

India Ratings Assigns S.E. Investments' Bank Loans 'IND A-'/Stable

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India Ratings and Research (Ind-Ra) has assigned S.E. Investments Limited's (SEIL) INR6.5bn bank loans an 'IND A-' rating with a Stable Outlook.

KEY RATING DRIVERS

The rating reflects SEIL's strong capitalisation, well-managed asset quality, healthy profitability metrics, and well-matched asset-liability profile. The rating also considers SEIL's customer-wise concentrations in the loan portfolio, concentrated funding profile, high cost of debt, and the fact that a fairly large part (around 24%) of the loan portfolio is uncollateralised and geographically concentrated (state-wise) and thus inherently faces a fair amount of credit risk.

The company's capitalisation (9MFY16: Tier 1 capital ratio: 49.5%) is likely to remain strong over the next three years. Although the company has a fairly high loan growth target (26% CAGR loan growth over FY17-FY19), the leverage (debt/equity ratio at 9MFY16: 0.82x) is projected to remain fairly low and range-bound between 1.4x and 2x over the next three years.

SEIL's top 30 customers accounted for around 32% of the overall loans at FYE15. The company reports zero NPLs as it immediately writes off loans past 150 days past due, and thus the NPL is equivalent to the credit cost. SEIL's credit costs (9MFY16: 1.48% of average loans) are the lowest among peers and its pre-provision operating profit (PPOP) /credit costs buffer (6.5x) is highest. SEIL mainly provides secured business loans (to small and medium enterprise (SME) owners largely collateralised by residential property) and unsecured income generation loans (mainly to dairy farmers in villages of Uttar Pradesh; most of these borrowers have relatives / family members who are also borrowers of SEIL, which creates peer pressure to repay loans). Asset quality metrics for both the business loans and the income generation loan portfolios are likely to remain reasonable over the near-term.

SEIL entered the loans against property (LAP) segment in FY16, into some areas of Rajasthan, lending small ticket size loans averaging INR0.2m and ranging between INR0.1m and INR1m. LAP accounts for only 0.7% of SEIL's loan portfolio, though the company aims to scale this up to around 10% of the overall loan portfolio over the next two to three years. The unsecured portion of SEIL's loan portfolio will slowly reduce to around 15% of the overall loans over the next two to three years from 24% currently, while the LAP portfolio will rise to 8%-10%. While the LAP portfolio has not exhibited delinquencies so far, managing asset quality in this portfolio over the medium term will become increasingly important.

The key risk to SEIL's business loan portfolio quality is a steep deterioration in real estate prices. In such a case, given its chunky nature, this portfolio could see a spike in delinquencies, though ultimate credit losses are likely to be manageable given the fairly reasonable average loan to value ratios (around 45%) at which the business loan (SME) portfolio is originated. Furthermore, the company's PPOP buffer is likely to absorb credit costs even in a stress case scenario. The key risk in the unsecured loan product portfolio is contagion risk, wherein the borrowers could willfully default in large numbers. However, portfolio quality trends are likely to remain broadly stable given the peer pressure created in a village/rural environment.

The company's return on average assets (9MFY16: 4.71%; FYE15: 4.11%) is healthy though it could moderate gradually over the medium term as the company increases leverage. Profitability declined over the past few years due to declining yields as SEIL started to progressively increase the collateral on its business loan portfolio over the last five years to FY15. Funding costs for SEIL are the highest among the peers, but given that leverage is low and is projected to remain range-bound between 1.4x and 2x over the next three years, overall net interest margin (NIM) (9MFY16: 12.26%) should stay high.

SEIL's risk-adjusted NIM and the PPOP/credit costs buffers are the highest among the peer group. SEIL plans to increase the high-yielding low ticket LAP loan component of its loan portfolio over the next two years, which should support the overall yields and thus NIM. Credit costs (9MFY16: 1.48%; FYE15: 2.12%)

may increase over FY17-FY18 given the transition to 90-day recognition of NPLs but return on average assets is not likely to be materially impacted.

SEIL's funding profile predominantly comprises short-term bank facilities, namely cash credit (9MFY16: 94% of funding). Funding costs are high but should reduce over FY17 as SEIL plans to raise a fairly significant amount (around 25%) of incremental funding equally through lower-cost non-convertible debentures and commercial papers.

RATING SENSITIVITIES

Positive: A positive rating action could result from SEIL's increased access to cheaper and more diverse funding avenues, and reduced concentrations in its loan portfolio while the company maintains adequate liquidity and stable asset quality metrics as it scales up its operations.

Negative: A negative rating action could result from signs of significant deterioration in the company's asset quality and its profitability buffer, arising from a possible increase in delinquencies that significantly impact asset quality.

COMPANY PROFILE

SEIL is a non-deposit-accepting non-banking finance company incorporated in 1992 that mainly provides secured business loans (to SME owners) and unsecured income generation loans (mainly to dairy farmers and self-employed people). The company is headquartered in Agra with its corporate and registered offices in Delhi. It went public in 1996 and is listed on the Bombay Stock Exchange, National Stock Exchange, and Luxembourg Stock Exchange. SEIL has a total of 12 branches and operates in Delhi, Uttar Pradesh, Rajasthan, Maharashtra, West Bengal, Gujarat, Madhya Pradesh, Bihar, Andhra Pradesh, Kerala, and Punjab. Delhi and Uttar Pradesh together accounted for around 88% of SEIL's portfolio outstanding at end-March 2015.

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