Spandana Sphoorty Financial Ltd

Price Band ₹ 853 - 856

UNRATED

August 5, 2019

Spandana Sphoorty Financial (SSFL) is a leading, rural focused NBFC-MFI with a geographically diversified presence in India. SSFL was incorporated in 2003 as an NBFC with the RBI in 2004 and later as NBFC-MFI in 2015. SSFL offers income generation loans under the joint liability group model, predominantly to women from low-income households in rural areas. SSFL with its loan products and client centric approach endeavours to strengthen the socio-economic well-being of low-income households by providing financing on a sustainable basis to improve livelihoods, establish identity and enhance self-esteem.

With AUM size of ₹ 4437 crore as of June 30, 2019, SSFL is the fourth largest NBFC-MFI and the sixth largest among NBFC-MFIs and SFBs in India. Geographically, the company has ~63% exposure towards four states viz. Maharashtra, Karnataka, Odisha and Madhya Pradesh. SSFL has 7062 employees (including 5051 credit assistants) operating out of 929 branches in 269 districts across 16 states in India.

Seasoned business model with performance across cycle

SSFL has been able to leverage inherent strength of client centric business model, focus on internal controls, expertise of individual promoter and core management team through various business cycles. SSFL has been able to withstand a couple of turbulences viz. AP microfinance crisis & demonetisation and has exhibited a strong comeback. In the AP crisis, the company was referred to CDR by lenders, which it exited (in March 2017) post continuing operations outside Andhra Pradesh & focusing on rebuilding profitable operations through portfolio diversification, cost rationalisation, customer retention, and recovery from Andhra Pradesh portfolio. Further, during demonetisation SSFL through better business practices was able to keep their delinquencies lower compared to the industry.

Experienced promoter & management team

The promoter & management team have long standing experience of MFI lending, which gives it a competitive edge over its competitors & aids to perform better through various business cycle keeping growth healthy.

Key risk and concerns

- Geographical concentration acts as a risk
- Rising competition remains a challenge
- Regulatory and local disruption affects financial condition

Priced at P/BV of 2.7x FY19 on upper band

At the IPO price band of ₹ 853-856, the stock is available at a P/B multiple of ~2.7x at the upper band on FY19 basis.

SPANDANA

Particulars	
Issue Details	
Issue Opens	5-Aug-19
Issue Closes	7-Aug-19
Issue Size	₹ 1201 crore
Offer for Sale	₹ 801 crore
Fresh Issue	₹ 400 crore
Price Band (₹)	853-856
No of shares on offer (Crore)	0.93
QIB (%)	50
Non-Institutional (%)	15
Retail (%)	35
Minimum lot size (no of shares)	17

Shareholding Pattern (%)

	Pre-Issue	Post-Issue
Promoter & Promoter gr	81.22	62.58
Public/others	18.78	37.42

Objects of the Issue

Object of issue	Amount
a) To utilize proceeds to augment capital base b) receive benefits of listing of equity shares on stock exchanges	₹ 400 crore

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IPO Review

ICICI Securities – Retail Equity Research

Key Financial Summary

₹ crore	FY17	FY18	FY19
Net Interest Income	228	355	680
PPP	133	247	515
PAT	433	188	309
BV	326.0	467.3	316.8
P/E (x)	3.9	20.1	16.0
P/BV (x)	2.6	1.8	2.7
RoA (%)	35.2	8.4	8.2
RoE (%)	79.8	16.2	19.0

Source: ICICI Direct Research, RHP

Company background

Spandana Sphoorty Financial (SSFL) is a leading, rural focused NBFC-MFI with a geographically diversified presence in India. SSFL was incorporated in 2003, subsequently as an NBFC with the RBI in 2004 and later as NBFC-MFI in 2015. SSFL offers income generation loans under the joint liability group model, predominantly to women from low-income households in rural areas. SSFL with its loan products and client centric approach endeavours to strengthen the socio-economic well-being of low-income households by providing financing on a sustainable basis to improve livelihoods, establish identity and enhance self-esteem.

SSFL predominantly had a larger exposure of loans to Andhra Pradesh. Post the AP microfinance ordinance 2010, the company's collections were largely impacted and consequently cash flow shortage impacted its debt servicing capacity. Accordingly, lenders referred SSFL to corporate debt restructuring (CDR). Post years of operational efficiencies & capital infusion, the company was able to exit CDR mechanism in March 2017.

With AUM size of ₹ 4437 crore as of June 30, 2019, SSFL are the fourth largest NBFC-MFI and sixth largest among NBFC-MFIs and SFBs in India. The company's 63% exposure is towards four states viz. Maharashtra, Karnataka, Odisha and Madhya Pradesh. SSFL has 7062 employees (including 5051 credit assistants) operating out of 929 branches in 269 districts across 16 states in India.

Exhibit 1: Key Financials

₹ crore	2019	2018	2017	2016*
Gross AUM	4,437	3,166	1,302	1,220
Gross AUM Growth (%)	40.1	143.3	6.8	2.2
Disbursements	4969	3858	2059	1793
Disbursement Growth (%)	28.8	87.3	14.8	-9.6
Total Revenue	1049	588	379	351
Operating Expense/ Annual Average Gross (%)	4.52	4.85	7.61	7.41
Cost to Income Ratio (%)	24.9	30.5	41.8	40.1
Provisions/Annual Average Gross AUM (%)	1.2	-1.6	7.8	0.9
Profit after tax	312	188	443	246
Stage III PAR 90+ (excluding old AP portfolio)	4	72	89	1
Stage III PAR 90+ Ratio (excluding the old AP portfolio) (%)	0.1	2.3	6.9	0.1
Stage III Net PAR 90+ (excluding the old AP Portfolio)	0.6	11.7	8.7	1.0
Stage III Net PAR 90+ Ratio (excluding the old AP portfolio) (%)	0.0	0.4	0.7	0.1
Collection Efficiency (%)	99.74	99.25	97.13	99.41
Return on Annual Average Gross AUM (%)	8.2	8.4	35.2	20.4
Return on Annual Average Net Worth (%)	19.0	16.2	79.8	291.1

*Source: RHP, ICICI Direct Research, *- INDIAN GAAP*

Industry Overview

Global microfinance industry

Globally, ~119.9 million microfinance borrowers had access to credit products, with an overall gross loan portfolio of US$111.6 billion outstanding as of 2019 (according to Icra Research).

Exhibit 2: Top 10 countries by active microfinance borrower

Country	Active Borrowers ('000)	% total	GLP (US$ Million)	% total	GLP Per Borrower (US$)
India	37892	32	21033	19	555
Bangladesh	26916	22	7897	7	293
Vietnam	7317	6	8766	8	1198
Mexico	6465	5	3069	3	475
Peru	5187	4	1044	1	201
Colombia	5062	4	1681	2	332
Cambodia	4921	4	12443	11	2528
Ecuador	2743	2	6335	6	2309
Bolivia	2173	2	7713	7	3550
Kenya	2091	2	999	1	478
Total	**119985**		**111568**		**930**

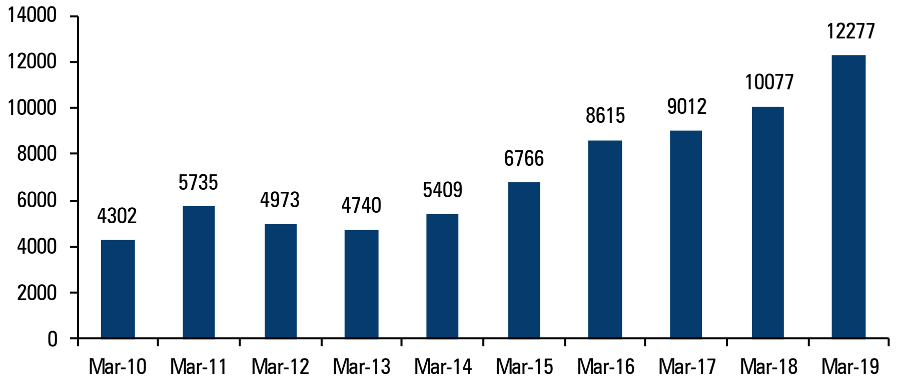
Source: RHP, ICICI Direct Research

India is the largest market in terms of number of microfinance borrowers and outstanding gross loan portfolio (GLP) with 19% of US$111.6 billion microfinance market in value terms and 32% of total borrower population. However, ticket size was significantly lower than the world average.

Historical trend of Indian microfinance industry

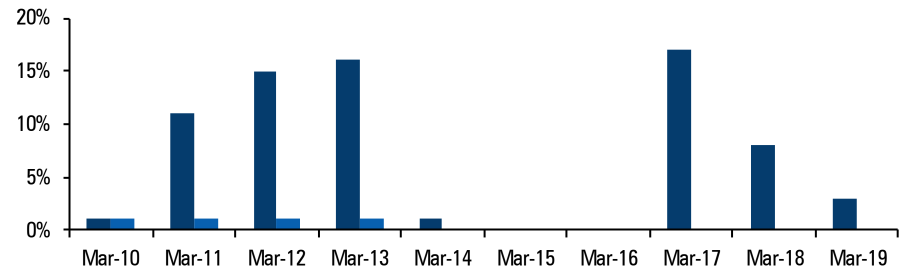
For several decades, microfinance sector, in its various forms, has been in existence in India. The industry has grown manifold, driven by an inherent demand for credit at the bottom of the pyramid, which remained largely underserved. Number of negative events in the past have influenced growth as well as asset quality of the microfinance sector including – the AP crisis of October 2010, farm loan waivers by several states, as well as demonetisation in November 2016. Despite some setbacks, the industry has evolved over the cycles and demonstrated resilience by adapting to changing dynamics. The microfinance sector in India has grown at a CAGR of 23.1% over the past 10 years to reach ~₹ 263300 crore as of March 2019.

Exhibit 3: Branch network on uptrend in industry



Source: RHP, ICICI Direct Research

Exhibit 4: Industry trend in asset quality



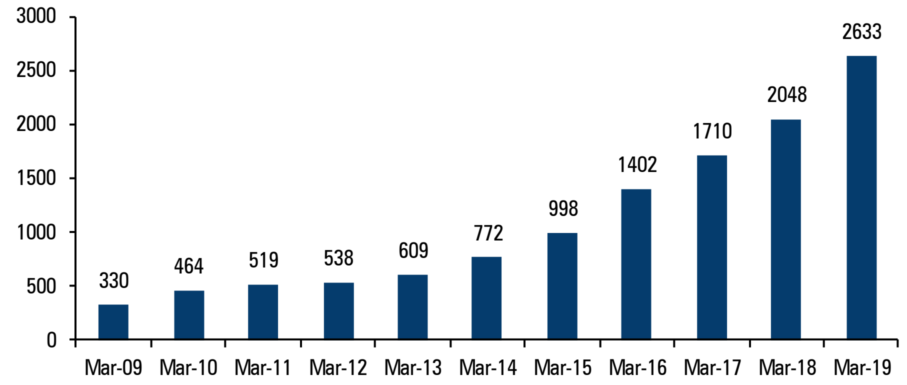
Source: RHP, ICICI Direct Research

Overview of Indian micro finance industry

The share of portfolio in urban (and semi-urban) areas was at 39% (for MFIS +SFBs) as of December 31, 2018. Initially, MFIs exposure to urban areas was on the rise till March 2016 as lending in urban areas enables disbursement of higher ticket loans. However, post conversion of SFB licensees and their exclusion from NBFC-MFI category, share of rural clients has increased for NBFC-MFIs as they are more focused on serving rural clients.

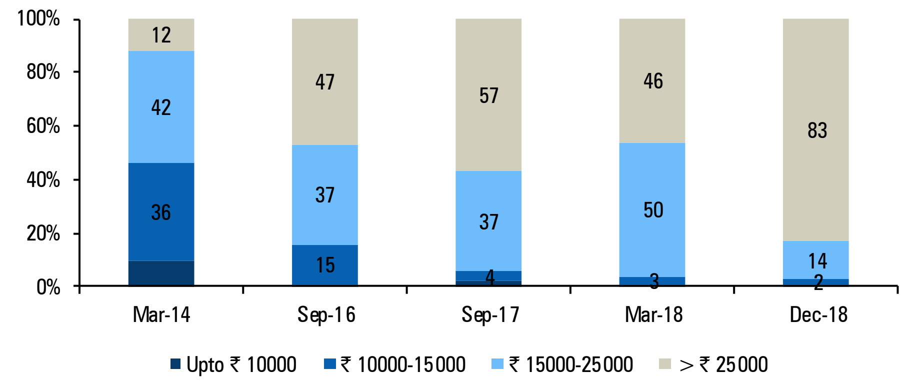
Over the years, average ticket size in the MFI business has been on the rise. While ~10% of borrowers had loans less than ₹ 10,000 in March 2014, the share came down to slightly above 2% in September 2016 and remained broadly comparable as of December 2018. In contrast, loans with ticket size greater than ₹ 25,000 have increased from 12% as on March 2014 to 47% of the portfolio as on September 30, 2016 and further to 83% as on December 2018.

Exhibit 5: GLP of MFI industry (₹ billion)



Source: RHP, ICICI Direct Research

Exhibit 6: Ticket size portfolio of industry



Source: RHP, ICICI Direct Research

Exhibit 7: Peer comparison

as of March-19	AUM (₹ crore)	Market Share	AUM growth
Bandhan Bank	34,700	21.10%	68.60%
Bharat Financial Inclusion	17,390	10.60%	38.20%
Jana Small Finance Bank*	6,220	3.80%	3.10%
Ujjivan Small Finance Bank*	11,050	6.70%	46.20%
Satin Credit Care Network	6,370	3.90%	25.50%
CreditAccess Grameen	7,160	4.30%	43.90%
Spandana Sphoorty	4,270	2.60%	34.70%
Equitas Small Finance Bank ^	2,960	1.80%	28.50%
Annapurna Finance Ltd	3,020	1.80%	54.80%
Arohan Financial Services	4,050	2.50%	86.40%

Source: RHP, ICICI Direct Research

Investment Rationale

Seasoned business model with performance across cycle

The company has been able to leverage the inherent strength of client centric business model, focus on internal controls, expertise of individual promoter and core management team through various business cycles. SSFL has been able to withstand a couple of turbulences viz. AP microfinance crisis & demonetisation and shown a strong comeback. Within AP crisis, it was referred to CDR by lenders, which it exited (March 17) post continuing operations outside Andhra Pradesh & focusing on rebuilding profitable operations through portfolio diversification, cost rationalisation, customer retention, and recovery from Andhra Pradesh portfolio. Further during demonetisation SSFL through better business practices were able to keep their delinquencies lower compared to the industry.

Client engagement, risk control to aid superior return ratios

SSFL focuses on a high degree of client engagement (village/block level centre meetings and client training) through their large employee base and operating procedures. Based on above practices, the company has been able to perform better than peers on collection efficiency and asset quality. Further, the company's strong business process and prudent risk management strategy are adequately designed to tackle various business risks including frauds by employees. As a result, the company's profitability & asset quality remain one of the best in the industry.

Exhibit 8: Superior asset quality on back of strong risk management

₹ crore	2019	2018	2017	2016*
Collection Effciency (%)	99.74	99.25	97.13	99.41
Stage III PAR 90+ (excluding old AP portfolio)	0.611	12	9	4
Stage III PAR 90+ Ratio (excluding the old AP portfolio) (%)	0.1	2.27	6.86	0.1
Stage III Net PAR 90+ Ratio (excluding the old AP portfolio) (%)	0.01	0.38	0.71	0.08
Stage I, II, III PAR 0+ (excluding AP portfolio)	38	74	1390	

*Source: RHP, ICICI Direct Research, *-INDIAN GAAP*

Under penetrated rural market to drive future growth

With 68% of population residing in rural region, banking penetration in India has been lower compared to other countries. The market for formal banking is quite high as only 35% of loans and 30% of deposited originate from the rural region. On back of this, the company strategically focuses on clients in the rural sector as it has a relatively deeper reach, existing client relationships and local employee base to address this demand, which is currently being met by informal sources like local money lenders. As of September 30, 2017, 80% of the company's portfolio was located in rural areas vs. industry average of 49%.

Experienced promoter & management team

The promoter & management team have long standing experience of MFI lending, which gives them a competitive edge over its competitors and aids to perform better through various business cycle keeping growth healthy.

Key risks and concerns

Geographical concentration acts as risk

As of March 31, 2019, the company has ~67.6% branch and ~72.94% of gross AUM originated in Karnataka, Madhya Pradesh, Odisha, Maharashtra and Chhattisgarh. While it has endeavoured to manage and monitor concentration risk at the district level, the company is susceptible to risks relating to concentration in these states. In the event of a regional slowdown in economic activity in one or more of these states, or any other developments including political unrest, disruption or sustained economic downturn, the company may experience an adverse impact on business, financial condition, results of operations and cash flows.

Rising competition from MFIs, banks and other financial institution

Spandana faces 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 may be larger in terms of business volume or assets, higher geographical penetration and better access. Therefore, the company may encounter greater competition as it continue expanding operations in India. Further, disruption from digital platforms could also have an adverse effect on business model and the success of products and services on offer. Thus increasing competition may adversely affect business, financial condition and results of operations.

Regulatory, local disruption affect financial condition

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. Post this ordinance, loan collections and asset quality in the formerly unified AP was severely affected across the industry. As the company had large exposure in the formerly unified AP, the company had materially adverse effect on business. Thus, business operations may get affected by regulatory actions or any laws passed by state governments in which the company operates its business.

Financial Summary

Exhibit 9: Profit & Loss Statement

₹ crore	FY19	FY18	FY17
Interest Income	1036	587	377
Interest Expense	356	232	149
Net Interst Income	680	355	228
Other Income	5	0	2
Total Income	685	356	229
Operating Expense	170	108	96
Employee Cost	130	76	58
Other Operating expense	40	33	38
Operating Profit	515	247	133
Provisions	45	-35	98
Profit Before Tax	469	283	35
Tax	161	95	-398
PAT	**309**	**188**	**433**
EPS	53.46	42.52	213.55

Source: ICICI Direct Research; RHP

Exhibit 10: Balance Sheet

₹ crore	FY19	FY18	FY17
Liability & Equity			
Equity Share Capital	60	30	28
Reserves	1827	1361	899
Borrowing	2925	2311	932
Subordinated Liability	20	20	1
Other fiancial liability	67	42	68
Total Liability & Equity	**4898**	**3764**	**1929**
Asset			
Cash & Bank Balance	348	206	292
Advances	4165	3090	1195
Investment	6.4.635	2	0
Fixed Asset	7	6	7
Other Asset	377	461	435
Total Asset	**4898**	**3764**	**1929**

Source: ICICI Direct Research; RHP

Exhibit 11: Key Ratios

	FY19	FY18	FY17
Valuations			
No of equity shares	59.6	29.8	28.4
EPS (₹)	53.5	42.5	216.9
BV (₹)	316.8	467.3	326.0
P/E (x)	16.0	20.1	3.9
P/BV (x)	2.7	1.8	2.6
Yields & Margins (%)			
Net interest Margin	16.4	15.0	17.5
Yield on Advances	26.0	25.4	29.4
Cost of Borrowing	13.5	14.2	16.1
Quality & Efficiency (%)			
Collection effciency	99.7	99.3	97.1
Cost to Income ratio	24.9	30.5	41.8
GNPA	0.1	2.3	6.9
NNPA	0.01	0.38	0.71
ROA	8.2	8.4	35.2
ROE	19.0	16.2	79.8

Source: ICICI Direct Research, RHP

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