

IndoStar Capital Finance Limited

Full Rating Report

Ratings

Long-Term Bank Loan	IND AA-
Non-Convertible Debentures	IND AA-

Outlook

Long-Term Debt	Stable
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Financial Data

IndoStar Capital Finance Limited

	31 Mar 15	31 Mar 14
Total assets (USDm)	642	508
Total assets (INRm)	39,812	31,507
Total equity (INRm)	12,768	11,275
Net income (INRm)	1,491	1,121
ROA (%)	4.2	4.2
ROE (%)	12.4	10.4
Tier 1 capital ratio	32.3	41.1

Key Rating Drivers

Well-Managed Asset Quality: India Ratings and Research (Ind-Ra) assigned ratings to IndoStar Capital Finance Limited's (IndoStar) non-convertible debentures (NCDs) and bank loans in May 2015. The ratings are based on IndoStar's ability to manage its asset quality in the high-yield wholesale credits business, together with its solid capitalisation and above average liquidity policy. Despite a short operating history of around three years, about 55% of the company's total disbursements had seasoned by December 2014. This has been supported by its experienced management which strengthens its ability to assess credit risk.

The company structures its deals by mitigating risk through including support from the promoter/sponsor of the borrowing entity, ring fencing of cash flow, additional collaterals over and above those available to other lenders.

Adequate Equity Capital Buffers: IndoStar operates in the wholesale lending space and has a highly concentrated portfolio in moderate to modest credit borrowers. While the company has managed its portfolio well, even a couple of defaults could wipe out its annual profit and affect its capital buffers, necessitating a high capital requirement. IndoStar recognises this risk and hence maintains leverage of around 3x on a steady state basis in the wholesale lending business.

Comfortable Funding: Although IndoStar uses wholesale funding for its requirements, its borrowing profile includes multiple financial institutions. There is no disproportionate reliance on any particular bank. In addition, it has been gradually diversifying its funding sources. Market funding proportion now constitutes close to 35% of its borrowings (FY14: 33%).

Above Average Liquidity: The company's asset and liability tenors are well matched with no gaps in short-term buckets. Its borrowings are largely long term in nature and aligned to its long-term loans. The company also maintains sizeable on-balance sheet liquidity (in addition to unutilised cash credit lines) in form of unencumbered liquid assets which can support schedule repayments without triggering refinancing pressure in case of short-term tightening of systemic liquidity.

Short Operating History and Small Franchise: IndoStar has a short operating history and hence it has yet to build a track record of managing its portfolio over cycles. The company also has a smaller size than established non-banking financial companies (NBFCs).

Rating Sensitivities

Positive: A less concentrated loan portfolio, track record of managing delinquencies while building up loan portfolio over the medium to long term and maintaining capital and liquidity buffers could result in a positive rating action.

Negative: Dilution of capital and/or liquidity buffers, a sharp rise in delinquencies impacting capital buffers, or a rapid build-up of loan portfolio unaccompanied by a suitable ramp-up of infrastructure could result in a negative rating action.

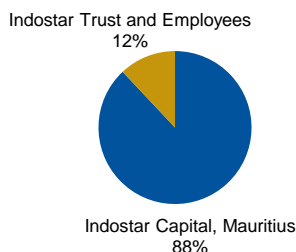
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Figure 1

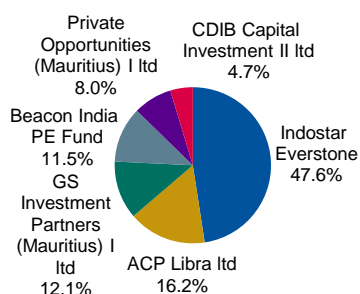
Shareholding: IndoStar Capital Finance Limited



Source: IndoStar

Figure 2

Shareholding: IndoStar Capital, Mauritius



Source: IndoStar

Profile

IndoStar operates as a wholesale credit institution in the high-yielding lending space. The company was formed in FY11 after taking over a Kolkata-based NBFC and started operations in FY12. Its registered office is located in Kolkata.

The company is majority owned by IndoStar Capital, Mauritius (a private limited company owning an 87.6% stake) which is sponsored by private equity firms Indostar Everstone, Goldman Sachs Investment Partners, ACP Libra, Baer Capital Partners and CDIB Capital Investment. The rest of the shares are held by employees and the IndoStar Trust.

Products/Portfolio

The company has segregated its operations into five major segments:

- **Secured Corporate Lending:** Lending to manufacturing companies and other corporates both as a sole lender and in syndication. The company lends both for new projects/expansion and for working capital requirements.
- **Real Estate Finance – Loan Against Property (LAP):** This component comprises about 40% of IndoStar's loan portfolio. The company lends to real estate companies (both as sole lenders and in syndication) for construction purpose.
- **Asset Finance/Retail Assets:** While IndoStar is a wholesale player, it had bought a commercial vehicle portfolio on a bilateral assignment for diversifying its asset base. However with the recent change in regulatory guidelines, the company may not be able to buy any more portfolios. It is planning to venture into medium ticket (INR5m-INR30m) size SME LAP loans and has started the business on a pilot basis.
- **Capital Market Exposure:** IndoStar has one exposure in this space with the current outstanding of INR1bn. The company does not plan to ramp this up significantly.
- **Special Situation Loans:** These are opportunistic deals that the company intends to pursue as and when they arrive.

IndoStar takes exposures both as loans and in form of debentures and then offloads them in the market. This helps in freeing up the resources as well as results in fee and yield gains for the company.

The company apart from providing wholesale funding to corporates is also into advisory and syndication services. The company plans to expand in the LAP business, keeping the overall exposure up to 40%.

It takes medium- to long-term exposure in corporates (both real estate and manufacturing). The loans could be fresh loans or for the purpose of takeover from existing lenders. The company generally provides a moratorium period on loans based on the circumstances through structures with mandatory prepayments on achieving milestones.

Portfolio/Asset Quality

IndoStar's loan portfolio is widely spread in terms of industries, though reflects high single-party concentration. The total portfolio is spread over 54 issuers with the top 10 constituting 31.6% of exposure and 35% of principal outstanding. This exposure constitutes about 102% of the total equity.

Applicable Criteria

Financial Institutions Rating Criteria,
12 September 2012

Non-Bank Finance Companies Criteria,
12 September 2012

Figure 3
Industry Exposure on 31 March 2015

Sl. no.	Industry	Amount (INRm)	% age of total
1	Real estate	11,956	35.4
2	Iron & steel	2,674	7.9
3	Dairy	2,400	7.1
4	Cement	1,642	4.9
5	Bank ATMs	1,639	4.9
6	Warehouse	1,460	4.3
7	Energy	1,404	4.2
8	Infrastructure	1,092	3.2
9	Entertainment	1,000	3.0
10	Glass	1,000	3.0
11	Publishing	960	2.8
12	Transportation	858	2.5
13	Tiles	750	2.2
14	Paper	691	2.0
15	Pipes	500	1.5
16	Packaging	472	1.4
17	Renewable power	169	0.5
18	Financial services	78	0.2
19	SME	74	0.2
20	Others	2,930	8.7
	Total	33,747	

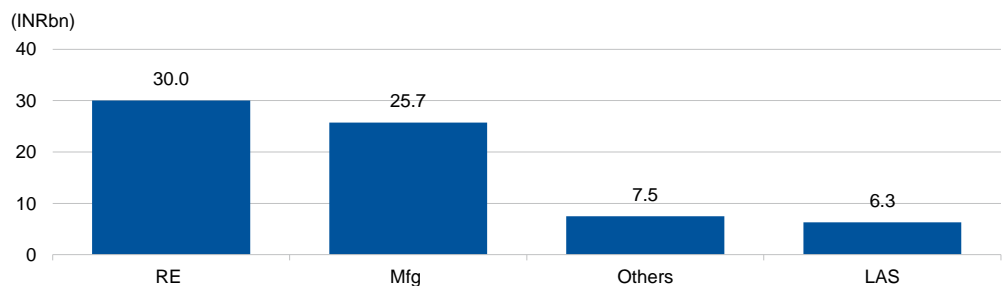
Source: IndoStar

Treasury assets are in the nature of short-term investments to deploy surplus resources in highly rated instruments, mainly fixed deposits.

IndoStar's borrowers are largely of average credit profile in the range of low investment grade/sub investment grade. However, the company has managed its loan book. It has disbursed and recouped amount to the tune of INR29.6bn of the loan portfolio since its inception out of the total INR69.5bn disbursed till December 2014 (excluding short-term treasury loans). This constitutes about 55% of the total disbursements, 14% each through sell down and scheduled payments and rest through prepayments.

Figure 4

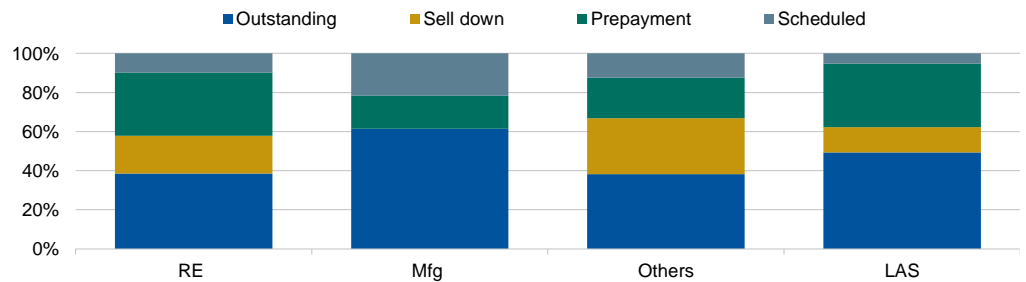
Total Disbursements Since Business Commencement (Till Dec 2014)



Source: Indostar

Figure 5

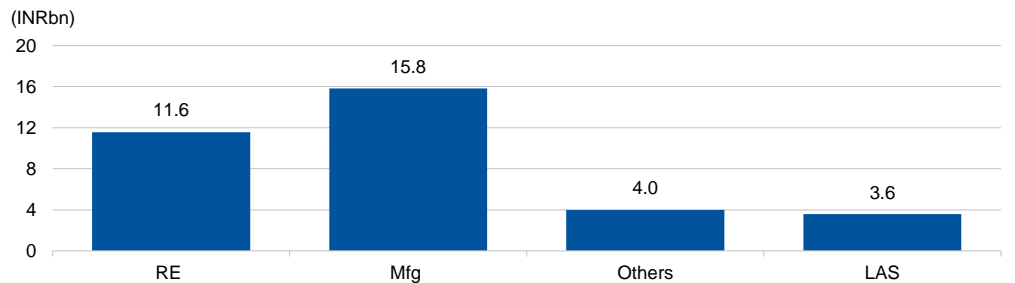
Total Disbursements to Current Status Since Business Commencement (Till Dec 2014)



Source: Indostar

Figure 6

Sector Exposure (Dec 2014)



Source: Indostar

IndoStar focuses on corporates whose business propositions are reasonably adequate though the financials may have come under short-term pressure. The company's ability to understand the business and its flexibility in structuring loans in line with borrowers' requirements are crucial to compete with other lenders.

The company mostly sources its loans in-house. While a majority of the exposures are in moderate to modest credits, its strength lies in its ability to assess and price credit risk and thereafter structure the transaction to mitigate the risk, in case the business performance is inadequate. The mitigants could include taking comfort from sponsor/promoter support or in few cases through additional collateral over and above that available to other lenders. IndoStar's experienced management team helps in assessing borrowing company's promoters/sponsors propensity and ability to refinance/repay loans in cases where the business performance turns out to be inadequate.

The company's loan portfolio has performed well till now, with only one account being delinquent since inception. The company has recouped a large part of its original outstanding with current outstanding being about one-third of its initial loan.

Nevertheless, while IndoStar has managed its portfolio well, there always remains a possibility where the business performance may not turn out as projected as has been the case in few of the company's loans. While the company would have sufficient collaterals in most of these cases, the ability to enforce collaterals and recover money in a time-bound manner could be a challenge. The concern is especially high in view of large ticket concentrated lending where even few defaults could have a high impact on the company's profitability buffers and could affect sizeable inflows.

In addition, multiple players have recently entered into the wholesale lending space, especially in real estate lending, intensifying competition. This could result in inadequate pricing of risk

and may also affect appraisal standards. The real estate sector has been facing headwinds in form of declining cash flows which could put pressure on some of the credits.

Strategy

The company plans to continue to expand into the mid- to high-yield lending segment with focus on healthy businesses. The company plans to limit its real estate lending book below 40% of its total portfolio.

To scale up the business, the company has expanded into the SME LAP business in medium ticket size loans.

Market Risk

The market risk primarily arises on account of equity and interest rate risks. Equity risk could be in terms of a fall in the price of collateral both in loan against shares and in other loans where the company has also taken equity shares as collaterals. This risk could be considerable and may be difficult to quantify in some cases as many of the collaterals are unlisted.

Interest rate risk arises both on the assets and liability sides. Nevertheless, the risk is limited as the company generally has a pass-through agreement with its borrowers. IndoStar also carries a certain amount of reinvestment risk on account of prepayment options available with its borrowers. Especially, since it expects a certain amount of prepayment in its lending.

Operational Risk

The company's business is people driven where senior management plays an important role in both generating business and managing the portfolio. The loss of senior management could be a significant key man risk in the business.

Funding and Liquidity

IndoStar's funding is comfortable for its size of business. The company's total borrowing of INR21.4bn comprises banks and non-banks in the proportions of 59% and 41%, respectively. The company's bank borrowings are spread over 18 banks with no significant concentration. Some of the company's loans are second and third loans from the banks.

Its debentures borrowings are also spread over multiple mutual funds namely, Franklin Templeton AMC, Kotak AMC, UTI AMC, HDFC AMC, Deutsche AMC. Apart from these, some banks including ING Vysya, Bank of India, Syndicate Bank, HDFC and Oriental Bank of Commerce have invested in the company's securities.

In line with its wholesale long-term exposure, the company's borrowings are mostly long term which is likely to be maintained. IndoStar's asset liability tenors are well matched with positive gaps in all the buckets. Its liquidity is further supported by its policy to maintain at least 15% of net worth in unencumbered liquid assets at all times. As a practice, the company maintains surplus liquidity which can suffice towards its one month's committed outflows.

Capitalisation/Leverage

IndoStar was set up with a sizeable start up equity capital of INR8.9bn. The large equity helped the company to strengthen its position in the wholesale lending business as it could take large single party exposures within the regulatory limitations.

As the company is in the ramp-up stage, its capitalisation remains comfortable. The company plans to operate at a conservative leverage of 3x, reflecting the risk involved in the wholesale business lending. The current capitalisation of IndoStar can support its growth for some time before incremental capital infusions would be required. The company is backed by global strong investors and should be able to raise growth capital, if required.

The company has started semi wholesale lending on a pilot basis. The capital allocation of this business would be assessed separately

Profitability

IndoStar's profitability is comfortable (FY15: return on assets 4.2%). The company operates in the high mid- to high-yield segment, resulting in wide margins. It also generates a sizeable fee income both through loan processing charges and syndication fees. As the company expands its liabilities to market borrowings, the spreads should benefit from the wide gap between market borrowings and bank borrowing rates.

The operating expenses of the company have been declining and should moderate further as it benefits from the economies of scale. This should further boost up the pre-provision operating profits of the company.

IndoStar has reported marginal credit costs. However, any delinquency could have a sizeable impact on its profitability. Managing credit costs would be a key monitorable for the profitability buffers of the company.

IndoStar Capital Finance Limited								
INCOME STATEMENT ANALYSIS								
INCOME STATEMENT ANALYSIS	As % of Average		As % of Average		As % of Average		As % of Average	
	31-Mar-15	Earning Assets	31-Mar-14	Earning Assets	31-Mar-13	Earning Assets	31-Mar-12	Earning Assets
IndoStar Capital Finance Limited	Year-End		Year-End		Year-End		Year-End	
	INRm		INRm		INRm		INRm	
Interest earned	4,666.5	15.2	3,644.8	15.9	2,119.0	14.5	803.8	16.0
Interest expended	2,579.3	8.4	1,918.9	8.4	758.6	5.2	3.0	0.1
Net Interest Income	2,087.2 ▲	6.8	1,725.9 ▲	7.5	1,360.3 ▲	9.3	800.8 ▲	16.0
Other Operating Income	614.1	2.0	324.2	1.4	296.8	2.0	94.7	1.9
Personnel Expenses	280.6	0.9	251.9	1.1	223.2	1.5	149.7	3.0
Operating Expenses	129.4	0.4	92.2	0.4	109.5	0.8	67.7	1.3
Pre-Provision Operating Profit	2,291.3 ▲	7.5	1,706.0 ▲	7.5	1,324.5 ▲	9.1	678.1 ▲	13.5
Provisions for Losses	30.4	0.1	13.5	0.1	27.6	0.2	88.2	1.8
Operating Income after Provisions	2,260.9 ▲	7.4	1,692.5 ▲	7.4	1,296.9 ▲	8.9	589.9 ▲	11.8
Other Non-operating Income	0.0	-	0.0	-	0.0	-	0.0	-
Prior Period adjustments	0.0	-	0.0	-	0.0	-	0.0	-
Pre-tax Profit	2,260.9 ▲	7.4	1,692.5 ▲	7.4	1,296.9 ▲	8.9	589.9 ▲	11.8
Taxes	770.2	2.5	571.1	2.5	395.9	2.7	57.8	1.2
Net Profit	1,490.7 ▲	4.9	1,121.4 ▲	4.9	900.9 ▲	6.2	532.1 ▲	10.6
RATIO ANALYSIS								
A. PROFITABILITY (%)								
Net Income/Equity (avg.)	12.4		10.4		9.2		6.7	
Net Income/Total Assets (avg.)	4.2		4.2		5.5		6.2	
Non-interest Expenses/(Net Interest Income+Other Operating Income)	15.2		16.8		20.1		24.3	
Net Interest Income/Total Assets (avg.)	5.9		6.4		8.4		9.4	
Pre-provision Operating Profit/Total Assets (avg.)	6.4		6.4		8.1		7.9	
Operating Profit after Provision/Total Assets (avg.)	6.3		6.3		8.0		6.9	
Interest expended / Total Borrowings (avg.)	11.4		12.5		12.4		0.6	
B. CAPITALIZATION (%)								
(Net Profit - Dividends)/Prior Period Equity	13.2		6.9		9.7		8.1	
Equity/Total Assets	32.1		35.8		46.3		88.6	
Equity/Loans	37.3		43.2		56.9		106.5	
Tier - I Capital Ratio	32.3		41.1		49.6		85.0	
Tier - II Capital Ratio	0.4		0.4		0.6		0.8	
Debt/Equity (x)	2.0		1.7		1.1		0.1	
Short term borrowings incl. LT debt due in 1 year /Total Borrowings	37.8		38.7		36.9		100.0	
C. ASSET QUALITY (%)								
Provision for loan losses/loans (avg.)	0.1		0.1		0.2		1.8	
Provision for loan losses/Pre-provision operating Profit	1.3		0.8		2.1		13.0	
Gross NPLs/Gross Loans	0.6		0.8		0.0		0.0	
Loan loss Reserves/Gross NPLs	10.0		10.0		NA		NA	
Net NPLs/Equity	1.4		1.5		0.0		0.0	

Source: IndoStar, Ind-Ra

IndoStar Capital Finance Limited

BALANCE SHEET ANALYSIS

	As % of 31-Mar-15 Assets		As % of 31-Mar-14 Assets		As % of 31-Mar-13 Assets		As % of 31-Mar-12 Assets	
	Year-End INRm		Year-End INRm		Year-End INRm		Year-End INRm	
A. Loans and Advances	34,227.9	86.0	26,082.5	82.8	17,960.8	81.5	8,740.8	83.2
Secured Loans	29,973.2	75.3	24,021.0	76.2	16,515.3	75.0	8,687.5	82.7
Unsecured Loans	3,773.1	9.5	1,699.6	5.4	1,164.0	5.3	15.0	0.1
Hire Purchase Assets	0.0	-	0.0	-	0.0	-	0.0	-
Financial Leases	0.0	-	0.0	-	0.0	-	0.0	-
Loans to related parties	0.0	-	0.0	-	0.0	-	0.0	-
Bills Discounted	481.6	1.2	361.9	1.1	281.5	1.3	38.3	0.4
B. Other Interest-bearing Assets	564.1	1.4	608.5	1.9	1,143.5	5.2	1,290.7	12.3
Other Interest-bearing loans	0.0	-	0.0	-	0.0	-	0.0	-
Investments	564.1	1.4	608.5	1.9	1,143.5	5.2	1,290.7	12.3
Operating Leases	0.0	-	0.0	-	0.0	-	0.0	-
C. Loan Loss Reserves	19.4	0.0	19.4	0.1	0.0	-	0.0	-
D. Total Earning Assets	34,772.6	87.3	26,671.6	84.7	19,104.3	86.7	10,031.5	95.5
E. Fixed Assets	8.7	0.0	10.9	0.0	18.0	0.1	19.8	0.2
F. Non-Earning Assets	5,031.0	12.6	4,824.9	15.3	2,910.1	13.2	456.9	4.3
Cash	4,856.4	12.2	4,681.7	14.9	2,821.0	12.8	447.7	4.3
Others	174.6	0.4	143.2	0.5	89.1	0.4	9.2	0.1
Total Assets	39,812.3	100.0	31,507.3	100.0	22,032.4	100.0	10,508.1	100.0
G. Short-term Funding	3,649.5	9.2	2,120.9	6.7	1,530.7	6.9	1,016.7	9.7
Unsecured	460.3	1.2	1,452.5	4.6	193.1	0.9	23.4	0.2
Secured	3,189.2	8.0	668.4	2.1	1,337.6	6.1	993.3	9.5
H. Long term debt due within a year	6,160.3	15.5	5,397.7	17.1	2,614.2	11.9	0.0	-
I. Long term Funding	16,138.4	40.5	11,915.7	37.8	7,091.5	32.2	0.0	-
Long term borrowings	16,138.4	40.5	11,915.7	37.8	7,091.5	32.2	0.0	-
Public Deposits	0.0	-	0.0	-	0.0	-	0.0	-
Subordinated Debt	0.0	-	0.0	-	0.0	-	0.0	-
J. Other Non-interest bearing liabilities	938.6	2.4	678.5	2.2	425.8	1.9	85.2	0.8
K. Provisions	158.0	0.4	119.3	0.4	159.1	0.7	95.9	0.9
L. Tangible Net Worth	12,767.5	32.1	11,275.2	35.8	10,211.1	46.3	9,310.3	88.6
Total Liabilities and Equity	39,812.3	100.0	31,507.3	100.0	22,032.4	100.0	10,508.1	100.0

Source: IndoStar, Ind-Ra

The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings and Research has been compensated for the provision of the ratings.

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