August 04, 2020

Sakthi Finance Limited: Ratings reaffirmed; Removed from Watch with Developing Implications and outlook Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible Debentures (NCDs)	317.71	317.71	[ICRA]BBB (Stable); reaffirmed and removed from Watch with Developing Implications
	110.40	110.40	[ICRA]BBB (Stable); reaffirmed, removed from Watch with Developing Implications and withdrawn
Fund Based – Term Loan	33.26	33.26	[ICRA]BBB (Stable); reaffirmed and removed from Watch with Developing Implications
Fund-based Long-term Facilities from Banks	131.50	131.50	[ICRA]BBB (Stable); reaffirmed and removed from Watch with Developing Implications
Fund Based – Interchangeable[#]	57.90	57.90	[ICRA]BBB(Stable)/[ICRA]A2; reaffirmed and removed from Watch with Developing Implications
Fund-based Short-term Facilities from Banks	100.00	100.00	[ICRA]A2; reaffirmed and removed from Watch with Developing Implications
Fixed Deposits	-	-	MA- (Stable); reaffirmed and removed from Watch with Developing Implications
Total*	**692.87**	**692.47**	

** Instrument details are provided in Annexure-1*
[#] Sub-limit of fund-based long-term facilities from banks

Rationale

The rating action considers Sakthi Finance Limited's (SFL) adequate liquidity profile, supported by the improvement witnessed in its collections in June 2020 vis-à-vis April and May 2020. ICRA takes notes of the timely redemption of the listed NCDs of Rs. 110.4 crore (~Rs. 130.0 crore including interest), partly funded through the proceeds from the public issue of NCDs (about Rs. 102.9 crore) in May 2020.

The ratings continue to factor in SFL's experience in the retail financing business and its established franchise, which has evolved over the last six decades of its operations. The ratings are, however, constrained by SFL's geographically concentrated operations, the highly competitive business environment, and its subdued profitability indicators. SFL's capitalisation profile improved with a gearing of 6.1 times (provisional) in March 2020 vis-à-vis 7.1 times in September 2019 on the back of the capital infusion in March 2020. While the portfolio growth would remain muted in the current fiscal considering SFL's modest internal generation[1], ICRA notes that its capital would have to be augmented to support the medium-term growth. The company is expected to raise about Rs. 25-crore equity from its promoters in H2 FY2021.

ICRA notes that a sustained improvement in the loan collections would be crucial going forward as the curtailment in economic activities on account of the Covid-19 pandemic would exert pressure on SFL's asset quality and earnings profile in the near term. This remains a monitorable from a rating perspective.

Key rating drivers and their description

Credit strengths

Established franchise and presence in the 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, with repeat customers accounting for about 55-60% of the incremental business.

ICRA notes that the Sakthi Group's presence in related businesses like automotive dealerships has aided in effective origination, prudent appraisal, 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 field investigation and income assessment and viability analysis as a part of its loan origination process. It has implemented a workflow management system in the majority of its branches, which enables the management to monitor the sourcing and collection activities on a real-time basis.

Adequate capitalisation profile; further improvement expected post the planned capital raise – SFL has an adequate capitalisation profile with a gearing of 6.1 times (Ind-AS) as of March 2020 (provisional; 6.6 times (Ind-AS) as of March 2019). The company had raised Rs. 25 crore through a preferential placement in March 2020, which resulted in an improvement in the gearing levels in FY2020 (from 7.1 times in September 2019). While the portfolio growth would remain muted in the current fiscal considering SFL's modest internal generation (2.9% in FY2020 (provisional); 1.8% in FY2019) levels, ICRA notes that its capital would have to be augmented to support the medium-term growth as SFL expects to maintain its leverage at about 6.0-6.5 times. The company is expected to raise about Rs. 25 crore from its promoters in H2 FY2021 (previously expected in Q1 FY2021).

Credit challenges

Modest portfolio growth; regionally concentrated operations – SFL's portfolio increased at a modest CAGR of about 4% during FY2016-FY2020 because of limited funding availability. However, its portfolio grew by 15.1% in FY2020 to Rs. 1,077 crore as on March 31, 2020. SFL has a regionally concentrated portfolio with Tamil Nadu and Kerala accounting for 95% of the total portfolio as of December 2019. ICRA expects the portfolio share to remain concentrated, given the company's limited branch expansion plans in the medium term.

Subdued profitability indicators – SFL's net interest margin declined to 5.6% (Ind-AS; provisional) in FY2020 from 5.8% in FY2019 (Ind-AS) and 6.0% in FY2018 (IGAAP) as it faced higher competition amid slowing demand. Its operating cost

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[1] *PAT less dividend as a proportion of average net worth*

ratio, however, improved to 4.0% in FY2020 from 4.3% in FY2019 (4.1% in FY2018) while the credit cost was stable at about 0.5%. SFL's profit before tax, as a proportion of total assets, stood at 1.6%, 1.3% and 1.2% (provisional) in FY2018, FY2019 and FY2020, respectively. The company's ability to improve its business margins and operating efficiencies further and keep the credit costs under control would be critical for incremental profitability.

Critical to improve collections; asset quality stable in FY2020 – The 90+dpd was stable at 5.1% in March 2020 vis-à-vis 5.0% in March 2019. The 180+dpd improved to 3.2% in March 2020 from 3.9% in March 2019. However, there was an increase in the softer buckets with the 30+dpd at 19.5% in March 2020 compared to 17.5% in March 2019. The company's credit cost has remained in the range of 0.3-0.5% in the last four years and the provision coverage on NPAs improved to 49% in March 2020 from 42% in March 2019.

Going forward, ICRA notes that the asset quality could witness pressure on account of the pandemic as about 30-35% of the portfolio as of June 2020 is under moratorium. Therefore, it would be critical for SFL to improve its collections (~60% collection efficiency in June 2020 and ~30% in May 2020) and undertake overall effective recoveries to keep the asset quality and credit costs under control.

Diversification of funding profile critical to meet long-term growth plans – SFL has limited financial flexibility as the continued weakness in the performance of Group entities constrains its ability to secure incremental funding from some banks. ICRA, however, notes that in the recent past, SFL has increased its dependence on retail deposits and debentures largely via public issuances. The capital raise in March 2020 has bolstered its ability to secure further retail deposits. The company raised about ~Rs. 102.9 crore through the public issuance of debentures and redeemed existing debentures of ~Rs. 130 crore (including interest) in May 2020. SFL would need to diversify its lender base to achieve its long-term growth plans and to maintain adequate liquidity.

Liquidity position: Adequate

The company had unencumbered cash and liquid investments of Rs. 2.5 crore and undrawn bank lines of Rs. 42.8 crore as on June 30, 2020, with debt servicing obligations of about Rs. 43 crore during July-September 2020. ICRA notes that SFL's collections, like other non-banking financial companies (NBFCs), have been adversely impacted by the Covid-19-related lockdown during April-May 2020 though the same picked up in June 2020 with collections of Rs. 32.4 crore (collection efficiency of 60-65%). Furthermore, SFL has Rs. 75-crore funding in the pipeline at various levels of approval.

The company redeemed the listed NCDs of Rs. 110.4 crore (~Rs. 130.0 crore including interest) falling due on May 18, 2020 partly via proceeds from the public issue of NCDs for ~Rs. 102.9 crore in May 2020 and other existing liquidity and funding sources.

Rating sensitivities

Positive triggers – ICRA could change the outlook or upgrade the ratings if SFL augments its capitalisation profile (gearing of around 6.0 times on a sustained basis) while steadily improving its funding, asset quality and earnings profiles.

Negative triggers – ICRA could change the outlook or downgrade SFL's ratings in case of a significant weakening in the asset quality, which could adversely impact its earnings, or an increase in the gearing beyond 7.0 times on a sustained basis or a deterioration in the liquidity profile.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA's Credit Rating Methodology for Non-Banking Finance Companies ICRA's policy on Withdrawal and Suspension of Credit Rating
Parent/Group Support	NA
Consolidation	To arrive at the ratings, ICRA has considered the standalone financials of SFL

About the company

Sakthi Finance Limited (SFL), incorporated in 1955, is a part of the Sakthi Group, which has a presence across sectors such as sugar, beverages, automobile and transport dealerships, auto components and textiles. SFL primarily finances CVs, which constituted 89% of its total portfolio as of March 2020. The remaining portfolio consisted of loans towards the purchase of cars, construction equipment and other machinery. SFL primarily operates in Tamil Nadu and Kerala, which together accounted for about 95% of the total portfolio.

In FY2019, SFL reported a net profit of Rs. 8.6 crore (Ind-AS) on a managed asset base of Rs. 1,076.9 crore compared to a net profit of Rs. 11.9 crore (IGAAP) on a managed asset base of Rs. 1,075.7 crore in FY2018. As per the provisional financials for FY2020, the company reported a net profit of Rs. 10.8 crore (Ind-AS) on a managed asset base of Rs. 1,196.1 crore.

Key financial indicators (audited)

	FY2018 IGAAP	FY2019 Ind-AS	FY2020* Ind-AS
Total Income	167.6	165.9	169.3
Profit after Tax	11.9	8.6	10.8
Net Worth	140.1	138.9	164.7
Total Managed Portfolio	902.6	936.0	1,077.4
Total Managed Assets	1,075.7	1,076.9	1,196.1
Return on Average Managed Assets (%)	1.0%	0.8%	1.0%
Return on Average Net Worth (%)	7.7%	6.1%	7.1%
Gross NPA % (90 days past due)	5.2%	5.0%	5.1%
Net NPA %	3.3%	2.9%	2.6%
Net NPA / Net Worth	21.4%	19.7%	16.9%
Gearing (reported; times)	6.4	6.6	6.1

*Note: Amount in Rs. crore; * Provisional*
Source: SFL, ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Current Rating (FY2021)					Rating History for the Past 3 Years				
		Type	Amount Rated	Amount Outstanding	04-Aug-20	13-Apr-20	FY2020	FY2019			FY2018
							20-Feb-20	21-Feb-19	14-Feb-19	6-Apr-18	17-Apr-17
1	NCDs	Long Term	317.71	317.71	[ICRA]BBB (Stable)	[ICRA]BBB&	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)
			110.40	0.00	[ICRA]BBB (Stable)	[ICRA]BBB&	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)
2	Term Loans	Long Term	33.26	33.26	[ICRA]BBB (Stable)	[ICRA]BBB&	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)
3	Long-term Bank Facilities	Long Term	131.50	131.50	[ICRA]BBB (Stable)	[ICRA]BBB&	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)
4	Fund-based Interchangeable	Long Term/ Short Term	(57.90)	(57.90)	[ICRA]BBB (Stable)/ [ICRA]A2	[ICRA]BBB&/ [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
5	Short-term Bank Facilities	Short Term	100.00	100.00	[ICRA]A2	[ICRA]A2&	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2
6	Fixed Deposits	Medium Term	-	-	MA-(Stable)	MA-&	MA- (Stable)	MA- (Stable)	MA- (Stable)	MA- (Stable)	MA- (Stable)

Amount in Rs. crore

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE302E07177	NCD	15-May-19	9.50%	15-May-21	6.47	[ICRA]BBB (Stable)
INE302E07193	NCD	15-May-19	9.75%	15-May-22	5.92	[ICRA]BBB (Stable)
INE302E07227	NCD	15-May-19	10.00%	15-May-23	19.09	[ICRA]BBB (Stable)
INE302E07185	NCD	15-May-19	9.50%	15-May-21	13.44	[ICRA]BBB (Stable)
INE302E07219	NCD	15-May-19	9.75%	15-May-22	8	[ICRA]BBB (Stable)
INE302E07243	NCD	15-May-19	9.75%	15-May-23	15.41	[ICRA]BBB (Stable)
INE302E07201	NCD	15-May-19	9.75%	15-May-22	2.69	[ICRA]BBB (Stable)
INE302E07235	NCD	15-May-19	10.00%	15-May-23	2.92	[ICRA]BBB (Stable)
INE302E08027	NCD	15-May-19	10.25%	15-Jun-24	20.85	[ICRA]BBB (Stable)
INE302E08043	NCD	15-May-19	10.25%	15-Jun-24	21.84	[ICRA]BBB (Stable)
INE302E08035	NCD	15-May-19	10.25%	15-Jun-24	1.07	[ICRA]BBB (Stable)
INE302E07250	NCD	8-May-20	9.50%	8-May-22	16.91	[ICRA]BBB (Stable)
INE302E07268	NCD	8-May-20	-	8-May-22	19.73	[ICRA]BBB (Stable)
INE302E07276	NCD	8-May-20	9.75%	8-Aug-23	8.12	[ICRA]BBB (Stable)
INE302E07284	NCD	8-May-20	9.75%	8-Aug-23	1.42	[ICRA]BBB (Stable)
INE302E07292	NCD	8-May-20	-	8-Aug-23	7.94	[ICRA]BBB (Stable)
INE302E07300	NCD	8-May-20	10.00%	8-Jun-24	18.94	[ICRA]BBB (Stable)
INE302E07318	NCD	8-May-20	10.00%	8-Jun-24	2.49	[ICRA]BBB (Stable)
INE302E07326	NCD	8-May-20	-	8-Jun-24	11.29	[ICRA]BBB (Stable)
INE302E08050	NCD	8-May-20	10.25%	8-Jul-25	7.39	[ICRA]BBB (Stable)
INE302E08068	NCD	8-May-20	10.25%	8-Jul-25	0.67	[ICRA]BBB (Stable)
INE302E08076	NCD	8-May-20	-	8-Jul-25	7.98	[ICRA]BBB (Stable)
Unutilised	NCD	NA	NA	NA	97.14	[ICRA]BBB (Stable)
INE302E07144	NCD	18-May-16	11.00%	18-May-20	60.5	[ICRA]BBB (Stable); reaffirmed and withdrawn
INE302E07151	NCD	18-May-16	11.00%	18-May-20	9.56	
INE302E07169	NCD	18-May-16	11.46%	18-May-20	40.34	
NA	Fixed Deposits	NA	-	NA	-	MA-
NA	Term Loan 1	31-Oct-17	-	15-Dec-20	8.11	[ICRA]BBB (Stable)
NA	Term Loan 2	NA	-	NA	0.15	[ICRA]BBB (Stable)
Unutilised	Term Loan	NA	-	NA	25	[ICRA]BBB (Stable)
NA	Fund-based Long-term Facilities from Banks	NA	-	NA	131.5	[ICRA]BBB (Stable)
NA	Fund-based Interchangeable	NA	-	NA	(57.9)	[ICRA]BBB (Stable) /[ICRA]A2
NA	Fund-based Short-term Facilities from Banks	NA	-	NA	100	[ICRA]A2

Source: SFL

Annexure-2: List of entities considered for consolidated analysis – Not applicable

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About ICRA Limited:

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