August 08, 2024

SK Finance Limited (erstwhile Ess Kay Fincorp Limited): [ICRA]AA- (Stable) assigned; rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debentures	850.0	850.00	[ICRA]AA- (Stable); reaffirmed
Non-convertible debentures	0.0	175.00	[ICRA]AA- (Stable); assigned
Non-convertible debentures	35.0	0.0	[ICRA]AA- (Stable); reaffirmed and withdrawn
Total	**885.0**	**1,025.0**	

**Instrument details are provided in Annexure I*

Rationale

The rating factors in SK Finance Limited's (SKFL) strengthened capital profile and healthy earnings profile. The capitalisation profile has 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 to Rs. 3,109 crore as on March 31, 2024. 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 with the return on managed assets (RoMA) and the return on average net worth (RoNW) remaining healthy at 2.7% and 12.6%, respectively, in FY2024 (2.8% and 13.0%, respectively, in FY2023), supported by the improvement in the operating efficiency and low credit costs despite the moderation in the net interest margin (NIM). The rating continues to factor in 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 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 52% of the portfolio as on March 31, 2024 (though lower than 94% as of March 31, 2014). The vehicle loan segment has consistently accounted for strong growth with a share of 79% in SKFL's assets under management (AUM) as on March 31, 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 21% as on March 31, 2024 from 11% as on March 31, 2021.

Further, ICRA notes that the reported non-performing advances (NPAs) weakened to 3.5% as on March 31, 2024 (3.1% as on March 31, 2023) and the 90+ days past due (dpd) for the overall AUM weakened marginally to 1.8% as on March 31, 2024 (1.6% as on March 31, 2023). The uptick in the reported NPAs was largely on account of the Reserve Bank of India's (RBI) clarification on Income Recognition and Asset Classification (IRAC) norms. On a lagged basis (one year), the 90+ dpd was higher at 2.5% as on March 31, 2024. Going forward, SKFL's ability to control fresh slippages 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.

ICRA has reaffirmed and withdrawn the rating assigned to the Rs. 35-crore non-convertible debentures (NCDs) as no amount is outstanding against the same, in accordance with ICRA's policy on the withdrawal of credit ratings.

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, two independent directors and two investor nominee directors. SKFL is promoted by Mr. Setia, who, along with his family members, holds an equity stake of 33.3% in the company (fully-diluted basis as on March 31, 2024). It is also backed by established equity investors such as Norwest Venture Partners X – Mauritius (Norwest), TPG Capital, Baring Private Equity India AIF, Evolvence India (Evolvence) and IIFL Special Opportunities Fund, which together held a 47.7% equity stake as on March 31, 2024. Following the recent capital raise, the new investors in the company include Motilal Oswal Private Equity (PE), Duro Capital, Axis Growth Avenues, Ananta Capital Venture and Mirae, which together held 11.6% equity as on March 31, 2024.

Comfortable capitalisation – SKFL's capitalisation has improved with the capital raise of ~Rs. 900 crore from new and existing investors in FY2024. This, along with internal capital generation, led to an increase in the net worth to Rs. 3,109 crore as on March 31, 2024 from Rs. 1,834 crore as on March 31, 2023. Consequently, the managed gearing reduced to 3.2x as on March 31, 2024 from 4.1x as on March 31, 2023. The reported capital adequacy was comfortable at 33.9% as on March 31, 2024 (26.1% as on March 31, 2023). The recent growth capital raise has given the company headroom for its near-term growth plans. ICRA notes that SKFL has outlined a road map for strong growth, which is likely to increase the leverage from the current level. ICRA expects the managed gearing to remain in the range of 3-4x in the next two years, based on the current capital position. The company 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 – 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 (FY2019-FY2023) of 20.0%[1]. The yields moderated to 17.6%[1] in FY2024 from 19.0%[1] in FY2023 because of an increase in the share of SME and car loans in incremental disbursements. These loans usually have lower yields compared to other segments. Further, the cost of funds moderated marginally to 9.3%[1] in FY2024 from 9.4%[1] in FY2023 because of the base effect despite the elevated systemic interest rates. This led to a compression in the lending spreads and hence NIM (managed assets basis) to 8.3%[1] and 8.5%[1], respectively, in FY2024 from 9.4%[1] and 9.2%[1], respectively, in FY2023. The operating expenses moderated marginally to 4.6%[1] in FY2024 from 4.8%[1] in FY2023, but remained high due to the cost-intensive business model and branch expansion. Credit costs remained largely stable at 1.0%[1] in FY2024 (1.1%[1] in FY2023). Overall, the profitability indicators remained healthy with RoMA of 2.7%[1] in FY2024 compared with 2.8%[1] in FY2023. ICRA notes that the profitability is expected to improve as the operating expenses stabilise with economies of scale, provided SKFL can maintain good control on fresh slippages over the medium term.

Adequately diversified borrowing profile for the scale of operations – SKFL's borrowing profile is adequately diversified, with sources including debt markets (16% of the total borrowings, including off-book, as on March 31, 2024), term loans and working capital lines from banks including external commercial borrowings (ECBs; 55%), term loans from FIs (4%) and others (1%). As on March 31, 2024, the company had borrowing relationships with over 60 FIs. It also continues to raise funds through securitisation/direct assignment (DA; 24% of the total borrowings as of March 31, 2024).

[1] *As per ICRA's calculations*

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 to 5.6% as on March 31, 2024 from 4.9% as on March 31, 2023 because of delinquencies in the tractor and commercial vehicle (CV) segments due to seasonality. The same remains high, given the target borrower profile and the nature of the business. Further, the 90+ dpd for the overall AUM weakened marginally to 1.8% as on March 31, 2024 vis-à-vis 1.6% as on March 31, 2023 because of roll forwards into harder buckets. However, on a lagged basis (one year), the 90+ dpd was higher at 2.5% as on March 31, 2024.

ICRA notes that the reported gross and net NPAs weakened to 3.5% and 2.5%, respectively, as on March 31, 2024, from 3.1% and 2.4%, respectively, as on March 31, 2023, largely on account of the RBI's clarifications on IRAC norms and partly because of SKFL's earlier strategy of focusing on collecting dues from the 90+ dpd buckets. However, the company has changed its collection strategy to control the roll forwards into harder buckets. The gross stage 3 also weakened to 2.2% as on March 31, 2024 from 1.9% as on March 31, 2023 on account of delinquencies in the tractor and CV segments in FY2024. The provision cover on the overall book declined to 1.7% as on March 31, 2024 from 2.0% as on March 31, 2023 as the company has reduced the provision cover on stage 1 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. 10,476 crore as on March 31, 2024 from Rs. 1,282 crore as on March 31, 2018. Further, it expanded its reach to 12 states/UTs in India through a network of 579 branches as on March 31, 2024. However, it remains a regional player with the home state of Rajasthan still accounting for 52% of the portfolio as on March 31, 2024, though this has moderated from 94% in March 2014. The balance is primarily in Madhya Pradesh (14%), Gujarat (10%), Punjab & Haryana (13%) 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 79% as on March 31, 2024 (though lower than 91% as on March 31, 2018). Also, while the share of the used vehicle segment moderated to 60% of the AUM as on March 31, 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 21% as on March 31, 2024 from 9% as on March 31, 2018.

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 the company 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 March 31, 2024, SKFL had scheduled principal debt repayments of Rs. 4,269 crore for the 12-month period ending March 31, 2025 against which it had scheduled inflows from performing advances of Rs. 3,151 crore. The unencumbered on-balance sheet liquidity (cash and liquid investments) of Rs. 1,957 crore (~22% of on-balance sheet borrowings), coupled with undrawn working capital lines of about Rs. 84 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 Policy on withdrawal of credit ratings
Parent/Group support	-
Consolidation/Standalone	Standalone

About the company

Incorporated in 1994, SKFL has its headquarters in Jaipur (Rajasthan). It is a non-banking financial company (NBFC) registered with the 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 579 branches, as on March 31, 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 with a share of 52% in the portfolio. As on March 31, 2024, the AUM stood at about Rs. 10,476 crore with commercial vehicles forming the largest share at 42.4%, followed by MSME loans (20.9%), cars (19.3%), tractors (13.3%) and two-wheelers (4.1%).

The promoter group, viz. Mr. Rajendra Setia and his family members, held a 33.3% equity stake (fully-diluted basis) in the company as on March 31, 2024. Other key equity investors include Northwest Venture Partners, TPG Capital, Evolvence, Baring India and IIFL Special Opportunities Fund Series 9 with equity stakes of 24.0%, 18.1%, 1.2%, 1.3% and 3.1%, respectively, as on March 31, 2024. Additionally, post the recent capital raise, the new investors in the company include Motilal Oswal Private Equity (PE), Duro Capital, Axis Growth Avenues, Ananta Capital Venture and Mirae, which together held 11.6% as on March 31, 2024.

The company reported a profit after tax (PAT) of Rs. 312 crore in FY2024 on total managed assets of Rs. 13,359 crore as on March 31, 2024 compared to a PAT of Rs. 223 crore in FY2023 on total managed assets of Rs. 9,597 crore as on March 31, 2023. Its net worth stood at Rs. 3,109 crore with a managed gearing of 3.2x as on March 31, 2024 (Rs. 1,834 crore and 4.1x, respectively, as on March 31, 2023). The gross and net stage 3 stood at 2.2% and 1.3%, respectively, as on March 31, 2024 (1.9% and 1.3%, respectively, as on March 31, 2023).

Key financial indicators (KFIs)

SKFL	FY2021	FY2022	FY2023	FY2024
	Audited	Audited	Audited	Audited
Total income	682	821	1,314	1,798
Profit after tax	91	143	223	312
Total managed assets	4,558	6,427	9,597	13,359
Return on average managed assets	2.2%	2.6%	2.8%	2.7%
Managed gearing (times)	3.4	2.9	4.1	3.2
Gross stage 3	4.0%	2.8%	1.9%	2.2%
Gross NPA (as per new IRAC norms)	4.0%	2.8%	3.1%	3.5%
CRAR	27.7%	30.4%	26.1%	33.9%

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

Source: ICRA Research
** As on July 31, 2024*

	Current (FY2025)					Chronology of rating history for the past 3 years					
				FY2025		FY2024		FY2023		FY2022	
Instrument	Type	Amount rated (Rs. crore)	08-Aug-2024	Date	Rating	Date	Rating	Date	Rating	Date	Rating
Bonds/ NCD/ Long Term Debt	Long term	850.00	[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)
				-	-	18-MAR-2024	[ICRA]AA- (Stable)	21-MAR-2023	[ICRA]A+ (Positive)	23-DEC-2021	PP-MLD[ICRA]A (Stable)
				-	-	18-MAR-2024	[ICRA]AA- (Stable)	21-MAR-2023	PP-MLD[ICRA]A+ (Positive)	07-MAR-2022	[ICRA]A+ (Stable)
				-	-	18-MAR-2024	PP-MLD[ICRA]AA- (Stable); withdrawn	-	-	07-MAR-2022	PP-MLD[ICRA]A+ (Stable)
Bonds/ NCD/ Long Term Debt	Long Term	175.00	[ICRA]AA- (Stable)	-	-	-	-	-	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Non-convertible debentures	Very Simple (Simple for ISIN INE124N08075, INE124N07697, INE124N07713)*
Non-convertible debentures (yet to be placed)	Very Simple

** Complexity Indicator is Simple for ISIN INE124N08075. Complexity Indicator is Simple for ISIN INE124N07697 because of put option on this NCD. Complexity Indicator is Simple for ISIN INE124N07713 because of put option on this NCD*

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
INE124N08075	**NCD**	Dec-29-2021	1-year SBI MCLR linked	Jun-29-2024	35.0	[ICRA]AA- (Stable); withdrawn
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)
INE124N07697	**NCD**	May-09-2024	9.25%	May-09-2027	350.0	[ICRA]AA- (Stable)
INE124N07713	**NCD**	Jun-19-2024	9.25%	Sep-19-2027	100.0	[ICRA]AA- (Stable)
NA	**NCD***	NA	NA	NA	245.0	[ICRA]AA- (Stable)

*Source: SKFL, ICRA Research; * Yet to be placed; ^ As on July 31, 2024*

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

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