

March 11, 2022

Northern Arc Capital Limited: Ratings reaffirmed for pooled NCD programme – Northern Arc Pooled Bond Issuance XIX

Summary of rating action

Sr. No.	Borrower name	Instrument*	Initial Rated Amount (Rs. crore)	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
1	Varthana Finance Private Limited (erstwhile Thirumeni Finance Private Limited)	NCD	25.00	8.33	8.33	[ICRA]BBB (Negative); reaffirmed
2	Aye Finance (P) Ltd.	NCD	32.00	16.00	10.67	[ICRA]BBB+ (Stable); reaffirmed
3	Kanakadurga Finance Limited	NCD	32.00	16.00	10.67	[ICRA]BBB- (Stable); reaffirmed
4	ASA International India Microfinance Limited	NCD	17.00	8.50	8.50	[ICRA]BBB- (Stable); outstanding
	Total		106.00	48.83	38.17	

*Instrument details are provided in Annexure-1

ICRA also has a rating outstanding on the other rated facilities/instruments of the following entities:

Varthana Finance Private Limited: Refer to this [link](#) for details

Aye Finance (P) Limited: Refer to this [link](#) for details

ASA International India Microfinance Limited: Refer to this [link](#) for details

Rationale

The ratings for the non-convertible debenture (NCD) programme are based on the standalone credit profile of each of the issuing entities. The pooled bond issuance (PBI) transaction also has a common external credit enhancement in the form of a corporate guarantee to the extent of 5.0% of the initial value of the total PBI principal amount provided by Northern Arc Capital Limited (NACL; rated [ICRA]A+ (Stable)/[ICRA]A1+). The common guarantee shall be used to meet shortfalls, if any, in debt servicing for any of the issuing entities. The transaction stipulates a defined payment mechanism to ensure that the guarantor is required to fund the designated account prior to the due date. ICRA notes that any additional disruptions on account of the Covid-19 pandemic and the consequent impact on macrolevel economic activity could have a bearing on the credit profiles of the underlying borrowers.

The common guarantee cover is expected to increase with the gradual amortisation of the PBI debentures. As per the terms of the transaction, when the guarantee (which is set at 5% of initial PBI principal) exceeds 10.00% of the aggregate outstanding principal of the PBI debentures, the guarantee cap is expected to be reset to 10.00% of the aggregate outstanding principal of the PBI debentures.

ICRA has taken note of the extension in the maturity of two bonds under the rated PBI programme by six months. These include the bonds issued by Varthana Finance Private Limited (Varthana) and Kanakadurga Finance Limited (KFL). Accordingly, the scheduled maturity date for the PBI has been revised to February 2023 from August 2022. There are no changes in any other terms and conditions of the transaction. ICRA understands that the said extension has been granted on the request of the investor to ensure compliance with the foreign portfolio investor (FPI) guidelines, and no relief or concession has been offered to the underlying borrowers.

Varthana Finance Private Limited (erstwhile Thirumeni Finance Private Limited)

The rating factors in Varthana's presence in the niche segment of private school financing, the experience of its senior management team, and its capital profile, which is supported by the fresh infusion in H1 FY2022. The rating takes cognizance of the deterioration in Varthana's 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 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.

ICRA notes that the Rs. 105-crore capital raised, 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.

The Negative outlook on the long-term rating considers Varthana's asset quality pressures and the consequent impact on its earnings, leading to a net loss (percentage of average managed assets; AMA) of 0.6% in FY2021 and a net profit of 0.03% in H1 FY2022 vis-à-vis a net profit of 1.3% in FY2020.

Aye Finance (P) Ltd.

The rating reaffirmation factors in Aye Finance's experienced promoters and senior management team. This, coupled with its good loan origination and credit appraisal systems and backed by its track record of operating in the micro, small and medium enterprises (MSME) financing segment, provides support to its credit profile. Further, the rating factors in the company's comfortable capitalisation profile and its demonstrated ability to raise capital in a timely manner. Aye Finance's net worth and gearing stood at Rs. 746 crore and 1.8 times, respectively, as on March 31, 2021 vis-à-vis Rs. 517 crore and 2.8 times, respectively, as on March 31, 2020. The net worth, however, declined to Rs. 701 crore as on September 30, 2021 with higher credit costs leading to losses in H1 FY2022. Nonetheless, with a capital adequacy ratio (CAR) of 44.7% as on September 30, 2021, the company is adequately capitalised for its scale of operations. ICRA notes that Aye Finance opened 100 new branches in Q3 FY2022 and ventured into 2 new states/Union Territories (UTs). However, its ability to ramp up its operations while improving the credit profile and maintaining a prudent capitalisation profile will be critical from a credit perspective.

The rating is constrained by the moderate scale of operations and the deterioration in the profitability indicators due to the elevated credit costs as the asset quality metrics weakened because of the Covid-19 pandemic-led challenges. After witnessing a deterioration in the asset quality metrics in FY2021 from the first wave of the pandemic, the company witnessed slippages

again in the portfolio amid the second wave in Q1 FY2022. It increased the provisioning and also wrote off the stressed portfolio in H1 FY2022, which impacted its profitability. This, coupled with higher operating expenses (incurred to support branch expansion plans in Q3 FY2022), led to net losses with a return on managed assets (RoMA) and a return on equity (RoE) of (4.7)% and (13.3)%, respectively, in H1 FY2022 vis-à-vis 0.8% and 2.7%, respectively, in FY2021. Aye Finance also restructured a sizeable portion of its portfolio under the Reserve Bank of India's (RBI) Covid resolution framework. As on December 31, 2021, it had an outstanding restructured book as a percentage of its assets under management (AUM) of 8.3% (9.8% as on September 30, 2021 and 8.9% as on March 31, 2021).

Aye Finance's ability to arrest further slippages and recover from its restructured and delinquent portfolio would remain a key monitorable from a credit perspective. Moreover, its funding profile remained relatively concentrated towards funding from non-banking financial companies (NBFCs) and domestic and international financial institutions. Going forward, the company's ability to further diversify its lender base and reduce the cost of funds will remain critical for the profitable scaling up of its business.

The Stable outlook reflects ICRA's opinion that Aye Finance will continue to benefit from its systems and processes, which have been established over the last few years, and its strong capitalisation profile which will enable it to meet its near-term growth plans.

Kanakadurga Finance Limited

The reaffirmation of the rating takes into consideration the experience of KFL's promoters and senior management team in the vehicle financing business and its adequate capital structure with a managed gearing of 3.5 times (provisional) as of December 2021 vis-à-vis 3.0 times as of March 2021. The rating also takes comfort from the adequate liquidity maintained by the company in recent months. It had encumbered cash and cash equivalents of Rs. 89.3 crore and undrawn bank lines of Rs. 13.2 crore as on December 31, 2021, which would support its portfolio growth target of Rs. 400 crore by March 2022 and Rs. 500 crore by March 2023.

However, the rating remains constrained by KFL's moderate scale and geographically concentrated portfolio and its subdued earnings performance with RoMA at 0.5% (provisional) for 9M FY2022 (2.1% in FY2021 and 0.7% in FY2020). KFL's 90+ days past due (dpd) deteriorated to 4.8% in December 2021 vis-à-vis 4.1% in March 2021 (5.3% in March 2020) largely due to the increase in delinquencies in the 4-wheeler segment (90+dpd of 8.0% in December 2021 from 3.5% in March 2021 and 5.3% in March 2020). Repo and other loan losses, as a percentage of the opening portfolio, increased to 3.0% (annualised) in 9M FY2022 and 1.9% in FY2021 (1.4% in FY2020), primarily on account of the 3-wheeler and 4-wheeler loans disbursed pre-Covid. Further, around 3.7% of the outstanding portfolio is restructured, largely consisting of borrowers in the 4-wheeler and 3-wheeler segments. However, KFL's provisions declined with total provisions/AUM at 1.3% as on December 31, 2021 vis-à-vis 2.3% as on March 31, 2021 (1.5% as on March 31, 2020). Going forward, the company's ability to control its credit cost and secure incremental funds at competitive rates would be crucial from an earnings perspective.

Key rating drivers and their description

Varthana Finance Private Limited (erstwhile Thirumeni Finance Private Limited)

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 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 an NBFC engaged in lending to private schools for construction, renovation and capacity expansion. Its 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 ChrysCapital, 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. Write-offs were limited at Rs. 2.4 crore in H1 FY2022 (Rs. 29.1 crore in FY2021). 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 efficiency¹ was impacted by the second wave of the pandemic; with the gradual reopening of schools in Q3 FY2022, as witnessed across most states, collections are expected to improve from the Q2 FY2022 level. 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 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 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 the 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.

¹ Current monthly collections/current monthly demand

Moderate scale of 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 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.

Aye Finance (P) Ltd.

Credit strengths

Experienced promoters, good loan origination, appraisal and management systems – The company has good loan origination and credit appraisal systems. The credit underwriting system comprises various checks and balances starting from know your customer (KYC) document collection, multiple reference checks, credit bureau checks, home and multiple visits, business viability, estimated cash flows and other debt liabilities, if any. The final credit call is taken by the centralised credit team with multiple levels of approval required at the branch. Post loan disbursement, loan utilisation checks are also conducted to verify the end use of the loan. Aye Finance is also leveraging data analytics capabilities by using machine learning input for credit decision-making for some of the products and for certain sets of borrowers.

Aye Finance lends to small and micro-enterprises that have an annual turnover between Rs. 10 lakh and Rs. 100 lakh with 41% of the portfolio as on December 31, 2021 comprising traders, 37% comprising borrowers engaged in livestock rearing and 13% comprising borrowers engaged in manufacturing activities. While there has been a deterioration in the credit profile of the borrowers amid the pandemic, the credit profile of incremental disbursements will also be a key monitorable going forward.

Adequately capitalised for current scale of operations – Aye Finance witnessed a degrowth in its portfolio as the economy and business got impacted due to the pandemic. Nonetheless, it was able to ramp up its operations and was managing an AUM of Rs. 1,509 crore as on December 31, 2021 (Rs. 1,570 crore as on March 31, 2021 and Rs. 1,781 crore as on March 31, 2020). Given its current scale of operations, Aye Finance is adequately capitalised with a gearing of 1.8 times as on December 31, 2021 and a CAR of 44.7% as on September 30, 2021.

The company has opened 100 new branches, thereby taking the tally to 311 branches as on December 31, 2021 and ventured into 2 new states/UTs, i.e. Jammu & Kashmir and West Bengal, in Q3 FY2022 to scale up its operations. Given the envisaged growth plans, the gearing is expected to increase with the incremental business being funded through fresh borrowings. The management plans to operate at a leverage of 3-4 times and sustain the same over the medium to long term. The current capital position seems sufficient for the targeted leverage level and the envisaged growth plans. Nevertheless, Aye Finance is planning to raise a fresh round of equity in the next fiscal.

Credit challenges

Deterioration in profitability indicators due to elevated credit costs amid weakened asset quality metrics – Following the spread of Covid-19 infections throughout the country, the borrowers’ livelihood and repayment capacity got impacted. As a result, Aye Finance’s asset quality metrics weakened. The company reported gross non-performing assets (GNPA) and net NPAs (NNPA) of 3.31% and 0.74%, respectively, as on March 31, 2021 vis-à-vis 2.26% and 0.14%, respectively, as on March 31, 2020. The asset quality witnessed further slippages as the nation grappled with the second wave of the pandemic in Q1 FY2022. Aye Finance subsequently reported GNPA and NNPA of 7.72% and 2.95%, respectively, as on December 31, 2021. Further, it has done restructuring under the Covid framework along with write-offs for its stressed portfolio. For its restructured portfolio, the company has provided a 9-month principal moratorium to most of its borrowers, though interest is payable on a monthly basis. As on December 31, 2021, Aye Finance’s restructured book (under Covid framework) outstanding, as a percentage of its AUM, stood at 8.3% (9.8% as on September 30, 2021 and 8.9% as on March 31, 2021).

The overall credit costs (provisions and write-offs) increased to 9.3% in H1 FY2022 from 2.6% in FY2021. Further, the operating expenses increased to 10.1% of the average managed assets (AMA) in H1 FY2022 from 8.6% in FY2021 as the company has increased its manpower to support the increase in branches in Q3 FY2022. Due to elevated credit costs and higher operating expenses, Aye Finance reported RoMA and RoE of (4.7)% and (13.3)%, respectively, as on September 30, 2021 vis-à-vis 0.8% and 2.7%, respectively, as on March 31, 2021. Although the company reported a marginal profit in Q3 FY2022, ICRA expects it to report a net loss in FY2022, given the high credit costs incurred in H1 FY2022. The profitability is expected to improve thereon, subject to Aye Finance's ability to arrest further slippages and recover from its overdue book.

Ability to diversify funding profile and tie up larger funding lines from lenders to meet growth plan – While Aye Finance has a diversified lender base with 28 distinct lender relationships (including 11 banks, 9 NBFCs and 8 domestic and foreign institutions), the dependence on NBFCs/development finance institutions (DFIs)/financial institutions (FIs) remains high. Aye Finance remains dependent on the marginally higher-priced NCD funding, which accounted for 70% of the overall funding including securitisation as on December 31, 2021.

ICRA notes that Aye Finance has plans to diversify its funding stream through securitisation lines. Given its target growth plans, the company will have to approach lenders willing to lend in larger ticket sizes while optimising its cost of funds. As bank funding is relatively scalable and cost competitive, the ability to increase the share of the same in the overall funding mix will be critical for the targeted growth while maintaining a competitive cost of funds.

Marginal borrower profile with susceptibility to income shocks – Aye Finance primarily lends to micro businesses like *kiranas*/general stores, dairies, manufacturers and traders with an annual turnover of Rs. 10 lakh-1 crore. The customers in this segment have limited credit history in the form of microfinance loans by the co-applicant or smaller-ticket vehicle loans. Their cash flows could be volatile and highly sensitive to minor business disruptions and external shocks. Also, such borrowers do not have the financial flexibility to pay more than one or two instalments at a time. Given the marginal borrower profile, comprising mostly self-employed customers, and the assessed income-based lending model, the segment remains susceptible to income shocks. Furthermore, given the vulnerability of the borrower profile with low ability to absorb income shocks, the pandemic has led to structural adversity for the business supply chains of micro-enterprise borrowers. This led to higher restructuring and write-offs for Aye Finance. The company's ability to control further deterioration in its asset quality and recover from its delinquent accounts would be critical from a credit perspective.

Kanakadurga Finance Limited

Credit strengths

Adequate near-term capitalisation profile; external capital would be required for higher portfolio growth – KFL's managed gearing stood at 3.5 times (provisional) as of December 2021 vis-à-vis 3.0 times as of March 2021 (4.9 times in March 2020). The managed gearing is expected to be maintained at about 4.0-5.0 times going forward. The company envisages an overall portfolio of Rs. 400 crore by March 2022, and around Rs. 500 crore by March 2023. KFL has entered into agreements with a few banks and FIs for co-lending gold loans and vehicle finance, which would also support its AUM growth. The company may have to secure external capital in case the portfolio grows at a steeper-than-envisaged rate for keeping the leverage at around 4.0-5.0 times as internal generation is expected to remain subdued.

Experienced promoters and senior management team – The promoters headed by Mr. Lakshmi Narayana, who has been in the vehicle financing business for the past three decades, are actively involved in the strategic and operational-level management of the company. The promoters are ably supported by the current senior management team for handling key business functions with state-level, zonal and regional heads to manage operations; this is commensurate with the current scale of operations.

Banyan Tree Growth Capital II LLC (BT) holds a stake of about 29% in the company, with the rest held by the promoter group; BT's stake increased from 15.5% in March 2018. The board is mainly represented by the promoter group. Of the total seven-member board, four are promoter representatives, one is an investor representative and two are independent directors.

Credit challenges

Moderate scale and geographically concentrated operations – KFL's managed portfolio remained stagnant at Rs. 367 crore as of December 2021 vis-à-vis Rs. 360 crore as of March 31, 2021, though there was some improvement in disbursements in 9M FY2022 compared to the lower base of FY2021. Overall, disbursements stood at Rs. 267 crore (Rs. 142 crore excluding gold loans) in 9M FY2022 vis-à-vis Rs. 193 crore (Rs. 66 crore excluding gold loans) in FY2021.

Over the past few years, KFL has increased its footprint and is present in five states vis-à-vis three in March 2014, though the portfolio is concentrated in a few states. As of December 2021, Andhra Pradesh and Karnataka accounted for about 34% and 29% of the total vehicle loan portfolio while Tamil Nadu, Gujarat and Telangana accounted for 12% each. Over the near term, KFL is expected to focus on the existing geographies of operations for business growth. It is expected to focus on 4-wheeler financing (45% of the total portfolio in December 2021), 2-wheelers (25%) and gold (18%) while the share of 3-wheelers (12%) is expected to moderate steadily going forward.

Modest profitability – KFL's RoMA (profit after tax (PAT)/AMA) stood at 0.5% (annualised; provisional) in 9M FY2022 and 2.1% in FY2021 (0.7% in FY2020). The operating expense ratio increased to 8.2% in 9M FY2022 from 6.8% in FY2021 (8.4% in FY2020) due to salary hikes and improvement in branch operations. The net interest margin declined due to on-balance sheet liquidity and interest reversal on write-off accounts. However, profitability was supported by a decline in credit costs to 1.1% in 9M FY2022 from 1.9% in FY2021 (1.6% in FY2020) due to provision reversal on standard assets. Overall provision/AUM stood at 1.3% as on December 31, 2021 vis-à-vis 2.3% as on March 31, 2021 (1.5% as on March 31, 2020). Going forward, KFL's ability to control its credit costs and secure incremental funds at competitive rates would be crucial from an earnings perspective.

Moderate asset quality indicators, despite write-offs – KFL's 90+dpd deteriorated to 4.8% in December 2021 vis-à-vis 4.1% in March 2021 (5.3% in March 2020) largely due to the 4-wheeler segment. The 90+ dpd in the 4-wheeler segment, which accounted for the bulk of the portfolio (45% of the overall portfolio), increased to 8.0% in December 2021 from 3.5% in March 2021 (5.3% in March 2020). Repo and other loan losses, as a percentage of the opening portfolio, stood at 3.0% (annualised) in 9M FY2022 and 1.9% in FY2021 (1.4% in FY2020), mainly for 3-wheeler and 4-wheeler loans disbursed pre-Covid. Further, the overdues in the softer buckets remain high with a 30+dpd of 30% in December 2021 and 36% in March 2021 (30% in March 2020). About 3.7% of the outstanding portfolio is restructured, largely consisting of borrowers in the 4-wheeler and 3-wheeler segments. Overall, KFL's 90+dpd in the vehicle finance segment (82% of the portfolio in December 2021) stood at 5.8% as on December 31, 2021 vis-à-vis 4.7% as on March 31, 2021 (5.7% as on March 31, 2020).

ICRA notes that the company's target customer segment has a modest credit profile and is vulnerable to adverse economic cycles; this is also witnessed by the high softer bucket delinquencies. Ensuring timely recoveries and keeping incremental slippages under control would be crucial, going forward.

Key rating assumptions

In the present PBI programme, the servicing of each repayment is firstly the obligation of the individual issuer. Thus, for rating the said bonds, the approach has been to factor in the likelihood of an individual borrower defaulting on its debt obligations (which is a function of its stand-alone credit rating). Any shortfall in meeting the scheduled payouts to the NCD holders is to be met through the common guarantee till it is available. However, since the common guarantee quantum is small (initially only 5% of the total outstanding amount and capped at 10%), the resulting probability of default on the PBI would not be materially lower than the default probability of the stand-alone debt of the individual issuers. Thus, the benefit of the credit enhancement is minimal. Hence, there is no rating uplift due to the presence of the guarantee (from ICRA's stand-alone rating on the individual entities).

Liquidity position

Varthana Finance Private Limited (erstwhile Thirumeni Finance Private Limited): 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 FIs, 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 a 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.

Aye Finance (P) Ltd.: Adequate

As per Aye Finance's liquidity statement as on December 31, 2021, its liquidity profile was adequate with no negative cumulative mismatches up to five years. The company's positive asset-liability maturity (ALM) mismatches are driven by its low leverage and matched asset-liability maturity of ~3 years. Further, the liquidity profile is supported by the high on-balance sheet unencumbered liquidity of Rs. 435 crore (including ~Rs. 120-crore investment in mutual funds) as on December 31, 2021 (for over five months' repayments including expenses). Going forward, the ALM surpluses may moderate with an increase in leverage and any stress on the collection efficiency could impact the mismatches.

Kanakadurga Finance Limited: Adequate

KFL had encumbered cash and cash equivalents of Rs. 89.3 crore and undrawn bank lines of Rs. 13.2 crore as on December 31, 2021 while its debt servicing obligations during January-June 2022 stood at Rs. 117.5 crore. ICRA notes that the company's collection efficiency improved to 105% in Q3 FY2022 from 89% in Q2 FY2022 and 94% in Q3 FY2021.

KFL's funding largely consists of term loans from NBFCs and banks, which accounted for 39% and 14%, respectively, of the total borrowings as of December 2021. Funding via NCDs accounted for 47%. Going forward, the company's ability to raise funds at competitive rates and achieve healthy collections would be critical.

Rating sensitivities

Varthana Finance Private Limited (erstwhile Thirumeni Finance Private Limited)

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.

Aye Finance (P) Ltd.

Positive factors – ICRA could change the outlook to Positive or upgrade the rating if the company is able to profitably scale up its business operations (RoMA above 3% on a sustained basis) while maintaining its asset quality (portfolio at risk (PAR) 90 plus one-year write-offs, below 4% of AUM) and diversifying its borrowing sources.

Negative factors – ICRA could change the outlook to Negative or downgrade the rating if the company’s leverage increases to more than 4 times on a sustained basis or if it continues to witness weak profitability metrics and a deterioration in its asset quality metrics.

Kanakadurga Finance Limited

Positive factors – ICRA could change the outlook or upgrade the rating if KFL shows a steady improvement in its asset quality and earnings profile, while keeping the capital profile under control (managed gearing of around 5.0 times).

Negative factors – ICRA could change the outlook or downgrade the rating if KFL experiences weakening in the asset quality, liquidity or capital profile (managed gearing of more than 6.0 times) on a sustained basis.

Analytical approach

The rating action is based on the credit profile of the underlying issuers.

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA’s Credit Rating Methodology for Non-Banking Finance Companies
Parent/Group Support	Not Applicable
Consolidation/Standalone	Not Applicable

About the company

Varthana Finance Private Limited (erstwhile Thirumeni Finance Private Limited)

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. 944.4 crore.

The previous detailed rating rationale is available on the following link: [Click here](#)

Key financial indicators

Varthana Finance Private Limited	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: Varthana, ICRA Research; * Provisional numbers; All ratios as per ICRA's calculations

Aye Finance (P) Ltd.

Aye Finance (P) Limited is registered with the Reserve Bank of India (RBI) as a systemically important non-deposit taking non-banking financial company (ND-NBFC). It provides loans to micro-enterprises in semi-urban areas with an annual turnover of Rs. 10 lakh – 1 crore. The company commenced operations in FY2014 and is promoted by Mr. Sanjay Sharma and Mr. Vikram Jetley, who have prior experience in retail lending. Aye Finance is backed by strong private equity (PE) investors – Capital G (Google), Falcon Edge, SAIF Partners, A91 Partners, LGT Impact and others.

As on December 31, 2021, the company had operations in 20 states/UTs (Uttar Pradesh, Rajasthan, Haryana, Punjab, Uttarakhand, Delhi NCR, Karnataka, Tamil Nadu, Andhra Pradesh, Telangana, Madhya Pradesh, Maharashtra, Himachal Pradesh, Bihar, Gujarat, Jharkhand, Chhattisgarh, Chandigarh, Jammu & Kashmir and West Bengal) through 311 branches.

It reported a net loss of Rs. 48 crore on a total asset base of Rs. 2,104 crore in H1 FY2022 vis-à-vis a net profit of Rs. 17.0 crore on a managed asset base of Rs. 2,139 crore in FY2021.

The previous detailed rating rationale is available on the following link: [Click here](#)

Key financial indicators (audited)

Aye Finance (P) Limited	FY2020	FY2021	H1 FY2022
Accounting as per	IndAS	IndAS	IndAS
Net interest income	251.4	247.4	124.1
Profit after tax	32.4	16.9	(48.0)
Net worth	516.7	746.7	700.9
Total managed assets	2,083.7	2,138.5	2,104.2
% PAT / Average managed assets	1.9%	0.8%	(4.7) %
% PAT / Average net worth	6.5%	2.7%	(13.3) %
% Gross NPAs	2.3%	3.3%	7.0%
% Net NPAs	0.1%	0.7%	1.8%
% Net NPA / Net worth	0.5%	1.6%	3.5%

Aye Finance (P) Limited	FY2020	FY2021	H1 FY2022
Accounting as per	IndAS	IndAS	IndAS
% Capital adequacy ratio	31%	41%	45%
Gearing (reported; times)	2.83	1.82	1.76

Source: Company, ICRA Research; All ratios as per ICRA calculations; Amount in Rs. crore

Kanakadurga Finance Limited

Kanakadurga Finance Limited (KFL) was incorporated as a private company in 1994 to take over the auto financing business of the proprietary entities of the promoter. It was converted into a public company in 1996. Mr. S. Lakshmi Narayana, the promoter, has been in the auto finance business for the past ~30 years. In FY2016, the name of the company was changed to KFL from Kanakadurga Leasing & Finance Limited. KFL is an ND-NBFC, primarily engaged in the business of vehicle financing and gold loans. The company has a presence in Andhra Pradesh, Telangana, Karnataka, Tamil Nadu, Puducherry and Gujarat.

Key financial indicators (managed portfolio)

Kanakadurga Finance Limited	FY2019 IGAAP	FY2020 Ind-AS	FY2021 Ind-AS	9M FY2022* Ind-AS
Net interest margin (adj. for BO costs)/AMA	11.3%	10.9%	11.4%	10.0%
Operating expenses / AMA	9.5%	8.4%	6.8%	8.3%
Operating profit / AMA	2.6%	2.6%	4.7%	1.8%
Credit prov. & write-offs / AMA	0.9%	1.6%	1.9%	1.1%
Operating profits (net of credit provisions) / AMA	1.7%	1.0%	2.9%	0.7%
PBT/ AMA	1.7%	1.0%	2.9%	0.7%
PAT/ AMA	1.2%	0.7%	2.1%	0.5%
Tier-I (%)	19.30%	20.82%	32.60%	26.80%
Tier-II (%)	2.06%	0.99%	0.16%	0.76%
Total CRAR (%)	21.35%	21.80%	32.76%	27.56%
Gearing – On-balance sheet (times)	4.7	3.9	2.9	3.4
Managed gearing (times)	5.3	4.9	3.0	3.5

*Provisional

Source: Company data, ICRA Research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

S. No.	Instrument	Current Rating (FY2022)					Chronology of Rating History for the Past 3 Years					
		Borrower name	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in FY2022			Date & Rating in FY2021			Date & Rating in FY2020	Date & Rating in FY2019
					Mar 11, 2022	Dec 10, 2021	Jun 04, 2021	Dec 31, 2020	Dec 18, 2020	May 27, 2020	Aug 02, 2019	-
1	Northern Arc Pooled Bond Issuance XIX	Varthana Finance Private Limited (erstwhile Thirumeni Finance Private Limited)	25.00	8.33	[ICRA]BBB (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Stable)	-
		Aye Finance (P) Ltd.	32.00	10.67	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB (Stable)	-
		ASA International India Microfinance Limited	17.00	8.50	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB(Negative)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	-
		Kanakadurga Finance Limited	32.00	10.67	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB- (Stable)	-

Complexity level of the rated instrument

Instrument	Complexity Indicator
Northern Arc Pooled Bond Issuance XIX	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

Annexure-1: Instrument details

Transaction Name	ISIN number	Borrower name	Date of Issuance	Coupon Rate	Scheduled Maturity Date*	Amount Rated (Rs. crore)	Current Rating
Northern Arc Pooled Bond Issuance XIX	INE125T07162	Varthana Finance Private Limited (erstwhile Thirumeni Finance Private Limited)	July 2019	Blended yield of 13.36%	February 2023**	8.33	[ICRA]BBB (Negative)
	INE501X07133	Aye Finance (P) Ltd.			August 2022	10.67	[ICRA]BBB+ (Stable)
	INE746T07082	ASA International India Microfinance Limited			August 2022	8.50	[ICRA]BBB- (Stable)
	INE104W07112	Kanakadurga Finance Limited			February 2023**	10.67	[ICRA]BBB- (Stable)

*NCD rated for all borrowers

** Changed from August 2022 to February 2023 following the revision in the terms of the transaction

Annexure-2: List of entities considered for consolidated analysis

Varthana Finance Private Limited (erstwhile Thirumeni Finance Private Limited): Not Applicable

Aye Finance (P) Ltd.:

Company Name	Aye Finance Ownership	Consolidation Approach
Aye Finance (P) Limited	100.00% (rated entity)	Full Consolidation
Foundation for Advancement of Micro Enterprises – Not-for-profit subsidiary of Aye Finance	100%	Full Consolidation

Kanakadurga Finance Limited: Not Applicable

ANALYST CONTACTS

Abhishek Dafria
+91 22 6114 3440
abhishek.dafria@icraindia.com

Samriddhi Chowdhary
+91 22 6114 3462
samriddhi.chowdhary@icraindia.com

Sushant Vanmali
+91 22 6114 3436
sushant.vanmali@icraindia.com

Himanshi Doshi
+91 22 6114 3410
himanshi.doshi@icraindia.com

RELATIONSHIP CONTACT

L Shivakumar
+91 22 6114 3406
shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

About ICRA Limited:

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 (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

ICRA Limited



Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001

Tel: +91 11 23357940-45



Branches



© Copyright, 2022 ICRA Limited. All Rights Reserved.

Contents may be used freely with due acknowledgement to ICRA.

ICRA ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. ICRA ratings are subject to a process of surveillance, which may lead to revision in ratings. An ICRA rating is a symbolic indicator of ICRA's current opinion on the relative capability of the issuer concerned to timely service debts and obligations, with reference to the instrument rated. Please visit our website www.icra.in or contact any ICRA office for the latest information on ICRA ratings outstanding. All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable, including the rated issuer. ICRA however has not conducted any audit of the rated issuer or of the information provided by it. While reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. Also, ICRA or any of its group companies may have provided services other than rating to the issuer rated. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents.