CARE Ratings
Professional Risk Opinion

CARE/CRO/RR/2018-19/1042

Mr. D. Arulmany
Managing Director and CEO
Veritas Finance Private Limited
SKCL Central Square 1, South Wing Unit # C28 - C35
CIPET Road, Thiru Vi Ka Industrial Estate, Guindy
Chennai– 600032.

May 31, 2018

Dear Sir,

Credit rating for Bank facilities and Non-convertible debenture issue

Please refer to our letters dated May 31, 2018 on the above subject.

2. The rationale for the rating is attached as an **Annexure-I**.

3. We request you to peruse the annexed document and offer your comments, if any. We are doing this as a matter of courtesy to our clients and with a view to ensure that no factual inaccuracies have inadvertently crept in. Kindly revert as early as possible. In any case, if we do not hear from you by June 01, 2018, we will proceed on the basis that you have no comments to offer.

If you have any further clarifications, you are welcome to approach us.

Thanking you,

Yours faithfully,

R. Ravishankar

Ravi Shankar R
Deputy Manager

Encl.: As above

Rating Rationale

Veritas Finance Private Limited

Ratings

Facilities	Amount (Rs. crore)	Ratings[1]	Rating Action
Non-convertible Debentures	150.00 (Rupees One Hundred and fifty crore)	**CARE BBB; Stable (Triple B; Outlook: Stable)**	**Revised from CARE BBB-;Stable (Triple B minus; Outlook:stable)**
Long-term Bank Facilities	100.00 (Rupees One hundred crore)	**CARE BBB; Stable (Triple B; Outlook: Stable)**	**Revised from CARE BBB-;Stable (Triple B minus; Outlook:stable)**

Details of instruments/facilities in Annexure-1

Rating Rationale

The revision in the ratings assigned to the bank facilities and debt instruments of Veritas Finance Private Limited (VFPL) factors in significant increase in scale of operations and improvement in financial performance of the company during FY18 (refers to the period April 01 to March 31) and further improvement in capitalisation with fresh equity infusion of Rs. 60.0 crore during May 2018. The ratings continue to factor in experience of the promoter and senior management team in lending business, presence of well managed in-house appraisal, origination & collection team, adequate risk management & MIS systems and good asset quality.

The ratings are however constrained by limited seasoning of its portfolio, geographical concentration amidst the efforts taken for diversification, presence in the MSME segment which is relatively risky, moderately diversified resource profile and moderate profitability profile on account of growing nature of operations.

In light of high growth plans envisaged by the company in the medium term, ability of VFPL to maintain its asset quality & profitability while geographically diversifying its portfolio and effectively manage its growing scale of operations would be the key rating sensitivities.

[1]*Complete definition of the ratings assigned are available at www.careratings.com and in other CARE publications*

Background

Veritas Finance Private Limited (VFPL) incorporated on April 30, 2015 is a non-deposit taking NBFC (loan company), registered with RBI. VFPL is promoted by Mr. D. Arulmany. VFPL lends to borrowers engaged in micro, small and medium enterprises (MSME) sector with limited access to formal financial services.

VFPL currently operates in Tamil Nadu, Puducherry, West Bengal, Orissa & Karnataka out of 18 regional offices, 54 branch offices and 108 Micro Centers for MSME lending and 15 branches for working capital vertical which is co-located along with MSME branches. For MSME lending, there are typically 3-4 branches under each regional office, which also functions as a hub.

VFPL offers three products based on the purpose such as MSME Loans, Working capital loan (WCL) and construction loan (CL). VFPL had a loan portfolio of Rs.335.0 crore as on March 31, 2018 of which around 96% of the portfolio was constituted by MSME loans and remaining 4% by WCL. The company recently started construction loan with ticket size of Rs. 5-15 lakhs and interest rate of 18-21% having tenure upto 10 years and the loan outstanding as on March 31, 2018 was around Rs.43.6 lakhs.

As at May 22, 2018 (post Equity infusion of Rs. 60.0 crore), Promoter & related parties held 8.54% of the equity, Resident Individual investors held 14.31% of the stake, Employees & related parties held 6.57% and remaining 70.58% equity held by institutional investors, namely, CDC Group (27.67%), Sarva Capital LLC (20.27%), Lok Capital Growth fund (20.26%) and Caspian Impact Investment Adviser Private Limited (2.38%).

Credit Risk Assessment

Experienced promoter and senior management

VFPL is promoted by Mr. D. Arulmany, who is MD and CEO of VFPL. Mr. D. Arulmany has overall experience of about 25 years most of which is in financial services industry and has held various positions in the companies under the Murugappa group and CEO of an affordable housing finance company. VFPL's board has five directors including three independent directors and one nominee director representing the Private Equity firm Sarva Capital LLC, who have infused equity capital in the company. Mr. D. Arulmany is assisted by experienced senior management team who were closely associated with him in earlier organisations and have significant experience in the lending business.

Improvement in the capitalization profile supported by recent equity capital infusion

During May 2018, VFPL received further capital infusion of Rs. 60.0 crore from existing investors in the form of both equity capital and compulsorily convertible preference shares (CCPS) which resulted in increase in total networth to Rs. 226.0 crore as on May 18, 2018 from Rs. 162.8 crore as on March 31, 2018. The total capital adequacy ratio as on March 31, 2018 was 48.02% and Tier-I CAR during the same period was 47.06%. VFPL has been able to attract equity infusion from various investors from inception (Rs.30.0 crore in FY16, Rs.120.0 crore in FY18 and Rs.60.0 crore in Q1FY19). The current level of capitalisation is expected to help the company to improve their business in next 2 years while maintaining capital adequacy at comfortable levels.

Robust Business growth witnessed during FY18 with expansion in newer geographies however Tamil Nadu remains major part of the loan portfolio

VFPL's portfolio grew from Rs.92.3 crore as on March 31, 2017 to Rs. 335.0 crore as on in March 31, 2018 supported by mobilisation of significant equity capital and expansion of its network. The company operates in 68 (PY: 34) districts with 18 (PY: 11) regional offices, 54 (PY: 32) branches and 108 (PY: 31) micro centers as on March 31, 2018. Apart from Tamil Nadu, the company was able to expand into newer states like West Bengal, Karnataka and Orissa during FY18. However the proportion of Tamil Nadu remained high at around 76.70% as on March 31, 2018 against 100.00% as on March 31, 2017. With company's plans to expand it network to newer states, geographical diversification is expected to improve, going forward. As on March 31, 2018, West Bengal constituted around 15.07% of the total portfolio, followed by Karnataka with 6.81%, Pondicherry with 1.18% and Odisha with 0.24%. The ability of the company to manage growing scale of operations and operational efficiencies as it opens new branches/ enters new geographies to grow the portfolio remains critical for its growth prospects.

Well managed in-house processes along with good MIS system

VFPL is engaged in lending to MSME segments which are secured by collateral and tenure upto 7 years with ticket size ranging between Rs.1-15 lakh, as against larger NBFCs and banks which lend at a higher ticket size. VFPL's target segment comprises of MSME enterprises where the business is on cash and carry basis especially in the rural and semi urban areas. The company has defined credit policy which is drafted based on the experience and knowledge of the target customer segment gathered in the past. The LTV ratio of less than 50% of the distressed value arrived by the company which gives them considerable cushion, in case of any delinquencies. Also the company considers upto 45% (FOIR) of the net income of the borrower (considering other loan repayments) for repayment of the loan obligation

VFPL has is its in-house team covering all the facets starting from business sourcing, credit, technical, legal, collection and recovery. The selection of customers runs through several levels of checks including sales team along with credit team visiting business premises of the customer for income assessment, LTV assessment, KYC norms, etc. All the appraisals including income assessment and property valuation are done at the branch level by the credit officer and for final approval reports sent to head office. The collections are done through ACH and the sales team holds the responsibility to follow up with the customers to recover the loan in case of delays. VFPL uses third party vendor software for its MIS systems which has been used by PSU banks and leading NBFCs. This system provides solutions for the business starting from loan origination and up to NPA management. This system enables to automate the entire processes thereby improving the efficiency. With such strong appraisal and collection mechanism, VFPL has been able to grow their business, without any significant strain on the asset quality.

Good Asset quality however limited seasoning of portfolio

The company recognizes NPA on 90 days overdue basis as against the regulatory requirement of 180 days for systemically non-important NBFCs. The Gross NPA and Net NPA (90 dpd) of the company as on March 31, 2018 was 0.74% and 0.53% as against 0.95% and 0.71% as on March 31, 2017 (FY16: nil) respectively. The company continues to provide 1.00% as standard assets provision against the RBI requirement of 0.25%. VFPL commenced lending operations in April 2015 and has relatively limited track record and limited seasoning of the loan portfolio. As a result, its asset quality performance through different economic cycles and geographies is yet to be established. Moreover, with increased number of branches and growth in portfolio in the recent past, ability of the company to manage its asset quality would remain critical.

Presence in the MSME segment which is relatively riskier

VFPL is primarily lending towards the business finance needs of the un-organised MSME segment in the rural and semi-urban areas which is characterized by marginal credit profile of the borrowers and are not serviced by the banking sector. Since this segment is highly susceptible to the impact of economic downturn and asset quality is a key monitorable. However, adequate collateral on the loans provided (secured by properties, most of them are Self-occupied residential) and the management team's good knowledge on this target customer segment provides comfort. The company would remain focused on this segment, as there is significant potential to grow their business though this segment is highly susceptible to the impact of economic downturn.

Moderately diversified resource profile with access towards market instruments during FY18

VFPL's source of funding was earlier skewed towards loans from Financial Institutions during the initial stage of operations. During FY18, the company has gained access into borrowings from banks and Market instruments in the form of Non-convertible debentures which resulted in moderation in cost of funds. The company raised around Rs. 109.0 crore in the form of Non-Convertible Debentures (NCDs) during FY18 and the proportion of Bank borrowings and NCD increased to 17.34% and 36.83% as on March 31, 2018 from 5.20% and nil respectively as on March 31, 2017. The total borrowing stood at 295.9 crore as on March 31, 2018 increased from Rs. 70.9 crore as on March 31, 2017. Going forward, the ability of the company to diversify their resource profile further and raise funds at competitive interest rates would remain critical for profitability of the company.

Moderate profitability however improved with increase in scale of operations in FY18

The company reported losses in FY16 & FY17 due to initial stage of operations however the company reported profit of Rs.6.1 crore during FY18 due to improvement in the overall business growth and reduction in operating costs. The company's NIM during FY18 was 9.67% improved from 7.80% during FY17 and operating cost declined to 9.31% during FY18 from 14.27% during FY17 due to increase in loan portfolio and benefits of scale. The company reported ROA and RONW of 2.08% and 5.98% respectively during FY18. With further improvement in the scale of operations along with expected reduction in the cost of borrowings, the profitability is expected to improve however the company needs to keep operating expenses and asset quality in control to avoid any impact on the same.

Industry Outlook and Prospects

Over the last few years, the NBFC sector has gained systemic importance with increase in share of NBFC's total advances to bank total advances. The same has resulted in the Reserve Bank of India (RBI) taking various policy actions resulting in NBFCs attracting higher support and regulatory scrutiny. The RBI has revised the regulatory framework for NBFCs which broadly focuses on strengthening the structural profile of NBFC sector. Overall the revised regulations are positive for the NBFC sector making it structurally stronger, increase transparency and improve their ability to withstand asset quality shocks in the long run.

The last three years have been challenging period for the NBFCs due to change in NPA norms resulting in higher provisioning and rising delinquencies due to demonetization thereby impacting profitability. However, with support from the external equity investors and lenders and the experience of the management to control the liquidity position provides additional comfort to the credit profile of NBFCs in spite of impact on profitability. However with the increased competition prevailing in the financial sector, the ability to remain focused on target customers and improve the business without impacting their asset quality would be key rating sensitivity going forward

Financial Performance

Year ended/ As on March 31	2016 (12m, A*)	2017 (12m, A)	(Rs. Cr) 2018 (12m,A)
Working Results			
Fund based income	0.6	10.4	47.4
Fee based income	0.1	2.3	7.5
Other income	0.0	0.0	0.1
Total Income	**0.7**	**12.7**	**55.0**
Operating Expenses	2.6	11.1	27.2
Provisions	0.1	1.1	3.3
Interest	0.0	3.3	18.0
PBT	**-1.9**	**-2.9**	**6.5**
PAT	**-1.9**	**-2.9**	**6.1**
Financial Position			
Tangible Networth	41.0	39.7	162.8
Total Borrowings	0.0	71.0	295.9
Total Loans Portfolio	6.1	92.3	335.0
Assets Under Management	6.1	92.3	335.0
Total Assets	41.8	112.9	472.5
Key Ratios (%)			
Solvency			
Overall Gearing (times)	0.00	1.79	1.82
Interest Coverage (times)	NM	0.13	1.36
Capital Adequacy Ratio (CAR) (%)	593.14	42.15	48.02
Tier I CAR (%)	592.25	41.18	47.06
Profitability			
Net Interest Margin (%)	1.53	7.89	9.67
ROTA (%)	-9.33	-3.71	2.08
Operating Expenses to Average total assets	12.53	14.42	9.31
Asset Quality			
Gross NPA Ratio (%)(90 dpd)	0.00	0.95	0.74
Net NPA Ratio (%)	0.00	0.71	0.53
Net NPA to Networth (%)	0.00	1.60	1.11

***Note:** A – Audited;*

(a) NIM has been calculated as net interest income/average annual total assets;

(b) Ratios have been computed based on average of annual opening and closing balances

***incorporated on 30thApril 2015**

Details of Rated Facilities

1. Long-term facilities

S.No	Name of the bank	Type of facility	Rated Amount (Rs.crore)
1	RBL Bank Limited-I	Term Loan	1.12
2	RBL Bank Limited-II	Term Loan	6.59
3	Equitas Small Finance bank Limited-I	Term Loan	3.28
4	Equitas Small Finance bank Limited-II	Term Loan	3.86
5	AU Small Finance Bank Limited	Term Loan	8.06
6	Utkarsh Small Finance Bank Limited	Term Loan	17.69
7	RBL Bank Limited	Cash credit	5.00
8	AU Small Finance Bank Ltd	Cash Credit	5.00
	Proposed	Proposed	49.40
	Total		**100.00**

Total long-term facilities- Rs. 100 crore