May 23, 2024

Sakthi Finance Limited: Ratings reaffirmed; [ICRA]BBB (Stable) assigned to NCDs

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debentures (NCDs) – Public issue	657.41	657.41	[ICRA]BBB (Stable); reaffirmed
	20.61	-	[ICRA]BBB (Stable); reaffirmed and withdrawn
	-	150.00	[ICRA]BBB (Stable); assigned
NCDs – Private issue	150.00	150.00	[ICRA]BBB (Stable); reaffirmed
Fixed deposits	-	-	[ICRA]BBB (Stable); reaffirmed
Fund based – Term loans	114.76	114.76	[ICRA]BBB (Stable); reaffirmed
Fund-based long-term facilities from banks	100.00	100.00	[ICRA]BBB (Stable); reaffirmed
Fund based – Interchangeable#	(47.88)	(47.88)	[ICRA]BBB (Stable)/[ICRA]A2; reaffirmed
Fund-based short-term facilities from banks	100.00	100.00	[ICRA]A2; reaffirmed
Total	**1,142.78**	**1,272.17**	

**Instrument details are provided in Annexure I; #Sub-limit of fund-based long-term facilities from banks*

Rationale

The ratings reaffirmation takes into consideration Sakthi Finance Limited's (SFL) track record in the retail financing business and its established franchise, which has evolved over the last six decades of operations. The ratings also factor in the company's demonstrated ability to raise market borrowings via non-convertible debentures (NCDs), which are retail in nature, through public placement over the years. The ratings are, however, constrained by SFL's geographically concentrated operations, the highly competitive business environment, and its subdued profitability indicators. The ratings also take into consideration the moderate asset quality, with the gross stage 3 assets (GS3) standing at 5.6% (provisional) as of December 2023.

SFL's capitalisation profile is adequate for its medium-term growth plans; its gearing stood at 6.0 times as of December 2023 (provisional; 5.9 times as of March 2023). ICRA notes that the company is planning to raise Rs. 150.0 crore through the public issuance of debentures in June 2024, which is expected to support its liquidity position in the near term. Going forward, it would be crucial for SFL to diversify its funding profile to support portfolio growth while maintaining adequate liquidity.

ICRA notes that SFL had stopped taking fresh deposits from H2 FY2021 while the renewal of existing deposits was discontinued from April 2021, following the Reserve Bank of India's (RBI) observations on the sub-debt raised by the company via private placement till FY2020[1]. Accordingly, the deposits outstanding were being run down till September 2023. Since then, the company has started accepting fresh deposits and renewing existing deposits as the non-compliant sub-debt has been declining due to scheduled maturities. SFL's public deposits and non-compliant sub-debt totalled ~Rs. 209 crore as of December 2023, which is estimated to be within the permissible deposit cap of 1.5 times of the net owned funds (NOF). Nevertheless, it would be required to augment its statutory liquid assets for the non-compliant sub-debt until their maturity by April 2025 (in case of any adverse observation by the RBI regarding the same), though the extent of shortfall would decline steadily, in line with the maturities over the next few quarters. The company is also expected to mobilise incremental public deposits, while remaining within the permissible deposit cap, over the next few years.

[1] The sub-debt raised by the company until FY2020, via private placement to retail/high-net-worth individual (HNI) investors (Rs. 209 crore outstanding as of December 2023), was not in adherence to the RBI's guidelines on raising money via private placement by a non-banking financial company (NBFC)

The Stable outlook reflects ICRA's belief that the asset quality performance would remain steady while the company scales up its operations, which would support its earnings profile in the near term.

ICRA has also withdrawn the long-term rating on the Rs. 20.61-crore NCDs in accordance with its policy on the withdrawal of credit ratings as the instruments have matured and have been fully repaid.

Key rating drivers and their description

Credit strengths

Established franchise and track record in regional market – SFL has a track record of more than six decades in the vehicle finance segment, with operations across Tamil Nadu, Kerala, Andhra Pradesh and Karnataka. It has a good understanding of the target segments, mainly the used commercial vehicle (CV) segment, and has established customer relationships. The company has leveraged the franchise by raising market borrowings via NCDs, which are retail in nature, through public placement over the years. SFL has demonstrated its ability to do the same by raising Rs. 666 crore over five and a half years (FY2019-H1 FY2024), with each issuance having a sizeable number of retail investors and an average investment size of about Rs. 5 lakh.

ICRA notes that the Sakthi Group's presence in related businesses, like automotive dealerships, has aided effective origination, prudent appraisal, and good market responsiveness, monitoring and collections. The company has a branch-centric operating model with an in-house origination team, which is responsible for collections, while the credit sanctions are centralised. SFL conducts credit bureau checks to screen its customers, followed by a field investigation and an income assessment and viability analysis as a part of its loan origination process. It has a workflow management system at most of its branches, which enables the management to monitor sourcing and collection activities on a real-time basis.

Adequate capitalisation, considering medium-term growth plans – SFL has an adequate capitalisation profile with a gearing[2] of 6.0 times as of December 2023 (5.9 times as of March 2023 and 6.1 times as of March 2022). ICRA notes that the company's modest near-term portfolio growth expectations would keep its capital structure under control. SFL envisages to reduce its gearing below 6.0 times over the medium term, supported by the raising of capital (including via disposal of non-core assets) and better internal accruals. This would help the company improve its portfolio growth further over the medium to long term. SFL's total capital adequacy stood at 18.0% (provisional; Tier I at 13.6%) as of December 2023.

Credit challenges

Regionally concentrated operations – SFL has a regionally concentrated portfolio with Tamil Nadu and Kerala accounting for 94% of the total portfolio as of December 2023. ICRA expects the portfolio share to remain concentrated, given the company's limited branch expansion plans for the medium term.

SFL's portfolio increased at a compound annual growth rate (CAGR) of about 6% during FY2020-FY2023. The portfolio grew by a moderate 4% in FY2023 and further by 5% YoY to Rs. 1,255 crore as of December 2023. This was supported by higher disbursements, which stood at Rs. 822 crore in FY2023 vis-à-vis Rs. 597 crore in FY2022 (Rs. 539 crore in 9M FY2024).

Subdued profitability indicators, notwithstanding improvement in FY2023 and 9M FY2024 – SFL's profit after tax (PAT), as a proportion of total assets, has been subdued in the past (average of 0.9% during FY2018-FY2022). It improved slightly to 1.0% in FY2023 and 1.2% in 9M FY2024, supported by higher interest margins and lower credit costs. The net interest margin (NIM) increased to 6.5% in 9M FY2024 and 6.3% in FY2023 from 5.6% in FY2022 (5.1% in FY2021) due to higher yields and stable cost of funds, notwithstanding the rise in systemic rates. Further, credit costs moderated to 0.4% in 9M FY2024 (0.7% in FY2023) from 0.8% in FY2022, as the impact of the Covid-19 pandemic has largely been absorbed. However, the operating costs

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[2] *Net worth (Ind-AS) adjusted for revaluation reserve*

increased to 4.7% in 9M FY2024 (4.4% in FY2023) from 4.1% in FY2022 (4.0% in FY2021) due to the modest portfolio growth. Going forward, the company's ability to increase its operating efficiency and keep the credit costs under control would be critical for improving its profitability.

Moderate asset quality – SFL's GS3 increased to 5.6% in December 2023 (5.8% in March 2023) from 5.2% in March 2022 as it has aligned the GS3 reporting with the updated IRAC[3] norms, which require the daily stamping of accounts. Consequently, the provision coverage on the GS3 assets declined to 49.5% as of December 2023 and 51.0% as of March 2023 from 60.4% in March 2022. The softer bucket overdues (30+ days past due; dpd) stood at 13.3% in September 2023 and 17.7% in March 2023 vis-à-vis 12.9% in March 2022 (14.1% in March 2021). Nevertheless, ICRA notes that SFL has been able to keep its credit costs (0.4% in 9M FY2024, 0.7% in FY2023 and 0.4-0.8% during FY2018-FY2022) under control, demonstrating its ability to make recoveries from harder bucket delinquencies as well. ICRA also notes that it would be critical for the company to keep recoveries in line with the past, so as to maintain the asset quality and ensure that the credit costs are under control.

Diversification of funding mix critical for long-term growth plans – As of December 2023, loans from banks and financial institutions, deposits, NCDs (public issue), NCDs (private placement), preference shares, and sub-debt accounted for 14%, 6%, 45%, 11%, 2% and 22%, respectively, of the total debt. The increase in the share of public NCDs in the recent past has led to chunky outflows on maturity, which the company has been managing through incremental fresh issuances. SFL is currently in the process of raising Rs. 150.0 crore through the public issuance of debentures in June 2024, which is expected to support its NCD redemptions in the coming months and help it maintain an adequate liquidity profile. The company's track record of raising money via public issuances provides comfort.

Over the last few years, SFL's financial flexibility was constrained by the continued weakness in the performance of Group entities; however, with the recent resolution of some of the Group-related issues, the same is expected to improve, going forward. ICRA notes that SFL has been significantly dependent on market borrowings in the recent past, especially via the public issuance of debentures.

ICRA notes that the company would be required to augment its statutory liquid assets for the non-compliant sub-debt in case of any adverse observation by the RBI. However, the extent of shortfall would decline steadily, in line with the scheduled maturities of the above-mentioned sub-debt over the next few quarters. Moreover, SFL's ability to diversify its lender base to achieve its long-term growth plans and to maintain adequate liquidity will be a key monitorable.

Environmental and social risks

Given the service-oriented business of SFL, its direct exposure to environmental risks/material physical climate risks is not significant. However, the residual value of the security could reduce in case of policy changes such as incremental rulings 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. However, this process is in an early stage and ICRA expects any adverse consequences to manifest only over a longer time horizon, giving financing companies adequate time to adapt and minimise the credit implications.

With regard to social risks, data security and customer privacy are among the key sources of vulnerability for lending institutions as material lapses could be detrimental to their reputation and invite regulatory censure. The company has not faced any lapse over the years, which highlights its sensitivity to such risks.

Liquidity position: Adequate

SFL had unencumbered cash and liquid investments of Rs. 66.8 crore as on March 31, 2024 with a debt obligation of Rs. 160.9 crore (including sub-debt payments of Rs. 34.9 crore) during April 2024 – June 2024. Monthly collections have been stable and

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[3] *RBI circular dated November 12, 2021 regarding prudential norms on Income Recognition, Asset Classification and Provisioning*

remained healthy at ~Rs. 60-65 crore, which will support the liquidity profile. The asset-liability maturity (ALM) profile, as on March 31, 2024, does not reflect cumulative negative mismatches up to 12 months. The proposed public issuance of NCDs in June 2024 is expected to improve its liquidity position further.

Rating sensitivities

Positive factors – A steady improvement in SFL's funding, asset quality and earnings profile shall positively impact the ratings.

Negative factors – Pressure on the ratings could arise on a deterioration in SFL's liquidity profile or an increase in the gearing beyond 7.0 times on a sustained basis or a significant weakening in the asset quality, which could adversely impact its earnings.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Rating Methodology for Non-banking Finance Companies Policy on Withdrawal of Credit Ratings
Parent/Group support	Not applicable
Consolidation/Standalone	The ratings are based on the standalone financial statements of SFL

About the company

Sakthi Finance Limited (SFL), incorporated in 1955, is a part of the Sakthi Group, which has a presence in sectors such as sugar, beverages, automobile and transport dealerships, auto components and textiles. It primarily finances CVs (88% of the total portfolio as of December 2023) with loans towards the purchase of cars, construction equipment and other machinery accounting for the rest of the portfolio. SFL mainly operates in Tamil Nadu and Kerala, which together accounted for about 94% of the total portfolio as of December 2023.

SFL reported a net profit of Rs. 12.5 crore on a managed asset base of Rs. 1,275.9 crore in FY2023 compared to Rs. 9.5 crore and Rs. 1,244.3 crore, respectively, in FY2022. As per the provisional financials for 9M FY2024, the company reported a net profit of Rs. 11.5 crore on a managed asset base of Rs. 1,356.8 crore.

Key financial indicators (audited)

SFL	FY2022	FY2023	9M FY2024*
Total income	181.0	191.5	150.3
PAT	9.5	12.5	11.5
Total managed assets	1,244.3	1,275.9	1,356.8
Return on managed assets	0.8%	1.0%	1.2%
Managed/ Adjusted/ Reported gearing (times)$	6.1	5.9	6.0
Gross stage 3	5.2%	5.8%	5.6%
CRAR**	21.7%	19.7%	18.0%

*Source: Company, ICRA Research; * Provisional numbers; All ratios as per ICRA's calculations; Amount in Rs. crore*
*$Adjusted for revaluation reserve; **Not considering sub-debt (private placement) as Tier II capital*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2025)				Chronology of Rating History for the Past 3 Years					
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in FY2025	Date & Rating in FY2024		Date & Rating in FY2023		Date & Rating in FY2022	
					May 23, 2024	Feb 05, 2024	Jan 12, 2024	Mar 20, 2023	May 31, 2022	Mar 22, 2022	Apr 26, 2021
1	NCDs (public issue)	Long term	657.41	657.41	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)
			150.00	0.00	[ICRA]BBB (Stable)	-	-	-	-	-	-
2	NCDs (private issue)	Long term	150.00	150.00	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)
3	Fixed deposit	Long term	-	-	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	MA- (Stable)	MA- (Stable)
4	Term loans	Long term	114.76	114.76	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)
5	Long-term bank facilities	Long term	100.00	100.00	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA] BBB (Stable)	[ICRA] BBB (Stable)
6	Fund-based interchangeable^	Long term/ Short term	(47.88)	(47.88)	[ICRA]BBB (Stable)/ [ICRA]A2	[ICRA]BBB (Stable)/ [ICRA]A2	[ICRA]BBB (Stable)/ [ICRA]A2	[ICRA]BBB (Stable)/ [ICRA]A2	[ICRA]BBB (Stable)/ [ICRA]A2	[ICRA]BBB (Stable)/ [ICRA]A2	[ICRA]BBB (Stable)/ [ICRA]A2
7	Short-term bank facilities	Short term	100.00	100.00	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term fund based – Cash credit	Simple
Short-term fund based – Working capital demand loan	Simple
Fund based – Interchangeable^	Simple
Long-term fund based – Term loans	Simple
Fixed deposit programme	Very Simple
NCD	Very 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	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE302E07300	NCD (public issue)	May-08-2020	10.00%	Jun-08-2024	18.94	[ICRA]BBB (Stable)
INE302E07318	NCD (public issue)	May-08-2020	10.00%	Jun-08-2024	2.49	[ICRA]BBB (Stable)
INE302E07326	NCD (public issue)	May-08-2020	12.17%	Jun-08-2024	11.29	[ICRA]BBB (Stable)
INE302E07359	NCD (public issue)	Jul-29-2021	9.75%	Oct-29-2024	16.63	[ICRA]BBB (Stable)
INE302E07367	NCD (public issue)	Jul-29-2021	11.32%	Oct-29-2024	15.95	[ICRA]BBB (Stable)
INE302E07375	NCD (public issue)	Jul-29-2021	10.00%	Aug-29-2025	35.66	[ICRA]BBB (Stable)
INE302E07383	NCD (public issue)	Jul-29-2021	12.17%	Aug-29-2025	21.07	[ICRA]BBB (Stable)
INE302E07425	NCD (public issue)	Apr-29-2022	8.75%	Apr-29-2025	4.12	[ICRA]BBB (Stable)
INE302E07441	NCD (public issue)	Apr-29-2022	9.00%	Apr-29-2026	2.28	[ICRA]BBB (Stable)
INE302E07466	NCD (public issue)	Apr-29-2022	10.00%	Apr-29-2027	43.75	[ICRA]BBB (Stable)
INE302E07433	NCD (public issue)	Apr-29-2022	9.88%	Apr-29-2025	6.81	[ICRA]BBB (Stable)
INE302E07458	NCD (public issue)	Apr-29-2022	10.69%	Apr-29-2026	1.26	[ICRA]BBB (Stable)
INE302E07474	NCD (public issue)	Apr-29-2022	12.77%	Apr-29-2027	21.17	[ICRA]BBB (Stable)
INE302E08027	NCD (public issue)	May-15-2019	10.25%	Jun-15-2024	20.85	[ICRA]BBB (Stable)
INE302E08035	NCD (public issue)	May-15-2019	10.25%	Jun-15-2024	1.07	[ICRA]BBB (Stable)
INE302E08043	NCD (public issue)	May-15-2019	13.24%	Jun-15-2024	21.84	[ICRA]BBB (Stable)
INE302E08050	NCD (public issue)	May-08-2020	10.25%	Jul-08-2025	7.39	[ICRA]BBB (Stable)
INE302E08068	NCD (public issue)	May-08-2020	10.25%	Jul-08-2025	0.67	[ICRA]BBB (Stable)
INE302E08076	NCD (public issue)	May-08-2020	13.30%	Jul-08-2025	7.98	[ICRA]BBB (Stable)
INE302E08084	NCD (public issue)	Jul-29-2021	10.50%	Aug-29-2026	30.89	[ICRA]BBB (Stable)
INE302E08092	NCD (public issue)	Jul-29-2021	13.64%	Aug-29-2026	16.71	[ICRA]BBB (Stable)
INE302E07573	NCD (public issue)	May-08-2023	9.00%	May-08-2025	13.49	[ICRA]BBB (Stable)
INE302E07508	NCD (public issue)	May-08-2023	9.74%	May-08-2025	19.53	[ICRA]BBB (Stable)
INE302E07540	NCD (public issue)	May-08-2023	9.25%	May-08-2026	6.56	[ICRA]BBB (Stable)
INE302E07516	NCD (public issue)	May-08-2023	10.52%	May-08-2026	15.4	[ICRA]BBB (Stable)
INE302E07557	NCD (public issue)	May-08-2023	9.50%	May-08-2027	2.1	[ICRA]BBB (Stable)
INE302E07490	NCD (public issue)	May-08-2023	11.40%	May-08-2027	2.51	[ICRA]BBB (Stable)
INE302E07565	NCD (public issue)	May-08-2023	10.25%	May-08-2028	50.75	[ICRA]BBB (Stable)
INE302E07524	NCD (public issue)	May-08-2023	13.17%	May-08-2028	16.16	[ICRA]BBB (Stable)
INE302E07532	NCD (public issue)	May-08-2023	14.30%	May-08-2030	20.36	[ICRA]BBB (Stable)
INE302E07607	NCD (public issue)	Feb-27-2024	9.00%	Feb-27-2026	11.02	[ICRA]BBB (Stable)
INE302E07615	NCD (public issue)	Feb-27-2024	9.74%	Feb-27-2026	14.13	[ICRA]BBB (Stable)
INE302E07656	NCD (public issue)	Feb-27-2024	9.25%	Feb-27-2027	7.08	[ICRA]BBB (Stable)
INE302E07599	NCD (public issue)	Feb-27-2024	10.52%	Feb-27-2027	17.87	[ICRA]BBB (Stable)
INE302E07649	NCD (public issue)	Feb-27-2024	10.25%	Feb-27-2029	57.03	[ICRA]BBB (Stable)
INE302E07631	NCD (public issue)	Feb-27-2024	13.17%	Feb-27-2029	25.56	[ICRA]BBB (Stable)
INE302E07623	NCD (public issue)	Feb-27-2024	14.30%	Feb-27-2031	15.40	[ICRA]BBB (Stable)
Unutilised	NCD (public issue)	NA	NA	NA	53.64	[ICRA]BBB (Stable)
Unutilised	NCD (public issue)	NA	NA	NA	150.00	[ICRA]BBB (Stable)
Unutilised	NCD (private issue)	NA	NA	NA	150.00	[ICRA]BBB (Stable)
NA	Fixed deposits	NA	NA	NA	-	[ICRA]BBB (Stable)
NA	Term loans	Sep 2023 to Dec 2023	NA	Mar 2024 to Apr 2028	114.76	[ICRA]BBB (Stable)
NA	Cash credit	NA	NA	NA	100.00	[ICRA]BBB (Stable)
NA	Fund-based interchangeable^	NA	NA	NA	(47.88)^	[ICRA]BBB (Stable) /[ICRA]A2
NA	Working capital demand loan	NA	NA	NA	100.00	[ICRA]A2
INE302E07409	NCD (public issue)	Apr-29-2022	8.50%	Apr-29-2024	8.26	[ICRA]BBB (Stable); reaffirmed and withdrawn
INE302E07417	NCD (public issue)	Apr-29-2022	9.16%	Apr-29-2024	12.35	

Source: Company

[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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