

February 28, 2024

Veritas Finance Private Limited: Provisional ratings assigned to PTCs backed by small business loan and home construction loans receivables issued by Vajra 006 Trust

Summary of rating action

Trust Name	Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Vajra 006 Trust	Series A1 PTC	74.00	Provisional [ICRA]AAA(SO); Assigned
	Series A2 PTC	29.00	Provisional [ICRA]AA(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 provisional ratings to the Series A1 pass-through certificates (PTCs) and Series A2 PTCs backed by a pool of Rs. 113.80-crore (pool principal; receivables of Rs. 168.86 crore) small business loan (SBL) and home construction loan receivables originated by Veritas Finance Private Limited (Veritas/originator).

The provisional ratings are based on the strength of the cash flows from the selected pool of contracts. Credit enhancement (CE) is available in the form of (i) a cash collateral (CC) of 5.00% of the initial pool principal to be provided by the originator, (ii) subordination of 34.97% of the initial pool principal (including principal payable to Series A2 PTCs) for Series A1 PTCs and 9.49% of the initial pool principal for Series A2 PTCs, and (iii) the excess interest spread (EIS) of 41.33% of the initial pool principal for Series A1 PTCs and 34.58% of the initial pool principal for Series A2 PTCs in the structure, as well as the integrity of the legal structure. The ratings are subject to the fulfilment of all the conditions under the structure, due diligence audit of the pool, ICRA's review of the documentation pertaining to the transaction, and the furnishing of a legal opinion on the transaction to ICRA by Veritas.

Key rating drivers

Credit strengths

- Availability of CE 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 ~21 months and average pre-securitisation amortisation of ~21% as on the cut-off date

Credit challenges

- High geographical concentration with top 3 states contributing around 67% 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

As per the transaction structure, Series A2 PTCs are subordinate to Series A1 PTCs. During the tenure of Series A1 PTCs, the collections from the pool will be used to make the promised interest and principal payouts (to the extent of 90.51% of the principal billed) to Series A1 PTCs. 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 PTCs and the replenishment of the CE (to the extent utilised and not reimbursed till the previous month), will be used to make the expected principal payouts to Series A1 PTCs to the extent of 9.49% of the billed pool principal. The expected principal portion is not promised and any shortfall in making the expected principal payment to Series A1 PTCs would be carried forward to the subsequent payout. Any prepayment

amount would be used for the payment of Series A1 PTCs. After the maturity of Series A1 PTCs, a similar structure would be followed to make the promised interest and principal payouts to Series A2 PTCs. The final maturity date is February 20, 2027 for Series A1 PTCs and August 20, 2029 for Series A2 PTCs.

A part of the residual cash flows from the pool (50% 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 balance (50% of the residual cash flow) would be used for the payment of the equity tranche. Hence, the actual tenure of the PTCs 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.

Support for Series A1 PTCs in the transaction is in the form of a principal subordination of 34.97% of the initial pool principal (includes principal payable to Series A1 PTCs). After Series A1 PTCs have been fully paid, subordination of 9.49% of the pool principal will be available for Series A2 PTCs. Further support is available in the form of the EIS of 41.33% of the initial pool principal for Series A1 PTCs and 34.58% of the initial pool principal for Series A2 PTCs. A CC of 5.00% of the initial pool principal (Rs. 5.69 crore), to be provided by Veritas, acts as further CE in the transaction. In the event of a shortfall in meeting the promised PTC payouts during any month, the trustee will utilise the CC (in case the principal subordination and EIS are insufficient) 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 20.1¹ months with pre-securitisation amortisation of 20.6% as on the cut-off date. The pool had high geographical concentration with the top 3 states (Tamil Nadu, Telangana and Andhra Pradesh) contributing 67.2% to the initial pool principal amount. At the district level, the top district accounted for 4.0% of the initial pool principal amount while the top 10 districts accounted for 28.8%. 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 coefficient 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 the credit quality of 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, geographical distribution and credit bureau score, ICRA estimates the shortfall in the pool principal collection within the pool's tenure at 4.0-5.0%, 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

¹ Basis the number of instalments paid as shared by the originator

also factors in Veritas’ relatively shorter track record. The average prepayment rate for the underlying pool is estimated at 18% per annum.

Liquidity position: Superior

The liquidity for both PTC instruments is superior after factoring in the CE available to meet the promised payout to the investors. The total CE would be greater than 8 times the estimated loss in the pool.

Rating sensitivities

Positive factors – Not applicable for Series A1 PTCs

The rating could be upgraded for Series A2 PTCs if sustained strong collection performance is witnessed in the underlying pool, leading to low delinquency levels and build-up of cover from the CE of the balance pool principal.

Negative factors – The sustained weak collection performance of the underlying pool (monthly collection efficiency <90%), leading to higher-than-expected delinquency levels and higher CE utilisation levels, would result in a rating downgrade. Weakening in the credit profile of the servicer could also exert pressure on the ratings.

Analytical approach

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

Analytical Approach	Comments
Applicable rating methodologies	Rating Methodology for Securitisation Transactions
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 ratings are provisional and would be converted into final upon the execution of:

1. Trust deed
2. Assignment agreement
3. Legal opinion
4. Trustee letter
5. Chartered Accountant’s know your customer (KYC) certificate
6. 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

Veritas Finance Private Limited (Veritas) is a non-banking financial company (NBFC) incorporated on April 30, 2015 and 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 the self-employed borrowers for their businesses. As on June 30, 2023, Veritas had a net worth of Rs. 1,636 crore. As on December 31, 2023, it operates out of 423 branches in ten states, namely Tamil Nadu, West Bengal, Karnataka, Odisha, Andhra Pradesh, Telangana, Bihar, Jharkhand, Chhattisgarh and Madhya Pradesh, as well as the Union Territory (UT) of Puducherry.

Veritas had a gross loan portfolio of Rs. 5,046 crore as on December 31, 2023 (Rs. 3,534 crore as on March 31, 2023). The company has divided the MSME loan product segment into two broad heads – MSME Rural and MSME Urban apart from home loans. The MSME Rural segment consisting of small business loans (SBL) and home construction loans (HCL) as one segment, MSME Urban which is a segment focused on unsecured business loans meant for working capital purposes. Home loans (HL) as another segment focusing on affordable housing. These products are differentiated typically on the basis of the purpose of the loan, customer segment, etc.

MSME-Rural is a secured loan product offered for business purposes with a ticket size of Rs. 1 lakh to Rs. 50 lakh and home construction loans within that is given for home construction, home improvement or shop construction with a ticket size of Rs. 5 lakh to Rs. 25 lakh. HLs are given for purchase or self-construction with a ticket size in the range of Rs. 5 lakh to Rs. 30 lakh. MSME-Urban is an unsecured product for a ticket size of Rs. 1 lakh to Rs. 5 lakh.

As on December 31, 2023, on a fully-diluted basis, the promoter, Mr. Arulmany and his relatives held 11.70% while other shareholders include Norwest Venture Partners X (21.78%), Multiples PE and affiliates (16.38%), Kedaara Capital Fund II LLP (15.21%), Lok Capital and affiliates (11.33%), British International Investments Plc. (10.42%), Avendus Future Leaders Fund (2.34%), and Caspian Impact Investment Advisers Private Limited (0.19%). The balance is held by individual shareholders and employees and their relatives.

Key financial indicators

Veritas Finance Private Limited	FY2022	FY2023	9M FY2024
	Audited	Audited	Unaudited*
Total income	443.65	682.21	792.17
PAT	75.85	174.70	165.82
Assets under management (AUM)	2,187.35	3,533.73	5,046.30
Gross NPA	3.94%	2.19%	1.86%
Net NPA	2.34%	1.26%	1.05%

*Subjected to limited review

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
Vajra 006 Trust	Series A1 PTC	74.00	74.00	Feb 28, 2024* Provisional [ICRA]AAA(SO)	-	-	-
	Series A2 PTC	29.00	29.00	Provisional [ICRA]AA(SO)	-	-	-

*Provisional rating assigned

Complexity level of the rated instrument

Instrument	Complexity Indicator
Series A1 PTC	Moderately Complex
Series A2 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 Type	Date of Issuance / Sanction	Coupon Rate	Maturity Date*	Amount Rated (Rs. crore)	Current Rating
Vajra 006 Trust	Series A1 PTC	February 2024	9.37%	February 2027	74.00	Provisional [ICRA]AAA(SO)
	Series A2 PTC	February 2024	9.93%	August 2029	29.00	Provisional [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

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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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