January 12, 2023 (Revised)

Shriram Finance Limited (erstwhile Shriram Transport Finance Company Limited): [ICRA]AA+ (Stable) assigned/reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fixed deposit programme	-	-	[ICRA]AA+ (Stable); reaffirmed
Non-convertible debenture programme	500.0	500.0	[ICRA]AA+ (Stable); reaffirmed
Non-convertible debenture programme	-	525.0	[ICRA]AA+ (Stable); assigned
Total	**500.0**	**1,025.0**	

**Instrument details are provided in Annexure I*

Rationale

ICRA has assigned a rating of [ICRA]AA+ (Stable) to the instruments transferred from erstwhile Shriram City Union Finance Limited (SCUF) and has reaffirmed the rating outstanding for the borrowings of Shriram Finance Limited [SFL; erstwhile Shriram Transport Finance Company Limited (STFC)]. ICRA has taken note of the completion of the merger of SCUF and Shriram Capital Limited (SCL) with STFC, which has been renamed SFL.

The rating continues to factor in SFL's leadership position in the preowned commercial vehicle (CV) financing segment with a long-standing track record, established brand, strong customer reach and a granular retail loan book. Also, the merger has resulted in a diversification in SFL's product offering, which now includes vehicle finance, small enterprise loans, personal loans, auto loans, 2-wheeler finance, gold loans, loan against property (LAP) and housing finance (through the subsidiary – Shriram Housing Finance Limited). The merger also provides SFL with the chance to access a larger customer base and explore cross-selling opportunities, besides widening the reach of its relatively less penetrated products in newer geographies.

The rating also considers the merged entity's track record of healthy profitability, notwithstanding intermittent pressures amid a challenging environment, and its comfortable capitalisation profile. As of September 30, 2022, SFL's reported net worth stood at about Rs. 40,900 crore with an estimated gearing of 3.9 times and a total capital adequacy ratio of 23.1%. It is noted that the key management personnel of erstwhile STFC and SCUF continue to be involved in the operations and oversight of SFL.

Given the exposure to the high-yielding borrower segment with modest credit profiles under SCUF and STFC, the overall asset quality of the merged entity remains moderate. SFL's gross stage 3 assets aggregated 6.7% of the loan book as on September 30, 2022, while the net stage 3 assets stood at 3.4% of the loan book. While taking the rating action, ICRA has considered the vulnerability in the asset quality due to the relief extended to the borrowers through the Emergency Credit Line Guarantee Scheme (ECLGS: 0.3% of the loan book as of March 31, 2022) and the restructured book of 0.6% as on March 31, 2022. Nonetheless, the company has demonstrated a track record of reporting a swift recovery in its collection efficiency through cycles, though the asset quality metrics would remain a key monitorable.

The company has a track record of raising retail borrowings, besides tapping funds from a diverse set of investors. This has facilitated a diversified borrowing mix for supporting the large-scale operations and borrowing programme. However, the borrowing cost has remained relatively higher than the peers with instances of adverse fluctuations in yields. In this regard, especially in the backdrop of a further increase in the scale of the post-merger borrowing programme, SFL's sustained ability to mobilise funds from different sources at competitive rates remains imperative.

Key rating drivers and their description

Credit strengths

Diversified product offerings with leadership position in preowned CV financing segment – SFL (post-merger) is one of the largest retail NBFCs with a consolidated AUM of about Rs. 1,78,000 crore as of September 30, 2022. It is the largest player in the preowned CV financing segment in the country with a dominant market position. The company's proven track record, along with its well-established franchise (3,633 branches and rural centres as on September 30, 2022), results in strong customer reach and a granular retail loan book. Moreover, the merger has resulted in a diversification in SFL's product offering, which now includes CV financing (77%), small enterprise loans (11%), and 2-wheeler finance (5%) with auto loan, personal loan, gold loan, LAP and housing finance (through its subsidiary) accounting for the balance.

Pre-merger, SFL had a pan-India presence in the CV finance business while the other offerings through SCUF were largely concentrated in the southern states of India. The merger provides SFL the chance to access a larger customer base and explore cross-selling opportunities, besides widening the reach of relatively less penetrated products in newer geographies. While the share of other products in the AUM will increase over the medium term, SFL is expected to maintain its competitive position in the CV segment.

Healthy profitability – Notwithstanding the inherent riskiness of the target customer segment, SFL is expected to maintain healthy yields and lending spreads commensurate with the underlying credit risk. ICRA estimates SFL's average yield on advances to have been about 16% with a lending spread of 7% between FY2020 and FY2022. In H1 FY023, the average yield on advances and lending spread are estimated to have improved to 16.8% and 8%, respectively. This, coupled with the scale-based operating efficiency, is expected to support the profitability, notwithstanding the expected increase in the borrowing cost and hence the possibility of a compression in the incremental lending spread amidst the rising interest rate scenario. Also, the credit cost for the merged businesses remains high at 2.3-2.5% on account of the target customer segment.

The overall profitability has remained healthy, with the three-year average return on assets (RoA) estimated at 2.2% and the return on net worth at 13.1%, despite the Covid-19 pandemic-related challenges witnessed during this period. In H1 FY2023, the RoA and the return on equity (RoE) were 2.7% and 15.1%, respectively. SFL's operating expenses to average total assets, basis merged operations, is estimated to have been range-bound at 2.1-2.4% over the last three years.

Comfortable capitalisation – SFL's capitalisation profile is comfortable with a reported net worth of ~Rs. 40,900 crore, estimated gearing of 3.9 times and a total capital adequacy ratio of 23.1% as of September 30, 2022. Given the stable growth trajectory expected for SFL and the satisfactory pace of internal capital generation, the capitalisation is expected to remain at a reasonable level with adequate cushion over the regulatory minimum, provided SFL is able to continue controlling fresh slippages. STFC had raised Rs. 3,952 crore in FY2020 and FY2021. This, coupled with healthy internal accruals and the moderation in the pace of growth, had supported the improvement in the leverage with the gearing declining to 4.4 times as of March 31, 2022 from 5.6 times as of March 31, 2019.

Credit challenges

Modest borrower profile and moderate asset quality – SFL's target customers primarily comprise the high-yielding borrower segment with modest credit profiles. These customers generally have a limited credit history and restricted buffer to absorb income shocks. Hence, the inherent credit risk in the portfolio is high. The same has been reflected in the moderate asset quality of STFC and SCUF over the years. Consequently, SFL's asset quality indicators also remain moderate with the gross stage 3 assets aggregating 6.7% of the loan book as on September 30, 2022, while the net stage 3 assets stood at 3.4% of the loan book. While taking the rating action, ICRA has taken cognisance of the vulnerability in the asset quality due to the relief extended to the borrowers through the ECLGS (0.3% of the loan book as of March 31, 2022) and the restructured book of 0.6% as on March 31, 2022. While the company has demonstrated a track record of reporting a swift recovery in its collection efficiency through cycles, the asset quality metrics would remain a key monitorable.

Relatively modest borrowing profile, notwithstanding established track record of raising funds from diverse sources – The company has a track record of raising retail borrowings, besides tapping funds from a diverse set of investors. This has facilitated a diversified borrowing mix for supporting the large-scale operations and borrowing programme. As on September 30, 2022, SFL's borrowings stood at over Rs. 1,58,000 crore and are estimated to have primarily comprised non-convertible debentures (NCDs; 21%), term loans (27%), public deposits (20%), external commercial borrowings (ECBs; 16%), and securitisation (13%). However, the borrowing cost has remained relatively higher than the peers with instances of adverse fluctuations in yields. In this regard, especially in the backdrop of a further increase in the scale of the borrowing programme after the merger, SFL's sustained ability to mobilise funds from different sources at competitive rates remains imperative.

Environmental and Social Risk

Given the service-oriented business of SFL, its direct exposure to environmental risks as well as those emanating from regulations or policy changes is not material. However, the residual value of the security could reduce in case of policy changes such as incremental ruling on the reduction in the operating life of CVs, thereby impacting the profitability. Further, there is increasing interest from policymakers towards identifying the exposure of financing companies to carbon emissions through their financing activities. This process, however, is in an early stage, and ICRA expects any adverse implications to manifest only over a longer time horizon, giving financing companies adequate time to adapt and minimise the credit implications.

Exposure to social risks is low for a financial institution like SFL. SFL serves the financing needs of a relatively underserved borrower category which supports social inclusion and economic development. ICRA notes that a large portion of SFL's portfolio qualifies for priority sector lending which augurs well for its ability to do securitisation transactions at competitive rates. Moreover, the company has demonstrated ability to tap resources from overseas markets/impact investors through social bonds issuances

Liquidity position: Adequate

As on September 30, 2022, STFC and SCUF's asset-liability maturity (ALM) profiles were characterised by positive cumulative mismatches across the near-term and medium-term maturity buckets, supported by the relatively comfortable matching of the average tenor of the assets and liabilities, and the modest on-balance sheet liquidity. Furthermore, as on September 30, 2022, STFC's had on-balance sheet liquidity of Rs. 20,700 crore, while SCUF had on-balance sheet liquidity of Rs. 4,559 crore. The available liquidity adequately covered the debt obligations due over the next three months. The liquidity position is further supported by the availability of unutilised working capital lines.

Rating sensitivities

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

Negative factors – A deterioration in the asset quality, leading to the sustained weakening of the solvency and/or profitability, could warrant a revision in the outlook and/or the credit rating. A significant weakening in the capital adequacy 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 Rating Approach -Consolidation
Parent/Group support	Not applicable
Consolidation/Standalone	Consolidation

About the company

Shriram Finance Limited [SFL; erstwhile Shriram Transport Finance Company Limited (STFC)], incorporated in 1979, is a part of the Shriram Group of companies and is a top-layer NBFC. Based on the National Company Law Tribunal (NCLT) order dated November 14, 2022, the operations of Shriram City Union Finance Company Limited (SCUF) and Shriram Capital Limited were merged with STFC and STFC was rechristened Shriram Finance Limited on November 30, 2022.

SFL enjoys a leadership position in preowned commercial vehicle finance and has a pan-India presence with 3,633 branches and other offices. As of September 30, 2022, SFL (post-merger) is estimated to have had an AUM of Rs. 1.7 lakh crore comprising preowned commercial vehicle finance (76%), small and medium-sized enterprise (SME) lending (10%), personal loans (2%), gold loans (3%) 2-wheeler loans (5%) and housing loans (4%; through its subsidiary – Shriram Housing Finance Limited)[1].

As of September 30, 2022, SFL's (post-merger) financial profile is estimated to have been characterised by a consolidated net worth of about Rs. 40,900 crore (as reported by SFL)[2] and capital adequacy of 23.1%.

Key financial indicators

SFL (estimates, as reported by the company in corporate presentation)	H1 FY2023
PAT	2,900
Net worth	40,900
Assets under management (AUM)	1,78,000
Return on average assets	2.7%
Return on average equity	15.1%
Gearing (times)	3.9
CRAR (%)	23.1%
Gross stage 3 (%)	6.7%
Net stage 3 (%)	3.4%
Solvency (Net stage 3/ Net worth)	13.6%

Source: As reported by company; Amount in Rs. crore; Amount rounded off to the nearest multiple of 100; AUM includes the housing finance business

STFC – Standalone	FY2021 Audited	FY2022 Audited	H1 FY2023 Limited Review
PAT	2,487	2,708	2,032
Net worth	21,568	25,932	27,856
Assets under management (AUM)	1,17,243	1,27,041	1,35,249
Return on average assets	1.9%	1.9%	2.6%
Return on average equity	12.6%	11.1%	15.1%
Gearing (times)	4.9	4.4	4.1
CRAR	22.5%	23.0%	22.5%
Gross stage 3 (%)	7.1%	7.1%	6.9%
Net stage 3 (%)	4.2%	3.7%	3.5%
Solvency (Net stage 3/ Net worth)	22.3%	17.2%	16.1%

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

[1] *SFL holds an 85% stake in Shriram Housing Finance Limited while the balance is held by Valiant Mauritius Partners FDI Limited*

[2] *~Rs. 38,152 crore as per ICRA's estimates (summation of net worth of STFC and SCUF-C)*

SCUF – Consolidated	FY2021 Audited	FY2022 Audited	H1 FY2023 Limited Review
PAT	1,078	1,165	739
Net worth	8,388	9,278	10,112
Assets under management (AUM)	33,500	38,541	42,663
Return on average assets	3.0%	2.8%	3.2%
Return on average equity	13.6%	13.2%	15.2%
Gearing (times)	3.4	3.7	3.7
CRAR^	28.6%	26.8%	26.2%
Gross stage 3 (%)^	6.4%	6.3%	5.9%
Net stage 3 (%)^	3.1%	3.3%	3.3%
Solvency (Net stage 3/ Net worth)^	10.8%	11.8%	11.4%

Source: SCUF, ICRA Research; All ratios as per ICRA's calculations; Consolidated: Including Shriram Housing Finance Limited; ^Details for SCUF (standalone)
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)						Chronology of Rating History for the Past 3 Years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Jan 12, 2023	Sep 30, 2022	Jun 17, 2022	Date & Rating in FY2022		Date & Rating in FY2021	Date & Rating in FY2020
								Dec 21, 2021	Jun 22, 2021	May 26, 2020	Apr 05, 2019
1	**Fixed deposit programme**	Long term	-	-	**[ICRA]AA+ (Stable)**	**[ICRA]AA+ (Stable)**	**[ICRA]AA+ (Stable)**	**MAA+ (Stable)**	**MAA+ (Stable)**	**MAA+ (Stable)**	**MAA+ (Stable)**
2	**NCD programme**	Long term	525.0	415.0	**[ICRA]AA+ (Stable)**	-	-	-	-	-	-
3	**NCD programme**	Long term	500.0	0.0	**[ICRA]AA+ (Stable)**	**[ICRA]AA+ (Stable)**	-	-	-	-	-

Source: ICRA Research

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fixed deposit programme	Very Simple
NCD programme	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: Click Here

Annexure I: 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)
INE722A07AW2*	**NCD programme**	Jul 23, 2021	8.25%	Jul 23, 2024	50.0	[ICRA]AA+ (Stable)
INE722A07AX0*	**NCD programme**	Jul 23, 2021	8.75%	Jul 23, 2031	100.0	[ICRA]AA+ (Stable)
INE722A07AV4*	**NCD programme**	Jun 23, 2021	9.00%	Jun 23, 2031	100.0	[ICRA]AA+ (Stable)
INE722A07AQ4*	**NCD programme**	Feb 22, 2021	9.50%	Feb 21, 2031	75.0	[ICRA]AA+ (Stable)
INE722A07AP6*	**NCD programme**	Feb 22, 2021	9.25%	Feb 22, 2030	50.0	[ICRA]AA+ (Stable)
INE772A07AN1*	**NCD programme**	Feb 08, 2021	9.25%	Feb 08, 2030	10.0	[ICRA]AA+ (Stable)
INE772A07AO9*	**NCD programme**	Feb 08, 2021	9.50%	Feb 07, 2031	30.0	[ICRA]AA+ (Stable)
NA	**NCD programme (yet to be placed)**	-	-	-	610.0	[ICRA]AA+ (Stable)

*Source: ICRA Research; *ISIN transferred from SCUF*

Annexure II: List of entities considered for consolidated analysis:

Company Name	Ownership as on November 30, 2022	Consolidation Approach
Shriram Finance Limited	100.00% (rated entity)	Full consolidation
Shriram Housing Finance Limited	85.02%	Full consolidation
Shriram Automall India Limited	44.56%	Equity Method

Corrigendum:

Rationale dated January 12, 2023, has been revised with the following changes:

The link for ‘Rating Approach – Consolidation’ is added in the analytical approach table, on page no. 3

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