

JM Financial Asset Reconstruction Company Limited

July 10, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debenture programme-		1,000	[ICRA]AA-(Stable); Assigned
Long-term market linked debenture programme	-	100	PP-MLD[ICRA]AA-(Stable); Assigned
Commercial paper programme	750	1,500	[ICRA]A1+; Assigned
Long-term bank lines	650	1,000	[ICRA]AA-(Stable); Assigned
Non-convertible debenture programme	1,000	1,000	[ICRA]AA-(Stable); Outstanding
Long-term market linked debenture programme	200	200	PP-MLD[ICRA]AA-(Stable); Outstanding
Total	2,600	4,800	

*Instrument details are provided in Annexure-1

Rating action

ICRA has assigned the rating of [ICRA]AA- (pronounced ICRA double A minus) to the Rs. 1,000-crore non-convertible debenture programme and Rs. 1,000-crore (enhanced from Rs. 650 crore) long-term bank lines of JM Financial Asset Reconstruction Company Limited (JMFARC). ICRA has also assigned the rating of PP-MLD[ICRA]AA- (pronounced principal protected market linked debenture ICRA double A minus) to JMFARC's Rs. 100-crore long-term market linked debenture programme and the rating of [ICRA]A1+ (pronounced ICRA A one plus) to the Rs. 1,500-crore (enhanced from Rs. 750 crore) commercial paper programme.

ICRA has the rating outstanding of [ICRA]AA- for JMFARC's Rs. 1,000-crore non-convertible debenture programme. ICRA also the rating outstanding of PP-MLD[ICRA]AA- for the company's Rs. 200-crore market linked debenture programme. The outlook on the long-term ratings is Stable.

According to the terms of the rated market linked debentures, the amount invested, that is the principal, is protected against erosion while the returns on the investment could vary, being linked to movements in one or more variables, such as equity indices, commodity prices, and/or foreign exchange rates. The rating assigned expresses ICRA's current opinion on the credit risk associated with the issuer concerned. The rating does not address the risks associated with variability in returns resulting from adverse movements in the variable(s) concerned.

Rationale

The ratings factor in JMFARC's strong parentage by virtue of being a part of JM Financial Group, which is a well-diversified financial services provider with a leading position in capital markets businesses viz. investment banking, broking and securities-based lending. The company is a strategically important venture of JM Financial Group and shares

strong linkages with the parent, as evidenced by the shared brand name and demonstrated support at the operational, managerial and financial level. The ratings also factor in the company's strong position in the asset reconstruction space with sizeable assets under management (AUM), an experienced management team, stable profitability indicators and comfortable capitalisation levels. The company raised fresh capital of Rs. 279 crore in FY2018, which helped improve its gearing to 1.46 times as of March 2018 from 2.07 times as of March 2017. The ratings, however, are constrained by the high-risk profile of the company's asset class given the focus on large ticket size single credit exposures, limited seasoning of the asset reconstruction industry, its evolving nature given the significant changes in the regulatory environment and the challenges faced by the industry in continuously acquiring assets at reasonable prices. Going forward, the company's ability to ramp up its operations, achieve timely resolution for its assets, and maintain profitability and leverage, given the inherent risks associated with the asset reconstruction industry, remains critical from a credit perspective.

Outlook: Stable

ICRA believes that JMFARC will continue to benefit from its financial strength, comfortable capitalisation, demonstrated track record and established position in the asset reconstruction space. The outlook may be revised to Positive if there is a substantial and sustained improvement in the company's recoveries and profitability, leading to an improvement in its financial risk profile. The outlook may be revised to Negative if there is significant deterioration in the resolution performance and profitability indicators, thereby adversely affecting its financial risk profile.

Key rating drivers

Credit strengths

Strong brand name of Group with diversified revenue stream - JM Financial Group is a diversified financial services entity with interests in investment banking, retail and institutional equity broking, wealth management, investment advisory services, portfolio management, asset management, commodity broking, securities-based lending, corporate lending, real estate lending, private equity, and asset reconstruction. The Group is one of the leading entities in capital markets and related businesses with a prime focus on investment banking and merchant banking operations and has been engaged in many marquee deals. On a consolidated basis, the Group's revenue stream remains well diversified with fund-based businesses, investment banking and related businesses, and asset management and related businesses contributing 70%, 26% and 4%, respectively, to total revenues during FY2018 compared to 69%, 27% and 4%, respectively, during FY2017.

Strong linkages with parent coupled with demonstrated track record of support - JM Financial Limited (JMFL, rated [ICRA]AA/Stable/[ICRA]A1+), the holding company of JM Financial Group, has a 57.07% stake in JMFARC. The asset reconstruction business is a strategically important venture for JM Financial Group. Thus, the Group has allocated significant resources in the form of demonstrated financial (Rs. 279 crore equity infused during FY2018) as well as management support to the company.

Strong position in asset reconstruction space and experienced management team - JMFARC is among the leading players in the asset reconstruction business with AUM of Rs. 12,965 crore as on March 31, 2018 (Rs. 11,874 crore as on March 31, 2017). The company mainly operates in the large single borrower corporate segment, which is riskier than the retail segment, on account of the larger ticket size, higher complexity involved in the transactions and the resolution process, and the high degree of engagement required with promoters. The presence in the corporate and SME portfolios

consisting of multiple borrowers provides some diversification to the AUM. As on March 31, 2018, single assets formed 72% of the total AUM (74% as of March 2017) followed by corporate and SME accounts at 27% (25% as of March 2017) with the balance 1% (1% as of March 2017) being retail assets. After a sharp growth of ~130% during FY2015, the growth in the company's AUM has moderated over the years on account of limited acquisitions and a challenging operating environment. AUM growth remained muted during FY2018 at 9%. Like most other players in the industry, a substantial portion of JMFARC's AUM was acquired in FY2014 and FY2015. ICRA takes comfort from the experienced management team with most of them having been with the company since inception.

Stable profitability indicators - JMFARC's income, which comprises management fees, interest income from restructured accounts and profit on the redemption of security receipts (SRs), improved to Rs. 376 crore in FY2018 from Rs. 222 crore in FY2017 on account of increased fee income. With the increase in revenues, and stable expenses, the company's net profit improved to Rs. 108 crore during FY2018 (return on average net worth, RONW of 14%) compared to a net profit of Rs. 55 crore during FY2017 (RONW of 9.9%). ICRA takes note of the company's ability to maintain profitability even in a weak operating environment.

Comfortable capitalisation profile - The company's net worth remains adequate at Rs. 967 crore as on March 31, 2018 for the current scale of operations. ICRA takes note of the Rs. 279-crore equity infusion during FY2018. Supported by the equity infusion and accretion to reserves, the company's gearing remained comfortable at 1.46 times as on March 31, 2018 compared to 2.07 times as on March 31, 2017 despite the increase in AUM. Further, ICRA takes comfort from the company's strong current capitalisation levels and willingness of the parent to infuse further capital to support its growth plans.

Credit challenges

Exposed to concentration risks given the focus on large ticket size single credit exposures - The company focusses on the large single borrower segment, an asset class with a high-risk profile on account of its complexity, higher ticket size as well as high degree of engagement with promoters. This, coupled with the company's strategy of focussing on resolution through the revival of operations and debt restrictions, can result in a protracted process. Given the lumpy nature of these assets, inability to achieve resolution as per expectations, in terms of amount recovered as well as timelines, can have a bearing on the company's profitability. In ICRA's view, JMFARC faces asset quality related challenges, given its exposure to stressed assets, despite having an adequate asset acquisition and resolution policy framework in place. In the current economic scenario, marked by significant pressure on cash flows of borrowers, JMFARC's ability to resolve the assets and recover outstanding amounts will remain a key monitorable. The resolution performance of the company was healthy till FY2014 with a recovery ratio (defined as cumulative recovery to cumulative acquisition price) of nearly 22-33%. However, due to a sharp increase in AUM since then, the overall pace of resolution has reduced, and the recovery ratio stood at 23% till March 31, 2018. The SR redemption ratio was lower at 12.2% of total SRs issued as on March 31, 2018. It is to be noted that the recovery proceeds are used for the payment of management fees and other expenses and dues, while the balance is used for the redemption of SRs. Thus, the SR redemption ratio trails behind the recovery ratio.

Going ahead, the pace of resolution of assets and additional recoveries from lumpy assets like the one acquired during Q1 FY2015 will remain key rating monitorables. JMFARC, like other asset reconstruction companies, is covered under the

SARFAESI Act. In ICRA's view, this, along with a focussed approach towards NPA resolution, may facilitate speedy recoveries.

Limited seasoning of industry with challenges in acquiring assets at reasonable prices - In ICRA's view, the seasoning of the ARC industry remains limited. Also, the ability of ARCs to judiciously acquire new assets while maintaining a comfortable capital structure and competitive cost of borrowings remains a key rating sensitivity. In ICRA's view, any delay or inability in the resolution of delinquent assets could impact the company's profitability and liquidity profile and will remain a key rating monitorable. Also, while a change in the provisioning guidelines for banks for investments in SRs and changes in regulations of foreign investments in SRs are likely to augur well for the ARC industry, the positive impact of these remains to be seen.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria:

[ICRA's Credit Rating Methodology for Non-Banking Finance Companies](#)

About the company

JM Financial Asset Reconstruction Company Limited

Incorporated in September 2007, JM Financial Asset Reconstruction Company Limited is registered with the Reserve Bank of India (RBI) under the SARFAESI Act, 2002 as a securitisation and asset reconstruction company. The company is engaged in the business of acquiring non-performing financial assets from banks/financial institutions and the resolution of the same. The company is a subsidiary of JM Financial Limited (JMFL), which holds a 57.07% stake in JMFARC. The balance is held by Mr. Narotam Sekhsaria (16.50%), Valiant Mauritius Partners FDI Ltd. (8.42%), Indian Overseas Bank (6.09%) and others (11.92%) as on March 31, 2018. During FY2018, JMFARC reported a net profit of Rs. 108 crore on a total income base of Rs. 376 crore compared to a net profit of Rs. 55 crore on a total income base of Rs. 222 crore during FY2017. As on March 31, 2018, the company operated through six branches (including the head office) – two in Mumbai and one each in Bangalore, Delhi, Kolkata and Hyderabad.

JM Financial Group

JM Financial Group has interests in investment banking, retail and institutional equity broking, wealth management, investment advisory services, portfolio management, asset management, commodity broking, securities-based lending, corporate lending, commercial real estate lending, private equity, and asset reconstruction. The Group's clients include corporates, domestic and foreign financial institutions, high net worth individuals (HNIs), and retail investors. While each business is independent in itself, the companies in the Group have integrated operations. JM Financial Limited (JMFL) is the holding company of the operating companies in JM Financial Group. During FY2018, JMFL reported a consolidated net profit¹ of Rs. 631 crore on a total income² of Rs. 3,131 crore compared to a consolidated net profit¹ of Rs. 470 crore on a total income² of Rs. 2,267 crore during FY2017.

Key financial indicators of JMFARC (Audited)

	FY2017	FY2018
Total Income	222	376
Profit after tax	55	108
Net worth	580	967
Assets under management	11,874	12,965
Total assets	1,810	2,429
Return on average total assets	3.5%	5.1%
Return on average net worth	9.9%	14.0%
Gearing (times)	2.1	1.5

Source: Company & ICRA research; Amounts in Rs. crore

All ratios are as per ICRA calculations

¹ Including share in profit of associates and net of minority interest

² Net of sub-brokerage commission

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

Instrument	Current Rating (FY2019) Type	Current Rating (FY2019)		Chronology of Rating History for the past 3 years						
		Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Jul-18	FY2018 Jan-18	Jul-17	FY2017 Jan-17	Nov-16	Apr-16	FY2016 -
1 Non-convertible debentures	Long Term	1,000.00	859.90	[ICRA]AA- (stable)	[ICRA]AA- (stable)	[ICRA]AA- (stable)	[ICRA]AA- (stable)	[ICRA]AA- (stable)	[ICRA]A+ (positive)	[ICRA]A+ (stable)
2 Long term market linked debentures (Principal protected)	Long Term	200.00	75.00	PP-MLD[ICRA]AA- (stable)	PP-MLD[ICRA]AA- (stable)	PP-MLD[ICRA]AA- (stable)	-	-	-	-
3 Term loans	Long Term	250.00	250.00	[ICRA]AA- (stable)	[ICRA]AA- (stable)	[ICRA]AA- (stable)	[ICRA]AA- (stable)	[ICRA]AA- (stable)	[ICRA]A+ (positive)	[ICRA]A+ (stable)
4 Cash credit/WCDL	Long Term	225.00	NA	[ICRA]AA- (stable)	[ICRA]AA- (stable)	[ICRA]AA- (stable)	[ICRA]AA- (stable)	[ICRA]AA- (stable)	[ICRA]A+ (positive)	[ICRA]A+ (stable)
5 Overdraft	Long Term	120.00	NA	[ICRA]AA- (stable)	[ICRA]AA- (stable)	[ICRA]AA- (stable)	[ICRA]AA- (stable)	[ICRA]AA- (stable)	[ICRA]A+ (positive)	[ICRA]A+ (stable)
6 Bank lines – Unallocated*	Long Term	405.00	NA	[ICRA]AA- (stable)	[ICRA]AA- (stable)	[ICRA]AA- (stable)	[ICRA]AA- (stable)	[ICRA]AA- (stable)	[ICRA]A+ (positive)	[ICRA]A+ (stable)
7 Commercial paper	Short Term	1,500.00 (enhanced 750.00)	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
8 Non-convertible debentures*	Long Term	1,000.00	-	[ICRA]AA- (stable); assigned	-	-	-	-	-	-
9 Long term market linked debentures (Principal protected)*	Long Term	100.00	-	PP-MLD[ICRA]AA- (stable); assigned	-	-	-	-	-	-

*Proposed

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 No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE265J07134	Long Term Market Linked Debenture	30-Jun-17		27-Sep-19	10	PP-MLD[ICRA]AA- (stable)
INE265J07142	Long Term Market Linked Debenture	30-Jun-17		07-Oct-19	5	PP-MLD[ICRA]AA- (stable)
INE265J07167	Long Term Market Linked Debenture	04-Sep-17		05-Sep-19	35	PP-MLD[ICRA]AA- (stable)
INE265J07217	Long Term Market Linked Debenture	2-May-18		30-Apr-20	25	PP-MLD[ICRA]AA- (stable)
NA	Long Term Market Linked Debenture*	-	-	-	225	PP-MLD[ICRA]AA- (stable)
INE265J07050	Non-convertible debenture programme	10-Oct-14	12.00%	26-Oct-17	20	[ICRA]AA- (stable)
INE265J07068	Non-convertible debenture programme	10-Oct-14	12.00%	11-Dec-17	30	[ICRA]AA- (stable)
INE265J07035	Non-convertible debenture programme	18-Aug-14	13.00%	22-Sep-17	100	[ICRA]AA- (stable)
INE265J07076	Non-convertible debenture programme	03-Feb-15	0.00%	25-Apr-18	50	[ICRA]AA- (stable)
INE265J07092	Non-convertible debenture programme	27-Dec-16	0.00%	20-Apr-20	100	[ICRA]AA- (stable)
INE265J07084	Non-convertible debenture programme	27-Dec-16	0.00%	08-May-20	50	[ICRA]AA- (stable)
INE265J07100	Non-convertible debenture programme	27-Feb-17	9.40%	27-Feb-19	40	[ICRA]AA- (stable)
INE265J07118	Non-convertible debenture programme	21-Jun-17	9.3085%	22-Jun-20	50	[ICRA]AA- (stable)
INE265J07126	Non-convertible debenture programme	21-Jun-17	9.25%	21-Jun-19	50	[ICRA]AA- (stable)
INE265J07159	Non-convertible debenture programme	20-Jul-17	9.30%	02-Sep-20	28.5	[ICRA]AA- (stable)
INE265J07175	Non-convertible debenture programme	07-Sep-17	9.10%	07-Sep-20	185	[ICRA]AA- (stable)
INE265J07159	Non-convertible debenture programme	12-Sep-17	9.15%	02-Sep-20	14.7	[ICRA]AA- (stable)
INE265J07183	Non-convertible debenture programme	26-Sep-17	9.10%	26-Sep-19	75	[ICRA]AA- (stable)
INE265J07209	Non-convertible debenture programme	25-Apr-18	9.25%	12-May-20	26.7	[ICRA]AA- (stable)
INE265J07191	Non-convertible debenture programme	25-Apr-18	9.35%	25-May-21	14	[ICRA]AA- (stable)
INE265J07191	Non-convertible debenture programme	23-May-18	9.50%	25-May-21	21	[ICRA]AA- (stable)
INE265J07191	Non-convertible debenture programme	21-Jun-18	9.75%	25-May-21	5	[ICRA]AA- (stable)
NA	Non-convertible debenture programme*	-	-	-	1,140.10	[ICRA]AA- (stable)
NA	Term Loans	2017	-	2020-21	250	[ICRA]AA- (stable)
NA	Cash Credit	2017	-	-	225	[ICRA]AA- (stable)
NA	Overdraft	2017	-	-	120	[ICRA]AA- (stable)
NA	Proposed Bank Lines*	-	-	-	405	[ICRA]AA- (stable)
NA	Commercial Paper programme	-	-	7-365 days	1,500	[ICRA]A1+

*Proposed

Source: JM Financial Asset Reconstruction Company Limited

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