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Financials

Q2FY21 result review and TP change

Target price: Rs900

Target price revision

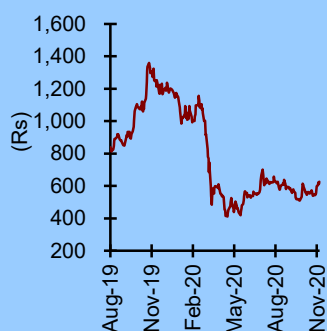
Rs900 from Rs740

Shareholding pattern

	Mar '20	Jun '20	Sep '20
Promoters	62.6	62.6	62.6
Institutional investors			
MFs and other	16.3	16.3	15.5
Banks/ FIs	4.2	4.2	4.2
Insurance	0.5	0.5	0.5
FII	0.0	0.0	0.0
FII	11.6	11.6	10.8
Others	21.1	21.1	21.9

Source: BSE

Price chart



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Spandana Sphoorty

BUY

Maintain

Capital sufficiency and adequate contingency buffer
to help tackle current cycle

Rs745

Spandana Sphoorty Financial (Spandana) in Q2FY21 continued its proactive approach in strengthening its balance sheet by building additional Covid-related provisions at Rs1.14bn (~155bps of AuM), taking cumulative contingency buffer to ~450bps (highest in MFI space). Notably, collection efficiency improved steadily from lows of 2% in April to as high as 93% in October with customer activation remaining robust at ~94%. Collections in states like Maharashtra, Odisha and Chhattisgarh remained lower than the average due to extended lockdown and a few instances of political interference. While the company's ~6% inactive customer base poses near-term risk to asset quality, we believe it will navigate through the current cycle relatively better than peers on the back of: 1) its diversified operations with 95% of districts having <1% exposure per district, 2) adequate provisioning buffer at Rs3.3bn (4.5% of AuM), and 3) comfortable capital position (CAR 45%). Maintain BUY with a revised target price of Rs900 (earlier: Rs740).

► **Collection efficiency surprises positively, but company continued to strengthen balance sheet; total provision cushion now at ~450bps.** Spandana's collection efficiency at 93% in October is one of the highest in MFI space. Customer activation remains strong as reflected in non-paying borrowers pool falling to 0.16mn or 6% (5.6% in value) from 0.9mn in June. However, due to extended lockdowns and a few instances of political interference, collections in some states like Maharashtra, Odisha and Chhattisgarh remained lower than average. Hence, Spandana continued to strengthen its balance sheet by proactively building an additional Rs1.14bn Covid-related contingency buffer and taking the cumulative provisioning buffer to ~450bps of AuM as in September (highest in MFI space). We believe, building higher contingency buffer is correct approach in the current scenario given that tail-end risk is yet to unfold. Further, strong PPOP margin at an average of 14% over past five quarters and adequate contingency buffer would ensure Spandana navigates through the current challenging cycle relatively better than peers.

► **Collection efficiency touched 93% in October indicating business resilience.** Nearly 94% of Spandana borrowers are in rural areas (which are relatively less impacted during lockdown) and ~57% are engaged in essential services. This borrower profile, coupled with effective communication about the cost of moratorium and significance of credit score to avail of next loan, helped the company improve collections to as high as ~93% in October from a mere 2% in April. Also, customer activation remains robust at 94%. Currently, all branches are operational and all employees have resumed work. However, ~6% borrowers are currently inactive, which poses risk to asset quality going ahead.

Market Cap	Rs47.9bn/US\$643mn	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)	1324/412	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 (%)	10.8	BVPS (Rs)	315.1	409.4	455.8	526.6
Daily Volume (US\$'000)	460	P/E (x)	14.3	13.6	12.8	8.4
Absolute Return 3m (%)	26.6	P/BV (x)	2.4	1.8	1.6	1.4
Absolute Return 12m (%)	(43.0)	Net NPA (%)	0.0	0.1	0.5	0.1
Sensex Return 3m (%)	15.8	RoAuM (%)	8.3	6.3	5.2	6.9
Sensex Return 12m (%)	10.2	RoE (%)	19.0	15.6	13.5	18.0

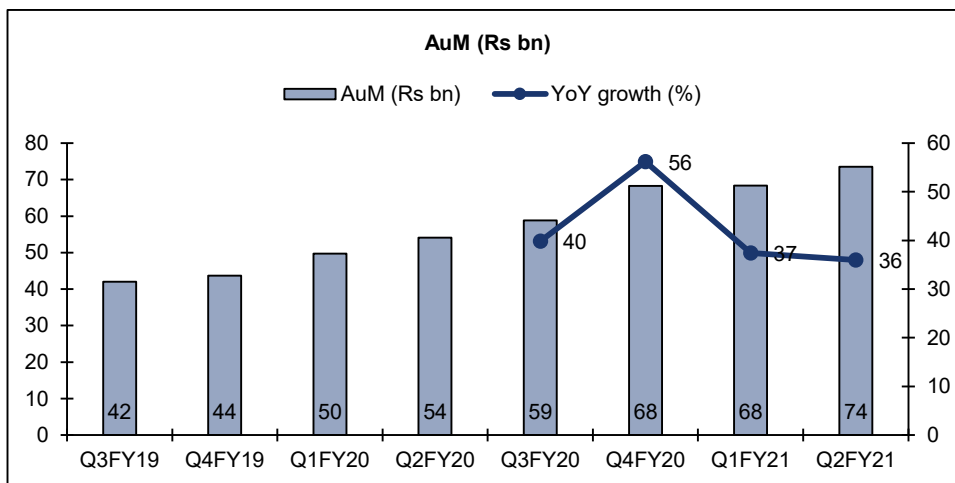
- **Core operating performance remains strong with disbursements already touching pre-Covid levels in October.** Spandana's Q2FY21 financial performance remained robust with NII growth strong at 8% QoQ driven by similar AuM growth, operating expenses growing in line with revenue growth, and proven record of raising funds whenever required at competitive rates. While incremental disbursements in Q2FY21 were mainly to existing borrowers migrating to next loan cycle (higher loan eligibility), Spandana expects customer addition to reach pre-Covid levels by March. Overall, it expects AuM growth to remain at 25-30% in FY21E.
- **Outlook.** While near-term asset quality and credit cost concerns persist, we believe Spandana's comfortable capital position (CAR at 45%), industry-leading profitability (PPoP margin at average 14%) and ~450bps of contingency buffer would ensure it achieves normalcy quicker than peers. Maintain **BUY** with a revised target price of Rs900 (earlier: Rs740). The stock is currently trading at 1.6x / 1.4x FY21E / FY22E P/BV respectively.

Table 1: Q2FY21 result review*(Rs mn)*

	Q2FY21	Q2FY20	% change YoY	Q1FY21	% change QoQ
Interest Income	3,448	3,585	(3.8)	3,260	5.8
Interest Expended	841	996	(15.6)	850	(1.0)
Net interest income (NII)	2,607	2,589	0.7	2,410	8.2
Other income	93	79	17.4	10	839.8
Total income	2,700	2,668	1.2	2,420	11.6
Operating expenses	565	542	4.2	521	8.3
-Staff expenses	420	403	4.3	416	1.1
-Other expenses	144	139	3.8	105	37.1
Operating profit	2,136	2,126	0.4	1,899	12.5
Total provisions	1,221	210	481.6	1,115	9.6
Profit before tax	914	1,916	(52.3)	784	16.6
Tax	246	1,457	(83.1)	194	26.8
Profit after tax	669	459	45.7	590	13.2
Key statistic (Rs mn)					
AuM	73,540	54,070	36.0	68,350	7.6
Borrowers (in Lakh)	26	25	4.5	26	0.4
Avg ticket size	28,504	21,891	30.2	26,595	7.2
AuM mix					
MFI	98	98		98	-
Non MFI	2	2		2	-
Ratios (%)			bp chg YoY		bp chg QoQ
Profitability ratios					
Portfolio Yields	22.4	24.0	(160)	23.0	(60)
Cost of Funds	10.6	12.7	(210)	11.0	(40)
NIM	15.9	18.6	(270)	15.5	40
RoA	10.0	12.0	(200)	8.7	130
RoaE	26.4	28.6	(220)	22.3	410
Asset Quality					
Gross NPL ratio	0.5	0.8	(23)	0.6	(10)
Business & Other Ratios					
Cost-income ratio	20.9	20.3	59	21.5	(63)
CAR	45.0	50.0	(500)	-	4,500

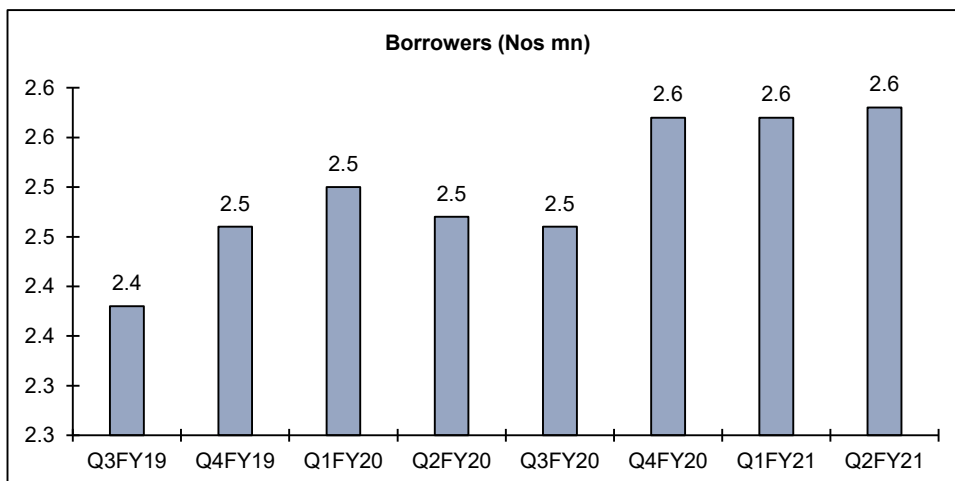
Source: Company, I-Sec research

Chart 1: AUM growth remains robust at 36% as disbursements accelerated in Q2FY21



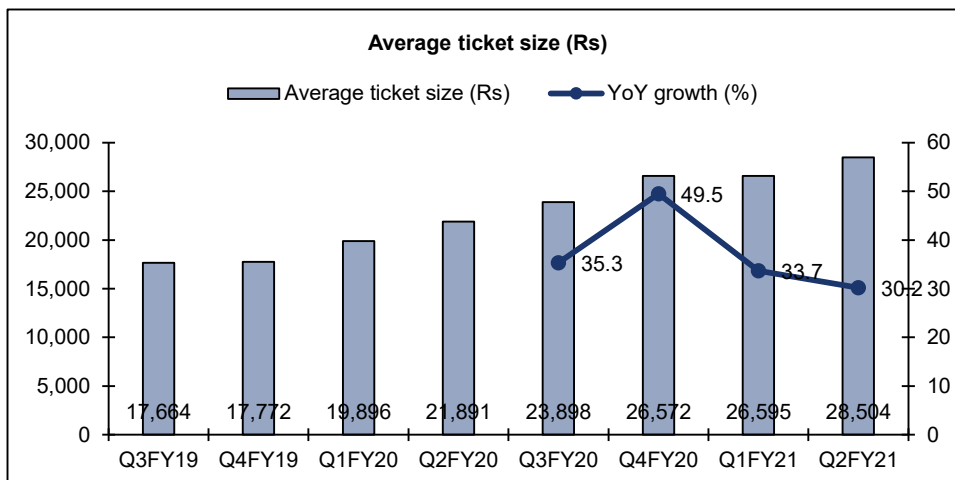
Source: Company, I-Sec research

Chart 2: Borrower base remained flat QoQ



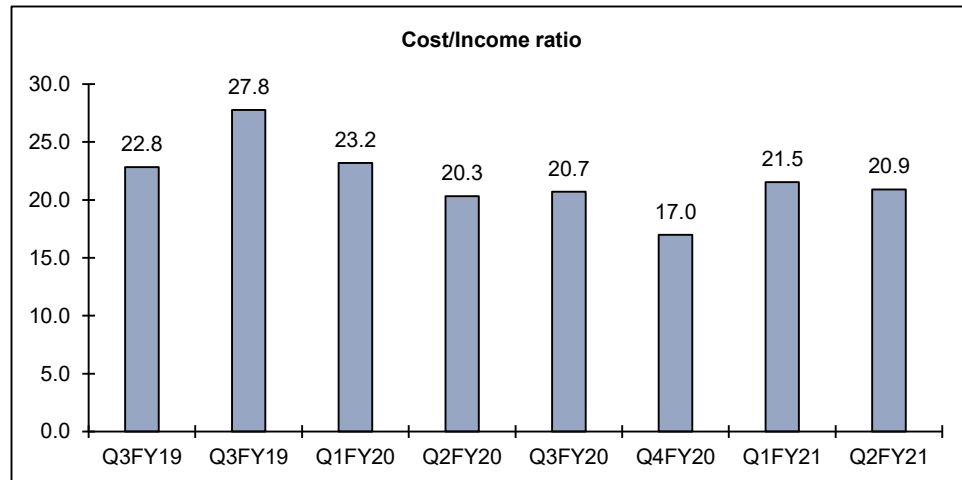
Source: Company, I-Sec research

Chart 3: Average ticket size increased 30% YoY due to higher loans to vintage customers in recent past



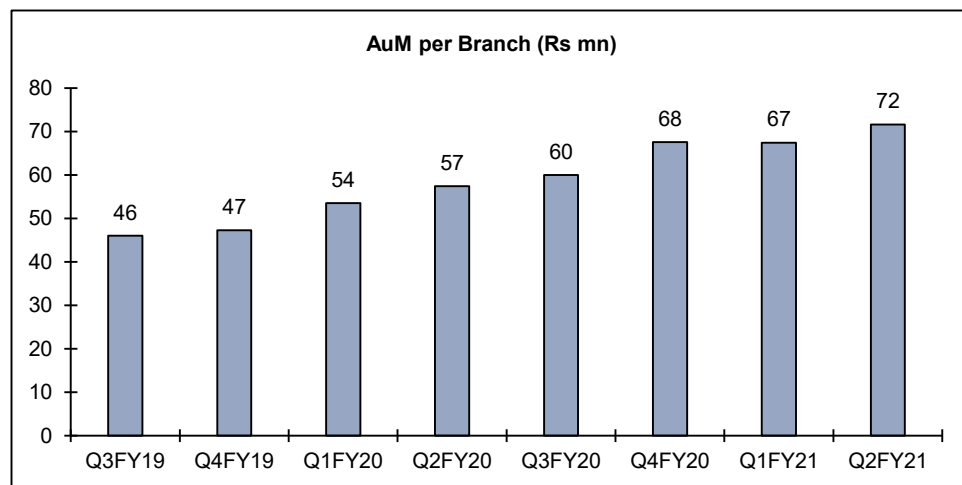
Source: Company, I-Sec research

Chart 4: Cost/income ratio fell to 20.9%



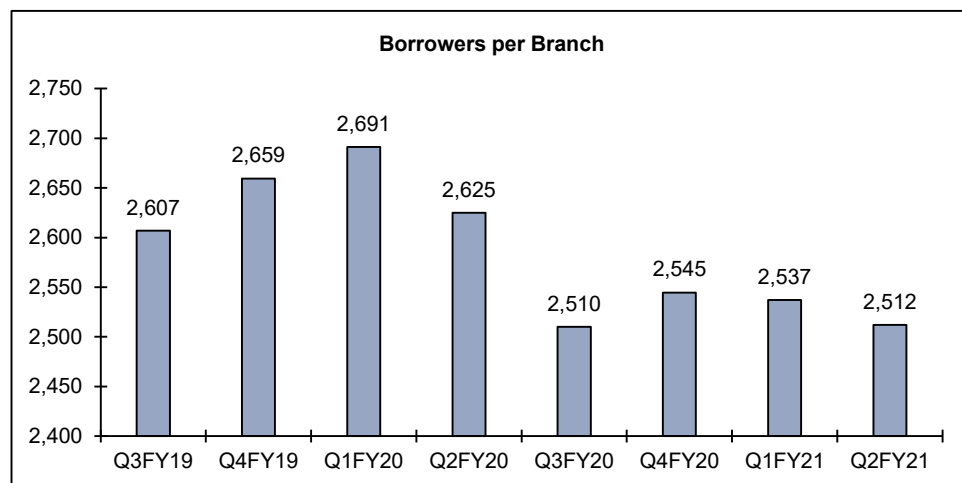
Source: Company, I-Sec research

Chart 5: Consistent improvement in AuM per branch – now at Rs72mn



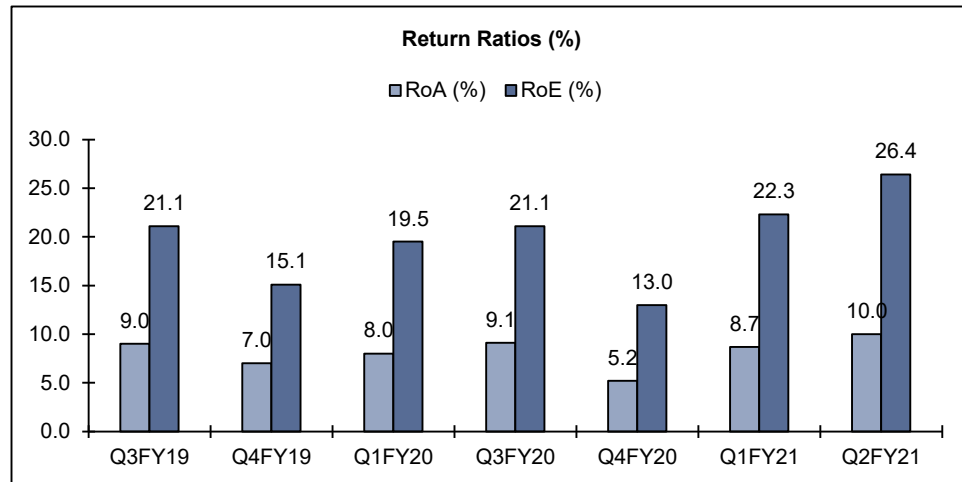
Source: Company, I-Sec research

Chart 6: Borrowers per branch remained 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)	14.3	13.6	12.8	8.4
P/B (x)	2.4	1.8	1.6	1.4
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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