

December 16, 2019

## Karvy Financial Services Limited: Ratings downgraded

### Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Bank Lines (Basel II)	174.36	174.36	[ICRA]B- (negative); downgraded from [ICRA]BBB (stable)
Sub Debt Programme	30.00	30.00	[ICRA]B- (negative); downgraded from [ICRA]BBB (stable)
<b>Total</b>	<b>204.36</b>	<b>204.36</b>	

\*Instrument details are provided in Annexure-1

### Rationale

The rating factors in the prior lending experience of Karvy Financial Services Limited (KFSL). The rating is, however, constrained by a default on a debt by the parent company, the limited track record of KFSL's new lending operations, and its high operational and infrastructure building cost that exerts pressure on its earnings profile. ICRA also takes note of the high exposure, in terms of intercorporate deposits (ICDs) of Rs. 306.90 crore given to Group companies which were rated below investment grade in November 2019.

The ability to diversify its funding profile to maintain good liquidity, improve the profitability and keep the asset quality and capital structure under control as the business expands would be critical from a rating perspective.

### Key rating drivers and their description

#### Credit strengths

#### Credit challenges

**Default by parent company posing funding and capital-raising challenges** – ICRA notes the default by the parent entity, Karvy Stock Broking Limited (KSBL; rated [ICRA]D ISSUER NOT COOPERATING), on its commercial paper obligations. KFSL shares the same brand name and common directors with the parent entity, which would negatively impact its future fund-raising drives in the financial services domain. Without any capital infusion and given the dearth of funding avenues, KFSL's business plans would be severely impacted. ICRA also notes that KFSL has given ICDs of Rs. 112 crore to KSBL and Karvy Data Management Services Limited (KDMSL), which have witnessed a significant deterioration in their financial profiles in the past 12 months. The total stressed exposure amounted to 75% of the total net worth as of September 2019.

**Rebuilding the infrastructure post sale of substantial assets in NBFC business** – KFSL sold Rs. 816 crore of its loan assets to Small Business Fincredit India Private Limited (SBFC). With the completion of the transaction in September 2017, the entire infrastructure (77 branches along with the entire team) has shifted to SBFC. KFSL will have to rebuild the team and set up the entire branch network as it plans to start the lending business again. In FY2019, the company set up a new corporate office, a central processing facility and it hired a team of over 150 personnel. Though KFSL commenced disbursements in December 2018, it had disbursed only Rs. ~35.43 crore till September 30, 2019 (Rs. 11.32 crore in

FY2019 and Rs. 24.12 crore in H1 FY2020). As of September 30, 2019, the bulk of KFSL's lending (Rs. 307 crore i.e. ~74% of the total loan book of ~Rs. 414 crore) was to Karvy Group companies which were rated below investment grade in November 2019 (except Karvy Holdings Limited which is not rated).

**High leverage at Group level to support subsidiaries** – Gearing, at 2.63 times (as on September 30, 2018), was high on a consolidated basis for the broker – KSBL<sup>1</sup>. This was on account of the high level of borrowings to support KDMSL and its subsidiaries as most of KSBL's subsidiaries are in the early stages of operations. ICRA notes the reduction in KFSL's debt (~Rs. 104 crore as of September 30, 2019 vs ~Rs. 1,464 crore in March 2017) as it sold its MSME and SME loan book to SBFC.

### Liquidity position: Adequate

The company management has mentioned that they expect cash inflows of Rs. 59 crore to Rs. 61 crore from sale of SRs investments against which it has payment obligations of Rs. 19 crore till March 2020.

### Rating sensitivities

**Positive triggers** – The outlook may be revised to Stable if KFSL reduces its exposure towards Group companies or if there is an improvement in the parent's credit profile and in KFSL's ability to grow at a steady pace and increase its scale of operations.

**Negative triggers** – Delay in debt servicing would lead to a rating downgrade.

### Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	<a href="#">Rating Methodology for Non-Banking Finance Companies</a>
Parent/Group Support	Rated on standalone operations
Consolidation/Standalone	The rating is based on the standalone financial statements of the company

### About the company

Karvy Financial Services Limited is a fully-owned subsidiary of Karvy Stock Broking Limited (KSBL), directly and through other Group companies. It received its NBFC licence in Q1 FY2010. During the initial phase of operations, the company had a significant exposure to capital markets through products such as loans against shares and commodities, and margin funding, which was largely done in conjunction with the broking and commodities arms of the Group. In FY2017, the company sold a substantial part of its assets to SBFC and transferred most of its employees and the entire branch network and infrastructure facilities to the latter.

During the FY2019, the company set up a new office, a central processing facility as well as a new team and commenced disbursements in December 2018.

<sup>1</sup> recent group / KSBL consolidated level updates are not available

KFSL reported a net profit of Rs. 3.48 crore on a total asset base of Rs. 556.51 crore as on March 31, 2019 compared to net profit of Rs. 11.76 crore on a total asset base of Rs. 661.97 crore in FY2018. In H1 FY2020, the company reported a net profit of Rs. 0.67 crore on a total asset of Rs. 549.29 crore.

### Key financial indicators – (Standalone)

Parameters	31-Mar-18	31-Mar-19	30-Sep-19 (Provisional)
Interest Income	141.77	51.36	22.35
Interest Expense	111.96	20.28	7.13
Net Interest Income	29.82	31.08	15.22
Operating Income	35.33	73.30	23.73
Operating Expense	56.48	27.20	14.70
Operating Profit	-21.15	46.10	9.03
Provisions-Credit	220.61	41.73	7.36
Profit before Tax (PBT)	20.18	5.49	2.03
Profit after Tax (PAT)	11.76	3.48	0.67
Total Assets	661.97	556.51	549.29
Net Worth	406.70	410.18	410.86

*Amount in Rs. crore*

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

**Any other information: None**

## Rating history for last three years

Instrument	Current Rating (FY2020)				Chronology of Rating History for the Past 3 Years				
	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	FY2020	FY2019	FY2018	FY2018	FY2017	
				16-Dec-19	08-Mar-19	21-Feb-18	23-Oct-17	19-Dec-16	
1 Subordinated Debt Programme	Long Term	30	NA	[ICRA]B- (negative) downgrade d from [ICRA]BBB (stable)	[ICRA]BBB (Stable); reassigne d	Provisional [ICRA] A+ (SO) confirmed as final	Provisional [ICRA] A+ (SO) (stable); reassigned from [ICRA]A (Watch with Developing Implications )	[ICRA]A; placed on Watch with Developing Implications	
2 Long-term Bank Lines	Long Term	174.36	NA	[ICRA]B- (negative) downgrade d from [ICRA]BBB (stable)	[ICRA]BBB (Stable); reassigne d	[ICRA]A+ (SO) (stable)	[ICRA] A+ (SO) (stable), Reaffirmed	[ICRA]A+ (SO) (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](http://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	Long-term Bank Lines	Apr-14	NA	Oct-20	174.36	[ICRA]B- (negative)
INE308L08011	Subordinated Debt Programme	12-Feb-15	15.60%	11-May-20	30.00	[ICRA]B- (negative)

Source: Karvy Financial Services Limited

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

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