RETAIL EQUITY RESEARCH

Spandana Sphoorty Financial Ltd.

NBFC-MFI

Sensex: 37,118

Nifty: 10,997

SUBSCRIBE

Price Range Rs. 853 - Rs. 856

Seasoned business model with resilient performance

Spandana Sphoorty Financial Ltd (SSFL), is the 4th largest NBFC-MFI in India in terms of AUM as on FY19. The company provides micro-loans predominantly to women from low-income households in rural areas under a joint-liability-mechanism where borrowers form an informal joint liability group (JLG) of 5-10 members and loans are sanctioned and disbursed to individual borrowers. JLG loans comprise about 85% of SSFL's gross loan portfolio. The company provides loans for income generation, business and gold jewelry. The company has maintained strong track record of financial and operational efficiencies over the years through high rates of customer retention, geographical expansion, improved staff productivity, lower credit cost and growth in customer base led by branch expansion.

- **SSFL's Net Interest Income (NII) and AUM grew at a CAGR of 44% and 52% during FY17-19 respectively.**
- **Company's NNPA reduced from 2.9% to zero with 99% collection efficiency from FY17 to FY19.**
- **Company's average effective cost of borrowing reduced from 16.3% in FY17 to 14.7% and 12.8% in FY18 and FY19 respectively.**
- **SSFL has a strong capital position with a Capital Adequacy Ratio (CAR) of 39.61% as on FY19 compared to the mandated requirement of 15%.**
- **Strong presence in Orissa, Madhya Pradesh and Karnataka accounting for more than 54% of AUM, as on FY19.**
- **At the upper price band of Rs 856, SSFL is available at Adj.P/BV of 2.4x FY19. Compared to its peers the valuation is reasonable and we have a 'SUBCRIBE' rating on a long-term perspective.**

Purpose of IPO

The IPO comprises of fresh share sale of Rs 400cr and an offer for sale for about Rs 800.9cr. Company proposes to utilize the net proceeds from the fresh issue for augmenting its capital base to meet its future capital requirements.

Key Risks

- Business mix is concentrated on few states increasing the risk of change in state regulations.
- Microfinance loans are unsecured and are susceptible to risk.
- Operational risk is high in the segment given the significant high level of cash collections and disbursements.

Issue Details	
Date of Opening	05th August, 2019
Date of Closing	07th August, 2019
Total no. of Shares offered(cr)	1.4
Post Issue No. of shares (cr)	6.4
Price Band	Rs. 853- 856
Face Value	Rs. 10
Bid Lot	17 shares
Minimum application for retail (upper price band for 1 lot)	Rs. 14,552
Maximum application for retail (upper price band for 13 lot)	Rs. 1,89,176
Listing	BSE & NSE
Lead Manager	Axis Capital, ICICI Securities, IIFL Securities
Registrars	Karvy Fintech Private Ltd.

Issue size (upper price)	Rs. Cr
Fresh Issue	400.0
OFS	800.9
Total Issue	**1,200.9**

Shareholding (%)	Pre Issue	Post Issue
Promoters	81	61
Others	19	39
Total	100	100

Issue structure	Allocation %	Size Rs.cr
Retail	35	600.5
Non -Institutional	15	180.1
QIB	50	420.3
Total	**100**	**1,200.9**

Y.E March (Rs cr)	FY17*	FY18	FY19
NII	**228**	**355**	**685**
Growth (%)	6	56	93
NIM (%)	14.2	16.6	18.6
PAT Adj	**443.4**	**188**	**312**
Growth (%)	82	-58	66
EPS	**69**	**29.2**	**48.5**
P/E (x)	12	29	18
P/BV (x)	5.9	4.0	2.4
Adj.P/BV (x)	5.9	3.1	2.4
RoE (%)	79.8	16.2	19.0
RoA (%)	22	6.6	7.2

**FY17 - Standalone*

Peer Valuation

Company	MCap (Rs cr)	NII (Rs cr)	PAT (Rs cr)	AUM (Rs cr)	RoA (%)	RoE (%)	BV(Rs)	P/E	Adj P/BV
Spandana Spoorthy Financial Ltd	**5,505**	**685**	**312**	**4,437**	**7.2**	**19.0**	**356.6**	**18**	**2.4**
Bandhan Bank	55,282	4,496	1,951	44,776	3.8	18.9	93.8	29	5.1
AU Small finance Bank	19,232	1,342	381.8	24,246	1.4	14.0	108.1	51	6.3
CreditAccess Grameen Ltd	7,154	865	322	7,159	0.05	16.9	164.7	23	3.2

Source: Geojit Research, Bloomberg; Note: Valuations of SSFL are based on upper end of the price band, Financials as per FY19

Company Description

Spandana Sphoorty Financial Ltd, incorporated in 2003, is a leading, rural focused NBFC-MFI with a geographically diversified presence in India. The company provides micro-loans predominantly to women from low-income households in rural areas under a joint liability mechanism whereby borrowers form an informal joint liability group of 5-10 members and loans are sanctioned and disbursed to individual borrowers. Joint Liability Group (JLG) loans comprised of 84.6% of SSFL's gross loan. The company provides income generation loans, business loans and loans against gold jewelry. As of March 31, 2018, they were the fourth largest NBFC-MFI and the sixth largest amongst NBFC-MFIs and SFBs in India, in terms of AUM. Spandana has a presence across 15 states in India with 4,045 employees and 694 branch network. By offering the loan products to low-income households, the company is strengthening the socio-economic condition and improving their livelihoods. The company has started working under CDR mechanism (Corporate Debt Restructuring) of the RBI to revive the business and restructure the borrowings in 2010, and exited successfully in March 2017. ICRA Research notes that Spandana is one of the only 2 major companies that were able to successfully exit from CDR. Before the 2010 crisis, the company had Rs 4,500cr loan portfolio. The company started recovering and made the first profit in the year 2013-14. As of March 2019, Spandana had Rs 4,267cr loan portfolio.

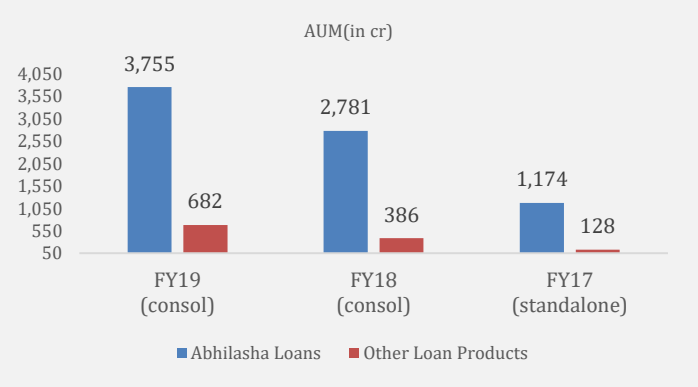
An overview of operations

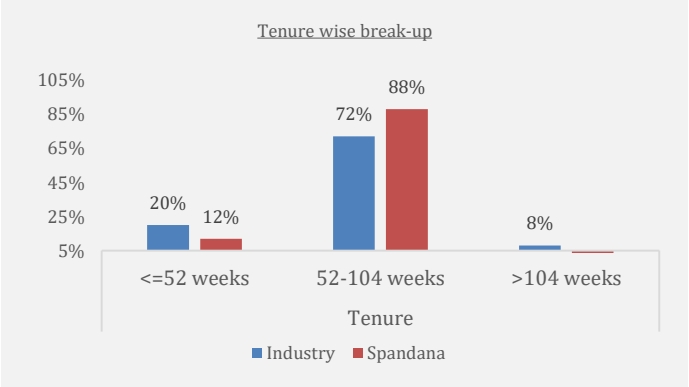
- **Abhilasha Loans**
  As of March 31, 2019, Abhilasha loans amounted to 84.62% of company's Gross AUM. Abhilasha loans are given for income generation purposes and are designed for low income households that aspire to improve their financial well-being through small ventures.
- **Other Loan Products**
  - **Loans against property**
    Loans against property are provided to clients who own businesses, are self-employed or salaried. These loans are offered in AP and Telangana with a monthly repayment structure.
  - **Shree loans**
    "Shree" or "good beginning" loans are provided in AP to low/lower middle-income women with a group guarantee.
  - **Gold loans**
    Gold loans are given against the mortgage of jewelry.
  - **Interim loans**
    Interim loans are designed to assist clients who are struggling to meet short-term liquidity requirements. The loan tenure ranges from 12 months to 36 months.
- In addition to their core business of providing micro-credit, Spandana also have contractual arrangements with one of their Group Companies, **Abhiram Marketing Services Limited** (Abhiram Marketing), a company engaged in the business of consumer goods (such as mobile phones, sarees, solar lamps, pressure cookers, mixers and grinders and bicycles, among other products) that are intended for purposes such as improving the quality of life of their clients, improving health and hygiene for families, reducing household expenditures and improving awareness, communication and mobility.

Most of the portfolio is in 1-2-year tenure

Average portfolio outstanding per client for Spandana were lower than peers as of December 31, 2018 while the share of portfolio at tenure > 1 year is higher than that of the industry.

AUM mix: by products

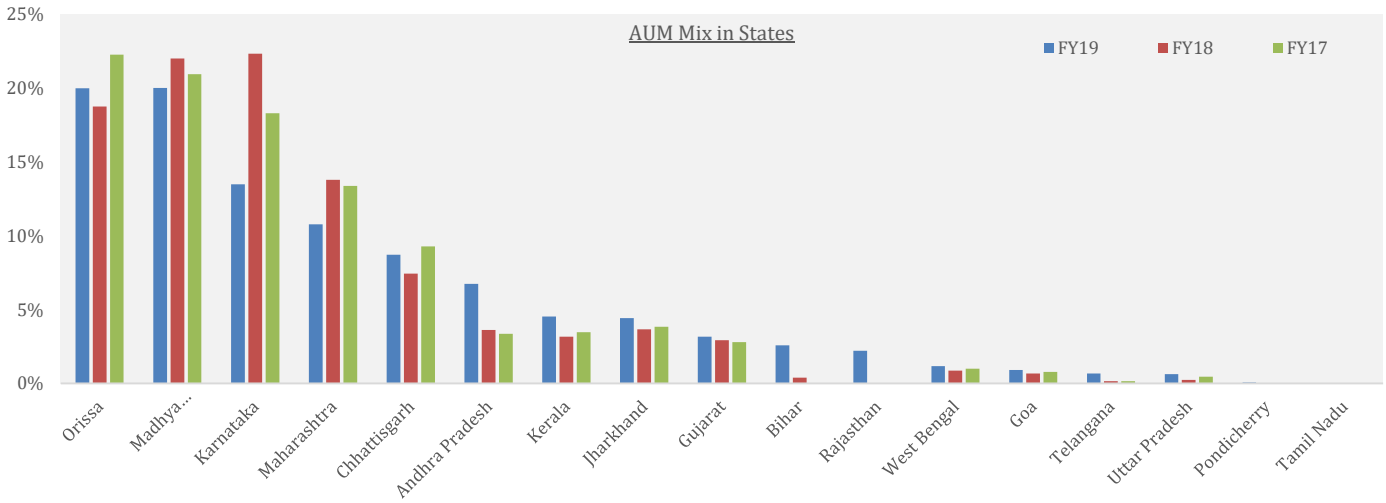




Source: RHP

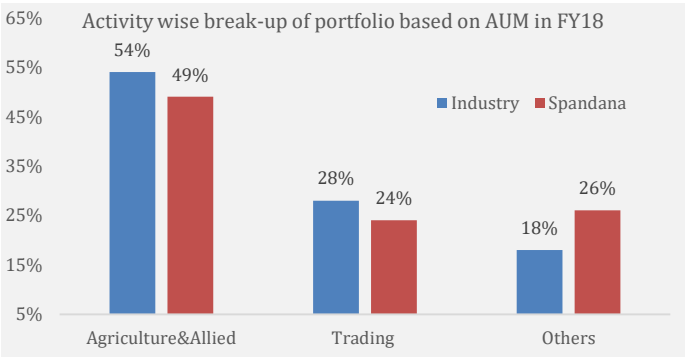
Geographically diversified operations leading to risk containment and business resilience

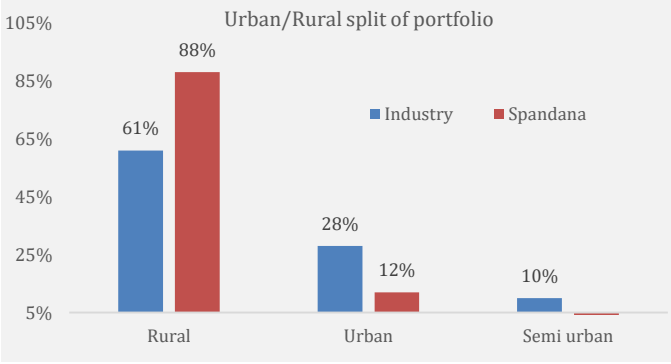
As of June 30, 2019, Spandana cover more than 74,749 villages in 269 districts in 16 states and 1 union territory across India through 929 branches. Their operations are well-diversified at the branch, district and state levels. To address geographic concentration risk, Spandana has specified exposure caps at the state, district and branch levels. With the adopted norm, their operations are geographically well-diversified with no single state contributing more than 20.01% to the AUM, no district contributing more than 1.82% to the AUM and no branch more than 0.3% to the AUM as of March 31, 2019. Regular internal audits helps SSFL to ensure the highest levels of compliance with advanced cash management systems. Orissa, Madhya Pradesh and Karnataka accounts more than 54% of AUM mix among states with strong branch networks and large employee base.



Source: RHP

Further, according to ICRA Research, Spandana had the 2nd 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 their risk containment norms, disbursements for any single state must be less than 22.5% of their total disbursements. As of FY18, the industry share of the portfolio in urban (and semi-urban) areas was 39%. Exposure of MFIs to urban areas is on the rise owing to better connectivity & higher population density. However, trends indicate that delinquencies in the urban portfolios of NBFC-MFIs are higher than the delinquencies vis-a-vis rural areas, and therefore rural portfolios exhibited stronger performance vis-a-vis urban portfolios. Spandana's share of portfolio in rural areas is higher than the industry average. Shares of agriculture and allied activities for Spandana was lower than that of the industry.

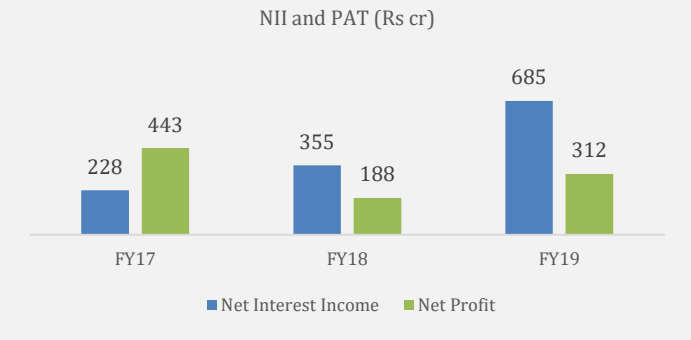


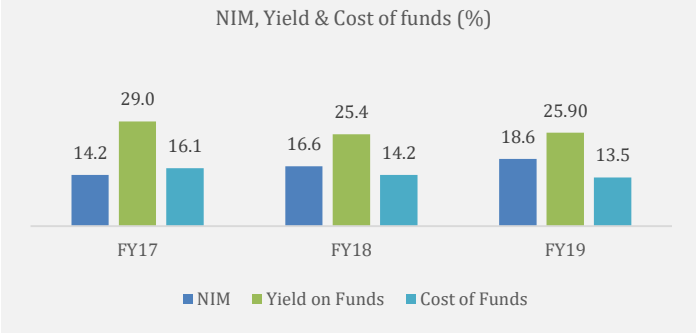


Source: RHP

Consistent financial performance

The company has maintained strong track record of financial performance and operating efficiency over the years through high rates of customer retention, geographical expansion, improved staff productivity, lower credit cost and growth in customer base led by branch expansion. Net interest income grew at a CAGR of 44% FY17-19 led by rise in interest on portfolio loans which was largely driven by volume growth in loans as a result of expansion in branch networks and customer base. AUM grew at a CAGR of 52% over FY17-19. SSFL has a strong capital position with a Capital Adequacy Ratio (CAR) of 39.61% as on FY19 compared to the mandated requirement of 15%.



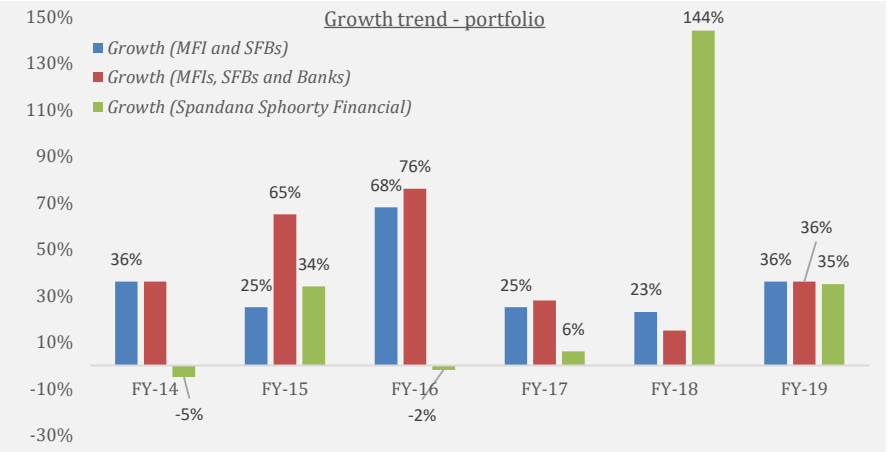


Source: RHP

At the branch level, company 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 operations.

Growth trend in portfolio

Overall growth rates for Spandana until the year ended March 31, 2017, have been lower than industry growth rates owing to the impact of the AP crisis(severely impacted due to the AP Microfinance Ordinance 2010, which enforced several restrictions on the operations of MFIs) on the liquidity position and borrowing ability of the company which constrained its growth. However, post April 2017 after Spandana came out of CDR, coupled with equity and funding infusion, Spandana's pace of growth has been strong. Prior to the AP crisis, Spandana was the second largest MFI in terms of AUM as on March 2010.



Source: RHP

Overall, MFIs, SFBs and banks had an AUM of about Rs1,646 billion as on March 31, 2019. Spandana Sphoorty Financial is the fourth largest among MFIs and the sixth largest amongst MFIs and SFBs among over 50 players who serve the microfinance customers. Spandana's AUM growth was in line with the industry growth.

Lower portfolio per branch to augment business growth

Post exit from CDR in March 2017, company increased their lender base, diversified borrowings to new banks and NBFCs and also issued NCDs in the capital markets (leading to a reduction in Average Effective Cost of Borrowing from 16.31% for FY17 to 14.74% for FY18 and further to 12.84% for FY19). As a result, during FY18, with increasing flow of capital, company expanded operations and were able to effectively utilize existing branch network and employees (that were earlier underutilized due to lack of capital). Prior to exit from CDR in 2017, company had limited access to capital, due to which they were able to offer loans in lower ticket sizes than the demand from the clients. According to ICRA Research, Spandana had the lowest portfolio per branch amongst peer comparison of major NBFC-MFIs and SFBs, as of March 31, 2017. Post exit from CDR, they were able to optimize the ticket sizes and also acquire new clients at existing and new branches. This helped company grow their Gross AUM in Fiscal 2018 at one of the highest rates (143.8%) among large NBFC-MFIs in India. Over Fiscals 2018 and 2019, Disbursements increased by 87.34% and 28.82% (from ₹20,591.65 million as of March 31, 2017 to Rs 38,576.48 million as of March 31, 2018 and to Rs 49,692.83 million as of March 31, 2019) and standalone Gross AUM was Rs13,015.36 million as of March 31, 2017 and consolidated Gross AUM grew from Rs 31,667.85 million as of March 31, 2018 and to Rs 44,372.78 million as of March 31, 2019.

Key financial & operational metrics

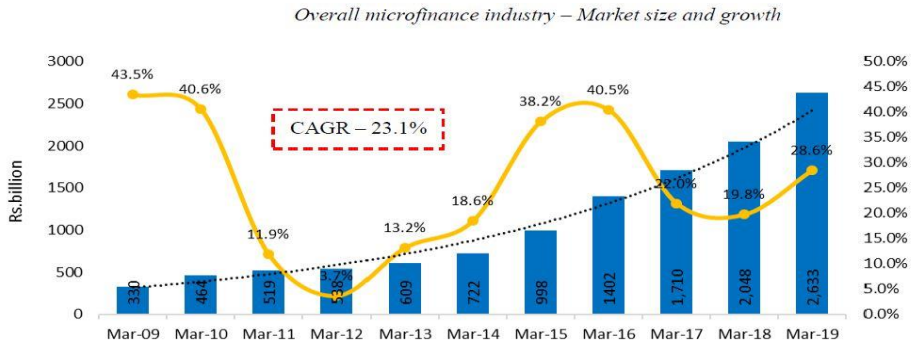
Key financial & operational metrics	FY19(consol.)	FY18(Consol.)	FY17(Standalone)
Gross AUM (including the old AP* Portfolio)	4,796	3,960	2,099
Gross AUM	4,437	3,167	1,302
Gross AUM Growth (%)	0	1	0
Disbursements	4,969	3,858	2,059
Disbursement Growth (%)	0	1	

*Source: RHP, *AP – Andhra Pradhesh*

Industry Outlook

Overview of Indian Microfinance industry

The microfinance sector in India has grown at a CAGR of 23.1% over the past ten years to reach Rs. 2,633bn as of March 2019, despite some setbacks that have impacted the industry's growth. The industry has evolved over time, starting with the Self-Help Group (SHG) Bank Linkage programme and not-for-profit organisations (NGOs) being the key participants in the sector, to the scaling of NBFCs, the conversion of Bandhan Financial Services into a universal commercial bank and the launch of the SFBs. Presently, the demand for micro credit is primarily being serviced by industry participants such as MFIs, NBFC-MFIs, SHG, banks, SFBs, NGOs and other informal lenders. Over the years, the size of the overall microfinance sector has witnessed steady growth, mainly attributed to improved awareness and deeper penetration into rural India that led to increased volumes. Further, increasing inflation a higher number of borrowers with higher loan cycles has been driving higher average ticket sizes.

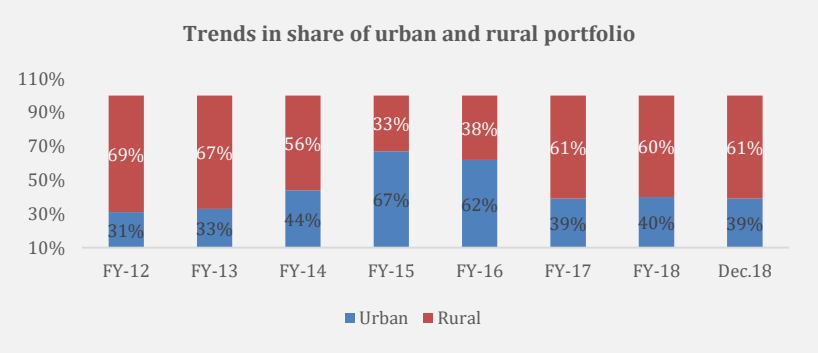


Source: RHP

ICRA Research expects the traction in disbursements to sustain and the industry to report a portfolio growth in the range of 20- 24% per annum over the medium term. Within this, the pace of growth of the non-SHG portfolio is expected to be higher at 25- 30% per annum. Further, the ticket sizes are likely to go up in the states where the penetration levels are high. Overall client growth is expected to be 8-10% and loan outstanding per borrower is expected to increase by 12-15%. Overall growth, however, would be moderated to an extent by the focus of SFBs on increasing portfolio share of other asset classes such as business loans, affordable housing and retail lending. The conclusion of recent inorganic activities in the MFI space will also result in the redistribution of business across participant categories.

Trends in share of urban and rural portfolio

As of December 31, 2018, the share of the portfolio in urban (and semi-urban) areas was 39.0% (for MFIS and SFBs). ICRA Research notes that exposure of MFIs to urban areas was on the rise until March 2016 as lending in urban areas enables MFIs to give higher ticket loans vis-a-vis rural areas, partly to bring down the operating expense ratios while complying with the margin cap regulation by the RBI. However, more specifically, post-conversion of SFB licensees and their exclusion from the NBFC-MFI category, the share of rural clients has increased for NBFC-MFIs as they are more focused on serving the rural clients.



Source: RHP

Several initiatives that are aimed at enhancing access of credit for the unbanked and weaker section of the society are being taken up by the government of India. While this has resulted in increasing number of borrowers forming part of the formal financing chain, the scope for enhancing credit availability in rural areas remains significantly high. There is tremendous scope for increment in ticket sizes and growth for the MFI industry given that some of the large states such as Uttar Pradesh, Bihar, Madhya Pradesh, Gujarat, Chhattisgarh, Punjab and Haryana have relatively more rural population and relatively more low income households and are still underpenetrated. Further, given that MFIs have the scope to lend another.

Promoter and promoter group

Padmaja Gangireddy and Kangchenjunga are the promoters of the company. Promoters hold an aggregate of 46,940,336 equity shares, comprising 81% of the pre-Offer issued, subscribed and paid up equity share capital of the Company. Kangchenjunga is a company incorporated on April 9, 2013 under the laws of Mauritius. Kangchenjunga is promoted by Kedaara Capital. After the issue, promoters shall hold 61% of the post issue paid up equity share capital of the company.

Brief Biographies of Directors

- **Deepak Calian Vaidya** is the non-executive chairman and independent director of the company. He has served as a director on the board of the various companies. He has been a director on the company board since June 6, 2018.
- **Padmaja Gangireddy** is the promoter and managing director of the company. She also serves as a director on the board of directors of Caspian Financial Services Limited. She has been a director on the company board since April 19, 2003. She founded Spandana Rural and Urban Development Organisation ("**SRUDO**") in 1998.
- **Jagadish Capoor** is the independent director of the company. He has previously worked as the deputy governor of the Reserve Bank of India for more than 4 years. He also serves as a director on the board of various companies. He has been a director on the company board since June 6, 2018.
- **Bharat Dhirajlal Shah** is an independent director of the company. He is the chairman of HDFC Securities Limited and a co-founder of HDFC Bank Limited. He has been a director on the company board since April 13, 2018.

Consolidated Financials

Profit & Loss Account

Y.E March (Rscr)	FY17*	FY18	FY19
Interest Income	**377**	**587**	**1,043**
Interest Expense	149	232	358
Net Interest Income	**228**	**355**	**685**
% change	*6*	*56*	*93*
Non-Interest Income	1.6	0.2	5.4
Operating Income	**229**	**356**	**691**
Pre-Prov. Profit	133	247	519
Provisions	98	-35	45
PBT	45.6	282.8	473.6
Tax	**-**	**95**	**162**
Tax Rate%	-	*34*	*34*
Reported PAT	**443.4**	**188**	**312**
Adj.	-	-	-
Adj. PAT	**443.4**	**188**	**312**
% change	*82*	*-58*	*66*
No. of shares (cr)	6.43	6.43	6.43
Adj EPS (Rs)	**69**	**29.3**	**48.5**
% Change	82	-58	66

Balance Sheet

Y.E March (Rscr)	FY17*	FY18	FY19
Liabilities			
Capital	28	30	60
Reserves & Surplus	899	1,361	1,831
Deposits	0	0	0
Borrowings	932	2,311	2,947
Provision & Other liabilities	69	62	94
Total Liabilities	**1,929**	**3,764**	**4,932**
Assets			
Fixed Assets	7	6	7
Investments	0.1	0.1	0.1
Advances	1,195	3,090	4,268
Other Assets	9	73	96
Cash & Balances	292	208	352
Def. Tax Assets	426	388	208
Total Assets	**1,929**	**3,764**	**4,932**

Ratios

Y.E March	FY17*	FY18	FY19
Per share data (Rs)			
EPS	69	29.2	48.5
BV	144.2	216.2	356.1
ABV	143.9	278.1	355.6
Spread (%)			
NIM	14.2	16.6	18.6
Yield on funds	29.0	25.4	25.9
Cost of Borrowing	16.1	14.2	13.5
Interest Spread	12.8	11.2	12.4
Capital (%)			
CAR	49.0	32.5	39.6
Tier I	48.5	31.6	38.6
Tier II	0.4	0.98	1.04
Asset Quality %			
GNPA	42.1	25.9	7.9
NNPA	2.9	0.3	0
Return Ratios (%)			
RoE	79.8	16.2	19.0
RoA	22.0	6.6	7.2
Valuations (x)			
P/E (x)	12	29	18
P/BV (x)	5.9	4.0	2.4
P/ABV (x)	5.9	3.1	2.4

- *FY18, FY19 figures consolidated.*
- **FY17 Standalone*

Investment Rating Criteria

Large Cap Stocks;			Mid Cap and Small Cap;		
Buy	-	**Upside is above 10%.**	**Buy**	-	**Upside is above 15%**
Hold	-	**Upside is between 0% - 10%.**	**Accumulate**	-	**Upside is between 10% - 15%.**
Reduce	-	**Downside is more than 0%.**	**Hold**	-	**Upside is between 0% - 10%.**
Neutral	-	**Not Applicable**	**Reduce/Sell**	-	**Downside is more than 0%.**
			Neutral	-	**Not Applicable**

To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell. The recommendations are based on 12 - month horizon, unless otherwise specified. The investment ratings are on absolute positive/negative return basis. It is possible that due to volatile price fluctuation in the near to medium term, there could be a temporary mismatch to rating.
For reasons of valuations/return/lack of clarity/event we may revisit rating at appropriate time. Please note that the stock always carries the risk of being upgraded to BUY or downgraded to a HOLD, REDUCE or SELL.
Neutral- The analyst has no investment opinion on the stock under review.

General Disclosures and Disclaimers

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I, Rajeev T author(s) of this Report, hereby certify that all the views expressed in this research report reflect my personal views about any or all of the subject issuer or securities. This report has been prepared by the Research Team of Geojit Financial Services Limited, hereinafter referred to as Geojit.

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RAJEEV T

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