Sipradi Hire Purchase Private Limited: [ICRANP] LBBB-/A3 assigned; ratings placed on Watch with Negative Implications

August 10, 2020

Summary of rated instruments

Instrument	Rated Amount (NPR million)	Rating Action
Long-term, fund-based (Revolving term loans)	7,100	[ICRANP] LBBB-@; assigned
Short-term, fund-based (Overdraft)	(5)	[ICRANP] A3@; assigned
Total	**7,100**	

@ - indicates ratings on watch with negative implications

Rating action

ICRA Nepal has assigned the rating of [ICRANP] LBBB- (pronounced ICRA NP L triple B minus) to the long-term loans of Sipradi Hire Purchase Private Limited (SHPPL). ICRA Nepal has also assigned a rating of [ICRANP] A3 (pronounced ICRA NP A three) to the short-term loans of SHPPL. The ratings are on Watch with Negative Implications.

Rationale

The ratings take cognisance of the expected impact of the Covid-19 induced lockdowns on SHPPL's business, asset quality and financial performance. SHPPL's business growth was muted during FY2020[1], while its delinquencies, which were already increasing because of portfolio seasoning and weak operating environment for the borrowers, spiked on account of the pandemic. The delinquencies (90+dpd) shot up to ~15% in mid-July 2020 from ~2.3% in mid-July 2019. The non-performing assets (NPA, i.e. 180+ dpd) stood at 2.31% as on mid-July 2020 (0.54% in mid-July 2018). The resultant increased credit costs and decline in lending spreads (in line with regulatory requirements) led to the company reporting losses on a net basis for FY2020. SHPPL's incremental liquidity outlook also remains a monitorable amid the expected continuation of stress over asset quality, with no regulatory forbearance for SHPPL's borrowers as well as for SHPPL for its NPA recognition/provisioning norms.

The rating, however, notes that the company is a part of the Sipradi Group, which has a long presence (~38 years) in the Nepalese automobile sector and allied businesses. SHPPL, therefore, has timely access to managerial and operational support from the Group and also augments its financial flexibility for securing funding at competitive rates. ICRA Nepal takes note of the corporate guarantee provided by Sipradi Trading Private Limited (STPL), which holds 100% stake in SHHPL and expects timely capital infusion from the Group, if required.

ICRA Nepal takes note of SHHPL's short track record (operating since 2014) and the challenges in the operating environment for entities like SHPPL, given the slowdown in the automobile industry and the increasing competition due to rapid franchise expansion by banks over the last few years. The company's relatively modest borrower profile compared to banks and the limited regulatory oversight for the sector along with lenient credit provisioning requirements remain rating concerns. SHPPL's capitalisation was also moderate with gearing of ~7.4 times as of mid-July 2020 against the regulatory cap of 10 times. ICRA Nepal also takes note of the evolving liquidity and the risk management practices within the company, which could be strengthened. Going forward, SHPPL's ability to achieve good quality, profitable and sustainable portfolio growth, while keeping its capital structure under control, would be crucial.

[1] *FY2020/mid-July 2020 numbers are provisional as per management provided data.*

Key rating drivers

Credit strengths

Part of the Sipradi Group – SHPPL is a part of the Sipradi Group, which has a track record of nearly 38 years in the Nepalese automotive and allied business sectors. The company is solely promoted by STPL, a major unit of the Group and the sole distributor of TATA Motors, Exide, and Mak Lubricants for Nepal. STPL was the largest taxpaying trading company of Nepal during FY2014-FY2017 and it also provided corporate guarantees for the entire line of credit of SHPPL. In addition to management and oversight support, the association with the Group provides SHPPL with significant financial flexibility, mainly through timely equity injections as per business requirements and easier access to debt funds from diverse lenders, including some top-tier banks, at competitive rates.

Moderate growth in recent periods; sizeable portfolio base – SHPPL mainly finances TATA commercial vehicles (CVs), which are the highest selling vehicles in this segment. Hence, the company was able to report high growth rates in initial years of operation (108% in FY2018), which helped in making it one of the large entities in the sector. However, the pace of growth has sharply declined in recent years (~23% for FY2019 and ~6% for FY2020), an effect of the economic cyclicality as well as the pandemic. Growth is further likely to remain low over the medium term amid the expected economic slowdown due to the pandemic and hence the focus is likely to remain along recovery/consolidation. While the low seasoning due to high growth earlier remains a concern, the already attained sizeable portfolio base is likely to provide support to profitability over the near to medium term.

Credit challenges

Increasing delinquencies, further shot up by the pandemic impact – The profile of the borrowers approaching entities like SHPPL for their financing needs, is relatively modest, as is evident in the relatively high interest rates. SHPPL's delinquencies were already in an increasing trend during FY2019-FY2020, with gradual seasoning of the credit book, which registered a sharp growth between FY2016 and FY2018. The pandemic-induced lockdown further impacted the collections, leading to a spike in the overdues. The overdue loans, which were in the range of ~20-25%, gradually increased to ~44% in mid-July 2019. This further spiked to ~90% in mid-July 2020 as the lockdown impacted income streams of major borrower segments (i.e. CVs). The gross NPA, however, remains moderate so far at 2.31% as of mid-July 2020 with 90+ dpd of ~14.7%.

About ~92% of SHHPL's portfolio as of mid-July 2020 was constituted by credit extended to the Tata CV segment, followed by the TATA passenger vehicles (PV) segment at ~4%. The rest accounts for financing towards TATA Hitachi construction equipment (CE). The company mostly finances new vehicles (~96%) with almost entire loans for the income-generating segment. The portfolio is relatively granular (average ticket size of ~NPR 1.1 million) and the average LTV is low in the range of 60-65%. However, considering the modest borrower profile and subdued operating environment, its ability to undertake recoveries from the overdue accounts and keep incremental slippages under control would remain crucial.

Reduced spreads and rising credit costs likely to put pressure on profitability – In November 2018, the Nepal Rastra Bank (NRB, the central bank of Nepal) reduced the lending spreads for companies like SHPPL to 3% from 3.5% earlier. SHPPL's net interest margins declined to 4.78% in FY2019 and further to 3.02% in FY2020 (6.81% in FY2018) because of the cut in lending spreads to comply with this regulation and meet competitive pressures. This, along with the increased credit costs, 3.45% for FY2020 vis a vis 0.59% for FY2019, impacted its earnings profile. SHHPL reported a net loss of 1%[2] for FY2020 vis a vis a net profit of 2.4% in FY2019

Moderate capitalisation – As of mid-July 2020, the company's capitalisation was moderate with gearing of ~7.4 times (~6.1 times as of mid-July 2019), albeit lower than the regulatory cap of 10 times. The capitalisation deteriorated in FY2020, amid the losses and the dividend pay-out for FY2019. Against the regulatory capital requirement of NPR 300 million to be met by mid-July 2021, the company already has a capital of NPR 500 million. Considering the challenges in internal generation, SHPPL's ability to keep the capital structure under control going forward remains a rating monitorable.

[2] *PAT/ATA*

Short track record of operations – Established in 2014, SHPPL has a short track record. However, prior to SHPPL's establishment, its promoter STPL was operating the vehicle financing department for over eight years (in a similar manner as SHPPL). SHPPL, however, is yet to reveal its ability to maintain sustainable growth with focus on the quality of underwriting and incremental asset quality over a longer timeframe.

Evolving risk management policies and liquidity profile – SHPPL sanctions most of the loans based on the evaluation of the assessed income. The company is yet to obtain membership of the Credit Information Bureau, as required by revised regulations, which raises the concerns on overleveraging at the borrower level. While the industry is growing at a healthy pace, the regulatory controls are yet to be strengthened. NPA recognition and provisioning norms are also lenient with the NPAs recognised and provisions required only after the loans have been overdue for 180 days. Nonetheless, SHPPL is proactively creating 25% provisions for 90-180 days dpd, which is a positive. ICRA Nepal notes that the risk management framework is moderate in relation to the business risk profile and there is scope for strengthening the same in the areas like credit assessment and monitoring of portfolio level risks. Additionally, the scale of operations is increasing, and the liquidity management practices, including assessment of asset liability maturity profiles and gap analysis, would have to be further improved.

SHPPL's incremental liquidity profile might remain under pressure as the asset quality is likely to stay suppressed and hence the collection trend from the borrowers could remain weak. The regulator has not introduced any forbearances for the borrowers from this sector so far and hence in the event of elongated delays from borrowers, SHPPL's ability to timely settle its bank obligations remains to be seen. ICRA Nepal expects support from the parent in case of exigencies.

Analytical approach: For arriving at the ratings, ICRA Nepal has applied its rating methodology as indicated below.

Links to applicable criteria:
Credit Rating Methodology for Non-banking Finance Companies

About the company

Established in 2014, Sipradi Hire Purchase Private Limited (SHPPL) is a hire purchase financing institution, which operates in accordance to the broad guidelines of the Nepal Rastra Bank. SHPPL is a 100% subsidiary of STPL, which is the authorised dealer of Tata Motors for Nepal. SHPPL's registered office is in Thapathali, Kathmandu, and it has its presence in the 38 regional offices of STPL. The company is a part of the Sipradi Group, which has long presence in the Nepalese automotive sector with around 38 years of operations. At present. Mr. Siddhartha SJB Rana is the Chairman of the company. SHPPL largely finances the CV, PV, and CE segment vehicles sold by its sister concerns. Given the relatively strong demand outlook for the CV segment, SHPPL's portfolio is likely to remain concentrated to this segment.

Key financial indicators

	FY2017 (Audited)	FY2018 (Audited)	FY2019 (Audited)	FY2020 (Provisional)
Total income (NPR million)	208	576	816	768
Net worth (NPR million)	474	709	846	715
Total managed portfolio (NPR million)	2,202	4,573	5,611	5,926
Total managed assets (NPR million)	2,397	4,859	6,031	6,065
Return on average managed assets	2.57%	3.70%	2.43%	-1.00%
Gross NPA	0.16%	0.54%	0.99%	2.31%
Net NPA	0.04%	0.26%	0.43%	1.05%
Net NPA/Net worth	0.20%	1.68%	2.80%	8.32%
Managed gearing (times)	3.98	5.78	6.07	7.37

Source: Company data

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About ICRA Nepal Limited:

ICRA Nepal Limited, the first credit rating agency of Nepal, is a subsidiary of ICRA Limited (ICRA) of India. It was licenced by the Securities Board of Nepal (SEBON) on October 3, 2012. ICRA Nepal is supported by ICRA Limited through a technical support services agreement, which envisages ICRA helping ICRA Nepal in areas such as rating process and methodologies, analytical software, research, training, and technical and analytical skill augmentation.

Our parent company, ICRA Limited, was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment information and credit rating agency. Today, ICRA and its subsidiaries together form the ICRA Group of Companies.

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