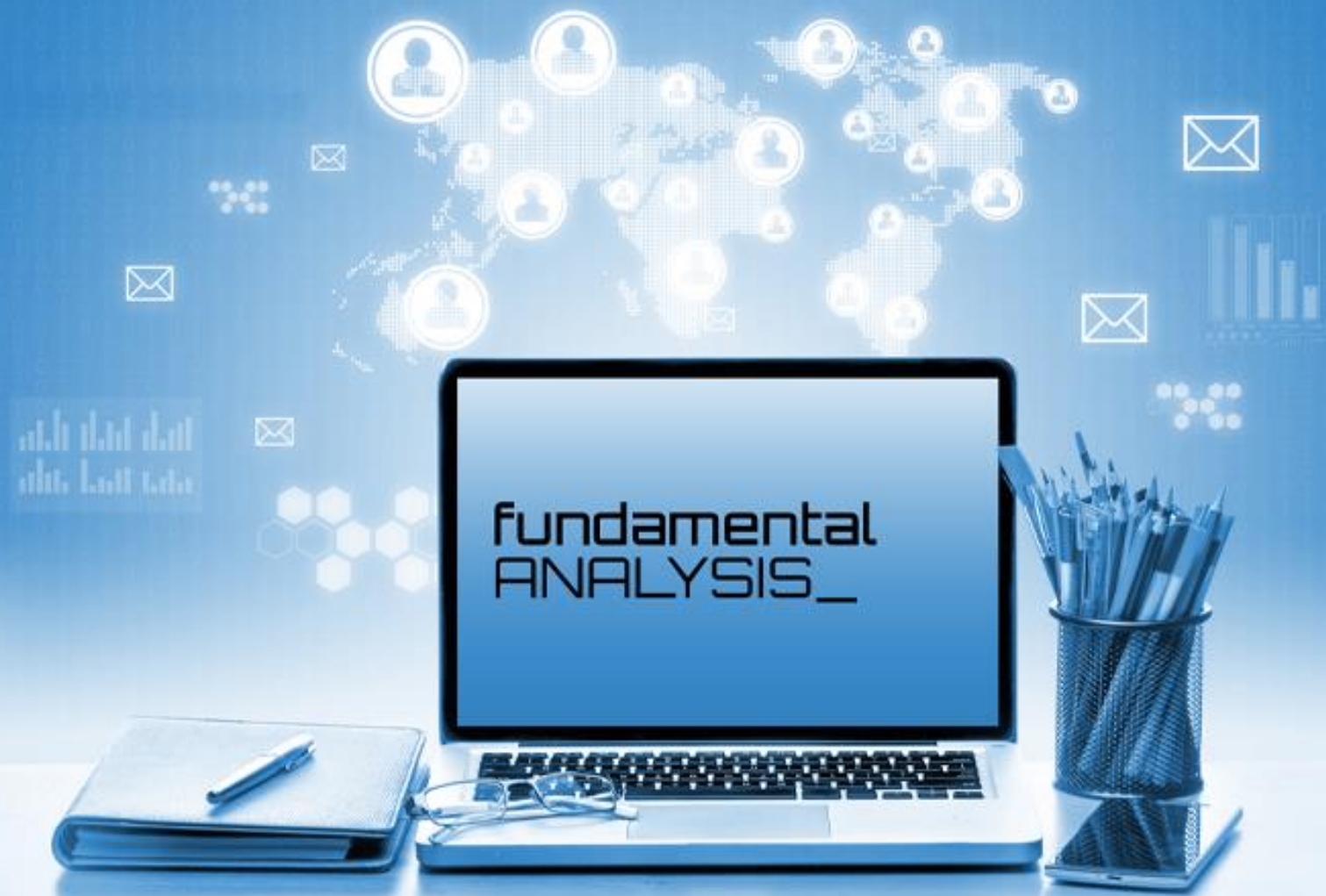


Stock Update Spandana Sphoorty Financial Ltd.

August 10, 2023





Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
BFSI – NBFC (MFI)	Rs 829	Buy in Rs 825-845 band and add on dips in Rs 740-755 band	Rs 916	Rs 974	2 quarters

HDFC Scrip Code	SPASPHEQNR
BSE Code	542759
NSE Code	SPANDANA
Bloomberg	SPANDANA IN
CMP Aug 10, 2023	829.1
Equity Capital (Rs cr)	71.0
Face Value (Rs)	10
Equity Share O/S (cr)	7.1
Market Cap (Rs cr)	5867
Adj. Book Value (Rs)	449.0
Avg. 52 Wk Volumes	137,200
52 Week High (Rs)	863.9
52 Week Low (Rs)	427.0

Share holding Pattern % (Jun, 2023)	
Promoters	62.4
Institutions	29.7
Non Institutions	7.9
Total	100.0



HDFCsec Retail research
stock rating meter

for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings

Fundamental Research Analyst

Atul Karwa

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Our Take:

Spandana Sphoorty Financial Ltd. (SSFL) has taken concrete steps towards rebuilding the company under the new management. It has filled key managerial positions, strengthened governance risk and control, invested in technology to simplify process and make systems robust. Customer focused initiatives are driving strong borrower accretion. Modest credit costs and improvement in cost-to-income ratio is likely to result in higher profitability and expansion of return ratios.

With the top and middle management team in place, SSFL aims to achieve assets under management (AUM) of Rs 15,000cr by FY25, supported by its new customer acquisition strategy, increasing ticket sizes for its existing customers as needed and by diversifying within its distribution models, such as business correspondence, co-lending, and balance sheet funding in the near to medium term.

On May 22, 2023, we had released a Stock Update report ([Link](#)) with a recommendation to 'Buy in Rs 650-665 band and add on dips in Rs 590-600 band' for base case fair value of Rs 735 and bull case fair value of Rs 795 over next 2 quarters. Both the targets were achieved within the given time frame.

Valuation & Recommendation:

We expect advances of the company to increase at 30% CAGR over FY23-FY25E after a strong growth of 40% in FY23. Return ratios are likely to improve as the company has cleaned up its balance sheet and it focusses on growing its book and improving its yield. We have valued the company at 1.6x FY25E ABV for a base case target of Rs 916 and 1.7x FY25E ABV for a bull case target of Rs 974 over 2 quarters. Investors can buy the stock in the band of Rs 825-845 and add on dips in Rs 740-755 band (1.3x FY25E ABV).

Financial Summary

Particulars (Rs cr)	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)	FY22	FY23	FY24E	FY25E
NII	312	153	103.3	349	-10.6	923	943	1279	1621
PPoP	189	51	273.4	261	-27.5	578	562	763	993
PAT	119	-220	-154.4	106	13.2	70	12	435	602
EPS (Rs)	16.8	-31.0	-154.3	14.9	13.1	10.1	1.8	61.2	84.8
P/E (x)						81.9	474.8	13.5	9.8
P/ABV (x)						2.3	1.9	1.7	1.4
RoAA (%)						0.9	0.2	4.0	4.4

(Source: Company, HDFC sec)



Q1FY24 Result Update

SSFL reported a strong quarter of growth with PAT of Rs 119cr (+13.2% QoQ) against a loss of Rs 220cr in Q1FY23. AUM growth momentum sustained in Q1FY24 as reflected in 4% QoQ growth even in a seasonally weak quarter. Disbursements stood at Rs 1664cr vs Rs 354cr in Q4FY23. Net operating income doubled YoY to Rs 312cr while NIM expanded by 430/30 bps YoY/QoQ to 14.2%. Normalized yield increased to 24% from 22.8% in the previous quarter.

On the asset quality front, GNPA/NNPA improved from 2.1%/0.6% to 1.6%/0.5% sequentially. Provision coverage stood at 70%. Technical write-offs stood at Rs 21cr (Rs 6cr P&L impact) while Rs 23cr was recovered from written off accounts.

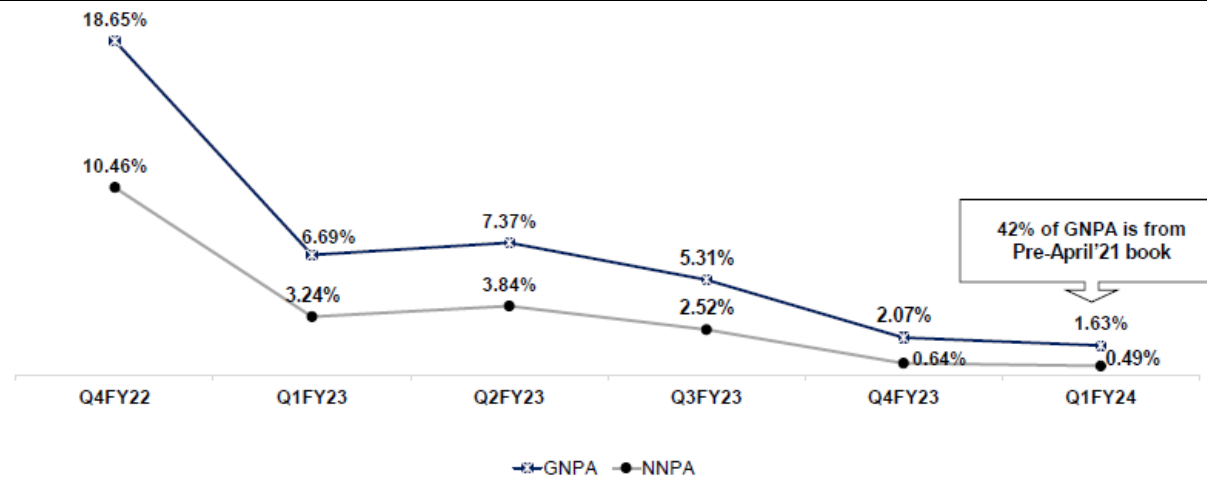
Management has maintained AUM guidance of Rs 15,000cr by the end of FY25 and credit costs of less than 2%. The company added 76 branches on a net basis and its branch count stood at 1303 at the end of Q1FY24. Client addition was 2.6 lakh taking the number of borrowers to 24.1 lakh from 22.6 lakh in the previous quarter.

Recent developments

Portfolio quality continues to improve

Asset quality of the company continued to improve, with GNPA/NNPA declining ~44bp/15bp QoQ to 1.6%/0.5%. Of the GNPA pool, about 42% is contributed by pre- April '21 book, which itself is 1.2% of the loan book now. PCR on S3 loans rose ~80bp QoQ to ~70%. Credit costs

Improving asset quality



(Source: Company, HDFCsec)



declined sharply to 0.4% as compared to 1.7% in the previous quarter on account of better collection efficiencies. The management has guided for credit costs of ~1.5-1.6% in FY24. Gross collection efficiency (including arrears) was at 101.5% and net collection efficiency improved to 98.1%.

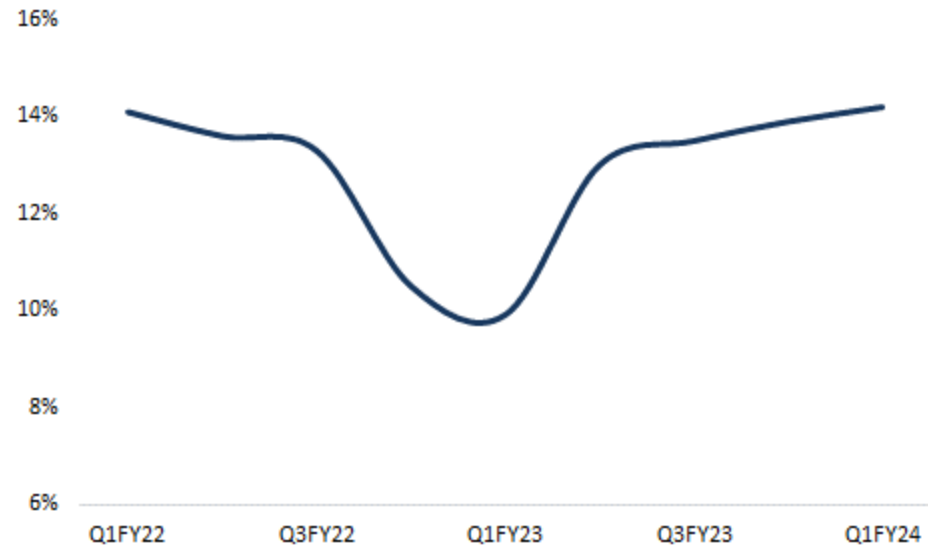
Diversifying and limiting geographical exposure

The company is focusing on seven states Rajasthan, Uttar Pradesh, Bihar, West Bengal, Gujarat, Haryana, and Tamil Nadu for future growth. ~26% of new borrowers during the quarter were added from these seven focus states. It targets ~45% of the AUM mix from these seven states by FY25. This would also reduce the risk from regions with high delinquencies and reduce concentration of each state to 11-12%.

NIMs to increase on higher yields

SSFL has been disbursing new loans at 24% yields as compared to 22.8% in Q4FY23. Consequently, NIMs are expected to improve further as old loans get repaid.

NIM expansion



(Source: Company, HDFCsec)



Aggressive branch expansion to capture higher market share

SSFL has added 76 branches in Q1FY24 taking its network to 1303 branches. It intends to reach 1500 branches by the end of FY25. A typical microfinance branch takes about five months to break even on its own, and about 11 months to come into a full black.

Top and mid management level positions filled

SSFL has filled its senior leadership positions completing its hiring agenda with a strong management team in place. Its focus now is on setting-up employee centric people practices with the aim to make Spandana a preferred employer.

Risks & Concerns

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 in that direction.

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 in MFI dues

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

Higher dependence on few states

Spandana's business is heavily dependent on its operations in Madhya Pradesh, Orissa and Karnataka, accounting for over ~40% of its AUM. Although, the company is diversifying geographically, any material changes in the socio-political and economic conditions affecting these markets could adversely impact its business.



Industry Overview

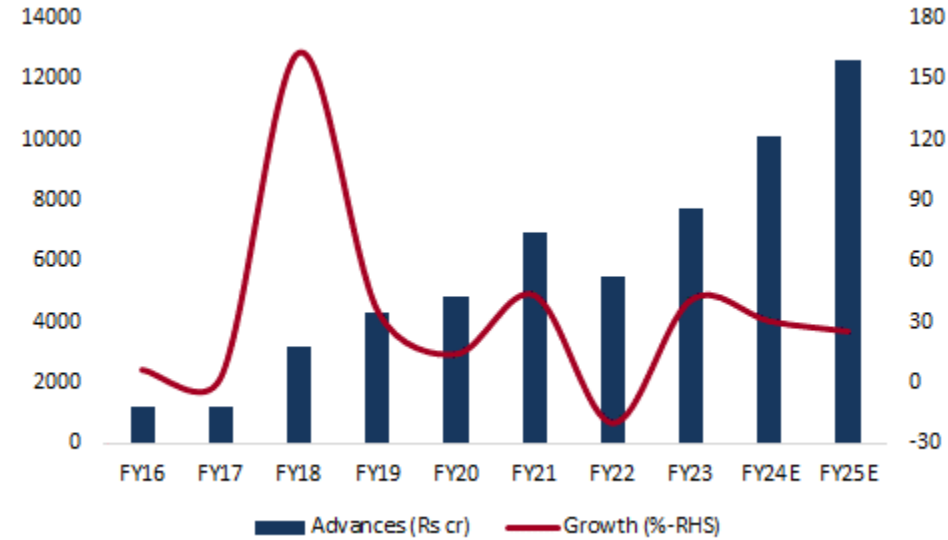
- As on 31 March 2023, 3.9 Cr clients have loan outstanding from NBFC-MFIs, which is 20.0% higher than clients as on 31 March 2022.
- The Asset Under Management (AUM) of MFIs is Rs 1,31,163 Cr as on 31 March 2023, including owned portfolio Rs 1,07,232 Cr and managed portfolio (off BS) of Rs 23,931 Cr. The owned portfolio of MFIN members is about 77.5% of the NBFC-MFI universe portfolio of Rs 1,38,310 Cr.
- On a YoY basis AUM has increased by 38.7% as compared to 31 March 2022 and by 15.7% in comparison to 31 December 2022.
- Loan amount of Rs 1,30,563 Cr was disbursed in FY 22-23 through 3.1 Cr accounts, including disbursement of Owned as well as Managed portfolio. This is 59.3% higher than the amount disbursed in FY 21-22.
- Average loan amount disbursed per account during FY 22-23 was Rs 42,010 which is an increase of around 12.9% in comparison to the last financial year.
- As on 31 March 2023, the borrowings O/s were Rs 97,420 Cr. Banks contributed 60.3% of borrowings O/s followed by 22.2% from Non-Bank entity, 9.3% from AIFs, 4.1% from other sources and 4.1% from External Commercial Borrowings (ECB).
- During FY22-23, NBFC-MFIs received a total of Rs 74,787 Cr in debt funding, which is 59.2% higher than FY21-22. Banks contributed 69.2% of the total Borrowing received followed by Non-Bank entities 21.0%, AIFs 6.7%, ECB 1.8% and Others 1.3%.
- Total equity increased by 25.4% as compared to end of Q4 FY 21-22 and is at Rs 26,332 Cr as on 31 March 2023.
- Portfolio at Risk (PAR)>30 days as on 31 March 2023 has reduced to 4.0% as compared to 9.7% as on 31 March 2022.
- MFIs have presence in 27 states and 5 union territories. In terms of regional distribution of portfolio (GLP), East and North-East accounts for 32% of the total NBFC-MFI portfolio, South 26%, North 17%, West 15%, and Central contributes 10%.

Company Background:

Founded in 1998 Spandana Sphoorty Financial Ltd. (SSFL) is a rural focused NBFC-MFI with a geographically diversified presence in India. The company offers income generation loans under the joint liability group model, predominantly to women from low-income households in Rural Areas. At its peak, SSFL had 1,856 branches with presence across 10 states and a work force of over 13,500 employees. As of FY23, SSFL had over 10,000 employees operating out of 1,227 branches. It disbursed ~Rs 8,100cr of loans in FY23 and had an outstanding AUM of Rs 8,511cr.



Outstanding loan book growth



(Source: Company, HDFC sec)

Business Overview:

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

Chetana Loans: SSFL's main lending product is 'Chetana' 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 FY23 Chetana accounted for over 90% of the total loans.

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

- loans against property to clients who run businesses, are self-employed or salaried;
- personal loans for meeting with the working capital requirements, increasing the scale of business
- 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.



Financials

Income Statement

(Rs cr)	FY21	FY22	FY23	FY24E	FY25E
Interest Income	1483	1463	1401	2067	2631
Interest Expenses	423	540	458	788	1010
Net Interest Income	1059	923	943	1279	1621
Non interest income	23	17	76	90	117
Operating Income	1082	940	1019	1369	1738
Operating Expenses	237	362	457	606	746
PPoP	846	578	562	763	993
Prov & Cont	645	481	544	172	187
Profit Before Tax	200	97	18	591	805
Tax	55	27	5	157	203
PAT	145	70	12	435	602

Balance Sheet

(Rs cr)	FY21	FY22	FY23	FY24E	FY25E
Share Capital	64	69	71	71	71
Reserves & Surplus	2685	3018	3028	3463	4065
Shareholder funds	2749	3088	3099	3534	4136
Minority Interest	2	2	0	0	0
Borrowings	5373	3772	6074	8256	10617
Other Liab & Prov.	453	214	209	478	550
SOURCES OF FUNDS	8577	7076	9383	12268	15303
Fixed Assets	38	31	47	59	73
Investment	2	2	189	186	197
Cash & Bank Balance	1381	1202	1005	1238	1376
Advances	6933	5518	7760	10321	13107
Other Assets	222	322	382	464	550
TOTAL ASSETS	8577	7076	9383	12268	15303

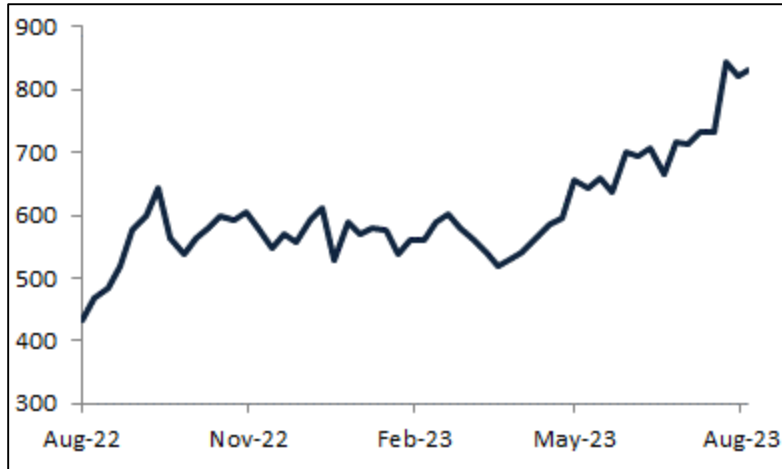
Ratio Analysis

Particulars	FY21	FY22	FY23	FY24E	FY25E
Return Ratios (%)					
Calc. Yield on advances	24.2	23.5	20.8	22.4	22.1
Calc. Cost of borrowing	10.1	11.8	9.3	11.0	10.7
Calc. NIM	17.3	14.8	14.0	13.9	13.6
RoAE	5.4	2.4	0.4	13.1	15.7
RoAA	2.0	0.9	0.2	4.0	4.4
Asset Quality Ratios (%)					
GNPA	5.6	17.7	2.1	2.0	1.9
NNPA	3.3	11.8	0.6	0.5	0.5
Growth (%)					
Advances	42.9	-20.4	40.6	33.0	27.0
Deposits	77.6	-29.8	61.0	35.9	28.6
NII	-1.8	-12.9	2.2	35.6	26.8
PPoP	-5.5	-31.7	-2.7	35.7	30.1
PAT	-58.7	-51.9	-82.3	3406.7	38.6
Valuation Ratios					
EPS (Rs)	22.6	10.1	1.7	61.2	84.8
P/E (x)	36.7	81.9	474.8	13.5	9.8
Adj. BVPS (Rs)	393.9	357.0	429.5	489.9	573.9
P/ABV (x)	2.1	2.3	1.9	1.7	1.4
Dividend per share (Rs)	0.0	0.0	0.0	0.0	0.0
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0
Operating efficiency					
Cost-average assets	21.9	38.6	44.8	44.3	42.9
Cost-income	2.5	1.8	2.5	2.9	3.2

(Source: Company, HDFC sec)



Price chart



HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. These stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicity of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.



Disclosure:

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