March 21, 2023

SK Finance Limited (erstwhile Ess Kay Fincorp Limited): Rating for bank facilities withdrawn; earlier ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debentures	35.0	35.0	[ICRA]A+ (Positive); reaffirmed
Long-term market linked debentures	150.0	150.0	PP-MLD[ICRA]A+ (Positive); reaffirmed
Long-term fund-based term loan	275.0	-	[ICRA]A+ (Positive); reaffirmed and withdrawn
Total	**460.0**	**185.0**	

**Instrument details are provided in Annexure I*

Rationale

The ratings factor in SK Finance Limited's (SKFL) comfortable capitalisation and improving earnings profile as it scaled up its business. The capitalisation profile stood comfortable with the net worth increasing to Rs. 1,745.9 crore as on December 31, 2022 (Rs. 1,596.4 crore as on March 31, 2022) supported by the equity infusion of Rs. 487.0 crore in FY2022. ICRA notes the track record of healthy profitability with the return on managed assets (RoMA) and the return on average net worth (RoNW) improving to 2.5% and 11.3%, respectively, in 9M FY2023 (2.2% and 9.8%, respectively, in FY2021). The ratings factor in SKFL's established franchise in Rajasthan with good knowledge of and track record in the local market. SKFL has an adequately diversified borrowing profile for the current scale of operations with sources including debt markets, term loans and working capital lines from banks, term loans from financial institutions (FIs) and securitisation/direct assignment (DA) transactions. The Positive outlook reflects ICRA's expectation that the company would continue to profitably scale up while maintaining good control on asset quality and prudent capitalisation.

The ratings are, however, constrained by SKFL's high, albeit improving, geographical and product concentration. While the company has, over the years, expanded its reach to 10 states, the home state of Rajasthan still accounted for 56.6% of the portfolio as on December 31, 2022 (though lower than 94% as of March 31, 2014). Further, as the vehicle loan segment has consistently accounted for strong growth, its share in SKFL's assets under management (AUM) remained 85% as on December 31, 2022. The portfolio vulnerability is also augmented, given the target borrower profile which largely consists of first-time borrowers, single vehicle and small business owners, who are susceptible to economic shocks and have limited income buffers. ICRA notes that SKFL has gained traction in the micro, small and medium enterprise (MSME) lending space to cater to a similar category of low and middle-income group borrowers and its share in the AUM increased to 15% as on December 31, 2022 from 11% as on March 31, 2021.

Further, ICRA notes that the reported gross non-performing assets (NPAs) deteriorated to 4.5% as on December 31, 2022 following the adoption of the Reserve Bank of India's (RBI) circular for NPA recognition as per the new Income Recognition and Asset Classification (IRAC) norms. However, the credit costs are not impacted, given the relatively higher provisions carried by the company under IndAS norms. The 90+ days past due (dpd) remained stable at 2.2% as on December 31, 2022 (2.3% as on March 31, 2022), reflecting controlled fresh slippages and good collection efficiency. However, on a lagged basis (1 year), the 90+ dpd was higher at 3.1% as on December 31, 2022.

ICRA has reaffirmed and withdrawn the rating assigned to the Rs. 275-crore bank facilities at the request of the company and based on the No Objection Certificate received from the bankers, in accordance with ICRA's policy on withdrawal (click here for the policy).

Key rating drivers and their description

Credit strengths

Good market knowledge and track record; established franchise in Rajasthan – SKFL is promoted by Mr. Rajendra Setia, who, along with his family members, holds an equity share of 38.5% in the company (as on December 31, 2022). The company, under the leadership of Mr. Setia, has a long track record of over two decades in the local vehicle financing market, whereby it has established a retail franchise in Rajasthan and gained good understanding of the local market. Also, it is backed by established equity investors such as Norwest Venture Partners X – Mauritius (Norwest), TPG Capital, Baring Private Equity India AIF, Evolvence India (Evolvence) and IIFL Special Opportunities Fund, which together held 57.3% equity as of December 31, 2022. SKFL's board of directors comprises two promoter directors, two independent directors and two investor nominee directors.

Comfortable capitalisation – SKFL's capitalisation stands comfortable, supported by the equity infusion of Rs. 487 crore in FY2022. Following this, the net worth increased to Rs. 1,596.4 crore March 31, 2022 from Rs. 971.5 crore as on March 31, 2021. In 9M FY2023, the net worth increased further to Rs. 1,745.9 crore on account of internal capital generation. Four rounds of equity raises in the past four years have facilitated a sustained improvement in the leverage to a comfortable level with reported and managed gearing of 2.9x as on March 31, 2022. However, with incremental business in 9M FY2023 being funded out of fresh borrowings, the managed gearing increased to 3.8x as on December 31, 2022. The reported capital adequacy was comfortable at 26.3% (based on provisional financials) as on December 31, 2022 (30.4% as on March 31, 2022). ICRA notes that SKFL has outlined a roadmap for strong growth, which is likely to increase the leverage from the current level. In this regard, as demonstrated in the past, SKFL would have to raise capital from investors, in a timely manner, to maintain prudent capitalisation.

Track record of healthy profitability – Given the relatively vulnerable target borrower profile, SKFL commands high lending yields. While the yields have softened over the past few years with the diversification into the new vehicle and small and medium-sized enterprise (SME) loan segments, they remained high at 18.6%[1] in 9M FY2023 (compared to 17.8%[1] in FY2022 and 19.1%[1] in FY2021) with a five-year average of about 20%[1]. Although the cost of funds moderated to 8.9%[1] in FY2022 from 10.2%[1] in FY2021 because of the improvement in the company's competitive position and the systemic decline in the interest rates, the same increased to 9.2%[1] in 9M FY2023 amid the rising interest rate environment. The net interest margin (NIM; on a managed asset basis) increased to 9.2%[1] in 9M FY2023 from 8.2%[1] in FY2022 (8.7%[1] in FY2021) because of the increase in the share of DA (4% as on December 31, 2022 from 2% as on March 31, 2022) in the overall portfolio.

The company's operating expenses remained relatively high at 4.8%[1] in 9M FY2023 due to the cost-intensive business model and branch expansion. While the credit cost declined to 0.3%[1] in FY2022 from 2.2%[1] in FY2021 because of the reversal of management overlays (created during the Covid-19 pandemic) in addition to recoveries from NPAs, the same increased to 1.4%[1] in 9M FY2023, in line with the incremental growth in the portfolio. Overall, the profitability improved (post moderation in FY2021 during pandemic) with RoMA and RoNW of 2.5%[1] and 11.3%[1], respectively, in 9M FY2023 (2.6%[1] and 11.1%[1], respectively, in FY2022) from 2.2%[1] and 9.8%[1], respectively, in FY2021. ICRA notes that as the operating expenses stabilise with economies of scale, the profitability is expected to improve, provided SKFL can maintain good control on fresh slippages over the medium term.

[1] *As per ICRA's calculations*

Adequately diversified borrowing profile for the scale of operations – SKFL's borrowing profile is adequately diversified, with sources including debt markets (28.8% of the total borrowings as on December 31, 2022), term loans and working capital lines from banks (48.2%), and term loans from FIs (6.5%). As on December 31, 2022, the company had borrowing relationships with over 60 FIs. It also continues to raise funds through securitisation/DA, (15.5% of the total borrowings as of December 31, 2022). Moreover, with the improvement in its competitive position and the systemic decline in interest rates, SKFL's cost of funds stood improved to 8.9% in FY2022 from 10.2% in FY2021. Further, the cost of borrowing remained stable at 9.2% in 9M FY2023 despite the marginal increase in the cost of incremental borrowing during the period.

Credit challenges

Exposure to relatively modest borrower profiles – As SKFL primarily operates in the used vehicle financing segment, its customers are mostly first-time borrowers and single vehicle and small business owners, who are susceptible to economic shocks and have limited income buffers. Thus, the delinquencies in the softer buckets could remain volatile for the company. ICRA notes that SKFL has demonstrated satisfactory asset quality over the years, excluding the adverse impact witnessed during the first wave of the pandemic and during demonetisation. While the 30+ dpd improved to 6.9% as on December 31, 2022 from 14.4% as on March 31, 2021, it remains high given the target borrower profile and the nature of the business. The 90+ dpd improved to 2.2% as on December 31, 2022 from 3.5% as on March 31, 2021 amid the improvement in the operating environment.

Earlier, SKFL's restructured loans had been affected by the second wave of the pandemic; restructured advances moderated to 0.5% of the AUM as on December 31, 2022 from the peak of 1.3% as on March 31, 2022. The company holds a 40.0% provision on restructured assets. ICRA notes that the reported gross NPA increased to 4.5% as on December 31, 2022 following the migration to reporting as per the clarification on the RBI's IRAC norms. The gross stage 3 remained under control at 2.8% as on December 31, 2022. On a lagged basis (1-year), the 90+ dpd was elevated at 3.1% as on December 31, 2022. The gross stage 2 improved to 5.1% as on March 31, 2022 from 11.6% as on March 31, 2021. The provision cover on the overall book reduced to 2.3% as on December 31, 2022 from 4.7% as on March 31, 2021 as the company used management overlay and the overall collections improved. Going forward, SKFL's ability to control fresh slippages will remain a key monitorable, especially given the company's growth plans.

High, albeit improving, geographical and product concentration – SKFL has expanded the scale of its operations in the last few years with its AUM increasing to Rs. 6,714.0 crore (based on provisional financials) as on December 31, 2022 from Rs. 1,282.0 crore as on March 31, 2018. Further, it expanded its reach to 10 states in India through a network of 441 branches as on December 31, 2022. However, it remains a regional player with the home state of Rajasthan still accounting for 56.6% of the portfolio as on December 31, 2022 though concentration has moderated compared to 94.0% in March 2014. The balance portfolio is primarily in Madhya Pradesh (13.4%), Gujarat (12.3%), Punjab & Haryana (10.7%) and Maharashtra (4.2%).

Moreover, as the vehicle loan segment has consistently accounted for the company's growth, its share in SKFL's AUM remained at 85% as on December 31, 2022 (though lower than 91% as on March 31, 2018). Also, while the share of the used vehicle segment moderated to 65% of the AUM as on December 31, 2022, it remains the largest business area for the company. ICRA notes that SKFL has gained traction in the MSME lending space to cater to a similar category of low and middle-income group borrowers and its share in the AUM increased to 15% as on December 31, 2022 from 9% as on March 31, 2018.

Liquidity position: Strong

The tenure of the loans extended by SKFL (with average tenure of 3.5 to 4 years) matches well with the weighted average tenure of the term facilities availed by the company and reflects positively in the asset-liability maturity (ALM) profile. Thus, SKFL's ALM profile, in the normal course of business, is characterised by positive cumulative mismatches across all buckets up to 1 year. As per the provisional ALM profile as on December 31, 2022, SKFL had scheduled principal debt repayments of Rs. 2,810 crore for the 12-month period ending December 31, 2023 against which it had scheduled inflows from performing advances of Rs. 2,184 crore. The unencumbered on-balance sheet liquidity (cash and liquid investments) of Rs. 1,440.2 crore

(~22% of total borrowings), coupled with undrawn working capital lines of about Rs. 81 crore, further support the company's liquidity profile.

Rating sensitivities

Positive factors – The ratings could be upgraded on a sustained improvement in the profitability (RoMA>3.0%) and competitive position through a healthy growth in the scale while maintaining comfortable asset quality and capitalisation.

Negative factors – Pressure on the ratings could emerge on a significant deterioration in the asset quality and/or the capitalisation profile (managed gearing increasing beyond 4x on a sustained basis) or weakening in the liquidity and earnings profile of the company.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	[ICRA's Credit Rating Methodology for Non-banking Finance Companies] [Policy on Withdrawal of Credit Ratings]
Parent/Group support	Not applicable
Consolidation/Standalone	Standalone

About the company

Incorporated in 1994, SKFL has its headquarters in Jaipur (Rajasthan). It is a non-banking financial company (NBFC) registered with the RBI. It primarily finances used light commercial vehicles, multi-utility vehicles, cars, tractors and two-wheelers. It also advances SME loans. SKFL had a network of 441 branches as on December 31, 2022 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 56.6% in the portfolio. As on December 31, 2022, the AUM stood at about Rs. 6,714 crore with commercial vehicles forming the largest share at 48% followed by cars (17%), MSME loans (15%), tractors (13%) and two-wheelers (6%).

The promoter group, viz. Mr. Rajendra Setia and his family members, held 38.5% equity share in the company as on December 31, 2022. Other key equity investors include Northwest Venture Partners, TPG Capital, Evolvence, Barings India and IIFL Special Opportunities Fund Series 9 with equity shareholding of 24.5%, 18.9%, 5.6% and 4.7% and 3.6%, respectively, as on December 31, 2022.

The company reported a profit after tax (PAT) of Rs. 142.9 crore in FY2022 on total managed assets of Rs. 6,434.5 crore as on March 31, 2022 compared to PAT of Rs. 91.1 crore in FY2021 on total managed assets of Rs. 4,557.5 crore as on March 31, 2021. In 9M FY2023, the company reported a PAT of Rs. 141.5 crore on total managed assets of Rs. 8,706.3 crore as on December 31, 2022. The company's net worth stood at Rs. 1,745.9 crore as on December 31, 2022, based on provisional financials (Rs. 1,596.4 crore as on March 31, 2022 and Rs. 971.5 crore as on March 31, 2021). The gross and net stage 3 stood at 2.8% and 2.0%, respectively, as on December 31, 2022 and March 31, 2022 (4.1% and 1.9%, respectively, as on March 31, 2021).

Key financial indicators (KFIs)

	FY2020	FY2021	FY2022	9M FY2023*
Total income	582.4	682.5	820.7	927.1
Profit after tax	78.5	91.1	142.9	141.5
Net worth	878.7	971.5	1,596.4	1,745.9
Gross loan book	2,992.2	3,469.5	4,779.9	6,678.2
Total managed assets	3,756.8	4,557.5	6,434.5	8,706.3
Return on average managed assets	2.5%	2.2%	2.6%	2.5%
Return on average net worth	10.9%	9.8%	11.1%	11.3%
CRAR	31.7%	27.7%	30.4%	26.3%
Managed gearing (times)	3.1	3.4	2.9	3.8
Gross stage 3	4.0%	4.0%	2.8%	2.8%
Net stage 3	2.4%	1.9%	2.0%	2.0%
Gross NPA% (as per new IRAC norms)	4.0%	4.0%	2.8%	4.5%
Net NPA% (as per new IRAC norms)	2.4%	1.9%	2.0%	3.5%
Solvency (Net stage 3/Net worth)	8.1%	6.7%	6.0%	7.6%

*Source: SKFL, ICRA Research; Amount in Rs. crore; All figures and ratios as per ICRA's calculations; * KFIs for 9M FY2023 are based on provisional financials*

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		Date & Rating in FY2022					Date & Rating in FY2021	Date & Rating in FY2020
					Mar 21, 2023	Mar 06, 2023	Mar 07, 2022	Dec 23, 2021	Nov 08, 2021	Oct 28, 2021	Sep 08, 2021	-	-
1	Non-convertible debentures	Long term	35.0	35.0	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A (Stable)	-	-	-	-	-
2	Long-term market linked debentures	Long term	150.0	150.0	PP-MLD [ICRA]A+ (Positive)	PP-MLD [ICRA]A+ (Positive)	PP-MLD [ICRA]A+ (Stable)	PP-MLD [ICRA]A (Stable)	PP-MLD [ICRA]A (Stable)	-	-	-	-
3	Long-term fund-based term loan	Long term	275.0	-	[ICRA]A+ (Positive); Rating withdrawn	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	-	-

Source: ICRA Research
** As on March 16, 2023*

Complexity level of the rated instruments

Instrument	Complexity Indicator
Non-convertible debentures	Simple
Long-term market linked debentures	Complex
Long-term fund-based term loan	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 (as on March 16, 2023)

ISIN	Instrument Name	Date of Issuance/ Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE124N08075	**NCD**	Dec-29-2021	9.25%	Jun-29-2024	35.0	[ICRA]A+ (Positive)
INE124N07564	**Long-term MLD**	Nov-12-2021	G-Sec Linked	Jan-12-2024	150.0	PP-MLD[ICRA]A+ (Positive)
NA	**Term loan 1**	Aug-05-2021	NA	Feb-25-2025	30.5	[ICRA]A+ (Positive); Rating withdrawn
NA	**Term loan 2**	Aug-04-2021	NA	Jun-27-2024	15.0	[ICRA]A+ (Positive); Rating withdrawn
NA	**Term loan 3**	Oct-18-2021	NA	Dec-30-2024	63.4	[ICRA]A+ (Positive); Rating withdrawn
NA	**Long-term fund-based term loan – Proposed/ Unallocated**	NA	NA	NA	166.1	[ICRA]A+ (Positive); Rating withdrawn

*Source: SKFL, ICRA Research; * Yet to be placed*

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis – Not applicable

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