

India Ratings Assigns Star Housing Finance's NCDs and Additional Bank Loans 'IND BBB'/Stable

May 10, 2023 | Housing Finance Company

India Ratings and Research (Ind-Ra) has taken the following rating action on Star Housing Finance Limited's (Star HFL) instruments:

Instrument Type	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (million)	Rating	Rating Action
Bank loan	-	-	-	-	INR4,500 (increased from INR1,590)	IND BBB/Stable	Affirmed
Non-convertible debentures (NCDs)*	-	-	-	-	INR500	IND BBB/Stable	Assigned

* Yet to be issued

The rating reflects Star HFL's expansion in franchise along with growth of granular loans in the book. Alongside, the entity has increased the number of lending relationships along with improving its liquidity buffers on an ongoing basis. The upgrade also reflects the demonstrated ability of Star HFL to raise capital to support its strong growth plans while keeping the leverage ratio under check. While seasoning in the book remains low as a significant portion of the assets under management (AUM) has been generated in the past 12 months, the asset quality metrics have fared well.

The rating also reflects Star HFL's long operating track record and its strategic partnership with Arkfin Investments Private Limited, which has led to a renewed focus on the housing finance business. The rating also factors in the company's modest-but-growing scale of operations, significant geographic concentration, funding concentration, low seasoning of book, and volatile profitability.

Key Rating Drivers

Franchise in Expansion Mode; Focus on Granular Growth: Star HFL operates in the affordable housing finance segment and had AUM of INR1,876 million at end-December 2022. Retail home loans constituted 88% of the AUM at end-December 2022, retail mortgage loans constituted 8.3% of the portfolio, unsecured loans accounted for 1.6%; project loans declined to 1.9% in 9MFY23 from 5.0% in FY22 and management expects them to be completely run down in 1QFY24. In the past, the company had also provided loans to small developers (1.9% of the AUM), but it has been consciously reducing the same and plans to entirely run it off completely in 1QFY24. Star HFL operates through 11 branches in five states, with 12 digital branches acting as spokes. As the company continues to expand, it will deepen its presence in its existing geography along with entering into new states namely Uttar Pradesh, Andhra Pradesh, and Telangana over FY24-FY25.

Along with the geographic expansion, Star HFL has been focusing on making the loan book more granular, with the incremental generation beyond October 2019 largely being with a maximum ticket size of INR2.5 million. Additionally, the sourcing of new business, underwriting and collections are now being handled by an internal team against being done by direct selling agents earlier. The company expects AUM to touch INR5 billion in FY24, led by the maturing of existing branches and the opening-up of new branches. Star HFL also has a co-lending arrangement with Capital India Home Loans, Family Home and Singularity Credit which while at a nascent stage will help the company in growing through a capital-light model.

Profitability Turned Around in FY23; Sustenance Will be Key: Star HFL's profit improved sharply in FY23. The improvement in profitability can be attributed to several factors, including a strong disbursement trend, contained cost of borrowings on improving share of the low-cost National Housing Bank (NHB, IND AAA/Stable) funding; higher other operating income, which is up by 4.0x yoy and even higher than cumulative other operating income earned between FY18 and FY22; improving operating leverage and lower loan loss provision. The company reported a return on assets of 3.2% in FY23 (FY22: 0.4%; FY21: 1.4%). However, continuing sustenance of profitability along with control on loan loss provision will be key monitorable since a significant portion of the portfolio has low seasoning, and any negative surprises can derail the momentum. Further, as the company is currently operating at a low leverage, the impact of cost of borrowing on absolute profitability is low.

Leverage Building from Lows, but Capital Raise Should Provide Relief Even as Book Growth Continues: At end-March 2023, Star HFL had an equity base of INR1,064 million (9MFY23: Tier I capital of 81.9% and CAR of 82.7%) with a leverage of 1.53x. The company had raised equity of INR216 million and INR112 million in 2QFY23 and 3QFY23, respectively, from a diversified retail investor base. In the near term, the company plans to grow its AUM further by increasing leverage to around 3x. Alongside, it is looking to raise INR400 million-850 million during FY24 to support the loan book growth while containing the leverage. The agency believes that to scale up its AUM to INR5 billion and maintain its growth momentum, a capital infusion in the near to medium term will be imperative.

Adequate Diversification in Funding for its Size of Business: Star HFL has a relationship with 13 lenders, which include a mix of public sector banks, non-banking finance companies, housing finance companies and NHB. The company has been diversifying its funding avenues since FY20 and reduced the reliance on bank loans to 38.6% in 9MFY23 (FY19: 53.7%). Similarly, the dependence on non-banks declined to 35.9% in 9MFY23 (FY19: 46.3%), with Star HFL tapping into NHB funding (25.5% of funding mix in 9MFY23). Star HFL is also looking to raise NCDs from select high net worth investors which could be about 10% of NCDs in its liability mix on a steady-state basis.

Liquidity Indicator – Adequate: Star HFL had cumulative surplus in all time frames up to one-year of structural liquidity at end-December 2022. Even on stressing the inflows at end-December 2022, cumulative surplus remains sufficient in the up to one-year of structural liquidity. As a practice, Star HFL plans to keep two months of disbursements in form of on-balance sheet liquidity along with undrawn bank lines. At end-March 2023, Star HFL has in principal sanction of INR353 million in addition to on-balance sheet liquidity (unencumbered cash and fixed deposits) of INR281 million, against a scheduled debt repayment of INR419 million over the next one year.

Portfolio Concentration Remain High; Asset Quality Seasoning Needs to be Established: Until early 2019, Star HFL catered to borrowers located only in tier 2 and below cities in the southern part of Rajasthan and adjoining parts of Madhya Pradesh. However, the company has subsequently enhanced its presence across different geographies, and in FY23, it operated in five states. This has been accompanied by a commensurate increase in the team, including on-the-field executives (overall team size increased to 150 employees in March 2023 from 16 in March 2019). Over the past 24 months, Star HFL has strengthened its presence in Gujarat, Maharashtra and Tamil Nadu; consequently, the portfolio concentration in Rajasthan reduced sharply to 10%-12% in FY23 (FY20: over 70%). However, the concentration in Maharashtra increased significantly to 62.5% in FY23 (FY20: 16.4%), indicating that the majority of the growth is coming from this state. Furthermore, the seasoning in the portfolio is low as nearly 59% of the FY23 AUM has been generated in the past 12 months. This however gives comfort that most of the recent generation has been done at a time when the effect of COVID-19 was waning. Given the limited seasoning of its book, Ind-Ra believes control over softer bucket migration needs to be actively monitored with the rising scale and will thus be a key monitorable for the agency.

Lending to Vulnerable Self-Employed Borrower Profile: Star HFL mainly lends to borrowers in the self-employed category (71.3% of the portfolio as of 9MFY23) and the balance to those belonging to the salaried segment. The average ticket size of housing loans is around INR 0.95 million while the incremental ticket size is INR1.2 million-1.3 million in geographies closer to cities and INR0.6 million-0.8 million in rural areas. The agency believes lending to the under-banked rural and semi-urban customers with limited documented income proof carries a higher risk, and thus, assessment of the credit worthiness along with strong monitoring and collection focus is essential to avoid asset quality shocks. The company's gross stage 3 assets came in at 1.68% (3.8% on a one year lagged basis) and net stage 3 assets at 1.25% at end-March 2023 (FY22: 2.99%,2.40%). However, its stage 3 provisioning is on a lower side at around 25%, lower than most of its peers. With the low seasoning of book, the risk of delinquency remains high and could lead a ramp-up in the provisioning thereby hampering the profitability.

Rating Sensitivities

Positive: Factors that could collectively lead to a positive rating action are:

- a significant growth in the franchise and loan portfolio coupled with significant reduction in the geographical concentration
- the continued ability to maintain asset quality even on a lagged basis through low delinquency and modest credit costs as portfolio demonstrates steady state performance in the opinion of the agency
- diversification and improvement of the funding profile and maintaining of adequate liquidity

Negative: Inability to materially expand the franchise, deterioration in the liquidity buffers, leverage exceeding 3.5x on a sustained basis, deteriorating asset quality on an ongoing basis and losses leading to erosion of capital buffers could lead to a negative rating action.

Company Profile

Star HFL (erstwhile Akme Star Housing Finance Limited) is a housing finance company registered with NHB and was incorporated in 2005. It commenced business operation in September 2009. The company is focused on providing retails loans and mortgage loans to the affordable segment catering to both salaried and self-employed customers. Self-employed customers contribute a lion share of 71% to the total AUM. The company operations are spread across 14 branches and over 15 digital points of presence mainly in the states of Madhya Pradesh, Gujarat, Maharashtra, Rajasthan and Tamil Nadu. As on March 2023, the company had an AUM of INR2,514 million.

FINANCIAL SUMMARY

Particulars	FY23	FY22	FY21
Total assets (INR million)	2,885	1,533	1,248
Total equity (INR million)	1,064	641	536
Net profit (INR million)	70	24	16
Return on average assets (%)	3.2	1.7	1.4
Debt/Equity (x)	1.5	1.2	1.2
Tier 1 capital (%)	81.9	83.8	84.7
Source: Star HFL, Ind-Ra's analysis			

Solicitation Disclosures

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Rating History

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook	
	Rating Type	Rated Limits (million)	Rating	27 April 2023	3 February 2022
Bank loans	Long-term	INR4,500	IND BBB/Stable	IND BBB/Stable	IND BBB-/Stable
NCDs	Long-term	INR500	IND BBB/Stable	-	-

Bank wise Facilities Details

[Click here to see the details](#)

Complexity Level of Instruments

Complexity Indicator	Complexity Indicator
Bank loans	Low
NCDs	Low

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

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APPLICABLE CRITERIA

Financial Institutions Rating Criteria

Non-Bank Finance Companies Criteria

The Rating Process

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