January 08, 2025

SK Finance Limited: [ICRA]AA- (Stable) assigned; earlier rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debentures	1,325.00	1,325.00	[ICRA]AA- (Stable); reaffirmed
Non-convertible debentures	0.00	175.00	[ICRA]AA- (Stable); assigned
Total	**1,325.00**	**1,500.00**	

**Instrument details are provided in Annexure I*

Rationale

The rating factors in SK Finance Limited's (SKFL) comfortable capitalisation and healthy earnings profile. The capitalisation profile had improved following the capital raise in FY2024 from new and existing investors, leading to a sizeable increase of ~Rs. 900 crore in the net worth. ICRA believes that the company will be able to leverage its capital base and grow as per its business plans. SKFL has demonstrated healthy profitability, notwithstanding the recent moderation, with a return on managed assets (RoMA) of 2.1% in H1 FY2025 (2.7% in FY2024) because of higher credit costs despite the improvement in the net interest margin (NIM). The rating continues to consider the company's established franchise in Rajasthan with a long track record and good 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 rating is, 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/Union Territories (UTs), the home state of Rajasthan still accounted for 50% of the portfolio as on September 30, 2024 (though lower than 70% as on March 31, 2020). The vehicle loan segment has consistently accounted for strong growth with a share of 77% in SKFL's assets under management (AUM) as on September 30, 2024. 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 23% as on September 30, 2024 from 9% as on March 31, 2020.

ICRA also notes that the reported non-performing advances (NPAs) weakened to 4.7% as on September 30, 2024 from 3.5% as on March 31, 2024 and the 90+ days past due (dpd) for the overall AUM weakened to 2.5% as on September 30, 2024 (1.8% as on March 31, 2024). The uptick in delinquencies in H1 FY2025 was largely attributable to the challenges in the operating environment, including adverse weather patterns and overleveraging in certain borrower segments. On a lagged basis (one year), the 90+ dpd was higher at 3.4% as on September 30, 2024. Going forward, SKFL's ability to control fresh slippages and contain the forward flow across delinquency buckets 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 and controlled asset quality.

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, three independent directors and two investor nominee directors. SKFL is promoted by Mr. Setia, who, along with his family members, holds an equity stake of 31.9% in the company (fully-diluted basis as on September 30, 2024). It is also backed by established equity investors, such as Norwest Venture Partners X – Mauritius (Norwest), TPG Capital, India Business Excellence Fund IV, Evolvence, IIFL Special Opportunities Fund, which had a total equity stake of 52.3% as on September 30, 2024.

Comfortable capitalisation – SKFL's capitalisation stood comfortable with a net worth of Rs. 3,264 crore as on September 30, 2024 (Rs. 3,109 crore as on March 31, 2024) and a managed gearing of 3.5x (3.2x as on March 31, 2024). The reported capital adequacy was comfortable at 31.6% as on September 30, 2024 (33.9% as on March 31, 2024). While the growth capital received in the previous fiscal provided the company with headroom for its near-term growth plans, ICRA notes that the leverage is likely to increase from the current level given the growth plans. ICRA expects the managed gearing to remain in the range of 3-4x in the next two years, based on the current capital position. SKFL is in the process of launching an initial public offering (IPO), which would be key for maintaining a prudent capitalisation profile over the medium term.

Track record of healthy profitability, notwithstanding recent moderation – 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 (FY2020-FY2024) of 18.7%[1]. The yields remained stable at 17.6%[1] in H1 FY2025 compared to 17.7%[1] in FY2024. However, the cost of funds increased to 9.6%[1] in H1 FY2025 from 9.3%[1] in FY2024, given the elevated systemic interest rates. This led to a compression in the lending spreads to 7.9%[1] from 8.5%[1] during this period. However, the NIM (managed assets basis) improved to 8.8%[1] in H1 FY2025 from 8.5%[1] in FY2024, supported by higher upfront income from the direct assignment (DA) transactions. Operating expenses remained stable at 4.6%[1] in H1 FY2025, but remained high due to the cost-intensive business model and branch expansion. Credit costs increased sharply to 2.2%[1] in H1 FY2025 from 1.0%[1] in FY2024 because of higher delinquencies. This led to higher incremental provisions and increased losses on repossessed assets. Overall, the profitability indicators weakened with RoMA of 2.1%[1] in H1 FY2025 compared with 2.7%[1] in FY2024. ICRA expects that the asset quality related pressures and hence credit costs would stabilise over the next few quarters and the profitability would improve to the historical levels over the medium term as the operating efficiency improves with economies of scale, provided SKFL is able to control fresh slippages.

Adequately diversified borrowing profile for the scale of operations – SKFL's borrowing profile is adequately diversified, with sources including debt markets (17% of the total borrowings, including off-book, as on September 30, 2024), term loans and working capital lines from banks including external commercial borrowings (ECBs; 48%), term loans from FIs (3%) and others (1%). As on September 30, 2024, the company had borrowing relationships with over 64 FIs. It also continues to raise funds through securitisation/DA (31% of the total borrowings as on September 30, 2024). The share of debt market borrowings and ECBs is expected to increase gradually with SKFL focusing on reducing its reliance on bank funding, going forward.

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 sharply to 8.0% as on September 30, 2024 from 5.6% as on March 31, 2024 because of challenges in the operating environment, including adverse weather patterns and overleveraging in certain borrower segments. The same remains high, given the target borrower profile and the nature of the business. Further, the 90+ dpd for the overall AUM weakened to 2.5% as on September 30, 2024 from 1.8% as on March 31, 2024, because of roll-forwards into harder buckets. On a lagged basis (one year), the 90+ dpd was even higher at 3.4% as on September 30, 2024.

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[1] *As per ICRA's calculations*

ICRA notes that the reported gross and net NPAs weakened to 4.7% and 3.3%, respectively, as on September 30, 2024 from 3.5% and 2.5%, respectively, as on March 31, 2024, because the removal of NPA categorisation is usually slower due to the modest borrower profile. The gross stage 3 also weakened to 3.2% as on September 30, 2024 from 2.2% as on March 31, 2024, in line with the movement in the 90+ dpd. The provision cover on the overall book increased to 2.3% as on September 30, 2024 from 1.7% as on March 31, 2024, given the higher provision cover on standard assets. 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 its scale of operations in the last few years with its AUM increasing to Rs. 11,850 crore as on September 30, 2024 (Rs. 10,476 crore as on March 31, 2024) from Rs. 2,986 crore as on March 31, 2020. Further, it expanded its reach to 12 states/UTs in India through a network of 615 branches as on September 30, 2024. However, it remains a regional player with the home state of Rajasthan still accounting for 50% of the portfolio as on September 30, 2024, though this has moderated from 70% as on March 31, 2020. The balance is primarily in Madhya Pradesh (14%), Punjab & Haryana (14%), Gujarat (9%), 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 77% as on September 30, 2024 (79% as on March 31, 2024), though lower than 91% as on March 31, 2020. Also, while the share of the used vehicle segment moderated to 58% of the AUM as on September 30, 2024, 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 23% as on September 30, 2024 from 9% as on March 31, 2020.

Liquidity position: Strong

The tenure of the loans extended by SKFL (average tenure of 3.5-4 years) matches well with the weighted average tenure of the term facilities availed by it 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 ALM profile as on September 30, 2024, SKFL had scheduled principal debt repayments of Rs. 3,995 crore for the 12-month period ending September 30, 2025 against which it had scheduled inflows from performing advances of Rs. 3,521 crore. The unencumbered on-balance sheet liquidity (cash and liquid investments) of Rs. 1,897 crore (~19% of on-balance sheet borrowings), coupled with undrawn working capital lines of ~Rs. 94 crore, further support the 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
Parent/Group support	-
Consolidation/Standalone	Standalone

About the company

Incorporated in 1994, Jaipur-based SKFL is a 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 SME loans. SKFL had a network of 615 branches, as on September 30, 2024, across 12 states/UTs, namely Rajasthan, Gujarat, Maharashtra, Madhya Pradesh, Punjab, Haryana, Chhattisgarh, Delhi, Himachal Pradesh, Uttarakhand, Karnataka and Uttar Pradesh, though concentration in Rajasthan remains high at 50% of the portfolio. As on September 30, 2024, the AUM stood at about Rs. 11,850 crore with commercial vehicles forming the largest share at 40.5%, followed by MSME loans (22.8%), cars (20.0%), tractors (12.8%) and two-wheelers (3.9%).

The promoter group, viz. Mr. Rajendra Setia and his family members, held a 31.9% equity stake (fully-diluted basis) in the company as on September 30, 2024. Other key equity investors include Norwest Venture Partners X – Mauritius (Norwest), TPG Capital, India Business Excellence Fund IV, Evolvence, IIFL Special Opportunities Fund, which held a total equity stake of 52.3% as on September 30, 2024.

The company reported a profit after tax (PAT) of Rs. 148.2 crore in H1 FY2025 on total managed assets of Rs. 15,100.8 crore as on September 30, 2024 compared to PAT of Rs. 311.9 crore in FY2024 on total managed assets of Rs. 13,358.3 crore as on March 31, 2024. The company's net worth stood at Rs. 3,264.4 crore with a managed gearing of 3.5x as on September 30, 2024 compared to Rs. 3,108.6 crore and 3.2x, respectively, as on March 31, 2024. The gross and net NPAs stood at 4.7% and 3.3%, respectively, as on September 30, 2024 compared to 3.5% and 2.5%, respectively, as on March 31, 2024.

Key financial indicators (KFIs)

SKFL	FY2023	FY2024	H1 FY2025
	Audited	Audited	Provisional
Total income	1,314	1,798	1,127
Profit after tax	223	312	148
Total managed assets	9,597	13,358	15,101
Return on average managed assets	2.8%	2.7%	2.1%
Managed gearing (times)	4.1	3.2	3.5
Gross stage 3	1.9%	2.2%	3.2%
Gross NPA (as per new IRAC norms)	3.1%	3.5%	4.7%
CRAR	26.1%	33.9%	31.6%

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 (FY2025)					Chronology of Rating History for the Past 3 Years					
				FY2025		FY2024		FY2023		FY2022	
Instrument	**Type**	**Amount Rated (Rs. crore)**	**08-JAN-2025**	**Date**	**Rating**	**Date**	**Rating**	**Date**	**Rating**	**Date**	**Rating**
Bonds/NCD/ Long-term debt	Long term	1,325.00	[ICRA]AA- (Stable)	12-APR-2024	[ICRA]AA- (Stable)	21-SEP-2023	[ICRA]AA- (Stable)	06-MAR-2023	[ICRA]A+ (Positive)	08-NOV-2021	PP-MLD[ICRA]A (Stable)
				12-APR-2024	[ICRA]AA- (Stable)	21-SEP-2023	PP-MLD[ICRA]AA- (Stable)	06-MAR-2023	PP-MLD[ICRA]A+ (Positive)	23-DEC-2021	[ICRA]A (Stable)
				08-AUG-2024	[ICRA]AA- (Stable)	18-MAR-2024	[ICRA]AA- (Stable)	21-MAR-2023	[ICRA]A+ (Positive)	23-DEC-2021	PP-MLD[ICRA]A (Stable)
				08-AUG-2024	[ICRA]AA- (Stable)	18-MAR-2024	[ICRA]AA- (Stable)	21-MAR-2023	PP-MLD[ICRA]A+ (Positive)	07-MAR-2022	[ICRA]A+ (Stable)
				23-DEC-2024	[ICRA]AA- (Stable)	18-MAR-2024	PP-MLD[ICRA]AA- (Stable); withdrawn	-	-	07-MAR-2022	PP-MLD[ICRA]A+ (Stable)
				23-DEC-2024	[ICRA]AA- (Stable)	-	-	-	-	-	-
Bonds/NCD/ Long-term debt	Long term	175.00	[ICRA]AA- (Stable)	-	-	-	-	-	-	-	-
				-	-	-	-	-	-	-	-
				-	-	-	-	-	-	-	-
				-	-	-	-	-	-	-	-
				-	-	-	-	-	-	-	-
				-	-	-	-	-	-	-	-

Source: ICRA Research

Complexity level of the rated instruments

Instrument	Complexity Indicator
Non-convertible debentures	Very Simple (Simple for ISIN INE124N07697, INE124N07713)*
Non-convertible debentures (yet to be placed)	Very Simple

** Complexity indicator is Simple for ISINs INE124N07697 and INE124N07713 because of put option on these NCDs*

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
INE124N07689	**NCD**	Apr-02-2024	9.25%	Apr-02-2026	280.0	[ICRA]AA- (Stable)
INE124N07705	**NCD**	Jun-03-2024	9.25%	Jun-03-2026	50.0	[ICRA]AA- (Stable)
INE124N07721	**NCD**	Aug-14-2024	9.25%	Aug-14-2026	220.0	[ICRA]AA- (Stable)
INE124N07697	**NCD**	May-09-2024	9.25%	May-09-2027	350.0	[ICRA]AA- (Stable)
INE124N07697 (re-issue)	**NCD**	Aug-23-2024	9.25%	May-09-2027	25.0	[ICRA]AA- (Stable)
INE124N07713	**NCD**	Jun-19-2024	9.25%	Sep-19-2027	100.0	[ICRA]AA- (Stable)
INE124N07747	**NCD**	Jan-02-2025	9.25%	Jan-02-2028	125.0	[ICRA]AA- (Stable)
NA	**NCD***	NA	NA	NA	350.0	[ICRA]AA- (Stable)

*Source: SKFL, ICRA Research; * Yet to be placed; ^ As on January 06, 2025*

Annexure II: List of entities considered for consolidated analysis

Not applicable

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