

June 21, 2023

Spandana Sphoorty Financial Limited: Rating confirmed as final for PTCs issued under a microfinance loan securitisation transaction

Summary of rating action

| Trust Name | Instrument* | Current Rated Amount (Rs. crore) | Rating Action |
|-------------------|---------------|-------------------------------------|---|
| Sunflower 03 2023 | PTC Series A1 | 48.52 | [ICRA]A-(SO); provisional rating confirmed as final |

*Instrument details are provided in Annexure I

Rationale

In May 2023, ICRA had 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). Since the executed transaction documents are in line with the rating conditions and the legal opinion for the transaction has been provided to ICRA, the said rating has now been confirmed as final.

As per the transaction structure the originator would assign follow-on pool to the trust during the replenishment period basis defined eligibility criteria. The amortisation of the PTCs would begin post crystallization of the pool either at end of replenishment period or on occurrence of trigger event. However, ICRA takes comfort from the defined eligibility criteria which is likely to ensure that the follow-on pools would have a better credit profile. The performance of the pool post May-23 payout has been healthy with low delinquencies with pool collections used for purchase of follow-on pool subject to the defined waterfall mechanism. Further post May-23 payout there has been marginal PTC amortisation due to unavailability of loans for purchase that meet the defined eligibility criteria.

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 43 microfinance loan receivable pools originated by SSFL. For the live pools that have completed at least one payout, there has been no CC utilisation till date and the loss-cum-0+ days past due (dpd) is below 1.0% as of the May 2023 payout.

Key rating assumptions

ICRA's cash flow modelling for rating asset-backed security (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, in the current transaction since the pool 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 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 contracts.

After making these adjustments, the expected mean shortfall in principal collection during the tenure of the current pool as well follow-on pools is estimated to be 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 trustee confirming compliance with the terms of the transaction and the executed transaction documents being in line with the terms initially shared with ICRA.

| Analytical Approach | Comments |
|---------------------------------|--|
| Applicable rating methodologies | Rating Methodology for Securitisation Transactions |
| Parent/Group support | Not Applicable |
| Consolidation/Standalone | Not Applicable |

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 | FY2020 | FY2021 | FY2022 | FY2023 |
|-------------------------------------|---------|---------|---------|---------|
| Total income | 1,430.9 | 1,431.7 | 1,350.8 | 1,355.8 |
| Profit after tax | 336.7 | 129.0 | 46.6 | 12.3 |
| Total managed assets | 8,006.0 | 9,635.3 | 7,985.5 | 9,717.7 |
| Gross NPA (%) | 0.4% | 3.26% | 17.70% | 2.0% |
| Net NPA (%) | 0.1% | 1.52% | 9.68% | 0.6% |

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

| 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 |
| | | | | | June 21, 2023 | May 04, 2023 | | | |
| 1 | Sunflower 03 2023 | PTC Series A1 | 48.52 | 48.52 | [ICRA]A-(SO) | 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) | Rating |
|--------------------------|---------------|-----------------------------|-------------|----------------|--------------------------|--------------|
| Sunflower 03 2023 | PTC Series A1 | April 2023 | 12.00% | December 2025 | 48.52 | [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:

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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.

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