Aditya Birla ARC Limited

January 23, 2023

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long-term bank facilities	100.00	CARE AA; Stable	Assigned
Market linked debentures	100.00	CARE PP-MLD AA; Stable	Reaffirmed
Non-convertible debentures	-	-	Withdrawn

Details of instruments/facilities in Annexure-1.

Rationale and key rating drivers

CARE Ratings Limited (CARE Ratings) has reaffirmed 'CARE PP-MLD AA' ratings with 'Stable' outlook to the Principal Protected – Market linked debentures (PP-MLD) and assigned 'CARE AA' ratings and 'Stable' outlook for the long-term bank facilities of Aditya Birla ARC Limited (ABARC).

The ratings primarily factor in ABARC's strong parental linkage with Aditya Birla Capital Limited (ABCL; a subsidiary of Grasim Industries Limited [Grasim], rated 'CARE AAA; Stable / CARE A1+'), which is demonstrated through its shared brand name, 100% ownership, Board-level representation, governance and strategic oversight, and regular capital support. CARE Ratings notes that all the issuances have been backed by a Letter of Comfort (LOC) from ABCL, which reiterates the promoter's support. The ratings are, however, constrained on account of the lack of portfolio diversification and granularity, exposure to wholesale distressed assets with associated uncertainties in terms of timeline and recovery and restricted funding environment for players operating in the space.

CARE Rating has withdrawn 'CARE AA' ratings with 'Stable' outlook for its proposed non-convertible debenture (NCD) as per the above-mentioned table with immediate effect at the request of the company.

Rating sensitivities: Factors likely to lead to rating actions

Positive factors

- Significant scale-up of operations with demonstration of strong recovery performance.
- Improvement in the earning profile.

Negative factors

- Dilution in the ARC's linkages with the parent company, resulting reduced intent and ability, to support the ARC.
- Weakening of the parent's credit profile.
- Any adverse event in the assets acquired by ABARC impacting recovery performance, which in turn will impact the overall profitability and solvency of the company.
- Any regulatory changes which might adversely impact business and financial performance of ARC.

Analytical approach: Standalone; factoring in linkages with the parent, ABCL.

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

Key strengths

Strong parentage and their continued support

ABARC is a step-down subsidiary of Grasim (rated 'CARE AAA; Stable/ CARE A1+') and is an asset reconstruction company for resolution of stressed assets. ABCL, which is a subsidiary of Grasim, holds 100% stake in ABARC. ABCL, one of the largest non-bank financial services players in India, is a part of the Aditya Birla Group, which employs over 140,000 people across 100 nationalities. It ranks among the top fund managers in the country, with over ₹370,000 crore of assets under management (AUM) across asset management, life insurance and health insurance. It is the holding company of all the financial services businesses of the Aditya Birla Group and is among the top five private diversified non-banking finance companies (NBFCs) in India. It is also one of the largest private life insurance companies, asset management companies and general insurance brokers in the country. The company reported consolidated revenue of over ₹22,241 crore, and profit after tax (PAT) of ₹1,660 crore in FY22. As on December 20, 2022, ABCL has market capitalisation of ₹37,147 crore.

ABCL has a lending book of ₹76,475 crore as on September 30, 2022. During H1FY23, it reported aggregate revenue and PAT of ₹12,432 crore and ₹918 crore.

ABARC has been constantly receiving parent support through equity infusion, ICDs, and LOC for its outside borrowings along with the sizeable representation of ABCL on its board and the shared brand name.

Experienced management and board representation support from the ABCL group

ABARC is headed by Sanjay Jain (CEO), having more than 30 years of experience in the financial services sector. The board of the company comprises experienced professionals with diversified backgrounds. It consists of three non-executive directors and two independent directors. The non-executive directors are Vishakha Mulye (CEO of ABCL), Tushar Shah (CEO of Infra & SF division of ABFL) and Pinky Mehta (CFO of ABCL). The strategic importance of ABARC to ABCL is visible from the high degree of management integration, wherein all three non-executive directors of the company are from the Aditya Birla Group.

Adequate capitalisation and resource-raising ability

ABARC is adequately capitalised with capital infusion from the parent, ABCL. Till date, ABARC has received capital support from ABCL to the tune of ₹100.00 crore in the form of equity infusion and ₹16 crore in the form of compulsory convertible preference shares (CCPS). In addition, it also has ICDs from ABCL to the tune of around ₹42 crore as of November 2022.

The company has also got capital support of ₹11 crore from its investment partner, Värde Partners, in the form of CCPS, as on September 30, 2022. On diluted basis, Värde Partners, has approximately 9% stake in the shareholding of the company.

Though the company's capital adequacy has remained consistent and stood at 27.07% as of 31st Dec, 2022 compared with 30.38% as of March, 2022 due to increase in its investments, it is expected to improve even further with commencement of recoveries. CARE Ratings expects capital support to be forthcoming from the parent as and when required to support its growth.

ABARC has recently raised the bank facilities worth ₹100 crore from Federal Bank for a tenure of three years at competitive rates which includes a ₹70 crore term loan and ₹30 crores of Working Capital Demand Loan (WCDL), even though long-term debt from banks and capital markets to ARCs has remained a funding constraint for the sector.

Key weaknesses

Early stage of operations along with high portfolio concentration

ABARC started its business operations in FY18. It has so far acquired 11 assets and has resolved two of them. Given the large ticket wholesale distressed exposure, ABARC is faced with high concentration risk and uncertainties in resolution of these assets resulting in longer pay-back period. However, comfort is drawn from the fact that assets are operating in nature, generating cash flows and there are no litigation assets forming the book currently. The company's strategy of resolution through restructuring or corporate insolvency resolution process rather than through security enforcement drives its asset acquisition choice. The track record of timely resolution and profitable recovery performance remains a key rating monitorable.

The AUM stood at ₹2,995.56 crore, while ABARC's investment is ₹492.37 crore (16.4% of AUM) as on November 2022. ABARC has demonstrated a good recovery track record from the stressed assets. Till November 2022, ABARC has issued total SRs worth ₹6,018.68 crore since inception with cumulative recoveries of ₹3,023.12 crore. The total recoveries have improved from 34.7% in March 2021 to 50.2% as of November 2022. ABARC has sponsored 11 trusts to acquire stressed assets, with 4 trusts recovering more than 80% of acquisition price. The company has seen healthy recoveries even during the volatile COVID-19 phase. RattanIndia Power Limited, which was one of the major SRs investments in FY20 has recovered 99.90% as per expectations. KSK Mahanadi Power Company Limited has been a major contributor to the portfolio with outstanding of 96.12%.

Majority of the SRs portfolio is invested in one borrower (KSK Mahanadi) creating a concentration risk for ABARC; however, the company expects to recover 100-150% in this asset. It is an operational asset, generating around ₹150 – ₹170 crore per month.

Despite having adequate asset acquisition and resolution policy framework, ABARC will continue to face challenges, given the inherent nature of the asset reconstruction business and the ARC industry as a whole. As the company's AUM has grown primarily in the past few years and it takes around four to five years to resolve an asset and recover dues, the performance of the recently acquired portfolio remains to be seen. Furthermore, in the current challenging macroeconomic scenario, marked by significant pressure on cash flows of highly leveraged borrowers, ABARC's ability to effect recoveries in timely manner will remain a key monitorable from the credit rating perspective.

Moderate profitability

With AUM of ₹2,997.76 crore as on September 30, 2022, ABARC's business is relatively small sized in the asset reconstruction space. During FY22, the company reported PAT of ₹21.67 crore on a total income of ₹74.44 crore as compared with PAT of ₹24.01 crore on a total income of ₹77.09 crore in FY21. PAT further remained stable at ₹12.03 crore for H1FY23 due to consistent management fees and gain on fair value changes to investment in SRs. The company has written off ₹0.03 crore of assets in FY22 and similar amount of write-off in H1FY23, which is negligible compared to the total income. There has been no net loss in valuation of SRs held by ABARC since inception. The valuation of ABARC's investments in SRs is estimated by the recovery ratings of the SRs, which are assigned by external credit rating agencies based on the recovery prospects of these SRs from the underlying assets. All the SRs issued by ABARC have an expected recovery probability of more than 100%. CARE Ratings continues to monitor the company's ability to recover from accounts acquired in a timely manner, which will be key towards maintaining healthy profitability.

A large part of revenue comprises consistent fee-based income derived from the management fee. The fee-based income stood at ₹15.26 crore (38% of total income) for H1FY23 (FY22: 37%, FY21: 39%). However, CARE Ratings note that the nature of write-offs and fair value changes (NAV) due to accounting adjustments can result in volatility of the profitability in the coming financial years.

Evolving distressed asset market and inherent risk associated with the business model

ARCs in India have been subject to large regulatory changes which can result in uncertainty in resolution of acquired assets with respect to recovery amounts and timelines. The Indian distressed assets market is in a nascent stage with limited seasoning and is gradually developing with regulatory policies taking shape steadily. To this effect, the recommendations by RBI's constituted committee include incentivising quicker resolutions, price discovery, acquisition of distressed assets with a lower seasoning and enabling ARC participation in the IBC process. CARE Ratings notes that RBI's recent guidelines for ARCs will structurally strengthen them through better governance norms, improved disclosures, lower funding requirement for asset acquisition, and more robust balance sheets.

Liquidity: Adequate

ABARC's liquidity is supported by financial flexibility it derives from being part of the Aditya Birla group. Apart from the financial flexibility, CARE Rating expects the recovery from SRs, undrawn lines from the bank and the stable fee income which would add further comfort to its liquidity position. As on September 30, 2022, ABARC's liquidity stood adequate, with cash and cash equivalents and fixed deposits worth ₹61.77 crore as against total debt obligations to the tune of ₹238.37 crore, for the next 12 months.

Applicable criteria

Policy on default recognition
Factoring Linkages Parent Sub JV Group
Financial Ratios - Financial Sector
Rating Outlook and Credit Watch
Market Linked Notes
Non Banking Financial Companies
Policy on Withdrawal of Ratings

About the company

ABARC has been registered with Reserve Bank of India (RBI) under Section 3 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ('SARFAESI Act') on March 13, 2018. It is a wholly-owned subsidiary of Aditya Birla Capital Limited (ABCL), and primarily focuses on the distressed assets in the corporate sector.

Brief Financials (₹ crore)	March 31, 2021 (A)	March 31, 2022 (A)	H1FY23 (UA)
Total operating income	77.09	74.44	40.25
PAT	24.01	21.67	12.03
Interest coverage (times)	1.90	1.86	1.89
Total Assets	485.79	464.86	691.75
ROTA (%)	4.84	4.56	4.16

A: Audited; UA: Unaudited

Aditya Birla Capital Ltd (ABCL) – holds 100% ownership of ABARC:

The Aditya Birla Group offers a bouquet of financial services under ABCL. ABCL has presence in various businesses like life insurance, asset management, NBFCs, infrastructure project and structured finance, private equity, broking, wealth management & distribution, online personal finance, insurance advisory services and housing finance. It reported consolidated revenue of over ₹22,241 crore, and PAT of ₹1,660 crore in FY22, which is around 15% and 50% growth, respectively, from FY21.

Värde Partners:

Värde Partners, the second shareholder of the company (on diluted basis), is an Alternate Investment Firm, and currently manages US $13 billion in assets on behalf of its investors around the world, that invest across a broad array of geographies, segments and asset types, including real estate, corporate credit, mortgages, specialty finance, transportation and infrastructure.

ABARC carries out deals on all cash basis where entire consideration is paid to the selling banks and SRs are subscribed by ABARC and its investment partner in the pre-decided ratio. Värde acts as an investment partner in majority of the deals done by the company.

Status of non-cooperation with previous CRA: None

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 the covenants of the rated instruments/facilities is given in Annexure-3

Complexity level of the various instruments rated: Annexure-4

Lender details: Annexure-5

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance (DD-MM-YYYY)	Coupon Rate (%)	Maturity Date (DD-MM-YYYY)	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Debentures-Market linked debentures	INE01Q807038	20-06-2022	GSEC Linked	20-12-2023	100.00	CARE PP-MLD AA; Stable
Debentures-Non-convertible debentures	-	-	-	-	0.00	Withdrawn
Fund-based-Long term	-	-	-	07-06-2025	100.00	CARE AA; Stable

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	Debentures-Non-convertible debentures	LT	-	-	1)CARE AA; Stable (03-Jun-22)	1)CARE AA; Stable (10-Jan-22)	-	-
2	Debentures-Market linked debentures	LT	100.00	CARE PP-MLD AA; Stable	1)CARE PP-MLD AA; Stable (03-Jun-22)	-	-	-
3	Fund-based-Long-term bank facilities	LT	100.00	CARE AA; Stable				

*Long term/Short term.

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

Name of the Instrument	Detailed Explanation
A. Financial covenants	
I. CRAR should always be above regulatory requirement i.e. CRAR of 15%, at present.	-
II. TOL/ATNW < 6x	-

Annexure-4: Complexity level of the various instruments rated

Sr. No.	Name of the Instrument	Complexity Level
1	Debentures-Market linked debentures	Highly complex
2	Debentures-Non-convertible debentures	Simple
3	Long-term bank facilities	Simple

Annexure-5: Lender details

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

Note on the 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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