Rating Rationale

May 08, 2017 | Mumbai

IndoStar Capital Finance Limited

Rated amount enhanced

Rating Action

Rs.1500 Crore Short Term Debt Programme (Including Commercial Paper) [Enhanced from Rs.1250 Crore]	**CRISIL A1+ (Reaffirmed)**

1 crore = 10 million
Refer to annexure for Details of Instruments & Bank Facilities

Detailed Rationale

CRISIL's rating on the short-term debt programme of IndoStar Capital Finance Limited (IndoStar) continues to reflect the company's experienced management and high level of operational involvement of its key sponsors, strong capitalisation with a conservative gearing philosophy. The ratings also factors healthy earnings profile, management's ability to appraise corporate loans, measured loan growth strategy, and conservative liquidity management policy. These strengths are partially offset by inherent vulnerability in IndoStar's asset quality given concentration risks, and short track record of operations.

Analytical Approach

The standalone business and financial risk profile of IndoStar has been considered for arriving at the ratings.

Key Rating Drivers & Detailed Description

Strengths

*** Experienced management, active involvement of sponsors in operations and strategy decisions:** Top management comprises professionals with proven expertise in the wholesale financing business and have a combined experience of over 65 years across sectors such as infrastructure, real estate, and capital markets. Furthermore, the company benefits from the high level of involvement of its principal sponsors and their expertise in the segment. They oversee operations, including policy formulation, risk management, credit approvals, and regulatory compliance. The sponsors play a key role in the credit evaluation process for most new proposals. CRISIL also believes that the management and sponsors share a common vision and philosophy for IndoStar, supported by the relatively long horizon of the investing entities. This will enable IndoStar to continue to grow its business in line with its stated strategy and with continuing adherence to its overall risk philosophy.

*** Strong capitalisation with conservative gearing philosophy:** IndoStar commenced operations with a healthy start-up capital of Rs 890 crore, infused through IndoStar Capital, Mauritius. This allows IndoStar to take large wholesale exposures as the sole/largest lender and undertake independent credit evaluations. As of March 31, 2017 [1] , networth was Rs 1901 crore and gearing around 1.8 times. (Networth of Rs 1541 and gearing of 2.0 times, respectively, as on March 31, 2016). Capital adequacy ratio (CAR) stood at 32.7% as on March 31, 2017 (34.2% as on March 31, 2016, and 32.6% as on March 31, 2015). As per IndoStar's stated policy, it will maintain a minimum CAR of 20% on a steady state basis. Furthermore, the company intends to maintain gearing below 2.5 times over the medium term. Though CRISIL believes this could increase over the next few years, it will be maintained below 3.5 times on a steady state basis. Capital position is also supported by ability to raise additional capital either through existing sponsors or new investors.

*** Healthy earnings profile:** The company has above industry average return on assets (RoA), supported by a strong fee income stream and steady improvement in funding profile. The company has been profitable almost since inception. The RoA was around 4.1% for the period ended March 2017 (4.5% for fiscal 2016). It earns an average interest spread of around 3.0% on loan portfolio, with highest yields on its real estate loans. The company has also been able to diversify resource profile and reduce borrowing costs over time. In the last few years, it has developed relationship with over 25 banks, mutual funds, insurance companies and other financial institutions. As on March 31, 2017, total borrowings stood at Rs 3300 crore, of which borrowings from banks accounted for 47%; while non-convertible debentures and short-term market borrowings accounted for the remainder. On a steady state basis, RoA will remain higher than industry levels, at 3.0-3.5%, supported by comfortable interest spreads and healthy fee income contribution. Any sharp deterioration in asset quality could, however, result in an increase in credit costs and impact profitability.

* **Conservative liquidity policy:** The Company maintains minimum 15% of networth in the form of liquid investments such as fixed deposits and liquid funds including undrawn bank lines. Furthermore, the company does not run an asset liability mismatch, and favourable repayments and prepayments trend also provide cushion to overall asset liability management position. Therefore, IndoStar will be better placed to withstand any liquidity pressure.

Weakness

* **Asset quality susceptible to concentration risks:** Asset quality will remain vulnerable to concentration risks inherent in the wholesale lending business model, despite strong credit appraisal and risk management processes that have been put in place. As on March 31, 2017, the five largest loans constituted ~18% of the portfolio (22% as on March 31, 2015). Furthermore, around 40% of the portfolio comprises real estate loans, a segment that is vulnerable to cyclical downturns. IndoStar follows strong credit appraisal and risk management practices, especially in the real estate segment. The company targets borrowers with a long track record of timely debt repayment. All loans have a minimum security cover of 1.5 times, with real estate loans having a minimum security cover of 2.5 times. Furthermore, in the real estate segment, the company caters primarily to reputed developers in the residential market. All project cash flows are escrowed and the loan is structured in a manner that enables mandatory prepayments, resulting in early repayment of loans. The company also sells down some part of the real estate loans originated. It has had only three non-performing asset since inception (gross non-performing assets of 1.4% as on March 31, 2017), of which one account is fully recovered.

While IndoStar will a remain wholesale financier, planned expansion into SMEs and retail self-employed mortgage segment {received Housing Finance company (HFC) licence in August 2016} will bring some granularity over the medium term. However, inherent nature of the loan portfolio renders IndoStar vulnerable to economic stress. Any sharp deterioration in asset quality may also affect profitability and capital.

* **Short track record of operations:** IndoStar's first full year of operations was fiscal 2012. The company had initially started operations focusing primarily on wholesale financing and has gradually expanded operations into SME and retail financing. SME financing is currently carried out of 10 branches and constitutes around 12% of the overall loan book as on March 31, 2017.

Given the overall nascent stage of operations, portfolio has seen limited seasoning, especially the SME book, which started building only towards the end of fiscal 2015. While asset quality has been healthy so far, performance of a portfolio of this nature would need to be seen through economic cycles.

About the Company

Originally incorporated as RV Vyapar Pvt Ltd in 2009, the non-banking financial company (NBFC) was rechristened IndoStar Capital Finance Pvt Ltd in November 2010. It was reconstituted as IndoStar on May 28, 2014. IndoStar is registered with the Reserve Bank of India as a systemically important non-deposit taking NBFC.

IndoStar has been sponsored by financial institutions such as Everstone Capital, Goldman Sachs Group, Baer Capital Partners, ACPI Investments, and CDIB Capital International Corporation. The funds have been invested through IndoStar Capital, Mauritius (IndoStar Everstone holds 49.4% stake in the company), which holds 90.74% in IndoStar Capital Finance, while 9.26% is held by the employees (resident individuals including employees, directors). IndoStar offers term loans, short-term working capital loans, real estate loans against property, promoter funding against shares, as well as special situation loans such as acquisition financing. The company's housing finance subsidiary, IndoStar Home Finance Private Limited, which received HFC licence in fiscal 2017, will help diversify the company into the retail segment. As on March 31, 2017, outstanding loan book was Rs 5247 crore (Rs 4272 crore as on March 31, 2016). Net profits were Rs 207 crore in fiscal 2017 (Rs 191 crore in fiscal 2016).

[1] *March 2017 numbers are provisional and yet to be audited*

Any other information: Not applicable

Note on complexity levels of the rated instrument:
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Annexure - Details of Instrument(s)

ISIN	Name of Instrument	Date of Allotment	Coupon Rate (%)	Maturity Date	Issue Size (Rs. Cr)	R Outs with
NA	Short-term debt programme (including commercial paper)	NA	NA	7 to 365 Days	1500	CRI

Annexure - Rating History for last 3 Years

	Current			2017 (History)		2016		2015		2014	
Instrument	Type	Quantum	Rating	Date	Rating	Date	Rating	Date	Rating	Date	Rating
Short Term Debt (Including Commercial Paper)	ST	1500	CRISIL A1+		No Rating Change		No Rating Change		No Rating Change	09-04-14	CRISIL A1+

Table reflects instances where rating is changed or freshly assigned. 'No Rating Change' implies that there was no rating change under the release.

Links to related criteria
[Rating Criteria for Finance Companies]
[Criteria for rating Short-Term Debt (including Commercial Paper)]

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