

November 19, 2021

SK Finance Limited (erstwhile Ess Kay Fincorp Limited): Rating reaffirmed for NCD programme

Summary of rating action

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible Debentures (NCDs)*	120.83	104.17	[ICRA]AA+(CE) (Stable); reaffirmed
Principal Protected Market Linked Debentures (PP-MLD)*	125.00	125.00	PP-MLD [ICRA]AA+(CE) (Stable); outstanding
PP-MLD*	50.90	50.90	PP-MLD [ICRA]AA+(CE) (Stable); outstanding
LT-Market Linked Debentures	150.00	150.00	PP-MLD [ICRA]A (Stable); outstanding
Long-term Fund-based Term Loan	275.00	275.00	[ICRA]A (Stable); Outstanding
Total	721.73	705.07	

Rating Without Explicit Credit Enhancement	[ICRA]A
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*Instrument details are provided in Annexure-1

Note: The (CE) suffix mentioned alongside the rating symbol indicates that the rated instrument/facility is backed by some form of explicit credit enhancement. This rating is specific to the rated instrument/facility, its terms and structure and does not represent ICRA's opinion on the general credit quality of the entity concerned. The last row in the table above also captures ICRA's opinion on the rating without factoring in the explicit credit enhancement

Rationale

The rating action takes into account the structural features available in the transaction such that in the event of non-payment of its expected repayments by SK Finance Limited (SK/Issuer), the cover pool along with the cash collateral (CC) would be utilised to support the servicing of the rated instrument. The key structural features of the rated instrument are summarised below:

Instrument	Trust Name	Security Cover	Structural Feature
Rs. 104.17-crore NCDs	Vivriti Omega Trust II 2020	1.21x cover pool [^] and Rs. 6-crore CC	Pool has been assigned upfront to the trust; post trigger events, all collections from the cover pool along with the CC will be used to transfer to the Debenture Trustee of the NCDs

[^] The cover pool requirement is calculated on the outstanding principal

The ratings also draw comfort from SK's established presence in the used vehicle financing space and its stable asset quality despite the disruptions caused by the spread of the Covid-19 pandemic. Nonetheless, post any trigger event, the performance of the cover pool would be exposed to further disruptions that may arise due to the pandemic.

Structural details, adequacy of credit enhancement and salient features of rated instrument

ICRA has taken note of the recent amendment in the terms of the Rs. 150-crore NCDs issued in November 2020 (Rs. 104.17 crore outstanding). SK, with consent from the investor, has made the following changes to the terms of these NCDs:

- There will be no further assignment of loan contracts to the cover pool.
- As the cover pool will not be replenished with new contracts, SK will prepay such an amount on the NCDs every month to maintain the stipulated cover on the outstanding amount.
- Also, the prepayment will not impact the amortisation schedule of the NCDs, i.e. prepayments will be adjusted against last repayments.

There are no other changes in the transaction structure and the cover pool is now static in nature due to the above changes. Details on the structure (other than the changes highlighted above), adequacy of credit enhancement and salient features of the rated instrument is available in ICRA's previous rationale: [Click here](#)

Key rating drivers and their description

Credit strengths

Presence of cover pool and CC to support servicing of NCD facility in the event of non-payment by entity – The primary obligation of meeting the NCD payments [rated [ICRA]AA+(CE) (Stable)] is on SK. However, if SK does not meet the expected payment on the NCDs, the collections from the cover pool along with the CC will be available to the Debenture Trustee. The principal as well as the interest amount on the NCDs are promised to the NCD investors on the legal maturity date.

Credit enhancement in the form of over-collateralisation and CC – Credit enhancement is available in the form of over-collateralisation and CC, which act as a buffer if the collections in the cover pool decline.

Credit challenges

Portfolio remains exposed to high geographical concentration mix – Notwithstanding the strong scale-up achieved by SK over the past few years, its scale of operations remains modest. Further, it has, over the years, expanded its reach to 7 states in India through a network of about 359 branches as on March 31, 2021. However, 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 from 94% (share of Rajasthan in the company's portfolio) in March 2014. The balance lending portfolio is primarily in Chhattisgarh, Gujarat, Maharashtra, Madhya Pradesh and Punjab & Haryana.

Performance of the pool would be exposed to any prolonged economic slowdown caused by the pandemic – Borrowers are facing several challenges following the spread of Covid-19 throughout the country. These include the continuity of business operations and the possible adverse impact on the asset quality as cash flows and economic activity have slowed down. SK's ability to navigate through the adversity and manage the impact on its business growth and asset quality would remain critical from a rating perspective, going forward.

Liquidity position

For the [ICRA]AA+(CE) (Stable) rating for Rs. 104.17-crore NCDs: Strong

Both the principal and the interest amount on the NCDs are promised to the lender on the legal final maturity date subject to the non-occurrence of a trigger event. The cash flows from the cover pool, along with the CC, are expected to be comfortable to meet the debt servicing in the event that the entity is unable to meet the scheduled payments on the NCDs.

For the [ICRA]A (Stable) rating: Adequate

The short to medium tenure of the loans extended by SK (average tenure of about 3.5 to 4 years) matches 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, SK's ALM profile, in the normal course of business, is characterised by positive cumulative mismatches across all buckets up to 1 year.

Further, while collections dipped in Q1 FY2022 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) and the undrawn working capital lines of about Rs. 57 crore are adequate to manage the debt servicing burden (both principal and interest) of about Rs. 565 crore up to December 2021. ICRA also notes that collections recovered post the initial dip in Q1 FY2022 as reflected by the collection efficiency (excluding prepayments) of about 99% in July 2021 compared to 89% in May 2021.

Rating sensitivities

For the [ICRA]AA+(CE) (Stable) rating for Rs. 104.17-crore NCDs

Positive factors – The rating is unlikely to be upgraded.

Negative factors – The rating could be downgraded on non-adherence to the key transaction terms envisaged at the time of the rating. The rating could also come under pressure in case of a deterioration in SK's asset quality or credit profile.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Non-Banking Finance Companies Covered Bond Transactions
Parent/Group Support	Not Applicable
Consolidation/Standalone	Not Applicable

About the company

Incorporated in 1994, SK Finance Limited (SK/Ess Kay) is a Jaipur (Rajasthan) headquartered non-banking financial 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 small and medium enterprise (SME) loans. SK had a network of 359 branches as on March 31, 2021 across seven states (Rajasthan, Gujarat, Maharashtra, Madhya Pradesh, Punjab, Haryana, and Chhattisgarh). However, portfolio concentration remains high in Rajasthan with a share of about 66%. As of June 30, 2021, the assets under 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	FY2020	FY2021	H1 FY2022
PAT	79	91	59
Net Worth	879	971	1,364
Gross Loan Book	2,948	3,422	3,759
Total Assets	3,644	4,465	4,969
Return on Average Assets	2.7%	2.2%	2.5%
Return on Average Equity	10.9%	9.8%	10.1%
Gearing (times)	2.9	3.4	2.5
CRAR (%)	31.7%	27.7%	33.0%
Gross Stage 3 (%)	4.0%	4.1%	4.9%
Net Stage 3 (%)	2.4%	1.9%	2.4%

Source: Company, ICRA Research; All ratios as per ICRA calculations

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	Initial Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating		Date & Rating in FY2021						Date & Rating in FY2020	Date & Rating in FY2019
					Nov 19, 2021	Jul 30, 2021	Mar 18, 2021	Mar 10, 2021	Feb 4, 2021	Feb 1, 2021	Dec 2, 2020	Nov 19, 2020	-	-
1	NCD	Long term	150.00	104.17	[ICRA]AA+(CE) (Stable)	[ICRA]AA+(CE) (Stable)	-	-	[ICRA]AA+(CE) (Stable)	[ICRA]AA+(CE) (Stable)	[ICRA]AA+(CE) (Stable)	Provisional [ICRA]AA+(CE) (Stable)	-	-
2	PP-MLD	Long term	125.00	125.00	PP-MLD [ICRA]AA+(CE) (Stable)	PP-MLD [ICRA]AA+(CE) (Stable)	PP-MLD [ICRA]AA+(CE) (Stable)	Provisional PP-MLD [ICRA]AA+(CE) (Stable)	-	-	-	-	-	-
3	PP-MLD	Long term	50.90	50.90	PP-MLD [ICRA]AA+(CE) (Stable)	PP-MLD [ICRA]AA+(CE) (Stable)	-	-	PP-MLD [ICRA]AA+(CE) (Stable)	Provisional PP-MLD [ICRA]AA+(CE) (Stable)	-	-	-	-

For details on other ICRA-rated instruments of the company, refer to the rationales given [here](#)

Complexity level of the rated instrument

Transaction Name	Instrument	Complexity Indicator
Vivriti Omega Trust II 2020	Non-convertible Debentures (NCDs)	Highly Complex
Elements 2021 CE MLD	Principal Protected Market Linked Debentures (PP-MLD)	Highly Complex
Northern Arc 2021 CE MLD Hemera	Principal Protected Market Linked Debentures (PP-MLD)	Highly Complex

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

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE124N07507	NCD	Nov 19, 2020	9.80%	Nov 19, 2024	104.17	[ICRA]AA+(CE) (Stable)
INE124N07549	PP-MLD	Mar 09, 2021	8.90%*	Mar 09, 2026	125.00	PP-MLD [ICRA]AA+(CE) (Stable)
INE124N07523	PP-MLD	Jan 28, 2021	9.50%*	Jul 28, 2024	50.90	PP-MLD [ICRA]AA+(CE) (Stable)

* Additionally, step-up interest of 4.0% is applicable from date of issuance in case of trigger event

Source: Company

Annexure-2: List of entities considered for consolidated analysis

Not Applicable

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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