



## 3R MATRIX

	+	=	-
Right Sector (RS)	✓	✗	✗
Right Quality (RQ)	✓	✗	✗
Right Valuation (RV)	✓	✓	✗

+ Positive = Neutral - Negative

## What has changed in 3R MATRIX

	Old		New
RS	✓	↔	✓
RQ	✓	↔	✓
RV	✗	↔	✗

## Reco/View

Reco/View	Change
Reco: Buy	↔
CMP: Rs. 761	
Price Target: Rs. 850	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

## Company details

Market cap:	Rs. 4,891 cr
52-week high/low:	Rs. 1187/403
NSE volume: (No of shares)	0.7 lakh
BSE code:	542759
NSE code:	SPANDANA
Free float: (No of shares)	2.4 cr

## Shareholding (%)

Promoters	62.3
FII	18.8
DII	7.7
Others	11.2

## Price chart



## Price performance

(%)	1m	3m	6m	12m
Absolute	0.0	26.2	18.9	-27.1
Relative to Sensex	-5.2	5.7	-20.9	-50.8

Sharekhan Research, Bloomberg

## Summary

- Spandana Sphoorty Financials Limited (SSFL) posted weak results for Q3FY2021 with operational numbers coming below expectations; however, pickup in disbursement was encouraging.
- Asset-quality performance mixed, with Q3 seeing large write-off of Rs. 212 crore, which made PAT miss estimates. However, collection efficiency (CE) at 96% and is nearing pre-Covid levels
- A diversified book with no district having more than 1.5% of AUM and no branch more than 1% of AUM augurs well; SSFL trades at 1.6x / 1.3x its FY2022E/FY2023E BVPS, which we believe are reasonable.
- We maintain Buy with an unchanged PT of Rs. 850.

Spandana Sphoorty Financials Limited (SSFL) posted weak results for Q3FY2021 with operational numbers coming below expectations, and asset-quality performance was a dampener. However, pickup in disbursement was encouraging. Net interest income (NII) stood at Rs. 213 crore, up 1.6% y-o-y but down 5.9% q-o-q and came below expectations. The company de-recognised interest on NPA loans amounting to Rs. 16 crore and Rs. 10 crore was adjusted to interest income. Pre-Provision Operating Profit (PPOP) at Rs. 156 crore, down 26.5% y-o-y and down 24.89% q-o-q and again missed expectations. Provisions were elevated at Rs. 194.6 crore; at around 3.8x its Q3FY2020 levels and up by 59.7% q-o-q. Cumulative provisions now stand at Rs. 411 crore (marginally increased from Rs. 396 crore in Q2FY2021), which accounts for 5.9% of total on-balance sheet portfolio is a cushion. Q3 saw a large write-off of Rs. 212 crore, (for loans with no instalment collected since September 2020). SSFL's management indicated that provisions have been made for consecutive four quarters, starting from Q4FY2020 and total provision of Rs. 623 crore (including write offs) has been made so far towards COVID and others, which accounts for 8.0% of total AUM and 9.1% of on-balance sheet portfolio. All non-paying loans were written off and Rs. 16 crore interest on these loans was derecognised, which indicates a relatively clean balance sheet going forward. Business operations improved, and SSFL assets under management (AIM) grew by 32.1% y-o-y and 5.6% q-o-q to Rs. 7,764 crore. SSFL achieved 96% collection efficiency in Q3FY2021. Factors such as 50% of portfolio has been created post April 2020 (Post-Covid portfolio), which consistently had 100% collection efficiency is encouraging. These loans have only been disbursed to existing borrowers with proven track record of on-time repayments – making this a low-risk book. SSFL disbursed Rs. 2,317 crore in Q3FY2021, which is at pre-Covid level and management commentary was cautiously optimistic and indicated SSFL's expectation to reach AUM of Rs. 8,200 crore by the end of FY2021. A diversified book with no district having more than 1.5% of AUM and no branch more than 1% of AUM augurs well. A well-capitalised balance sheet (39% CRAR), improved credit ratings (during Q3), and improving collection efficiencies indicate that SSFL is well placed to ride over medium-term challenges. We have fine-tuned our estimates and believe while the outlook has near-term low visibility, its provision buffer, upfront provisions, and write-offs and revert to growth are positive indicators. That said we believe credit cost and asset quality will be key monitorables in the medium term. We recommend Buy on the stock with an unchanged PT of Rs. 850.

## Key positives

- Disbursements touched historical high of Rs. 2,317 crore, up by 18% y-o-y and 42% q-o-q.
- Proforma GNPA of 2.7% and proforma NNPA of 1% is reasonably low.

## Key negatives

- NIMs for 9MFY2021 declined to 15.6%, down from 16.2% in FY2020.

## Our Call

**Valuation:** SSFL currently trades at 1.6x / 1.3x its FY2022E/FY2023E book value, which we believe are reasonable considering its strong capital position (CRAR of 39%) and steady operating parameters. Strong management and an efficient (and de-risked) business model with levers available for generating better returns offer support. However, for the near term, the asset quality and credit cost will be the key monitorable. We recommend Buy on the stock with a PT of Rs. 850.

## Key Risks

A prolonged recovery post opening of the lockdown, credit ratings downgrade, and effect on collection efficiency may affect NIM and results of operations.

## Valuation

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Net interest income	655.0	849.9	768.7	909.6	1,315.6
Net profit	311.9	351.8	144.3	433.9	722.1
EPS (Rs.)	48.6	54.8	22.5	67.6	112.5
PE (x)	15.7	13.9	33.9	11.3	6.8
Book value (Rs/share)	294.6	409.4	428.4	485.9	581.5
P/BV (x)	2.6	1.9	1.8	1.6	1.3
RoE (%)	16.5	13.4	5.2	13.9	19.3
RoA (%)	6.3	5.4	1.7	3.5	4.8

Source: Company; Sharekhan estimates

## Concall Highlights

- ◆ SSFL today have overtaken the second largest MFI and now are #2 MFI in terms of advances.
- ◆ Done the highest disbursement in Q3 of Rs. 1,630 crore and have been growing from Q2.
- ◆ Proforma GNPA calculations are done net of write-offs. If not considered write-offs, GNPA will be 4%.
- ◆ Written off most of portfolio of 120dpd + period. This was of borrowers who are less than 120DPD but no payment coming from them.
- ◆ Cash collections efficiency is at 83% as on Q3FY2021. Total amount collected is Rs. 4,127 crore, as against Rs. 5,080 crore demand.
- ◆ Written off is Rs. 224 crore in Q3, which is 6% post write-off AUM.
- ◆ Going forward, Q4 and Q1 have left Rs. 411 crore (of potential stressed assets), which will be done in the next two quarters. However, the provision writeback will balance that.
- ◆ AUM growth guidance was 25% y-o-y shared in Q2 for FY2021E. Net of written-off portfolio, AUM will be around Rs. 8,200 crore.
- ◆ Cost of borrowing has gone up during Q3. Marginal cost of borrowing has climbed up by 80 bps, as the company raised Rs. 600 crore NCD at 10.5%, which had fees (1.5-2%) component, which had to be paid, and which, therefore, increased the price. However, NCDs has opened a new source of funding for SSFL. SSFL was able to raise almost Rs. 5,000 crore through the lockdown. Raised Rs. 127 crore in Q3FY2021 via securitisation.
- ◆ Debt increased by Rs. 4,619 crore, up Rs. 1,300 crore q-o-q, which is why the interest cost has increased. Had Rs. 750 crore of cash, and net debt increased by Rs. 1,300 crore.
- ◆ Coverage ratio for Stage 2 assets is 17% and for Stage 3 assets is 23%. SSFL has Rs. 120 crore adhoc provision on the balance sheet. The coverage as per PAR basis is: PAR zero is 10.9% of assets, PAR 30+ is 9.4%, PAR 60+ is 5.7%, and PAR 90+ is 2.7% of total assets.
- ◆ NNPA as per proforma basis is 1% as on December 31.
- ◆ Collection Efficiency: Collection is at 96%, includes arrears. If adjusted, for arrears it will be 93% for Q3FY2021 and 89% in Q2FY2021.
- ◆ Maintaining 2-3 months interest repayment obligations worth liquidity on the balance sheet, which is why the liquidity is higher. SSFL has maintained Rs. 750 crore liquidity on its balance sheet.
- ◆ Acquired only 65,000 borrowers during Q3 and, hence, most of disbursals to existing customers.
- ◆ Geography issue: Odisha has highest % of write-offs, which stood at Rs. 51 crore, out of Rs. 234 crore loan book. The loan book to Odisha was 17% of AUM, but write-offs amounted to 26% of total write-offs, followed by Chhattisgarh, which is 7% of total portfolio, but 12% of total written-off loans. Written-off amount state wise was Odisha Rs. 51 crore, Maharashtra is Rs. 14 crore, and Chhattisgarh was Rs. 20 crore, which were main contributors.
- ◆ Rest of the borrowers were paying from November.
- ◆ In Q1FY2020, there was no provision requirement, so SSFL took Rs. 90 crore. In Q2, it made Rs. 114 crore and these were taken on prudent measures, and not on DPD basis.
- ◆ Salary cost has increased, till Q2 were not acquiring new borrowers, but since were taking new borrowers in Q3; hence, it has increased in cost opex.
- ◆ All loans usually get written-off exceeding the 90dpd basis.

Results				Rs cr	
Particulars	Q3FY21	Q3FY20	y-o-y (%)	Q2FY21	q-o-q (%)
<b>Total Revenue from operations</b>	<b>327.1</b>	<b>343.6</b>	<b>-4.8</b>	<b>337.5</b>	<b>-3.1</b>
Interest Income	322.4	286.2	12.6	310.3	3.9
Commission and Incentive Income	-	8.2	NA	-	NA
Net gain on fair value changes	-0.4	46.8	-100.8	23.8	-101.7
Others	5.1	2.4	115.3	3.5	47.4
Finance cost	113.9	84.4	34.8	83.7	35.9
<b>Net Interest Income (NII)</b>	<b>213.2</b>	<b>209.9</b>	<b>1.6</b>	<b>226.6</b>	<b>-5.9</b>
Other Income	6.2	8.5	-26.2	8.5	-26.7
<b>Total Income</b>	<b>333.3</b>	<b>352.0</b>	<b>-5.3</b>	<b>346.1</b>	<b>-3.7</b>
<b>Net Total Income</b>	<b>219.5</b>	<b>267.6</b>	<b>-18.0</b>	<b>262.3</b>	<b>-16.3</b>
Operating expenses	63.1	55.0	14.8	54.3	16.2
Employee benefits expense	42.6	41.0	4.0	41.0	3.9
Depreciation and amortization expense	2.0	2.2	-9.7	1.6	22.0
Other expenses	18.5	11.8	57.1	11.7	58.4
<b>Pre-Provisioning Profit</b>	<b>156.4</b>	<b>212.6</b>	<b>-26.5</b>	<b>208.0</b>	<b>-24.8</b>
Provisions	194.6	41.5	368.5	121.9	59.7
<b>PBT</b>	<b>-38.3</b>	<b>171.1</b>	<b>NA</b>	<b>86.1</b>	<b>NA</b>
Tax	-7.4	45.0	NA	23.1	NA
<b>PAT</b>	<b>-30.8</b>	<b>126.1</b>	<b>NA</b>	<b>63.0</b>	<b>NA</b>

Source: Company; Sharekhan Research

## Outlook and Valuation

### ■ Sector view - Green shoots in the economy are encouraging; Rural economy showing resilience

Post the unlocking of the economy, most lenders are reporting an incremental pickup in credit demand, especially in the rural segment. The rural economy was resilient due to limited spread of COVID-19 as well as buoyant agriculture output that was helped by normal monsoons. Leading indicators indicate recovery in economic activity, which will be a positive. Improving collection efficiencies and gradual normalising disbursements along with supportive monetary and regulatory environment augur well for the MFI segment's players.

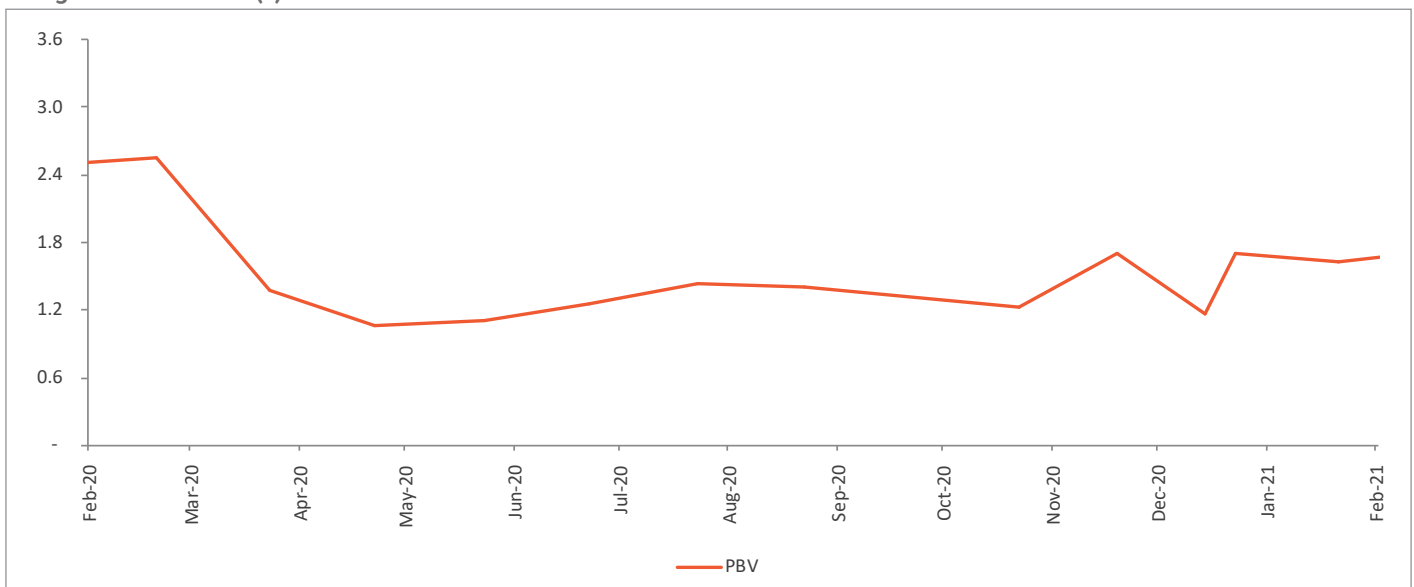
### ■ Company outlook - Strong and prudent management, company continues to be ready for future growth

SSFL's operational cost efficiencies, strong risk management, diversified book, and well-managed asset quality are key positives. We believe there are significant positive levers available to the company with its low leverage ratio, increased securitisation potential (priority sector qualification helps), and improving trend of rating profile (providing access to cheaper cost of funds). A growing and rising pool of securitised assets will help further ease the cost of funds for SSFL, even though at present, the stream is yet to regain full momentum. Factors such as well-capitalised balance sheet, stable ratings, and strong operating metrics indicate that SSFL is well placed. Though near-term challenges exist, we believe the strong domain expertise of the management, prudent cost management, and robust risk measures (standardised systems, real-time monitoring, automated checks and controls) will help SSFL tide over medium-term challenges.

### ■ Valuation - Near-term headwinds continue, but long-term outlook positive; Maintain Buy

SSFL currently trades at 1.6x/1.3x its FY2022E/FY2023E book value, which we believe are reasonable considering its strong capital position (CRAR of 39%) and steady operating parameters. A strong management and an efficient (and de-risked) business model with levers available for generating better returns offer support. However, for the near term, the asset quality and credit cost will be the key monitorable. We recommend Buy on the stock with a PT of Rs. 850.

#### One-year forward PBV (x) band



Source: Sharekhan Research

#### Peer valuation

Particulars	CMP (Rs)	P/BV (x)		P/E (x)		RoA (%)		RoE (%)	
		FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Spandana Spoority	761	1.8	1.6	33.8	11.2	1.7	3.5	5.2	13.9
Satin Credit Care	77	0.3	0.3	4.8	0.4	0.95	2.6	4.4	13.4
Credit Access Grameen	734	3.1	2.6	44.1	16.6	1.9	4.1	8.0	16.7

Source: Company, Bloomberg, Sharekhan Research

## About company

SSFL is a leading, rural-focused NBFC-MFI with a geographically diversified presence in India. The company has a pan-India presence across 18 states and has been operating as an NBFC since 2004 and NBFC-MFI since 2015. The company offers income-generation loans under the joint liability group model (JLG), predominantly to women from low-income households in rural areas. SSFL is the second largest microfinance company in India with an AUM of Rs. 7,764 crore and an active customer base of 25.5 lakhs. The NBFC-MFI was impacted but has successfully emerged stronger post the AP MFI crisis and demonetisation and today boasts of healthy margins and return ratios.

## Investment theme

SSFL had reported strong CAGR in AUM (~74%) and borrowers (~35%) over FY2017-FY2020; but the pandemic impacted its operations and disbursements. Of late, improving collections and disbursements are encouraging. Over the years, SSFL had built upon expanding its access to funds/capital, while seeing a gradually improving rating profile trend and a conservative asset-quality book and leverage. We believe there are significant positive cushions available to the MFI, with its low leverage ratio, increased securitisation potential (PSL qualification helps), and improving trend of rating profile (providing access to cheaper cost of funds), all of which can help support its long-term return ratios further. Strong management quality is reflected in the robust risk measures (standardised systems, real-time monitoring, automated checks, and controls built on the system, and mandatory credit bureau checks), which are key positives and will help the company tide over near-term challenges.

## Key Risks

A prolonged recovery post opening of the lockdown, credit ratings downgrade, and effect on collection efficiency may affect NIM and results of operations..

## Additional Data

### Key management personnel

Abdul Feroz Khan	Chief Strategy Officer
Padmaja Gangireddy	Managing Director
Mr. Satish Kottakota	Chief Financial Officer
Ramesh Periasamy	Secretary

Source: Bloomberg

### Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	QUALIFIED INSTIT BUYER	6.3
2	JM FINANCIAL INDIA FUND II	2.5
3	Bajaj Allianz Life Insurance Co Lt	1.6
4	Valiant Mauritius Partners Ltd	1.3
5	EDELWEISS ALTERNATIVE IN	1.3
6	Fiera Capital Corp	1.2
7	Goldman Sachs Group Inc/The	1.2
8	HELION VENTURE PRTNR LLC	1.0
9	VENDIDANDI VIJAYA SIVARAMI	0.8
10	Wells Fargo & Co	0.8

Source: Bloomberg

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## Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and deteriorating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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by BNP PARIBAS

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