March 13, 2023

Shriram Housing Finance Limited: Rating assigned to commercial paper programme

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Commercial paper	100.00	[ICRA]A1+; assigned
Total	**100.00**	

**Instrument details are provided in Annexure-I*

Rationale

For arriving at the rating, ICRA has taken a consolidated view of Shriram Finance Limited (SFL) and Shriram Housing Finance Limited (SHFL), hereafter referred to as SFL or the Group, given the shared brand name, common promoters, business-level synergies and financial interlinkages.

The rating factors in the Group's long-standing track record, established brand, strong customer reach and a granular retail loan book. Moreover, the merger has resulted in a diversification in product offering, which now includes housing finance (through SHFL), loan against property (LAP), small enterprise loans, personal loans, auto loans, two-wheeler finance and gold loans, besides the leadership position in the preowned commercial vehicle (CV) financing segment. The housing finance business is housed under SHFL, which has established a fairly diversified geographical presence in affordable housing finance segment with 123 branches across 15 states and an AUM of Rs. 7,178 crore as on December 31, 2022. SHFL has been growing at a 3-year CAGR of 46%, and primarily disburses retail loans with a focus on self-employed borrower segment, which comprised 78% of the AUM as on December 31, 2022. The recently concluded merger also provides the chance to access a larger customer base and explore cross-selling opportunities, besides widening the reach of the relatively less-penetrated products of the Group in newer geographies.

The rating also considers the Group's track record of healthy profitability, notwithstanding intermittent pressures amid a challenging environment, and its comfortable capitalisation profile. As of December 31, 2022, SFL's consolidated net worth stood at about Rs. 41,140 crore[1] with an estimated gearing of 3.9 times, while net worth and gearing (reported) stood at Rs. 1,260 crore and 4.3 times for SHFL. The capital adequacy ratio for SFL and SHFL remained comfortably above the regulatory requirement at 23.0% and 25%, respectively, as on December 31, 2022.

Given the exposure to a high-yielding borrower segment with modest credit profiles under the erstwhile STFC and SCUF, the overall asset quality (consolidated) of the Group remains moderate. SFL's consolidated gross stage 3 assets aggregated at 6.1% of the loan book as on December 31, 2022, while the net stage 3 assets stood at 3.2% of the loan book. Reported gross stage 3 and net stage 3 assets were relatively lower for SHFL and stood at 1.2% and 0.9%, respectively, as on December 31, 2022. While taking the rating action, ICRA notes that the stated asset quality does not factor in the relief extended to the borrowers through the Emergency Credit Line Guarantee Scheme and loan restructuring facilities, for both SFL and SHFL. Nonetheless, the Group has a demonstrated track record of reporting a swift recovery in its collection efficiency through cycles, though the asset quality metrics would remain a key monitorable.

[1]*Adjusted for goodwill of Rs. 1,408.6 crore*

Key rating drivers and their description

Credit strengths

Diversified product offerings with leadership position in preowned CV financing segment – Post merger, SFL is one of the largest retail NBFCs. The consolidated AUM (including the housing finance business) was Rs. 1,84,678 crore as of December 31, 2022. It is the largest player in the preowned CV-financing segment in the country with a dominant market position. The company's proven track record, along with its well-established franchise (3,647 branches and rural centres as on December 31, 2022), result in strong customer reach and a granular retail loan book. Moreover, the merger has resulted in a diversification in the Group's product offering, which now includes CV financing (76%), housing finance (4%), small enterprise loans (10%), and two-wheeler finance (5%) with auto loan, personal loan, gold loan and LAP accounting for the balance.

SFL conducts its housing finance business through its subsidiary, SHFL. SHFL has been growing at a 3-year CAGR of 46% and reported an AUM of Rs. 7,178 crore as on December 31, 2022. Home loans (including top-up loans) comprised 64% of the company's AUM as on December 31, 2022, followed by loan against property (LAP) 28% and construction finance/corporate loans 8%. The company primarily disburses retail loans with a focus on self-employed borrower segment, which comprised 78% of the AUM as on December 31, 2022. As on December 31, 2022, SHFL had operations in 15 states through a network of 123 branches. SHFL's operations are fairly diversified geographically with the largest share of AUM in Maharashtra (22% as on December 31, 2022), followed by Gujarat (20%) and Tamil Nadu (14%).

Since the Group has a pan-India presence, the merger provides SHFL the chance to access a larger customer base and explore cross-selling opportunities, besides widening the reach of relatively less-penetrated mortgage loan products in newer geographies. Apart from its own branches, SHFL has been operating through more than 200 branches of SFL under its Grihapoorti program, which enables SHFL to source new business at relatively lower operating cost.

Healthy profitability – Notwithstanding the inherent riskiness of the target customer segment, the Group is expected to maintain healthy yields and lending spreads commensurate with the underlying credit risk. ICRA estimates SFL's average yield on advances to have been about 16% with a lending spread of 7% between FY2020 and FY2022. In 9M FY2023, the average yield on advances and lending spreads are estimated to have improved to 16.4% and 8%, respectively. This, coupled with the scale-based operating efficiency, is expected to support the profitability, notwithstanding the expected increase in the borrowing cost and hence the possibility of a compression in the incremental lending spread amidst the rising interest rate scenario. While the credit cost for the merged businesses remains high at 1.8-2.5% on account of the target customer segment, the overall profitability has remained healthy, with the three-year average return on assets (RoA) estimated at 2.2% and the return on net worth at 13.1%, despite the Covid-19 pandemic-related challenges witnessed during this period. In 9M FY2023, the RoA and the return on equity (RoE) were 3.0% and 16.5%.

SHFL reported a net profit of Rs. 101 crore in 9M FY2023, translating into an adequate return of 1.9% on average managed assets (AMA) and 11.1% on average net worth, compared to Rs. 80 crore, 1.5% and 9.3% respectively in FY2022. SHFL's net interest margins improved to 5.0% of AMA in 9M FY2023 from 4.5% in FY2022 as it continues raise its lending rate at a faster pace compared to the systemic increase in cost of funds. As the company continues to scale up its operations, the operating efficiencies improved, and operating expenses were reported at 2.6% of AMA in 9M FY2023 compared to 2.9% in FY2022. With slippages from the restructured portfolio and the company selling-off/writing-off older non-performing assets, the credit costs increased to 0.4% of AMA in 9M FY2023 from 0.2% in FY2022. With improvement in net interest margins and operating efficiencies, the reported profitability indicators of SHFL improved in 9M FY2023 vis-à-vis FY2022. ICRA expects further improvement in operating efficiencies and overall profitability as SHFL continues scaling up of operations.

Comfortable capitalisation – SFL's capitalisation profile is comfortable with a consolidated net worth (adjusted for goodwill) of Rs. 41,140 crore and gearing of 3.9 times while SHFL reported a net worth of Rs. 1,260 crore and a gearing of 4.3 times as on December 31, 2022. The capital adequacy ratio for SFL and SHFL remained comfortably above the regulatory requirement at 23.0% and 25.4%, respectively, as on December 31, 2022. Given the stable growth trajectory expected for SFL and the satisfactory pace of internal capital generation, the capitalisation is expected to remain at a reasonable level with adequate cushion over the regulatory minimum, provided SFL is able to continue controlling fresh slippages. In ICRA's opinion, SHFL will however require ~Rs. 700-800 crore of additional equity capital to support its planned growth of 30-35% over the next three years while maintaining an adequate capitalisation profile with gearing remaining less than 5 times on a sustained basis. ICRA takes note of the company's capital raising plans and expects capital support from the Group to be forthcoming for SHFL, should the need arise.

Credit challenges

Modest borrower profile and moderate asset quality – SFL's target customers primarily comprise the high-yielding borrower segment with modest credit profiles and limited credit history, with restricted buffer to absorb income shocks. Hence, the inherent credit risk in the portfolio is high. The same has been reflected in the moderate asset quality. SFL's gross stage 3 assets aggregated 6.1% of the loan book as on December 31, 2022, while the net stage 3 assets stood at 3.2% of the loan book. ICRA notes that the stated asset quality does not factor in the relief extended to the borrowers through the Emergency Credit Line Guarantee Scheme and loan restructuring facilities by SFL. Nonetheless, the Group has a demonstrated track record of reporting a swift recovery in its collection efficiency through cycles, though the asset quality metrics would remain a key monitorable.

Reported gross stage 3 and net stage 3 assets were relatively lower for SHFL and stood at 1.2% and 0.9% respectively, as on December 31, 2022. Additionally, SHFL had a standard restructured portfolio of ~1.9%, investments in security receipts ~0.1% and stock of repossessed assets of ~1.3% as on December 31, 2022. ICRA notes that the share of such loans/assets is gradually coming down, albeit aided by an increase in scale of operations. Also, ~83% of the standard restructured portfolio as on December 31, 2022 was classified as stage 1 assets while rest was classified as stage 2 assets. 15-20% of such standard restructured loans remained under moratorium as on December 31, 2022. Further, the portfolio sourced since January 2019 (91% of the AUM as on December 31, 2022) reported relatively lower delinquencies with 90+dpd of 0.4% as compared to 90+dpd of 0.6% on overall AUM as on December 31, 2022.

Relatively modest borrowing profile, notwithstanding established track record of raising funds from diverse sources – The Group has a track record of raising retail borrowings, besides tapping funds from a diverse set of investors. This has facilitated a diversified borrowing mix for supporting the large-scale operations and borrowing programme. As on December 31, 2022, SFL's borrowings stood at over Rs. 1,58,280 crore and are estimated to have primarily comprised non-convertible debentures (NCDs; 21%), term loans (27%), public deposits (20%), external commercial borrowings (ECBs; 16%), and securitisation (13%). However, the borrowing cost of SFL has remained relatively higher than its peers with instances of adverse fluctuations in yields. In this regard, especially in the backdrop of a further increase in the scale of the borrowing programme after the merger, SFL's sustained ability to mobilise funds from different sources at competitive rates remains imperative.

SHFL's borrowing profile is also fairly diversified and comprised loan from banks (55%), refinance from the National Housing Bank (9%), debt capital market borrowings (14%) and securitisation/assignment (22%) as on December 31, 2022. The share of funding from debt capital markets and securitisation/assignment increased in 9M FY2023 from 11% and 18%, respectively, as on March 31, 2022. ICRA expects the funding profile of SHFL to remain fairly diversified with majority reliance on bank borrowings in the near term.

Environmental and social risks

Given the service-oriented business of SFL and SHFL, the direct exposure to environmental risks as well as those arising from regulations or policy changes is not material. However, the residual value of the security, particularly in the CV finance segment, could reduce in case of policy changes such as incremental ruling on the reduction in the operating life of CVs, thereby impacting profitability. Further, there is increasing interest from policymakers towards identifying the exposure of financing companies to carbon emissions through their financing activities. This process, however, is in an early stage, and ICRA expects likely adverse implications to manifest only over a longer time horizon, giving financing companies adequate time to adapt and minimise the credit implications.

Exposure to social risks is low for financial institutions like SFL and SHFL. The Group serves the financing needs of a relatively underserved borrower category which supports social inclusion and economic development. ICRA notes that a large portion of the Group's portfolio qualifies for priority sector lending, which augurs well for its ability to do securitisation transactions at competitive rates. Moreover, the company has demonstrated ability to tap resources from overseas markets/impact investors through social bonds issuances.

Liquidity position: Adequate

As on December 31, 2022, SFL's asset-liability maturity (ALM) profile was characterised by positive cumulative mismatches across the near-term and medium-term maturity buckets, supported by the relatively comfortable matching of the average tenor of the assets and liabilities, and the modest on-balance sheet liquidity. As on December 31, 2022, SFL (standalone) had on-balance sheet liquidity of ~Rs. 17,400 crore, equivalent to 11% of the borrowings. The available liquidity adequately covered the debt obligations due over the next three months. The liquidity position is further supported by the availability of unutilised working capital lines.

As per SHFL's ALM profile as on December 31, 2022, the company had no cumulative mismatches for a period of at least 1-year. The company was carrying adequate on-book liquidity of Rs. 802 crore in the form of free cash and unencumbered liquid investments as on January 31, 2023. The presence of Rs. 178 crore unutilised working capital lines and Rs. 950 crore sanctioned unutilised funding lines further support the company's liquidity profile. SHFL's available on-book liquidity and unutilised funding lines as on January 31, 2023 are sufficient to meet its debt obligations for at least six months.

Rating sensitivities

Positive factors – Not applicable

Negative factors – A deterioration in the SFL's consolidated asset quality, leading to the sustained weakening of the solvency and/or profitability, could warrant a revision in the credit rating. A significant weakening in the consolidated capital adequacy of SFL would also exert pressure on the rating.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Rating Methodology for Non-Banking Finance Companies Rating Approach - Consolidation
Parent/Group support	Not Applicable
Consolidation/Standalone	Consolidation

About the company

Shriram Housing Finance Limited (SHFL) is a housing finance company registered with the National Housing Bank (NHB). It is a part of Shriram Group. On August 04, 2011, the company received its Certificate of Registration from National Housing Bank

(NHB) as required under Section 29A of the National Housing Bank Act, 1987. The primary operation of the company is providing loans for the purchase or construction of residential space and loans against property. As on December 31, 2022, the company had an AUM of Rs. 7,178 crore while catering to more than 36,000 borrowers across 15 states in India through a network of 123 branches.

Key financial indicators (audited)

Shriram Housing Finance Limited (Standalone)	FY2021	FY2022	9M FY2023*
Total income	422	549	566
Profit after tax	62	80	101
Net worth	576	1,158	1,260
Assets under management	3,929	5,355	7,178
Return on average assets	1.7%	1.5%	1.9%
Return on average net worth	11.5%	9.3%	11.1%
Gross gearing (times)	5.5	3.4	4.2
Gross stage 3	1.9%	1.7%	1.2%
Net stage 3	1.5%	1.3%	0.9%
Solvency (Net stage 3/Net worth)	8.7%	5.2%	4.2%
Capital to risk (weighted) assets ratio	23.0%	30.9%	25.4%

*Source: Company, ICRA Research; *Unaudited numbers; All ratios as per ICRA's calculations; Amount in Rs. crore*

Shriram Finance Limited [SFL; erstwhile Shriram Transport Finance Company Limited (STFC)], incorporated in 1979, is a part of the Shriram Group of companies and is a top-layer non-banking finance company (NBFC). Based on the National Company Law Tribunal (NCLT) order dated November 14, 2022, the operations of Shriram City Union Finance Company Limited (SCUF) and Shriram Capital Limited were merged with STFC and STFC and the entity was rechristened Shriram Finance Limited on November 30, 2022.

SFL enjoys leadership position in pre-owned commercial vehicle finance and has a pan-India presence with 2,910 branches. As of December 31, 2022, SFL had consolidated AUM of Rs. 1.8 lakh crore comprising pre-owned commercial vehicle finance (76%), SME lending (10%), personal loans (3%), gold loans (2%), two-wheeler loans (5%) and housing finance (4%; through its subsidiary SHFL).

In 9M FY2023, on a consolidated basis, SFL reported a net profit of Rs. 4,726 crore on an AUM of Rs. 1,84,676 crore and net worth of Rs. 41,140 crore[2]. On a standalone level, the company reported PAT of Rs. 4,671 crore on an AUM of Rs. 1,77,498 crore. Its reported capital adequacy stood at 22.99% as of December 31, 2022.

Key financial indicators (audited)

Shriram Finance Limited (Consolidated)	9M FY2023*
Total income	22,542
Profit after tax	4,726
Net worth	41,140
Assets under management	1,84,678
Return on average assets	3.0%
Return on average net worth	16.5%
Gross gearing (times)	3.9
Gross stage 3	6.1%#
Net stage 3	3.2%#
Solvency (Net stage 3/Net worth)	13.4%
Capital to risk (weighted) assets ratio	23.0%^

*Source: Company, ICRA Research; *Unaudited numbers; #SFL + SHFL; ^SFL – Standalone; All ratios as per ICRA's calculations; Amount in Rs. crore*

[2] *Adjusted for goodwill of Rs. 1,408.6 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 as of Feb 28, 2023 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
					Mar 13, 2023	-	-	-
1	**Commercial paper**	Short term	100.00	--	**[ICRA]A1+**	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Commercial paper	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	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Commercial paper – Yet to be issued**	NA	NA	7-365 days	100.00	[ICRA]A1+

Source: Company

Annexure II: List of entities considered for consolidated analysis

Company Name	Ownership as on November 30, 2022	Consolidation Approach
Shriram Finance Limited	100.00%	Full Consolidation
Shriram Housing Finance Limited	85.02%	Full Consolidation
Shriram Automall India Limited	44.56%	Equity Method

Note: ICRA has taken a consolidated view of the parent (SFL), aforementioned subsidiaries and associates while assigning the ratings

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