IndoStar Capital Finance Limited

October 10, 2022

Rating

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long-term instruments	9,700.00	CARE A+ (CWN); Negative (Single A Plus) (Under Credit watch)	Continues to be on Credit watch with Negative Implications;
Market-linked debentures	100.00	CARE PP-MLD A+ (CWN); Negative	Continues to be on Credit watch with Negative Implications;
Market-linked debentures	200.00	CARE PP-MLD A+ (CWN); Negative	Continues to be on Credit watch with 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)	Continues to be on Credit watch with Negative Implications
Commercial paper	1,000.00	CARE A1+ (CWN) (A One Plus) (Under Credit watch)	Continues to be on Credit watch with Negative Implications
Total short-term instruments	**2,000.00 (₹ Two thousand crore only)**		

Detailed rationale and key rating drivers

CARE Ratings Limited (CARE Ratings) has reaffirmed the ratings assigned to the long-term instruments of IndoStar Capital Finance Limited (ICFL). The rating assigned to the long instruments 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). However, the rating continues to draw 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 ₹1,013 crore as on September 27, 2022, in comparison to ₹470 crore as on March 31, 2022. Furthermore, 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 capitalisation 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.

Control deficiencies and Qualified audit report

There were significant control deficiencies identified in the CV portfolio in relation to:

- Deviations from the credit policy of the company in approval processes for loans to existing customers and waivers in foreclosures of certain loan.
- For restructured loans, the company did not follow the stipulated process as detailed in the control description. The statutory auditor Deloitte Haskins & Sells LLP has given qualified option in relation to the control deficiencies in the CV and SME loans portfolio during the audit for the year ended March 31, 2022.
- The auditors have also expressed material uncertainty relating to going concern. As per the auditors, the total liabilities exceeded the total assets maturing within 12 months by around ₹1,724.04 crore and for certain borrowings, the gross non-performing asset (GNPA) and/or net non-performing asset (NNPA) ratios have exceeded thresholds because of the additional impairment allowance recorded during the year.

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

Furthermore, the audit committee of the company had also appointed E&Y and an external law firm, Cyril Amarchand Mangaldas (CAM), to undertake a conduct review for identifying the root cause of control deficiencies and reviewing transactions pertaining to the CV and SME loans portfolio. The review is ongoing and is expected to be completed by October 2022.

In ICFL's disclosure on May 6, 2022, based on the preliminary findings of the loan portfolio review, additional ECL provisioning was estimated to be in the range of ₹ 557 crores to ₹ 677 crore. As noted in the financial results published on August 5, 2022, basis the report provided by the external agency, ICFL recorded an impairment allowance (net of recoveries) of ₹ 1,158 crore 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 quarters and any incremental adverse impact on the earnings is highly unlikely. Also, the company has made improvements in the processes after the control deficiencies were observed. They have enhanced controls, implemented systemic changes, and updated policies & processes to ensure that such process lapse is not repeated. It has revamped its credit and operational policies to plug in loopholes identified.

CARE Ratings understands from the management that the quantum of borrowings that has been impacted due to breach of covenants stood at ₹ 1,882 crore as on June 30, 2022, of which ₹ 650 crore was in the form of debentures and ₹ 1,232 crore in the form bank borrowings. However as of August 31, 2022, none of the lenders have recalled the facility due to breach of covenants. Furthermore, the bank borrowings are relatively diversified and the probability of recall/termination of the entire amount is less likely. The management has also indicated to CARE Ratings that it has already repaid debentures of ₹ 700 crore in August 2022 which were due for repayment later to demonstrate its comfortable liquidity position.

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 or expected support from the promoters (Brookfield and Everstone)
- Significant deterioration in the earnings profile and/or asset quality
- 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 around 57% shareholding as on August 30, 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 ₹770 crore bank 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. Mr. Karthikeyan Srinivasan has been appointed as the new CRO. 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 ₹3,251 crore in FY21 to ₹2,243 crore in FY22 primarily owing to operating loss of ₹896 crore reported in FY22. However as of June 30, 2022, financial profile remains characterised by a comfortable consolidated net worth (net of goodwill) of ₹2,695 crore with a consolidated gearing (Total debt/Adjusted net worth) of 2.2 times and healthy standalone capital adequacy of 29% which still presents cushion over the regulatory requirement. The promoters remain fully supportive of the company. They have facilitated ₹770 crore of bank limits in June 2022 and will provide further support if required but currently company is well capitalised considering the level of operations.

Increased granularity of loan book owing to retail focus
As on June 30, 2022, loans in CV segment stood at around 51% of the loan book, followed by 18% in SME Segment, 16% in Corporate Lending and 15% in Affordable Housing Finance. The granularity of the loan book is likely to provide ample flexibility to the company for the purpose of securitisation. GNPA on the newly originated book has remained below 2%, which once adequately seasoned would be a good candidate for securitisation, 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.

Liquidity: Adequate
The company had unencumbered cash and cash equivalents of ₹1,013 crore as on September 27, 2022, which are adequate to meet scheduled repayments in the next 3 months. Also, the company has unutilised bank limits of ₹509 crores. Though the company has not obtained any fresh sanctions during Q1FY23, but it has been able to raise ₹480 crores in the month of July and August 2022 (₹380 crores from Barclays and Rs. 100 crores from SBI) from the earlier sanctions. Also, the company has done a PTC transaction in the CV portfolio of ₹877 crore in September 2022. It has slowed down disbursements and, till the situation stabilises, is likely to conserve liquidity generated out of collections (including prepayments). The company/ promoters have demonstrated strong ability to tap resources and have been able to raise around Rs. 1,850 crores from banks and other financial institutions in H1FY23 after public disclosure were made of control lapses in the CV 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 March 31,2022 stood at around ₹1,406 crore, recording 41% growth over FY21. The company recorded PBT of ₹21 crores in Q1FY23. GNPA stood at 1.9% and NNOA stood at 1.2%.

Key rating weaknesses

Weak earnings profile
The company's operating loss increased to ₹896 crore in FY22 on account of sharp rise in credit costs which increased to ₹1,158 crore (12.25% of Average Assets) in FY22. Pre-provision operating profit remained nearly stable at ₹262 crore. Of the total credit costs of ₹1,158 crore, ₹1,092 crore of the credit costs was recorded only in the CV Finance business, of which ₹624 crore was attributed to ECL provisions and ₹467 crore to write-offs. Of ₹1,092 crore, ₹945 crore was recorded in Q4FY22 alone. IFCL has incurred losses for past three years.
After reporting a loss of ₹754 crore in Q4FY22 due to high impairment allowance, the company has reported a profit of Rs.61 crores in Q1FY23. Going forward COF and NIM will be key monitorable due to potential rise in the funding costs However the company has taken measures to combat the same by increasing marginal interest rate for some of its products. It is in process of repricing its SME loans as majority of these are floating in nature. Also, incremental CV disbursements have been done at higher rate. While the management expects future earnings to benefit from write-backs, CARE Ratings believes that the 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 going forward.

Weak asset quality metrics
The company recorded GNPA of 8.2% and NNPA of 3.6% as on June 30, 2022, after recording overall high GNPA of 13.6% and NNPA of 6.4% on March 31, 2022 (consolidated). High GNPA in FY22 was primarily due to control deficiencies in ₹1,381 crore stressed CV portfolio, where restructuring was done without complying with the internal/RBI policy and impact of COVID-19 on its borrowers. Decline in GNPA from ₹1,180 crore in FY22 to ₹569 crores in Q1FY23 are on account of write off, of ₹412 crore and the remaining ₹199 crores is a combination of collections, pre-closure, refinance, and sell-offs. Out of the stressed CV pool

of ₹1,381 crore, the company has sold ₹516 crore loans for a discount of around 50% to an asset reconstruction company (ARC). It has written off ₹369 crore (₹199 crores + ₹170 crore (technical write offs) and has collected ₹94 crore till June 2022. This has reduced the CV stress pool to around ₹401 crores as on June 30, 2022. The new book has an GNPA of less than 2% of the overall portfolio. The total expected collection for the past six months was ₹1,439 crore against which the actual collections were around ₹2,327 crore (including ₹931 crore in prepayments). As on June 22, the company has restructured portfolio of ₹498 crore (₹196 crore in the CV and ₹302 crores in SME segment). ₹192 crores (38%) of the restructured book are in stage 3 and the rest ₹306 crore (61%) is in Stage 2. 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.

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. Furthermore, CARE Ratings has factored in linkages and support from the key promoter Brookfield.

Applicable criteria

Rating outlook and credit watch
CARE Ratings' policy on Default Recognition
Criteria for non-banking financial companies
Financial ratios – Financial sector
Consolidation
Rating of Short-term Instruments
Policy on Withdrawal of Ratings

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 413 branches across 22 states as on June 30, 2021.

The company is listed publicly with shareholding held by Brookfield (58%), Everstone (31%) and general public (11%).

Brief Financials (Rs. crore)	31-03-2021 (A)	31-03-2022(A)	Q1FY23(UA)
Total income	1,287	1,174	306
PAT	-214	-737	62
Total Assets	9,634	9,276	NA
Net NPA (%)	2.1	6.4	3.6
ROTA (%)	-2.22	-7.8	NA

A: Audited

Status of non-cooperation with previous CRA: NA

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)	INE896L07074	06-Jun-13	-	06-Jun-23	15	CARE A+ (CWN)
Non-Convertible Debentures (NCD)	INE896L07710	21-May-20	-	21-Feb-23	100	CARE A+ (CWN)
Non-Convertible Debentures (NCD)	INE896L07728	26-Jun-20	-	26-Jun-23	50	CARE A+ (CWN)
Non-Convertible Debentures (NCD)	INE896L07793	03-Jan-22	-	03-Jan-24	50*	CARE A+ (CWN)
Non-Convertible Debentures (NCD)	INE896L07561	02-May-18	-	02-May-23	500*	CARE A+ (CWN)
Non-Convertible Debentures (NCD)	INE896L08049	30-Jul-21	-	30-Aug-22	150*	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 & Working Capital	-	-	-	31-Mar-26	2089.99	CARE A+ (CWN)
Proposed facilities -LT	-	-	-	-	6720.01	CARE A+ (CWN)
Commercial Paper-Commercial Paper (Standalone)	INE896L14DC3	-	-	-	150	CARE A1+ (CWN)
Commercial Paper-Proposed	-	-	-	-	1850	CARE A1+ (CWN)

* The amount for these NCDs (totalling to Rs.700 crore) will be adjusted during the next cycle

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+ (CWN) (09-Aug-22) 2)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); Negative	1)CARE A+ (CWN) (09-Aug-22) 2)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) (17-Apr-20)	1)CARE AA-; Stable (09-Oct-19) 2)CARE AA-; Positive (02-Apr-19)
3	Debentures-Market Linked Debentures	LT	100.00	CARE PP-MLD A+ (CWN);	1)CARE PP-MLD A+ (CWN)	1)CARE PP-MLD AA-; Stable	1)CARE MLD AA-; Stable (08-Oct-20)	1)CARE PP-MLD AA-; Stable

				Negative	(09-Aug-22) 2)CARE PP-MLD AA- (CWD) (16-May-22)	(20-Aug-21)	2)CARE MLD AA-; Stable (17-Aug-20) 3)CARE MLD AA- (CW) (17-Apr-20)	(09-Oct-19)
4	Commercial Paper-Commercial Paper (Standalone)	ST	1000.00	CARE A1+ (CWN)	1)CARE A1+ (CWN) (09-Aug-22) 2)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); Negative	1)CARE PP-MLD A+ (CWN) (09-Aug-22) 2)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	Simple
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.

Contact us

Media contact
Name: Mradul Mishra
Phone: +91-22-6754 3596
E-mail: mradul.mishra@careedge.in

Analyst contact
Name: Shweta Sumeet Agrawal
Phone: 8879210128
E-mail: Shweta.Agrawal@careedge.in

Relationship contact
Name: Saikat Roy
Phone: +91-98209 98779
E-mail: saikat.roy@careedge.in

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.

For the detailed Rationale Report and subscription information,
please visit www.careedge.in