

September 29, 2023

Veritas Finance Private Limited: Rating confirmed as final for PTCs backed by small business loan and loan against property receivables issued by Indigo 023

Summary of rating action

Trust Name	Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Indigo 023	Series A1 PTC	100.00	[ICRA]AA+(SO); provisional rating confirmed as final

*Instrument details are provided in Annexure I

Rationale

In September 2023, ICRA had assigned a provisional [ICRA]AA+(SO) rating to the Series A1 pass-through certificates (PTC) issued under a securitisation transaction originated by Veritas Finance Private Limited (VFPL). The PTCs are backed by a mixed pool of Rs. 111.15 crore (pool principal; receivables of Rs. 156.21 crore) small business loan (SBL) and loan against property (LAP) receivables originated by VFPL. Since the executed transaction documents are in line with the rating conditions and the legal opinion for the transaction has been provided to ICRA, the said rating has now been confirmed as final.

Key rating drivers

Credit strengths

- Availability of credit enhancement in the form of EIS, principal subordination and CC
- No overdue contracts as on the cut-off date; all the contracts in the initial pool have never been delinquent
- Average seasoning of ~22 months and average pre-securitisation amortisation of ~26% as on the cut-off date

Credit challenges

- High geographical concentration with top 3 states contributing around 72% to the pool principal as on the cut-off date
- Performance of the pool would remain exposed to macro-economic shocks/business disruptions/natural calamities that may impact the income-generating capability of the borrower

Description of key rating drivers highlighted above

According to the transaction structure, the loan pool receivables are assigned at par to the PTC investors. The monthly promised cash flows for Series A1 PTC will comprise the scheduled principal amount (which is 89.97% of the billed pool principal) and the interest payment to Series A1 PTC at the predetermined interest rate on the principal outstanding. The balance principal billed is expected to be paid on a monthly basis but is not promised.

The collections from the pool, after making the promised payouts to Series A1 PTC and the replenishment of the credit enhancement (to the extent used and not reimbursed till the previous month), will be used to make the expected principal payouts to Series A1 PTC to the extent of 10.03% of the billed pool principal. The expected principal portion is not promised and any shortfall in making the expected principal payment to Series A1 PTC would be carried forward to the subsequent payout. Any prepayment amount would be used for the payment of Series A1 PTC.

A part of the residual cash flows from the pool (75% of the residual cash flows), after making the promised and expected payouts, would be used for the prepayment of the Series A1 PTC principal while the rest (25% of the residual cash flow) would be used for the payment of the equity tranche. Hence, the actual tenure of the PTC is expected to be shorter owing to such acceleration. In the event of a shortfall in meeting the promised PTC payouts during any month, the trustee will utilise the CC to meet the same.

There were no overdues in the pool as on the cut-off date. The weighted average seasoning of the pool was 22.0 months with pre-securitisation amortisation of 26.2% as on the cut-off date. The pool had high geographical concentration with the top 3 states (Tamil Nadu, West Bengal and Telangana) contributing 71.8% to the initial pool principal amount. At the district level, the top district accounted for 5.1% of the initial pool principal amount while the top 10 districts accounted for 27.1%. The performance of the pool would remain exposed to macro-economic shocks/business disruptions/natural calamities that may impact the income-generating capability of the borrower.

Key rating assumptions

ICRA's cash flow modelling for rating asset-backed securitisation (ABS) transactions involves the simulation of potential losses, delinquencies and prepayments in the pool. The losses and prepayments are assumed to follow a log-normal distribution. The mean and the co-efficient of variation (CoV) are calibrated on the basis of the values observed in the analysis of the past performance of the originator's loan portfolio. Given Veritas' limited track record in this business, ICRA has also considered the credit quality experience of other more established players and ICRA's expectation of credit quality for the asset classes involved. Veritas' target borrower segment could be financially quite vulnerable. Also, while the underlying loans are backed by the mortgage of immovable property, the timing and quantum of recovery, post default, are yet to be established in the absence of a longer track record in security enforcement.

The resulting collections from the pool, after incorporating the impact of losses and prepayments as above, are accounted for in ICRA's cash flow model, in accordance with the cash flow waterfall of the transaction. Various possible scenarios are simulated and the incidences of default to the investor as well as the extent of losses are measured. These are then compared with ICRA's internal benchmarks for the target rating.

For the current pool, after taking into account the above-mentioned factors regarding the asset class and after adjusting for key features like seasoning, overdues, instalment to income ratio (IIR), ticket size, peak days past due, rate of interest and geographical distribution, ICRA estimates the shortfall in pool principal collection within the pool's tenure at 4-5%, with certain variability around it. The variability is based on the static pool analysis of Veritas' portfolio as well as ICRA's observation on the performance of the same asset class for other originators. ICRA's estimation of the variability also factors in Veritas' relatively shorter track record. The average prepayment rate for the underlying pool is estimated at 18% per annum.

Liquidity position: Strong

The cash collections and the credit collateral available in the transaction are expected to be comfortable to meet the Series A1 PTC investor payouts. Assuming a monthly collection efficiency of even 50% in the underlying pool of contracts in a stress scenario, the recommended credit collateral would cover the shortfalls in the investor payouts for seven months.

Rating sensitivities

Positive factors – The sustained strong collection performance of the underlying pool of contracts (monthly collection efficiency >95%), leading to lower-than-expected delinquency levels, and an increase in the cover available for future investor payouts from the credit enhancement would result in a rating upgrade.

Negative factors – The sustained weak collection performance of the underlying pool (monthly collection efficiency <90%), leading to higher-than-expected delinquency levels and higher credit enhancement utilisation levels, would result in a rating downgrade.

Analytical approach

The rating action is based on the analysis of the performance of Veritas' portfolio till June 2023, the key characteristics and composition of the current pool, the performance expected over the balance tenure of the pool, and the credit enhancement cover available in the transaction.

Analytical Approach	Comments
Applicable rating methodologies	<u>Rating Methodology for Securitisation Transaction</u>
Parent/Group support	Not Applicable
Consolidation/Standalone	Not Applicable

About the originator

Veritas Finance Private Limited (Veritas) is a non-banking financial company (NBFC) incorporated on April 30, 2015, registered with the Reserve Bank of India (RBI). The company is promoted by Mr. D Arulmany and it lends to borrowers engaged in the micro, small and medium enterprise (MSME) sector with a primary focus on providing inclusive finance to self-employed borrowers for their businesses. As on June 30, 2023, Veritas had a net worth of Rs. 1,636 crore. It currently operates out of 304 branches in nine states, namely Tamil Nadu, West Bengal, Karnataka, Odisha, Andhra Pradesh, Telangana, Bihar, Jharkhand and Madhya Pradesh, as well as the Union Territory of Puducherry.

Veritas had a gross loan portfolio of Rs. 3,889 crore as on June 30, 2023 (Rs. 3,534 crore as on March 31, 2023). The company has divided its product segments into two heads – MSME Rural and MSME Urban. The MSME Rural segment includes small business loans (SBLs), loan against property - construction (LAP-C) and home loans (HLs) while the MSME Urban segment includes working capital loans (WCLs). These products are differentiated on the basis of the purpose of the loan.

SBL is a secured loan product offered for business purposes with a ticket size of Rs. 1 lakh to Rs. 50 lakh. LAP-C is given for home construction, home improvement or shop construction with a ticket size of Rs. 5 lakh to Rs. 25 lakh. Home loans are given for purchase or self-construction with a ticket size of Rs. 5 lakh to Rs. 30 lakh. WCL is an unsecured product with a ticket size of Rs. 1 lakh to Rs. 5 lakh.

On a fully-diluted basis, the promoter, Mr. Arulmany, and his relatives held 14.38% as on June 30, 2023, followed by Norwest Venture Partners X (24.11%), CDC Group PLC (17.41%), Kedaara Capital Fund II LLP (16.85%), Lok Capital (11.72%), Evolve India Fund (2.58%), Growth Catalyst Partners LLC (0.94%), and Caspian Impact Investment Advisers Private Limited (0.60%). Individual shareholders, employees and their relatives held the balance.

Key financial indicators (audited)

Veritas Finance Private Limited	FY2021	FY2022	FY2023
Total income	361.68	443.65	682.21
PAT	61.12	75.85	174.70
Assets under management (AUM)	1,562.75	2,187.35	3,533.73
Gross NPA	2.70%	3.94%	2.19%
Net NPA	1.37%	2.34%	1.26%

Source: Company, ICRA Research; All ratios as per ICRA's calculations; Amount in Rs. crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Trust Name	Instrument	Current Rating (FY2024)				Chronology of Rating History for the Past 3 Years		
		Initial Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in FY2024		Date & Rating in FY2023	Date & Rating in FY2022	Date & Rating in FY2021
				Sep 29, 2023	Sep 14, 2023			
Indigo 023	Series A1 PTC	100.00	100.00	[ICRA]AA+(SO)	Provisional [ICRA]AA+(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

ISIN No.	Trust Name	Instrument Type	Date of Issuance / Sanction	Coupon Rate	Maturity Date*	Amount Rated (Rs. crore)	Current Rating
INE0RAC15010	Indigo 023	Series A1 PTC	September 2023	9.75%	July 2028	100.00	[ICRA]AA+(SO)

**Scheduled maturity at transaction initiation; may change on account of prepayments in the underlying pool*

Source: Company

Annexure II: List of entities considered for consolidated analysis

Not Applicable

ANALYST CONTACTS

Abhishek Dafria

+91 22 6114 3440

abhishek.dafria@icraindia.com

Sachin Joglekar

+91 22 6114 3470

sachin.joglekar@icraindia.com

Sumit Pramanik

+91 22 6114 3462

sumit.pramanik@icraindia.com

Rushabh Gohel

+91 22 6114 3420

rushabh.gohel@icraindia.com

Ekta Baheti

+91 22 6114 3423

ekta.baheti@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



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