

Sept 20, 2022^(Revised)

Varthana Finance Private Limited (erstwhile Thirumeni Finance Private Limited): Ratings downgraded; outlook revised to Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debentures	32.80	32.80	[ICRA]BBB- (Stable); downgraded from [ICRA]BBB (Negative) and outlook revised to Stable from Negative
Non-convertible debentures	27.00	27.00	[ICRA]BBB- (Stable); downgraded from [ICRA]BBB (Negative) and outlook revised to Stable from Negative
Non-convertible debentures	20.00	-	[ICRA]BBB- (Stable); downgraded from [ICRA]BBB (Negative), outlook revised to Stable from Negative and withdrawn*
Term Loan	150.00	150.00	[ICRA]BBB- (Stable); downgraded from [ICRA]BBB (Negative) and outlook revised to Stable from Negative
Long Term -Unallocated	185.80	-	[ICRA]BBB- (Stable); downgraded from [ICRA]BBB (Negative), outlook revised to Stable from Negative and withdrawn*
Total	415.6	209.8	

*Instrument details are provided in Annexure-1

Rationale

The rating downgrade factors in the continued stress on Varthana's portfolio on the back of the prolonged unfavourable operating conditions for the school financing sector during the pandemic. With the third wave of the pandemic delaying the reopening of schools, Varthana's asset quality deteriorated further in H2 FY2022 and Q1 FY2023. The Gross stage 3 (GS3) of the company deteriorated to 15.4% as of June 2022 and 12.0% as of March 2022 from 10.3% as of September 2021 (2.9% as of March 2021). As of March 2022, Rs. 45.8 crore (24%) of the restructured book had slipped into the GS3 bucket. In addition, the company had a sizable standard restructured book at 15.2% of the portfolio as of March 2022. ICRA takes note of the stress in the restructured book, as repayments have commenced for this portfolio and were in various overdue buckets as of June 2022. Going forward, with the reopening of majority of the schools from the academic year 2022-23 onwards, ICRA expects the operating conditions for school financing to improve steadily. As such, incremental slippages in asset quality performance is expected to be controlled in the near term. However, the recoveries and improvement in the stressed portfolio levels is expected to be gradual over the next few quarters.

ICRA also notes that Varthana's asset quality pressure, consequently, impacted its net profitability which moderated to 0.2% in FY2022. Further, Varthana reported a net loss of 5.3% (provisional, annualised) in Q1 FY2023 largely due to increased credit & provision costs. Varthana's ability to keep its credit & provision cost and operating efficiencies under control would be crucial for incremental profitability. ICRA notes that the company increased its total provisions from 7.5% as of March 2021 to 11.9%

as of March 2022; though, the GS3 provision coverage remained similar at 54.2% as of March 2022 vis-à-vis 52.7% as of March 2021.

The rating also factors in the limited incremental funding obtained by the company in recent quarters, with the company being able to raise modest debt funding of about Rs. 77 crore in FY2022 and about Rs. 48 crore in 5MFY2023, largely from existing NBFC lenders and through securitisation transactions. The company was also in breach of some of the financial covenants with its lenders and has received temporary relaxation from some of them. In backdrop of this, Varthana's ability to restrict any adverse action from existing lenders and secure sufficient incremental funds for envisaged portfolio scale-up in FY2023 would be monitorable.

The rating continues to factor in the experience of its senior management team, led by Mr. Steve Hardgrave and Mr. Brajesh Mishra, who have adequate understanding of the target segment. ICRA also takes comfort from the significant number of institutional investors in the company, who have supported the company in raising capital in the past. With a capital raise of Rs. 105 crore undertaken in FY2022, Varthana is adequately capitalised for its current scale of operations and is not envisaging any immediate plans for further equity infusion. Varthana's leverage metrics improved in FY2022, with its managed gearing at 1.1 times as on June 2022 (1.1 times as of March 2022) vis-à-vis 1.9 times as of March 2021. The CRAR has also improved to 56.2% as of June 2022. 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 over the next few quarters as the portfolio expands.

ICRA has also downgraded and withdrawn the long-term rating outstanding on the Rs. 20-crore non-convertible debenture (NCD) as the instrument has matured and is fully repaid. ICRA has also downgraded and withdrawn the long-term rating outstanding on Rs. 185.80 crore of unallocated bank facilities at the request of the company, in accordance with ICRA's policy on the withdrawal of credit ratings.

Key rating drivers and their description

Credit strengths

Adequate capitalisation profile– Varthana raised capital of about Rs. 105 crore in FY2022, which supported the capital structure of the company, in view of the headwinds on the asset quality front. With Varthana maintaining its scale of operations rangebound (AUM of Rs. 957.8 crore as of March 2022 and Rs. 928.6 crore as of June 2022), the managed gearing of the company improved to 1.1 times as of June 2022 (1.1 times as of March 2022) from 1.9 times as of March 2021. The CRAR improved to 56.2% as of June 2022 (55.4% as of March 2022), compared to 33.5% in March 2021. Considering the current capitalisation level, the company is not envisaging any immediate plans for equity infusion.

Experienced senior management team– Varthana 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, Elevor Equity Management Limited, Omidyar Network, Kaizen Private Equity, etc.; most of these investors participated in the capital raise of Rs.105 crore undertaken in FY2022.

Credit challenges

Asset quality indicators continue to remain under pressure – Varthana's Gross stage 3 deteriorated to 15.4% as of June 30, 2022 (12.0% as of March 31, 2022) compared to 2.9% as of March 31, 2021. This may be attributed to the higher level of slippages witnessed given the prolonged disruption in the operations of schools and correspondingly, the fee collections. The Net Stage 3 also remained at elevated levels of 6.5% as of June 30, 2022. The second wave of the pandemic coincided with the resumption of repayments for the loan restructured in FY2021, leading to increased slippages from the restructured book. Further, with the re-opening of schools delayed on account of the third wave of the pandemic in Q4FY2022, improvement in

collections was significantly restricted during FY2022. As of March 2022, the Covid restructured book stood at Rs 191 crore (19.9% of the AUM), of which, Rs 45.8 crore had slipped into GS3 category. The total standard restructured book as of March 2022 stood at Rs. 145.2 crore (15.2% of the AUM). ICRA takes note of the stress in the restructured book; a sizeable portion of restructured book, where repayments have commenced are in various softer delinquency buckets, apart from the slippages detailed above. On the other hand, backed by some recoveries, the security receipts outstanding, received from sale of assets to the ARC during the last fiscal, moderated from about Rs. 31.2 crore in March 2021 to Rs 26.1 crore in March 2022 and further to Rs 23.9 crore in June 2022.

ICRA notes that while the GS3 provision coverage improved to 54.2% as on 31 March 2022 vis-à-vis 52.7% as on March 2021, the net stage 3 to net worth ratio increased to 12.5% as of June 2022 (10.6% as of March 2022) from 3.7% as of March 2021 due to increased slippages. As of March 31, 2022, the total provisions stood at Rs. 113.3 crore (11.9% of the portfolio) which includes a management overlay of Rs. 40.9 crore (4.3% of the portfolio). The company has access to the SARFAESI Act; the top 20 nonperforming advances (NPAs; 26.6% of the NPAs in March 2022) 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. As of March 31, 2022, about Rs 218.8 crore of the portfolio was under litigation through this forum. Going forward, Varthana's ability to effect recoveries from its stressed asset book and restrict incremental slippages would be critical for improving the asset quality performance and would be a key monitorable from the rating perspective.

Subdued profitability indicator– Varthana's profitability continues to be weak, given the stressed asset quality performance of the company, with its PAT/AMA at 0.2% in FY2022 (-0.6% in FY2021). In Q1 FY2023, the company reported a net loss of 5.3% (provisional, annualised) due to the elevated credit & provision costs of 9.5% (provisional, annualised) vis-à-vis 3.4% in FY2022 (5.0% in FY2021). Increased collection efforts and other initiatives to augment IT and internal MIS increased the operating expense ratio (operating expenses/AMA) to 6.8% (provisional; annualised) in Q1 FY2023 and 5.5% in FY2022 from 4.4% in FY2021. Varthana's ability to bring back its credit & provision costs and operating efficiencies under control would be crucial for incremental profitability going forward.

Ability to secure adequate debt funding critical for business growth– Varthana's debt funding was restricted over the last two years on account of the pandemic, which along with the management's decision to follow a more cautious approach for new business, resulted in a rundown of its loan book. The company has a limited incremental funding of about Rs. 77 crore in FY2022 and about Rs. 48 crore in 5MFY2023, raised largely from existing NBFC lenders and through securitisation transactions. In addition, Varthana also raised equity capital of about Rs. 105 crore in FY2022, supporting the modest disbursements undertaken during the year, in addition to its liquidity requirements. Going forward, given that there is no immediate equity raise plans, it would be critical for the company to secure adequate debt funding in H2 FY2023, which would enable them to maintain adequate liquidity and make incremental disbursements. ICRA notes that the company currently has about Rs 245 crores of debt funding in pipeline and securing firm sanctions from the same in a timely manner remains to be seen.

ICRA also notes that the company was in breach of some financial covenants with its lenders and has received temporary relaxations from some lenders. In backdrop of this, Varthana's ability to restrict any adverse action from existing lenders and secure incremental funds for envisaged portfolio scale-up in FY2023 would be key monitorable.

Moderate scale of operations– With a portfolio size of Rs. 957.8 crore as on March 2022 (Rs 928.6 crore as of June 2022), VFPL's current scale of operations remains moderate. The company was cautious on incremental disbursements in FY2022, aggregating Rs. 117.9 crore vis-à-vis Rs. 106.2 crore in FY2021 (Rs. 459.5 crore in FY2020). In Q1 FY2023, Varthana was able to sustain its disbursements at Rs.38.4 crore, in line with the disbursement made during Q4 FY2022. The disbursements are expected to gain momentum from H2 FY2023 onwards, with the company targeting an AUM in the range of around Rs. 1,500 crore by March 2023.

Liquidity position: Adequate

Varthana's ALM profile was adequate as on March 31, 2022 with no negative cumulative mismatches in any of the buckets. The company has repayment obligations of Rs. 124.1 crore over September 2022 to December 2022 against which it had unencumbered cash and liquid investment of Rs. 82.7 crore as of August 2022. With monthly collections of Rs. 20–25 crores, as seen in the recent months, Varthana's liquidity position is adequate.

VFPL's borrowing profile comprised of ECBs, NBFCs, NCDs from FIs, securitisation and bank borrowings accounting for 38%, 28%, 20%, 5% and 8% of the overall borrowing as of March 2022. 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 could revise the outlook to positive or upgrade the rating if Varthana is able to demonstrate a sustained improvement in its asset quality and scale of operations, leading to an improved earnings profile.

Negative factors – ICRA could revise the outlook to negative or downgrade the rating if the asset quality continues to remain weak, thereby exerting further pressure on the earnings and liquidity profile of the company. Inability to secure incremental funding lines in a timely manner could also negatively impact the rating.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	ICRA's Credit Rating Methodology for Non-Banking Finance Companies Policy on Withdrawal of Credit Ratings
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 non-banking financial company, 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, 2022, the promoters held an 10.6% stake in the company with the balance held by institutional investors (83.6%), 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 and 1 Union Territory, including Karnataka, Maharashtra, Madhya Pradesh, Tamil Nadu, Odisha, Rajasthan, and Chhattisgarh, with its head office in Bengaluru. As on June 30, 2022, Varthana had a loan book of Rs.928.6 crore.

Key financial indicators (audited)

Company Name	FY2020	FY2021	FY2022
Total income (Rs. crore)	227.4	211.6	190.7
Profit after tax (Rs. crore)	15.3	-7.7	2.5
Net worth (Rs. crore)	403.1	386.7	495.2
Assets under management (Rs. crore)	1,104.0	1,044.8	957.8
Total assets (Rs. crore)	1,225.9	1,164.4	1048.7
Return on managed assets (Rs. crore)	1.3%	-0.6%	0.2%
Return on net worth (Rs. crore)	3.9%	-1.9%	0.6%
Gearing (times)	2.0	1.9	1.1
Gross Stage 3 (%)	7.1%	2.9%	12%

Company Name	FY2020	FY2021	FY2022
Net Stage 3 (%)	4.3%	1.5%	5.5%
Solvency (Net stage 3/Net worth)	11.3%	3.7%	10.6%
CRAR (%)	36.8%	35.7%	55.4%

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

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Chronology of Rating History for the Past 3 Years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in FY2023	Date & Rating in FY2022		Date & Rating in FY2021	Date & Rating in FY2020	
					Sept 20, 2022	Dec 10, 2021	May 28, 2021	Nov 25, 2020	Jan 27, 2020	Apr 01, 2019 May 03, 2019 Aug 28, 2019
1	NCDs	LT	27.00	27.00	[ICRA]BBB- (Stable)	[ICRA]BBB (Negative)	-	-	-	-
2	NCDs	LT	20.00	-	[ICRA]BBB- (Stable); Withdrawn	[ICRA]BBB (Negative)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Stable)
3	NCDs	LT	32.80	32.80	[ICRA]BBB- (Stable)	[ICRA]BBB (Negative)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Stable)
4	Term loan	LT	150	150.00	[ICRA]BBB- (Stable)	[ICRA]BBB (Negative)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Stable)
5	Long term-Unallocated	LT	185.8	-	[ICRA]BBB- (Stable); Withdrawn	[ICRA]BBB (Negative)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Stable)

Complexity level of the rated instruments

Instrument	Complexity Indicator
Term loan	Simple
Long term - Unallocated	NA
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

Annexure-1: Instrument details

ISIN/Banker Name	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term loan	Nov-21-2018 to Nov-26-2019	12.00% to 13.25%	Nov-29-2022 to Nov-26-2023	30.78	[ICRA]BBB- (Stable)
NA	Term loan-Unallocated	NA	NA	NA	119.22	[ICRA]BBB- (Stable)
NA	Long Term-Unallocated	NA	NA	NA	185.80	[ICRA]BBB- (Stable); Withdrawn
INE125T07121	NCD	Dec-16-2016	12.72%	Dec-16-2021	20.00	[ICRA]BBB- (Stable); Withdrawn
INE125T07105	NCD	May-03-2019	12.75%	May-03-2023	32.40	[ICRA]BBB- (Stable)
INE125T07154	NCD	Dec-23-2021	12.00%	Jan-01-2025	27.00	[ICRA]BBB- (Stable)
Unallocated	NCD - Unallocated	NA	NA	NA	0.40	[ICRA]BBB- (Stable)

Source: Company

Annexure-2: List of entities considered for consolidated analysis

Not Applicable

Corrigendum

The rating rationale document dated September 20,2022 has been corrected with the revision as detailed below:

- The word “reaffirmed” is replaced by “downgraded” in the last paragraph of the rationale section.

ANALYST CONTACTS

Karthik Srinivasan

+91 22 6114 3444

karthiks@icraindia.com

R Srinivasan

+91 44 4596 4315

r.srinivasan@icraindia.com

Ramya G

+91 44 4596 4309

ramya.g@icraindia.com

Krishan Kumar Saini

+91 124 4545 442

krishan.saini@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee

+91 80 4332 6401

jayantac@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

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ICRA Limited



Registered Office

B-710, Statesman House, 148 Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45



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