June 17, 2022 (Revised)

Shriram Transport Finance Company Limited: Migration of rating outstanding on the medium-term scale to the long-term rating scale

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fixed Deposit Programme	-	-	[ICRA]AA+ (Stable); migrated from MAA+(Stable)

**Instrument details are provided in Annexure-1*

Rationale

The rating factors in Shriram Transport Finance Company Limited's (STFC) continued leadership position in the pre-owned commercial vehicle (CV) financing segment with a long-standing track record, established brand, strong customer reach and a granular retail loan book. The rating also considers the company's track record of healthy profitability, notwithstanding intermittent pressures amid a challenging environment. ICRA notes that STFC raised sizeable equity capital over the last two years, which helped to further augment the capitalisation profile with gearing improving to 4.4 times as of March 2022 (compared to 5.3 times as on March 31, 2020), and total capital adequacy ratio of 22.97% as on March 31, 2022.

The rating is, however, constrained by STFC's relatively moderate asset quality indicators led by exposure to a high yielding borrower segment with modest credit profiles. Nonetheless, ICRA favourably notes that the reported asset quality remained range bound (7.1%-8.4%) during the pandemic-impacted period (FY2021 and FY2022) in line with the 5-year average of 8% (i.e. the period since STFC adopted 90 days past due (dpd) recognition policy). The rating also takes cognisance of the vulnerability in asset quality data driven by relief extended to borrowers through the Emergency Credit Line Guarantee Scheme (ECLGS; 0.4% of the loan book as on March 31, 2022) and restructured book of 0.6% as of March 2022. Nonetheless, ICRA draws comfort from STFC's track record of reporting swift recovery in collection efficiency through cycles, though the asset quality metrics would remain a key monitorable.

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

ICRA is aware of the proposed merger of STFC, Shriram City Union Finance Ltd. (SCUF) and their promoter entity Shriram Capital Limited (SCL), which is subject to the receipt of requisite statutory and regulatory approvals. The transaction would be entirely through a stock swap arrangement[1]. Following the completion of merger, the promoter group's shareholding in the amalgamated entity is expected to be 20.11%. ICRA notes the strategic rationale of the merger, wherein it would help the Group to bring together all of its lending products – CVs, two-wheeler loans, gold loan, personal loan, auto loan and small enterprise finance – under a single roof. The Group envisages synergies related to customer acquisition cost/cross sell opportunities, employee productivity/better operating efficiencies on account of back office operations, liabilities strategy, etc. ICRA expects the merger to be completed by October-November 2022 and would monitor the development around the merger process and the impact of the same on STFC's risk profile.

[1] *The proposed transaction is entirely non-cash and is based on a share swap arrangement, wherein pursuant to the merger, STFC will issue 1.55 shares for every 1 share of SCUF and 0.09783305 share for every 1 share of SCL.*

In compliance with the circular [SEBI/HO/MIRSD/MIRSD_CRADT/P/CIR/2021/594] issued by the Securities and Exchange Board of India (SEBI) on July 16, 2021 and the subsequent circular SEBI/HO/MIRSD/MIRSD_CRADT /P/CIR/2022/43 of April 1, 2022, for standardising the rating scales used by the credit rating agencies, ICRA has discontinued the medium-term rating scale used for assigning ratings to the fixed deposit programmes of entities. Accordingly, ICRA has migrated the rating currently outstanding for the fixed deposits programme of STFC from the medium-term rating scale to the long-term rating scale. The medium-term rating scale of ICRA was a 14-point scale, while the long-term rating scale is a 20-point scale. The migration of the rating has resulted in a change in the rating symbol.

Key rating drivers and their description

Credit strengths

Leadership position in pre-owned CV financing segment – STFC is the largest player in the pre-owned CV financing segment in the country with a dominant market position. The company's proven track record, along with its well-established franchise (1,854 branches and 775 rural centres, as on March 31, 2022) results in a strong customer reach and a granular retail loan book. It also provides loans for new CVs, passenger vehicles (PVs), tractors and business loans for equipment finance and the working capital requirements of small road transport operators. The assets under management (AUM) stood at Rs. 1,27,041 crore (YoY growth of 8.4%) as on March 31, 2022 with the loan book consisting of used vehicles (~93%), new vehicles (~5%) and small business loans (the balance). Given its wide geographical reach and understanding of its borrower's credit profile, the company is expected to maintain its competitive position in the pre-owned CV financing segment.

Healthy profitability trajectory – STFC has a track record of healthy profitability as reflected by 10-year average RoMA and RoE of 2.0% and 15%, respectively. The company's average yield on advances and lending spread remained range-bound at a level of about 15% and 6%, respectively, which is commensurate with the underlying credit risk. This, coupled with scale-led operating efficiencies and hence low operating expense ratio (1.5%-1.7% of average managed assets) supported its overall profitability trajectory, notwithstanding the intermittent pressures amid a challenging environment due to elevated credit cost post March 2020. Nonetheless, the annual net credit cost (as percentage of average total assets) trajectory has largely remained under control in the range of 2%-3% with 10-year average of 2.5%. Even during the past nine quarters, despite the pressures arising from the pandemic-led challenges, STFC continued to report satisfactory profitability with average net credit cost of 2.9%, RoMA of 1.8% and RoE of 11%. In FY2022, the company reported a net credit cost of 2.7%, RoMA of 1.9% and RoE of 11.4%.

Comfortable capitalisation – STFC's capitalisation profile remains comfortable with net worth of Rs. 25,932 crore as on March 31, 2022. The capitalisation level remains supported by the healthy internal accruals, besides capital infusion of Rs. 1,493 crore in FY2021 and Rs. 2,479 crore in FY2022. STFC's reported gearing improved to 4.4 times as on March 31, 2022 from 6 times in March 2018. The current capitalisation indicators remain comfortable for the scale of operations with Tier-I and total capital adequacy ratios of 20.7% and 23.0%, respectively, as on March 31, 2022. Given the stable state growth trajectory and satisfactory pace of internal capital generation, STFC's capitalisation is expected to remain at a reasonable level with comfortable cushion over the regulatory minimum, provided it is able to control fresh slippages.

Credit challenges

Modest borrower profile and moderate asset quality – Notwithstanding its strong market position, STFC caters to a high-yielding borrower segment with modest credit profiles, comprising mostly first-time users and buyers and the owner-cum-driver profile. The customers generally have a limited credit history and restricted buffer to absorb income shocks. Hence, the inherent credit risk in the portfolio remains high. Also, the company's high portfolio concentration towards the used vehicle segment (~93% of AUM as on March 31, 2022) exposes it to industry-specific risks.

In line with the inherent credit risk in the portfolio, STFC's asset quality indicators remain moderate with the gross stage 3 assets typically having aggregated 8%-9% of the loan book, notwithstanding the improvement in the reported figures in the last quarter of FY2022. While the reported gross stage 3 assets (%) declined to 7.1% as on March 31, 2022 from a quarterly average of 8.1% in 9M FY2022, ICRA has factored in the opaqueness in asset quality data driven by relief availed by borrowers under Emergency Credit Line Guarantee Scheme (ECLGS; 0.4% of the loan book) and restructuring of loans (0.6% of the loan book as of March 2022). Nonetheless, ICRA draws comfort from STFC's track record of reporting swift recovery in collection efficiency 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 – STFC has a track record of raising retail borrowings, besides tapping funds from a diverse set of investors through securitisation, external commercial borrowings, domestic debt markets, money market, development finance institutions, banks and other financial institutions. This has facilitated a diversified borrowing mix for supporting large-scale operations and borrowing programme. As on March 31, 2022, STFC's borrowing mix comprised bonds (19%), subordinated debt (4%), foreign currency borrowings (21%), term loans (20%), public deposits (19%) and securitisation (17%). However, ICRA notes that STFC's borrowing cost has remained relatively higher vis-à-vis its peers with instances of adverse volatility in yields. Also, the share of various sources in incremental borrowings has fluctuated, wherein a constrained ability at times to raise funds from certain sources at commensurate rates cannot be ruled out. In this regard, STFC's sustained ability to mobilise funds from diverse sources, at competitive rates, will remain a monitorable and will be critical for growth.

Liquidity position: Adequate

STFC's asset-liability maturity (ALM) profile, in the normal course of business, is mostly characterised by positive cumulative mismatches across the near-term and medium-term maturity buckets, supported by relatively comfortable matching of average tenor of assets and liabilities, and modest on-balance sheet liquidity. As on March 31, 2022, STFC had unencumbered on-balance sheet liquidity of Rs. 13,746 crore vis-à-vis a debt repayment obligation (excluding interest) of ~Rs. 11,800 crore due over the next three months. The liquidity position is further supported by availability of unutilised working capital lines of Rs. 3,963 crore as on March 31, 2022, thereby providing adequate liquidity buffer to meet contingencies, if any.

Rating sensitivities

Positive factors – An improvement in the portfolio diversification and an improved asset quality trajectory (gross stage 3 assets below 5%) resulting in a sustained improvement in solvency and profitability indicators, while maintaining adequate capitalisation, could lead to an upward revision in the outlook and/or the credit rating.

Negative factors – Deterioration in asset quality indicators leading to sustained weakening of solvency and/or profitability could warrant a revision in the outlook and/or the credit rating. A weakening in the Tier-I capital adequacy below 12% would also exert pressure on the rating.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA's Credit Rating Methodology for Non-Banking Finance Companies
Parent/Group Support	Not applicable
Consolidation/Standalone	Standalone

About the company

Shriram Transport Finance Company Limited (STFC), incorporated in 1979 and a part of the Shriram Group, is a deposit-accepting non-banking financial company. It is the market leader in pre-owned CV financing with a pan-India presence encompassing 1,854 branches and 775 rural centres as on March 31, 2022. STFC primarily provides financing for vehicles such as CVs (both pre-owned and new), tractors, and passenger vehicles. Assets under STFC's management aggregated Rs. 1,27,041 crore as on March 31, 2022.

In FY2022, STFC reported a net profit of Rs. 2,708 crore on AUM of Rs. 127,041 crore against a net profit of Rs. 2,487 crore on AUM of Rs. 1,17,243 crore in FY2021. As on March 31, 2022, the company's capitalisation was characterised by a net worth of Rs. 25,932 crore and total capital adequacy ratio of 22.97%.

On December 13, 2021, the board of directors of STFC, SCUF and SCL (promoter entity) approved the merger of SCL and SCUF with STFC, subject to the receipt of requisite statutory and regulatory approvals. The transaction would be entirely through a stock swap arrangement. Following the completion of merger, the promoter group's shareholding in the amalgamated entity is expected to be 20.11%.

Key financial indicators

	FY2020 Audited	FY2021 Audited	FY2022 Audited
PAT	2,502	2,487	2,708
Net Worth	18,005	21,568	25,932
Assets under Management (AUM)	109,749	117,243	127,041
Return on Average Assets	2.2%	1.9%	1.9%
Return on Average Equity	14.7%	12.6%	11.1%
Gearing (times)	5.3	4.9	4.4
Net Worth/ AUM	16.4%	18.4%	20.4%
CRAR	22.0%	22.5%	23.0%
Gross Stage 3 (%)	8.4%	7.1%	7.1%
Net Stage 3 (%)	5.6%	4.2%	3.7%
Provision Coverage – Stage 3 (%)	34.7%	42.0%	50.0%
Solvency (Net Stage 3/ Net Worth)	33.3%	22.3%	17.2%

Source: *STFC, ICRA Research; All ratios as per ICRA's calculation*
Amount in Rs. crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Rating History for the Past 3 Years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Jun 17, 2022	FY2022		FY2021	FY2020
						Dec 21, 2021	Jun 22,2021	May 26,2020	Apr 05, 2019
1	Fixed Deposit Programme	Long term	-	-	[ICRA]AA+ (Stable)	MAA+ (Stable)	MAA+ (Stable)	MAA+ (Stable)	MAA+ (Stable)

Source: ICRA Research; 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 its structure and does not represent ICRA's opinion on the general credit quality of the entity concerned.

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fixed Deposit Programme	Very 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

Annexure-1: 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)

Source: *ICRA*

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

Corrigendum:

Rationale dated June 17, 2022, has been revised with the following changes:
In the 'Credit Strengths' section, on page no. 2, the capitalisation profile of the company inadvertently captured as adequate has been corrected to comfortable.

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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.

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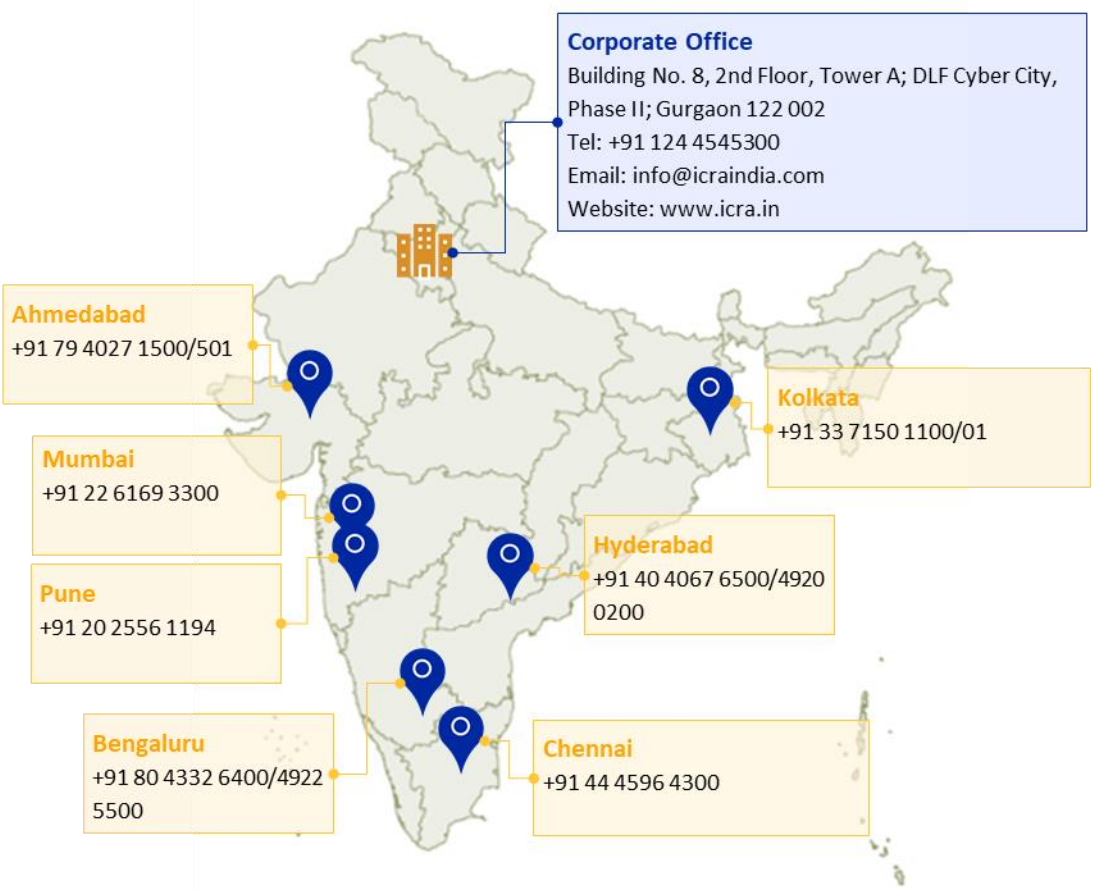

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