

April 19, 2023

Arth Padarth Factors and Finance Private Limited: Provisional [ICRA]BBB-(SO) assigned to PTCs to be issued by REST 2 PTC

Summary of rating action

Trust Name	Instrument*	Current Rated Amount (Rs. crore)	Rating Action
REST 2 PTC	Series A1 PTC	3.27	Provisional [ICRA]BBB-(SO); Assigned

*Instrument details are provided in Annexure I

Rating in the absence of pending actions/documents	No rating would have been assigned as it would not be meaningful
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Rationale

ICRA has assigned a provisional rating to the pass-through certificate (PTC) Series A1 to be issued under a securitisation transaction originated by Arth Padarth Factors and Finance Private Limited (AP Factors/Originator). The PTCs are backed by a pool of trade receivables arising from invoices discounted by AP Factors. The invoices are raised by a set of vendors (Sellers) on their customers (Buyers) against the supply of goods to the Buyers and these invoices have been financed by AP Factors as a part of its factoring business.

The rating factors in the strong credit profile of the Buyers, which are well-established and financially strong entities with domestic credit ratings of at least AA- category or are a part of established global conglomerates. The rating also considers the stringent pool eligibility criteria during the replenishment period of the transaction and the integrity of the legal structure. The rating is, however, constrained by the limited track record of operations between the Buyers and the Sellers. Moreover, a relatively small share of the procurement needs of the Buyers is being met by the Sellers. Further, the securitised receivables would be contractual payments to be received from the Buyers and not a financial obligation.

The rating takes support from the credit enhancement (CE) available in the transaction in the form of (i) a cash collateral (CC) of 5.00% of the initial pool principal to be provided by AP Factors, and (ii) principal subordination of 15.00% of the initial pool principal in form of Series A2 PTC (unrated), as well as the integrity of the legal structure. The provisional rating is subject to the fulfilment of all the conditions under the structure, due diligence audit of the pool, review by ICRA of the documentation pertaining to the transaction, and the furnishing of a legal opinion.

Key rating drivers

Credit strengths

- Strong credit profile of the Buyers whose invoices will be assigned
- Stringent predefined eligibility criteria of the invoices, supporting the quality of the cover pool
- Presence of credit enhancement (CE) in the form of cash collateral and subordination (for Series A1 PTC)

Credit challenges

- Exposure to any delays in payments by Buyers, as payment obligation from Buyers is only a contractual payment
- Relatively small share of procurement needs of Buyers being met by Sellers
- Limited track record of operations between Sellers and Buyers

Description of key rating drivers highlighted above

The Trustee shall settle a Trust and AP Factors would assign the future receivables of Rs. 3.85 crore arising from the selected invoices to the bankruptcy remote trust. The receivables are registered on CERSAI¹ for avoidance of claim from any other creditor of the Seller. The Trust will issue two series of PTCs backed by the receivables. The upfront purchase consideration to be paid to the Trustee will be 85.00% of the pool principal, i.e. Rs. 3.27 crore, for Series A1 PTC and 15.00% of the pool principal, i.e. Rs. 0.58 crore, for Series A2 PTC (unrated). The transaction timeline consists of a replenishment period spanning 11.5 months from the date of issuance of the PTCs. During this period, the cashflows from maturing invoices will be utilised to purchase further invoices, which mature not more than 12 months from the PTC issuance date. Post 11.5 months from the PTC issuance, the amortisation period will commence. The payouts for Series A1 PTC (interest and principal) would be made in two equal instalments, i.e. at the end of 11.5 months and 12 months. No interest payment is made during the replenishment period. The payouts for Series A2 PTC will be made once Series A1 PTC has been fully redeemed. The principal and interest are promised to Series A1 PTC on the final maturity date, which is 15 months post the PTC issuance date. This provides an additional cushion of three months to factor in delays in payments from the Buyers.

The first line of support for Series A1 PTC in the transaction is in the form of a principal subordination of 15.00% of the initial pool principal (through the principal payable to Series A2 PTC). A CC of 5.00% of the initial pool principal (Rs. 0.19 crore), to be provided by AP Factors, would act as further CE in the transaction. In the event of a shortfall in meeting the promised PTC payouts, the Trustee will utilise the CC to meet the same.

The underlying pool would consist of the trade receivables arising from the invoices discounted by AP Factors. The invoices are raised by a predefined set of Sellers on a predefined set of Buyers against the supply of goods by the Sellers to the Buyers. The pool would also include the receivables purchased from the Trade Receivables Discounting System (TReDS) platform with a predefined condition on the credit quality of the Buyer. The invoices would have to be 'confirmed' or 'accepted' and marked as 'scheduled for payment' by the Buyers. ICRA notes that the payments from the Buyers would be received in designated escrow accounts operated by a trustee and would then be passed on to the Collection and Payout Account of the PTC trust. The allocation and calculation of the amounts to be transferred between various accounts will also be determined by an independent CA firm, which would have access to the systems of AP Factors. ICRA notes that there would be no commingling of funds for the transaction with the Originator's own cashflows.

The replenished pool will be guided by stringent eligibility criteria. The eligibility criteria would ensure the quality of the pool in terms of the Buyers and the Sellers that can be considered, the maximum Buyer and invoice-level concentration, the minimum rate at which AP Factors has discounted the invoice, etc. The Buyers also have strong credit profiles, thus minimising the default risk. However, ICRA notes that the trust would be seen as an operational creditor of the buyers. Therefore, the risk of non-payment by the Buyers can be deemed to be higher vis-à-vis the obligations to its financial creditors. Nonetheless, the sellers would be assigning their rights, title and interest in the receivables to the trust, and the trust would therefore be entitled to all the rights under the Insolvency and Bankruptcy Code, 2016, which would be a mitigant.

The rating is also constrained by the relatively modest scale of operations of the Sellers compared to the Buyers. Thus, the Sellers may witness some delays in the receipt of payments during periods of economic stress. Further, the operations between the Sellers and the Buyers have a limited track record, though the payments have largely been within the contractual terms so far. As the pool would remain concentrated with the top Buyer's exposure capped at 20%, the transaction would remain exposed to any material dispute between the Buyer and the Seller such that the Buyer does not honour the obligated payments.

¹ Central Registry of Securitisation Asset Reconstruction and Security Interest of India

Key rating assumptions

ICRA's cashflow modelling for rating securitisation transactions involves the simulation of potential losses in the pool. ICRA's rating assumption on the quality of the cashflows being securitised, along with the tenure of the payments, has been taken into account to estimate the default probability on each of the underlying Buyer payments. Additionally, a certain degree of correlation is assumed in the performance of the various entities in the pool, by virtue of being in the same sector/sub-sector. ICRA has also taken note of the Originator's track record in the business. The cashflow modelling also considers the assumptions on the build-up of delinquency/loss and the transaction structure.

Liquidity position: Adequate

As per the transaction structure, both the interest and the principal amount are promised to the PTC holders on the scheduled maturity date of the transaction. The cashflows from the pool and the available CE are expected to be adequate to meet the promised payouts to the Series A1 PTC investors.

Rating sensitivities

Positive/Negative factors – The rating is unlikely to be revised during the replenishment period. Any rating revision would depend on the performance of the underlying pool and the CE utilisation during the amortisation period. The rating could also be under pressure if sustained delays are observed in the payments by the Buyers to the Sellers in the normal course of business.

Analytical approach

The rating action is based on the legal structure of the transaction and factors in the payment mechanism along with the credit profile of the Buyers.

Analytical Approach	Comments
Applicable rating methodologies	Rating Methodology for Collateralised Debt Obligations
Parent/Group support	Not Applicable
Consolidation/Standalone	Not Applicable

Pending actions/documents required to be completed for conversion of the provisional rating into final

The assigned rating is provisional and would be converted into final upon the execution of:

1. Trust deed
2. Deed of Assignment
3. Collection Agreement
4. Legal opinion
5. Tax opinion
6. Trustee letter
7. Master Receivable Purchase Agreement between Sellers and AP Factors and associated documents
8. Any other documents executed for the transaction

Validity of the provisional rating

The trust is expected to complete the pending actions/execute the pending documents in the near term. However, in case of continued pendency of the actions/documents beyond one year of this publication, the provisional rating would be withdrawn for the transaction even if the instrument has been issued.

Risks associated with the provisional rating

In case the issuance is completed, but the pending actions/documents are not completed for the transaction within one year (validity period) from the assignment of the rating, the provisional rating will be withdrawn in accordance with ICRA's Policy on Provisional Ratings available at www.icra.in.

About the Originator

Arth Padarth Factors and Finance Private Limited (AP Factors) is engaged in factoring and supply chain finance, supporting micro, small and medium enterprises (MSMEs) in managing their receivables and working capital cycles through receivables/payables and supply chain financing solutions. It is registered as a non-deposit taking, factoring non-banking financial company (NBFC-ND Factor). It carries on the business of factoring, i.e. the business of acquisition by way of the assignment of the receivables of the assignor for a consideration for the purpose of collection of such receivables or for financing/purchasing with or without recourse against such assignment. This includes domestic factoring, supply chain finance for vendors and dealers, collection and dunning services, platform-based invoice discounting services for anchor running vendor and dealer finance programmes with various financial institutions. It also participates as an NBFC Factor on the Trade Receivables Discounting System (TReDS) platform for facilitating the financing/discounting of the trade receivables of MSMEs.

Key financial indicators (audited)

	FY2021	FY2022	9M FY2023*
Total income	0.05	0.17	0.36
Profit after tax	-0.07	-0.55	-0.46
Gross loan portfolio	0.00	0.72	2.61
Gross stage 3	0%	0%	0%
Net stage 3	0%	0%	0%

Source: Company, ICRA Research; *Provisional financials
Amount in Rs. crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

1	Trust Name	Current Rating (FY2024)				Chronology of Rating History for the Past 3 Years		
		Instrument	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in FY2024	Date & Rating in FY2023	Date & Rating in FY2022	Date & Rating in FY2021
					Apr 19, 2023	-	-	-
	REST 2 PTC	Series A1 PTC	3.27	3.27	Provisional [ICRA]BBB-(SO)	-	-	-

Complexity level of the rated instrument

Instrument	Complexity Indicator
Series A1 PTC	Moderately Complex

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: [Click Here](#)

Annexure I: Instrument details

Trust Name	Instrument	Date of Issuance / Sanction	Coupon Rate	Maturity Date*	Amount Rated (Rs. crore)	Current Rating
REST 2 PTC	Series A1 PTC	April 2023	10.00%	July 2024	3.27	Provisional [ICRA]BBB-(SO)

* Scheduled maturity date at transaction initiation; may change on account of prepayments
Source: Company

Annexure II: List of entities considered for consolidated analysis

Not Applicable

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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.

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