

December 10, 2021

## Varthana Finance Private Limited (erstwhile Thirumeni Finance Private Limited): Ratings reaffirmed; outlook revised to Negative; [ICRA]BBB (Negative) assigned to Rs. 27 crore-NCD programme

### Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debentures	-	27.00	[ICRA]BBB (Negative); assigned
Non-convertible debentures	41.00	-	[ICRA]BBB (Negative); rating reaffirmed and withdrawn, outlook revised from Stable
Non-convertible debentures	52.80	52.80	[ICRA]BBB (Negative); rating reaffirmed and outlook revised from Stable
Bank facilities	335.80	335.80	[ICRA]BBB (Negative); rating reaffirmed and outlook revised from Stable
<b>Total</b>	<b>429.60</b>	<b>415.60</b>	

\*Instrument details are provided in Annexure-1

### Rationale

The revision in the outlook factors in the deterioration in Varthana Finance Private Limited's (Varthana) asset quality because of the prolonged unfavourable operating environment for the school financing sector and the consequent impact on its earnings performance. Varthana's asset quality deteriorated further as the second wave of the Covid-19 pandemic delayed the reopening of schools. The gross stage 3 (GS3) deteriorated to 10.3% as of September 30, 2021 from 2.9% as of March 31, 2021. The overlapping of the second wave with the resumption of the repayment of the loans restructured in the last fiscal led to higher slippages from the restructured book. By September 2021, Rs. 37.3 crore (19%) of the restructured book as of March 2021 had slipped into the GS3 bucket. The company additionally restructured about 7% of its portfolio in H1 FY2022 and the total standard restructured book stood at 15% as of September 2021. ICRA takes note of the stress in the restructured book, as a sizeable portion of the same, for which repayments have commenced, was in various overdue buckets as of October 2021.

Varthana's asset quality pressure consequently impacted its net profitability, which remained subdued at Rs. 0.2 crore in H1 FY2022. ICRA notes that although the overall provisions carried by the company increased in H1 FY2022 and stood at 9.4% of the overall portfolio vis-à-vis 7.5% in March 2021, the GS3 provision coverage moderated to about 37% in September 2021 from 53% in March 2021 (42% in March 2020) on account of the increase in the GS3. The early resolution of overdues would be crucial for an improvement in the near-term earnings performance. The rating factors in the company's moderate scale of operations with a portfolio of Rs. 1,025 crore as on September 30, 2021.

The rating continues to factor in Varthana's presence in the niche segment and the experience of its senior management team. ICRA notes that the Rs. 105 crore of capital raise, in the form of compulsorily convertible preference shares (CCPS) and compulsorily convertible debentures (CCDs), provided support to the capitalisation profile. Varthana's managed gearing stood at 1.2 times as of September 2021 (provisional) vis-à-vis 1.9 times as on March 31, 2021 (2.0 times in March 2020). The company is in the process of raising another round of capital (about Rs. 110 crore) by Q4 FY2022, which is expected to augment its capital and solvency profile. Varthana's liquidity profile is adequate at present. However, it would be crucial to diversify its

funding profile and secure longer-tenure funding at competitive rates to support its liquidity profile as the portfolio expands. A sustained improvement in the asset quality would, however, be key from a rating perspective over the near term.

ICRA has also revised the outlook to Negative and reaffirmed and withdrawn the long-term rating on the Rs. 41-crore non-convertible debenture (NCD) programme in accordance with ICRA's policy on the withdrawal of credit ratings.

## Key rating drivers and their description

### Credit strengths

**Capital profile supported by fresh infusion in H1 FY2022; further augmentation expected in the near term** – Varthana raised capital of about Rs. 105 crore in H1 FY2022, which would support its capital structure in view of the headwinds on the asset quality front. The infusion was in the form of CCPS and CCDs from four existing and two new investors. The company's managed gearing improved to 1.2 times (provisional) as on September 30, 2021 from 1.9 times as on March 31, 2021. Varthana has initiated the process of raising further capital of about Rs. 110 crore, which is expected to be completed by Q4 FY2022. ICRA expects the gearing to remain below 3 times over the next 1-2 years, considering the above-mentioned capital plan, as growth is expected to be moderate.

**Presence in niche asset segment; commensurate experience of senior management team** – Varthana is a non-banking financial company (NBFC) engaged in lending to private schools for construction, renovation and capacity expansion. Varthana's focus is on affordable private schools. The company has an experienced management team, led by Mr. Steve Hardgrave and Mr. Brajesh Mishra, who have adequate understanding of the target segment. The company augmented its senior management team in FY2021, including the Chief Business Officer, Chief Risk Officer, Head of Collections, Head of Legal and Head of Credit. The company is backed by investors like ChryCapital, LGT Capital Invest Mauritius, Elevar Equity Management Limited and Kaizen Private Equity; most of them also participated in the recent capital raise of Rs. 105 crore.

### Credit challenges

**Asset quality remains under pressure due to higher slippages and unfavourable operating environment for school financing sector** – The GS3 deteriorated to 10.3% as of September 30, 2021 from 2.9% as of March 31, 2021. This was because of the higher slippages witnessed on the back of the prolonged disruption in school operations; the second wave further delayed the reopening of schools. The second wave coincided with the resumption of the repayment of loans restructured in the last fiscal, leading to higher slippages from the restructured book. The company had restructured Rs. 115.9 crore of its loans in FY2021, of which Rs. 37.3 crore slipped into the GS3 category as of September 2021. It restructured Rs. 72.13 crore in H1 FY2022, with repayments commencing from January 2022. The total standard restructured book stood at Rs. 157 crore as of September 2021 (15% of the portfolio). ICRA takes note of the stress in the restructured book as a sizeable portion of the restructured book, for which repayments have commenced, is in various overdue buckets other than GS3. The write-offs were limited at Rs. 2.4 crore in H1 FY2022 (Rs. 29.1 crore in FY2021). The security receipts from the sale of assets to the asset reconstruction company during the last fiscal moderated to Rs. 27.4 crore in September 2021 from Rs. 31.2 crore in March 2021. The asset quality is likely to remain under pressure in the near term till school operations stabilise. Varthana's current collection efficiency<sup>1</sup> was impacted on account of the second wave of the pandemic; with gradual reopening of the schools in Q3 FY2022, as witnessed across most states, collections are expected to improve from Q2 FY2022 levels. The asset quality, however, is likely to remain under pressure in the near-term till the stabilisation of school operations.

ICRA notes that the GS3 provision coverage moderated to 36.8% in September 2021 from 52.7% in March 2021 (42.1% in March 2020) on account of the increase in the GS3 level. The net stage 3 to net worth (solvency) ratio stood at 13.8% in September 2021 (3.7% in March 2021 and 11.3% in March 2020), supported to an extent by the capital raise in H1 FY2022. The

<sup>1</sup> Current monthly collections/current monthly demand

total provisions stood at Rs. 96.2 crore (9.4% of the portfolio), including a management overlay of Rs. 19.8 crore (1.9% of the portfolio). The proposed capital raise in Q4 FY2022 would also lend support to the solvency profile in view of the near-term uncertainty around the resumption of school operations. The company has access to the SARFAESI Act; the top 20 non-performing advances (NPAs; 41.9% of the NPAs in September 2021) in entirety and 95% of the portfolio are secured, which could limit the ultimate losses, though repossession of the property and recovery of dues may take time.

**Profitability indicators remain subdued** – Varthana reported a net loss (percentage of average managed assets; AMA) of 0.6% in FY2021 vis-à-vis a net profit of 1.3% in FY2020 because of a sharp increase in the credit costs (credit provisions and write-offs/AMA) to 5.2% in FY2021 from 2.8% in FY2020 (1.5% in FY2019). The company reported a modest profit of Rs. 0.2 crore in H1 FY2022. The credit cost was relatively lower at 3.7% (provisional, annualised) in H1 FY2022 as GS3 provision coverage moderated and there were limited write-offs. Operating expenses/AMA increased to 5.4% (provisional, annualised) in H1 FY2022 from 4.6% in FY2021 because of the normalisation of expenses, which had moderated on account of the pandemic-related lockdown in the last fiscal. Varthana's ability to control incremental slippages and make effective recoveries from the standard restructured book and GS3 would be crucial for incremental profitability.

**Moderate scale of current operations** – Varthana's current scale of operations remains moderate with a portfolio size of Rs. 1,025 crore as on September 30, 2021. It is targeting assets under management (AUM) of Rs. 1,100-1,200 crore by March 2022. The company was cautious on incremental disbursements in H1 FY2022, aggregating Rs. 63.0 crore vis-à-vis Rs. 106.2 crore in FY2021 (Rs. 86.0 crore in H2 FY2021 and Rs. 459.5 crore in FY2020). Varthana has a presence in 15 states with the top 3 states accounting for 47% of the AUM as on September 30, 2021 vis-à-vis 66% in March 2017. However, geographical diversification is also expected to be slower, given the likely moderate growth in the near term.

## Liquidity position: Adequate

Varthana's liquidity profile was adequate as on September 30, 2021 with no negative cumulative mismatches in any of the short-term buckets. Unencumbered cash and liquid investments stood at Rs. 71.3 crore as of September 2021 vis-à-vis debt maturities of Rs. 77 crore during October-December 2021. While the cash and expected inflows are expected to take care of the debt repayments till March 2022, lower collection efficiency could impact the liquidity position.

The company's borrowing profile comprised external commercial borrowings, NBFCs, NCDs from financial institutions, securitisation and bank borrowings with the same accounting for 36%, 33%, 16%, 4% and 11%, respectively, of the overall borrowing as of September 2021. Varthana's ability to secure incremental funds from banks and others at competitive rates would be crucial from the cost of funding and liquidity perspective. ICRA notes that the company's borrowings have an average tenure of about 4 years while the loans have a contractual tenure averaging about 6-8 years. It is, therefore, crucial to improve the funding diversity and secure longer-tenure loans as the portfolio expands.

## Rating sensitivities

**Positive factors** – ICRA will revise the outlook to Stable if the asset quality improves on a sustained basis.

**Negative factors** – ICRA could downgrade the rating if the asset quality remains weak, thereby exerting pressure on the earnings. Weakening in the funding and liquidity profile or an increase in the leverage beyond 5 times would also negatively impact the rating.

## Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	<a href="#">Rating Methodology for Non-Banking Finance Companies</a> <a href="#">Policy on Withdrawal of Credit Ratings</a>
Parent/Group Support	Not Applicable
Consolidation/Standalone	The rating is based on the standalone financial statements of the company

## About the company

Varthana is a non-deposit taking NBFC, incorporated in Cochin (Kerala) in June 1984. It was acquired by the current promoters – Mr. Steve Hardgrave and Mr. Brajesh Mishra – in May 2012 and commenced financing operations in January 2013. As on March 31, 2021, the promoters held a 10.6% stake in the company with the balance held by institutional investors (83.5%), individual investors (2.4%) and an employee share ownership trust (3.4%). Varthana offers credit facilities to private schools, including affordable private schools, for improvement, capacity expansion and growth. It operates in 15 states including Karnataka, Maharashtra, Madhya Pradesh, Tamil Nadu, Odisha, Rajasthan and Chhattisgarh, with its head office in Bengaluru. As on September 30, 2021, Varthana had a loan book of Rs. 1,025.2 crore.

## Key financial indicators

Varthana	FY2020	FY2021	H1 FY2022*
Total income (Rs. crore)	227.4	211.6	95.9
Profit after tax (Rs. crore)	15.3	-7.7	0.2
Net worth (Rs. crore)	403.1	386.7	491.7
Loan book (Rs. crore)	1,077.9	980.0	944.4
Total assets (Rs. crore)	1,225.9	1,164.4	1,107.7
Return on managed assets (%)	1.3%	-0.6%	0.03%
Return on net worth (%)	3.9%	-1.9%	0.1%
Gross gearing (times)	2.0	1.9	1.2
Gross stage 3 (%)	7.1%	2.9%	10.3%
Net stage 3 (%)	4.3%	1.5%	7.2%
Solvency (Net stage 3/Net worth)	11.3%	3.7%	13.8%
CRAR (%)	36.8%	35.7%	47.8%

Source: Company, ICRA Research; \* Provisional numbers; All ratios as per ICRA calculations

## Status of non-cooperation with previous CRA: Not applicable

## Any other information: None

## Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the Past 3 Years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in FY2022		Date & Rating in FY2021	Date & Rating in FY2020		Date & Rating in FY2019
					Dec 10, 2021	May 28, 2021	Nov 25, 2020	Jan 27, 2020	Apr 01, 2019 May 03, 2019 Aug 28, 2019	Aug 13, 2018 Aug 27, 2018
1	NCDs	LT	27.0	27.0	[ICRA]BBB (Negative)	-	-	-	-	-
2	NCDs	LT	41.0	-	[ICRA]BBB (Negative): Withdrawn	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
3	NCDs	LT	52.8	52.8	[ICRA]BBB (Negative)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
4	Bank facilities	LT	335.80	335.80	[ICRA]BBB (Negative)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)

## Complexity level of the rated instruments

Instrument	Complexity Indicator
Bank facilities	Simple
Non-convertible debentures	Very simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: [www.icra.in](http://www.icra.in)

### Annexure-1: Instrument details

ISIN/Banker Name	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Bank Facilities	Jan-05-2017 to Nov-26-2019	10.85% to 13.50%	Dec-31-2021 to Nov-26-2023	107.09	[ICRA]BBB (Negative)
	Bank Facilities - Unallocated	NA	NA	NA	228.71	[ICRA]BBB (Negative)
INE125T07121	NCD	Dec-16-2016	12.72%	Dec-16-2021	20.00	[ICRA]BBB (Negative)
INE125T07147*	NCD	Jul-31-2017	12.30%	Jul-31-2021	10.00	[ICRA]BBB (Negative); reaffirmed and withdrawn
INE125T07089	NCD	Aug-23-2018	11.60%	Aug-23-2021	31.00	[ICRA]BBB (Negative); reaffirmed and withdrawn
INE125T07105	NCD	May-03-2019	12.75%	May-03-2023	32.40	[ICRA]BBB (Negative)
Yet to be placed	NCD		12.00%		27.00	[ICRA]BBB (Negative)
Unallocated	NCD - Unallocated				0.40	[ICRA]BBB (Negative)

**Source:** Company; \* ISIN was changed to INE125T07147 from INE125T07063

### Annexure-2: List of entities considered for consolidated analysis

Not Applicable

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