CFM Asset Reconstruction Private Limited [CFM ARC]

January 10, 2024

Ratings

Instrument / Facility	Amount (Rs. crore)	Ratings	Rating Action	Complexity Indicator (Simple/ Complex/ Highly complex)
Long Term Fund based facilities Term Loan	34.90 (Enhanced from Rs. 13.71 Cr.)	IVR A-/ Stable [IVR A Minus with Stable Outlook]	Rating reaffirmed and removed from Rating Watch	Simple
Long Term Fund based facilities Term Loan	0.00 (Reduced from Rs. 11.30 Cr.)	-	Rating withdrawn	Simple
Short Term Fund based facilities Secured Overdraft	50.00	IVR A2+ [IVR A Two Plus]	Rating reaffirmed and removed from Rating Watch	Simple
Long Term Fund based facilities Proposed Fund based limit	90.10 (Reduced from Rs. 99.99 Cr.)	IVR A-/ Stable [IVR A Minus with Stable Outlook]	Rating reaffirmed and removed from Rating Watch	Simple
Total	**175.00**			

Details of Facilities are in Annexure 1

Rating Action:

The rating has been reaffirmed and removed from Rating watch with Negative Implications and assigned Stable Outlook on account of improved FY23 Audited and H1FY24 Prov. operational income, profitability, liquidity, increase in Asset under management (AUM) and on-going strong traction in recoveries and redemptions. Further, the rating also takes into account the update on Reserve Bank of India’s (RBI) show cause notice issued to the company wherein all the observations raised by the Reserve Bank of India’s (RBI) have been responded by the company vide letter dated February 17 & 20, 2023 and confirming compliance of the said observations.

Detailed Rationale

The rating assigned to the bank facilities of CFM Asset Reconstruction Private Limited (CFM ARC) continues to derive strength from experienced promoter & qualified management team, growth in Asset under management (AUM), improved revenue & PAT margin and strong capitalization and comfortable gearing. The rating is however constrained by any significant crystallization of the liabilities which is contingent in nature; arising out of the Income Tax demand assessment and/ or any adverse orders from regulator, poor track record of resolution of stressed assets in India, intense competition in the asset reconstruction sector and the vulnerability of earning profile due to volatile nature of cash flows and risk associated with any adverse changes in the distressed assets policy framework.

The term loan facility rated for Karnataka Bank has been withdrawn based on the No due certificate received from the bank where in the entire term loan has been repaid as of September 21, 2023.

Key Rating Sensitivities:

Upward Factor:

- Substantial increase in Asset under management (AUM), followed by an increase in the scale of operations coupled with stable revenue stream from asset management fees.
- Timely recoveries and redemptions of recently acquired assets.

Downward Factor

- Any significant crystallization of the liabilities arising out of the Income Tax demand assessment which is contingent in nature and/or any adverse orders from the regulator which could have an impact on the business.
- Lower than expected acquisition of new assets, delay in resolution of assets purchased in the past or more than expected rise in gearing and/ or deterioration in capital adequacy.

List of Key Rating Drivers with Detailed Description

Key Rating Strengths

Experienced management team

CFMARC has a three-member executive committee (EC) comprising of industry leaders and veterans to take a decision on Stressed assets acquisition and resolution proposals. The board of director comprises of Chairman and majority Independent Directors. The company has robust governance framework with various committees to enable integrity and transparency namely, Committee for Acquisition & Resolution of Financial Assets (CARFA), Independent Advisory Committee (IAC), Risk Management Committee, CSR Committee, Audit Committee etc.

Growth in Asset under management (AUM)

The Company's overall Asset under management (AUM) has been consistently increasing year on year basis with Asset under management (AUM) at Rs. 3,020.62 Crore as at FY21 to Rs. 4,251.99 Cr. in FY23. The company has projected to increase its Asset under management (AUM) supported by substantial growth in acquisitions. Asset under management (AUM) as of Q2FY24 stood at Rs. 5,000.18 Cr.

Improved revenue & Profit after tax (PAT) margin

The total revenue of the company witnessed ~16% growth in FY23 driven by an increase in management fees, recovery incentive, profit on sale of financial assets/ Security Receipts (SRs). The revenue increased from Rs. 177.19 Crore in FY22 to Rs. 204.69 Cr. in FY23. The Profit after tax (PAT) margin of the company remained healthy at ~15% in FY23 however marginally lowered from that of the previous year of 17.07%.

Strong capitalization and comfortable gearing

The promoters and associates infused funds in FY22 in the form of Equity of Rs. 2.56 Crore. The overall Capital adequacy ratio (CAR) stood comfortable at 41.68% as on September 30, 2023, as against regulatory requirement of 15%. Further, the liquidity position remains to be comfortable as of August 31, 2023. The overall gearing has remained improved from 1.47x as at FY22 to 0.50x in FY23 as the company repaid significant portion of secured and unsecured term loans.

Key Rating Weaknesses

Any significant crystallization of the liabilities which is contingent in nature arising out of the Income Tax demand assessment and/ or any adverse orders from regulator.

The assessment proceedings consequent to the search u/s 132 of the Income-tax Act, 1961 were completed in the months of December-2022 & June-2023 & accordingly assessment orders along with demand notices were received. The company has filed appeals before the Commissioner of Income-tax (Appeals), Mumbai. This remains to be a key rating sensitivity factor and Infomerics shall continue to closely monitor the same.

Poor track record of resolution of stressed assets in India

The Indian distressed assets market is still in a nascent stage with limited seasoning. The sector is gradually growing with more regulatory policies taking shape. Generally, the track record of resolution of stressed assets in India is poor. However, with the onset of the IBC (Insolvency and Bankruptcy Code) in India, the situation is very likely to improve.

Intense competition in the Asset Reconstruction sector and the vulnerability of earning profile due to volatile nature of cash flows

There are ~28 registered Asset Reconstruction Companies (ARCs) in India, which manage more than Rs. 1 lakh Crore of Asset under management (AUM). The competition in the stressed asset market is on the rise with an increase in the number of players. Also, due to the change in the model of Asset Reconstruction Companies (ARCs) to more cash-based buying as against largely a security receipts-based model adopted earlier, big players may give stiff competition to smaller players. The recoveries might not always be as estimated, as the resolution of stressed assets is subject to many factors. Due to the nature of its business the recoveries from acquired assets is difficult to predict.

Risk associated with any adverse changes in the distressed assets policy framework

The Company is exposed to risk emerging out of any adverse changes in the distressed assets policy framework. Despite having sufficient asset acquisition and resolution policy framework, Asset Reconstruction Companies (ARCs) might keep on confronting difficulties given the inherent nature of the business and the asset reconstruction industry.

Analytical Approach: Standalone Approach

Applicable Criteria:

Financial Institutions/NBFCs Infomerics Rating

Criteria of Rating Outlook | Infomerics Ratings

Policy on Withdrawal of Ratings

Liquidity – Adequate

The Net Worth of CFM ARC increased over the years and increased to Rs. 228.38 Cr. in FY23 from that of Rs. 196.82 Cr. The average overdraft utilization stood at ~35% for the 12-months period ended August-2023. As of August 31, 2023, the company had a cash and bank balance of Rs. 43.88 Cr. The overall Capital adequacy ratio (CAR) stood comfortable at 41.68% as on September 30, 2023, as against regulatory requirement of 15%.

About the Company:

CFM Asset Reconstruction Pvt. Ltd. ("CFM ARC" or the "Company") was incorporated on 30th July 2015 and has successfully secured Asset Reconstruction Company license on 3rd Aug 2016 from the Reserve Bank of India ("RBI") under Securitization and Reconstruction of Financial Asset and Enforcement of Security Interest Act 2002 (SARFAESI Act).

CFM ARC is in the business of Acquisition and Resolution of Stressed Financial Assets from banks, financial institutions and other Qualified sellers. The company has a focused and specialized approach to resolve and recover Stressed Assets in SME, MSME and mid-corporate and retail sectors. The Company offers an opportunity to Banks/Financial Institutions to recover the best possible value from the Stressed Assets thereby unlocking their Capital.

Financials (Standalone):

(Amounts in Rs. Cr.)

For the year ended/ As on*	31-03-2022 (Audited)	31-03-2023 (Audited)
Total Income	177.19	204.69

PAT	30.24	31.56
Total Debt	288.45	114.05
Tangible Net Worth	196.82	228.38
Assets Under Management	5004.63	4251.99
PAT margin (%)	17.07	15.42
Overall Gearing Ratio (x)	1.47	0.50
Total Capital adequacy ratio (CAR) (%)	19.64	33.30

**Classification as per Infomerics standards*

Status of non-cooperation with previous CRA: None

Any other information: Mr. Malay Mukherjee who is a member of the Rating Review Committee at Infomerics is also on the Board of CFM Asset Reconstruction Private Limited. However, Mr. Mukherjee did not participate in the entire rating exercise, including the rating decision. The rating note has not been sent to him.

Rating History for last three years:

Name of Instrument/ Facility	Current Rating (Year: 2023-24)			Rating History for the past 3 years		
	Type	Amount (INR Crore)	Rating	Rating assigned in 2022-23 (Dated March 08, 2023)	Rating assigned in 2022-23	Rating assigned in 2021-22 (Dated Dec. 28, 2021)
Long Term Fund based facilities	Term Loan	34.90 (Enhanced from Rs. 13.71 Cr.)	IVR A-/ Stable	IVR A-/ Rating Watch with Negative Implications	IVR A-/ Credit Watch with Developing Implications **(Dated: Jan. 10, 2022 & Jun 28, 2022)** IVR A-/ Stable **(Dated: Oct 11, 2022)**	IVR BBB+/ Credit Watch with Negative Implication
Long Term Fund based facilities	Term Loan	0.00 (Reduced from Rs. 11.30 Cr.)	-	IVR A-/ Rating Watch with Negative Implications	IVR A-/ Credit Watch with Developing Implications **(Dated: Jan. 10, 2022 & Jun 28, 2022)** IVR A-/ Stable	IVR BBB+/ Credit Watch with Negative Implication

Name of Instrument/ Facility	Current Rating (Year: 2023-24)			Rating History for the past 3 years		
	Type	Amount (INR Crore)	Rating	Rating assigned in 2022-23 (Dated March 08, 2023)	Rating assigned in 2022-23 (Dated: Oct 11, 2022)	Rating assigned in 2021-22 (Dated Dec. 28, 2021)
Long Term Fund based facilities	Proposed	50.00	IVR A-/ Stable	IVR A-/ Rating Watch with Negative Implications	IVR A-/ Credit Watch with Developing Implications **(Dated: Jan. 10, 2022 & Jun 28, 2022)** IVR A-/ Stable **(Dated: Oct 11, 2022)**	IVR BBB+/ Credit Watch with Negative Implication
Short Term Fund based facilities	Secured Overdraft	90.10 (Reduced from Rs. 99.99 Cr.)	IVR A2+	IVR A2+/ Rating Watch with Negative Implications	IVR A2+/ Credit watch with Developing Implications **(Dated: Jan. 10, 2022 & Jun 28, 2022)** IVR A2+ **(Dated: Oct 11, 2022)**	IVR A2

Name and Contact Details of the Rating Analyst:

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About Infomerics:

Infomerics Valuation and Rating Private Ltd (Infomerics) was founded in the year 1986 by a team of highly experienced finance professionals for research and risk evaluation. Infomerics commenced its activities as External Credit Assessment Institution after obtaining registration from Securities Exchange Board of India (SEBI) and accreditation from Reserve Bank of India (RBI).

Adhering to best international practices and maintaining high degree of ethics, the team of analysts at Infomerics deliver quality credit ratings. Infomerics evaluates wide range of debt instruments which helps corporates access to financial markets and provides investors credit ratings backed by in-depth research. The transparent, robust, and credible ratings have gained the confidence of investors and the banks.

Infomerics has a pan India presence with Head Office in Delhi and Corporate Office at Mumbai, with branches in major cities and representatives in several locations.

Infomerics also has international presence with credit rating operations in Nepal through its JV subsidiary.

For more information visit www.infomerics.com.

Annexure 1: Details of Facilities:

Sr. No.	Name of Facility	Date of Issuance	Coupon Rate/ IRR	Maturity Date	Size of Facility (INR Crore)	Rating Action
1	Term Loan	--	--	16 quarterly instalments	25.00*	IVR A-/ Stable

				from disbursement		
2	Term Loan	--	--	June-2025	9.90	IVR A-/ Stable
3	Proposed fund-based limit	--	--	--	90.10	IVR A-/ Stable
4	Secured Overdraft	--	--	--	50.00	IVR A2+

**Yet to be disbursed*

Annexure 2: List of companies considered for consolidated analysis: Not Applicable

Annexure 3: Facility wise lender details:
https://www.infomerics.com/admin/prfiles/len-CFMAsset-jan24.pdf

Annexure 4: Detailed explanation of covenants of the rated instrument/ facilities: Not Applicable

Note on complexity levels of the rated instrument: Infomerics has classified instruments rated by it on the basis of complexity and a note thereon is available at www.infomerics.com