furthermore, the company has adopted a conservative approach during the challenging times witnessed in the past two years, with higher on-balance sheet liquidity being maintained. As of March 31, 2021, cash and liquid investments held by the group aggregated about Rs. 1,689 crore. Nevertheless, while the Group has established relationships over the years with banks and investors to diversify its lender base, ICRA notes that its dependence on incremental borrowings from banks, mutual funds and other domestic investors has remained limited in the recent past due to sizeable equity infusions and curtailed portfolio growth. Going forward, given the growth plans, it would be imperative to leverage and demonstrate the relationship network to re-establish financial flexibility and to borrow sizeable funds for a prudent tenure at competitive rates from diverse sources.

Diversified product portfolio with declining share of wholesale exposures; however, limited track record in retail lending and wholesale book remains concentrated – Indostar's diversified product basket encompasses vehicle finance for new and used vehicles, loans to small-to-medium-size enterprises, wholesale funding to corporates, and home finance through a wholly-owned subsidiary. As of December 31, 2020, the consolidated assets under management (AUM) aggregated Rs. 8,865 crore comprising commercial vehicle (CV) finance (45% share), real estate corporate funding (21%), non-real estate corporate funding (5%), SME finance (20%) and housing finance (10%). However, while the Group has a track record of almost a decade in wholesale lending, its experience in the retail lending segment is limited as it started SME lending in FY2016, and CV financing and housing finance in FY2018. Thus, its ability to prudently calibrate the expansion in the retail segments and further improve the granularity of the portfolio while maintaining the underwriting standards and hence the asset quality and profitability will be a key monitorable going forward.

Also, while the wholesale portfolio is being run down and has experienced a churn, especially in the real estate segment where prepayments have been high in the past, the wholesale loan book is characterised by concentration towards a few borrower groups. Hence, the asset quality is susceptible to lumpy slippages despite the established credit appraisal and risk management processes. Nevertheless, ICRA notes that Indostar's wholesale book was originated with a focus on reputed borrower groups/developers with an established track record of timely debt servicing. All project cash flows are escrowed and the loan is structured in a manner that enables mandatory prepayments and hence the early repayment of loans.

Experienced management team and strong institutional investors – Indostar's institutional investors have played an active role in its decision making since inception. The risk committee, which is responsible for managing risk at the overall level, comprises both investors and independent directors, and the credit committee is constituted by nominees of the investors. As a result, the company gains from the involvement of the key institutional investors, including Brookfield, and their experience in the Indian and global markets. Further, the company has onboarded senior professionals with established expertise and track records in the respective product segments, which augurs well for achieving the envisaged roadmap while maintaining prudent underwriting standards and its risk philosophy.

Credit challenges

Asset quality challenges – Given the Covid-19-induced disruptions and the associated impact on various segments of the economy, the Group's portfolio vulnerability stands augmented as reflected by the uptick in the delinquencies in the softer buckets. Thus, the overall asset quality performance in the near term will remain a monitorable. Although the Group reported proforma gross stage 3 and net stage 3 percentages of 2.8% (2.1% with the Supreme Court's dispensation) and 1.8%, respectively, as of December 31, 2020 compared to 4.8% and 3.8%, respectively, as on March 31, 2020, the improvement in the reported asset quality metrics in 9M FY2021 was primarily driven by the sale of stressed CV loans aggregating Rs. 126 crore (gross value of Rs. 161 crore; 1.8% of the loan book) to an asset reconstruction company at net book value with security receipts carried by the company. Moreover, the Group had restructured 3.66% of the retail loan book by the end of December 2020.

Nonetheless, ICRA draws comfort from the encouraging trajectory of the collection efficiency, which improved for the retail portfolio to 137% in December 2020 and 114% in November 2020 from 92% in September 2020 (including foreclosures) after having remained low at 65-70% in July 2020 and August 2020. Also, it is noted that the overall provision coverage on the loan portfolio stands enhanced at about 7% (was less than 3% in March 2019) backed by management overlay of Rs. 256 crore (~3% of the loan book). Earlier, the Group's asset quality had come under pressure in FY2020 with the gross and net stage 3 increasing to 4.8% and 3.8%, respectively, in March 2020 (significantly higher if adjusted for large write-offs aggregating Rs. 497 crore) from 2.6% and 1.7%, respectively, in March 2019. As a result, the company's solvency metric (net stage 3/ net worth) had also weakened to 13.9% in March 2020 (from 6% in March 2019) before witnessing a recovery supported by a capital raise in Q1 FY2021.

At the standalone level, Indostar reported proforma gross and net stage 3 percentages of 2.9% and 1.8%, respectively, as of December 31, 2020 compared to 5.1% and 4.1%, respectively, as on March 31, 2020. For IHFPL (standalone), the reported proforma gross and net stage 3 percentages stood at 1.8% and 1.5%, respectively, as of December 31, 2020 compared to 0.8% and 0.7%, respectively, as on March 31, 2020.

Subdued profitability trajectory – Notwithstanding the increased share of the higher-yielding CV finance business in Indostar's portfolio, an improvement in the lending spreads and net interest margins didn't materialise during the past two years amid elevated borrowing costs (though the incremental borrowing cost trajectory turned favourable in recent quarters). Further, the decline in the loan book due to the focus on portfolio realignment and the conservative lending strategy in the challenging operating environment led to an adverse movement in the cost structure with increased operating cost as a proportion of the asset base. Moreover, the weakened asset quality manifested into a spurt in credit costs, whereby provisions and write-offs amounted to 7.8% of the total assets in FY2020 compared to 0.2% in FY2019. As a result, the already modest profitability of the Group, amid the growing scale of operations in new business segments and hence higher operating costs, weakened as reflected by the large net loss reported in FY2020 compared to the consolidated RoA and RoE of 2.5% and 10.1%, respectively, in FY2019. The profitability pressure sustained in FY2021 as well with consolidated RoA and RoE of 1.3% and 4.5%, respectively, in 9M FY2021, given the pandemic-induced challenges and the large infrastructure set up by the Group to expand its retail lending footprint. In this regard, the company's ability to scale up the loan book over the medium term by leveraging the existing infrastructure network and partnerships while maintaining prudent underwriting standards and hence good control over incremental slippages will remain a key determinant of the profitability trajectory.

Liquidity position: Strong

The Group has a sound policy of maintaining ~15% of its net worth in liquid investments and undrawn bank lines at all times, and the management endeavours to avoid asset-liability mismatches. Furthermore, the company has adopted a conservative approach during the challenging times witnessed in the past two years, with higher on-balance sheet liquidity being maintained. As of March 31, 2021, the Group's asset liability maturity (ALM) profile reflected scheduled debt repayments (principal + interest) of Rs. 1,149 crore over the next three months compared to liquid investments aggregating Rs. 1,689 crore (cash & bank balances and unencumbered investments in term deposits and mutual funds) and the inflows from loan repayments of over Rs. 416 crore. Besides, the undrawn funding lines stood at Rs. 174 crore and the company has the ability to securitise loans to manage liquidity.

Rating sensitivities

Positive factors – Not applicable

Negative factors – The rating could be downgraded if the liquidity position or asset quality deteriorates significantly with the consolidated solvency metric (net stage 3/Tier I) deteriorating to a level over 20% on a sustained basis. Inability to improve the profitability would also be a credit negative.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA's Credit Rating Methodology for Non-Banking Finance Companies ICRA's Credit Rating Methodology for Housing Finance Companies Financial Consolidation and Rating Approach
Parent/Group Support	-
Consolidation/Standalone	Consolidation; To arrive at the rating, ICRA has taken a consolidated view of the credit profiles of Indostar Capital Finance Limited (Indostar) and its subsidiary – Indostar Home Finance Private Limited (IHFPL), referred to as the Group or Indostar, owing to the common management, shared infrastructure, as well as the strategic importance of IHFPL to the Group.

About the company

Indostar Capital Finance Limited is a systemically important non-banking financial company (NBFC). It offers vehicle finance for new and used vehicles, loans to small-to-medium-size enterprises, long-term wholesale funding to corporates, and home finance through its wholly-owned subsidiary – Indostar Home Finance Private Limited (IHFPL). As of December 31, 2020, the assets under Indostar's management (at the consolidated level) aggregated Rs. 8,865 crore with the commercial vehicle (CV) finance book holding a 45% share, the real estate corporate funding segment holding 21%, non-real estate corporate funding holding 5%, SME finance holding 20% and the housing finance book holding 10% (PY: 8%).

While Indostar commenced lending operations in 2011 with a primary focus on wholesale lending, it ventured into SME finance in FY2016, followed by used and new vehicle financing for transporters and loans to SME borrowers in FY2018. The proportion of CV financing increased substantially (to 44% in December 2019 from 9% in September 2018) post the acquisition of the Rs. 3,514-crore CV portfolio (AUM basis) from IIFL Finance in March 2019. With this acquisition, the company's branch network increased to 322 from 161 before being rationalised/consolidated to 217 in December 2020.

As of December 31, 2020, Brookfield held a 52% stake in Indostar, followed by IndoStar Capital Mauritius at 41% (including ECP II & ECP III). Brookfield Group invested Rs. 1,225 crore in Indostar (through BCP V Multiple Holdings Pte Ltd) in May 2020 to become the largest shareholder and co-promoter of the company. Indostar 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. Subsequently, the company got listed on stock exchanges in May 2018 and received a fresh equity infusion of Rs. 700 crore.

On a standalone basis, the company reported a net loss of Rs. 340 crore in FY2020 on an asset base of about Rs. 9,847 crore compared to a net profit of Rs. 255 crore on an asset base of Rs. 12,254 crore in FY2019. In 9M FY2021, the company reported a net profit of Rs. 70 crore.

On a consolidated basis, the company reported a net loss of Rs. 325 crore in FY2020 on an asset base of about Rs. 9,917 crore compared to a net profit of Rs. 241 crore on an asset base of Rs. 12,277 crore in FY2019. In 9M FY2021, the company reported a net profit of Rs. 103 crore on an on-book asset base of about Rs. 11,732 crore.

Key financial indicators

Indostar Capital Finance Limited	Standalone			Consolidated		
	FY2019	FY2020	9M FY2021	FY2019	FY2020	9M FY2021
	Audited	Audited	Provisional	Audited	Audited	Provisional
PAT	255	(340)	70	241	(325)	103
Adjusted* Net Worth	2,730	2,388	3,680	2,706	2,380	3,704
Assets under Management (AUM)	11,187	8,859	7,949	11,735	9,690	8,865
Return on Average Assets	2.6%	-3.1%	0.9%	2.5%	-2.9%	1.3%
Return on Average Equity	10.6%	-13.3%	3.1%	10.1%	-12.8%	4.5%
Gearing (times)	3.3	2.8	1.9	3.3	2.8	1.9
Adjusted Net Worth/ AUM	23.3%	27.0%	46.3%	23.1%	24.6%	41.8%
CRAR	24.0%	25.3%	35.3%			
Proforma Gross Stage 3 (%)	2.6%	5.1%	2.8%	2.6%	4.8%	2.8%
Net Stage 3 (%)	1.6%	4.1%	1.7%	1.6%	3.8%	1.8%
Net Stage 3/ Adjusted Net Worth	6.0%	13.7%	3.6%	6.1%	13.9%	3.8%

Source: *Indostar, IHFPL, ICRA research; *Adjusted for Rs. 300-crore goodwill*
Amount in Rs. crore

Indostar Home Finance Private Limited

Incorporated in January 2016, Indostar Home Finance Private Limited (IHFPL) is a housing finance company (HFC). It is a wholly-owned subsidiary of Indostar Capital Finance Limited. IHFPL offers housing loans with a focus on the affordable housing segment, with ticket sizes ranging from Rs. 3 lakh to Rs. 30 lakh. As of December 31, 2020, IHFPL's on-book loan portfolio stood at Rs. 753 crore compared to Rs. 530 crore in March 2019 (Rs. 753 crore in March 2020) and Rs. 51 crore in March 2018. The loan book is currently equally split between the salaried and self-employed segments with 82% of the loan book concentrated in four states, i.e. Tamil Nadu, Maharashtra, Andhra Pradesh and Telangana. While 63% of the loan book has a tenor of over 15 years, 71% of the exposures have a loan-to-value (LTV) of less than 70%.

In FY2020, IHFPL reported a net profit of Rs. 14 crore on an asset base of about Rs. 800 crore compared to a net loss of Rs. 19 crore on an asset base of Rs. 568 crore in FY2019. In 9M FY2021, the company reported a net profit of Rs. 34 crore on an asset base of about Rs. 840 crore.

Key financial indicators

Indostar Home Finance Private Limited	FY2019	FY2020	9M FY2021
	Audited	Audited	Provisional
PAT	(19)	14	34
Net Worth	172	186	221
Loan Book	530	753	753
Return on Average Assets	-6.1%	2.1%	5.5%
Return on Average Equity	-17.2%	7.9%	22.0%
Gearing (times)	2.2	3.1	2.6
CRAR	58.3%	46.8%	NA
Proforma Gross Stage 3 (%)	0.1%	0.8%	1.8%
Net Stage 3 (%)	0.1%	0.7%	1.5%
Net Stage 3/ Adjusted Net Worth	0.3%	2.7%	5.1%

Source: *IHFPL, 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

	Instrument	Current Rating (FY2022)				Rating History for the Past 3 Years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Apr 16, 2021	FY2020	FY2019			FY2018
						Mar 17, 2020	Feb 14, 2019	Dec 31, 2018	May 22, 2018	Sep 21, 2017
1	Commercial Paper	Short Term	1,250	125*	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**

Source: *ICRA research; *As of March 31, 2021*

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance/ Sanction	Coupon Rate/ Yield	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE896L14CT9	Commercial Paper	Jun-10-20	8.5%	Jun-10-21	125	[ICRA]A1+
NA*	Commercial Paper	NA	NA	7-365 days	1,125	[ICRA]A1+

Source: *ICRA; *Not placed*

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Indostar Capital Finance Limited	Rated Entity	Full Consolidation
Indostar Home Finance Private Limited	Subsidiary	Full Consolidation
Indostar Asset Advisory Private Limited	Subsidiary	Full Consolidation

ANALYST CONTACTS

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

Manushree Saggar
+91-124-4545316
manushrees@icraindia.com

Deep Inder Singh
+91-124-4545830
deep.singh@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

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

ICRA Limited

Registered Office

1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches