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IPO REPORT

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SPANDANA SPHOORTY FINANCIAL

Strong fundamentals, but value for long term

IPO UPDATE

Aug 2 2019

Salient features of the IPO:

- **Spandana Sphoorty Financial Limited (SSFL),** incorporated in 2003, is the leading, rural focused NBFC-MFI.
- The company offers income generation loans under the joint liability group (JLG) model, predominantly to women from low-income households in rural areas.
- As of March 31, 2019, 94.6% of portfolio was located in rural areas.

Valuation : At the higher price band of Rs856, SSFL's share is valued at P/ABV multiple of 2.4(x) (to its post issue FY19 adjusted BVPS).

Below are few key observations of the issue:

- Given rural India as the highly underserved market for formal banking services in terms of access, SSFL strategically focuses on clients in this region and as of March 31'2019, 94.6% of portfolio was located in rural. The company offers income generation loans under the joint liability group (JLG) model, predominantly to women from low-income households in rural areas. As per the mgmt, the group consist of 8 to 10 women working as the agriculture labour. The ticket size is as small as in the multiple of few thousands below <Rs20,000 (Abhilasha Loan). The collection is done on the fortnightly basis and the subsequent loan processing to existing customers starts before the last two installments of previous loan. The flagship 'Abhilasha' loan which is income generation loans accounted for 84.6% of AUM by FY19. Other categories of loans such as LAP, small business loan, gold loan and interim loan cumulatively accounted for 15.4% by FY19.
- SSFL has diversified geographical presence across 16 states with no state compromising more than 22.5% of AUM. Well diversified presence across the region immunes the company from any particular region stress. Aftermath of the 2010 AP crisis, the company successfully exited the CDR and remained largely unaffected by the impact of demonization.
- Delinquency trend indicates that assets quality of rural portfolio are higher than the urban areas. As the 95% of AUM was related to rural, portfolio at risk (PAR) for stage III assets excluding old AP portfolio was significant at 0.1% by FY19. Resilient quality of incremental portfolio post 2010 can also be attributed to various company's initiatives. Mgmt highlighted few channel checks before disbursement of loan include 1)women should work as agri or allied worker earning daily income form farmers 2)must have home with some cattle like buffalo or cow 3) husband must do work and 4) not having more than 2 to 3 children. The client is also assessed for credit history with other lenders reporting into the credit bureau. Further, to prevent frauds by employees, SSFL follows a standard transfer policy.
- C/I ratio at ~25% in FY19 is way lower than the other micro financiers. As per the mgmt, strict expenditure budget like electricity bill limit for each branch, multiple role of field officers and branch manager like cashiers or interchange in roles etc., streamline the process of travelling expenses and low TAT are key factors for low opex ratio.
- Funding profile diversified across term loan, cash credit (Banks at 34.7%), NCD (46.2%) and securitization. CoF reduced significantly to 12.8% in FY19 (14.7% in FY18). With credit rating by ICRA improving to A- in Mar'2019 from BBB+ in May 2018 and continued profitability trend, we think CoB will reduce further which will boost the NIM. Furthermore, the company maintains positive ALM across all maturities of loans.
- Meanwhile the prevailing slowdown in agriculture sector (GVA growth slummed to 2.9% in FY19) with rural stress, slow progress of monsoon in current season is the business concern for company given its large chuck of income fetched from agriculture labour. Furthermore, the prevailing sentiments are very much negative for NBFCs and micro-financiers post the IL&FS crises ***making risk-return unfavorable for short term investors or individual looking for listing gain.***
- At the higher price band of Rs856, SSFL's demanding valuation at Rs55 bn is valued at P/ABV of 2.4(x) to FY19 adjusted BVPS (post issue). Meanwhile SSFL peer such as Creditaccess Grameen (much nearer listed peer) is trading at P/ABV of 3.4(x), Satin Credit Care Network at P/ABV of 1.1(x). Considering all these parameters, we assign **'Subscribe with Caution'** rating to the issue.

Recommendation	Subscribe with Caution
Price Band (per share)	Rs853-856
Face Value	Rs10
Shares for fresh issue	4.7 mn
Shares for OFS	9.4 mn
Fresh issue size	Rs4,000 mn
Total Issue Size (on Higher Price Band)	Rs12,009.4 mn
Bidding Date	Aug 05, 2019 - Aug 7, 2019
MCAP on Higher Price Band	Rs55,046.4 mn
Book Running Lead Manager	Axis Capital Limited, ICICI Securities Limited, IIFL Securities Ltd., JM Financial Limited, IndusInd Bank Limited, YES Securities (India) Limited,
Registrar	Karvy Fintech Private Limited
Industry	NBFCs

Allocation detail	
Qualified Institutional Investors (QIBs)	50%
Non Institutional Investors (NII)	15%
Retail Individual Investors (RII)	35%

Pre and post issue shareholding pattern

	Pre - Issue	Post – Issue
Promoter and Promoter Group	81.2%	62.6%
Non- promoter	18.8%	37.4%
Total	100.0%	100.0%

Retail Application Money at Higher Cut-Off Price per Lot	
Number of Shares per Lot	17
Application Money	Rs14,552

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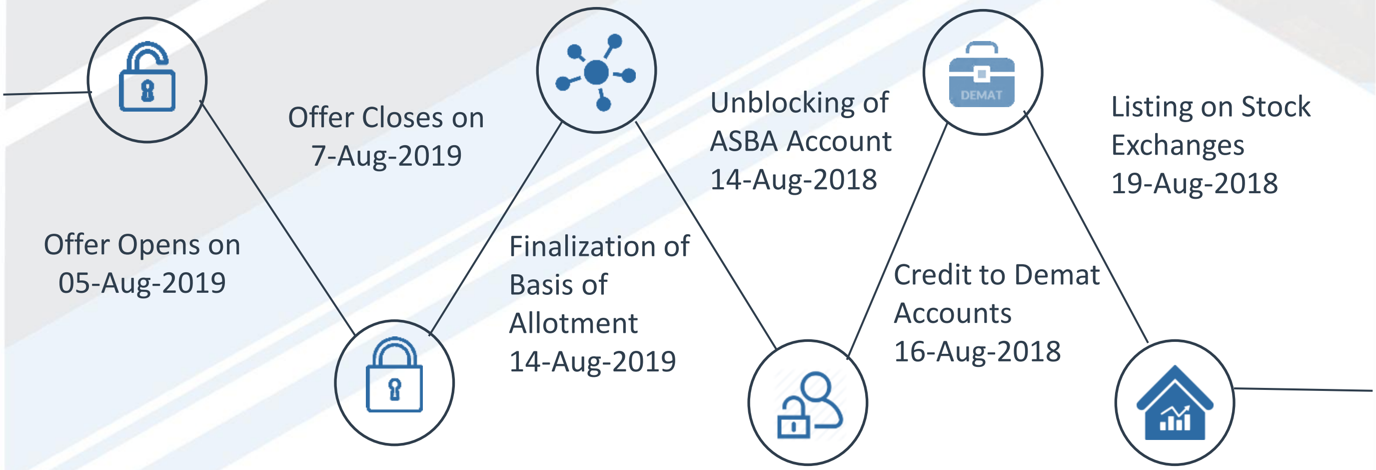
About the issue:

- SSFL is coming up with an initial public offering (IPO) with 4.7 mn shares as a fresh issue and 9.4 mn shares as offer for sale (OFS). Post issue promoter and promoter group's holding will reduce to 62.6% and non-promoter shareholding will increase to 37.4% from 18.8%.
- The issue will open on 5th Aug 2019 and close on 7th Aug 2019. Post allotment, shares will be listed on BSE and NSE.
- Not more than 50% of the issue will be allocated to qualified institutional buyers. Further, not less than 15% of the issue will be available for non-institutional bidders and not less than 35% for retail investors.
- Total issue size is Rs12,009.4 mn on higher price band out of which ~66.7% is OFS.
- Selling shareholders are mainly promoters of the company. Out of the 9.4 mn share of OFS, 8.2 mn are selling by the promoters.
- Averge cost of share acquisition of promoters include Padmaja Gangireddy is Rs109, Kangchenjunga at Rs237 and Vijay Siva Rami Reddy at Rs 3.33.
- **The company will receive Rs4,000 mn as a fresh issue . The company proposes to utilise the net proceeds from the fresh issue towards augmenting its capital base to meet future capital requirements.**

Pre and post issue shareholding pattern

	Pre - Issue	Post - Issue
Promoter and Promoter Group	81.2%	62.6%
Public	18.8%	37.4%
Total	100.0%	100.0%

Source: Choice Broking Research, Company data, RHP



Source: Choice Broking Research, Company data, RHP

Company Introduction:

Spandana Sphoorty Financial Limited (SSFL) is the leading, rural focused NBFC registered with RBI in 2004. With the branch network of 929 in 269 districts across 16 states and 1 union territory, the company has a strong geographically diversified presence in India. The company offers income generation loans under the joint liability group (JLG) model, predominantly to women from low-income households in rural areas. As of March 31, 2019, SSFL was the fourth largest NBFC-MFI and the sixth largest amongst NBFC-MFIs and SFBs in India, in terms of AUM which stood at Rs44 bn. Meanwhile the company was one of the few erstwhile macro financers along with Bharat Financial Inclusion (BFI) and Bhadhan Bank, it stood second in terms of AUM as of March 2010 behind BFI. However in October 2019, AP Microfinance Ordinance 2010, which enforced several restrictions on the operations of MFIs severely impacted its collections and the consequent cash-flow shortage impacted the company ability to service debt, which in turn impaired growth and profitability.

Afterwards, lenders pulled the company into the corporate debt restructuring (CDR) to restructure borrowings and revive business by allowing cash-flow relaxations, enabling efforts towards portfolio diversification, process improvement and cost rationalization. These measures helped SSFL turn operations profitable from the year ended March 31, 2014. While operating under the CDR mechanism and continued efforts for recovering dues; the company had successfully made profit for the consecutive four years. Profit after tax (under Previous Indian GAAP) was Rs1,051 mn and ₹2,432.4 million for FY15 and FY16. Restated standalone profit for the period (under Ind AS) was Rs4,434.1 million for FY17, and restated consolidated profit for the period (under Ind AS) for FY18 and FY19 was Rs1,879.5 mn and Rs3,119.00 mn. As a result of collections from the old AP portfolio and the profits generated from operations in other states, SSFL was able to restructure outstanding debt as well as raise refinancing debt from existing CDR lenders. Thus, the company exited from CDR mechanism successfully in March 2017 with approvals from the RBI and lenders. SSFL was one of only two major companies that were able to successfully exit from CDR.

Post exit from CDR in March 2017, the SSFL increased lender base, diversified borrowings to new banks and NBFCs and also issued NCDs in the capital markets. Diversification in borrowing has reduced cost of borrowing (CoF) significantly as the avg. effective CoF declined from 16.31% for FY17 to 14.74% for FY18 and further to 12.84% for FY19. With the increase in capital flows, the company expanded operations and were able to effectively utilize existing branch network and employees (that were earlier underutilized due to lack of capital during CDR). Post exit from CDR, the company was able to optimize the ticket sizes and also acquire new clients at existing and new branches supporting AUM growth. Disbursement rose from Rs20,591.6 mn as of FY17 to Rs38,576.5 mn as of FY18 and to Rs49,692.8 mn as of FY19. As of December 31, 2018, 88% of SSFL's portfolio was located in rural areas, as compared with 61% for 33 NBFC-MFIs as a whole. Rural focused portfolio rose to 94.6% of total portfolio as of March'2019.

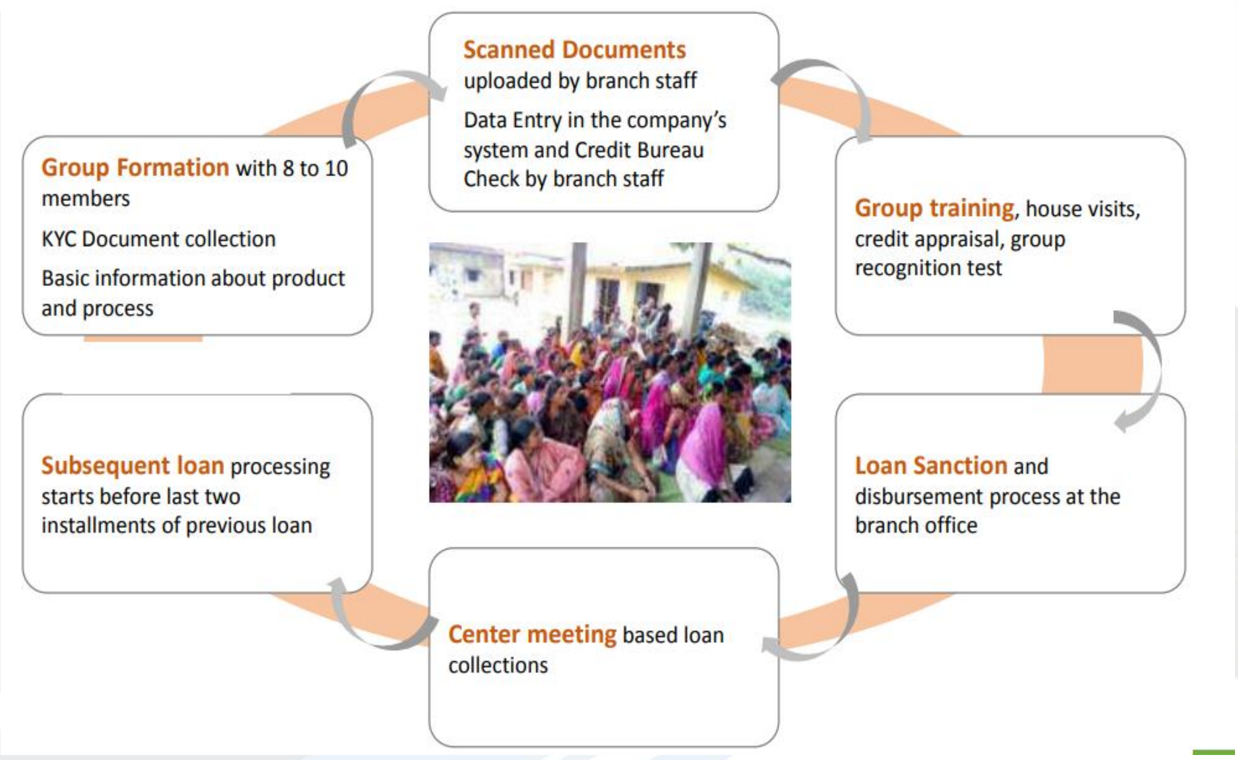
	As of / For the		
	Year ended March 31, 2019 (consolidated)	Year ended March 31, 2018 (consolidated)	Year ended March 31, 2017 (standalone)
	(₹ in millions, except percentages and number of borrowers)		
Gross AUM(1)	44,372.78	31,667.85	13,015.36
Gross AUM Growth (%)(2)	40.12%	143.31%	6.78%
Disbursements(3)	49,692.83	38,576.48	20,591.65
Disbursement Growth(4)	28.82%	87.34%	14.83%
Borrowers (millions) (5)	2.46	1.59	1.06
Total Income(6)	10,485.29	5,875.31	3,786.66
Operating Expense / Annual Average Gross AUM(7)	4.52%	4.85%	7.61%
Cost to Income Ratio(8)	24.89%	30.49%	41.78%
Impairment of financial instruments / Annual Average Gross AUM(9)	1.19%	-1.58%	7.81%
Profit before tax(10)	4,734.72	2,827.01	455.86
Profit for the period(11)	3,119.00	1,879.46	4,434.14

Source: Choice Broking Research, Company data, RHP

Business Overview:

Through the extensive corporate history, the company has developed an in-depth understanding of the borrowing requirements of the low-income client segment. The company's business model involves regular client meeting processes through employees, who maintain contact with clients across the districts that it cover. As of June 30, 2019, the company had 7,062 employees (including 5,051 credit assistants).

SSFL focuses on a high degree of client engagement through large employee base and operating procedures. Client engagement practices include village/block level centre meetings and client training. Prior to lending to a client, the company 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 staff at regular intervals (typically based on their installment payments frequency). All these initiatives helps to improve collection efficiency which stood at 97.1% for Fiscal 2017 on a standalone basis and 99.25% and 99.74% for FY18 and FY19, respectively.



To remain well geographical diversified, SSFL put limit for exposure to states and districts. For instance, the gross loan portfolio of each state must not exceed 22.5% of total portfolio (except for AP and Telangana, to which, the combined cap of portfolio is 6% of the gross loan portfolio) or 100% of net worth. The gross loan portfolio for each district must not exceed 2.5% of total portfolio and 7.5% of net worth. With this adopted norm, SSFL's operations are geographically well-diversified with no single state contributing more than 20.0% to AUM, no district contributing more than 1.82% to AUM and no branch more than 0.3% to AUM as of March 31, 2019.

Source: Choice Broking Research, Company data, RHP

Competitive Strengths:

- Seasoned business model with resilient performance through business cycles
- High degree of client engagement and robust risk management, leading to superior asset quality and collections
- Streamlined systems and processes and high employee productivity leading to low operating expense ratio
- focus on the high potential and under-served rural segment
- Geographically diversified operations leading to risk containment and business resilience
- Significant industry experience of promoter and management team

Business Strategy:

- Leverage popular income generation loan products to derive organic business growth
- Leverage existing branch network by increasing loan portfolio and enhancing employee productivity
- Increase presence in under-penetrated states and districts
- Further diversify borrowing profile and reduce cost of borrowings

Risk and Concerns:

- Industry specific concerns due to political interference
- Increasing competition in microfinance segment
- Risk of higher slippage in loan portfolio
- Prevailing slowdown in agriculture sector
- NBFCs crises due to current liquidity cruch

Peer Comparison and Valuation:

Particulats (Rs)	CMP	6M R(%)	12M R(%)	Mar. Cap. (Rs mn)	P/ABV (x)	P/E (x)	AUM (Rs bn)	PAT Rs mn
Spandana Sphoorty Financial	**856**			**55,046.4**	**2.4**	**17.6**	**44,372.78**	**3,119.0**
Indostar Capital Finance	297	-6.2%	-38.2%	27,500.8	0.98	11.4	117,352.0	2,408.0
Ujjivan Financial Services	287	-6.3%	-30.6%	34,826.8	1.8	17.6	110,490.0	1,984.0
Equitas Holdings	115	-6.2%	-19.9%	39,330.0	1.7	18.2	11,800.0	2,160.0
Credit Access Granmin	**530**	**32.2%**		76,081.5	3.4	23.6	**71,590.0**	3,217.6
Satin Credit Care Network	268	3.2%	-20.3%	13,006.3	1.1	6.5	70680.0	2,010.0
Average	**299.7**	**3.3%**	**-27.2%**	**38149.1**	**1.8**	**15.5**	**76382.4**	**2355.9**

Particulats (Rs)	RoE (%)	RoA(%)	GNPA (%)	NNPA (%)	NIM (%)	C/I (%)	AUM CAGR FY17-FY19	CAR (%)
Spandana Sphoorty Financial	**19.0%**	**6.3%**	**7.9%**	**0.0%**	**10.0%**	**24.9%**	**52.0%**	**39.6%**
Indostar Capital Finance	9.5%	2.0%	2.6%	1.7%	5.8%	38.4%	42.0%	24.30%
Ujjivan Financial Services	10.2%	1.4%	0.9%	0.3%	9.6%	76.7%	27.0%	18.9%
Equitas Holdings	8.6%	1.3%	2.5%	1.4%	8.2%	70.0%	-3.0%	22.4%
Credit Access Granmin	16.3%	5.0%	0.6%	0.0%	12.7%	33.9%	41.0%	35.7%
Satin Credit Care Network	19.8%	3.1%	2.9%	0.0%	12.8%	54.3%	25.0%	28.5%
Average	**12.9%**	**2.6%**	**1.9%**	**0.7%**	**9.8%**	**54.7%**	**26.4%**	**26.0%**

Source: Choice Broking Research, Company data, RHP

Below are few key observations of the issue:

- Given rural India as the highly underserved market for formal banking services in terms of access, SSFL strategically focuses on clients in this region and as of March 31'2019, 94.6% of portfolio was located in rural. The company offers income generation loans under the joint liability group (JLG) model, predominantly to women from low-income households in rural areas. As per the mgmt, the group consist of 8 to 10 women working as the agriculture labour. The ticket size is as small as in the multiple of few thousands below <Rs20,000 (Abhilasha Loan). The collection is done on the fortnightly basis and the subsequent loan processing to existing customers starts before the last two installments of previous loan. The flagship 'Abhilasha' loan which is income generation loans accounted for 84.6% of AUM by FY19. Other categories of loans such as LAP, small business loan, gold loan and interim loan cumulatively accounted for 15.4% by FY19.
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Financial Statements (Consolidated, Rs mn)

Profit & Loss A/c		
Particulars (Rs mn)	**FY18**	**FY19**
Interest Income:	5,730.4	9,978.7
Interest expenses	2,317.9	3,578.7
Net Interest Income (NII)	**3,412.5**	**6,400.1**
Other Income	144.9	506.6
Total Income	3,557.4	6,906.6
Staff cost	758.7	1,310.5
Other Operating expenses	325.8	408.5
Pre-Prov. Operating Profit	**2,472.9**	**5,187.7**
Provisions and write offs	-354.09	453.00
Operating Profit before Tax	2,827.0	4,734.7
Tax	947.6	1,615.7
Net profit	1,879.5	3,119.0
Extraordinary items	0.0	0.0
Adjusted PAT	**1,879.5**	**3,119.0**
	18.5%	23.4%

Balance Sheet		
Particulars (Rs mn)	**FY18**	**FY19**
Share capital	297.6	596.3
Reserves & Surplus	13,608.8	18,298.0
Net Worth	**13,906.4**	**18,894.4**
Borrowings	23,313.76	29,677.37
Other liablities & Provisions	422.4	745.3
Total Liabilities	**37,642.5**	**49,317.1**
Advances	30,896.3	42,677.6
Fixed Assets	58.5	71.7
Cash and bank balance	2,077.8	3,518.0
Deffered tax assets	3,882.7	2,083.2
Other Assets	727.1	966.6
Total Assets	**37,642.5**	**49,317.1**

Financial ratios		
Particulars (Rs mn)	**FY18**	**FY19**
Profitability ratios (%)		
Net interest margin (NIM)	8.6%	10.0%
Yield on loan book	23.3%	22.8%
RoA (%)	5.0%	6.3%
RoE (%)	13.5%	19.0%
Operating ratios (%)		
Cost of borrowings	14.7%	12.8%
Cost to income	30.5%	24.9%
Non interest income / Total income	4.1%	7.3%
Capital adequacy	32.5%	39.6%
Asset Quality ratios (%)		
GNPA (%)	25.9%	7.9%
NNPA (%)		0.0%
Collection efficiency (%)	99.3%	99.7%
Per Share Data (Rs)		
Restated EPS (Diluted)	29.2	48.5
Restated BVPS	216.3	293.8
Adjusted BVPS	216.3	293.8
Valuation ratios (x)		
P/E (x)	29.3	17.6
P/BV (x)	4.0	2.9
P/ABV (x)	4.0	2.9
Growth Ratios (%)		
Advances		38.1%
Net interest income		87.5%
Interest income		74.1%
PAT		66.0%

Source: Choice Broking Research, Company data, RHP

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