

Press Release

SK Finance Limited (Erstwhile Ess Kay Fincorp Limited)

February 10, 2022



Rating Assigned

Product	Quantum (Rs. Cr)	Long Term Rating	Short Term Rating
Bank Loan Ratings	2500.00	ACUITE AA- Stable Assigned	-
Commercial Paper (CP)	50.00	-	ACUITE A1+ Assigned
Total Outstanding Quantum (Rs. Cr)	2550.00	-	-
Total Withdrawn Quantum (Rs. Cr)	0.00	-	-

Rating Rationale

Acuite has assigned the short term rating of 'ACUITE A1+' (read as ACUITE A one plus) on the Rs. 50.00 Cr proposed Commercial Paper Programme of SK Finance Limited (SKFL) (Erstwhile ESS KAY Fincorp Limited).

Acuite has assigned the long term rating of 'ACUITE AA-' (read as ACUITE double A minus) on the Rs. 2500.00 Cr proposed bank facilities of SK Finance Limited (SKFL) (Erstwhile ESS KAY Fincorp Limited). The outlook is 'Stable'.

The rating derives strength from SKFL's operating track record in vehicle financing, well-entrenched franchise in Rajasthan, demonstrated ability to raise capital as well as its experienced management team. Since FY18, SKFL has raised Rs. 1122 Cr from marquee private equity players and its promoter, Mr. Rajendra Kumar Setia. Given the regular capital infusions, the company has a comfortable capital structure; CRAR and gearing stood at 32.93 percent and 2.49 times (total debt includes lease liabilities) as on September 2021. The rating further takes into account a gradual improvement in profitability led by steady growth in disbursements in the current fiscal year. SKFL also benefits from a diversified resource profile and strong liquidity buffers with a policy of keeping liquidity equivalent to debt obligations for the next three months.

The rating, is however constrained by its modest scale of operations with geographical concentration in the state of Rajasthan (~62 percent of AUM as on December 2021). The rating is also constrained by its moderate asset quality along with an exposure to relatively weak customer segment. Nevertheless, Acuite takes cognizance of the company's ability to curtail slippages and build comfortable provision buffers. While the on time portfolio stood at 75.4 percent as on December 2021, it has not been much adversely affected by the Covid-19 led pandemic. The company's Gross Stage 3 stood at 4.88% as on September 30, 2021 vis-à-vis 4.04% as on March 31, 2021 [P.Y.: 4.04%].

Going forward, the company's ability to profitably scale up its operations while maintaining its asset quality shall be the key monitorables.

About the company

Incorporated in 1994, SK Finance Limited (Formerly known as Ess Kay Fincorp Limited) is a Jaipur (Rajasthan) headquartered non-banking finance company (NBFC) registered with the Reserve Bank of India (RBI). SK Finance Limited has a wide network of more than 400+ branches across 10 states i.e., Gujarat, Rajasthan, Punjab, Haryana, Maharashtra, Chhattisgarh, Madhya Pradesh, Himachal Pradesh, Delhi NCR and Uttarakhand. The company has a track record of 27 years into financing a wide range of tractors and vehicles, which includes used and new, 2-wheelers, car loan as well as extending loans to MSMEs i.e., Micro, Small and Medium Enterprises.

Analytical Approach

Acuité has considered the standalone business and financial risk profiles of SKFL to arrive at this rating.

Key Rating Drivers

Strength

- **Adequate track record of operations**

SKFL has track record of more than 27 years in vehicle financing segment with significant presence in the state of Rajasthan (~62 percent of the portfolio as on December 31, 2021). The company has established network of 409 branches across 10 states with loan portfolio outstanding at Rs. 4,177.85 Cr as on December 31, 2021. The Company is promoted by Mr. Rajendra Setia who holds 38.47% and is backed by private equity players like Norwest Venture Partners X-Mauritius, Baring Private Equity, Evolve, TPG Capital, IIFL and Massachusetts Institute of Technology these players together hold 61.27 percent of equity shareholding as on December 31, 2021. Mr. Rajendra Kumar Setia has vast experience of more than two decades in finance sector mainly vehicle financing. The board of the company comprises of two promoter directors, two independent directors and two investor nominee directors who have over a decade of experience in banking and advisory services. The company is supported by experienced senior management team heading different verticals with adequate and relevant experience in their respective fields.

Acuité believes that SKFL will benefit from established presence and long track record in the area of operations as well as from the expertise and experience of the board and key management personnel.

- **Comfortable capitalization levels supported by regular capital infusion by its promoter and investor**

The Company is promoted by Mr. Rajendra Setia who holds 38.47% and is backed by private equity players like Norwest Venture Partners X-Mauritius, Baring Private Equity, Evolve, TPG Capital, IIFL and Massachusetts Institute of Technology, these players together hold 61.27 percent of equity shareholding as on December 31, 2021. SKFL has been able to raise Rs. 1122 Cr since FY2018 till YTD. Out of which, Rs. 150 Cr was raised in December 31, 2021 by three new investors and Rs. 337 Cr was infused in May 2021 by existing investors and promoter. The company's capital structure consists of Networth of Rs. 1364.37 Cr (FY2021: Rs. 971.50 Cr, FY2020:- Rs. 878.73 Cr), Debt of Rs. 3398.93 Cr (FY2021: Rs. 3256.10 Cr, FY2020:- 2585.46 Cr) and resultant gearing of 2.49 times (total debt includes lease liabilities) as on September 30, 2021 (FY2021: 3.35 times, FY2020:- 2.94 times). SKFL's gearing is moderate and the company is well capitalized supported by the regular capital infusions. Capital Adequacy Ratio stood at 32.93 percent in H1FY2022 compared to 27.67 percent in FY2021 and 31.66 percent in FY2020. Regular support from investors through capital infusion has facilitated sufficient headroom for growth and ability to absorb losses.

Going forward, ACUITÉ believes, SKFL's capitalization levels will remain comfortable supported by its internal accruals and regular capital infusions from its investors.

- **Prudent risk management policy and comfortable provisioning buffers**

SKFL mainly focuses on used vehicles – S/LCV, MUV, Car, and Tractor – which are 3-10 years old. The total loan portfolio outstanding as on December 31, 2021 has increased by 39.89 percent to Rs. 4,177.85 Cr as compared to 2,986.47 Cr in FY2020. Commercial Vehicle contributes ~49 percent to the total AUM followed by Tractor (~18.5%), CAR (17.5%), MSME (11.7%) and 2-wheeler (3.3%). Notwithstanding the challenging macro-economic environment, SKFL has managed to disburse around Rs. 2088.67 Cr during 9M-FY2022, which is better than pre-Covid level disbursements which stood at Rs. 1521.26 Cr during 9M-FY2020. This is mainly because of the capital raising ability of the company along with prudent risk management practices and stringent credit assessment procedures adopted by the company. The underwriting procedure of SKFL is separate for both segments i.e. Vehicle and MSME. It has a write-off policy at 510+ dpd and it can vary from case to case basis. The company has also restructured Rs. 75.97 Cr (1.82% of AUM) of the outstanding loans as of December 2021 and has 52 percent as provisioning on Stage III. SKFL's Provision Cover on Stage III has increased over the years from 28.99 Cr in FY2019 to 94.77 Cr as on December 31, 2021.

ACUITÉ believes that SKFL's adequate underwriting procedures and risk management practices will help in keeping asset quality under control.

- **Improvement in profitability parameters**

Considering the segment of operations and customer profile, SKFL accrues higher lending yields. The lending yields has been in the range of ~20-23 percent over the past three years. Further, their cost of borrowing has also improved over the years to ~10.2 percent in FY2021, resulting in interest rate spread of ~10-12 percent. Hence, Net Interest Margin has remained healthy driven by improving cost of funds and higher yields. It stood at 10.25 percent in FY2021 and 12.06 percent in FY2020, whereas its annualized Net Interest Margin (NIM) stood at 8.72 percent in H1 FY2022. Though company's OPEX has remained high at 5.28 percent (annualized) as compared to 4.58 percent in FY2021 and 4.63 percent in FY2020 due to diversification into new geographies but the company has been able to maintain PAT at Rs. 59.23 Cr in H1 FY2022. The improvement in profitability in H1FY2022 is mainly led by higher disbursements of around Rs. 1130.51 Cr, reduction in credit cost followed by write-back of Rs. 6.12 Cr and higher margins. PAT stood at Rs. 91.08 Cr in FY2021 as compared to Rs. 78.54 Cr in the previous financial year. Despite the challenging operating environment, the company has been able to maintain ROAA of 2.34 percent in FY2021 as compared to 2.76 percent in FY2020. Annualized ROAA stood at 2.62 percent in H1 FY2022.

Going forward, SKFL's ability to be profitable while commanding higher yields and lower cost of funds will be a key monitorable.

Weakness

- **Modest scale of operations with limited geographical presence**

SKFL's scale of operations remains modest with AUM of Rs. 4,177.85 Cr as on December 2021 as compared to Rs. 3,417.17 Cr in FY2021 and Rs. 2,986.47 Cr in FY2020. Commercial Vehicle contributes ~49 percent to the total AUM followed by Tractor (~18.5%), CAR (17.5%), MSME (11.7%) and 2-wheeler (3.3%). The share of MSME loans has substantially increased over the years and going forward it is expected to rise further. Geographically, Rajasthan accounts for ~62 percent of the portfolio while Gujarat contributes ~14 percent. However, the company has been diversifying in other states like MP, Maharashtra, Haryana, Punjab and Chhattisgarh. Further, the Company has expanded in three more states viz: Uttarakhand, Himanchal & Delhi NCR with 2 branches in each state.

Going forward, the company's ability to profitably scale up its operations will be a key rating

sensitivity.

- **Moderate Asset Quality with an exposure to a relatively weak customer segment**

SKFL's product segment focuses on used vehicles (70.5% of the portfolio as on December 2021) -S/LCV, MUV, Car, Tractor – which are 3-10 years old. Given that the company caters to Low-income, self-employed individuals in rural and semi-urban areas, this segment is more susceptible to economic downturns and hence risky. Despite the downside asset quality risks, Acuite takes cognizance of the company's ability to curtail slippages and comfortable provision buffers. The asset quality is moderate, with Gross Stage 3 being at 4.88 percent and Net Stage 3 at 2.36 percent as on September 30, 2021. However, Gross Stage 3 had remained unchanged in FY2020 (Net Stage 3: - 2.42%) and FY2021 (Net Stage 3: - 1.90%) at 4.04 percent. Although it's on time portfolio is at 75.4 percent as on December 31, 2021, but over the last 3 years it has been at the same level and hence, it was not affected by Covid-19 led pandemic. The company has restructured Rs. 75.97 Cr (1.82% of AUM) of the outstanding loans as of December 2021 and has 52 percent as provisioning on Stage III in H1FY2022.

Going forward, the company's ability to control fresh slippages will remain a key monitorable.

ESG Factors Relevant for Rating

SK Finance Limited (SKFL) (Formerly known as Ess Kay Fincorp Limited) is a non-banking finance company (NBFC) registered with the Reserve Bank of India (RBI). Some of the material governance issues for the financial services sector are policies and practices with regard to business ethics, board diversity and independence, compensation structure for board and KMPs, role of the audit committee and shareholders' rights. On the social aspect, some of the critical issues for the sector are the contributions to financial inclusion and community development, responsible financing including environmentally friendly projects and policies around data privacy. The industry, by nature has a low exposure to environmental risks.

SKFL maintains adequate transparency in its business ethics practices as can be inferred from the entity's disclosures regarding its grievance redressal, related party transaction, fair practice code, whistle blower policy, Anti bribery policy and prevention of sexual harassment policy. The board of directors of the company comprise of two promoter directors out of which there's one female director; further, there are two independent directors and two investor nominee directors out of which there's one female nominee director. The entity has the necessary audit committee, nomination and remuneration committee and corporate social responsibility committee in place. The company is also governed by an information technology framework as recommended by RBI.

SKFL provides financing to the priority sector including a wide range of both new and used tractors and vehicles, 2-wheelers, cars as well as MSMEs i.e., Micro, Small and Medium Enterprises. SKFL aims to penetrate to the remotest areas lying at the bottom of the pyramid through various financial offerings and support financial inclusion efforts towards the underprivileged sections of the society. It has 97 percent of the clientele in rural or semi-urban areas. It continues to work on several community development initiatives through its corporate social responsibility projects in the sectors of education, healthcare, animal welfare and providing relief to poor. The company facilitates environmental initiatives by extending finance for the vehicles running on LPG/CNG; another initiative includes moving towards paperless transactions.

Rating Sensitivity

- Scalability of operations over the medium term
- Movement in capitalisation levels
- Movement in asset quality and profitability
- Changes in regulatory environment

Material Covenants

SKFL is subject to covenants stipulated by its lenders/investors in respect of various parameters like asset quality among others.

Liquidity Position: Strong

The management maintains a policy of keeping surplus liquidity for meeting debt obligations for the next three months. The company has monthly debt obligations of ~Rs. 97.85 Cr and operating expense of ~Rs. 22 Cr as against monthly collections of ~Rs. 227.68 Cr. The company has Rs. 714 Cr of encumbered cash balance and Rs. 113 Cr of unutilized limit. Liquidity is further supported by constant capital infusions done by its investors and promoter. Also, the company has diversified borrowing mix majorly contributed by Term loans (49.83%), NCDs (45.23%), CC (2.07%), ECBs (2.25%) and Tier II capital loans (0.61%).

Outlook: Stable

Acuité believes that SKFL will maintain a 'Stable' outlook over the medium term supported by its established presence in the vehicle financing segment along with demonstrated ability to raise capital. The outlook may be revised to 'Positive' in case of higher than expected growth in the loan portfolio while maintaining asset quality and capital structure. The outlook may be revised to 'Negative' in case of any headwinds faced in scaling up of operations or in case of significant deterioration in asset quality, thereby impacting profitability metrics.

Key Financials - Standalone / Originator

Particulars	Unit	FY21 (Actual)	FY20(Actual)
Total Assets	Rs. Cr.	4263.15	3507.12
Total Income*	Rs. Cr.	394.17	349.92
PAT	Rs. Cr.	91.08	78.54
Networth	Rs. Cr.	971.50	878.73
Return on Average Assets (RoAA)	(%)	2.34	2.76
Return on Net Worth (RoNW)	(%)	9.85	10.89
Total Debt/Tangible Net Worth (Gearing)**	Times	3.35	2.94
Gross Stage III	(%)	4.04	4.04
Net Stage III	(%)	1.90	2.42

*Total income equals to Net interest income plus other income

**Total debt includes lease liabilities

Status of non-cooperation with previous CRA (if applicable):

Not Applicable

Any other information

Not Applicable

Applicable Criteria

- Application Of Financial Ratios And Adjustments: <https://www.acuite.in/view-rating-criteria-53.htm>
- Commercial Paper: <https://www.acuite.in/view-rating-criteria-54.htm>
- Default Recognition: <https://www.acuite.in/view-rating-criteria-52.htm>
- Non-Banking Financing Entities: <https://www.acuite.in/view-rating-criteria-44.htm>

Note on complexity levels of the rated instrument

<https://www.acuite.in/view-rating-criteria-55.htm>

Rating History:

Not applicable

Annexure - Details of instruments rated

Lender's Name	ISIN	Facilities	Date Of Issuance	Coupon Rate	Maturity Date	Quantum (Rs. Cr.)	Rating
Not Applicable	Not Applicable	Proposed Commercial Paper Program	Not Applicable	Not Applicable	Not Applicable	50.00	ACUITE A1+ Assigned
Not Applicable	Not Applicable	Proposed Long Term Bank Facility	Not Applicable	Not Applicable	Not Applicable	2500.00	ACUITE AA- Stable Assigned

Contacts

Analytical	Rating Desk
Mohit Jain Senior Vice President-Rating Operations Tel: 022-49294041 mohit.jain@acuite.in	Varsha Bist Senior Manager-Rating Operations Tel: 022-49294011 rating.desk@acuite.in
Meghali Parmar Management Trainee-Rating Operations Tel: 022-49294065 meghali.parmar@acuite.in	

About Acuité Ratings & Research

Acuité Ratings & Research Limited is a full-service Credit Rating Agency registered with the Securities and Exchange Board of India (SEBI). The company received RBI Accreditation as an External Credit Assessment Institution (ECAI), for Bank Loan Ratings under BASEL-II norms in the year 2012. Since then, it has assigned more than 8,850 credit ratings to various securities, debt instruments and bank facilities of entities spread across the country and across a wide cross section of industries. It has its Registered and Head Office in Kanjurmarg, Mumbai.

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