

## Karvy Financial Services Limited

February 21, 2018

### Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long term bank lines	174.36	174.36	[ICRA]A+ (SO) (stable) ; Reaffirmed
Long term bank lines	85.64	0.00	[ICRA]A+ (SO) (stable) ; Withdrawn
Principle Protected NCD Programme	2.90	2.90	Provisional PP-MLD [ICRA] A+ (SO) (stable) confirmed as final
Subordinated Debt Programme	30.00	30.00	Provisional [ICRA] A+ (SO) (stable) confirmed as final
<b>Total</b>	<b>292.90</b>	<b>207.26</b>	

### Rating action

ICRA has reaffirmed the long term rating of [ICRA]A+ (SO) (stable) for the Rs. 174.36 crore long-term bank lines of Karvy Financial Services Limited (KFSL). ICRA has confirmed the provisional rating of Provisional [ICRA]A+ (SO) (stable) assigned to the Rs. 30 crore subordinated debt programme of KFSL. ICRA has also confirmed the provisional rating of Provisional [ICRA]A+ (SO) (stable) assigned for the Rs. 2.90 crore principle protected NCD programme of KFSL. Since the documents are in line with the initial rating conditions, the rating for the NCD and PP-MLD programme has now been confirmed as final.

The Structured Obligation (SO) ratings do not represent ICRA's opinion on the general credit quality of KFSL. The confirmed/ reaffirmed ratings are based on the strength of unconditional and irrevocable corporate guarantees provided by KFSL's parent - Karvy Stock Broking Ltd (KSBL; rated [ICRA]A+(stable)/ [ICRA]A1+). The guarantees from KSBL would cover all obligations that may arise on the rated NCDs and the bank line programme.

ICRA has also withdrawn the rating of [ICRA]A+ (SO) (stable) outstanding for the Rs. 85.64 crore long term bank lines. The rating has been withdrawn as the company has fully redeemed the facility and there is no amount outstanding against the rated facility.

### Rationale

KSBL has provided an unconditional and irrevocable guarantee for KFSL. The ratings take comfort from the long experience of Karvy Group in retail equity broking business and the group's diversified revenue profile with growing contribution from data management business. The ratings also takes note of the completion of the transaction whereby Small Business Fincredit India Private Limited (SBFC) acquired the retail lending book along with the existing infrastructure, branch network and employee team from Karvy Financial Services Limited. While the rating factors in the group's adequate risk management systems, it is constrained by the cyclical nature of Karvy Group's primary business being dependent on the domestic capital market, and corporate guarantees provided to the group's relatively new businesses. However, ICRA takes note of the management's efforts to diversify into non-capital market businesses that provide stability to the group's financial performance over the medium term.

## Outlook: Stable

ICRA believes KSBL will continue to benefit from its long track record in the capital markets and growing presence in the data management business. The outlook may be revised to 'Positive' if a healthy scaling up of operations along with greater diversification in revenue stream strengthens the company's financial risk profile. The outlook may be revised to a 'Negative' in the event of a downturn in the industry or any changes in the regulatory environment, which may have an impact on the business operations and consequently on the financial performance of the company.

## Key rating drivers

### Credit strengths

**Unconditional and irrevocable guarantee from KSBL** - The reaffirmed ratings are based on the strength of unconditional and irrevocable corporate guarantees provided by KSBL. The guarantees from KSBL would cover all obligations that may arise on the rated NCDs and the bank line programme.

**Group having a diversified revenue profile, with businesses like mortgage finance, data management, registrar and transfer agency that is not linked to the volatile capital markets** - Incorporated in 1983 to undertake the registrar and transfer agency business, Karvy Group has a diversified business profile within the capital market space with KSBL and its wholly owned subsidiaries are engaged in business operations including equity broking, commodity broking, retail lending, real estate advisory services and data management services. Some businesses like mortgage finance, data management services and registrar and transfer agency have relatively more stable income profile with no direct linkage to performance of capital markets.

**Moderate presence in retail broking space** - KSBL is a broking player with a focus on domestic and high net worth clients. Supported by the upswing in capital markets, KSBL's total equity broking volumes increased by 67% during FY2017, with growth in both the cash and futures and options (F&O) segments. The company outperformed the industry growth of 35%, resulting in its market share improving to 0.64% in FY2017 from 0.52% in FY2016. The company also services its ~9 lakh customer base through its own network of 259 branches and 1,176 franchisees as on September 30, 2017.

**Growing presence in the data management business** - Karvy group incorporated Karvy Data Management Services Limited (KDMSL) in 2008 to provide business and knowledge services. The company started off as a pure-play back office service provider and has moved on to operate in business verticals like E Governance, Telecom and Banking. The company has been able to increase its operating income to Rs. 405.54 crore in FY2017 from Rs. 287.17 crore in FY2016. The Contribution of E-Governance to the total Revenues of the company has been significantly increasing from 1% in FY2011 to ~62% in FY2017. KDMSL has been reporting healthy internal accruals and has become a primary contributor to KSBL's consolidated net profit.

**Adequate capitalization for current scale of operations for the NBFC business; further improvement expected due to the deal** - KFSL had a networth of Rs. 394.95 crore as on March 31, 2017 and a CRAR of 20.75% as on that date. The company had a modest gearing of 3.71 times as on March 31, 2017 as compared with 4.80 times as on March 31, 2016. With a large part of the loan book being sold in September 2017, the company has repaid bulk of their bank borrowings which has reduced the gearing to 0.68 times as on September 30, 2017. Moreover, the assets have been sold at a premium of Rs. 261 crore which has been used to clean up the balance sheet by writing-off a substantial portion of the loan book.

## Credit challenges

**High intensity of competition in capital markets** – KSBL is engaged in the equity broking business. With increasing competition in equity broking and the advent of discount brokerage houses, average yields for broking players have been under downward pressure. However, the low level of equity market penetration in the country (number of demat accounts in India is about 2% of the country's population) indicates significant untapped potential for expansion.

**Sale of substantial assets in the NBFC business; rebuild the infrastructure** - As a part of the transaction, Karvy Financial Services Limited (KFSL) has sold Rs. 816 crore of the loan assets to Small Business Fincredit India Private Limited (SBFC). Moreover, the balance loan book (~Rs. 520 crore) had a high share of delinquent accounts. However, the company has written-off a substantial portion (Rs. 257 crore) of the NPAs to clean up the balance sheet. The impact of these write-offs were cushioned by the Rs. 261 crore profit on the sale of assets to SBFC. With the transaction completed in September 2017, the entire infrastructure in terms of the 77 branches along with the entire employee team has shifted to SBFC. The company would have to rebuild the team and set up the entire branch network in future if it plans to enter the retail lending business again.

**High gearing on a consolidated basis** – KSBL's broking business has a comfortable liquidity profile with low utilisation of the margins placed with stock exchanges (generally ~60-70%) and ready access to client's assets (backed by share collateral) that can be monetised without a significant lag. KSBL's gearing is also relatively low at 1.62 times as on March 31, 2017. However, on a consolidated basis, the gearing is much higher at 5.07 times as on March 31, 2017, although it has reduced from 6.01 times as on March 31, 2016. The gearing is high at the consolidated level primarily due to the borrowings in the NBFC business and data management business. ICRA, however, takes comfort from the recent slump sale of assets in the NBFC business which would help the company in lowering the gearing at the consolidated level. ICRA also takes comfort from the reduction in corporate guarantee limits extended by KSBL to its subsidiaries after the slump sale of NBFC business.

**Poor asset quality indicators in the balance loan book post the deal** – As on March 31, 2017, the company had a gross NPA of 13.41% and net NPA of 11.10%. As part of the transaction, SBFC would acquire primarily the performing accounts in the retail loan book. Hence, KFSL had a large share of non-performing accounts which have been written off in H1FY2018. As a result of the substantial write-offs, the company's asset quality in the balance loan book remains stable with GNPA and NNPA at 11.06% and 9.50% respectively as on September 30, 2017. The write-offs would result in a short-term impact on the profitability and capitalisation of the KFSL.

**Analytical approach:** For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

**Links to applicable criteria:**

[ICRA's Credit Rating Methodology for Non-Banking Finance Companies](#)

[Approach for rating debt instruments backed by third-party explicit support](#)

## About the company

Karvy Financial Services Limited (KFSL) is a 100% subsidiary of Karvy Stock Broking Limited (through other group subsidiaries) and got its NBFC license in 2009. The company is engaged in providing loan against shares, loan against gold, loan against property and small commercial vehicles (SCV). During FY2017, KFSL reported a net loss of Rs. 29.67 crore on an income base of Rs. 280.26 crore as compared with a net profit of Rs 11.60 crore on an income base of Rs. 352.04 crore during FY2016. The company had a networth of Rs. 394.95 crore as on March 31, 2017.

## About Karvy Stock Broking Limited

Karvy Stock Broking Ltd. (KSBL) is a part of the Hyderabad-based Karvy group of companies. The key promoters of the group are Mr. C. Parthasarathy, Mr. M.S.Ramakrishna and Mr. M. Yugandhar. In November 2007, ICICI Venture and Baring Asia PE acquired 30.95% stake in Karvy Stock Broking Limited (KSBL) by buying the entire 20% equity held by Pacific Century Group and an additional 10.95% stake in the form of fresh equity. KCL, the promoter company acquired the stake of ICICI Venture in the last financial year. KSBL is engaged in the equity broking, depository operations, distribution of financial products, advisory services and wealth management.

## Key financial indicators (KSBL - Consolidated)

	FY2016	FY2017
Brokerage Income (net)	123.56	193.79
Fee Income (other than broking)	81.31	88.75
Net Interest Income	(5.79)	(82.47)
Other Non-Interest Income	421.32	482.59
Net Operating Income	620.40	682.61
Total Operating Expenses	547.16	651.95
Profit Before Tax	58.08	13.71
Profit After Tax	39.87	4.21
Net Worth	529.50	533.76
Gearing	6.01	5.07
Return on Net Worth	7.62%	0.84%

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

**Any other information: None**

### Rating history for last three years:

Instrument	Current Rating (FY2018)			Chronology of Rating History for the past 3 years						
	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	FY2018		FY2017	FY2016		FY2015	
				Feb-18	Oct-17	Dec-16	Sep-15	Mar-15	Feb-15	
1 Subordinated Debt Programme	Long term	30.00	30.00	Provisional [ICRA] A+ (SO) (stable) confirmed as final	Provisional [ICRA] A+ (SO) (stable) **; reassigned from [ICRA]A (watch with developing implications)	[ICRA]A; put on watch with developing implications	[ICRA]A (stable)	[ICRA]A (stable)	[ICRA]A (stable)	
2 Principle Protected NCD Programme	Long term	2.90	2.90	Provisional PP-MLD [ICRA] A+ (SO) (stable) confirmed as final	Provisional PP-MLD [ICRA] A+ (SO) (stable) **; reassigned from PP-MLD [ICRA]A (watch with developing implications)	PP-MLD [ICRA]A; put on watch with developing implications	PP-MLD [ICRA]A (stable)	PP-MLD [ICRA]A (stable)	PP-MLD [ICRA]A (stable)	
3 Long term bank lines	Long term	174.36	174.36	[ICRA]A+ (SO) (stable)	[ICRA] A+ (SO) (stable), Re-affirmed	[ICRA]A+ (SO) (stable)	[ICRA]A + (SO) (stable)	[ICRA]A + (SO) (stable)	[ICRA]A+ (SO) (stable)	
4 Long term bank lines	Long term	85.64	0.00	[ICRA]A+ (SO) (stable); Withdrawn	[ICRA] A+ (SO) (stable), Re-affirmed	[ICRA]A+ (SO) (stable)	[ICRA]A + (SO) (stable)	[ICRA]A + (SO) (stable)	[ICRA]A+ (SO) (stable)	

\*\*Rating backed by Guarantee by parent viz. Karvy Stock Broking Limited (KSBL)

### Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website [www.icra.in](http://www.icra.in)

## Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Long term bank lines	Apr-14	NA	Oct-20	174.36	[ICRA]A+ (SO) (stable)
INE308L07450	Principle Protected Market Linked Debenture Programme	6-Jan-15	CNX Nifty Linked	29-Jun-18	1.20	PP-MLD [ICRA]A+ (SO) (stable)
INE308L07492	Principle Protected Market Linked Debenture Programme	10-Feb-15	CNX Nifty Linked	5-Jun-18	1.70	PP-MLD [ICRA]A+ (SO) (stable)
INE308L08011	Subordinated Debt Programme	12-Feb-15	15.60%	11-May-20	30.00	[ICRA]A+ (SO) (stable)

Source: Karvy Financial Services Limited

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## 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.

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For more information, visit [www.icra.in](http://www.icra.in)

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