January 11, 2024

Shriram Finance Limited: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fixed deposit programme	-	-	[ICRA]AA+ (Stable); reaffirmed
Non-convertible debenture programme	1,025.0	1,025.0	[ICRA]AA+ (Stable); reaffirmed
Total	**1,025.0**	**1,025.0**	

**Instrument details are provided in Annexure I*

Rationale

ICRA has reaffirmed the rating outstanding for the various borrowing programmes of Shriram Finance Limited [SFL; erstwhile Shriram Transport Finance Company Limited (STFC)]. The rating continues to factor in SFL's leadership position in the preowned commercial vehicle (CV) financing segment with a long-standing track record, established brand, strong customer reach and granular retail loan book. Also, the merger with Shriram City Union Finance Limited (SCUF) has resulted in a diversification in SFL's product offering, which now includes vehicle finance, small enterprise loans, personal loans, auto loans, two-wheeler (2W) finance, gold loans, loan against property (LAP) and housing finance (through the subsidiary – Shriram Housing Finance Limited). The merger also provides SFL access to a larger customer base and the chance to explore cross-selling opportunities, besides widening the reach of its relatively less penetrated products in newer geographies. The rating also considers the merged entity's track record of healthy profitability, notwithstanding intermittent pressures amid a challenging environment, and its comfortable capitalisation profile. As of September 30, 2023, SFL's consolidated net worth[1] stood at about Rs. 44,872 crore with a managed gearing[2] of 4.0 times and a capital adequacy ratio of 22.2% (Tier I: 21.1%).

Given the exposure to the high-yielding borrower segment with modest credit profiles, the overall asset quality remains moderate, though the same is improving. SFL's consolidated gross and net stage 3 assets declined to 5.6% and 2.7%, respectively, as on September 30, 2023 (Standalone 5.8% and 2.8%, respectively, as on September 30, 2023), from 6.0% and 3.1%, respectively, as on March 31, 2023 (Standalone 6.2% and 3.2%, respectively as on March 31, 2023). Also, given the reported improvement in the asset quality indicators, the merged entity's credit cost has been moderating and was estimated at 1.6% of AMA in H1 FY2024 (1.8% of AMA in FY2023) compared to the 3-year average of 2.4% for STFC in the preceding fiscals. The company has demonstrated a track record of reporting a swift recovery in its collections and delinquencies through cycles, though the asset quality metrics would remain a key monitorable.

SFL has a track record of raising retail borrowings, besides tapping funds from a diverse set of investors. This has facilitated a diversified borrowing mix for supporting the large-scale operations and borrowing programme. However, the borrowing cost has remained relatively higher than the peers with instances of adverse fluctuations in yields. In this regard, SFL's sustained ability to mobilise funds from different sources at competitive rates remains monitorable.

The Stable outlook on the [ICRA]AA+ rating reflects ICRA's expectation that SFL's strong market position in the preowned CV financing segment will continue to result in a steady growth trajectory and healthy profitability profile. This, coupled with prudent capitalisation, will continue to support the credit profile despite the moderate asset quality.

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[1] *Adjusted for goodwill of Rs. 1,741 crore and including non-controlling interest of Rs. 307 crore*

[2] *Managed gearing includes assigned portfolio as debt*

Key rating drivers and their description

Credit strengths

Diversified product offerings with leadership position in preowned CV financing segment – SFL is one of the largest retail non-banking financial companies (NBFCs) with consolidated assets under management (AUM) of about Rs. 2,13,457 crore as of September 30, 2023. It is the largest player in the preowned CV financing segment in the country with a dominant market position. The company's proven track record, along with its well-established franchise (3,683 branches and rural centres as on September 30, 2023), results in strong customer reach and a granular retail loan book. Moreover, the merger has resulted in a diversification in SFL's product offering, which now includes CV financing (73%), small enterprise loans (10%), and 2W finance (5%) with auto loan, personal loan, gold loan, LAP and housing finance (through its subsidiary) accounting for the balance.

Pre-merger, SFL had a pan-India presence in the CV finance business while the other offerings through SCUF were largely concentrated in the southern states of India. The merger provides SFL access to a larger customer base and the chance to explore cross-selling opportunities, besides widening the reach of relatively less penetrated products in newer geographies. While the share of other products in the AUM will increase over the medium term, SFL is expected to maintain its competitive position in the CV segment.

Healthy profitability – Notwithstanding the inherent riskiness of the target customer segment, SFL is expected to maintain healthy yields and lending spreads, commensurate with the underlying credit risk. With the merger leading to the addition of the relatively higher-yielding portfolio of erstwhile SCUF, the earnings profile has improved. The company reported an estimated return of 2.8% on average managed assets (AMA) in FY2023 compared to 2.0% in FY2022. The earnings profile has improved further in the current fiscal with an annualised return of 3.0% on AMA. SFL was able to maintain a net interest margin (NIM) of 7.8% of AMA in H1 FY2024 compared to the estimated NIM of 7.7% in FY2023 despite the increase in the cost of funds. Also, given the reported improvement in the asset quality indicators, the merged entity's credit cost has been moderating and was estimated at 1.6% of AMA in H1 FY2024 (1.8% of AMA in FY2023) compared to the 3-year average of 2.4% for STFC in the preceding fiscals. Further, the operating efficiency is expected to improve gradually as the company continues to increase its scale of operations. Overall, SFL is expected to maintain a healthy profitability profile.

Comfortable capitalisation – SFL's capitalisation profile is comfortable with a reported consolidated net worth of Rs. 44,872 crore, a managed gearing of 4.0 times and a capital adequacy ratio of 22.2% (Tier I: 21.1%). Given the expected growth trajectory and the satisfactory pace of internal capital generation, the capitalisation is expected to remain at a reasonable level with a comfortable cushion over the regulatory minimum, provided SFL is able to continue controlling fresh slippages and credit costs.

Credit challenges

Modest borrower profile and moderate asset quality – SFL's target customers primarily comprise the high-yielding borrower segment with modest credit profiles. These customers generally have a limited credit history and restricted buffer to absorb income shocks. Hence, the inherent credit risk in the portfolio is high. The same has been reflected in the moderate asset quality over the years. Consequently, SFL's asset quality indicators also remain moderate, but improving, with consolidated gross and net stage 3 assets of 5.6% and 2.7%, respectively, as on September 30, 2023 (Standalone 5.8% and 2.8%, respectively, as on September 30, 2023), compared to 6.0% and 3.1%, respectively, as on March 31, 2023 (Standalone 6.2% and 3.2%, respectively as on March 31, 2023). The company has demonstrated a track record of reporting a swift recovery in its collections and delinquencies through cycles, though the asset quality metrics would remain a key monitorable.

Relatively modest borrowing profile, notwithstanding established track record of raising funds from diverse sources – The company's borrowing cost has remained relatively higher than the peers with instances of adverse fluctuations in yields. In this regard, SFL's sustained ability to mobilise funds from different sources at competitive rates remains monitorable. Nevertheless, ICRA takes cognisance of the company's track record of raising retail borrowings, besides tapping funds from a diverse set of investors, which has supported its large-scale operations and borrowing programme. As on September 30, 2023, SFL's on-balance sheet borrowings exceeded Rs. 1,65,000 crore and are estimated to have primarily comprised non-convertible debentures (NCDs; 17%), term loans (25%), public deposits (24%), external commercial borrowings (ECBs; 13%), and securitisation (15%).

Environmental and social risks

Given the service-oriented business of SFL, its direct exposure to environmental risks as well as those emanating from regulations or policy changes is not material. However, the residual value of the security could reduce in case of policy changes, such as incremental rulings on the reduction in the operating life of CVs, thereby impacting the profitability. Further, there is increasing interest from policymakers towards identifying the exposure of financing companies to carbon emissions through their financing activities. However, this process is in an early stage and ICRA expects any adverse implications to manifest only over a longer time horizon, giving financing companies adequate time to adapt and minimise the credit implications.

Exposure to social risks is low for a financial institution like SFL. SFL serves the financing needs of a relatively underserved borrower category, which supports social inclusion and economic development. ICRA notes that a large portion of SFL's portfolio qualifies for priority sector lending, which augurs well for its ability to do securitisation transactions. Moreover, the company has demonstrated its ability to tap resources from overseas markets/impact investors through social bond issuances.

Liquidity position: Adequate

The company had lien-free on-balance sheet liquidity of Rs. 15,627 crore, as on September 30, 2023, and its liquidity profile is further supported by the availability of unutilised funding lines. The liquidity coverage ratio of 220% for the quarter ended September 30, 2023 was well above the regulatory requirement. As on November 30, 2023, SFL's asset-liability maturity (ALM) profile was characterised by positive cumulative mismatches across the near-term and medium-term maturity buckets, supported by the relatively comfortable matching of the average tenor of the assets and liabilities.

Rating sensitivities

Positive factors – An improvement in portfolio diversification and a better asset quality trajectory (gross stage 3 assets below 5%), resulting in a sustained improvement in the solvency and profitability indicators while maintaining adequate capitalisation, could positively impact the rating.

Negative factors – A deterioration in the asset quality, leading to the sustained weakening of the solvency and/or profitability, could negatively impact the credit rating. A significant weakening in the capital adequacy would also exert pressure on the rating.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Rating Methodology for Non-banking Finance Companies
Parent/Group support	Not applicable
Consolidation/Standalone	Consolidated

About the company

Shriram Finance Limited [SFL; erstwhile Shriram Transport Finance Company Limited (STFC)], incorporated in 1979, is a part of the Shriram Group of companies and an upper layer NBFC. Based on the National Company Law Tribunal (NCLT) order dated November 14, 2022, the operations of Shriram City Union Finance Limited (SCUF) and Shriram Capital Limited were merged with STFC and STFC was rechristened Shriram Finance Limited on November 30, 2022.

SFL enjoys a leadership position in preowned commercial vehicle finance and has a pan-India presence with 3,683 branches and other offices. As of September 30, 2023, SFL had an AUM (consolidated) of Rs. 2.1 lakh crore comprising commercial vehicle finance (46%), passenger vehicle finance (19%), construction equipment and farm equipment finance (9%), small and medium-sized enterprise (SME) lending (10%), personal loans (4%), gold loans (3%) two-wheeler loans (5%) and housing loans (5%; through its subsidiary Shriram Housing Finance Limited).

Key financial indicators

Shriram Finance Limited (consolidated)	FY2022	FY2023	H1 FY2024
Total income	19,274	30,508	17,189
PAT	2,721	6,011	3,500
Total managed assets	1,52,742	2,23,769	2,39,003
Return on managed assets	1.9%	2.8%	3.0%
Managed gearing (times)	4.5	4.0	4.0
Gross stage 3 assets	7.1%	6.0%	5.6%
CRAR	23.0%	22.6%	22.2%

Source: Company, ICRA Research; All ratios as per ICRA's calculations; Amounts in Rs. crore
Total managed assets = Total assets + Impairment allowance + Direct assignments – Goodwill; Managed gearing includes direct assignment as debt
With the scheme of arrangement and amalgamation of STFC, SCUF and Shriram Capital Limited becoming effective, figures for the year ended March 31, 2023 are not comparable with the figures for the year ended March 31, 2022

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2024)				Chronology of Rating History for the Past 3 Years					
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Jan 11, 2024	Date & Rating in FY2023			Date & Rating in FY2022		Date & Rating in FY2021
						Jan 12, 2023	Sep 30, 2022	Jun 17, 2022	Dec 21, 2021	Jun 22, 2021	May 26, 2020
1	Fixed deposit programme	Long term	-	-	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	MAA+ (Stable)	MAA+ (Stable)	MAA+ (Stable)
2	NCD programme	Long term	525.0	415.0	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	-	-	-	-	-
3	NCD programme	Long term	500.0	0.0	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	-	-		-

Source: ICRA Research

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fixed deposit programme	Very Simple
NCD programme	Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate / Yield	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Fixed deposit programme**	NA	NA	NA	NA	[ICRA]AA+ (Stable)
INE722A07AW2*	**NCD programme**	Jul 23, 2021	8.25%	Jul 23, 2024	50.0	[ICRA]AA+ (Stable)
INE722A07AX0*	**NCD programme**	Jul 23, 2021	8.75%	Jul 23, 2031	100.0	[ICRA]AA+ (Stable)
INE722A07AV4*	**NCD programme**	Jun 23, 2021	9.00%	Jun 23, 2031	100.0	[ICRA]AA+ (Stable)
INE722A07AQ4*	**NCD programme**	Feb 22, 2021	9.50%	Feb 21, 2031	75.0	[ICRA]AA+ (Stable)
INE722A07AP6*	**NCD programme**	Feb 22, 2021	9.25%	Feb 22, 2030	50.0	[ICRA]AA+ (Stable)
INE772A07AN1*	**NCD programme**	Feb 08, 2021	9.25%	Feb 08, 2030	10.0	[ICRA]AA+ (Stable)
INE772A07AO9*	**NCD programme**	Feb 08, 2021	9.50%	Feb 07, 2031	30.0	[ICRA]AA+ (Stable)
NA	**NCD programme (yet to be placed)**	-	-	-	610.0	[ICRA]AA+ (Stable)

*Source: Company; *ISIN transferred from SCUF; NCD – Non-convertible debentures; NA – Not applicable*

Annexure II: List of entities considered for consolidated analysis

Company Name	Ownership (Mar 31, 2023)	Consolidation Approach
Shriram Finance Limited	100.00% (rated entity)	Full Consolidation
Shriram Housing Finance Limited	84.82%	Full Consolidation
Shriram Automall Limited	44.56%	Equity Method

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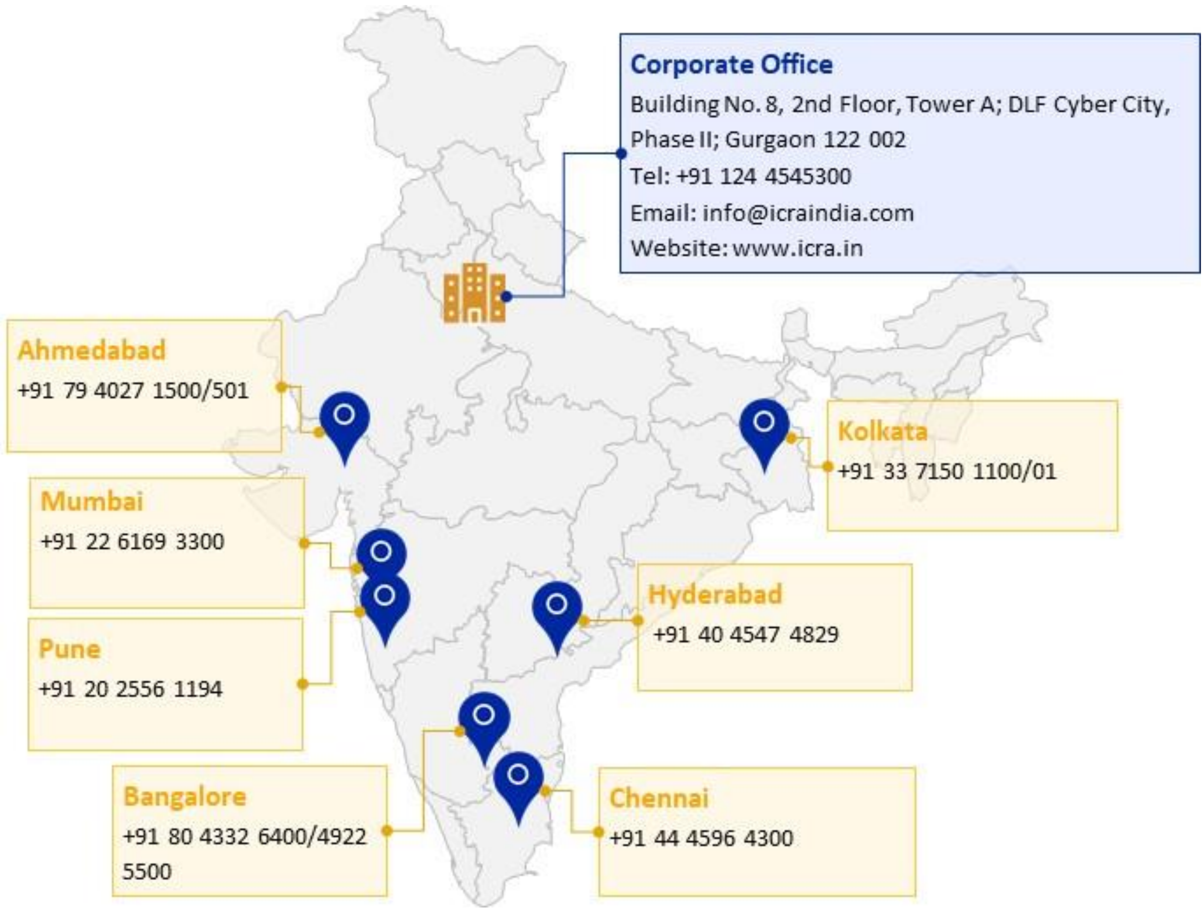

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