

India Ratings Revises Outlook on Akara Capital Advisors's NCDs and Bank Loans to Stable; Affirms 'IND BBB'

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India Ratings and Research (Ind-Ra) has taken the following rating action on Akara Capital Advisors Private Limited's (ACAPL) debt instruments:

Details of Instruments

Instrument	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (million)	Rating assigned along with Outlook/ Watch	Rating Action
Non-convertible debentures*	-	-	-	INR2,000	IND BBB/Stable	Outlook revised to Stable from Positive; rating affirmed
Bank loans	-	-	-	INR500	IND BBB/Stable	Outlook revised to Stable from Positive; rating affirmed

* Yet to be issued

Analytical Approach

Ind-Ra continues to take a consolidated view of financial and credit profiles of ACAPL and its 100% parent Morus Technologies Pte. Ltd. (MTPL) along with its parent's other key wholly owned subsidiaries Titanium Fortune Financial Services Private Limited (TFFSPL) and EQX Analytics' (EQX; technology platform Stashfin). This is due to the strong operational linkages among them in the form of common promoters, shared management and fungibility of funds. ACAPL's and EQX's contribution to the consolidated financials remains significant.

Detailed Rationale of the Rating Action

The Outlook revision reflects (1) an increase in the borrowing cost which has been higher than peers', due to a change in the risk weight on unsecured lending impacting capital buffers along with a slower pace of diversification of funding across lenders (i.e. less than expected progress on rise in proportion of bank funding); (2) deterioration in the profitability, leading to loss at the consolidated level against Ind-Ra's expectations, though this includes employee stock option (ESOP) impact which is non cash in nature and networth neutral; and (3) decline in disbursement through co-lending partnerships leading

to reduced diversification between on- and off-book assets under management (AUM), thereby driving the importance of having adequate funding tie-ups with unutilised lines from diverse lenders. The Outlook revision also factors in the dynamic business environment ACAPL operates in and a rise in the softer delinquencies; however, the overall hard bucket delinquencies have been stable. Nonetheless, the ratings are supported with low leverage and adequate liquidity at the consolidated level.

List of Key Rating Drivers

Strengths

- Group-level equity
- Defined product in the form of line of credit; yields partially price in risk

Weaknesses

- Modest borrower profile
- Scaling franchise along with driving operating leverage
- High funding dependence on alternative investment funds (AIFs), needs diversification among banks and non-banks
- Asset quality remains monitorable with seasoning
- Regulatory risk

Detailed Description of Key Rating Drivers

Group-level Equity; Adequately Capitalised to Manage Growth: Since inception, MTPL has raised about INR8,261 million of equity from a diverse set of sources such as private equity players, promoters and high net-worth individuals, of which INR4,544 million was raised in FY23. MTPL's promoters have over 20 years of experience in investment banking and private equity. MTPL has supported ACAPL and EQX by infusing regular capital to support growth plans. At end-December 2023, the consolidated net worth was INR7,840 million, which will further increase with the proposed additional equity infusion of USD1 million in 4QFY24. The consolidated leverage at end-9MFY24 stood at 1.2x (FY23: 1.3x; FY22: 2.8x). On a standalone basis, EQX's net worth, including compulsorily convertible debentures, was INR526 million at end-9MFY24 while ACAPL's was INR4,305 million and leverage (debt/equity) at 1.8x (2.2x; 1.2x). ACAPL received a fresh equity infusion of INR410 million from MTPL in 2QFY24, providing a modest runway for growth until FY25. However, post the Reserve Bank of India's (RBI) directive to increase risk weight on unsecured assets, ACAPL's capital buffers had been impacted with a tier 1 capital ratio of 24.28% (FY23: 33.92%; FY22: 43.3%). Ind-Ra expects a continuous infusion from MTPL in the form of equity to help ACAPL maintain adequate capital buffers. In addition, capital support from MTPL for growth, maintenance of adequate capital buffer at MTPL level in form of unencumbered liquid investments for contingent needs of the lending entity, and the ability to manage on-book and off-balance sheet strategy (capital light manner) to support growth plans will remain key monitorables.

Defined Product in the form of Line of Credit; Yields Partially Price in the Risk: Stashfin provides an average loan of 90-180 days through its product Elevate (small ticket size) and 12-36 months through Liberate (large ticket size), where funds are made available through lines of credit. The monthly yield on these loans is more than 6%, including processing fees for Elevate and 2%-6% for Liberate. The share of Liberate product increased to 92.2% at end-December 2023 against 89.6% at end-FY23.

Stashfin sanctions lines of credit to Liberate customers for a maximum tenor of 36 months, which can be drawn at any point of time for a multiple number of times up (maximum five times) to the sanctioned limit. Each drawdown is then considered as a fresh term loan, and accordingly, yield and tenor are approved for the withdrawn limit. Each individual will have a unique customer identification number; however, each drawdown will have a different loan identification number. Stashfin provides the flexibility to pay within 30 days without charging interest, along with the flexibility to prepay within 90 days without any additional fee. Even though the end-use of the loan amount remains

difficult to assess, some of the uses could be for travel, medical, educational exigencies, or debt consolidation varying across borrowers.

EQX generates income through a processing fee for each disbursement under Elevate and the incremental AUM build up for Liberate booked under ACAPL. It also earns an excess interest spread above the hurdle rate for loans originated for platform partners through the co-lending arrangement, except those generated for its non-banking finance company (NBFC) ACAPL. There have been accounting changes in both EQX and ACAPL, where prior to November 2022, ACAPL was eligible for 24% internal rate of return on all loans originated from EQX's platform. Also, all credit losses above 150 days past due (dpd) in ACAPL were borne by EQX. However, post November 2022, this has been normalised post digital lending guidelines, whereby all interest income earned and credit losses incurred including write-offs (ACAPL had a write-off policy of 150dpd, which has been revised to 180 dpd) will be booked in ACAPL. EQX be the loan service provider, and its income would be classified only as fee income and the excess interest spread on co-lending.

Modest Borrower Profile; Scalable Business Aided by Technology-based Model: Stashfin operates in an unsecured segment where the borrower profile is modest and largely linked to gig economy, blue-collar workers and government employees. Stashfin advances unsecured personal loans of INR1,000 to INR0.5 million to salaried and self-employed (about 90% of whom are salaried employees).

EQX has adopted a branchless business model, driven by its in-house technology platform Stashfin, which is a fully automated digital lending model deployed through an application to assist borrowers with the loan process. It has an end-to-end integration in the form of sourcing, disbursement, collections, along with underwriting the loan applicants through data analytics and algorithms to assess the creditworthiness of borrowers. The algorithm is largely based on credit bureau data, along with multiple permutation and combination-based filtering on different cohorts such as postal code, age, salary scale and phone data of the borrower. As a digital lending platform, Stashfin originates on a pan-India basis; the management has shifted its product focus from short tenure loans to long tenure loans, largely ranging from 12 to 36 months product. Moreover, the company has seen an increase in the share of fee-based loans (paying within 30 days) in its Liberate product where the interest is charged post 30 days of utilisation in the overall disbursement, which was more than 40% of the disbursement at end-9MFY24 as against 28% during 9MFY23.

Furthermore, the platform has tie-ups with various lending partners for scaling co-lending, and ACAPL is one of the lending partners. The consolidated AUM has seen lower growth against its peer group's during FY24 (9MFY24: INR17,995 million; FY23: INR14,654 million; FYE22: INR5,588 million), largely due to an increase in the repayment of loans within 30 days. With the RBI's move on unsecured product lending, the co-lending partnership volumes have reduced and thereby, the on-book share increased to 79.6% at end-9MFY24 (FYE23: 72.9%). For the on-book share to increase, the company has to demonstrate more resilient funding tie-ups to achieve the growth plans.

Scaling Franchise along with Driving Operating Leverage needs to be Monitored: On a standalone basis, ACAPL reported a loss before tax of INR9 million in 9MFY24 (profit in FY23: INR398 million & FY22: INR77 million), due to higher write offs of INR2,890 million (INR888 million; INR782 million). However, net of ESOP which is a noncash expense ACAPL is profitable with profit before tax of INR81 million. Moreover, on the combined level (EQX and ACAPL), the group reported a loss of INR324 million in 9MFY24 on account of ESOP (noncash expenses) at EQX level as well. EQX and ACPAL, on a combined level, achieved breakeven in FY23 with a profit before tax of INR418 million after incurring consistent losses in the previous fiscals due to investments in customer acquisition, technology development and manpower costs. The operating expenses to AUM has increased largely due to the employee stock option (share-based payment) made during 9MFY24 and remained elevated at 18% at end-9MFY24 (FY23: 13%; FY22: 23%); this could largely increase in line with the business growth other than share-based payment expenses. At consolidated level, the operating profit (excluding ESOP expense) stands at INR 143 million (FY23: INR 324 million, FY22: negative INR 212 million) Furthermore, the build-up in scale or franchise could moderate over the medium term due to a higher proportion of borrowers in ACAPL's Liberate product closing their loan before amortisation or equated monthly instalment cycle starts, thereby supporting profitability through processing fee on a monthly churn in the near term and monthly churn of capital, reducing month-on-month borrowing requirement. Ind-Ra expects the scaling-up of the platform with the increase in on-balance and off-balance sheet exposure while onboarding new co-lenders over the near-to-medium term will drive EQX's

profitability.

High Funding Dependence on Alternative Investment Funds (AIFs), Needs Diversification among Banks and Non-Banks:

ACAPL's borrowing profile is skewed towards AIFs which formed 49.4% of the total borrowings at end-December 2023, which includes support from the parent in the form of external commercial borrowings (ECBs; 32%). The company has borrowed funds from NBFCs through term loans (28%) and capital market instruments - NCDs (15.8%). ACAPL has also raised funds through the commercial paper subscribed by AIFs, encompassing only 3.1% of the total funding. Furthermore, ACAPL has borrowed from banks; however, their share remains low in the overall proportion and compared to peers. ACAPL's relationships with lenders have decreased to 32 lenders from 36 during 3QFY24. While it has deepened exposure with some lenders, the concentration of the top five lenders has increased. Furthermore, the cost of borrowing for ACPAL has moved up by 50bp to 60bp as cost for incremental borrowing has increased amid the RBI's tightening of the unsecured lending for NBFCs and has remained higher than its peer groups. ACAPL's ability to diversify funding across banks and NBFCs and a material reduction in the concentration across lenders are key monitorables. Fasanara Capital Ltd (a shareholder in MTPL) has provided ECBs support to ACAPL through MTPL when required. Fasanara Capital has sanctioned committed three-year tenor debt lines of USD75 million, of which USD34 million is unutilised. Ind-Ra believes MTPL's role to support ACAPL in the form of liquidity and the capital support to grow its balance sheet will further gain importance post the full utilisation of ECBs.

Asset Quality Needs to be Closely Monitored for Seasoning:

ACAPL faced asset quality pressure during 9MFY24 with the overall portfolio early delinquencies (1+dpd) rising to 24.1% in 9MFY24 compared to 15.1% at end-1HFY24; however, the 90+dpd were manageable largely on the back of write offs as well actual recoveries. The gross non-performing assets (GNPAs) reduced to 4.6% in 9MFY24 (1HFY24: 6.2%; FY23: 4%), but remains impacted due to the modest credit profile of the borrowers.

The company's collection efficiency has improved during the past 12 months due to the repayment of loans within 30 days along with pre-payments and foreclosures, which have been in the range of 55%-60% of the current collections. ACAPL and EQX has written off 5.9% of the loan since the inception; however, on a six-month lagged basis, the write offs stood at 8.3% at end-December 2023. The increase in write offs can be attributed to the credit profile of the borrowers; however, Ind-Ra expects the write-offs, along with 90+dpd, to moderate with better customer selection and an improvement in the cohort structure of lending algorithm. The asset quality trajectory of ACAPL with seasoning will be a key monitorable. Also, the devolvement of first loss default guarantee provided to co-lending partners remains monitorable.

Regulatory Risk:

Digital lending has been subject to scrutiny since the beginning of 2023. Moreover, the default loss guarantee guidelines implemented June 2023 onwards provide a greater clarity around this, and Ind-Ra believes the economics of digital lenders may improve over the near-to-medium term. However, much will depend on how the bilateral contracts are constructed. Given that this may involve several regulated and non-regulated entities, and the fact that its relatively a new area of lending, the regulation will be evolving. However, given the high growth seen in the unsecured segment, the RBI's move on increasing risk weights on consumer loans has led to a tightening of the credit underwriting by NBFCs, impacting growth, capital buffers and margins for fintechs. The rapid growth, supported by financial institutions through co-lending/partner with new age-fintechs, will moderate as the move has led to a substantial recalibration by lender partners. At the same time, digital lending could move into personal loan adjacencies, asset-backed finance segments slowly, which may attract more scrutiny. Furthermore, the RBI's recent amendment on video know your customer has increased verification layers for lending entities along impacting overall operating expense further. The business environment for digital lenders is dynamic and there are possibilities that subsequent regulations could impact the economics and compliance requirements of the business seen in the current form.

Liquidity

Adequate: At end-December 2023, ACAPL's contractual structural liquidity statement had a cumulative surplus as a percentage of total assets of 31.9% in the less-than-one-year bucket, excluding committed undrawn lines, because of the funding duration of over two years and assets-side duration of about one-and-a-half-years. Regarding the

liquidity buffer, there is a board-approved policy and the management maintains an on-balance sheet liquidity to manage one and a half months of debt repayments. ACAPL had unencumbered cash and liquid investments of about INR477 million and unutilised bank lines of INR825 million at end-December 2023. Furthermore, MTPL has INR1,740 million of equity, which can flow down to ACAPL, as and when required. This level of equity support would be required for growth as well as providing support for repayments in changing the operating environment. Ind-Ra expects ACAPL to keep at least three months of unencumbered liquidity at any point of time covering debt repayments and operating expense.

Rating Sensitivities

Positive: The following developments collectively could result in a positive rating action:

- franchise expansion leading to a significant improvement in the profitability buffers
- widening and deepening of liability relationship with existing and new lenders
- maintaining stable asset quality with seasoning

Negative: Following factors that can individually or collectively lead to a negative rating action:

- sharp deterioration in the scale of operations, inability to tie-up funding for growth which could lead to a significant weakening of the profitability and/or capital buffers
- lack of funding diversification and a rise in the concentration risk across lenders
- the tier 1 capital falling below 22.5% on a sustained basis
- sustained deterioration in the asset quality
- inadequate liquidity buffers
- any regulatory changes or guidelines impacting the overall business model

ESG Issues

ESG Factors Minimally Relevant to Rating: Unless otherwise disclosed in this section, the ESG issues are credit neutral or have only a minimal credit impact on ACAPL, due to either their nature or the way in which they are being managed by the entity. For more information on Ind-Ra’s ESG Relevance Disclosures, please [click here](#). For answers to frequently asked questions regarding ESG Relevance Disclosures and their impact on ratings, please [click here](#).

About the Company

Founded in 2016, ACAPL is a non-deposit taking, systemically important NBFC, which provides loans mainly unsecured personal loans of up to INR0.5 million through line of credit to salaried as well as self-employed. The company has entirely branchless lending model while the corporate office is in Gurugram.

KEY FINANCIAL INDICATORS

EQX and ACAPL Combined

Particulars	9MFY24	FY23	FY22
Total assets (INR million)	15,837	15,327	6,905
Total equity (INR million)	5,315	4,477	2,900
Net income (INR million)	-145	270.7	-104.1
Return on average assets (%)	-1.2	2.4	-2.4
Leverage (x)	1.8	2.2	1.2
Source: ACAPL and EQX, Ind-Ra’s analysis			

MTPL Consolidated

Particulars	9MFY24	FY23	FY22
Total assets (INR million)	19,677	18,093	8,054
Total equity (INR million)	7,840	7,503	2,010
Net income (INR million)	-228	258	-221
Return on average assets (%)	-1.7	1.8	-4
Leverage (x)	1.3	1.3	2.8
Source: MTPL, Ind-Ra’s analysis			

Status of Non-Cooperation with previous rating agency

Not applicable

Rating History

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook
	Rating Type	Rated Limits (million)	Rating	7 August 2023
Non-convertible debentures	Long-term	INR2,000	IND BBB/Stable	IND BBB/Positive
Bank loan	Long-term	INR500	IND BBB/Stable	IND BBB/Positive

Bank wise Facilities Details

Click here to see the details

Complexity Level of the Instruments

Instrument Type	Complexity Indicator
Non-convertible debentures	Low
Bank loan	Low

For details on the complexity level of the instruments please visit <https://www.indiaratings.co.in/complexity-indicators>.

APPLICABLE CRITERIA

Non-Bank Finance Companies Criteria
Evaluating Corporate Governance
The Rating Process
Financial Institutions Rating Criteria

Contact

Primary Analyst

Vani Girotra

Analyst

India Ratings and Research Pvt Ltd

Wockhardt Towers, 4th Floor, West Wing, Bandra Kurla Complex, Bandra East, Mumbai - 400051

022 40356118

For queries, please contact: infogrp@indiaratings.co.in

Secondary Analyst

Jinay Gala

Associate Director

+91 22 40356138

Media Relation

Ameya Bodkhe

Marketing Manager

+91 22 40356121

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