India Ratings & Research
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India Ratings Affirms IndoStar Capital Finance’s NCDs and Bank Loans at ‘IND AA-’/Stable

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India Ratings and Research (Ind-Ra) has affirmed the ratings of IndoStar Capital Finance Limited’s (IndoStar) debt instruments as follows:

Instrument Type	Date of Issuance	Coupon Rate (%)	Maturity Date	Outstanding amount (billion)	Rating/Outlook	Rating Action
Non-convertible debentures (NCDs)*	-	-	-	INR2.25 (reduced from INR3.0)	IND AA-/Stable	Affirmed
Proposed NCDs^	-	-	-	INR3.50	IND AA-/Stable	Affirmed
Bank loans	-	-	-	INR0.47 (reduced from INR1.34)	IND AA-/Stable	Affirmed

*Details in Annexure,
^unutilised

Analytical Approach: Ind-Ra continues to take a consolidated view of IndoStar and IndoStar Home Finance Pvt. Limited (100% stake; ‘IND AA-/Stable) to arrive at the ratings.

KEY RATING DRIVERS

Capital Buffers to Strengthen Due to Equity Infusion: In January 2020, IndoStar made an announcement that a Brookfield entity (BCP V Multiple Holdings Pte. Ltd.) has entered into an agreement with Everstone Capital, the present promoters, to invest in IndoStar by making a primary equity infusion of INR12.2 billion (INR8.75 billion of equity and INR3.5 billion of compulsorily convertible preference shares). In addition, it would purchase stake from the existing promoters and also make an open offer. IndoStar has received the Reserve Bank of India’s approval for the transaction. Post the infusion, which is likely to happen in the last week of May, IndoStar’s capital buffers would strengthen significantly (Tier I; 9MFY20: 26.7%; FY19: 21.7%) and the leverage (debt to equity) would fall below 2.0x (FY19: 3.0x). This is much required in the prevailing environment wherein there are high chances of increased pressure on asset quality and a rise in credit costs. Even prior to this, IndoStar had been operating at a modest leverage of 2.1x during 9MFY20 (FY19: 3.0x, FY18: 2.4x), given the decline in the loan portfolio post March 2019 and the concentrated nature of the wholesale book (31% of assets under management); the top 10 group exposures accounted for 86% of the equity at FYE20).

Liquidity Indicator – Adequate: The asset liability maturity profile at end-February 2020 shows a positive surplus in all the buckets since the payment to be made for the purchased CV portfolio has been cleared and there are no commercial paper obligations. At end-April 2020, the quantum of on-balance sheet liquidity stood at INR4.8 billion, and unutilised working capital lines and sanctioned undrawn bank lines stood at INR2.2 billion; this would be sufficient to take care of the debt repayments (principal plus interest) of INR7.0 billion for May-July 2020 (without considering collections and factoring in nil disbursements). With the equity infusion of INR12.2 billion, the liquidity buffers would improve significantly and would be enough to take care of the liabilities till January 2021. The infusion of equity might also result in increased funding flexibility for IndoStar and might enable the company to mobilise additional funding from lenders. IndoStar has requested for a debt moratorium from banks, though there is uncertainty on that front, and has offered moratorium to its borrowers. The collections were negligible for April 2020 and might remain so for May 2020; even after the lockdown is lifted, the collections might improve only with some lag.

Deteriorating Operating Environment could lead to Higher Delinquencies: IndoStar has been focused on developing a retail granular portfolio (69% of the total book at end-9MFY20), comprising vehicle financing (44%), small and medium enterprises (SME; 18%) and affordable housing loans (7%). The borrower segment in the vehicle financing portfolio is generally vulnerable, with weaker buffers to absorb downsides in business; this can result in higher delinquencies. The slowdown in the economy prior to the COVID-19-related lockdown, and the resultant idle capacity and fall in freight availability, had already impacted the asset quality of this portfolio (GNPA: 9MFY20: 5.7%, FY19: 6.1%). The segment has been impacted further by the COVID-19- related lockdown, with the restricted movement of commercial vehicles and lack of load availability impinging on the cash flows. Moreover, used vehicle borrowers (60% of the vehicle financing portfolio) are more vulnerable to such shocks. Ind-Ra expects the delinquencies to increase materially due to this lockdown.

The SME segment (GNPA: 9MFY20: 2.0%, FY19: 3.1%), which has already faced various headwinds in the past such as demonetisation, introduction of GST and overall economic slowdown, is now facing the brunt of the nationwide lockdown, which has adversely affected demand and the working capital cycle. With borrowers facing a dilution in the liquidity buffers and deterioration in debt servicing capacity, IndoStar might witness rising credit costs. The customers in the affordable housing segment either belong to the self-employed category or receive their salaries in cash; these borrowers would face higher impact on their income levels, which can push up delinquencies.

The real estate sector (25% of the portfolio) was already reeling under the pressure of inventory overhang, anaemic sales velocity and funding challenges. The lockdown has exacerbated the challenges, with a further decline in sales volumes, due to the likely postponement of home-buying decisions by the customers. Funding issues have increased manifold for the developer community, which can increase the project completion risk, thereby increasing delinquencies. Furthermore, IndoStar's credit cost for the corporate segment (GNPA: 9MFY20: 4.8%, FY19: 0%) had already increased in 3QFY20 due to write-offs in two accounts.

Franchise Growth to be Impacted by Asset Quality Headwinds: The segments in which IndoStar operates, especially vehicle financing, SME and real estate, are facing challenges; thus, it could be difficult for the company to grow its franchise. The equity capital infusion would strengthen IndoStar's ability to grow the book; however, it would face challenges because of the disruption in the business environment due to the lockdown and the consequent economic deceleration. Furthermore, the recovery cycle is likely to be prolonged, which could restrain business growth. Also, during the recovery cycle, IndoStar would face stiff competition from bigger established players in the above segments.

Volatile Funding Environment: NCDs constitute more than one-third of IndoStar's borrowings, while bank loans account for 55%. The funding environment for NBFCs has been extremely challenging, with mutual funds taking exposure only on top-rated NBFCs and banks exercising restraint in lending funds to the sector. Therefore, the regulator has taken steps for infusing liquidity in the same. However, the results are yet to be seen for moderate-sized NBFCs. IndoStar has the option to raise funds through the securitisation route, since its retail assets qualify as priority sector, but that window can only be accessed when the environment becomes conducive. Having said that, the company has received a sanction of INR1 billion under the TLTRO 2.0 scheme and has also received funding of INR750 million from National Housing Bank ('IND AAA'/Stable). The planned equity infusion at end-May 2020 could provide the much-needed access to funding lines for IndoStar; this will be an important monitorable.

Profitability under Pressure: In 9MFY20, IndoStar's profitability deteriorated (ROA: 9MFY20: 1.2%, FY19: 2.5%, FY18: 3.2%) due to the rise in credit costs, resulting from the write-off in two corporate accounts and a rise in delinquency for the vehicle financing portfolio. There has been a rise in the funding cost, partly due to the replacement of short-term borrowings by long-term funding, and an overall rise in borrowing cost; however, the margins are protected due to the transition to a higher yielding retail book. Given the challenges to grow the loan book, and the likelihood of a continued rise in credit costs, IndoStar's profitability might remain under pressure for the medium term.

RATING SENSITIVITIES

Negative: The following developments, individually or collectively, could lead to a downgrade:

- A delay or deferral in the equity infusion of the agreed quantum
- Challenges in mobilising funds from diverse sources post the equity infusion or dilution in the liquidity buffers (less than three months)
- significant deterioration in the asset quality impacting profitability and capital buffers

Positive: Successful growth in the franchise along with strong control on the asset quality while maintaining comfortable liquidity and capital buffers could lead to a positive rating action.

COMPANY PROFILE

IndoStar is a systemically important NBFC, offering long-term wholesale funding and retail funding. The company is sponsored by large financial institutions such as Everstone Capital, Goldman Sachs, CDIB Capital and others. It is listed on BSE Ltd and National Stock Exchange Limited, post its initial public offering in May 2018.

FINANCIAL SUMMARY (Consolidated)

Particulars	**FY19**	**FY18**
Total assets (INR billion)*	122.8	71.3
Total equity (INR billion)*	29.9	20.1
Net income (PAT) (INR billion)	2.4	2.0
Return on average assets (%)	2.5	3.2
Source: IndoStar, Ind-Ra analysis, *net of deferred tax asset		

FINANCIAL SUMMARY (Standalone)

Particulars	**FY19**	**FY18**
Total assets (INR billion)*	122.6	71.3
Total equity (INR billion)*	30.1	20.2
Net income (PAT) (INR billion)	2.6	2.1
Return on average assets (%)	2.6	3.4
Tier 1 capital (%)	21.7	28.0
Source: IndoStar, Ind-Ra *net of deferred tax asset		

RATING HISTORY

Instrument Type	**Current Rating/Outlook**			**Historical Rating/Outlook**		
	Rating Type	**Rated Limits (billion)**	**Rating**	**12 June 2019**	**20 March 2018**	**22 December 2016**

NCDs	Long-term	INR5.75	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable
Bank loans	Long-term	INR0.47	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable

ANNEXURE

ISIN	Date of issue	Coupon (%)	Maturity Date	Amount Outstanding (billion)	Rating/Outlook
INE896L07298	8 January 2016	10.05	8 January 2021	INR0.50*	WD
INE896L07306	8 January 2016	10.05	8 December 2020	INR0.25 (reduced from INR0.50)^	IND AA-/Stable
INE896L07421	8 February 2017	9.25	8 February 2022	INR0.50	IND AA-/Stable
INE896L07678	25 February 2019	11.25	26 February 2021	INR1.50	IND AA-/Stable
Total outstanding NCDs				**INR2.25**	
Unutilised NCDs				**INR3.50**	
Total				**INR5.75**	

*full buyback of the NCD

^partial buyback

COMPLEXITY LEVEL OF INSTRUMENTS

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Applicable Criteria

Financial Institutions Rating Criteria
Non-Bank Finance Companies Criteria

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