

CareEdge Global assigns Long Term Foreign Currency Rating of 'CareEdge B-/Stable' to the External Commercial Borrowing Bond Issuance plan of Varthana Finance Private Limited

USD 15 million External Commercial Borrowing Bonds	CareEdge B-/Stable
USD 14 million External Commercial Borrowing bonds (Proposed)	CareEdge B-/Stable

CareEdge Global has assigned '**CareEdge B-/Stable**' to Varthana Finance Private Limited's (Varthana) USD 29 million External Commercial Borrowing bond issuance plan, to be issued in tranches starting at USD 15 million.

Rating Rationale

The rating is primarily driven by a comfortable capitalisation position, and the established track record and experience of the promoters in the school finance sector. These credit strengths are, however, partially offset by moderate asset quality, low profitability, and a limited resource profile.

Key Rating Drivers

Strengths

Established track record of promoters in the school finance sector

Varthana is involved in financing education institution loans, mainly to affordable private schools, and has established a track record of more than 10 years in the segment. These are primarily collateral-backed loans offered to private educational institutions (generally K-12 schools) for brownfield expansion and their working capital requirements. The company also launched student loan financing in FY18. These loans are provided to students seeking upskilling or test preparation coaching in tie-ups with the institutions offering these courses. The founders, Mr. Steven Edwin Hardgrave and Mr. Brajesh Mishra, have significant experience in education financing. The promoters are supported by management team with extensive experience in the financial services industry.

Comfortable capitalisation level

Varthana has a comfortable capitalisation profile with an overall capital adequacy ratio of 31.0% as of September 30, 2024. To support its growth plans, the company is in the initial stages of discussions with investors about raising fresh equity and expects to complete the

same by H1FY26. The total tangible net worth of Varthana stood at Rs 510 crore (~USD 61 mn¹) as of September 30, 2024, supported by an equity raise of Rs 454 crore from investors since inception, along with internal accruals. The company has large and diversified institutional investors, including Chryscapital, Lightrock, Kaizen Private Equity, Omidyar Network, Elevar Equity, Blue Haven and Potencia Ventures, on its cap table. Gearing was comfortable at 2.1x as of March 31, 2024, and increased to 2.4x as on September 30, 2024, with the increased scale of operations.

CareEdge Global expects that, with its planned growth trajectory, the company will maintain a buffer of approximately 5-10% above the regulatory capitalisation requirements (currently at 15%), even if the expected equity infusion does not occur within the envisaged timelines. The company aims to keep gearing within the range of 3 to 3.5x over the medium term.

Weaknesses

Low profitability

The company's low profitability, primarily due to elevated credit costs and high operating expenses, has been impacting its return ratios. Varthana's return on assets (RoA) improved to 2.2% in FY24 from 0.5% in FY23, mainly due to a one-time gain of Rs 47 crore on the sale of its non-performing assets (NPAs) assets to Asset Reconstruction Companies (ARCs). In H1FY25, profitability continued to be low with a ROA (annualised) of 0.7%.

The company has high operating expenses in the student loan segment, primarily due to upfront investments in technology infrastructure, which is also adversely impacting profitability. However, going ahead, with the company planning to expand its student loan segment and raise its share to 35% of the total AUM, up from the current 19%, the operating expenses are expected to decline, leading to an improvement in profitability.

Weak asset quality

The company, primarily engaged in financing schools, experienced a significant deterioration in asset quality due to the Covid-19 pandemic, as schools remained closed for nearly two years. These schools were predominantly small private institutions, and irregular fee collections during this period severely impacted the company's asset quality. The prolonged school closures during the pandemic disrupted fee payments from parents, many of whom were blue-collar workers. Job losses among these parents further hindered their ability to pay school fees, leading to elevated NPA levels for the company during that time. However, Gross NPA and Net NPA have subsequently improved to 3.0% and 1.1% as of March 31, 2024, and further to 2.5% and 1.3% as of September 2024. However, this improvement is also due to significant write-offs and the sale of its stressed books to ARCs.

The company, however, has taken various steps to improve its asset quality which is reflected

¹ 1 USD=84 Rupees

in the book which has been generated post Covid which has relatively better asset quality with negligible NPAs as of now. Going forward, as the company focuses on an unsecured student loan book, which is relatively unseasoned, the stability of the asset quality numbers needs to be seen over an extended period.

Limited resource profile leading to a relatively higher cost of borrowing

Varthana continues to rely significantly on non-banking financial companies (NBFCs) for its debt requirements, though this dependence has gradually reduced. As of March 31, 2024, borrowing from NBFCs accounted for 40% of the total debt, which was reduced to 37.5% as of October 2024. Typically, these loans are at relatively high cost as compared to other sources of financing. Earlier, borrowing rates for Varthana were also higher due to asset quality challenges resulting from the impact of Covid. Varthana's average borrowing cost stood at 12.5% as of September 30, 2024.

Varthana is making efforts to optimise its borrowing profile by exploring other financing options, including international debt issuances, which are expected to be fully hedged. The pace of reduction in NBFC borrowings is likely to be gradual as a large portion of current borrowings are from NBFCs.

Liquidity

Varthana's liquidity profile is moderate. The company has no negative cumulative mismatches in upto one year bucket. However, there are negative cumulative mismatches in more than one year time bucket. The mismatch is due to the higher tenor of its major offering i.e. school loan financing with an average tenor of 7 years while borrowings have an average tenor of 2 years. The mismatch is expected to continue for some time, however as the company increases its student loans portfolio, which has an average loan tenure of 18 months, the mismatch is expected to improve. Varthana keeps adequate liquidity (three months of repayments and operating expenses) in the form of on-balance sheet liquidity along with undrawn bank lines. As of November 2024, it had a cash and bank balance of Rs 180 crore and liquid investments of Rs 62 crore.

Outlook: Stable

The stable rating outlook reflects CareEdge Global's expectation that Varthana will maintain comfortable capitalization levels while reporting moderate growth in scale of operations over the medium term. Furthermore, Varthana's growth is expected to be supported by promoters and other major investors.

Rating Sensitivities

Upward factors

- Significant increase in its scale of operations while maintaining profitability and overall gearing level below 3.5x

- Significant improvement and sustenance in asset quality

Downward factors

- Deterioration in capitalisation profile on a sustained basis
- Deterioration in liquidity profile
- Significant deterioration in asset quality

Environmental, Social and Governance (ESG) considerations

CareEdge Global observes that Varthana primarily engages in lending to businesses operating in semi-urban actively promoting sustainable practices among its borrowers. This includes encouraging the efficient use of natural resources such as water and raw materials, alongside fostering initiatives for recycling and reuse, aligning with broader environmental sustainability goals.

From a social perspective, the company addresses critical social risks by providing funding to institutions which are in the business of quality education to children. This approach empowers affordable schools in India by providing crucial financial support, helping them expand and improve educational opportunities for low-income students.

On the governance front, while the company demonstrates a reasonable commitment to governance practices, further improvements in board structure and practices could enhance resilience and stakeholder confidence.

About the company

Varthana Finance Private Limited is a non-deposit accepting non-banking finance company headquartered in Bengaluru. It was founded by Steven Edwin Hardgrave and Brajesh Mishra, who have extensive experience in education financing. Varthana started operations after its promoters acquired an erstwhile NBFC, Thirumeni Finance Private Limited, in May 2012. School financing operations under the brand Varthana were started in January 2013. The company is engaged in financing private schools for improvement, capacity expansion and growth requirements. These loans have an average ticket size of Rs 30 lakhs with an average tenure of 7 years. Further, the company also launched student loan financing in 2018. The average ticket size of student loans is Rs 1.1 lakhs with tenure of 1.5 years.

As of September 30, 2024, the operations of the company are spread across 16 states with a branch network of 41 branches with AUM of Rs 1,526 crore. The growth has been aided by the growth in the school financing portfolio which forms 81% of the total AUM while the rest 19% is contributed by student loans.

The company has been raising equity capital from private equity investors and major shareholders apart from founders. To date the company has raised Rs 453 crore of equity from the founders and various institutional investors. Varthana's institutional investors are Chryscapital, Lightrock, Kaizen Private Equity, Omidyar Network, Elevar Equity, Blue Haven and Potencia Ventures.

Solicitation Status

These ratings are solicited. The management has provided information and meetings to the CareEdge Global analytical team for the rating.

Rating History

Instrument	Type	Rating	Date
External Commercial Borrowing Bonds	Long Term Foreign Currency (Solicited)	CareEdge B-/Stable	December 24, 2024

Criteria Applied

[CareEdge Global's Rating Methodology for Financial Institutions](#)

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