March 20, 2023

Sakthi Finance Limited: Ratings reaffirmed; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debentures (NCDs)	544.55	544.55	[ICRA]BBB (Stable); reaffirmed
	53.25	0.00	[ICRA]BBB (Stable); reaffirmed and withdrawn
	-	200.00	[ICRA]BBB (Stable); assigned
Fixed deposits	-	-	[ICRA]BBB (Stable); reaffirmed
Fund based – Term loans	83.10	83.10	[ICRA]BBB (Stable); reaffirmed
Fund-based long-term facilities from banks	131.66	131.66	[ICRA]BBB (Stable); reaffirmed
Fund based – Interchangeable#	(68.66)	(59.66)	[ICRA]BBB (Stable)/[ICRA]A2; reaffirmed
Fund-based short-term facilities from banks	100.00	100.00	[ICRA]A2; reaffirmed
Total	**912.56**	**1,059.31**	

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

Rationale

The reaffirmation of the ratings takes into consideration Sakthi Finance Limited's (SFL) 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. The ratings also take into consideration the company's moderate asset quality profile, with its 90+ days past due (dpd) standing at 5.3% (provisional) as of December 2022.

SFL's capitalisation profile is adequate for its medium-term growth plans; its gearing stood at 6.0 times as of December 2022 (provisional; 6.1 times as of March 2022). ICRA notes that SFL is planning to raise about Rs. 200.00 crore through the public issuance of debentures in April 2023, which is expected to support its liquidity position in the near term. Going forward, it would be crucial for the company to diversify its funding profile to support portfolio growth while maintaining an adequate liquidity profile.

ICRA notes that SFL had stopped taking fresh deposits since H2 FY2021 and stopped renewing existing deposits since April 2021, following the Reserve Bank of India's (RBI) observations on the sub-debt raised by the company via private placements till FY2020[1]. Considering the non-compliant sub-debt as deposits, SFL would have been in breach of the cap on deposits at 1.5 times of the net owned funds (NOF). Nevertheless, the deposits outstanding have run down over the last two years and the same along with the non-compliant sub-debt stood at ~Rs. 260 crore as of February 2023, which is estimated to be within the permissible deposit cap. However, the company would be required to augment its statutory liquid assets for the non-compliant sub-debt, in case of any adverse observation from the RBI regarding the same.

ICRA has reaffirmed and withdrawn the rating of [ICRA]BBB (Stable) on the Rs. 53.25-crore non-convertible debentures (NCDs) of SFL. These instruments were fully redeemed and there is no amount outstanding against the rated instruments. The rating was withdrawn in accordance with the policy on withdrawal of credit ratings.

[1] The sub-debt raised by the company until FY2020, via a private placement to retail/high-net-worth individual (HNI) investors (Rs. 234 crore outstanding as of December 2022), was not in adherence to the RBI's guidelines on raising money via private placement by a non-banking financial company (NBFC).

Key rating drivers and their description

Credit strengths

Established franchise and presence 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.

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 most of its branches, which enables the management to monitor sourcing and collection activities on a real-time basis.

Adequate near-term capitalisation structure, considering medium-term growth plans – SFL has an adequate capitalisation profile with a gearing[2] of 6.0 times as of December 2022 (provisional; 6.1 times as of March 2022). It had raised Rs. 25.00 crore through a preferential placement in March 2020, which resulted in an improvement in the gearing level in FY2020 to 6.3 times from 6.8 times in March 2019. ICRA notes that the company's modest near-term portfolio growth expectations would keep its capital structure under control. However, as SFL envisages to reduce its gearing below 6 times and improve its growth over the medium to long term, it may require capital infusion for the same. SFL's total capital adequacy, not factoring in the non-compliant sub-debt, stood at 19.1% (provisional; Tier I at 13.2%) as of December 2022.

Credit challenges

Modest portfolio growth; regionally concentrated operations – SFL's portfolio increased at a modest compound annual growth rate (CAGR) of about 7% during FY2020-9M FY2023. The portfolio grew by a modest 2% in FY2022 and further by 6% (annualised) to Rs. 1,197 crore in 9M FY2023. This was supported by improved disbursements, which stood at Rs. 551 crore in 9M FY2023 vis-à-vis Rs. 597 crore in FY2022. SFL has a regionally concentrated portfolio with Tamil Nadu and Kerala accounting for 96% of the total portfolio as of December 2022. ICRA expects the portfolio share to remain concentrated, given the company's limited branch expansion plans in the medium term.

Subdued profitability indicators, notwithstanding improvement in 9M FY2023 – SFL's net interest margin increased to 6.1% in 9M FY2023 from 5.6% in FY2022 on the back of the improvement in the yields on loans while the average cost of funds remained stable in 9M FY2023. Its operating cost ratio stood at 4.4% in 9M FY2023 (4.1% in FY2022 and 3.8% in FY2021) and the credit cost was stable at 0.8% in 9M FY2023 and FY2022 (0.3-0.6% in the prior 5 years). SFL's profit after tax (PAT), as a proportion of total assets, stood at 0.8% and 1.0% (provisional) in FY2022 and 9M FY2023, respectively. The company's ability to improve its business margins and operating efficiency further while keeping its credit costs under control would be critical for improving its profitability, going forward.

Moderate asset quality – The 90+dpd was largely stable at 5.3% in December 2022 (provisional), similar to the March 2022 level. The softer bucket overdues (30+dpd) stood at 13.2% in December 2022 and 12.9% in March 2022 (14.1% in March 2021). The company's credit cost stood at 0.8% in 9M FY2023 and FY2022 (0.4-0.6% in FY2018-FY2021). Its gross stage 3 (GS3) stood at 6.2% in December 2022 compared to 5.2% in March 2022 as SFL has aligned the GS3 reporting with the IRAC[3] norms. Consequently, the provision coverage on the GS3 assets declined to 51.0% as of December 2022 from 60.4% in March 2022.

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

[3] *Income Recognition & Asset classification*

ICRA notes that it would be critical for the company to undertake effective recoveries to keep the asset quality and credit costs under control.

Access to adequate funding critical to meet long-term growth plans – Over the last few years, SFL's financial flexibility was constrained by the continued weakness in the performance of the 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 was significantly dependent on retail/HNI sources in the recent past, especially via the public issuance of debentures. As of December 2022, loans from banks and financial institutions, deposits, NCDs (public issue), NCDs (private placement), preference shares, and sub-debt accounted for 14%, 3%, 44%, 11%, 1% and 25%, 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 public issuance of NCDs. SFL is currently in the process of raising about Rs. 200.00 crore through the public issuance of debentures in April 2023, which is expected to support its NCD redemptions during May-August 2023 and help it maintain an adequate liquidity profile. The company's track record of raising monies via public issuances provides comfort.

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 from the RBI. As such, 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 an incremental ruling 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 implications 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 any 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 has unencumbered cash and liquid investments of Rs. 30.6 crore and undrawn bank lines of Rs. 36.5 crore as on February 28, 2023 with a debt obligation of Rs. 85.6 crore during March 2023 - May 2023. The asset-liability maturity (ALM) profile, as on December 31, 2022, does not reflect cumulative negative mismatches up to 12 months. The proposed public issuance of NCDs in April 2023 is expected to improve its liquidity position further.

Rating sensitivities

Positive factors – ICRA could change the outlook or upgrade the ratings if SFL steadily improves its funding, asset quality and earnings profiles.

Negative factors – ICRA could change the outlook or downgrade SFL's ratings in case of a deterioration in its 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	ICRA's Credit 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 across sectors such as sugar, beverages, automobile and transport dealerships, auto components and textiles. SFL primarily finances CVs, which constituted 90% of its total portfolio as of December 2022. The remaining portfolio consisted of loans towards the purchase of cars, construction equipment and other machinery. SFL mainly operates in Tamil Nadu and Kerala, which together accounted for about 96% of the total portfolio.

In FY2022, SFL reported a net profit of Rs. 9.5 crore on a managed asset base of Rs. 1,244.3 crore compared to a net profit of Rs. 9.4 crore on a managed asset base of Rs. 1,212.2 crore in FY2021. As per the provisional financials for 9M FY2023, the company reported a net profit of Rs. 9.0 crore on a managed asset base of Rs. 1,272.3 crore.

Key financial indicators (audited)

Sakthi Finance Limited	FY2021	FY2022	9M FY2023
	Ind-AS	Ind-AS	Ind-AS
Total income	171.0	181.0	142.5
Profit after tax	9.4	9.5	9.0
Net worth*	166.5	172.8	178.9
Total managed portfolio	1,126.4	1,144.1	1,197.1
Total managed assets	1,212.2	1,244.3	1,272.3
Return on managed assets	0.8%	0.8%	1.0%
Return on net worth	5.7%	5.6%	6.9%
Gearing (times)*	6.2	6.1	6.0
Gross stage 3	5.0%	5.2%	6.2%
Net stage 3	2.2%	2.1%	3.1%
Solvency (Net stage 3/Net worth)	15.2%	13.6%	20.4%
CRAR**	19.2%	21.7%	19.1%

*Source: Company, ICRA Research; *Adjusted for revaluation reserve; **Not considering sub-debt (private placement) as Tier II capital*
Amount in Rs. crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)					Chronology of Rating History for the Past 3 Years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in FY2023		Date & Rating in FY2022		Date & Rating in FY2021		Date & Rating in FY2020
					Mar 20, 2023	May 31, 2022	Mar 22, 2022	Apr 26, 2021	Aug 04, 2020	Apr 13, 2020	Feb 20, 2020
1	NCDs	Long term	544.55	544.55	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB&	[ICRA]BBB (Stable)
			53.25	0.00	[ICRA]BBB (Stable); withdrawn	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB&	[ICRA]BBB (Stable)
			200.00	0.00	[ICRA]BBB (Stable)	-	-	-	-	-	-
2	Fixed deposits	Medium term	-	-	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	MA- (Stable)	MA- (Stable)	MA- (Stable)	MA-&	MA- (Stable)
3	Term loans	Long term	83.10	83.10	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB&	[ICRA]BBB (Stable)
4	Long-term bank facilities	Long term	131.66	131.66	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA] BBB (Stable)	[ICRA] BBB (Stable)	[ICRA] BBB (Stable)	[ICRA]BBB&	[ICRA] BBB (Stable)
5	Fund-based interchangeable ^	Long term/ Short term	(59.66)	(59.66)	[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&/ [ICRA]A2&	[ICRA]BBB (Stable)/ [ICRA]A2
6	Short-term bank facilities	Short term	100.00	100.00	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2&	[ICRA]A2

Note: &- rating on watch

Complexity level of the rated instrument

Instrument	Complexity Indicator
Long-term fund based – Cash credit	Simple
Short-term fund based – Working capital demand loan	Simple
Long-term fund based – Term loans	Simple
Fixed deposit programme	Very Simple
Non-convertible debentures	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
INE302E07227	NCD	May-15-2019	10.00	May-15-2023	19.09	[ICRA]BBB (Stable)
INE302E07235	NCD	May-15-2019	10.00	May-15-2023	2.92	[ICRA]BBB (Stable)
INE302E07243	NCD	May-15-2019	12.11	May-15-2023	15.41	[ICRA]BBB (Stable)
INE302E07276	NCD	May-08-2020	9.75	Aug-08-2023	8.12	[ICRA]BBB (Stable)
INE302E07284	NCD	May-08-2020	9.75	Aug-08-2023	1.42	[ICRA]BBB (Stable)
INE302E07292	NCD	May-08-2020	11.31	Aug-08-2023	7.94	[ICRA]BBB (Stable)
INE302E07300	NCD	May-08-2020	10.00	Jun-08-2024	18.94	[ICRA]BBB (Stable)
INE302E07318	NCD	May-08-2020	10.00	Jun-08-2024	2.49	[ICRA]BBB (Stable)
INE302E07326	NCD	May-08-2020	12.17	Jun-08-2024	11.29	[ICRA]BBB (Stable)
INE302E07334	NCD	Jul-29-2021	9.50	Sep-29-2023	29.49	[ICRA]BBB (Stable)
INE302E07342	NCD	Jul-29-2021	10.42	Sep-29-2023	32.14	[ICRA]BBB (Stable)
INE302E07359	NCD	Jul-29-2021	9.75	Oct-29-2024	16.63	[ICRA]BBB (Stable)
INE302E07367	NCD	Jul-29-2021	11.32	Oct-29-2024	15.95	[ICRA]BBB (Stable)
INE302E07375	NCD	Jul-29-2021	10.00	Aug-29-2025	35.66	[ICRA]BBB (Stable)
INE302E07383	NCD	Jul-29-2021	12.17	Aug-29-2025	21.07	[ICRA]BBB (Stable)
INE302E07409	NCD	Apr-29-2022	8.50%	Apr-29-2024	8.26	[ICRA]BBB (Stable)
INE302E07425	NCD	Apr-29-2022	8.75%	Apr-29-2025	4.12	[ICRA]BBB (Stable)
INE302E07441	NCD	Apr-29-2022	9.00%	Apr-29-2026	2.28	[ICRA]BBB (Stable)
INE302E07466	NCD	Apr-29-2022	10.00%	Apr-29-2027	43.75	[ICRA]BBB (Stable)
INE302E07417	NCD	Apr-29-2022	9.16%	Apr-29-2024	12.35	[ICRA]BBB (Stable)
INE302E07433	NCD	Apr-29-2022	9.88%	Apr-29-2025	6.81	[ICRA]BBB (Stable)
INE302E07458	NCD	Apr-29-2022	10.69%	Apr-29-2026	1.26	[ICRA]BBB (Stable)
INE302E07474	NCD	Apr-29-2022	12.77%	Apr-29-2027	21.17	[ICRA]BBB (Stable)
INE302E08027	NCD	May-15-2019	10.25	Jun-15-2024	20.85	[ICRA]BBB (Stable)
INE302E08035	NCD	May-15-2019	10.25	Jun-15-2024	1.07	[ICRA]BBB (Stable)
INE302E08043	NCD	May-15-2019	13.24	Jun-15-2024	21.84	[ICRA]BBB (Stable)
INE302E08050	NCD	May-08-2020	10.25	Jul-08-2025	7.39	[ICRA]BBB (Stable)
INE302E08068	NCD	May-08-2020	10.25	Jul-08-2025	0.67	[ICRA]BBB (Stable)
INE302E08076	NCD	May-08-2020	13.30	Jul-08-2025	7.98	[ICRA]BBB (Stable)
INE302E08084	NCD	Jul-29-2021	10.50	Aug-29-2026	30.89	[ICRA]BBB (Stable)
INE302E08092	NCD	Jul-29-2021	13.64	Aug-29-2026	16.71	[ICRA]BBB (Stable)
INE302E07193	NCD	May-15-2019	9.75	May-15-2022	5.92	[ICRA]BBB (Stable); withdrawn
INE302E07201	NCD	May-15-2019	9.75	May-15-2022	2.69	[ICRA]BBB (Stable); withdrawn
INE302E07219	NCD	May-15-2019	11.17	May-15-2022	8.00	[ICRA]BBB (Stable); withdrawn
INE302E07250	NCD	May-08-2020	9.50	May-08-2022	16.91	[ICRA]BBB (Stable); withdrawn
INE302E07268	NCD	May-08-2020	10.33	May-08-2022	19.73	[ICRA]BBB (Stable); withdrawn
Unutilised	NCD	NA	NA	NA	98.59	[ICRA]BBB (Stable)
Unutilised	NCD – Fresh	NA	NA	NA	200.00	[ICRA]BBB (Stable)
NA	Fixed deposits	NA	NA	NA	-	[ICRA]BBB (Stable)
NA	Term loans	NA	NA	NA	83.10	[ICRA]BBB (Stable)
NA	Cash credit	NA	NA	NA	131.66	[ICRA]BBB (Stable)
NA	Fund-based interchangeable	NA	NA	NA	(59.66)^	[ICRA]BBB (Stable) /[ICRA]A2
NA	Working capital demand loan	NA	NA	NA	100.00	[ICRA]A2

Source: Company; ^ Sub-limit of fund-based long-term facilities from banks

[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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