

Spandana Sphoorty Financial Ltd

Subscribe for Long Term

Price Band: INR 853 – 856

| ISSUE SUMMARY | |
|--------------------------------|-----------|
| Issue Opens | 05-Aug-19 |
| Issue Closes | 07-Aug-19 |
| Offer Price (INR per share) | 853-856 |
| Face Value (INR) | 10.0 |
| Pre Issue Shares o/s (mn) | 59.6 |
| *Offer for Sale (No of sh. mn) | 9.4 |
| Fresh Issue (mn) | 4.7 |
| Post Issue shares o/s (mn) | 64.3 |
| ^Issue Size (INR bn) | 12.0 |
| QIB | =<50% |
| Non-institutional | =>15% |
| Retail | =>35% |
| ^ Issue Size (@INR856) | |

| POST ISSUE DETAILS | |
|-----------------------------|-------|
| Mcap @INR856/sh. (INR bn) | 55.1 |
| Shareholding pattern | |
| Promoters | 62.6% |
| Non-Promoters | 37.4% |

Spandana Sphoorty Financial Ltd (Spandana) is a rural focused Micro-Finance Institution (MFI) with a pan India presence. It is the 4th largest NBFC-MFI and the 6th largest amongst NBFC-MFIs and Small Finance Banks in terms of AUM (as on Mar'19). It offers income generation loans under the joint liability group model, largely to women from low-income households in rural areas.

Diversified book with focus on high potential/ under-served rural segment: Spandana's operations are well-diversified with presence in more than 74,749 villages in 269 districts in 16 states and 1 union territory across India through 929 branches. No single state/district/branch contributes more than 20%/1.8%/0.3% to the AUM as of Mar'19. It focuses on highly under-penetrated rural areas, forming 95% of its portfolio vs. ~60% for the industry.

Resilient performance through business cycles: In 2010, Spandana was severely impacted due to AP Microfinance Ordinance 2010, post which it entered into CDR. It returned to profits by FY14 and exited CDR by FY17 end with capital infusion from Kangchenjunga (Corporate Promoter) and Kedaara AIF-1 (PE firm). It was one of the only 2 major companies that were able to successfully exit from this CDR. Its AUM grew >3x over last 2 years to INR44bn, demonstrating strength of its business, policies and client relationships.

Efforts to reduce cost of borrowings: The average cost of borrowing reduced from 16.3% in FY17 to 12.8% in FY19. Its credit rating improved from BBB- (Stable) as of Aug'17 to A- (Stable) in Mar'19. The company intends to further diversify its lender base by raising financing through lower cost avenues.

Object of Issue: The IPO consists of a fresh issue of INR4bn (33% of the issue size) and an offer for sale of INR8bn (67%) by promoters, Kedaara Capital and others. The fresh issue proceeds will be used for augmentation of capital base.

View: Spandana has delivered robust financials post its CDR exit with revenue/EBITDA/PBT CAGR of 66%/109%/267% over FY17-19. Its NIM of 17% is higher than peers while its opex ratio of 4.5% is below the industry average of 6-7%. At the upper price band, it is valued at 2.4x P/B on FY19 diluted basis, compared to CreditAccess Grameen 3.2x P/B. Given Spandana's efficient business model, its display of strong resilience during tested times, higher RoA and NIMs, we are positive on the company and its business model. However considering the current market environment and NBFC liquidity issues, investor can look at Subscribing to the IPO from a Long Term perspective.

Financials & Valuations (INR mn) :

| Y/E March | FY15 | FY16 | FY17 | FY18 | FY19 |
|----------------|---------|--------|-------|-------|-------|
| NII | 138 | 1,101 | 2,212 | 3,412 | 6,336 |
| Growth (%) | NA | 696.6 | 101.0 | 54.3 | 85.7 |
| Net Profit | 1,051 | 2,432 | 4,434 | 1,879 | 3,118 |
| Growth (%) | NA | 131.4 | 82.3 | -57.6 | 65.9 |
| EPS | 16.3 | 18.6 | 67.3 | 29.2 | 48.5 |
| ROE | -290.5% | 161.4% | 77.9% | 16.2% | 16.9% |
| ROA | 4.5% | 5.4% | 21.5% | 6.6% | 6.9% |
| Adj. BV (INR)* | -5.6 | 28.6 | 144.2 | 216.3 | 356.2 |
| P-ABV (x)* | -152.2 | 29.9 | 5.9 | 4.0 | 2.4 |

Source: Company RHP, MOFSL

Ratios are calculated on the upper price band of INR856

FY18 & FY19 financials are consolidated and hence not comparable to previous years

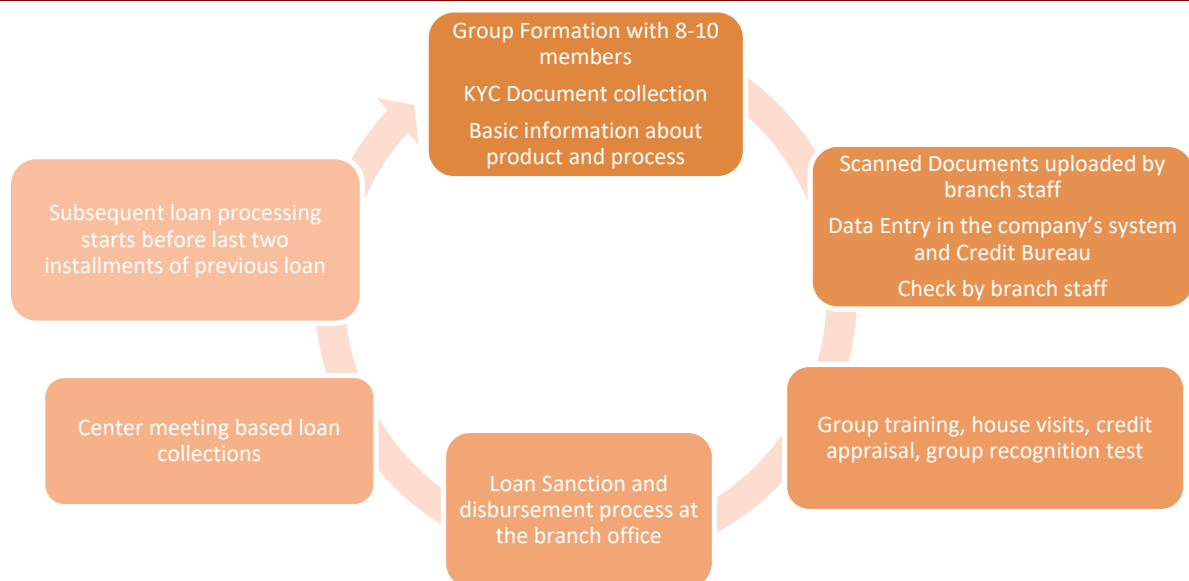
About the Company

Incorporated in 2003, Spandana is the 4th largest rural focused NBFC-MFI with a geographically diversified presence in India. It registered as an NBFC with the RBI in 2004 and subsequently, it registered as an NBFC-MFI in 2015. It offers income generation loans under the joint liability group model, predominantly to women from low-income households in rural areas. As of June 30, 2019, it had 7,062 employees (including 5,051 credit assistants) operating out of 929 branches in 269 districts across 16 states and 1 union territory in India.

Between the years 2005 to 2010, Spandana grew its micro-finance operations and by FY10 end, became the second largest MFI in terms of AUM. However, in October 2010, the MFI industry was severely impacted due to external regulatory action, as the government of the formerly unified Andhra Pradesh promulgated the AP Microfinance Ordinance 2010, which enforced several restrictions on the operations of MFIs. This severely impacted Spandana’s collections and the consequent cash-flow shortage impacted its ability to service its debt, which in turn impaired growth and profitability. It was referred to the Corporate Debt Restructuring (CDR) mechanism of the RBI by its lenders, in order to restructure its borrowings and revive business. With the help of CDR, its operations became profitable from FY14.

In FY17 end, Spandana received capital infusion from Kangchenjunga, its Corporate Promoter, and Kedaara AIF – 1, which enabled it to exit from CDR mechanism successfully. Post exit from CDR, Spandana increased its lender base, diversified its borrowings to new banks and NBFCs and also issued NCDs in the capital markets which led to reduction in cost of borrowing from 16.3% in FY17 to 12.8% in FY19. In FY18, with increased flow of capital, Spandana expanded its operations and could effectively utilize its existing branch network and employees. Thus its AUM expanded from INR11.9bn in FY17 to INR30.9bn in FY18 and INR41.7bn in FY19.

Exhibit 1: Business Process



Source: RHP, MOFSL

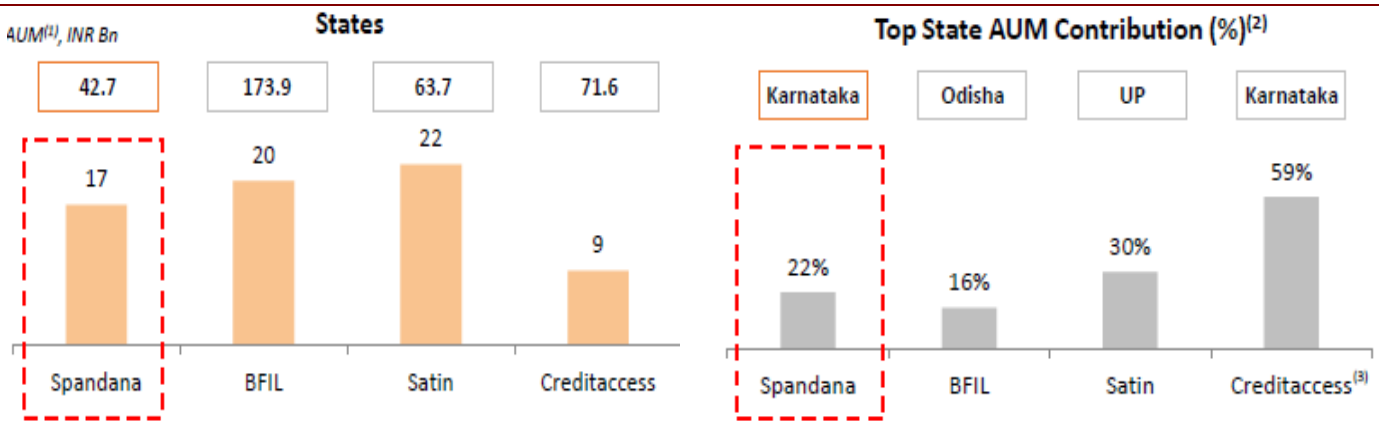
Exhibit 2: Strong Performance post CDR exit

| INR million | March 2017 | March 2019 |
|-------------------------------|------------|---|
| Gross AUM (excl. old AP book) | 13,015 | 44,373 |
| Net worth | 9,276 | 18,894 |
| PAR 0+ | 1,391 | 383 |
| Profit before Tax | 456 | 4,735 |
| Lenders | 3 | 28 |
| Credit Rating ⁽¹⁾ | NA | A- (Stable) |
| Avg. Effective Borrowing Cost | 16.3% | 12.8% |
| | CDR Exit | 4 th largest MFI in the country* |

2Yrs

Source: RHP, MOFSL

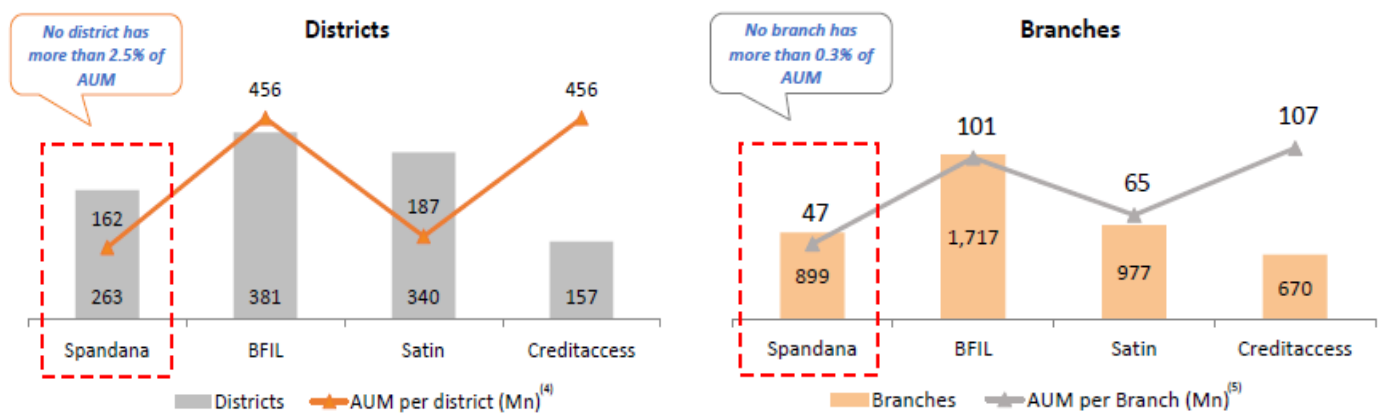
Exhibit 3: Well diversified across states



Source: RHP, MOFSL

Source: RHP, MOFSL

Exhibit 4: Well diversified at district and branch level too



Source: RHP, MOFSL

Source: RHP, MOFSL

Story in Charts

Exhibit 5: Strong growth in Gross AUM and Disbursement...

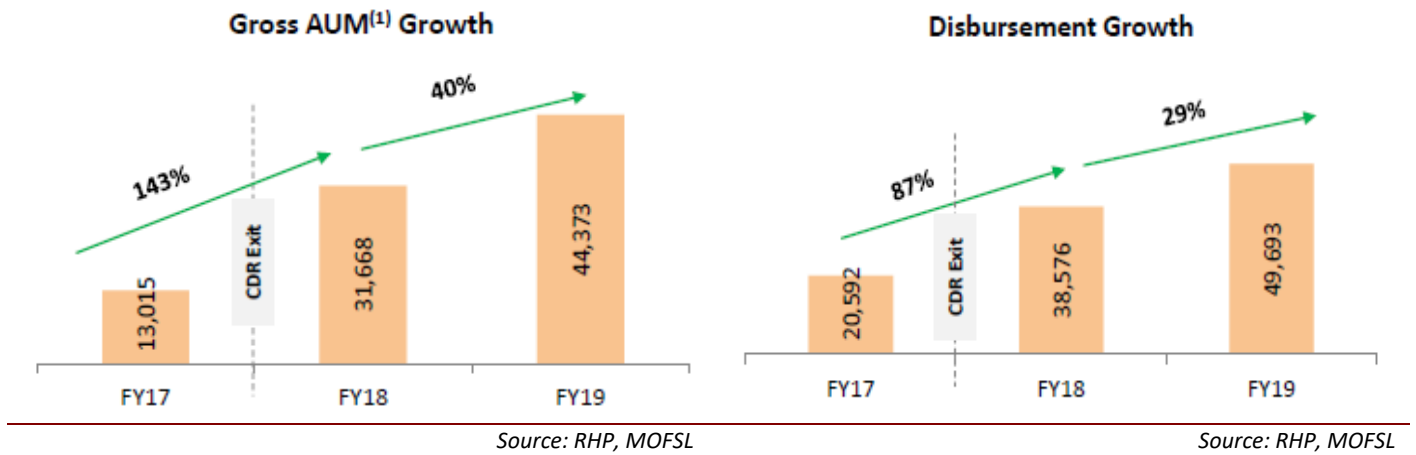


Exhibit 6: led by expansion in Borrowers & Employees base...

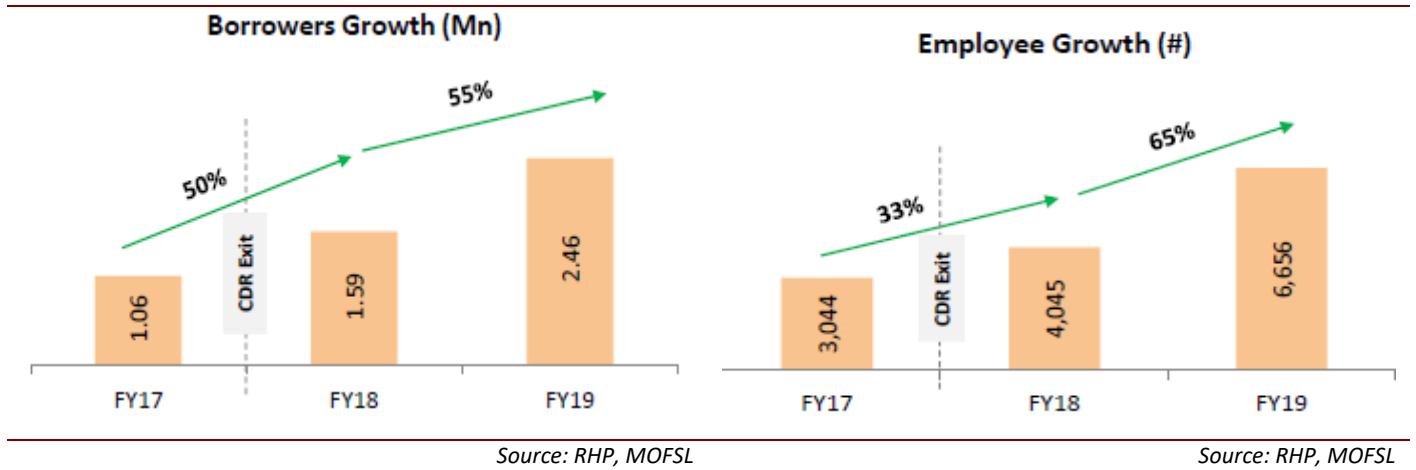
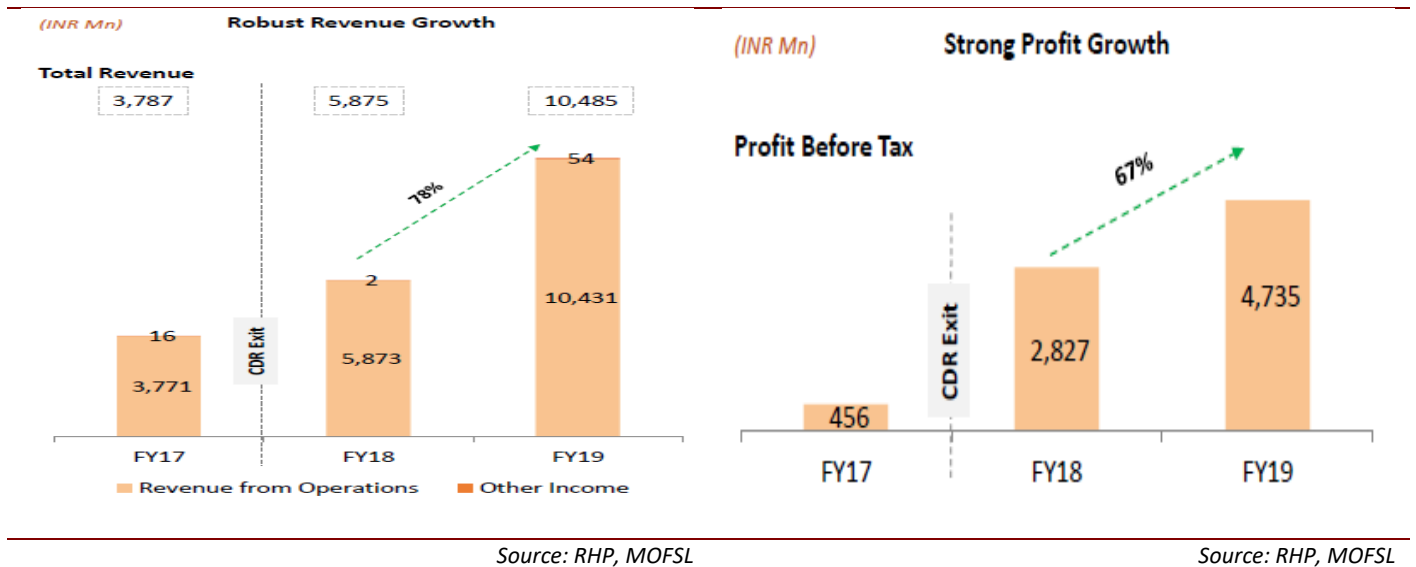


Exhibit 7: Resulted in robust performance post CDR exit



Risk and concerns

- ✓ Spandana's operations are concentrated in the states of Karnataka (20%), Madhya Pradesh (20%), Orissa (13%), Maharashtra (11%) and Chhattisgarh (9%). Any adverse developments in these states could have a negative effect on its financials.
- ✓ Volatility in interest rates could have an adverse effect on its net interest income, net interest margin and overall financial performance.
- ✓ Microfinance loans are unsecured in nature and are prone to various risks which may result in increased levels of NPA. Increase in NPAs, impairments and write-offs could adversely affect Spandana's business.
- ✓ Any change in the RBI regulations on priority sector lending, or inability to access diversified low cost funding could adversely affect Spandana's business.
- ✓ Given the latest developments in NBFC industry and the mayhem in the overall capital market, IPO may fail to garner much interest.

Peer Comparison

Exhibit 8: Key Matrix as on Mar'19

| Company | AUM (INR Bn) | Clients (mn) | Branch Strength | Employee Strength |
|----------------------------|--------------|--------------|-----------------|-------------------|
| Bharat Financial Inclusion | 174 | 7.4 | 1,717 | 19,241 |
| CreditAccess Grameen | 72 | 2.5 | 670 | 8,064 |
| Spandana Sphoorty | 44 | 2.4 | 899 | 6,500 |
| Ujjivan Financial Services | 111 | 4.0 | 524 | 14,757 |
| Satin Creditcare Network | 64 | 3.1 | 977 | 10,419 |

Source: Company RHP, MOFSL

Exhibit 9: Relative Valuation (Data for FY19)

| Company | Mcap (INR Bn) | GNPA (%) | NNPA (%) | RoA (%) | RoE (%) | P/E | P/BV |
|----------------------------|---------------|----------|----------|---------|---------|------|------|
| Bharat Financial Inclusion | NA | 0.8 | 0.2 | 9.0 | 23.3 | NA | NA |
| CreditAccess Grameen | 76 | 0.6 | - | 5.2 | 16.9 | 23.6 | 3.2 |
| Spandana Sphoorty | 55 | 7.9 | - | 6.9 | 16.9 | 17.6 | 2.4 |
| Ujjivan Financial Services | 35 | 0.9 | 0.3 | 1.3 | 8.0 | 23.0 | 1.8 |
| Satin Creditcare Network | 14 | 3.9 | 2.4 | 3.1 | 17.5 | 6.8 | 1.2 |

Source: Company RHP, Bloomberg, MOFSL

*Price Data as on 2nd August, 2019

Spandana M.cap. based on the upper price band of INR856

Financial Analysis

| Income Statement | | | | | | (INR mn) |
|------------------------------|--------------|--------------|--------------|--------------|--------------|----------|
| Y/E March | FY15 | FY16 | FY17 | FY18 | FY19 | |
| Interest Income | 1,256 | 2,395 | 3,706 | 5,730 | 9,914 | |
| Interest Expense | 1,118 | 1,294 | 1,494 | 2,318 | 3,579 | |
| Net Interest Income | 138 | 1,101 | 2,212 | 3,412 | 6,336 | |
| Change (%) | NA | 696.6 | 101.0 | 54.3 | 85.7 | |
| Non-Interest Income | 1,998 | 1,093 | 81 | 145 | 571 | |
| Net Income | 2,136 | 2,194 | 2,293 | 3,557 | 6,907 | |
| Change (%) | NA | 2.7 | 4.5 | 55.2 | 94.1 | |
| Operating Expenses | 1,020 | 932 | 958 | 1,084 | 1,718 | |
| Pre Provision Profits | 1,116 | 1,262 | 1,335 | 2,473 | 5,189 | |
| Change (%) | NA | 13.1 | 5.8 | 85.3 | 109.8 | |
| Provisions (excl tax) | 57 | 68.38 | 984 | -354 | 454 | |
| PBT | 1,059 | 1,193 | 351 | 2,827 | 4,735 | |
| Tax | 8 | 0 | -3,978 | 948 | 1,616 | |
| Tax Rate (%) | 0.7 | 0.0 | -872.7 | 33.5 | 34.1 | |
| PAT | 1,051 | 1,193 | 4,329 | 1,879 | 3,119 | |
| Change (%) | NA | 13.6 | 262.8 | -56.6 | 66.0 | |
| Adj. PAT | 1,051 | 2,432 | 4,434 | 1,879 | 3,118 | |
| Change (%) | NA | 131.4 | 82.3 | -57.6 | 65.9 | |

Source: Company RHP, MOFSL

FY18 & FY19 financials are consolidated and hence not comparable to previous years

| Balance Sheet | | | | | | (INR mn) |
|---------------------------|---------------|---------------|---------------|---------------|---------------|----------|
| Y/E March | FY15 | FY16 | FY17 | FY18 | FY19 | |
| Equity Share Capital | 8,280 | 8,114 | 284 | 298 | 596 | |
| Preference Share Capital | | | | | | |
| Reserves & Surplus | -8,642 | -6,273 | 8,991 | 13,609 | 18,307 | |
| Net Worth | -362 | 1,841 | 9,276 | 13,906 | 18,904 | |
| Deposits | 0 | - | 0 | 0 | 0 | |
| Change (%) | NA | NA | NA | NA | NA | |
| Borrowings | 3,752 | 0 | 9,335 | 23,314 | 29,677 | |
| Other Liabilities & Prov. | 20,134 | 19,158 | 676 | 422 | 736 | |
| Total Liabilities | 23,525 | 20,999 | 19,286 | 37,642 | 49,317 | |
| Current Assets | 950 | 665 | 3,012 | 1,787 | 2,339 | |
| Investments | 1 | 1 | 24 | 1,033 | 2,033 | |
| Change (%) | NA | 0.0 | 2,308.0 | 4,191.8 | 96.7 | |
| Loans | 22,462 | 20,188 | 11,945 | 30,896 | 42,678 | |
| Change (%) | NA | -10.1 | -40.8 | 158.6 | 38.1 | |
| Fixed Assets | 112 | 145 | 90 | 85 | 268 | |
| Other Assets | 0 | 0 | 4,215 | 3,841 | 2,000 | |
| Total Assets | 23,525 | 20,999 | 19,286 | 37,642 | 49,317 | |

Source: Company RHP, MOFSL

FY18 & FY19 financials are consolidated and hence not comparable to previous years

Key Ratios

| Y/E March | FY17 | FY18 | FY19 |
|---------------------------------|-------------|-------------|-------------|
| Asset Quality | | | |
| Gross AUM | 13,015.0 | 31,668.0 | 44,373.0 |
| Change (%) | 6.7 | 143.3 | 40.1 |
| Disbursements | 20,592.0 | 38,576.0 | 49,693.0 |
| Change (%) | 14.4 | 87.3 | 28.8 |
| GNPA Ratio | 42.1% | 25.9% | 7.9% |
| NNPA Ratio | 2.9% | 0.3% | 0.0% |
| Spreads Analysis (%) | | | |
| Avg. Yield on Gross AUM | 29.4 | 25.4 | 26.0 |
| Avg. Cost of Borrowing | 16.1 | 14.2 | 13.5 |
| Net Interest Margin | 17.5% | 15.3% | 16.7% |
| Opex/AUM | 7.6% | 4.9% | 4.5% |
| Profitability Ratios (%) | | | |
| RoE | 77.9% | 16.2% | 16.9% |
| RoA | 21.5% | 6.6% | 6.9% |
| Efficiency Ratios (%) | | | |
| Cost/Income* | 41.8% | 30.5% | 24.9% |
| Valuation | | | |
| Book Value (INR) | 144.2 | 216.3 | 356.2 |
| Change (%) | 403.9 | 49.9 | 64.7 |
| Price-BV (x) | 5.9 | 4.0 | 2.4 |
| EPS (INR) | 67.3 | 29.2 | 48.5 |
| Change (%) | 262.8 | -56.6 | 66.0 |
| Price-Earnings (x) | 12.7 | 29.3 | 17.6 |

Source: Company RHP, MOFSL

FY18 & FY19 financials are consolidated and hence not comparable to previous years
Ratios are calculated on the upper price band of INR856

| Explanation of Investment Rating | Expected return (over 12-month) |
|----------------------------------|--|
| Investment Rating | |
| BUY | >=15% |
| SELL | < - 10% |
| NEUTRAL | > - 10 % to 15% |
| UNDER REVIEW | Rating may undergo a change |
| NOT RATED | We have forward looking estimates for the stock but we refrain from assigning recommendation |

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