

Dear Sir / Madam,

Today there was a news article in a local online digital portal called "THE KEN". Kindly find below our clarifications to the points highlighted in this news article.

Things don't add up at Vakrangee: Share price, biz model, and even a Sebi probe

The Mumbai-headquartered IT company was in hot water with Sebi recently, but then it disappeared from the news cycle. Very few know about Vakrangee, and fewer still are willing to talk about it

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Vakrangee at its peak had a market cap of Rs 50,000 crore

The company's customer base is primarily illiterate and semi-literate, which relies on MNREGA for its daily income

These customers, Vakrangee says, shop worth an average of Rs 500 on Amazon every month

Vakrangee was under a Sebi scanner but was cleared rather quickly

Comment: We believe our business model has been misunderstood as Amazon services are currently activated only in Urban locations and not activated in rural locations. Customer base in Rural might depend on agriculture or government subsidies like MNREGA and various other subsidies for their daily income but the Urban customer base includes people from all profiles. Average Ticket size of Rs. 500 is very nominal amount, even basic pantry products cost around Rs. 500.

It is a hot, dry 23 March. Just before lunch.

"This has been a bank for the last eight years," says Dileep Kumar Mehta, bank manager of Andhra Bank in Kota.

Comment: We have never done any business transaction with Andhra bank. We do not have any BC point for Andhra bank.

No kendra? “Never.”

Did they conduct camps? “No.”

Is the address correct? “Yes.”

Do you know about them? “Yes, I have heard about them. But they were never here.”

It is a surreal conversation. The address is right, to the T, from the annual report of Vakrangee, but the kendra doesn’t exist.

A few weeks back, *The Ken* took a short trip to Kota. The city in Rajasthan, known for its Indian Institute of Technology (IIT) coaching classes, hotels that don’t allow unmarried couples to room up, a biggish train station, and, well, not much else. The small city is where Mumbai-based Information Technology (IT) services company, Vakrangee Ltd, has its largest number of kendras or outlets. The company, headed by Dinesh Nandwana, has a business model, which can be best described as a supermarket for financial inclusion services. It has white label ATMs, helps people open and run bank accounts, gives out money to those enrolled in rural employment schemes, enables people to buy insurance, and, in some cases, it helps customers connect to Amazon, which is trying to reach the rural populace of the country.

Where are the kendras?

Of the 20 kendras listed on the company's website, which The Ken visited, four were completely operational, eight were cyber cafes, which processed online payments and the last eight did not exist

Comment: Many of our outlets are typically in slum areas or hutment areas or far off rural areas and could be difficult to find. Therefore, We have already appointed a very reputed

Consultant - Grant Thornton to perform the Business quality analysis, whereby they will certify :-

- Number of Silver and Gold Kendras as per Vakrangee Defined parameters: Number of Silver and Gold Kendras as per specified counters-verified physically once a year, Exclusivity of Kendras, adherence to branding standards, availability of staff, functioning of equipment, etc.
- Service activation and delivery: Number of services activated and available at each of the Kendras
- Franchisee Delight: Experience of franchisee with Vakrangee on the parameters of on-boarding experience, branding, service activation, training, support from field staff, help-desk, sales training, marketing support through call centre and on-line/ offline surveys, etc.
- Customer Delight: Experience of the customers at Vakrangee Stores in terms of sales, service, customer support, price competitiveness, interaction with staff and recognition of Vakrangee store brand and available services, etc.

Also, I would like to highlight that 15-20% of our stores have been the first generation stores made in earlier years between 2011 to 2014. Since we are a first generation company and our business model was new, it was difficult in initial phase to appoint franchisees as well as demand exclusivity and branding as the bouquet of services was much less. However today we have a large bouquet of services with strong partnerships and also the brand awareness is much higher, thereby there is a huge pipeline of potential franchises who are ready with our terms of branding and exclusivity. We are hence also in process of upgrading those first generation franchises into the silver or gold model.

To offer these services, Vakrangee has outlets, which it calls kendras. It claims it has over 40,000 such kendras in the country. In Kota, it has 146 kendras listed on the website. Of the 146, *The Ken* visited 20 centres. Of the 20, only four were fully functional. It means they had a working ATM, a tie-up with a public sector bank and offered eMitra services provided by the Rajasthan government—essentially a centre for bill payment and voter registration. Eight other centres had no services except for eMitra. The rest were never part of Vakrangee. Some had applied to be part of the network, but for one reason or another, they were never operational, and others had never even applied for a franchise.

We reached out to Vakrangee. What gives? “We are in process for appointment of a reputed consultant to carry out business quality analysis of Vakrangee kendras and have

scheduled a Board meeting on 31 March 2018. The consultant would physically visit the stores and also analyse the activation of various services at the kendra outlet,” said a Vakrangee spokesperson in an emailed reply.

The company then declared to the exchange that it had appointed the consulting firm Grant Thornton to audit the kendras.

When in Kota

Of the four functional kendras, three are owned and have been run by Nandwana’s nephew, Nikhil, for the last three years. The other is run by Aman Agrawal, who got the franchise two months ago. He records 15-20 transactions a day and has not seen a single person make a purchase from Amazon. “Everyone orders on the mobile these days,” he says. Agrawal has not been able to break-even yet.

Comment: Any new outlet takes at least 4 to 6 months to activate all the services, create service awareness and get maturity. Currently, all services are activated at this particular store and has been doing fairly well.

The biggest use case of these centres is the ATM. “The three ATMs see a daily combined footfall of around 500-600,” says Nikhil. Of the eMitra service counters, many of them are cyber cafes, which came on the Vakrangee network during the Aadhaar enrollment boom. Once that died down, they now process bill payments, which fetches them around Rs 500-1,500 (\$7.69- \$23.07) per month.

Now, switch to Mumbai. In Worli, an upmarket suburb in the city, the company lists three centres. One was owned and operated by the company, one did not exist, and the third, which is 100 meters from a private bank, has ATM services, banking correspondence, sells insurance and provides access to Amazon. The manager of the

third franchise says the ATM has been out of order for a while and has not been repaired because it doesn't make him money.

He gets two customers a day.

Comment – This seems to be incorrect. Even logically, Worli is a very high density urban area and also the rentals are robust in this area. A franchisee getting only 2 customers a day is highly impossible to sustain. Our worli outlets are running for more than 2 years now which implies that these franchisees are making enough business to sustain.

Vakrangee is listed on the Bombay Stock Exchange (BSE). With these numbers, one would expect the company to be struggling. Well, far from it. In the financial year ending March 2017, Vakrangee had a topline of Rs 4,000 crore (~\$615 million) with a peak market cap of Rs 50,000 crore (~\$7.7 billion). It has continued this growth over the last six months of the current financial year.

Vakrangee is a curious company. It does many unique things. It makes money off financial inclusion; it was a penny stock a decade ago and is now trading in triple digits; its market cap has been steadily increasing, but yet few analysts want to talk about it. They are even more tight-lipped after *Mumbai Mirror* reported that the Securities and Exchange Board of India (Sebi) had started an [investigation](http://mumbaimirror.indiatimes.com) against Vakrangee for share price manipulation. Sebi, [curiously](http://prnewswire.co.in), cleared Vakrangee in its short-lived enquiry. More on this, in just a little while.

“Sebi has given a clean chit to Vakrangee! The initial list under investigation included 22 related entities that were also related to Vakrangee that together accounted for around 75% of the trading volume in the stock on certain days. 18 out of the 22 had 90% of their dealing in Vakrangee stock only!” says independent value investor Bhaskar Chakraborty.

From 22, Sebi's investigative team expanded the list to include 119 companies. "It then said that only 12% of the synchronised trades could be tracked back to these 119 entities! Neither did it observe any Circular trading. So, Sebi announced it is not going to pursue the matter any further. So much for investor protection!" Chakraborty exclaims.

"First, Sebi is not god or an investigation agency like CBI or ED. However, it has its own system for working on the violation of the securities law," says JN Gupta, former executive director, Sebi. He adds that the monitoring body has surveillance systems to keep track of companies, but it is not easy. "Sebi tries to do everything that is possible, but somehow or other, the final outcome is not to the liking of the public or Sebi." While that may be true, there are several companies which it needs to look at carefully. Companies where the most basic check suggests that things don't add up. Vakrangee is a good case in point.

First look

Vakrangee had been motoring along for the last three years when it pivoted to the kendra-led model. Its stock price had gone up on the back of it winning Aadhaar enrollment contracts and being the logistics partner for Amazon in rural and slum areas.

But in January 2018, Vakrangee [bought](https://www.bloombergquint.com) 2 million shares of another listed entity, PC Jeweller Ltd. For Rs 112 crore (~\$17 million). It was an unusual purchase and was announced on the stock exchange. This is when news of the Sebi investigation started getting traction.

Vakrangee released a [statement](https://www.vakrangee.in) claiming it had received no notice that it wasn't under investigation. But that did not convince the market. The stock tanked. The stock exchange then had to slap a [lower circuit](https://www.financialexpress.com) on the company.

A lower circuit is put on by an exchange to slow down the decline in share price of a company to prevent erosion of value. The investigation wing of Sebi did conduct an

enquiry, according to a [report\[indiatoday.in\]](#) by *India Today*. But it didn't amount to anything. Sebi issued an order against a small trading company, Abhirati Trading, and fined it Rs 9.5 lakh (~\$14,600) over disclosure lapses. It found that the shareholding of Abhirati in Vakrangee got reduced on 28 May 2013 by 2.31% and by 2.07% on 4 September 2013.

Thus, upon change of more than 2% in its shareholding in the company, Abhirati ought to have disclosed, in terms of PIT (Prohibition of Insider Trading) and SAST (Substantial Acquisition of Shares and Takeovers). However, it failed to make these disclosures, and Sebi levied the fine accordingly.

So why was this one investment by a company an eyebrow-raiser? It was Varkangee's first major investment. It has invested in mutual funds worth Rs 2 crore (~\$307,600) in the last three years. And nothing else.

The company had Rs 500 crore (~\$76.9 million) in cash lying idle in a current account, earning no interest. For context, Vakrangee, in FY17, made a profit after tax of Rs 522 crore (~\$80 million). Red flag. Vakrangee could have done a lot with this cash. It had a license to set up 15,000 ATMs. However, over the last four years, it has been able to set up just 800. The company currently claims it has just 25 self-run kendras; it could invest in growing those; it could easily put this in corporate fixed deposit receipts (FDRs). But it chooses to let it lie in the current account. Vakrangee says let cash lie there because it's payments from a "legacy e-governance project", and it only arrived in the last week of March so it showed in the current account. Also, that it had been paying debts from the money in the current account.

Somehow, this doesn't explain why it had never invested its cash before. A closer look at the balance sheet shows many inconsistencies. How does Vakrangee end up making the Rs 4,000 crore (~\$615 million) it claims it made?

This is where matters get confusing. Vakrangee didn't make Rs 4,000 crore in revenue from 35,000 kendras. According to the annual report, the company made about Rs 1,500 crore (~\$230 million) from e-governance contracts alone. The remaining Rs 2,500 crore (~\$384 million) was made from the kendras in one fiscal year. This comes down to the company making about Rs 60,000 (~\$922) from each centre, every month. "This number looks like a lot, but if 300 people made transactions worth Rs 500 (~\$7.7) per day, we would make that money," says Ameet Sabarwal, president, investor relations, Vakrangee.

If Sabarwal is taken at face value, it brings Vakrangee's revenue split to 40%. But he insists the revenue share between Vakrangee and the franchises is 80-20, with Vakrangee taking the lower billing. How? The company combines gross merchandise value (GMV) and net revenue. Sabarwal refuses to break it down any further. Vakrangee also includes its ATM and e-commerce services under revenue. In fact, it claims it processes 25 orders a day from Amazon from these kendras with an average ticket size of Rs 500 (~\$7.7).

Comment – We have always maintained that the revenue sharing with our franchisees start at 65:35 and moves upto 80:20 in favour of franchisees based on milestone revenue targets. This has been consistently communicated across to all shareholders through results conference calls over the last 3 years. Also we recognize the gross revenues and the commission payment we make to franchisees is the COGS to us. Also we recognize the GMV for three services – Mobile Recharge, DTH Recharge and Gold product booking which is again disclosed to shareholders through conference call and is also available on our website.

"These numbers seem high. Especially in rural areas, where the population density is low," says an analyst who asked not to be identified as his company doesn't allow him to talk to the press. Even if people did come to the kendra as often as Vakrangee claims

they do, these people may not have the financial bandwidth to make transactions as high as Rs 500 per day, he notes.

However, Vakrangee's biggest use case is the Rs 180 (~\$2.77) credited to its customers' account via Mahatma Gandhi National Rural Employment Guarantee (MNREGA). Sabarwal, however, claims that Vakrangee's customers had the funds to buy "Rs 7,000 (~\$107) worth Redmi phones" during Amazon's annual Diwali sale.

Comment – We would like to explain our business model. Amazon services are activated currently only in Urban locations which is 10,500 outlets. This information is available in public domain. MNREGA daily wage subsidy is primarily provided to people in rural areas. We believe there is confusion as we are comparing the rural population income with amazon orders which are available to urban customer base.

Take a step back. India's average [per capita income](http://economictimes.indiatimes.com) in 2016-17 was Rs 1.03 lakh (~\$1,600). Most of Vakrangee's customers are illiterate and semi-literate people living in villages and hutment areas without official addresses. "In this country, the smartphone penetration is 28% and the data penetration is 18%. Our customers fall below that," says Sabarwal. It is difficult to imagine them making a Rs 500 (~\$7.7) purchase from Amazon through Vakrangee. Another red flag.

Comment – Customers are getting genuine products at competitive prices through Amazon. Amazon is offering even pantry and daily usage products. It is not difficult for urban customer base to buy orders worth average ticket size of Rs. 500. Average e-commerce ticket size is Rs. 2000-2500 per order. Our ticket sizes are much lower as compared to industry standards.

The Ken sent an email to Amazon to verify Vakrangee's claims. The Seattle-headquartered company did not respond.

The biggest revenue source for Vakrangee has been Aadhaar enrollment, and now that it has been taken off private contractors, that source is gone. But there is no stopping Vakrangee as its revenue continues to climb the charts.

Comment – We would like to bring to notice that Aadhaar enrolments as part of e-governance business. E-governance is a not a major revenue contributor currently and hence aadhaar services do not have any major impact on our financials.

Vakrangee is full of surprises. Despite being an IT services company, it has an opening stock of Rs 2,500 crore (~\$384 million) on its books.

Independent analyst Nitin Mangal says this is one of the biggest question marks on the company's balance sheet. "Opening stock is usually something that is consumed to generate revenue. What is that Vakrangee uses?" he asks.

When asked what kind of stock is consumed to generate revenue, the company spokesperson said, "Our cost of goods sold include the goods as well as service commission paid to the franchisee. Also, the governance business includes electoral rolls as well as the hardware kits sold to the franchisees."

The cost of goods in the inventory is quite high vis-a-vis the revenue in the company's books, Mangal says. "There is no clarification from the management on this and the clarification they give does not add up to the numbers," he adds.

A step further

Following the market uproar and a steep fall in share price, the company announced a one-time share buyback of Rs 1,000 crore (~\$153 million) and a dividend payout of Rs 250 crore (~\$38 million) in February. The company, however, did not give a timeline of the buyback.

On closer inspection

Based on the reported Q2 and Q3 FY18 financials, the current net worth (paid-up equity + free reserves) of Vakrangee should be around Rs 2,800 crore (\$430 million). Hence, the company cannot do a buyback of more than Rs 700 crore

“Surprisingly, over the last two months, we haven’t seen any additional details on the buyback from the company. If it feels the price fall is unjustified, it should take advantage of the situation and buyback shares at a low price. This will be value-accretive for shareholders. Why is it waiting for the price to recover?” asks Amit Mantri, Managing Partner, 2Point2 Capital PMS.

Comment – We have already selected the merchant banker for the Buyback process. Share Buyback is a properly defined process whereby we need to first select the merchant banker post which we decide on the methodology and the price. Post that we need to prepare the Letter of offer and do an Extraordinary General Meeting (EGM) for the shareholder approval. We are following the properly defined process and are on track with respect to our share buyback.

Based on the reported Q2 and Q3 FY18 financials, Mantri estimates that the current net worth (paid-up equity + free reserves) of Vakrangee should be around Rs 2,800 crore (\$430 million). Hence, the company cannot do a buyback of more than Rs 700 crore (\$107million), if it plans to do in the next month or two, he says.

After the share buyback announcement, the back-to-back lower circuits came to a stop and the stock price started climbing, hitting consecutive upper circuits for a couple of trading session. The momentum did not sustain, and the price peaked at Rs 286 (~\$4.4) per share and has been in free fall since then, hitting the lower circuit every day. The market cap now stands at Rs 22,245 crore (~\$3.4 billion), as of Monday.

But this doesn’t bother Vakrangee too much. On 31 March, however, the company announced that it has appointed Arihant Capital Markets as a merchant banker to assist

with the buyback. It also has plans to launch an ad campaign soon. For it is time to improve its image.