

May 04, 2023

## Spandana Sphoorty Financial Limited: Provisional [ICRA]A-(SO) assigned to PTCs issued under microfinance loan securitisation transaction – Sunflower 03 2023

### Summary of rating action

Trust Name	Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Sunflower 03 2023	PTC Series A1	48.52	Provisional [ICRA]A-(SO); Assigned

\*Instrument details are provided in Annexure I

Rating in the absence of pending actions/documents	No rating would have been assigned as it would not be meaningful
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### Rationale

ICRA has assigned a provisional rating to the pass-through certificates (PTCs) issued under a securitisation transaction backed by microfinance loan receivables originated by Spandana Sphoorty Financial Limited {SSFL; rated [ICRA]A-(Positive)}. The PTCs are backed by a pool of Rs. 60.18-crore microfinance loan receivables (underlying pool principal of Rs. 52.45 crore; initial pool). As per the transaction structure, the originator would assign follow-on pools to the trust during the replenishment period of 12 months basis the defined eligibility criteria. The amortisation of the PTCs would begin, post crystallisation of the pool, either at the end of the replenishment period or on the occurrence of any predefined trigger event, whichever is earlier.

The provisional rating is based on the strength of the cash flows from the selected pool of contracts and the credit enhancement available in the form of (i) a credit collateral comprising a cash collateral (CC) of 5.00% and a corporate guarantee (CG) of 5.00% of the initial pool principal to be provided by the originator, (ii) over-collateralisation of 7.50% of the initial pool principal and (iii) the entire excess interest spread (EIS) in the structure. The provisional rating is also based on the integrity of the legal structure. The provisional rating is subject to the fulfilment of all the conditions under the structure and the review of the documentation pertaining to the transaction by ICRA.

### Key rating drivers

#### Credit strengths

- Availability of credit enhancement in the form of Excess Interest Spread, overcollateralisation/subordination and credit collateral
- The initial pool has no overdue contracts as on pool cut-off date. Further any follow-on pool would also not include any overdue contracts on date of assignment to trust

#### Credit challenges

- The performance of the transaction would be exposed to performance of the follow-on pools which have a moderate selection criteria
- Performance of current and follow-on pools would remain exposed to natural calamities that may impact the income generating capability of the borrower, given the marginal borrower profile; further, pool performance would also be exposed to political and communal risks.
- Performance of the current and follow-on pools would remain exposed to macro-economic shocks / business disruptions, if any

## Description of key rating drivers highlighted above

SSFL would assign the future receivables arising from the selected pool of microfinance loans to a special purpose vehicle (trust).

The trust would issue one series, viz. PTC Series A1, backed by the assigned microfinance loan receivables. The entire principal amount is promised to PTC Series A1 in a single bullet instalment on the scheduled maturity date. The cash flows available after meeting the expected principal and promised interest payouts to the PTC Series A1 investor are available as a form of support. A credit collateral of 10.00% of the pool receivables provided by SSFL acts as further credit enhancement in the transaction. In the event of a shortfall in meeting the promised PTC monthly interest payouts and the PTC principal on the scheduled maturity date, the trustee will utilise the CC to meet the shortfall.

The legal maturity of the PTCs is scheduled on December 23, 2025. The tenure of the transaction shall be divided into two periods:

- Replenishment period
- Amortisation period

### Replenishment period

During the replenishment period, the principal collections from the pool will be utilised to purchase additional receivables (or further receivables or a fresh set of additional receivables) at monthly intervals. These receivables would be assigned to the trust. The replenishment period will be for 12 months from the transaction commencement date. During this period, PTC Series A1 investors will receive only the promised interest payouts on a monthly basis and the trust will purchase fresh pools as per the selection criteria from the available balance amount. Any residual amount will flow back to the originator.

### Amortisation period

Post the replenishment period, the residual pool collections, after meeting the promised interest payouts to the PTC investors, shall be used to make the expected principal payouts to the PTC investors. However, the principal is 'promised' to the investors only on the legal final maturity date of the transaction. The transaction also entails certain trigger events for pool amortisation. A breach of any of these trigger events would lead to the end of the replenishment period and the start of the amortisation period. If a trigger event occurs at any time during the replenishment period, then the tenure of the PTCs shall be reduced and be co-terminus with the remaining tenure of the pool of receivables held by the trust.

### Additional or further receivables

In conventional securitisation transactions, all or the majority of the pool collections in a particular month (including prepayments, if any) are passed on to the PTC investors on the following payout date as per the cash flow waterfall. However, in the present structure, only the PTC interest will be serviced and the balance pool cash flows will be utilised to acquire further receivables during the replenishment period of 12 months post the transaction date. Principal collections, including part prepayment/foreclosures, will be used to purchase these additional receivables from the originator during the replenishment period. The contracts in the fresh pools would be required to meet certain prespecified eligibility criteria.

### Key eligibility criteria for the receivables

The eligibility criteria shall be met:

1. On commencement of the transaction
2. At each replenishment event for all the new assets being added as well as for the updated pool (as applicable)

The following key eligibility criteria will have to be met:

Weighted average internal rate of return (IRR) of replenished pool should not be less than weighted average IRR of initial pool and

Maturity date of the underlying loans of replenished pool should not be more than August 2025

The facility is a loan to an individual or propriety or partnership firm

No facility is classified as a non-performing asset (NPA) for the purpose of the directions and guidelines of the Reserve Bank of India (RBI)

The pool should comply with the minimum holding period requirements prescribed by the RBI

None of the loans in the pool has residual maturity of less than 365 days

No facility is/shall be overdue as on the respective pool cut-off date for initial pool/additional receivables to be purchased during the replenishment period

Underlying obligor for any facility should not have been restructured or rescheduled by any lender or NPA with any lender.

Underlying obligor should not have had a written-off status with the originator

All facilities have an interest payment frequency of less than or equal to a month

All facilities are fully disbursed by the originator

No security deposits (howsoever described) have been taken as security in relation to the facility

State concentration to be capped at 25% and district concentration at 7% of the pool principal outstanding (POS) as on the respective cut-off dates

As on the respective cut-off dates, initial pool/additional receivables to be purchased during the replenishment period shall exclude contracts from districts where the portfolio at risk (PAR) 90+ exceeds 5% as per the latest portfolio cuts

All facilities have been disbursed at a fixed or floating rate of interest by the eligible originator and the rate of interest has not been downgraded by the eligible originator (nor has the eligible originator agreed or committed to any such reduction) and there are no provisions for a downward reset of the interest rate

#### Trigger events

On the occurrence of any of the following triggers, replenishment will stop and all collections (for avoidance of doubt, any principal payment, interest payment, penalties or fees) will be used as per the amortisation period waterfall:

Utilisation of credit collateral to service PTC Series A1 interest

Rating downgrade of originator/servicer by two notches from date of transaction

30+ PAR on the outstanding pool breaches 10%

Satisfaction of conditions that will trigger turbo amortisation trigger as defined in the legal documents

A potential concern pertaining to a replenishing structure is the uncertainty regarding the exact composition of the additional receivables. However, the specified eligibility criteria ensure a reasonable credit quality of the assigned pool during the replenishment period through favourable seasoning, credit profile of the borrower and low delinquency levels. The performance of the initial and follow-on pools would be exposed to political and communal risks and natural calamities that may impact the income-generating capability of the borrower. The performance of both the initial and the follow-on pools would also remain exposed to macroeconomic shocks/business disruptions.

**Performance of past rated pools:** ICRA has previously rated 40 microloan receivable pools originated by SSFL, of which nine are live. There has been no CC utilisation till date for the live pool and the loss-cum-30+ days past due (dpd) was below 1.0% as of the March 2023 payout.

#### Key rating assumptions

ICRA's cash flow modelling for rating asset-backed securitisation (ABS) transactions involves the simulation of potential delinquencies (shortfall in principal collection during the tenor of the pool) and prepayments in the pool. The assumptions for the shortfall in collections are arrived at after taking into account the past performance of the originator's portfolio and the rated pools as well as the characteristics of the current pool being evaluated. However, since the pool in the current transaction would be revised during the replenishment period, the characteristics of the pool would change unlike other PTC transactions where the pool is static. ICRA has used the defined eligibility criteria to arrive at a potential loss for the follow-on pools. Additionally, the assumptions may be adjusted to account for the current macroeconomic situation as well as any industry-specific factors that ICRA believes could impact the performance of the underlying pool of contracts.

After making these adjustments, the expected mean shortfall in principal collection during the tenure of the current pool and the follow-on pools is estimated at 4.5-5.5% with certain variability around it. The prepayment rate for the underlying pool is estimated in the range of 3.0-9.0% per annum.

### Liquidity position: Strong

The principal amount on the rated PTCs is promised on the scheduled maturity date. Only the interest amount is promised on a monthly basis. The amortisation of the PTCs will start after the end of the replenishment period (12 months) or the occurrence of a trigger event and the collected principal will be passed on to the investor on expected basis. Additionally, a credit collateral of 10.00% of the initial pool principal is available in the transaction. The pool collections and the credit enhancement are expected to be comfortable to meet the promised payouts to the investors.

### Rating sensitivities

**Positive factors** – Since the principal amortisation would begin on the crystallisation of the final pool, the rating is unlikely to be upgraded till the final pool is crystallised. The rating could be upgraded basis the healthy collections observed in the final crystallised pool, leading to the build-up of the credit enhancement cover over the rated PTCs.

**Negative factors** – The rating could be downgraded on the occurrence of a trigger event, non-adherence to the key transaction terms and deterioration in the performance of the follow-on pools such that the delinquencies during the amortisation period are higher than expected.

### Analytical approach

The rating action is based on the analysis of the performance of SSFL’s portfolio till December 2022, the key characteristics and composition of the current pool, the performance expected over the balance tenure of the pool, and the credit enhancement available in the transaction.

Analytical Approach	Comments
Applicable rating methodologies	<a href="#">Rating Methodology for Securitisation Transactions</a>
Parent/Group support	Not Applicable
Consolidation/Standalone	Not Applicable

### Pending actions/documents required to be completed for conversion of the provisional rating into final

The assigned rating is provisional and would be converted into final upon the execution of:

1. Trust deed
2. Assignment agreement
3. Legal opinion
4. Trustee letter
5. Power of Attorney
6. Chartered Accountant’s (CA) certificate
7. Any other documents executed for the transaction including for the CC

### Validity of the provisional rating

The Trust is expected to complete the pending actions/execute the pending documents in the near term. However, in case of continued pendency of the actions/documents beyond one year of this publication, the provisional rating would be withdrawn for the transaction even if the instrument has been issued.

## Risks associated with the provisional rating

In case the issuance is completed, but the pending actions/documents are not completed for the transaction within one year (validity period) from the assignment of the rating, the provisional rating will be withdrawn in accordance with ICRA's Policy on Provisional Ratings available at [www.icra.in](http://www.icra.in).

## About the Originator

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 a non-banking financial company – 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 a fresh 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. Following Ms. Padmaja Reddy's exit from her executive position in the company in November 2022, a new leadership team – led by Mr. Shalabh Saxena (CEO & MD) - has taken over the management of the company.

## Key financial indicators (audited) (standalone)

Spandana Sphoorty Financial Limited (standalone)	FY2020	FY2021	FY2022	9M FY2023*
<b>Total income</b>	1,430.9	1,431.7	1,350.8	863.5
<b>Profit after tax</b>	336.7	129.0	46.6	(103.9)
<b>Loan book</b>	5,092.7	7,040.1	5,915.7	6,567.7
<b>Total managed assets</b>	8,006.0	9,635.3	7,985.5	8,695.6
<b>Gross NPA (%)</b>	0.4%	3.26%	17.70%	5.1%#
<b>Net NPA (%)</b>	0.1%	1.52%	9.68%	2.3%

Source: Company, ICRA Research; \* Provisional numbers; # After sale of assets to asset reconstruction company (ARC); All ratios as per ICRA's calculations; Amount in Rs. crore; All ratios as per ICRA's calculations

## Status of non-cooperation with previous CRA: Not applicable

Any other information: None

## Rating history for past three years

Sr. No	Trust Name	Current Rating (FY2024)				Chronology of Rating History for the Past 3 Years			
		Instrument	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in FY2024	Date & Rating in FY2023	Date & Rating in FY2022	Date & Rating in FY2021	
					May 04, 2023	-	-	-	
1	Sunflower 03 2023	PTC Series A1	48.52	48.52	Provisional [ICRA]A-(SO)	-	-	-	

## Complexity level of the rated instrument

Instrument	Complexity Indicator
PTC Series A1	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**

Trust Name	Instrument	Date of Issuance / Sanction	Coupon Rate	Maturity Date*	Amount Rated (Rs. crore)	Current Rating
<b>Sunflower 03 2023</b>	PTC Series A1	April 2023	12.00%	December 2025	48.52	Provisional [ICRA]A-(SO)

\* Scheduled maturity date at transaction initiation; may change on account of prepayments

Source: Company

**Annexure II: List of entities considered for consolidated analysis**

Not applicable

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## About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit [www.icra.in](http://www.icra.in)



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