Alpha Alternatives Financial Services Private Limited

December 20, 2023

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Market-linked debentures	1,000.00	CARE PP-MLD BBB; Stable	Assigned
Market-linked debentures	1,000.00	CARE PP-MLD BBB; Stable	Reaffirmed

Details of instruments/facilities in Annexure-1.

Rationale and key rating drivers

The rating of the principal protected-market-linked debentures (PP-MLDs) issued or proposed to be issued by Alpha Alternatives Financial Services Private Limited (AAFSPL) factors in the ring-fenced structure, the deployment of proceeds of the proposed PP-MLD largely in marginable securities to execute the identified strategy, and the well-defined payment mechanism. The rating also considers the background of the experienced fund managers, who possess strong understanding of the capital and commodity markets, and the consistent performance of their deployed strategies, reflecting a track record of achieving favourable results. The support from a well-capitalised parent entity further strengthens the position.

The rating is, however, constrained by the non-banking finance company's (NBFC's) limited operating performance track record, the high leverage, the inherent risk in the capital and commodity markets, and the potential Information Technology (IT), regulatory or operational risk.

Rating sensitivities: Factors likely to lead to rating actions

Positive factors – Factors that could, individually or collectively lead to positive rating action/upgrade:

- Sustained improvement in profitability, with return on total asset (ROTA) above 3.5%, with consistent positive returns of strategies.
- Sustained increase in the scale of operations.

Negative factors – Factors that could, individually or collectively lead to negative rating action/downgrade:

- Deterioration in the credit profile of the parent.
- Change in the overall business model or strategy, increasing the risk profile of the NBFC or parent.
- Sustained negative returns impacting the credit profile, with return on total assets (ROTA) below 1%.
- Decrease in the valuation of any MLD below the subscription amount (face value and premium) or significantly different structure for incremental debt.
- Non-adherence to transaction structure or any material covenants.
- Material changes in the management team or the fund manager.

Analytical approach

The standalone profile of AAFSPL has been considered, strengthened by its linkage with its parent, Alpha Alternative Holdings Private Limited (Alpha Holdings), along with the additional comfort derived from the structure.

Outlook: Stable

The 'stable' outlook for the long-term instruments of AAFSPL factors in the improvement in the financial metrics, the growth in the scale of operations, and adequate liquidity profile.

Detailed description of the key rating drivers:

Key strengths

Ring fencing of cash flows for deployed strategies with utilisation of funds largely in marginable high-quality assets

The proceeds from the issue of the PP-MLDs for equity absolute return (EQAR) and commodity absolute return (CAR) strategies, together with the earnings thereon, will be ring-fenced. The issuer cannot utilise the same for other business operations. The proceeds will be invested in highly liquid securities like government securities (G-Secs), reverse repo, certificates of deposit (CDs), liquid mutual funds (MFs), and similar assets. These will be pledged with the broker as to serve as margin for taking exposures in strategies managed by AAFSPL. The MLDs are backed by the investments made by the company using these funds, all within a secured ring-fenced framework.

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

Well-defined payment structure of PP-MLD and deployment of funds with the buffer of premium and undistributed return from the strategy / ring-fenced assets
The current structure followed by the group is to issue a PP-MLD through the non-banking financial company (NBFC) route to investors. Each PP-MLD issuance is for a specific strategy (currently EQAR and CAR). The proceeds from the issuance are secured against investments made by the company using such proceeds through the ring-fenced structure. The PP-MLD carry an interest rate, which is linked to the underlying investment strategy over the tenure of debentures.

The investors will get full returns if the returns are less than the hurdle rate as defined; and in case of returns greater than the hurdle rate, excess returns will be divided between investors and the NBFC as per the agreed mechanism. The PP-MLDs are issued at a premium (currently 18%) and the income from strategy will get accrued every year. The quantum of the premium that will be returned to the investors is a function of the profit or loss generated by the underlying strategy. Any losses in the underlying strategy will be first set off from the undistributed profits from previous periods, the returns generated on the investments kept as margin money, and the premium received on the proposed issuance of the PP-MLDs with general recourse to other assets of AAFSPL. The interest to investors along with the principal is paid at maturity, while the interest or fees are accruing to the NBFC on an annual basis, with no claw-back provision. The PP-MLD has a quarterly put or call option, and in case of sustained losses, the investors are likely to exercise the put option and exit.

Experienced fund managers in capital markets with support from the parent
Naresh Kothari, who is the Executive Director at the AAFSPL, also serves as a director at the parent company, Alpha Holdings. He possesses over 25 years of experience in asset management, investment banking, equities, and institutional relations within the corporate sector in India. The EQAR strategy is managed by Prashant Mohanraj, a partner at Alpha Holdings. He has over 18 years of experience in capital markets, leads the equity business, and oversees the portfolio allocation and risk management at Alpha Holdings. The CAR strategy is managed by Mudit Singhania, another partner at Alpha Holdings, having over 17 years of experience and insights into commodity markets.

CARE Ratings Limited (CARE Ratings) believes that the ongoing managerial support from the parent company, Alpha Holdings, will be crucial for the performance of the strategies. Also, the ability of AAFSPL to retain its existing fund managers and partners and recruit new ones with sufficient experience in the capital and commodity markets will remain a key monitorable.

Consistent positive track record of strategies deployed
The company has not incurred quarterly loss while running this strategy in any of the calendar months in the last 12 months at the NBFC level and in the past five years at the parent level. To date, the EQAR and CAR strategies have been deployed. The EQAR strategy focusses on investing in equity strategies having low corelation to the market. For the last 26 quarters ending September 30, 2023, the EQAR strategy has not earned any negative returns in any quarter. The minimum and maximum returns earned in any quarter has been 0.1% and 10.3%, respectively.

The CAR strategy is focussed on investing in commodities having low co-relation to the market movements. For the last nine quarters ending September 30, 2023, the CAR strategy has not earned any negative returns in any quarter. The minimum and maximum returns earned in any quarter has been 2.3% and 11.00%, respectively. Although there may be monthly negative returns in some positions, the strategy has consistently recovered these losses, yielding a net positive return in every quarter.

According to CARE Ratings, the consistent performance of the strategies, and thus, the stable increase in the valuation of MLDs is vital for fulfilling the repayment obligations towards investors in the MLD, and is therefore, a key monitorable.

Adequate capitalisation with support from the parent
Considering the early scale of operations, the capital position is adequate. Currently, the entity maintains adequate capitalisation, evidenced by a capital adequacy ratio of 16.50% as on September 30, 2023 (compared with 21.32% as on March 31, 2023). Since the acquisition of the NBFC, the parent has injected approximately ₹150 crore of equity into the entity. There has been a recent infusion of ₹45 crore in FY23 and ₹103 crore in the preceding fiscal year. An additional ₹68.33 crore through compulsorily convertible preference shares (CCPS) was raised (of which ₹10 crore was raised during H1FY24). The entity also raised subordinate debt of around ₹186.35 crore in H1FY24 as part of Tier-2 capital. With an increase in the MLD issuances and the subsequent increase in assets, CARE Ratings expects the entity to infuse capital based on similar trends of past infusions. Primarily, the debt is raised at the NBFC level, while the holding company is predominantly capitalised through its net worth. As a result, the gearing ratio at the parent level on a consolidated basis stood at 2.80x as on March 31, 2023 (compared with 2.85x in the previous year). This favourable gearing ratio provides a cushion for AAFSPL as it allows for potential support from the parent company in the event of capital stress.

The rating considers the steady capital infusion by the parent, Alpha Holdings, in the event the capital adequacy of the company approaches near regulatory requirement. The inability of the entity to raise capital through the parent or externally to maintain the regulatory requirement is a key rating sensitivity.

Key weaknesses

While the strategy has elements of hedging, the returns are generated through investing in capital markets which are inherently volatile

While strategies have been deployed at the NBFC level since March 2022, the parent entity has an experience of dealing in various strategies, including similar equity-based strategies since 2017. Although the deployed strategies have demonstrated stable and consistent performance so far, it is important to acknowledge the inherent market risk associated with these strategies. The returns achieved in the past may not necessarily continue in the future, as market conditions and dynamics can evolve over time. CARE Ratings believes that it is essential for the entity to maintain a significant reliance on non-directional or delta neutral strategies and employ adequate risk management practices to ensure the continuation of satisfactory performance.

Key man risk in terms of managing or adjusting strategies

The loss or resignation of a key person such as the founder or an experienced fund manager handling the EQAR and CAR strategies can have a negative impact on the business. However, the key managerial persons and fund managers are the shareholders and partners in the organisation, thus reducing the key man risk. The fund manager looks after the overall portfolio level risk. In addition, all the strategies have their individual heads and senior portfolio managers, who look after the sub strategy and their own book, whereby the key man risk is diversified. There are around 10-25 people under each fund manager, which creates an ecosystem for new leadership.

Exposure to regulatory, IT, and operational risk

Having robust IT systems are a must for effective risk management, which enable companies to reduce the transactional, compliance, and operational risks. The operational risk can result from a variety of factors, including failure to obtain proper internal authorisations, improperly documented transactions, failure of information security procedures, computer systems, software, delays in placing orders, fraud, inadequate training, and employee errors. The fund managers largely look after risk management practices for their own strategies along with small team monitoring separately. A significant failure of security measures or operational procedures can have a material adverse effect on business and future financial performance.

As majority of the trades are through algorithm, it is vital to have effective IT and risk management systems in place. The current risk management practices are adequate as the trading desk head, who specialises in strategies, manages the risk and does not participate in trading. However, as the entity grows, CARE Ratings believes that it is vital to have a separate risk officer looking after the overall risk management practices and have a defined and detailed risk policy.

The financial and capital market industries are highly regulated. The market regulator has been closely monitoring the sector and has introduced various new regulations at regular intervals. The players are further subjected to regular audits by the exchanges, the Securities and Exchange Board of India (SEBI), and the Reserve Bank of India (RBI). CARE Ratings believes that any adverse changes in regulations or law concerning the capital markets, NBFC, or MLD, may impact the credit profile of the entity.

Limited operating performance track record and high leverage at NBFC level

AAFSPL's track record of operating businesses at the NBFC level is limited. In FY23, which marked the first full year of operations post issuance of the MLDs, the company achieved a high ROTA of 3.40%, which further improved to 5.91% (annualised basis) in H1FY24. Considering the historical performance of the strategies deployed across market cycles at the parent level as well as the expertise of fund managers with over a decade of experience in the capital market, CARE Ratings anticipates that the ROTA will sustain above 3.0% in the long run, with the possibility of an increase in operating expenses, as part compensation structure to traders is also linked to performance of strategy and increase in asset base. The profitability of AAFSPL is contingent upon the performance of the deployed strategies. In case profit from strategies crosses above the hurdle rate on an annual basis, the profit accrues to the NBFC with a watermark provision and no clawback.

The consistent performance of the strategies is the key to profitability, even for growth in the scale of operations, and is therefore, a key monitorable.

The adjusted net worth and gearing stood at ₹344.82 crore and 7.55x, respectively, as on September 30, 2023, as against ₹245.98 crore and 5.63x, respectively, as on March 31, 2023. The adjusted net worth in FY23 includes CCPS amounting to ₹58.33 crore subscribed by external investors and that during H1FY24 stood at ₹68.33 crore. The overall debt-to-equity increased due to raising

MLD and subordinate debt, and the same is yet to be fully utilised to earn income accruals. With an increase in accruals and thereby the net worth, CARE Ratings expects the gearing to come down below 6.5x by FY25. However, as the debt includes premium and accrued interest, which is to be returned only in case there is profit from underlying strategy and only face value is protected, such structure provides additional buffer to AAFSPL in terms of leverage and capital requirement.

Liquidity: Adequate

The liquidity of the entity is supported by the fact that coupons for investors are accrued annually, and both the interest and principal are to be paid only upon maturity or on exercise of the put option. Moreover, the underlying investment strategies in the equity and commodities markets are expected to exhibit a high level of liquidity, effectively mitigating any potential redemption pressure. As on September 30, 2023, the entity holds a cash and bank balance and liquid funds of ₹37.02 crore (including bank balance of ₹0.97 crore, CD or reverse repo of ₹30.98 crore, and liquid funds of ₹5.07 crore), in addition to a balance of ₹0.97 crore with brokers. The company's stated liquidity policy involves utilising G-sec and liquid funds as margin with brokers, while the entity's own net worth are majorly invested in liquid investments, further reinforcing its liquidity management approach. CARE Ratings expects that the bullet payment structure, combined with the liquidity of the underlying capital markets and underlying investments and the comfortable asset liability (ALM) position, ensures the adequacy of the entity's liquid position.

Applicable criteria

Policy on default recognition
Factoring Linkages Parent Sub JV Group
Financial Ratios - Financial Sector
Rating Outlook and Credit Watch
Market Linked Notes
Non Banking Financial Companies

About the company and industry

Industry classification

Macro-economic Indicator	Sector	Industry	Basic Industry
Financial services	Financial services	Finance	Non-banking financial company (NBFC)

AAFSPL is a systematically important non-deposit-taking NBFC that was acquired by Alpha Holdings in January 2019. Up to May 2023, AAFSPL operated under the name of Provincial Financial and Leasing Co Private Limited. Currently, AAFSPL's primary focus is on the deployment of strategies that were once managed under the structure of the parent company, and it is not involved in lending or financial services activities. AAFSPL functions as a wholly owned subsidiary of Alpha Holdings, which itself is owned 90.21% by the Naresh Kothari Family Trust. Alpha Holdings has been a pioneer in using the NBFC structure in raising PP-MLDs and returns linked with underlying strategies.

Alpha Holdings is an asset management firm founded in 2013, creating and managing proprietary strategies among various asset classes such as equity, debt, commodities, structured credit, along with advisory business to provide investment solutions for the clients. The objective of the institution is to generate better risk adjusted returns for the investors. Alpha Holdings manages assets under management (AUM) of around ₹5,298 crore (PY: ₹3,511 crore) as on March 31, 2023, through portfolio management services (PMS), alternative investment funds (AIFs), or the NBFC route, with more than 150 employees under its workforce. Under the NBFC route, AAFSPL manages ₹1,623 crore (PY: ₹976 crore), distributed among the EQAR and CAR strategies.

Brief Financials (₹ crore)	March 31, 2022 (A)	March 31, 2023 (A)	H1FY24 (UA)
Total operating income	1.85	281.19	319.84
PAT	0.04	43.82	69.03
Total assets	922.68	1,654.54	3,019.59
ROTA (%)	0.01	3.40	5.91 *

A: Audited; UA: Unaudited. Note: The above results are the latest financial results available.
*Annualised

Status of non-cooperation with previous CRA:
None

Any other information:
Not applicable

Rating history for the last three years: Please refer Annexure-2

Covenants of the rated instruments/facilities: Detailed explanation of the covenants of the rated instruments/facilities is given in Annexure-3

Complexity level of the various instruments rated: Annexure-4

Lender details: Annexure-5

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Principal protected-Market-linked debentures EQAR C	INE0L6807039	19-Aug-2022	Market Linked	03-Sep-2025	90.80	CARE PP-MLD BBB; Stable
Principal protected-Market-linked debentures EQAR D	INE0L6807054	18-Nov-2022	Market Linked	04-Dec-2025	207.00	CARE PP-MLD BBB; Stable
Principal protected-Market-linked debentures CAR C	INE0L6807104	28-Sep-23	Market Linked	13-Oct-23	87.95	CARE PP-MLD BBB; Stable
Principal protected-Market-linked debentures EQAR G	INE0L6807096	20-Oct-23	Market Linked	04-Nov-26	384.77	CARE PP-MLD BBB; Stable
Principal protected-Market-linked debentures (Proposed)	-	-	-	-	1229.48	CARE PP-MLD BBB; Stable

Annexure-2: Rating history for the last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2023-2024	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021
1	Debentures-Market-linked debentures	LT*	1000.00	CARE PP-MLD BBB; Stable	1)CARE PP-MLD BBB; Stable (08-Sep-23)	-	-	-
2	Debentures-Market-linked debentures	LT*	1000.00	CARE PP-MLD BBB; Stable				

*Long term.

Annexure-3: Detailed explanation of the covenants of the rated instruments/facilities

Not applicable

Annexure-4: Complexity level of the various instruments rated

Sr. No.	Name of the Instrument	Complexity Level
1	Debentures-Market-linked debentures	Highly complex

Annexure-5: Lender details

To view the lender wise details of bank facilities please click here

Note on the complexity levels of the rated instruments: CARE Ratings has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

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About us:
Established in 1993, CARE Ratings is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India, it has been acknowledged as an External Credit Assessment Institution by the RBI. With an equitable position in the Indian capital market, CARE Ratings provides a wide array of credit rating services that help corporates raise capital and enable investors to make informed decisions. With an established track record of rating companies over almost three decades, CARE Ratings follows a robust and transparent rating process that leverages its domain and analytical expertise, backed by the methodologies congruent with the international best practices. CARE Ratings has played a pivotal role in developing bank debt and capital market instruments, including commercial papers, corporate bonds and debentures, and structured credit.

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