India

**ADD** *(no change)*

| Consensus ratings*: | Buy 8 | Hold 0 | Sell 0 |
|---|---|---|---|

| | |
|---|---|
| Current price: | Rs790 |
| Target price: | Rs1,000 |
| Previous target: | Rs1,000 |
| Up/downside: | 26.6% |
| InCred Research / Consensus: | 0.3% |
| Reuters: | |
| Bloomberg: | SPANDANA IN |
| Market cap: | US$675m |
| | Rs56,126m |
| Average daily turnover: | US$2.7m |
| | Rs224.6m |
| Current shares o/s: | 0.0m |
| Free float: | 16.0% |

*Source: Bloomberg

### Key changes in this note

- Improving employee productivity, rebuilding employee confidence along with a process-driven approach are a few key focus areas of the company's new management.


*Source: Bloomberg*

| Price performance | 1M | 3M | 12M |
|---|---|---|---|
| Absolute (%) | (4.0) | 13.3 | 48.3 |
| Relative (%) | (4.7) | 10.5 | 27.7 |

| Major shareholders | % held |
|---|---|
| KANGCHENJUNGA | 41.0 |
| PADMAJA GANGIREDDY | 14.5 |
| KEDAARA CAPITAL | 7.0 |

# Spandana Sphoorty Financial

## Rising confidence on growth & asset quality

- Our recent discussions with Mr. Vishal Sharma (COO) & Mr. Deepak Varma (CBO) of Spandana reiterate our belief in a solid turnaround of the company.
- Improving employee productivity, rebuilding employee confidence along with a process-driven approach are a few key focus areas of the new management.
- We remain confident of robust AUM growth led by new customer acquisition & improvement in collection efficiency through superior underwriting practices.

### Shift in collection method from monthly to weekly, date to day-based

The previous management of Spandana Sphoorty Financial (SSFL) had a monthly collection mechanism with a date-based collection schedule from the first to the tenth of each month. Thus, for the first 10 days of the month, a field officer will be least productive. Under its new management, the collection mechanism has shifted from date-based to a day-based, which is the first week of each month and the remaining period will be utilized for sourcing and disbursement. Management also believes in weekly centre meetings due to better client recall. Management has implemented weekly meetings for new centres, but the complete rollout is likely by FY25F.

### Expanding centre size with implementation of five by five-by-five rule

The centre size of SSFL under its old management remained relatively low - ranging from single-digit to mid-teen customers in each centre, which impacted employee productivity. SSFL's new management intends to implement a five by five-by-five rule, whereby each new centre will contain five groups of five members each. Also, each loan officer has a target to attend five such centres each day. This will connect 125 customers a day and 625 customers a week, thereby boosting the overall employee productivity to the next level.

### Collection efficiency may witness a further improvement

SSFL has witnessed a gradual improvement in collections over the quarters, with 1QFY24 net collection efficiency at ~98.1%, which is better than the industry average of ~96%. Management remains confident about a further improvement of ~50-100bp in the coming quarters with diversity in overall AUM, as the company is entering new geographies apart from its superior underwriting practices.

### Outlook & valuation

SSFL is probably the only MFI, which is offering lower loan ticket sizes for its first-cycle customers and is shifting to weekly meetings for such new customers. Though the overhang of stock-selling pressure from the ex-promoter may stay in the near term, with streamlining of processes and lower employee attrition, SSFL is operationally equivalent to most MFI peers. At current valuation, SSFL enjoys an attractive risk-reward ratio. We maintain ADD rating on it with a higher target price of Rs1,000 (~1.6x FY25F ABV) from Rs850 earlier. Slower growth and a spurt in delinquencies remains the key downside risks.


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| Financial Summary | Mar-22A | Mar-23A | Mar-24F | Mar-25F | Mar-26F |
|---|---|---|---|---|---|
| Net Interest Income (Rsm) | 7,964 | 8,196 | 13,365 | 18,735 | 24,137 |
| Total Non-Interest Income (Rsm) | 1,435 | 1,995 | 1,939 | 2,299 | 2,961 |
| Operating Revenue (Rsm) | 9,399 | 10,192 | 15,304 | 21,034 | 27,098 |
| Total Provision Charges (Rsm) | (4,805) | (5,443) | (2,187) | (3,967) | (5,085) |
| Net Profit (Rsm) | 700 | 124 | 5,354 | 7,129 | 9,241 |
| Core EPS (Rs) | 10.14 | 1.75 | 75.51 | 100.55 | 130.33 |
| Core EPS Growth | (55%) | (83%) | 4,220% | 33% | 30% |
| FD Core P/E (x) | 77.96 | 452.12 | 10.47 | 7.86 | 6.06 |
| DPS (Rs) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Dividend Yield | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
| BVPS (Rs) | 446.9 | 447.1 | 529.7 | 637.3 | 774.6 |
| P/BV (x) | 1.77 | 1.77 | 1.49 | 1.24 | 1.02 |
| ROE | 2.4% | 0.4% | 15.5% | 17.2% | 18.5% |
| % Change In Core EPS Estimates | | | | | |
| InCred Research/Consensus EPS (x) | | | | | |

SOURCE: INCRED RESEARCH, COMPANY REPORTS

# Focus on improving employee productivity

Our discussions with Mr. Vishal Sharma (COO) & Mr. Deepak Varma (CBO) of SSFL indicates that one of the key operational challenges that the management faced was the existing scheduled centre visits, which were the least productive and a key hurdle for growth.

## Changing the collection mechanism for old centres from date-based to day-based

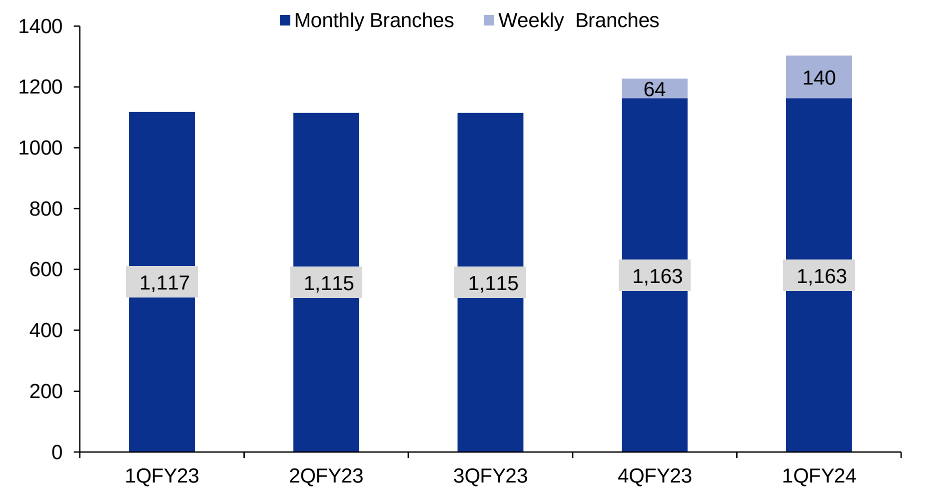
SSFL's previous management had monthly collection with a date-based collection mechanism whereby from the first day of each month to the tenth day of each month, a field officer will have the task to remain engaged in collections from each loan centre irrespective of the day (weekend, etc.) or holidays (including national or festive holidays). Thus, for the first 10 days of the month, there would be minimum disbursement and the field officer used to be much stressed and least productive.

Under new management's process, the collection mechanism has shifted from date-based to a day-based whereby the collections will happen in the first week of each month, excluding weekends, with each day allocated to a particular centre. Weekends will again be utilized for new customer sourcing and disbursement. This will enhance overall employee productivity, with an equal focus on collection as well as disbursement.

## Shifting from monthly to weekly collections for new centres

SSFL's new management remains firm over its preference for weekly centre meetings against the previous norm of monthly meetings. Though the issue remains debatable, SSFL's management believes that weekly centre meetings have an advantage of better client recall, which ensures superior recoveries at the time of adversities. Also, the overall customer discipline improves with more frequent meetings. Management has implemented weekly meetings for all new centres whereas old centres are still functioning with meetings at monthly intervals.

**Figure 1: With incremental branches adapting to weekly meetings, one-third of SSFL's total branches are already under the weekly norm**




SOURCE: INCRED RESEARCH, COMPANY REPORTS

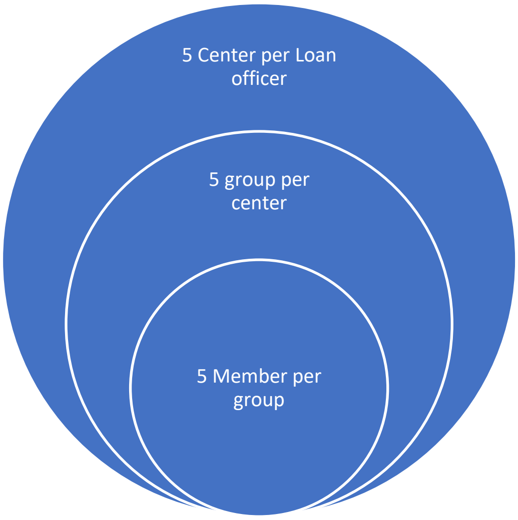
## Gradual conversion to weekly collections probably by FY25F

SSFL's new management remains firm over gradually converting 100% of centre visits to the weekly mode instead of the monthly mode, but the same would be a gradual affair and would be implemented after gaining complete customer confidence and sufficient employee communication. Management expects to achieve the same by the end of FY25F.

## Expanding centre size with implementation of five by five-by-five rule for relationship managers

The centre size of SSFL under old management remained relatively low, ranging from single-digit to mid-teen members/customers in each centre, which not only impacted employee productivity but also kept overall operating expenses higher and operating leverage low. New management intends to implement a five by five-by-five rule for all employees, whereby each new centre will contain five groups of five members each, thus increasing the total customer count to 25 for each centre. Also, each loan officer must attend five such centres each day. Thus, each loan officer must meet at least 125 customers each day, which will boost overall employee productivity of the company in the coming years.

**Figure 2: SSFL aspires for efficiency of 125 customer interactions per day for each loan officer**



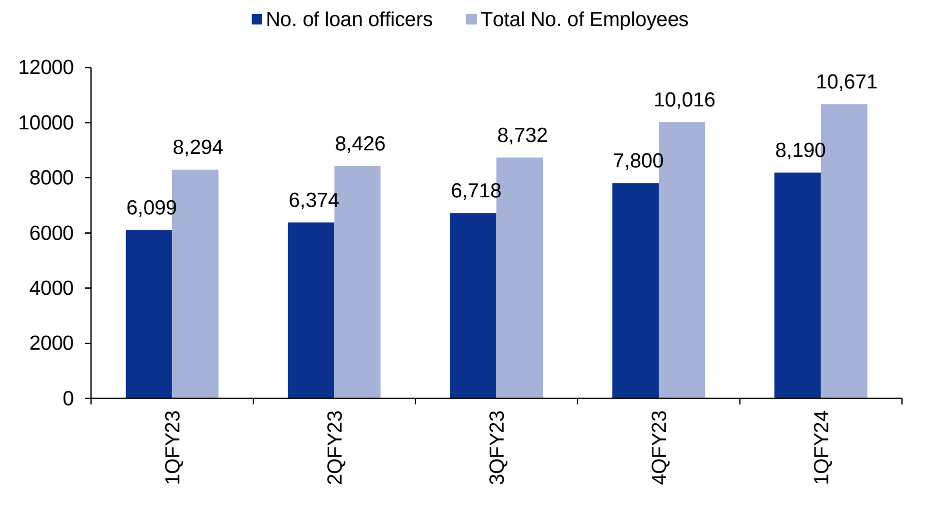

SOURCE: INCRED RESEARCH,

# Focus on improving employee confidence

The biggest challenge faced by most companies which have witnessed a change in the top management is elevated employee attrition due to insecurity and uncertainty among existing employees. SSFL's management also had similar issues last year, but the company is witnessing a gradual easing in the overall attrition rate. To improve the employees' confidence, management has undertaken various steps including, but not restricted to the following:

- **Introduction of human resource** as a key function within the organization. This allows the employees to resolve their disputes and address their queries in a systematic manner.
- **Regular monthly payment of salaries** has been introduced by the new management, as there had been irregularities in the payment structure earlier.
- **Three days' leave each month has been introduced**, which helps the employees, especially at the field level, to manage their work-life balance.
- **Insurance coverage for employees as well as their families,** which safeguards employee interest and enhances productivity.
- **Clarity on payment structure and performance-based incentives,** which enhances employee productivity.
- **Prioritizing existing employees for any promotion/vacancy/elevation** within the organization, instead of bringing in new employees from outside.
- **Introduction of hierarchy** within the organization. which provides clarity about authority-responsibility among the employees.
- **Clear communication from top management about vision and achievements of the company** through monthly townhall meeting, etc.

**Figure 3: Gradual rise in the employee strength of SSFL**




SOURCE: INCRED RESEARCH, COMPANY REPORTS

# Focus on enhancing customer experience

Along with rebuilding employee confidence in the organization and employees, SSFL's new management is equally working towards enhancing customer experience through better and faster execution, frequent touch points and superior focus on its unique customer base.

## Centre attendance normalizes; new centres perform better

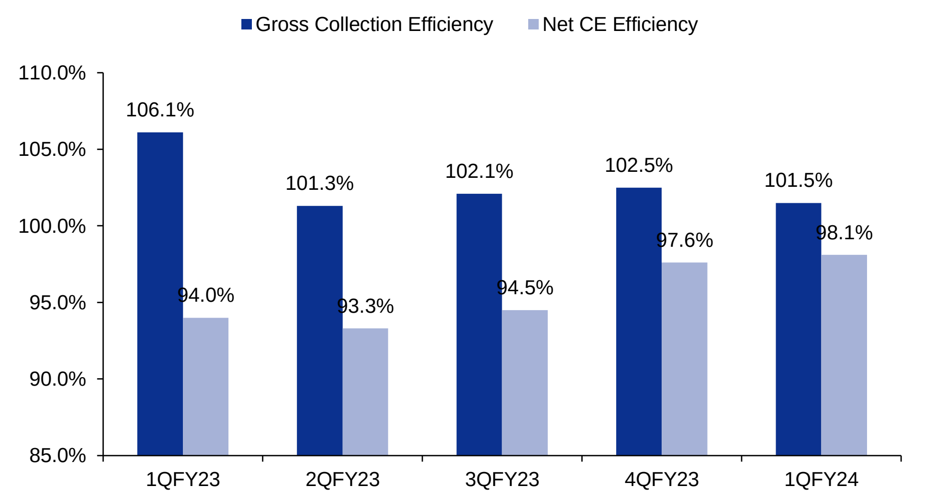
Post Covid-19 pandemic-led lockdowns, all microfinance companies have been facing low attendance during their centre meetings. SSFL witnessed its centre meeting attendance as low as ~30% during the pandemic, but management remained firm over improving this trend as the physical touch point is necessary to build customer confidence as well as to avoid future risk of default.

**Management has highlighted that SSFL is currently operating at an average ~60-65% attendance, which is improving on a consistent basis. The new centres (roughly 200 branches) with weekly group meetings are functioning at 82% attendance level whereas the attendance among unique customers of SSFL also remains healthy at ~77%.**

## Collection efficiency may witness a further improvement

After the change in management, SSFL reported lower collection efficiency due to managerial crisis, but this trend witnessed a gradual improvement over the quarters, with 1QFY24 net collection efficiency at ~98.1%, better than the industry average of ~96%.

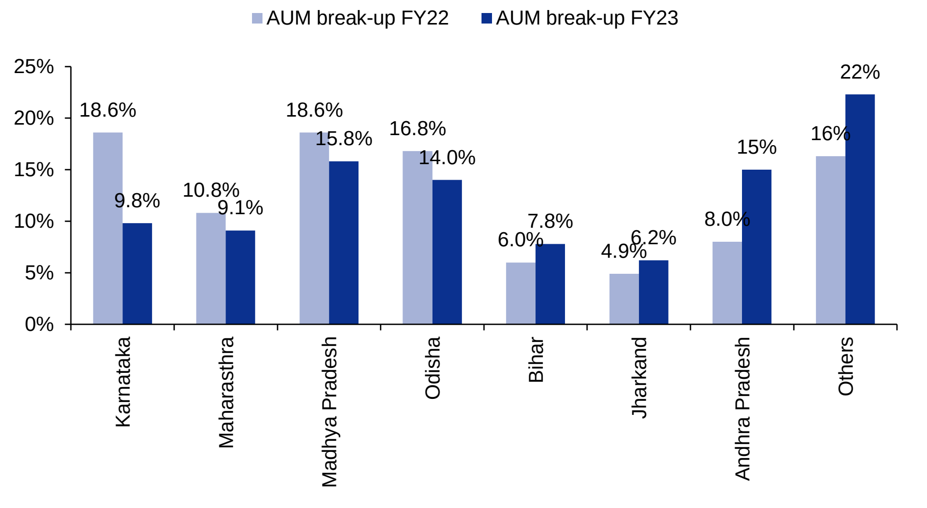
Figure 4: Net collection efficiency likely to further improve structurally




SOURCE: INCRED RESEARCH, COMPANY REPORTS

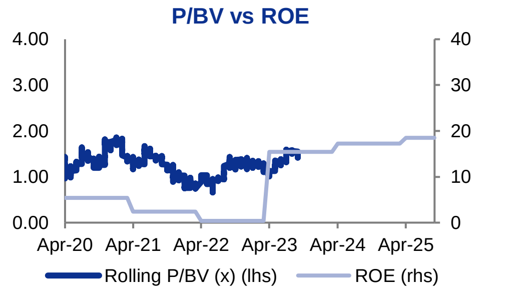
Management remains confident about a further improvement of ~50-100bp in the coming quarters, with diversity in overall assets under management or AUM as the company is entering new geographies, apart from its superior underwriting practices. Management is firm on avoiding the concentration risk and have maximum diversity in its loan book.

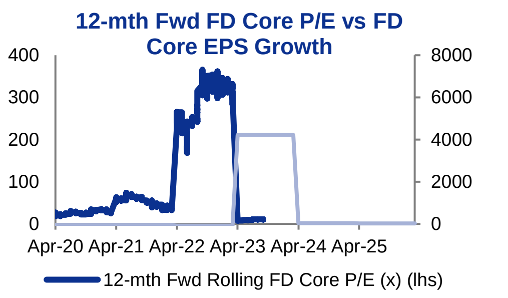
**Figure 5: Gradual reduction in concentration risk is clearly visible on a yoy basis**




SOURCE: INCRED RESEARCH, COMPANY REPORTS

## BY THE NUMBERS




### Profit & Loss

| (Rsm) | Mar-22A | Mar-23A | Mar-24F | Mar-25F | Mar-26F |
|---|---|---|---|---|---|
| Net Interest Income | 7,964 | 8,196 | 13,365 | 18,735 | 24,137 |
| **Total Non-Interest Income** | **1,435** | **1,995** | **1,939** | **2,299** | **2,961** |
| Operating Revenue | 9,399 | 10,192 | 15,304 | 21,034 | 27,098 |
| **Total Non-Interest Expenses** | **(3,624)** | **(4,570)** | **(5,931)** | **(7,498)** | **(9,609)** |
| Pre-provision Operating Profit | 5,775 | 5,621 | 9,374 | 13,536 | 17,489 |
| **Total Provision Charges** | **(4,805)** | **(5,443)** | **(2,187)** | **(3,967)** | **(5,085)** |
| Operating Profit After Provisions | 970 | 178 | 7,186 | 9,569 | 12,403 |
| **Pretax Income/(Loss) from Assoc.** | | | | | |
| Operating EBIT (incl Associates) | 970 | 178 | 7,186 | 9,569 | 12,403 |
| **Non-Operating Income/(Expense)** | | | | | |
| Profit Before Tax (pre-EI) | 970 | 178 | 7,186 | 9,569 | 12,403 |
| **Exceptional Items** | | | | | |
| Pre-tax Profit | 970 | 178 | 7,186 | 9,569 | 12,403 |
| Taxation | (270) | (54) | (1,833) | (2,440) | (3,163) |
| Consolidation Adjustments & Others | | | | | |
| **Exceptional Income - post-tax** | | | | | |
| Profit After Tax | 700 | 124 | 5,354 | 7,129 | 9,241 |
| Minority Interests | | | | | |
| Pref. & Special Div | | | | | |
| **FX And Other Adj.** | | | | | |
| Net Profit | 700 | 124 | 5,354 | 7,129 | 9,241 |
| Recurring Net Profit | | | | | |

### Balance Sheet Employment

| (Rsm) | Mar-22A | Mar-23A | Mar-24F | Mar-25F | Mar-26F |
|---|---|---|---|---|---|
| Gross Loans/Cust Deposits | | | | | |
| Avg Loans/Avg Deposits | | | | | |
| Avg Liquid Assets/Avg Assets | 96.0% | 94.1% | 94.2% | 95.1% | 95.7% |
| **Avg Liquid Assets/Avg IEAs** | **120.7%** | **116.6%** | **105.5%** | **100.7%** | **102.4%** |
| Net Cust Loans/Assets | | | | | |
| **Net Cust Loans/Broad Deposits** | | | | | |
| Equity & Provns/Gross Cust Loans | | | | | |
| Asset Risk Weighting | | | | | |
| **Provision Charge/Avg Cust Loans** | | | | | |
| **Provision Charge/Avg Assets** | | | | | |
| Total Write Offs/Average Assets | | | | | |

SOURCE: INCRED RESEARCH, COMPANY REPORTS

# BY THE NUMBERS…cont'd

**Balance Sheet**

| (Rsm) | Mar-22A | Mar-23A | Mar-24F | Mar-25F | Mar-26F |
|---|---|---|---|---|---|
| **Total Gross Loans** | **55,184** | **77,598** | **121,241** | **162,111** | **201,127** |
| Liquid Assets & Invst. (Current) | | | | | |
| Other Int. Earning Assets | | | | | |
| Total Gross Int. Earning Assets | 55,184 | 77,598 | 121,241 | 162,111 | 201,127 |
| **Total Provisions/Loan Loss Reserve** | | | | | |
| Total Net Interest Earning Assets | 55,184 | 77,598 | 121,241 | 162,111 | 201,127 |
| Intangible Assets | | | | | |
| **Other Non-Interest Earning Assets** | **3,219** | **3,994** | **4,194** | **4,403** | **4,624** |
| **Total Non-Interest Earning Assets** | **3,531** | **4,290** | **4,548** | **4,829** | **5,134** |
| Cash And Marketable Securities | 12,022 | 10,045 | 976 | 955 | 7,899 |
| **Long-term Investments** | **24** | **1,894** | **2,272** | **2,954** | **3,840** |
| Total Assets | 70,762 | 93,826 | 129,038 | 170,849 | 218,001 |
| Customer Interest-Bearing Liabilities | | | | | |
| Bank Deposits | | | | | |
| Interest Bearing Liabilities: Others | 37,519 | 60,743 | 88,409 | 121,878 | 158,442 |
| Total Interest-Bearing Liabilities | 37,519 | 60,743 | 88,409 | 121,878 | 158,442 |
| Banks Liabilities Under Acceptances | | | | | |
| Total Non-Interest Bearing Liabilities | 2,344 | 1,445 | 3,074 | 3,786 | 4,635 |
| Total Liabilities | 39,863 | 62,187 | 91,483 | 125,664 | 163,076 |
| Shareholders Equity | 30,876 | 31,699 | 37,553 | 45,182 | 54,922 |
| **Minority Interests** | **24** | **2** | **2** | **2** | **2** |
| Total Equity | 30,899 | 31,701 | 37,555 | 45,184 | 54,925 |

**Key Ratios**

| | Mar-22A | Mar-23A | Mar-24F | Mar-25F | Mar-26F |
|---|---|---|---|---|---|
| Total Income Growth | (15.2%) | 2.9% | 63.1% | 40.2% | 28.8% |
| Operating Profit Growth | (31.7%) | (2.7%) | 66.7% | 44.4% | 29.2% |
| Pretax Profit Growth | (52%) | (82%) | 3,931% | 33% | 30% |
| Net Interest To Total Income | 84.7% | 80.4% | 87.3% | 89.1% | 89.1% |
| Cost Of Funds | 11.86% | 9.32% | 11.75% | 11.00% | 10.50% |
| Return On Interest Earning Assets | 21.5% | 19.2% | 22.3% | 21.4% | 21.4% |
| Net Interest Spread | 9.60% | 9.92% | 10.51% | 10.39% | 10.89% |
| Net Interest Margin (Avg Deposits) | | | | | |
| Net Interest Margin (Avg RWA) | | | | | |
| Provisions to Pre Prov. Operating Profit | 83% | 97% | 23% | 29% | 29% |
| Interest Return On Average Assets | 10.18% | 9.96% | 11.99% | 12.49% | 12.41% |
| Effective Tax Rate | 27.8% | 30.5% | 25.5% | 25.5% | 25.5% |
| Net Dividend Payout Ratio | | | | | |
| Return On Average Assets | 0.89% | 0.15% | 4.80% | 4.75% | 4.75% |

SOURCE: INCRED RESEARCH, COMPANY REPORTS

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|---|---|---|
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| actual/beneficial ownership of 1% or more in securities of the subject company at the end of the month immediately preceding the date of publication of the research report or date of the public appearance; | NO | NO |
| any other material conflict of interest at the time of publication of the research report or at the time of public appearance | NO | NO |
| received any compensation from the subject company in the past twelve months for investment banking or merchant banking or brokerage services or investment advisory or depository or distribution from the subject company in the last twelve months for products/services other than investment banking or merchant banking or broker- age services or investment advisory or depository or distribution from the subject company in the last twelve months | NO | NO |
| managed or co-managed public offering of securities for the subject company in the last twelve months | NO | NO |
| received any compensation or other benefits from the subject company or third party in connection with the research report | NO | NO |
| served as an officer, director or employee of the subject company | NO | NO |
| been engaged in market making activity for the subject company | NO | NO |

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