July 15, 2024

Spandana Sphoorty Financial Limited: Ratings upgraded; outlook revised to 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 and outlook revised to Stable from Positive
Non-convertible debentures	258.00	258.00	[ICRA]A+ (Stable); upgraded from [ICRA]A and outlook revised to Stable from Positive
Non-convertible debentures	100.00	0.00	[ICRA]A+ (Stable); upgraded from [ICRA]A and outlook revised to Stable from Positive and withdrawn
Market linked debentures	20.00	0.00	PP-MLD [ICRA]A+ (Stable); upgraded from PP-MLD[ICRA]A and outlook revised to Stable from Positive and withdrawn
Total	**2,483.00**	**2,363.00**	

**Instrument details are provided in Annexure I*

Rationale

The rating action factors in the improvement in Spandana Sphoorty Financial Limited's (SSFL) profitability and asset quality in FY2024. The net profitability (return on average managed assets; RoMA) increased to 4.1% (consolidated) in FY2024 (0.1% in FY2023 and 0.8% in FY2022), supported by lower credit costs (credit and other provision costs stood at 2.1% in FY2024 compared to 5.5% in FY2023 and 5.3% in FY2022) and higher portfolio yields. SSFL's gross stage 3 assets (consolidated) improved to 1.7% as of March 2024 from 2.2% as of March 2023. The company witnessed some uptick in delinquencies from the levels seen in September 2023, partly attributable to operational changes, including the transition to the weekly collection model from the existing monthly model. While these changes are expected to strengthen borrower connect and loan collections in the long run, the collection process, and consequently the asset quality, shall witness some near-term headwinds until the changes are streamlined. ICRA, nevertheless, expects the overall asset quality to stay healthy, with credit costs remaining under control. Further, SSFL's risk profile is supported by its comfortable capitalisation profile with a capital adequacy ratio of 32.0% and a standalone managed gearing of 2.7x as of March 2024 (consolidated managed gearing of 2.8x).

The ratings also consider the risks associated with the marginal borrower profile, unsecured lending business, political risks and the high pace of growth. SSFL's consolidated assets under management (AUM) stood at Rs. 11,973 crore as of March 2024, catering to 33.2 lakh active borrowers through a network of 1,687 branches (including 45 co-located branches) spread across 20 states and union territories. Its portfolio remains diversified with no state accounting for more than 15% of the same. SSFL's ability to manage such risks while expanding to new geographies would be crucial. ICRA takes note of various initiatives for risk management, technology and operational improvements, which shall partly offset the impact of the above risks.

The Stable outlook reflects ICRA's opinion that SSFL would continue to maintain healthy profitability and asset quality along with a comfortable capital structure as it scales up its AUM.

ICRA has upgraded the ratings for the Rs. 100.00-crore non-convertible debenture (NCD) programme and the Rs. 20.00-crore market linked debenture (MLD) programme and revised the outlook to Stable from Positive while simultaneously withdrawing the ratings as the instruments have been fully redeemed with no amount outstanding against the same. The ratings have been withdrawn as per ICRA's policy on the withdrawal of credit ratings as confirmed by the client.

Key rating drivers and their description

Credit strengths

Diversified geographical presence – SSFL's consolidated AUM grew by 41.0% year-on-year (YoY) in FY2024 to Rs. 11,973 crore as of March 2024. The company expects to achieve a consolidated AUM of Rs. 28,000 crore by FY2028, which is likely to be largely supported by borrower additions in new geographies and diversification into newer asset segments.

SSFL's portfolio remains fairly diversified with no state accounting for more than 15% of the portfolio. The concentration of the top 5 states in the company's portfolio (on a standalone basis) was 59.6% as on March 31, 2024 (63.1% as on March 31, 2022). As on March 31, 2024, its largest state, Odisha, accounted for 14.3% of the standalone portfolio, followed by Madhya Pradesh (13.5%), Bihar (11.5%), Karnataka (10.3%) and Andhra Pradesh (10.1%). The company has identified six focus states for scaling up and diversifying its AUM, which would bring down its geographical concentration further.

Healthy asset quality and earnings – SSFL's gross stage 3 assets (consolidated) improved to 1.4% as of September 2023 from 2.2% as of March 2023, though it weakened slightly thereafter and stood at 1.7% as of March 2024. The higher delinquencies in H2 FY2024 were partly attributable to operational changes, including the transition to the weekly collection model from the existing monthly model. These changes are expected to strengthen borrower connect and loan collections in the long run; however, the collection process, and consequently the asset quality, shall witness some near-term headwinds until these changes are streamlined. ICRA, nevertheless, expects the overall asset quality to stay healthy, with credit costs remaining under control. ICRA notes that the company had largely recovered from the Covid-19 pandemic-related issues and operational disruptions by the end of FY2023, supported by significant write-offs and the sale of stressed loans to an asset reconstruction company (ARC). Write-offs had moderated significantly to Rs. 86.2 crore (0.8% of closing AUM) in FY2024, supported by healthy collections from the loans originated after the pandemic.

SSFL reported a consolidated profit after tax (PAT) of Rs. 500.7 crore, translating into RoMA of 4.1% as of March 2024 (Rs. 12.4 crore and 0.1%, respectively, as of March 2023). As the company had addressed the legacy stress in its loan portfolio in FY2024, its credit and other provision costs moderated to 2.1% FY2024 from 5.5% in FY2023. Further, SSFL's lending rate has increased to 24.0-25.0% in FY2023 from around 21% in previous years. Consequently, the net interest margin improved to 11.4% in FY2024 from 9.5% in FY2023 and 9.2% in FY2022. ICRA notes the initiatives taken by the company to cut its lending rates for seasoned borrowers and expects the net profitability to remain at 3.5-4.0% in the medium term.

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 2.8x as of March 2024 and 2.1x as of March 2023 (1.4x as of March 2022). SSFL's standalone managed gearing stood at 2.7x as of March 2024. Going forward, given the strong growth plans envisaged by the management, the gearing is expected to increase with fresh borrowings funding incremental business. However, ICRA expects SSFL to keep its consolidated managed gearing below 3.5x over the next two years.

Credit challenges

Ability to strengthen funding profile – SSFL's borrowing profile has improved steadily in the last 4-6 quarters, characterised by the addition of new lenders. The group raised about Rs. 10,441 crore in FY2024 (compared to about Rs. 5,775 crore in FY2023) from existing as well as new lenders. The marginal cost of borrowing has declined over the last four quarters and stood at 11.9% in Q4 FY2024 compared to 12.6% in Q4 FY2023. However, SSFL's cost of borrowing is higher compared to some of the industry peers. ICRA notes that the share of bank borrowings (as a percentage of the total consolidated borrowings) increased to 52% as of March 2024 from 45% as of March 2023, while the combined share of the other relatively higher-cost borrowings (non-banking financial companies (NBFCs), external commercial borrowings (ECBs), and capital market sources, etc.) moderated to 48% as of March 2024 from 55% as of March 2023. The company was in breach of some covenants on NCDs, amounting to Rs. 31.7 crore as of March 2024. Going forward, it is critical for SSFL to strengthen its funding profile, secure funding at competitive rates and achieve the targeted AUM over the near-to-medium term.

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 policies of microfinance institutions (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.

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. Nevertheless, 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.

Liquidity position: Adequate

The company has a provisional unencumbered cash and liquid investments of Rs. 1,025 crore and sanctioned undrawn bank lines of Rs. 630 crore as on June 30, 2024. SSFL's total debt obligation over the next three months (July-September 2024) is Rs. 2,056 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. 800-900 crore, providing support to the liquidity profile.

As of March 2024, SSFL had lending relationship with 55 lenders including 22 NBFCs/Financial Institutions, 20 private banks/ small finance banks, 4 public sector banks, 1 foreign private investor and 2 Development Financial Institution (DFI). Its funding profile (on a consolidated basis) comprised borrowings from banks (54.0%), financial institutions (FIs)/NBFCs (18.4%), non-convertible debentures and MLDs (19.7%), DFI (6.1%) and external commercial borrowings (1.7%).

Rating sensitivities

Positive factors – A significant scale-up in the operations, while maintaining healthy profitability and asset quality, would be a positive factor.

Negative factors – Managed gearing of more than 5x on a sustained basis or a significant weakening in the asset quality or profitability (RoMA of less than 2.5%) on a sustained basis could lead to a negative impact.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Non-banking Financial Companies (NBFCs) 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). However, it took over the microfinance operations of Spandana, a non-governmental organisation 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 (standalone)	FY2022	FY2023	FY2024
Total income	1,350.8	1,355.8	2,386.7
Profit after tax	46.6	12.3	467.9
Total managed assets	7,985.5	9,933.3	13,852.3
Return on managed assets	0.5%	0.1%	3.9%
Managed gearing (times)	1.4	2.1	2.7
Gross stage 3	18.9%	1.9%	1.6%
CRAR	50.7%	36.9%	32.0%

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

Spandana Sphoorty Financial Limited (consolidated)	FY2022	FY2023	FY2024
Total income	1,479.9	1,438.3	2,510.8
Profit after tax	69.9	12.4	500.7
Total managed assets	8,214.2	10,159.5	14,406.9
Return on managed assets	0.8%	0.1%	4.1%
Managed gearing (times)	1.4	2.1	2.8
Gross stage 3 assets	15.0%	2.2%	1.7%
CRAR	NA	NA	NA

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 (FY2025)			Chronology of Rating History for the Past 3 Years				
		Type	Amount Rated (Rs. crore)	Date & Rating in FY2025	Date & Rating in FY2024		Date & Rating in FY2023		Date & Rating in FY2022
				Jul-15-2024	Jan-15-2024	Dec-15-2023 Aug-18-2023	Mar-27-2023 Mar-01-2023	Sep-29-2022	Nov-10-2021
1	NCD	LT	258.00	[ICRA]A+ (Stable)	[ICRA]A (Positive)	[ICRA]A (Stable)	[ICRA]A- (Positive)	[ICRA]A- (Stable)	[ICRA]A-&
2	Term loan	LT	2,105.00	[ICRA]A+ (Stable)	[ICRA]A (Positive)	[ICRA]A (Stable)	[ICRA]A- (Positive)	[ICRA]A- (Stable)	[ICRA]A-&

LT – Long term; & - 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	**Term loan**	Sep-30-2021 to Mar-24-2023	NA	Jul-29-2024 to Jan-27-2026	339.73	[ICRA]A+(Stable)
Unutilised	**Term loan**	NA	NA	NA	1765.27	[ICRA]A+(Stable)
INE572J07323	**NCD**	Mar-12-2021	11.49%	Mar-12-2027	35.00	[ICRA]A+(Stable)
INE572J07414	**NCD**	Aug-01-2022	12.29%	Aug-01-2028	23.00	[ICRA]A+(Stable)
INE572J07703	**NCD**	Mar-28-2024	9.81%	Apr-02-2026	100.00	[ICRA]A+(Stable)
Yet to be placed	**NCD**	-	-	-	100.00	[ICRA]A+(Stable)
INE572J07315	**NCD**	Feb-26-2021	12.50%	Feb-26-2024	100.00	[ICRA]A+(Stable); withdrawn
INE572J07208	**MLD programme**	Oct-28-2020	-	Jun-27-2024	20.00	PP-MLD [ICRA]A+ (Stable); withdrawn

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	**99.90%**	Full Consolidation
Caspian Financial Services Limited	**100.00%**	Full consolidation

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

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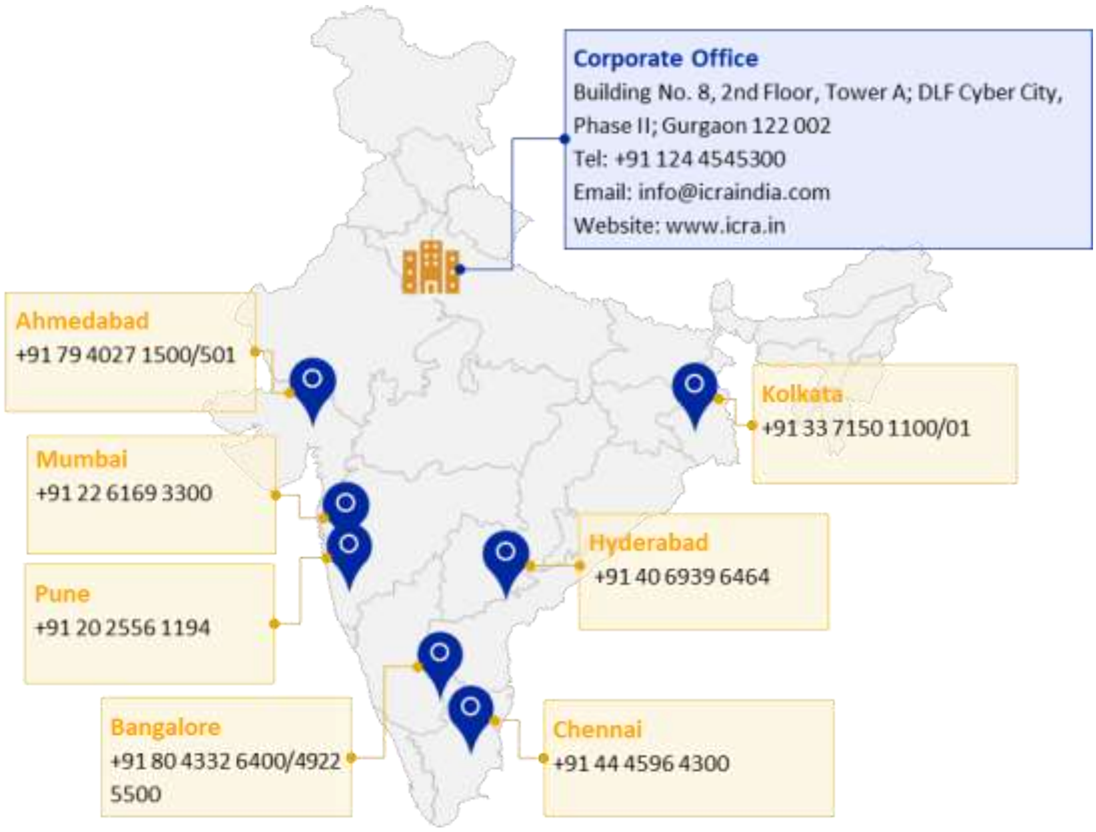

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