

Spandana Sphoorty Financial Limited

July 17, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non Convertible Debenture Programme	735.00	735.00	[ICRA]BBB+ (Stable); rating outstanding
Long-term bank facilities	500.00	2,500.00	[ICRA]BBB+ (Stable); rating assigned
Total	1,235.00	3,235.00	

Rating action

ICRA has assigned the long-term rating of [ICRA]BBB+ (pronounced ICRA triple B plus) to the Rs.2,500.00 crore¹ (enhanced from Rs.500 crore) long-term bank facilities of Spandana Sphoorty Financial Limited (Spandana)². The outlook on the rating is 'Stable'. ICRA also has rating outstanding of [ICRA]BBB+ (pronounced ICRA triple B plus) on the Rs.735.00 crore non-convertible debenture programme of Spandana. The outlook on the rating is 'Stable'

Rationale

The assigned rating takes into account the company's diversified geographical presence and track record of operation, promoter's experience in the microfinance business and its adequate internal control and monitoring. The company, supported by the above, witnessed a rapid business scale up during FY2018, while maintaining a healthy profitability and asset quality indicators. For FY2018, Spandana reported net profitability³ of 5.1% (2.3% in FY2017) driven by enhanced operating efficiencies on the back of portfolio growth (~91%) and equity infusions during the period (about Rs 275 crore); net profitability excluding the fully provided AP portfolio stood at 6.8% for FY2018. The company's asset quality indicators remain comfortable with 90 days past due (dpd) delinquencies, adjusted for provisions, at 0.16% (0.13% in September 2017) as on March 31, 2018⁴. The company's gearing stood low at 1.6 times as on March 31, 2018; this along with the proposed capital raise in FY2019 is expected to support the overall leveraging over the period FY2019 and FY2020 as the company is expected to grow its portfolio at a steep pace going forward. ICRA also takes note of the initiatives taken by the company to augment its senior management bandwidth to support the envisaged steep portfolio expansion plans.

Given the ongoing steep portfolio growth, it is crucial for the company to keep the internal controls, processes and, asset quality under control. Also, timely availability of incremental funding from diverse sources would be crucial. In the near to medium term, it is key for the company to expand its borrower base, and recruit, train and retain employees as the portfolio and geographical presence expands, in view of the current challenges faced by the microfinance segment. The rating continues to factor 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.

¹ 100 lakh = 1 crore = 10 million

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

³ Profit After Tax/Average Managed Assets

⁴ Excluding the non-yielding old AP portfolio

ICRA takes note of the auditors' report for FY2018 highlighting certain delays in servicing of the loans from financial institutions and banks during the year. However, ICRA notes that the aforesaid delays were technical in nature - caused due to certain procedural issues and not owing to liquidity pressures. Based on the subsequent strengthening of processes and measures put in place by the company, ICRA believes such delays to not repeat going forward.

Outlook: Stable

ICRA expects the company to report business and geographical expansion while maintaining a comfortable capital structure. The outlook may be revised to 'Positive' if Spandana is able to keep credit costs under control, diversify its funding profile and report healthy capitalisation profile as business grows and diversifies to new geographies. The outlook may be revised to 'Negative' if the asset quality, earnings and capital profile weakens on account of the steep portfolio growth.

Key rating drivers

Credit strengths

Established track record of operations and experienced board and 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. The company is also taking efforts to further strengthen its senior and middle level management team to manage the targeted portfolio growth. The company has ten board members, including five investor nominee directors and four independent directors. The committees to board include audit and risk management committee, nomination and remuneration committee, CSR committee and management committee.

Comfortable capitalisation, supported by 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 Investment Managers Limited⁵ (Kedaara Capital) amounting to Rs.300 crore and acquisition of Optionally Convertible Cumulative Redeemable Preference Shares (OCCRPS) of Rs.791 crore (at 73% discount) after converting them into Compulsorily Convertible Preference Shares (CCPS). Additionally, the company raised capital of Rs.275 crore during H2 FY2018. This, together with healthy profitability during FY2018 aided in strengthening of its net worth to Rs.984.2 crore as on March 31, 2018. The company's gearing was comfortable at 1.6x times as on March 31, 2018 and the management aims to cap the managed gearing at around 4.0-4.5 times going forward.

Fairly diversified geographically with presence across 15 states and Union Territories - Spandana's portfolio is adequately diversified with Karnataka contributing 22.4% of the total portfolio as on March 31, 2018, followed by Madhya Pradesh (22.0%), Orissa (18.8%) and Maharashtra (13.7%). The district level concentration is also moderate in relation to peers with top 10 districts constituting 15.4% of the company's total portfolio as on March 31, 2018.

Improving asset quality indicators - As on September 31, 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 31, 2016 (Rs. 116.6 crore) post demonetization. ICRA notes that the company collected specified bank notes (SBN) between November 08, 2016 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.

⁵ Through a special purpose vehicle called Kanchenjunga Limited

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), 3.6% as on September 30, 2017 (Rs. 78.8 crore) and 2.1% as on March 31, 2018 (Rs. 66.8 crore). ICRA notes that the company had extended interim loans (smaller-ticket and shorter tenor loans) to its borrowers during FY2018, including to some overdue borrowers, based on recent debt servicing track record. ICRA notes that the performance of interim loans has been healthy so far and the share of these loans as on March 31, 2018 stood at 8.9%. Going forward, ability to keep asset quality under control as borrower level exposure increases along with the sharp portfolio growth would be a key monitorable.

Good profitability indicators – Spandana's profit after tax on average managed assets including old AP portfolio was comfortable at 5.1% in FY2018 (6.8% excluding the old AP portfolio). The operating expenses as a proportion of managed assets reduced from 4.2% in FY2017 (6.5% excluding the old AP portfolio) to 3.2% in FY2018 (4.2% excluding the old AP portfolio) aided by improvement in scale. Post demonetisation, Spandana has created adequate provisions, which stood at Rs. 60.4 crore as on March 31, 2018 against the 90+ dpd of Rs. 65.2 crore as on March 31, 2018; thus, the incremental provisioning requirement is expected to be moderate. Ability to maintain operating efficiencies at optimal levels and keeping incremental credits costs under control would be crucial in view of the steep expansion plan.

Adequate internal controls and monitoring systems for the current scale of operations – Spandana has a separate internal audit and risk management team. It undertakes operational, financial and trigger based branch audits. ICRA notes that the company is taking various initiatives to increase the branch audit frequency in relation to its growth plans; the current internal audit team strength of around 120 is expected to be increased to around 150 in the near term. The 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. Spandana's disbursements are completely in cash mode; the collections are largely on fortnightly basis. The overall systems and processes followed by the company are adequate for its current scale of operations.

Credit challenges

Ability to diversify the funding profile adequately to scale-up operations - Spandana's borrowings from scheduled commercial banks constituted 71.1% of its total borrowings of Rs.2,280.3 crore (including securitisation) as on March 31, 2018 with the balance being borrowings from other financial institutions and debentures. ICRA notes that the company would require sizeable funding in relation to the envisaged portfolio growth. 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.

Limited product and revenue diversification – Currently, Spandana's entire portfolio consists of microfinance loans. Its revenue diversification is also modest with non-interest income / average total assets at 0.3-0.4% during the past five fiscals, primarily constituting of commission income from sale of third party utility products to its members. ICRA takes note of the company's proposal to diversify into other loan segments including secured lending like vehicle loans, mortgage loans etc over the next 2-3 years. The company's ability to diversify into these new product segments, while maintaining good asset quality and profitability indicators is crucial.

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. Going forward, Spandana's ability to expand into new geographies by on-boarding borrowers with good credit history along with recruitment and retaining of employees, especially in view of the attrition observed at the field level, would be key for managing the high envisaged growth.

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 Spahoorty 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 Limited⁶ (Kedaara Capital) and fresh funding from three banks. The key shareholders in the company as on April 24, 2018 on a diluted basis are Kedaara Capital and Affiliates (62.7%), JM Financial Ltd group (6.7%) and the company's promoter Ms. Reddy (19.4%), who continues to be the Managing Director.

As on March 31, 2018, the company had operations in 15 states and union territories spanning across 222 districts with a total loan portfolio outstanding of Rs. 3,166 crore. The active member base and number of credit assistants stood at 15.9 lakh and 2,746 respectively as on March 31, 2018.

Key financial indicators

	FY 2016 (audited)	FY 2017 (audited)	FY2018 (audited)
Total Income	347.5	376.0	525.7
Profit after Tax	243.2	52.9	171.9
Net worth	-606.9	537.2	984.2
Total Managed Portfolio [^]	2,018.8	2,094.6	4,013.9
Total Managed Assets [^]	2,099.9	2,413.2	4,262.9
Return on Average Managed Assets [^] (%)	10.9%	2.3%	5.1%
Return on Average Net worth (%)	-33.5%	-152.0%	22.6%
Gross NPA [^] (%)	39.7%	42.1%	25.9%
Net NPA [^] (%)	0.1%	2.9%	0.3%
Net NPA [^] / Net worth	-0.2%	6.9%	0.7%
Managed Gearing (times)	-2.9	1.8	2.3
CRAR [^] (%)	-18.6%	49.0%	37.2%

Note: Amounts in Rs. crore

[^]Includes the non-yielding old AP portfolio of about Rs. 800 crore, which has 100% provision cover

Source: Spandana, ICRA research

⁶ Through a special purpose vehicle called Kanchenjunga Limited

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2019)						Chronology of Rating History for the past 3 years					
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs Crore)	FY2019			FY2018				FY2017	FY2016
					Jul 2018	May 2018	May 2018	Feb 2018	Oct 2017	Sep 2017	Aug 2017	-	-
1	Unallocated bank facilities	LT	500.00	2,500.00	[ICRA]BBB+ (Stable)	[ICRA]BB B+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB (Positive)	-	-	[ICRA]BB B- (Stable)	-	-
2	Non-convertible debenture	LT	12.00	12.00	[ICRA]BBB+ (Stable)	[ICRA]BB B+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB (Positive)	-	-	[ICRA]BB B- (Stable)	-	-
3	Non-convertible debenture	LT	18.00	18.00	[ICRA]BBB+ (Stable)	[ICRA]BB B+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB (Positive)	-	-	[ICRA]BB B- (Stable)	-	-
4	Non-convertible debenture	LT	120.00	120.00	[ICRA]BBB+ (Stable)	[ICRA]BB B+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB (Positive)	-	[ICRA]BB B- (Stable)	-	-	-
5	Non-convertible debenture	LT	400.00	400.00	[ICRA]BBB+ (Stable)	[ICRA]BB B+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB (Positive)	[ICRA]BBB- (Stable)	-	-	-	-
6	Non-convertible debenture	LT	35.00	35.00	[ICRA]BBB+ (Stable)	[ICRA]BB B+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB (Positive)	[ICRA]BBB- (Stable)	-	-	-	-
7	Non-convertible debenture	LT	150.00	150	[ICRA]BBB+ (Stable)	[ICRA]BB B+ (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

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	Unallocated bank facilities	-	-	-	2,500.00	[ICRA]BBB+ (Stable)
INE572J07026	Non-convertible debenture programme	21-Aug-17	12.30%	21-Aug-20	12.00	[ICRA]BBB+ (Stable)
INE572J07059	Non-convertible debenture programme	26-Oct-17	12.30%	26-Oct-20	18.00	[ICRA]BBB+ (Stable)
INE572J07034	Non-convertible debenture programme	18-Sep-17	14.00%	18-Sep-23	100.00	[ICRA]BBB+ (Stable)
INE572J08016	Non-convertible debenture programme	26-Sep-17	12.4-13.3%	25-Sep-20	20.00	[ICRA]BBB+ (Stable)
INE572J07042	Non-convertible debenture programme	28-Sep-17	13.50%	28-Sep-20	400.00	[ICRA]BBB+ (Stable)
INE572J07067	Non-convertible debenture programme	31-Oct-17	13.15%	31-Oct-23	35.00	[ICRA]BBB+ (Stable)
Yet to be placed	Non-convertible debenture programme	-	-	-	150.00	[ICRA]BBB+ (Stable)

Source: Spandana

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