January 27, 2023

SK Finance Limited (erstwhile Ess Kay Fincorp Limited): Rating upgraded to [ICRA]A+(SO) for assignee payouts issued under 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	42.30	9.24	[ICRA]A+(SO); upgraded from [ICRA]A(SO)

**Instrument details are provided in Annexure I*

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 SKFL's credit profile vis-à-vis the last rating exercise {currently rated [ICRA]A+ (Stable)}. SKFL's guarantee acts as a credit enhancement (CE) in the structure. Also, the high amortisation in the transaction has led to the build-up of the CE cover over the future assignee payouts. The performance of the pool remains healthy 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 2022 collection month (December 2022 payout) has been tabulated below.

Pool performance summary

Parameter	Ess Kay IB DA 20
Months post securitisation	25
Pool and assignee amortisation (as % of initial pool and assignee payout principal)	90.8%
Last 3 months' average monthly collection efficiency[1]	107.8%
Cumulative prepayment rate	13.8%
Average monthly prepayment rate	0.6%
Loss-cum-90+ dpd[2] (% of initial pool)	1.5%
Loss-cum-180+ dpd[3] (% of initial pool)	1.0%
Cumulative credit collateral (CC) utilisation[4]	0.0%
Breakeven collection efficiency[5] for assignee payouts	52.0%
CC (% of balance pool)	36.0%
Excess interest spread (EIS; % of balance pool) for assignee payouts[6]	15.1%

Key rating drivers

Credit strengths

- Healthy cumulative collection efficiency witnessed in the pool
- Significant amortisation of assignee payouts, leading to high build-up in CE cover for future payouts

[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 SKFL
[5] (Balance cash flows payable to investor – CC available)/ Balance pool cash flows
[6] (Pool cash flows – Cash flows to assignee)/ Pool principal outstanding

Credit challenges

- Yield on underlying pool of contracts is fixed while assignee yield is linked to assignee's marginal cost of funds based lending rate (MCLR), leading to interest rate risk in the structure
- Pool's performance will remain exposed to any macro-economic shocks/business disruptions

Description of key rating drivers highlighted above

The credit collateral (CC) in the transaction is in the form of an unfunded CE facility provided by SKFL. The company has scaled up its business while maintaining healthy capitalisation and controlling slippages despite the challenging operating environment. The pool's performance has remained healthy with a cumulative collection efficiency of more than 98% till December 2022 (payout month) with no instance of CC utilisation. Any shortfall in collections in the past was absorbed by the subordination/excess interest spread (EIS) in the structure with nil CC utilisation. The loss-cum-90+ days past due (dpd) was low at 1.5% after the December 2022 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 the amount collected in excess of 90% is to be passed on to the originator every month. Hence, despite the high pool amortisation, overall CE build-up has been lower for the balance tenure of the assignee payouts (subordination remains constant as a percentage of the pool principal).

The improvement in the credit profile of the guarantor and the CE available for meeting the balance payouts to the assignee payout holder 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 1.00-2.00% (on initial 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. 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 as well as an improvement in the credit profile of SKFL (guarantor).

Negative factors – The rating could be downgraded on 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, the performance of the pool till December 2022 (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, 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. As on September 30, 2022, SKFL had a network across 10 states, namely Rajasthan, Gujarat, Maharashtra, Madhya Pradesh, Punjab, Haryana, Chhattisgarh, Uttarakhand, Himachal Pradesh and Delhi, though concentration towards Rajasthan remains high with a share of ~58% in the portfolio. As on September 30, 2022, the assets under management (AUM) stood at Rs. 5,960 crore.

The promoter group, viz. Mr. Rajendra Setia and his family members, held 38.7% equity in the company as on September 30, 2022. Other key equity investors include Northwest Venture Partners, TPG Capital, Evolvence and Baring India with equity stakes of 24.5%, 19.0%, 5.6% and 4.7%, respectively, as of September 30, 2022.

Key financial indicators (audited)

SKFL	FY2021	FY2022	H1 FY2023
Total income	683	821	591
Profit after tax	91	143	97
AUM	3,417	4,714	5,960
Gross NPAs	4.1%	2.8%	3.1%
Net NPAs	1.9%	2.0%	2.2%

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

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 (FY2023)				Chronology of Rating History for the Past 3 Years			
		Instrument	Initial Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date and Rating	Date & Rating in FY2022	Date & Rating in FY2021		Date & Rating in FY2020
					Jan 27, 2023	Jan 31, 2022	Jan 14, 2021	Oct 27, 2020	-
1	Ess Kay IB DA 2020	Assignee Payouts	42.30	9.24	[ICRA]A+(SO)	[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: Click Here

Annexure I: 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	9.24	[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 II: 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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