

**Varam Capital Private Limited**

May 17, 2017

ICRA assigns a rating of [ICRA]BB (stable) to the bank lines of Varam Capital Private Limited**Summary of rated instruments**

Instrument*	Rated Amount (Rs. crore)¹	Rating Action
Term loans	100.00	[ICRA]BB(stable); assigned
Total	100.00	

*Instruments details are provided in Annexure-1

Rating action

ICRA has assigned an [ICRA]BB (pronounced ICRA double B)² rating with stable outlook to the Rs.100.00 crore long term bank facilities of Varam Capital Private Limited (Varam).

Detailed rationale

The rating takes into consideration the company's relatively small scale of operations with high concentration risk; its moderate capitalisation profile; deterioration in asset quality during FY2017 because of operational lapses in a few branches during H1FY2017, and to some extent, because of demonetisation; and its modest profitability indicators. The rating however takes note of the experience of the senior management team in their respective functional domains and the various initiatives taken by the company to strengthen its IT, credit processes and risk management systems over the recent past. The strengthening of systems is expected to result in improved operating efficiency as business scale improves and also provide better management controls. The rating also takes cognisance of the risks associated with the unsecured nature of the company's loans, its marginal borrower profile and other socio-political and operational risks inherent in the microfinance business.

The company's asset quality has deteriorated with portfolio at risk (90+ dpd³ on the total managed book) increasing from 1.0% as on March 31, 2016 to 5.9% as on September 30, 2016 and further to 7.1% as on March 31, 2017, on account of some operational lapses in its credit appraisal, collections and other internal processes and to an extent because of demonetization during H2FY2017. The 90+dpd is quite sizeable in relation to Varam's network. It is therefore essential for the company to raise equity and improve its capitalisation levels in the near term to support its overall credit risk profile. Going forward, the company's ability to grow and diversify its portfolio and improve its asset quality and profitability metrics will be other key rating sensitivities.

Key rating drivers**Credit strengths**

- Experienced senior management team
- Initiatives underway to augment IT, internal controls, MIS and audit processes
- Ongoing investments in digital infrastructure likely to support credit and risk management processes and, improve operational efficiency

¹ Rs. 1 crore = Rs. 10 million = Rs. 100 lakh

² For complete rating scale and definitions, please refer to ICRA's website (www.icra.in) or other ICRA rating publications.

³ 90+ dpd includes overdue portfolio moved to a separate trust for recovery



Credit challenges

- Small size with geographical concentration risk; 92% of gross loan portfolio as on February 28, 2017 in Tamil Nadu
- Weak profitability
- Moderation in asset quality metrics; ability to strengthen internal controls and improve collection efficiency remains critical going forward
- Leveraged capital structure; timely equity infusion critical in the near term
- To achieve diversity in funding profile; however, the present funding mix is adequate given the current scale of operations

Detailed description of key rating drivers:

Varam provides microfinance loans to women through the joint liability group (JLG) lending model. The company has an experienced management team with good knowledge of microfinance operations. The promoters managed self-help groups through their associate entity, Sornammal Education Trust (SET) from 1996, before commencing operations in Varam in 2011.

Varam's managed assets grew from Rs.10.2 crore as on March 31, 2014 to Rs. 107.6 crore as on March 31, 2017, aided by branch expansion and new member additions. The company has high concentration risks with Tamil Nadu accounting for 92% of the total portfolio (although moderated from 98% in previous fiscal) and the rest being in Chhattisgarh. This exposes the company to geographical concentration risk which could accentuate other risks inherent to the microfinance industry.

Varam has reported low profitability over the past three financial years (profit after tax/average managed assets stood at less than 1%) on account of its high setup costs and moderate interest margin. ICRA expects the company's profitability to remain subdued on account of the expected high credit costs.

The company's asset quality has deteriorated with its 90+dpd increasing from 1% as on March 31, 2016 to 5.9% as on September 30, 2016 and further to 7.1% as on March 31, 2017. The decline in asset quality was primarily on account of operational lapses of earlier years which were identified in H1FY2017, and recovery process initiated. Recoveries were impacted to an extent by demonetisation, which resulted in overdues remaining high. The company has been steadily investing in IT infrastructure over the past year to improve its loan appraisal, disbursal, and collection monitoring systems. The company's ability to strengthen its internal systems, improve collections and asset quality, even as the business expands, would be critical going forward.

The company's managed gearing improved to 5.1x as on December 31, 2016, from 8.5x as on March 31, 2016, on account of a moderation in the portfolio in recent months. The gearing is, however, likely to increase given the company's branch expansion and growth plans. The company is expected to raise fresh capital of Rs.20.00 crore in the near term, which would support its credit profile given the increase in delinquencies. Over the next two years (FY2018-2020), the company intends to grow its portfolio at a CAGR of 70-75%, which would require periodic equity infusion to maintain prudent capitalization levels.

ICRA takes note of the company's current funding profile which predominantly consists of term loans from banks and financial institutions; it is, therefore, critical for the company to diversify its funding resources and secure borrowings at competitive rates to support margin expansion.

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](#)

About the company

Promoted by Ms. Hemalatha Pandiarajan, Varam Capital Private Limited (erstwhile Karpaga Ganapathi Capital Private Limited) is a registered NBFC, engaged in providing microfinance loans under the JLG lending model. The company operates in two states, Tamil Nadu and Chhattisgarh. It had 20 branches, 184 employees and a managed portfolio of Rs.100.6 crore as on December 31, 2016.

As per the provisional financials for 9MFY2017, Varam reported a net profit of Rs. 0.1 crore on a total managed asset base of Rs. 100.6 crore. During FY2016, Varam reported a net profit of Rs. 0.5 crore on a total managed asset base of Rs. 125.3 crore vis-a-vis a net profit of Rs. 0.3 crore on a total managed asset base of Rs. 70.3 crore during FY2015.

Status of non-cooperation with previous CRA:

Credit Analysis and Research Limited has in its rationale published on Varam Capital Private Limited dated April 06, 2017, stated that the issuer is not cooperating to review the ratings.

Any other information: Not Applicable

Rating History for last three years:

Table: Rating History

S. No	Name of Instrument	Current Rating			Chronology of Rating History for the past 3 years		
		Type	Rated amount (Rs. crore)	April 2017	FY2016	FY2015	FY2014
1	Term loans – Bank	Long term	100.00	[ICRA]BB(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

Details of Instruments

Name of the Instrument	Date of Issuance	Coupon Rate %	Maturity Date	Size of the Issue (Rs. crore)	Current Rating and Outlook
Term loans	-	-	-	100.00	[ICRA]BB (Stable)

Source: Varam



Contact Details

Analyst Contacts

Mr. Rohit Inamdar

+91 124 4545 847

rohit.inamdar@icraindia.com

Mr. A M Karthik

+91 44 4596 4308

a.karthik@icraindia.com

Mr. Govindaraj Prabhu M

+91 44 4596 4306

govindaraj.m@icraindia.com

Relationship Contact

Mr. L. Shivakumar

+91 22 6114 3406

shivakumar@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; Fax: +91 124 4050424
Email: info@icraindia.com, Website: www.icra.in

REGISTERED OFFICE

1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50; Fax: +91 11 23357014

Branches: **Mumbai**: Tel.: + (91 22) 24331046/53/62/74/86/87, Fax: + (91 22) 2433 1390 **Chennai**: Tel + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294, Fax + (91 44) 2434 3663 **Kolkata**: Tel + (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008, Fax + (91 33) 2287 0728 **Bangalore**: Tel + (91 80) 2559 7401/4049 Fax + (91 80) 559 4065 **Ahmedabad**: Tel + (91 79) 2658 4924/5049/2008, Fax + (91 79) 2658 4924 **Hyderabad**: Tel +(91 40) 2373 5061/7251, Fax + (91 40) 2373 5152 **Pune**: Tel + (91 20) 2552 0194/95/96, Fax + (91 20) 553 9231

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