Spandana Sphoorty Financial Limited

Issue Snapshot:

Issue Open: August 05 – August 07, 2019

Price Band: Rs. 853 – 856

Issue Size: 14,029,622 eq shares (Fresh issue of 4,672,897 + 9,356,725 Offer for sale)

Issue Size: Rs.1196.73 crs – 1200.94 crs

QIB	upto 60% eq sh
Non Institutional	atleast 15% eq sh
Retail	atleast 35% eq sh

Face Value: Rs 10

Book value: Rs 316.84 (March 31, 2019)

Bid size: - 17 equity shares and in multiples thereof

100% Book built Issue

Capital Structure:

Pre Issue Equity:	Rs. 59.63 cr
Post issue Equity:	Rs. 64.31 cr

Listing: BSE & NSE

Global Co-Ordinators & Book Running Lead Managers: Axis Capital Limited, ICICI Securities Limited, IIFL Securities Limited, JM Financial Limited

Book Running Lead Manager: IndusInd Bank Limited, YES Securities (India) Limited

Registrar to issue: Karvy Fintech Private Limited

Shareholding Pattern

Shareholding Pattern	**Pre issue %**	**Post issue %**
Promoter and Promoter Group	81.22	63.82
Public & Employee	18.78	36.18
Total	100.0	100.0

Source for this Note: RHP

*Assuming pricing at the higher end of band

Background & Operations:

Spandana Sphoorty Financial Limited (SSFL) is a leading, rural focused NBFC-MFI with a geographically diversified presence in India offering income generation loans under the joint liability group model, predominantly to women from low-income households in Rural Areas. As of March 31, 2019, it was the fourth largest NBFC-MFI and the sixth largest amongst NBFC-MFIs and SFBs in India, in terms of AUM. Through its extensive corporate history, it has developed an in-depth understanding of the borrowing requirements of the low-income client segment. Its business model involves regular client meeting processes through its employees, who maintain contact with its clients across the districts that it covers. As of June 30, 2019, it had 7,062 employees (including 5,051 credit assistants) operating out of 929 branches in 269 districts across 16 states and 1 union territory in India. Through its loan products and client-centric approach, SSFL endeavours to strengthen the socio-economic well-being of low-income households by providing financing on a sustainable basis in order to improve livelihoods, establish identity and enhance self-esteem.

SSFL was incorporated as a public company in 2003 and registered as an NBFC with the RBI in 2004. Subsequently, it registered as an NBFC-MFI in 2015. Between the years 2005 to 2010, it grew its micro-finance operations and, as of March 2010, it was the second largest MFI in terms of AUM. Its lenders referred it to the corporate debt restructuring (CDR) mechanism of the RBI to develop a plan to restructure its borrowings and revive its business. It agreed on a CDR plan with its lenders, which allowed to get cash-flow relaxations to enable to continue its efforts towards portfolio diversification, process improvement and cost rationalization. These measures helped SSFL turn its operations profitable from the year ended March 31, 2014. It had the lowest portfolio per branch amongst peer comparison of major NBFC-MFIs and SFBs, as of March 31, 2017. Post exit from CDR, it was able to optimize the ticket sizes and also acquire new clients at existing and new branches. This helped it to grow its Gross AUM in Fiscal 2018 at one of the highest rates (143.8%) among large NBFC-MFIs in India. Over Fiscals 2018 and 2019, its Disbursements increased by 87.34% and 28.82% (from Rs20,591.65 million as of March 31, 2017 to Rs38,576.48 million as of March 31, 2018 and to Rs49,692.83 million as of March 31, 2019) and its standalone Gross AUM was Rs13,015.36 million as of March 31, 2017 and its consolidated Gross AUM grew from Rs31,667.85 million as of March 31, 2018 and to Rs44,372.78 million as of March 31, 2019.

Objects of Issue:

The Offer comprises of the Fresh Issue and the Offer for Sale.

The Net Proceeds will be utilized to augment the capital base of SSFL to meet future capital requirements which are expected to arise out of growth in the assets, primarily the loans and advances given by SSFL.

Competitive Strengths

Seasoned business model with resilient performance through business cycles: Through various business cycles, SSFL has been able to leverage the inherent strength of its client centric business model, focus on internal controls, the expertise of its Individual Promoter and core management team to maintain its status as a leading NBFC-MFI. Its response to the 2010 AP crisis demonstrated the strength of its decision making, planning and execution. In the aftermath of the 2010 AP crisis, even while SSFL was under CDR, it continued operations outside Andhra Pradesh in various states. In this period, it focused on rebuilding profitable operations through portfolio diversification, cost rationalization, customer retention, and recovery from its Andhra Pradesh portfolio. These measures helped it to raise new debt from existing lenders and gain capital infusion from Kangchenjunga, its Corporate Promoter and Kedaara AIF 1, which allowed SSFL to exit from CDR in March 2017. Its performance (in terms of reductions in 30 dpd delinquencies and 90 dpd delinquencies) and asset quality was superior to the industry after demonetization, as a result of its rural focus, lower share of portfolio in the most affected districts and its geographically diversified portfolio. Its track record of dealing with the aftermath of the 2010 AP Crisis, CDR and demonetization demonstrates the strength of its business model, policies and client relationships as well as ability to manage the expectations of varying stakeholders in the business, including staff, lenders, shareholders and clients.

High degree of client engagement and robust risk management, leading to superior asset quality and collections: SSFL focus on a high degree of client engagement through large employee base and operating procedures. Its client engagement practices include village/block level centre meetings and client training. Prior to lending to a client, it imparts training over three days on loan terms, utilization and repayment, insurance and client support services. It also conducts center meetings where clients interact with its staff at regular intervals (typically based on their installment payments frequency). Further, its risk management norms are designed keeping in mind the various kinds of risks to its business. It makes changes to these norms from time to time in response to business environment to ensure a responsive risk management strategy. Many risk control measures are embedded in the business process. Further, in order to prevent frauds by its employees, SSFL follow a standard transfer policy, whereby all its field employees are transferred after spending a fixed period (not exceeding 18 months) at one location. It follows certain criteria while transferring employees to prevent the possibility of collusion with each other.

Streamlined systems and processes and high employee productivity leading to low operating expense ratio: SSFL's business processes are designed for scale and efficiency and it constantly review and endeavor to strengthen them as the scale of its operations increase. Its operational efficiency is also driven by streamlined systems and procedures and scalable workforce deployment. At the branch level, it has implemented standardized systems and a front-end interface that gives real time information on demand and collections. The systems follow an accounting module with budget controls built and approval authorities clearly earmarked. These practices and systems help in reducing the time and cost of its operations. In addition, with a view to offering timely service to its clients and thereby increase client retention and increasing its loan portfolio, SSFL provides repeat loans on a timely basis to its existing clients. Faster processing of loans improves client experience and also helps save time, thereby improving cost utilization at branch level.

Focus on the high potential and under-served rural segment*:* Rural Areas in India are a highly under-served market for formal banking services in terms of access, availability and suitability of products and services. Therefore, SSFL strategically focus on clients in the rural sector. According to ICRA Research, while rural India accounts for approximately 68% of India's population as of March 2018, it accounted for only 34% of total deposit accounts and 23% of the loan accounts in scheduled commercial banks. ICRA Research notes that the significant under penetration of credit in Rural Areas offers strong potential for improvement and that given the relatively deeper reach, existing client relationships and employee base, micro-finance institutions are well placed to address this demand, which is currently being met by informal sources such as local money lenders. Accordingly, with SSFL focus on the rural segment as of December 31, 2018, 88% of its portfolio was located in Rural Areas, as compared with 61% for 33 NBFC-MFIs as a whole. Further, loans given to its clients for agriculture and allied activities can be classified as "Direct Agri" by banks pursuant to the RBI's priority sector lending guidelines, which provides it with the opportunity to assign this portfolio to banks that need to meet their target on Direct Agri loans. As of March 31, 2019, 94.6% of its portfolio was located in Rural Areas.

Geographically diversified operations leading to risk containment and business resilience: As of June 30, 2019, SSFL cover 74,749 villages in 269 districts in 16 states and 1 union territory across India through 929 branches. Its operations are well-diversified at the branch, district and state levels. Presence in widespread geographies in India offers it a potential growth opportunity to further grow the business penetration in same areas and also reach out to more congruent geographies. To address geographic concentration risk, it has specified exposure caps at the state, district and branch levels. With this adopted norm, its operations are geographically well-diversified with no single state contributing more than 20.01% to AUM, no district contributing more than 1.82% to its AUM and no branch more than 0.3% to its AUM as of March 31, 2019. Further, according to ICRA Research, it had the second lowest GLP per branch amongst peer comparison of certain NBFC-MFIs and SFBs, as of March 31, 2018 and lowest GLP per branch amongst peer comparison of certain NBFC-MFIs and SFBs in March 31, 2019. Further, as per SSFL's risk containment norms, disbursements for any single state must be less than 22.5% of its total disbursements. In addition, total disbursement at each branch is capped at 600 loans per month, to ensure that sufficient supervisory checks can be done to maintain quality of appraisals.

Significant industry experience of Promoter and management team: The long-standing industry experience of SSFL's Individual Promoter and its management team provides it with an understanding of the needs and behaviour of the clients particularly in Rural Areas, the nuances of lending to these clients and issues specific to the microfinance industry in India. This expertise gives a competitive advantage in this industry and has helped in maintaining resilience through industry cycles. Ms. Padmaja Gangireddy, its Individual Promoter and Managing Director, has over 24 years of experience in social development and microfinance sector. Abdul Feroz Khan, its Chief Strategy Officer, holds a masters' degree in business administration from Institute of Chartered Financial Analysts of India University, Dehradun.

Further, at the field level, SSFL has a high retention rate of employees at the middle to senior management level. The average experience of its assistant vice-presidents, division managers ("Divisional Managers") and cluster managers ("Cluster Managers") was 7.6 years, 5.6 years and 6.4 years, respectively, as of March 31, 2019.

Business Strategy:

Leverage popular income generation loan products to derive organic business growth*:* Through SSFL's client-centric business model, it focuses on providing financing to its clients on a speedy and continual basis (while always adhering to its strict risk management policies), according to their life-cycle needs. It focuses on providing income generation loans and its popular 'Abhilasha' loans (which are income generation loans) amounted to 84.62% of its Gross AUM, as of March 31, 2019. SSFL expects to derive organic growth through its popular income generation loan products that are offered through the JLG model. To this end, it intends to utilize its existing branch infrastructure and employee base to increase its volume of income generation loans. It intends to offer income generation loans both to its existing clients (as they complete their existing loan cycles) and to new clients through its existing branches. SSFL's commence processing loans for existing clients at the time when two instalments of their existing loan are due, so as to disburse loans on the same day that the existing loan is fully repaid.

Leverage existing branch network by increasing loan portfolio and enhancing employee productivity: SSFL has a large branch network which can be further leveraged since it has maintained low exposure levels per branch thus far. While it was under CDR, it focused on retaining its branch franchise as much as possible and this required maintaining low ticket sizes (leading to low AUM/branch levels) to ensure that once its funding levels improve post CDR exit, it can leverage on the branch franchise. Within the branches, during the time that SSFL were in CDR, it focused on retaining clients even though it had to keep its ticket sizes lower than the client demand and credit approval levels. As its funding levels improve further, it can further expand its operations from the existing branch network and bring exposure per branch on par with industry averages. Given the seasoning of SSFL's operating team, it can open branches in different regions and leverage on the experience of its seasoned field staff who can take up larger roles. Further, with the objective of expanding its loan portfolio, it intends to incentivize its employee base to further service more client demand while adhering to its risk containment norms - both to existing and new clients. This will help SSFL improve its Gross AUM per employee (excluding trainee CAs) from its current level (Rs12.58 million as of March 31, 2019) leading to increased employee productivity with expansion in client base.

Increase presence in under-penetrated states and districts: SSFL has grown its geographical presence by expanding its branches into different regions. With this strategy, it expanded its operations into three new states, Bihar, West Bengal and Tamil Nadu and one union territory, Pondicherry, in the last two years besides restarting operations in Rajasthan where it had exited. Its contiguous growth strategy is also relevant for expanding into newer districts within the states where it already has operations. It intends to continue to expand its geographical coverage into newer states and union territories as well where it sees business potential (for instance, Assam, Punjab and Haryana). According to ICRA Research, many large states such as UP, Bihar, MP, Gujarat, Chhattisgarh, Punjab, Haryana are under penetrated and offer good potential for growth. (Source: ICRA Research). It has commenced operations in some of these states such as Bihar, West Bengal and Rajasthan in the recent past. These features offer growth opportunities for it in newer geographies. SSFL first test the market by setting up a few branches. It is only after these branches are able to demonstrate full compliance with its internal processes and procedures that subsequent expansion is planned. It also only place experienced BMs and CAs in new branches as they serve to lay the foundation for the growth of future branches by providing the requisite training.

Further diversify borrowing profile and reduce cost of borrowings*:* SSFL's funding sources are varied, as it believes that a diversified debt profile ensures that it is not overly dependent on any one type or source for funding. Post its exit from CDR, it has diversified its lender base and accessed diverse sources of liquidity, such as term loans, cash credit and subordinated debt from banks, financial institutions and non-banking financial companies, proceeds from loan assets securitized, and proceeds from the issuance of NCDs to meet its funding requirements. it increased its lender base from three lenders as of March 31, 2017 to 22 as of March 31, 2018 and further to 28 as of March 31, 2019. Its Average Effective Cost of Borrowing reduced from 16.31% for Fiscal 2017 to 14.74% for Fiscal 2018 and further reduced to 12.84% as of Fiscal 2019. ICRA Research notes that the continuation of priority sector lending status for NBFC-MFIs and allowing NBFC-MFIs to act as business correspondents for banks augurs well for funding profile of NBFC-MFIs. Further NBFC-MFIs also has opportunities to raise off balance sheet funding through business correspondent model, securitization and assignments as a significant proportion of underlying portfolios which would qualify under the key categories of PSL targets.

Industry

Financial Inclusion

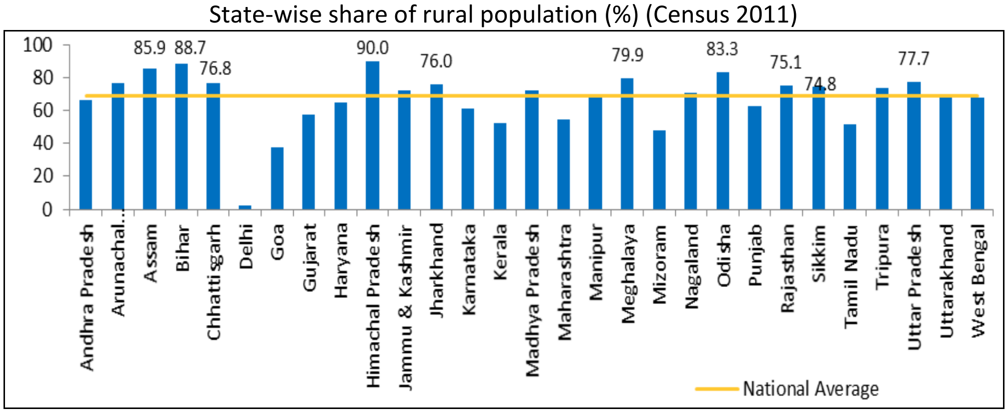
Current scenario and key developments

The Committee on Financial Inclusion, chaired by Dr. C. Rangarajan, defines financial inclusion as the process of ensuring affordable access to financial services and timely and adequate credit when needed by vulnerable groups of society. Financial inclusion promotes economic development and reduces poverty as access to financial services makes it easier for people to manage their savings, prepare for emergencies and protect their health. Therefore, promoting financial inclusion has been a key priority for various development banks and nations.

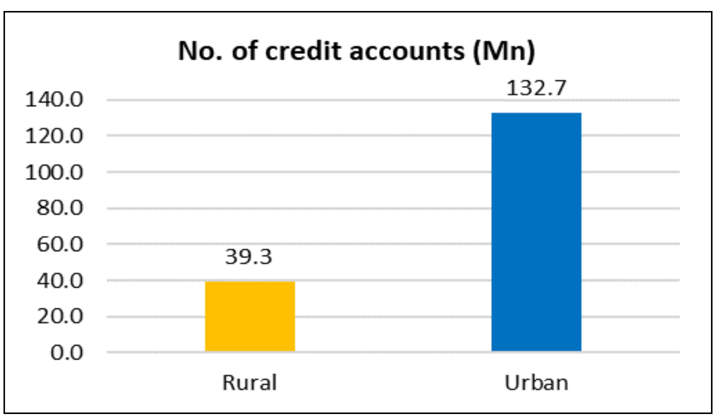
Between 2014 and 2017, approximately 515 million adults worldwide opened an account at a financial institution or through a mobile money provider, which led to an increase in account ownership among adults from 51% in 2011 to 62% in 2014, and further to 69% in 2017. The share of adults with a bank account in India has more than doubled to approximately 80% since 2011, largely supported by the Pradhan Mantri Jan Dhan Yojana ("PMJDY") (a scheme of the government of India), which led to account growth and traction in savings. However, while significant traction is present on the deposit side, ICRA Research notes that India is still among the Top 3 nations with unbanked people in the world, reflecting the strong need for an enhancement of the financial inclusion agenda.

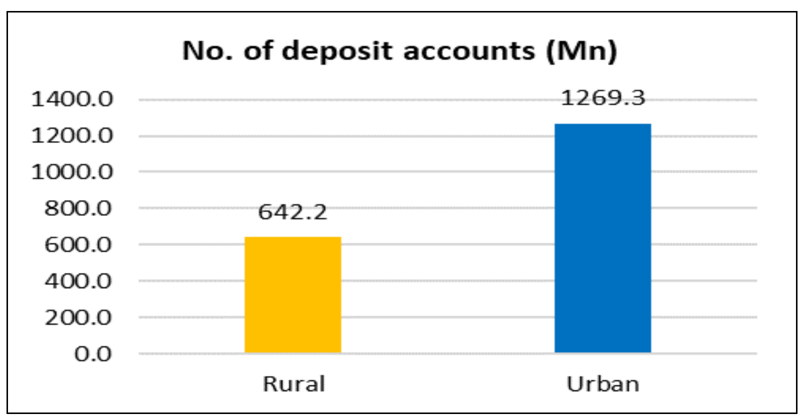
Rural areas account for almost half of NDP, but only 10% of banking credit According to 2011 Census of India, there were about 640,000 villages in rural India and close to 68% of the total population residing in them. Rural India accounted for about 47% of the Net Domestic Product ("NDP") but only 10% of the country’s total credit in comparison to 90% for urban India, which only contributed to 53% of the country’s NDP, as of 2011. Low penetration of banking credit in rural areas

State-wise share of rural population (%) (Census 2011)



As against the national average of the share of rural population in India of 68.8%, the share of rural population in certain states is significantly higher at 88.7% in Bihar, 83.3% in Odisha, 90.0% in Himachal Pradesh, 77.7% in Uttar Pradesh and 76.8% in Chhatisgarh. In most of these states where the average rural population is higher than the national average, the credit penetration also has been correspondingly lower. Even though southern states have a fairly healthy rural credit penetration, Uttar Pradesh and eastern states like Assam, Bihar, Jharkhand, West Bengal and Orissa are under penetrated, thus providing scope for microfinance players.





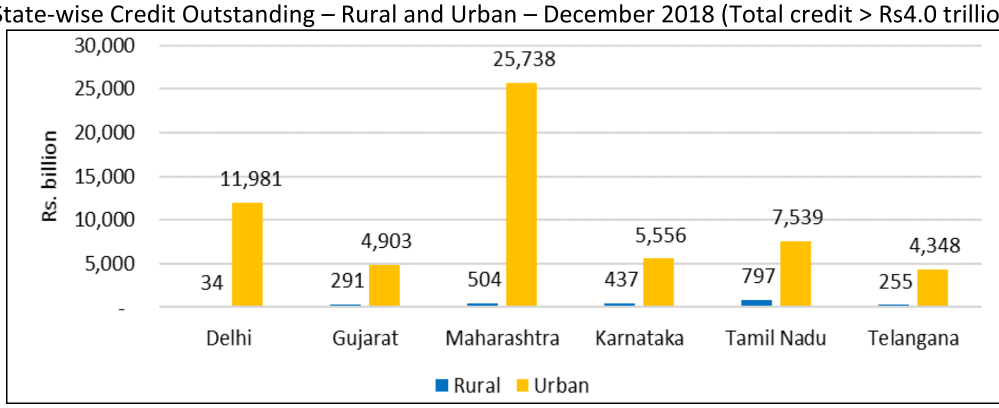
As of March 2018, there were only about 642 million deposit accounts and 39 million credit accounts in rural India, which accounted for about 34% of the total deposit accounts and 23% of the loan accounts in scheduled commercial banks despite rural India making up about 68% of the total population. The significant under-penetration of credit in rural areas offers strong potential for improvement. Given that microfinance institutions (“MFIs”) have relatively deeper reach, existing customer relationships and employee bases, they are well placed to address this demand which is currently being met by informal sources of funds such as local money lenders.

Large variations in availability of credit across states and districts

According to ICRA Research, a common feature among states with credit outstanding of more than Rs4.00 trillion and states with credit outstanding of less than Rs4.00 trillion is the sizeable gap between the credit outstanding in rural areas and urban areas. In most states, the credit outstanding in urban areas outweighed that of rural areas by multiple times, which indicates the extent of deficiency of credit availability in rural areas. While the Reserve Bank of India ("RBI") and the government of India have been taking steps to improve credit availability in rural areas, the gap remains substantial. This offers significant potential for private players to serve this unmet demand. In particular, MFIs with deep reach in rural areas are better placed to deliver credit to the largely underserved segment in the country. Given the lack of organised financial aid to this segment of the society, for many of whom the alternate source of funds is money lenders who charge exorbitant rates. Hence, ICRA Research observes that the general inclination of borrowers to default on these loans is low.

Increasingly, several MFIs have shown a greater focus on the urban poor in the quest for better operating efficiency owing to ease of management. However, ICRA Research notes that the MFIs with strong branch infrastructure in rural areas that continue to focus on the credit-starved rural segment would stand to benefit from the growth potential offered by the rural segment.

State-wise Credit Outstanding – Rural and Urban – December 2018 (Total credit > Rs4.0 trillion)



Key steps taken by government to boost financial inclusion

The RBI and the government of India have launched various schemes for improving the penetration of credit, banking services, insurance and other social security programmes over the past three to four years. For example, the launch of the Stand-Up India Scheme, various new government-backed insurance schemes, the establishment of the PMJDY, and the Micro Units Development & Refinance Agency Ltd (MUDRA).

Some major steps taken by the government to increase financial inclusion are:

PSL Requirements: The RBI has set priority sector lending ("PSL") target for banks, which are aimed at providing access to financial services to borrowers with modest credit profiles. PSL loans include loans to farmers for agriculture and allied activities, poor people for housing, and students for education. Social infrastructure and renewable energy are also eligible categories under this mechanism. The total PSL target for banks is currently 40% of the adjusted net bank credit ("ANBC") or credit equivalent amount of off-balance sheet exposure, whichever is higher. As per the RBI, these sub-divisions include:

Agriculture: Generally, all scheduled commercial banks are to extend 18% of ANBC or credit equivalent amount of off-balance sheet exposure, whichever is higher, towards agricultural purposes. Within the 18% target for agriculture, a sub-target of 8% of ANBC or credit equivalent amount of off-balance sheet exposure, whichever is higher, is prescribed for small and marginal farmers.

Micro enterprises: 7.5% of ANBC or credit equivalent amount of off-balance sheet exposure, whichever is higher, for all scheduled commercial banks should be given to micro enterprises.

Advances to weaker sections: 10% of ANBC or credit equivalent amount of off-balance sheet exposure, whichever is higher, needs to be extended to weaker sections.

Education loans: Education loans (including loans for vocational courses) of up to Rs1 million will be made eligible for the priority sector irrespective of the sanctioned amount.

Social infrastructure: Bank loans of up to Rs50 million per borrower will be provided for building social infrastructure for activities, namely schools, healthcare facilities, drinking water facilities and sanitation facilities in Tier II to Tier VI centers.

Renewable energy: Bank loans of up to Rs150 million per borrower will be provided for purposes such as solar-based power generators, biomass-based power generators, wind mills, micro-hydel plants and for nonconventional energy-based public utilities viz street lighting systems and remote village electrification. For individual households, the loan limit will be Rs1 million per borrower.

The RBI permitted continuation of the priority sector status to MFIs vide its circular in May 2011. According to ICRA Research, the continuation of priority sector benefit to MFIs was instrumental in the resumption of credit flow to the sector. Further, RBI guidelines have also forced MFIs to adopt customer friendly policies, strong origination practices, target newer areas with lower penetration and rein in their operating expenses. The continuation of PSL status for NBFC-MFIs and allowing NBFC-MFIs to act as business correspondents for banks augurs well for funding profile of NBFC MFIs. Further NBFC MFIs also have opportunities to raise off balance sheet funding through business correspondent model, securitization and assignments as a significant proportion of underlying portfolios which would quality under the key categories of PSL targets.

Pradhan Mantri Jan Dhan Yojana: PMJDY was launched on August 28, 2014 as a National Mission for Financial Inclusion, to ensure access to basic financial services such as banking accounts, remittance, credit, insurance and pensions in an affordable manner. An economic survey for year ended March 31, 2019, found that approximately Rs 1.0 trillion is deposited in over 350 million accounts opened under PMJDY.

Small Finance Banks: On September 16, 2015, the RBI granted “in principle” approval to ten applicants, of which seven were non-banking finance companies – microfinance institutions (“NBFC-MFIs”) to set up Small Finance Banks (“SFBs”). Such a scheme is likely to increase financial inclusion as the new licensees now have the ability to offer full range of services such as deposits and a diversified asset mix as opposed to a singular primary credit product (for NBFC-MFIs). With a view to further enhance access to banking facilities to small borrowers and to encourage competition, the RBI is in the process of issuing Draft Guidelines for "on tap" Licensing of Small Finance Banks by August 2019. The ability to offer a full range of services, reduced political risk, opportunities to cross-sell, and better regulatory supervision by the RBI and liquidity support are some of the positives. However, these new players will still face key challenges in the form of deposit mobilization and diversification of asset mix.

Key Concerns:

Operations are concentrated in the states of Karnataka, Madhya Pradesh, Orissa, Maharashtra and Chhattisgarh*:* As of June 30, 2019, SSFL conducted its operations through 929 branches in India, of which 149, 149, 136, 111 and 83 branches, were located in Orissa, Madhya Pradesh, Karnataka, Maharashtra and Chhattisgarh, respectively. As of March 31, 2019, 20.01%, 19.98%, 13.48%, 10.77% and 8.70%, respectively, of its Gross AUM originated in Madhya Pradesh, Orissa, Karnataka, Maharashtra and Chhattisgarh. While it endeavors to manage and monitor its concentration risk at the district level, it is susceptible to risks relating to concentration in these states and in the event of a regional slowdown in the economic activity in one or more of these states, or any other developments including political unrest, disruption or sustained economic downturn that make its products in any of these states less beneficial, SSFL may experience an adverse impact on its business, financial condition, results of operations and cash flows. Further, the market for its products in these states may fluctuate and be subject to, market and regulatory developments that are different for various states of India. There can be no assurance that the demand for its products will grow and will not decrease in the future in these states.

In order to support and grow business, SSFL must maintain a minimum capital to risk weighted assets ratio: As an NBFC-MFI, the RBI requires SSFL to maintain a minimum capital to risk weighted assets ratio (“CRAR”) consisting of Tier I and Tier II capital of 15% of its aggregate risk weighted assets. Further, the total of its Tier II capital cannot exceed 100% of its Tier I capital at any point of time. Its ability to support and grow business would become limited if the CRAR is low. It’s CRAR as of March 31, 2016 and 2014 was negative. Further, in the past it has been unable to maintain the minimum amount of NOF and CRAR prescribed by the RBI. While it may access the capital markets to offset any declines to its CRAR, it may be unable to access the markets at the appropriate time or the terms of any such financing may be unattractive due to various reasons attributable to changes in the general environment, including political, legal and economic conditions. As SSFL continues to grow its loan portfolio and asset base, it will be required to raise additional Tier I and Tier II capital in order to continue to meet applicable CRAR with respect to its business. There can be no assurance that it will be able to raise adequate additional capital in the future on terms favorable to it, and this may adversely affect the growth of the business.

SSFL is subject to certain conditions and restrictions in terms of its financing arrangements: As of March 31, 2019, SSFL had total borrowings on a consolidated basis aggregating to Rs 29,677.37 million, comprising debt securities amounting to Rs 13,719.64 million, borrowings (other than debt securities) amounting to Rs 15,754.79 million and subordinated liabilities amounting to Rs 202.94 million, each on a consolidated basis. Incurring indebtedness is a direct consequence of the nature of its business, and having large outstanding borrowings portfolio may have significant implications on the business and results of operations. Further, under certain financing arrangements, SSFL is required to maintain specific credit ratings and other financial ratios, which may restrict or delay certain actions or initiatives that it may propose to take in the ordinary course of business. Failure to observe the covenants under financing arrangements may lead to the termination of its credit facilities, acceleration of amounts due under such facilities, trigger cross-default provisions and the enforcement of security provided. There can be no assurance that it would be able to persuade its lenders to grant extensions or refrain from exercising such rights which may adversely affect its operations and cash flows. SSFL's inability to comply with the conditions prescribed under the financing arrangements, or repay the loans as per the repayment schedule, may have an adverse impact on its credit rating, business operations and future financial performance. Further, if it is unable to service its existing debt, its ability to raise debt in the future will be adversely affected, which will have a significant adverse effect on the results of operations, financial condition and the business.

Business is vulnerable to interest rate risk, and volatility in interest rates could have a material adverse effect on net interest income: SSFL's results of operations depend to a large extent on the level of its net interest income as its primary revenue source is interest income. Net interest income represents gross interest income for the relevant year reduced by finance costs and cost of portfolio derecognized in such year. Changes in market interest rates affect the interest rates it charges on its interest-earning assets differently from the interest rates it pays on its interest bearing liabilities. An increase in interest rates could result in an increase in interest expense relative to interest income if SSFL is not able to increase the rates charged on its loan portfolio and advances or if the volume of its interest bearing liabilities is larger or growing faster than the volume of its interest-earning assets. As the repricing maturities of its liabilities and assets are spread over different time periods, it is exposed to interest rate risk in the form of non-parallel movement in yield curves. Further, in a declining interest rate environment, if SSFL's cost of funds does not decline simultaneously or to the same extent as the yield on its interest-earning assets, it could lead to a reduction in net interest income (representing revenue from operations as reduced by finance costs) and net interest margin. The quantum of the changes in interest rates for its assets and liabilities may also be different, leading to a decrease in the interest margin.

One of the Promoters and certain of its Directors have entered into, and may enter into, ventures that may lead to real or potential conflicts of interest with the business: SSFL Promoters may become involved in ventures that may potentially compete with the Company. The interests of the Promoters may conflict with the interests of its other Shareholders and its Promoters may, for business considerations or otherwise, cause SSFL to take actions, or refrain from taking actions, in order to benefit themselves instead of the Company's interests or the interests of its other Shareholders and which may be harmful to the Company's interests or the interests of its other Shareholders, which may materially adversely impact the business, financial condition and results of operations. Further, SSFL hold such products in its branches and offices physically in trust of Abhiram Marketing. Any risk with respect to unsold inventory, storage, damage, cancellation, non-payment of dues by clients, product/service failure with respect to the products sold by Abhiram Marketing may result in dispute, litigation and non-payment of commission in terms of the MoU, which may affect the business operations at branches.

Business, financial condition, cash flows and results of operations have been adversely affected in the past by certain state regulations: In the past, SSFL's business operations has been severely impacted by regulatory action. In October 2010, the AP government passed the AP Microfinance Ordinance to put in place extremely stringent operating guidelines in response to the allegedly coercive collection practices adopted by MFIs in the formerly unified Andhra Pradesh. After the implementation of the ordinance, loan collections in the formerly unified Andhra Pradesh dropped severely and the asset quality across the industry deteriorated sharply. At this time, it had a large exposure to the formerly unified Andhra Pradesh as most of its loans originated from that state. As a result, it had to make provisions for its outstanding portfolio originating from Andhra Pradesh, which had a materially adverse effect on the business. While NBFC-MFIs are currently regulated by the RBI, the respective state government of the states where SSFL operates may pass laws either suo moto, or in response to any legal action initiated against the NBFC-MFIs of a state, which impact the business of NBFC-MFIs. There can be no assurance that any such actions taken by the state governments in these states will not adversely impact the business, financial condition and results of operations.

Microfinance loans are unsecured and are susceptible to various operational, credit and political risks which may result in increased levels of non-performing assets ("NPAs"): The focus client segment for SSFL's micro-loans is women in Rural Areas. As of June 30, 2019, 99.82% of its clients were women. Its clients typically have limited sources of income, savings and credit histories and as a result, are usually adversely affected by declining economic conditions. Further, for most of its loans, its clients do not provide any collateral or security for their borrowings as the RBI has mandated that loans given by NBFC-MFIs should be collateral free for the purpose of "Qualifying Assets". Such clients generally do not have a high level of financial resilience, and, as a result, they can be adversely affected by declining economic conditions and natural calamities. In addition, the microfinance business is susceptible to various political and social risks, including political interference in the working of MFIs at the district, state or national level; adverse publicity or litigation relating to the microfinance sector; public criticism of the microfinance sector; introduction of a stringent regulatory regime; or religious beliefs relating to loans and interest payments, which adversely affect repayment by its clients and may have an adverse effect on its business prospects and future financial performance. Due to the underlying profile of SSFL's clients, it may, in the future, experience increased levels of non-performing assets and related impairments and write-offs, which would materially and adversely impact its business and results of operations.

An increase in portfolio of NPAs and/or impairments and write-offs may adversely affect the business, results of operations and cash flows: SSFL's management of credit risk involves having appropriate credit policies, underwriting standards, approval processes, loan portfolio monitoring, collection and remedial management, provisioning policies and an overall architecture for managing credit risk. If the credit quality of its clients deteriorates or its levels of impairments and write-offs increase, it could have an adverse effect on its business, results of operations and financial condition. In addition, even if SSFL's policies and procedures are appropriate, it may not be able to anticipate future economic or financial developments or downturns, which could lead to an increase in its NPAs. SSFL's credit quality is also susceptible to other external events that impact the industry as a whole. The application of the expected credit loss methodology requires SSFL to consider its internal estimates for loan losses and risks inherent in the loan portfolio when deciding on the appropriate level of classification of its assets. This determination requires that it make estimates. Any incorrect estimation may result in its impairments or write-offs not being adequate to cover any further increase in the amount of NPAs or any further deterioration in its NPA portfolio

Competition from MFIs, banks and other financial institutions, as well as state-sponsored social programs, may adversely affect the profitability and position in the Indian microcredit lending industry: SSFL face significant competition from other MFIs and banks in India (including SFBs), as the microfinance industry is characterized by low barriers to entry. Many of the institutions with which it competes may be larger in terms of business volume or may have greater assets, higher geographical penetration and better access to, and lower cost of, funding than it does. In certain areas, they may also have better brand recognition and larger client bases than it. SSFL anticipates that it may encounter greater competition as it continues expanding its operations in India, and this may result in an adverse effect on the business, results of operations and financial condition. SSFL face threats to its business from newer business models that leverage technology to bring together savers and borrowers. It may not be competitive in facing up to the challenges from such newer entrants. Increasing competition may adversely affect the business, financial condition and results of operations. In addition, as competition amongst micro-finance player increases, borrowers may take more than one loan from different micro-finance players, which may adversely affect the asset quality or the asset quality of the industry as a whole.

Any downgrade of credit ratings may increase borrowing costs: The cost and availability of funds is dependent, among other factors, on SSFL's short-term and long-term credit ratings. Credit ratings reflect a rating agency's opinion of its financial strength, operating performance, industry position, and ability to meet its obligations. Any future performance issues for the Company or the industry may result in a downgrade of its credit ratings, which may in turn lead to an increase in its borrowing costs and constrain its access to capital and debt markets and, as a result, may adversely affect the net interest income and net interest margin. In addition, any downgrade of SSFL's credit ratings could result in additional terms and conditions being included in any additional financing or refinancing arrangements in the future.

There can be no assurance that SSFL will be able to access capital as and when it need it and at a cost favorable for the growth: SSFL's liquidity and profitability are, in large part, dependent upon timely access to capital and costs associated with raising capital. Its funding requirements has historically been met from a combination of term loans, working capital facilities, assignment or securitization of its portfolio to banks and financial institutions, proceeds from issuance of non-convertible debentures, subordinated debt as well as equity contributions. Any change in the RBI regulations on priority sector lending, or its inability to maintain relationships with such banks and financing institutions could adversely affect the business, results of operations and financial condition. If SSFL is unable to access the necessary amounts of capital, it may adversely impact its ability to grow its overall business and may even require it to curtail or withdraw from some of its current business operations. If SSFL is unable to access funds at an effective cost that is comparable to or lower than its competitors, it may not be able to offer competitive interest rates on its loans to clients. There can also be no assurance that it would be able to raise adequate additional capital in the future on terms favorable to it, or at all, and this may hamper and adversely impact the growth plans.

If SSFL is unable to manage its growth effectively, it's financial, accounting, administrative, operational and technology infrastructure, as well as the business and reputation could be adversely affected: SSFL's growth strategy includes organic business growth and branch expansion, which may further constrain its capital and human resources, and make asset quality management increasingly important. As it moves to newer geographies, it may not be able to maintain the level of its NPAs or the quality of its portfolio. It will need to continue to enhance and improve its financial, accounting, information technology, administrative/ risk management and operational infrastructure and internal capabilities in order to manage the future growth of its business effectively. There can be no assurance that the network infrastructure required for communication with the centralized system can be expanded in scale to meet any increase in the volume of SSFL's transactions. Further, it may be unable to develop adequate infrastructure or devote sufficient financial resources or develop and attract talent to manage its growth.

Success depends, in large part, upon management team and skilled personnel and on its ability to attract and retain such persons: SSFL is highly dependent on the continued services of its management team, including Individual Promoter. It is also dependent on its experienced members of its Board of Directors. Its future performance is dependent on the continued service of these persons. The RBI also mandates NBFCs to have in place supervisory standards to ensure that their directors have appropriate qualifications, technical expertise and a sound track record, and such requirements will make it more difficult for it to replace its directors if and when SSFL have to. It may not be able to replace its Board of Directors with similarly experienced professionals, which could materially and adversely impact the quality of its management and leadership team. Competition for management and other skilled personnel is intense, and it may not be able to attract and retain the personnel it need in the future. The loss of key personnel or SSFL's inability to replace key personnel may restrict its ability to grow, to execute it strategy, to raise the profile of its brand, to raise funding, to make strategic decisions and to manage the overall running of its operations, which would have a material adverse impact on its results of operations and financial position.

Require various statutory and regulatory approvals, licenses, registrations and permissions to conduct business*:* SSFL require various approvals, licenses, registrations and permissions to operate its business, including a registration for the company with the RBI as an NBFC-MFI as well as various other corporate actions. It is also required to comply with the prescribed requirements, including classification of NPAs and provisioning, KYC requirements, ticket sizes, qualifying assets and other internal control mechanisms. There can be no assurance that the relevant authorities will issue any of such permits or approvals in a timely manner, or at all, and/ or on favorable terms and conditions. Failure to comply with the terms and conditions of such permits or approvals and/ or to maintain or obtain the required permits or approvals may result in an interruption of its business operations and may have a material adverse effect on SSFL's business operations, future financial performance and price of its Equity Shares.

Any deterioration in the performance of any pool of receivables assigned or securitized to banks and other institutions may adversely impact the financial performance: SSFL may, in the ordinary course of business to improve liquidity and minimize risks, assign or securitize a portion of its receivables from its loan portfolio to banks and NBFCs. Such securitization/ assignment transactions are undertaken by SSFL on the basis of its internal estimates of funding requirements, and may vary from time to time. As at March 31, 2017, the outstanding carrying value of loans securitized on a standalone basis was Rs Nil million and the outstanding carrying value of loans derecognised on a standalone basis was Rs Nil million. Any change in the RBI or other government regulations in relation to assignments securitisations by NBFCs could have an adverse impact on its assignment/ securitisation initiatives. However, in the event the bank or NBFC does not realise the receivables due under loans that have been securitized, the relevant bank or NBFC can enforce the underlying credit enhancements assured by it. Further, any deterioration in the performance of any batch of receivables assigned to banks and NBFCs could adversely affect its credibility and therefore SSFL's ability to conduct further assignments and securitizations.

Any failure or material weakness of internal control systems could cause significant operational errors, which would materially and adversely affect the profitability and reputation: SSFL is responsible for establishing and maintaining adequate internal measures commensurate with the size and the complexity of its operations. Its internal or concurrent audit functions are equipped to make an independent and objective evaluation of the adequacy and effectiveness of internal controls on an ongoing basis to ensure that business personnel adhere to its policies, compliance requirements and internal circular guidelines. While it periodically tests and update its internal control systems as necessary, it is exposed to operational risks arising from the potential inadequacy or failure of internal processes or systems, and its actions may not be sufficient to guarantee effective internal controls in all circumstances. In addition, SSFL carry out certain processes manually, which may increase the risk that human error, tampering or manipulation will result in losses that may be difficult to detect. As a result, it may suffer material losses. Such instances may also adversely affect its reputation, thereby adversely impacting SSFl's business, results of operations and financial condition.

Depend on the accuracy and completeness of information provided by credit bureaus about clients and counterparties for credit assessment and risk management: To ascertain the creditworthiness of potential borrowers, SSFL depends on credit information companies or credit bureaus, and its reliance on any misleading information may affect its judgment of credit worthiness of potential borrowers, which may affect its business, prospects, results of operations and financial condition. SSFL may receive inaccurate or incomplete information as a result of negligence or fraudulent misrepresentation. Its risk management measures may not be adequate to prevent or deter such activities in all cases, which may adversely affect its business prospects, financial condition and results of operations.

As an NBFC-MFI, SSFL is subject to periodic inspections by the RBI. Non-compliance with observations made by the RBI during these inspections could expose SSFL to penalties and restrictions: As an RBI-registered NBFC-MFI, SSFL is subject to periodic inspections by the RBI to verify the correctness or completeness of its business and operations, internal controls, and any statement, information or particulars furnished to the RBI. SSFL will continue to be subject to inspections by the RBI, in the course of which the RBI may report on divergences (if any) from regulatory requirements applicable to NBFCs. There can be no assurance that the RBI would not make adverse observations, including on divergences, in the future. If it is unable to resolve such deficiencies and other matters to the RBI's satisfaction, it could be exposed to penalties and restrictions, and its ability to conduct the business may be adversely affected.

SSFL handles cash in a high volume of transactions occurring through a dispersed network of branches; as a result, it is exposed to operational risks, including fraud, petty theft and embezzlement: As SSFL handles a large amount of cash through a high volume of transactions taking place across its branch network, it is exposed to the risk of fraud or other misconduct by employees, third parties or any outsiders. This risk is further exacerbated by the high level of autonomy on the part of its loan officers and back-end managers, which its business model requires. In addition, it does not have a cash-in-transit insurance policy, which also exacerbates the risk. Given the high volume of transactions it processes on a daily basis, certain instances of fraud and misconduct may go unnoticed or may only be discovered and successfully rectified after substantial delays. Even when SSFL discover such instances of fraud or theft and pursue them to the full extent of the law or with its insurance carriers, there can be no assurance that it will recover any of the amounts involved in these cases. Its reputation could be adversely affected by fraud committed by employees, clients or outsiders, or by its perceived inability to properly manage fraud-related risks. Its dependence upon automated systems to record and process transactions may further increase the risk that technical system flaws or employee tampering or manipulation of those systems will result in losses that are difficult to detect.

SSFL depends on its brand recognition, and failure to maintain and enhance awareness of its brand would adversely affect the ability to retain and expand base of clients: SSFL owns trademark registration of its brand names, “Spandana Sphoorty”, “SSFL”, as well as an image consisting of coined word “Spandana” with emblem. Any damage to its reputation could substantially impair its reputation and the ability to maintain or grow its business, or have a material adverse effect on its overall business, financial condition and results of operations. In addition, it also faces the risk of its brand name being misused for fraudulent purposes, which may adversely affect its reputation.

Results of operations could be adversely affected as a result of any disputes with the employees*:* SSFL’s operations are personnel-driven, and it place a lot of emphasis on the effective training of its personnel in communication and service orientation skills. However, a failure to train and motivate its employees may lead to an increase in itsr employee attrition rates and erode the quality of client service. It employ 7,062 full-time employees as of June 30, 2019. There can be no assurance that there will not be any future disruptions in its operations due to any disputes with its employees. SSFL depends on its branch-level employees for sourcing, disbursements and collections and client liaison, and significant attrition at any of its branches could adversely impact its operations.

Operate in a highly regulated environment*:* SSFL operates in a highly regulated environment in which it is regulated by the RBI, the MCA, the Registrar of Companies and other domestic and international regulators. Accordingly, legal and regulatory risks are inherent and substantial in SSFL’s business. As it operates under licenses or registrations obtained from appropriate regulators, it is subject to actions that may be taken by such regulators in the event of any non-compliance with any applicable policies, guidelines, circular, notifications and regulations issued by the relevant regulators. In addition, SSFL is also exposed to the risk of it or any of its employees being non-compliant with insider trading rules or engaging in front running in securities markets. In the event of any such violations, regulators could take regulatory actions, including financial penalties against it and the concerned employees. This could have a materially adverse financial and reputational impact on it. Any change to the existing legal or regulatory framework will require SSFL to allocate additional resources, which may increase its regulatory compliance costs and direct management attention and consequently affect the business.

Financial difficulty and other problems in certain financial institutions in India could materially and adversely affect the business, results of operations, financial condition and prospects: As a non-deposit taking NBFC-MFI, SSFL rely on borrowings from banks, financial institutions and capital markets. In the recent past, certain NBFCs has faced financial difficulties, which has led to them defaulting on their borrowings. In particular, in the second half of 2018, issues around debt repayments at Infrastructure Leasing & Financial Services Limited led to heightened investor focus around the health of the broader NBFC sector as well as their sources of liquidity, which led to a tightening in liquidity available to NBFCs generally. Most recently, Dewan Housing Finance Corporation Limited’s delayed bond payments resulted further concerns about the well-being of the NBFC sector generally. These events, a repeat of such an event or any similar events may lead to adverse perceptions about the NBFC sector as a whole or cause an instability in the Indian financial system generally. This in turn could have a material adverse impact on its borrowing capability and in turn, have a material adverse effect on its business, results of operations, financial condition and prospects.

Ability to raise foreign funds may be constrained by Indian law: As an Indian NBFC ND-SI, SSSFL is subject to exchange controls that regulate borrowing in foreign currencies. Such regulatory restrictions could constrain its ability to obtain financings on competitive terms and refinance existing indebtedness. In addition, there can be no assurance that any required regulatory approvals for borrowing in foreign currencies will be granted to it without onerous conditions, or at all. Limitations on foreign debt may have an adverse effect on its business growth, financial condition and results of operations.

Changing laws, rules and regulations and legal uncertainties, including adverse application of tax laws and regulations, across the multiple jurisdictions SSFL operates in may materially adversely affect the business and financial performance: SSFL’s business and financial performance could be materially adversely affected by changes in the laws, rules, regulations or directions applicable to it and its general and microfinance businesses, or the interpretations of such existing laws, rules and regulations, or the promulgation of new laws, rules and regulations. The governmental and regulatory bodies may notify new regulations and/ or policies, which may require SSFL to obtain approvals and licenses from the government and other regulatory bodies, impose onerous requirements and conditions on its operations, in addition to those which SSFL are undertaking currently, or change the manner in which it conduct KYC or authenticate its customers. Any such changes and the related uncertainties with respect to the implementation of new regulations may have a material adverse effect on its business, financial condition and results of operations.

India's existing credit information infrastructure may cause increased risks of loan defaults: All of SSFL's business is located in India. India's existing credit information infrastructure may pose problems and difficulties in running a robust credit check on its borrowers. It may also face difficulties in the due diligence process relating to its clients or to any security or collateral it takes in relation to its loans. SSFL may not be able to run comprehensive searches relating to the security and there are no assurances that any searches it undertakes will be accurate or reliable. Hence, its overall credit analysis could be less robust as compared to similar transactions in more developed economies. Any inability to undertake a comprehensive due diligence or credit check might result in an increase in its NPAs and it may have to increase its provisions correspondingly. Any of the foregoing may have a material adverse effect on the business, financial condition and results of operations.

Profit & Loss **Rs in million**

Particulars	FY19	FY18
Interest Income	9978.7	5730.4
Commission Income	150.1	39.8
Net gain on fair value changes	266.8	42.2
Others	35.3	60.8
Total Revenue from operations	**10431.0**	**5873.1**
Other income	54.3	2.3
Total Income	**10485.3**	**5875.3**
Total Expenditure	**5750.6**	**3048.3**
Finance cost	3578.7	2317.9
Impairment on financial instruments	453.0	-354.1
Employee benefit expenses	1310.5	758.7
Depreciation and amortization expense	69.7	57.2
Other expenses	338.8	268.5
Profit before tax	**4734.7**	**2827.0**
Tax (incl. DT & FBT)	**1615.7**	**947.6**
Current tax	12.9	573.4
Deferred tax (net)	1602.8	374.1
Profit for the period	**3119.0**	**1879.5**
EPS (Rs.)	52.30	63.2
Equity	596.3	297.6
Face Value	10.0	10.0

Balance Sheet: **Rs in million**

Particulars	FY19	FY18
Assets		
Financial assets	**46836.5**	**33659.7**
Cash and cash equivalents	1,486.12	1045.4
Bank Balances other than cash and cash equivalents	2031.9	1032.5
Trade Receivables	35.5	25.0
Loan Portfolio	42677.6	30896.3
Investments	1.0	1.0
Others financial assets	604.5	659.6
Non-financial assets	**2480.5**	**3982.8**
Current tax assets	83.4	41.9
Deferred tax assets (net)	1999.8	3,840.84
Property, Plant and Equipment	71.7	58.5
Intangible assets	22.2	26.0
Goodwill	173.7	0.0
Other non-financial assets	129.7	15.5
Total Assets	**49317.1**	**37642.5**

Equity & Liabilities		
Financial Liabilities	**30122.2**	**23458.9**
Debt Securities	13719.6	10147.1
Borrowings (Other than Debt Securities)	15754.8	12965.1
Subordinated Liabilities	202.9	201.6
Other Financial liabilities	444.9	145.1
Non-Financial Liabilities	**291.3**	**277.2**
Current Tax Liabilities (net)	62.8	93.0
Provisions	3.6	3.9
Other Non-Financial liabilities	224.9	180.3
Equity	**18903.6**	**13906.4**
Equity Share Capital	596.3	297.6
Other Equity	18298.0	13608.8
Non Controlling Interest	9.2	0.0
Total Equity & Liabilities	**49317.1**	**37642.5**

The following table sets forth SSFI's key financial and operational metrics as of or for the periods indicated: **Rs in million**

Particulars	FY19*	FY18*	FY17
Gross AUM	44,372.78	31,667.85	13,015.36
Gross AUM Growth (%)	40.12%	143.31%	6.78%
Disbursements	49,692.83	38,576.48	20,591.65
Disbursement Growth	28.82%	87.34%	14.83%
Borrowers (millions)	2.46	1.59	1.06
Total Income	10,485.29	5,875.31	3,786.66
Operating Expense / Annual Average Gross AUM	4.52%	4.85%	7.61%
Cost to Income Ratio	24.89%	30.49%	41.78%
Impairment of financial instruments / Annual Average Gross AUM	1.19%	-1.58%	7.81%
Profit before tax	4,734.72	2,827.01	455.86
Profit for the period	3,119.00	1,879.46	4,434.14
Stage III PAR 90+ (excluding the old AP Portfolio)	43.11	719.35	892.56
Stage III PAR 90+ (excluding the old AP Portfolio) Ratio	0.10%	2.27%	6.86%
Stage III PAR 90+ Net (excluding the old AP Portfolio)	6.11	117.45	87.21
Stage III PAR 90+ Net (excluding the old AP Portfolio) Ratio	0.01%	0.38%	0.71%
Collection Efficiency	99.74%	99.25%	97.13%
Return on Annual Average Gross AUM Portfolio	8.20%	8.41%	35.21%
Return on Annual Average Net Worth	19.02%	16.21%	79.77%
Net Worth	18,894.36	13,906.36	9,275.69

*= Consolidated nos

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