August 18, 2023

Spandana Sphoorty Financial Limited: Ratings upgraded with change in outlook to [ICRA]A (Stable) and PP-MLD[ICRA]A (Stable)

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term fund based – Term loan	2,105.00	2,105.00	[ICRA]A (Stable); upgraded from [ICRA]A- (Positive) and outlook revised to Stable from Positive
Non-convertible debentures	379.50	379.50	[ICRA]A (Stable); upgraded from [ICRA]A- (Positive) and outlook revised to Stable from Positive
Non-convertible debentures	184.17	0.00	[ICRA]A (Stable); upgraded from [ICRA]A- (Positive), outlook revised to Stable from Positive, and rating withdrawn
Market-linked debentures	120.00	120.00	PP-MLD[ICRA]A (Stable); upgraded from PP-MLD[ICRA]A- (Positive) and outlook revised to Stable from Positive
Total	**2,788.67**	**2,604.50**	

**Instrument details are provided in Annexure I*

Rationale

The ratings upgrade factors in the improvement in Spandana Sphoorty Microfinance Limited's (SSFL) asset quality and earnings over the last few quarters and ICRA's expectation of a sustained performance, going forward. SSFL's gross stage 3 assets (%) improved to 1.5% as of June 2023 from 5.0% as of December 2022 and (18.9% as of March 2022). Also, the standard restructured portfolio declined to 0.04% (of the on-book assets under management; AUM) as of June 2023 from 0.3% as of December 2022 and 8.2% as of March 2022. In FY2023, SSFL had undertaken significant loan write-offs of Rs. 886.1 crore (largely in Q1 FY2023) and sold Rs. 258.0 crore to an asset reconstruction company (ARC). This helped reduce its stressed exposures on account of the Covid-19 pandemic and the operational disruptions faced due to management changes in H2 FY2022. Along with a good delinquency profile, fresh loans originated in FY2023 have demonstrated good collections, contributing to the improved asset quality.

On a consolidated basis, SSFL's net profitability (return on average managed assets; RoMA) improved to 4.7% in Q1 FY2024 (from 0.1% in FY2023 and 0.8% in FY2022), supported by the moderation in credit costs (credit and provisions costs stood at 1.1% in Q1 FY2024 compared to 5.5% in FY2023 and 5.3% in FY2022) and improvement in portfolio yields. The company had changed it lending rates in FY2023 following the revised regulatory framework for microfinance institutions (MFIs). The ratings also factor in SSFL's comfortable capitalisation profile with a capital adequacy ratio of 38.0% and a standalone managed gearing of 2.1x as of June 2023. The consolidated managed gearing stood at 2.1x as of June 2023.

SSFL's consolidated AUM stood at Rs. 8,848 crore as of June 2023, catering to more than 24 lakh borrowers through a network of 1,303 branches spread across 361 districts and 18 states. Its portfolio remains fairly diversified with no state accounting for more than 20% of the portfolio.

The ratings, however, remain constrained by SSFL's funding profile, with the share of bank borrowings (as a percentage of the total consolidated borrowings) declining to 47.0% as of June 2023 from 68.0% as of March 2021 on account of the operational issues faced by the company during the transition to the current management team. During this period, SSFL's reliance on high-cost funding from non-banking financial companies (NBFCs), external commercial borrowings and other capital market sources increased, with their combined share jumping to 53.0% as of June 2023 from 32.0% as of March 2021. Going forward, SSFL's ability to improve bank borrowings and secure funding at competitive rates would be crucial from a rating perspective.

The ratings also consider the risks associated with the marginal borrower profile, unsecured lending, business and political risks along with the high pace of growth. SSFL's ability to manage such risks while expanding to new geographies would be crucial. Additionally, in line with the industry, the company's ability to onboard borrowers with a good credit history and recruit and retain employees would be a key monitorable.

ICRA has upgraded the long-term rating on the Rs. 184.17-crore non-convertible debenture (NCD) programme to [ICRA]A from [ICRA]A-, while revising the outlook to Stable from Positive, and has simultaneously withdrawn the rating as the instrument has been fully redeemed with no amount outstanding against the same. The rating was withdrawn as per ICRA's policy on the withdrawal of credit ratings.

Key rating drivers and their description

Credit strengths

Improving asset quality and earnings – SSFL's gross stage 3 assets (%) improved to 1.5% as of June 2023 and 1.9% as of March 2023 from 18.9% as of March 2022. The improvement was on account of the significant write-off of Rs. 886.1 crore in FY2023. SSFL also sold Rs. 258.0 crore of its stressed portfolio to an ARC in FY2023. ICRA takes note of the steady improvement in collections with the monthly collection efficiency (collections against only the current month's demand) at 98.1% as of June 2023 (93.8% as of December 2022 and 91.9% as of June 2022). As of June 2023, SSFL was carrying provisions of Rs. 185.8 crore (stage 3 provisions stood at Rs. 82.4 crore; 70% of provision coverage ratio).

SSFL reported a consolidated profit after tax (PAT) of Rs. 119.5 crore, translating into a RoMA of 4.7% as of June 2023 (Rs. 12.4 crore and 0.1%, respectively, as of March 2023). As the company had addressed the legacy stress on its loan portfolio in FY2023, its credit costs moderated to 1.1% in Q1 FY2024 from 5.5% in FY2023. Further, following the revised regulatory framework, SSFL increased its lending rate in July 2022 to 24.0% from 21.0% and is currently lending at 25.0%. Consequently, the net interest margin improved to 11.4% in Q1 FY2024 from 9.5% in FY2023 and 9.2% in FY2022. ICRA expects SSFL's net profitability to remain in the range of 3.5%- 4.0% over the medium term, supported by the moderation in credit costs and improvement in interest margins.

Comfortable capitalisation profile – SSFL's capital adequacy ratio remains well above the regulatory requirement of 15% and the leverage has been comfortable, supported by regular equity infusions. On a consolidated basis, the managed gearing was comfortable at 2.1x as of June 2023 and March 2023 (1.4x as of March 2022). SSFL's standalone managed gearing stood at 2.1x as on June 30, 2023. Its capitalisation profile provides it with a comfortable runway for scaling up its operations over the medium term. Going forward, given the strong growth plans envisaged by the management, the gearing is expected to increase with incremental business being funded through fresh borrowings. However, ICRA expects SSFL to maintain its consolidated managed gearing below 4x over the next two years despite the significant growth plans.

Diversified geographical presence; expected to improve further with expansion in new states – SSFL's consolidated AUM grew by 29.0% year-on-year (YoY) in FY2023 and 4.0% quarter-on-quarter (QoQ) in Q1 FY2024 and stood at Rs. 8,848 crore as of June 2023. The company expects to reach a consolidated AUM of about Rs. 18,000.0 crore by FY2025, which will be supported by mainly borrower additions in new geographies as well as diversification into newer asset segments.

SSFL's portfolio remains fairly diversified with no state accounting for more than 20% of the portfolio. The concentration of the top 3 states in the company's portfolio (on a standalone basis) was 42.4% as on June 30, 2023 (50% as on March 31, 2021). As on June 30, 2023, its largest state, Madhya Pradesh, accounted for 16.5% of the standalone portfolio, followed by Odisha (15.0%), Andhra Pradesh (10.9%) and Karnataka (10.6%). The company has identified seven states for scaling up and diversifying its AUM, which would bring down its geographical concentration further.

Credit challenges

Ability to strengthen funding profile critical – ICRA notes SSFL's increased dependence on NBFCs and capital market instruments, including NCDs and market linked debentures (MLDs), for funding. The share of funding through these routes (including external commercial borrowings) increased to 53.0% as of June 2023 from 32.0% as of March 2021, while the share bank borrowings declined to 47.0% from 68.0% during this period. The company is in active discussions with lenders, including public sector banks, for incremental borrowings in the current financial year. Going forward, it is critical for SSFL to strengthen its funding profile, secure funding at competitive rates and achieve the targeted AUM over the next two years.

As of March 2023, ICRA notes that SSFL was not in compliance with certain covenants (pertaining to return on assets(RoA[1]), portfolio at risk(PAR) greater than 30 days(ratio)[2], minimum tangible net worth[3] and liquidity cover[4]) for 12 of its NCD ISINs. Subsequently, some of the covenants were complied with as of June 2023, which reduced the number of ISINs with non-compliance to six (amounting to Rs. 305.8 crore). SSFL has made some early redemptions of Rs. 5.07 crore of NCDs (Rs. 5.09 crore including principal & interest) and has paid an additional interest on the remaining debentures for which the covenant breaches occurred as per respective trust deed. The company is working on curing the breaches as well as is in discussions with the arrangers, debenture trustee and debenture holders seeking covenant waivers in the interim period.

Risks associated with microfinance business – The ratings factor in the risks associated with the marginal borrower profile, unsecured lending, business and political risks, along with the challenges associated with a high pace of growth and attrition. SSFL's ability to manage such risks while expanding in new geographies would be crucial. The company's ability to onboard borrowers with a good credit history, recruit and retain employees and maintain a geographically diversified portfolio would be key for managing high growth rates. While credit bureau checks and the regulatory ceiling on the borrower's fixed obligation to income ratio reduce concerns on overleveraging, issues related to the policy of MFIs, regarding their underwriting practices, borrowers' income and leverage assessment, multiple identity proof as well as gaps in the information available with the bureaus remain. The revised guidelines for the microfinance industry are expected to provide the players, including SSFL, with better pricing ability in view of the underlying risks.

Environmental and social risks

Given the service-oriented business of SSFL, its direct exposure to environmental risks as well as those emanating from regulations or policy changes is not material. While lending institutions can be exposed to environmental risks indirectly through their portfolio of assets, SSFL's exposure to environmentally sensitive segments remains moderate. However, most of its borrowers are in small businesses, with the majority engaged in essential commodity related activities, primarily dependent on local demand-supply forces. If such borrowers face livelihood disruptions because of physical climate adversities, the same could translate into credit risks for entities such as SSFL.

With regard to social risks, data security and customer privacy are among the key sources of vulnerability for lending institutions as material lapses could be detrimental to their reputation and could invite regulatory censure. In FY2022, SSFL had faced such a lapse following a dispute with its erstwhile promoter and information technology (IT) vendor, whereby it lost access to its old systems and servers, resulting in significant operational constraints. However, it was able to retrieve the old systems and servers with all the legacy systems intact, following the resolution of the dispute. Going forward, it would be critical for the company to maintain failsafe policies and processes to mitigate the occurrence of such instances. ICRA notes that SSFL has recently upgraded its loan management system software and is making further investments to create a stable infrastructure to minimise data breaches and safeguard stakeholder data.

[1] *Adjusted RoA to be greater than 0.5% until redemption*

[2] *PAR greater than 30 days to be maintained as specified in the debenture trust deed*

[3] *Tangible net worth to be maintained at the minimum of Rs. 2,800 crore*

[4] *Minimum liquidity cover for debt servicing (without considering any cash inflows) to be maintained*

Liquidity position: Adequate

The company's unencumbered cash and liquid investment balance stood at Rs. 823.3 crore as on June 30, 2023. SSFL's total debt obligation over the next three months (July 2023-September 2023) is Rs. 1,029.7 crore. The on-book liquidity is sufficient to cover approximately two months of debt repayment obligations. The monthly average collection over the next few months is expected to be about Rs. 550-600 crore, providing support to the liquidity profile.

As of June 2023, SSFL (on a consolidated basis) had lending relationships with 45 lenders including 23 NBFCs/financial institutions, 18 private banks, 3 public sector banks and 1 foreign private investor. Its funding profile (on a consolidated basis) comprised borrowings from banks (47.0%), financial institutions (FIs)/NBFCs (18.0%), non-convertible debentures and MLDs (31.0%) and external commercial borrowings (4.0%).

Rating sensitivities

Positive factors – ICRA could revise the outlook to Positive or upgrade the ratings if there is an improvement in SSFL's funding profile, while sustaining its asset quality and earnings profile as it scales up.

Negative factors – Pressure on the ratings or outlook could arise if the company's managed gearing exceeds 5x on a sustained basis or there is a weakening of the profitability (RoMA of less than 2%) on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Rating Methodology for Non-banking Finance Companies Rating Approach – Consolidation Policy on Withdrawal of Credit Ratings
Parent/Group support	Not Applicable
Consolidation/Standalone	The ratings are based on SSFL's consolidated financial statements (Annexure II)

About the company

Spandana Sphoorty Financial Limited (SSFL) 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 an NBFC-microfinance institution (NBFC-MFI) in 2015. Following the microfinance crisis in Andhra Pradesh (AP), the company 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 an equity investment led by Kedaara Capital Investment Managers Limited (Kedaara Capital) and fresh funding from three banks. SSFL completed its initial public offering (IPO) in August 2019. The current leadership team is led by Mr. Shalabh Saxena (Managing Director & Chief Executive Officer) and Mr. Ashish Damani (President & Chief Financial Officer). The company has a 10-member board of directors, including 5 independent directors.

Key financial indicators (audited)

Spandana Sphoorty Financial Limited (consolidated)	FY2022	FY2023	Q1 FY2024
Total income	1,438.4	1,438.3	528.0
Profit after tax	69.8	12.4	119.5
Net worth	3,089.9	3,099.0	3,228.0
Total managed assets	8,214.2	10,159.6	10,479.0
Return on average managed assets	0.8%	0.1%	4.7%
Return on average net worth	2.4%	0.4%	15.2%
Managed gearing (times)	1.4	2.1	2.1

Source: Company, ICRA Research; All ratios as per ICRA's calculations; Amount in Rs. crore;

Spandana Sphoorty Financial Limited (standalone)	FY2022	FY2023	Q1 FY2024
Total income	1,350.8	1,355.8	496.8
Profit after tax	46.6	12.3	111.1
Net worth	3,031.5	3,043.2	3,164.0
Total managed assets	7,985.5	9,933.3	10,260.9
Return on average managed assets	0.5%	0.1%	4.4%
Return on average net worth	1.6%	0.4%	14.3%
Managed gearing (times)	1.4	2.1	2.1
Gross stage 3 (on-b/s)	18.9%	1.9%	1.5%
Net stage 3 (on-b/s)	11.5%	0.6%	0.4%
Solvency (net stage 3/net worth)	20.5%	1.5%	1.1%
CRAR	50.7%	36.9%	38.0%

Source: Company, ICRA Research; All ratios as per ICRA's calculations; Amount in Rs. crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)											
		Chronology of Rating History for the Past 3 Years											
		Type	Amount Rated (Rs. crore)	Amount O/S (Rs. crore)	Date & Rating in FY2024	Date & Rating in FY2023			Date & Rating in FY2022	Date & Rating in FY2021			
					Aug-18-2023	Mar-27-2023	Mar-01-2023	Sep-29-2022	Nov-10-2021	Nov-20-2020	Oct-12-2020	Jul-01-2020	Jun-19-2020
1	MLD	LT	120.00	120.00	PP-MLD[ICRA] A (Stable)	PP-MLD[ICRA] A- (Positive)	PP-MLD[ICRA] A- (Positive)	PP-MLD[ICRA] A- (Stable)	PP-MLD[ICRA] A-&	PP-MLD[ICRA] A- (Stable)	PP-MLD[ICRA] A- (Stable)	-	-
2	NCD	LT	379.50	295.38	[ICRA]A (Stable)	[ICRA]A- (Positive)	[ICRA]A- (Positive)	[ICRA]A- (Stable)	[ICRA]A-&	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)
3	NCD	LT	184.17	0.00	[ICRA]A (Stable); withdrawn	[ICRA]A- (Positive); Withdrawn	[ICRA]A- (Positive)	[ICRA]A-&	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)
4	Term loan	LT	2,105.00	2,105.00	[ICRA]A (Stable)	[ICRA]A- (Positive)	[ICRA]A- (Positive)	[ICRA]A- (Stable)	[ICRA]A-&	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)

**Outstanding amount has declined on account of part payment against ISIN INE572J07281 (reduced to Rs. 16.13 crore from Rs. 21.50 crore), ISIN INE572J07315 (reduced to Rs. 30.00 crore from Rs. 100.00 crore) and ISIN INE572J07323 (reduced to Rs. 26.25 crore from Rs. 35.00 crore)*

& - Denotes Rating Watch with Developing Implications

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term fund based – Term loan	Simple
Non-convertible debentures	Simple
Market linked debentures	Moderately complex

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 are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Long-term fund based – Term loan	June 09, 2017 to March 24, 2023	NA	August 31, 2023 to January 27, 2026	1,493.48	[ICRA]A (Stable)
Unutilised	Term loan	NA	NA	NA	611.52	[ICRA]A (Stable)
INE572J07133	NCD programme	September 18, 2017	11.34%	June 30, 2023	85.00	[ICRA]A (Stable); withdrawn
INE572J07224	NCD programme	October 31, 2017	11.34%	June 30, 2023	32.50	[ICRA]A (Stable); withdrawn
INE572J07117	NCD programme	June 19, 2020	12.75%	April 21, 2023	66.67	[ICRA]A (Stable); withdrawn
INE572J07281	NCD programme	December 24, 2020	11.49%	December 22, 2023	21.50	[ICRA]A (Stable)
INE572J07315	NCD programme	February 26, 2021	12.50%	February 26, 2024	100.00	[ICRA]A (Stable)
INE572J07323	NCD programme	March 12, 2021	11.49%	March 12, 2027	35.00	[ICRA]A (Stable)
INE572J07414	NCD programme	August 1, 2022	12.29%	August 1, 2028	23.00	[ICRA]A (Stable)
Unutilised	NCD programme	-	-	-	200.00	[ICRA]A (Stable)
INE572J07257	MLD programme	November 24, 2020	-	November 24, 2023	100.00	PP-MLD[ICRA]A (Stable)
INE572J07208	MLD programme	October 28, 2020	-	June 27, 2024	20.00	PP-MLD[ICRA]A (Stable)

Source: Company

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Criss Financial Holdings Limited	**99.85%**	Full Consolidation
Caspian Financial Services Limited	**100.00%**	Full consolidation

Source: Company
Note: ICRA has taken a consolidated view of the parent (SSFL), its subsidiaries and associates while assigning the ratings

ANALYST CONTACTS

Karthik Srinivasan
+91 22 6114 3444
karthiks@icraindia.com

R Srinivasan
+91-44-4596 4315
r.srinivasan@icraindia.com

A M Karthik
+91 44 4596 4308
a. karthik@icraindia.com

Deepali Panda
+91 80 4332 6400
deepali.panda@icraindia.com

RELATIONSHIP CONTACT

L. Shivakumar
+91 22 6114 3406
shivakumar@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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For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

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