March 18, 2024

SK Finance Limited (erstwhile Ess Kay Fincorp Limited): Ratings reaffirmed and rating withdrawn for matured instrument; [ICRA]AA- (Stable) assigned

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); reaffirmed
Non-convertible debentures	0.0	300.0	[ICRA]AA- (Stable); assigned
Long-term market linked debentures	150.0	0.0	PP-MLD[ICRA]AA- (Stable); reaffirmed and withdrawn
Total	**185.0**	**335.0**	

**Instrument details are provided in Annexure I*

Rationale

The ratings factor in SK Finance Limited's (SKFL) strengthened capital profile and healthy earnings profile along with the scaled-up business. The capitalisation profile has improved following the recent capital raise from new and existing investors, leading to a sizeable increase of ~Rs. 900 crore in the net worth (net worth of Rs. 2,738 crore as on December 31, 2023, post receipt of first tranche of ~Rs. 664 crore in 9M FY2024 and subsequent second tranche of Rs. ~225 crore received in January 2024). ICRA believes that the company will be able to leverage this capital base and grow as per its business plans. The ratings also consider SKFL's track record of healthy profitability with the return on managed assets (RoMA) and the return on average net worth (RoNW) remaining healthy at 2.7% and 12.7%, respectively, in 9M FY2024 (2.8% and 13.0%, respectively, in FY2023), despite the rise in credit costs owing to the higher provision cover on non-performing assets (NPAs). The ratings continue to factor in SKFL's established franchise in Rajasthan with a good track record and knowledge of 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/assignment 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 53% of the portfolio as on December 31, 2023 (though lower than 94% as of March 31, 2014). The vehicle loan segment has consistently accounted for strong growth with a share of 80% in SKFL's assets under management (AUM) as on December 31, 2023. Further, the target borrower profile largely consists of first-time borrowers and 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 20% as on December 31, 2023 from 11% as on March 31, 2021.

Further, ICRA notes that the reported NPAs weakened to 4.6% as on December 31, 2023 (3.1% as on March 31, 2023) and the 90+ days past due (dpd) weakened marginally to 2.2% as on December 31, 2023 (1.6% as on March 31, 2023). The uptick in the reported NPAs was largely on account of the Reserve Bank of India's (RBI) clarification on Income Recognition and Asset Classification (IRAC) norms. On a lagged basis (one year), the 90+ dpd was higher at 2.9% as on December 31, 2023. Going forward, SKFL's ability to control fresh slippages will remain a key monitorable, especially given its growth plans.

The Stable outlook reflects ICRA's expectation that the company would continue to scale up profitably while maintaining a prudent capitalisation profile.

ICRA has reaffirmed and withdrawn the rating assigned to the Rs. 150-crore long-term market linked debentures at the request of the company as no amount is outstanding against the same. The rating has been withdrawn in accordance with ICRA's policy on the withdrawal of credit ratings.

Key rating drivers and their description

Credit strengths

Good market knowledge and track record; established franchise in Rajasthan – SKFL, under the leadership of Mr. Rajendra 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. The company's board of directors comprises two promoter directors, two independent directors and two investor nominee directors. SKFL is promoted by Mr. Setia, who, along with his family members, holds an equity stake of 32.6% in the company (fully-diluted basis as on January 31, 2024). It is also 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 49.6% equity stake as on January 31, 2024. Additionally, post the recent capital raise, the new investors in the company include Motilal Oswal Private Equity (PE), Duro Capital, Axis Growth Avenues, Ananta Capital Venture and Mirae, which together held 11.5% equity as on January 31, 2024.

Comfortable capitalisation – SKFL's capitalisation has improved with the recent capital raise of ~Rs. 900 crore from new and existing investors. The net worth increased to Rs. 2,738 crore as on December 31, 2023 from Rs. 1,834 crore as on March 31, 2023 on the receipt of the first tranche (~Rs. 664 crore) of the capital infusion as well as internal capital generation. Consequently, the managed gearing reduced to 3.2x as on December 31, 2023 from 4.1x as on March 31, 2023. The reported capital adequacy was comfortable at 30.5% as on December 31, 2023 (26.1% as on March 31, 2023). ICRA notes that the company received the second of tranche of capital (~Rs. 225 crore) in January 2024. The recent growth capital received from new and existing investors has brought down the leverage, 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 the current level. In this regard, as demonstrated recently, the company 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 due to diversification into the new vehicle and small and medium-sized enterprise (SME) loan segments, they remain high with a five-year average (FY2019-FY2023) of 20.0%[1]. The yields moderated to 18.5%[1] in 9M FY2024 from 19.0%[1] in FY2023 because of an increase in the share of SME and car loans in incremental disbursements. These loans usually have lower yields compared to other segments. Further, the cost of funds increased to 9.7%[1] in 9M FY2024 from 9.4%[1] in FY2023 because of the rise in systemic interest rates, leading to a compression in the lending spreads to 8.7%[1] in 9M FY2024 from 9.6%[1] in FY2023. Nonetheless, the net interest margin (NIM; managed asset basis) remained stable at 9.3%[1] in 9M FY2024 compared with 9.2%[1] in FY2023 because of the increase in the share of direct assignment (DA) transactions (10% as on December 31, 2023 compared to 6% as on March 31, 2023) in the overall portfolio resulting in increase in DA income to Rs. 85 crore in 9M FY2024 and Rs. 49 crore in FY2023. The company's operating expenses moderated marginally to 4.6%[1] in 9M FY2024 from 4.8%[1] in FY2023, but remain high due to the cost-intensive business model and branch expansion. Credit costs increased to 1.4%[1] in 9M FY2024 from 1.1%[1] in FY2023 because of the higher provision cover on NPAs.

Overall, the profitability indicators remained healthy with RoMA and RoNW of 2.7%[1] and 12.7%[1], respectively, in 9M FY2024 compared to 2.8%[1] and 13.0%[1], respectively, in FY2023. ICRA notes that the profitability is expected to improve as the operating expenses stabilise with economies of scale, 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 (20% of the total borrowings including off-book as on December 31, 2023), term loans and working capital lines from banks (54%), term loans from FIs (6%) and others (1%). As on December 31, 2023, the company had borrowing relationships with over 60 FIs. It also continues to raise funds through securitisation/DA (19% of the total borrowings as of December 31, 2023). The cost of borrowing remained stable at 9.3% in 9M FY2024 (9.3% in FY2023), despite the marginal increase in the cost of incremental borrowings during this 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 Covid-19 pandemic and demonetisation. Subsequently, the 30+ dpd weakened to 6.9% as on December 31, 2023 from 4.9% as on March 31, 2023 because of delinquencies in the tractor and commercial vehicle (CV) segments due to seasonality. The same remains high, given the target borrower profile and the nature of the business. Further, the 90+ dpd weakened marginally to 2.2% as on December 31, 2023 from 1.6% as on March 31, 2023 because of roll forwards into harder buckets. Moreover, on a lagged basis (one year), the 90+ dpd was higher at 2.9% as on December 31, 2023.

Restructured advances were negligible at 0.1% of the loan book as on December 31, 2023 compared to the peak of 1.3% as on March 31, 2022. The company holds a provision of 34.7% on restructured assets. ICRA notes that the reported gross and net NPAs weakened to 4.6% and 3.2%, respectively, as on December 31, 2023, from 3.1% and 2.4%, respectively, as on March 31, 2023, largely on account of the RBI's clarifications on IRAC norms and partly due to SKFL's strategy of focusing on collecting dues from the 90+ dpd buckets. However, the company is in the process of revising its collections strategy to control the roll forwards into harder buckets. The gross and net stage 3 also weakened to 2.9% and 1.6%, respectively, as on December 31, 2023 from 1.9% and 1.3%, respectively, as on March 31, 2023 on account of delinquencies in the tractor and CV segments in 9M FY2024. The provision cover on the overall book increased to 2.4% as on December 31, 2023 from 2.0% as on March 31, 2023, as the company has increased the provision cover on NPAs. Going forward, SKFL's ability to control fresh slippages will remain a key monitorable, especially given its 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. 9,525 crore as on December 31, 2023 from Rs. 1,282 crore as on March 31, 2018. Further, it expanded its reach to 12 states in India through a network of 535 branches as on December 31, 2023. However, it remains a regional player with the home state of Rajasthan still accounting for 53% of the portfolio as on December 31, 2023, though this has moderated from 94% in March 2014. The balance portfolio is primarily in Madhya Pradesh (14%), Gujarat (11%), Punjab & Haryana (12%) and Maharashtra (5%).

Moreover, as the vehicle loan segment has consistently accounted for the company's growth, its share in SKFL's AUM remained at 80% as on December 31, 2023 (though lower than 91% as on March 31, 2018). Also, while the share of the used vehicle segment moderated to 60% of the AUM as on December 31, 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 20% as on December 31, 2023 from 9% as on March 31, 2018.

Liquidity position: Strong

The tenure of the loans extended by SKFL (with average tenure of 3.5-4 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, the 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 December 31, 2023, SKFL had scheduled principal debt repayments of Rs. 3,636 crore for the 12-month period ending December 31, 2024 against which it had scheduled inflows from performing advances of Rs.

2,905 crore. The unencumbered on-balance sheet liquidity (cash and liquid investments) of Rs. 1,613.5 crore (~20% of on-balance sheet borrowings), coupled with undrawn working capital lines of about Rs. 75 crore, further support the company's liquidity profile.

Rating sensitivities

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

Negative factors – Pressure on the rating 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	-
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 535 branches, as on December 31, 2023, across 12 states, namely Rajasthan, Gujarat, Maharashtra, Madhya Pradesh, Punjab, Haryana, Chhattisgarh, Delhi, Himachal Pradesh, Uttarakhand, Karnataka and Uttar Pradesh, though concentration in Rajasthan remains high with a share of 53% in the portfolio. As on December 31, 2023, the AUM stood at about Rs. 9,525 crore with commercial vehicles forming the largest share at 44%, followed by MSME loans (20%), cars (19%), tractors (13%) and two-wheelers (5%).

The promoter group, viz. Mr. Rajendra Setia and his family members, held a 32.6% equity stake (fully-diluted basis) in the company as on January 31, 2024. Other key equity investors include Northwest Venture Partners, TPG Capital, Evolvence, Barings India and IIFL Special Opportunities Fund Series 9 with equity shareholding of 23.7%, 17.9%, 3.6%, 1.3% and 3.1%, respectively, as on January 31, 2024. Additionally, post the recent capital raise, the new investors in the company include Motilal Oswal Private Equity (PE), Duro Capital, Axis Growth Avenues, Ananta Capital Venture and Mirae, which together held 11.5% equity as on January 31, 2024.

The company reported a profit after tax (PAT) of Rs. 217 crore in 9M FY2024 on total managed assets of Rs. 11,891 crore as on December 31, 2023 compared to PAT of Rs. 223 crore in FY2023 on total managed assets of Rs. 9,597 crore as on March 31, 2023. Its net worth stood at Rs. 2,738 crore with a managed gearing of 3.2x as on December 31, 2023 (Rs. 1,834 crore and 4.1x, respectively, as on March 31, 2023). The gross and net stage 3 stood at 2.9% and 1.6%, respectively, as on December 31, 2023 (1.9% and 1.3%, respectively, as on March 31, 2023).

Key financial indicators (KFIs)

	FY2021	FY2022	FY2023	9M FY2024
	Audited	Audited	Audited	Provisional
Total income	682	821	1,314	1,315
Profit after tax	91	143	223	217
Total managed assets	4,558	6,427	9,597	11,891
Return on average managed assets	2.2%	2.6%	2.8%	2.7%
Managed gearing (times)	3.4	2.9	4.1	3.2
Gross stage 3	4.0%	2.8%	1.9%	2.9%
Gross NPA (as per new IRAC norms)	4.0%	2.8%	3.1%	4.6%
CRAR	27.7%	30.4%	26.1%	30.5%

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

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
					Mar 18, 2024	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	4.67*	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A (Stable)	-	-	-	-
2	**Non-convertible debentures**	Long term	300.0	0.00^	[ICRA]AA- (Stable)	-	-	-	-	-	-	-	-	-
3	**Long-term market linked debentures**	Long term	150.0	-	PP-MLD [ICRA]AA- (Stable); withdrawn	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)	-	-	-
4	**Long-term fund-based term loan**	Long term	-	-	-	-	[ICRA]A+ (Positive); withdrawn	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	-

Source: ICRA Research
** As on February 29, 2024; ^ As on March 14, 2024*

Complexity level of the rated instruments

Instrument	Complexity Indicator
Non-convertible debentures (INE124N08075)	Simple
Non-convertible debentures (yet to be placed)	Very simple
Long-term 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: Click Here

Annexure I: Instrument details^

ISIN	Instrument Name	Date of Issuance/ Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE124N08075	**NCD**	Dec-29-2021	1-year SBI MCLR linked	Jun-29-2024	35.0	[ICRA]AA- (Stable)
NA	**NCD***	NA	NA	NA	300.0	[ICRA]AA- (Stable)
INE124N07564	**Long-term MLD**	Nov-12-2021	G-Sec Linked	Jan-12-2024	150.0	PP-MLD[ICRA]AA- (Stable); withdrawn

*Source: SKFL, ICRA Research; * Yet to be placed; ^ As on February 29, 2024 for existing NCD and as on March 14, 2024 for yet to be placed NCD*

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

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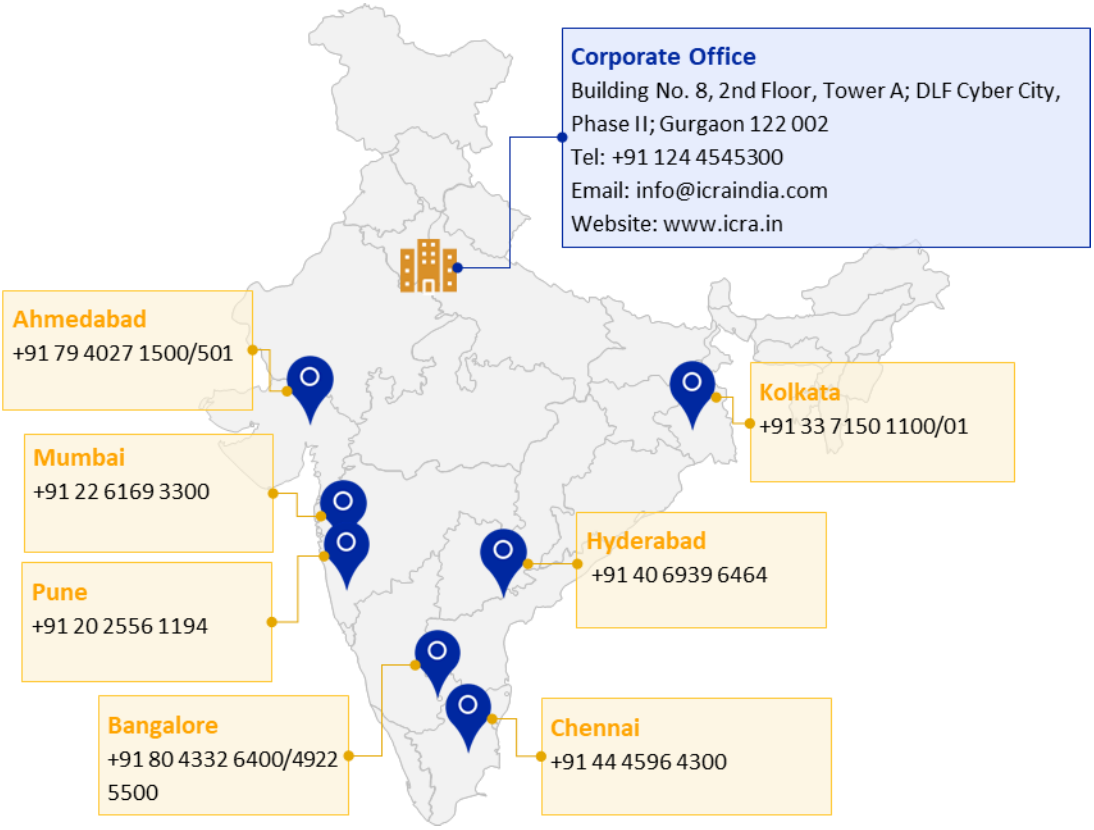

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