Altico Capital India Limited

Issuer Credit Research

Ratings

Long Term Issuer Rating	IND AA-
Short Term Issuer Rating	IND A1+
INR32 billion Bank Loan	IND AA-
INR14 billion Non-convertible Debentures (NCDs)	IND AA-
INR8.5 billion Commercial Paper	IND A1+
INR1 billion Principal Protected Market - Linked Debenture	IND PP-MLD AA-emr

Outlook

Long Term Issuer Rating	Stable
INR32 billion Bank Loan	Stable
INR14 billion NCDs	Stable
Principal Protected Market - Linked Debenture	Stable

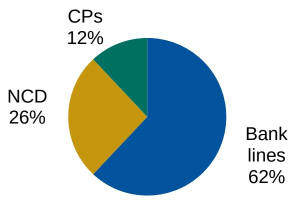
Financial Data

Altico Capital India Limited

	1HFY18	FY17
Total assets (USD million)	827	648
Total assets (INR million)	54,035	42,013
Total equity (INR million)	24,653	22,928
Net income (INR million)	1,731	2,708

Figure 1

Liability Profile – Dec 17



Source: Company, Ind-Ra

Videos

Analysts

Udit Kariwala
+91 22 4000 1749
udit.kariwala@indiaratings.co.in

Jinay Gala
+91 22 4035 6138
Jinay.gala@indiaratings.co.in

Key Rating Drivers

Prudent Financial Profile and Benefit from Support: The ratings reflect Altico Capital India Limited's (Altico; formerly Altico Capital India Private Limited) sizeable starting capital, providing it a head start in the real estate lending space; experienced management with sizeable industry experience; and a conservative leverage philosophy (projected debt-equity to remain below 2x in the foreseeable future) factoring in its current single sector lending focus, industry dynamics, and concentrated lending profile. The ratings benefit from India Ratings and Research's (Ind-Ra) expectation of timely support from Altico's ultimate shareholders - Clearwater Capital Partners, Abu Dhabi Investment Council (Fitch Ratings Ltd – Issuer Default Rating 'AA') and Varde Partners, if required.

Although the company has a concentrated and expanding lending book which is funded through wholesale borrowings, Altico's marquee shareholder background, their articulated commitment towards Altico over the medium term including liquidity support, if required, and their cohesive vision provide significant comfort. Commitment of its shareholders is further established by INR20 billion of upfront equity commitment and a nil dividend policy.

Evolving Liability Franchise: Altico has progressed towards diversifying its funding sources over the last 18 months, continuing its journey to keep strengthening its evolving liability franchise. Altico's funding mix has seen some diversification with addition of multilateral agencies, banks, non-banking financial companies and capital market participants to its list of lenders. Altico aims to maintain a long term to short term debt ratio at 80:20 (December 2017 mix on balance sheet - 86:14), shifting from erstwhile 50:50 ratio policy, keeping in line with the long gestation period of its asset book. Presently, the average debt tenor of 28 months is lower than the average asset book tenure of 36 months. Additionally, Altico continues its efforts to diversify its funding sources in support of its overall liquidity requirement.

Ind-Ra believes the wholesale real estate lending segment at any point remains vulnerable to volatile market liquidity conditions, considering the company's weak and stretched borrower profile, relatively illiquid collateral and extended principal moratorium period (18-24 months). Factoring in these structural challenges, Ind-Ra in its rating exercise for any entity in the segment lays strong emphasis on a diversified and an entrenched liability profile with a conservative liquidity reserve policy. Adherence of the stated liquidity policy continues to be a key monitorable on a continual basis.

Short Operating History, Although Strong Management Track Record: Altico's credit profile is constrained by its shorter operating history than established non-banking financial companies', highly concentrated and unseasoned lending book, and moderate scale of operations (December 2017 loan book of INR48.7 billion; FY17: INR36.7 billion; FY16: INR15.9 billion). Altico's asset quality remains exposed to the risk of slippages in large exposures that could result in a sharp increase in delinquencies, especially in the event of stress in the economy. The company's operating performance remains vulnerable to slippages on its sizeable single-borrower exposures. Although capital buffers remain strong, even a couple of defaults may significantly impact its operating performance in the near term. However, Altico's proven record in managing wholesale credit (in the previous platform) and its coherent risk management systems and processes to help structure and manage these exposures offer comfort. It continues to follow reasonably prudent lending practices which could help mitigate shocks in the real estate sector which continues to remain under stress.

Capitalisation

- Well capitalised with core Tier 1 ratio of 52% (net worth base of INR25.5 billion as of December 2017)
- Projected core Tier 1 ratio of 28% by FY20

Strategy and Lending Philosophy

- Prioritise lending to mid-market residential and commercial projects
- Focus on established promoters in Tier 1 cities
- Lending to ring fenced assets with significant underlying collateral at low Loan To Value ratios

Liquidity: Two Tier Monitoring Approach

- Each loan is approved by the finance committee which forms the sub-committee of the board
- Asset Liability Committee includes participation of independent director, enables continuous guidance in asset liability management

Applicable Criteria

Financial Institutions Rating Criteria

Non-Bank Finance Companies Criteria

Capitalisation and Profitability Buffers Remain Intact: Ind-Ra conducted a stress test on the company, factoring in the median credit rating of its borrowers and multiplying historical default experience for the rating category. The stress test also tested the high single-name concentration risk by assuming additional two defaults out of top 20 borrowers (by FY20), over and above the stress based on rating migration, which is consistent with the stress test that Ind-Ra conducts on lenders with concentrated exposures. The resultant equity post the test remains reasonably strong after absorbing losses and is favourable compared to peers'. Its current capitalisation (INR25.5 billion) should be sufficient to drive growth over the medium term and also provides a buffer against the asset quality challenges inherent in the business.

Altico's profitability (9MFY18: return on equity of 14.3%, FY17: 12.5%) coupled with capital adequacy ratio (December 2017: 52%, March 2017: 59%) is also likely to drive healthy accruals supporting capitalisation.

Rating Sensitivities

Positive: A positive rating action would depend on Altico's ability to expand its franchise while managing the inherent risks in its niche business over the economic cycles will be demonstrated only over the medium term. A key monitorable would be how Altico builds the asset vintage with higher granularity on one hand, and diversifies the funding mix on the other.

Negative: Any weakness in Altico's credit profile, which, among other factors, could result from dilution of capital buffers or from inadequate liquidity buffers could result in a negative rating action. The rating could also be downgraded in case a sustained weak operating performance leads to reduced importance of this business to its shareholders.

Franchise and Strategy

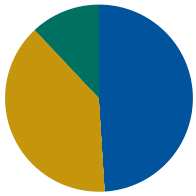
Prudent Liquidity Management Framework: Altico maintains a prudent liquidity reserve policy of holding sufficient liquidity to fund the next six months of operating costs, debt servicing costs as well as loan disbursement in the form of unencumbered liquid assets on its balance sheet in addition to having unutilised cash credit lines as additional buffers to support payment obligations and operating costs. Ind-Ra further draws comfort from Altico's shareholders' commitment to aptly provide necessary liquidity support to the company as and when required to ensure that it is able to timely comply with its board approved liquidity policy.

Moderate Leverage: Altico has an outstanding gross debt of close to INR32.5 billion as of October 2017, with a net debt/equity ratio of 0.9 (October 16: 0.2), which is lower than that of similar rated peers. However, Altico's leverage is likely to inch up as the company continues with its growth trajectory, with a strong disbursement deal pipeline and projected balance sheet size exceeding INR130 billion by FY20. The company, however, remains committed to maintain the leverage below 2x over the medium term, which would remain a key rating monitorable

Focus on Mid-Market and Late Stage Financing Segments: Altico's focus remains on senior secured lending to mid-market segments across residential and commercial real estate projects spread across most of the metro and Tier-1 cities in India, with a total loan book of INR48.7 billion at end-December 2017. Mid-market segment formed 54% of the overall loan portfolio as of December 2017. Altico's lending focus has been to fund 1) projects in the advanced stages of development which include projects where launch has been initialled, 2) projects which are partially constructed and 3) projects where key approvals are in place and are about to be launched soon. As of December 2017, Altico's exposure to greenfield projects (land stage with no key approvals in place) was limited, emphasising its focus on late stage funding and more resourceful Tier 1 developers, leading to onboarding of loans at lower yields compared to its historic averages, precipitating a shift in its overall risk and margin profile.

Figure 2

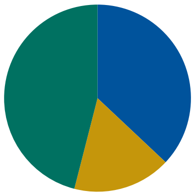
Stages of Construction – Dec 17



Source: Company, Ind-Ra

Figure 3

Projects by Affordability – Dec 17

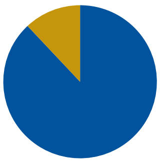


Source: Company, Ind-Ra

Increasing Granularity and Structured Underwriting Approach: The inherent business risk on account of its single sector focus, coupled with high borrower concentration (top 10 forming around 59% of portfolio as of December 2017) is mitigated to an extent by Altico's defined asset management practices and monitoring mechanisms including escrow reconciliations, quarterly site visits and assessment of plans vs actuals and enterprise wide promoter engagement. Over a period of time, granularity of Altico's loan book has shown improvement to 47 loans and 29 borrowers as of December 2017 from a mere four loans and four borrowers as of March 2015. Similarly, average loan ticket size fell to INR1 billion as of December 2017 from INR1.4 billion as of March 2015. Altico undertakes various deals that involve offering leverage on multiple projects of a single developer, providing them a single lender interface, and can use the funds in a fungible manner across their portfolio. While the portfolio is yet to witness seasoning, Ind-Ra derives comfort from the management's proven track record and implementation of required systems and processes. Any build-up of stress would be key rating monitorable, given the substantial concentration risk.

Figure 4

Residential vs. Commercial – Dec 17



Source: Company, Ind-Ra

Diversification on Cards: As of December 2017, Altico's loan portfolio largely comprised residential projects with 88% share and commercial projects (predominantly green building certified projects) accounting for the remaining 12% share – which is likely to inch up to 15% by March 2018. Going forward, commercial real estate would be a focus segment for Altico. In Ind-Ra's view, while the average profile of a commercial real estate developer would fare better than an average profile of a residential real estate developer, presence in commercial real estate segment could expose Altico to increased volatility given historically higher variability of sales in the commercial real estate segment. Additionally, the company also has plans to diversify into non-real estate ancillary segments to real estate such as hospitality, education warehousing and logistics. Ind-Ra understands underwriting across these segments would encompass a tangible security cover, cash flow visibility along with ring fenced assets. By FY20, the company projects non-real estate segment to contribute 25%-30% to the overall loan book. Altico's ability to scale up its franchise across newer segments while managing the inherent risks in its business over economic cycles will be a key monitorable.

Transitioning Regulations: The introduction and implementation of the goods and services tax as well as the Real Estate Regulation & Development Act in 1HFY18 has caused interim disruption in the real estate sector, which also reflects in the moderation of Altico's loan book growth to 43% in 9MFY18 (FY17: 131%). On an aggregate basis, as of December 2017, around 52% projects financed by Altico fall within the ambit of Real Estate Regulation & Development Act and need registration, out which 21 have already secured the registration. Effectively, around 73% of projects funded by Altico are currently compliant; most of the remaining projects have initialled the registration process. Only a small number of projects remain which are yet to file for registration where the company is taking active steps to enable the registration process.

Profile and Management

Background

Altico was established in 2004 by the funds managed by Clearwater Capital Partners as Clearwater Capital Partners India Private Limited for wholesale lending to capital-constrained Indian small and medium enterprises. It was registered as a non-deposit accepting non-banking finance company with the Reserve Bank of India in January 2005. Its business strategy initially focused on special situation opportunities across capital structure. In FY15, the company was rebranded as Altico Capital India Pvt. Ltd, embarking on a change in the business strategy. Clearwater Capital Partners, Abu Dhabi Investment Council, and Varde Partners infused a combined capital of USD300 million in Altico over FY15. The company's total net worth as of December 2017 was INR25.5 billion. Altico also has executed a USD75 million, five-year NCD facility with the International Finance Corporation and a five year facility of INR4 billion with a leading public sector bank, which strengthens its capital base and provides funding stability.

Management Team

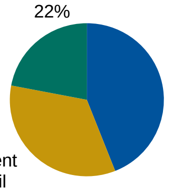
Altico's management team is led by Mr. Sanjay Grewal (CEO). Sanjay's prior work experience include his eight year stint with IDFC Ltd with a proven record of building a large loan book over nearly a decade. The CEO is aided by experienced professionals with a proven track record. Altico recently hired Mr. Sanjeev Agrawal (COO) whose prior experience includes 23 years work experience at Standard Charted Bank, with his latest role being CFO- Singapore, ASEAN and South Asia.

Board Composition and Shareholders

Altico's board comprises representatives from all shareholders: Clearwater Capital Partners (four directors, including both co-founders of Clearwater Partners), Abu Dhabi Investment Council (one director – CIO-SSG), Varde Partners (one director – Co-Head for Global real estate) as well as three independent directors. The board includes individuals having long and distinguished record across various disciplines, including the real estate sector especially in senior secured lending, debt and equity raising, structured credit including financial restructurings and risk management across emerging markets. The key committees such as audit, credit, asset-liability, and finance among others are led by independent directors. Further, all lending decisions are made at the sole discretion of the credit committee whose members comprise the shareholder representatives.

Figure 5

% Shareholding – Dec 17



Source: Company, Ind-Ra

Background of Financial Sponsors

Clearwater Capital Partners (Shareholding 44%)

Clearwater Capital Partners provides investors with access to a full spectrum of special-situation investments in public and private debt or equity of local, Asia-region issuers. From its inception in 2001, the company has invested USD4.3 billion in 350 companies across Asia, with extensive history in India in particular – having invested close to USD1 billion through direct lending, private and public debt as well as equity markets. It has expanded its activities to six global locations, including locally staffed offices in Hong Kong, Singapore, Beijing, Mumbai, Seoul and New York, and has assets under management of over USD1.5 billion at present. The breadth of the targeted investment market and Clearwater Capital Partners' established and experienced 'on-the-ground' presence make it possible for the firm to source, develop and capture value in diverse opportunities across capital structures that include but are not limited to the following:

- investments in post-restructured or operationally sound public and private companies that are undervalued or poorly capitalised due to their inaccessibility to capital,
- financial restructurings,
- operational turnarounds and
- portfolios, pools and individual non-performing loans.

Abu Dhabi Investment Council (Shareholding 34%)

The council is an investment arm of the government of Abu Dhabi. It started operations in April 2007 and is responsible for investing part of the government's surplus financial resources through a globally diversified investment strategy, targeting positive capital returns through an expansive portfolio of highly diversified asset classes and active investment management strategies. With assets under management in excess of USD100 billion, Abu Dhabi Investment Council is one of the largest sovereign wealth funds in the world, having significant global real estate portfolio through both externally managed funds as well as direct investments.

Varde Partners (Shareholding 22%)

The firm is a global investment adviser focused on credit and value investing strategies. The firm was founded in 1993 in Minnesota by a group of three investment professionals. It has assets under management of nearly USD10 billion, with a vast real estate experience, with over USD7.6 billion invested since 2011. At a fundamental level, the firm focuses on unlocking value, by seeking opportunities in less-efficient markets and pursuing assets at a discount to their potential value. The firm's approach is centred on an integrated platform with a unified focus on the generation of attractive risk adjusted returns. A key tenet of this strategy is a flexible investment approach – investing and allocating capital and resources across multiple segments and markets. The firm has invested over USD40 billion since inception and has 65 investment professionals managing investments world-wide. The firm continues to have a significant presence in its city of origin – Minneapolis – but has established offices in London and Singapore. Additional offices exist to support key activities in those regions. Having invested nearly USD400 million in residential and commercial real estate in Asia, India represents an important investment market and strategic fit to expand long term investment strategy and real estate lending in Asia.

Strategy and Underwriting Philosophy

Altico's focuses on high-yielding asset-backed senior secured credit opportunities in the real estate sector. Its business and investment strategy is driven by some of the following factors:

Business Strategy

- Lending backed by tangible collateral
- Senior secured loans with strong underlying assets and resourceful counterparties
- High cash generative business model with moderate leverage and significant cushion; focus on ROE
- Optimisation of promoters/developers and underlying assets
- Risk mitigation through diversification, selective lending, and rigorous asset monitoring
- Robust system and processes driven organisation

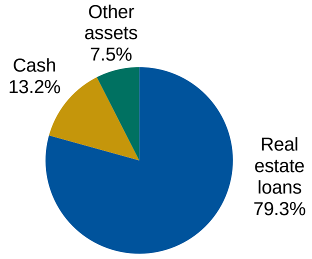
Investment Strategy

- Select tier I cities with sustainable real estate markets and higher institutionalisation
- Group diversifications
- Developer background: Resourcefulness, track record and enterprise comfort
- Strong focus on underlying assets: product offering, location, break-even points
- Structure: Mortgage, security, share pledge, guarantees, covenants, milestones
- Cash control: Escrow of all receivables and control on cash outflows
- Around 2x cash cover; minimum 1.5x collateral cover

Loan Book Snapshot

Figure 6

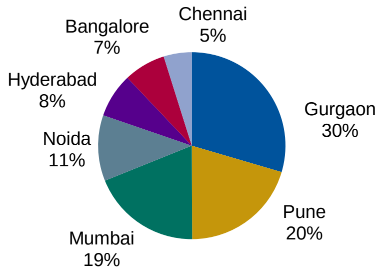
Asset Break Down – Sep 17



Source: Company, Ind-Ra

Figure 7

Geographic Exposure – Dec 17



Source: Company, Ind-Ra

Altico India Capital Limited

Figure 8

P & L Account Statement

(INR million)	FY17	FY16	FY15
Operating revenue	5,882	2,618	942
Other income	0.3	-	-
Total revenue	5,882	2,618	942
Expenditure	1,719	403	2
Personnel expenses	347	198.9	142.9
Admin expenses	199.9	152.6	76.6
Provisions/write-offs	148.9	33.6	-223.2
Depreciation	7	4.4	4.5
Finance costs	1017	13.6	0.9
Profit before tax	4,163	2,215	940
Profit after tax	2,708	1,448	618

Source: Company, Ind-Ra

Figure 9

Balance Sheet

(INR million)	FY17	FY16	FY15
Liabilities			
Shareholder's funds	**22,928**	**20,220**	**11,544**
Share capital	4,795	4,795	3,120
Reserves & surplus	18,133	15,425	8,424
Non-current liabilities	**9,009**	**58**	**34**
Long-term borrowings	8,755	0	0
Other long-term liabilities	6	6	17
Long-term provisions	248	52	18
Current liabilities	**10,076**	**136**	**93**
Current maturities of long term debt	3,125	0	0
Short term borrowings	6,404	0	0
Other current liabilities	396	41	31
Short-term provisions	151	95	62
Total liabilities	**42,013**	**20,413**	**11,672**
Assets			
Non-current assets	**33,183**	**14,598**	**5,794**
Tangible assets	6	7	9
Intangible assets	7	7	6
Deferred tax assets	36	16	17
Non-current investments	4,472	9,025	3,750
Long-term loans and advances	28,662	5,542	2,011
Current assets	**8,831**	**5,815**	**5,878**
Current investments	1,736	675	0
Cash & bank balances	3,432	3,886	5,766
Short-term loans and advances	2,132	876	4
Other current assets	1,531	377	107
Total assets	**42,013**	**2,041**	**1,167**

Source: Company, Ind-Ra

Figure 10

Key Metrics

(%)	FY17	FY16	FY15
NIM	15.6	19.3	15.9
Capital adequacy ratio	58.9	123	199
Loan book & investments to net worth	160	79	49
Gross NPA	-	-	-
RoE	12.6	9.1	8.3

Source: Company, Ind-Ra

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