

## Dvara Kshetriya Gramin Financial Services Private Limited

December 31, 2018

### Dvara Kshetriya Gramin Financial Services Private Limited: Rating reaffirmed

#### 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); reaffirmed
Subordinated Debt	30.00	30.00	[ICRA]BBB-(Stable); reaffirmed
Non-convertible Debentures (NCD)	8.00	-	[ICRA]BBB-(Stable); withdrawn
	5.58	-	
<b>Total</b>	<b>243.58</b>	<b>208.58</b>	

*Instrument details are provided in Annexure-1*

#### Rationale

ICRA has withdrawn the [ICRA]BBB- (pronounced triple B minus) rating with the Stable outlook on the Rs. 8.00-crore NCD programme, at the request of the company, as it was not issued and there is no amount outstanding on the rated instrument. ICRA has also withdrawn the [ICRA]BBB-(Stable) rating for the Rs. 5.58-crore NCD programme, at the request of the company, as the debentures were redeemed fully on maturity.

ICRA has taken a consolidated view of Dvara Kshetriya Gramin Financial Services Private Limited (Dvara KGFS; formerly Pudhuaru Financial Services Private Limited) and its parent company, IFMR Rural Channels and Services Private Limited (IRCS; has a 100% stake in Dvara KGFS) while assigning the ratings, given the significant operational and business interlinkages between the entities. Henceforth, these two entities are together referred to as the IRCS Group or the Group.

The rating reaffirmation factors in the Group's experienced senior management team and the adequate capitalisation with adjusted gearing<sup>1</sup> of 4.8x as on September 30, 2018 supported by capital infusion of Rs. 30 crore in H1 FY2019. The rating also considers the improvement in the net profitability with PAT/AMA<sup>2</sup> increasing to 1.4% in FY2018 and further to 2.7% in H1 FY2019 from 0.3% in FY2017, supported by business growth and better operating efficiencies. ICRA takes notes of the ongoing Group-level business reorganisation, whereby IRCS's branch infrastructure, business correspondent (BC) and wealth management services (insurance agency and NPS distribution business) would be transferred to Dvara KGFS, which currently focuses on the lending and distribution of liability products. The reorganisation also involves changes in the holding structure of the IRCS Group. Some of the required approvals for the overall reorganisation are currently pending, including approval from the National Company Law Tribunal (NCLT).

The rating, however, considers the moderate scale of operations (consolidated assets under management (AUM)<sup>3</sup> of Rs. 681 crore as on September 30, 2018) with regional concentration, the risks emanating from the modest credit profile of the borrower segments and the significant share of unsecured loans. The Group intends to expand its presence to 10 states (from four at present) over a five-year period (FY2019-FY2023) and grow AUM at a compounded annual growth rate (CAGR) of 30% to about Rs. 2,200 crore. The Group's ability to improve the business volumes and operating

<sup>1</sup> Total debt/(net worth-FLDG on direct originations (DO) for a partner)

<sup>2</sup> Profit after tax/average managed assets

<sup>3</sup> IRCS's AUM include its own book (Dvara KGFS's portfolio) as well as loans originated for its DO partner through the KGFS units

efficiency, secure funds at competitive rates, and control its credit costs while maintaining a comfortable capital structure would be crucial, going forward. This will remain a key rating sensitivity.

## Outlook: Stable

ICRA believes that the IRCS Group will continue to benefit from the experienced management team and its risk management systems which should support business growth. The outlook may be revised to Positive if the overall financial risk profile remains comfortable as the business expands and if the company is able to maintain the asset quality. The outlook may be revised to Negative if there is a significant weakening in the company's profitability or asset quality or if there is a significant deterioration in its capital structure.

## Key rating drivers

### Credit strengths

**Experienced senior management team and commensurate internal controls systems** – The IRCS Group has an experienced management team, which is adequate for its current scale of operations. The senior management team, headed by Mr. LVLN Murthy (Chief Business Officer), has vast experience in the retail lending business. The Group commenced rural financing operations in FY2008 and currently operates 207 branches across five KGFS<sup>4</sup> in India with a AUM of Rs. 681 crore as on September 30, 2018. IRCS's board consists of three members, including a representative from Dvara Trust. Given its significant growth plans, the Group would have to augment its senior management team going forward.

The Group has commensurate loan origination, appraisal and technology systems. At the branch level, IRCS has wealth managers, credit and collection personnel. The wealth managers gather basic customer information including KYC and household income details during the enrolment process for its loan products. It conducts credit bureau checks through High Mark and Equifax, and the decision to sanction the loan is delegated to the appropriate authority based on the loan product and ticket size. The company has an adequate internal audit team, which audits the branches thrice a year. The scope of the internal audit team includes loan monitoring, field visits and cash verification among others. The Group uses the IT systems developed by an associate company and the branch data is updated at the Head Office on a real-time basis.

**Adequate capital profile; regular equity infusion essential for achieving long-term growth plans** – IRCS's consolidated capital profile is characterised by adjusted gearing of 4.8 times as on September 30, 2018, supported by a capital infusion of Rs. 30 crore in H1 FY2019. Given the envisaged AUM growth (30% during FY2019-FY2023), ICRA expects incremental capital requirement in the range of Rs. 120-140 crore over the same period (excluding the Rs. 30 crore raised recently), assuming internal generation of 12-14% and gearing at a maximum of about 5 times. Timely capital infusion would be critical to maintain a prudent capitalisation profile, going forward.

**Improvement in profitability** – The Group's net profitability (PAT/AMA) improved to 1.4% in FY2018 from 0.3% in FY2017, supported by the improvement in the business scale and operating efficiencies. Net profitability stood at 2.7% in H1 FY2019 (provisional). The consolidation of some of its branch operations in Tamil Nadu over the past two years led to a decline in the branch network to 207 as of September 2018 from 258 as of March 2016. Consequently, the Group's operating cost/AMA declined to 6.7% in FY2018 from 7.5% in FY2017 and stood at 6.5% in H1 FY2019. The Group's ability

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<sup>4</sup> KGFS - Kshetriya Gramin Financial Services is a local financial institution offering financial products and services in a specific geographic area, catering to the financial needs of the local population

to increase business volumes, particularly in new geographies, and improve the operating efficiency while controlling the credit costs would be crucial going forward.

## Credit challenges

**Moderate scale of operations with concentration risks** – The Group’s scale remained moderate with a AUM of Rs. 582.9 crore as on March 31, 2018. The AUM stood at Rs. 681 crore as on September 30, 2018. It grew by a strong 33% in FY2018 aided by disbursement growth of 28%. As on March 31, 2018, joint liability loans (non-qualifying), small business loans, personal and other loans accounted for 92%, 4%, 3% and 1%, respectively, of the Group’s total AUM. Further, Tamil Nadu accounted for 92% of the overall AUM as on September 30, 2018, thereby exposing the Group to concentration risks. During the current fiscal, the Group opened two new KGFS, one each in Karnataka and Odisha, and intends to set up a new KGFS (Jharkhand) by March 2019, which would alleviate the concentration risks to an extent. Overall, the Group is targeting a total of 11 KGFS across 10 states in India and is looking to achieve AUM growth at a CAGR of 30% during FY2019-FY2023. The Group’s ability to expand in these new states and penetrate further in existing geographies remains critical for achieving the targeted expansion over the medium to long term.

**Modest credit profile of target borrower segments** – The IRCS Group remains exposed to vulnerable customer segments and the unsecured nature of credit. The Group predominantly targets remote rural areas where access to financial services through formal channels is limited. The Group’s asset quality is characterised by a 90+dpd of 5.5% (including overdues in the BC portfolio that are fully provided for) as on March 31, 2018 compared to 6.8% as on March 31, 2017. The 90+ stood at 4.8% as in September 30, 2018. The Group suspended operations in Dhanei KGFS (Odisha) while it is merging some of its branches in Sahastradhara KGFS (Uttarakhand), which faced asset quality issues in the past. These two KGFSs constituted 5.5% of the overall AUM as of September 2018. On a cumulative basis, IRCS had created provisions of about Rs. 24 crore during FY2016-FY2018 to compensate its partners, including Dvara KGFS. Adjusting for these provisions, the 90+ dpd stood at 1% as on March 31, 2018. Given the steep expansion plans, the ability to contain slippages at reasonable levels would be critical going forward.

**Ability to diversify funding profile to support growth plans** – Dvara KGFS’s borrowings include term loans from non-banking finance companies (NBFCs)/financial institutions (65% of the funding as on June 30, 2018), term loans from banks (24%), NCDs (7%) and others (4%). Going forward, the Group’s ability to diversify its lender base and secure funding at competitive rates is crucial from an earnings and liquidity perspective.

## Liquidity position

Dvara KGFS’s asset-liability maturity (ALM) profile reflects no cumulative mismatches in the <1-year bucket, supported by the short-term nature of its loans. As on September 30, 2018, Dvara KGFS had cash of Rs. 38 crore and its inflow from advance repayments is expected to be Rs. 249 crore for the six-month period of October 2018 to March 2019, while debt repayments are expected to be Rs. 154 crore. The Group’s ability to tap incremental funding is key for meeting its disbursement targets.

## Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	<a href="#">ICRA’s Credit Rating Methodology for Non-Banking Finance Companies</a>
Parent/Group Support	Not applicable
Consolidation/Standalone	The rating is based on the consolidated financial statements of IRCS, given the significant operational and business interlinkages between IRCS and Dvara KGFS

## About the company

### Dvara Kshetriya Gramin Financial Services Private Limited

Dvara Kshetriya Gramin Financial Services Private Limited is a systemically important non-deposit taking non-banking finance company (ND-NBFC) providing financial services in remote and rural areas. It is a 100% subsidiary of IRCS. The company was operational only in Tamil Nadu before acquiring the portfolios of two other KGFS entities in Uttarakhand (Sahastradhara KGFS) and Odisha (Dhanei KGFS) in FY2012. The branch infrastructure and operations are fully owned and managed by IRCS, which originates loan assets for Dvara KGFS on the payment of a fee.

In January 2018, IRCS's board approved a scheme of arrangement and amalgamation with Dvara KGFS, IFMR Holdings Private Limited (IFMR Holdings; has a 100% stake in IRCS), and an associate entity, Dvara Solutions Private Limited (Dvara Solutions). As per the scheme, IRCS's branch infrastructure, BC and wealth management services (insurance agency and NPS distribution) would be transferred to Dvara KGFS while the technology solutions of IFMR Holdings would be amalgamated into Dvara Solutions. The shareholders of IFMR Holdings would become direct shareholders of Dvara KGFS and Dvara Solutions, the two resultant entities of the scheme, while IFMR Holdings and IRCS would cease to exist. The scheme, which will be effective from April 1, 2017, is expected to be completed by Q1 FY2020. The reorganisation is currently pending various approvals, including NCLT approval.

Post the reorganisation, Dvara Trust would have a 45% stake in Dvara KGFS while Accion International and Leapfrog Financial Inclusion India II Limited would hold about 33% and 22%, respectively. Further, the flagship entity of IFMR Holdings, Northern Arc Capital Limited (NACL; rebranded from IFMR Capital and rated [ICRA]A+(Stable)/[ICRA]A(Stable)/[ICRA]A1+), would have some common shareholders (as that of Dvara KGFS) with Dvara Trust having a 17% stake in NACL, while Leapfrog and Accion would hold 43% and 15%, respectively. The rest would be held by other shareholders.

In FY2018, Dvara KGFS reported a net profit of Rs. 9.2 crore on a managed asset base of Rs. 525.6 crore compared with a net profit of Rs. 2.3 crore on a managed asset base of Rs. 309.6 crore in FY2017.

### IFMR Rural Channels and Services Private Limited

IRCS was incorporated in August 2011. It operates through the KGFS model and provides various financial products and services in rural areas with a network of 207 branches as on September 30, 2018. The company operates five KGFS in four states (Tamil Nadu, Odisha, Uttarakhand and Karnataka). It originates loans for Dvara KGFS and a bank.

In FY2018, IRCS reported a consolidated net profit of Rs. 9.1 crore on a managed asset base of Rs. 582.9 crore compared with a net profit of Rs. 1.6 crore on a managed asset base of Rs. 438.6 crore in FY2017.

## Key financial indicators (Audited)

IRCS (Consolidated)	FY2017	FY2018
	IGAAP	IGAAP
Total Income	84.9	123.5
Profit after Tax	1.6	9.1
Net Worth	80.9	87.2
AUM	438.6	582.9
Total Managed Assets <sup>5</sup>	589.9	742.9
RoMA	0.3%	1.4%
Return on Net Worth	2.2%	10.8%
Gearing	4.4	6.7 ^
Gross NPA% #	0.4%	0.1%
Net NPA% #	0.2%	0.0%
CAR % #	30.6%	18.4%

Amount in Rs. crore; # Pertains to Dvara KGFS

^ Gearing stood at 4.7 times as on Sep 30, 2018 following the equity infusion of Rs.30 crore in H1FY2019

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

## Any other information: None

## Rating history for last three years

S. No	Instrument	Type	Rated Amount (Rs. crore)	Amount Outstanding (Rs. crore)	Current Rating (FY2019)	Chronology of Rating History for the Past 3 Years		
						FY2018	FY2017	FY2016
						Sep 2017	June 2016	Aug 2015
1	Fund-based Term Loans	Long Term	200.00	200.00	[ICRA] BBB-(stable)	[ICRA] BBB-(stable)	[ICRA] BBB-(stable)	[ICRA] BBB-(stable)
2	NCD	Long Term	13.58	-	[ICRA] BBB-(stable); withdrawn	[ICRA] BBB-(stable)	[ICRA] BBB-(stable)	-
3	Subordinated Debt	Long Term	30.00	30.00	[ICRA] BBB-(stable)	[ICRA] BBB-(stable)	[ICRA] BBB-(stable)	-

<sup>5</sup> Total assets + loans originated for its DO partner

## 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		Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
		/Sanction	Coupon Rate			
NA	Term Loan 1		NA		56.33	[ICRA]BBB- (Stable)
NA	Term Loan 2		NA		27.79	[ICRA]BBB- (Stable)
NA	Term Loan 3	6-Mar-2017	NA	10-Mar-2021	2.50	[ICRA]BBB- (Stable)
NA	Term Loan 4	to 28-Mar-	NA	to 28-Feb-	19.33	[ICRA]BBB- (Stable)
NA	Term Loan 5	2018	NA	2021	4.00	[ICRA]BBB- (Stable)
NA	Term Loan 6		NA		15.00	[ICRA]BBB- (Stable)
NA	Term Loan 7		NA		20.00	[ICRA]BBB- (Stable)
Unutilised	Term Loan	NA	NA	NA	55.05	[ICRA]BBB- (Stable)
INE179P07019	NCD	28-Jun-13	14.58%	5-May-18	5.58	[ICRA]BBB- (Stable); withdrawn
Unutilised	NCD	-	-	-	8.00	[ICRA]BBB- (Stable); withdrawn
INE179P08017	Subordinated Debt	29-Jun-16	15.80%	29-Jun-22	18.00	[ICRA]BBB- (Stable)
INE179P08025	Subordinated Debt	28-Jul-16	15.80%	28-Jul-22	12.00	[ICRA]BBB- (Stable)

Source: Dvara KGFS

## Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
IFMR Rural Channels and Services Private Limited*	-	Full Consolidation

\*Holds a 100% stake in Dvara KGFS

## ANALYST CONTACTS

**Karthik Srinivasan**

+91-22-6114 3444

[karthiks@icraindia.com](mailto:karthiks@icraindia.com)

**A M Karthik**

+91-44-4596 4308

[a.karthik@icraindia.com](mailto:a.karthik@icraindia.com)

**Govindaraj Prabhu M**

+91-44-4596 4306

[govindaraj.m@icraindia.com](mailto:govindaraj.m@icraindia.com)

**Meenakshi D**

+91-44-4297 4324

[meenakshi.d@icraindia.com](mailto:meenakshi.d@icraindia.com)

## RELATIONSHIP CONTACT

**Mr. Jayanta Chatterjee**

+91 80 43326401

[jayantac@icraindia.com](mailto:jayantac@icraindia.com)

## MEDIA AND PUBLIC RELATIONS CONTACT

**Ms. Naznin Prodhani**

Tel: +91 124 4545 860

[communications@icraindia.com](mailto:communications@icraindia.com)

## Helpline for business queries:

+91- 124- 2866928 (open Monday to Friday, from 9:30 am to 6 pm)

[info@icraindia.com](mailto:info@icraindia.com)

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## ICRA Limited

### Corporate Office

Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002

Tel: +91 124 4545300

Email: [info@icraindia.com](mailto:info@icraindia.com)

Website: [www.icra.in](http://www.icra.in)

### Registered Office

1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001

Tel: +91 11 23357940-50

### Branches

Mumbai + (91 22) 24331046/53/62/74/86/87  
Chennai + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,  
Kolkata + (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,  
Bangalore + (91 80) 2559 7401/4049  
Ahmedabad+ (91 79) 2658 4924/5049/2008  
Hyderabad + (91 40) 2373 5061/7251  
Pune + (91 20) 020 6606 9999

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