

Financials

Q1FY21 result review

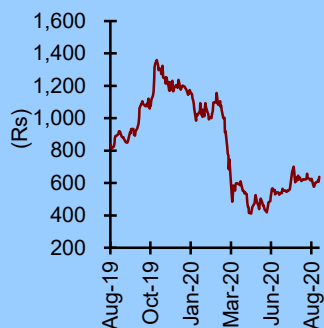
Target price: Rs690

Shareholding pattern

	Dec '19	Mar '20	Jun '20
Promoters	62.6	62.6	62.6
Institutional investors			
MFs and other	16.1	16.3	16.3
Banks/ FIs	6.8	4.2	4.2
Insurance	0.5	0.5	0.5
FIs	0.0	0.0	0.0
Fills	8.8	11.6	11.6
Others	21.3	21.1	21.1

Source: BSE

Price chart



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INDIA

Spandana Sphoorty

BUY
MaintainAdequate provisioning to cushion earnings volatility;
capital sufficiency to help tackle current cycle

Rs595

Spandana Sphoorty Financial (Spandana) in Q1FY20 continued its proactive approach in strengthening balance sheet by building additional Covid-19-related provisions at Rs0.9bn (~130bps of AuM) and taking cumulative contingency buffer to 320bps - highest within the MFI space. Notably, collection efficiency improved steadily - from lows of 2% in April, it improved to as high as 92% as on 30th August'20 with customer activation remaining robust at ~87%. Better-than-industry collections were supported by A) higher rural-based customers (~95%), B) bi-weekly collection model, C) ability to extend emergency loans to needy borrowers and D) effective communication with borrowers about cost of moratorium & benefits of maintaining good payment track record. While ~13% inactive customer base poses near-term risk on asset quality, diversified operations with 95% of districts having <1% exposure per district, adequate provisioning buffer and comfortable capital position (CAR 53%) would ensure it navigates through the current cycle relatively better than peers. Maintain BUY.

- ▶ **Additionally created Rs0.9bn Covid-19 related contingency buffer; total provision cushion now stands at ~320bps.** Spandana continued to strengthen balance sheet by proactively building additional Rs0.9bn Covid-19-related contingency buffer and taking cumulative provisioning buffer to ~320bps as on June'20 - highest within the MFI space. We believe building higher contingency buffer is correct approach in the current scenario given tail-end risk is yet to unfold. However, strong PPop margin at average 14% over the past five quarters and adequate contingency buffer would ensure Spandana navigates through the current challenging cycle relatively better than peers.
- ▶ **Collection efficiency touching 92% as on 30th August'20 shows business resilience.** Nearly 95% Spandana borrowers are in rural areas (which are relatively less impacted during lockdown), and ~57% are engaged in essential service activities. This borrower profile coupled with effective communication about cost of moratorium and significance of credit score to avail next loan helped it improve collections to as high as ~92% as on 30th August'20 from mere 2% in April'20. Secondly, customer activation also remains robust at 87%. Currently, all its branches are operational and all employees have resumed work. However, ~13% borrowers, mostly in urban / semi-urban areas, are inactive currently – which poses risk to asset quality going ahead.

Market Cap	Rs38.3bn/US\$524mn	Year to Mar	FY19	FY20	FY21E	FY22E
Bloomberg	SPANDANA IN	NII (Rs bn)	6.9	10.8	10.8	12.7
Shares Outstanding (mn)	64.3	Net Profit (Rs bn)	3.1	3.5	3.7	5.7
52-week Range (Rs)	1360/412	EPS (Rs)	52.0	54.8	58.3	88.5
Free Float (%)	37.4	% Chg YoY	34.9	5.5	6.4	51.8
FII (%)	11.6	BVPS (Rs)	315.1	409.4	455.8	526.6
Daily Volume (US\$'000)	459	P/E (x)	11.4	10.8	10.2	6.7
Absolute Return 3m (%)	16.2	P/BV (x)	1.9	1.4	1.3	1.1
Absolute Return 12m (%)	(33.1)	Net NPA (%)	0.0	0.1	0.5	0.1
Sensex Return 3m (%)	16.2	RoAuM (%)	8.3	6.3	5.2	6.9
Sensex Return 12m (%)	5.9	RoE (%)	19.0	15.6	13.5	18.0

Please refer to important disclosures at the end of this report

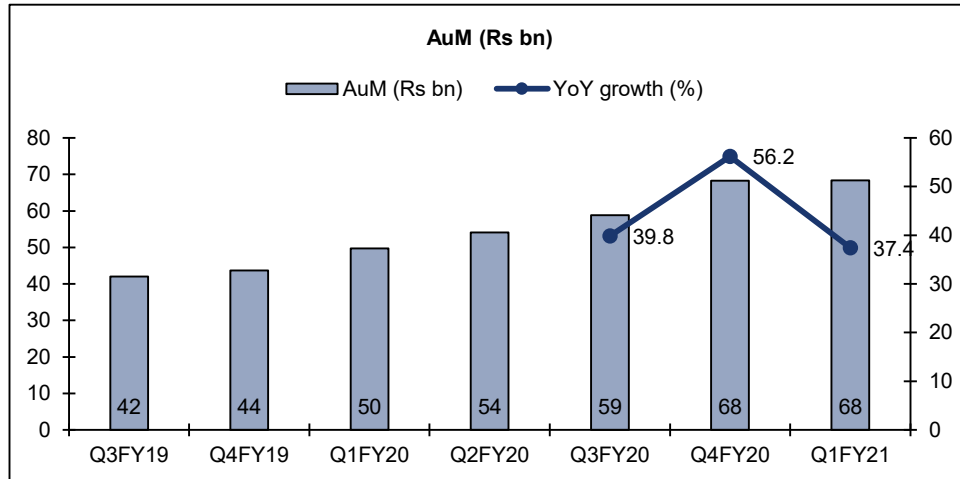
- **Disbursement remains muted but ongoing moratorium-restricted portfolio downtrend.** Despite disbursement falling by ~98% QoQ to Rs0.4bn in Q1FY21, gross AuM remained flat sequentially supported by ongoing payment holiday due to moratorium. As a result, core NII grew 5% QoQ; however, lower direct assignment income (down 86% QoQ) impacted overall revenue progression. Greater focus on collection and ongoing Covid-19 related regulations like social distancing norms etc, resulted in borrower base remaining static at ~2.5mn. However, we believe, with easing regulations and improving collection, disbursements are likely to improve sharply in H2FY21E.
- **Outlook.** While near term asset quality and growth concerns persist, we believe, Spandana's comfortable capital position (CAR at 53%), industry-leading profitability (PPoP margin at average 14%) and ~320bps of contingency buffer would ensure it achieves normalcy quicker than peers. Maintain **BUY** with a revised target price of Rs690 (earlier: Rs620). The stock is currently trading at 1.3x / 1.1x FY21E / FY22E P/BV, respectively.

Table 1: Q1FY21 result review*(Rs mn)*

	Q1FY21	Q1FY20	% change YoY	Q4FY20	% change QoQ
Interest Income	3,260	2,982	9.3	4,287	(24.0)
Interest Expended	850	892	(4.8)	825	3.0
Net interest income (NII)	2,410	2,089	15.3	3,461	(30.4)
Other income	10	67	(85.3)	111	(91.1)
Total income	2,420	2,156	12.2	3,572	(32.3)
Operating expenses	521	500	4.2	607	(14.1)
-Staff expenses	416	398	4.4	486	(14.5)
-Other expenses	105	102	3.3	120	(12.5)
Operating profit	1,899	1,656	14.7	2,966	(36.0)
Total provisions	1,115	229	387.2	1,881	(40.7)
Profit before tax	784	1,427	(45.1)	1,085	(27.7)
Tax	194	493	(60.7)	254	(23.8)
Profit after tax	590	935	(36.8)	830	(28.9)
Key statistic (Rs mn)					
AuM	68,350	49,740	37.4	68,290	0.1
Borrowers (in Lakh)	26	25	2.8	26	-
Avg ticket size	26,595	19,896	33.7	26,572	0.1
AuM mix					
MFI	98	N/A		98	-
Non MFI	2	N/A		2	-
Ratios (%)					
			bp chg YoY	bp chg QoQ	
Profitability ratios					
Portfolio Yields	23.0	-	2,300	24.0	(100)
Cost of Funds	11.0	11.8	(80)	10.9	10
NIM	15.5	16.5	(100)	16.6	(110)
RoA	8.7	8.0	70	N/A	-
RoaE	22.3	19.5	280	N/A	-
Asset Quality					
Gross NPL ratio	0.6	-	64	0.4	28
Business & Other Ratios					
Cost-income ratio	21.5	23.2	(166)	17.0	456
CAR	-	-	-	52.9	(5,290)

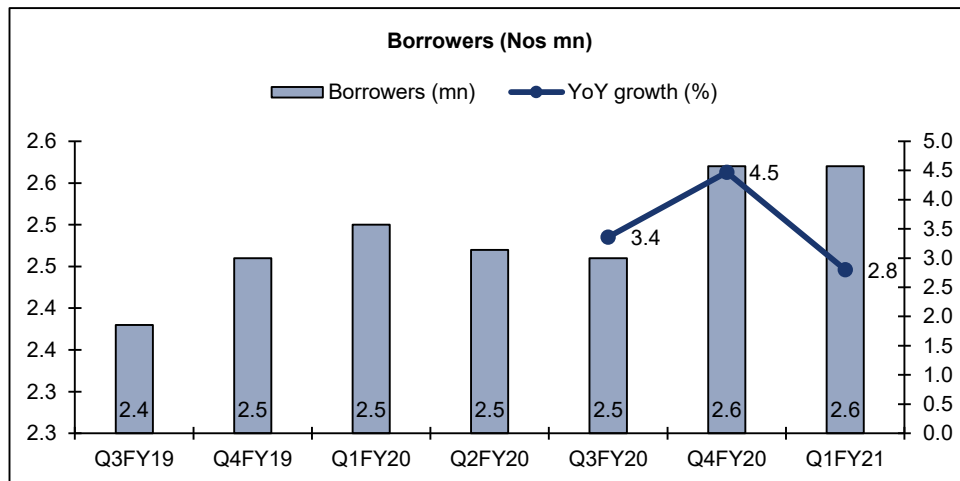
Source: Company, I-Sec research

Chart 1: AUM growth fell to 37% due to muted disbursement in Q1FY21



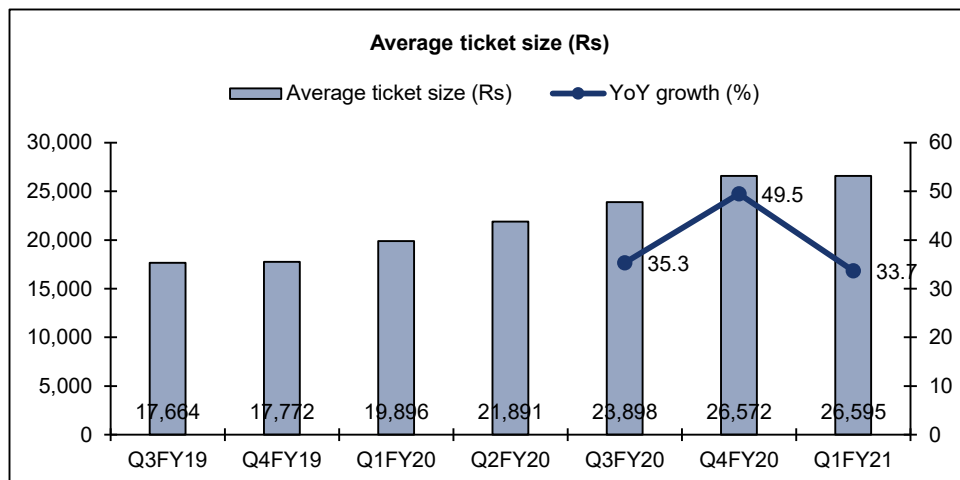
Source: Company, I-Sec research

Chart 2: Borrower base remained flat QoQ; focus on collections and social distancing norms impacted new customer acquisition



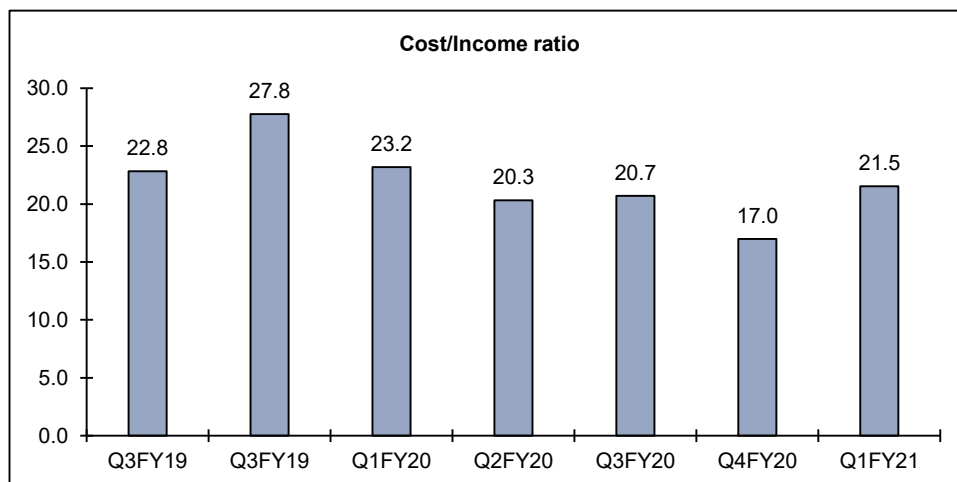
Source: Company, I-Sec research

Chart 3: Average ticket size increased 34% YoY due to higher loans to vintage customers in recent past



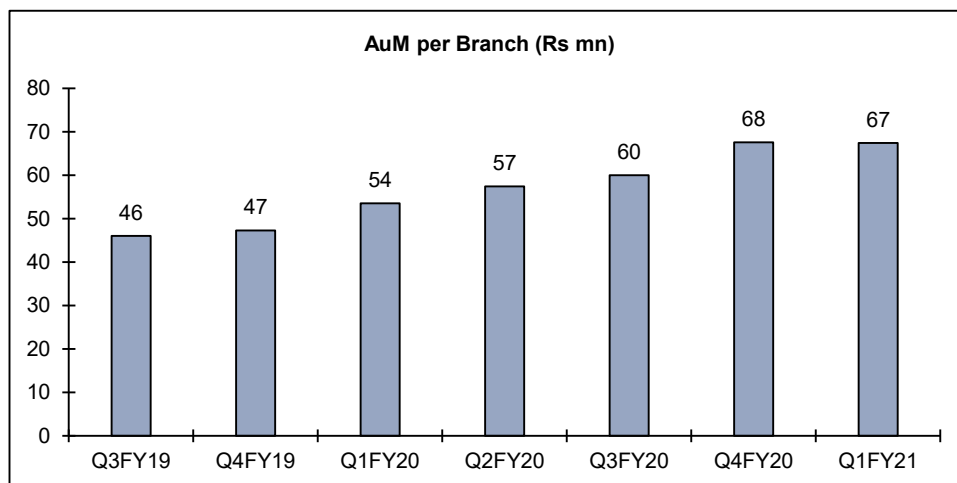
Source: Company, I-Sec research

Chart 4: Cost/income ratio increases to 21.5%; lower DA income and additional Covid-19 related expenses resulted in higher other expenses



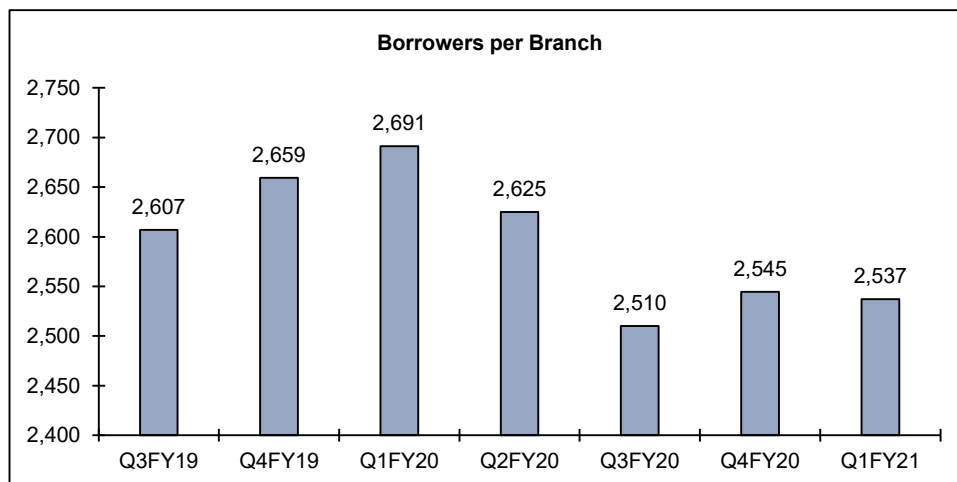
Source: Company, I-Sec research

Chart 5: Consistent improvement in AuM per branch – now at Rs67mn



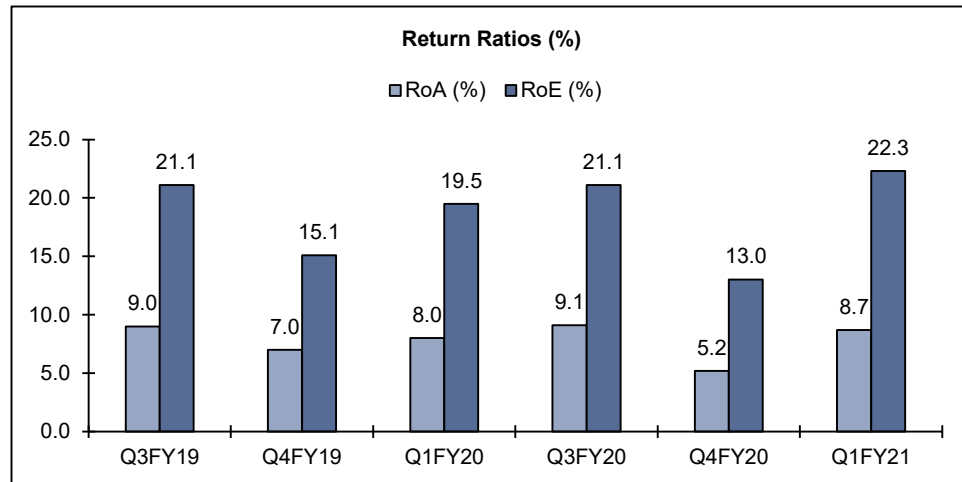
Source: Company, I-Sec research

Chart 6: Borrowers per branch remain lower due to tepid AuM growth in recent past and expanded branch network in H2FY20



Source: Company, I-Sec research

Chart 7: Industry-leading return ratios



Source: Company, I-Sec research

Financial summary

Table 2: Profit and loss statement

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E
Interest income on portfolio loans	9,979	11,692	12,800	15,271
Finance costs	3,579	3,563	3,838	4,795
NII	6,852	10,790	10,781	12,746
NII growth	104%	57%	0%	18%
Net Revenue	6,907	11,132	10,846	12,811
Total Opex	1,719	2,212	2,870	3,424
Employee benefits expenses	1,310	1,708	2,251	2,731
Y-Y growth	73%	30%	32%	21%
Other expenses	339	416	530	605
Y-Y growth	26%	23%	28%	14%
PPoP	5,188	8,920	7,976	9,387
YoY growth	110%	72%	-11%	18%
Provision and write-offs	453	2,736	2,975	1,794
Adjusted PBT	4,735	6,184	5,001	7,593
Exceptional items (IV)	0	0	0	0
Profit before tax	4,735	6,184	5,001	7,593
Tax	1,616	2,666	1,259	1,911
Profit after tax	3,119	3,518	3,743	5,682

Source: Company data, I-Sec research

Table 3: Balance sheet

(Rs mn, year ending March 31)

Year to March	FY19	FY20E	FY21E	FY22E
Share capital	596	642	642	642
Reserves and surplus	18,298	25,616	28,610	33,156
Shareholders' funds	18,904	26,271	29,252	33,798
Debt securities	13,720	7,776	16,751	23,005
Borrowings (other than debt securities)	15,755	22,273	16,751	23,005
Subordinated liabilities	203	203	203	203
Other financial liabilities	445	2,272	2,726	2,726
Other non-financial liabilities	225	301	362	362
Equity and liabilities	49,317	59,772	66,721	83,775
Total borrowings	29,677	30,253	33,706	46,214
Assets				
Property, plant and equipment	72	152	152	152
Intangible assets	22	13	13	13
Non-current investments	1	4,875	750	750
Loan Portfolio	42,678	48,524	54,285	65,490
Other non-financial assets	339	510	510	510
Non-current assets				
Cash and bank balances	3,518	2,571	7,085	11,850
Other financial assets	604	2,905	3,776	4,909
Tax assets	2,083	223	100	100
Assets	49,317	59,774	66,671	83,775

Source: Company data, I-Sec research

Table 4: Key ratios

(Year ending March 31)

	FY19	FY20	FY21E	FY22E
Growth ratios (%)				
NII growth	104	57	0	18
AuM Growth	38	56	9	21
Asset yields	26	21	18	19
Cost of funds	14	12	12	12
Spread	13	9	6	7
Opex growth	59	29	30	19
Productivity ratio - Customer / LO	514.0	421.1	575.0	575.0
AuM/LO	9.4	11.2	11.7	12.6
Avg borrowing ticket size	18,201	26,572	20,334	21,944
PPP growth	110	72	-11	18
Provisions growth	-228	504	9	-40
Credit cost	1.2	4.9	4.2	2.2
PAT growth	66	13	6	52
Key ratios (%)				
Cal NIM	18.2	19.3	15.1	15.5
Opex/AUM	4.6	3.9	4.0	4.2
Opex/AUM (Cal.)	4.6	3.9	4.0	4.2
Cost/Income ratio	24.9	19.9	26.5	26.7
Credit cost	1.2	4.9	4.2	2.2
Asset quality (%)				
GNPA	0.0	0.8	6.0	0.9
NNPA		0.1	0.5	0.1
PCR	100	89	92	89
Per share data Rs)				
Diluted EPS	52.0	54.8	58.3	88.5
EPS growth (%)	34.9	5.5	6.4	51.8
Book value per share	315.1	409.4	455.8	526.6
BVPS growth (%)	10.5	29.9	11.3	15.5
Valuation				
P/E (x)	11.4	10.8	10.2	6.7
P/B (x)	1.9	1.4	1.3	1.1
RoA decomposition				
Net interest income (%)	18.2	19.3	15.1	15.5
Other income (%)	0.1	0.6	0.1	0.1
Total income (%)	18.3	19.9	15.2	15.6
Employee expenses (%)	3.5	3.0	3.2	3.3
Depre (%)	0.9	0.7	0.7	0.7
Other operating exp (%)	0.2	0.2	0.1	0.1
Total operating exp (%)	4.6	3.9	4.0	4.2
Pre provisioning profits (%)	13.8	15.9	11.2	11.4
Provisions (%)	1.2	4.9	4.2	2.2
Pre tax profits (%)	12.6	11.0	7.0	9.3
Tax (%)	4.3	4.8	1.8	2.3
RoAUM (%)	8.3	6.3	5.2	6.9
Leverage	2.3	2.5	2.6	2.6
RoE (%)	19.0	15.6	13.5	18.0
Capital Adequacy				
CRAR - Tier I capital (%)	38.6	51.9	43.6	40.0
CRAR - Tier II capital (%)	1.0	1.0	1.0	1.0
CRAR (%)	39.6	52.9	44.6	41.0

Source: Company data, I-Sec research

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