

April 29, 2022

Karunya Educational and Research Trust: Rating continues to remain under Watch with Negative Implications

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loan	30.00	25.00	[ICRA]A-@; continues to remain under Rating watch with Negative Implications
Untied Limits	-	5.00	[ICRA]A-@; continues to remain under Rating Watch with Negative Implications
Total	30.00	30.00	

*Instrument details are provided in Annexure-1

Rationale

The rating of Karunya Educational and Research Trust (KERT/trust) continues to remain under Rating Watch with Negative Implications as there is no clarity yet on the impact of the ongoing investigations by the Income Tax Department over reported tax irregularities. ICRA will continue to monitor the situation and the possible impact on the credit risk profile of the trust and take an appropriate rating action once the final outcome of the investigation is known.

The rating continues to factor in the established track record of KERT in imparting quality education through its reputed college, Karunya Institute of Technology and Sciences (KITS), and schools offering various graduation and post-graduation courses in Tamil Nadu for over three decades. The rating factors in the traction in new enrolments in the recently introduced courses like agricultural courses, forensics, artificial intelligence, data science, robotics etc. This in turn supported the overall student strength, partly compensating for the downward trend of enrolments in conventional engineering courses such as mechanical and electronic engineering. Moreover, gradual resumption of offline classes from November 2021 post unlocking of the economy has supported new admissions from students hailing from states other than Tamil Nadu, which has also been a key factor behind the healthy growth in revenue in FY2022. Being a non-affiliated and self-financed university, KITS enjoys operational and financial flexibility in deciding the syllabi as well as the fee structure. The cash flows are not dependent on the recovery of subsidies from any government body. The rating derives comfort from KERT's robust financial profile, characterised by its strong liquidity position, a conservative capital structure, coupled with healthy cash accruals and comfortable debt protection metrics. The trust maintains strong liquidity, marked by a large cash balance of over Rs. 230 crore against negligible external debt outstanding as on March 31, 2021. Given its limited growth plans over the medium term, ICRA does not expect any major increase in KERT's debt level.

The rating, however, is constrained by high reliance of KERT's revenues on the engineering courses (which account for more than 40% of its revenue) and high geographical concentration with its presence restricted to Coimbatore, Tamil Nadu. Additionally, the rating notes the highly regulated education sector in India, which exposes KERT to significant regulatory risks associated with stringent compliance requirements. Intense competition in engineering courses resulted in a steady decline in student admissions in KITS' engineering courses in the recent years. ICRA notes that KERT's turnover and profits dipped following the pandemic, and notwithstanding a sequential uptick from FY2022, its performance in FY2023 is unlikely to reach the pre-Covid high-watermark that was achieved in FY2019. The ratings are further tempered by the modest placement track record in B-Tech and MBA courses, which constrains the business risk profile. Going forward, the established track record of

the trust in the education sector, prudent capital allocation policy and its healthy financial risk profile are expected to keep the credit metrics at comfortable levels over the near-to-medium term.

Key rating drivers and their description

Credit strengths

Demonstrated track record of the trust in the education sector spanning over three decades – KITS, the flagship higher educational institute of KERT, has an established position and brand presence in Coimbatore, Tamil Nadu, imparting quality education with good infrastructure since 1986. Despite having a regional presence, the institute has witnessed ~50% enrollments from students outside the state, which indicates that it has gained prominence pan India. Further, KITS' engineering courses are approved by the All India Council for Technological Education (AICTE) and the University Grants Commission (UGC), while the schools are affiliated to the Central Board of Secondary Education (CBSE) and the Tamil Nadu Matriculation Board. KITS has been accredited at B grade (on a scale of A to D, with A being the highest grade) by the National Assessment and Accreditation Council (NAAC).

Good infrastructure facilities support its competitive position – KITS is equipped with good infrastructural facilities for research laboratories, workshops, academic facilities such as gallery classrooms, modern library and latest teaching aids, various outdoor and indoor sports facilities and hostel residences spread across its 700 acres campus in Coimbatore. KITS' well-equipped infrastructural facilities augment its competitive advantage.

Established position of institution in Tamil Nadu with diversified course offerings – KITS is a deemed-to-be-university offering graduate and post-graduate programmes with a wide spectrum of courses in engineering, arts and sciences, management among others in the higher education segment with close to 7,750 students and 489 faculties as of AY2022. Consistently healthy admissions in the emerging new courses like agricultural courses, forensics, artificial intelligence, data science, robotics, etc. supported student strength notwithstanding pandemic related disruptions.

Healthy financial risk profile – With steady free cash flow generation over the years, KERT's financial profile has remained comfortable, marked by a healthy capital structure and robust coverage indicators with a gearing of 0.03 times, an interest cover of 19.2 times and the total debt vis-à-vis the operating profit of 0.05 times as on March 31, 2021. Further, its liquidity position remained strong with an unencumbered cash and liquid investment (primarily fixed deposits) accumulating to over Rs. 230 crore as of March 2022.

Credit challenges

Decline in turnover and profits following the onset of Covid – A decrease in KERT's revenue and profitability since FY2020 can be attributed primarily to the decline in student strength (compared to FY2019 levels) and lower absorption of fixed costs. Moreover, KITS witnessed a steady decline in student strength in engineering courses since the academic year 2019-20 owing to changing preferences away from conventional engineering courses like mechanical and electronics. However, healthy enrolments in emerging new courses have supported a gradual increase in the overall student strength from the lows of FY2020. Given that offline classes have gradually resumed, ICRA anticipates an improvement in enrolment of students outside the state in FY2023. That said, the overall performance in FY2023 is unlikely to reach the pre-Covid levels of FY2019.

Vulnerability to risks related to highly regulated nature of the education sector – The education sector in India remains regulated and the trust's operations may be impacted in case of any adverse regulatory development. The trust's operations are vulnerable to various regulations framed by regulatory bodies such as the University Grants Commission (UGC), the All India Council for Technical Education (AICTE), the Ministry of Human Resource Development (MHRD), state governments, among others, restricting the flexibility and autonomy with respect to fees and student intake. Any non-compliance or violations of these regulations may put restriction on the institute beside loss of reputation, which can hamper its revenues and cash flows.

Exposure to intense competition in the fragmented sector – KITS faces intense competition from other reputed public and private institutes of Tamil Nadu. This makes attracting and retaining talented students and faculty members a challenging task. Thus, the ability of the university to maintain healthy enrolment levels for all its course offerings will be a key rating sensitivity.

Modest placement track record – While the institute attracts students from various states, which reflects favourably on the demand for its courses and its good market standing, its placement track record remains modest, with around 40-45% of the outgoing batch getting campus job offers in a year. Going forward, the institution’s ability to improve the placement track record would remain crucial from strengthening the business risk profile.

Liquidity position: Strong

KERT’s liquidity position is strong with unencumbered cash and liquid investment accumulating to over Rs. 230 crore as of March 31, 2022 coupled with modest debt servicing obligations. The trust’s moderate capex plans and consistently positive retained cash flows also support its liquidity profile. Further, its negative working capital intensive nature of operations, driven by advance tuition fee collections, enables KERT to maintain a strong liquidity position.

Rating sensitivities

Positive factors – The rating is unlikely to be upgraded till it continues to remain under watch during the period of ongoing proceedings by the Income Tax authorities. Following resolution of the watch, ICRA may upgrade KERT’s ratings if the trust is able to significantly improve its competitive position while increasing its scale of operations, profitability and maintaining strong liquidity and credit metrics.

Negative factors – Negative pressure on the ratings could arise if KERT witnesses any sustained deterioration in its scale of operations (owing to decline in students’ enrolment, decrease in approved intake, among others) or profitability. Its ratings could be downgraded if the trust’s liquidity position / capital structure weakens owing to any large capex plans or investments or large crystallisation of claims from the IT authorities.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Entities in the Higher Education Sector
Parent/Group Support	Not Applicable
Consolidation/Standalone	Standalone financial statements of the issuer.

About the Company

Founded by Late Dr. D. G. S. Dhinakaran, KERT manages educational institutes including schools. KITS, the flagship educational institute of KERT and a deemed-to-be-university, offers graduate and post-graduate courses in various branches of engineering, arts and sciences, management, among others in the higher education segment with close to 7,750 students and 489 faculties as of AY2022.

Key financial indicators

KERT	FY2020 (Audited)	FY2021 (Audited)
Operating Income (Rs. crore)	192.5	135.5
PAT (Rs. crore)	47.3	26.7
OPBDIT/OI (%)	27.7%	25.2%
RoCE (%)	9.0%	4.9%
Total Outside Liabilities/Tangible Net Worth (times)	0.1	0.1
Total Debt/OPBDIT (times)	0.4	0.5
Interest Coverage (times)	20.9	19.2
DSCR (times)	7.5	8.2

*Source: Company data

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net Worth + Deferred Tax Liability - Capital Work in Progress); DSCR: (PBIT + Mat Credit Entitlements - Fair Value Gains through P&L - Non-cash Extraordinary Gain/Loss)/(Interest + Repayments made during the Year)

Status of non-cooperation with previous CRA: CRISIL has revised KERT's rating to CRISIL B(Stable) ISSUER NOT COOPERATING in March 16, 2021 as the issuer remained non-cooperative.

Any other information: None

Rating history for past three years

	Instrument	Type	Amount Rated (Rs. crore)	Current Rating (FY2023)		Chronology of Rating History for the past 3 years		
				Amount Outstanding as of Mar 31, 2022 (Rs. crore)	Date & Rating	Date & Rating in FY2021		Date & Rating in FY2020
						29-Apr-2022	28-Jan-2021	
1	Term Loans	Long Term	25.0	11.6	[ICRA]A-@	[ICRA]A-@	[ICRA]A-(Stable)	-
2	Untied	Long Term	5.0	-	[ICRA]A-@	-	-	-

Amount in Rs. Crore, @ on Watch with Negative Implications

Complexity level of the rated instrument

Instrument	Complexity Indicator
Term Loans	Simple
Untied	NA

The complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate*	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loans	FY2018	NA	FY2025	25.00	[ICRA]A-@
NA	Untied	NA	NA	NA	5.00	[ICRA]A-@

Source: Company data; NA, @ on Watch with Negative Implications

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
NA		

Source: Company data

ANALYST CONTACTS

Jayanta Roy

+91 33 71501100

jayanta@icraindia.com

Priyesh Ruparelia

022 6169 3328

priyesh.ruparelia@icraindia.com

Ritabrata Ghosh

+91 33 71501107

Ritabrata.ghosh@icraindia.com

Brinda Goradia

022 6169 3341

brinda.goradia@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee

+91 80 4332 6401

jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani

Tel: +91 124 4545 860

communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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ICRA Limited



Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001

Tel: +91 11 23357940-45



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