

October 04, 2017

Spandana Sphoorty Financial Limited

Summary of rated instruments

Instruments*	Amount (Rs. crore) ¹	Rating Action
Non-convertible debentures	400.00	[ICRA]BBB- (stable); assigned
Total	400.00	

*Instrument details are provided in Annexure-1

Rating action

ICRA has assigned a long-term rating of [ICRA]BBB- (pronounced ICRA triple B minus) to the Rs. 400.00 crore non-convertible debenture programme of Spandana Sphoorty Financial Ltd (Spandana)². The outlook on the long-term rating is stable. ICRA also has rating outstanding of [ICRA]BBB- with stable outlook for the company's Rs. 150.00 crore non-convertible debenture programme and Rs. 500.00 crore bank facilities.

Rationale

The assigned rating takes into consideration the promoter's experience in the microfinance business, the company's established track record, its relatively diversified geographical presence, and good earnings profile. Following a fresh capital investment by Kedaara Capital Investment Managers Limited³ (Kedaara Capital) and financing by a group of banks in March 2017, all the existing liabilities of the company under corporate debt restructuring (CDR) arrangement, which it had entered with its lenders in September 2011, were settled in March 2017. The above was part of a separate settlement arrangement entered by the company with its lenders, which included repayment of outstanding debt of about Rs. 900 crore and purchase of outstanding Optionally Convertible Cumulative Redeemable Preference Shares (OCCRPS) of Rs.791 crore at a 73% discount by Kedaara Capital. The OCCRPS were converted to Compulsorily Convertible Preference Shares (CCPS), through a separate arrangement, before their acquisition by Kedaara Capital in March 2017. Spandana's formal exit from the CDR was confirmed by the CDR Empowered Group in April 2017. The company's net worth, following the above transactions, turned positive as on March 31, 2017 and stood at Rs. 537.2 crore with a comfortable gearing of 1.8 times (2.5 times as on August 31, 2017).

Spandana is expected to embark on a steep business growth at a CAGR of 80% over the period FY2018-FY2020 in the non-AP portfolio; while the expected capital infusion of Rs. 125.0 crore by Kedaara Capital in Q3FY2018 is likely to support the near term capitalisation profile, Spandana would require regular infusion going forward for maintaining a comfortable capital structure as internal generation would be moderate in relation to the targeted portfolio growth. Timely availability of incremental funding from diverse sources would be crucial. The company is in the process of strengthening and broad basing its senior management team for supporting its growth plans. However, in the near to medium term, Spandana's ability to expand its borrower base, and recruit, train and retain employees, in view of the challenges faced by the microfinance segment currently, would be a key monitorable.

The rating takes note of the deterioration in the company's asset quality post demonetisation, with 90+dpd (in the non-AP portfolio) at 4.0% as on August 31, 2017 as compared with 0.2% as on September 30, 2016. The 90+ dpd however witnessed steady improvement from 5.1% as on June 30, 2017 and 6.0% as on March 31, 2017. Nevertheless, the asset quality remains relatively comfortable as compared with

¹ Rs. 1 crore = Rs. 10 million = Rs. 100 lakh

² For complete rating scale and definitions, please refer to ICRA's website (www.icra.in) or other ICRA rating publications

³ Through a special purpose vehicle called Kanchenjunga Limited

the prevailing industry average. ICRA also takes comfort from the steady decline in the overdues in recent months and the provisions made by the company on these overdues. The old AP portfolio, which became delinquent post the crisis in 2010-2011, is also fully provided for. The rating factors in the risks associated with the unsecured nature of microfinance loans, credit risk emerging from the marginal borrower profile and other socio-political and operational risks inherent to the microfinance business.

Key rating drivers

Credit strengths

- **Established track record of operations and experienced senior management team** – Spandana was established in 2003 by Ms. Padmaja Reddy, the company's Promoter and Managing Director, who has nearly two decades of experience in microfinance operations. Currently, the company has experienced senior managers heading key functions including internal audit, risk management, IT, MIS, training, human resources and operations. However, it would be crucial for the company to strengthen its senior and middle level management team further to manage the targeted portfolio expansion.
- **Improved financial position, supported by the large capital infusion** - During FY2017, Spandana's net worth turned positive to Rs. 537.2 crore as on March 31, 2017 (- Rs. 606.9 crore as on March 31, 2016) on account of the fresh capital infusion from Kedaara Capital amounting to Rs. 300 crore and acquisition of Rs. 791 crore OCCRPS (at 73% discount) by converting them into CCPS. Kedaara Capital is expected to infuse further equity of around Rs. 125 crore in Q3FY2018. The company's gearing was comfortable at 2.5 times (provisional) as on August 31, 2017; going forward, the management aims to cap the managed gearing at around 4.0-4.5 times. ICRA notes that the company would however require additional capital of about Rs. 500-600 crore over the period FY2019-FY2020 to maintain the gearing at targeted levels.
- **Fairly diversified geographically with presence across 13 states and Union Territories** - Spandana's portfolio is adequately diversified with Madhya Pradesh contributing 22.1% of the loan book as on August 31, 2017, followed by Karnataka (21.6%), Orissa (19.7%) and Maharashtra (13.9%). The district level concentration is also moderate in relation to peers with top 5 districts constituting 9.1% of the company's total portfolio as on August 31, 2017.
- **Comfortable profitability indicators** – For FY2017, the company's net profitability⁴ (adjusted for the AP portfolio) was comfortable at 3.6%. Spandana's operating efficiencies are expected to improve going forward with improvement in scale; operating expenses as a proportion of managed assets (adjusted for the AP portfolio) improved to 5.0% (provisional) for 5MFY2018 as compared with 6.5% in FY2017. Spandana has also created provisions of Rs. 45.5 crore on account of the overdues post demonetization in Q4FY2017 and further Rs. 25.3 crore in 5MFY2018. Considering the steady decline observed in the overdues in recent months and the current provisions made, incremental provisioning requirement is expected to be moderate. ICRA expects the profitability indicators to remain healthy with the growth in portfolio; however, maintaining operating efficiencies at optimal levels and incremental credits costs under control would be crucial. The company's overall profitability in the past was supported by its optimal cost structure, reversals in provision/write offs (made post the AP crisis) and tax benefit because of the accumulated losses.

⁴ ROA

- **Adequate internal controls and monitoring systems for the current scale of operations** – The company has a separate internal audit and risk management team. Spandana undertakes operational, financial and trigger based audits. The company's IT system is based on FIMO solutions and it also uses Microsoft Business Intelligence tool for portfolio monitoring and analysis. For all loan applications, Spandana undertakes credit bureau checks centrally and also undertakes house visits and centralised tele-calling at the pre-disbursement stage to verify the authenticity of applications. The company undertakes fortnightly collections. The overall systems and processes followed by the company are adequate for its current scale of operations.

Credit weaknesses

- **Deterioration in asset quality post demonetisation** - As on September 30, 2016, the company had a good asset quality profile with 0+ dpd (non-AP) at 0.3%, which steeply increased to 9.1% as on December 30, 2016 post demonetization (0+ PAR at Rs. 116.6 crore). ICRA notes that the company collected specified bank notes (SBN) notes between November 08, 2016 to and December 31, 2016 (amounting to 4.1% of its portfolio as on September 30, 2016); however, the company did not allow prepayments in SBN and it maintains the required KYC documents of the customers who paid instalments in SBNs. With improvement in currency circulation and the company's focused collections efforts, the 0+ dpd steadily decreased to 7.8% as on March 31, 2017 (Rs. 101.5 crore), 5.3% as on June 30, 2017 (Rs. 93.3 crore) and 4.1% as on August 31, 2017 (Rs. 83.6 crore). The 90+ dpd stood at 4.0% as on August 31, 2017 (6.0% as on March 31, 2017 and 5.1% as on June 30, 2017), which is lower level than the prevailing industry average.
- **Ability to manage political, communal and other risks in the microfinance sector** – The microfinance industry is prone to socio-political and operational risks, which could negatively impact its operations and thus financial position. However, a geographically diversified portfolio would mitigate these risks to some extent as such issues have largely been region specific so far. Spandana's ability to on-board borrowers with good credit history, recruit and retain employees, especially in view of the attrition observed at the field level and expand into new geographies would be key for managing the high growth.
- **Ability to diversify the funding profile adequately to scale up operations** - Spandana's bank borrowings constituted 73% of its total borrowings of Rs. 1,409 crore as on August 31, 2017, wherein 63% of the total borrowings are from bank loans (from 3 banks) availed at the time of CDR exit; the remaining 37% of the total borrowings are from a few private-sector banks and some NBFCs. ICRA notes that the company would require sizeable funding in relation to the envisaged portfolio growth. Going forward, therefore it is critical for the company to diversify its funding sources to secure funding in a timely manner, commensurate with the envisaged portfolio growth, while maintaining a comfortable liquidity profile.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria:

[ICRA's Credit Rating Methodology for Non-Banking Finance Companies](#)

About the company:

Spandana Sphoorty Financial Limited (Spandana) was incorporated in 2003 as a non-banking financial company (NBFC) and 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 Limited⁵ (Kedaara Capital) and fresh funding from three banks. The key shareholders in the company as on July 31, 2017 on a diluted basis are Kedaara Capital and Affiliates (58.2%), JM Financial Ltd group (9.5%) and the company's erstwhile promoter Ms. Reddy (17.3%), who continues to be the Managing Director.

As on August 31, 2017, the company had operations in 13 states and union territories spanning across 198 districts with a total loan portfolio outstanding of Rs. 2,002 crore. The active member base and number of credit assistants stood at 10.6 lakh and 2,279 respectively as on August 31, 2017.

As per the provisional financial statements for 5M FY2017, the company achieved a net profit of Rs. 35.0 crore on a total asset base of Rs. 2,956.3 crore as on August 31, 2017. During FY2017, Spandana reported a net profit of Rs. 52.9 crore on an asset base of Rs. 2,413.2 crore as on March 31, 2017 as compared with a net profit of Rs. 243.2 crore during FY2016 on an asset base of Rs. 2,099.9 crore as on March 31, 2016.

Key Financial Indicators (Audited)

	FY2016	FY2017
Net Interest Income	213.8	162.5
Profit before tax	243.2	76.5
Profit after tax	243.2	52.9
Loan advances (including non-yielding old AP portfolio)	2,018.8	2,094.6
Total assets	2,099.9	2,413.2
% Tier 1	-18.6%	48.5%
% CRAR	-18.6%	49.0%
% Net Interest Margin / Average total assets	9.6%	7.2%
% Net Profit / Average total assets	10.9%	2.3%
% Return on Net Worth	-33.5%	-152.0%
% 90+ dpd	0.0%	6.0%
% 30+ dpd	0.1%	7.5%
% Net NPAs	0.1%	1.6%
% Net NPA/ Net worth	-0.2%	6.9%

Note: Amounts in Rs. crore

While the company's financial parameters consider the non-yielding old AP portfolio of about Rs. 800 crore, which has 100% provision cover, the operational parameters do not consider this portfolio

Source: Spandana, ICRA research

⁵ Through a special purpose vehicle called Kanchenjunga Limited

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years:

Table:

S.No	Instrument	Current Rating (FY2018)					Chronology of Rating History for the past 3 years		
		Type	Rated amount (Rs. crore)	October 2017	September 2017	August 2017	FY2017	FY2016	FY2015
1	Unallocated bank facilities	Long term	500.00	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	-	-	-
2	Non-convertible debenture programme	Long term	12.00	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	-	-	-
3	Non-convertible debenture programme	Long term	18.00	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	-	-	-
4	Non-convertible debenture programme	Long term	120.00	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	-	-	-	-
5	Non-convertible debenture programme	Long term	400.00	[ICRA]BBB-(Stable)	-	-	-	-	-

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

Instrument	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Rated Amount (Rs. crore)	Current Rating and Outlook
Unallocated bank facilities	-	-	-	500.00	[ICRA]BBB-(stable)
Non-convertible debenture programme	21-Aug-17	12.30%	21-Aug-20	12.00	[ICRA]BBB-(stable)
Non-convertible debenture programme [#]	-	-	-	18.00	[ICRA]BBB-(stable)
Non-convertible debenture programme	18-Sep-17	14.00%	18-Sep-23	100.00	[ICRA]BBB-(stable)
Non-convertible debenture programme	26-Sep-17	12.4-13.3%	25-Sep-20	20.00	[ICRA]BBB-(stable)
Non-convertible debenture programme	28-Sep-17	13.50%	28-Sep-20	400.00	[ICRA]BBB-(stable)

[#]yet to be placed
Source: Spandana

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About ICRA Limited:

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