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Initiating Coverage

Spandana Sphoorty Financial Ltd.

22-December-2020

RETAIL RESEARCH

Spandana Sphoorty Financial Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
BFSI – NBFC	Rs 673.8	Buy at LTP and add on dips to Rs 579-583 band	Rs 809	Rs 928	2 quarters

HDFC Scrip Code	SPASPH
BSE Code	542759
NSE Code	SPANDANA
Bloomberg	SPANDANA IN
CMP Dec 21, 2020	673.8
Equity Capital (cr)	64.3
Face Value (Rs)	10
Eq- Share O/S(cr)	6.4
Market Cap (Rscr)	4333.6
Adj. Book Value (Rs)	439.8
Avg.52 Wk Volume	68,500
52 Week High	1262.0
52 Week Low	405.0

Share holding Pattern % (Sep, 2020)	
Promoters	62.63
Institutions	15.46
Non Institutions	21.90
Total	100.0

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Our Take:

Spandana Sphoorty Financial (SSFL) has been in existence for 16+ years and withstood multiple crisis in the microfinance space. It is the 3rd largest NBFC-MFI in India with an AUM of Rs. 7,354 crs with 25+ lakh members and 1,027 branches. It has strengthened its risk management process after every crisis and diversified geographically to reduce the impact thereof. As of Q2FY21 none of the states accounted for more than 18% of its portfolio and none of the districts contributed to more than 2% of the outstanding. Post the easing of lockdown all its branches became operational by May-end. It has provided for ~6% of its portfolio and with improving collection trends (Oct-20 absolute collections at 110%) might not be required to make significant provisions going forward. Despite the company being cautious in lending to new borrowers, its outstanding advances have expanded by 25.7% in Q2FY21 indicating strong growth potential in the microfinance space. NPA levels are comfortable and capital raising in the last few years has led to a strong capital adequacy ratio of 45%.

Valuations & Recommendation:

We expect the company to post a PAT growth of 30% CAGR over FY20-FY22 driven by robust growth in advances, lower provisioning requirements and stable NIMs. Return ratios are likely to improve in FY22 after a dip in FY21 due to Covid pandemic and higher provisioning. RoA and RoE are expected to improve by 150/290 bps to 7.7%/17.9% in FY22. We have valued the company at 1.4x FY22E ABV for a base case target of Rs 809 and 1.6x FY22E ABV for a bull case target of Rs 928 over 2 quarters. Investors can buy the stock at the LTP (1.16xFY22E ABV) and add further on dips to Rs 579-583 band (1.00x FY22E ABV).

Financial Summary

Particulars (Rs cr)	Q2FY21	Q2FY20	YoY-%	Q1FY21	QoQ-%	FY19	FY20	FY21E	FY22E
NII	260.7	258.8	*0.7*	241.0	*8.2*	685.2	1079.0	1018.7	1196.0
PPoP	213.6	212.5	*0.5*	189.9	*12.5*	521.1	895.0	826.5	986.9
PAT	66.9	45.7	*46.2*	59.1	*13.2*	311.9	351.8	330.2	548.8
EPS (Rs)	10.4	7.1	*46.1*	9.2	*13.2*	52.3	59.0	55.4	92.0
P/E (x)						12.9	11.4	12.2	7.3
P/ABV (x)						2.1	1.5	1.4	1.2
RoAA (%)						7.2	6.5	5.1	7.1

(Source: Company, HDFC sec)

Recent Triggers

Q2FY21 Financials

Spandana delivered a reasonably strong performance in Q2FY21. Net interest income grew by 14.6% yoy to Rs 226.6cr driven by much stronger-than-expected AUM growth (8% qoq/36% yoy). Operating profit declined marginally as the company enhanced its provisioning buffer based on prudential assessment of advances. Provisions increased to ~6x from Rs 21cr in Q2FY20 to Rs 122cr in Q2FY21. PAT increased 48% yoy to Rs 63cr on account of lower tax rates due to deferred tax write back.

Disbursements at Rs 1634cr was only 10.7% lower than Q2FY20. Disbursement in the month of September was at an all-time high of Rs 905cr. AUM grew by 36% yoy to Rs 7354cr while outstanding advances increased 25.7% to Rs 5529cr. The management is targeting AUM of Rs 8500-9000cr by end of FY21.

SSFI has made additional provision of Rs 114cr taking the cumulative Covid provisioning to Rs 332cr which accounts for 6.1% of on-balance sheet portfolio. As per the management, 6.1% of provisioning will be enough to contain covid-19 related stress. Also 88% of the borrowers have cleared all dues till Oct-20 while 6% of the borrowers have not paid at all and another 6% have paid partially. However collection efficiency has been improving with November efficiency at 117% as compared to 110% in October and 103% in September.

The company opened 14 new branches in Q2FY21 while the number of borrowers increased marginally as it focused on giving loans to existing customers. It has added near 1 lac new clients in Oct and Nov v/s about 50K in Q2. SSFI has not availed any moratorium on its term loan dues and is able to service the installments in entirety as per the original repayment schedule due to strong liquidity position and Comfortable ALM position.

On the asset quality front, GNPA/NNPA stood at 0.54%/ 0.11% which improved by 10/1 bps over the previous quarter. However, this was largely on account of moratorium on loans till Aug-2020 and the true picture will be visible only after Q3. Capital adequacy was comfortable at 45%.

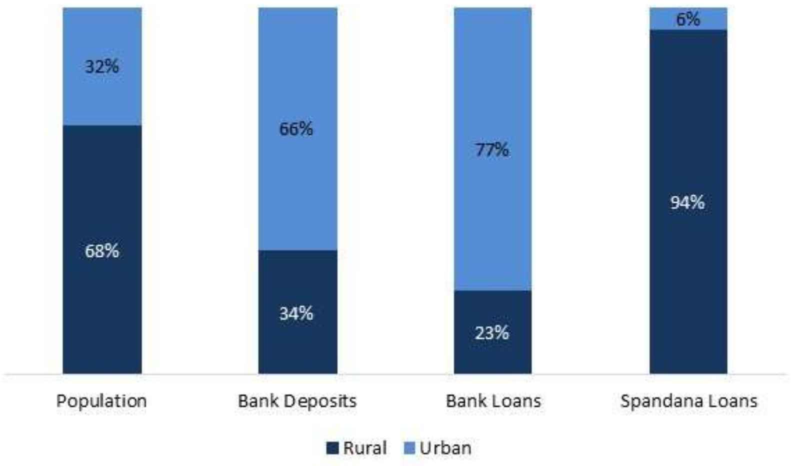
Long term Triggers

Focus on high potential and under-served rural segment

SSFL focuses on rural markets as these areas in India are highly under-served markets for formal banking services in terms of access, availability and suitability of products and services. According to ICRA Research, while rural India accounts for ~2/3rd of India's population as of FY20, its share in deposits and loans stood at 34% and 23% respectively in scheduled commercial banks. The significant under penetration of credit in rural areas offers strong potential for improvement. Given the relatively deeper reach, existing client relationships and employee base, micro-finance institutions like SSFL are well placed to address this demand, which is currently being met by informal sources such as local money lenders.

As of FY20, ~94% of the company's portfolio was located in rural areas as compared with 54% for the NBFC-MFIs as a whole. Also the loans given by the company for agriculture and allied activities are classified as "Direct Agri" by banks pursuant to the RBI's priority sector lending guidelines, which provides Spandana with an opportunity to assign this portfolio to banks that need to meet their target on Direct Agri loans.

Rural-Urban share

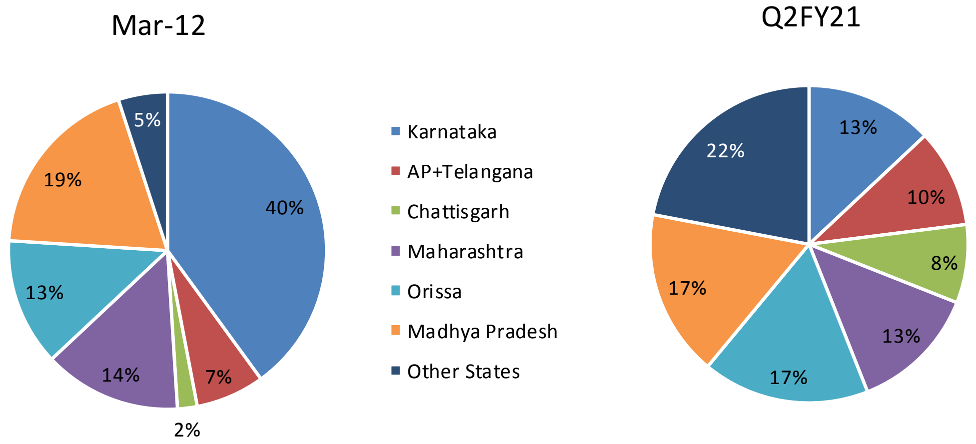


(Source: Company, HDFC sec)

Geographically diversified operations leading to risk containment

SSFL has been cognizant of risks associated with geographical concentration of portfolio and has been constantly making efforts to diversify its exposure while leveraging on the knowledge gained in each territory where it operates. As the portfolio started expanding, SSFI started venturing into contiguous states. Post the micro finance crisis in Andhra Pradesh in 2010, which led to the company entering into CDR mechanism, it was even more apparent for it to diversify geographically. Spandana was one of only two NBFC – MFIs to exit CDR successfully, post the AP crisis, in March 2017.

State-wise Portfolio distribution



(Source: Company, HDFC sec)

To contain its risks, SSFL has specified exposure caps at the state, district and branch levels. The Gross Loan Portfolio (GLP) of each state must not exceed 18% of the total portfolio (except for AP and Telangana, to which, the combined cap is 6% of the gross loan portfolio) or 100% of net worth. State-wise disbursement limit has been set at 16% of total disbursements. At the district level, the GLP must not exceed

2% of total portfolio. With this adopted norm, no single state contribution is more than 18% to AUM, no district contributes more than 2% to AUM as of FY20.

% Contribution	AUM		Disbursements	
	No. of Districts	% of Total Districts	No. of Districts	% of Total Districts
<0.5%	211	75%	215	76%
0.5% - 1%	56	20%	53	19%
1% - 2%	13	5%	10	4%
>2%	0	0%	3	1%
Total	280	100%	**280**	100%

The diversification is evident from the exposure to top-10 districts being 13.2% only of the total AUM for SSFI, while it is much higher for other large MFIs/ SFBs.

Buckets	AUM (Rs cr)	% of Total AUM
Top 5 Districts	516	7.60%
Top 10 Districts	903	13.20%
Top 50 Districts	3060	44.80%
Remaining Districts	3770	55.20%

High degree of client engagement and robust risk management

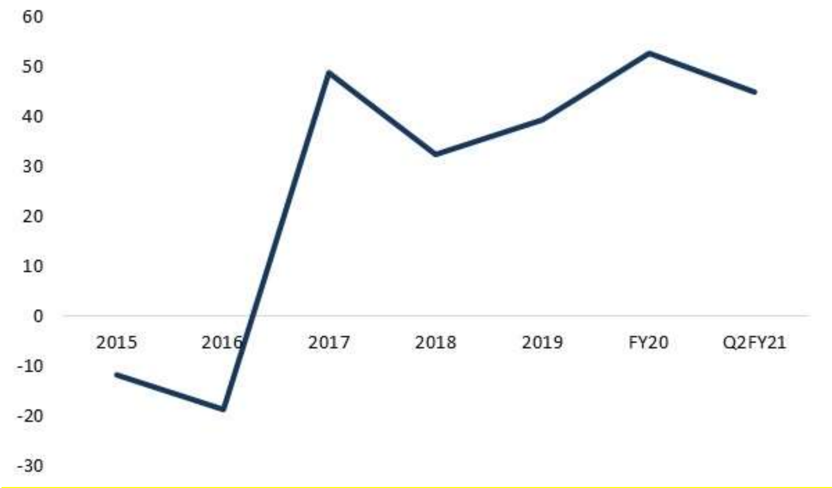
Client engagement is extremely important for a micro finance institution to build lasting relationships. Since majority of the customers lack any sort of credit history, it is only through client engagement that loan officers would be able to build trust and get early signs of default. SSFL focuses on a high degree of client engagement through its 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. The clients interact with the staff at center meetings at regular intervals (typically based on their installment payments frequency).

These practices have helped the company stay in close contact with clients resulting in better collection efficiency and improved asset quality. It has completely written off the non-yielding old Andhra Pradesh portfolio in December 2019 and had Gross NPAs of just Rs 18cr at the end of FY20. GNPA/NNPA ratio stood at 0.36%/0.07% respectively in Q2FY21.

Comfortable capitalisation profile

SSFL's net worth turned positive to Rs 537cr in FY17 from negative Rs 607cr in FY16 on account of the fresh capital infusion from Kedaara Capital amounting to Rs 300cr and acquisition of Optionally Convertible Cumulative Redeemable Preference Shares (OCCRPS) of Rs 791cr (at 73% discount) after converting them into Compulsorily Convertible Preference Shares (CCPS). Subsequently, the company raised capital Rs 275cr during H2FY18, Rs 138cr in Q1FY19, Rs 389cr in Q2FY20 through an IPO), which together with healthy internal generation during the last three years aided in strengthening of its networth to Rs 2544cr at the end of FY20. The company had a gearing of 1.8x in FY20 and the management expects gearing to be capped at around 4.0-4.5 times going forward.

Capital Adequacy ratio improved post capital infusion

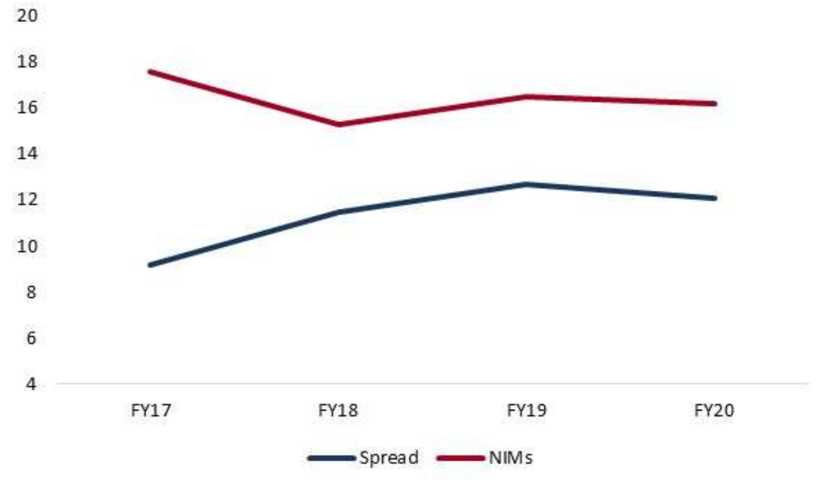


(Source: Company, HDFC sec)

Higher credit rating to result in lower cost of borrowing

Post its exit from CDR SSFL 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. The lender base increased from 3 lenders in FY17 to 30 lenders in FY20. Improved performance of the company coupled with capital raising resulted in its credit rating progress from BBB- (Stable in Aug-17 to A- (Stable) in Mar-19. SSFL is looking to lower its cost of borrowing by raising funds through NCDs, securitizations and under priority sector lending from banks. 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. The average cost of borrowing for SSFL has improved from 16.2% for FY17 to 11.9% in FY20. The recent interest rate cuts combined with the credit rating improvement should lead to lower cost of borrowing in coming years.

Trend of Spreads and NIMs



(Source: Company, HDFC sec)

Leverage branch network to expand portfolio

Prior to entering the CDR mechanism, SSFL had a large branch network. While under CDR the company focused on retaining its branch franchise which required maintaining low ticket sizes leading to low AUM/branch levels. Since the exit from CDR in March 2017, SSFL increased its lender base, diversified borrowings and also received additional capital infusion from Kangchenjunga and Kedaara AIF 1. With increased capital flow, it was able to enhance ticket sizes and also acquire new clients at existing branches. AUM per branch grew from Rs 2.3cr in FY17 to Rs 7.2cr in Q2FY21. However, according to ICRA Research, SSFL had the lowest GLP per branch amongst peer comparison of certain NBFC-MFIs and SFBs in March 31, 2020. This provides the company with the potential to further increase its loan portfolio and enhance employee productivity. Being predominantly rural focused, it has one of the most cost efficient opex profile within the MFI space. Its cost-to-income is at an industry-leading 20% in FY20.

What could go wrong

Unsecured nature of business

Microfinance loans are unsecured and are susceptible to various operational and credit risks. SSFL lends to women under the JLG model. These women typically do not have any stable source of income and are usually adversely affected by declining economic conditions. Natural calamities lead to fall in incomes and consequently default in repayment of Microfinance loans.

Limited product and revenue diversification

Presently, SSFL's portfolio comprises almost solely of microfinance loans. The management is looking to diversify into other loan segments including secured lending like vehicle loans, mortgage loans etc. over the next 2-3 years. However, we will have to wait and watch if the company is able to scale up its operations.

Competition from SFBs

Many of the erstwhile MFIs have converted to small finance banks (SFBs) or merged with a large bank. It has provided them with access to low-cost funds which they can utilize to offer lower interest rates. This could hamper the growth of MFIs like SSFI who have to depend on bank/market borrowings.

Political interference to not pay back dues

Political instigation in some states asking people not to pay back their Microfinance dues could result in higher NPAs.

Delays in recovering dues could curtail profit

Almost 6% of the borrowers have not paid their dues and another 6% have paid partially. Delays/inability to recover these dues could hurt the profitability. Spandana's results may be constrained due to evolving liquidity conditions from time to time. In such times, aggressive disbursements growth, even to an existing customer, raises the risk of not only overleveraging the customer, but also ever-greening *by* the customer. Hence Spanadana should opt for prudent calibrated sustainable growth rather than going very aggressive in lending.

Key personnel risk

SSFL's management is led by Ms. Padmaja G Reddy who is a pioneer of the microfinance industry and has been leading the company since its incorporation. In our view, Ms Padmaja's direction and vision is critical for future growth.

Higher dependence on few states

Spandana's business is heavily dependent on its operations in Madhya Pradesh (17%), Orissa (17%), Karnataka (13%) and Maharashtra (13%). Any material changes in the socio-political and economic conditions affecting these markets could adversely impact its business.

About the company

Founded in 1998 Spandana Sphoorty Financial Ltd. (SSFL) is a rural focused NBFC-MFI with a geographically diversified presence in India. In terms of AUM it was the third largest NBFC-MFI in India at the end of Q2FY21. The company offers income generation loans under the joint liability group model, predominantly to women from low-income households in Rural Areas. As of Q2FY21, SSFL had 7,614 employees (operating out of 1027 branches in 282 districts across 17 states and 1 union territory in India). It disbursed ~Rs 8,000cr of loans in FY20 and had an outstanding AUM of Rs 7,354cr.

Following the microfinance crisis in Andhra Pradesh (AP), SSFL 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. Post the exit from CDR in March 2017, SSFL has increased its lender base, diversified borrowings to new banks and NBFCs and also issued NCDs in the capital markets which has led to lower cost of borrowing. With the restrictions lifted and availability of capital it could increase its ticket size which led to AUM growing to over 5x in the three years from FY17 to FY20.

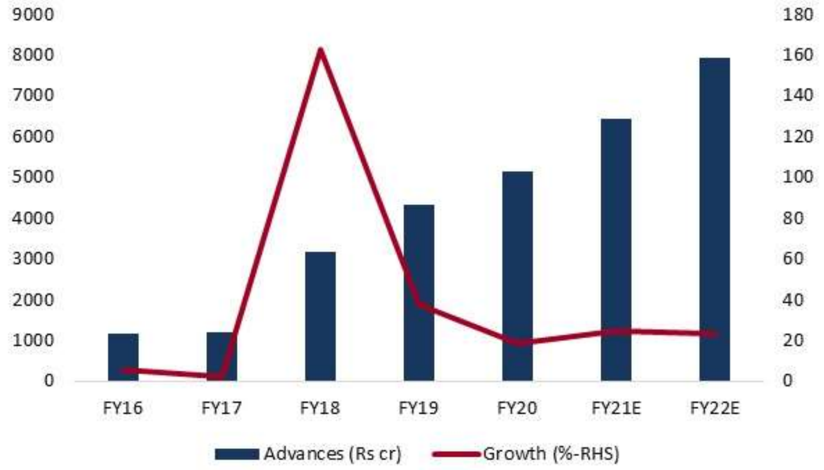
Spandana Sphoorty Financial Ltd.

Business Overview:

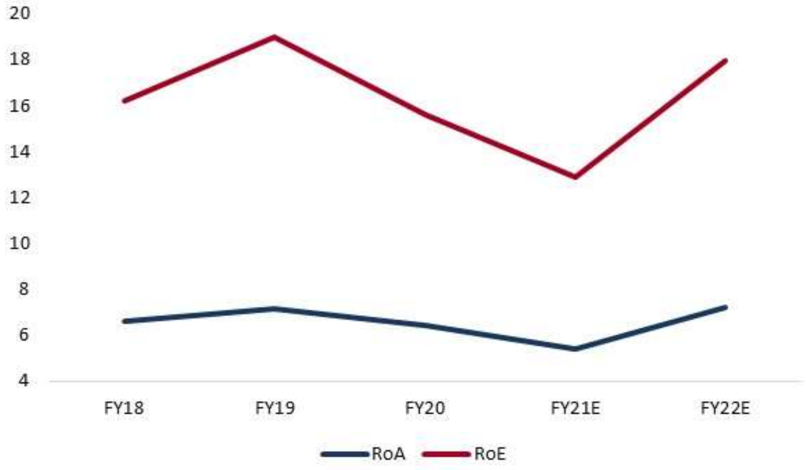
The operations of SSFL focus on women from low-income groups in Rural Areas who aspire to improve their financial well-being.

Abhilasha Loans: SSFL's main lending product is 'Abhilasha' loans, which are income generation loans designed to empower women by enabling them to set up and expand income generating activities. These loans are primarily given to women, who are willing to borrow in a group and are agreeable to accept joint liability for the loans. Loans are provided to groups without any collateral, with each group consisting of 8 to 10 women. Under the JLG model, loans are provided to individual clients as well where the group guarantees the repayment of loans given to individual members of the group. In FY20 Abhilasha accounted for 88% of the total loans.

Advances growth trend



Return ratios trend



(Source: Company, HDFC sec)

Other Loans: Besides Abhilash loans SSFL also provides certain other categories of loans which include

- loans against property to clients who run businesses, are self-employed or salaried;

- ‘shree’ loans for low/lower middle-income women in AP with clear credit histories for cash flow smoothening or working capital requirements
- gold loans given to individuals against the mortgage of gold jewelry for agriculture, business and short-term liquidity needs; and
- interim loans, which are top up loans given to existing clients (on a group guarantee) to use for their capital working needs, seasonal requirements or emergency needs.

Other loans amounted to 12% of total loans as of FY20.

Peer comparison

(FY20)	CMP	MCap	AUM	PAT	NIM	GNPA	RoAA	ABV	P/ABV
Bandhan Bank	374.1	60244	66630	3024	11.1	1.5	4.1	91.9	4.1
Credit Access	783.1	12176	11,996	335.49	11.9	1.6	3.4	197.1	4.0
Spandana Sphoorty	673.8	4337	6,829	352	16.2	0.4	6.5	439.8	1.5
Satin CreditCare	73.15	407	8174	155	8.1	2.9	2.2	272.0	0.3
Ujjivan SFB	37.05	6403	14044	350	11.5	1.0	2.2	17.1	2.2

Spandana Sphoorty Financial Ltd.

Financials

Income Statement

(Rs cr)	FY18	FY19	FY20	FY21E	FY22E
Interest Income	587	1043	1435	1402	1649
Interest Expenses	232	358	356	383	453
Net Interest Income	**356**	**685**	**1079**	**1019**	**1196**
Non-interest income	0	5	34	38	47
Operating Income	**356**	**691**	**1113**	**1057**	**1243**
Operating Expenses	107	170	218	230	256
PPoP	249	521	895	826	987
Prov & Cont	-34	48	276	355	203
Profit Before Tax	283	473	618	472	784
Tax	95	162	267	141	235
PAT	**188**	**312**	**352**	**330**	**549**

BALANCE SHEET

(Rs cr)	FY18	FY19	FY20	FY21E	FY22E
Share Capital	30	60	64	64	64
Reserves & Surplus	216	1830	2562	2892	3411
Shareholder funds	**245**	**1889**	**2626**	**2956**	**3475**
Borrowings	2331	2968	3025	3761	4476
Other Liab & Prov.	42	74	325	209	490
SOURCES OF FUNDS	**2619**	**4931**	**5976**	**6925**	**8441**
Fixed Assets	8	27	34	41	48
Investment	0	0	487	182	149
Cash & Bank Balance	208	352	257	303	373
Advances	3157	4268	4852	6065	7461
Other Assets	391	285	346	334	410
TOTAL ASSETS	**3764**	**4932**	**5977**	**6925**	**8441**

Balance Sheet

	FY18	FY19	FY20	FY21E	FY22E
Return Ratios (%)					
Calc. Yield on adv	27.0	28.1	29.9	24.2	23.8
Calc. Cost of borr	14.2	13.5	11.9	11.3	11.0
NIM	16.3	18.5	22.5	17.6	17.3
RoAE	16.2	19.0	15.6	11.8	17.1
RoAA	6.6	7.2	6.5	5.1	7.1
Asset Quality Ratios (%)					
GNPA	27.2	8.5	0.4	4.9	0.6
NNPA	0.2	0.0	0.1	0.5	0.3
Growth Ratios (%)					
Advances	162.9	35.2	13.7	25.0	23.0
Borrowings	149.8	27.3	1.9	24.3	19.0
NII	60.5	92.7	57.5	-5.6	17.4
PPP	71.9	109.1	71.7	-7.6	19.4
PAT	-57.6	65.9	12.8	-6.2	66.2
Valuation Ratios					
EPS (Rs)	63.2	52.3	59.0	55.4	92.0
P/E (x)	10.7	12.9	11.4	12.2	7.3
Adj. BVPS (Rs)	465.6	316.7	439.8	490.2	579.4
P/ABV (x)	1.4	2.1	1.5	1.4	1.2
Dividend per share (Rs)	0.0	0.0	0.0	0.0	5.0
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.7
Other Ratios					
Cost-Income (%)	29.9	24.5	19.6	21.8	20.6
Leverage (x)	2.3	2.3	1.8	2.1	2.1

(Source: Company, HDFC sec Research)

Spandana Sphoorty Financial Ltd.

Price Chart

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