Shriram Transport Finance Company Limited

February 25, 2022

Rating

Facilities/Instruments	Amount (Rs. crore)	Rating[1]	Rating Action
Non-convertible Debentures	1,000.00	CARE AA+; Stable (Double A Plus; Outlook: Stable)	Assigned
Total Long-term Instruments	**1,000.00 (Rs. One thousand crore only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The rating assigned to the non-convertible debentures of Shriram Transport Finance Company Limited (STFC) is supported by the company's dominant franchise in the used commercial vehicle (CV) financing segment and its proven ability and experience in navigating through multiple cyclical downturns in its around four-decade-long operational history. The rating derives strength from a management team which has the required experience in the used CV financing business. Adequate capital buffers, access to capital markets, moderately diversified resource profile are positive factors contributing to the ratings. The company's ability to generate consistent and sustainable profits through various economic cycles remains a core component underpinning its relative credit strength.

The rating remains constrained on account of its modest asset quality metrics which has further deteriorated during Q3FY22 on account of the revised non-performing assets (NPA) norms. The underlying borrowers are perceived to be economically weak whose income is closely linked to performance of the overall economy. Additionally, while STFCL has provided sufficient evidence of its access to capital markets along with the ability to raise funds from a diversified pool of banks and Financial Institutions (FIs), the overall cost of funding remains higher as compared to similar rated peers. While the company's focus towards the same has led to a month-on-month narrowing of the spread as observed over FY21 (refers to the period April 1 to March 31) and 9MFY22, the decline in funding costs on a sustained basis will remain a key monitorable.

Earlier, in the press release dated December 17, 2021, CARE Ratings Ltd had reaffirmed the ratings of STFC with a 'Stable' outlook following the announcement by the Board of Directors approving a Composite Scheme of Arrangement and Amalgamation (Scheme) involving various Shriram group entities

Rating Sensitivities

Positive Factors - Factors that could lead to positive rating action/upgrade:

- Continuous improvement in the asset quality on a sustained basis.
- Strengthening of capital position resulting in increased capacity to absorb losses.
- A well-diversified resource profile with evident decline in borrowing costs better than similar rated peers on a sustained basis.

Negative Factors- Factors that could lead to negative rating action/downgrade:

- Deterioration in the asset quality metrics with Gross Stage 3 ratio above 10%.
- Inability/Reduced ability to raise and diversify resources at competitive rates leading to constrained liquidity buffers.
- Visible signs of weakening of STFC's leading market position in the used vehicle financing business.

Detailed description of the key rating drivers

Key Rating Strengths

Strong Competitive Position Led by Dominant Market Share and Long Operational History: As on December 31, 2021, STFC had Assets Under Management (AUM) of Rs. 1,24,602 crore (Financial Year Ended (FYE21)): Rs.1,17,243 crore) of which used CV comprised 92% (FYE21: 89%) thereby translating into around 75% market share in the consolidated segment. In CVs, STFC mainly has presence in HCV & CE (47.94%), M&LCV (26.45%), passenger vehicles (20.37%), tractors (2.46%), Business loans (1.29%) and others (1.49%). New CV constituted 5% of its AUM as on December 31, 2021. Operational in the sector since 1979, STFC benefits from its understanding of the market and its borrowers which is evident from its established market position, customer relationships and relative pricing power. About 60% of the company's borrowers are repeat customers, the remaining being sourced through a reference-based model, wherein the existing clients of STFC provide references to the new customers which strengthens its client relationships.

Driven by increase in rural demand, STFC has expanded its outreach during the FY21, adding 59 branches mainly in the rural and semi-urban areas. Rural branches constitute 50% of the AUM as on December 31, 2021 (FYE21: 49%). CARE Ratings Ltd estimates the potential for growth opportunities in this sector to be wide considering the overall used CV market is unorganised and much larger. Also, the inherent weakness of the borrowers of the used CV segment which is partly mitigated by an innate understanding of the borrower requires other companies to invest both manpower, and considerable time to form longstanding relationships with customers. This acts as a barrier to entry for other financial institutions especially banks.

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

Going forward, CARE expects STFC’s market standing to remain resilient based on the strength of its competitive advantages and adequate growth prospects for the segment.

Noticeable Progress on Resource Diversification and Incremental Funding Rates: Retail deposits increased to 19.0% of the total funding as on December 31, 2021 as compared with 15.2% as on March 31, 2021. The improved traction is the result of a strategised focus on relatively low-cost deposits by providing the liability product in almost all its branches. STFC being a deposit taking Non-Banking Finance Company (NBFC), has over the years, developed a strong depositor base of over 2 lakh depositors till date. Going forward, STFC’s ability to increase its retail depositor base will be a key monitorable. As on December 31, 2021, STFC’s resource profile remains moderately diversified as reflected by the composite mix – Bonds (18.3%); Foreign currency borrowings (20.6%); term loans (19.1%), retail deposits (19.0%); subordinated debt (4.2%), securitisation (18.3%) and other borrowings (0.6%). The borrowing profile is also supported by securitisation which constituted 18.3% of the total borrowings.

STFC’s incremental borrowing rates have improved sequentially quarter-on-quarter as seen over the four quarters of FY21 and continues in FY22. CARE Ratings Ltd understands that the company is making a conscious effort to reduce its borrowing rates. Nevertheless, overall cost of funding still remains higher relative to peers and will only improve with newer lower-rate borrowings over the medium term. The cost of borrowings will remain a critical parameter for the company’s rating in the medium term. Furthermore, the volatility in bond spreads in the secondary capital market will be closely monitored.

Steady Profitability; Albeit Likely to Remain Relatively Subdued: On an absolute basis, the profitability remained stable in FY21 owing to steady net interest income, lower operating expenses partly offset by higher credit cost. STFC reported a profit after tax of Rs. 2,487 crore in FY21 (FY20: Rs. 2,502 crore). Yield on loans and cost of borrowings remained almost stable at 14.8% (FY20: 14.9%) and 9.0% (FY20: 9.1%) respectively in FY21. However, Net Interest Margin (NIM) compressed to 6.6% (FY20: 7.3%) as a result of increased cash holdings on its balance sheet to 12.7% of total assets (FYE20: 6.4%). Cost/income at 23% remained lowest among peers’ average of 32%-34%. However, COVID-19 related provisioning led to a slight increase in credit costs to 2.54% (FY20: 2.5%). Consequently, return on total assets (ROTA) ROTA declined to 2.03% (FY20: 2.25%) and RONW declined to 12.80% (FY20: 14.85%). During 9MFY22, ROTA declined to 2.10% (annualised) on account of higher provisioning. CARE Ratings Ltd expects ROTA to remain range bound between 1.5% to 1.8% for FY22.

Sufficient capitalisation levels: As on December 31, 2021, STFC’s tangible net-worth stood at Rs.24,291 crore (March 31, 2021: Rs.20,927 crore), with a capital adequacy ratio (CAR) at 23.31% (March 31, 2021: 22.50%) and Tier 1 ratio of 21.35% (March 31, 2021: 19.94%). The management plans to maintain Tier I capital above 15% on a steady state basis to augment further business growth and maintain operating leverage levels. The company’s overall gearing (Debt/Tangible Net worth) as at December 31, 2021 improved to 4.64x (March 31, 2021: 5.09x).

Competent management team: STFC is a part of the Shriram group and its Board of Director is headed by Mr. S. Lakshminarayanan (Chairman) who is an ex-IAS officer and has served at senior positions in Ministry of Home Affairs and Ministry of Communication & IT. The operations of the company are led by Mr. Umesh Revankar (Vice Chairman & Managing Director), who has been with the Shriram group for more than 28 years. The management team includes Mr. Parag Sharma (Joint Managing Director and Chief Financial Officer) and several others, who have been associated with STFC for several years. The senior management of the company is equipped with a rich experience of operating in the CV financing business.

Key Rating Weaknesses

Modest Asset Quality Metrics; Collections Back at Historical Levels: Collections (including overdues) improved with collection efficiency gradually back to pre-Covid levels at 101% during December 2021. This ability for substantial recovery from its overdue accounts reflects STFC’s solid client relationship engagements and underlines the company’s understanding of its borrower profile. STFC reported Gross Stage 3 ratio of 8.40% at December 31, 2021 (As on March 31, 2021: 7.1%) led by change in NPA norms. Moreover, Provision Coverage Ratio increased to 50.3% as on December 31, 2021. (March 31, 2021: 42.1%).

As at December 31, 2021, STFC had restructured assets amounting to Rs. 1,152.8 crore constituting 1.1% of AUM. Restructuring was mainly done for school and office transportation vehicles, aggregator vehicles and Ola & Uber vehicles. Post the reopening of the economy, around 60-70% of the borrowers on these accounts started repaying resulting in expectations of reduction in the actual restructuring required as compared to earlier estimates. Going forward, asset quality indicators will remain a key monitorable.

Underlying Industry Risk Associated with its Borrower Segment: The underlying borrowers in this segment are viewed as an economically weaker class who are susceptible to economic downturns. In an environment of economic slowdown, STFC’s asset quality comes under pressure since it has high exposure to small fleet operators and first-time buyers who are more vulnerable to the negative effects of an economic downturn. However, these are mainly owner operators with ~1-2 vehicles operating mainly in the transport of agricultural and agri-related goods, mining, e-commerce etc. which although facing disruption during the lockdown period have bounced back post the restart of economic activities. This is evidenced in the increased capacity utilisation and ability to pass on the rise in freight rates on the back of improved demand and rise in fuel prices. Additionally, past cyclical behaviour suggests that the used CV sales recover earlier than new CV sales in an improving cycle.

Liquidity: Strong
The structural liquidity statement for December 31, 2021, reported a cumulative surplus in all maturity time periods till one year. Excluding unutilised cash credit the company had Rs. 16,845 crore of liquidity as on December 31, 2021. Furthermore, STFC had sanctioned, committed undrawn bank lines including cash credit of Rs. 3,319 crore as on December 31, 2021. CARE Ratings Ltd notes that STFC has increased its balance sheet liquidity with lien free cash and bank balances (including FD) and investments at about 13% of its total assets. CARE Ratings Ltd expects liquidity profile to be adequately supported by the company's ability to securitise its assets.

Analytical approach: Standalone

Applicable Criteria
Criteria on assigning 'Outlook' and 'Credit Watch' to Credit Ratings
CARE's Policy on Default Recognition
Financial Ratios-Financial Sector
CARE's Rating Methodology for Non-Banking Finance Companies (NBFCs)

About the Company: **Shriram Transport Finance Company Limited**
Shriram Transport Finance Company Ltd (STFCL) is the flagship company of the Chennai-based Shriram Group and was founded by Mr R. Thyagarajan, Mr T. Jayaraman and Mr A. V. S. Raja. It is classified as a deposit-taking Asset Financing NBFC. The company was incorporated in 1979, with an objective to provide hire purchase and lease finance for the medium and heavy commercial vehicles to individual truck operators. It is the largest asset financing NBFC in India, concentrated mainly in the used vehicle financing business. Presently, STFCL has a network of 1,834 branches with a mix of 999 in rural and 835 in urban and semi-urban areas as on December 31, 2021.

Brief Financials: Standalone (Rs. crore)	FY20 (A)	FY21 (A)	Q1FY22(UA)	Q2FY22 (UA)	Q3FY22 (UA)
Total income	16,576	17,436	**4,652**	**4,703**	**4,832**
PAT	2,502	2,487	**170**	**771**	**681**
Interest coverage (times)	1.42	1.36	1.09	1.43	1.39
Total Assets (tangible)	1,14,063	1,29,037	1,29,767	1,33,822	1,38,360
Net Stage 3 (%)	5.62	4.22	4.74	4.18	4.36
ROTA (%)	2.25	2.03	0.55	2.43	2.10

A: Audited; UA: Unaudited; All ratios are as per CARE's calculations.
Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

Covenants of rated instrument / facility: *Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3*

Complexity level of various instruments rated for this company: Annexure-4
Annexure-1: Details of Instruments/Facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Debentures-Non-Convertible Debentures - Proposed	NA	NA	NA	NA	1,000.00	CARE AA+; Stable

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2021-2022	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019
1	Debt-Subordinate Debt	LT	1424.49	CARE AA+; Stable	1)CARE AA+; Stable (17-Dec-21) 2)CARE AA+; Stable (07-Jul-21)	1)CARE AA+; Stable (26-Mar-21) 2)CARE AA+; Negative (22-Jun-20)	1)CARE AA+; Stable (09-Oct-19)	1)CARE AA+; Stable (08-Jan-19)
2	Debentures-Non-Convertible Debentures	LT	2178.19	CARE AA+; Stable	1)CARE AA+; Stable (17-Dec-21) 2)CARE AA+; Stable (07-Jul-21)	1)CARE AA+; Stable (26-Mar-21) 2)CARE AA+; Negative (22-Jun-20)	1)CARE AA+; Stable (09-Oct-19)	1)CARE AA+; Stable (08-Jan-19)
3	Commercial Paper-Commercial Paper (Standalone)	ST	7500.00	CARE A1+	1)CARE A1+ (17-Dec-21) 2)CARE A1+ (07-Jul-21)	1)CARE A1+ (26-Mar-21) 2)CARE A1+ (22-Jun-20)	1)CARE A1+ (09-Oct-19)	1)CARE A1+ (08-Jan-19)
4	Debentures-Non-Convertible Debentures	LT	10000.00	CARE AA+; Stable	1)CARE AA+; Stable (17-Dec-21) 2)CARE AA+; Stable (07-Jul-21)	1)CARE AA+; Stable (26-Mar-21) 2)CARE AA+; Negative (22-Jun-20)	1)CARE AA+; Stable (09-Oct-19) 2)CARE AA+; Stable (29-Jun-19)	-
5	Debentures-Non-Convertible Debentures	LT	1000.00	CARE AA+; Stable				

Annexure 3: Covenants of rated instrument / facility: NA

Annexure 4: Complexity level of various instruments rated for this company

Sr. No	Name of instrument	Complexity level
1	Debentures-Non-Convertible Debentures	Simple

Annexure 5: Bank Lender Details for this Company

To view the lender-wise details of bank facilities please **click here**

Note on complexity levels of the rated instrument: CARE Ratings Ltd. has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

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About CARE Ratings Limited:

Established in 1993, CARE Ratings Ltd. is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India (SEBI), it has also been acknowledged as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). With an equitable position in the Indian capital market, CARE Ratings Limited provides a wide array of credit rating services that help corporates to raise capital and enable investors to make informed decisions backed by knowledge and assessment provided by the company.

With an established track record of rating companies over almost three decades, we follow a robust and transparent rating process that leverages our domain and analytical expertise backed by the methodologies congruent with the international best practices. CARE Ratings Limited has had a pivotal role to play in developing bank debt and capital market instruments including CPs, corporate bonds and debentures, and structured credit.

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