

India Ratings Affirms Arka Fincap's CP at 'IND A1+'

Dec 11, 2025 | Non Banking Financial Company (NBFC)

India Ratings and Research (Ind-Ra) has affirmed Arka Fincap Limited's (AFL) commercial paper (CP) as follows:

Details of Instruments

Instrument Type	Date of Issuance	Coupon Rate	Maturity Date	Size of Issue (million)	Rating assigned along with Outlook/Watch	Rating Action
Commercial Paper#	-	-	-	INR500	IND A1+	Affirmed

#Yet to be issued

Analytical Approach

The rating continues to factor in AFL's strategic importance to its ultimate parent, Kirloskar Oil Engines Limited (KOEL; 100% stake) and is derived from the credit strength of KOEL. Ind-Ra expects timely financial support from KOEL, if required.

Detailed Rationale of the Rating Action

The rating factors in the strong parentage of KOEL and the importance of AFL for KOEL in terms of being a value and growth driver. The rating also accounts for the increasing granularisation of the loan book and AFL's ability to manage asset quality for the entire book; however, the asset quality in the retail book has inched up in 1HFY26 due to the current operating environment and the discontinuation of unsecured business loans and digital personal loans. AFL also has a diversified borrowing mix, with a healthy share of funding from banks and other financial institutions. The rating also factors in timely equity infusion from the parent to further increase the size of the franchisee. AFL has focused on new segment categories namely small ticket (LAP) and used commercial vehicle from 1HFY26 to increase the secured mix along with granularity. Ind-Ra will continue to monitor the impact of the same on profitability and asset quality.

List of Key Rating Drivers

Strengths

- Strategically important business for KOEL
- Diversified funding profile
- Regular capital infusion to manage franchisee expansion
- Comfortable asset quality and increasing granularity of portfolio

Weaknesses

- Moderate profitability

Detailed Description of Key Rating Drivers

Strategically Important Business for KOEL: AFL's business is strategically important to KOEL in terms of business diversification. KOEL committed a capital of INR10 billion to be infused in AFL has already infused the same till end-June 2023. AFL is KOEL's largest investment by far and accounted for around one-third of the latter's standalone net worth at 1HFY26. A holding company (core investment company), Arka Financial Holdings Private Limited, has been formed to house other financial services business under this company. To manage further expansion over the medium term, additional capital will be required; however, KOEL will continue to hold a majority ownership in AFL.

Three of the board members of KOEL are also on the eight-member board of AFL. KOEL also has representation in most of AFL's key committees namely credit, asset liability and risk management. AFL's performance is regularly monitored by KOEL and the former's business strategies are discussed in detail with KOEL's board.

Diversified Funding Profile: AFL has a diversified funding profile, wherein it has managed to mobilise debt funding from multiple banks and financial institutions in a short time period. AFL's borrowing stood at INR52.7 billion at end-1HFY26, of which 24% was in the form of non-convertible debentures, 5% in the form of CPs, 68% in the form of loans from banks and financial institutions and rest other from pass-through certificate. The proportion of NCD instruments may increase along with that of the CP to take advantage of the lower rates in market. AFL has funding tie-ups with about 33 banks and non-banking financial companies for raising funds. The company has been able to access mutual funds and corporate bodies for raising funds through CPs. The management expects the funding costs to reduce in 2HFY26, driven by the repo rate cut, with Marginal Cost of Fund Based Lending Rate (MCLR)-linked borrowings likely to benefit as most portion of the funding is tied to floating rates. AFL also has a co-lending tie up with two lenders and is in the process of increasing this partnership with other lenders.

Regular Capital Infusion to Manage Franchisee Expansion: AFL has benefited from timely capital support from its parent over the years and remains adequately capitalised, with leverage (debt/tangible equity) at 4.0x and a capital adequacy ratio of 22.31% at end-1HFY26 (FYE25: 4.38x, 20.84%; FYE24: 3.28x, 25.09%). The company's tangible net worth stood at INR13.2 billion. The management intends to operate at a leverage level below 5.0x; however, while AFL has adequate headroom to support medium-term growth, maintaining prudent leverage will necessitate a capital raise in FY27 to fund the envisaged expansion. AFL is also focused on increasing retail mix and portfolio granularity, having expanded its branch network to 125 across 15 states at end-1HFY26 and strengthened manpower to drive retail business growth. Ind-Ra expects timely capital infusion to ensure AFL's capitalisation remains adequate for managing loan book growth and absorbing potential asset quality shocks. The agency will continue to monitor capitalisation levels as compared with the evolving book composition.

Comfortable Asset Quality and Increasing Granularity of Portfolio: AFL commenced operations in April 2019 in the wholesale segment (real estate and corporate loans) and diversified into small and medium-sized enterprises (SME) financing in FY21. Its assets under management (AUM) increased to INR75.58 billion at end-1HFY26 (FYE25: INR72.55 billion; FYE24: INR52.1 billion). SME financing for the industry has faced challenges and given the evolving nature of operations, asset quality is a close monitorable. AFL has consciously discontinued unsecured business loans and digital personal loans, given the current operating environment, and is focusing on building a secured book. It has also introduced new products such as small-ticket LAP and used vehicle financing. The company has significantly increased its retail share over the past few years, with the portfolio mix skewed towards retail (1HFY26: 67%; FY25: 64.5%; FY24: 50.2%; FY23: 28.6%). This shift has reduced the concentration risk inherent in wholesale lending and there are no softer bucket delinquencies in the wholesale book. Ind-Ra expects the wholesale lending's share to decline further over the next two years as retail growth accelerates, with retail expected to comprise 70% to 75% of the portfolio by FYE26. However, given limited seasoning and the exit from unsecured products, the gross non-performing assets (NPAs) of the on-book portfolio stood at 0.98% at end-September 2025. Ind-Ra believes a close monitoring of softer bucket migration will be critical as scale rises.

Moderate Profitability: AFL earned a profit after tax of INR0.36 billion in 1HFY26 (FY25: INR0.80 billion; FY24: INR0.69 billion), impacted by elevated credit costs primarily due to higher write-offs in the discontinued book and increased operating expenses to support retail expansion. The net interest margins were compressed in 1HFY26 due to an increase in the overall cost of funding. Ind-Ra expects AFL's return on assets (1HFY26: 1.03%; FY25: 1.30%; FY24: 1.44%) to remain modest in the near-to-medium term until the operating leverage improves with scale. AFL also undertakes asset-light co-lending, which supports its return ratios.

Given the early stage of SME operations, the overall gross NPAs increased to 0.98% at 1HFY26 (FY25: 0.69%; FY24: 0.23%) leading to the credit cost rising accordingly. The provision coverage remained healthy at 67% in 1HFY26. Ind-Ra believes AFL's profitability will hinge on competitive pricing and tighter control over operating and credit costs, while operating profit buffers to absorb credit costs will be a key monitorable as the portfolio seasons and SME share rises.

Liquidity

Adequate: As per AFL's asset-liability management (ALM, prepared on contractual basis) statement as on 30 September 2025, there was no cumulative mismatch in any time bucket up to one year. At end-September 2025, the company had INR7,518 million of cash and cash equivalents, and undrawn bank lines of INR6,260 million, which, are sufficient to meet the company's debt repayment of INR4,694 million until end-December 2025. AFL generally maintains liquidity sufficient to cover two months of debt obligations. Also, liquidity at AFL can get support from KOEL, if required. Furthermore, the ALM is well matched because still one third of the portfolio consists of the wholesale book, which has contractual tenors of two-to-three years against borrowings with an average tenor of three years. Even in a stress case scenario, AFL has no cumulative mismatch over short-term bucket of up to six months.

Rating Sensitivities

Positive: Not applicable

Negative: Future developments that could, individually or collectively, lead to a negative rating action include:

- deterioration in the credit profile of KOEL or KOEL ceding control of the company
- in Ind-Ra's opinion, any dilution in the support stance of KOEL towards AFL, or a decreased importance of AFL for KOEL, which could be on account of weakened business prospects or any other factors
- sustained diluted liquidity buffers

Any Other Information

Not applicable

ESG Issues

ESG Factors Minimally Relevant to Rating: Unless otherwise disclosed in this section, the ESG issues are credit neutral or have only a minimal credit impact on AFL, due to either their nature or the way in which they are being managed by the entity. For more information on Ind-Ra's ESG Relevance Disclosures, please click [here](#). For answers to frequently asked questions regarding ESG Relevance Disclosures and their impact on ratings, please click [here](#).

About the Company

AFL is a non-deposit taking systemically important non-banking financial company and is owned 100% by Arka Financial Holdings, which is 100% held by KOEL. The company commenced its operations from April 2019. AFL aims to build a loan book with a mix of corporate, real estate and small, medium enterprise segments. At 1HFYE26, it had around 1,173 employees and 125 branches, spread across 15 states.

Key Financial Indicators

Particulars	1HFY26	FY25	FY24
Total tangible assets (INR million)	68,491	70,705	52,846
Total tangible equity (INR million)	13,198	12,458	11,652
Net profit after tax (INR million)	359	804	692
Return on average assets (%)	1.03	1.30	1.44

Tangible equity/assets (%)	19.27	17.62	22.05
Tier-I (%)	19.54	17.97	22.54
Source: AFL, Ind-Ra's analysis			

Status of Non-Cooperation with previous rating agency

Not applicable

Rating History

Instrument Type	Current Rating			Historical Rating		
	Rating Type	Rated Limits (million)	Rating	12 December 2024	14 December 2023	16 December 2022
Issuer rating	Short-term	-	-	-	-	WD
Commercial paper	Short-term	INR500	IND A1+	IND A1+	IND A1+	IND A1+

Complexity Level of the Instruments

Instrument Type	Complexity Indicator
Commercial Paper	Low

For details on the complexity level of the instruments, please visit <https://www.indiaratings.co.in/complexity-indicators>.

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APPLICABLE CRITERIA AND POLICIES

Evaluating Corporate Governance

Financial Institutions Rating Criteria

Non-Bank Finance Companies Criteria

Rating FI Subsidiaries and Holding Companies

The Rating Process

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