October 12, 2020

Spandana Sphoorty Financial Limited: Ratings reaffirmed; Rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible Debentures	0.00	200.00	PP-MLD[ICRA]A-(Stable); assigned
Non-convertible Debentures	0.00	200.00	[ICRA]A-(Stable); assigned
Non-convertible Debentures	463.88	428.38	[ICRA]A-(Stable); reaffirmed
Bank Facilities	3,500.00	3,500.00	[ICRA]A-(Stable); outstanding
Total	**3,963.88**	**4,328.38**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings consider Spandana Sphoorty Financial Limited's (Spandana) established track record of operations, its geographically diversified portfolio mix and its financial risk profile, which is characterised by good profitability and comfortable capitalisation. As on June 30, 2020, Spandana was catering to more than 25 lakh active borrowers through a network of 983 branches spread across 281 districts in 18 states (including 1 Union Territory) with assets under management (AUM) of Rs. 6,777 crore. The company reported a return on managed assets of 2.7% (annualised) in Q1 FY2021 compared to 5.0% as on March 31, 2020; the decline in the profitability was primarily because of higher provisions including Rs. 89 crore of Covid-19-related provisions made in Q1 FY2021. Spandana's capitalisation has also remained comfortable supported by regular equity infusions and healthy accruals over the last few years. As on June 30, 2020, the company's gearing was 1.2x (managed gearing[1] of 1.9x) and its 0+dpd[2] and 90+dpd[3] stood at 2.5% and 0.6%, respectively (0.6% and 0.4%, respectively, as on March 31, 2020). The company's collections from the loan accounts have been impacted by the curtailment in economic activities and the extension of the moratorium to the borrowers on account of the Covid-19 pandemic. The ratings continue to factor in the risks associated with the unsecured nature of microfinance loans, the credit risk emerging from the marginal borrower profile and other socio-political and operational risks inherent to the microfinance business. ICRA, however, takes note of the company's adequate internal controls and risk management practices, which are expected to mitigate some of these risks.

Spandana was significantly reliant on securitisation/assignment transactions for its funding requirements in FY2020. However, as funding via this route is expected to be impacted in the near term, it would be crucial to secure funding from other diverse sources. Overall, the company's ability to steadily improve its collections and its funding profile would remain a key near-term monitorable from a rating perspective. Also, ICRA notes that the company has witnessed some churn in its senior management team in the recent past. The key person risk associated with the Managing Director (Ms. Padmaja Reddy) is a concern as many key stakeholders draw comfort from her active involvement in the management of the company. While Spandana is taking initiatives to augment its senior management team, a stable team would be important to manage the future growth.

[1] Managed gearing - (Total debt + assigned portfolio)/ (net worth)

[2] 0+dpd – Total overdue principal portion of delinquent contracts, as a percentage of total principal outstanding

[3] 90+dpd overdue principal portion of delinquent contracts with 90 days past due, as a percentage of total principal outstanding

Key rating drivers and their description

Credit strengths

Diversified geographical presence; established track record – Spandana was established in 2003 and is registered as a non-banking financial company – microfinance institution (NBFC-MFI) with the Reserve Bank of India (RBI). With AUM of Rs. 6,777 crore (on-balance sheet portfolio stood at Rs. 4,890 crore) as on June 30, 2020, the company has an established presence in the domestic microfinance industry. It has a predominantly rural presence with rural borrowers accounting for almost 95% of its total borrower base. Spandana's portfolio is diversified with no state accounting for more than 18% of the portfolio. The concentration of the top three states in the company's portfolio reduced to 48.4% as on March 31, 2020 (48.3% as on June 30, 2020) from 51.58% as on March 31, 2019. As on June 30, 2020, its largest state, Odisha, accounted for 17.3% of the portfolio followed by Madhya Pradesh (17.5%), Maharashtra (13.5%) and Karnataka (12.8%). The district-level concentration is also moderate, in relation to peers, with the top 10 districts constituting 12.0% and the top 20 districts constituting 21.8% of the company's total portfolio as on June 30, 2020. No district accounts for more than 2% of the portfolio. While Spandana envisages to grow its AUM at a CAGR of 25-30% during FY2021-FY2023, the near-term growth will be impacted by the pandemic.

Comfortable capitalisation profile – Spandana's capital adequacy ratio remains well above the regulatory requirement of 15% and the leverage has been comfortable, supported by regular equity infusions and good internal capital generation. As on June 30, 2020, the managed gearing stood at 1.9x. ICRA also notes that the management expects to keep the managed gearing at 2.0-3.0x over the near-to-medium term, which provides comfort.

Efficient monitoring mechanisms supported asset quality in the past; impact of pandemic on collections is a monitorable – The 0+dpd and 90+dpd stood at 2.5% and 0.6%, respectively, as on June 30, 2020, compared to 0.6% and 0.4%, respectively, as on March 31, 2020. ICRA expects the delinquency levels to rise further in the short term, given the impact on its loan collections on account of the pandemic. The collection efficiency[4] (as on September 24, 2020) stood at ~88%, up from ~83% in August 2020 and ~72% in July 2020. As on August 31, 2020, about 10% of the company's total borrower base was under complete moratorium between April 2020 and August 2020. Further improvement in the collections and keeping the credit cost under control would be crucial going forward; the company has created additional provisions in view of the pandemic.

Spandana has strengthened its internal audit team and reduced the number of branches per auditor to enhance the effectiveness of the internal audit. For all loan applications, it conducts credit bureau checks centrally and undertakes house visits and centralised tele-calling at the pre-disbursement stage to verify the authenticity of the applications. The company has moved to cashless disbursements, which were rolled out across geographies from January 2019. This is expected to reduce the operational risks associated with cash handling and frauds. Collections are made on a fortnightly and monthly basis.

Good profitability indicators; near-term pressure expected due to higher provisions – Spandana's profitability metrics have been healthy over the last three years, supported by its tight control on the operating expenses and its low credit costs. The return on managed assets stood at 5.0% and 5.9% in FY2019 and FY2020, respectively. The profitability stood at 2.7% (annualised) in Q1 FY2021; the decline was primarily due to the higher provisioning because of the pandemic. The company has made additional cumulative provisions amounting to about 4.9% of the on-balance sheet portfolio in

[4] *Collection efficiency – Total collections (excluding prepayments)/Total monthly demand*

Q4 FY2020 (Rs. 129 crore) and Q1 FY2021 (Rs. 89 crore) in view of the pandemic. The operating expenses and credit costs, as a proportion of the managed assets, were 2.5% and 5.4%, respectively, in Q1 FY2021 (3.2% and 3.9%, respectively, in FY2020). ICRA takes note of the reduction in the company's loan yields in the recent past. Spandana's current yield on incremental microfinance loans stands at 21.0 % vis-à-vis 24.0% in December 2019 (23.4% as of March 2020). This, along with the higher credit/provision expenses would affect the near-term profitability. Thus, Spandana's ability to maintain the operating efficiencies at optimal levels and keep the incremental credits costs under control would be crucial.

Credit challenges

Vulnerability to key person risk; stability and augmentation of senior management team crucial going forward – Spandana was established in 2003 by Ms. Padmaja Reddy, the Promoter and Managing Director (MD), who has nearly two decades of experience in microfinance operations. The company has a 17-member management team and a 9-member board of directors (BoD) with significant experience in the areas of banking, microfinance, consulting and investment management among others. ICRA notes the high involvement of the MD in the operations of the company and the consequent high dependence and associated key person risk. Further, Spandana has witnessed some churn in its senior management team (including the Chief Financial Officer, Chief Risk Officer and the Company Secretary) in the last few quarters. While the company is taking initiatives to augment its senior management team, a stable team would be important to manage the future growth.

Limited product and revenue diversification – Currently, ~98% of Spandana's portfolio consists of unsecured microfinance loans. Its revenue diversification is also modest with non-interest income/average total assets at <1% during the past five fiscals. Going forward, the company's ability to diversify into new product segments, while maintaining good asset quality and profitability indicators, is crucial.

Ability to manage political, communal and other risks in microfinance sector – Microfinance borrowers typically have a marginal income profile with lower financial literacy and banking habits. The borrowers, mostly dwelling in rural areas, are dependent on agriculture and allied activities, micro/small business activities, etc. as their primary occupation. Consequently, their susceptibility to income shocks is high. The ratings factor in the risks associated with unsecured lending to marginal borrowers with limited ability to absorb income shocks and the rising borrower leverage levels owing to an increase in multiple lending in the areas of operations. Also, the microfinance industry is prone to socio-political and operational risks, which could negatively impact the company's operations and its financial position. A geographically diversified portfolio mitigates these risks to some extent as such issues have largely been region specific so far. Going forward, Spandana's ability to expand into new geographies by on-boarding borrowers with a good credit history along with the commensurate recruitment and retention of employees would be key for managing the future growth.

Ability to diversify funding profile –The company had raised Rs. 3,776 crore thorough securitisation/assignment transactions in FY2020, which accounted for 64.2% of the overall funds raised during the year. Its ability to diversify its lender profile and secure adequate funding would be crucial for maintaining an adequate liquidity profile and for business growth as near-term funding via the securitisation/assignment route would be muted. Spandana had debt outstanding with about 30 lenders as of August 2020 and it raised about Rs. 1,490 crore till August 30, 2020, largely in the form of term loans.

Liquidity position: Adequate

Spandana's unencumbered cash and liquid investment balance stood at about Rs. 449 crore as on September 30, 2020. Additionally, it has unavailed sanctions of Rs. 35.5 crore. Debt repayments (including interest) during October 2020-

January 2021are about Rs. 1,665 crore. The total collections in September 2020 (till September 24, 2020), including prepayments of about Rs. 148 crore, stood at about Rs. 530 crore against an expected demand of Rs. 434 crore. Spandana's liquidity profile is adequate considering the expected collection efficiency of about 85-90% in the near term, the available sanctions and its incremental funding proposals, which are in various stages of approval.

Loans from banks, NBFCs and financial institutions constituted 49% of Spandana's total borrowings (including off-balance sheet) as on August 31, 2020. Funding via the securitisation/assignment route accounted for 44% of the total borrowings with funding through the issuance of debentures accounting for the balance. As securitisation/assignment volumes are expected to be impacted in the current fiscal, it is critical for the company to diversify its borrowing sources to secure funding in a timely manner.

Rating sensitivities

Positive triggers – ICRA could revise the outlook or upgrade the ratings if the company demonstrates sustained healthy profitability and a comfortable capitalisation and asset quality profile over the near-to-medium term even as the portfolio scales up.

Negative triggers – Pressure on the ratings could arise if there is a material deterioration in the asset quality with the 90+dpd increasing beyond 3.0% or if the managed gearing exceeds 5.0x on a sustained basis or if there is a sizeable weakening in the liquidity and earnings profile.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA's Credit Rating Methodology for Non-Banking Finance Companies
Parent/Group Support	NA
Consolidation/Standalone	The ratings are based on Spandana's standalone financial statements. However, in line with its limited consolidation approach, ICRA has factored in the capital requirement of the company's subsidiary – Criss Financial Holdings Limited.

About the company

Spandana Sphoorty Financial Limited (Spandana) was incorporated in 2003 as a non-banking financial company (NBFC) and it took over the microfinance operations of Spandana, a non-governmental organisation started by Ms. Padmaja Reddy in 1998. The company was classified as a non-banking financial company – microfinance institution (NBFC-MFI) in 2015. Following the microfinance crisis in Andhra Pradesh (AP), Spandana entered into a Master Restructuring Agreement (MRA) as a part of the corporate debt restructuring (CDR) with its lenders in September 2011. It exited the CDR in April 2017 after a fresh equity investment led by Kedaara Capital Investment Managers Limited (Kedaara Capital) and fresh funding from three banks. The company completed its initial public offering (IPO) in August 2019.

As on June 30, 2020, Spandana had operations in 18 states/Union Territories spanning 281 districts with a total loan portfolio outstanding of Rs. 6,777 crore (excluding the fully-provided AP portfolio). The active member base and number of credit assistants stood at 25.1 lakh and 5,883, respectively, as on June 30, 2020.

Key financial indicators (Ind-AS)

	FY2019	FY2020	Q1 FY2021
Total Income	1,022.6	1,217.0	308.1
Profit after Tax	308.8	336.7	54.7
Net Worth	1,886.4	2,608.1	2,673.5
Total Managed Portfolio	4,269.2	6,660.8	6,777.3
Total Managed Assets	5,425.6	8,006.0	8,261.5
Return on Managed Assets (%)	5.9%	5.0%	2.7%
Return on Net Worth (%)	18.8%	15.0%	8.3%
Managed Gearing (times)	1.6	1.9	1.9
Gross NPA (%)	8.0%	0.4%	0.6%
Net NPA (%)	0.0%	0.1%	0.1%

Amounts in Rs. crore; All ratios as per ICRA calculations

Status of non-cooperation with previous CRA: Not applicable

Any other information

As per the Auditor's Report for FY2020 and the disclosure made in the Annual Report, ICRA notes that debt repayments to some lenders were not made on the due dates in March 2020 because of the Covid-19-related lockdown and in view of the COVID-19 – Regulatory Package announced by the RBI. ICRA notes that these were because of the lockdown, which created temporary operational challenges in servicing the debt, and the procedural delays in getting approval for a moratorium on the loans from the lending institutions. All these payments were subsequently made in April 2020 irrespective of the receipt of moratorium approval from these institutions.

Rating history for past three years

					Current Rating (FY2021)				Rating History for the Past 3 Years										
					Rating				FY2020	FY2019					FY2018				
	Instrument	Type	Amount Rated	Amount Outstanding	12-Oct-20	01-Jul-20	19-Jun-20	23-Apr-20	07-Jan-20	29-Mar-19	07-Dec 18	17-Jul-18	05-Jun-18	21-May-18	01-Feb-18	23-Oct-17	04-Oct-17	18-Sep-17	18-Aug-17
	MLD	LT	200.00	200.00*	PP-MLD[ICRA]A-(Stable)														
1	NCD	LT	200.00	200.00*	[ICRA]A-(Stable)	-	-	-	-	-	-	-	-	-	-				-
2	NCD	LT	428.38	428.38**	[ICRA]A-(Stable)	[ICRA]A-(Stable)	[ICRA]A-(Stable)	[ICRA]A-(Stable)	[ICRA]A-(Stable)	[ICRA]A-(Stable)	[ICRA]BBB+(Stable)	[ICRA]BBB+(Stable)	[ICRA]BBB+(Stable)	[ICRA]BBB+(Stable)	[ICRA]BBB(Positive)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	-
3	Bank facilities	LT	3,500.00	3,500.00***	[ICRA]A-(Stable)	[ICRA]A-(Stable)	[ICRA]A-(Stable)	[ICRA]A-(Stable)	[ICRA]A-(Stable)	[ICRA]A-(Stable)	[ICRA]BBB+(Stable)	[ICRA]BBB+(Stable)	[ICRA]BBB+(Stable)	[ICRA]BBB+(Stable)	[ICRA]BBB(Positive)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)

Amount in Rs. crore; LT- Long term
** Yet to be placed*
*** Rs. 41.50 crore is unallocated*
**** Rs. 1,155 crore is unallocated*

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: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	Bank facilities	Jun-2017 – Mar-2020	9.55%-15.00%	Jun-2020–Jun-2024	3500.00	[ICRA]A-(Stable)
-	Bank facilities-unallocated	-	-	-	1,155.00	[ICRA]A-(Stable)
INE572J07133*	NCD programme	18-Sep-17	11.3448%	30-Jun-23	85.00	[ICRA]A-(Stable)
INE572J07042	NCD programme	28-Sep-17	13.50%	28-Sep-20	17.88	[ICRA]A-(Stable)
INE572J07067	NCD programme	31-Oct-17	13.15%	31-Oct-23	32.50	[ICRA]A-(Stable)
INE572J07109	NCD programme	07-Dec-18	12.40%	07-Dec-21	61.50	[ICRA]A-(Stable)
INE572J07117	NCD programme	19-Jun-20	12.75%	21-Apr-23	100.00	[ICRA]A-(Stable)
NE572J07125	NCD programme	08-Sep-20	14.00%	08-Sep-22	25.00	[ICRA]A-(Stable)
INE572J07141	NCD programme	24-Sep-20	13.25%	24-Oct-21	40.00	[ICRA]A-(Stable)
INE572J07158	NCD programme	29-Sep-20	12.75%	29-Sep-22	25.00	[ICRA]A-(Stable)
Unutilised	NCD programme	-	-	-	41.50	[ICRA]A-(Stable)
Unutilised	MLD programme	-	-	-	200.00	PP-MLD[ICRA]A-(Stable)

*Source: Company; * Revised from INE572J07034*

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Criss Financial Holdings Limited	97.5%	Limited consolidation

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About ICRA Limited:

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