

August 23, 2022

IndoStar Home Finance Private Limited: Update on recent developments

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Outstanding
Commercial paper programme	200	200	[ICRA]A1+@
Total	200	200	

*Instrument details are provided in Annexure I, @ Rating Watch with Negative Implications

Rationale

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

ICRA had placed IndoStar and IHFPL on rating Watch with Negative Implications on May 17, 2022. The rating action followed the disclosure by IndoStar regarding the preliminary findings of the review of the commercial vehicles (CV) loan portfolio. The portfolio review was initiated because of certain observations and control deficiencies identified during the interim statutory audit of the company's annual financial statements. In this regard, the independent external agency suggested that the company may be required to make sizeable additional provisions.

On August 05, 2022, IndoStar disclosed to the exchanges that the final findings have resulted in an impairment allowance, which is higher than the earlier estimate. Moreover, the auditor issued a qualified opinion for the financial year ended March 31, 2022. The auditor also noted the material uncertainty related to the going concern due to past losses as well as the breach of covenants associated with certain borrowings. However, the auditor opinion is not modified with respect to the uncertainty relating to the going concern. The finding of the higher-than-anticipated impairment charge was due to the revised expected credit loss (ECL) staging approach by the statutory auditors.

ICRA notes that the stressed pool identified amounted to Rs. 1,380 crore, i.e. 15% of the assets under management (AUM) of the IndoStar Group as on March 31, 2022. Basis the Q4 FY2022 results and the Q1 FY2023 results declared by IndoStar on August 14, 2022, a large part of the identified pool has been provided for. As of June 30, 2022, the gross stressed pool stood at Rs. 401 crore (~50% provision cover is being maintained against the same). The performance of this stressed pool was satisfactory with collections against scheduled billings standing at 80% while the total collection efficiency stood at 130%. The rundown in the identified stressed pool was driven by write-offs and sale to an asset reconstruction company (ARC) besides repayments.

ICRA favourably views the support from The Brookfield Group (Brookfield), the majority shareholder in IndoStar as of June 30, 2022. ICRA expects Brookfield to support IndoStar through its global relationships. It has clearly demonstrated its support by arranging Rs. 770-crore debt funding in June 2022. Any reduction in its stake or support would be a credit negative for IndoStar. ICRA also favourably factors in IndoStar's comfortable capitalisation profile with a capital-to-risk weighted assets ratio (CRAR) of 29.0% as of June 30, 2022. While it posted significant losses in the last three years (FY2020: Rs. 325 crore, FY2021: Rs. 214 crore, FY2022: Rs. 737 crore), which caused significant erosion in the net worth, ICRA notes that the Group reported a net profit of Rs. 61 crore in Q1 FY2023. It is expected to continue to be adequately capitalised with a comfortable cushion over the regulatory level.

At the consolidated level, the Group had an unencumbered cash and bank balance of Rs. 948 crore as of July 31, 2022 (Rs. 956 crore as of August 10, 2022) and undrawn funding lines of Rs. 609 crore (approximately half of this would be used for onward

lending) as of August 05, 2022. Against this, the Group has scheduled principal debt repayments of Rs. 658 crore from August 01, 2022 to September 30, 2022. Apart from this, IndoStar has already made a buyback offer for some of the series of debentures (aggregating Rs. 700 crore out of the total debentures of Rs. 1,085.90 crore as of June 30, 2022), which is expected to be completed by August 26, 2022. Assuming no acceleration by the lenders, it has scheduled principal debt repayments of Rs. 557 crore and Rs. 730 crore, respectively, in Q3 FY2023 and Q4 FY2023. The Group is also in advanced talks to raise funds aggregating Rs. 1,000 crore through securitisation transactions, which are expected to be completed within August 2022. The ability to raise funds through securitisation is imperative for its near-term liquidity position.

Nevertheless, ICRA favourably notes the collection efficiency (including foreclosures), which stood comfortable for the Group's overall portfolio at 181% in Q1 FY2023 against 142% in Q4 FY2022. Going forward, the Group's ability to improve the asset quality indicators to a level comfortably below the debt covenant thresholds and seek waiver of the covenant breaches in the interim would be critical for maintaining adequate liquidity. The rating watch will be resolved upon the emergence of more clarity on the impact of the recent developments on the Group's ability to raise funds and maintain adequate liquidity and lender confidence over the near term.

Key rating drivers and their description

Credit strengths

Strong institutional shareholder – Brookfield, a Canada-based alternative asset manager, held a majority (56.20%) stake in IndoStar as of June 30, 2022. Brookfield, through its subsidiary BCP V Multiple Holdings Pte Ltd, invested Rs. 1,225 crore in IndoStar in May 2020 to become the largest shareholder and co-promoter of the company. Brookfield is actively involved in the affairs of IndoStar with representatives on the board and an active role in discussions with key stakeholders. ICRA expects Brookfield to support IndoStar through its global relationships. It has clearly demonstrated its support to IndoStar by arranging Rs. 770-crore debt funding in June 2022. Any reduction in Brookfield's stake or support would be a credit negative for IndoStar.

Comfortable capitalisation, notwithstanding significant erosion following large losses – IndoStar's financial profile remains characterised by a comfortable consolidated net worth (net of goodwill) of Rs. 2,695 crore with a consolidated gearing (Total debt/Adjusted net worth) of 2.2 times and healthy standalone capital adequacy of 29% as of June 30, 2022. IndoStar's capitalisation had strengthened earlier following the capital raise in Q1 FY2021. However, it posted significant losses in the last two years (FY2021: Rs. 214 crore, FY2022: Rs. 737 crore), which has caused significant erosion in the net worth. Nonetheless, the leverage has remained comfortable.

As on March 31, 2022, IHFPL's standalone financial profile was characterised by a gearing of 1.5 times and solvency (Net stage 3/Net worth) of 2.8%. While ICRA notes that IHFPL would need equity infusions 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.

Credit challenges

Asset quality challenges – IndoStar's product basket encompasses vehicle finance for new and used vehicles, loans to small-to-medium-sized enterprises, wholesale funding to corporates (defocused), and home finance through a wholly-owned subsidiary. As of June 30, 2022, the consolidated AUM (including IHFPL) aggregated Rs. 8,247 crore comprising CV finance (46.5% share), small and medium enterprise (SME) finance (20.0%), housing finance (17.8%), and corporate funding (15.6%; defocused). 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 and housing finance in FY2018. 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.

IndoStar's reported asset quality has deteriorated sharply following the identification of issues pertaining to the control deficiencies primarily in the CV portfolio. On a consolidated basis, the Group reported gross and net stage 3 ratios of 13.6% and 6.4%, respectively, as of March 31, 2022 compared to 4.3% and 2.0%, respectively, as of March 31, 2021, before witnessing some respite in Q1 FY2023 with gross and net stage 3 ratios of 8.2% and 3.6%, respectively, as of June 30, 2022. ICRA notes that the improvement in the reported asset quality ratios as of June 30, 2022 compared to March 31, 2022 was on the back of the sale of assets to an ARC and write-offs, besides resolutions and collections.

At the standalone level, IndoStar reported gross and net stage 3 ratios of 9.4% and 4.1%, respectively, as of June 30, 2022 compared to 15.5% and 7.3%, respectively, as of March 31, 2022 and 4.4% and 2.0%, respectively, as on March 31, 2021. ICRA notes that despite the reduction in standalone gross stage 3% in Q1 FY2023, it remains in breach of the financial covenants of some of the lenders. However, as on date, ICRA notes (based on discussions with the IndoStar management) that none of the bank lenders have recalled their loans. Any recall by the bank lenders and a delay in the proposed securitisation of a sizeable CV loan pool would put pressure on the company's liquidity position and may warrant immediate capital support in the form of equity or debt from Brookfield.

As far as IHFPL is concerned, the gross and net stage 3 ratios were under control at 1.9% and 1.2%, respectively, as of June 30, 2022. Furthermore, the collection efficiency for the overall portfolio has been high in recent quarters though the trajectory has been volatile, especially for billing-to-billing collections, with frequent instances of dips. Overall, the collection efficiency (including foreclosures) stood at 181% in Q1 FY2023 compared to 142% in Q4 FY2022 for IndoStar. Going forward, the Group's ability to resolve the asset quality issues and reduce the gross and net stage 3% significantly would be critical for curing the debt covenants and liquidity.

Weak profitability – IndoStar posted losses in the last three consecutive years. It saw an increase in the provisioning requirements in FY2022 following the implementation of the revised ECL staging policy after the control deficiencies identified primarily in the CV portfolio. Thus, the impairment cost increased to Rs. 1,158 crore in FY2022 (FY2021: Rs. 487 crore), which resulted in a net loss of Rs. 737 crore in FY2022 (net loss of Rs. 214 crore in FY2021 and Rs. 325 crore in FY2020). Further, the decline in the loan book due to the focus on portfolio realignment and the conservative lending strategy in the challenging operating environment during the Covid-19 pandemic impacted the operating efficiency with higher operating cost as a proportion of the asset base. Nonetheless, ICRA notes that the Group reported a net profit of Rs. 61 crore in Q1 FY2023. 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 a key determinant of the profitability trajectory hereon.

Liquidity position: Adequate

On a consolidated basis, IndoStar had an unencumbered cash and bank balance of Rs. 948 crore as of July 31, 2022 (Rs. 956 crore as of August 10, 2022) and undrawn funding lines of Rs. 609 crore (approximately half of this is available for onward lending) as of August 05, 2022. The current liquidity would be adequate for the Rs. 700-crore buyback of non-convertible debentures (NCDs) and the scheduled principal repayment of Rs. 198 crore in August 2022, assuming no acceleration by the lenders. The company also expects cash inflow (loan repayment inflows-principal) of Rs. 80 crore in August 2022. The Group is also in advanced talks to raise funds aggregating Rs. 1,000 crore through securitisation transactions, which are expected to be completed within August 2022. The ability to raise funds through securitisation is imperative for its near-term (September 2022 onwards) liquidity position.

Rating sensitivities

Positive/Negative factors – The rating watch will be resolved upon the emergence of more clarity on the impact of the recent developments on the ability to raise funds and maintain adequate liquidity and lender confidence over the near term.

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 March 31, 2022, IHFPL's on-book loan portfolio stood at Rs. 1,223 crore compared to Rs. 846 crore in March 2021 and Rs. 748 crore in March 2020. The loan book is currently split equally between the salaried and self-employed segments while 84% is concentrated in four states, i.e. Tamil Nadu, Maharashtra, Andhra Pradesh and Telangana.

Key financial indicators

IndoStar Home Finance Private Limited	FY2021	FY2022	Q1 FY2023
	Audited	Audited	Provisional
PAT	28	34	16
Net worth	215	499	NA
Gross loan book	846	1,223	1,234
Return on average assets	3.3%	3.1%	NA
Return on average equity	13.9%	9.6%	NA
Gearing (times)	3.0	1.5	NA
CRAR	49.2%	83.2%	76.5%
Gross stage 3	1.8%	1.8%	1.9%
Net stage 3	1.4%	1.2%	NA
Net stage 3/ Adjusted net worth	5.6%	2.8%	NA

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-sized enterprises, long-term wholesale funding to corporates (defocused), and home finance through its wholly-owned subsidiary – IndoStar Home Finance Private Limited (IHFPL). As of June 30, 2022, the consolidated AUM (including IHFPL) aggregated Rs. 8,247 crore comprising CV finance (46.5% share), small and medium enterprise (SME) finance (20.0%), housing finance (17.8%), and corporate funding (15.6%; defocused).

As on June 30, 2022, Brookfield held a 56.20% stake in IndoStar, followed by IndoStar Capital Mauritius at 33% (including ECP II & ECP III). Brookfield 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.

Key financial indicators

IndoStar Capital Finance Limited	Standalone			Consolidated		
	FY2021	FY2022	Q1 FY2023	FY2021	FY2022	Q1 FY2023
	Audited	Audited	Provisional	Audited	Audited	Provisional
PAT	(241)	(769)	45	(214)	(737)	61
Adjusted net worth*	3,379	2,578	NA	3,398	2,629	2,695
Assets under management (AUM)	7,994	8,003	6,727	8,990	9,658	8,247
Return on average assets	-2.4%	-8.2%	NA	-2.1%	-7.4%	2.7%
Return on average equity	-8.4%	-25.8%	NA	-7.4%	-24.4%	9.2%
Gearing (times)	1.7	2.1	NA	1.8	2.4	2.2
CRAR	34.6%	25.8%	29.0%			
Gross stage 3	4.4%	15.5%	9.4%	4.3%	13.6%	8.2%
Net stage 3	2.0%	7.3%	4.1%	2.0%	6.4%	3.6%
Net stage 3/ Adjusted net worth	4.2%	20.1%	NA	4.5%	10.0%	9.3%

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	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Current Rating (FY2023)			Chronology of Rating History for the Past 3 Years		
					Aug 23, 2022	May 17, 2022	Apr 20, 2022	FY2022	FY2021	FY2020
								Apr 16, 2021	-	Mar 17, 2020
1	Commercial paper programme	Short Term	200	0*	[ICRA]A1+@	[ICRA]A1+@	[ICRA]A1+	[ICRA]A1+	-	[ICRA]A1+

Source: ICRA Research; *As of June 30, 2022, @: Rating Watch with Negative Implications

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 I: Instrument details as on June 30, 2022

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

Source: ICRA; *Not placed, @ Rating Watch with Negative Implications

Annexure II: 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

ANALYST CONTACTS

Karthik Srinivasan
+91-22-6114 3444
karthiks@icraindia.com

Deep Inder Singh
+91-124-4545830
deep.singh@icraindia.com

Sainath Chandrasekaran
+91-22-6114 3439
sainath.chandrasekaran@icraindia.com

Komal Mody
+91-22-6114 3424
komal.mody@icraindia.com

RELATIONSHIP CONTACT

L. Shivakumar
+91 22 6114 3406
shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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

ICRA Limited



Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001

Tel: +91 11 23357940-45



Branches



© Copyright, 2022 ICRA Limited. All Rights Reserved.

Contents may be used freely with due acknowledgement to ICRA.

ICRA ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. ICRA ratings are subject to a process of surveillance, which may lead to revision in ratings. An ICRA rating is a symbolic indicator of ICRA's current opinion on the relative capability of the issuer concerned to timely service debts and obligations, with reference to the instrument rated. Please visit our website www.icra.in or contact any ICRA office for the latest information on ICRA ratings outstanding. All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable, including the rated issuer. ICRA however has not conducted any audit of the rated issuer or of the information provided by it. While reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. Also, ICRA or any of its group companies may have provided services other than rating to the issuer rated. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents.