BUY (Maintained)

CMP: **INR 879** Target Price: **INR 1,200 (INR 1,450)** ▲ 37%

ICICI Securities

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30 April 2024

India | Equity Research | Q4FY24 results review

Spandana Spoorthy Financial

Financial Services

Operating performance continued to be robust; shift in collection model from monthly to weekly is having transitory impact on 1-90 DPD buckets

Spandana Spoorthy's (Spandana) core operating performance in Q4FY24 continued to be robust with AUM growth at 15% QoQ primarily led by new customer acquisition (up 12% QoQ) and sharp reduction in cost of borrowing to 11.7% vs 12.3%, thereby, driving 130bps QoQ NIM expansion, resulting in 11% QoQ growth in PPoP. However, transitory impact on 1+ DPD portfolio due to shift in collection frequency to weekly from monthly earlier (hence, higher forward flows) and change in ECL model leading to one-time impact of INR 160mn led to a sequential increase in credit cost to 3.4% vs 3% QoQ. As a result, PAT remained flat QoQ at INR 1.29bn during Q4FY24. While we believe management's long-term vision of building sustainable and scalable model by shifting collection model from monthly to weekly is a step in the right direction, the same raises concern over medium term credit cost trajectory.

However, strong operating profitability may help Spandana in sustaining RoA at >4.5% during FY25-26E. We maintain **BUY** with a revised target price of INR 1,200 (earlier INR 1,450), valuing the stock at 1.8x (vs 2.2x earlier) Sep'25E BVPS. We cut our earnings estimate by 10% for FY25-26E as we now model higher credit cost at 2.2% vs 2% earlier in FY25E and 2% vs 1.8% earlier in FY26E.

Execution of business strategy as per Vision 2025 remains on track…

When new management took charge in FY22, it laid down strategic priorities and business parameters to be achieved by FY25. Notably, it delivered successfully on most business parameters – 1) As on Mar'24 total branch network stood at 1,642 vs planned 1,500 by Mar'25, 2) customer led growth journey – 3.3mn customers as on Mar'24 vs 4mn customers by FY25. It also reflects in disbursement to existing customers grew by only 9% YoY while new customers grew by 62%, reflecting the market share gain, and 3) geographical concentration risk – top 2 states were 18-19% in FY22, which fell to 14% by Mar'24 and it plans to further reduce the share of single state to 13% by Mar'25. Overall, it continues to deliver as per Vision 2025 except credit cost, which remained higher than earlier guidance range of 2%.

Financial Summary

Y/E 2023	FY23A	FY24A	FY25E	FY26E
Net Interest Income (NII)	8,836	14,024	18,064	22,513
PAT (INR mn)	123	4,679	6,199	7,916
EPS (INR)	1.7	65.9	87.3	111.5
% Chg YoY	(82.8)	3,690.7	32.5	27.7
P/E (x)	505.7	13.3	10.1	7.9
P/BV (x)	2.0	1.7	1.5	1.2
Gross Stage - 3 (%)	2.1	1.5	2.0	2.0
RoAA (%)	0.1	4.1	4.3	4.6
RoAE (%)	0.4	13.9	15.7	17.0

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Market Data

Market Cap (INR)	63bn
Market Cap (USD)	752mn
Bloomberg Code	SPANDANA IN
Reuters Code	SPAD BO
52-week Range (INR)	1,243 /594
Free Float (%)	32.0
ADTV-3M (mn) (USD)	2.1

Price Performance (%)	3m	6m	12m
Absolute	(13.9)	(0.3)	47.2
Relative to Sensex	(17.7)	(17.4)	25.0

Earnings Revisions (%)	FY25E	FY26E
Revenue	(2)	(3)
EPS	(10)	(10)

Previous Reports

23-01-2024: Q3FY24 results review

23-12-2023: Company Update

…but shift in collection model from monthly to weekly is having temporary impact on collections and forward flows

Management strongly believes in JLG concept and is also of the opinion that JLG is best followed in weekly model. It also highlighted that weekly collection model helps in establishing better relationship with customers than monthly collection model. With this backdrop, it planned to shift its erstwhile monthly collection model to weekly collection model from Q2FY24. While we believe this is a step in the right direction, steady increase in 1-90 DPD to 2.85% by Q4FY24 vs 2.49% in Q3FY24 vs 2.04% in Q2FY24 vs 1.36% in Q1FY24 raises concern over acceptability of new model by customers. However, management sounded confident about maintaining asset quality and restricting credit cost at 2% in FY25.

Disbursements revived sharply in Q4FY24 as reflected in strong 56% QoQ growth

Spandana spent the initial phase of FY23-24 towards redefining its business model, which includes: 1) Improving people practices and communication – initiated Town Hall meetings for two-way communication, introduction of mediclaim for all employees, long service awards etc. 2) Weekly model: It believes ~80% of AUM by FY25 will be on weekly collection. 3) Focus on customer-led growth. 4) Geographical mitigation approach – by FY25, no single state would contribute >13% of total AUM. 5) Focus on JLG: 5 days a week meeting, 5 members per group and 5 groups per centre. With most strategic priorities being executed, management shifted its focus on growth during H2FY24. Of the total INR 106.9bn disbursement during FY24, ~61% of total disbursement came in H2 and 37% came in Q4FY24 alone. Notably, new customer acquisition remained the top priority as reflected in 47% YoY growth in customer base to 3.3mn vs 2.3mn in FY23. The same resulted in strong 41% YoY growth in AUM to INR 119.7bn as on Mar'24. Notably, average outstanding per borrower continued to be range bound at ~INR 35,000-36,000 during all the four quarters of FY24.

Lower collection and change in ECL model led to higher credit cost; provision cover on stage-3 assets improved to 80% vs 70% QoQ

Spandana tweaked its ECL model during Q4FY24 to make it smoother and predictable - earlier ECL model was capturing 8 years' inputs only year-end data so ECL outcome was based on 8 sample sets, but now with revised framework, ECL outcome will be based on 96 sample sets (8 years * 12 months) to eliminate yearly data discrepancies. Earlier, ECL model was based on blanket data fill with no weightage on state exposures – now it implemented enterprise wide data, thereby, capturing state-wise exposure and historical PD & LGDs in that state. The same led to provision release in stage 1 implying better quality incremental growth in the recent past. However, stage 2 and stage 3 provisioning requirement has gone up which resulted in one-time impact of INR 160mn during Q4FY24.

While the management is committed towards achieving its full year FY24 growth (35-40%) and profitability guidance, it also remained at the forefront of taking initiatives to build long-term sustainable franchise, even if it leads to temporary disruption in business momentum. In line with this goal, it launched 'Project Parivartan', wherein it proposed to shift the repayment policy to the first week of the month (Monday to Friday), from the previous practice of collecting on the 1st and the 10th day of the month. As a result, net collection fell to 96.5% during Q4FY24 vs 97.2% in Q3FY24 vs 97.7% in Q2FY24 and 98.1% in Q1FY24.

The impact of lower collections also resulted in a rise in early delinquencies as 1-30dpd/31-60dpd to 1.29% / 0.92% in Q4FY24 vs 1.20% / 0.82% in Q3FY24 vs

0.85%/0.60% in Q2FY24 vs 0.55%/0.42% Q1FY24, respectively. However, gross NPA fell to 1.50% during Q4FY24 from 1.61% in Q3FY24 vs 1.4% in Q2FY24. Management highlighted that the rise in early buckets is transitionary in nature and will normalise in subsequent quarters.

Diversifying lender base to drive lower cost of funds; NIM to remain steady at 13.5% in near term, but sustainable range would be ~12.5%

With sustained improvement in operating performance and controlled asset quality, Spandana had been able to bring down the cost of borrowing materially during Q4FY24. Its successful execution of revamped business strategy also resulted in credit rating upgrade to A / Positive from A/ Stable by ICRA and CRISIL during Q3FY24. The same helped it lower marginal cost of borrowing by 30bps to 11.9% in Q4FY24 from 12.2% in Q3FY24. With strong operating performance and recent credit rating upgrade, the company expects active participation from public sector banks, which will further help in improving its cost of borrowing. However, as the company funds its incremental growth through debt, management expects NIM to settle at ~13.5% as the gearing reaches four times in medium term. Nevertheless, it is likely to be offset by steady-state credit cost level of ~2%, which may keep overall RoA at >4.5% on a sustainable basis.

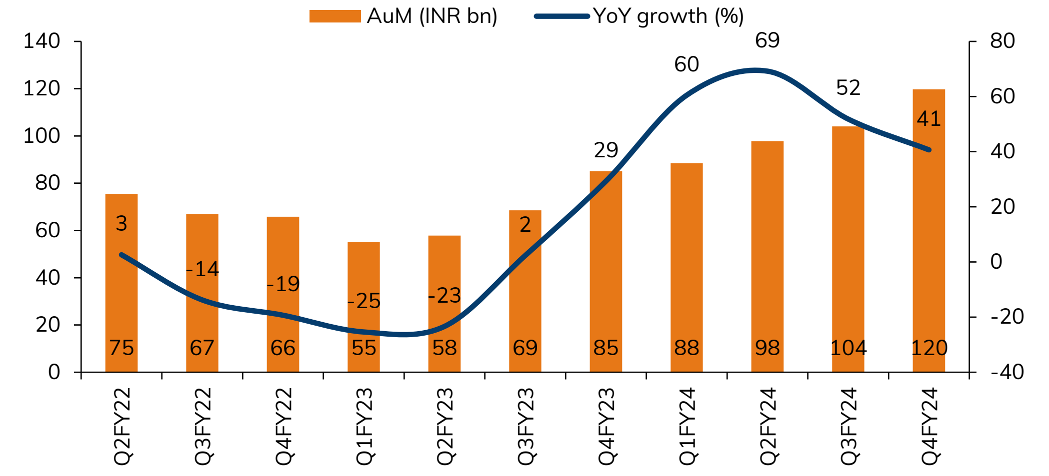
Key risks: A) Stress unfolding higher than anticipated; and B) operational instability caused by outside interference.

Exhibit 1: Q4FY24 result review

(INR mn)	Q4FY24	Q4FY23	% chg YoY	Q3FY24	% chg QoQ
Interest Income	6,758	4,981	35.7	6,260	7.9
Interest Expended	2,493	1,490	67.3	2,502	(0.4)
Net interest income (NII)	**4,265**	**3,491**	**22.2**	**3,758**	**13.5**
Other income	338	349	(3.1)	308	9.7
Total income	**4,603**	**3,840**	**19.9**	**4,067**	**13.2**
Operating expenses	1,943	1,232	57.7	1,662	16.9
-Staff expenses	1,409	855	64.9	1,210	16.5
-Other expenses	534	378	41.3	452	18.0
Operating profit	**2,660**	**2,608**	**2.0**	**2,405**	**10.6**
Total provisions	938	1,222	(23.2)	701	33.8
Profit before tax	**1,722**	**1,386**	**24.3**	**1,703**	**1.1**
Tax	435	330	31.8	429	1.3
Profit after tax	**1,287**	**1,055**	**21.9**	**1,274**	**1.0**
Key statistics					
AuM (INR mn)	1,19,730	85,110	40.7	1,04,040	15.1
Borrowers (in Lakh)	33	23	46.9	30	12.2
Calc. Avg ticket size (INR)	36,063	37,659	(4.2)	35,149	2.6
Ratios (%)			**bp chg YoY**		**bp chg QoQ**
Profitability ratios					
Portfolio Yields	24.2	22.8	140	24.1	10
Cost of Funds	11.7	12.4	(70)	12.3	(60)
NIM	**14.6**	**13.9**	**70**	**13.3**	**130**
RoAum	4.5	5.1	(61)	5.1	(61)
Asset Quality					
Gross NPL ratio	1.5	2.1	(57)	1.6	(11)
Business & Other Ratios					
Cost-income ratio	42.2	32.1	1,012	40.9	134
CAR	35.0	36.3	(130)	35.0	-

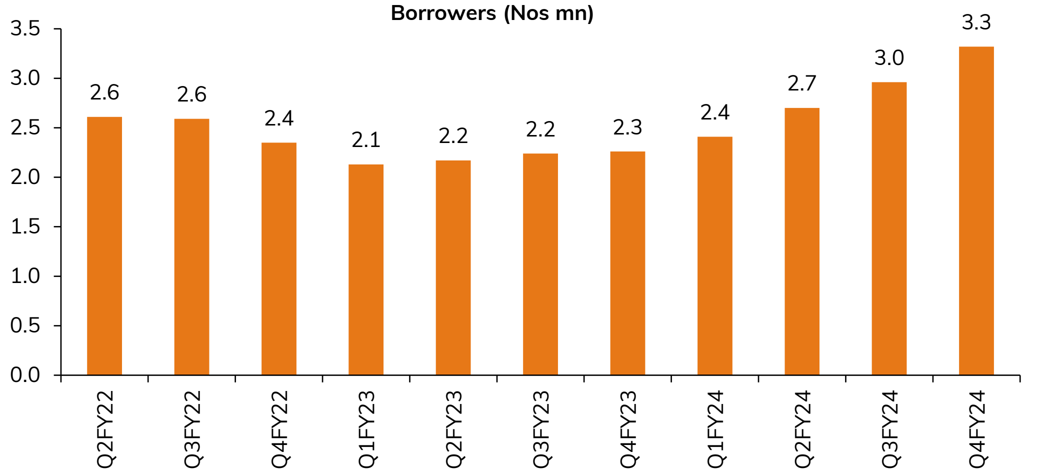
Source: Company data, I-Sec research

Exhibit 2: Growth momentum sustained as AUM grew 41% YoY/ 15%QoQ



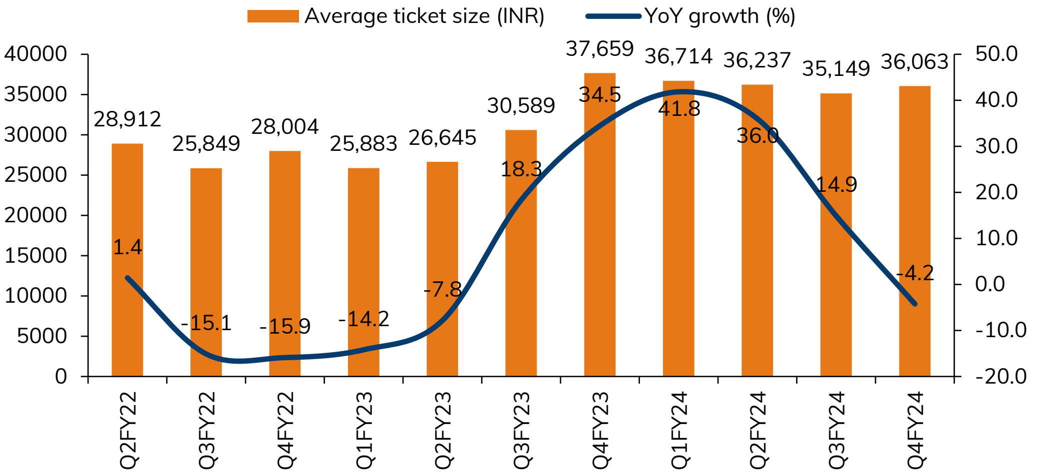
Source: Company data, I-Sec research

Exhibit 3: Growth supported by borrower base growing at 12% QoQ



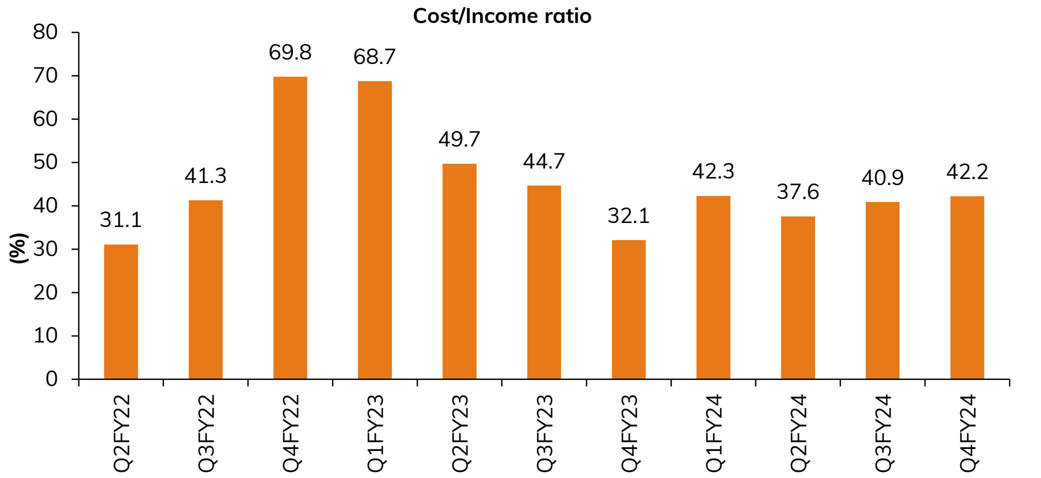
Source: Company data, I-Sec research

Exhibit 4: Average ticket-size at INR 36,063 remains lower than industry average



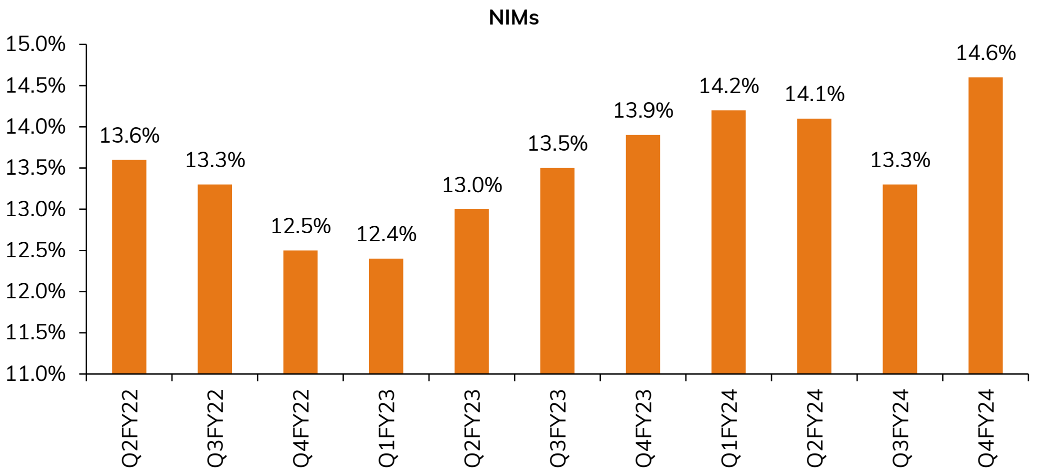
Source: Company data, I-Sec research

Exhibit 5: Cost to income rose to 42.2% as company made investments towards franchisee building



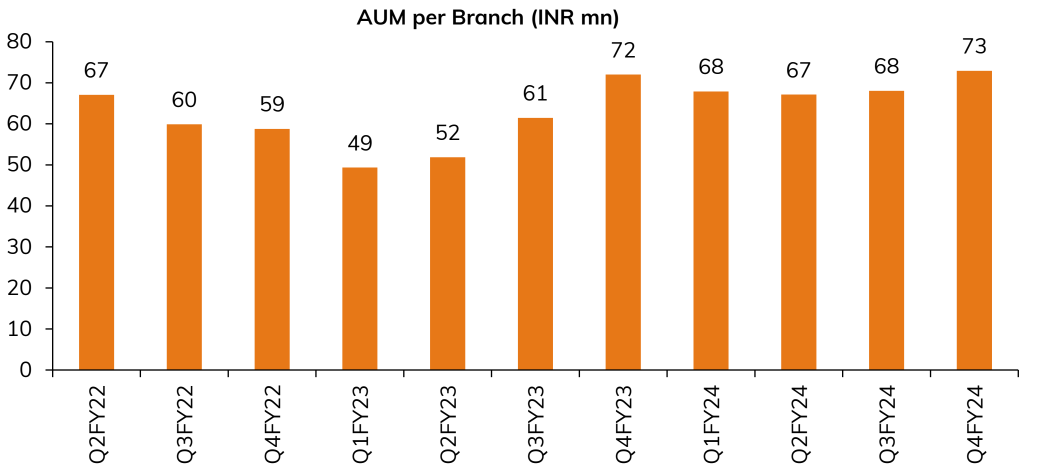
Source: Company data, I-Sec research

Exhibit 6: NIM rose to 14.6% resulting from business growth and reduction in cost of borrowing



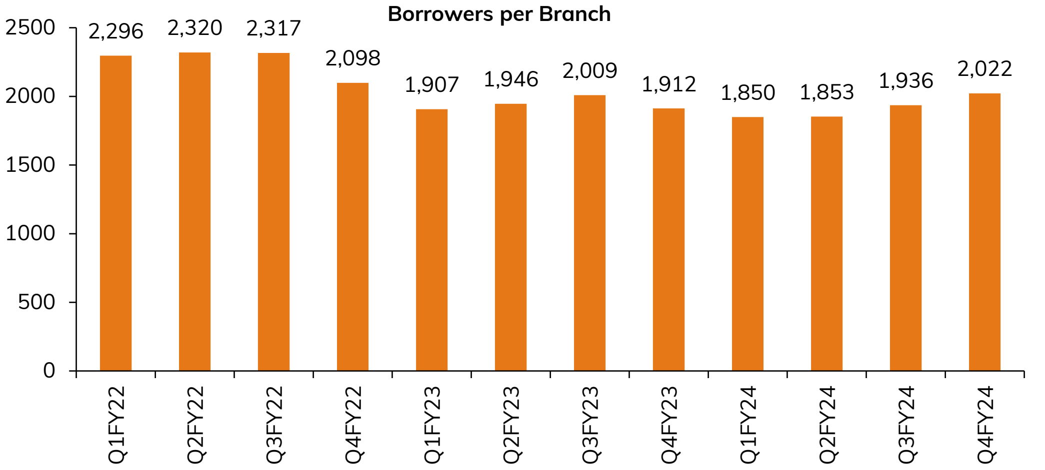
Source: Company data, I-Sec research

Exhibit 7: AUM per branch improved to INR 73mn vs INR 68mn QoQ, as branch productivity increased...



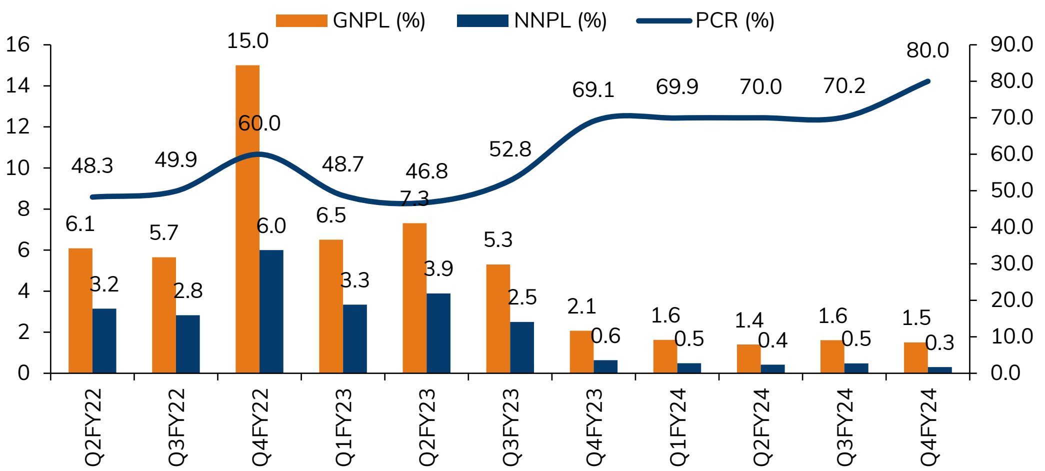
Source: Company data, I-Sec research

Exhibit 8: ...which also resulted in increasing borrowers per branch



Source: Company data, I-Sec research

Exhibit 9: Provision coverage improved to 80% vs 70% QoQ



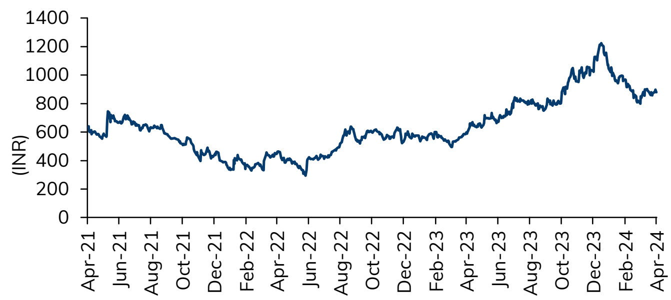
Source: Company data, I-Sec research

Exhibit 10: Shareholding pattern

%	Jun'23	Sep'23	Mar'24
Promoters	62.4	60.4	59.8
Institutional investors	29.7	31.8	32.3
MFs and other	0.6	1.3	2.3
Banks/ FIs	0.3	0.3	0.3
Insurance Cos.	4.1	8.0	5.7
FIIs	24.6	22.2	24.0
Others	7.9	7.8	7.9

Source: Bloomberg, I-Sec research

Exhibit 11: Price chart



Source: Bloomberg, I-Sec research

Financial Summary

Exhibit 12: Profit & Loss

(INR mn, year ending 2023)

	FY23A	FY24A	FY25E	FY26E
Interest Income	13,287	22,998	30,042	36,324
Interest Expenses	(4,451)	(8,974)	(11,978)	(13,811)
Net Interest Income (NII)	**8,836**	**14,024**	**18,064**	**22,513**
Other Income	658	1,072	1,072	1,072
Total Income (net of interest expenses)	**9,494**	**15,095**	**19,136**	**23,584**
Employee benefit expenses	(2,938)	(4,509)	(5,727)	(6,987)
Depreciation and amortization	(107)	(197)	(120)	(120)
Other operating expenses	(1,269)	(1,496)	(1,870)	(2,244)
Total Operating Expense	**(4,314)**	**(6,203)**	**(7,717)**	**(9,351)**
Pre Provisioning Profits (PPoP)	**5,180**	**8,893**	**11,419**	**14,234**
Provisions and write offs	(4,998)	(2,633)	(3,135)	(3,656)
Profit before tax (PBT)	**183**	**6,260**	**8,284**	**10,578**
Total tax expenses	(59)	(1,581)	(2,085)	(2,663)
Profit after tax (PAT)	**123**	**4,679**	**6,199**	**7,916**

Source Company data, I-Sec research

Exhibit 13: Balance sheet

(INR mn, year ending 2023)

	FY23A	FY24A	FY25E	FY26E
Share capital	710	710	710	710
Reserves & surplus	30,283	35,733	41,932	49,847
Shareholders' funds	**30,992**	**36,443**	**42,642**	**50,557**
Borrowings	**60,743**	**94,240**	**1,09,642**	**1,35,884**
Provisions	2,051	3,077	3,077	3,077
Deferred tax liabilities (net)	40	60	60	60
Other Liabilities	2,051	3,077	3,077	3,077
Total Liabilities and Stakeholder's Equity	**93,826**	**1,33,820**	**1,55,421**	**1,89,578**
Fixed assets	249	300	300	300
Loans	**77,598**	**1,10,140**	**1,35,855**	**1,66,332**
Investments	1,894	1,120	750	750
Deferred tax assets (net)	2,364	1,820	1,820	1,820
Current Assets including cash and bank	10,045	18,940	14,944	18,297
Other Assets	1,677	1,500	1,752	2,080
Total Assets	**93,826**	**1,33,820**	**1,55,421**	**1,89,578**

Source Company data, I-Sec research

Exhibit 14: Key ratios

(Year ending 2023)

	FY23A	FY24A	FY25E	FY26E
AUM and Disbursements (INR mn)				
AUM	85,110	1,19,730	1,49,291	1,82,783
Disbursements	81,250	1,06,880	1,13,537	1,36,307
Repayments	61,950	72,260	83,976	1,02,815
Growth (%):				
Total AUM (%)	29.3	40.7	24.7	22.4
Disbursements (%)	(140.9)	(31.5)	(6.2)	(20.1)
Repayments (%)	25.2	16.6	16.2	22.4
Total Assets (%)	32.6	42.6	16.1	22.0
Net Interest Income (NII) (%)	(4.2)	58.7	28.8	24.6
Non-interest income (%)	281.5	62.9	-	-
Total Income (net of interest expenses) (%)	1.0	59.0	26.8	23.2
Operating Expenses (%)	19.0	43.8	24.4	21.2
Employee Cost (%)	28.7	53.5	27.0	22.0
Non-Employee Cost (%)	1.6	17.9	25.0	20.0
Pre provisioning operating profits (PPoP) (%)	(10.3)	71.7	28.4	24.6
Provisions (%)	4.0	(47.3)	19.1	16.6
PBT (%)	(81.2)	3,330.2	32.3	27.7
PAT (%)	(82.3)	3,691.6	32.5	27.7
EPS (%)	(82.8)	3,690.7	32.5	27.7
Yields, interest costs and spreads (%)				
NIM on loan assets (%)	13.3	14.9	14.7	14.9
NIM on IEA (%)	10.2	12.0	11.9	12.3
NIM on AUM (%)	11.7	13.7	13.4	13.6
Yield on loan assets (%)	20.0	24.5	24.4	24.0
Yield on IEA (%)	15.4	19.7	19.8	19.9
Yield on AUM (%)	17.6	22.5	22.3	21.9
Cost of borrowings (%)	9.0	11.6	11.8	11.3
Interest Spreads (%)	11.0	12.9	12.7	12.8
Operating efficiencies				
Non interest income as % of total income	63.4	58.3	58.1	60.2
Cost to income ratio	45.4	41.1	40.3	39.6
Op.costs/avg assets (%)	5.2	5.4	5.3	5.4
Op.costs/avg AUM (%)	5.7	6.1	5.7	5.6
Salaries as % of non-interest costs (%)	68.1	72.7	74.2	74.7
Capital Structure				
Average gearing ratio (x)	2.0	2.6	2.6	2.7
Leverage (x)	3.0	3.5	3.7	3.8
CAR (%)	36.3	32.0	32.3	31.4
Tier 1 CAR (%)	35.3	31.0	31.2	30.3
Tier 2 CAR (%)	1.0	1.0	1.0	1.0
RWA (estimate) - INR mn	79,752	1,13,747	1,32,108	1,61,141
RWA as a % of loan assets	102.8	103.3	97.2	96.9

Source Company data, I-Sec research

	FY23A	FY24A	FY25E	FY26E
Asset quality and provisioning				
GNPA (%)	2.1	1.5	2.0	2.0
NNPA (%)	4.3	0.5	0.2	0.4
GNPA (INR mn)	1,606	1,652	2,717	3,327
NNPA (INR mn)	3,311	497	330	679
Coverage ratio (%)	(106.1)	69.9	87.8	79.6
Credit Costs as a % of avg AUM (bps)	662	257	233	220
Credit Costs as a % of avg on book loans (bps)	662	257	233	220
Return ratios				
RoAA (%)	0.1	4.1	4.3	4.6
RoAE (%)	0.4	13.9	15.7	17.0
ROAAUM (%)	0.2	4.6	4.6	4.8
Valuation Ratios				
No of shares	71	71	71	71
No of shares (fully diluted)	71	71	71	71
ESOP Outstanding	-	-	-	-
EPS (INR)	1.7	65.9	87.3	111.5
EPS fully diluted (INR)	1.7	65.9	87.3	111.5
Price to Earnings (x)	505.7	13.3	10.1	7.9
Price to Earnings (fully diluted) (x)	505.7	13.3	10.1	7.9
Book Value (fully diluted)	437	513	601	712
Adjusted book value	402	508	597	705
Price to Book	2.0	1.7	1.5	1.2
Price to Adjusted Book	2.2	1.7	1.5	1.2

Source Company data, I-Sec research

Exhibit 15: Key metrics

(Year ending 2023)

	FY23A	FY24A	FY25E	FY26E
DuPont Analysis				
Average Assets (INR mn)	82,294	1,13,823	1,44,620	1,72,500
Average Loans (INR mn)	66,391	93,869	1,22,997	1,51,093
Average Equity (INR mn)	30,946	33,718	39,542	46,600
Interest earned (%)	16.1	20.2	20.8	21.1
Net gain on fair value changes (%)	-	-	-	-
Interest expended (%)	5.4	7.9	8.3	8.0
Gross Interest Spread (%)	**10.7**	**12.3**	**12.5**	**13.1**
Credit cost (%)	6.1	2.3	2.2	2.1
Net Interest Spread (%)	**4.7**	**10.0**	**10.3**	**10.9**
Operating cost (%)	5.2	5.4	5.3	5.4
Lending spread (%)	**(0.6)**	**4.6**	**5.0**	**5.5**
Non interest income (%)	0.8	0.9	0.7	0.6
Operating Spread (%)	**0.2**	**5.5**	**5.7**	**6.1**
Tax rate (%)	32.4	25.3	25.2	25.2
ROAA (%)	**0.1**	**4.1**	**4.3**	**4.6**
Effective leverage (AA/ AE)	265.9	337.6	365.7	370.2
RoAE (%)	**0.4**	**13.9**	**15.7**	**17.0**

Source Company data, I-Sec research

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