Spandana Sphoorty
(India's Leading Microfinance Company)
Transforming Lives Through Micro Credit

SPANDANA

SPANDANA SPHOORTY FINANCIAL LIMITED

What is Microfinance?

Microfinance refers to mostly unsecured loans made only to women in low income groups, averaging between Rs.30,000-40,000 (US$360-$480). It was pioneered by Nobel laureate Muhammad Yunus in neighboring Bangladesh, fueled by the belief that credit is a fundamental human right.

With 66 million borrowers, India is today the largest microfinance market in the world. Indian microfinance (MFIs) firms have added more products, including loans against property, secured business loans to small and medium enterprises, vehicle financing and loans against gold. MFIs in India operate as per the joint liability group (JLG) model where women to take loans by forming groups of five women each, where group members guarantee each other's loans.

The Reserve Bank of India classifies all collateral-free loans disbursed to households having annual income up to Rs.300,000 ($3,600), regardless of end-use, as microfinance loans. With Rs.3.5 trillion ($40 billion) of loans outstanding, India's microfinance market is about as large as the country's credit card market. The borrowers of an MFI are often microentrepreneurs in need of economic support to launch or scale their businesses.

Microfinance has emerged as an important tool to foster financial inclusion. It has enabled low-income households to rise out of poverty and helped women to become asset owners and decision makers. Borrowers often utilize their lines of credit not only for business activities, but also for education and healthcare requirements. Therefore, microfinance serves a safety net for those at the bottom of India's economic pyramid.

The Indian microfinance sector has demonstrated enormous resilience and adaptability over the years, having grown from strength-to-strength despite political challenges and macro events like demonetization and pandemic induced lockdowns. The gross loan portfolio of India's MFIs grown at a CAGR of 29%, from Rs.60 billion ($700 million) in FY08 to Rs.3.5 trillion ($40 billion) in FY23.

The Key Players

The MFI industry is currently comprised of more than 150 players spread across four broad segments: Banks (40% market share), NBFC-MFIs (35%), Small Finance Banks (SFBs, 17%), and NBFCs (7%). From FY15 to FY20, banks gained market share over NBFC-MFIs due to organic and inorganic growth as well as conversion of NBFC-MFIs into banks. Post-COVID, there has been a resurgence of NBFC-MFIs (market share has risen by 400 bps) as incumbent banks have adopted a calibrated growth approach due to frequent disruptions, a possible nudge from the regulator to limit exposure to unsecured loans, and new MFI lending regulations issued by the RBI in 2022 which provide a level playing field for NBFC-MFIs.

Some Key MFI Players			
Banks	**NBFC-MFIs**	**SFBs**	**NBFCs**
Bandhan	CreditAccess Grameen	Equitas	L&T Finance
IndusInd	Fusion	Ujjivan	Piramal Enterprises
Kotak Mahindra	Spandana Sphoorty	Utkarsh	MAS Financial

Spandana Sphoorty (SPANDANA IN)
A Nepean Capital investee company
Spandana Sphoorty is a leading pan-India NBFC-MFI headquartered in Hyderabad with AUM of Rs.88.5 billion ($1.1 billion) and a clientele of 2.4 million borrowers spread across 1,300 branches. Its market cap is Rs.5,590 Crores ($670 Mn) (+48% in the past 12 months) and is backed by Kedaara Capital, one of India's largest homegrown private equity funds.

Spandana has been undergoing a transformation which began after its founder and CEO resigned and was replaced by a professional team under the leadership of Shalabh Saxena in November 2021. In his previous role, Shalabh and his team at Bharat Financial Ltd grew that company into India's largest MFI; its now owned by IndusInd Bank. He is the only CEO in India's listed MFI space to have ever scaled and managed a Rs.250 billion ($3 billion) book. As of 1Q FY24 results, YoY Shalabh improved Net Interest Margins (NIMs) by 434 bps to 14.2%, ROA to 5.9% (vs.-14.2%), ROE to 15.2% (vs.-29.8%) and reduced cost to income ratio from 68% to 36%.

Spandana is a rural-focused (86% of its portfolio) MFI offering income generation micro loans to women under the JLG model with an average outstanding loan per borrower of Rs.37,000 ($445). Four states account for 55% of its loan book, namely Madhya Pradesh (16% of the portfolio), Andhra Pradesh (15%), Odisha (14%), and Karnataka (10%).

Spandana Sphoorty Site Visit
Starting at 7:30 AM on the 14th of this month, we visited Spandana Sphoorty's branch in and centers near Ujjain in order to get a feel for the company's on-the-ground operations. Ujjain is a tier 2 town located 55 kilometers from Indore, the financial capital of Madhya Pradesh, the country's second largest state located in Central India.

We began our journey by meeting the head of Spandana's operations in the state. He oversees a Rs.13.5 billion ($162 million) portfolio in a Rs.200 billion ($2.4 billion) market. With a market share of 7%, Spandana is the largest NBFC-MFI in the region. The company's new management has set up strong systems and processes and created separate verticals and divisional heads for IT, HR, assets, liabilities, finance, and risk. The new management now ensures timely payment of salaries. They have articulated a clear roadmap for their *Vision 2025* plan to their regional heads. The entire team is aligned to achieve the company's stated objective to grow its book 2.5x through customer acquisition and branch expansion in seven focus states. The Spandana employees we met were highly motivated to realize this vision.

The MFI has adopted strict measures in order to mitigate risk. In conversation, an employee revealed that the company forbids dealing with brokers. Spandana mandates that each loan officer must build a deep relationship (by way of KYC, regular interactions, etc.) with their customers and ensure that there are no middlemen. Despite some peers diversifying away from the traditional JLG model, Spandana's management maintains its deep belief in that model. Its team on the ground reiterated the company's commitment to continue solidifying group structures (with only one family member in each JLG), which will build a sense of community among the customers and ease repayment obligations during financially challenging times. Almost all of Spandana's customers are homeowners (their homes are geotagged by the company), which mitigates the risk of them permanently migrating away from their centers.

After concluding our first meeting, we visited Spandana's center located in Sanwer, a village 26 km from Ujjain. Thereafter we attended center meetings in Juna Somwariya (district of Ujjain), and Mangrola (10 km from Ujjain). We were accompanied by the branch manager and quality manager of Spandana's Ujjain branch, as well as loan officers from each of the three centers that we visited.

Exhibit 1: Sanwer Center Meeting

Two groups of five women comprise the membership of the Sanwer center, which is about 10 years old. They began their meeting with by narrating a pledge in unison to pay all EMIs to Spandana on time. This was followed by a pledge by the loan officer to be true to Spandana and its customers. Most of the center's customers have been with Spandana since its inception and their loan sizes have gradually increased (at every 18–24-month maturity) from Rs.10,000 ($120) about 10 years ago to Rs.60,000-80,000 ($720-970) today.

Around 40% of the center's customers have also obtained a loan from other MFI lenders like Jana SFB and State Bank of India. Spandana is the largest lender to these customers, including for those who have obtained a second loan. The members of this group perform activities such as dairy farming, livestock farming (goats and buffalo), recycling of gunnysacks and construction work. Half the loans are taken out for business (purchase of assets like goats, buffaloes, machinery, construction materials). The balance is to meet household cash flow requirements (husband's business, healthcare, etc.). The women earn Rs.15,000-20,000 ($180-240) per month, a sum that is greater than India's rural GDP per capita (which we estimate at $1,500 per year or $125 per month). Most live with their adult sons and daughters-in-laws. Household income for larger families can be as high as Rs.50,000-60,000 ($600-700) per month, where equal monthly installments (EMIs) range from Rs.2,500-4,500 ($30-55). The women reported that EMI serviceability did not pose a challenge for them as they were able to generate steady and sufficient cash flows from their businesses.

Spandana disburses loans directly into the bank accounts of its customers. Before loan disbursal, the company conducts one-day training sessions with its customers during which it explains all details pertaining to EMI, income, and the importance of timely loan servicing.

Our next stop was the center meeting being held at Juna Somwariya (a district of Ujjain).

Exhibit 2: Juna Somwariya Center Meeting

Two groups of five women comprise the membership of the Juna Somwariya center, which is 10-12 years old. Once again, the center meeting began with pledges delivered by its loan officer and members. All of the center's members have been with Spandana since the center opened. Most have increased the value of their borrowings from Rs.10,000 ($120) about 10 years ago to Rs.60,000-80,000 ($720-960) today. Around 30% of the members have loans from other MFIs (up to $500) in the region including Satin Creditcare, Swadhan, and Share Microfin. Spandana is the largest lender for the oldest members of the group.

Juna Somwariya is a predominantly Muslim district. Three to four women in the group are engaged in the manufacture of skull caps, which earns them about Rs.400-500 ($4-5) per day. Their husbands run a gas stove repair service. Cumulative family incomes are in the range of Rs.30,000-40,000 ($360-480) per month. Two women in the group had taken out loans to purchase cows, but any milk they produce is used for their own consumption and is not for sale.

An important takeaway from the meeting was that all members were aware of the importance of making timely EMI payments and the impact that this can have on creditworthiness and their ability to take out further loans in the future. These members reported that they were totally unaware of the significance of credit scores just six years ago.

Our next stop was the center meeting held at Mangrola.

Exhibit 3: Mangrola Center Meeting

The Mangrola center's membership is composed of ten women divided into two groups, eight of which have been Spandana customers for a decade. The other two are first time Spandana customers and had been disbursed loans of about Rs.30,000 ($360). They will be able to take larger loans in the future after they demonstrate strong repayment behavior. Other members of the group have taken loans of Rs.60,000-80,000 ($720-960). One of the center's longest standing members took her first loan from the company 10 years ago to purchase one goat and today she proudly owns a herd of 30-40 goats. She reported that each goat can be sold for Rs.4,000-10,000 ($50-$120). After excitedly showing us her goat shed, she revealed to us that the total value of her herd was about Rs.250,000 ($3,000). She is an inspiration to the other members of her center who have also begun goat farming businesses (presently owning one to five goats each) with loans from Spandana and other microlenders.

These women also work as contract laborers at nearby farms, earning Rs.15,000-Rs.20,000 ($180-240) per month during the sowing and harvesting seasons. Their husbands work as masons and construction workers in larger cities like Indore, earning about the same amount. The members of this center were also aware of the importance of making timely EMI payments. We learned that no member of the Mangrola center has ever delayed an EMI payment, and that for this achievement the center was presented with an award by the company.

After lunch we proceeded onwards to our last stop, Spandana's Ujjain branch.

Exhibit 4: Ujjain Branch

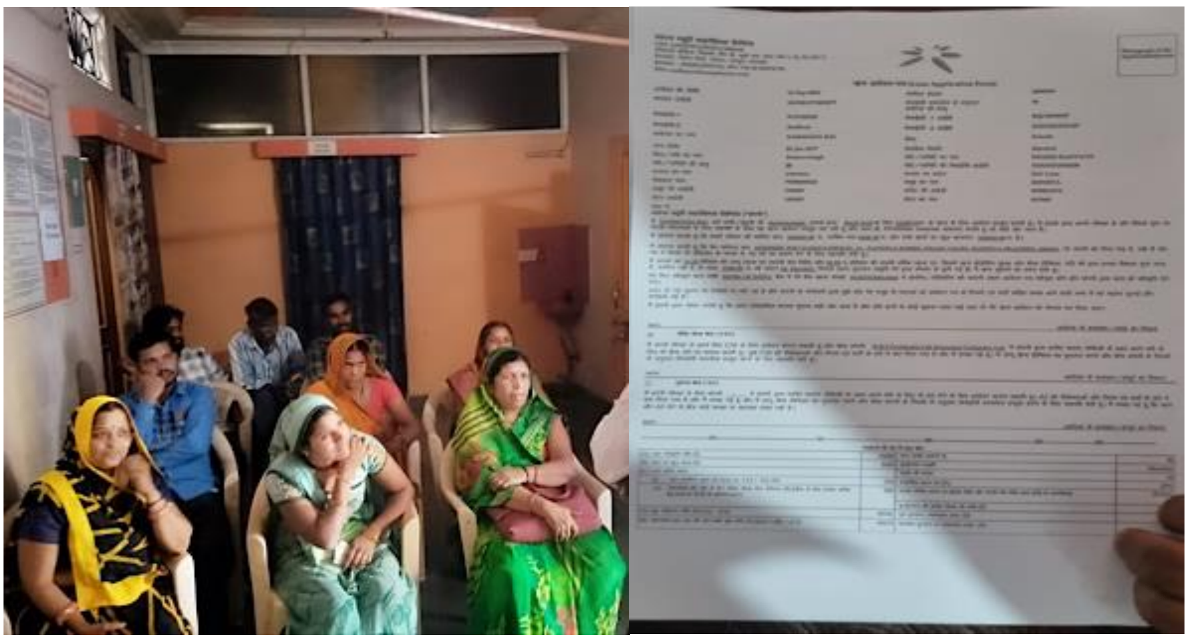
Like most MFI branches, the Ujjain branch is located in a residential area. Most MFI branches serve not only as centers for documentation and loan disbursals, but also double as a home for the loan officers that work within them. This branch has a strength of 12: one branch manager, one assistant vice president (AVP), eight loan officers, and two temporary loan officers (TLO). TLOs undergo 27 days of training before they begin field work. Spandana has grown manpower at its branches by 50% YoY as operations have stabilized and growth has picked up.

The team meets twice a day, once early in the morning and once in the afternoon. At both meetings, team members update the branch manager and AVP about their recent field activities. We took part in an afternoon meeting during which they discussed recent wins and challenges. The branch's AUM is about Rs.86.9 million ($1 million). Spandana issues monthly disbursement targets to its branches. This branch's monthly target was Rs.12 million ($145,000), of which they had achieved 45% disbursal as on September 14, 2023. The branch team was extremely confident that they would achieve their target, having exceeded their August target by 10%. The targets issued this year have been 33% higher than the monthly targets that were issued during FY22.

Spandana has revised its incentive structure for branch staff, who now receive sourcing commissions after EMIs are collected. The new incentive structure has led to higher payouts as credit behavior is near perfect. The Ujjain branch has achieved 100% collections year-to-date. Branch staff reported that they were very happy with the new incentive structure offered by the company and that they looked forward to succeeding with and performing well for Spandana.

After attending the team meeting, we observed know your customer (KYC) documentation and loan sanctions processes being undertaken for a couple customers at the branch.

Exhibit 5: Loan Disbursal at Ujjain



Once customers receive preliminary oral approval for loans (30% rejection rate), they come to their local branch accompanied by their spouses to submit mandatory documents like their Aadhar cards and voter IDs. At this time, they fill out and sign a loan application form that includes the following details:

- Interest rate
- Fee towards life insurance (borrower takes a mandatory life insurance policy that equals the size of the loan)
- EMI schedule
- Name of the borrower and name of their spouse
- Residential address and date of birth
- Name of their JLG, Loan amount and tenure

After the loan documentation is submitted, the loan amount is disbursed directly into the bank account of the borrower. About 10% of loan applications are rejected (owing to submission of missing/inadequate documents or poor credit scores). We interacted with a customer who was taking out a loan to purchase a pedal-operated plate making machine for Rs.45,000 ($542), and another customer who was planning to purchase a buffalo. Both expect to generate Rs.500 ($6) per day from their ventures.

Table 1: Key Financial Metrics - India's Listed NBFC-MFI Companies (figures in Rs. Bn as of the 1Q FY24)

Company	Key States	AUM (Jun'23)	NII (Qtr)	PPoP (Qtr)	ROE	P/B (FY25)
CreditAccess Grameen	Karnataka, Maharashtra, Tamil Nadu	218	7.63	5.44	26.4%	2.5x
Fusion Microfinance	Uttar Pradesh, Bihar, Madhya Pradesh	97	2.94	2.35	20.2%	1.7x
Spandana Sphoorty	Madhya Pradesh, Andhra Pradesh, Orissa	89	3.28	1.89	15.2%	1.3x
Satin Creditcare	Uttar Pradesh, Bihar, West Bengal	84	2.09	1.30	17.5%	0.9x

CONCLUSION:
We returned from the site visit convinced that Spandana Sphoorty has adopted some of the best practices in the MFI industry that will help it gain market share. We chose Spandana from the above NBFC-MFI companies because of:

1. The new management's ability to build a resilient and sizable portfolio gives us confidence that it will be able to grow the company's book 2.5x over the next couple of years.
2. Substantial reduction in stress-pool with gross NPAs falling substantially from 18.7% in FY22 to 1.6% in Q1FY24.
3. Expansion strategy of growing customer count in existing geographies and expanding branch count in new and underpenetrated geographies.
4. The new management has inherited a fairly unstructured organization with many levers for cost rationalization.
5. The company could potentially become a takeover target in the future given that it is owned by a large private equity fund.
6. There are clear tailwinds for the sector given the revised MFI rules that have created a level playing field, improved margins in a benign credit cost environment, and given and extraordinary boost to profits and ROEs.