Gold Finance NBFCs

Turning a corner

October 2019

Shubhranshu Mishra

research@bobcaps.in

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

NBFC

03 October 2019

Gold Finance NBFCs: Turning a corner

Gold loans being self-liquidating and well-collateralised, India's top-2 gold finance NBFCs, MUTH and MGFL, have found favour with debt/liquid funds post the IL&FS crisis. We expect better operating leverage and benign credit costs to underpin steady-state ROA of 5-6% from their gold businesses, alongside low levered (~4x) growth over FY20-FY22. Diversification into allied credit products would augment profits in the near term. MUTH and MGFL look well on track to maintain market leadership; we initiate coverage on both companies with BUY.

Shubhranshu Mishra
research@bobcaps.in

The resurgence of gold finance: Post the regulatory purge in FY12-FY14 (due to LTV restrictions) and consolidation over FY15-FY18 (14% growth), India's organised gold loan industry grew 10% YoY to Rs 2.8tn in FY19, as LTV caps were harmonised between banks and NBFCs, gold prices stayed flattish, and NBFCs clawed back market share ceded to banks. We estimate a 10.2% CAGR in the organised market to Rs 3.6tn over FY19-FY22 (~25% NBFC share). Muthoot Finance (MUTH)/Manappuram Finance (MGFL) are well placed to grow in line with the market and maintain 50%/20% share.

Competitive headwinds easing: South India-based private banks which have >60% of their gold portfolio as loans against pledged ornaments are primary competitors to specialised gold finance NBFCs. We expect these players to see subdued growth in gold loans over FY19-FY22 due to (a) RBI's stricter end-use monitoring and (b) sectoral cap on gold loan exposure.

MUTH to stay firmly in the lead: MUTH's focus on customer retention, tighter collections and cost control has led to ~3x growth in PAT (FY15-FY19) to Rs 20bn in FY19. Diversifying the borrowing mix by replacing gold bonds with NCDs and CPs has fuelled a resurgence in spreads to ~11.5% in FY19. We expect these steps to support a 13% gold loan CAGR and stable ROA of ~6% with low leverage of ~3.5x over FY20-FY22. Initiate with BUY; Sep'20 SOTP-based TP of Rs 825.

MGFL reaping benefits of portfolio rejig: MGFL has transited to 3-9-month short-term loans, linked LTV to tenor, driven regular collections, and expanded beyond South India, thereby tripling PAT growth (FY15-FY19) to ~Rs 8bn in FY19. Borrowings and business mix diversification began from FY15; microfinance now forms 14% of consolidated profit. We expect the gold loan book to deliver ~5% ROA and stay low levered at ~4x during FY20-FY22. Initiate with BUY; Sep'20 SOTP-based TP Rs 165.

KEY RECOMMENDATIONS

Ticker	Price	Target	Rating
MUTH IN	672	825	BUY
MGFL IN	134	165	BUY

Price & Target in Rupees

Contents

Muthoot vs. Manappuram 3

Comparative analysis 3

Initiate with BUY on MUTH and MGFL 8

Gold finance landscape 11

Market dominated by unorganised players 11

Top 3 NBFCs on a strong wicket 11

Industry evolution: A tumultuous ride 15

Phase 1: Rapid growth during FY08-FY12 15

Phase 2: Regulatory purge of FY12-FY14 15

Phase 3: Diversification and consolidation during FY15-FY18 16

FY19 a recovery year; outlook positive 17

Competitive landscape has eased 17

MUTH, MGFL well placed to maintain market share 17

Annexures 19

Annexure A: Why informal gold financing is preferred 19

Annexure B: Gold loan disbursal and appraisal process 20

Companies

Muthoot Finance 22

Manappuram Finance 53

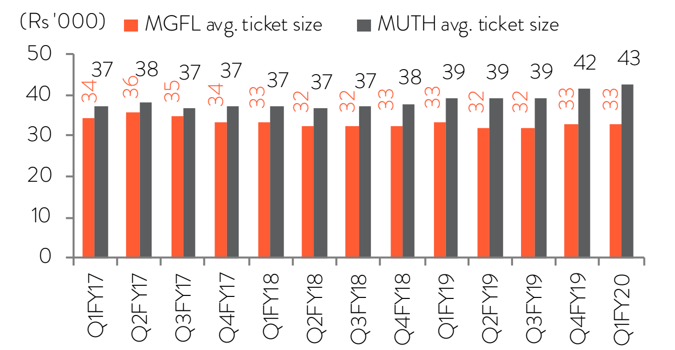
Muthoot vs. Manappuram

MUTH is our top pick among gold finance NBFCs followed by MGFL. Our order of preference is supported by MUTH's consistently superior business metrics vis-à-vis MGFL, as outlined below:

- **30% more branches**
- **16% higher average ticket size** with ~30% of AUM >Rs 1mn
- **70% average LTV** vs. 67% for MGFL backed by 15% more pledged collateral
- **60% more loan accounts per branch** processed
- **100% more AUM** per branch
- **Early-mover advantage** in North and West India

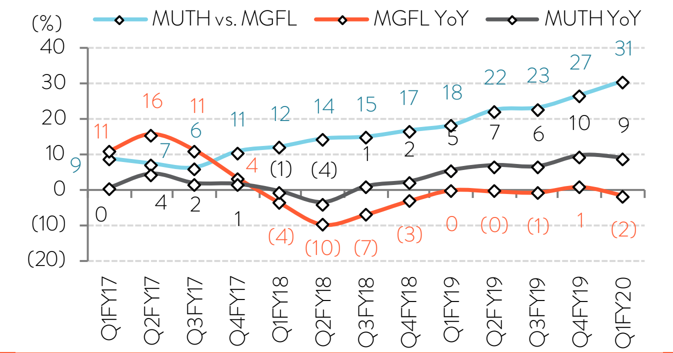
Comparative analysis

FIG 1 – MUTH HAS A HIGHER AVERAGE TICKET SIZE THAN MGFL…



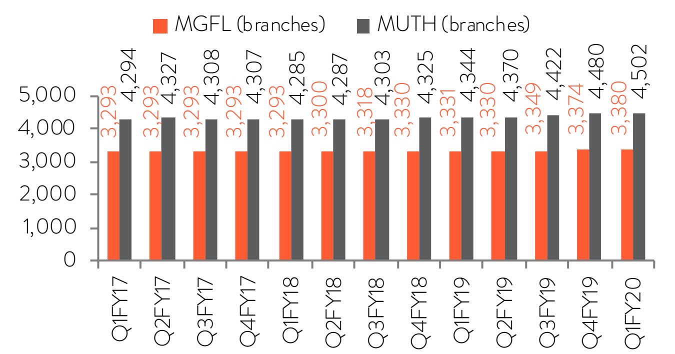
Source: Company, BOBCAPS Research

FIG 2 – …AS 30% OF MUTH'S PORTFOLIO HAS TICKET SIZE OF >RS 1MN



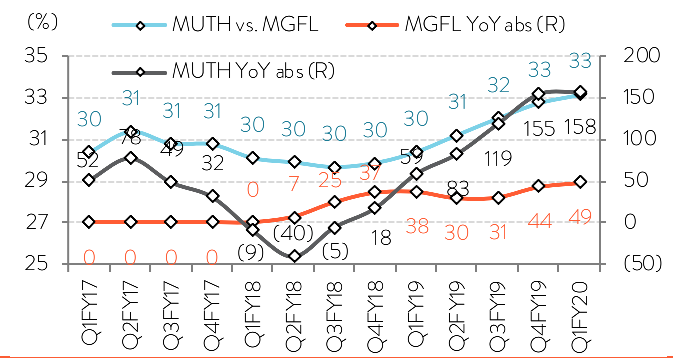
Source: Company, BOBCAPS Research | Red line shows avg. ticket size difference

FIG 3 – MUTH HAS HAD A WIDER REACH THAN MGFL HISTORICALLY…



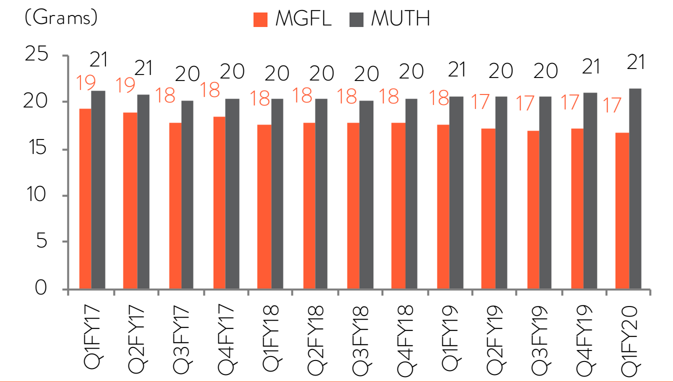
Source: Company, BOBCAPS Research

FIG 4 – …DESPITE BOTH COMPANIES RATIONALISING THEIR BRANCH COUNT



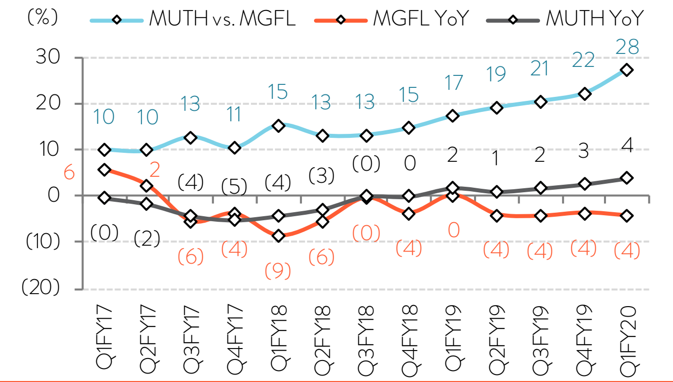
Source: Company, BOBCAPS Research | Shows branch count difference

FIG 5 – AVERAGE GOLD PLEDGED PER LOAN IS HIGHER FOR MUTH…



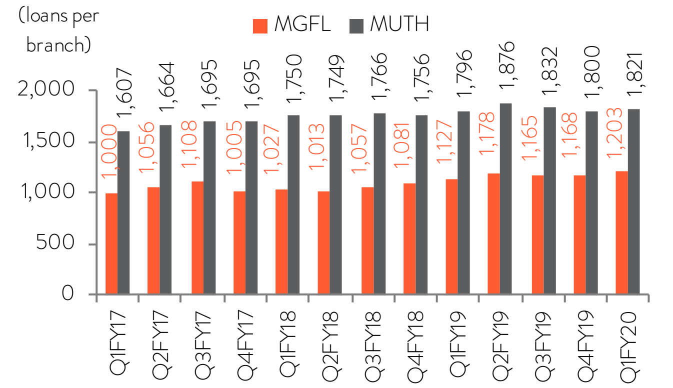
Source: Company, BOBCAPS Research

FIG 6 – …DUE TO MUTH'S FOCUS ON LARGER TICKET SIZES



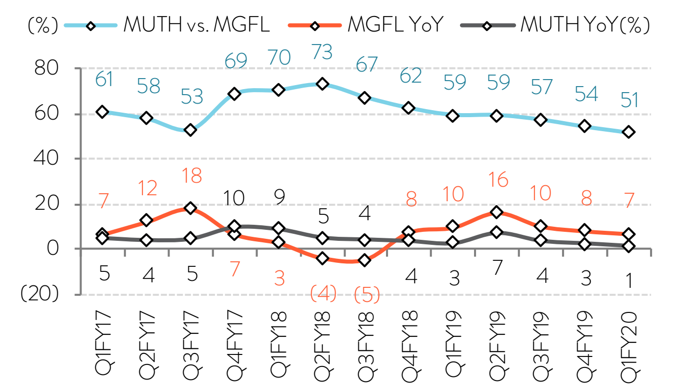
Source: Company, BOBCAPS Research

FIG 7 – MGFL STEADILY CLOSING THE PRODUCTIVITY GAP…



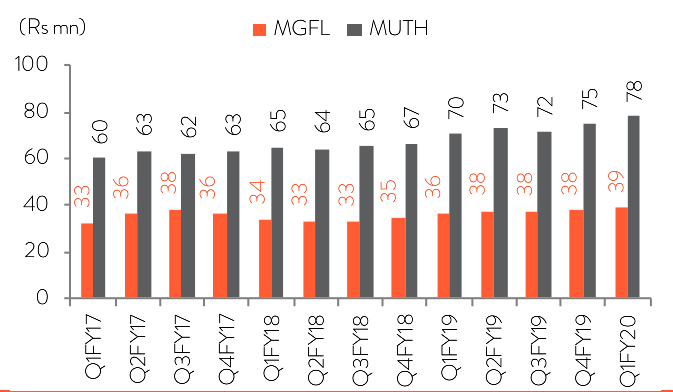
Source: Company, BOBCAPS Research

FIG 8 – …LED BY GREATER FOCUS ON ONLINE GOLD LOAN (OGL) SOURCING THAN MUTH



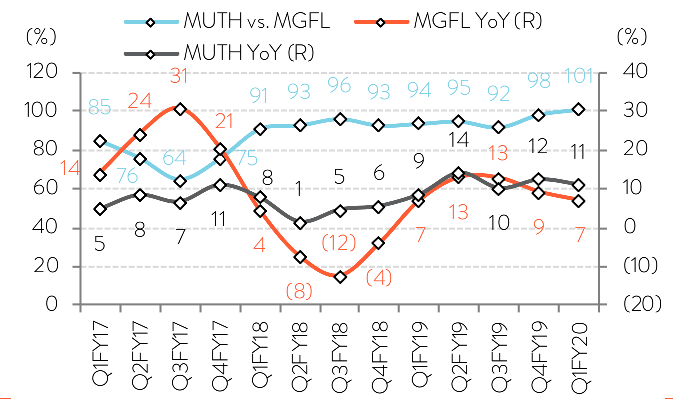
Source: Company, BOBCAPS Research

FIG 9 – MUTH HAS DOUBLE THE AUM PER BRANCH…



Source: Company, BOBCAPS Research

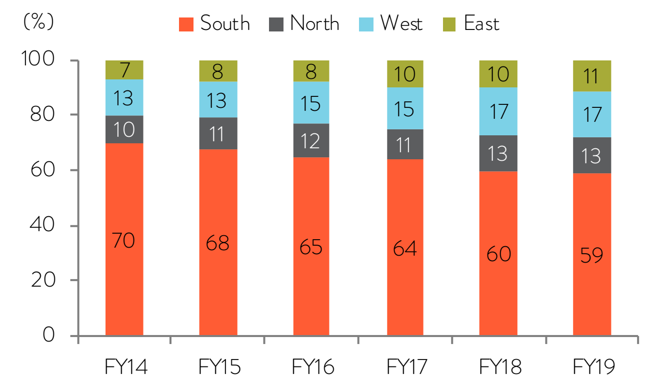
FIG 10 – …AT RS 78MN VS. RS 39MN FOR MGFL



Source: Company, BOBCAPS Research | Note: % difference in AUM per branch

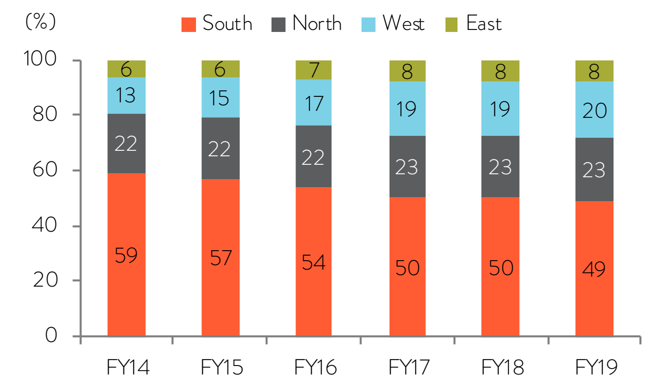
BOBCAPS
TRUST | INNOVATION | EXCELLENCE

FIG 11 – MGFL SOURCES ~60% OF AUM FROM SOUTH INDIA...



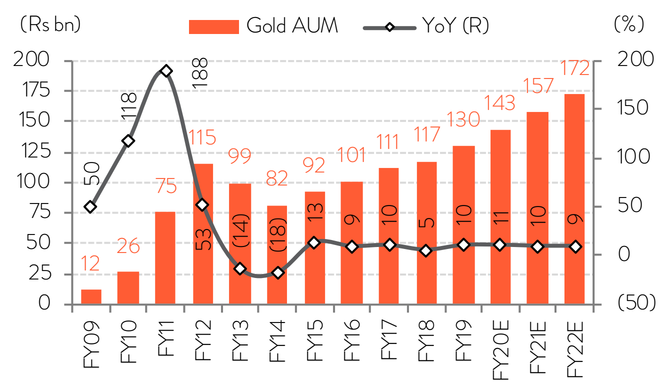
Source: Company, BOBCAPS Research

FIG 12 – ...AS COMPARED TO 50% FOR MUTH



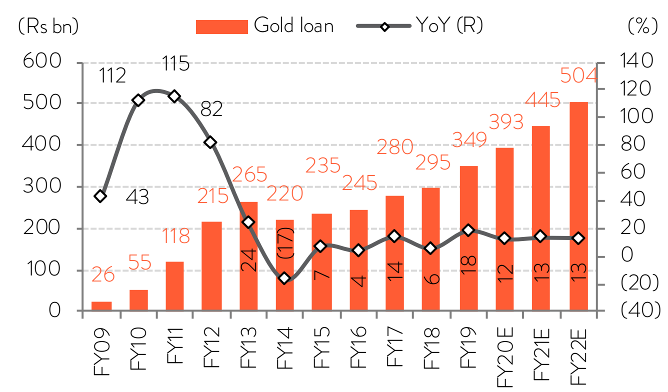
Source: Company, BOBCAPS Research

FIG 13 – WE EXPECT 10% LOAN CAGR FOR MGFL...



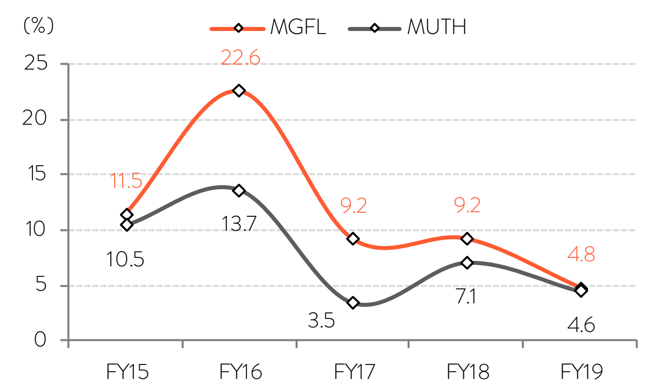
Source: Company, BOBCAPS Research

FIG 14 – ...VS. 13% CAGR FOR MUTH IN FY19-FY22E



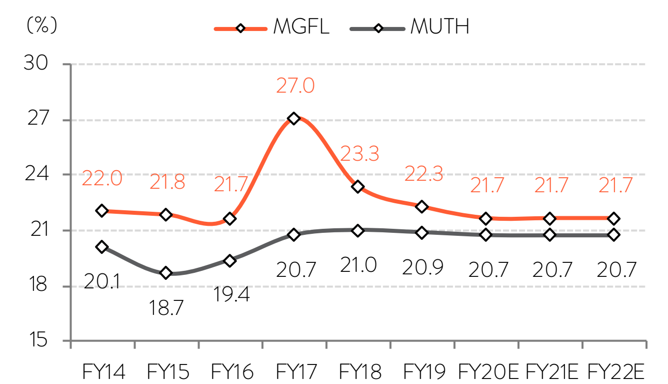
Source: Company, BOBCAPS Research

FIG 15 – AUCTIONED ACCOUNTS AS % OF TOTAL HAVE HALVED FOR BOTH PLAYERS IN FY15-FY19...



Source: Company, BOBCAPS Research

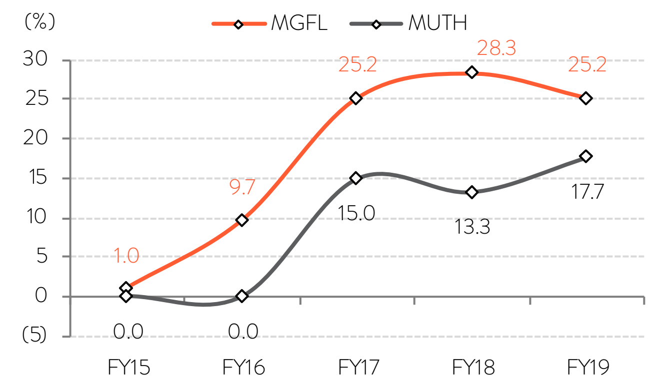
FIG 16 – ...LEADING TO CONSISTENT RISK-ADJUSTED YIELDS



Source: Company, BOBCAPS Research

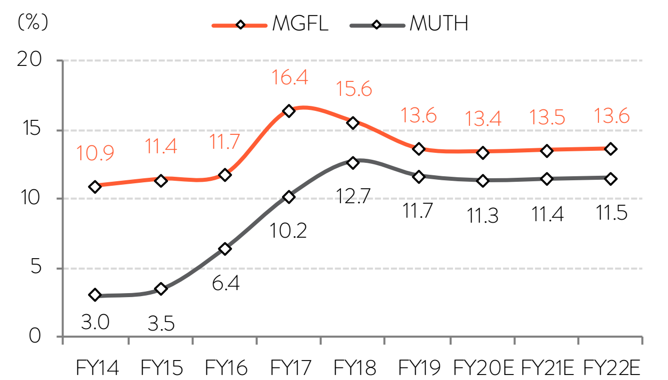
BOBCAPS
TRUST | INNOVATION | EXCELLENCE

FIG 17 – INCREASING SHARE OF COMMERCIAL PAPERS IN BORROWING MIX...



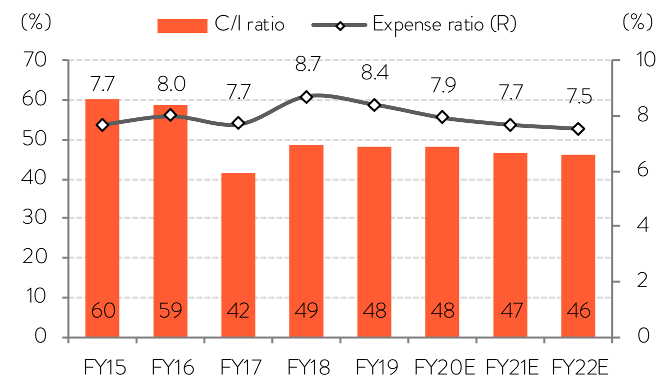
Source: Company, BOBCAPS Research

FIG 18 – ...WILL LEAD TO STABILITY OF SPREADS



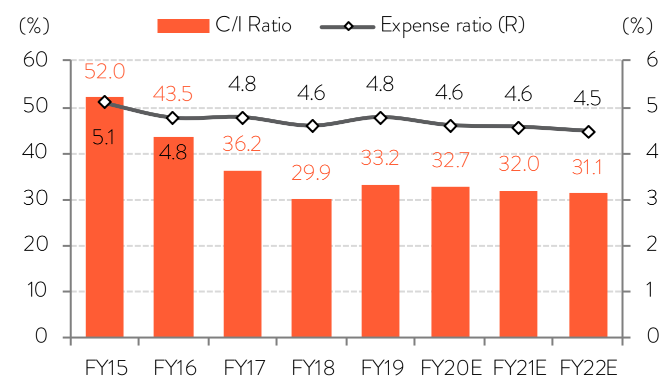
Source: Company, BOBCAPS Research

FIG 19 – WE EXPECT EXPENSE RATIO FOR MGFL TO DECLINE BY 100BPS IN FY19-FY22E...



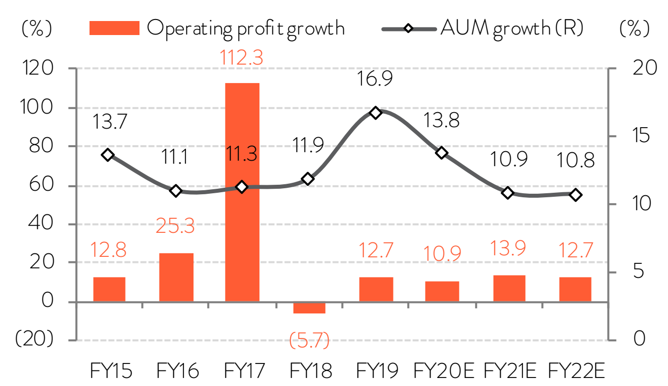
Source: Company, BOBCAPS Research

FIG 20 – ...WHILE STAYING FLATTISH FOR MUTH IN THE SAME PERIOD



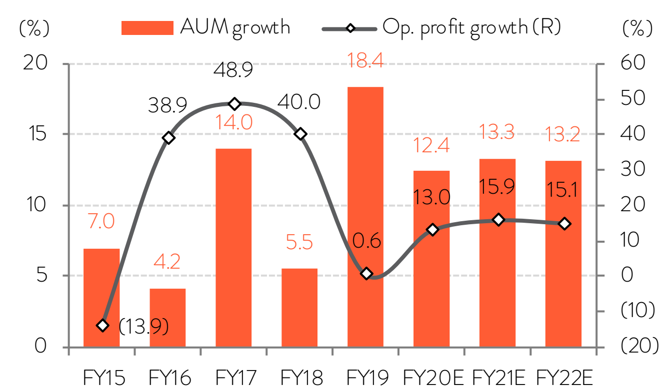
Source: Company, BOBCAPS Research

FIG 21 – WE EXPECT OPERATING PROFIT TO GROW FASTER THAN AUM GROWTH FOR MGFL...



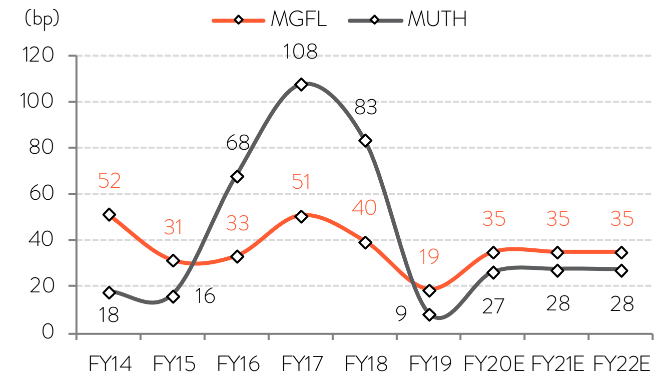
Source: Company, BOBCAPS Research

FIG 22 – ...AS WELL AS FOR MUTH DURING FY19-FY22E



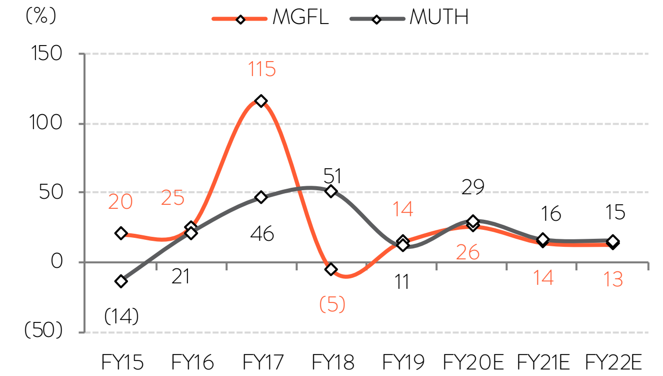
Source: Company, BOBCAPS Research

FIG 23 – CREDIT COSTS TO STAY STABLE FOR BOTH OVER FY20E-FY22E DUE TO REGULAR COLLECTIONS…



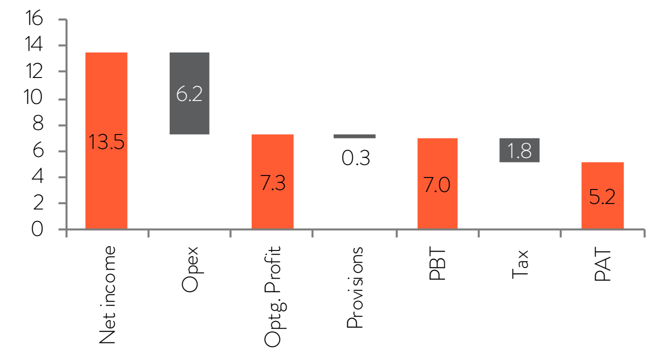
Source: Company, BOBCAPS Research

FIG 24 – …LEADING TO PAT CAGR OF 17-20% IN FY19-FY22E



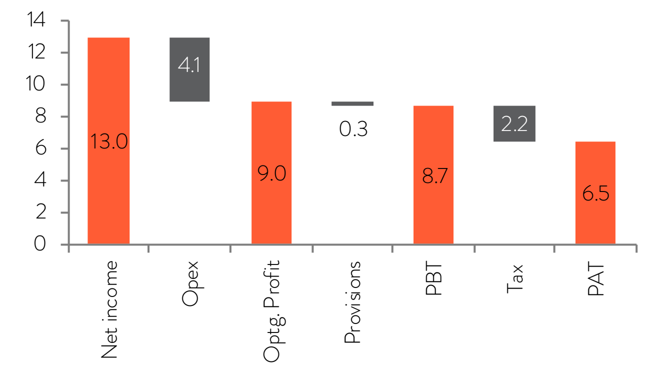
Source: Company, BOBCAPS Research

FIG 25 – ROA TREE FOR MGFL IN FY22E



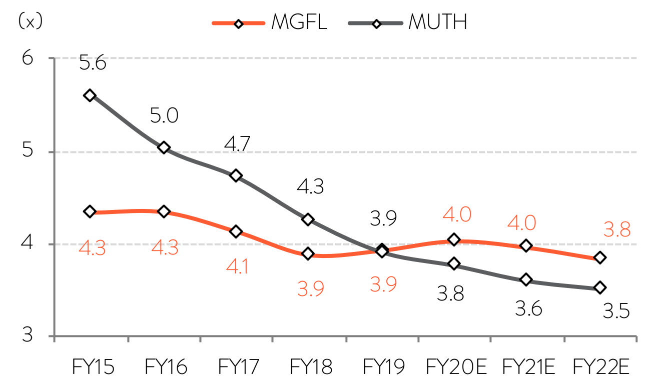
Source: Company, BOBCAPS Research

FIG 26 – ROA TREE FOR MUTH IN FY22E



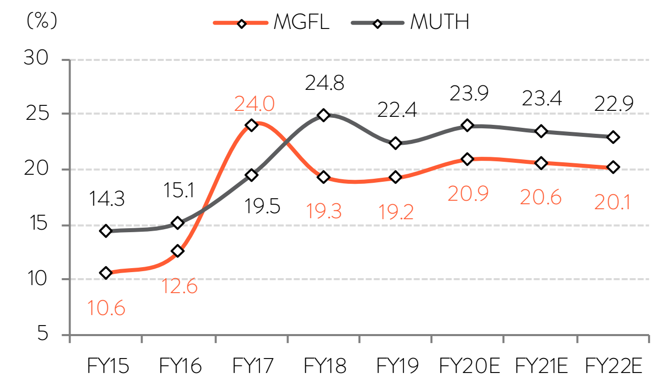
Source: Company, BOBCAPS Research

FIG 27 – BOTH MGFL AND MUTH LIKELY TO REMAIN LOW LEVERED…



Source: Company, BOBCAPS Research

FIG 28 – …AND STILL DELIVER HIGH ROE OVER FY20E-FY22E



Source: Company, BOBCAPS Research

Initiate with BUY on MUTH and MGFL

Muthoot – Staying firmly in the lead

MUTH is trading at 2.3x/2.0x FY20E/FY21E BV for ROE of 23.9%/23.4%. We believe its focused strategies to become gold financier of choice have helped MUTH cement leadership in gold finance.

The strategic focus on customer stickiness and higher branch productivity is expected to fuel a robust ~13% loan CAGR over FY19-FY22. Incentivising staff for regular collections has produced a high-churn portfolio and curbed auction losses, stabilising yields – we model for yields of 21% in FY20-FY22. Further, a favourable borrowing mix underpinned by a short-tenor portfolio should anchor spreads at ~11.5%. MUTH is the lowest cost gold financier in India and its expense ratio is forecast to remain at 4.5% of AUM through to FY22. We expect the company to maintain market leadership in NBFC gold financing and yield steady-state ROA of ~6%, with leverage of ~3.5x.

The company has diversified into home finance and microfinance (Belstar), with vehicle finance as a second priority. Belstar being a dominant SHG business model is a safer MFI play despite geographic concentration in Tamil Nadu. We expect incremental capital to be allocated to these fledgling businesses, of which Belstar is well placed to contribute meaningfully in the near term.

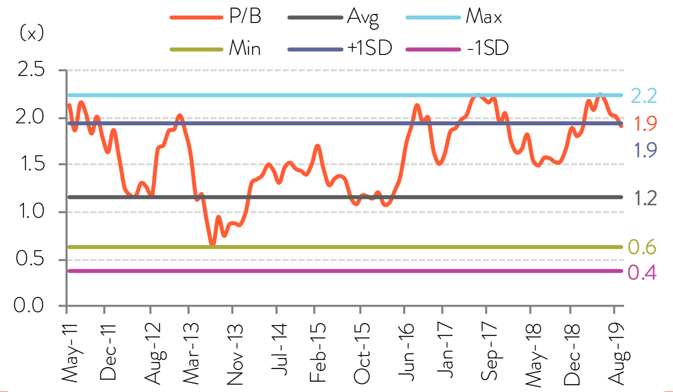
We initiate coverage on MUTH with BUY and a Sep'20 target price of Rs 825. Our fair value is derived using the sum-of-the-parts (SOTP) method as follows (a) Rs 771/sh for the standalone book based on 2.2x Sep'21E BV, (b) Rs 46/sh for MHFL based on 4.0x Sep'21E BV (from last stake sale), and (c) Rs 21/sh for Belstar based on 2.5x Sep'21E BV (post holdco discount of 20%).

FIG 29 – SOTP VALUATION SUMMARY

SOTP	Value (Rs bn)	Value (US$ bn)	Value per share (Rs)	% of total	Valuation rationale
Core business	**309**	**4.4**	**770**	**93.4**	**2.2x Sep'21E BV**
Key ventures					
- Muthoot Home Finance	18	0.3	46	5.6	4.0x Sep'21E BV based on last stake sale
- Belstar Investment and Finance	9	0.1	21	2.6	2.5x Sep'21E BV
Total value of ventures	**27**	**0.4**	**68**	**8.2**	
Less: 20% holding discount	5	0.1	14	1.6	
Value of key ventures	**22**	**0.3**	**54**	**6.6**	
Target value post 20% holding co disc	330	4.7	824	100.0	
CMP	269	3.8	672		
Upside (%)	22.7	22.7	22.7		

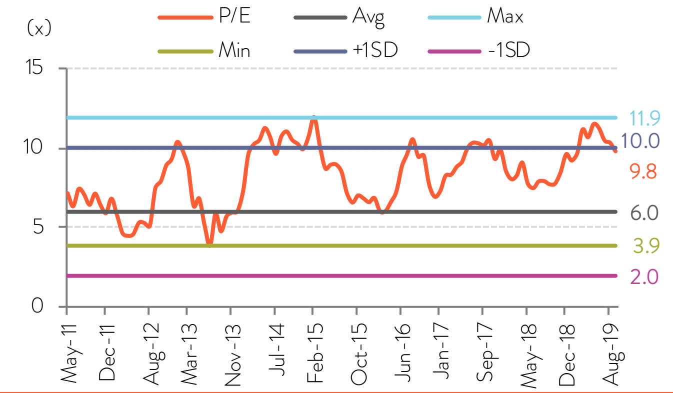
Source: BOBCAPS Research

FIG 30 – ONE-YEAR FORWARD P/B BAND



Source: Company, BOBCAPS Research

FIG 31 – ONE-YEAR FORWARD P/E BAND



Source: Company, BOBCAPS Research

MGFL – Reaping benefits of portfolio rejig, diversification

MGFL is trading at 2.2x/1.9x FY20E/FY21E BV for ROE of 20.9%/20.6%. We initiate coverage on the company with BUY and a Sep'20 sum-of-the-parts (SOTP) target price of Rs 165. MGFL has retained its market share in gold finance during FY15-FY19 and we expect the business to yield a steady-state ROA of ~5% and remain low-levered at ~4x over FY20-FY22E. We forecast a modest ~10% loan CAGR as the company is focusing on lower ticket sizes and on reshaping customer attitudes towards gold finance in non-south geographies.

Diversification into allied businesses is likely to meaningfully contribute to the bottomline in the near term. MFI arm Asirvad Microfinance is among the top-5 MFIs in the country and has leading productivity metrics compared to peers. MGFL will incrementally allocate capital towards growing new businesses.

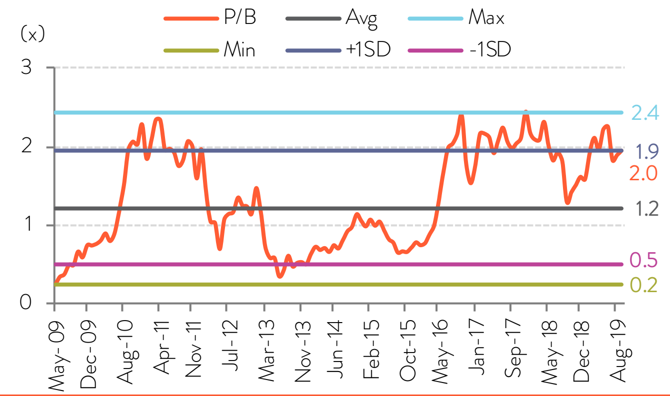
For our SOTP model, we value (a) the standalone book, which includes gold finance, vehicle finance, SME finance and on-lending, at Rs 147/sh based on 2.0x Sep'21E BV, and (b) Asirvad MFI at Rs 18/sh based on 2.2x (from last stake sale) Sep'21E BV after a holding company discount of 20%.

FIG 32 – SOTP VALUATION SUMMARY

SOTP	Value (Rs bn)	Value (US$ bn)	Value per share (Rs)	% of total	Valuation rationale
Core business	**124**	**1.8**	**147**	**89.3**	**2.0x Sep'21E BV**
Key ventures					
- Asirvad Microfinance	19	0.3	22	13.4	2.2x Sep'21E BV based on last stake sale
Total value of ventures	**19**	**0.3**	**22**	**13.4**	
Less: 20% holding discount	4	0.1	4	2.9	
Value of key ventures	**15**	**0.2**	**18**	**10.7**	
Target value post 20% holding co disc	139	2.0	165	100.0	
CMP	113	1.6	134		
Upside (%)	22.8	22.8	22.8		

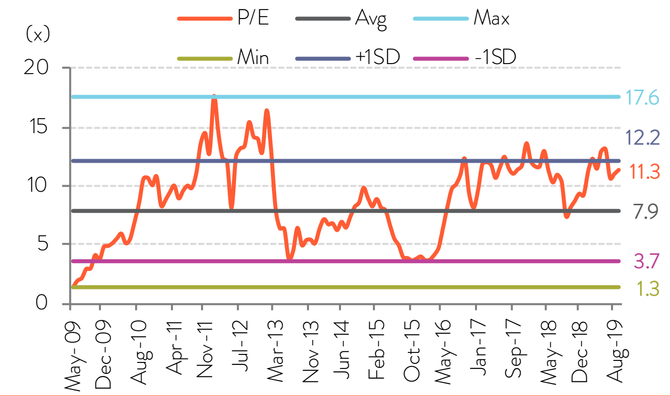
Source: BOBCAPS Research

FIG 33 – ONE-YEAR FORWARD P/B BAND



Source: Bloomberg, BOBCAPS Research

FIG 34 – ONE-YEAR FORWARD P/E BAND



Source: Bloomberg, BOBCAPS Research

FIG 35 – COMPARISON ON KEY METRICS

Ticker	CMP (Rs)	M Cap (Rs bn)	Standalone PAT (Rs bn)			Gold loan (Rs bn)			Standalone EPS (Rs)			Standalone BVPS (Rs)		
			FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
MUTH	672	270	25.5	29.6	34.0	393	445	504	64	74	85	289	341	400
MGFL	134	113	9.9	11.3	12.7	171	189	210	12	13	15	60	70	80

Ticker	Gold finance ROA (%)			Gold finance ROE (%)			Standalone P/E (x)			Standalone P/B (x)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
MUTH	6.3	6.5	6.5	23.9	23.4	22.9	10.6	9.1	7.9	2.3	2.0	1.7
MGFL	5.2	5.2	5.2	20.9	20.6	20	11.4	10.0	8.9	2.2	1.9	1.7

Source: BOBCAPS Research

Gold finance landscape

We expect NBFCs to grow to ~25% of India's Rs 3tn (as of FY20) organised gold loan market, while banks account for the majority share. MUTH, MGFL and Muthoot Fincorp (MFL) are undisputed leaders in the non-banking space, forming ~80% of NBFC gold finance market share. We expect the top-3 to maintain share against banks as they compete on customer outreach, turn-around time and specialised in-house underwriting skills. Though loan book growth for our coverage stocks (MUTH and MGFL) is projected to be modest at 10-12% levels over FY19-FY22, we expect return ratios to surpass that of banks' gold finance products (average ROA of 4% vs. 1%).

Market dominated by unorganised players

Until a couple of decades ago, the gold loan market was entirely dominated by unorganised private players offering loans against gold at usurious interest rates. Traditionally a hyperlocal retail business, India has gradually seen the emergence of larger gold loan specialty players and also widespread participation by the banking sector, bringing about a sea-change in market dynamics.

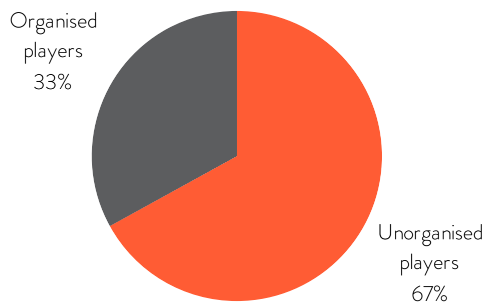
As per Fitch group company IRR Advisory, India's gold loan market is estimated to reach Rs 9tn in FY20, wherein the organised segment will form a third of business at Rs 3tn (see Annexure A for reasons behind the continued popularity of informal gold loans). Banks will continue to dominate the organised market with 74% share, while NBFCs form the balance 26% (vs. 22% in FY12).

Top 3 NBFCs on a strong wicket

India's formal gold loan market grew at a 4% CAGR to Rs 2.8tn during FY14-FY19 – a feeble showing due to the regulatory purge of FY13-FY14 which placed restrictions on LTV for NBFCs, disruptions arising from demonetisation in FY17, and poor rural demand amid weak monsoons in FY15 and FY16. We note that NBFC gold loan players posted a higher 7% CAGR during the same period. This segment is dominated by three players that together have commanded ~80% market share over the past two years, viz. MUTH (50% share in FY19), MGFL (19%) and MFL (13%).

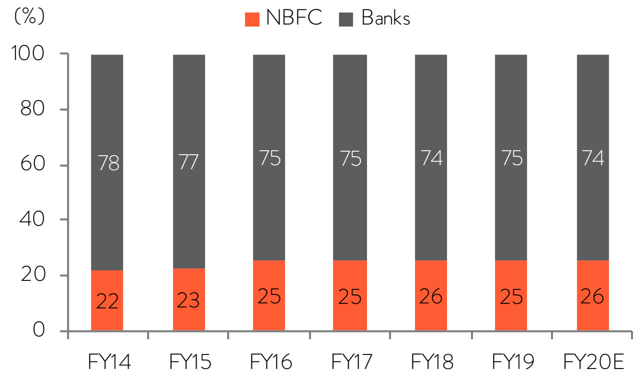
We expect our coverage stocks MUTH and MGFL to hold onto their market share ahead as they have a single-minded focus on gold loans, shorter turnaround time and better customer proximity. Further, they are likely to outstrip banks on return ratios as they incur lower costs for gold assaying and have a nimble-footed collection architecture.

FIG 36 – INDIA'S GOLD FINANCE MARKET ESTIMATED TO REACH RS 9TN AS OF FY20



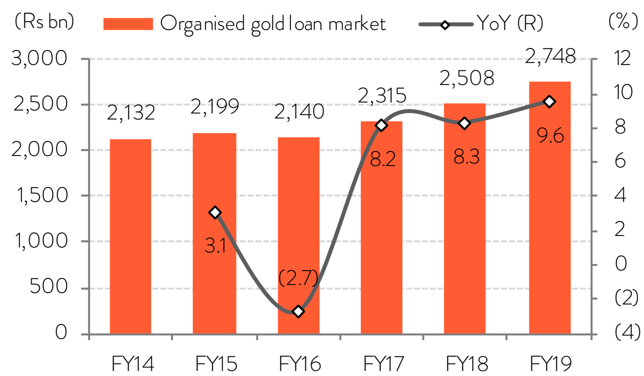
Source: Company, BOBCAPS Research, CRISIL

FIG 37 – BANKS HAVE LION'S SHARE OF ORGANISED GOLD FINANCE MARKET



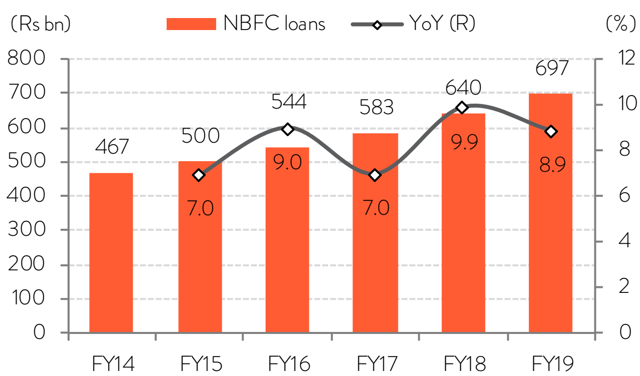
Source: Company, BOBCAPS Research, CRISIL

FIG 38 – ORGANISED GOLD LOAN MARKET GREW ONLY 4% OVER FY14-FY19…



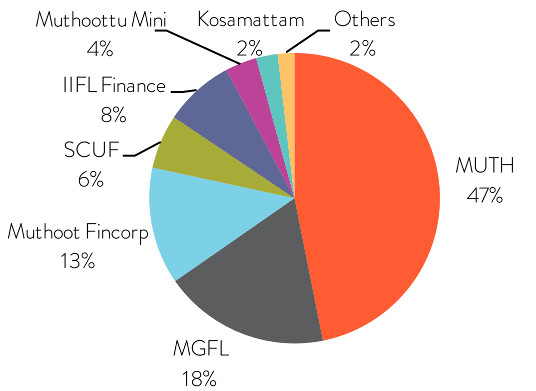
Source: Company, BOBCAPS Research, IRR Advisory

FIG 39 – …BUT NBFC GOLD LOANS GREW AT A FASTER 7% CAGR



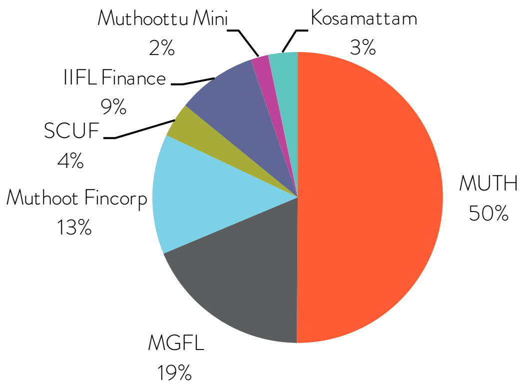
Source: Company, BOBCAPS Research, IRR Advisory

FIG 40 – NBFC GOLD LOAN MARKET SHARE IN FY15…



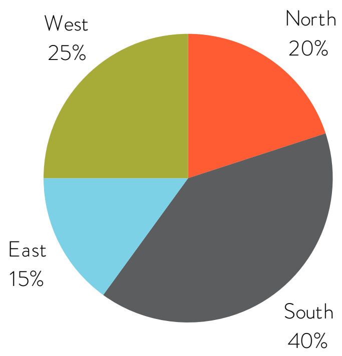
Source: Company, BOBCAPS Research, IRR Advisory

FIG 41 – …AND IN FY19; TOP 3 NBFCs HAVE CONSISTENTLY MAINTAINED ~80% SHARE



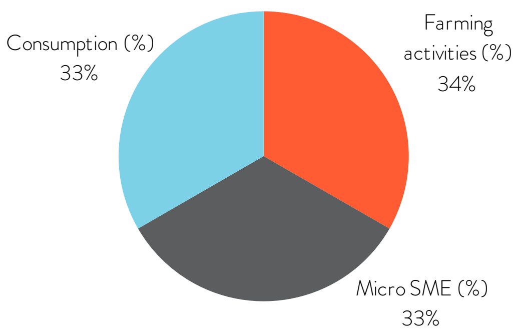
Source: Company, BOBCAPS Research, IRR Advisory

FIG 42 – GOLD LOAN DEMAND DOMINATED BY SOUTH INDIA, FY18



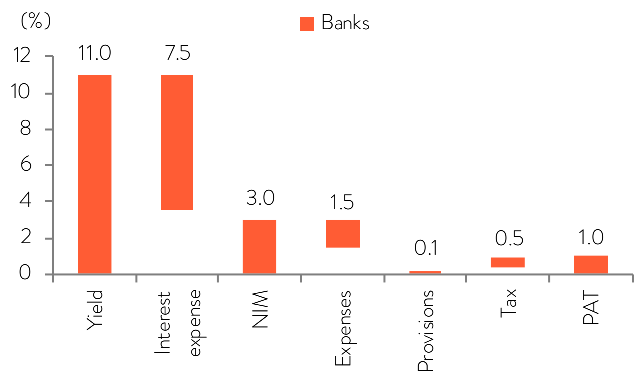
Source: Company, IRR Advisory, Bloomberg, BOBCAPS Research

FIG 43 – USAGE OF GOLD LOANS



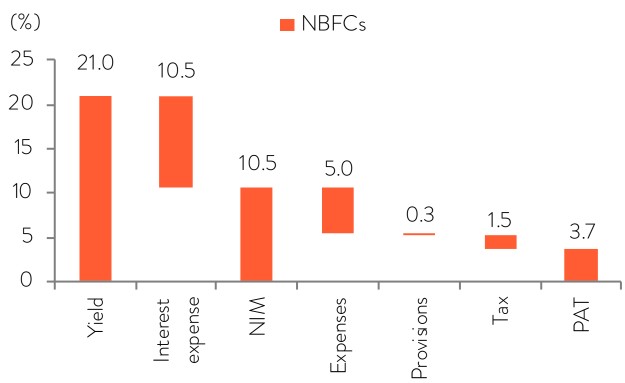
Source: Company, IRR Advisory, Bloomberg, BOBCAPS Research

FIG 44 – ROA TREE FOR BANKS (GOLD LOANS)



Source: Company, BOBCAPS Research

FIG 45 – ROA TREE FOR NBFCs



Source: Company, BOBCAPS Research

FIG 46 – GOLD LOAN AVENUES: A COMPARISON

Parameters	Gold Loan NBFCs	Banks	Money Lenders
Loan to value	Up to 75%	Up to 75%	Higher than 75%
Market penetration	Highly penetrated	Not highly penetrated; available at select branches	Highly penetrated
Interest charges	~18-24% p.a.	~12-15% p.a.	~35-60% p.a.
Regulatory body	RBI	RBI	Not regulated
Processing fees	No/Minimal processing fees	Higher than NBFCs	Nil
Documentation	Minimal, Govt. ID proof	Complete KYC compliance	Nil or minimal
Customer service	Core focus area	Non-core focus area	Core focus area
Repayment structure	Flexible; no pre-payment charges	EMI-based; pre-payment penalty	One-time
Model of disbursal	Cash, Cheque/Electronic Transfer (Cash up to Rs 20,000/-)	Cash, Cheque/Electronic Transfer	Cash
Working hours	Open beyond banking hours	Typical banking hours	Open beyond banking hours
Fixed office space	Branch with dedicated staff	Bank branches	No fixed place
Turnaround time	~10 minutes	1-2 hours	>10 minutes

Source: Company, IRR Advisory, BOBCAPS Research

FIG 47 – COMPETITIVE POSITIONING OF GOLD LOAN NBFCs FAVOURABLE VS. BANKS

Parameters	Specialised NBFCs	South-based banks	New NBFC entrants	New bank entrants	Cooperative banks
Strategic stance and focus					
Focus on the segment	High	Medium	Medium	Low to Medium	Medium
Willingness to expand in non-south regions	High	Low	High	Medium	Low
Ability to provide accessibility					
Size of existing branch network	High	Medium	Medium	Medium	Low
Flexibility to add branches	High	Low	High	Low	Low
Ability to provide flexibility					
Understanding of target customer segments	High	Medium	Medium	Low	Medium
Ability to provide a wide range of products – e.g. high-LTV loans	Medium	Medium	Medium	Medium	Medium
Competitive advantage on account of flexibility – e.g. long hours, cash disbursals	High	Low	Medium	Low	Low

Source: IMaCS Industry Report 2012 Regulatory stress points for various categories of lenders Potential threats to competitive positioning of specialised NBFCs

Industry evolution: A tumultuous ride

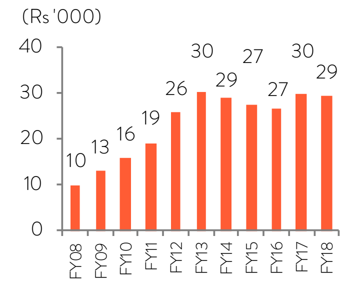
To better gauge performance trends and growth prospects of India's gold loan NBFCs, we trace the industry evolution from a period of heady growth over FY08-FY12 (AUM CAGR of 95%, branch network up 7x) to an abrupt downturn over FY12-FY14 amid tighter RBI regulation, followed by a phase of consolidation through to FY18. NBFCs such as MUTH, MGFL and MFL who were able to derisk the business by leveraging technology, building stronger collection architecture and diversifying the portfolio into non-gold segments have emerged stronger.

Phase 1: Rapid growth during FY08-FY12

Phase 1 from FY08-FY12 saw accelerated growth supported by a low cost of funds, as gold loans were eligible for securitisation under priority sector lending (PSL). Also, the rise of India's middle class, consumerism and urbanisation helped support demand. Lastly, this period was witness to rising gold prices due to positive macro conditions.

As NBFCs were competing against unorganised players, they disbursed loans at high LTV up to 85%. Convenience of access, quick disbursals and lower interest rates compared to pawnbrokers led to NBFCs becoming a preferred choice for borrowers. According to KPMG, the industry witnessed a strong AUM CAGR of 95% and a seven-fold rise in branch network over FY08-FY12.

GOLD PRICE (FOR 10GM) MOVEMENT THROUGH LAST DECADE



Source: Company, BOBCAPS Research

Phase 2: Regulatory purge of FY12-FY14

Phase 2 over FY12-FY14 witnessed a regulatory clampdown by the RBI, which imposed strict guidelines to stabilise the books of gold loan NBFCs. These included:

- removal of PSL status, which immediately resulted in substantially higher borrowing cost;
- capping of LTV at 60%, which weakened the competitive advantage against banks (75% permissible LTV) and unorganised pawnbrokers. Higher LTV-focused customers moved to moneylenders and rate-sensitive ones moved to banks;
- restrictions on banks' credit exposure to a single gold NBFC (at 7.5% of advances from 10%), resulting in lower bank funding; and
- ban on loans against bullion and gold coins, which limited the client base.

Adding to these woes, gold prices began to reduce drastically globally in 2013. With pledged gold carrying lower market value, customers started to default, driving up NPAs. Consequently, specialised gold loan NBFCs lost significant market share to public sector banks and the unorganised sector.

Newer players caught in the regulatory crosshairs found themselves unable to manage asset quality amid declining gold prices, leading to business exits. Of the new entrants, only two companies, India Infoline Finance (IIFL) and Shriram City Union Finance (SCUF), continue to operate in the segment. Though IIFL has been able maintain its market share at ~8% during FY15-FY19 as it focused more on urban branches, SCUF has lost 200bps market share during the same period to 4% due to a lack of focus.

In a bid to stem the downslide, key players started to leverage technology (online gold loans), offer personalised loan schemes, ramp up branding and launch targeted marketing. Incremental efforts were taken to delink gold price volatility from business profitability by the introduction of shorter tenure loans (for 3-9 months vs. 3-24 months earlier). MUTH started offering low-rate schemes to lure back lost customers, while MGFL offered 75% LTV on 3-month loan tenors.

Phase 3: Diversification and consolidation during FY15-FY18

Phase 3 during FY15-FY18 witnessed diversification by gold loan NBFCs into other credit products, geographic expansion and business consolidation. In Feb'14, the RBI increased LTV to 75%, thus levelling the playing field with banks.

During this phase, established NBFC players moved to diversify their lending businesses into areas such as microfinance, vehicle finance and home finance. In terms of market presence, South India has traditionally been the dominant geography for gold loans. Post the FY12-FY14 regulatory challenges, gold loan NBFCs started spreading into the less penetrated non-south states.

In FY16, though the regulatory environment stabilised and gold prices strengthened, gold loan NBFCs failed to clock stronger growth as each category of lenders focussed on consolidating rather than expanding their book. Demonetisation towards the fag-end of FY17 caused a cash crunch in the market and disrupted business. The introduction of GST in FY18 also roiled the market. Pre-GST, gold was taxed at 1% excise duty, along with a VAT of 1-1.5%, totaling to 2% tax. GST rates on gold have now been pegged at 3%. This is in addition to an import duty of 10% and 5% GST on making charges.

FY19 a recovery year; outlook positive

Following the consolidation phase over FY15-FY18, India's organised gold loan industry grew 10% YoY to Rs 2.8tn in FY19 as LTV regulations were harmonised between banks and NBFCs, gold prices remained largely range-bound, and NBFCs recaptured market share lost to banks and unorganised players. We conservatively estimate a 10.2% CAGR in India's organised gold finance market to Rs 3.6tn over FY19-FY22, with NBFCs continuing to account for ~25% share. We expect MUTH and MGFL to grow largely in line with the organised segment and maintain their market shares of ~50% and 20% respectively.

Competitive landscape has eased

South India-based private sector banks which have 60-85% of their gold loan portfolio as loans against pledged ornaments are primary competitors to specialised gold finance NBFCs. However, their growth over the past 4-5 years has been restricted by a focus on other segments, slow growth in the overall balance sheet, and geographical concentration in one or two states of South India.

We expect south-based private banks as well as PSU players to clock subdued growth in the gold loan segment over FY19-FY22 due to (a) regulatory guidelines for stricter end-use monitoring, (b) limited flexibility to increase their exposure to gold loans due to sector concentration, (c) concerns emanating from their rising share of wholesale lending bad debts, and (d) a likely sharper focus on non-priority sector lending as banks can now buy priority sector lending certificates (PSLC).

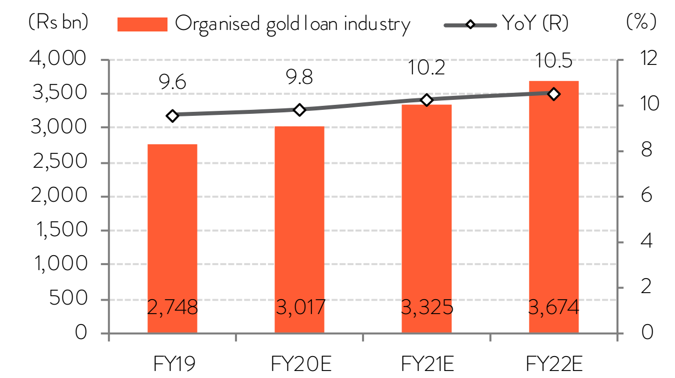
In terms of new entrant NBFCs, several have either exited or gone slow on gold finance over FY12-FY15 for reasons such as market share loss to banks (Mahindra Finance and Magma Fincorp), or to rid the portfolio of non-focus, me-too products used simply as a diversification tool.

Other prominent NBFCs that still offer gold loans such as IIFL Finance and Shriram City Union Finance (SCUF) have tempered the pace of lending in the segment over FY15-FY19. Bajaj Finance is a fledgling entrant but could be a meaningful player in the medium term.

MUTH, MGFL well placed to maintain market share

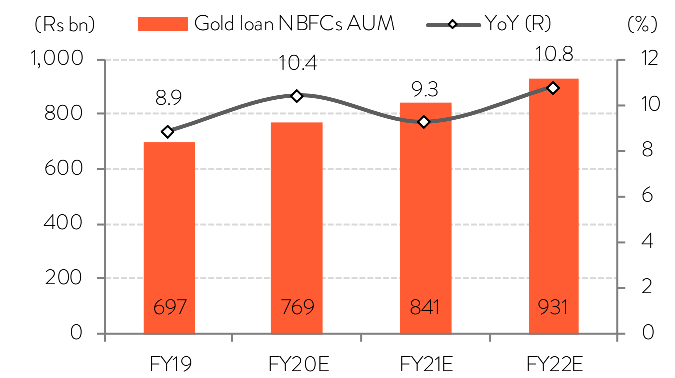
We expect the top-2 players MUTH (50% of NBFC market share) and MGFL (19%) to largely maintain their market share in the gold finance space. Growth is likely to come from non-south geographies, tailormade processes and systems for small-ticket disbursement, and the ability to recover adequate value on gold auctioned to contain credit losses.

FIG 48 – ORGANISED GOLD LOAN INDUSTRY TO GROW AT 10% CAGR OVER FY19-FY22E…



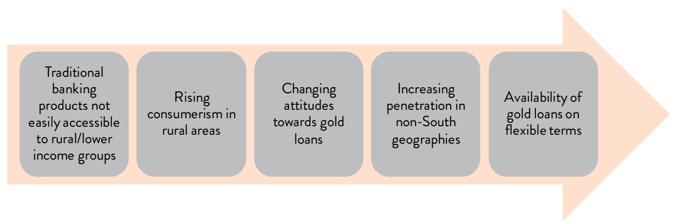
Source: Company, IRR Advisory, BOBCAPS Research

FIG 49 – …GOLD LOAN NBFCs EXPECTED TO GROW AT 10% CAGR AS WELL



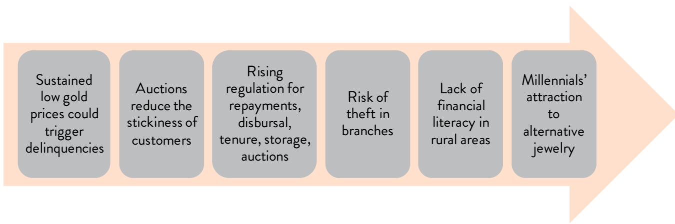
Source: Company, IRR Advisory, BOBCAPS Research

FIG 50 – DEMAND DRIVERS OF GOLD LOANS



Source: Company, BOBCAPS Research

FIG 51 – KEY RISKS TO GOLD FINANCING



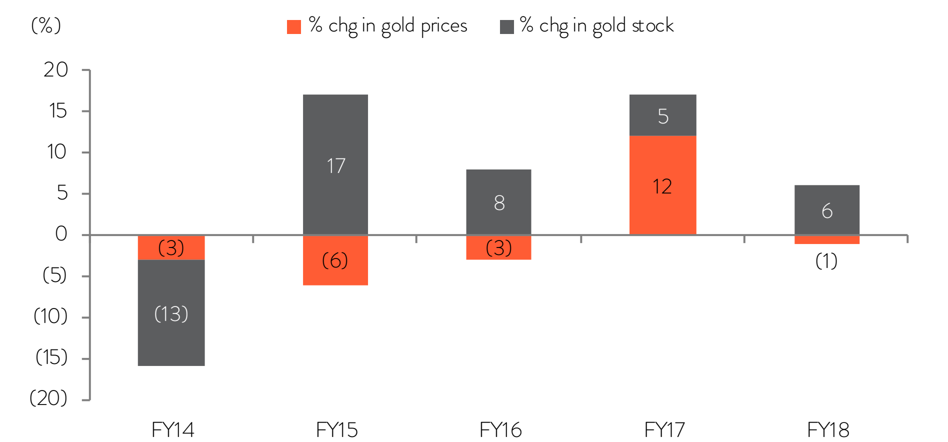
Source: Company, BOBCAPS Research

FIG 52 – FACTORS THAT AFFECT GOLD DEMAND IN INDIA

Long-term factors		Short-term factors	
Rising Income	**Gold Price Movement**	**Inflation**	**Excess Rainfall**
For a 1% increase in income, demand for gold rises by 1%	For a 1% increase in gold price, demand decreases by 0.5%	For a 1% increase in inflation, demand rises by 2.6%	For a 1% increase in monsoon rainfall, gold demand rises 0.5%

Source: Company, World Gold Council, BOBCAPS Research

FIG 53 – STABLE GOLD PRICES AND INCREASING GOLD STOCK PENETRATION HOLD THE KEY FOR AUM GROWTH



Source: Company, BOBCAPS Research

Annexures

Annexure A: Why informal gold financing is preferred

India's gold loan market is estimated to reach Rs 9tn in FY20, wherein the unorganised segment has a dominant 67% share, as per Fitch group company IRR Advisory. The primary reason why gold loans form a major source of credit within the informal sector is because they are easily available with minimal procedural requirements. Other reasons include a lack of customer awareness about the organised gold finance channel, non-proximity of the organised gold finance channel to customers, and lower client literacy which complicates documentation requirements.

In order to analyse the differences in profile of formal versus informal clients, we compare their economic and demographic characteristics. We find that both client types have largely similar annual incomes and ownership of a micro business. However, clients who access the informal channel are more likely to have lower literacy levels, i.e. 62% vs. 86% for those who access the formal channel. Also, household savings of clients who access the formal channel are ~3x that of clients who tap informal channels.

FIG 1 – CHARACTERISTIC DIFFERENCES BETWEEN FORMAL AND INFORMAL CLIENTS

Variables	Formal client	Informal client
Avg. household size	4.4	4.3
Dependency ratio (per 100 working population)	237	190
Live in own house (%)	59	65
Currently own a business (%)	31	28
Avg. annual income (INR)	106,197	97,985
Primary occupation as wage employers (%)	53	74
Literacy level of head of household (read and write) (%)	86	62
# of o/s loans (have multiple loans) (%)	42	46
Household savings (%)	20	6

Source: Company, IFMR Research, BOBCAPS Research

FIG 2 – CHARACTERISTIC DIFFERENCES BETWEEN SOURCES OF CREDIT AVAILABLE TO LOW-INCOME HOUSEHOLDS

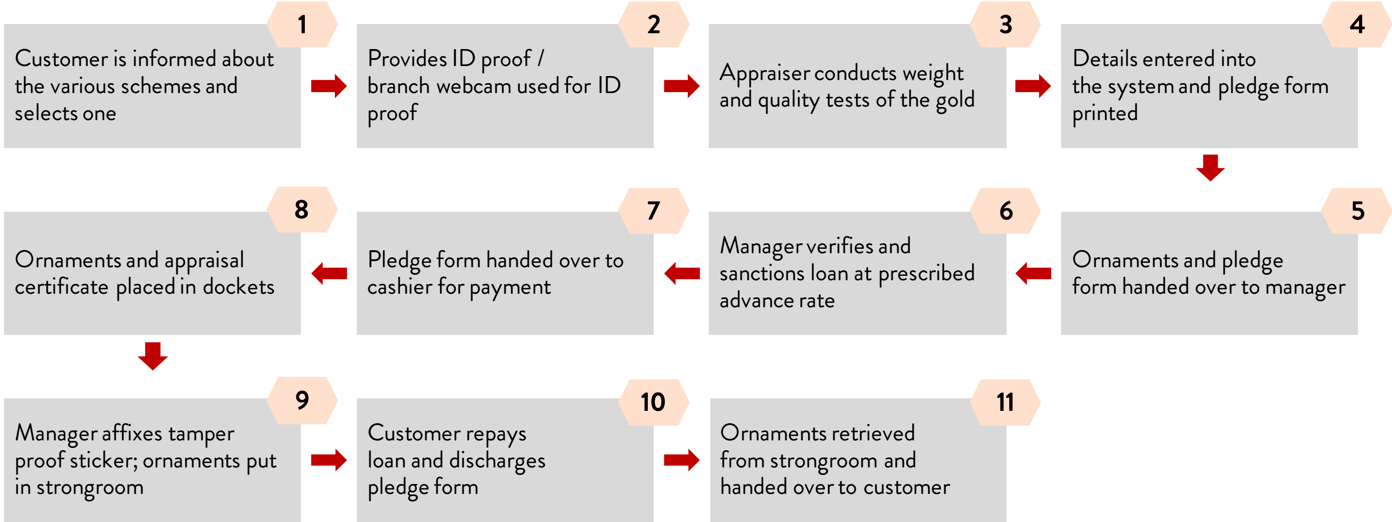
Product structure	MFI	SHG	Gold Loan NBFC
Target group	Collateral-free loan given to joint liability groups	Collateral-free loan given to self-help groups	Loan against gold as collateral given to individuals
Loan duration	Short-term loans; a typical MFI loan is for one year	Medium- and long-term loans, with a minimum duration of one year	Average duration of 3-6 months
Rate of interest	Minimum of 26%	Average of 24%	Formal sector: 10-26% Informal sector: 20-50%

Product structure	MFI	SHG	Gold Loan NBFC
Loan disbursement time	Within one month of forming joint liability groups	2-3 months after group formation	Less than one day
Repayment schedule	Weekly/monthly repayment	Weekly/monthly repayment	Flexible repayment schedule
Purpose of loans	70% of MFI loan should be used for income generating activities	For enterprise creation	For any purpose

Source: Company, IFMR, BOBCAPS Research

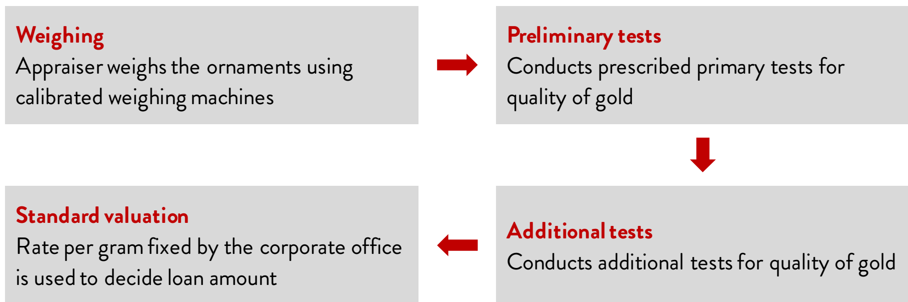
Annexure B: Gold loan disbursal and appraisal process

FIG 3 – GOLD LOAN DISBURSAL PROCESS



Source: Company, BOBCAPS Research

FIG 4 – LOAN APPRAISAL PROCESS



Source: Company, BOBCAPS Research

Companies

BUY
TP: Rs 825 | ⮝ 23%

MUTHOOT FINANCE | NBFC | 03 October 2019

Firmly in the lead – initiate with BUY

We initiate on Muthoot Finance (MUTH) with BUY and a Sep'20 TP of Rs 825. A focus on client retention and differentiated products has elevated AUM per branch by 36% over FY15-FY19, while flexible auctions and regular collections have more than halved write-offs, cementing MUTH's leadership among gold loan NBFCs. The company has found favour among debt market funds at pre-IL&FS prices, but should stay low levered at ~3.5x. We expect stable spreads and credit costs to aid steady ROA of ~6% through to FY22, while ROE rises to ~23%.

Shubhranshu Mishra
research@bobcaps.in

Sharp focus on client retention: By positioning products as lifestyle credit, holding off on auctions for clients with high repayment visibility, and training an early focus on non-South India markets, MUTH has increased customer stickiness. The company processed 1,800 loans per branch as of FY19 vs. ~1,500 in FY16. We expect volume growth driven by client traction and branch productivity to fuel a robust 13% gold loan book CAGR to Rs 500bn by FY22.

High-churn book, strong liability offtake to aid stable spreads: MUTH maintains average LTV of ~70%, supporting yields. Given a positive asset-liability mismatch in the one-year bucket and a diversified borrowing mix, we model for stable spreads of ~11.5% in the gold finance business over FY20-FY22.

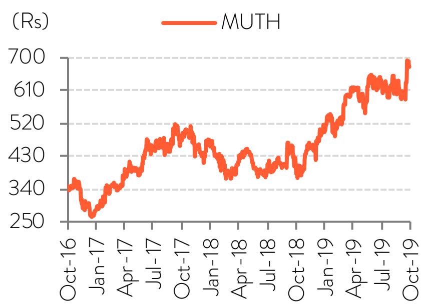
Earnings visibility healthy: As productivity increases, we expect operating profit (15% CAGR in FY19-FY22E) to outpace loan growth. We model for credit cost of ~27bps, a 20% PAT CAGR and healthy ~23.5% ROE. Diversification into related credit businesses, to be meaningful in near term.

BUY, TP Rs 825: Using SOTP, we value on Sep'21E BV (a) gold finance at Rs 771/sh (2.2x), (b) home finance at Rs 37/sh (4x), (c) Belstar at Rs 17/sh (2.5x).

Ticker/Price	MUTH IN/Rs 673
Market cap	US$ 3.8bn
Shares o/s	401mn
3M ADV	US$ 8.4mn
52wk high/low	Rs 699/Rs 543
Promoter/FPI/DII	73%/14%/8%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	42,707	45,202	50,787	58,289	66,344
NII growth (%)	27.7	5.8	12.4	14.8	13.8
Adj. net profit (Rs mn)	17,776	19,721	25,507	29,554	34,038
EPS (Rs)	44.4	49.2	63.7	73.8	85.0
P/E (x)	15.1	13.7	10.6	9.1	7.9
P/BV (x)	3.4	2.8	2.3	2.0	1.7
ROA (%)	5.8	5.7	6.3	6.5	6.5
ROE (%)	24.8	22.4	23.9	23.4	22.9

Source: Company, BOBCAPS Research

Return of pricing power

Following stagnant gold loan growth and market share loss to banks in the wake of tighter regulation over FY12-FY14, MUTH deployed four strategies – (1) increase customer stickiness to regain market share, (2) build a high-churn portfolio, (3) adopt a flexible auction policy, and (4) diversify into related credit businesses.

Aided by these strategies, loans processed per branch rose from ~1,500 in FY16 to ~1,800 in FY19, spurring a ~36% increase in AUM per branch to Rs 75mn and raising market share to ~50% (vs. 47% in FY15). As pricing power returned, gold loan yields firmed up to ~21% in FY19 vs. 19-20% levels in FY14-FY15, while an improving borrowing mix saw spreads spike from 3.5% to ~11.5%. Auction losses per account also contracted to Rs 3,226 in FY19 vs. Rs 8,962 in FY16.

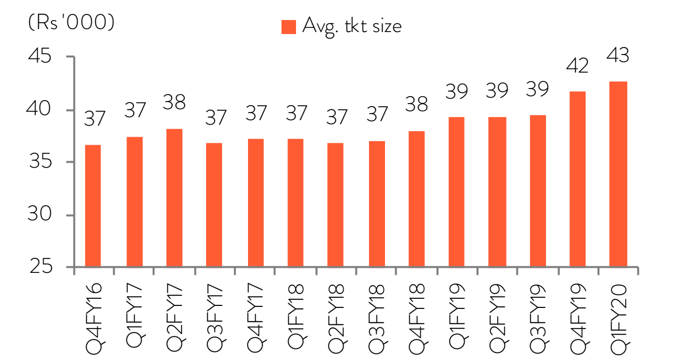
Strategy 1: Increase customer stickiness to regain market share

During FY12-FY14, MUTH's gold loan market share dropped from 47% to 45% from FY15 to FY16 as it ceded ground to banks and unorganised players amid RBI's LTV restrictions. To combat the slowdown and regain lost share, the company (a) introduced new, competitive low-rate schemes and (b) reoriented gold loans as "push products" via intensified marketing spends.

Aided by these initiatives, MUTH posted a recovery in AUM growth from –17% to +4% over FY14-16. During FY15-FY19, the company posted a ~6% CAGR in number of loan accounts processed per branch and an 8% CAGR in gold AUM per branch, implying value growth over volume growth during this period. We note a consistent rise in average ticket from ~Rs 37,000 in FY16 to ~Rs 42,000 in FY19.

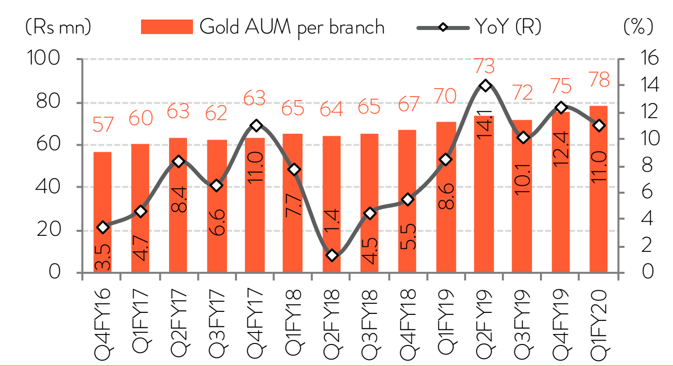
MUTH processed 1,800 loans per branch as of FY19 (vs. ~1,450 in FY15), taking throughput per branch to Rs 75mn (vs. Rs 55mn in FY15). Consequently, market share among gold finance NBFCs recovered to 50% in FY19 vs. 47% in FY15.

FIG 1 – AVERAGE TICKET SIZE HAS INCREASED CONSISTENTLY SINCE Q3FY18



Source: Company, BOBCAPS Research

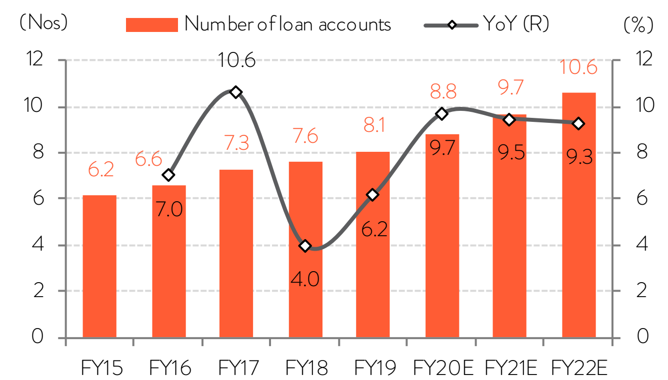
FIG 2 – GOLD AUM PER BRANCH UP 30% IN LAST THREE YEARS



Source: Company, BOBCAPS Research

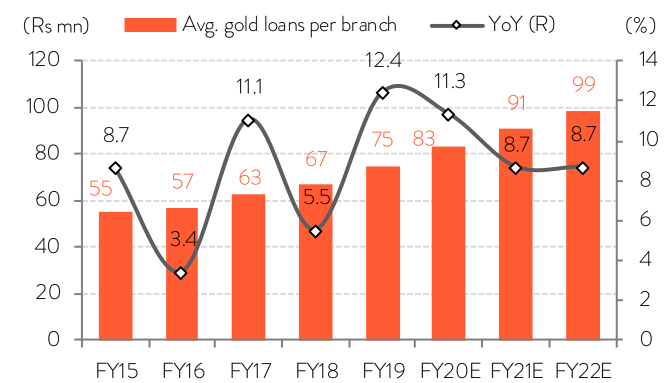
We expect AUM per branch to increase 32% to Rs 99mn by FY22. Aided by customer stickiness and rising loan throughput per branch, we model for a robust 13% gold loan CAGR through FY19-FY22.

FIG 3 – NUMBER OF LOAN ACCOUNTS TO GROW AT 9% CAGR DURING FY19-FY22E...



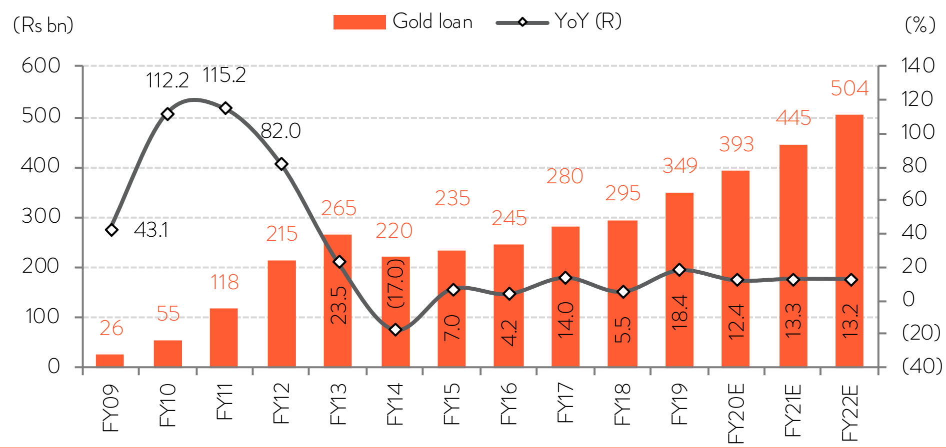
Source: Company, BOBCAPS Research

FIG 4 – ...AND GOLD LOANS PER BRANCH TO GROW AT 10% CAGR



Source: Company, BOBCAPS Research

FIG 5 – WE EXPECT 13% LOAN CAGR OVER FY19-FY22E

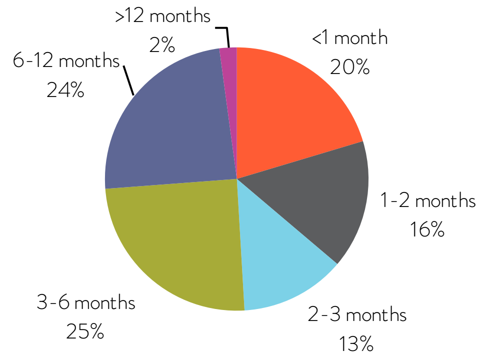


Source: Company, BOBCAPS Research

Strategy 2: Build a high-churn portfolio

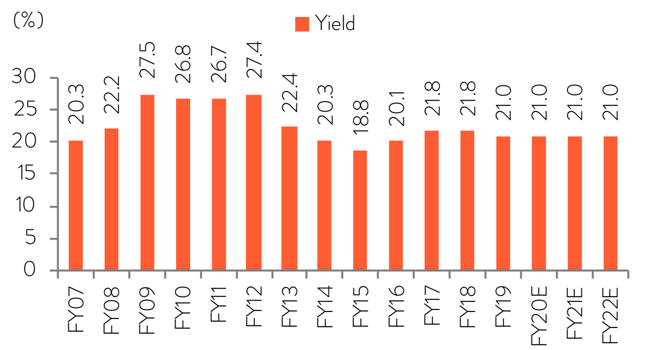
To deliver a high-churn portfolio, MUTH incentivised branch staff to pursue collections on a regular basis. A key outcome was disciplined client repayments – MUTH's gold loans have a maximum tenure of 12 months, but 61% of loans get repaid within six months as of Q1FY20, thus creating a high-churn portfolio. The company also maintains average LTV at ~70%, which implies that most loans are in-the-money and well collateralised. This has reduced accrued interest and stabilised yields. We expect MUTH to maintain ~21% yields in FY20-FY22.

FIG 6 – 74% OF PORTFOLIO HAS LOAN MATURITY BELOW SIX MONTHS, FY19



Source: Company, BOBCAPS Research

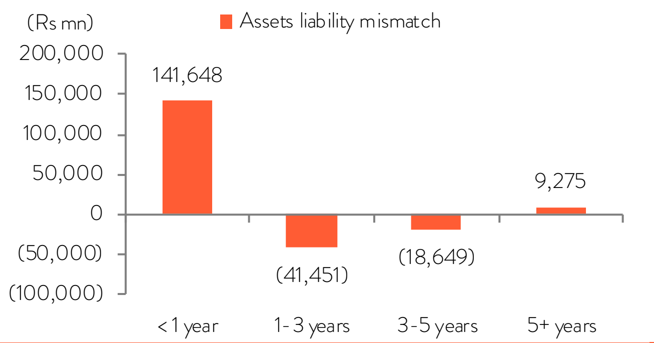
FIG 7 – YIELDS EXPECTED TO REMAIN STABLE THROUGH FY20E-FY22E



Source: Company, BOBCAPS Research

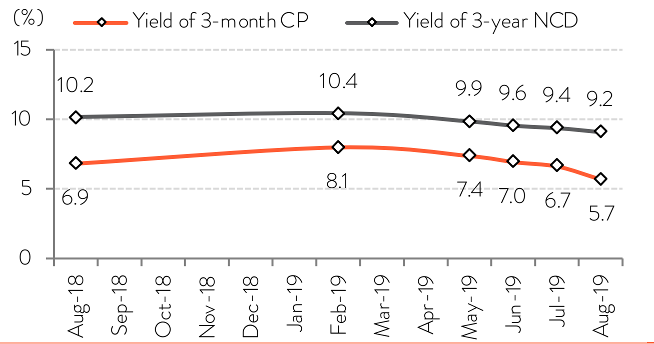
Creating a high-churn and shorter-tenure collateralised portfolio has found favour among debt market lenders. Commercial papers (CP) formed ~18% of the company's borrowing mix as of FY19 vs. nil in FY16. Also, MUTH has been replacing its legacy gold bonds with non-convertible debentures (NCD). This has helped reduce the cost of funds by ~450bps over FY16-FY19 to ~9.3%. We expect a stable cost of funds at ~9.5% in FY20-FY22, leading to steady spreads of ~11.5% in the same period.

FIG 8 – 93% OF ASSETS COME UP FOR MATURITY IN LESS THAN A YEAR



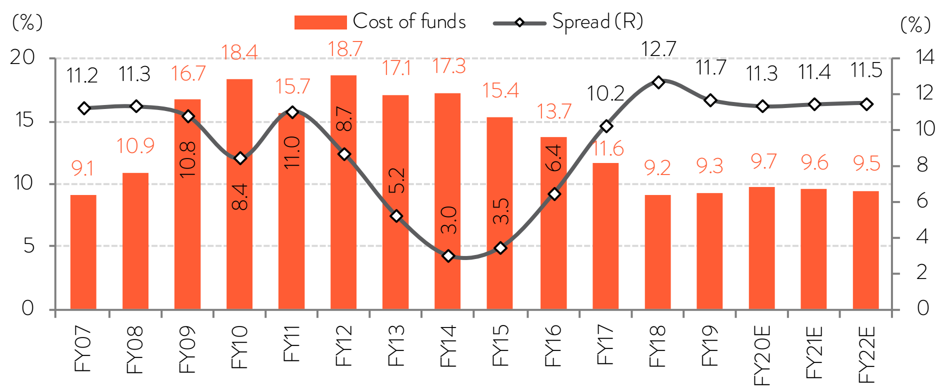
Source: Company, BOBCAPS Research

FIG 9 – CP AND NCD YIELDS ARE AT PRE-IL&FS CRISIS LEVELS



Source: Company, BOBCAPS Research

FIG 10 – SPREADS TO HOLD AT ~11.5%



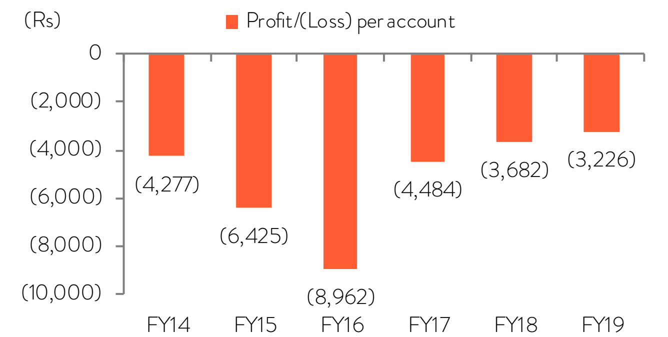
Source: Company, BOBCAPS Research

Strategy 3: Adopt a flexible auction policy

MUTH has adopted a policy of holding off on auctions if the branch staff are reasonably confident that the customer will be able to service the principal and at least 70-80% of interest – thus ensuring sticky client relationships. Flexible auctions have contained average write-offs at ~2bps as a percentage of AUM during FY13-FY16. Also, given the emotive value of ornaments pledged by customers, the credit product becomes self-liquidating as borrowers make every effort to avoid delinquency. Consequently, the gross NPA ratio has remained largely unchanged at ~2.8% levels during FY16-FY19.

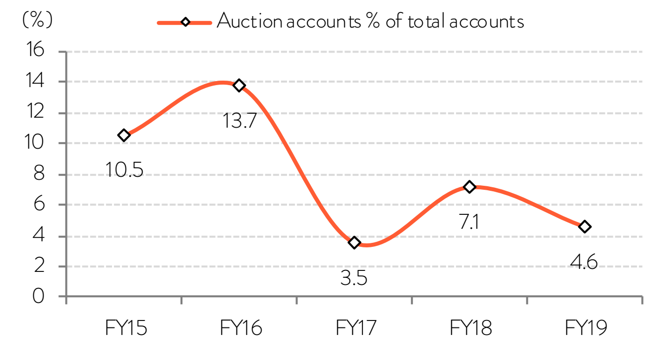
With regular interest collection and a strong incentive structure for branch level employees, auction losses have been coming off since FY16. In FY19, auction losses per account stood at Rs 3,226 vs. Rs 8,962 in FY16. The number of loan accounts that came up for auctioning also reduced by nearly two-third from 0.90mn to 0.36mn over this period.

FIG 11 – LOSS PER ACCOUNT IS A THIRD OF THE LEVELS SEEN IN FY16…



Source: Company, BOBCAPS Research

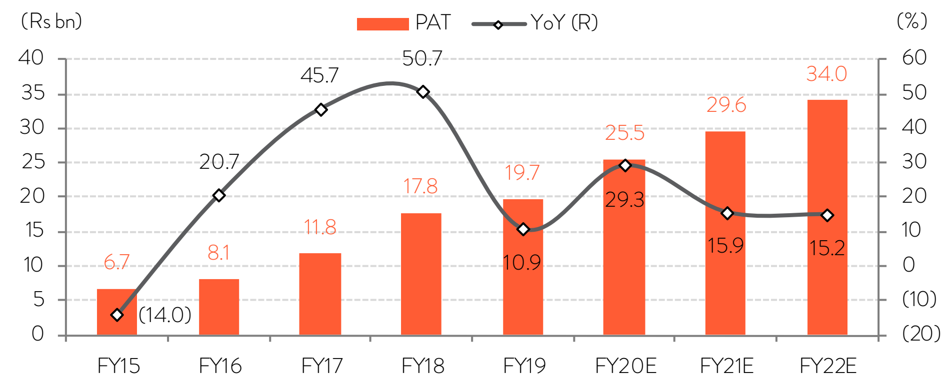
FIG 12 – …NUMBER OF AUCTION ACCOUNTS AS % OF TOTAL HAS ALSO DROPPED



Source: Company, BOBCAPS Research

We expect the company to have average credit cost of ~27bps during FY20-FY22, about half of the average credit cost of ~60bp during FY15-FY19. This should aid a 20% PAT CAGR in FY19-FY22.

FIG 13 – PAT CAGR ESTIMATED AT 20% DURING FY19-FY22E

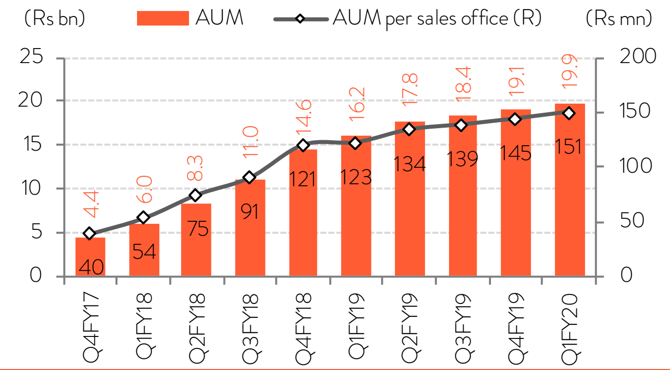


Source: Company, BOBCAPS Research

Strategy 4: Diversify into related credit businesses

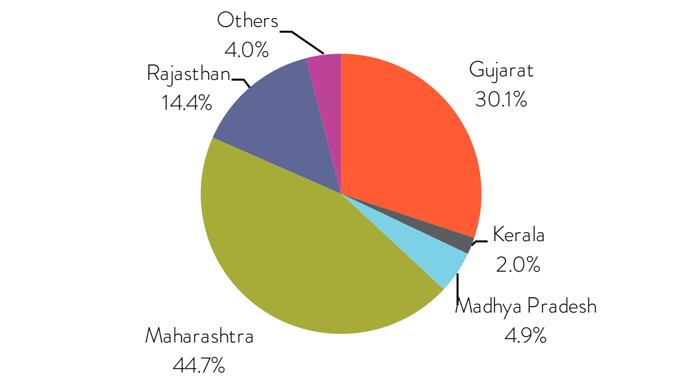
MUTH decided to diversify into home finance in FY15. The business, housed in 100% subsidiary Muthoot Home Finance (MHFL), focuses on lending to the affordable housing segment where average ticket size is ~Rs 1mn. As of FY19, the company posted 31% growth in AUM and earnings respectively. Though MHFL formed only 5% of consolidated AUM and ~2% of consolidated profit as of FY19, it is expected to be a meaningful contributor to profits in the medium term.

FIG 14 – MHFL: STEADY AUM GROWTH AND PRODUCTIVITY



Source: Company, BOBCAPS Research

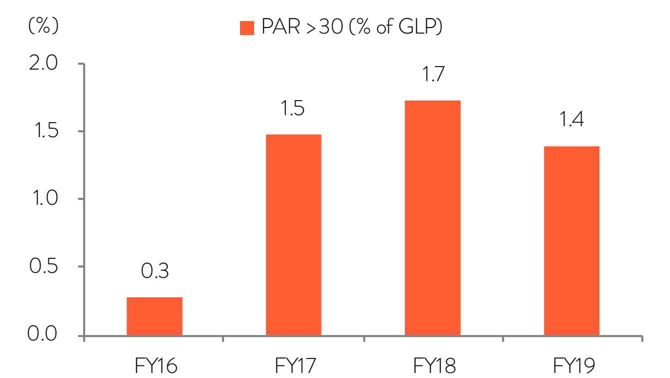
FIG 15 – STATE-WISE LOAN BOOK SPLIT, Q2FY19



Source: Company, BOBCAPS Research

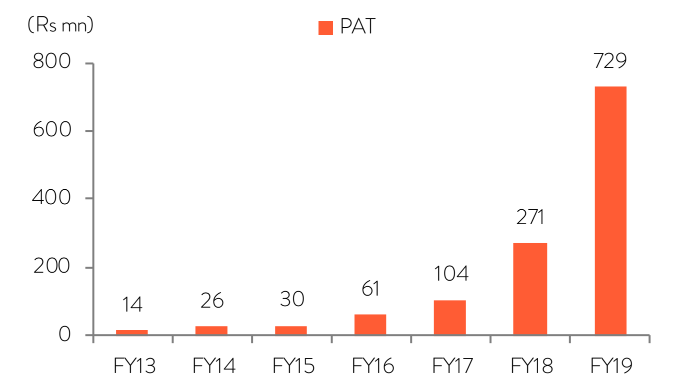
MUTH entered the microfinance business in Q4FY16 with the acquisition of Belstar Investment & Finance. Belstar offers agriculture loans to low-income households. The MFI has seen rapid growth over the past two years with gross loan portfolio (GLP) rising three-fold since acquisition in FY17 to Rs 19bn and net profit surging ~7x from Rs 104mn to Rs 729mn. Belstar contributed ~3.5% of consolidated profit as of FY19 (vs. 1.5% in FY18). We think the business can scale up profitably in the near term given geographic diversification and sturdy capital buffers.

FIG 16 – BELSTAR: LARGE SHG ORIGINATIONS HAVE KEPT RISK AT LOW LEVELS…



Source: Company, BOBCAPS Research

FIG 17 – …HELPING PROFIT GROW ~7X SINCE ACQUISITION



Source: Company, BOBCAPS Research

Cementing leadership in gold finance

Following a stagnant gold loan growth during the regulatory phase of FY12-FY14, MUTH was quick to deploy a mix of strategic initiatives that helped swiftly turn around the business and cement its No. 1 market position. A sustained focus on client retention, regular collections but lenient auctions, staff productivity and, in recent years, branch expansion has seen MUTH stay firmly in the lead (50% NBFC market share as of FY19), with loan volumes spiking 31% and AUM surging 44% to Rs 336bn over FY15-FY19.

Aided by customer stickiness and rising loan throughput per branch, we expect the company to continue to outpace peers, clocking a 13% loan AUM CAGR through FY19-FY22 to reach a book size of Rs 500bn by FY22.

Nimble-footed amid regulatory shake-up

After the regulatory purge of FY12-FY14 when the RBI introduced an LTV cap of 75% for gold loans, effectively leading to customer attrition to informal moneylenders and banks over NBFCs, MUTH adopted the following strategic initiatives to bring growth rapidly back on track even as peers languished.

- **Attractive schemes:** In order to counter the customer shift to banks due to LTV reduction, the company introduced new, competitive low-rate schemes. Though the discounts caused a 50-100bps drop in yields over Q1FY15-Q3FY16, the company posted a recovery in AUM growth from –17% to 13% over the period. In Q4FY16, management decided to streamline yields and hence started phasing out low-rate teaser schemes.

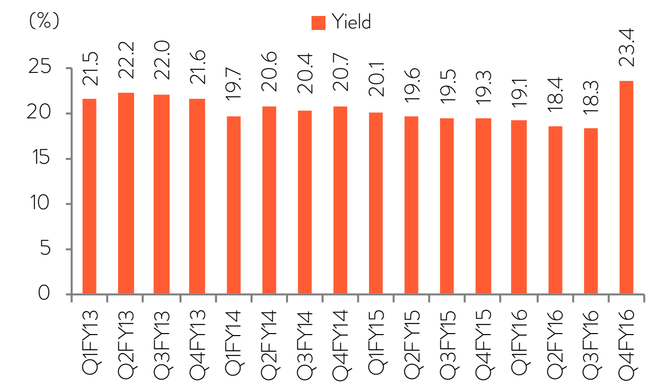
- **Regular collections:** With loan tenures of up to 12 months (4.5 months on average), branch staff were incentivised to pursue collections on a regular basis. The company also built a robust interest collection mechanism at the branch and regional office level along with dedicated call centres to service clients. Gross NPA ratio has largely remained unchanged during FY16-19 at ~2.8% levels.

- **Flexible auction policy:** Mindful of the emotive value of ornaments pledged for gold loans, MUTH adopted a policy of holding off on auctions if the branch staff was reasonably confident that the customer would be able to service the principal and at least 70-80% of interest – thus ensuring sticky client relationships. Holding off auctions contained average write-offs at ~2bps as a percentage of AUM during FY13-FY16.

  The company also maintained average LTV at ~70%, which implies that most loans were in-the-money and well collateralised – a practice that continues to date.

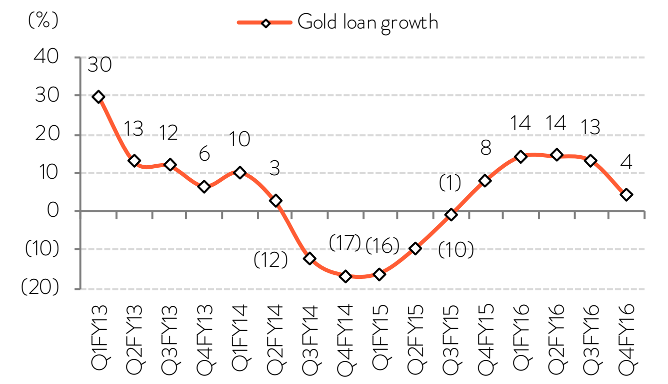
- **Branch rationalisation:** The branch count was retained between 4,260 and 4,275 from Q3FY14 to Q4FY16. During this period, the company closed a few branches and amalgamated others in order to bolster productivity.
- **Gold loans as 'push' products:** During FY07-FY12, gold loans were 'pull' products due to the rising gold prices, high LTV and lower loan penetration. After the regulations kicked in, the company successfully reoriented and retrained its sales personnel to hard sell gold loans to new customers through marketing campaigns at branches.

FIG 18 – YIELD DROPPED 50-100BPS IN Q1FY15-Q3FY16 DUE TO LOW-RATE TEASER SCHEMES...



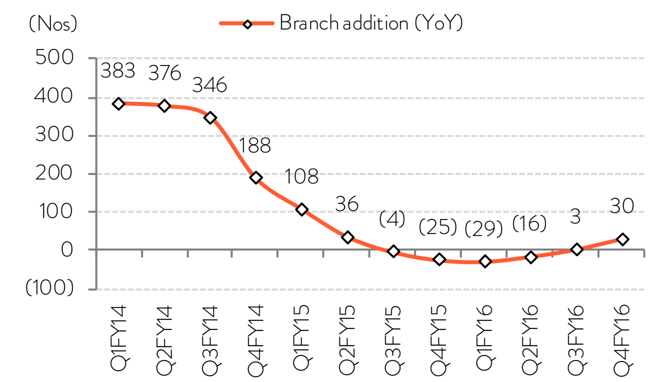
Source: Company, BOBCAPS Research

FIG 19 – ...BUT LOAN GROWTH RECOVERED TOWARDS EARLY-FY16



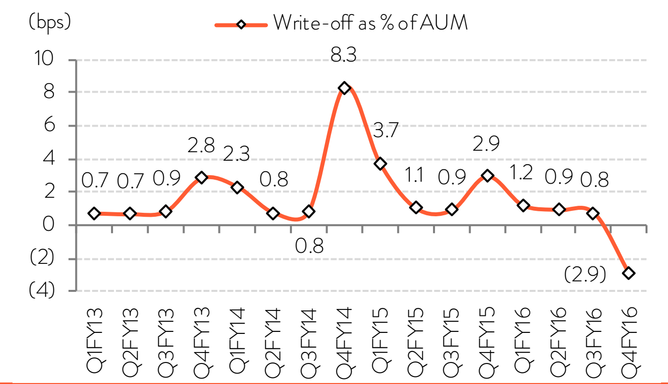
Source: Company, BOBCAPS Research

FIG 20 – BRANCHES WERE RATIONALISED TO SHED NON-PERFORMERS



Source: Company, BOBCAPS Research

FIG 21 – HOLDING OFF ON AUCTIONS KEPT AVG. WRITE-OFFS LOW AT ~2BPS DURING FY13-FY16

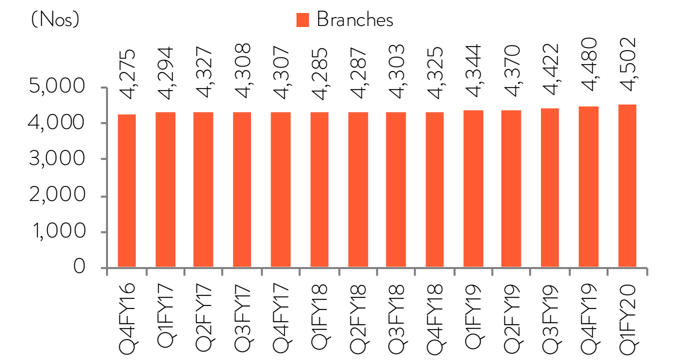


Source: Company, BOBCAPS Research

Loan book fast gaining momentum

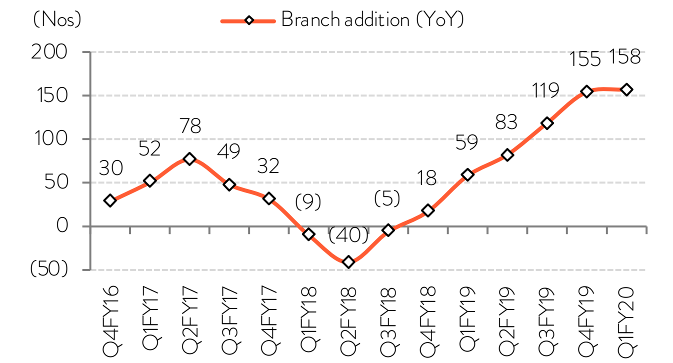
Following a 11% decline in growth during the regulatory phase of FY12-FY14, MUTH's strategic initiatives supported recovery to a 6% CAGR in loan accounts processed per branch and 8% CAGR in gold AUM per branch over FY15-FY19. This implies value growth over volume growth during this period. The proof of the pudding is in the consistent rise in average ticket since Q3FY18.

FIG 22 – STEADY BRANCH ADDITION



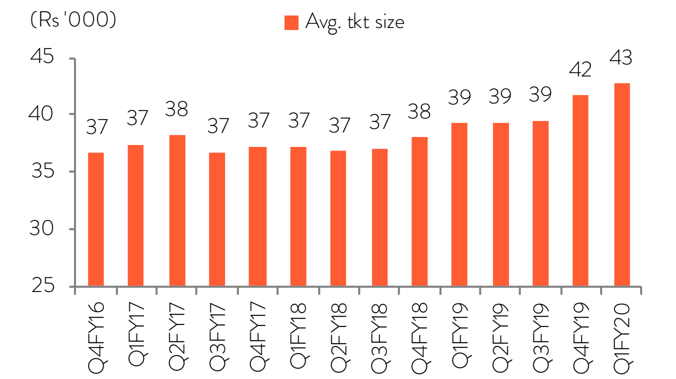
Source: Company, BOBCAPS Research

FIG 23 – EXPANSION GAINED STEAM FROM Q4FY18



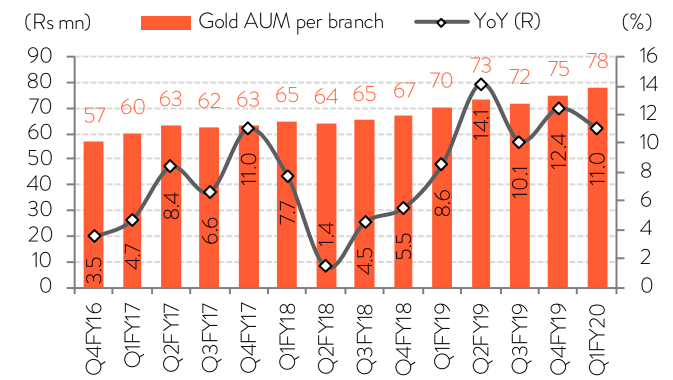
Source: Company, BOBCAPS Research

FIG 24 – AVERAGE TICKET SIZE CONSISTENTLY INCREASING SINCE Q3FY18



Source: Company, BOBCAPS Research

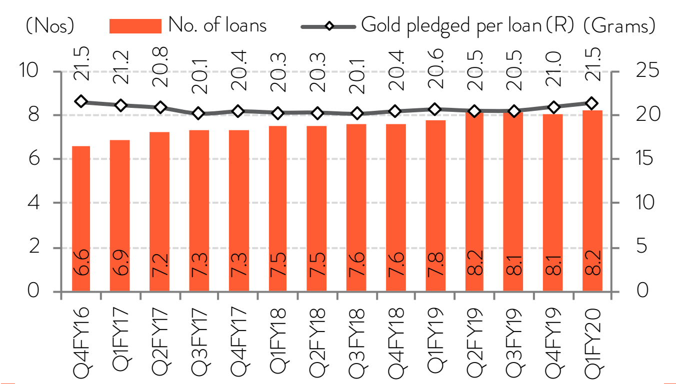
FIG 25 – GOLD AUM PER BRANCH UP 30% IN LAST THREE YEARS



Source: Company, BOBCAPS Research

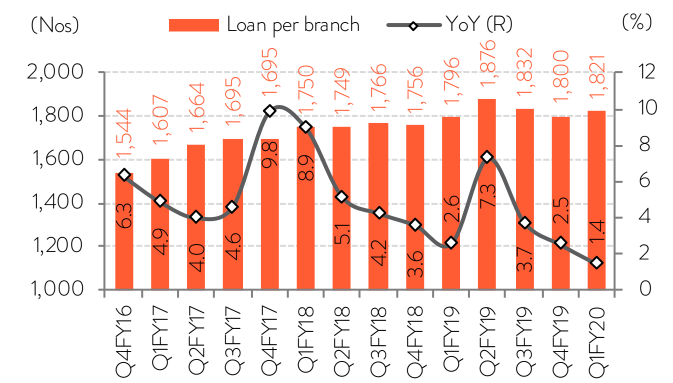
MUTH targets customers who would otherwise rely on the unorganised sector. While the company ensures relentless focus on collections, its policy of forbearance on collateral auction is a key factor behind sticky customer relationships, alongside branch personnel with local knowledge and understanding of customer needs. The management has indicated that ~75% of clients are repeat customers.

FIG 26 – REGAINING LOST MARKET SHARE AS LOANS OUTSTANDING HAS RISEN CONSISTENTLY…



Source: Company, BOBCAPS Research

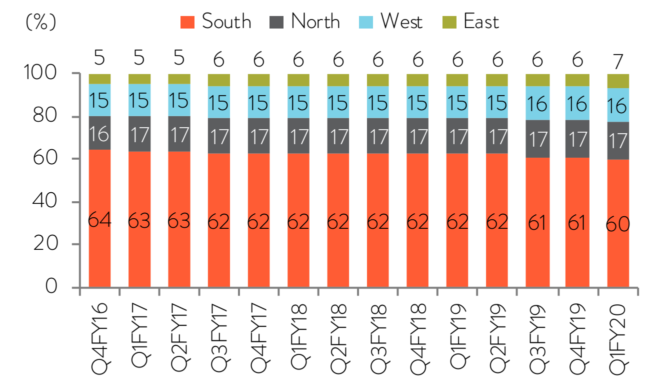
FIG 27 – …AND THROUGHPUT HAS INCREASED (13% MORE LOANS PROCESSED PER BRANCH IN 3 YEARS)



Source: Company, BOBCAPS Research

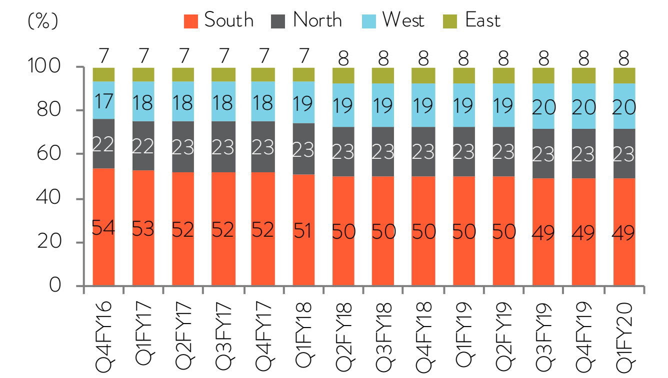
The company has added ~230 branches over the past three years to build a ~4,500-strong network in Q1FY20 and plans to ramp up to 200-250 branch additions annually in the near term. The core branch expansion strategy is to penetrate new markets and expand the customer base. Expansion is also dictated by the twin goals of consolidating market leadership in South India (49% of portfolio) and building a stronger footprint in North India.

FIG 28 – THOUGH SOUTH INDIA HAS THE HIGHEST BRANCH CONCENTRATION…



Source: Company, BOBCAPS Research | Note: % split of branches

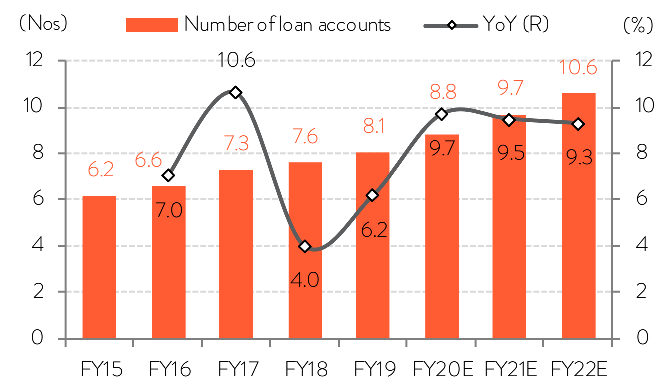
FIG 29 – …WEST AND NORTH INDIA ARE MORE PRODUCTIVE AS BRANCHES ARE MORE URBAN



Source: Company, BOBCAPS Research | Note: % split of AUM

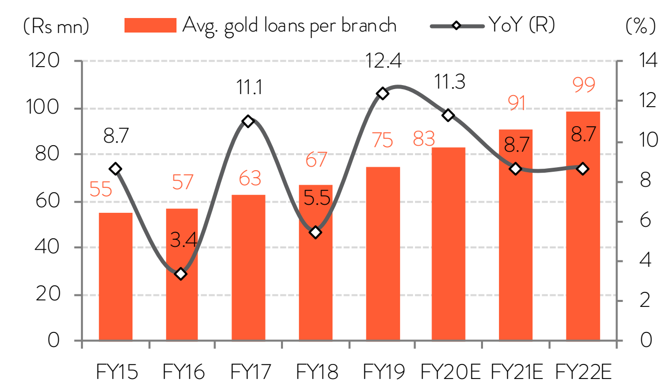
MUTH processed 1,800 loans per branch as of FY19 (vs. ~1,500 in FY16), and we expect this number to increase by 5% p.a. through FY20-FY22, assuming 200 touch points are added per year. Accordingly, throughput per branch is estimated to rise from Rs 75mn in FY19 to Rs 99mn by FY22. We estimate that volume growth driven by higher branch productivity will expand the company's loan book from Rs 349bn in FY19 to Rs 500bn by FY22, representing a robust 13% CAGR.

FIG 30 – NUMBER OF LOAN ACCOUNTS TO GROW AT 9% CAGR DURING FY19-FY22E…



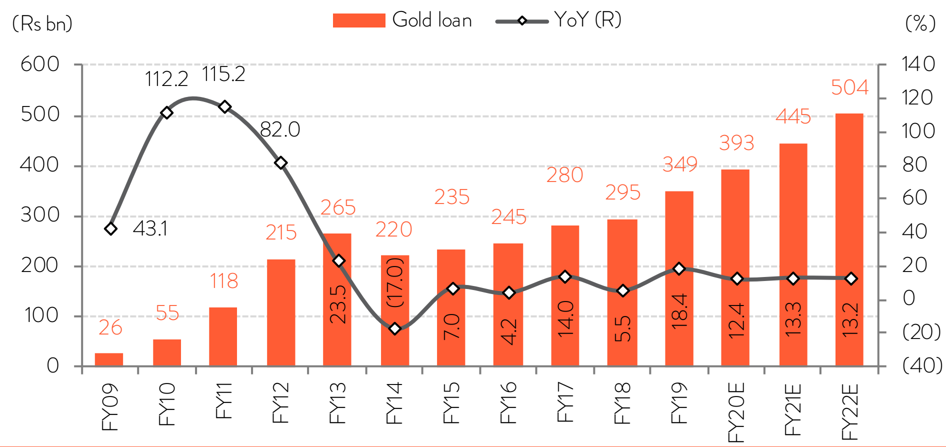
Source: Company, BOBCAPS Research

FIG 31 – …AND GOLD LOANS PER BRANCH TO GROW AT 10% CAGR



Source: Company, BOBCAPS Research

FIG 32 – WE EXPECT 13% LOAN CAGR OVER FY19-FY22E



Source: Company, BOBCAPS Research

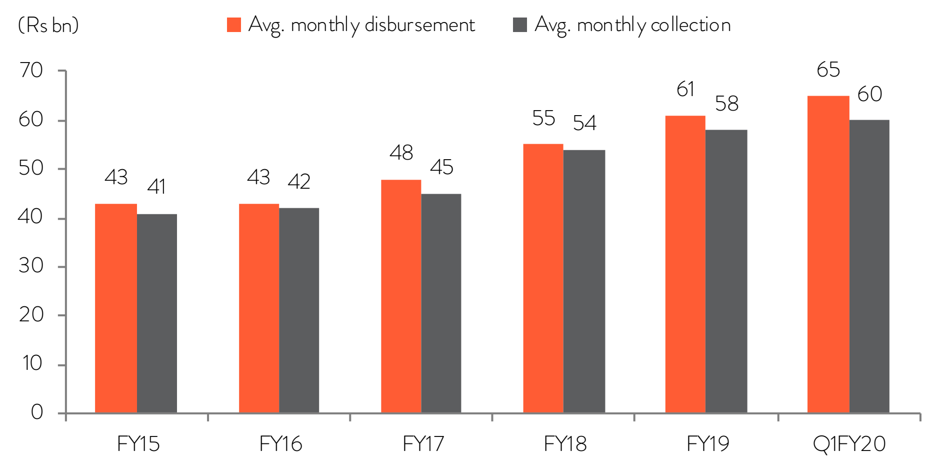
Spreads to remain stable over FY20E-FY22E

MUTH has been able to create a high-churn portfolio backed by a loyal, growing customer base. The company maintains an average LTV of ~70% and a granular book, supporting yields. We expect yields on the gold portfolio to sustain at ~21% during FY20-FY22. An improving credit rating, positive asset-liability mismatch in the one-year bucket and conducive borrowing mix should contain the cost of funds at 9.5% levels through FY20-FY22. We thus forecast stable spreads of ~11.5% on the gold finance business through this period.

Yields to hold at ~21%

MUTH's gold loans have an average tenure of ~4.5 months (61% of loans repaid within six months in 1QFY20), thus creating a high-churn portfolio. Also, given the emotive value of ornaments pledged by customers, the credit product becomes self-liquidating as borrowers make every effort to avoid delinquency. The high churn is reflected in average monthly disbursements and collections of Rs 65bn and Rs 60bn respectively in Q1FY20.

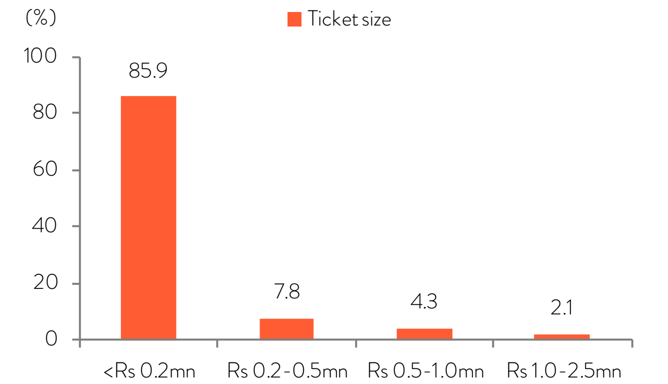
FIG 33 – HIGH-CHURN PORTFOLIO



Source: Company, BOBCAPS Research

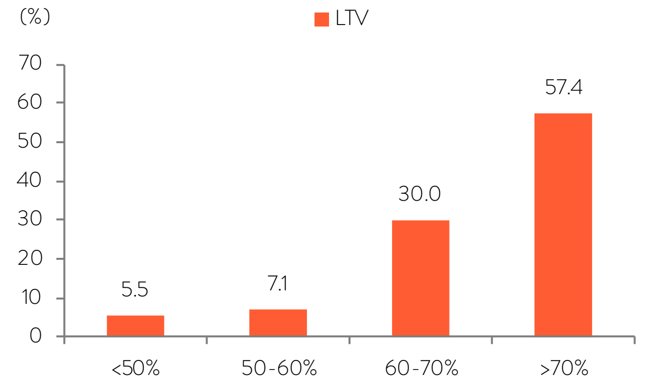
Customers are not rate sensitive and MUTH's LTV and auction policies ensure ~75% repeat business. The company maintains an average LTV of ~70% on its portfolio with ticket size of under Rs 0.2mn for 86% of the loan book (FY18), making for a granular lending profile.

FIG 34 – GRANULARITY IN PORTFOLIO IS EVIDENT, FY18



Source: Company, BOBCAPS Research

FIG 35 – ~87% OF PORTFOLIO HAS LTV OF 60-80%, FY18

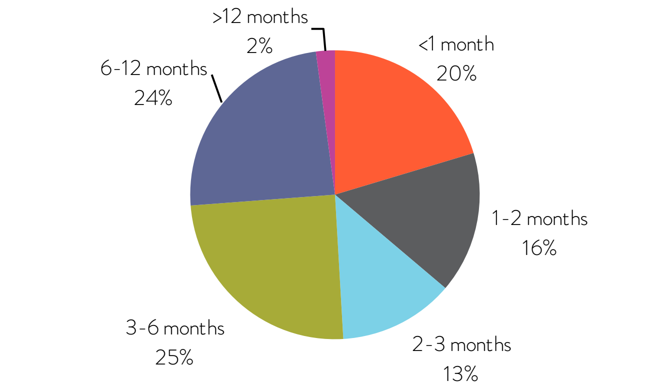


Source: Company, BOBCAPS Research

Traditionally, the market for loan products was confined to lower- and middle-income groups, who viewed gold loans as a last resort. The company has undertaken sustained marketing efforts to position gold loans as a lifestyle product, in order to expand the customer base to upper-income groups.

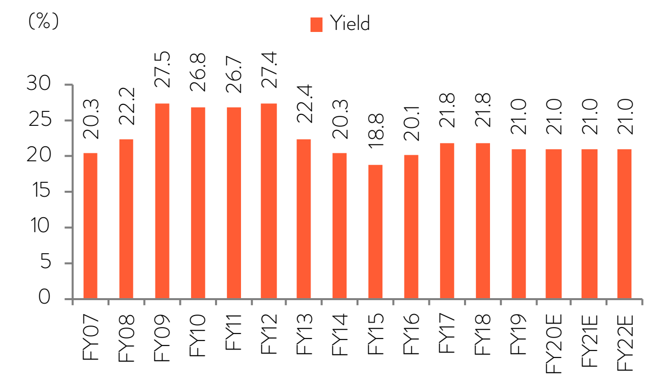
We note of average ticket size per loan has increased from Rs 37,000 in Q3FY18 to Rs 43,000 in Q1FY20. We expect the company to maintain an average LTV of ~70% through FY20-FY22 and deliver an average yield of ~21%.

FIG 36 – 74% OF PORTFOLIO HAS LOAN MATURITY BELOW SIX MONTHS, FY19



Source: Company, BOBCAPS Research

FIG 37 – YIELDS EXPECTED TO REMAIN STABLE THROUGH FY20E-FY22E



Source: Company, BOBCAPS Research

Positive ALM and borrowing mix

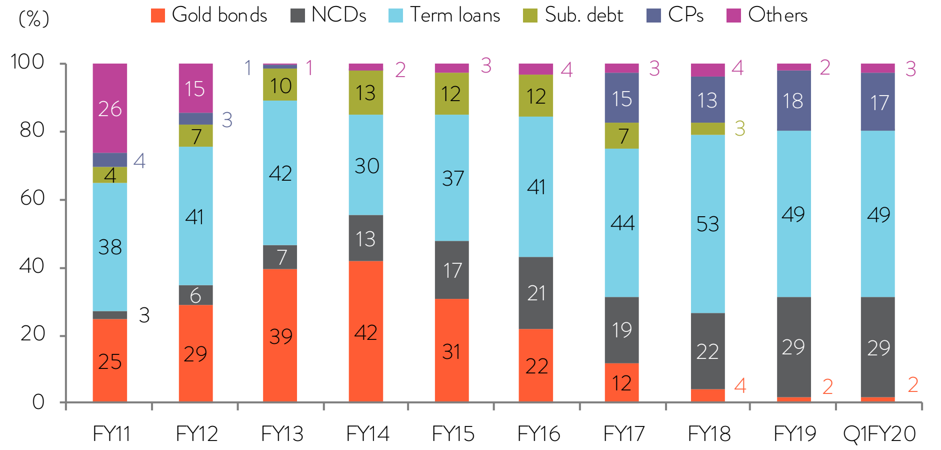
MUTH's credit rating has improved over FY11-FY19, enabling it to increase short-term money market instruments such as commercial papers. Also, following restrictions on gold bond issuance, the company has incrementally replaced these with secured and unsecured NCDs. Better internal accruals have also enabled a reduction in expensive subordinated debt.

FIG 38 – IMPROVEMENT IN CREDIT RATING

	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19
CPs	A1+	A1+	A1+	A1+	A1+	A1+	A1+	A1+	A1+
Bank Loans	AA-	AA-	AA-	AA-	AA-	AA	AA	AA	AA
NCDs	AA-	AA-	AA-	AA-	AA-	AA	AA	AA	AA

Source: Company, BOBCAPS Research

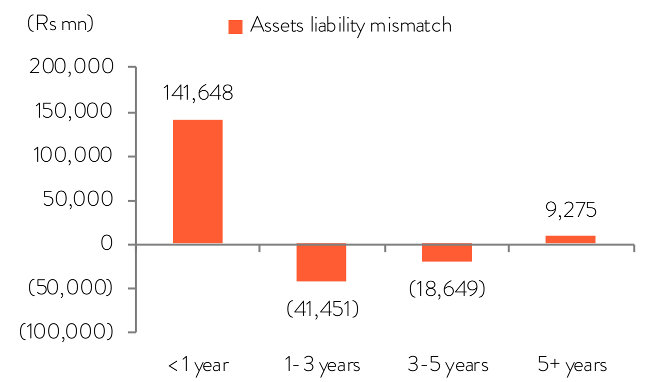
FIG 39 – GOLD BONDS PROGRESSIVELY REPLACED BY NCDs



Source: Company, BOBCAPS Research

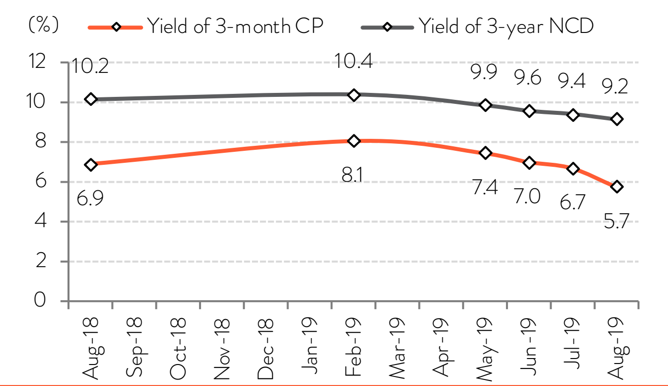
As of FY19, MUTH had a positive asset-liability mismatch in the less than one-year bucket, which is conducive for spreads. With ~93% of loans maturing in less than a year and gold loans being a self-liquidating product with close to zero loss-given defaults, liquid funds have found favour in MUTH's CP issuances. We note that yields of three-month CPs and three-year NCDs have come off in the last six months and now trend below pre-IL&FS crisis levels.

FIG 40 – 93% OF ASSETS COME UP FOR MATURITY IN LESS THAN A YEAR



Source: Company, BOBCAPS Research

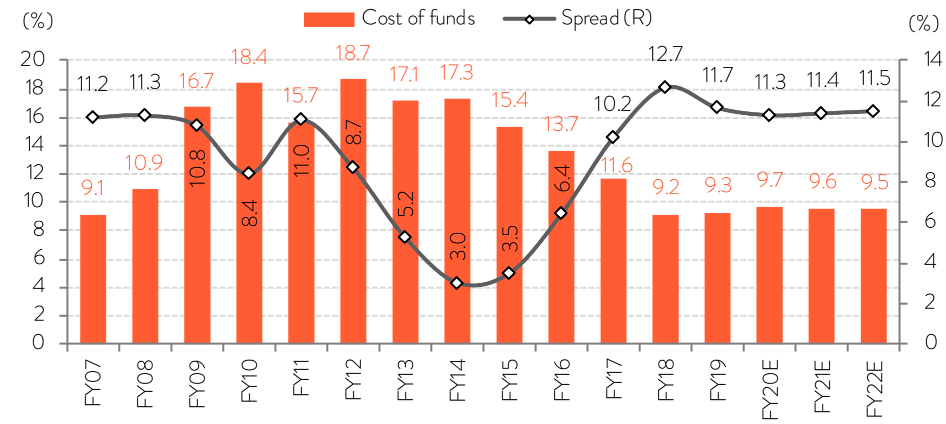
FIG 41 – CP AND NCD YIELDS ARE AT PRE-IL&FS CRISIS LEVELS



Source: Company, BOBCAPS Research

We expect the company to have a stable cost of funds at ~9.5% levels through FY20-FY22 given its strong franchise, customer traction and incremental CP share in the borrowing mix. Stability in both yields and cost of funds should anchor spreads at a steady ~11.5% over our forecast period.

FIG 42 – SPREADS TO HOLD AT ~11.5%



Source: Company, BOBCAPS Research

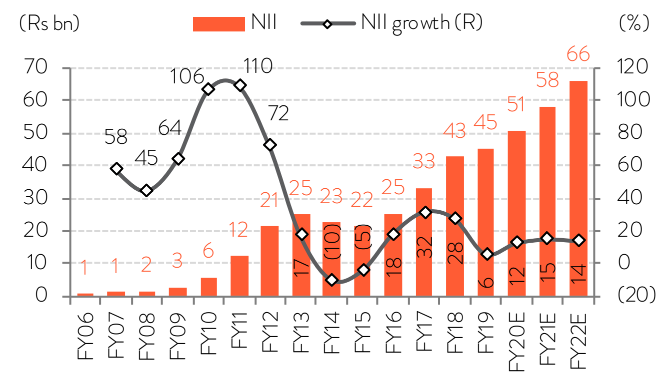
Healthy earnings visibility

Aided by increased branch productivity, we expect NII growth at 14% CAGR to outstrip opex growth during FY19-FY22, thus manifesting in operating leverage. Branch rationalisation to weed out low performers and employee cost controls alongside process automation should see the expense ratio trending down 30bps during FY19-FY22, which will take operating profit growth ahead of AUM growth. Baking in MUTH's customer-friendly auction policy that contains write-offs at benign levels, we forecast credit cost of ~27bps during FY20-FY22 and a 20% PAT CAGR in FY19-22.

Increased productivity to bolster operating leverage

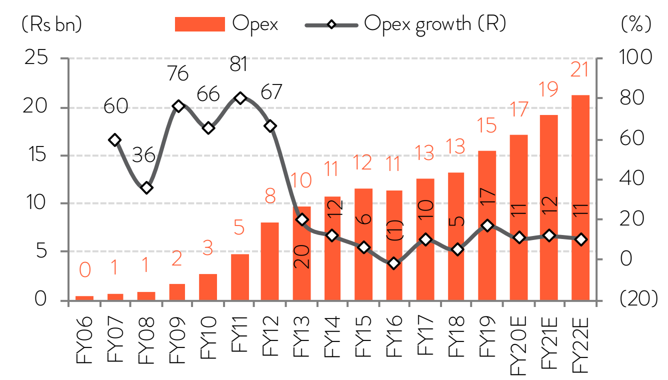
A steady focus on customer retention and addition, uniform LTV across loan tenures and a beneficial borrowing mix is expected to fuel a 14% CAGR in NII for MUTH over FY19-FY22. During the same period, we forecast a lower operating expense CAGR of 11% led by employee cost control and increased use of technology.

FIG 43 – NII CAGR AT 14% AND...



Source: Company, BOBCAPS Research

FIG 44 – ...OPEX CAGR AT 11% DURING FY19-FY22E



Source: Company, BOBCAPS Research

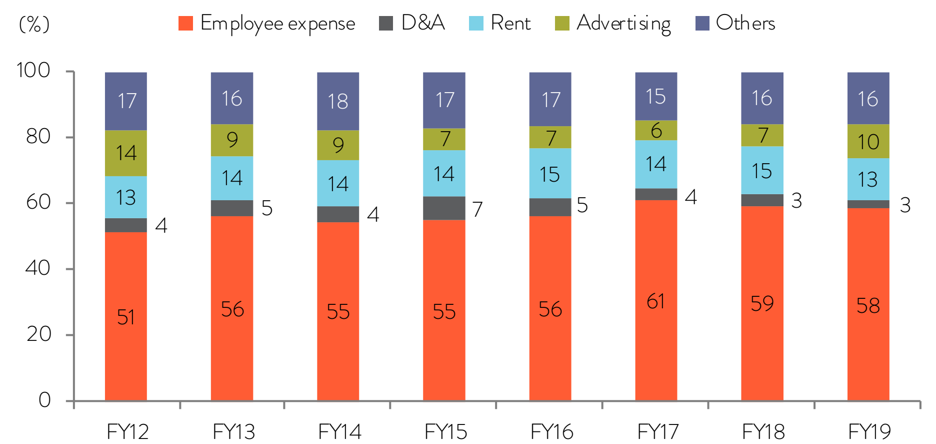
Employee cost control keeps opex in check

Employee count and expense per employee have remained largely range-bound during the last four years due to MUTH's preference for the contractual recruitment model, especially at call centres. Over the past 4-5 years, the company also rationalised its network by merging some low performing branches with high performers, thereby cutting the employee count and raising productivity.

AUM per employee has grown 1.4x during Q1FY16-Q1FY20. If we look at the split of opex, employee expense has averaged ~57% share during FY12-FY19. Advertising and rent remained between 20% and 27% of opex.

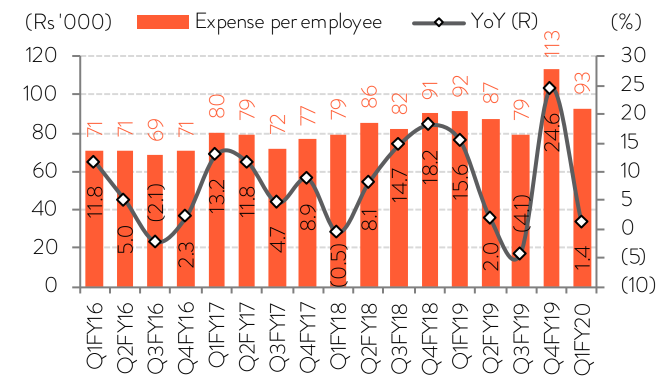
We note that gold finance has high fixed costs as vaults have to be built at each branch, small dockets are needed to handle pledged gold, and security costs are substantial, both technology and human. However, increased throughput aided by customer stickiness and faster loan turnaround time are likely to offset the rise in opex due to branch expansion and other increments given to employees.

FIG 45 – BREAKUP OF OPEX



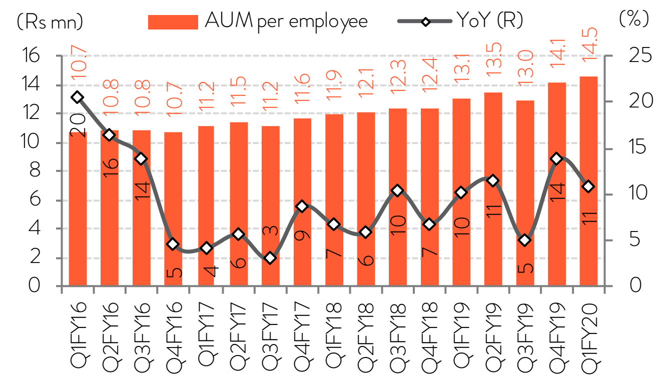
Source: Company, BOBCAPS Research

FIG 46 – EXPENSE PER EMPLOYEE RANGE-BOUND DURING Q1FY16-Q1FY20…



Source: Company, BOBCAPS Research

FIG 47 – …THOUGH AUM PER EMPLOYEE HAS GROWN AT 8% CAGR DURING THE SAME PERIOD

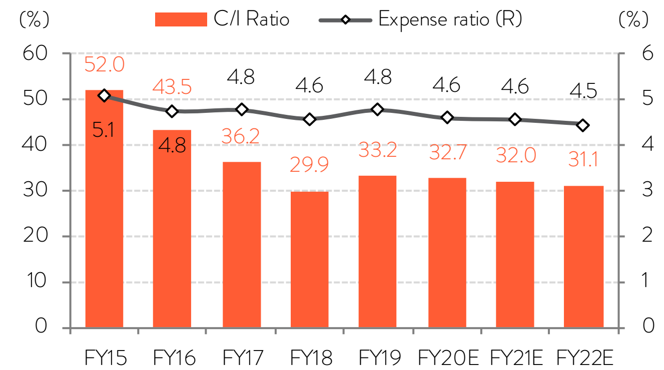


Source: Company, BOBCAPS Research

Value growth to outpace volume growth

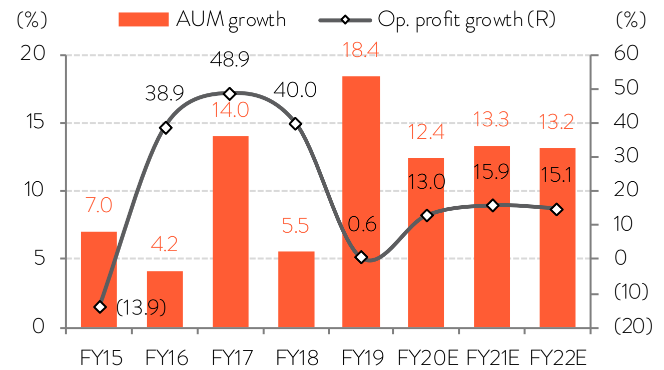
Given the focus on lower turnaround time and cost control, we expect the cost-to-income ratio to decline by 200bps during FY19-FY22 and expense ratio to trend down 30bps. All these factors should lead to operating profit growth leading AUM growth over this period.

FIG 48 – WE EXPECT EXPENSE RATIO TO DECLINE 30BPS TO 4.5% BY FY22E



Source: Company, BOBCAPS Research

FIG 49 – OPERATING PROFIT GROWTH TO OUTPACE AUM GROWTH DURING FY20E-FY22E



Source: Company, BOBCAPS Research

Stable credit to augur well for PAT growth

Trained staff help safeguard loan origination through stringent collateral quality checks. The recovery process and employee incentives are oriented to keep interest collection regular and minimise accrued interest, while a customer-friendly auction process lowers write-offs. Keeping these factors into account, we bake in average credit cost of ~27bps during FY20-FY22, ~50% of that during FY15-FY19. This should lead to a 20% PAT CAGR in FY19-FY22.

Trained staff ensure safe loan origination

MUTH has two management academies in Delhi and Kochi to train staff on gold collateral assessment. It also has 74 regional training centres.

Strong recovery process

The credit department assigns interest collection targets for each branch, reviews performance against targets, makes visits to branches and advises on timely corrective measures and repossession action. The company has procedures in place to penalise branches for loans overdue beyond three months and has linked employee compensation with branch performance.

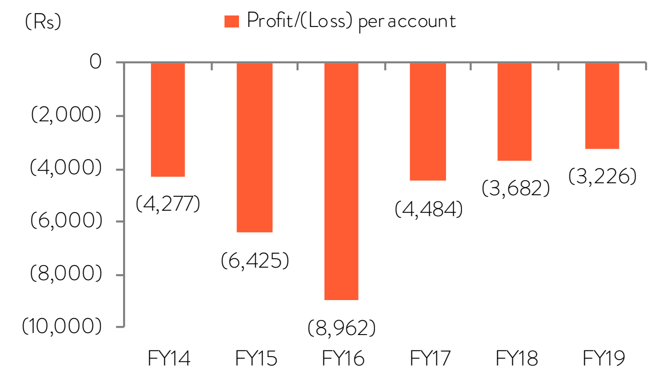
Auction process designed to minimise write-offs

The auction process typically takes place only after the customer is given sufficient notice, usually a month. Management has indicated that the quality of collateral is already checked at loan origination and gold being a safe collateral, they are able to hold off auctions for a longer period. Partial interest waivers in exceptional cases also increase customer loyalty.

With regular interest collection and a strong incentive structure for branch level employees, auction losses have been coming off since FY16. In FY19, auction losses per account were Rs 3,226 vs. Rs 8,962 in FY16. The number of loan accounts that came up for auctioning also reduced by nearly two-third from 0.90mn to 0.36mn over FY16-FY19, dropping from 13.7% of total loan accounts to 4.6%.

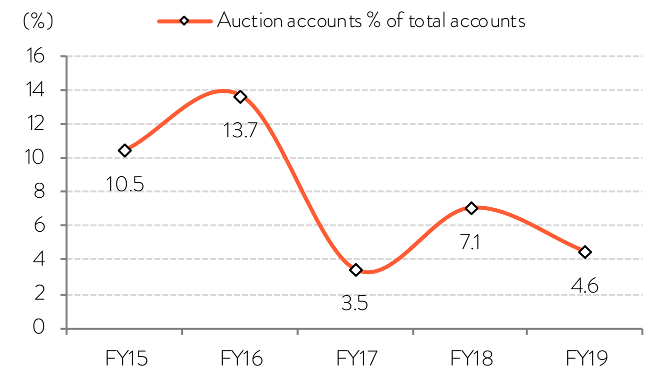
This is also reflected in average one-year lagged write-offs of ~6bps through FY15-FY19. We expect the company to have an average credit cost of ~27bps during FY20-FY22, ~50% of that during FY15-FY19.

FIG 50 – LOSS PER ACCOUNT IS A THIRD OF THE LEVELS SEEN IN FY16…



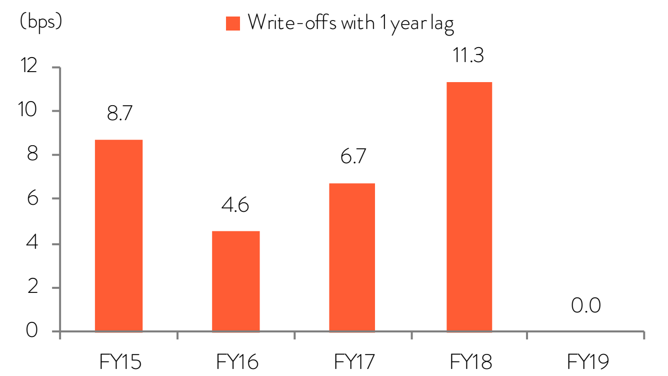
Source: Company, BOBCAPS Research

FIG 51 – …NUMBER OF AUCTION ACCOUNTS AS % OF TOTAL HAS ALSO DROPPED



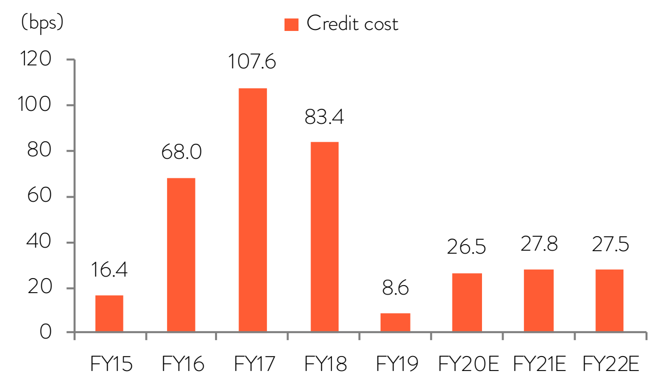
Source: Company, BOBCAPS Research

FIG 52 – AVERAGE ONE-YEAR LAGGED WRITE-OFF AT ~6BPS THROUGH FY15-FY19



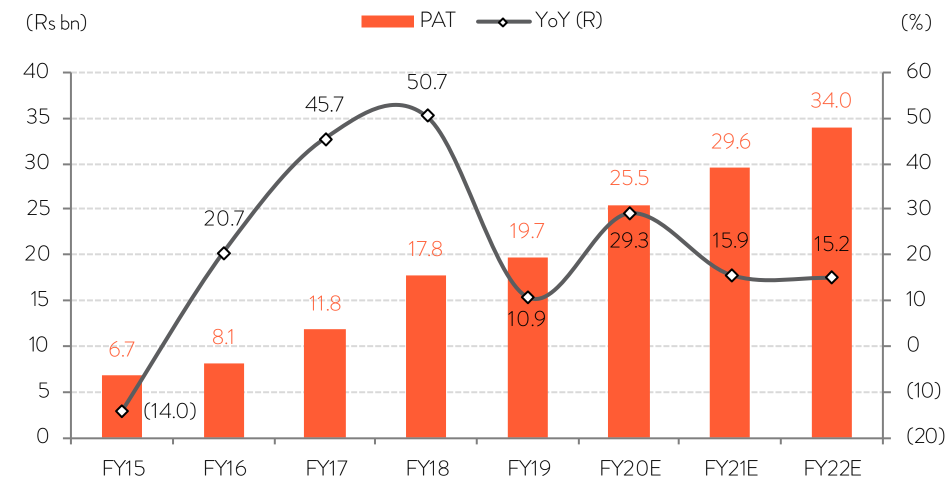
Source: Company, BOBCAPS Research

FIG 53 – WE EXPECT CREDIT COST AT ~27BPS DURING FY20E-FY22E



Source: Company, BOBCAPS Research

FIG 54 – PAT CAGR ESTIMATED AT 20% DURING FY19-FY22E

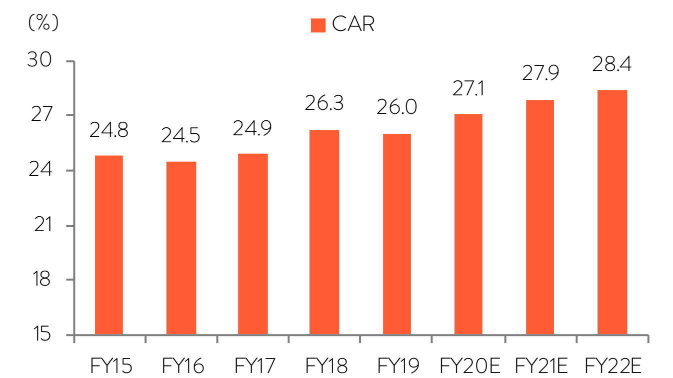


Source: Company, BOBCAPS Research

Return ratios look sustainable

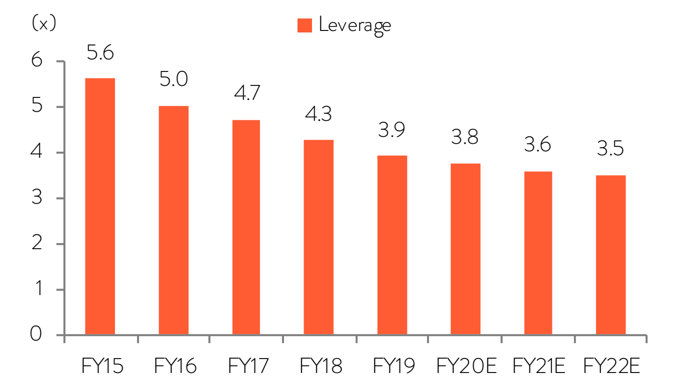
MUTH has been increasing its capital adequacy during FY12-FY19 (from 18.3% to 26%), largely backed by higher internal accruals. The sturdy capital buffer helps tide over event risks arising during the product lifecycle. Underpinned by strong loan origination, regular collections, low credit costs, and positive ALM in the one-year bucket, we expect stable ROA of ~6.5% over FY20-FY22. We have baked in a low-levered business model with an average of ~3.6x leverage during FY20-FY22. Average ROE is forecast at ~23.5%.

FIG 55 – INTERNAL ACCRUALS HAVE HELPED BUILD STRONG CAPITAL BUFFERS…



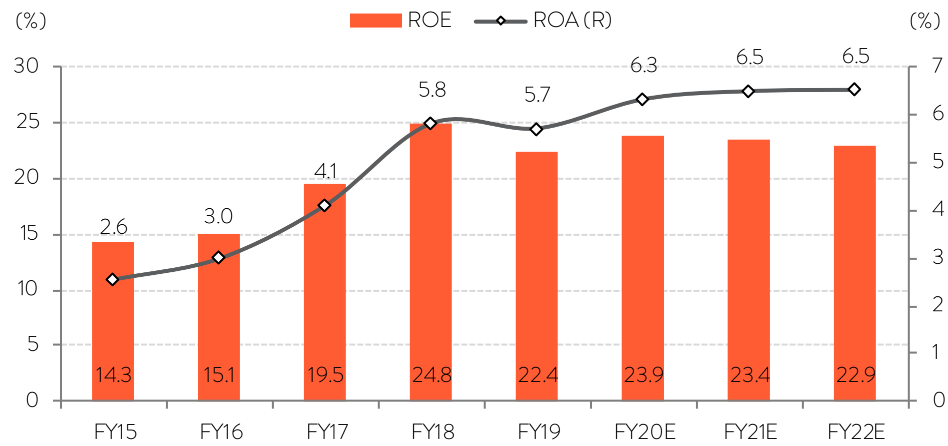
Source: Company, BOBCAPS Research

FIG 56 – …LEADING TO LOW LEVERED BUSINESS MODEL



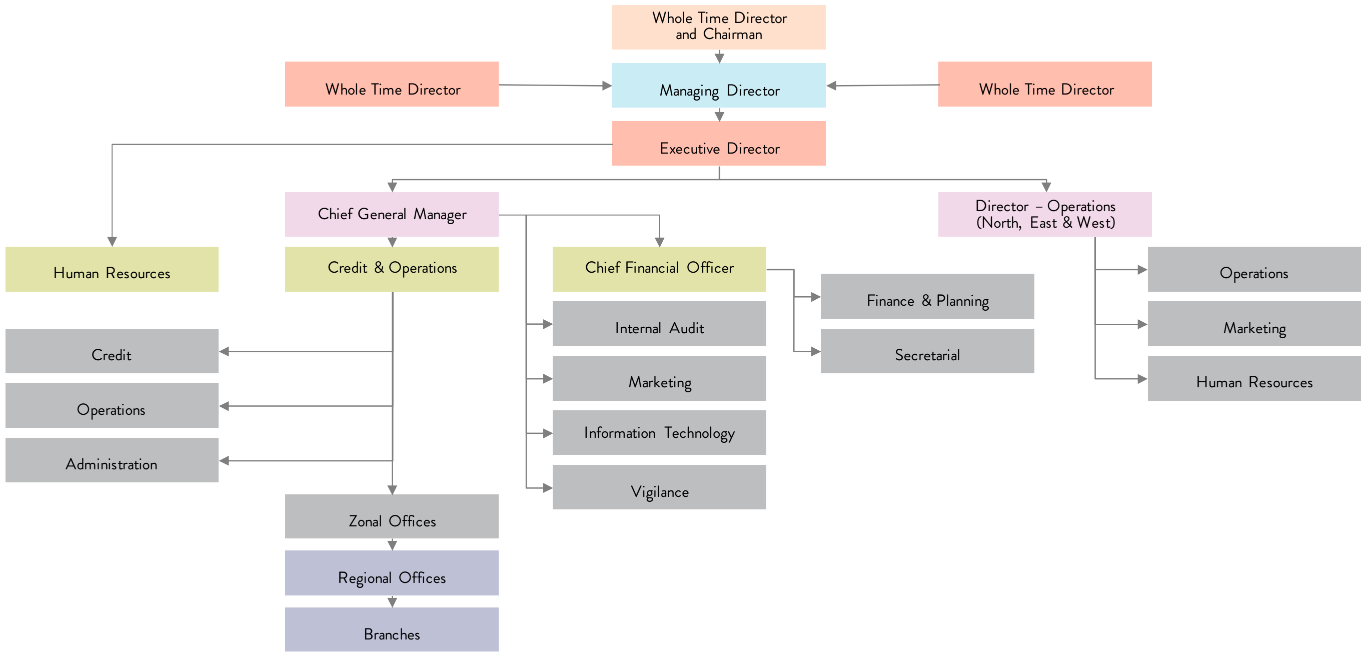
Source: Company, BOBCAPS Research

FIG 57 – WE EXPECT HEALTHY RETURN RATIOS DURING FY20E-FY22E



Source: Company, BOBCAPS Research

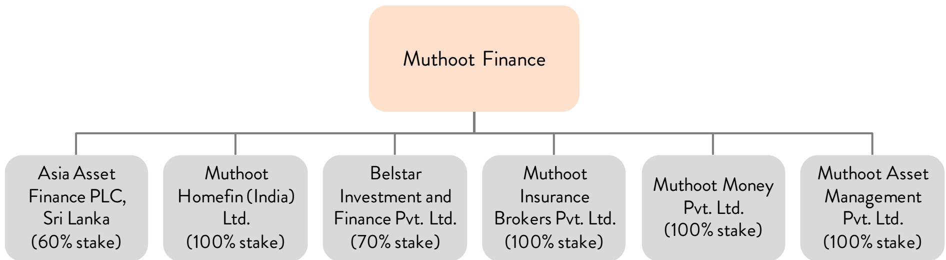
FIG 58 – ORGANISATION STRUCTURE



Source: Company, BOBCAPS Research

Corporate structure

FIG 59 – MUTHOOT FINANCE: CORPORATE STRUCTURE



Source: Company, BOBCAPS Research

Home finance business on steady growth path

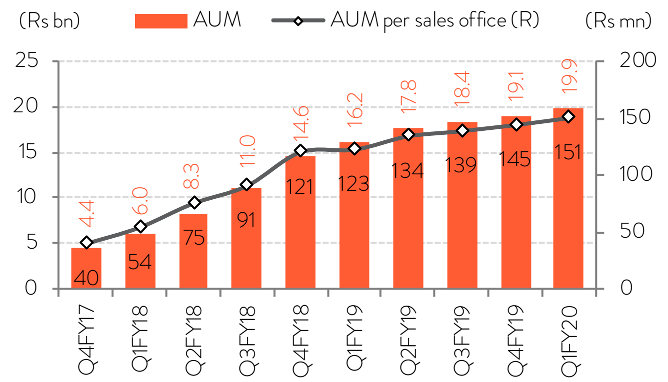
In the wake of tighter gold finance regulations, MUTH decided to diversify into home finance in FY15. The business, housed in 100% subsidiary Muthoot Home Finance (MHFL), focuses on lending to the affordable housing segment where average ticket size is ~Rs 1mn. As of FY19, the company posted 31% growth in AUM and earnings respectively. MHFL formed only 5% of consolidated AUM and ~2% of consolidated profit as of FY19, but is expected to be a meaningful contributor to the profit pool over the medium term.

Focused strategy to be a retail player

MHFL leverages the gold finance branches as lead generators and focuses on affordable housing where average ticket size is ~Rs 1mn. It has a separate management team based in Mumbai and works on a hub-and-spoke model with centralised processing at the corporate office. MHFL sources loans through its own personnel to keep prudent pricing of loans in the affordable housing segment.

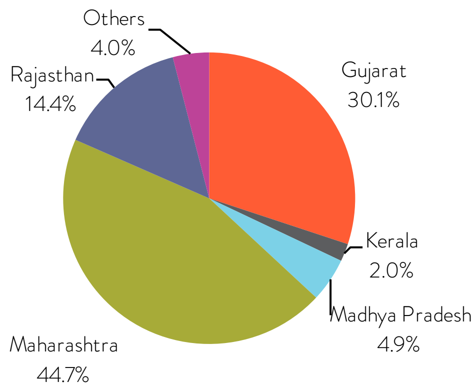
The company is currently present in 16 states and serves ~23,000 customers, with plans to expand into underserved and smaller cities.

FIG 60 – STEADY AUM GROWTH AND PRODUCTIVITY



Source: Company, BOBCAPS Research

FIG 61 – STATE-WISE LOAN BOOK SPLIT, Q2FY19



Source: Company, BOBCAPS Research

Business model geared for steady spreads

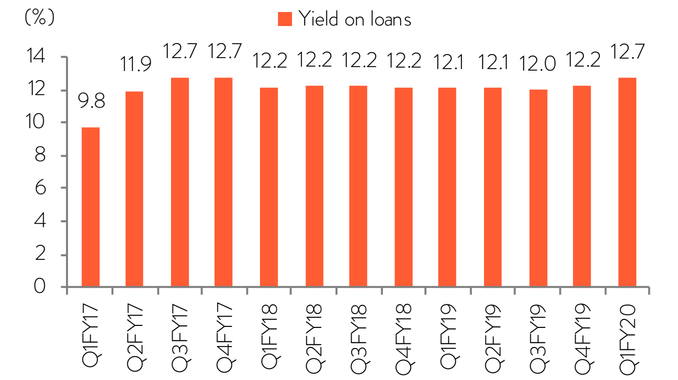
As MHFL is a ~100% housing loan portfolio with a focus on lower middle-income customers, yields have been sticky. Strong parentage and improving credit ratings have helped MHFL raise money from debt markets as well as banks since inception at competitive interest rates. Management has guided for spreads of 3-3.5% in the near term.

FIG 62 – STRONG CREDIT RATINGS

Nature of Borrowing	CRISIL Rating
Long-term Bank Loan	AA/Stable
Secured NCDs	AA/Stable

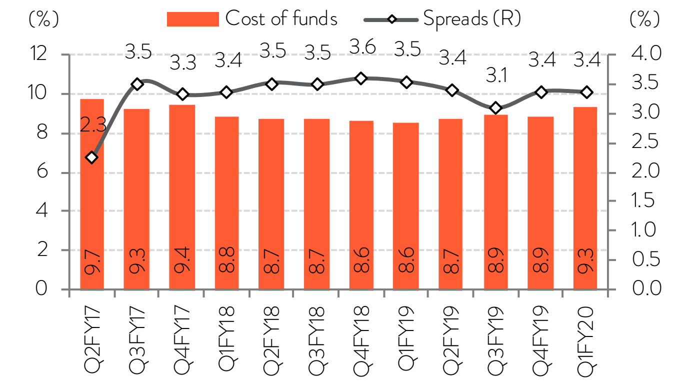
Source: Company, BOBCAPS Research

FIG 63 – OWN SOURCED RETAIL LOANS HAVE LED TO STICKY YIELDS



Source: Company, BOBCAPS Research

FIG 64 – BETTER CREDIT RATING AND PARENTAGE SUPPORT STEADY BORROWING COST

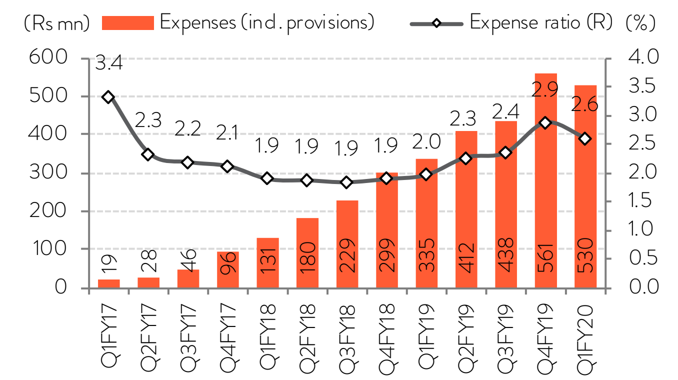


Source: Company, BOBCAPS Research

Cost controls and healthy asset quality

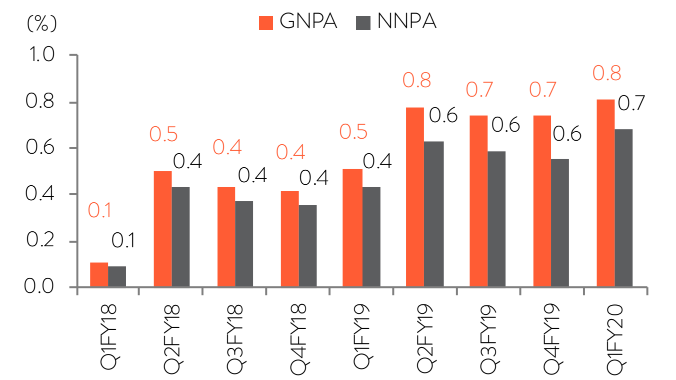
Strong cost controls have led to an average expense ratio of ~2.3% over last three years. The company has an incentivised collections team to tackle hard bucket delinquencies. GNPA increased from 11bp in 1QFY18 to 81bp in 1QFY20 due to seasoning of the portfolio.

FIG 65 – EXPENSE RATIO REMAINS IN CONTROL…



Source: Company, BOBCAPS Research

FIG 66 – …SEASONING OF PORTFOLIO LED TO INCREASE IN GNPA

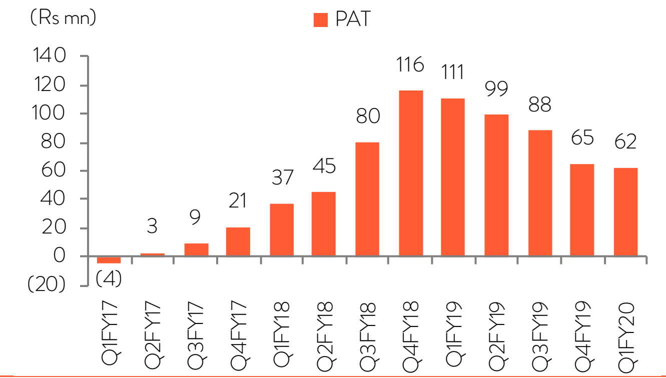


Source: Company, BOBCAPS Research

Management expects ~2.5% ROA in near term

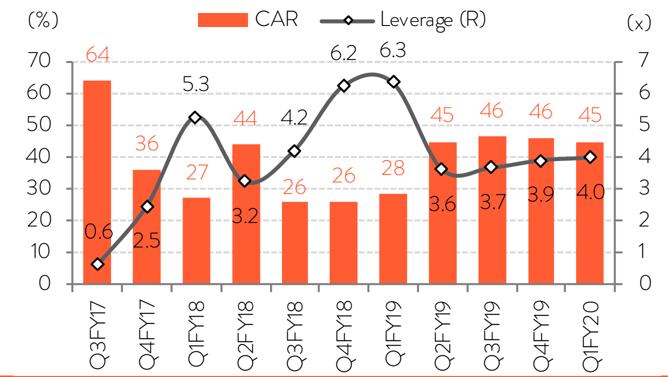
The promoters infused Rs 1.5bn into the home finance arm in Q2FY19, though the business was well capitalised at 28.4% CAR at the end of Q1. This was done in anticipation of growth in the loan book in the near term and to maintain lower leverage in the business.

FIG 67 – HOME FINANCE PROFITS HAVE BEEN DIPPING IN LAST ONE YEAR…



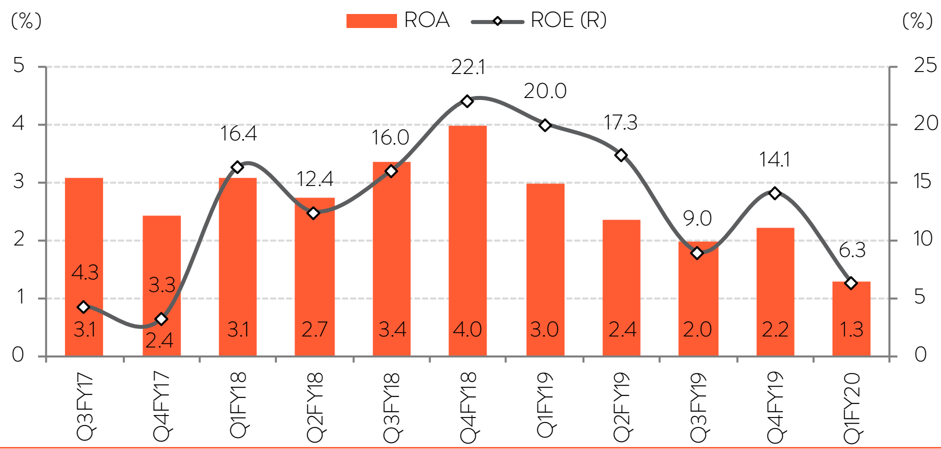
Source: Company, BOBCAPS Research

FIG 68 – …THOUGH THE BUSINESS IS WELL CAPITALISED AND LOW LEVERED



Source: Company, BOBCAPS Research

FIG 69 – MANAGEMENT GUIDES FOR ROA OF 2.5% IN NEAR TERM



Source: Company, BOBCAPS Research

Belstar acquisition adding to profit pool

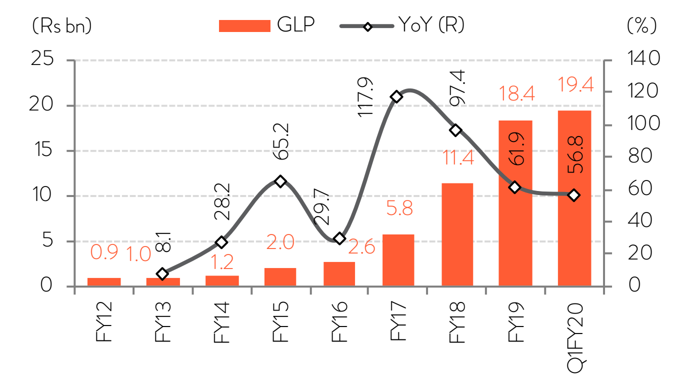
MUTH entered the microfinance business in Q4FY16 with the acquisition of 57% in Belstar for a consideration of Rs 550mn; this stake was later raised to 70%. Belstar offers agriculture loans to low income households, and has seen rapid growth over the past two years with GLP rising three-fold to Rs 19bn since acquisition in FY17 and net profit surging ~7x from Rs 104mn to Rs 729mn. Belstar contributed ~3.5% of consolidated profit as of FY19 (vs. 1.5% in FY18). Given geographic expansion and strong capital buffers, the business is well positioned to scale up profitably in the near term.

Loan book has tripled since FY17

Belstar offers agriculture loans to women, with more than a third of its clients coming from vulnerable families. The company follows both the self-help group (SHG, 80% of customers) as well as the joint liability group (JLG, 20%) model of lending. Gross loan portfolio (GLP) has grown three-fold since acquisition in FY17 to Rs 19bn, led by a tripling of branches to 441, diversification into sixteen states, and higher ticket size per customer (from Rs 17k to Rs 23k).

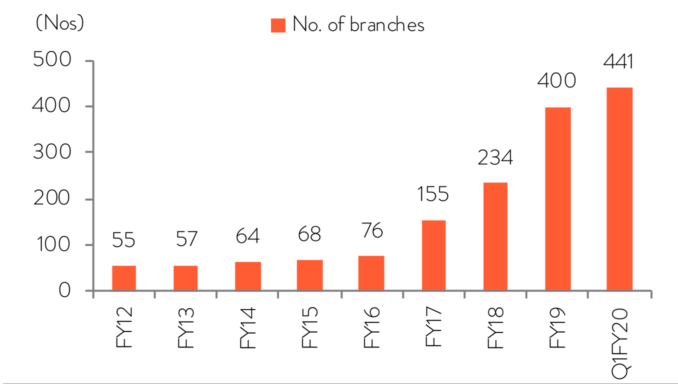
GLP market share post acquisition in FY17 has risen from 1.8% to 2.7% in FY19, as new products including consumer goods loans, first cycle loans and small enterprise lending have led to healthy client additions. Large SHG originations have kept risk at low levels, helping profit grow ~7x since acquisition to Rs 729mn.

FIG 70 – GLP HAS GROWN ~3X SINCE ACQUISITION IN FY17…



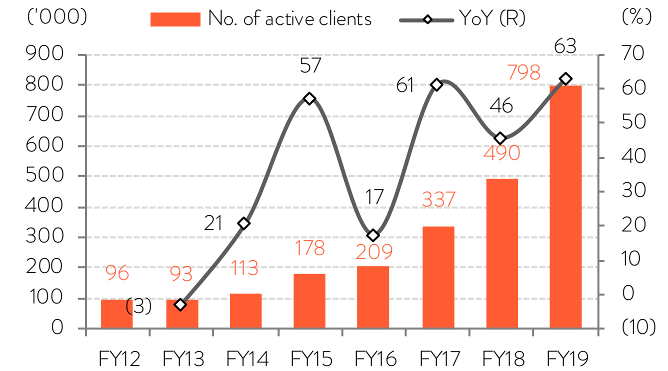
Source: Company, BOBCAPS Research

FIG 71 – …LED BY BRANCH EXPANSION WHICH HAS GROWN ~3X IN THE SAME PERIOD



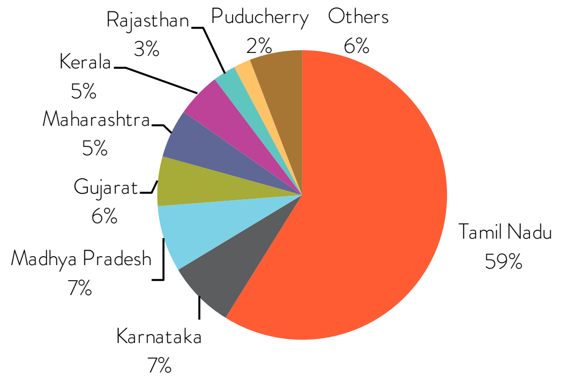
Source: Company, BOBCAPS Research

FIG 72 – ACTIVE CLIENTS HAVE GROWN ~4X DURING FY6-FY19...



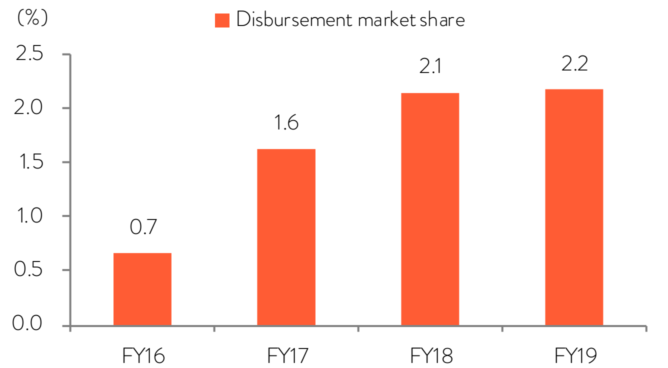
Source: Company, BOBCAPS Research

FIG 73 – ... NOW WELL DIVERSIFIED INTO 16 STATES AS OF FY19



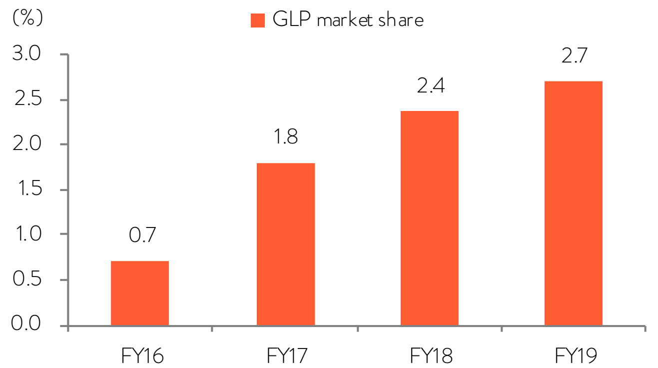
Source: Company, BOBCAPS Research

FIG 74 – MARKET SHARE IMPROVING...



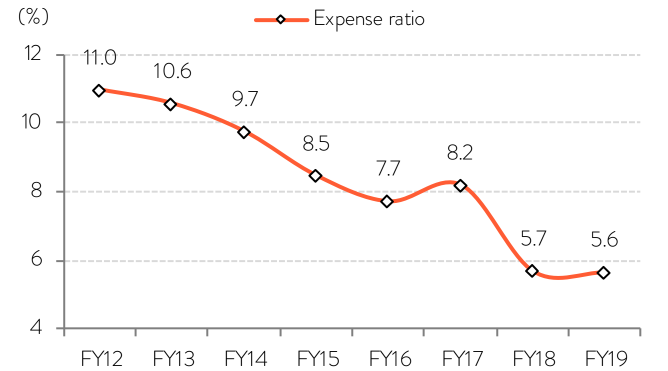
Source: Company, BOBCAPS Research

FIG 75 – ...POST ACQUISITION IN FY17



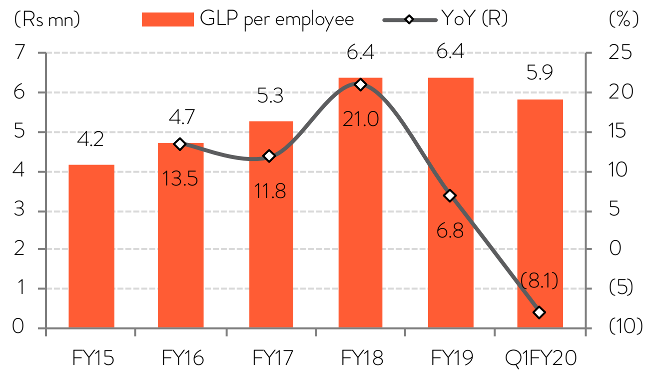
Source: Company, BOBCAPS Research

FIG 76 – COST BEING MANAGED EFFICIENTLY...



Source: Company, BOBCAPS Research

FIG 77 – ...AS EMPLOYEE PRODUCTIVITY IS HEALTHY

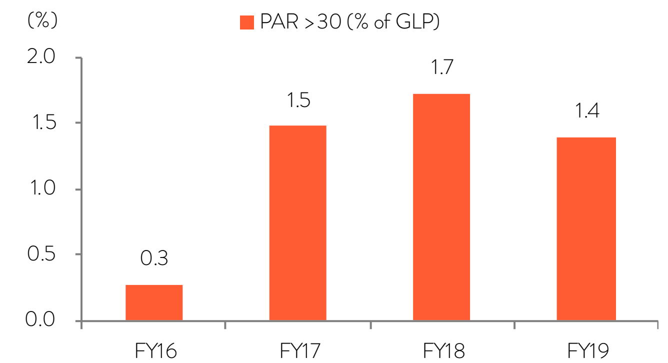


Source: Company, BOBCAPS Research

Credit cost benign, well capitalised for growth

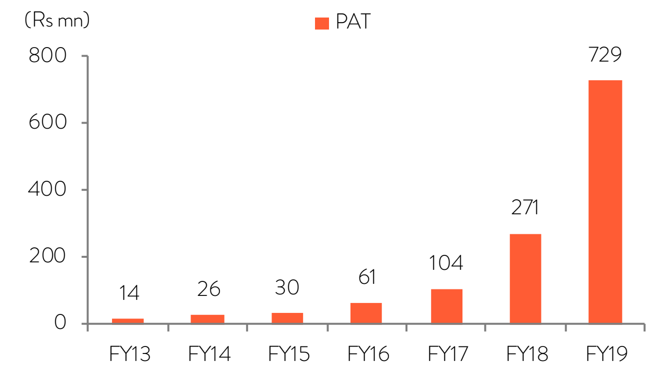
Belstar has established centralised centres to enable continuous monitoring and ensure quality of loans disbursed. All borrowers are insured for life, covering the entire loan exposure and repayment duration. As of FY18, Belstar relied largely on banks for its funding requirements (71% of borrowing mix). Securitisation has helped the company generate better ROE. Given its high SHG mix, the business is adequately capitalised, thus supporting ROE.

FIG 78 – LARGE SHG ORIGINATIONS HAVE KEPT RISK AT LOW LEVELS…



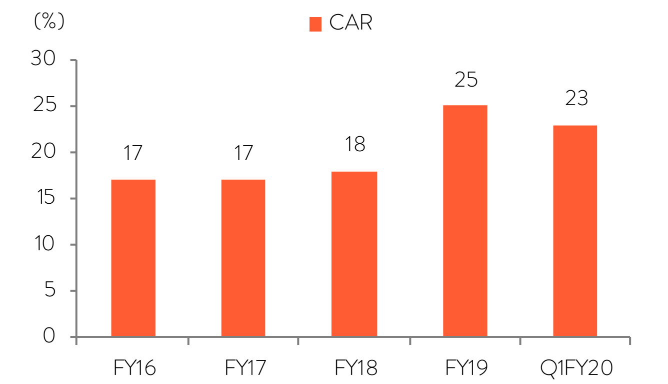
Source: Company, BOBCAPS Research

FIG 79 – …HELPING PROFIT GROW ~7X SINCE ACQUISITION



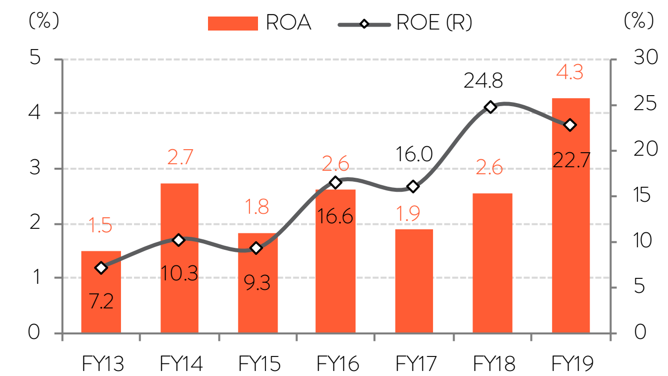
Source: Company, BOBCAPS Research

FIG 80 – ADEQUATELY CAPITALISED…



Source: Company, BOBCAPS Research

FIG 81 – …AND MAINTAINING HIGH RETURN RATIOS



Source: Company, BOBCAPS Research

Valuation methodology

MUTH is trading at 2.3x/2.0x FY20E/FY21E BV for ROE of 23.9%/23.4%. We believe its focused strategies to become gold financier of choice have helped MUTH cement leadership in gold finance.

The strategic focus on customer stickiness and higher branch productivity is expected to fuel a robust ~13% loan CAGR over FY19-FY22. Incentivising staff for regular collections has produced a high-churn portfolio and curbed auction losses, stabilising yields – we model for yields of 21% in FY20-FY22. Further, a favourable borrowing mix underpinned by a short-tenor portfolio should anchor spreads at ~11.5%. MUTH is the lowest cost gold financier in India and its expense ratio is forecast to remain at ~4.5% of AUM through to FY22. We expect the company to maintain market leadership in NBFC gold financing and yield steady-state ROA of ~6%, with leverage of ~3.5x.

The company has diversified into home finance and microfinance (Belstar), with vehicle finance as a second priority. Belstar being a dominant SHG business model is a safer MFI play despite geographic concentration in Tamil Nadu. We expect incremental capital to be allocated to these fledgling businesses, of which Belstar is well placed to contribute meaningfully in the near term.

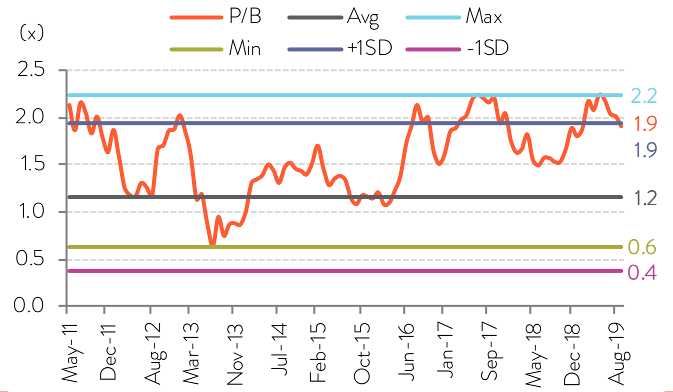
We initiate coverage on MUTH with BUY and a Sep'20 target price of Rs 825. Our fair value is derived using the sum-of-the-parts (SOTP) method as follows (a) Rs 771/sh for the standalone book based on 2.2x Sep'21E BV, (b) Rs 46/sh for MHFL based on 4.0x Sep'21E BV (from last stake sale), and (c) Rs 21/sh for Belstar based on 2.5x Sep'21E BV (post holdco discount of 20%).

FIG 82 – SOTP VALUATION SUMMARY

SOTP	Value (Rs bn)	Value (US$ bn)	Value per share (Rs)	% of total	Valuation rationale
Core business	**309**	**4.4**	**771**	**93.4**	**2.2x Sep'21E BV**
Key ventures					
- Muthoot Home Finance	18	0.3	46	5.6	4.0x Sep'21E BV based on last stake sale
- Belstar Investment and Finance	9	0.1	21	2.6	2.5x Sep'21E BV
Total value of ventures	**27**	**0.4**	**68**	**8.2**	
Less: 20% holding discount	5	0.1	14	1.6	
Value of key ventures	**22**	**0.3**	**54**	**6.6**	
Target value post 20% holding co disc	330	4.7	825	100.0	
CMP	269	3.8	672		
Upside (%)	22.7	22.7	22.7		

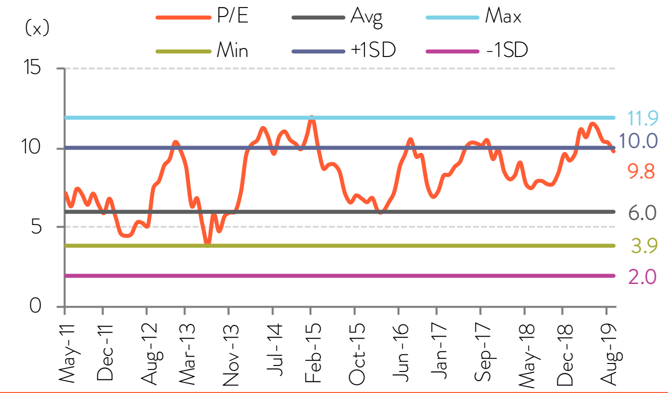
Source: BOBCAPS Research

FIG 83 – ONE-YEAR FORWARD P/B BAND



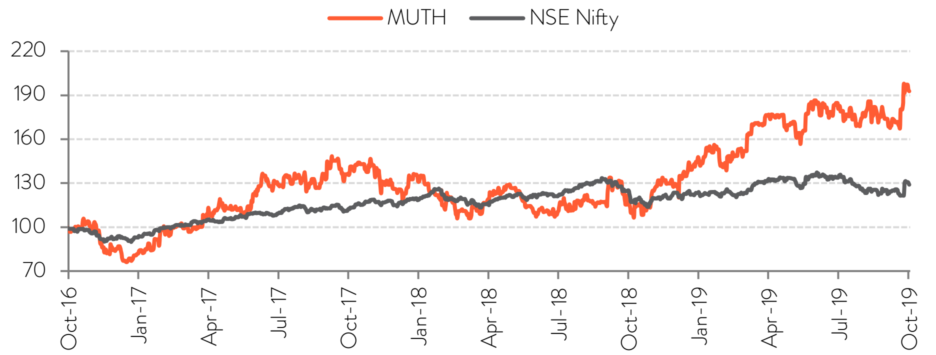
Source: Company, BOBCAPS Research

FIG 84 – ONE-YEAR FORWARD P/E BAND



Source: Company, BOBCAPS Research

FIG 85 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Key downside risks to our estimates include:

- any chunky delinquencies in high-ticket gold loans,
- weak collections in home finance, and
- high dependence on the state of Tamil Nadu in the Belstar MFI.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	**42,707**	**45,202**	**50,787**	**58,289**	**66,344**
NII growth (%)	27.7	5.8	12.4	14.8	13.8
Non-interest income	1,310	1,236	1,358	1,491	1,638
Total income	44,017	46,438	52,145	59,780	67,982
Operating expenses	13,174	15,394	17,062	19,106	21,172
Operating profit	30,843	31,044	35,083	40,674	46,811
Operating profit growth (%)	40.0	0.6	13.0	15.9	15.1
Provisions	2,397	275	984	1,163	1,305
PBT	28,447	30,768	34,100	39,511	45,505
Tax	10,671	11,047	8,593	9,957	11,467
Reported net profit	**17,776**	**19,721**	**25,507**	**29,554**	**34,038**
Adjustments	0	0	0	0	0
Adjusted net profit	**17,776**	**19,721**	**25,507**	**29,554**	**34,038**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Equity capital	4,000	4,007	4,007	4,007	4,007
Reserves & surplus	74,120	93,921	111,775	132,463	156,290
Net worth	78,120	97,927	115,782	136,470	160,296
Deposits	0	0	0	0	0
Borrowings	211,670	268,332	290,844	327,238	373,033
Other liabilities & provisions	18,132	14,428	17,314	20,777	24,932
Total liabilities and equities	**307,923**	**380,687**	**423,940**	**484,484**	**558,261**
Cash & bank balance	4,870	17,355	15,239	21,004	33,488
Investments	3,954	9,826	11,299	12,994	14,943
Advances	295,068	349,329	392,639	445,044	503,594
Fixed & Other assets	2,062	2,154	2,369	2,606	2,867
Total assets	**307,923**	**380,687**	**423,940**	**484,484**	**558,261**
Deposit growth (%)	NA	NA	NA	NA	NA
Advances growth (%)	5.5	18.4	12.4	13.3	13.2

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
EPS	44.4	49.2	63.7	73.8	85.0
Dividend per share	10.0	12.0	15.9	18.4	21.2
Book value per share	195.3	244.4	289.0	340.6	400.1

Source: Company, BOBCAPS Research

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
P/E	15.1	13.7	10.6	9.1	7.9
P/BV	3.4	2.8	2.3	2.0	1.7
Dividend yield (%)	1.5	1.8	2.4	2.7	3.2

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	14.0	13.1	12.6	12.8	12.7
Non-interest income	0.4	0.4	0.3	0.3	0.3
Operating expenses	4.3	4.5	4.2	4.2	4.1
Pre-provisioning profit	10.1	9.0	8.7	9.0	9.0
Provisions	0.8	0.1	0.2	0.3	0.3
PBT	9.3	8.9	8.5	8.7	8.7
Tax	3.5	3.2	2.1	2.2	2.2
ROA	5.8	5.7	6.3	6.5	6.5
Leverage (x)	4.3	3.9	3.8	3.6	3.5
ROE	24.8	22.4	23.9	23.4	22.9

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Net interest income	27.7	5.8	12.4	14.8	13.8
Pre-provisioning profit	40.0	0.6	13.0	15.9	15.1
EPS	50.4	10.8	29.3	15.9	15.2
Profitability & Return ratios (%)					
Net interest margin	14.9	14.0	13.7	13.9	14.0
Fees / Avg. assets	0.0	0.0	0.0	0.0	0.0
Cost-Income	29.9	33.2	32.7	32.0	31.1
ROE	24.8	22.4	23.9	23.4	22.9
ROA	5.8	5.7	6.3	6.5	6.5
Asset quality (%)					
GNPA	4.4	2.7	2.6	2.4	2.3
NNPA	6.2	2.3	2.1	2.0	1.8
Provision coverage	14.8	13.9	16.2	18.6	20.8
Ratios (%)					
Credit-Deposit	0.0	0.0	0.0	0.0	0.0
Investment-Deposit	0.0	0.0	0.0	0.0	0.0
CAR	26.3	26.0	27.1	27.9	28.4
Tier-1	25.5	25.6	26.6	27.4	28.0

Source: Company, BOBCAPS Research

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

BUY
TP: Rs 165 | ⮝ 23%

MANAPPURAM FINANCE | NBFC | 03 October 2019

Low-levered, diversification-led growth – initiate with BUY

Shubhranshu Mishra
research@bobcaps.in

We initiate coverage on Manappuram Finance (MGFL) with BUY and a Sep'20 TP of Rs 165. MGFL's twin strategies of delinking the gold portfolio from short-term gold price volatility and diversifying its credit products are paying off. Lower accrued interest, rising operating leverage, benign credit cost (35bps) and stable spreads (~13.5%) should support steady-state ROA of ~5% over FY20-FY22. Despite low leverage at ~4x, ROE is estimated to hold at ~20%. New credit businesses and a strong microfinance franchise will lend further growth impetus.

Winning loan strategy: Over FY15-FY19, MGFL has transitioned to a 100% short-term gold loan portfolio (3-9 months), aiding lower delinquencies and a 50% drop in accrued interest. We expect this shift coupled with a rising share of online loans and branch expansion to fuel a 10% gold loan CAGR for FY19-FY22.

Spreads stable, operating leverage rising: As gold loans are inherently self-liquidating, the company has been able to raise the share of CPs in the borrowing mix despite the systemic liquidity crunch – this should support stable spreads of ~13.5% over our forecast period. An NII CAGR of 11% and expense control is expected to aid an operating profit CAGR of 12% over FY19-FY22.

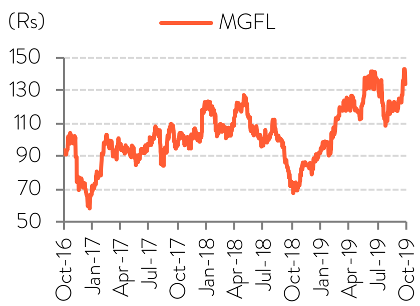
Return ratios healthy, leverage low: Regular collections and auctions are likely to cap credit costs at 35bps in FY20-22. The microfinance and home/ vehicle loan businesses will further de-risk the portfolio and augment profits. We model for a 17% PAT CAGR and 20.5% average ROE at low 4x leverage.

Initiate with BUY: Our SOTP-based target price of Rs 165 includes (a) Rs 147/sh for the standalone book based on 2.0x Sep'21E BV, and (b) Rs 18/sh for Asirvad MFI (after 20% holdco discount) based on 2.2x BV.

Ticker/Price	MGFL IN/Rs 134
Market cap	US$ 1.6bn
Shares o/s	843mn
3M ADV	US$ 8.6mn
52wk high/low	Rs 145/Rs 108
Promoter/FPI/DII	35%/44%/3%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	20,943	23,525	25,840	28,785	31,885
NII growth (%)	5.0	12.3	9.8	11.4	10.8
Adj. net profit (Rs mn)	6,889	7,884	9,907	11,293	12,734
EPS (Rs)	8.2	9.4	11.8	13.4	15.1
P/E (x)	16.4	14.3	11.4	10.0	8.9
P/BV (x)	3.0	2.6	2.2	1.9	1.7
ROA (%)	5.0	4.9	5.2	5.2	5.2
ROE (%)	19.4	19.3	20.9	20.6	20.1

Source: Company, BOBCAPS Research

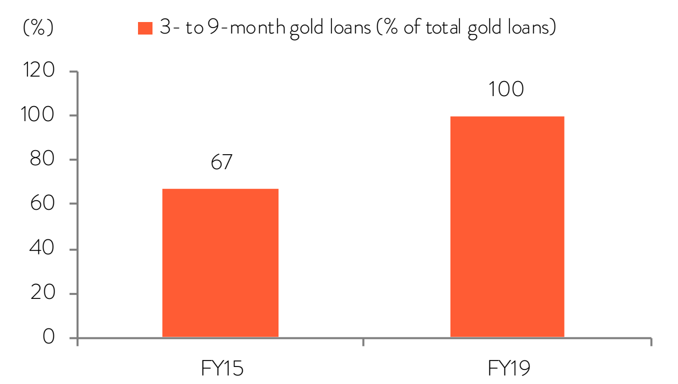
Twin strategies playing out

After losing market share to banks over FY13-FY14 post RBI's LTV restrictions, MGFL moved to (1) delink the gold portfolio from short-term volatility, and (2) diversify beyond gold loans for a similar client profile. The twin strategies are playing out well. Over the past five years, MGFL has reported lower accrued interest (3% in FY19 vs. 6% in FY15 as % of AUM), steady yields (~23.5%) and stable market share (in NBFCs) at ~18%. Diversification into micro-finance, vehicle & home finance is progressing well. We forecast a 10% CAGR in gold loan, a 17% PAT CAGR over FY19-FY22.

Strategy 1: Delink gold portfolio from gold price volatility

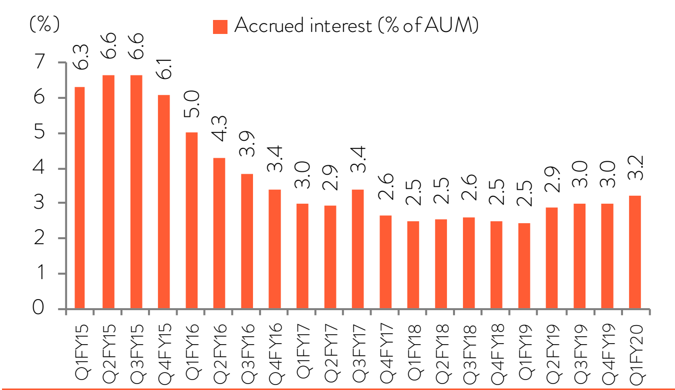
Over FY15-FY19, MGFL has taken its 3-9-month book from 67% to ~100% of its gold loan portfolio. The key benefits of transition are lower delinquencies, steady portfolio yield, and lower accrued interest levels, as illustrated below.

FIG 1 – SHIFT TO SHORT-TERM PRODUCTS…



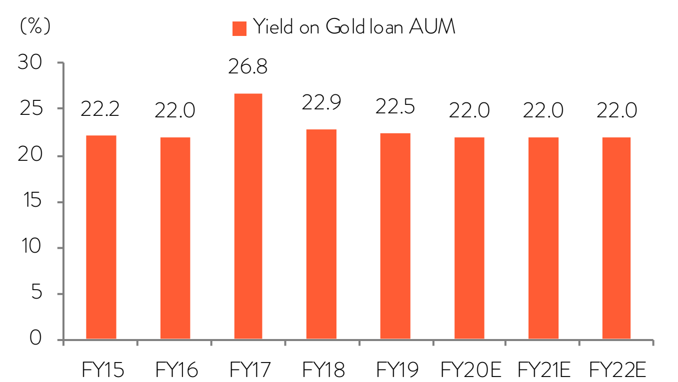
Source: Company, BOBCAPS Research

FIG 2 – …HALVED ACCRUED INTEREST % IN 4 YEARS



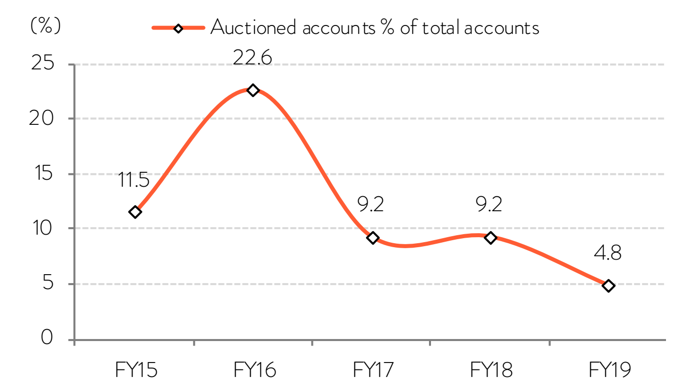
Source: Company, BOBCAPS Research

FIG 3 – WE FORECAST STABLE YIELD OF ~22% FOR FY20E-FY22E



Source: Company, BOBCAPS Research

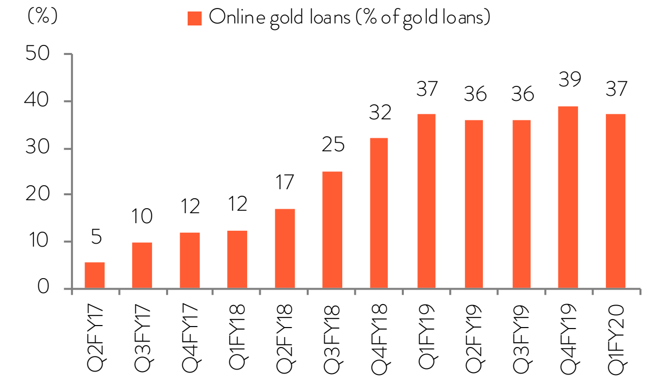
FIG 4 – AUCTION LOSSES PER ACCOUNT HAVE REDUCED DRASTICALLY



Source: Company, BOBCAPS Research

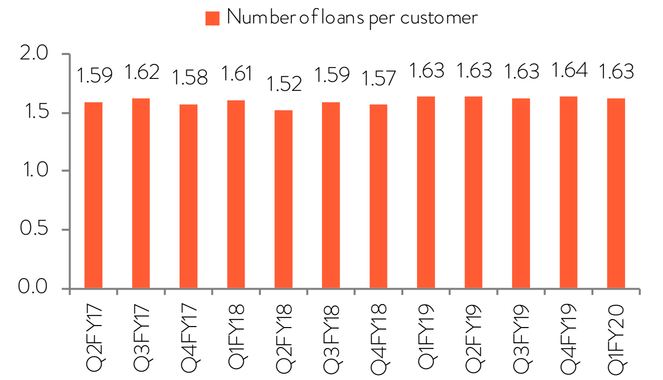
We believe the recalibrated loan book profile together with increased contribution of online loans and geographic expansion would aid a 10% gold loan CAGR over FY19-FY22. With diversified borrowing sources and incremental share of commercial papers in the borrowing mix, we model for stable spreads.

FIG 5 – ONLINE GOLD LOANS FORMED 37% OF GOLD LOANS IN Q1FY20…



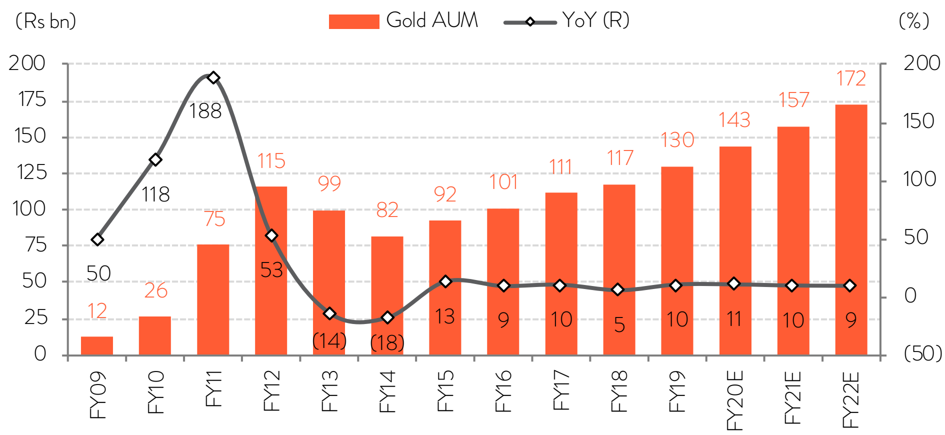
Source: Company, BOBCAPS Research

FIG 6 – …AND LED TO HIGHER LOANS PER CUSTOMER



Source: Company, BOBCAPS Research

FIG 7 – WE EXPECT GOLD AUM CAGR OF 10% THROUGH FY19-FY22E

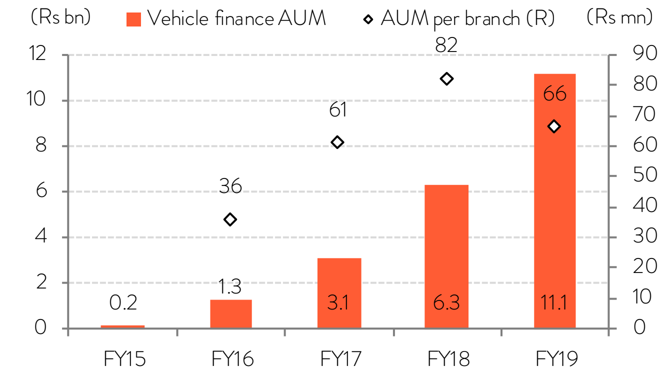


Source: Company, BOBCAPS Research

Strategy 2: Diversify beyond gold loans to similar clientele

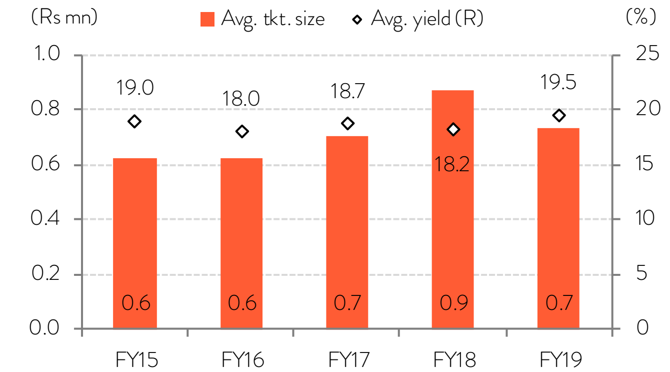
The second strategy comprised deploying incremental capital in related credit businesses that serve similar clientele, so as to curb dependence on gold finance and diversify the loan book across different product cycles. Vehicle finance, which is undertaken through existing gold finance branches and sits in the standalone book, is likely to a be a meaningful contributor to growth. This business along with SME finance and on-lending to NBFCs is expected to register a 23% loan book CAGR over FY19-FY22.

FIG 8 – VEHICLE FINANCE GROWING INTO A MEANINGFUL CONTRIBUTOR…



Source: Company, BOBCAPS Research

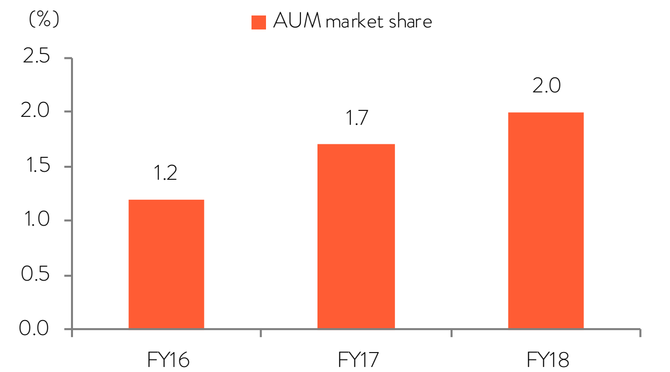
FIG 9 – …WHILE MAINTAINING MODEST TICKET SIZE AND HIGH YIELDS



Source: Company, BOBCAPS Research

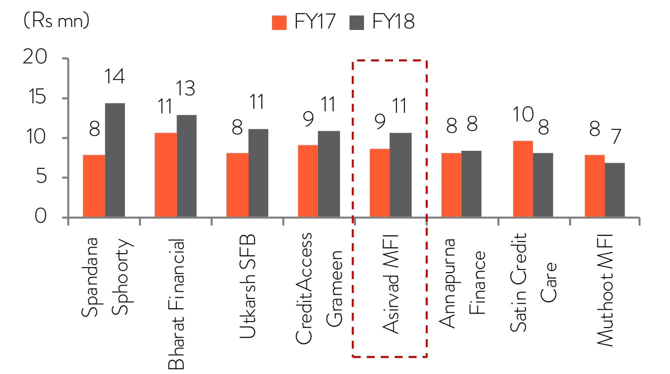
MGFL entered the microfinance business with the purchase of 85% stake in Asirvad Microfinance for Rs 1.1bn in FY15 (holding raised the following year to 90.4%). As of FY19, the company has operations in 22 states through ~175,000 centres and an active member base of 1.8mn. Asirvad has a geographically diverse book, leading productivity metrics compared to peers, a diverse borrowing mix, and is well capitalised for growth. We expect a 25% loan book CAGR through to FY22.

FIG 10 – THOUGH ASIRVAD IS LOW ON MARKET SHARE…



Source: Company, BOBCAPS Research, ICRA

FIG 11 – …GROSS LOAN PORTFOLIO PER LENDING OFFICER MEASURES AMONG TOP-5 MFIs



Source: Company, BOBCAPS Research, ICRA

Gold loan business on a firm footing

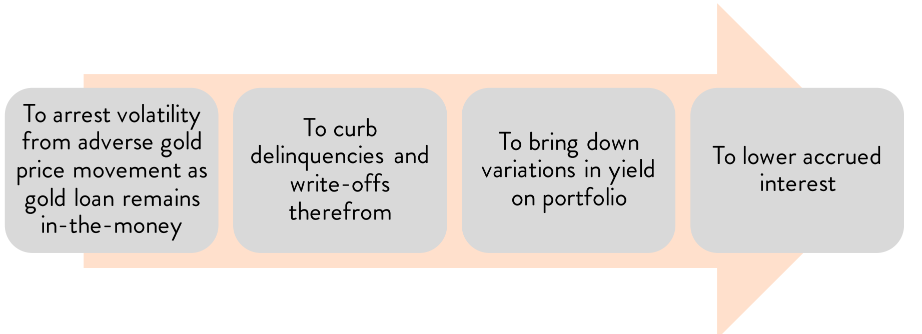
MGFL's 100% transition to short-term gold loans has helped minimise auction losses and cut accrued interest as a percentage of AUM by half to 3.2% in the last five years. This coupled with a rising share of online gold loans, at 39% in FY19 vs. 12% in FY17, expansion into non-South markets and higher branch productivity is expected to aid a 6% CAGR in gold loan AUM per branch to Rs 46mn over FY19-FY22, 40% more than the company's average through FY10-FY19.

Transition to short-term gold loans paying off

In 2013, the KUB Rao Committee on gold loan financing recommended that NBFCs in the segment restrict loan-to-value (LTV) at 60% to level the playing field with banks (the RBI later raised the cap to 75% in Jan'14). In order to comply with this requirement, MGFL decided to introduce short-tenor 3-9-month gold loan products offered at 60-75% LTV in place of longer-tenor loans.

Over FY15-FY19, the company has taken its 3-9-month book from 67% to ~100% of its gold loan portfolio. The transition has yielded key benefits by way of minimising linkage to volatile gold prices, curbing delinquencies (auctioned accounts down to 5% in FY19 vs. 12% in FY15), limiting variation in portfolio yield, and halving accrued interest levels.

FIG 12 – RATIONALE FOR SHORT-TERM GOLD LOANS



Source: Company, BOBCAPS Research

Higher margin of safety for lenders

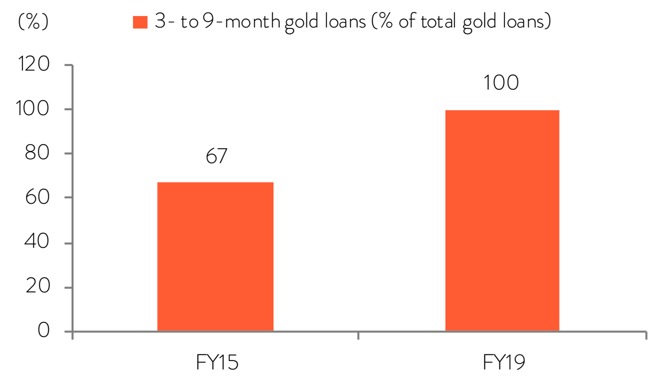
In the past, if a customer did not pay or close a loan, the company typically suffered a loss of interest for two months during the auction phase for the gold collateral. Now, as illustrated in Fig 2, NBFCs have ample margin of safety to recover the principal as well as interest as LTV varies from 60-75% based on tenor of loan. Further, the shift to short-term products has halved accrued interest levels for MGFL to ~3.2% of AUM in Q1FY20 vs. 6.6% in Q2FY15.

FIG 13 – LOWER TENOR PRODUCTS WITH LINKED LTV INCREASE MARGIN OF SAFETY

(Rs)	Earlier	Now			
	Single product offering	3 months	6 months	9 months	12 months
Gold value	100	100	100	100	100
LTV (%)	75	75	70	65	60
Gold loan	75	75	70	65	60
Interest rate (%)	24	24	24	24	24
Interest cost*	21.0	7.5	11.2	14.3	16.8
Total Principal + Interest	96.0	82.5	81.2	79.3	76.8
Margin of safety (%)	4.0	17.5	18.8	20.7	23.2

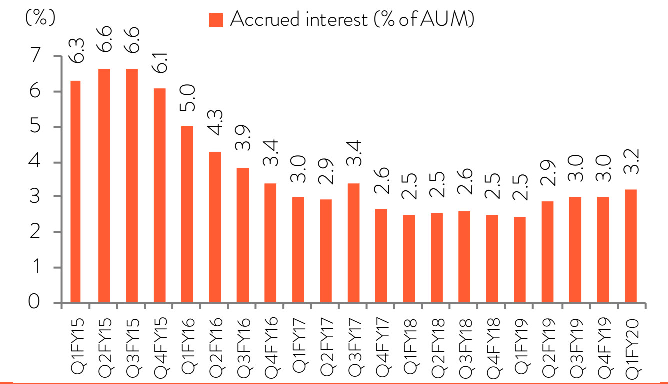
Source: Company, BOBCAPS Research | *Includes interest outgo during two months of auction period

FIG 14 – SHIFT TO SHORT-TERM PRODUCTS…



Source: Company, BOBCAPS Research

FIG 15 – …HALVED ACCRUED INTEREST IN 4 YEARS

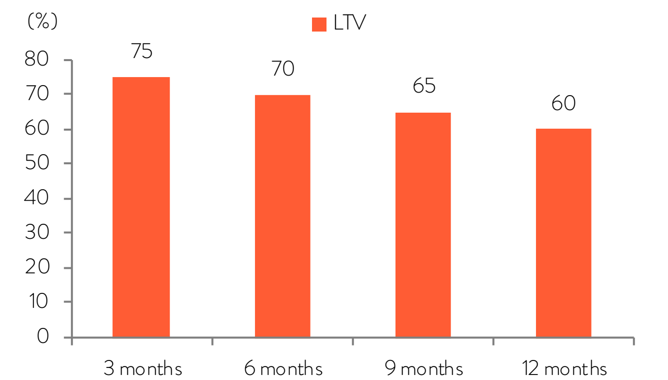


Source: Company, BOBCAPS Research

Substantial reduction in auction losses

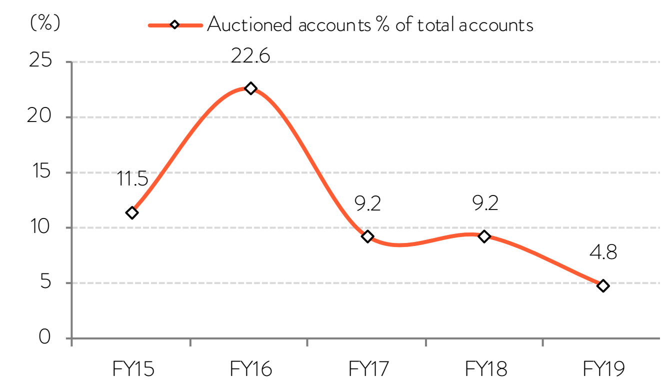
The shift to short-tenure products along with a focus on regular interest collection saw MGFL clocking a substantial reduction in auction losses – only ~5% of its loan accounts came up for auction in FY19 vs. 12% in FY15. Another reason was the lower incidence of interest reversals as fewer loans go out-of-money due to tenor-linked LTVs.

FIG 16 – LTV REDUCES 5% FOR EVERY INCREMENTAL 3-MONTH TENOR



Source: Company, BOBCAPS Research

FIG 17 – AUCTION LOSSES PER ACCOUNT HAVE REDUCED DRASTICALLY



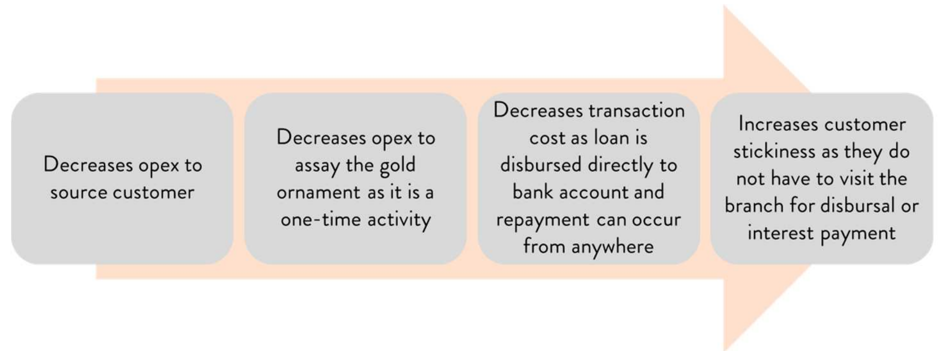
Source: Company, BOBCAPS Research

Online gold loans a key driver of repeat business

In Sep'15, MGFL began offering online gold loans (OGL) to customers who avail of its gold depository services. Eligible candidates can apply for loans up to the permissible LTV limits online, without physically visiting a branch. Loans are disbursed directly to the customer's bank account or eWallet. The depository service comes at no cost to customers and doubles up as a locker facility.

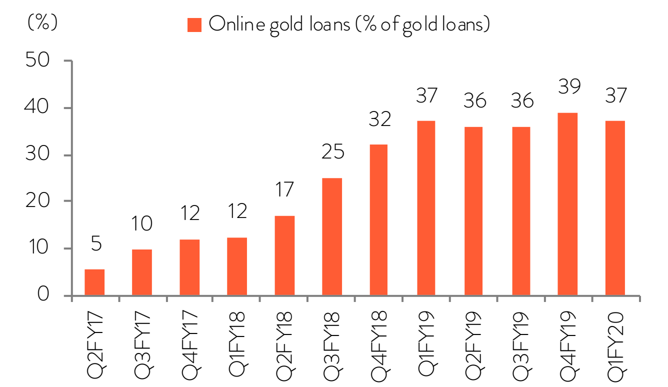
Online transaction and operational costs are significantly lower than offline loans, with a bulk of the discounts passed on to customers. Consequently, the service has proved hugely popular, attracting both new and repeat business, with online transactions accounting for 37% of the company's gold loans in Q1FY20 from 12% in FY17.

FIG 18 – OGL HELPS CHURN EXISTING CUSTOMERS AT LOWER OPEX



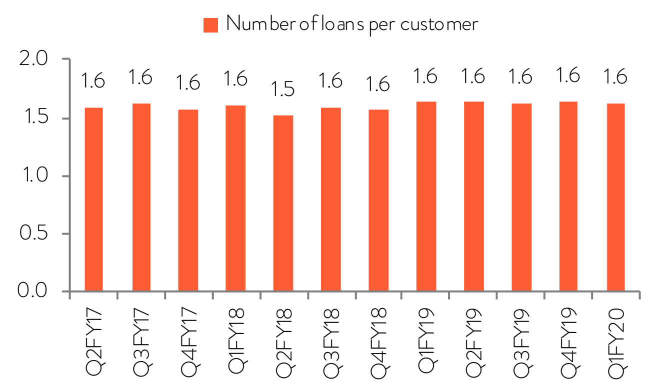
Source: Company, BOBCAPS Research

FIG 19 – OGL FORMED 37% OF GOLD LOANS IN Q1FY20…



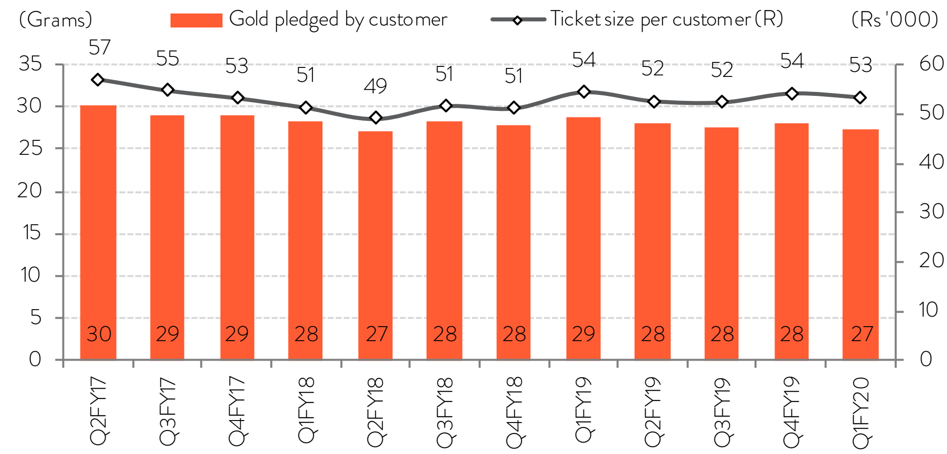
Source: Company, BOBCAPS Research

FIG 20 – …AND LED TO HIGHER LOANS PER CUSTOMER…



Source: Company, BOBCAPS Research

FIG 21 – ...KEEPING GOLD PLEDGED & TICKET SIZE PER CUSTOMER IN CHECK

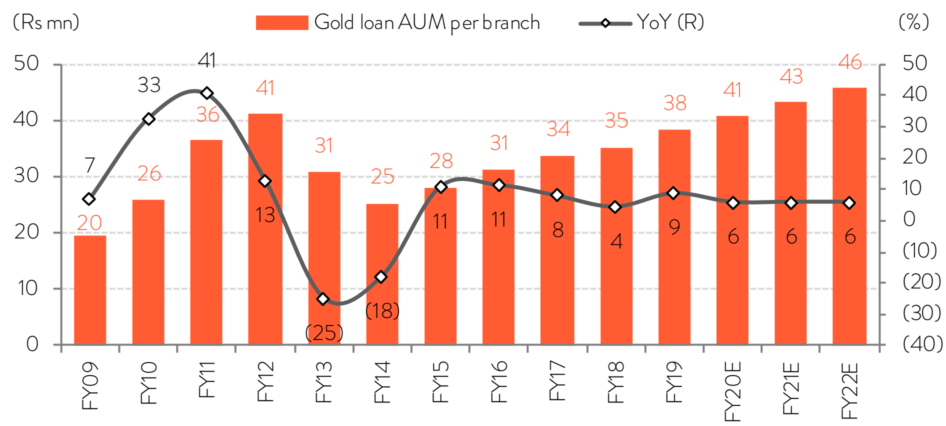


Source: Company, BOBCAPS Research

Throughput increase to drive loan growth

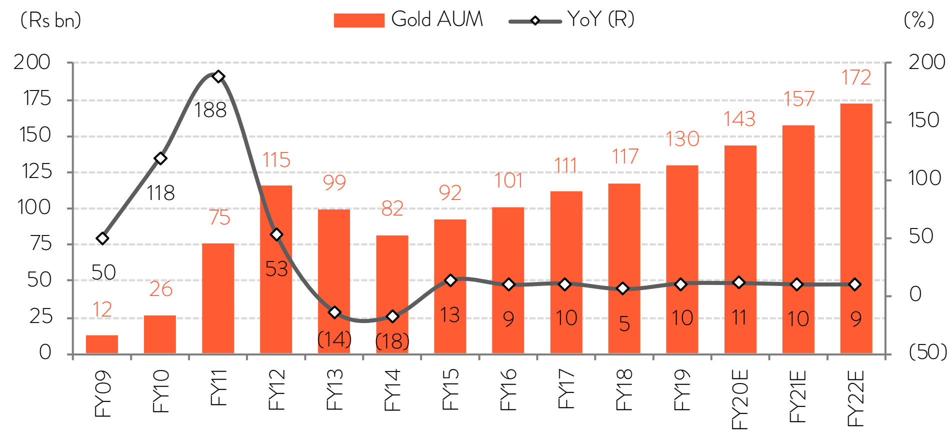
We see a strong case for higher branch throughput and customer acquisition at MGFL backed by (1) sustained marketing spends over the last five years totalling Rs 2.1bn, (2) expansion into 27 states across 3,380 branches, (3) a robust incentive model geared towards volumes, and (4) key technology initiatives to hasten turnaround time. On a conservative basis, we model for a 6% CAGR in gold loan AUM per branch through FY19-FY22 reaching Rs 46mn in FY22 – 11% more than the pre-regulation level in FY12 and 40% more than the company's average through FY10-FY19.

FIG 22 – BRANCH PRODUCTIVITY TO TOUCH PRE-CRISIS LEVELS IN FY20...



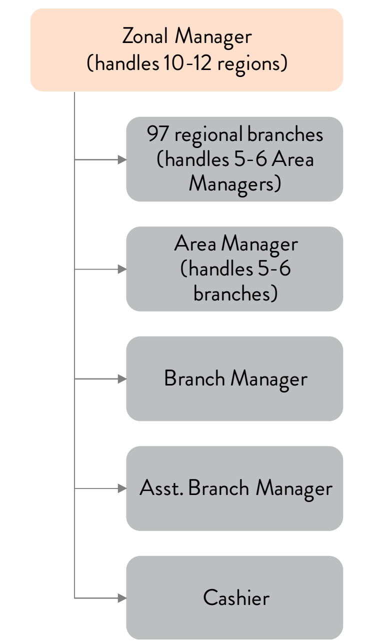
Source: Company, BOBCAPS Research

FIG 23 – …LEADING TO GOLD AUM CAGR OF 10% THROUGH FY19-FY22E



Source: Company, BOBCAPS Research

GOLD LOAN OPERATIONS STRUCTURE



Source: Company, BOBCAPS Research

Large marketing spends and localised sales strategy

MGFL undertakes intense marketing activities across branches and key geographies – the company has cumulatively spent Rs 2.1bn on marketing over the last five years to consolidate its pan-India reach, besides focusing on branch activation through increased incentives and performance scorecards for employees.

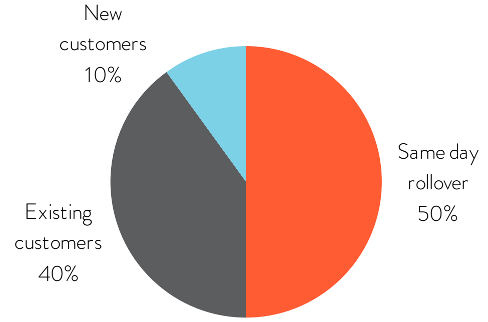
The company uses a localised strategy for customer acquisition and also ties up with local movie stars for brand creation. Branches undertake promotional pamphlet distribution at 'panchayats', grocery stores and other local centres. Each branch has 4-5 business associates, including the village head, local tea shop owner, and existing vetted customers with a good repayment history. Business associates account for 5-8% of new gold finance customers and earn incentives depending on the loan tenor.

Staff incentives geared towards volume growth

Staff incentives are structured to focus on gold collateral volume growth and customer numbers. All employees are gold ornament assayers, enabling MGFL to disburse loans within 10-15 minutes. A branch typically disburses 10-15 new loans per day with an average ticket size of Rs 33,000 per loan.

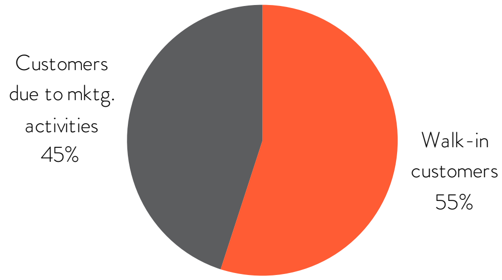
Turnaround time is also faster because a large quantum of repeat business means that 85-90% of ornaments pledged have already been assayed before. Regional offices have 5-6 auditors who assess new gold ornaments within 45 days, besides the presence of 100 vigilance personnel companywide. Collections are undertaken by the branch team itself.

FIG 24 – 90% OF CUSTOMERS ARE REPEAT BUSINESS



Source: Company, BOBCAPS Research

FIG 25 – 55% OF NEW CUSTOMERS ARE WALK-INS



Source: Company, BOBCAPS Research

Technology improving customer turnaround time

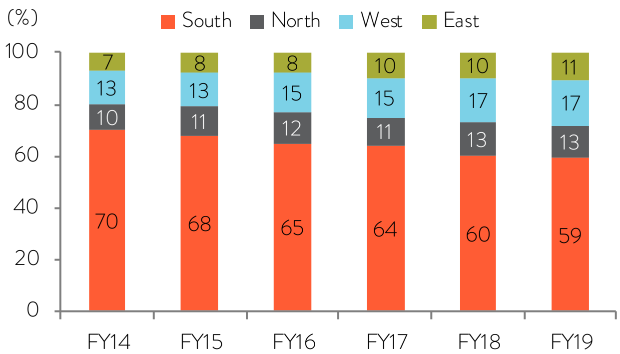
MGFL has been investing in technology to further lower operating expenses, increase customer stickiness and reduce turnaround time for loan disbursals. Some key technology highlights are:

- eKYC at all branches since FY18 following Aadhar card rollout,
- partnerships with leading solution providers to digitise paperwork at branches and move to a 100% paperless workspace, and
- robotic process automation, image processing software to read supporting documents, and self-serve vaults to eliminate theft losses.

Incremental growth to come from non-South market expansion

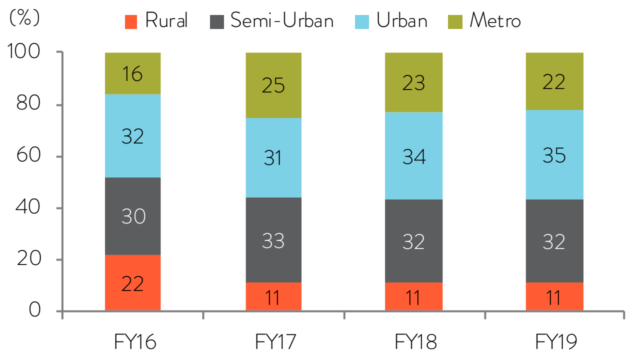
MGFL currently has 3,380 branches in 27 states. The company plans to expand in non-south geographies as competition and gold loan penetration in these areas is low. Key focus states will be Assam, Tripura, Odisha, Bihar, Uttar Pradesh and Madhya Pradesh.

FIG 26 – CONCENTRATION RISK REDUCED BY FOCUS ON NEW GEOGRAPHIES…



Source: Company, BOBCAPS Research

FIG 27 – …AND CHANGE IN URBAN-RURAL MIX OF LOAN SOURCING

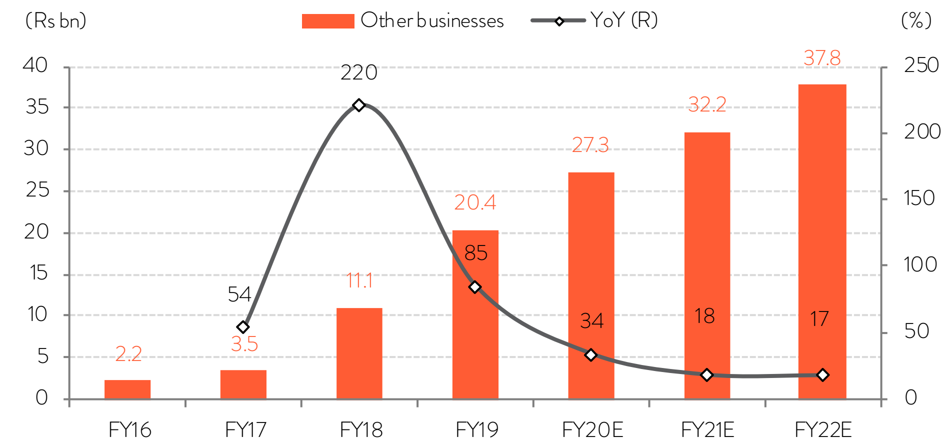


Source: Company, BOBCAPS Research

Diversifying standalone portfolio

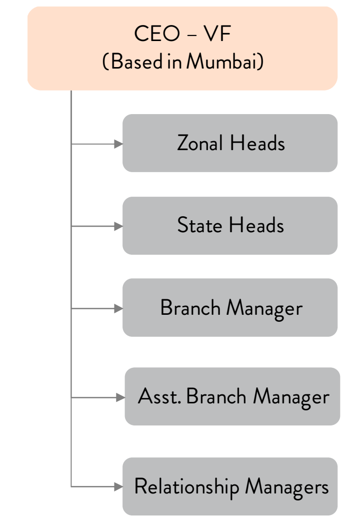
In a bid to diversify and derisk its business beyond gold loans, MGFL has launched a variety of financing products over the past five years, comprising loans for vehicles, SMEs and the construction sector, as well as on-lending to NBFCs. We expect these businesses to register a 23% CAGR in AUM over FY19-FY22.

FIG 28 – OTHER BUSINESSES TO REGISTER 23% CAGR, FY19-FY22E



Source: Company, BOBCAPS Research

VF ORGANISATION STRUCTURE



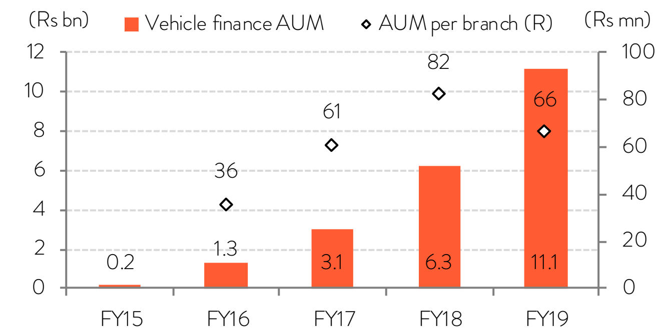
Source: Company, BOBCAPS Research

Vehicle finance – on a stable footing

As part of its asset class diversification strategy, MGFL started vehicle financing towards the end of FY15. The business is co-located with gold loan branches and caters largely to the unorganised category of customers who are underserved by banks. In FY17, it was extended to construction equipment (CE), auto loans and two-wheeler loans.

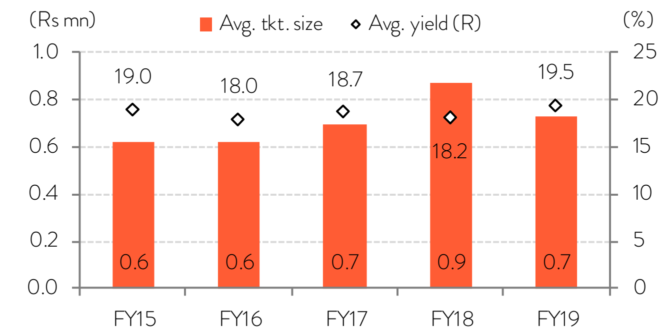
MGFL focuses on used vehicles and offers 70-75% LTV on products. The business is supported by strong pre-screening and credit assessment methods, helmed by a team of domain specialists. Sourcing is via references and old client relationships. All branches have a separate collection team (in-house) as well as an operations team that conducts credit bureau checks from CIBIL and Equifax. Due to strong risk management, yields have been sticky at ~18-19%.

FIG 29 – VEHICLE FINANCE GROWING INTO A MEANINGFUL CONTRIBUTOR…



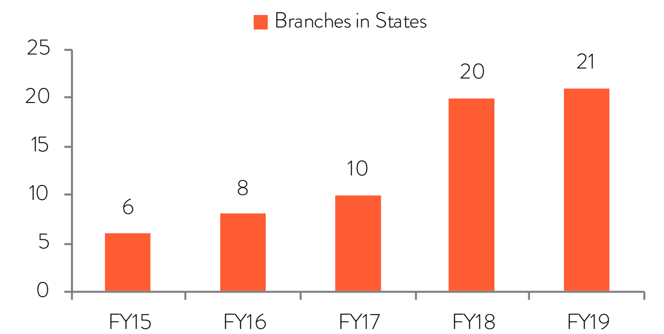
Source: Company, BOBCAPS Research

FIG 30 – …WHILE MAINTAINING MODEST TICKET SIZE AND HIGH YIELDS



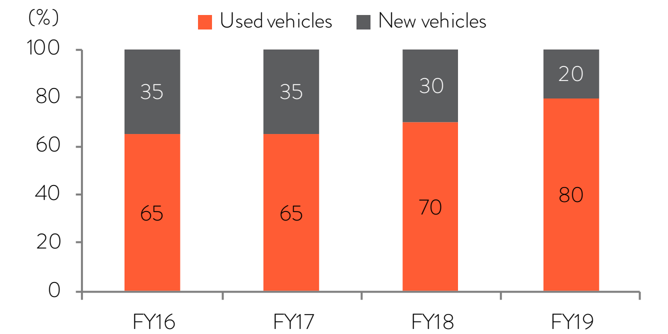
Source: Company, BOBCAPS Research

FIG 31 – VEHICLE FINANCE OPERATIONS BEING EXPANDED



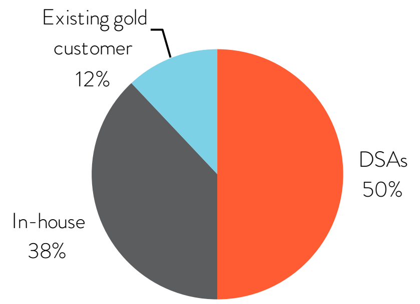
Source: Company, BOBCAPS Research

FIG 32 – INCREMENTAL SOURCING OF USED VEHICLES



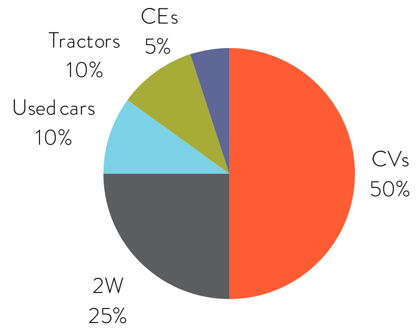
Source: Company, BOBCAPS Research

FIG 33 – VEHICLE FINANCE SOURCING MIX, FY19



Source: Company, BOBCAPS Research

FIG 34 – VEHICLE FINANCE AUM SPLIT, FY19



Source: Company, BOBCAPS Research

SME finance – scaling up

MGFL launched SME financing during FY15, though the business gained meaningful scale only in FY18. It offers working capital loans with an average ticket size of Rs 4mn and focuses on tier-1 to tier-3 cities.

On-lending to NBFCs – judicious client screening

MGFL on-lends to other NBFCs for an average yield of ~14%. Due diligence and loan sourcing are done by IFMR Capital, but this entails no fee or yield sharing for the company. As of FY19, the on-lending book totalled ~Rs 9bn.

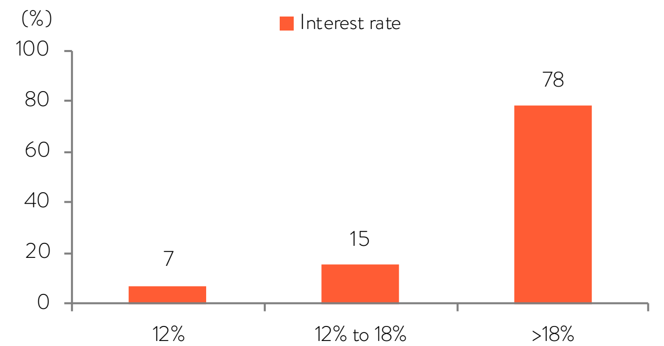
Spreads expected to remain stable

As the product life shortens, the LTV increases and hence the net effect is an increase in yield. We forecast a stable cost of funds at 8.5% levels through FY20-FY22 given the company's short-term loan strategy, self-liquidating product and incremental CP share in the borrowing mix. We also expect stable to improving risk-adjusted spreads at ~13.0% (defined as spread minus credit cost).

Short-term gold loans help steady yields

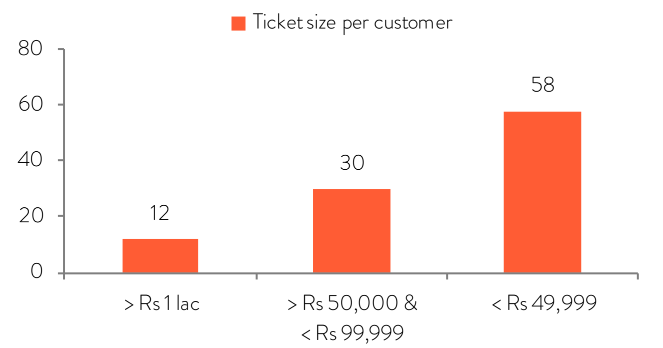
MGFL's move to migrate its entire gold portfolio to 3-9-month tenor loans over FY15-FY19 has led to an average LTV of 67%, lower accrued interest and reduced loss on gold auction. With all of these factors, the company is able to deliver stable ~22% yields on the portfolio, which are closer to card rates.

FIG 35 – 78% OF GOLD LOANS ARE AT >18% INTEREST RATE (FY18) ...



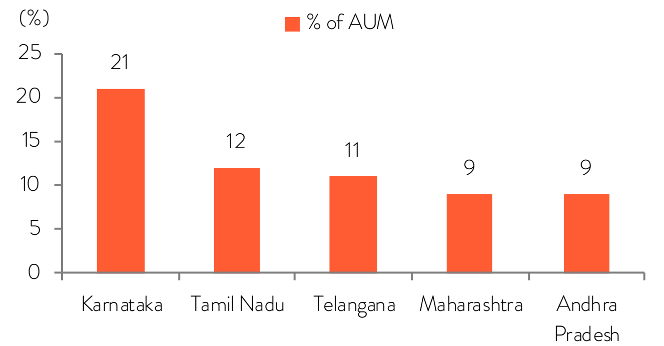
Source: Company, BOBCAPS Research

FIG 36 – ...AS MOST OF THE PORTFOLIO IS TURNING GRANULAR, FY18



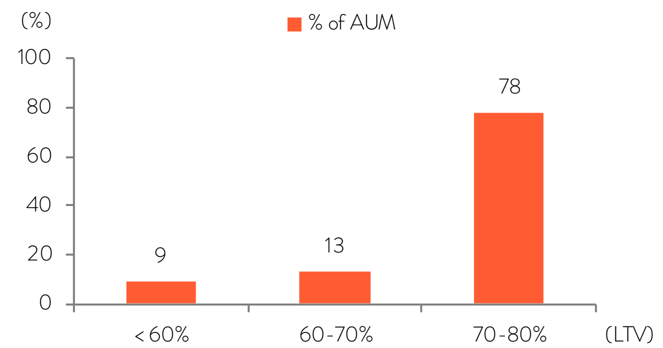
Source: Company, BOBCAPS Research

FIG 37 – KARNATAKA LEADS THE TOP 5 STATES FOR GOLD AUM, FY18



Source: Company, BOBCAPS Research

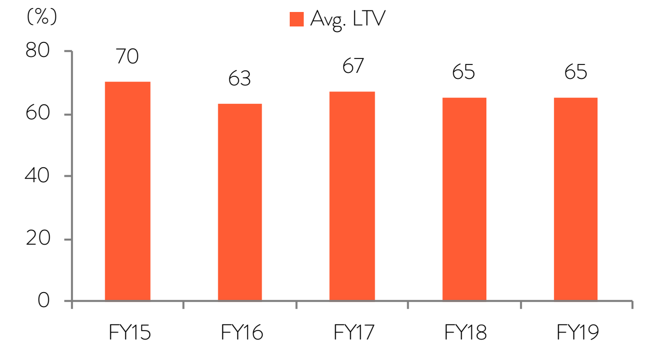
FIG 38 – 78% OF GOLD AUM PORTFOLIO HAS 70-80% LTV, FY18



Source: Company, BOBCAPS Research

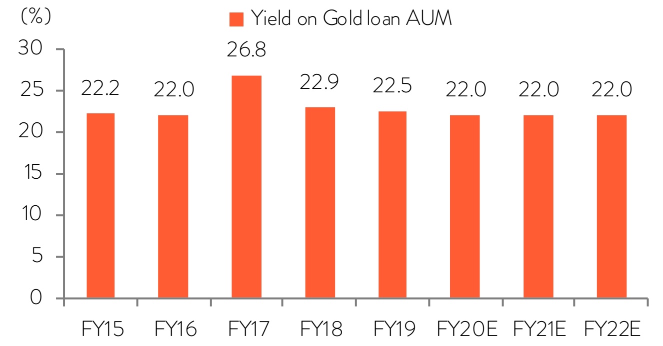
As the product life shortens, the LTV moves up. Thus, the net effect is an increase in net yield – the shorter the loan tenor, the lower the interest loss during auctions.

FIG 39 – AVERAGE LTV DURING FY15-FY19 WAS 67%



Source: Company, BOBCAPS Research

FIG 40 – WE FORECAST STABLE YIELD OF ~22% FOR FY20E-FY22E



Source: Company, BOBCAPS Research

Rating upgrades and positive ALM anchor spreads

MGFL's credit rating has improved during FY15-FY19 as the company switched to short-term loan products post the regulatory purge of FY13-FY14. Portfolio recalibration also led to a change in borrowing mix as gold loans, being bullet repayments, were no longer classified as priority sector loans and hence were no longer eligible for assignment transactions.

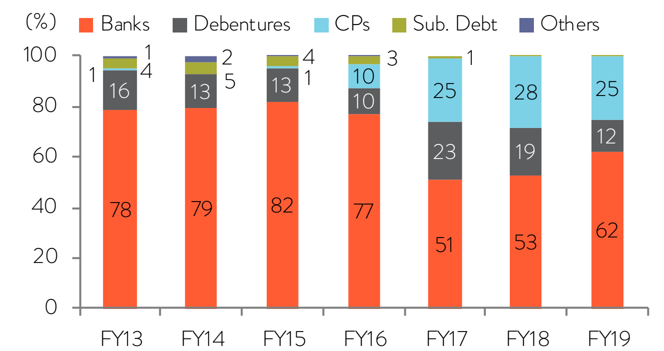
Consequently, the company started moving towards commercial papers (CP) as a source of funding. As CPs are a cheaper funding avenue, their increased share in the borrowing mix has led to a lower-to-stable cost of funds. As of FY19, CPs formed 25% of borrowings vs. only 1% in FY15.

FIG 41 – CREDIT RATING IMPROVED THROUGH FY15-FY19

Credit rating	FY15	FY16	FY17	FY18	FY19
Commercial Paper	A1+	A1+	A1+	A1+	A1+
Long-term Non-Convertible Debentures	A+	A+	AA-	AA-	AA-

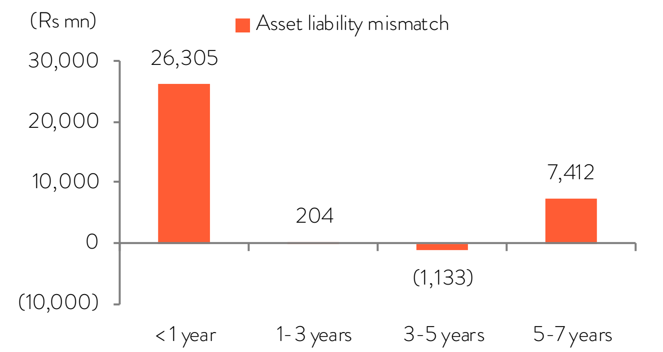
Source: Company, BOBCAPS Research

FIG 42 – BORROWING MIX HAS HIGHER SHARE OF CP FUNDING NOW…



Source: Company, BOBCAPS Research

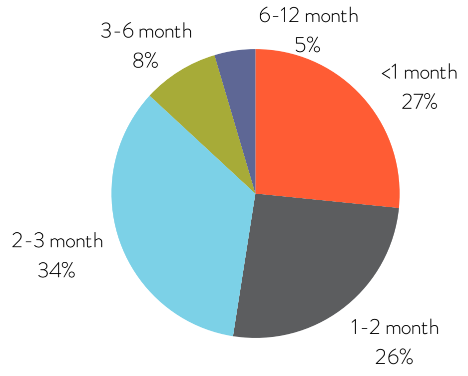
FIG 43 – …AS 86% OF ASSETS COME UP FOR MATURITY IN LESS THAN A YEAR



Source: Company, BOBCAPS Research

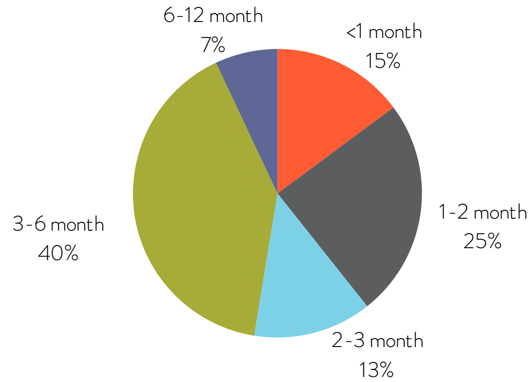
As of FY19, MGFL had a positive mismatch in the less than one-year bucket, which is conducive for spreads. With ~84% of loans maturing in less than three months and gold loans being a self-liquidating product, liquid funds have locked into MGFL CP issuances. We note that yields of 3-month CPs and 3-year NCDs have come off in the last six months and now trend close to pre-IL&FS crisis levels.

FIG 44 – SPLIT OF ASSETS MATURING IN LESS THAN ONE YEAR, FY19



Source: Company, BOBCAPS Research

FIG 45 – SPLIT OF LIABILITIES MATURING IN LESS THAN ONE YEAR, FY19

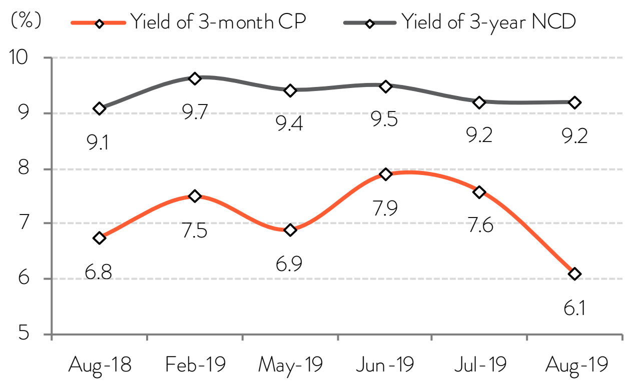


Source: Company, BOBCAPS Research

Cost of funds forecast at 8.5%, risk-adj. spreads at 13%

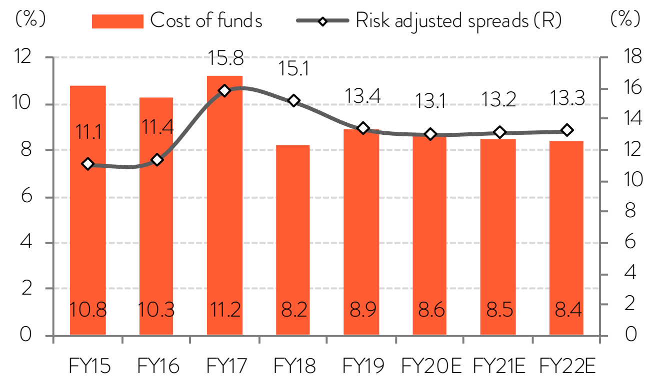
We forecast a stable cost of funds at 8.5% levels through FY19-FY22 given the company's short-term loan strategy, self-liquidating product and incremental CP share in the borrowing mix. We also expect stable-to-improving risk-adjusted spreads of ~13% (defined as spread minus credit cost).

FIG 46 – CP AND NCD YIELDS ARE AT PRE-IL&FS CRISIS LEVELS



Source: Company, BOBCAPS Research

FIG 47 – WE FORECAST STABLE RISK-ADJUSTED SPREADS OF ~13% THROUGH FY20E-FY22E



Source: Company, BOBCAPS Research

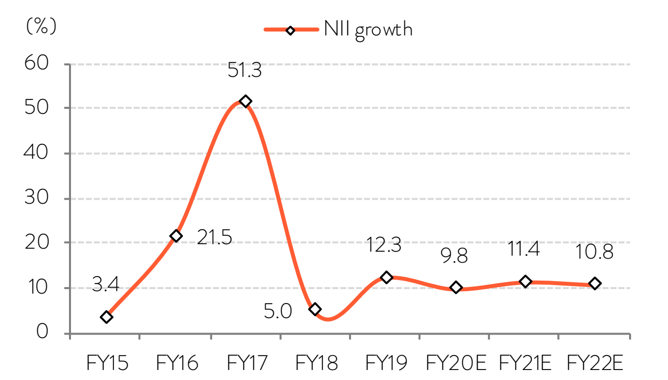
Low-levered, steady earnings growth

During FY19-FY22, MGFL's NII CAGR of 11% is estimated to outpace operating expense CAGR of 9%, thus manifesting in higher operating leverage. We expect the cost-to-income ratio to trend down by 250bps and expense ratio to dip 85bps during our forecast period. This will lead to operating profit growing ahead of AUM. We model for stable credit costs at 35bps through FY20-FY22, supporting a robust 17% PAT CAGR. The business remains low levered due to high capital buffers, underpinning our expectations of stable ROE at ~20.5%.

Operating leverage to play out

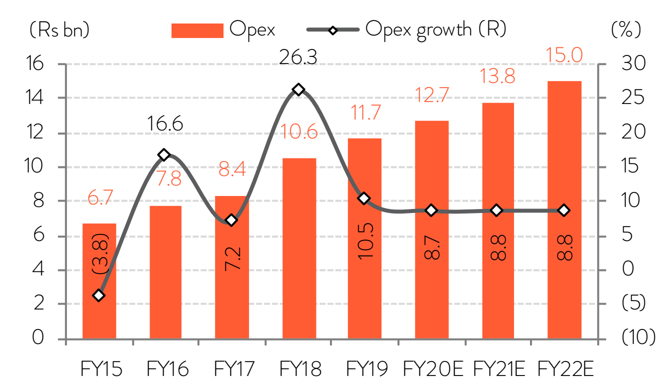
We expect NII to register an 11% CAGR over FY19-FY22 as MGFL focuses on client acquisition, account mining, short-term lending, and augmenting CPs in the borrowing mix. During the same period, we forecast a lower operating expense CAGR of 9% as productivity and automation/cost-cutting initiatives yield results, thus manifesting in higher operating leverage.

FIG 48 – NII CAGR AT 11% DURING FY19-FY22E



Source: Company, BOBCAPS Research

FIG 49 – OPEX CAGR AT 9% DURING FY19-FY22E

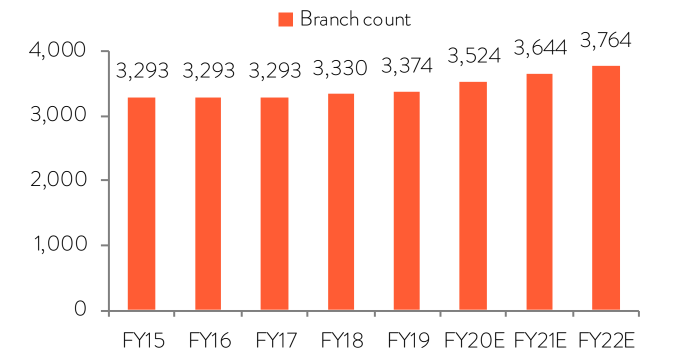


Source: Company, BOBCAPS Research

Sustained rise in customer base

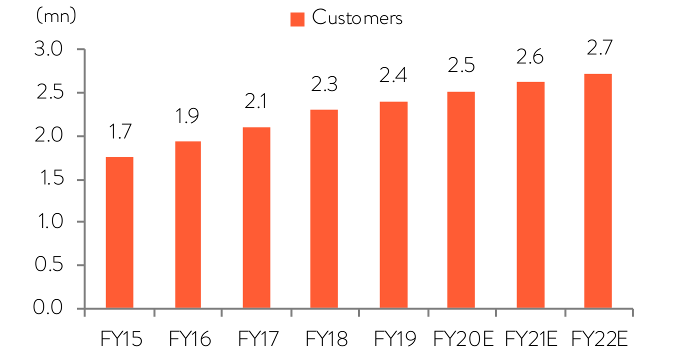
Our interactions with management indicate a steady increase in branch count, with 150 additions planned during FY20. Digitisation is helping the company reach more customers and make faster decisions. MGFL adds 4,000 accounts and disburses ~10 loans per day, equalling to ~40,000 loans daily. It takes an AUM of Rs 15mn for a new branch to break even, which implies a gestation period of 15-18 months at the present run-rate.

FIG 50 – WE EXPECT BRANCH COUNT TO CLIMB STEADILY THROUGH FY20E-FY22E…



Source: Company, BOBCAPS Research

FIG 51 – …LEADING TO AN INCREASE IN CUSTOMER BASE



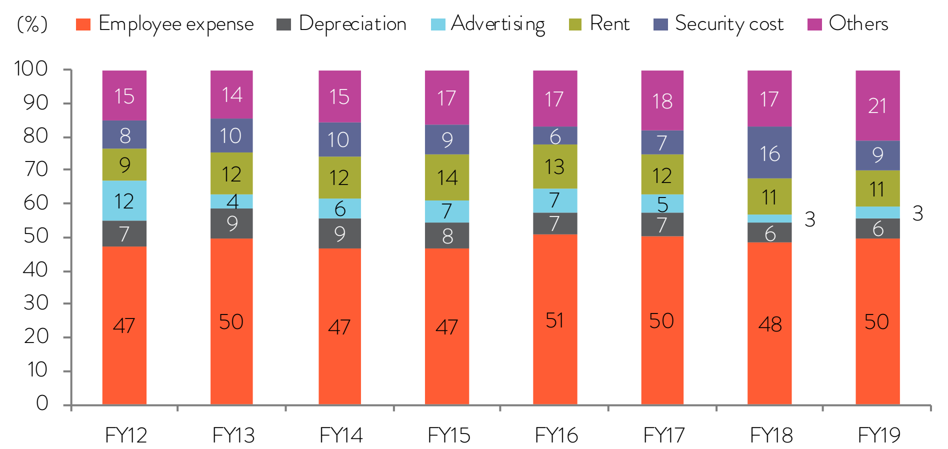
Source: Company, BOBCAPS Research

Operating costs to decline

Management does not anticipate fresh recruitment this year and also expects security costs of Rs 1.7bn in FY18 to fall to Rs 600mn levels in FY20. The new security set-up has an electromagnetic system for strong rooms along with cameras in every branch, limiting the need for higher-cost human intervention.

e-KYC has been live in all branches since FY18 and the company plans to digitise all paperwork shortly. It is also in the process of implementing image-processing software that can read details from standard government documents such as voter ID and PAN card to hasten the disbursal process.

FIG 52 – BREAKUP OF OPEX



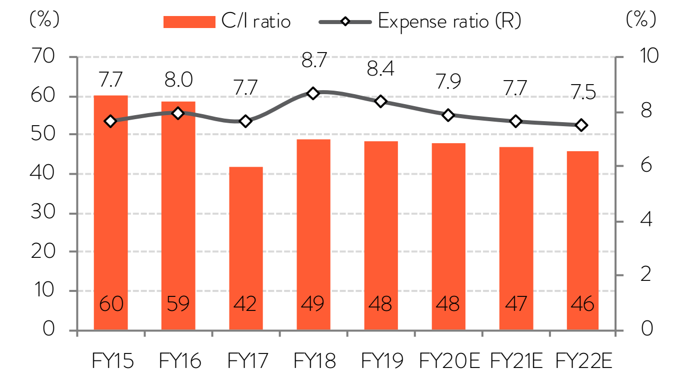
Source: Company, BOBCAPS Research

Operating profit to outpace AUM growth

Given the focus on online gold loans, lower turnaround time and increasing usage of technology in business processes, we expect the cost-to-income ratio to trend down by 250bps and expense ratio to trend down by 85bps during FY19-FY22.

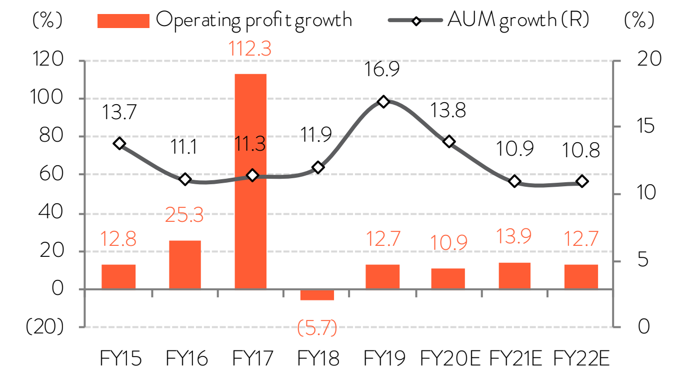
All these factors should lead to operating profit growth outpacing AUM growth over this period.

FIG 53 – WE EXPECT EXPENSE RATIO TO TREND DOWN 85BPS OVER FY19-FY22E



Source: Company, BOBCAPS Research

FIG 54 – OPERATING PROFIT GROWTH TO LEAD AUM GROWTH



Source: Company, BOBCAPS Research

Credit costs holding steady

Following the Rao committee restrictions on LTV in 2013, MGFL recalibrated its portfolio to have short-term products carrying a quarterly LTV reset, besides instituting stringent interest collection norms. Our analysis finds that adverse gold price movement and restrictive LTV norms have contained one-year lag write-offs as a percentage of AUM at an average of ~25bps through FY13-FY17.

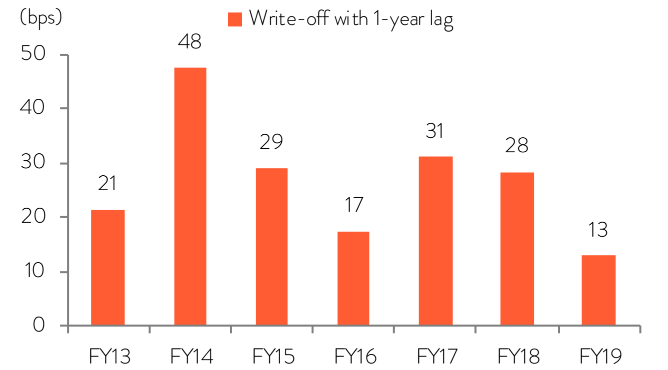
We expect this trend to continue and model for stable credit costs at 35bps through FY20-FY22. This coupled with falling auction losses upon introduction of a new auction policy last year and the recent corporate tax cut should drive a 17% PAT CAGR over FY19-FY22.

Restrictive LTV policy contains write-offs

MGFL has an average LTV of 67% across its gold loan book in FY15-19. If a consumer has not serviced the loan for 90 days, i.e. paid the interest or reset the LTV to current levels of gold prices, it is considered a default and the loan is classed as a non-performing asset (NPA). Non-payment for a further 90 days triggers auction of gold collateral by the company.

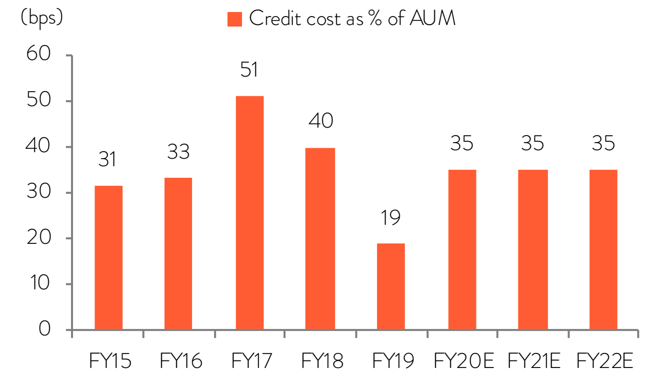
If the customer services at least 75% of the interest, the company can use its discretion to defer the auction. We note that though this restrictive LTV policy and robust interest collection framework work well for risk management, the downside is that customers may prefer to migrate back to unorganised lenders.

FIG 55 – AVERAGE ONE-YEAR LAGGED WRITE-OFF OF ~25BPS THROUGH FY15-FY19



Source: Company, BOBCAPS Research

FIG 56 – WE EXPECT CREDIT COST AT ~35BPS DURING FY20E-FY22E



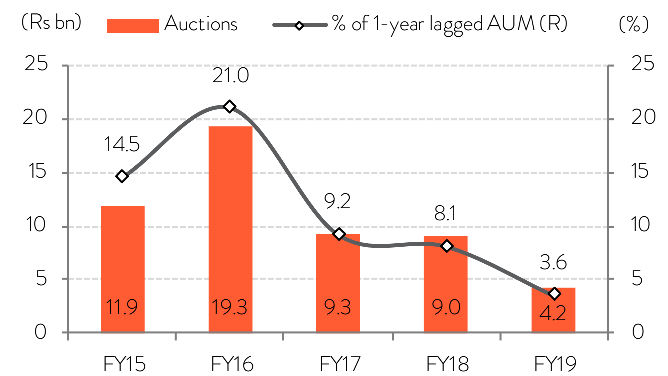
Source: Company, BOBCAPS Research

Auction losses shrinking

Auctions have been coming down in absolute value and as a percentage of AUM (with a one-year lag) for various reasons: (1) lower interest reversals on short-tenure products, (2) incentives of branch level employees oriented towards collections, and (3) the new "as is where is" auction policy implemented from Q4FY19 onwards, wherein the gold collateral is sold in the same location from it was sourced.

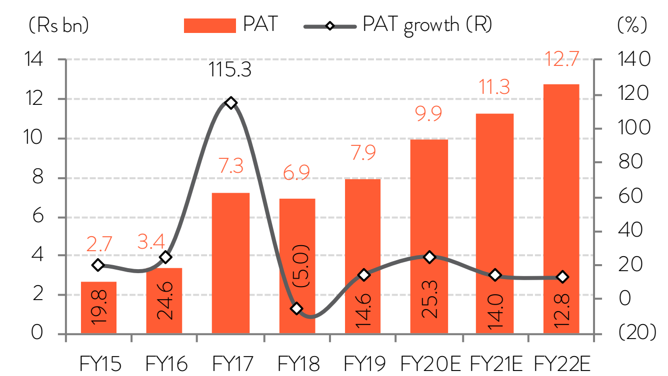
The company was earlier experiencing a 5-6% loss in auctions. With the new auction policy, it expects close to 100% realisation as traders are reluctant to participate.

FIG 57 – AUCTION LOSSES HAVE BEEN COMING DOWN



Source: Company, BOBCAPS Research

FIG 58 – WE EXPECT A PAT CAGR OF 17% DURING FY19-FY22E LED BY CORPORATE TAX CUT

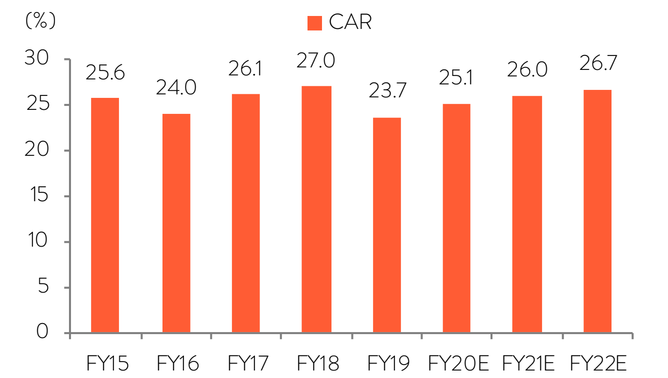


Source: Company, BOBCAPS Research

Return ratios sustainable

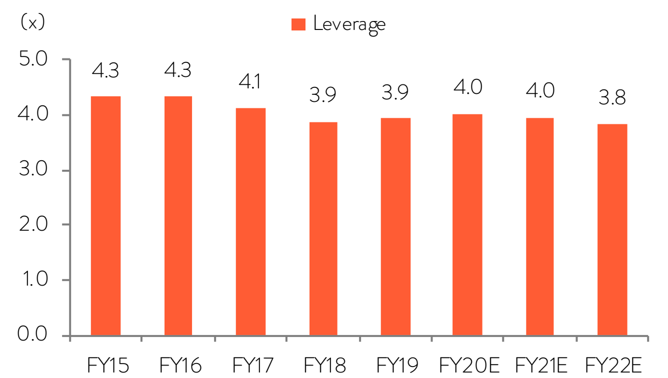
MGFL has remained well capitalised with an average CAR of ~26% during FY10-FY19. This ensures a strong capital buffer for any event risk arising over the product lifecycle. We expect stable ROA of ~5.2% over FY20-FY22 given a favourable product mix, focus on regular collections, business process automation, and positive ALM in the one-year bucket. As the business remains low levered at ~4x, we model for stable ROE of ~20.5% during the same forecast period.

FIG 59 – WELL CAPITALISED…



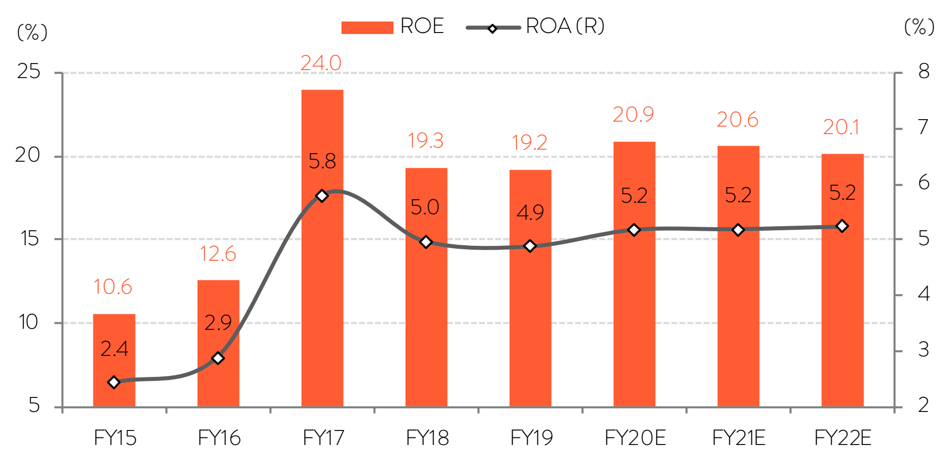
Source: Company, BOBCAPS Research

FIG 60 – …AND LOW LEVERED



Source: Company, BOBCAPS Research

FIG 61 – WE EXPECT STABLE RETURN RATIOS OVER FY20E-FY22E



Source: Company, BOBCAPS Research

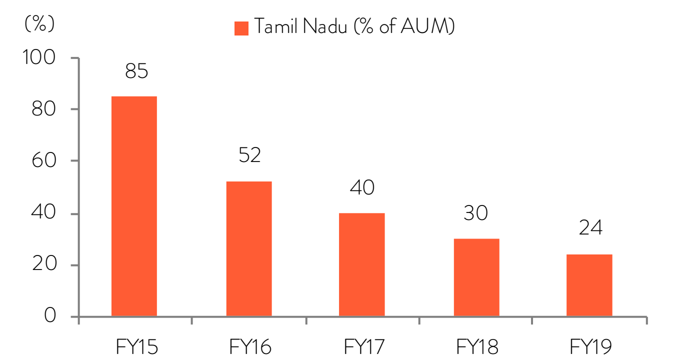
Asirvad: Aiding growth and diversification

In a bid to diversify into complimentary businesses, MGFL bought ~90% stake in Asirvad Microfinance in two tranches over FY15-FY16. Asirvad currently acquires ~100,000 customers per month and has posted eight-fold growth in its microfinance portfolio over FY15-FY18. GLP per lending officer measures among the top-5 MFIs. Management has guided for 40% YoY growth in AUM to Rs 45bn in FY20 led by new customer acquisition, branch expansion and cashless disbursements. The management expects ROA for the MFI arm to touch 4-4.5% levels in FY20.

Derisking business via new market forays

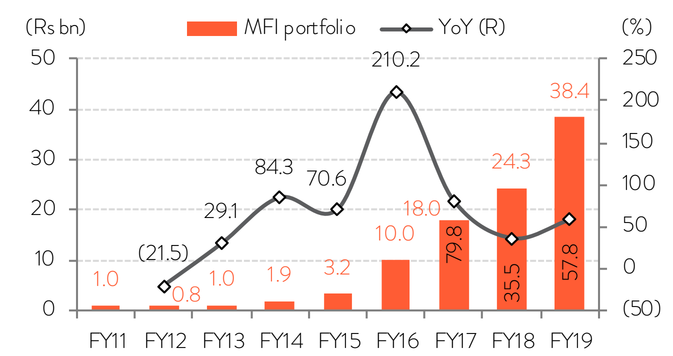
Since the acquisition in FY15, Asirvad has striven to diversify its base by entering into multiple states and reducing dependence on its home market of Tamil Nadu. In FY15, Asirvad had operations in Tamil Nadu, Kerala and Karnataka. As of FY19, the company has operations in 22 states through ~175,000 centres and an active member base of 1.8mn.

FIG 62 – DERISKING TAMIL NADU DEPENDENCE



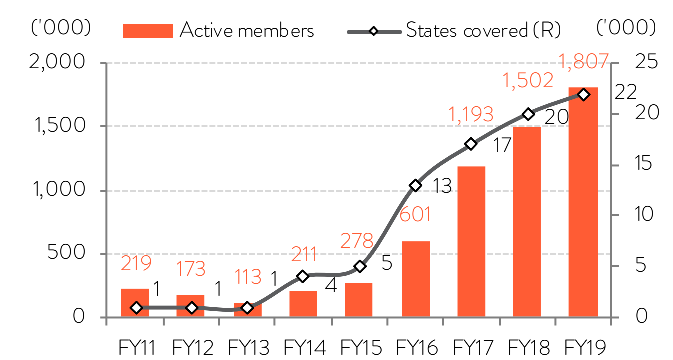
Source: Company, BOBCAPS Research

FIG 63 – MICROFINANCE PORTFOLIO HAS GROWN ~12X SINCE FY15 ACQUISITION



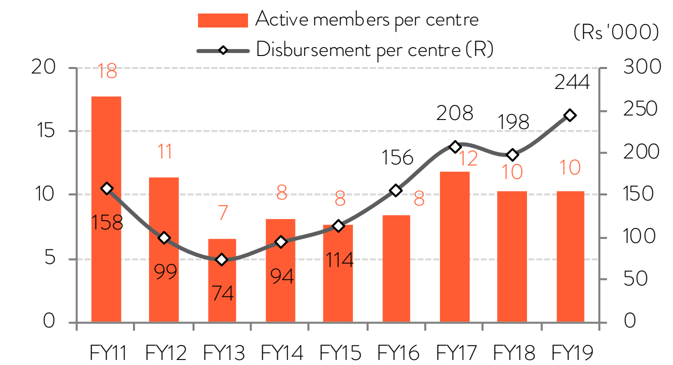
Source: Company, BOBCAPS Research

FIG 64 – ACTIVE MEMBERS HAVE GROWN ~6.5X SINCE ACQUISITION



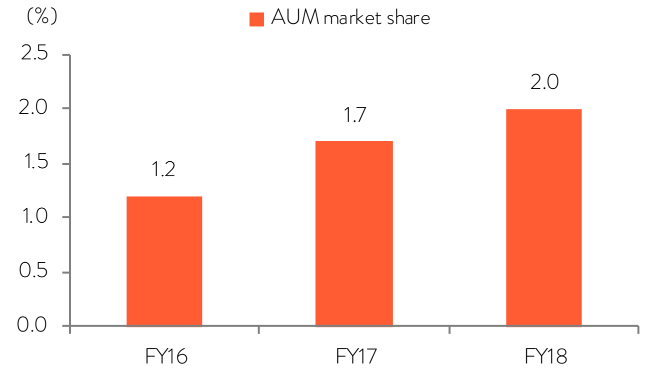
Source: Company, BOBCAPS Research

FIG 65 – PRODUCTIVITY METRICS GROWING AT A STEADY PACE



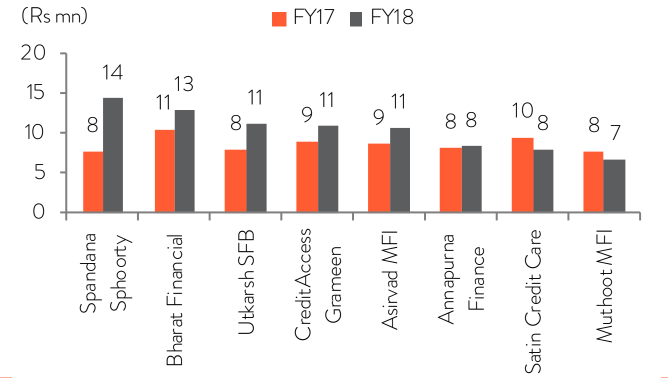
Source: Company, BOBCAPS Research

FIG 66 – THOUGH ASIRVAD IS LOW ON MARKET SHARE...



Source: Company, BOBCAPS Research, ICRA

FIG 67 – ...GLP PER LENDING OFFICER MEASURES AMONG TOP-5 MFIs



Source: Company, BOBCAPS Research, ICRA

The MFI arm has a separate branch structure and works independently from MGFL's gold finance business. However, as microfinance caters to the bottom of the pyramid through income-generation credit products, MGFL is likely to find synergy with Asirvad's client base for its next leg of growth. The overlap between MFI and gold finance customers is ~15% as of FY19.

Spreads stable and credit costs normalising

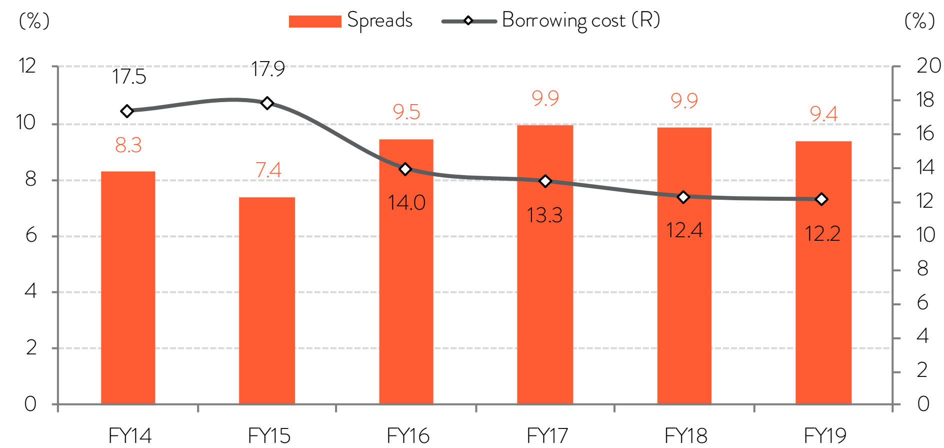
Post-acquisition by MGFL, Asirvad's credit ratings have improved steadily, thus leading to a better borrowing mix and lower cost of funds.

IMPROVING CREDIT RATING...

	FY16	FY17	FY18
MFI rating	MFI 1	MFI 1	MFI 1
Bank loan rating	A-	A+	A+

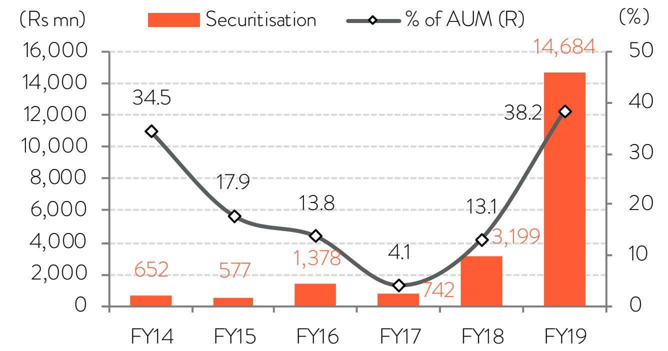
Source: Company, BOBCAPS Research

FIG 68 – ...LEADING TO BETTER SPREADS



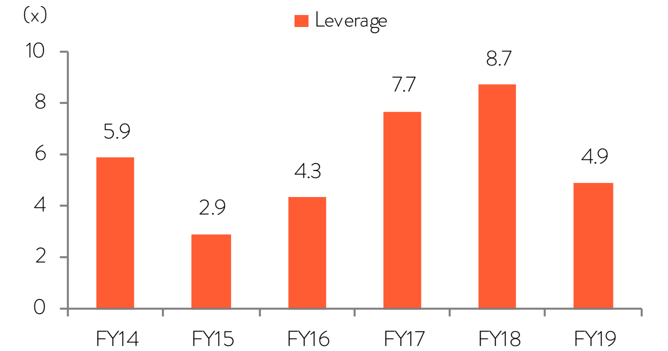
Source: Company, BOBCAPS Research

FIG 69 – RISING SECURITISATION VOLUMES…



Source: Company, BOBCAPS Research

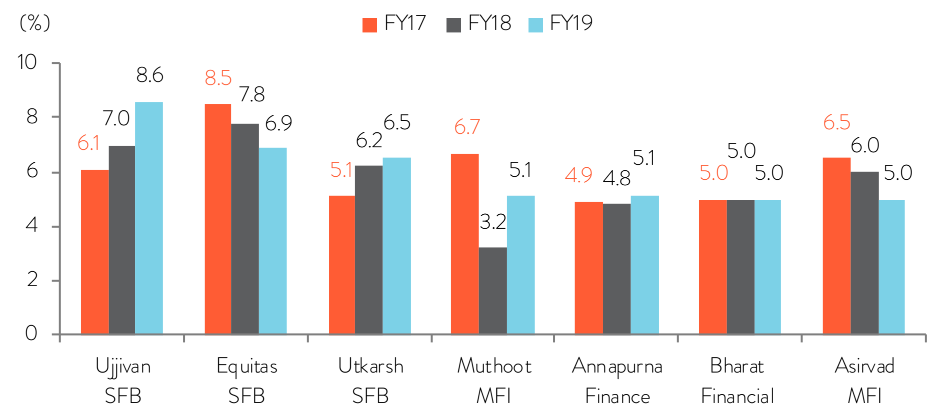
FIG 70 – …TO KEEP BUSINESS MODEL LOW LEVERED



Source: Company, BOBCAPS Research

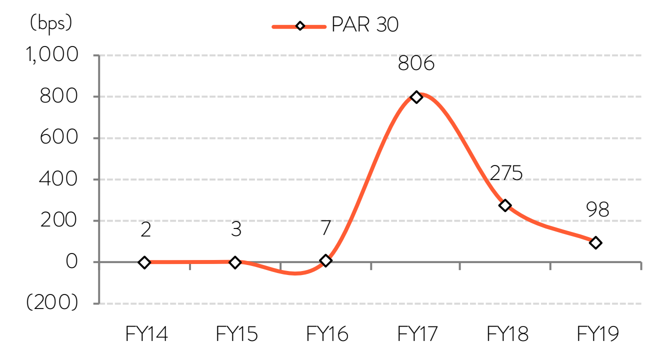
Asirvad uses CRIF Highmark and Equifax credit bureau reports for every loan that is sanctioned. This coupled with efficient processes has resulted in strong portfolio quality with minimal delinquencies. Further, based on portfolio risk mapping, management has decided to have over two-thirds of its book in the southern and eastern belts of India, while reducing exposure to northern and central states. The company has also been strengthening its technology across branches, leading to improved back-office productivity.

FIG 71 – OPEX TO AVERAGE MANAGED ASSETS LOWER THAN PEERS



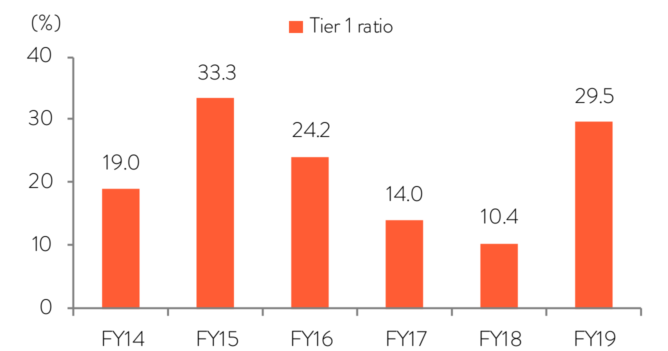
Source: Company, BOBCAPS Research, ICRA

FIG 72 – PAR 30 COMING DOWN STEADILY



Source: Company, BOBCAPS Research

FIG 73 – WELL CAPITALISED FOR EVENT RISKS



Source: Company, BOBCAPS Research

Organisation and management structure

FIG 74 – MGFL ORGANISATION STRUCTURE

MD & CEO

Departments which report directly to CEO	Risk
Compliance	Information Security
Legal	Audit
Finance	Vigilance and Fraud Control
Sales	Corporate Loans
Marketing	Security and Admin
Operation	IT
Human Resources	Financial Analysis Wing

Source: Company, BOBCAPS Research

FIG 75 – EXPERIENCED MANAGEMENT TEAM

VP Nandakumar
Managing Director & CEO

- Chief Promoter of Manappuram Group
- Certified Associate of Indian Institute of Bankers

BN Raveendra Babu
Executive Director

- Director since July 1992
- Worked in a senior role with Blue Marine International in UAE

Bindu A L
CFO

- Chartered Accountant with over 20 years of experience in the area of Finance and Accounts

Raja Vaidhyanathan
Managing Director – MFI

- Erstwhile Promoter of Asirvad Microfinance
- IIT IIM Alumni with over 33 years of experience across industries

Jeevandas Narayan
Managing Director – Housing Finance

- Erstwhile MD of State Bank of Travancore
- Over 37 years of experience in the financial services industry

Subhash Samant
CEO – Housing Finance

- Over 21 years of experience with organisations such as L&T Housing, DHFL, ICICI Bank, GIC Housing

K Senthil Kumar
Head – Commercial Vehicle

- Over 21 years of experience with organisations such as Fullerton India, Citi Bank, HDFC Bank

Kamalakar Sai Palavalasa
EVP – Insurance

- Over 24 years of experience with organisations such as Genosar, IndiaFirst, Reliance, Birla Insurance

Puneet Kaur Kohli
SVP - CTO

- Over 22 years of experience with organisations such Bajaj Capital, Motricity, Bharti Airtel, Accenture, Duncan Industries, ITC Hotel

Source: Company, BOBCAPS Research

FIG 76 – CORPORATE STRUCTURE

Manappuram Finance

- Asirvad Microfinance (92.3% stake)
- Manappuram Home Finance (100% stake)
- Manappuram Insurance Broker Ltd. (100% stake)

Source: Company, BOBCAPS Research

Valuation methodology

MGFL is trading at 2.2x/1.9x FY20E/FY21E BV for ROE of 20.9%/20.6%. We initiate coverage on the company with BUY and a Sep'20 sum-of-the-parts (SOTP) target price of Rs 165. We think management's twin strategies are playing out well – MGFL has retained its market share (~18%) in gold finance over the past five years and we expect the business to yield a steady-state ROA of ~5% and remain low-levered at ~4x. We are not overly concerned with a ~10% loan CAGR as the company is focusing on lower ticket sizes and on reshaping customer attitudes towards gold finance in non-south geographies.

Diversification into allied businesses is likely to meaningfully contribute to the bottom-line in the near term. Asirvad is among the top-5 MFIs in the country and has leading productivity metrics compared to peers. MGFL will incrementally allocate capital towards growing these new businesses.

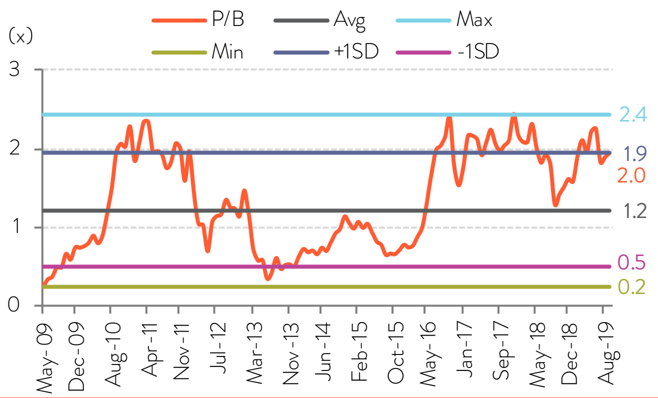
For our SOTP model, we value (a) the standalone book, which includes gold finance, vehicle finance, SME finance and on-lending, at Rs 147/sh based on 2.0x Sep'21E BV, and (b) Asirvad MFI at Rs 18/sh based on 2.2x (from last stake sale) Sep'21E BV after a holding company discount of 20%.

FIG 77 – SOTP VALUATION SUMMARY

SOTP	Value (Rs bn)	Value (US$ bn)	Value per share (Rs)	% of total	Valuation rationale
Core business	**124**	**1.8**	**147**	**89.3**	**2.0x Sep'21E BV**
Key ventures					
- Asirvad Microfinance	19	0.3	22	13.4	2.2x Sep'21E BV based on last stake sale
Total value of ventures	**19**	**0.3**	**22**	**13.4**	
Less: 20% holding discount	4	0.1	4	2.7	
Value of key ventures	**15**	**0.2**	**18**	**10.7**	
Target value post 20% holding co disc	139	2.0	165	100.0	
CMP	113	1.6	134		
Upside (%)	22.8	22.8	22.8		

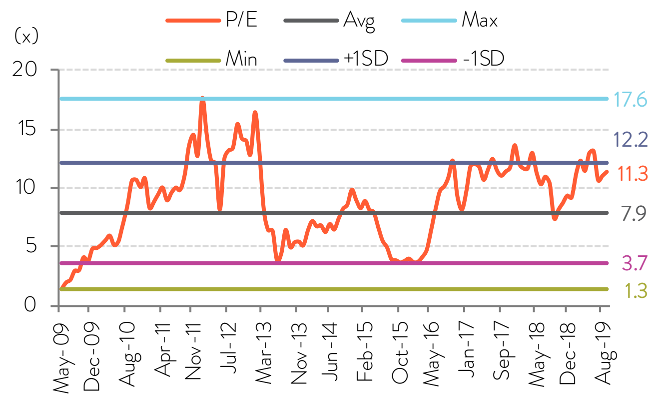
Source: BOBCAPS Research

FIG 78 – ONE-YEAR FORWARD P/B BAND



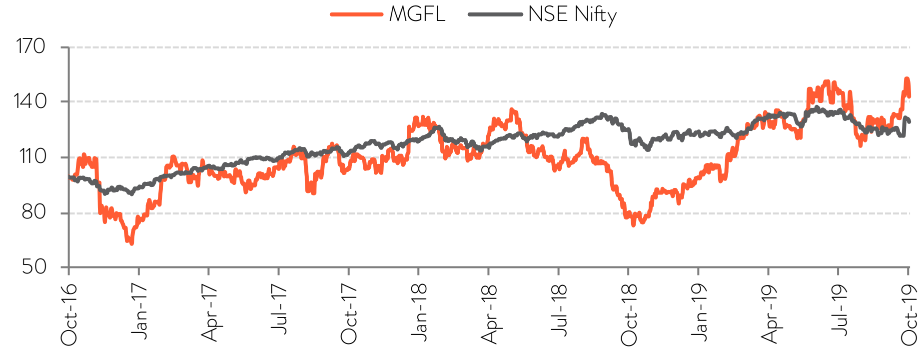
Source: Bloomberg, BOBCAPS Research

FIG 79 – ONE-YEAR FORWARD P/E BAND



Source: Bloomberg, BOBCAPS Research

FIG 80 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Key downside risks to our estimates are:

- slower-than-expected productivity increase,
- significant increase in credit costs for the vehicle finance and on-lending businesses, and
- event risk in the microfinance business.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	**20,943**	**23,525**	**25,840**	**28,785**	**31,885**
NII growth (%)	5.0	12.3	9.8	11.4	10.8
Non-interest income	639	548	624	710	811
Total income	21,582	24,074	26,464	29,495	32,697
Operating expenses	10,551	11,657	12,676	13,786	14,996
Operating profit	11,031	12,417	13,788	15,708	17,701
Operating profit growth (%)	(5.8)	12.6	11.0	13.9	12.7
Provisions	484	260	561	630	699
PBT	10,547	12,157	13,226	15,078	17,002
Tax	3,658	4,273	3,320	3,785	4,267
Reported net profit	**6,889**	**7,884**	**9,907**	**11,293**	**12,734**
Adjustments	0	0	0	0	0
Adjusted net profit	**6,889**	**7,884**	**9,907**	**11,293**	**12,734**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Equity capital	1,685	1,686	1,686	1,686	1,686
Reserves & surplus	36,441	42,236	49,171	57,076	65,990
Net worth	38,126	43,922	50,856	58,762	67,676
Deposits	0	0	0	0	0
Borrowings	102,378	127,426	148,490	163,300	180,978
Other liabilities & provisions	5,427	5,112	5,879	6,760	7,775
Total liabilities and equities	**145,931**	**176,460**	**205,224**	**228,822**	**256,428**
Cash & bank balance	4,425	4,508	9,192	10,461	13,268
Investments	3,782	10,108	11,119	11,953	12,850
Advances	128,407	150,052	170,763	189,428	209,935
Fixed & Other assets	13,742	16,299	23,342	27,441	33,644
Total assets	**145,931**	**176,460**	**205,224**	**228,822**	**256,428**
Deposit growth (%)	NA	NA	NA	NA	NA
Advances growth (%)	11.9	16.9	13.8	10.9	10.8

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
EPS	8.2	9.4	11.8	13.4	15.1
Dividend per share	2.0	2.3	2.9	3.3	3.8
Book value per share	45.3	52.1	60.3	69.7	80.3

Source: Company, BOBCAPS Research

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
P/E	16.4	14.3	11.4	10.0	8.9
P/BV	3.0	2.6	2.2	1.9	1.7
Dividend yield (%)	1.5	1.7	2.2	2.5	2.8

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	15.1	14.6	13.5	13.3	13.1
Non-interest income	0.5	0.3	0.3	0.3	0.3
Operating expenses	7.6	7.2	6.6	6.4	6.2
Pre-provisioning profit	8.0	7.7	7.2	7.2	7.3
Provisions	0.4	0.2	0.3	0.3	0.3
PBT	7.6	7.6	6.9	6.9	7.0
Tax	2.6	2.7	1.7	1.7	1.8
ROA	5.0	4.9	5.2	5.2	5.2
Leverage (x)	3.9	3.9	4.0	4.0	3.8
ROE	19.4	19.3	20.9	20.6	20.1

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Net interest income	5.0	12.3	9.8	11.4	10.8
Pre-provisioning profit	(5.8)	12.6	11.0	13.9	12.7
EPS	(5.1)	14.6	25.3	14.0	12.8
Profitability & Return ratios (%)					
Net interest margin	17.2	16.9	16.1	16.0	16.0
Fees / Avg. assets	0.3	0.3	0.3	0.3	0.3
Cost-Income	48.9	48.4	47.9	46.7	45.9
ROE	19.4	19.3	20.9	20.6	20.1
ROA	5.0	4.9	5.2	5.2	5.2
Asset quality (%)					
GNPA	0.7	0.6	0.6	0.6	0.6
NNPA	0.3	0.3	0.3	0.3	0.4
Provision coverage	40.9	41.7	41.1	40.6	40.2
Ratios (%)					
Credit-Deposit	0.0	0.0	0.0	0.0	0.0
Investment-Deposit	0.0	0.0	0.0	0.0	0.0
CAR	27.0	23.7	25.1	26.0	26.7
Tier-1	26.6	23.3	24.8	25.7	26.4

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

Rating distribution

As of 30 September 2019, out of 77 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 47 have BUY ratings, 15 are rated ADD, 6 are rated REDUCE and 9 are rated SELL. None of these companies have been investment banking clients in the last 12 months.

Analyst certification

The research analyst(s) authoring this report hereby certifies that (1) all of the views expressed in this research report accurately reflect his/her personal views about the subject company or companies and its or their securities, and (2) no part of his/her compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) in this report. Analysts are not registered as research analysts by FINRA and are not associated persons of BOBCAPS.

General disclaimers

BOBCAPS is engaged in the business of Institutional Stock Broking and Investment Banking. BOBCAPS is a member of the National Stock Exchange of India Limited and BSE Limited and is also a SEBI-registered Category I Merchant Banker. BOBCAPS is a wholly owned subsidiary of Bank of Baroda which has its various subsidiaries engaged in the businesses of stock broking, lending, asset management, life insurance, health insurance, wealth management and portfolio management, among others.

BOBCAPS's activities have neither been suspended nor has it defaulted with any stock exchange authority with whom it has been registered in the last five years. BOBCAPS has not been debarred from doing business by any stock exchange or SEBI or any other authority. No disciplinary action has been taken by any regulatory authority against BOBCAPS affecting its equity research analysis activities.

BOBCAPS has obtained registration as a Research Entity under SEBI (Research Analysts) Regulations, 2014, having registration No.: INH000000040 valid till 03 February 2020. BOBCAPS is also a SEBI-registered intermediary for the broking business having SEBI Single Registration Certificate No.: INZ000159332 dated 20 November 2017.

BOBCAPS prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, BOBCAPS prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover.

Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additionally, other important information regarding our relationships with the company or companies that are the subject of this material is provided herein.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of BOBCAPS's clients. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice.

The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. BOBCAPS does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment in certain transactions — including those involving futures, options, and other derivatives as well as non-investment-grade securities —that give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only. We endeavour to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so.

We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have "long" or "short" positions in, act as principal in, and buy or sell the securities or derivatives thereof of companies mentioned herein and may from time to time add to or dispose of any such securities (or investment). We and our affiliates may act as market makers or assume an underwriting commitment in the securities of companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis, and may also perform or seek to perform investment banking or advisory services for or relating to these companies and may also be represented in the supervisory board or any other committee of these companies.

For the purpose of calculating whether BOBCAPS and its affiliates hold, beneficially own, or control, including the right to vote for directors, one per cent or more of the equity shares of the subject company, the holdings of the issuer of the research report is also included.

BOBCAPS and its non-US affiliates may, to the extent permissible under applicable laws, have acted on or used this research to the extent that it relates to non-US issuers, prior to or immediately following its publication. Foreign currency denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of or income derived from the investment. In addition, investors in securities such as ADRs, the value of which are influenced by foreign currencies, effectively assume currency risk. In addition, options involve risks and are not suitable for all investors. Please ensure that you have read and understood the Risk disclosure document before entering into any derivative transactions.

In the US, this material is only for Qualified Institutional Buyers as defined under rule 144(a) of the Securities Act, 1933. No part of this document may be distributed in Canada or used by private customers in the United Kingdom.

No part of this material may be (1) copied, photocopied, or duplicated in any form by any means or (2) redistributed without BOBCAPS's prior written consent.

Company-specific disclosures under SEBI (Research Analysts) Regulations, 2014

The research analyst(s) or his/her relatives do not have any material conflict of interest at the time of publication of this research report.

BOBCAPS or its research analyst(s) or his/her relatives do not have any financial interest in the subject company. BOBCAPS or its research analyst(s) or his/her relatives do not have actual/beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

The research analyst(s) has not received any compensation from the subject company in the past 12 months. Compensation of the research analyst(s) is not based on any specific merchant banking, investment banking or brokerage service transactions.

BOBCAPS or its research analyst(s) is not engaged in any market making activities for the subject company.

The research analyst(s) has not served as an officer, director or employee of the subject company.

BOBCAPS or its associates may have material conflict of interest at the time of publication of this research report.

BOBCAPS's associates may have financial interest in the subject company. BOBCAPS's associates may hold actual / beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

BOBCAPS or its associates may have managed or co-managed a public offering of securities for the subject company or may have been mandated by the subject company for any other assignment in the past 12 months.

BOBCAPS may have received compensation from the subject company in the past 12 months. BOBCAPS may from time to time solicit or perform investment banking services for the subject company. BOBCAPS or its associates may have received compensation from the subject company in the past 12 months for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory services in a merger or specific transaction. BOBCAPS or its associates may have received compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past 12 months.