

August 13, 2019

Dvara Kshetriya Gramin Financial Services Private Limited: Rating upgraded to [ICRA]BBB (Stable)

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Bank Loans	200.00	200.00	[ICRA]BBB(Stable); upgraded from [ICRA]BBB-(Stable)
Subordinated Debt	30.00	30.00	[ICRA]BBB(Stable); upgraded from [ICRA]BBB-(Stable)
Total	230.00	230.00	

*Instrument details are provided in the Annexure-1

Rationale

The rating upgrade considers the improvement in Dvara Kshetriya Gramin Financial Services Private Limited's (Dvara KGFS) capitalisation profile, which would be adequate to support its growth plans over the next 18-24 months. In Q1 FY2020, the company raised an equity of about Rs. 45.00 crore (Rs. 40.00 crore raised in FY2019) and additional equity infusion of Rs.12.00 crore is expected in the immediate term, currently pending RBI approval. The company envisions to grow its assets under management¹ (AUM) at a compounded annual growth rate (CAGR) of about 40-45% over the period FY2020-FY2022, while capping the adjusted gearing² at about 5.0 times (stood at 3.1 times as of June 2019). The rating also considers the stable collection efficiency witnessed in the recent past (99% in FY2019 in line with the previous year), which, along with write-offs in certain geographies (which were fully provided for in prior years) led to some improvement in the asset quality, with the 90+ dpd improving to 2.2% as of June 2019 (2.9% as of March 2019) from 5.5% as of March 2018. The rating also factors in the ongoing measures to strengthen internal controls and IT systems, given the steep expansion plans.

The rating is, however, constrained by the moderate scale of operations (Rs. 805-crore as of June 2019), regional concentration risks, arising from the modest credit profile of the customer segment and the limited diversity in its funding profile. The rating factors in the improvement in profitability with PBT/AMA³ increasing to 2.4% in FY2019 from 2.0% in FY2018 (0.5% in FY2017), though it remains moderate in relation to its peers. Going forward, the company's ability to improve business volumes and operating efficiency and maintain a tight control over asset quality would be crucial from a rating perspective.

Please refer to our rationale dated [April 26, 2019](#) updating the acquisition of assets and liabilities of Varam Capital Private Limited.

¹ Own portfolio + securitised portfolio + Business correspondent (BC) portfolio

² Total debt/(net worth-FLDG on direct originations for BC partners)

³ Profit before tax/average managed assets; Total managed asset - Total assets + securitized portfolio + BC portfolio

Outlook: Stable

ICRA believes that the company will benefit from the comfortable near-term capitalisation and the augmentations in the internal controls, which would support growth. The outlook may be revised to Positive if there is a sustained improvement in the profitability and funding diversity as the company grows and diversifies the portfolio while maintaining a good asset quality profile. The outlook may be revised to a Negative if there is a significant weakening in the asset quality, liquidity or earnings profile.

Key rating drivers

Credit strengths

Comfortable capitalisation profile – Dvara KGFS' capitalisation profile is comfortable with a managed gearing of 3.1x as of June 2019 (3.5x as of March 2019) vis-à-vis 7.0x as of March 2018. The improvement in gearing was supported by the capital infusion of Rs. 40 crore and Rs.45 crore during FY2019 and Q1 FY2020 respectively. The company expects another Rs.12-crore capital infusion, which is currently pending RBI approval. ICRA expects incremental capital requirement in the range of Rs. 30-50 crore (excluding Rs. 45 crore raised in Q1 FY2020) to achieve a CAGR of 40-45% over the FY2020-2022 period, assuming an internal generation of 12% and capping the adjusted gearing at about 5.0 times.

Reasonable improvement in asset quality - Dvara KGFS' asset quality improved with 30+ and 90+ reducing to 4.0% and 2.2% as of June 2019 (5.3% and 2.9% as of March 2019) from 6.4% and 5.5% as of March 2018, supported by a strong collection efficiency (about 99% in FY2019 in line with previous year), despite the impact of the Gaja cyclone, and partly due to a write-off in the Orissa portfolio (about Rs. 20 crore which was fully provided for in the prior years). While the collection efficiency was briefly affected during Nov-Dec 2018 in a few districts in Tamil Nadu due to the impact of the Gaja cyclone, it recovered subsequently. The company remains exposed to the unsecured nature of credit and the vulnerable customer segments, given that it predominantly targets remote rural areas where access to financial services through formal channels is limited. ICRA, however, derives comfort from the strengthening internal controls and conservative provision policy, with 100% provisioning once the loan crosses 90+ dpd. Given the expansion plans, it would be critical to maintain a tight control over slippages going forward.

Dvara KGFS conducts credit bureau checks through High Mark/CIBIL, captures the borrower indebtedness at a household level and undertakes residential verification for all the loan applications. A third-party vendor verification is done prior to the loan sanction and disbursement. The company has been strengthening its credit team for the non-joint liability group (JLG) loans, particularly the medium enterprise loan (MEL), where it intends to scale up its presence gradually over the next few years. The company uses IT systems (Perdix) developed by Dvara Solutions Private Limited (DSPL), including customer service workflows and loan management systems (LMS) and also supports audit and business intelligence tools. It also has an analytical team, which regularly monitors the underlying portfolio behaviour and provides early warning signals. Its internal audit team conducts snap audits for all the branches thrice a year, and the scope of audit coverage has enhanced in the recent years. The audit team also carries out compulsory loan utilisation checks for the MEL segment, and on a sample basis, for the JLG loans.

Credit challenges

Moderate scale of operations with concentration risks – Dvara KGFS' AUM grew by 17% YoY to Rs. 679.7 crore as of March 2019, driven by customer addition, particularly in new geographies (primarily Karnataka and Orissa). The active member base increased by 13% YoY to 3 lakh as of March 2019. Supported by the acquisition of branch network of Varam Capital Private Limited in April 2019, the company's AUM increased to Rs. 805 crore as of June 2019. The share of

TN in the total portfolio reduced from 93% as of March 2018 to 87% as of June 2019, which remains high. The company is taking measures to reduce the concentration risks by opening new branches in Jharkhand and expanding operations in Karnataka, Orissa and Chhattisgarh during FY2020. Product-wise, the joint liability loans (non-qualifying), small business loans, personal loans and other loans accounted for 94%, 2%, 2% and 2% respectively, as of June 2019. It intends to reduce the share of JLG loans below 80% by March 2020. Going forward, the company intends to grow at a CAGR of 40-45% over the FY2020-2022 period. The share of the BC book is expected to be in the range of 15-20%. The company's ability to diversify its portfolio geographically and across various product segments would remain the key monitorables.

Scope to improve profitability – The company's profitability (PBT/AMA) stood at 2.4% as of March 2019 vis-à-vis 2.0% in March 2018 - at 1.3% in Q1 FY2020. The improvement in profitability during FY2019 was because of higher net margins (9.6% as of March 2019 vis-à-vis 7.9% as of March 2018) on the back of a reduction in gearing levels. The company's credit cost stood at 1.1% in FY2019 (0.7% in FY2018) due to its conservative provisioning policy. The operating costs are expected to remain elevated, given the significant branch expansion (planned addition in FY2020 likely to be about 25-30% of existing network). Therefore, it would be crucial for the company to improve business volumes and augment fee-income while maintaining a tight control over credit costs to improve its profitability.

Diversified funding profile likely to support growth plans –Dvara KGFS's borrowings include term loans from non-banking finance companies (NBFC)/financial institutions (FI) comprising 58% of the total borrowings followed by term loan from banks (30%) and NCDs (7%) and the sell-down (4%) as of March 2019. Given the tight availability of funds from banks, especially for the NBFCs, the company's ability to secure funding lines in a timely manner and at competitive rates would be crucial from an earnings and liquidity perspective.

Liquidity position

Dvara KGFS's asset-liability maturity (ALM) profile as of March 2019, reflects no cumulative mismatches in the <1-year bucket, supported by the short-term nature of its loans. As per the structural liquidity statement of March 2019, Dvara KGFS' cumulative positive mismatch in the <1 bucket was positive at Rs. 183 crore. It had undrawn sanctions from banks and NBFCs of about Rs.10.00 crore as of June 2019. The active funding relationship with more than 15 banks and FIs, however, provides some comfort from a liquidity perspective. Diversification of the funding profile is crucial in view of the envisaged growth plans.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA's Credit Rating Methodology for Non-Banking Finance Companies
Parent/Group Support	Not applicable
Consolidation/Standalone	The rating is based on the standalone financial statements of the issuer

About the company

Dvara Kshetriya Gramin Financial Services Private Limited is a systemically important non-deposit taking non-banking finance company (NBFC-ND-SI) providing financial services in remote and rural areas. Besides loan origination, the company carries out business correspondent activity for two banks and an NBFC operating across five states (Tamil Nadu, Orissa, Uttarakhand, Karnataka and Chhattisgarh) with 258 branches as of June 2019. Dvara Trust, Accion Africa, Leapfrog Financial Inclusion India Ltd and Skateboat Capital held stakes of 37%, 25%, 30% and 8% respectively as of June 2019, on a diluted basis.

Till recently, Dvara KGFS was a wholly-owned subsidiary of IFMR Rural Channel Services Private Limited (IRCS), which in turn was a wholly-owned subsidiary of IFMR Holdings Limited (IHL). Following a board-approved scheme of arrangement and amalgamation of Dvara KGFS with IRCS, IHL and Dvara Solutions Private Limited(DSPL); IRCS' branch infrastructure, BC and wealth management services were transferred to Dvara KGFS while the technology solutions of IHL were amalgamated into DSPL; the scheme was effective from March 21, 2019. Post the reorganisation, the shareholders of IHL became direct shareholders of Dvara KGFS and DSPL, the two resultant entities of the scheme, while IHL and IRCS no longer exist.

Dvara KGFS reported a net profit of Rs. 33.2 crore in FY2019 on a total asset base of Rs. 836.9 crore compared with a net profit of Rs. 9.1 crore on a managed asset base of Rs. 742.9 crore in FY2018.

Key financial indicators (Audited)

IRCS (Consolidated)	FY2018	FY2019
	IGAAP	IGAAP
Total Income	123.5	162.1
Profit after Tax	9.1	33.2
Net Worth	87.2	168.1
AUM	582.9	679.7
Total Managed Assets ⁴	742.9	836.9
RoMA	1.4%^	4.2%^
Return on Net Worth	10.8%	26.0%
Adjusted Gearing	7.0	3.5
Gross NPA%	0.1%	2.0%
Net NPA%	0.0%	0.0%
CAR % [#]	18.4%	24.1%

Amount in Rs. crore; ^PBT/AMA stood at 2.0% in FY2018 and 2.4% in FY2019

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

⁴ Total assets + loans originated for its DO partner

Rating history for last three years

S. No	Instrument	Type	Rated Amount (Rs. crore)	Amount Outstanding (Rs. crore)	Current Rating (FY2020) August 2019	Chronology of Rating History for the Past 3 Years		
						FY2019	FY2018	FY2017
						Dec 2018	Sept 2017	June 2016
1	Fund-based Term Loans	Long Term	200.00	200.00	[ICRA]BBB (stable)	[ICRA]BBB- (stable)	[ICRA]BBB- (stable)	[ICRA]BBB- (stable)
2	Subordinated Debt	Long Term	30.00	30.00	[ICRA]BBB (stable)	[ICRA]BBB- (stable)	[ICRA]BBB- (stable)	[ICRA]BBB- (stable)

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

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance /Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan 1		NA		36.83	[ICRA]BBB (Stable)
NA	Term Loan 2		NA		17.77	[ICRA]BBB (Stable)
NA	Term Loan 3		NA		1.25	[ICRA]BBB (Stable)
NA	Term Loan 4		NA		8.00	[ICRA]BBB (Stable)
NA	Term Loan 5		NA		3	[ICRA]BBB (Stable)
NA	Term Loan 6		NA		10	[ICRA]BBB (Stable)
NA	Term Loan 7		NA		24.86	[ICRA]BBB (Stable)
NA	Term Loan 8	16-Feb-18 to 24-Apr-19	NA	24-Jan-20 to 17-May-24	13.79	[ICRA]BBB (Stable)
NA	Term Loan 9		NA		7.57	[ICRA]BBB (Stable)
NA	Term Loan 10		NA		17.39	[ICRA]BBB (Stable)
NA	Term Loan 11		NA		39	[ICRA]BBB (Stable)
NA	Term Loan 12		NA		0.41	[ICRA]BBB (Stable)
NA	Term Loan 13		NA		3.06	[ICRA]BBB (Stable)
NA	Term Loan 14		NA		1.75	[ICRA]BBB (Stable)
Unutilised	Term Loan		NA		15.32	[ICRA]BBB (Stable)
INE179P08017	Subordinated Debt	29-Jun-16	15.80%	29-Jun-22	18	[ICRA]BBB (Stable)
INE179P08025	Subordinated Debt	28-Jul-16	15.80%	28-Jul-22	12	[ICRA]BBB (Stable)

Source: Dvara KGFS

Annexure-2: List of entities considered for consolidated analysis: Not applicable

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