

September 08, 2021

## Ess Kay Fincorp Limited: [ICRA]A (Stable) rating assigned

### Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based Term Loan	175.0	[ICRA]A (Stable); Assigned

\*Instrument details are provided in Annexure-1

### Rationale

The assigned rating considers Ess Kay Fincorp Limited's (Ess Kay) healthy capitalisation; its established franchise in Rajasthan with good knowledge of and track record in the local market; track-record of adequate profitability, notwithstanding the ongoing pressures; and the adequately diversified borrowing profile for the scale of operations. While ICRA believes that the asset quality, especially for select asset segments, would weaken due to the likely impact of the pandemic, it is noted that Ess Kay has, over the years, demonstrated satisfactory asset quality trajectory. With reference to the impact of the Covid-19 pandemic, the Company has managed to keep asset quality metrics under control as reflected by gross stage 3 % of 5.3% as on June 30, 2021 compared to 4.0% in March 2020. This is despite the company not having undertaken any disbursements under Emergency Credit Line Guarantee Scheme (ECLGS) and extended relief to only 0.4% of AUM through restructuring up till March 2021. Further, the increased provision cover on the overall book (5.0% as on June 30, 2021 vis-à-vis 4.0% as on March 31, 2020) provides comfort. ICRA also notes that the collections recovered post the initial dip Q1FY2022 as reflected by about 99% collection efficiency (excluding prepayments) in July 2021 compared to collection efficiency of 89% in May 2021.

The rating is, however, constrained by Ess Kay's modest scale, though improving, with high geographical and product concentration. While the company has, over the years, expanded its reach to seven states, the home state of Rajasthan still accounts for 66% of the portfolio as on March 31, 2021 (though lower than 94% six years ago). Further, as the strong growth has been consistently accounted for by the vehicle loan segment, its share in Ess Kay's AUM remains about 89%. Also, while the share of the used vehicle segment has moderated to 73% of the AUM in March 2021, it remains the largest business area for the company. As Ess Kay primarily operates in the used vehicle financing segment, its customers are mostly first-time borrowers, single vehicle and small business owners, who are susceptible to economic shocks and have limited income buffers. Thus, the delinquencies in the softer buckets could remain volatile for the company.

### Key rating drivers and their description

#### Credit strengths

**Healthy capitalisation** – Ess Kay's capitalisation stands augmented, led by the equity infusion of Rs. 337 crore in Q1 FY2022. Following this, its net worth has increased to about Rs. 1,330 crore as on June 30, 2021 from Rs. 879 crore in March 2020 and Rs. 563 crore in March 2019. Thus, while the capitalisation had moderated in FY2017 (gearing of 7.2x in March 2017), multiple rounds of equity raises in the past four years have facilitated a sustained improvement in the leverage to a comfortable level with gearing of 2.5x as on June 30, 2021. This provides cushion for absorbing asset side shocks, if any, emanating from the ongoing challenging operating environment. Besides, this puts the company in a good position for the medium term with sufficient headroom for growth. Given the augmented net owned funds, Ess Kay's capitalisation, in terms of capital adequacy, also stands improved with CRAR of over 35% as on June 30, 2021. However, ICRA notes that Ess Kay has outlined a road map for strong growth (CAGR of 30%+ for over the medium term), which is likely to increase the leverage from current levels. In this regard, growth capital from investors is expected to be forthcoming, if required to maintain prudent capitalisation.

**Good knowledge of and track record in the local market; established franchise in Rajasthan** – Ess Kay is promoted by Mr. Rajendra Setia, who along with his family members holds 40% equity share in the company (as on June 30, 2021). The company,

under the leadership of Mr. Setia, has a long track-record of over two decades in the local vehicle-financing market, whereby it has established large retail franchise in Rajasthan and gained good understanding of the local market. Also, the company is backed by established equity investors such as Norwest Venture Partners X – Mauritius (Norwest), TPG Capital, Baring Private Equity India AIF and Evolvence India (Evolvence) which together hold 59% equity shareholding as of June 30, 2021. Ess Kay's BoD comprises of two promoter directors, two independent directors and two investor nominee directors.

**Track-record of adequate profitability, notwithstanding the ongoing pressures** - Given the weak target borrower profile, Ess Kay commands high lending yields. While the yields have softened over past few years led by diversification into new vehicle and SME loan segment and decline in systemic rates, nonetheless they remain high as reflected ~20% yield on average loans during FY2021 with five-year average of about 22%. Further, with an improvement in the company's competitive position and the systemic decline in interest rates, its cost of funds has also improved from about 12% in FY2017 to 10.2% in FY2021. As a result, its overall lending spreads and net interest margin (NIM) have remained buoyant in a healthy range. So, while the company's operating expenses remain relatively high at 4.2% of managed assets for FY2021 (despite significant improvement in recent years) due to the cost intensive business model and rapid branch expansion, it has maintained a track-record of healthy profitability with five-year average (FY2017-FY2021) ROA of 2.5% and ROE of 14%. Even in FY2021, despite the challenging operating environment, the company achieved ROA of 2.2% and ROE of 9.8%. ICRA however notes that profitability may remain under pressure in FY2022, given the likelihood of adverse asset quality trajectory amid the challenging operating environment. Nevertheless, as the operating expenses stabilise with economies of scale, the profitability is expected to improve, provided Ess Kay can maintain good control on fresh slippages over the medium term.

**Adequately diversified borrowing profile for the scale of operations** – Ess Kay's borrowing profile is adequately diversified, with sources including debt markets (~46% of the total borrowings as on March 31, 2021), term loans and working capital lines from banks (30%), and term loans from FIs (~9%). As of March 31, 2021, the company had borrowing relationships with over three dozen financial institutions. It also continues to raise funds through securitisation/direct assignments, with such on-balance sheet and off-balance sheet borrowings amounting to 14% of the total borrowings, as of March 31, 2021. Also, with an improvement in its competitive position and a systemic decline in interest rates, KFIL's cost of funds stood improved at 10.2% in FY2021 compared to 11.2% in FY2020. Cost of incremental borrowings in FY2021 was 9.7%.

## Credit challenges

**Exposure to relatively weak borrower profiles, which are susceptible to economic shocks and have limited income buffers** – As Ess Kay primarily operates in the used vehicle financing segment, its customers are mostly first-time borrowers, single vehicle and small business owners, who are susceptible to economic shocks and have limited income buffers. Thus, the delinquencies in the softer buckets could remain volatile for the company. Nevertheless, while ICRA believes that the asset quality, especially for select asset segments, would weaken due to the likely impact of the pandemic, it is noted that Ess Kay has, over the years, demonstrated satisfactory asset quality trajectory (excluding the adverse impact witnessed during the demonetisation drive). While the 30+dpd remains high (19% as on June 30, 2021 with five-year average of 20%) due to the inherently weak credit profiles of borrowers and the nature of business, the 90+ dpd has remained range-bound with an average of about 5% during this period and 5.4% as on June 30, 2021. ICRA notes that Ess Kay didn't undertake any disbursements under Emergency Credit Line Guarantee Scheme (ECLGS) and extended relief to only 0.4% of AUM through restructuring uptill March 2021. Thus, optical impact of relief availed by borrowers on reported asset quality has been limited. Despite this, it is noted that Ess Kay kept asset quality metrics under good control as reflected by gross stage 3 % of 5.3% as on June 30, 2021 compared to 4.0% in March 2021.

Further, the increased provision cover on the overall book (5.0% as on June 30, 2021 vis-à-vis 4.0% as on March 31, 2020) provides comfort. ICRA also notes that the collections recovered post the initial dip Q1FY2022 as reflected by about 99% collection efficiency (excluding prepayments) in July 2021 compared to collection efficiency of 89% in May 2021. Going forward, the company's ability to control fresh slippages will remain a key monitorable, especially given the ongoing challenging operating environment. In this regard, it is however noted that the company's healthy capitalisation level provides adequate cushion for absorbing asset side shocks, if any.

**High geographical and product concentration, though improving** – Notwithstanding the strong scale-up achieved by Ess Kay over past few years, its scale of operations remains modest. Further, it has, over the years, expanded its reach to seven states in India through a network of about 359 branches as on March 31, 2021, it remains a regional player with the home state of Rajasthan still accounting for 66% of the portfolio as on March 31, 2021. Nevertheless, single state concentration has moderated to 66% as of March 2021 compared to 94% share of Rajasthan in the company’s portfolio in Mar 2014. The balance lending portfolio is primarily in the neighbouring states of Gujarat, Maharashtra, Madhya Pradesh and Punjab & Haryana. Moreover, as the strong growth has been consistently accounted for by the vehicle loan segment, its share in Ess Kay’s AUM remains about 89% (though lower than 98% four years ago). Also, while the share of the used vehicle segment has moderated to 73% of the AUM in March 2021, it remains the largest business area for the company. Nevertheless, ICRA notes that Ess Kay has gained traction in the MSME lending space to cater to a similar category of low- and middle-income group borrowers, and its share in AUM has increased to about 11%.

### Liquidity position: Adequate

The short to medium tenure of the loans extended by Ess Kay (with average tenure of about 3.5 to 4 years) match well with the weighted average tenure of the term facilities availed by the company and reflects positively in the asset liability maturity (ALM) profile. Thus, Ess Kay's ALM profile, in the normal course of business, is characterised by positive cumulative mismatches across all buckets up to 1 year. Further, while the collections dipped in Q1FY2022 due to the impact of the second wave of the pandemic, it is noted that the company was carrying sufficient liquidity back-up as on July 31, 2021. The on-balance sheet liquidity of Rs. 820 crore (cash and liquid investments) coupled with undrawn working capital lines of about Rs. 57 crore is adequate to manage the debt servicing burden (both, principal and interest) of about Rs. 565 crore upto December 2021. ICRA also notes that the collections recovered post the initial dip Q1FY2022 as reflected by about 99% collection efficiency (excluding prepayments) in July 2021 compared to collection efficiency of 89% in May 2021.

### Rating sensitivities

**Positive factors** –The rating could be upgraded on a sustained improvement in the profitability (RoA >3.0%) and competitive position through continued growth, while maintaining comfortable asset quality and capitalisation level.

**Negative factors** – Pressure on the rating could emerge on a significant deterioration in the asset quality and/or the capitalisation profile (gearing worsening to over 4 times on a sustained basis) or weakening in the liquidity and earnings profile of the Issuer.

### Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	<a href="#">ICRA’s Credit Rating Methodology for Non-Banking Finance Companies</a>
Parent/Group Support	Not Applicable
Consolidation/Standalone	Standalone

## About the company

Incorporated in 1994, Ess Kay Fincorp Limited (Ess Kay) is a Jaipur (Rajasthan) headquartered non-banking finance company (NBFC) registered with the Reserve Bank of India (RBI). It primarily finances used light commercial vehicles, multi-utility vehicles, cars, tractors and two-wheelers. It also advances SME loans. Ess Kay operates through a network of 359 branches as on March 31, 2021 across seven states of Rajasthan, Gujarat, Maharashtra, Madhya Pradesh, Punjab, Haryana, and Chhattisgarh, though concentration towards Rajasthan remains high with about 66% share in portfolio. As of June 30, 2021, assets under its management stood at Rs. 3,406 crore.

The promoter group viz. Mr. Rajendra Setia and his family members held 40% equity share in the company as on June 30, 2021. Other key equity investors include Northwest Venture Partners, TPG Capital, Evolve and Barings India with equity shareholding of 25.11%, 19.42%, 8.11% and 5.43%, respectively, as of June 30, 2021.

## Key financial indicators (audited)

Amounts in Rs. crore	FY2019	FY2020	FY2021	Q1 FY2022
PAT	63	79	91	25
Net Worth	563	879	971	1,330
Gross Loan Book	1,810	2,948	3,422	3,455
Total Assets	2,254	3,644	4,465	4,848
Return on Average Assets	3.7%	2.7%	2.2%	2.2%
Return on Average Equity	16.6%	10.9%	9.8%	8.7%
Gearing (times)	2.8	2.9	3.4	2.5
CRAR (%)	34.1%	31.7%	27.7%	35.0%
Gross Stage 3 (%)	4.2%	4.0%	4.1%	5.3%
Net Stage 3 (%)	2.6%	2.4%	1.9%	2.9%

Source: Ess Kay, ICRA research

**Status of non-cooperation with previous CRA: Not applicable**

**Any other information: None**

## Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Sep 08, 2021	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
1	Long-term Fund-based Term Loan	Long Term	175.0	175.0*	[ICRA]A (Stable)	-	-	-

Source: ICRA research; \*As of August 28, 2021

## Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term Fund-based Term Loan	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: [www.icra.in](http://www.icra.in)

**Annexure-1: Instrument details**

ISIN/ Bank Name	Instrument Name	Date of Issuance/ Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
SIDBI	Term Loan	Jul 02, 2021	NA	Jun 10, 2022	100.0	[ICRA]A (Stable)
Kotak Mahindra Bank	Term Loan	Aug 05, 2021	NA	Feb 25, 2025	50.0	[ICRA]A (Stable)
Karnataka Bank	Term Loan	Aug 04, 2021	NA	Jun 27, 2024	25.0	[ICRA]A (Stable)

Source: ICRA research

**Annexure-2: List of entities considered for consolidated analysis: Not Applicable**

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### Branches



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