

January 31, 2022

SK Finance Limited (erstwhile Ess Kay Fincorp Limited): Rating upgraded to [ICRA]A(SO) for assignee payouts issued under a tractor loan securitisation transaction

Summary of rating action

Trust Name	Instrument*	Initial Rated Amount (Rs. crore)	Current Outstanding Amount after Dec-21 Payout (Rs. crore)	Rating Action
Ess Kay IB DA 2020	Assignee Payouts	100.00	42.30	[ICRA]A(SO); upgraded from [ICRA]A-(SO)

*Instrument details are provided in Annexure-1

Rationale

The assignee payouts are backed by tractor loan receivables originated by SK Finance Limited (SKFL). The rating upgrade is primarily due to the improvement in the credit profile of SKFL vis-à-vis at the time of the initial rating of the transaction {currently rated [ICRA]A (Stable)}. SKFL's guarantee acts as credit enhancement (CE) in the structure. Also, the high amortisation in the transaction has led to the marginal build-up of the CE cover over the future assignee payouts. The performance of the pool remains satisfactory with the delinquency levels remaining lower than ICRA's initial estimates despite the Covid-19 pandemic-induced disruptions. A summary of the performance of the pool till the November 2021 collection month (December 2021 payout) has been tabulated below.

Pool performance summary (after December 2021 payout month)

Parameter	Ess Kay IB Dec 20
Months Post Securitisation	13
Pool and Assignee Amortisation (as % of initial pool and assignee payout principal)	57.70%
Last 3 Months' Average Monthly Collection Efficiency ¹	102.68%
Cumulative Prepayment Rate	7.57%
Average Monthly Prepayment Rate	0.46%
Loss-cum-90+ dpd ² (% of initial pool)	1.79%
Loss-cum-180+ dpd ³ (% of initial pool)	0.99%
Cumulative Credit Collateral (CC) Utilisation ⁴	0.00%
Breakeven Collection Efficiency ⁵ for Assignee Payouts	72.39%
CC (% of balance pool)	7.10%
Excess Interest Spread (EIS; % of balance pool) for Assignee Payouts ⁶	16.51%

Key rating drivers

Credit strengths

- Improvement in credit profile of guarantor, i.e. SKFL, vis-à-vis at the time of initial rating of the transaction
- Healthy cumulative collection efficiency witnessed in the pool

¹ Average of (Total Current and Overdue collections for the month as a % of Total Billing for the month) for 3 months

² Inclusive of Unbilled and Overdue Principal portion of contracts delinquent for more than 90 days, as a % of Initial Pool Principal

³ Inclusive of Unbilled and Overdue Principal portion of contracts delinquent for more than 180 days, as a % of Initial Pool Principal

⁴ CC is available in the form of an unconditional and irrevocable guarantee from STFC

⁵ (Balance Cash flows payable to investor – CC available)/ Balance Pool Cash flows

⁶ (Pool Cash flows – Cash flows to Assignee)/ Pool Principal outstanding

- Marginal build-up in CE cover for future payouts

Credit challenges

- In the structure, the yield on the underlying pool of contracts is fixed while the assignee yield is linked to the assignee's MCLR, leading to interest rate risk in the structure
- Performance of the pool remains exposed to any disruptions caused by the pandemic

Description of key rating drivers highlighted above

The CC in the transaction is in the form of an unfunded CE facility provided by SKFL. There has been an improvement in the credit profile of SKFL vis-à-vis at the time of the initial rating of the transaction as evidenced by the company's healthy capitalisation and adequate profitability and asset quality, notwithstanding the Covid-related pressures.

The pool's performance has remained healthy with a cumulative collection efficiency of more than 95% from April 2021 to December 2021 (payout month) and there has been no instance of CC utilisation. Any shortfall in collections in the past was absorbed by the subordination/EIS in the structure with nil CC utilisation. The loss-cum-90+ days past due (dpd) was low at 1.79% after the December 2021 payout month. As per the transaction structure, on each payout date, 90% of the monthly billed principal is to be paid on an expected basis (interest is promised) and amount collected in excess of 90% of the pool billing is to be passed on to the originator every month. Hence, in spite of the high pool amortisation, there has been a marginal build-up in the credit enhancement cover for the balance tenure of the assignee payouts (subordination remains constant as a percentage of the pool principal).

Overall, the improvement in the credit profile of the guarantor and the CE available for meeting the balance payouts to the assignee investor is sufficient to upgrade the rating of the transaction. ICRA will continue to monitor the performance of the transaction as it would remain exposed to the impact of fresh disruptions in collection activities caused by the pandemic. Any further rating action will be based on the credit profile of the guarantor, the performance of the pool and the availability of CE relative to ICRA's expectations.

The assignment has been done under the Partial Credit Guarantee (PCG) Scheme offered by the Government of India (GoI) to public sector banks (PSBs). ICRA has not factored in the PCG while arriving at the rating.

Key rating assumptions

ICRA's cash flow modelling for the surveillance of asset-backed securitisation (ABS) transactions involves the simulation of potential delinquencies, losses (shortfall in principal collection during the balance tenor of the pool) and prepayments in the pool. The assumptions for the loss and coefficient of variation (CoV) are arrived at after taking into account the past performance of the originator's portfolio and the rated pools, as well as the performance and characteristics of the specific pool being evaluated. Additionally, the assumptions may be adjusted to factor in the current operating environment and any industry-specific factors that ICRA believes could impact the performance of the underlying pool of contracts.

After making these adjustments, the expected mean shortfall in principal collection during the tenure of the pool is estimated at 6.00-7.00% (on balance principal outstanding), with certain variability around it. The prepayment rate for the underlying pool is estimated at 6.0-9.0% per annum.

Liquidity position: Strong

As per the transaction structure, only the interest amount is promised to the assignee payout holders on a monthly basis while the principal amount is promised on the scheduled maturity date of the transaction. This imparts liquidity to the transaction in the interim period. The cash flows from the pool and the available CE are expected to be comfortable to meet the promised payouts to the assignee.

Rating sensitivities

Positive factors – The rating could be upgraded on the sustained strong collection performance of the underlying pool of contracts (monthly collection efficiency >95%), leading to lower-than-expected delinquency levels, and on a further increase in the cover available for future investor payouts from the CE and on an improvement in the credit profile of SKFL (guarantor).

Negative factors – The rating could be downgraded on account of the sustained weak collection performance of the underlying pool, leading to higher-than-expected delinquency levels and CE utilisation, or on a deterioration in the credit profile of SKFL.

Analytical approach

The rating action is based on the credit profile of the guarantor, performance of the pool till December 2021 (payout month), the present delinquency levels and the CE available in the pool, and the performance expected over the balance tenure of the pool.

Analytical Approach	Comments
Applicable Rating Methodologies	Rating Methodology for Securitisation Transactions
Parent/Group Support	Not Applicable
Consolidation/Standalone	Not Applicable

About the company

Incorporated in 1994, SK Finance Limited (SKFL) 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. SKFL 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)

Amount 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

S. No.	Trust Name	Current Rating (FY2022)				Chronology of Rating History for the Past 3 Years			
		Instrument	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in FY2022	Date & Rating in FY2021		Date & Rating in FY2020	Date & Rating in FY2019
					Jan 31, 2022	Jan 14, 2021	Oct 27, 2020		
1	Ess Kay IB DA 2020	Assignee Payouts	100.00	42.30	[ICRA]A(SO)	[ICRA]A-(SO)	Provisional [ICRA]A-(SO)	-	-

Complexity level of the rated instrument

Trust Name	Instrument	Complexity Indicator
Ess Kay IB DA 2020	Assignee Payouts	Moderately 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

Trust Name	Instrument	Date of Issuance / Sanction	Coupon Rate [^]	Maturity Date [*]	Amount Rated (Rs. crore)	Current Rating
Ess Kay IB DA 2020	Assignee Payouts	October 2020	9.35%	April 2025	42.30	[ICRA]A(SO)

[^] Floating rate linked to 1 year MCLR + 2.00%; yield will increase by 0.25% post PCG cover period

^{*} Scheduled maturity and average life at transaction initiation; may change on account of prepayment

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.

For more information, visit www.icra.in

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