

## Rating Rationale

24 November 2020

### SREI Equipment Finance Limited

**Brickwork Ratings revises the ratings to BWR A (SO) while placing it under ‘Credit watch with negative implications’ of SREI Equipment Finance Ltd.’s assignee payouts pool of Rs 54.13 Crs.**

#### Particulars

Transaction	Previous Amount (Rs in Crs)	Present Amount (Rs in Crs)	Payout Maturity Date	Previous Rating (Mar 2020)	Present Rating*
Assignee Payouts	82.27	54.13	10 June 2024 (Revised from 10 Dec 2023)	BWR AA (SO) Stable	BWR A (SO) Credit Watch with negative implications
<b>Total</b>	<b>82.27</b>	<b>54.13</b>	<b>INR Fifty Four Crores and Thirteen lakhs Only</b>		

Please refer to BWR website [www.brickworkratings.com/](http://www.brickworkratings.com/) for definition of the ratings

Brickwork Ratings (BWR) revises the ratings assigned to assignee payouts pool of Rs 54.13 Crs issued and originated by “SREI Equipment Finance Ltd” (SEFL) and assigned to ‘Bank of Baroda’ to BWR A (SO) from BWR AA (SO)/Stable and places it under ‘credit watch with negative implications’ as tabulated above.

The rating revision factors deteriorating financial and credit risk profile of the originator and the weak pool performance as reflected in its low cumulative collections efficiency and high 90+days shortfall for the transaction. However, the rating continues to derive comfort from the credit enhancement available in the form of Excess Interest Spread (EIS) and cash collateral in the form of fixed deposit.

Rating has been placed under “Credit watch with negative implications” as BWR expects the collection efficiency of the pool will continue to be under pressure given the liquidity challenges faced by the majority of the underlying borrowers in the respective pools and the expected cash flow mismatches in the pool in case the underlying loans in the pool gets restructured under “one time restructuring” (OTR) available under the RBI scheme and in case the investors in the pool do not extend the same to the transaction. The rating watch will be resolved once BWR gets clarity on the collections status over the near term and utilisation of cash collateral in case of any shortfall in collections.

BWR also understands that the majority of the borrowers of SEFL, the originator and servicer for the PCG transactions have sought or are expected to seek one-time restructuring of their loans, which may result in severe cash flow shortage and put further pressure on the liquidity position of the originator in the absence of fresh funding which might impact the servicing ability of the originator.

As a part of the COVID-19 – Regulatory Package extended by the Reserve Bank of India (RBI) on May 22, 2020, the investor for the said transaction had extended moratorium to eligible customers in the pool and

at the end of September 2020, ~30% of pool was under moratorium with an cumulative collection efficiency of 61.77%.

### **Pool Characteristics**

The selected pool consists of equipment loan receivables with an average ticket size of Rs 2.14 Crs and average tenure of 48 months. The underlying loans have monthly repayment frequency and service the interest on a monthly basis. The average seasoning of the pool is ~24 months. The initial pool amount rated was Rs 82.27 Crs which has amortised by ~34% and current outstanding is Rs 54.13 Crs.

### **Key Rating Drivers**

#### **Credit Strengths**

- Credit enhancement available in the form of Excess Interest Spread (EIS) of 10.12% and First Loss Credit Facility (FLCF) of Rs 12.34 Crs (~23% of outstanding pool principal when compared to 13% of the initial pool amount) in the form of FD

#### **Credit Weakness**

- Low cumulative collection efficiency of 61.77% and high 90+days shortfall of 12.88% as on 31 October 2020.
- Originator's deteriorating financial risk profile as reflected in its weak profitability, low capitalisation, weak asset quality and given the additional provisioning requirements and stress on the borrowers under the current environment, the ability of the originator to absorb asset side risks is very low. BWR expects that the financial risk profile of the originator will continue to be under stress which might impact the originator's collections and servicing ability under the said transaction.
- SEFL has approached NCLT seeking one-time restructuring of its loans as the majority of the borrowers of SEFL have sought or are expected to seek one-time restructuring of their loans, which has resulted in and will result in severe cash flow shortage as reported by the company.

**Rating Sensitivities:** The rating is driven by the strength of cash flows of the underlying pool, credit enhancement in the form of First Loss Credit Facility (FLCF) in the form of fixed deposits and SEFL's (originator) servicing capabilities.

**Positive:** Improvement in collection efficiency and pool performance coupled with improvement in originators credit profile and liquidity position will be key rating positives.

**Negative:** Any deterioration in the credit enhancement, shortfall in the cash flows and deterioration in the servicing capabilities of the originator will be key rating monitorables.

### **Liquidity Position: Adequate**

The credit cum liquidity enhancement available in the transaction is Rs 12.34 Crs which is in the form of fixed deposit. The fixed deposit as a percentage of the initial pool was 13% which with amortisation of the pool has increased to 23%. This covers ~3 months of principal and interest obligations even in the event of



no collections from the underlying pool. The liquidity might come under pressure in case of OTR being allowed to the borrowers under the pool and the investors in the pool not allowing OTR for the transaction.

**Coronavirus disease (COVID-19)**, declared a pandemic by the World Health Organisation (WHO), has become a full-blown crisis globally, including in India. As a containment measure, the Indian Government had announced a 21-day nationwide lockdown on 24 March 2020, which was subsequently extended until 31 May 2020. As per BWR, financial institutions, mainly those lending to the retail low-income borrower segments could be the most impacted. The 6-month moratorium announced by the Reserve Bank of India on interest and principal on bank debt has provided some cushion to the lending community to realign its collection machinery and operations during this period. However, lenders' ability to ensure credit discipline among borrowers to collect accumulated interest and principal dues on a timely basis will be a key monitorable. BWR is actively engaging with its clients on a continuous basis and taking updates on the impact on its operations and liquidity situation. BWR will take appropriate rating actions as and when it deems necessary and will publish the same.

### **Key Rating Assumptions**

To assess the collection shortfalls and gross default rates for this transaction, BWR has analyzed the pool characteristics vis-a-vis the overall portfolio of the company, the performance of dynamic pool of SEFL's loan portfolio and the current operating environment that could impact the performance of the underlying pool contracts and the prepayment rate. BWR expects the base case peak shortfall in the pool to be between 7.50 -8.00% of the pool principal and peak shortfall will be 12.88%. BWR expects the prepayments in the range of 1.00% to 2.00% per annum.

### **Analytical Approach**

The rating is based on the analysis of the past performance of SEFL's portfolio, key characteristics and composition of the current pool, performance expected over the balance tenure of the pool and the credit enhancement available in the transaction.

It is envisaged that for this transaction, the Assignee will avail the Partial Credit Guarantee (PCG)' under the Partial Credit Guarantee Scheme offered by the Government of India (GoI) to Public Sector Banks (PSBs) for purchasing high-rated pooled assets from NBFCs/Housing Finance Companies (HFCs). Brickwork Ratings has not factored in the PCG while arriving at the assigned rating.

### **About the Originator – SREI Equipment Finance Limited (SEFL)**

SREI Equipment Finance Ltd (SEFL) is a 100% subsidiary of SREI Infrastructure Finance Ltd (SIFL). SEFL is a non-deposit taking systemically important NBFC. The company is also registered with the RBI and is classified as an Asset Financing Company (AFC). The company is a leading financier in the Construction, Mining and allied Equipment (CME) sector in India offering loans and leases for new, as well as used equipment. The lending business, interest earning business and lease business of SIFL have merged with the company w.e.f 1 October 2019 pursuant to the slump exchange. The Company is currently rated at BWR BBB/BB/A3/Credit watch with negative implications for its various debt instruments. Given the CRAR constraints, the company curtailed its disbursements and focused more on

co-lending, which resulted in degrowth in the consolidated AUM from Rs 47,070 Crs in FY19 to Rs 44,836 Crs in FY20 and further to Rs 41,384 Crs as on 30 September 2020.

**Asset Quality:** The company's asset quality remains stressed, with reported gross Non-Performing Assets (NPAs) and net NPAs at 9.50% and 6.60%, respectively, as on 30 September 2020 (8.60% and 5.80%, respectively, as on 31 March 2020). Furthermore, given the wholesale nature of the loans with a larger ticket size, it exposes the combine to a high risk of delinquencies as the recovery and resolution of such exposures takes a longer time.

**Capital Adequacy:** Company's Capital to Risk Weighted Assets Ratio (CRAR) decreased in the last 2 years and has reached 15.50% as on 30 September 2020, which is near the minimum regulatory requirement of 15%. As on 30 September 2020, the consolidated networth stood at Rs. 4,071 Crs, against the total debt of Rs 31,469 Crs, resulting in a high gearing of 7.73x. With the weakening of the asset quality over the years, the networth cover for net NPAs had also decreased over years and stands low at 1.79 times.

**Company Financial Performance:** On a consolidated basis, for FY20, the company reported net income from operations and profit after tax (PAT) of Rs 2,325.35 Crs and Rs 88.75 Crs, respectively, compared with Rs 2,962.77 Crs and Rs 487.06 Crs, respectively, for FY19. Net income from operations and PAT further decreased to Rs 662.06 Crs and Rs 27.73 Crs respectively for H1FY21. The substantial decline in profitability is mainly on account of decline in the net income from operations on the back of a declining asset base, increasing finance cost and high loan loss provisions. The ROA and ROE for H1FY21 declined to 0.20% and 2.20%, respectively, compared with 0.10% and 1.40%, respectively, in FY20.

#### Key Financial Ratios:

Key Financial Indicators	Units	FY19	FY20
Result Type		Audited	Audited
Consolidated AUM	Rs in Crs	47,070	44,836
Net Income from operations	Rs in Crs	2,963	2,325
PAT	Rs in Crs	487	89
Networth	Rs in Crs	4,097	4,006
Gearing	Times	8.11	8.07
Gross NPA	%	9.42	8.60
Total CRAR	%	15.60	15.70

**Key Covenants of the Instruments/Facility rated: Nil**

**Non-cooperation with previous CRAs if any: Nil**

**RATING HISTORY FOR THE PREVIOUS THREE YEARS (Including withdrawal and suspended)**

		Current Rating (Nov 2020)			Rating History		
Sl no	Instrument	Long Term/Short Term	Amount (Rs in Crs)	Rating	2020	2019	2018
1	Assignee Payouts	Long Term	54.13	<b>BWR A (SO)</b>  <b>Credit watch with negative implications</b>  <b>Downgrade</b>	<b>28 May 2020</b>  BWR AA (SO) (Stable)  Affirmed  <b>13 Mar 2020</b>  Provisional BWR AA (SO) (Stable)  Assigned	NA	NA
<b>Total</b>			<b>54.13</b>	<b>INR Fifty Four Crores and Thirteen Lakhs Only</b>			

**NON-COOPERATION WITH PREVIOUS RATING AGENCY IF ANY:NA**

**COMPLEXITY LEVELS OF THE INSTRUMENTS: Simple**

For more information, visit [www.brickworkratings.com/download/ComplexityLevels.pdf](http://www.brickworkratings.com/download/ComplexityLevels.pdf)

**Hyperlink/Reference to applicable Criteria**

- [General Criteria](#)
- [Rating Criteria for Securitisation Transactions](#)

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**SREI Equipment Finance Ltd**  
**Annexure I: Instrument Details**

<b>Instrument</b>	<b>Date of First Pay-out</b>	<b>Amount (Rs in Crs)</b>	<b>Coupon Rate (%)</b>	<b>Maturity date</b>	<b>ISIN</b>
Assignee Payouts	10 Apr 2020	54.13	9.50	10 June 2024 (revised from 10 Dec 2023)	NA