BUY (Maintained)

CMP: **INR 702** Target Price: **INR 950 (INR 1,200)** ▲ 35%

ICICI Securities

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29 July 2024

India | Equity Research | Q1FY25 results review

Spandana Spoorthy Financial

Financial Services

Core operating performance remains strong; elevated provisions mar earnings

Spandana Spoorthy's (Spandana) Q1FY25 financial performance is a mixed bag with – 1) NII growth (ex-DA income) remaining strong at 12% QoQ, as it continues to benefit from NIM expansion, resulting in 8% QoQ PPoP growth; and 2) however, asset quality deteriorating with credit cost inching up to 8% (annualised) due to lower collections. Collections fell sharply to 94% vs. 96.5% QoQ due to election-led operational challenges, heat wave and higher attrition in states such as Madhya Pradesh, Maharashtra, Rajasthan, Telangana and Gujarat which impaired timely customer service. Management highlighted that it has already initiated several measures to improve asset quality, but a weak Q1FY25 would likely have an impact on full year AUM growth and credit cost. It lowered FY25 guidance for AUM growth to ~17–18% vs. 25% earlier and increased credit cost guidance to 3.75% vs. 2.5% earlier.

While we slash our earnings estimate by 25% for FY25 and 12% for FY26, factoring in higher credit costs, we maintain **BUY** due to Spandana's inexpensive valuation of 1x on FY26E PBV. We revise our TP to INR 950 (earlier INR 1,200) as we cut our target multiple to 1.5x vs. 1.8x earlier.

While asset quality deteriorates sharply…

The combination of India's general elections, heat wave and higher attrition at select states led to collection falling to 94% vs. 96.5% QoQ. The resulted in PAR 31-60 DPD portfolio increasing to 1.68% vs. 0.9% QoQ and 61-90 DPD rising to 1.5% vs. 0.6% QoQ. Total 1+ DPD portfolio stands at ~9%, as on Jun'24. Similarly, GNPL ratio rose to 2.6% vs. 1.5% QoQ and NNPL to 0.5% vs. 0.3% QoQ. However, management highlighted that industry outlook remains strong, as they do not envisage stress on rural income, credit demand, cash flow etc.; also, barring a few pockets (in terms of overleveraging), customer behaviour remains healthy.

… management has initiated measures to improve asset quality

Management has highlighted that deterioration in asset quality during Q1FY25 is temporary and transient. In order to improve portfolio quality, management has initiated several course correcting measures such as – 1) stopped acquisition of new-to-credit customers. 2) Paused new member acquisition in 14% branches across key states (230 branches). 3) New centre addition restricted in 39% branches. 4) Higher workload is also one of the key reasons for higher attrition; hence, 50% of branches would be allocated additional resources to focus on portfolio quality.

Financial Summary

Y/E March	FY23A	FY24A	FY25E	FY26E
Net Interest Income (NII)	8,836	14,024	18,044	21,608
PAT	123	4,679	4,675	7,235
EPS (INR)	1.7	65.9	65.8	101.9
% Chg YoY	(82.8)	3,690.7	(0.1)	54.8
P/E (x)	403.5	10.6	10.7	6.9
P/BV (x)	1.6	1.4	1.2	1.0
Gross Stage - 3 (%)	2.1	1.5	2.0	2.0
RoAA (%)	0.1	4.1	3.3	4.4
RoAE (%)	0.4	13.9	12.1	16.2

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Market Data

Market Cap (INR)	50bn
Market Cap (USD)	598mn
Bloomberg Code	SPANDANA IN
Reuters Code	SPAD BO
52-week Range (INR)	1,243 /678
Free Float (%)	32.0
ADTV-3M (mn) (USD)	2.0

Price Performance (%)	3m	6m	12m
Absolute	(20.3)	(32.9)	(14.1)
Relative to Sensex	(30.6)	(47.9)	(36.0)

Earnings Revisions (%)	FY25E	FY26E
PAT	(25)	(12)

Previous Reports

30-04-2024: Q4FY24 results review

23-01-2024: Q3FY24 results review

Along with these measures and its conservative lending approach, as reflected in loans per customers at 1.17x vs. 1.91x for industry, only ~13% exposure to customers with >INR 0.1mn ticket size would ensure better asset quality going ahead.

Q1FY25 financial performance: Core performance strong; elevated credit cost dents earnings

Core operating performance, during Q1FY25, remained strong – evident in 12% QoQ NII growth despite a 2% QoQ decline in AUM. Disbursement fell >40% QoQ to INR 22.8bn, the volumes were partially impacted due to seasonality and course correction measures initiated by management to curb delinquencies. Notably, its focus on new customer acquisition continued to remain strong, evident in the ~0.1mn client addition during Q1FY25 despite lower disbursement. NIM saw steady expansion to >15% (up 60bps QoQ), benefiting from 20bps QoQ asset yield expansion and 10bps QoQ decline in cost of fund, boosting the top-line. Controlled expense (down 2% QoQ) coupled with strong revenue supported 8% QoQ PPoP growth.

However, a sharp rise in credit cost to 8% (annualised) led to 55% QoQ fall in earnings to INR 557mn. Similarly, RoA/RoE remained subdued 1.7%/6.1% during Q1FY25.

Better customer profile to ensure improvement in asset quality going forward

Collections fell to 94% vs. 96.5% QoQ due to – 1) extended seven-phase elections in UP, Bihar, Madhya Pradesh, Maharashtra and Odisha impacting operations; 2) severe heat wave across the country; and 3) high attrition in key states such as Madhya Pradesh, Maharashtra, Rajasthan, Telangana and Gujarat, leading to Branch Manager attrition at 10.5% vs. 5.9% in rest of India. ~47% of 31 to 90 DPD portfolio and 59% of GNPA flown from 5 majorly impacted states vs. AUM contribution of 32%. However, management believes this is transitory in nature and the corrective measures that it has initiated should help in improving collections going ahead.

Further, the bank has a conservative lending approach, evident in its – 1) steady focus on indebtedness – only ~13% exposure to customers with >INR 0.1mn ticket size, as on Jun'24 and ~48% of customers with <INR 50,000 exposure; 2) diversified presence with no single state contributing >14% of portfolio; 3) short tenure of loans; and 4) loans per customer at 1.17x vs. industry average of 1.9x.

Weekly branches performing well

While management highlighted that it would continue to drive project 'Parivartan' as envisaged earlier, it would execute the project in a calibrated and granular manner with greater focus on no disruption to existing business. It derives comfort of continuing project Parivartan from better collection efficiency at 98% in weekly branches vs. 94% in monthly branches. As on Jun'24 – 1) weekly branches stand at 434 (~52% of total branch network); 2) disbursement share of weekly branches now contributes 24% of total disbursements; and 3) weekly branches contributes ~12% of total portfolio.

FY25 outlook – upward revision in credit cost to 3.75% vs. 2.5% earlier

Owing to the weak asset quality performance in Q1FY25, management has revised its full-year FY25 credit cost guidance to 3.75% vs. 2.5% earlier. It also lowered its AUM growth guidance to 17–18% vs. 25% earlier. It also highlighted that the bank is looking to pass on scale benefit to customers going ahead. In line with this, it reduced lending rate by 1% for customers with >6 loan cycles, effective Apr'24. Factoring in the weak Q1FY25 and revised guidance, we lower our earnings estimate by 25% for FY25E and 12% for FY26E. Spandana's strong core operating performance would still help it sustain 12% RoE in FY25E and 16% RoE in FY26E despite the cut in earnings.

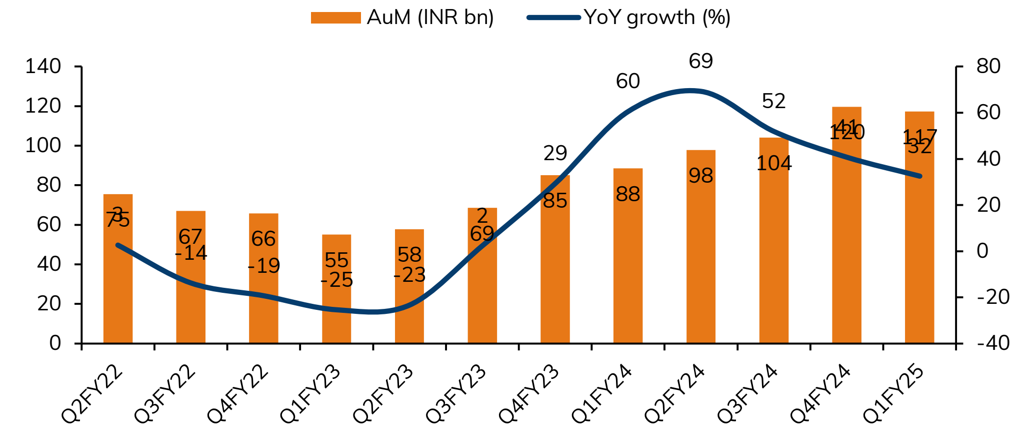
Key risks: 1) Stress unfolding higher-than-anticipated; and 2) operational instability caused by outside interference.

Exhibit 1: Q1FY25 result review

(INR mn)	Q1FY25	Q1FY24	%chg YoY	Q4FY24	% chg QoQ
Interest Income	7,099	5,116	38.8	6,758	5.0
Interest Expended	2,594	1,995	30.0	2,493	4.0
Net interest income (NII)	**4,505**	**3,121**	**44.4**	**4,265**	**5.6**
Other income	271	157	72.8	338	(19.9)
Total income	**4,776**	**3,277**	**45.7**	**4,603**	**3.8**
Operating expenses	1,908	1,386	37.6	1,943	(1.8)
-Staff expenses	1,347	1,031	30.7	1,409	(4.4)
-Other expenses	561	356	57.7	534	5.1
Operating profit	**2,869**	**1,891**	**51.7**	**2,660**	**7.8**
Total provisions	2,118	286	641.1	938	125.7
Profit before tax	**751**	**1,605**	**(53.3)**	**1,722**	**(56.4)**
Tax	193	411	(52.9)	435	(55.6)
Profit after tax	**557**	**1,195**	**(53.4)**	**1,287**	**(56.7)**
Key statistics			**% change YoY**		**% change QoQ**
AuM (INR mn)	117,230	88,480	32.5	119,730	(2.1)
Borrowers (in Lakh)	34	24	41.5	33	2.7
Calc. Avg ticket size (INR)	34,378	36,714	(6.4)	36,063	(4.7)
Ratios (%)			**bp change YoY**		**bp change QoQ**
Profitability ratios					
Portfolio Yields	24.4	24.0	40	24.2	20
Cost of Funds	11.6	12.5	(90)	11.7	(10)
NIM	**15.2**	**14.2**	**100**	**14.6**	**60**
RoAum	2.0	6.0	(398)	4.5	(255)
Asset Quality					
Gross NPL ratio	2.6	1.6	97	1.5	110
Business & Other Ratios					
Cost-income ratio	39.9	42.3	(235)	42.2	(227)
CAR	32.7	37.6	(490)	35.0	(230)

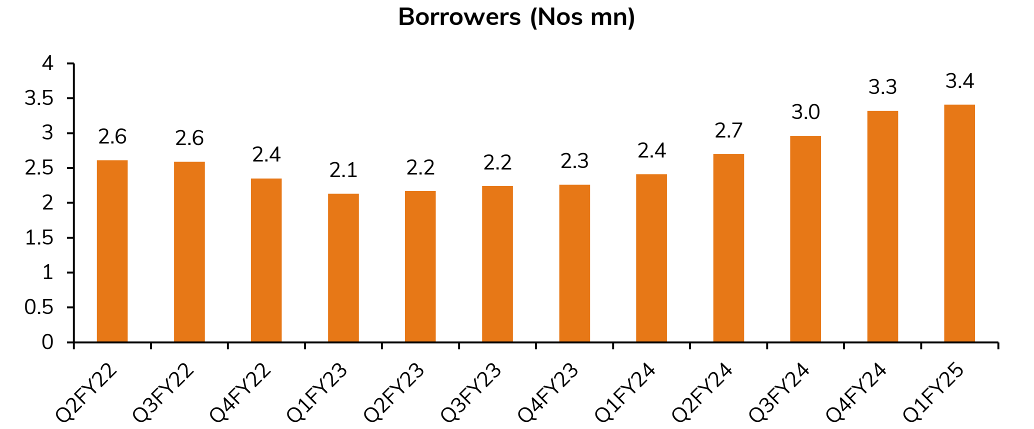
Source: Company data, I-Sec research

Exhibit 2: Disbursement fell >40% QoQ impacting AUM growth



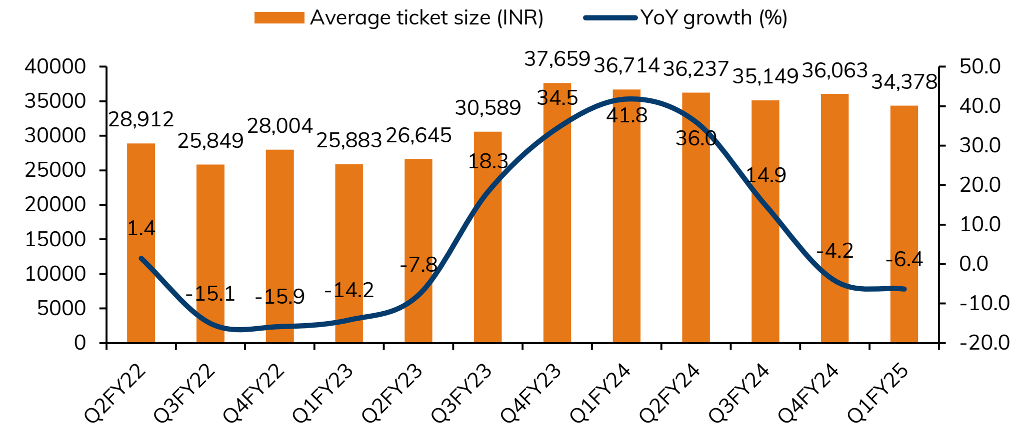
Source: Company data, I-Sec research

Exhibit 3: Added 1.0mn borrowers in the past 12 months



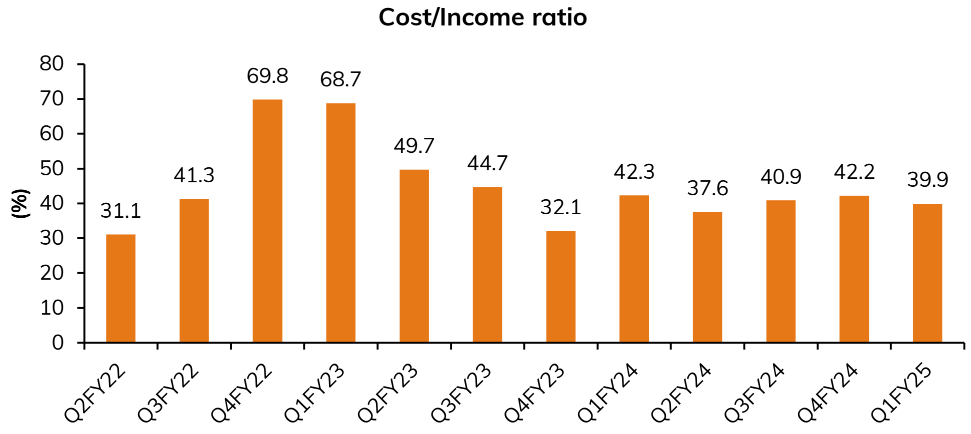
Source: Company data, I-Sec research

Exhibit 4: Average ticket-size at ~INR 35k



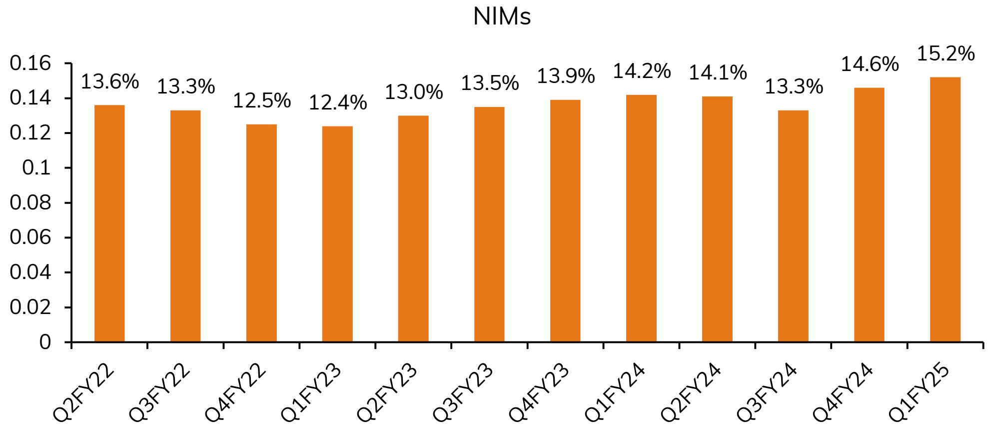
Source: Company data, I-Sec research

Exhibit 5: Cost-to-income ratio stable near 40%



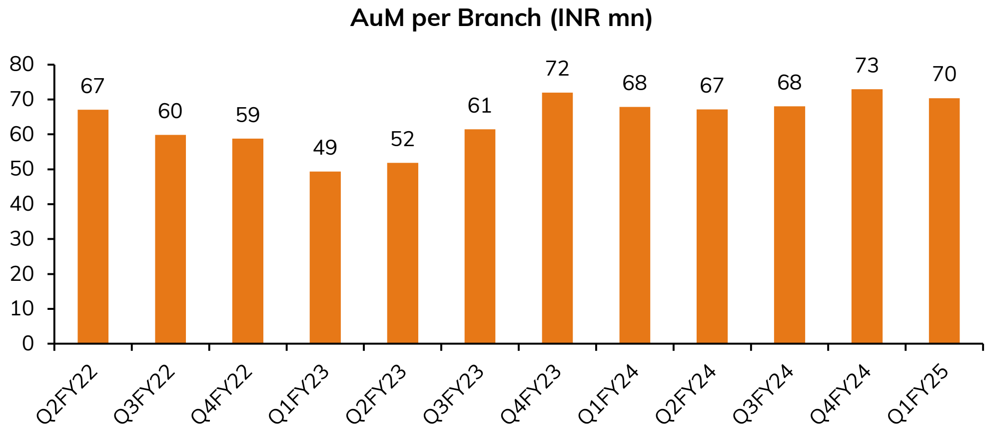
Source: Company data, I-Sec research

Exhibit 6: NIM saw steady expansion to >15% (up 60bps QoQ), benefiting from 20bps QoQ asset yield expansion and 10bps QoQ decline in cost of fund



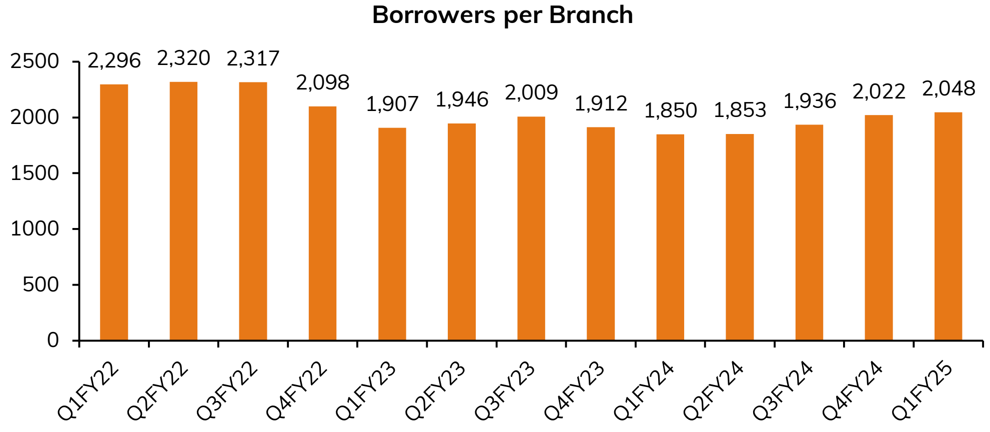
Source: Company data, I-Sec research

Exhibit 7: AUM per branch rangebound



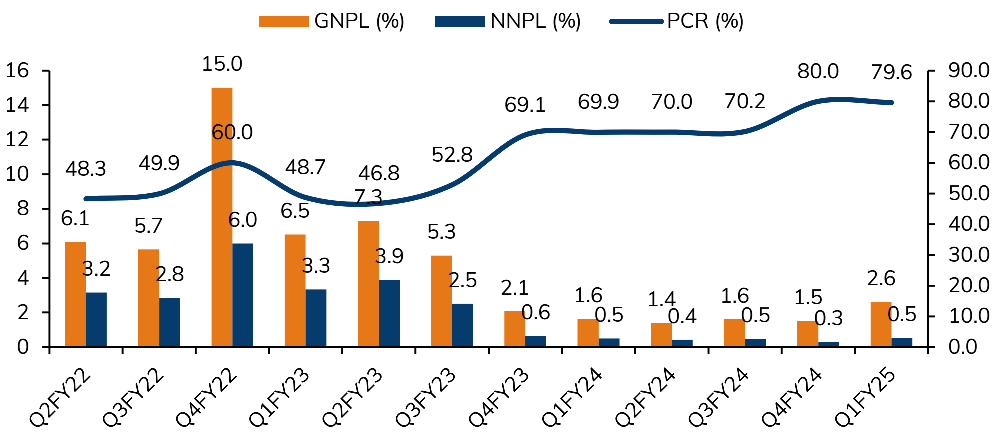
Source: Company data, I-Sec research

Exhibit 8: Borrowers per branch share inching up gradually



Source: Company data, I-Sec research

Exhibit 9: Asset quality deteriorates sharply



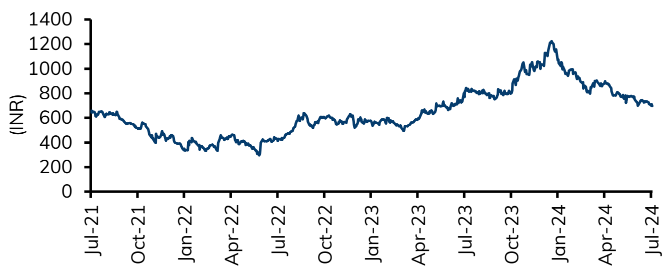
Source: Company data, I-Sec research

Exhibit 10: Shareholding pattern

%	Dec'23	Mar'24	Jun'24
Promoters	59.9	59.8	56.9
Institutional investors	32.5	32.4	31.9
MFs and other	3.6	2.3	1.8
Banks/ FIs	0.4	0.1	0.1
Insurance Cos.	6.9	5.7	4.5
FIIs	21.6	24.3	25.5
Others	7.6	7.8	11.2

Source: Bloomberg, I-Sec research

Exhibit 11: Price chart



Source: Bloomberg, I-Sec research

Financial Summary

Exhibit 12: Profit & Loss

(INR mn, year ending March)

	FY23A	FY24A	FY25E	FY26E
Interest Income	13,287	22,998	29,222	34,788
Interest Expenses	(4,451)	(8,974)	(11,178)	(13,180)
Net Interest Income (NII)	8,836	14,024	18,044	21,608
Other Income	**658**	**1,072**	**1,072**	**1,072**
Total Income (net of interest expenses)	9,494	15,095	19,116	22,680
Employee benefit expenses	**(2,938)**	**(4,509)**	**(5,637)**	**(6,877)**
Depreciation and amortization	(107)	(197)	(120)	(120)
Other operating expenses	(1,269)	(1,496)	(1,795)	(2,154)
Total Operating Expense	(4,314)	(6,203)	(7,552)	(9,151)
Pre Provisioning Profits (PPoP)	5,180	8,893	11,564	13,529
Provisions and write offs	**(4,998)**	**(2,633)**	**(5,317)**	**(3,860)**
Profit before tax (PBT)	**183**	**6,260**	**6,247**	**9,669**
Total tax expenses	(59)	(1,581)	(1,572)	(2,434)
Profit after tax (PAT)	**123**	**4,679**	**4,675**	**7,235**

Source Company data, I-Sec research

Exhibit 13: Balance sheet

(INR mn, year ending March)

	FY23A	FY24A	FY25E	FY26E
Share capital	710	710	710	710
Reserves & surplus	30,283	35,733	40,408	47,643
Shareholders' funds	30,992	36,443	41,118	48,353
Borrowings	60,743	94,240	103,596	130,710
Provisions	2,051	3,070	3,070	3,070
Deferred tax liabilities (net)	40	60	60	60
Other Liabilities	2,051	3,070	3,070	3,070
Total Liabilities and Stakeholder's Equity	**93,826**	**133,820**	**147,844**	**182,193**
Fixed assets	249	300	300	300
Loans	77,598	110,140	129,029	159,679
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	14,193	17,565
Other Assets	1,677	1,500	1,752	2,080
Total Assets	**93,826**	**133,820**	**147,844**	**182,193**

Source Company data, I-Sec research

Exhibit 14: Key ratios

(Year ending March)

	FY23A	FY24A	FY25E	FY26E
AUM and Disbursements (INR mn)				
AUM	**85,110**	**119,730**	**141,790**	**175,471**
Disbursements	81,250	106,880	101,816	132,384
Repayments	61,950	72,260	79,757	98,703
Growth (%):				
Total AUM (%)	29.3	40.7	18.4	23.8
Disbursements (%)	(140.9)	(31.5)	4.7	(30.0)
Repayments (%)	25.2	16.6	10.4	23.8
Total Assets (%)	**32.6**	**42.6**	**10.5**	**23.2**
Net Interest Income (NII) (%)	(4.2)	58.7	28.7	19.8
Non-interest income (%)	281.5	62.9	-	-
Total Income (net of interest expenses) (%)	1.0	59.0	26.6	18.6
Operating Expenses (%)	19.0	43.8	21.8	21.2
Employee Cost (%)	28.7	53.5	25.0	22.0
Non-Employee Cost (%)	1.6	17.9	20.0	20.0
Pre provisioning operating profits (PPoP) (%)	(10.3)	71.7	30.0	17.0
Provisions (%)	4.0	(47.3)	102.0	(27.4)
PBT (%)	(81.2)	3,330.2	(0.2)	54.8
PAT (%)	(82.3)	3,691.6	(0.1)	54.8
EPS (%)	(82.8)	3,690.7	(0.1)	54.8
Yields, interest costs and spreads (%)				
NIM on loan assets (%)	13.3	14.9	15.1	15.0
NIM on IEA (%)	10.2	12.0	12.2	12.4
NIM on AUM (%)	11.7	13.7	13.8	13.6
Yield on loan assets (%)	20.0	24.5	24.4	24.1
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	11.3	11.3
Interest Spreads (%)	11.0	12.9	13.1	12.8
Operating efficiencies				
Non interest income as % of total income	63.4	58.3	59.6	60.3
Cost to income ratio	45.4	41.1	39.5	40.3
Op.costs/avg assets (%)	5.2	5.4	5.4	5.5
Op.costs/avg AUM (%)	5.7	6.1	5.8	5.8
Salaries as % of non-interest costs (%)	68.1	72.7	74.6	75.2
Capital Structure				
Average gearing ratio (x)	2.0	2.6	2.5	2.7
Leverage (x)	3.0	3.5	3.7	3.8
CAR (%)	36.3	32.0	32.7	31.2
Tier 1 CAR (%)	35.3	31.0	31.7	30.2
Tier 2 CAR (%)	1.0	1.0	1.0	1.0
RWA (estimate) - INR mn	79,752	113,741	125,667	154,864
RWA as a % of loan assets	102.8	103.3	97.4	97.0

	FY23A	FY24A	FY25E	FY26E
Asset quality and provisioning				
GNPA (%)	2.1	1.5	2.0	2.0
NNPA (%)	4.3	0.5	0.3	0.4
GNPA (INR mn)	1,606	1,652	2,581	3,194
NNPA (INR mn)	3,311	497	330	645
Coverage ratio (%)	(106.1)	69.9	87.2	79.8
Credit Costs as a % of avg AUM (bps)	662	257	407	243
Credit Costs as a % of avg on book loans (bps)	662	257	407	243
Return ratios				
RoAA (%)	0.1	4.1	3.3	4.4
RoAE (%)	0.4	13.9	12.1	16.2
ROAAUM (%)	0.2	4.6	3.6	4.6
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	65.8	101.9
EPS fully diluted (INR)	1.7	65.9	65.8	101.9
Price to Earnings (x)	403.5	10.6	10.7	6.9
Price to Earnings (fully diluted) (x)	403.5	10.6	10.7	6.9
Book Value (fully diluted)	437	513	579	681
Adjusted book value	402	508	576	674
Price to Book	1.6	1.4	1.2	1.0
Price to Adjusted Book	1.7	1.4	1.2	1.0

Source Company data, I-Sec research

Exhibit 15: Key metrics

(Year ending March)

	FY23A	FY24A	FY25E	FY26E
DuPont Analysis				
Average Assets (INR mn)	82,294	113,823	140,832	165,018
Average Loans (INR mn)	66,391	93,869	119,584	144,354
Average Equity (INR mn)	30,946	33,718	38,780	44,735
Interest earned (%)	16.1	20.2	20.7	21.1
Net gain on fair value changes (%)	-	-	-	-
Interest expended (%)	5.4	7.9	7.9	8.0
Gross Interest Spread (%)	**10.7**	**12.3**	**12.8**	**13.1**
Credit cost (%)	6.1	2.3	3.8	2.3
Net Interest Spread (%)	**4.7**	**10.0**	**9.0**	**10.8**
Operating cost (%)	5.2	5.4	5.4	5.5
Lending spread (%)	**(0.6)**	**4.6**	**3.7**	**5.2**
Non interest income (%)	0.8	0.9	0.8	0.6
Operating Spread (%)	**0.2**	**5.5**	**4.4**	**5.9**
Tax rate (%)	32.4	25.3	25.2	25.2
ROAA (%)	**0.1**	**4.1**	**3.3**	**4.4**
Effective leverage (AA/ AE)	2.7	3.4	3.6	3.7
RoAE (%)	**0.4**	**13.9**	**12.1**	**16.2**

Source Company data, I-Sec research

Source Company data, I-Sec research

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