June 21, 2022

Shriram City Union Finance Limited: Rating continues to remain on watch with positive implication for NCD and MLD, and reaffirmed for commercial paper; Fixed deposit rating migrated from medium-term rating scale to long-term rating scale

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible Debenture Programme (NCD)	525.00	525.00	[ICRA]AA%; Remains on Watch with Positive Implications
Fixed Deposit Programme	7,500.00	7,500.00	[ICRA]AA%; Migrated from MAA+ (Stable) and rating placed on Watch with Positive Implications
Commercial Paper	3,000.00	3,000.00	[ICRA]A1+; Reaffirmed
Market Linked Debentures (MLD)	200.00	200.00	PP-MLD[ICRA]AA%; Remains on Watch with Positive Implications
Total	**11,225.00**	**11,225.00**	

**Instrument details are provided in Annexure-1*

Rationale

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 credit rating agencies, ICRA has discontinued the medium-term rating scale which was being used to assign ratings to the fixed deposit (FD) programmes of entities.

Accordingly, ICRA has migrated the rating currently outstanding for the FD programme of Shriram City Union Finance Limited (SCUF) 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; however, this is to be construed only as a recalibration of the rating from one scale to another and not as a reflection of a change in the credit risk of the FD programme.

ICRA is cognisant of the proposed merger of SCUF, Shriram Transport Finance Company Limited {STFC; rated [ICRA]AA+ (Stable)} and their promoter entity – Shriram Capital Limited (SCL)[1]. The merger is subject to the receipt of requisite statutory and regulatory approvals. The transaction would be entirely through a stock swap arrangement[2]. Following the completion of the merger, the shareholding of the promoter group in the amalgamated entity is expected to be 20.11%. Shriram Housing Finance Limited, in which SCUF holds 85.02%, shall become a subsidiary of Shriram Finance Limited (SFL; amalgamated entity), post the merger.

ICRA has taken note of the strategic rationale of the merger, which would help the Group bring together all its lending products – commercial vehicles, two-wheeler loans, gold loans, personal loans, auto loans and small enterprise finance – under a single roof. The Group envisages synergies related to customer acquisition costs/cross-sell opportunities, employee productivity/better operating efficiency on account of back office operations, liabilities strategy, etc. ICRA expects the merger

[1] Post amalgamation with Shrilekha Business Consultancy Private Limited and demerger of all other businesses of the Group, namely life insurance, general insurance and all non-lending and non-insurance activities

[2] 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 1 share of SCUF and 0.09783305 share for 1 share of SCL

to be completed by October-November 2022 and would monitor the development around the merger process and the impact of the same on SCUF's risk profile.

ICRA has also noted that the above-mentioned transaction would uplift SCUF's risk profile as it is proposed to be merged with STFC and would be a part of the resultant merged entity. ICRA had, therefore, previously placed SCUF's non-convertible debenture (NCD) and market linked debenture (MLD) ratings under Watch with Positive Implications in December 2021. Post the migration of the FD rating to the long-term rating scale, the same has also been placed under Watch with Positive Implications. The resolution of the rating watch would depend on the successful completion of the merger.

The ratings factor in SCUF's presence in diverse product segments and its comfortable capitalisation (Tier-I capital adequacy ratio of 26.8% as of March 2022). The ratings also take into consideration the uptick in the portfolio growth in FY2022 at 15% year-on-year (YoY) vis-à-vis the tepid 5% compound annual growth rate (CAGR) during FY2018-FY2021. SCUF's consolidated net profitability {profit after tax (PAT)/average managed assets (AMA)}, while remaining healthy, moderated to 2.8% in FY2022 and 3.0% in FY2021 from 3.1% in FY2020. This was on account of margin contraction due to higher on-balance sheet liquidity and increase in borrowing costs during the year. The ratings also consider SCUF's established track record in the retail finance segment and its position as a part of the Shriram Group. The ratings are, however, constrained by the moderate asset quality (gross stage 3 of 5.8% as of March 2022; consolidated basis) and the geographically concentrated operations with South India, particularly Andhra Pradesh, Tamil Nadu and Telangana, accounting for the majority of the portfolio.

The overall collections (non-gold loans; including arrears) to current demand has been above 100% since July 2021. However, maintaining the collection performance and controlling incremental slippages would be key from an asset quality perspective. While SCUF's liquidity profile is adequate at present, it would be crucial to diversify its funding sources to secure funds at competitive rates.

Key rating drivers and their description

Credit strengths

Fairly diversified product profile; growth improved in FY2022 – SCUF had a customer base of more than 40 lakh and standalone assets under management (AUM) of Rs. 33,186 crore as of March 2022 (Rs. 29,571 crore as of March 2021). It commenced operations by providing finance against vehicles and gradually diversified into other product segments, viz. personal loans (2002), small enterprises segment (2006), gold loans (2007) and loan against property (LAP; 2021). The small enterprises segment accounted for about 44% of the standalone AUM as of March 2022 followed by two-wheelers (27%; including pre-owned at 3%), gold loans (12%), personal loans (12%), auto loans (2%) and LAP (2%). It has an established presence in the enterprise finance segment with an AUM of Rs. 14,718 crore as of March 2022, where it targets self-employed borrowers.

SCUF is also one of the leading non-banking financial companies (NBFCs) in two-wheeler financing, with an AUM of Rs. 8,789 crore (including pre-owned of Rs. 1,025 crore) as of March 2022. It diversified into housing finance in FY2013 through its subsidiary, Shriram Housing Finance Limited. The housing finance book stood at Rs. 5,355 crore as of March 2022 (grew by 36% YoY) and was 13.9% of the consolidated AUM (11.7% as of March 2021). The consolidated AUM stood at Rs. 38,541 crore as of March 2022, up 15.0% YoY, largely driven by the personal loans and housing finance books. The consolidated AUM grew moderately by 6.7% in FY2021, remained flat in FY2020 and grew 7% in FY2019 vis-à-vis the previous three years' CAGR of 15%.

Healthy profitability, notwithstanding the moderation – On a consolidated basis, SCUF's net profitability (PAT/AMA) moderated to 2.8% in FY2022 and 3.0% in FY2021 from 3.1% in FY2020 on account of margin contraction due to higher on-balance sheet (b/s) liquidity and increase in the share of market instruments and retail deposits. The operating expense ratio stood at 4.3% in FY2022 and 4.1% in FY2021 (4.9% in FY2020). The credit cost improved to 1.7% in FY2022 from 2.1% in FY2021 (2.3% in FY2020) largely due to the stable asset quality and healthy recoveries from bad debts. SCUF, in view of the Covid-19 pandemic, had increased its expected credit loss provision since FY2020, though the same has moderated subsequently. However, the provision coverage is maintained at a similar level with the improvement in the stage 3 assets. The overall provisions stood at 5.5% of the AUM in March 2022 (standalone: 6.3%) vis-à-vis 6.9% in March 2020 (standalone: 7.0%).

SCUF (standalone) reported a net profitability of 2.9% in FY2022 vis-à-vis 3.1% in FY2021 (3.3% in FY2020). ICRA notes that a sustained improvement in collections would be crucial for keeping additional credit costs under control and securing funding at competitive rates would remain key for incremental profitability.

Comfortable capitalisation profile – On a standalone basis, SCUF's Tier-I capital adequacy ratio declined to 26.8% as of March 2022 from 28.6% as of March 2021 (27.7% as of March 2020), largely on account of the stronger portfolio growth witnessed in H2 FY2022. The net stage 3 in relation to the net worth stood at 11.8% in March 2022 and 10.8% in March 2021 (16.2% as of March 2020) and is under control. On a consolidated basis, SCUF's net worth to AUM stood at 24.5% as of March 2022 and 25.4% as of March 2021 (24.0% as of March 2020).

The consolidated managed gearing stood at 3.8 times as of March 2022 (3.5 times as of March 2021) and ICRA does not expect the leverage to increase beyond 4.5 times in the near term. ICRA also does not expect the company to extend sizeable support or take credit exposures to other stressed entities in the Shriram Group, especially those in the non-financial services businesses.

Strong franchise; part of Shriram Group – SCUF has an established track record of more than three decades in the retail finance segment. As of March 2022, it had operations in 24 states and Union Territories (UTs) with a total network of 986 branches (926 branches as of March 2021). As a part of the Shriram Group, it benefits from access to the Group's infrastructure and customer base, particularly of STFC. In addition to its own distribution franchisee, it can tap into the Group's network to mobilise funds (deposits, etc.) or for new business origination. SCUF also benefits from the in-house information technology (IT) systems developed and serviced by associate entities (Shriram Value Services Limited and Novac Technology Solutions Private Limited). It also has access to the Group's senior management, who have considerable experience in retail finance.

ICRA is cognisant of the proposed merger of SCUF, STFC and SCL. The merger scheme is subject to the receipt of requisite statutory and regulatory approvals. The transaction would be entirely through a stock swap arrangement. Following the completion of the merger, the shareholding of the promoter group in the amalgamated entity is expected to be 20.11%. Shriram Housing Finance Limited, in which SCUF holds 85.02%, shall become a subsidiary of SFL, post the merger. ICRA has taken note of the strategic rationale of the merger, which would help the Group bring together all its lending products – commercial vehicles, two-wheeler loans, gold loans, personal loans, auto loans and small enterprise finance – under a single roof. The Group envisages synergies related to customer acquisition costs/cross-sell opportunities, employee productivity/better operating efficiency on account of back office operations, liabilities strategy, etc. ICRA notes that the transaction would uplift SCUF's risk profile as it is proposed to be merged with STFC and would be a part of the resultant merged entity. It also 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 SCUF's risk profile.

Credit challenges

Moderate asset quality – On a standalone basis, the company's gross stage 3 remained relatively higher at 6.3% as of March 2022 (6.4% as of March 2020), notwithstanding the reduction from 7.9% as of March 2020 (8.9% as of March 2019). SCUF's stage 2 assets increased to 11.7% as of March 2022 from 7.9% as of March 2021 (5.9% as of March 2020[3] and 15.8% as of March 2019) because of the better collection efficiency observed in Q4 FY2021 and Q2 FY2022 onwards. ICRA notes that the provision coverage on the stage 3 assets was 49.3% as of March 2022 and 53.2% as of March 2021 (48.5% as of March 2020 and 43.6% as of March 2019).

[3] 17.1% as on March 31, 2020, excluding moratorium

The overall collections (non-gold loans; including arrears) to current demand has been above 100% since July 2021 and it improves slightly towards the quarter end, benefitting the asset quality. However, maintaining the collection performance and controlling incremental slippages would be key from an asset quality perspective.

On a consolidated basis, the gross stage 3 stood at 5.8% as of March 2022, similar to the March 2021 level (7.5% as of March 2020 and 8.5% as of March 2019). The company's exposures are largely to self-employed customers with modest credit profiles. ICRA, nevertheless, takes cognisance of SCUF's good understanding of its target segment, which, along with the established appraisal and collection processes and the adequate internal controls and monitoring systems, mitigates these credit risks to an extent.

Portfolio concentrated in South India – SCUF's operations are largely concentrated with South India accounting for about 61% and 64% of the company's managed portfolio and branch network, respectively, as of March 2022.The top 4 states constituted about 67% of the portfolio as of March 2022, which exposes the company to region-specific risks. Despite its ongoing efforts to gradually expand its operations, SCUF's portfolio is expected to remain concentrated in South India over the near to medium term.

Liquidity position: Adequate

SCUF had cash and liquid investments of Rs. 4,889 crore and undrawn lines of Rs. 633 crore as on May 31, 2022. The company's debt service obligations (principal) during June 2022-August 2022 stand at Rs. 3,620 crore (including Cash Credit/Working Capital Demand Loans of Rs. 648 crore). The overall collections (non-gold loans; including arrears) to current demand has been above 100% since July 2021. While the collections remain a monitorable, access to funds from diverse sources and the ability to secure funding at competitive rates provide financial flexibility to SCUF.

SCUF's funding profile is characterised by bank borrowings (about 50% of the total borrowings as of March 2022), followed by FDs (22%), debentures (21%), and sell-down (7%). As of March 2022, the company had funding support from more than 30 banks. Further, there is scope to expand its deposit franchisee as FDs stood at 0.8 times of the net owned funds as of March 2022 vis-à-vis the regulatory cap of 1.5 times.

Rating sensitivities

Positive/ Negative factors – The watch on the ratings will be resolved on the timely completion of the merger with STFC.

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	The ratings are based on the consolidated financial statements of SCUF and its subsidiary, Shriram Housing Finance Limited

About the company

SCUF is a deposit-accepting NBFC that commenced operations in 1986. It was largely focussed on vehicle finance till 2002 after which it gradually shifted its focus to other retail financing segments. SCUF currently provides small enterprise finance (44% of the standalone portfolio as of March 2022), two-wheeler loans (27%; including pre-owned at 3%), gold loans (12%), personal loans (12%), auto loans (2%) and LAP (2%). As of March 2022, the company had a total network of 986 branches in 24 states and UTs across India. Its loan portfolio is largely concentrated in the southern states, which accounted for about 61% of its portfolio as of March 2022.

SCL holds a 33.6% stake (as of March 2022) in SCUF, followed by Dynasty Acquisition Limited at 20.1%, and Piramal Enterprises Limited at 9.9%. Mutual funds and foreign institutional investors hold 32.2% and the rest is held by retail investors and others.

In FY2022, the company achieved a consolidated net profit of Rs. 1,165 crore on a managed asset base of around Rs. 45,420 crore compared to a net profit of Rs. 1,078 crore on a managed asset base of around Rs. 38,474 crore in FY2021.

Key financial indicators (audited) – Consolidated

	FY2020	FY2021	FY2022
Total income (Rs. crore)	6,091	6,057	6,895
Profit after tax (Rs. crore)	1,033	1,078	1,165
Net worth (Rs. crore)[4]	7,424	8,388	9,278
Loan book (Rs. crore)	31,390	33,500	38,541
Total managed assets (Rs. crore)	34,035	38,474	45,420
Return on managed assets (%)	3.1%	3.0%	2.8%
Return on net worth (%)	14.8%	13.6%	13.2%
Managed gearing (times)	3.5	3.5	3.8
Gross stage 3 (%)^	7.9%	6.4%	6.3%
Net stage 3 (%)^	4.2%	3.1%	3.3%
Solvency (Net stage 3/Net worth) ^	16.2%	10.8%	11.8%
CRAR (%)^	27.7%	28.6%	26.8%

Source: *Company, ICRA Research; All ratios as per ICRA's calculations; ^Details for SCUF (standalone)*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Chronology of Rating History for the Past 3 Years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in FY2023	Date & Rating in FY2022		Date & Rating in FY2021	Date & Rating in FY2020
					Jun-21-2022	Dec-21-2021	Jul-14-2021 Jun-16-2021	Nov-26-2020/ Dec-16-2020/ Feb 03-2021/ Feb-16-2021	Aug-30-2019
1	Commercial Paper	Short Term	3,000.00	3,000.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
2	Non-convertible Debenture Programme	Long Term	525.00	525.00	[ICRA]AA%	[ICRA]AA%	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)
3	Fixed Deposit Programme	Long Term	7,500.00	7,500.00	[ICRA]AA%	MAA+ (Stable)	MAA+ (Stable)	MAA+ (Stable)	MAA+ (Stable)

[4] *Excluding minority interest*

4	Market Linked Debentures	Long Term	200.00	200.00	**PP-MLD [ICRA]AA%**	**PP-MLD [ICRA]AA%**	**PP-MLD [ICRA]AA (Stable)**	**PP-MLD [ICRA]AA (Stable)**	-

% - Rating on Watch with Positive Implications

Complexity level of the rated instrument

Instrument	Complexity Indicator
Commercial Paper	Very Simple
NCD	Very simple
Fixed Deposits	Simple
Market Linked Debentures	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

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
Unallocated	Commercial Paper	-	-	7-365 days	3,000.00	[ICRA]A1+
Unallocated	NCD#	-	-	-	110.00	[ICRA]AA%
INE722A07AW2	NCD	Jul 23, 2021	8.25%	Jul 23, 2024	50.00	[ICRA]AA%
INE722A07AX0	NCD	Jul 23, 2021	8.75%	Jul 23, 2031	100.00	[ICRA]AA%
INE722A07AV4	NCD	Jun 23, 2021	9.00%	Jun 23, 2031	100.00	[ICRA]AA%
INE722A07AQ4	NCD	Feb 22, 2021	9.50%	Feb 21, 2031	75.00	[ICRA]AA%
INE722A07AP6	NCD	Feb 22, 2021	9.25%	Feb 22, 2030	50.00	[ICRA]AA%
INE772A07AN1	NCD	Feb 08, 2021	9.25%	Feb 08, 2030	10.00	[ICRA]AA%
INE772A07AO9	NCD	Feb 08, 2021	9.50%	Feb 07, 2031	30.00	[ICRA]AA%
NA	Fixed Deposit	-	-	-	7,500.00	[ICRA]AA%
INE722A07AL5	MLD	Dec 18, 2020	-	Aug 18, 2022	118.00	PP-MLD[ICRA]AA%
INE722A07AL5	MLD	Dec 28, 2020	-	Aug 18, 2022	35.00	PP-MLD[ICRA]AA%
INE722A07AL5	MLD	Jan 18, 2021	-	Aug 18, 2022	47.00	PP-MLD[ICRA]AA%

Source: *Company; #Yet to be placed*

% - Rating on Watch with Positive Implications

Annexure-2: List of entities considered for consolidated analysis

Company Name	SCUF Ownership	Consolidation Approach
Shriram Housing Finance Limited	85.02%	Full Consolidation

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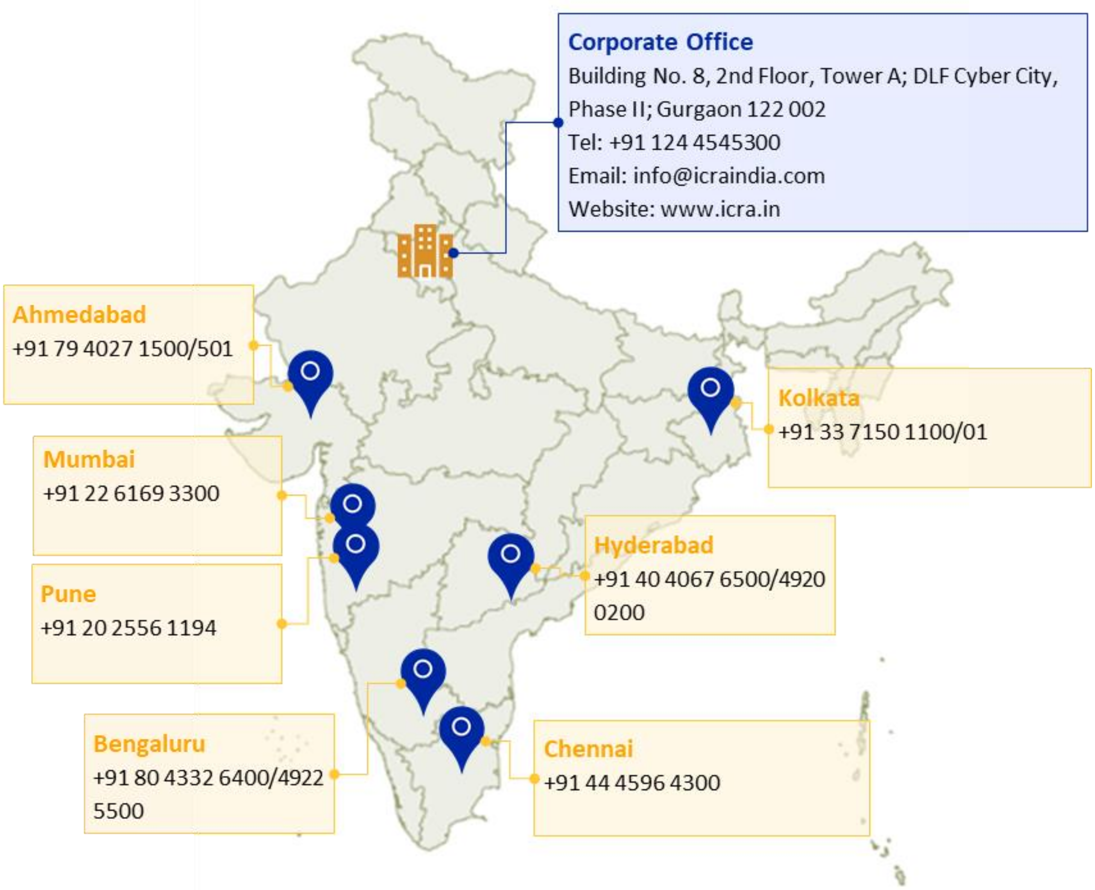

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