ICRA

Centrum Financial Services Limited

April 01, 2019

Summary of rated instruments

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Commercial Paper Programme	100.00	Provisional [ICRA]A1+(SO); Assigned
Total	**100.00**	

**Instrument details are provided in Annexure-1*

Rating action

ICRA has assigned a rating of Provisional [ICRA]A1+(SO) [pronounced Provisional ICRA A one plus (Structured Obligation)] to the proposed Rs. 100.0 crore commercial paper (CP) programme of Centrum Financial Services Limited ('CFSL/ Issuer'). The letters SO, in parenthesis, suffixed to the rating symbol stand for structured obligation. An SO rating is specific to the rated issue, its terms and structure. SO ratings do not represent ICRA's opinion on the general credit quality of the issuers concerned. The provisional ratings are subject to the fulfillment of all conditions under the structure, review by ICRA of the documentation pertaining to the transaction, and Issuer furnishing a legal opinion and tax opinion on the transaction to ICRA.

CFSL's proposed CP programme shall be a covered instrument. Commenting on the development, **Mr. Vibhor Mittal, Group Head – Structured Finance, ICRA Limited**, said *"The proposed CP Programme of Centrum Financial Services Limited shall be the second covered instrument issuance in the country after the Rs. 25.0 crore NCDs issued by Kogta Financial Services Limited (rated [ICRA]AA-(SO)) in January 2019. The CP investors shall have the benefit of dual recourse – recourse on the Issuer, and recourse on the bankruptcy remote Cover Pool assets (i.e. payments due from Larsen & Toubro Limited against invoices raised by its vendors) if the Issuer does not pay. This ensures that the instrument carries the highest credit rating on the short-term scale."*

Rationale

Centrum Financial Services Limited (CFSL) finances the vendors of Larsen & Toubro Limited (L&T/ Anchor; rated [ICRA]AAA stable/ [ICRA]A1+) against the receivables due from the Anchor as part of its supply chain finance business. As part of the transaction structure, an identified pool of such vendor receivables (i.e. payments due from Anchor to the vendors against invoices raised by vendors; 'Cover Pool') shall be assigned to a trust ('Vendor Trust'). As per the terms of the loan facility documents (between CFSL and vendors), the vendors have given CFSL the right to assign these receivables on their behalf to avail the funding from CFSL. The consideration paid by the Vendor Trust for the assignment shall be the loan itself that CFSL is providing to the vendors. Post assignment, the cover pool receivables shall form part of the Vendor Trust property and therefore be 'bankruptcy remote' from the creditors of both CFSL and the vendors that are part of the cover pool.

Only invoices raised against sale of goods and 'certified as good for payment' by the Anchor shall form part of the Cover Pool. Also, the Anchor shall confirm that it would make all payments against the Cover Pool assets directly into the designated account (account of the Vendor Trust) so that there is no commingling of cashflows with CFSL. Only vendors that are not overdue in the books of CFSL by more than 5 days shall be eligible to be part of the cover pool. Similarly, invoice level and vendor level concentration in the cover pool shall be capped at 1% and 5% of the overall cover pool respectively.

CFSL shall issue commercial paper (CP) amounting to not more than Rs. 100 crores (in single or multiple tranches). The CP shall be backed by an unconditional and irrevocable guarantee from the Vendor Trust covering the entire tenor of the CP. As per the terms of the transaction, the Cover Pool assets shall be minimum 1.2 times the maturity amount of the CP. Also, the maturity date of the Cover Pool assets shall be minimum 30 days prior to the maturity date of the CP. The availability of 20% over-collateralisation and minimum 30-day liquidity buffer (between the due date of the cover pool assets and the maturity date of the CP) should ensure that the proceeds realised from the cover pool assets is sufficient to cover all payments due on the CP. The payment mechanism is designed to ensure timely payment to the CP investors even if CFSL defaults, and the payment is made from proceeds lying in the Designated account (i.e. Vendor Trust assets/ property) through invocation of Vendor Trust guarantee by the CP Trustee.

The primary obligation of meeting the CP redemption is on the Issuer. However, in an unlikely event that the Issuer defaults on its payment obligation, the Vendor Trust guarantee shall be invoked and the collections from the Cover Pool assets shall be used for redeeming the instrument. Thus, the CP investors have the benefit of dual recourse – recourse on the Issuer, and recourse on the Cover Pool assets (that are bankruptcy remote from the Issuer) if the Issuer does not pay.

While assigning the rating, ICRA has taken comfort from the quality of the cover pool assets, the regular payment track record of the Anchor against such invoices in the past and the various other structural features that add strength to the transaction.

The Cover Pool shall be dynamic in nature i.e. payments against matured invoices can be used for purchasing fresh set of vendor receivables (follow-on/ top-up pools), provided the required asset cover is maintained and the eligibility criteria for top-up assets is fulfilled. CFSL shall also be permitted to take out cash from the Designated Account (i.e. deplete the Cover Pool) provided it replaces the equivalent amount through an unconditional and irrevocable SBLC issued by a bank acceptable to ICRA (i.e. ICRA has a rating/ internal shadow rating of A1+ on the bank) in favour of the CP Trustee.

Outlook: Not Applicable

Key rating drivers

Credit strengths

Bankruptcy remote nature of Cover Pool and availability of dual recourse to the CP investors – The CP investors shall have the benefit of dual recourse i.e. recourse on the Issuer, and recourse on the Vendor Trust/ Cover Pool assets if the Issuer does not pay. Cover Pool Assets are 'bankruptcy remote' and outside the reach of creditors of both CFSL and the vendors. Payments from the Anchor directly happen in the Designated Account belonging to the Vendor Trust and there is no commingling of cashflows with the Issuer.

Quality of Cover Pool – Cover pool comprises of receivables due from an entity rated AAA/ A1+ by ICRA. Only invoices certified as "good for payment" and from vendors that are not overdue by more than 5 days shall be part of the cover pool. 20% overcollateralization and a liquidity buffer of minimum 30 days should ensure that the proceeds realised from the cover pool assets are enough to meet all payments due on the CP. Caps on Invoice level and Vendor level concentration adds to the granularity of the Cover Pool Assets.

Payment mechanism – The payment mechanism is designed to ensure timely payment to CP investors even if CFSL defaults, and the payment is made from proceeds lying in the Designated account (i.e. Vendor Trust assets/ property) through invocation of Vendor Trust guarantee by the CP Trustee.

Centrum Group (the Group) has an established presence in the domestic financial services industry – The Group, through Centrum Capital Limited (CCL) and its subsidiaries, has diversified offerings in the financial services space with an established presence in the fee-based businesses such as investment banking, broking, wealth management, insurance broking and asset management. CCL is an investment bank and a holding company for the Group. It has an established position in the debt capital markets with clientele across public sector units, banks, state-level undertakings, private corporates and various provident funds. The Group's wealth management business has witnessed healthy traction in recent years with assets distributed and managed at Rs. 18,250 crore as on March 31, 2018, registering a five-year compound annual growth rate of ~43%. The Group held a leading position in the forex business through Centrum Direct Limited (CDL); the Group exited the business in April 2018. The Group ventured into distribution of insurance products and asset management business in FY2018. The Group also has a small equity broking operation under Centrum Broking Limited. The Group has now shifted its focus to grow the fund-based businesses and has set up a non-banking financial company (CFSL), a housing finance company (Centrum Housing Finance Limited) and a micro-finance institution (Centrum Microcredit Limited). With this diversification, the Group expects to expand its reach and customer base, thus increasing opportunity to cross-sell its offerings.

Committed financial support from CCL, the parent company; comfortable capitalisation of CCL and availability of investible surplus with the Group provides comfort – Centrum Group received cash flows to the tune of ~Rs. 1,000 crore in June 2018, on account of the stake sale in CDL, which is being used by the Group to fund the growth capital requirement of subsidiaries, including CFSL. CCL has given commitment to infuse funds aggregating to Rs. 450 crore in CFSL over the next two years (~Rs. 150 crore in FY2019 and ~Rs. 300 crore in FY2020). As part of the said infusion in FY2019, Rs. 50 crore was infused by CCL by subscribing to CFSL's compulsorily convertible debentures (CCD), out of which Rs. 35 crore was converted to equity as on December 31, 2018. Further, Rs. 90 crore of unsecured loan provided by CCL in September 30, 2018 was also converted to equity on November 30, 2018. Effectively, Rs. 125 crore of equity has already been infused by CCL into CFSL, in addition to the Rs. 60 crore infusion in March 2018. This capital infusion aided CFSL in acquiring loan portfolio and grow its book as on December 31, 2018. Gearing as on December 31, 2018 stands moderately at 3.20 times. Capital adequacy stands comfortable at 21.38%. The committed equity support from CCL will be used to grow the book further, while also maintaining the leverage and capital adequacy at comfortable levels.

Credit challenges

Payment obligation from Anchor is a contractual payment – Payment obligation against the Cover Pool assets is an operational or contractual obligation and not a financial obligation of the Anchor. While the obligation is unconditional and irrevocable in nature, there can be some instances of delays in the payment. However, the quality of the cover pool, and over-collateralisation/ liquidity buffer available in the transaction act as a risk mitigant. Also, in case of delay or default in payment, the vendor trustee (as an operational creditor) shall be able to take legal recourse against the Anchor under Insolvency and Bankruptcy Code, 2016 (IBC).

Moderate scale of operations with low seasoning of credit portfolio – CFSL's current scale of operations is moderate and is planning to grow the same through organic as well as inorganic routes. CFSL's loan book, which stood at ~Rs. 370 crore as on March 31, 2018 more than trebled to ~Rs. 1,245 crore as on December 31, 2018. Growth in the loan book was supported by the acquisition of the supply chain finance business from L&T Finance. CFSL's portfolio includes supply chain finance (55% of loan book as on December 31, 2018), loans to financial institutions (6%), loans to small and medium enterprises (30%), real estate finance (7%), and loan against shares (2%). ICRA, however, notes that the Group has limited experience in the lending business. Nonetheless, to scale up lending businesses, the Group has hired experienced professionals from the industry.

Recent tightening of liquidity in the market and resulting increase in cost of funds will test CFSL's ability to scale up business profitably – The liquidity available to NBFCs and HFCs has shrunk significantly over the past six months and this has increased their cost of borrowings considerably. With CFSL being in the growth phase, availability of fairly-priced funds is critical for a sustainable and profitable growth of the business. The company's ability to successfully scale up the business is a key rating sensitivity.

Liquidity Position

There shall be a minimum 30-day liquidity buffer between the due date of the cover pool assets and the maturity date of the corresponding CP tranche.
With CFSL's asset maturity profile being shorter term (maximum maturity in 120 days bucket), the asset-liability gap in the shorter term is positive. Liabilities mature over the next 24 months, with average maturity of 13 months. In addition, the company maintains sizeable cash and bank balance (Rs. 114.45 crore as on December 31, 2018), providing considerable liquidity cushion.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Approach for rating debt instruments supported by structural features (Non-securitized transactions) Rating Methodology for Non-Banking Finance Companies
Parent/Group Support	Not Applicable
Consolidation / Standalone	Not Applicable

About the company

Centrum Financial Services Limited (CFSL) is a registered Systemically Important Non-Deposit taking Non-Banking Finance Company (NBFC – NDSI) incorporated in August 2009. CFSL is a 100% subsidiary of CCL. CFSL is focused on providing short term financing products such as short-term corporate loans, loan against securities and margin funding to Corporates and HNIs functioning primarily as a service to the Group's wealth and investment banking verticals

The Group, founded by Mr. Chandir Gidwani – currently Chairman Emeritus of CCL, has presence across various segments including investment banking, wealth management, broking and forex business. With the appointment of Mr. Jaspal Bindra (more 30 years of global banking experience; previously the Asia-Pacific Head of Standard Chartered Bank and has also worked with Bank of America and UBS) as the Executive Chairman of CCL, the Group is planning to focus on the lending business which is complementary to the existing established non-fund business. In August 2016, the management decided to shift the focus to assisting SMEs, mid-sized companies and their founders to scale up their businesses, through loan products in a variety of forms, structures and collaterals. It targets entities in metros and tier II cities, that are either in a stage of building up or diversifying and are generally not addressed sufficiently by the mainstream banking system.

As on December 31, 2018, CFSL's portfolio stood at Rs. 1,245 crore, diversified across Supply Chain (55%), Commercial Finance (30%), Real Estate (7%), Loans to Financial Intermediaries (6%), and Loan against Shares (LAS) (2%).

Key financial indicators

CFSL	FY2017 I-GAAP	FY2018 I-GAAP
Total Income	38.60	70.46
Profit after tax (PAT)	5.48	0.39
Tangible Net worth	110.56	170.93
Total Loan Book	316.40	342.84
Total Assets	433.52	557.50
Return on average assets	1.66%	0.08%
PAT/ Average Net worth (ROE)	5.01%	0.28%
Gearing (times)	2.87	2.21

Source: Company, ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Current Rating (FY2019)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs Crore)	Date & Rating	Date & Rating in FY2018	Date & Rating in FY2017	Date & Rating in FY2016
					April 2019	-	-	-
1	CPs	Short-Term	100.00	-	Provisional [ICRA]A1+(SO)	-	-	-

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	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
Yet to be issued	Commercial Paper	-	-	7-365 days	100.00	Provisional [ICRA]A1+(SO)

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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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