September 21, 2023

SK Finance Limited (erstwhile Ess Kay Fincorp Limited): Ratings upgraded; outlook revised to Stable from Positive

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]AA- (Stable); upgraded from [ICRA]A+(Positive) and outlook revised to Stable from Positive
Long-term market linked debentures	150.0	150.0	PP-MLD[ICRA]AA- (Stable); upgraded from PP-MLD[ICRA]A+ (Positive) and outlook revised to Stable from Positive
Total	**185.0**	**185.0**	

**Instrument details are provided in Annexure I*

Rationale

The ratings upgrade factors in SK Finance Limited's (SKFL) strengthened capital profile and improving earnings profile as it scaled-up its business. The capitalisation profile of the company has improved post the recent capital raise from new and existing investors, leading to sizeable increase in net worth by ~Rs. 900 crore from Rs. 1,899.4 crore as on June 30, 2023. ICRA believes that the company will be able to leverage on this capital base and grow as per the business plans. The ratings also factor SKFL's track record of healthy profitability with the return on managed assets (RoMA) and the return on average net worth (RoNW) improving to 2.8% and 13.0%, respectively, in FY2023 (2.6% and 11.1%, respectively, in FY2022), notwithstanding the marginal dip in Q1 FY2024 with RoMA and RoNW of 2.4% and 12.7%, respectively, because of higher credit costs, owing to the seasonality attached to the business. The ratings continue to 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 transactions.

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 12 states, the home state of Rajasthan still accounted for 54% of the portfolio as on June 30, 2023 (though lower than 94.0% as of March 31, 2014). The vehicle loan segment has consistently accounted for strong growth, its share in SKFL's assets under management (AUM) stood at 82% as on June 30, 2023. Further, the target borrower profile 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 18% as on June 30, 2023, from 11% as on March 31, 2021.

Further, ICRA notes that the reported gross non-performing assets (NPAs) were relatively higher at 3.7% as on June 30, 2023, as per the Reserve Bank of India's (RBI) new Income Recognition and Asset Classification (IRAC) norms. The 90+ days past due (dpd) remained stable at 1.9% as on June 30, 2023 (1.6% as on March 31, 2023), reflecting controlled fresh slippages and good collection efficiency. However, on a lagged basis (one year), the 90+ dpd was higher at 2.8% as on June 30, 2023. Going forward, the ability of the company to continue the growth trajectory, while maintaining asset quality indicators and improving on profitability, would be imperative to maintain its credit profile.

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 June 30, 2023). 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 a 56.4% equity as on June 30, 2023. SKFL's board of directors comprises two promoter directors, two independent directors and two investor nominee directors.

- **Comfortable capitalisation** – SKFL's capitalisation has improved with the recent capital raise of ~Rs. 900 crore from new and existing investors. Earlier, the company received equity of Rs. 487 crore in FY2022, which led to increase in the net worth to Rs. 1,596.4 crore as on March 31, 2022, from Rs. 971.5 crore as on March 31, 2021. Subsequently, the net worth increased further to Rs. 1,899.4 crore as on June 30, 2023 (Rs. 1,833.7 crore as on March 31, 2023) on account of internal capital generation. Four rounds of equity raise during the four-year period between March 2018 to March 2022, had facilitated a sustained improvement in the leverage to a comfortable level with reported and managed gearing of 2.9 times as on March 31, 2022. However, with incremental business in FY2023 and Q1 FY2024 being funded out of fresh borrowings, the reported and managed gearing increased to 4.0 times and 4.3 times, respectively, as on June 30, 2023 (3.9 times and 4.1 times, respectively, as on March 31, 2023). The reported capital adequacy was comfortable at 25.4% (based on provisional financials) as on June 30, 2023 (26.1% as on March 31, 2023). The recent growth capital received from new and existing investors will bring down the leverage from current levels, giving the company headroom for its growth plans in the near term. ICRA notes that SKFL has outlined a road map for strong growth, which is likely to increase the leverage from current levels. In this regard, as demonstrated recently, 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 19.0%[1] in FY2023 (compared to 17.9%[1] in FY2022) with a five-year average of about 20%[1]. In Q1 FY2024, the yields moderated to 18.2% because of an increase in share of SME and car loans in incremental disbursements, where yields are typically lower than other segments. 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 9.5%[1] in Q1 FY2024 (9.4%[1] in FY2023) amid rising interest rates. The net interest margin (NIM; on a managed asset basis) increased to 9.0%[1] in Q1 FY2024 (9.2%[1] in FY2023) from 8.3%[1] in FY2022 because of the increase in the share of DA (8% as on June 30, 2023 from 2% as on March 31, 2022) in the overall portfolio.

The company's operating expenses remained relatively higher at 4.4%[1] in Q1 FY2024 (4.8%[1] in FY2023) due to the cost-intensive business model and branch expansion. The credit cost increased to 1.5%[1] in Q1 FY2024 (1.1%[1] in FY2023) from 0.3%[1] in FY2022, in line with the incremental growth in the portfolio. Overall, the profitability slightly improved with RoMA and RoNW of 2.8%[1] and 13.0%[1], respectively, in FY2023 from 2.6%[1] and 11.1%[1], respectively, in FY2022. In Q1 FY2024, the profitability indicators weakened moderately with RoMA and RoNW of 2.4%[1] and 12.7%[1], respectively, because of higher credit costs. 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.

Adequately diversified borrowing profile for the scale of operations – SKFL's borrowing profile is adequately diversified, with sources including debt markets (24.7% of the total borrowings as on June 30, 2023), term loans and working capital

[1] *As per ICRA's calculations*

lines from banks (52.2%), and term loans from FIs (7.3%). As on June 30, 2023, the company had borrowing relationships with over 65 FIs. It also continues to raise funds through securitisation (14.8% of the total borrowings as of June 30, 2023). The cost of borrowing has remained stable at 9.3% in Q1 FY2024 (9.3% in FY2023), despite marginal increase in 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 impacts of the first wave of the pandemic and demonetisation. While the 30+ dpd improved to 5.8% as on June 30, 2023, 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 1.9% as on June 30, 2023, 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 stood negligible at 0.2% of the AUM as on June 30, 2023, compared to the peak of 1.3% as on March 31, 2022. The company holds a 17.3% provision on restructured assets. ICRA notes that the reported gross NPA increased to 3.7% as on June 30, 2023, from 3.1% as on March 31, 2023, as per the RBI's new IRAC norms. The gross stage 3 remained under control at 2.5% as on June 30, 2023. However, on a lagged basis (one year), the 90+ dpd was higher at 2.8% as on June 30, 2023. The gross stage 2 improved to 3.3% as on June 30, 2023, from 11.6% as on March 31, 2021. The provision cover on the overall book reduced to 2.2% as on June 30, 2023 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. 7,931.9 crore (based on provisional financials) as on June 30, 2023, from Rs. 1,282.0 crore as on March 31, 2018. Further, it expanded its reach to 12 states in India through a network of 456 branches as on June 30, 2023. However, it remains a regional player with the home state of Rajasthan still accounting for 54.2% of the portfolio as on June 30, 2023, though concentration has moderated compared to 94.0% in March 2014. The balance portfolio is primarily in Madhya Pradesh (13.7%), Gujarat (11.5%), Punjab & Haryana (11.5%) and Maharashtra (4.5%).

Moreover, as the vehicle loan segment has consistently accounted for the company's growth, its share in SKFL's AUM remained at 82% as on June 30, 2023 (though lower than 91% as on March 31, 2018). Also, while the share of the used vehicle segment moderated to 63% of the AUM as on June 30, 2023, 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 18% as on June 30, 2023, 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 one year. As per the provisional ALM profile as on June 30, 2023, SKFL had scheduled principal debt repayments of Rs. 3,261 crore for the 12-month period ending June 30, 2024 against which it had scheduled inflows from performing advances of Rs. 2,540 crore. The unencumbered on-balance sheet liquidity (cash and liquid investments) of Rs. 1,796.2 crore (~23% of total borrowings), coupled with undrawn working capital lines of about Rs. 93 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 4 times 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
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 456 branches as on June 30, 2023, across 12 states, namely Rajasthan, Gujarat, Maharashtra, Madhya Pradesh, Punjab, Haryana, Chhattisgarh, Delhi, Himachal Pradesh, Uttarakhand, Karnataka and Uttar Pradesh, though concentration towards Rajasthan remains high with a share of 54.2% in portfolio. As on June 30, 2023, the AUM stood at about Rs. 7,932 crore with commercial vehicles forming the largest share at 46%, followed by cars (18%) and MSME loans (18%), tractors (14%) and two-wheelers (4%).

The promoter group, viz., Mr. Rajendra Setia and his family members, held 38.5% equity share in the company as on June 30, 2023. Other key equity investors include Northwest Venture Partners, TPG Capital, Evolvence, Barings India and IIFL Special Opportunities Fund Series 9 with equity shareholding of 24.1%, 18.7%, 5.5%, 4.6% and 3.5%, respectively, as on June 30, 2023.

The company reported a profit after tax (PAT) of Rs. 222.8 crore on total managed assets of Rs. 9,597.0 crore as on March 31, 2023, compared to PAT of Rs. 142.9 crore in FY2022 on a total managed assets of Rs. 6,434.5 crore as on March 31, 2022. The company's net worth stood at Rs. 1,833.7 crore with managed gearing of 4.1 times as on March 31, 2023, compared to Rs. 1,596.4 crore and 2.9 times, respectively, as on March 31, 2022. The gross stage 3 and net stage 3 for the company stood at 1.9% and 1.3%, respectively, as on March 31, 2023, compared to 2.8% and 2.0%, respectively, as on March 31, 2022. In Q1 FY2024, the company reported a PAT of Rs. 59.4 crore on total managed assets of Rs. 10,399.8 crore as on June 30, 2023. The company's net worth stood at Rs. 1,899.4 crore with managed gearing of 4.3 times as on June 30, 2023, based on provisional financials. The company's gross stage 3 and net stage 3 was 2.5% and 1.7%, respectively, as on June 30, 2023.

Key financial indicators (KFIs)

	FY2021	FY2022	FY2023	Q1 FY2024
Total income	682.5	820.7	1,314.2	401.9
Profit after tax	91.1	142.9	222.8	59.4
Net worth	971.5	1,596.4	1,833.7	1,899.4
Gross loan book	3,469.5	4,772.8	7,185.7	7,607.3
Total managed assets	4,557.5	6,427.4	9,597.0	10,399.8
Return on average managed assets	2.2%	2.6%	2.8%	2.4%
Return on average net worth	9.8%	11.1%	13.0%	12.7%
CRAR	27.7%	30.4%	26.1%	25.4%
Managed gearing (times)	3.4	2.9	4.1	4.3
Gross stage 3	4.0%	2.8%	1.9%	2.5%
Net stage 3	1.9%	2.0%	1.3%	1.7%
Gross NPA% (as per new IRAC norms)	4.0%	2.8%	3.1%	3.7%
Net NPA% (as per new IRAC norms)	1.9%	2.0%	2.3%	2.7%
Solvency (Net stage 3/Net worth)	6.7%	6.0%	5.1%	6.6%

*Source: SKFL, ICRA Research; Amount in Rs. crore; All figures and ratios as per ICRA's calculations; * KFIs for Q1 FY2024 are based on provisional financials*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

		Current Rating (FY2024)				Chronology of Rating History for the Past 3 Years							
		Type	Amount Rated (Rs. crore)	Amount Outstanding* (Rs. crore)	Date & Rating in FY2024	Date & Rating in FY2023		Date & Rating in FY2022					Date & Rating in FY2021
					Sep 21, 2023	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]AA- (Stable)	[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]AA- (Stable)	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	-	-	-	[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 August 31, 2023*

Complexity level of the rated instruments

Instrument	Complexity Indicator
Non-convertible debentures	Simple
Long-term market linked debentures	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 (as on August 31, 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]AA- (Stable)
INE124N07564	**Long-term MLD**	Nov-12-2021	G-Sec Linked	Jan-12-2024	150.0	PP-MLD[ICRA]AA- (Stable)

Source: SKFL, ICRA Research

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

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