IndoStar Capital Finance Limited (Revised)

August 09, 2022

Rating/Ratings

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long-Term Instruments	9,700.00	CARE A+ (CWN) (Single A Plus) (Under Credit watch with Negative Implications)	Revised from CARE AA- (Double A Minus); Revision in credit watch from Developing Implications to Negative Implications
Market Linked Debentures	100.00	CARE PP-MLD A+ (CWN) (Principal Protected-Market Linked Debentures Single A Plus); (Under Credit watch with Negative Implications)	Revised from CARE PP-MLD AA- (Principal Protected-Market Linked Debentures Double A Minus); Revision in credit watch from Developing Implications to Negative Implications
Market Linked Debentures	200.00	CARE PP-MLD A+ (CWN) (Principal Protected-Market Linked Debentures Single A Plus); (Under Credit watch with Negative Implications	Revised from CARE PP-MLD AA- (Principal Protected-Market Linked Debentures Double A Minus); Revision in credit watch from Developing Implications to Negative Implications
Total Long-Term Instruments	**10,000.00 (₹ Ten Thousand Crore Only)**		
Commercial Paper	1,000.00	CARE A1+ (CWN) (A One Plus) (Under Credit watch with Negative Implications)	Revision in credit watch from Developing Implications to Negative Implications
Commercial Paper	1,000.00	CARE A1+ (CWN) (A One Plus) (Under Credit watch with Negative Implications)	Revision in credit watch from Developing Implications to Negative Implications
Total Short Term Instruments	**2,000.00 (₹ Two Thousand Crore Only)**		

Detailed rationale and key rating drivers

CARE Ratings has revised the ratings assigned to the long-term instruments of IndoStar Capital Finance Limited (ICFL) to 'CARE A+' from 'CARE AA-' along with revision in credit watch from Developing Implications to Negative Implications and continues to maintain the rating of the short-term instruments at CARE A1+ with a revision in credit watch from Developing Implications to Negative Implications. The rating revision factors recently published annual accounts (including qualified audit opinion), deterioration in the business risk profile following disclosed control deficiencies and resultant losses leading to potential liability side challenges (including breach of covenants on several borrowings). The rating continues to draw significant comfort from the strength of the promoters. The promoters have been actively engaged with stakeholders and have demonstrated support by allocating management bandwidth and arranging liquidity. As a result, the cash and cash equivalents stood at around Rs.900 crore as on August 5, 2022, in comparison to Rs.470 crore as on March 31, 2022. Further, the promoters have reiterated that they would be willing to provide, or procure funding, through equity and/or debt, to support the liquidity position of the Company to satisfy its financial debt. The ratings factor the company's strong institutional sponsors, robust capitalization levels with healthy net-worth base and largely granular loan book. The rating is constrained by deterioration in asset quality, weak earnings and potential liability side challenges.

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

Control deficiencies and Qualified audit report
Post identification of control deficiencies in the CV and SME loans portfolio during the audit for the year ended 31 March 2022, the Audit Committee of the company, appointed an external agency viz., Ernst and Young (EY) to perform an in-depth analysis to assess the quality, controls and risks pertaining to this loan portfolio (including verification of the existence of borrowers / security for the CV and SME loans). Based on the preliminary findings released by the company on May 6, 2022, EY had estimated an additional estimated credit loss (ECL) provisioning between ₹557 crore and ₹677 crore, and the exercise was expected to be completed by the time of finalisation of the audited financial statements of the company. The report provided by EY was considered by ICFL in recording an impairment allowance (net of recoveries) of Rs.1,150 crore for the year ending March 31, 2022. Further, the Audit Committee of the company had also appointed an external law firm, Cyril Amarchand Mangaldas (CAM), to undertake a review for identifying the root cause of control deficiencies and reviewing transactions pertaining to the CV and SME loans portfolio that were executed with deficient controls. The review is ongoing and is expected to be completed by September 2022. Since significant judgements have been applied in determining the staging of the loan assets and the related impairment allowance for events and conditions which existed as on 31 March 22, the Company has concluded that it is not practicable to apply the same judgement without hindsight for the prior periods. As a result, the auditors have been unable to determine whether any adjustments are required for prior period(s) relating to the impairment recorded for the quarter and year ended March 31, 2022 and whether any additional adjustments are required relating to the outcome of the review. In view of the above reasons, the statutory auditors Deloitte Haskins & Sells LLP have issued a qualified audit opinion on the audit report for the year ended March 31, 2022. As indicated by the management, the behaviour of the loan pool in terms of the total collections has been encouraging, several assets would see favourable staging changes in the coming quarter and any incremental adverse impact on the earnings is highly unlikely.

The auditors have also expressed material uncertainty relating to going concern. As per the auditors, the total liabilities exceed the total assets maturing within 12 months by ~ Rs.2206.04 crore and for certain borrowings, the gross non-performing asset (GNPA) and/or net non-performing asset (NNPA) ratios have exceeded thresholds because of additional impairment allowance recorded during the year.

CARE Ratings understands from the management that the quantum of borrowings that has been impacted due to breach of covenants stands at Rs.1,882 crore as on June 30, 2022 of which Rs. 650 crore is in the form of debentures and Rs.1,232 is in the form bank borrowings. Further, the bank borrowings are relatively diversified and the probability of recall/termination of the entire amount is considered to be less likely. The management has also indicated to CARE Ratings that it has already made a buyback offer to the said debenture holders.

Further, the company had unencumbered cash and cash equivalents of Rs.900 crore as on August 5, 2022 and unutilised limit of Rs. 609 crore. The Company is also looking to generate liquidity by securitising / selling eligible pool of assets and securing additional loans from banks. Further, in addition to regular collections, the Company has a track record of reasonable pre-payments from its borrowers. Over and above this, the company/promoters have demonstrated strong ability to tap resources and have been able to raise Rs.1,000 crore after public disclosure were made of control lapses in the CV book.

Rating sensitivities

Positive factors – Factors that could lead to positive rating action/upgrade:

- Ability to generate risk calibrated growth in scale of operations
- Sustained improvement in profitability (ROTA above 2%) on a sustained basis
- Improvement in asset quality metrics on a sustainable basis

Negative factors – Factors that could lead to negative rating action/downgrade:

- Any change in ownership structure which results in reduction of Brookfield's stake in ICFL below 51% or moderation in linkages with the promoters (Brookfield and Everstone) reducing their intent and ability to support ICFL
- Adverse impact on the earnings profile and/or asset quality following observations, if any made as part of the ongoing reviews
- Significant increase in gearing levels to above 4x

Detailed description of the key rating drivers

Key rating strengths

Strong Institutional support

Brookfield is the largest shareholder with ~ 57% shareholding as on March 31, 2022. Listed on the New York Stock Exchange (NYSE: BAM) and the Toronto Stock Exchange (TSX: BAM.A) Brookfield is a global alternative asset manager offering investment strategies in property, infrastructure, renewable energy, private equity and public securities to institutional investors. It is one of the largest global managers of real estate assets and has significant funding capacity, with approximately US$725 billion in assets under management. ICFL is Brookfield's first private equity investment in India as well as first investment in the financial services space. Everstone, the second largest shareholder was founded in 2006 and is focused on cross-border North America – Asia investments as well as domestic investments in India and Southeast Asia. Brookfield has used its larger franchise as well as strong global banking relationships to raise funds for the company. The company has been able to raise Rs. 770 crore facility in June 2022, on the back of this support. Brookfield has been actively involved in managing the day-to-day operations of the company. Mr. Pankaj Thapar has joined as Director - Finance in July 2022, after ICFL's CFO resigned in July 2022. Prior to this, Mr. Pankaj Thapar had been working with IndoSpace Capital Advisors, an Everstone company. He had also served in the position of CFO on ICFL from 2011 to 2019. Mr. Deep Jaggi, who had joined ICFL in October 2020 as the Chief Business Officer was appointed as the CEO in January 2022. Several new appointments have been made in areas of Risk and Operations. The company under the leadership of the new team intends to become a pure 100% retail finance company and intends to continue its focus in the high yield used CV business and affordable housing finance business.

Strong capitalisation with healthy net worth base

The tangible net worth of ICFL decreased from Rs.3,251 crores as on March 31, 2021 to Rs.2,243 crore primarily owing to operating loss of Rs.896 crore reported in FY22. As a result, gearing increased from 1.85x as on March 31, 2021 to 2.77x (calculated using tangible net worth) as on March 31, 2022 and is expected to remain relatively rangebound. Capital Adequacy Ratio (CAR) remained strong at 25.8%, which still presents cushion over the regulatory requirement. As stated by the management, the CAR is likely to increase to around 30% levels by June 30, 2022, on account of ECL reversals and write-backs expected in the coming quarter, resulting from improvement in collection performance of the loan book and staging changes.

Increased granularity of loan book owing to retail focus, albeit low seasoning

As on March 31, 2022, loans in CV segment stood at around 47% of the loan book, followed by 19% in SME Segment, 18% in Corporate Lending and 16% in Affordable Housing Finance. The granularity of the loan book is likely to provide ample flexibility to the company for the purpose of securitization. GNPA on the newly originated book has remained below 2%, which once adequately seasoned would be a good candidate for securitization, if need be. The corporate lending book which formed 73% as on March 31, 2018, has been consciously run down in a span of three years, as part of long term retailisation strategy for the group. Going ahead, ICFL intends to focus on growing its book in the used CV segment and affordable housing finance book.

Continued strong performance of housing finance subsidiary

IndoStar Home Finance Private Limited, the company's housing finance subsidiary continued to register strong performance. AUM as of Mar'22 stood at ~Rs.1,406 crore, recording 41% growth over FY21. The company recorded PAT of Rs.34 crore resulting in ROA of 3.1%. The networth stood at Rs.499 crore and GNPA stood at 1.9%.

Key rating weaknesses

Weak asset quality metrics

The company recorded overall high GNPA of 15.50% and NNPA of 8.30% as on March 31, 2022 as compared to GNPA of 4.40% and NNPA of 3.80% in March 31, 2021. High GNPA was primarily due to control deficiencies in Rs.1,381 crore stressed CV portfolio, where restructuring was done without complying with the internal/RBI policy and impact of Covid19 on its borrowers. Post conclusion of FY22, out of the stress pool of Rs.1381 crores, the company has sold Rs.516 crore loans for a discount of ~50% to an asset reconstruction company (ARC). It has written off Rs.369 crore and has collected Rs.94 crores till Jun'22. This is expected to reduce the CV stress pool to around Rs.401 crore in June 30, 2022. The company has further clarified that control deficiencies that have been reported with respect to the SME portfolio are primarily pertaining to loans where the tenor was in excess of the internal policy threshold of 15 years, owing to which step up provisioning was undertaken on those accounts. The total expected collection for the past 6 months stood at 1,439 crores against which the actual collections were around Rs.2,327 crores (including Rs.931 crores in prepayments). Basis the sale of the loan to ARC and incremental seasoning for portfolio coming out of moratorium, the management has indicated that the overall quantum of the GNPA will be lower as on June 30, 2022. Ability of the company to bring about reduction in GNPA levels and broadly align itself with the covenants as part of the borrowing agreements, remains a key rating monitorable.

Weak earnings profile
The company's operating loss increased to Rs.896 crore in FY22 on account of sharp rise in credit costs which increased to Rs.1,158 crore (12.25% of Average Assets) in FY22. Pre-provision operating profit remained nearly stable at Rs.262 crore. Of the total credit costs of Rs.1,158 crore, Rs.1,092 crore of the credit costs was recorded only in the CV Finance business, of which Rs.624 crore was attributed to ECL provisions and Rs.467 crore to write-offs. Of Rs.1,092 crore, Rs.945 crore was recorded in Q4 alone. IFCL has incurred losses for past three years. While the management expects future earnings to benefit from write-backs, CARE believes that overall earnings will remain relatively lacklustre in the near term as it will take time for the company to strengthen its risk controls and restore meaningful growth in the loan book amid potential rise in the funding costs going forward.

Liquidity: Adequate
The company's cash and cash equivalents of around Rs.900 crore as on August 5, 2022 are adequate to meet scheduled repayments in the next 3 months. However, in the event of lender induced forced prepayments, the liquidity metrics would be stretched to some extent. The Company has unutilised limit of Rs. 609 crore and is also looking to generate liquidity by securitising / selling eligible pool of assets. It has slowed down disbursements and, till the situation stabilises, is likely to conserve liquidity generated out of collections (including prepayments). Over and above this, the company / promoters have demonstrated strong ability to tap resources and have been able to raise around Rs.1,000 crore after public disclosure were made of control lapses in the CV book.

Analytical approach: CARE has taken a consolidated view of ICFL and its subsidiary IndoStar Home Finance Pvt Ltd (IHFPL), together referred to as IndoStar Group. This is because of 100% ownership, shared brand name, strong operational, management and financial linkages and growing size and strategic importance of IHFPL to the group. Further, CARE has factored in linkages and support from the key promoter Brookfield.

Applicable criteria

Criteria on assigning Outlook to Credit Ratings
CARE's Policy on Default Recognition
Financial ratios – Financial sector
Rating Methodology: Consolidation
CARE's Criteria for Market Linked Notes/Debentures
Criteria for Short Term Instruments
Factoring Linkages in Ratings
Criteria for Non-Banking Financial Companies

About the company

IndoStar Capital Finance Ltd. (ICFL) is registered with the Reserve Bank of India (RBI) as a systemically important non-deposit taking NBFC. The company started off with corporate lending in 2011, ventured into SME financing from 2015 and CV Financing from May 2017 to have a diversified and a granular portfolio. ICFL also diversified into retail home financing from FY18 through its subsidiary IndoStar Home Finance Private Limited (IHFPL). ICFL also plans to tie up with smaller NBFCs which have reach in Tier III and Tier IV cities to further its penetration and presence in the used vehicle business. ICFL operates through 343 branches across 19 states as on December 31, 2021.
The company is listed publicly with shareholding held by Brookfield (56.2%), Everstone (33%) and general public (10.8%).

Brief Financials (Rs. crore)	31-03-2021 (A)	31-03-2022(A)	Q1FY23
Total income	1,287	1,174	NA
PAT	-214	-737	NA
Total Assets	9,634	9,276	NA
Net NPA (%)	2.1	8.3	NA
ROTA (%)	-2.22	-7.8	NA

A: Audited

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for the last three years: Please refer Annexure-2

Covenants of the rated instruments/facilities: Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3

Complexity level of various instruments rated for this company: Annexure-4

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (₹ crore)	Rating assigned along with Rating Outlook
Non-Convertible Debentures (NCD)	INE896L07702	25-Nov-19	-	25-Oct-24	25	CARE A+ (CWN)
Non-Convertible Debentures (NCD)	INE896L07793	03-Jan-22	-	03-Jan-24	50	CARE A+ (CWN)
Non-Convertible Debentures (NCD)	INE896L07074	06-Jun-13	-	06-Jun-23	15	CARE A+ (CWN)
Non-Convertible Debentures (NCD)	INE896L07561	02-May-18	-	02-May-23	500	CARE A+ (CWN)
Non-Convertible Debentures (NCD)	INE896L07710	21-May-20	-	21-Feb-23	100	CARE A+ (CWN)
Non-Convertible Debentures (NCD)	INE896L08049	30-Jul-21	-	30-Aug-22	150	CARE A+ (CWN)
Non-Convertible Debentures (NCD)	INE896L07728	26-Jun-20	-	26-Jun-23	50	CARE A+ (CWN)
Debentures-Market Linked Debentures	INE896L07785	25-Aug-21	-	23-Feb-24	75	CARE PP-MLD A+ (CWN)
Debentures-Market Linked Debentures	INE896L07777	18-May-21	-	18-May-23	45.9	CARE PP-MLD A+ (CWN)
Debentures-Market Linked Debentures (Proposed)	-	-	-	-	179.1	CARE PP-MLD A+ (CWN)
Fund Based -LT -Term loan	-	-	-	31-Mar-26	2,069.25	CARE A+ (CWN)
Proposed facilities -LT	-	-	-	-	6740.75	CARE A+ (CWN)
Commercial Paper-Commercial Paper (Standalone)	INE896L14CU7	-	-	-	100	CARE A1+ (CWN)
Commercial Paper-Commercial Paper (Standalone)	INE896L14DA7				105	CARE A1+ (CWN)
Commercial Paper-Proposed					1795	CARE A1+ (CWN)

Annexure-2: Rating history for the last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021	Date(s) and Rating(s) assigned in 2019-2020
1	Commercial Paper-Commercial Paper (Standalone)	ST	1000.00	CARE A1+ (CWN)	1)CARE A1+ (CWD) (16-May-22)	1)CARE A1+ (20-Aug-21)	1)CARE A1+ (08-Oct-20) 2)CARE A1+ (17-Aug-20) 3)CARE A1+ (CWD) (17-Apr-20)	1)CARE A1+ (09-Oct-19)
2	Debt	LT	9700.00	CARE A+ (CWN)	1)CARE AA- (CWD) (16-May-22)	1)CARE AA- ; Stable (20-Aug-21)	1)CARE AA- ; Stable (08-Oct-20) 2)CARE AA- ; Stable (17-Aug-20) 3)CARE AA- (CWD)	1)CARE AA- ; Stable (09-Oct-19) 2)CARE AA- ; Positive (02-Apr-19)

							(17-Apr-20)	
3	Debentures-Market Linked Debentures	LT	100.00	CARE PP-MLD A+ (CWN)	1)CARE PP-MLD AA- (CWD) (16-May-22)	1)CARE PP-MLD AA-; Stable (20-Aug-21)	1)CARE MLD AA-; Stable (08-Oct-20) 2)CARE MLD AA-; Stable (17-Aug-20) 3)CARE MLD AA- (CW) (17-Apr-20)	1)CARE PP-MLD AA-; Stable (09-Oct-19)
4	Commercial Paper-Commercial Paper (Standalone)	ST	1000.00	CARE A1+ (CWN)	1)CARE A1+ (CWD) (16-May-22)	1)CARE A1+ (20-Aug-21)	1)CARE A1+ (08-Oct-20) 2)CARE A1+ (17-Aug-20) 3)CARE A1+ (CWD) (17-Apr-20)	-
5	Debentures-Market Linked Debentures	LT	200.00	CARE PP-MLD A+ (CWN)	1)CARE PP-MLD AA- (CWD) (16-May-22)	1)CARE PP-MLD AA-; Stable (20-Aug-21)	-	-

*Long term/Short term.

Annexure-3: Detailed explanation of the covenants of the rated instruments/facilities

General Covenants-Non Convertible Debentures
A. Financial covenants
I. Capital adequacy shall be maintained at minimum 20% during the tenure of NCD
Ii. Gross NPA shall not exceed 5% of assets under management in case if it increases then spread shall increase by five basis points in case GNPA goes above 6% then another five basis points and in case GNPA goes above 7% then termination
Iii. If at any time during the tenure of the NCD the rating of the issuer falls below A, the debenture holder will have a right but not an obligation, to require the issuer to redeem the debenture
B. Non-financial covenants
I. No Change in the name of the issuer
Ii. Existing promoter group comprising Brookfield and Everstone to maintain promoter status Jointly

Annexure-4: Complexity level of various instruments rated for this company

Sr. No.	Name of Instrument	Complexity Level
1	Commercial Paper-Commercial Paper (Standalone)	Simple
2	Debentures-Market Linked Debentures	Highly Complex
3	Debentures-Market Linked Debentures	Highly Complex
4	Debt	Simple

Annexure-5: Bank lender details for this company

To view the lender wise details of bank facilities please click here

Note on complexity levels of the rated instruments: CARE Ratings has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

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About us:
Established in 1993, CARE Ratings is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India, it has been acknowledged as an External Credit Assessment Institution by the RBI. With an equitable position in the Indian capital market, CARE Ratings provides a wide array of credit rating services that help corporates raise capital and enable investors to make informed decisions. With an established track record of rating companies over almost three decades, CARE Ratings follows a robust and transparent rating process that leverages its domain and analytical expertise, backed by the methodologies congruent with the international best practices. CARE Ratings has played a pivotal role in developing bank debt and capital market instruments, including commercial papers, corporate bonds and debentures, and structured credit.

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