April 20, 2022

Indostar Home Finance Private Limited: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Commercial Paper	200	200	[ICRA]A1+; Reaffirmed

**Instrument details are provided in Annexure-1*

Rationale

While arriving at the rating, ICRA has taken a consolidated view of the credit profiles of Indostar Capital Finance Limited (Indostar) and its wholly-owned subsidiary – Indostar Home Finance Private Limited (IHFPL), referred to as the Group or Indostar, owing to the shared brand name and management oversight in addition to synergetic benefits.

The rating reaffirmation considers Indostar's strong capitalisation with a consolidated gearing of 1.7x and standalone capital adequacy of 35% as on December 31, 2021. The rating also factors in the strong institutional investors, the experienced management team, and the diversified product portfolio with the increasing granularity of the loan book led by increasing share of the retail loan book (82% as on December 31, 2021 as compared with 61% in March 2019), though the track record in retail lending is limited. Further, Indostar has adequate liquidity profile with the management's stated intention of maintaining ~15% of the net worth in liquid investments and undrawn bank lines at all times.

The aforesaid strengths are, however, partially offset by the asset quality challenges and weak profitability. While the company reported gross stage 3 and net stage 3 percentages of 4.3% and 2.3% as of December 31, 2021 compared to the level of 4.5% and 3.6% respectively as on March 31, 2020, the reported trajectory been supported by sizeable write offs and sale of stressed loans. Further, Indostar's restructured portfolio stands sizeable at about 13% of loan book as of December 31, 2021. Nonetheless, ICRA draws comfort from the overall provision coverage on the loan portfolio, which stands enhanced at about 7% as of December 31, 2021 (2.6% as on March 31, 2019). Furthermore, collection efficiency for the retail portfolio has been comforting over recent quarters. While reaffirming the rating, ICRA has also notes that the decline in loan book due to focus on portfolio realignment and conservative lending strategy amidst a challenging operating environment has impacted the operational efficiencies. Moreover, weakened asset quality manifested into a spurt in credit costs for Indostar. As a result, already modest profitability of Indostar weakened further as reflected by large net losses reported in FY2020 and FY2021. Further, the profitability pressure has sustained in FY2022 as well with ROA and ROE of 0.2% and 0.7% respectively in 9MFY2022, given the pandemic led asset quality challenges and large infrastructure set up by Indostar to expand its retail lending footprint. In this regard, the company's ability to scale up the loan book over the medium term by leveraging the existing infrastructure network while maintaining prudent underwriting standards and hence good control over incremental slippages will remain key determinant of the profitability trajectory hereon.

Also, while the Group has established relationships over the years with banks and investors to diversify its lender base, ICRA notes that its dependence on incremental borrowings from banks, mutual funds and other domestic investors has remained relatively limited in the recent years due to healthy capital base and tepid portfolio trajectory. Going forward, given the growth plans, it would be imperative to leverage and demonstrate the relationship network to re-establish financial flexibility and to borrow sizeable funds for a prudent tenure at competitive rates from diverse sources.

Key rating drivers and their description

Credit strengths

Strong capitalisation – Indostar's financial profile remains characterized by healthy consolidated net worth (net of goodwill) of Rs. 3,378 crore with a consolidated gearing (Total Debt/Adjusted Net Worth) of 1.7 times, strong standalone capital adequacy of 35% and comfortable consolidated solvency (Net Stage 3/Adjusted Net Worth) of 5.6% as on December 31, 2021. Its capitalization had earlier strengthened following the capital raise in Q1FY2021. Nonetheless, while the leverage has remained comfortable due to sizeable capital raise and tepid portfolio trajectory thereafter, ICRA expects the gearing to increase considerably from the current level with the growth in the retail portfolio over the medium term. The Group is, however, expected to maintain a prudent capitalisation level commensurate with the underlying portfolio mix and comfort is drawn from its flexibility to raise equity funds from capital markets. In May 2020, Indostar had raised capital from BCP V Multiple Holdings Pte Ltd (Brookfield), a private equity fund managed by Brookfield Business Partners. Brookfield infused about Rs, 1,225 crore in Indostar.

As on December 31, 2021, IHFPL's standalone financial profile was characterized by gearing of 1.3x and solvency (Net Stage 3/Net Worth of 4.2%). While ICRA notes that IHFPL would need equity infusion over the medium term to maintain prudent capitalisation levels while growing as per business plans, support from the parent is expected to be forthcoming as and when required

Diversified product portfolio with declining share of wholesale exposures; however, limited track record in retail lending and wholesale book remains concentrated – Indostar's diversified product basket encompasses vehicle finance for new and used vehicles, loans to small-to-medium-size enterprises, wholesale funding to corporates, and home finance through a wholly-owned subsidiary. As of December 31, 2021, the consolidated assets under management (AUM) aggregated Rs. 9,236 crore comprising commercial vehicle (CV) finance (49% share), SME finance (20%), housing finance (13%), real estate corporate funding (16%; defocused), and non-real estate corporate funding (2%; defocused). However, while the Group has a track record of almost a decade in wholesale lending, its experience in the retail lending segment is limited as it started SME lending in FY2016, and CV financing and housing finance in FY2018. Thus, its ability to prudently calibrate the expansion in the retail segments and further improve the granularity of the portfolio while maintaining the underwriting standards and hence the asset quality and profitability will be a key monitorable going forward.

Also, while the wholesale portfolio is being run down and has experienced a churn, especially in the real estate segment where prepayments have been high in the past, the wholesale loan book is characterised by concentration towards a few borrower groups. Hence, the asset quality is susceptible to lumpy slippages despite the established credit appraisal and risk management processes. Nevertheless, ICRA notes that Indostar's wholesale book was originated with a focus on reputed borrower groups/developers with an established track record of timely debt servicing. All project cash flows are escrowed, and the loan is structured in a manner that enables mandatory prepayments and hence the early repayment of loans.

As for IHFPL at standalone level, it offers housing loans with a focus on the affordable housing segment, with ticket sizes ranging from Rs. 3 lakh to Rs. 30 lakh. As of December 31, 2021, IHFPL's on-book loan portfolio stood at Rs. 1,103 crore compared to Rs. 854 crore in March 2021 and Rs. 753 crore in March 2020. The loan book is currently equally split between the salaried and self-employed segments with 84% of the loan book concentrated in four states, i.e. Tamil Nadu, Maharashtra, Andhra Pradesh and Telangana.

Experienced management team and strong institutional investors – Indostar's institutional investors have played an active role in its decision making since inception. The risk committee, which is responsible for managing risk at the overall level, comprises both investors and independent directors, and the credit committee is constituted by nominees of the investors. As a result, the Group gains from the involvement of the key institutional investors, including Brookfield, and their experience in the Indian and global markets. Further, the Group has onboarded senior professionals with established expertise and track records in the respective product segments, which augurs well for achieving the envisaged roadmap while maintaining prudent underwriting standards and its risk philosophy. It is however noted that the business and management transition phase has stretched longer-than-expected.

Credit challenges

Asset quality challenges – Given the pandemic induced disruptions and associated impact on various segments of the economy, Indostar's portfolio vulnerability increased during the past two years, alike the broader industry. Thus, overall asset quality performance in the near-term will remain a monitorable. Further, while the Group reported gross stage 3 and net stage 3 percentages of 4.3% and 2.3% as of December 31, 2021 compared to the level of 4.5% and 3.6% respectively as on March 31, 2020, the reported metrics have been supported by sizeable write offs and sale of stressed loans to an asset reconstruction company at net book value with security receipts carried by the company. Further, Indostar's restructured portfolio stands sizeable at about 13% of loan book as of December 31, 2021. Moreover, it is noted that Indostar's gross non-performing loan pool, calculated as per revised IRAC norms, stood at 7.2% as of December 2021. ICRA also notes that while the wholesale portfolio is being run down successfully, it continues to be characterised by concentration towards a few borrower groups; hence, the asset quality is susceptible to lumpy slippages despite the established credit appraisal and risk management processes.

Nonetheless, ICRA draws comfort from the overall provision coverage on the loan portfolio, which stands enhanced at about 7% (2.6% as on March 31, 2019) backed by Covid-19 related management overlay. Furthermore, collection efficiency for the retail portfolio has been comforting over recent quarters though the trajectory has been volatile, especially for billing to billing collections, with frequent instances of dips in-line with recurring waves of the pandemic. Overall, collection efficiency (including foreclosures) stood comfortable for the retail portfolio at 167% in December 2021 and 145% in November 2021 compared to 92.0% in September 2020 after having remained low at 65-71% in July 2020 and August 2020.

At the standalone level, Indostar reported proforma gross and net stage 3 percentages of 4.4% and 2.3%, respectively, as of December 31, 2021 compared to 4.4% and 2.0%, respectively, as on March 31, 2021. For IHFPL (standalone), the reported proforma gross and net stage 3 percentages stood at 2.6% and 1.9%, respectively, as of December 31, 2021 compared to 1.8% and 1.4%, respectively, as on March 31, 2021.

Weak profitability - Notwithstanding the increased share of higher yielding CV finance business in the portfolio of Indostar, the improvement in lending spreads and net interest margins eluded during past three years amidst the increased borrowing cost (though incremental borrowing cost trajectory has turned favourable over past one year). Further, the decline in loan book due to focus on portfolio realignment and conservative lending strategy in a challenging operating environment has impacted the operating efficiencies with increased operating cost as a proportion of asset base. Moreover, weakened asset quality manifested into a spurt in credit costs for Indostar. As a result, already modest profitability weakened further as reflected by large net losses reported in FY2020 and FY2021 compared to ROA and ROE of 2.5% and 10.1% respectively in FY2019. Further, the profitability pressure has sustained in FY2022 as well with ROA and ROE of 0.2% and 0.7% respectively in 9MFY2022, given the pandemic led asset quality challenges and large infrastructure set up by Indostar to expand its retail lending footprint. In this regard, the Group's ability to scale up the loan book over the medium term by leveraging the existing infrastructure network and partnerships while maintaining prudent underwriting standards and hence good control over incremental slippages will remain key determinant of the profitability trajectory hereon.

Liquidity position: Adequate

Indostar adopted a prudent approach during the challenging times witnessed during past three years, wherein higher on-balance sheet liquidity was being maintained with liquidity buffers in excess of 25% of the on-balance sheet borrowings. However, the Group has rationalized the on-balance sheet liquidity substantially in recent quarters. Furthermore, it has re-entered the money markets and increased the dependence on commercial paper borrowings in recent months. Hence, while the liquidity buffers remain adequate, it is noted that these have been substantially downsized from the levels seen in the past. Nonetheless, ICRA notes that Indostar has a policy of maintaining ~15% of net worth in liquid investments and undrawn bank lines at all times, and the management endeavours to avoid asset liability mismatches.

As of March 31, 2022, Indostar's asset liability maturity (ALM) profile reflected scheduled debt repayments about Rs. 1,000 crore over the next three months, against which, the inflows from loan repayments are estimated at Rs. 640 crore and cash & liquid investments stood at about Rs. 400 crore. Besides, the undrawn funding lines stood at Rs. 550 crore, and the Group has ability to securitise loans to manage liquidity. This provides comfort over the liquidity profile of the Group, though ICRA notes that liquidity profile of Indostar will remain sensitive to the actual pace of repayments. Evolving asset quality profile will hence remain a key monitorable.

Rating sensitivities

Positive factors – Not applicable

Negative factors – The rating could be downgraded if the liquidity position or asset quality deteriorates significantly with the consolidated solvency metric (net stage 3/Tier I) deteriorating to a level over 20% on a sustained basis. Inability to improve the profitability would also be a credit negative.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Rating Methodology for Non-Banking Finance Companies Rating Approach – Consolidation
Parent/Group Support	-
Consolidation/Standalone	Consolidation; To arrive at the rating, ICRA has taken a consolidated view of the credit profiles of Indostar Capital Finance Limited (Indostar) and its subsidiary – Indostar Home Finance Private Limited (IHFPL), referred to as the Group or Indostar, owing to the common management, shared infrastructure, as well as the strategic importance of IHFPL to the Group.

About the company

Incorporated in January 2016, Indostar Home Finance Private Limited (IHFPL) is a housing finance company (HFC). It is a wholly-owned subsidiary of IndoStar Capital Finance Limited (Indostar). IHFPL offers housing loans with a focus on the affordable housing segment, with ticket sizes ranging from Rs. 3 lakh to Rs. 30 lakh. As of December 31, 2021, IHFPL's on-book loan portfolio stood at Rs. 1,091 crore compared to Rs. 846 crore in March 2021 and Rs. 748 crore in March 2020. The loan book is currently equally split between the salaried and self-employed segments with 84% of the loan book concentrated in four states, i.e. Tamil Nadu, Maharashtra, Andhra Pradesh and Telangana.

In FY2021, the company reported a net profit of Rs. 28 crore on an asset base of about Rs. 906 crore compared to a net profit of Rs. 14 crore on an asset base of Rs. 800 crore in FY2020. In 9M FY2022, the company reported a net profit of Rs. 20 crore on an asset base of about Rs. 1,159 crore.

Key financial indicators

Indostar Home Finance Private Limited	FY2020	FY2021	9M FY2022
	Audited	Audited	Provisional
PAT	14	28	20
Net Worth	186	215	485
Gross Loan Book	748	846	1,091
Return on Average Assets	2.1%	3.3%	2.6%
Return on Average Equity	7.9%	13.9%	7.7%
Gearing (times)	3.1	3.0	1.3
CRAR	46.8%	49.2%	NA
Gross Stage 3 (%)	0.8%	1.8%	2.6%

Indostar Home Finance Private Limited	FY2020	FY2021	9M FY2022
Net Stage 3 (%)	0.7%	1.4%	1.9%
Net Stage 3/ Adjusted Net Worth	2.7%	5.6%	4.2%

Source: *IHFPL, ICRA research; Amount in Rs. crore*

Indostar Capital Finance Limited

IndoStar Capital Finance Limited (Indostar) is a systemically important non-banking financial company (NBFC). It offers vehicle finance for new and used vehicles, loans to small-to-medium-size enterprises, long-term wholesale funding to corporates (de-focused), and home finance through its wholly-owned subsidiary Indostar Home Finance Private Limited (IHFPL). As of December 31, 2021, the assets under Indostar's management (at consolidated level) aggregated Rs. 9,236 crore with 49% share of commercial vehicle (CV) finance book, 20% share of SME finance, 13% share of housing finance book, 16% share of real estate corporate funding segment, and 2% share of non-real estate corporate funding.

While Indostar commenced lending operations in 2011 with a primary focus on wholesale lending, it ventured into SME finance in FY2015, followed by used and new vehicle financing for transporters and loans to SME borrowers in FY2018. The proportion of CV financing increased substantially (to 44% in Dec-19 from 9% in Sep-18) post the acquisition of Rs. 3,514-crore CV portfolio (AUM basis) from IIFL Finance in March 2019. With the acquisition of the CV portfolio from IIFL Finance, the branch network of the company also increased from 161 branches to 322 branches, before being rationalized/consolidated subsequently. As of December 31, 2021, the company's branch network comprised of 343 branches across 21 states.

As on December 31, 2021, Brookfield held 56% stake in Indostar, followed by IndoStar Capital Mauritius at 33% (including ECP II & ECP III). Brookfield Group invested Rs 1,225 crore in Indostar (through BCP V Multiple Holdings Pte Ltd) in May 2020 to become the largest shareholder and co-promoter of the company. Indostar was originally established by a group of financial institutions including Everstone Capital, Goldman Sachs Baer Capital Partners, CDIB Capital and ACPI Investment Managers through Indostar Capital Mauritius with an initial capital of about Rs 900 crore. Subsequently, the company got listed on stock exchanges in May 2018 and received a fresh equity infusion of Rs. 700 crore.

In FY2021, the company on a standalone basis reported a net loss of Rs. 241 crore on an asset base of about Rs. 10,172 crore compared to a net loss of Rs. 340 crore on an asset base of Rs. 10,338 crore in FY2020. In 9MFY2022, the company has reported a net loss of Rs. 2 crore.

On a consolidated basis, the Group reported a net loss of Rs. 214 crore in FY2021 on an asset base of about Rs. 10,480 crore compared to a net loss of Rs. 325 crore on an asset base of Rs. 10,408 crore in FY2020. In 9MFY2022, the company, on a consolidated level, reported a net profit of Rs. 17 crore on an on-book asset base of about Rs. 10,014 crore.

Key financial indicators

Indostar Capital Finance Limited	Standalone			Consolidated		
	FY2020	FY2021	9M FY2022	FY2020	FY2021	9M FY2022
	Audited	Audited	Provisional	Audited	Audited	Provisional
PAT	(340)	(241)	(2)	(325)	(214)	17
Adjusted* Net Worth	2,388	3,379	3,341	2,380	3,398	3,378
Assets under Management (AUM)	8,859	7,994	8,015	9,690	8,990	9,236
Return on Average Assets	-3.0%	-2.4%	0.0%	-2.9%	-2.1%	0.2%
Return on Average Equity	-13.3%	-8.4%	-0.1%	-12.8%	-7.4%	0.7%
Gearing (times)	3.0	1.7	1.6	3.0	1.8	1.7
CRAR	25.3%	34.6%	34.8%			
Gross Stage 3 (%)	4.5%	4.4%	4.4%	4.5%	4.3%	4.3%
Net Stage 3 (%)	3.7%	2.0%	2.3%	3.6%	2.0%	2.3%
Net Stage 3/ Adjusted Net Worth	13.2%	4.2%	5.0%	13.4%	4.5%	5.6%

Source: *Indostar, IHFPL, ICRA research; *Adjusted for Rs. 300-crore goodwill; Amount in Rs. crore*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Apr 20, 2022	FY2022	FY2020	FY2019
						Apr 16, 2021	Mar 17, 2020	Dec 31, 2018
1	Commercial Paper	Short Term	200	0*	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**

Source: *ICRA research; *As of March 31, 2022*

Complexity level of the rated instruments

Instrument	Complexity Indicator
Commercial Paper Programme	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: www.icra.in

Annexure-1: Instrument details as on March 31, 2022

ISIN	Instrument Name	Date of Issuance/ Sanction	Coupon Rate/ Yield	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA*	Commercial Paper	NA	NA	7-365 days	200	[ICRA]A1+

Source: *ICRA; *Not placed*

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Indostar Capital Finance Limited	Parent Entity	Full Consolidation
Indostar Home Finance Private Limited	Subsidiary	Full Consolidation
Indostar Asset Advisory Private Limited	Subsidiary	Full Consolidation

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About ICRA Limited:

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For more information, visit www.icra.in

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