

**BUY**

TP: Rs 950 | ▲ 57%

**MUTHOOT FINANCE**

| NBFC

| 03 April 2020

## Return of pricing power

We delved into the operating metrics of three large gold financiers – Muthoot Finance (MUTH), Manappuram Finance (MGFL) and Muthoot Fincorp (MFIN) – and found that MUTH has a wider reach and is a better paymaster, aiding higher productivity. Also, its strong cost management fuels operating profit growth. Credit cost normalisation is a consistent theme for all three, but MUTH has the best profit metrics. We expect MUTH to remain in the lead and raise FY20/FY21/FY22 earnings by 12%/3%/3%, thus resetting our Mar'21 TP to Rs 950 (vs. Rs 875).

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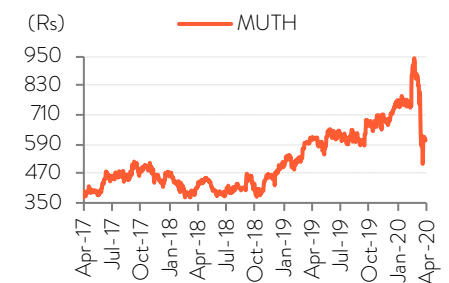
**Better reach fuels productivity:** MUTH had ~4,500 branches as of FY19, which is 30% and 20% higher than the average for MGFL and MFIN respectively through FY13-FY19. This coupled with being a better paymaster (avg. salary per employee ~30% more than MGFL and MFIN) has helped MUTH shore up productivity over this period (avg. AUM per employee ~2x that of both peers). We believe the company will maintain its productivity edge.

Ticker/Price	MUTH IN/Rs 605
Market cap	US\$ 3.2bn
Shares o/s	401mn
3M ADV	US\$ 25.1mn
52wk high/low	Rs 955/Rs 477
Promoter/FPI/DII	73%/15%/8%

Source: NSE

**Strong cost management bolsters operating profit:** Consistent pricing and strong cost management (~4.5% expense ratio) have helped MUTH nearly double NII through FY13-FY19 and maintain it at twice the average of MGFL and MFIN. Expanding spreads and a doubling of operating profit over this period have further helped build a strong profit pool for the company. Its operating profit averages ~6x that of both peers and this lead looks sustainable.

## STOCK PERFORMANCE



**Best placed in present uncertain environment:** With the impending credit squeeze and asset quality overhang due to Covid-19, we believe MUTH's clear edge over peers positions it for a strong run-up in stock price as the situation normalises. In our view, the company's spreads/NII are resilient in the current challenging environment as gold loans are usually well-collateralised and carry minimal challenges to ALM.

## KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	42,707	45,202	56,853	59,259	67,443
NII growth (%)	27.7	5.8	25.8	4.2	13.8
Adj. net profit (Rs mn)	17,776	19,721	29,937	30,181	34,750
EPS (Rs)	44.4	49.2	74.7	75.3	86.7
P/E (x)	13.6	12.3	8.1	8.0	7.0
P/BV (x)	3.1	2.5	2.0	1.7	1.5
ROA (%)	5.8	5.7	7.4	6.5	6.5
ROE (%)	24.8	22.4	27.6	23.3	22.8

Source: Company, BOBCAPS Research

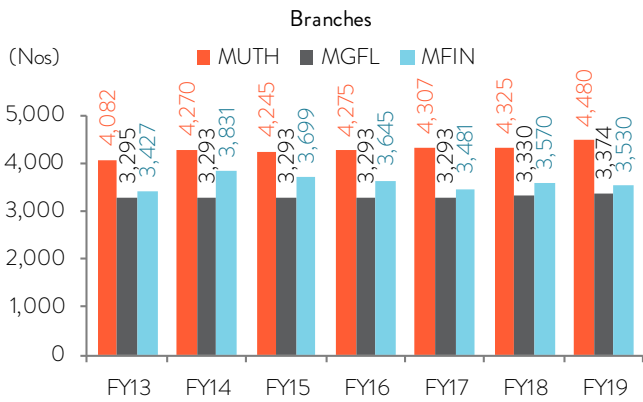
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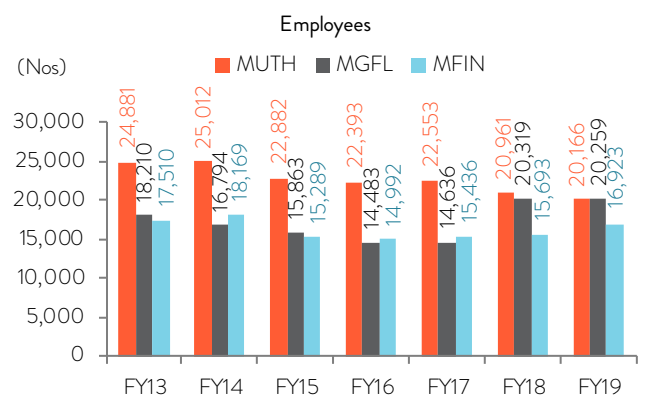
## Gold financiers: A comparative analysis

**FIG 1 – MUTH LEADS IN BOTH REACH...**



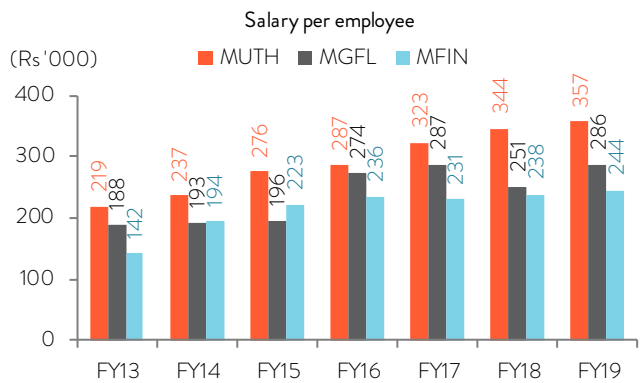
Source: Company, BOBCAPS Research

**FIG 2 – ...AND EMPLOYEE COUNT**



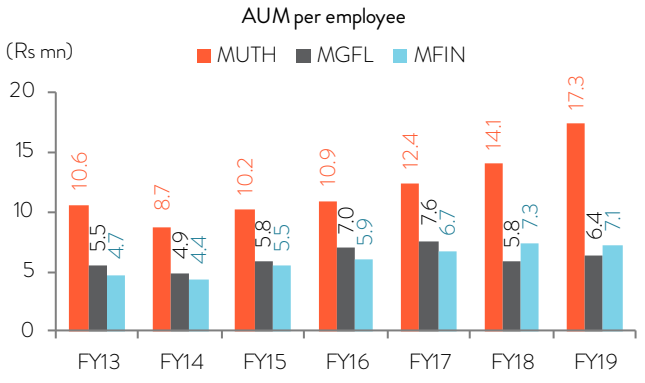
Source: Company, BOBCAPS Research

**FIG 3 – MUTH IS A BETTER PAYMASTER THAN PEERS...**



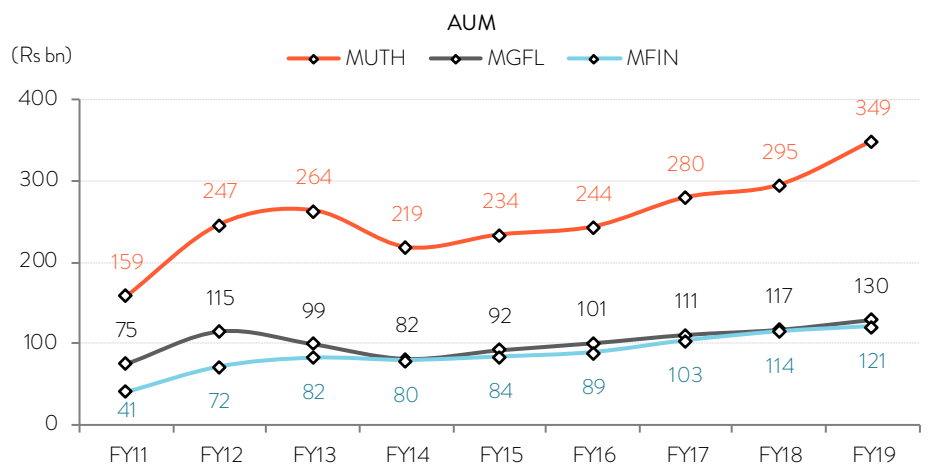
Source: Company, BOBCAPS Research

**FIG 4 – ...LEADING TO BETTER PRODUCTIVITY**



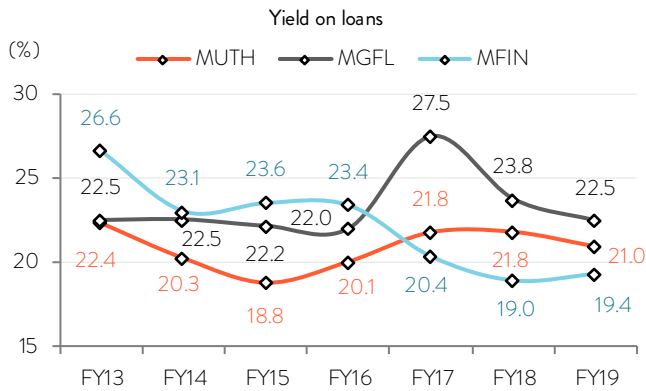
Source: Company, BOBCAPS Research

**FIG 5 – HIGHER PRODUCTIVITY REFLECTS IN RISING AUM**



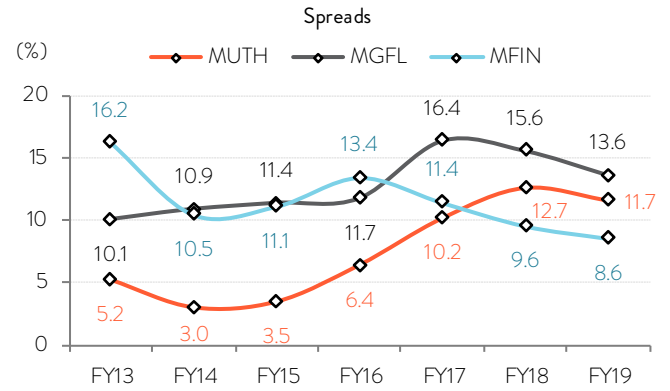
Source: Company, BOBCAPS Research

**FIG 6 – MUTH HAS HAD CONSISTENT PRICING...**



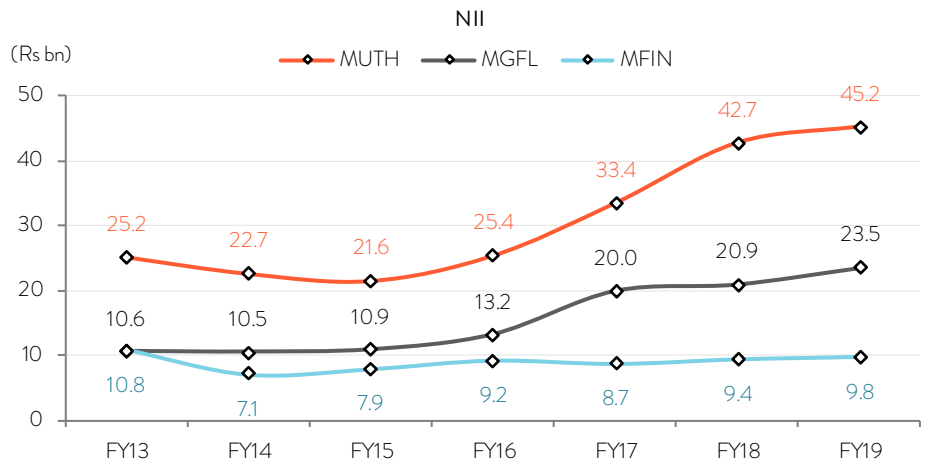
Source: Company, BOBCAPS Research

**FIG 7 – ...AND SPREADS VIS-À-VIS MGFL AND MFIN**



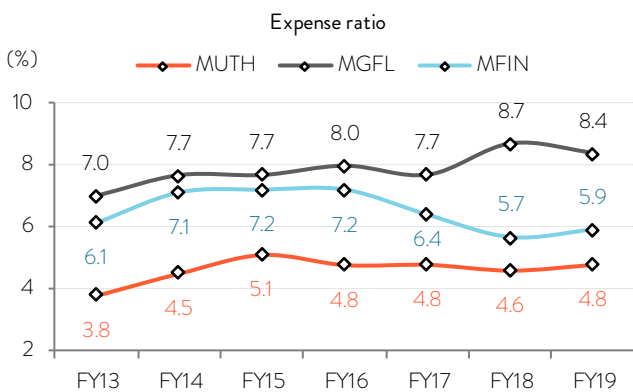
Source: Company, BOBCAPS Research

**FIG 8 – NII GROWTH TRAJECTORY FAR STRONGER**



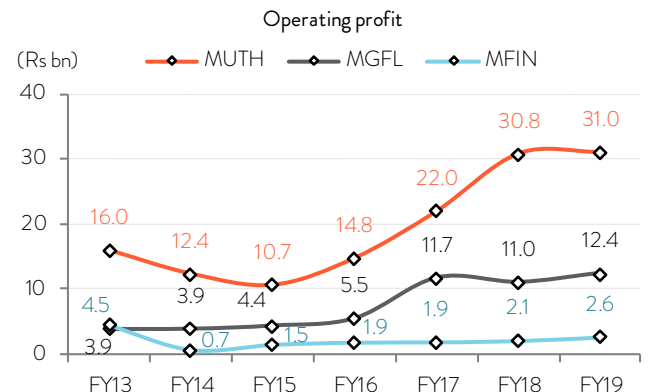
Source: Company, BOBCAPS Research

**FIG 9 – MUTH HAS BEEN BETTER AT MANAGING COSTS...**



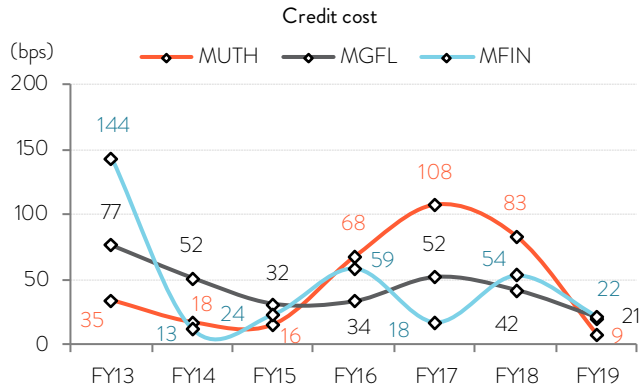
Source: Company, BOBCAPS Research

**FIG 10 – ...TRANSLATING TO HIGHER OPERATING PROFITS**



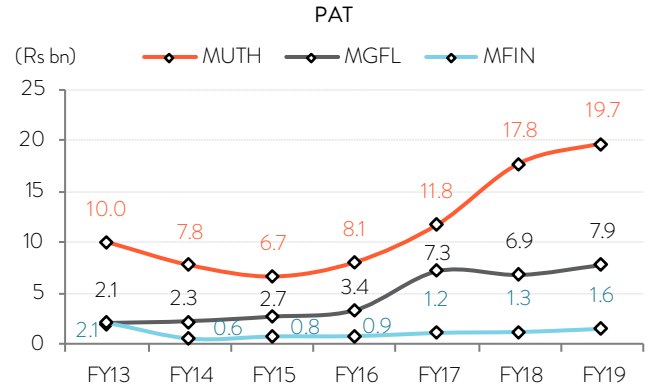
Source: Company, BOBCAPS Research

**FIG 11 – CREDIT COSTS ARE NORMALISING FOR ALL...**



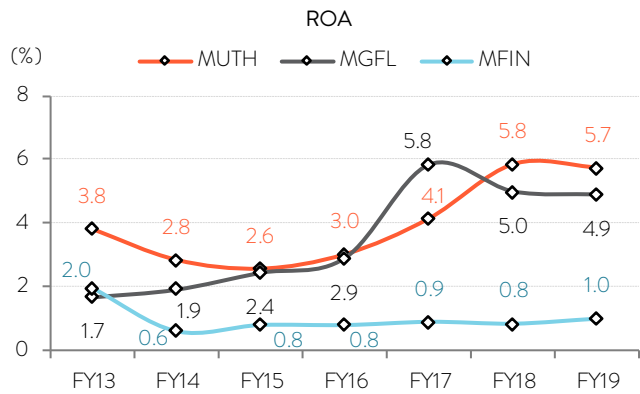
Source: Company, BOBCAPS Research

**FIG 12 – ...BUT MUTH HAS BETTER PAT GROWTH**



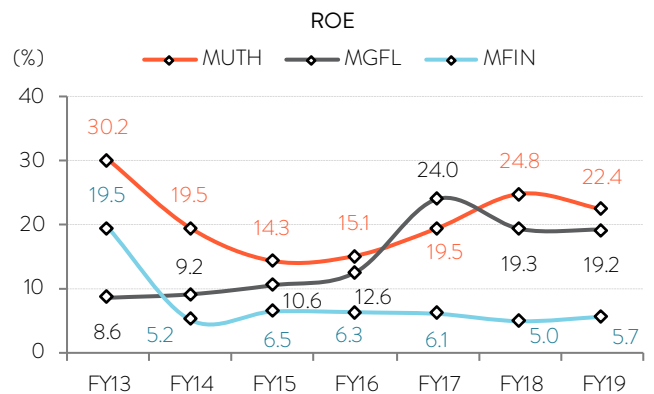
Source: Company, BOBCAPS Research

**FIG 13 – MUTH LEADS ON RETURN RATIOS...**



Source: Company, BOBCAPS Research

**FIG 14 – ...BOTH ROA AND ROE**



Source: Company, BOBCAPS Research

## Valuation methodology

MUTH is trading at 1.7x/1.5x FY21E/FY22E BV for ROE of 23.3%/22.8%. Focused strategies to become the gold financier of choice have helped MUTH cement leadership in gold finance. Emphasis on customer traction and branch productivity is expected to fuel a robust ~14% 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 21.5% in FY20-FY22. A favourable borrowing mix and short-tenor portfolio should anchor spreads at ~12%.

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 ~7%, with leverage at ~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.

In our view, MUTH is likely to remain the lowest cost gold financier in near term – we thus raise our FY20 earnings estimate by 12% and FY21-FY22 estimates by 3% each. Our Mar'21 target price stands revised to Rs 950 (vs. Rs 875 earlier). Our target is derived using the SOTP method as follows: (a) Rs 894/sh for the standalone book based on 2.3x FY22E BV, (b) Rs 47/sh for MHFL based on 4.0x FY22E BV (from last stake sale), and (c) Rs 22/sh for Belstar based on 2.5x FY22E BV (post holdco discount of 20%). Maintain BUY.

**FIG 15 – REVISED ESTIMATES**

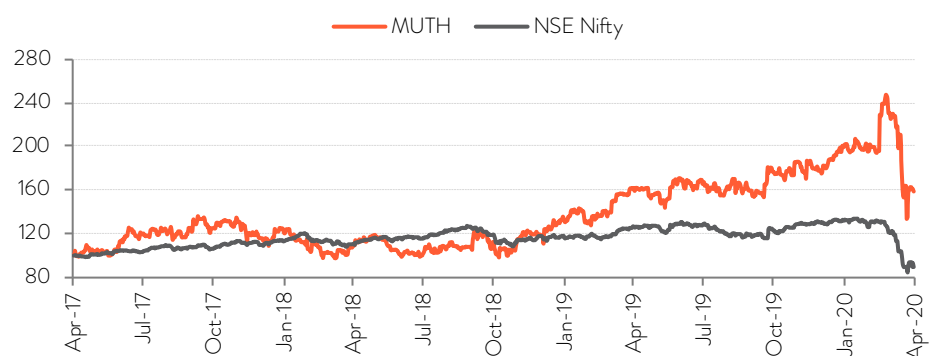
(Rs bn)	Old			New			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
NII	52.6	58.3	66.3	56.9	59.3	67.4	8.0	1.7	1.7
Other Income	1.5	1.5	1.6	1.5	1.5	1.6	-	-	-
Net Income	54.1	59.8	68.0	58.3	60.8	69.1	7.8	1.6	1.6
Operating Expenses	17.3	19.3	21.4	17.2	19.2	21.3	(0.5)	(0.5)	(0.5)
Operating Profits	36.8	40.5	46.6	41.1	41.5	47.8	11.7	2.7	2.6
Provisions	1.0	1.2	1.3	1.1	1.2	1.3	10.0	1.6	1.6
PBT	35.8	39.3	45.3	40.0	40.3	46.5	11.7	2.7	2.6
Tax	9.0	9.9	11.4	10.1	10.2	11.7	11.7	2.7	2.6
PAT	26.8	29.4	33.9	29.9	30.2	34.8	11.7	2.7	2.6
Loans	393	445	504	399	452	512	1.7	1.7	1.7
Borrowings	291	327	373	296	333	379	1.7	1.7	1.7
Spread (%)	11.8	11.4	11.5	12.8	11.4	11.5	100bps	0bps	0bps
ROA (%)	6.7	6.5	6.5	7.4	6.5	6.5	72bps	6bps	6bps
ROE (%)	25.0	23.1	22.7	27.6	23.3	22.8	265bps	17bps	13bps

Source: BOBCAPS Research

**FIG 16 – SOTP VALUATION SUMMARY**

SOTP FY22E Based (Rs)	Value (Rs bn)	Value (US\$ bn)	Value/Sh (Rs)	% of total	Rationale
Core business	358	5.1	894	94.1	2.3x BV
<b>Key Ventures</b>					
Muthoot Homefin	19	0.3	47	5.0	4.0x BV based on last stake sale
Belstar Investment and Finance	9	0.1	22	2.3	2.5x BV
Total Value of Ventures	28	0.4	70	7.3	
Less: 20% holding discount	6	0.1	14	25.0	
Value of Key Ventures	22	0.3	56	5.9	
<b>Target Value Post 20% Holding Co Disc</b>	<b>381</b>	<b>5.4</b>	<b>950</b>	<b>100.0</b>	
CMP	243	3.5	606		
Upside (%)	56.8	56.8	56.8		

Source: BOBCAPS Research

**FIG 17 – RELATIVE STOCK PERFORMANCE**

Source: NSE

## Key risks

Key downside risks to our estimates are:

- 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
<b>Net interest income</b>	<b>42,707</b>	<b>45,202</b>	<b>56,853</b>	<b>59,259</b>	<b>67,443</b>
NII growth (%)	27.7	5.8	25.8	4.2	13.8
Non-interest income	1,310	1,236	1,453	1,491	1,638
Total income	44,017	46,438	58,306	60,750	69,081
Operating expenses	13,174	15,394	17,161	19,220	21,297
Operating profit	30,843	31,044	41,145	41,531	47,784
Operating profit growth (%)	40.0	0.6	32.5	0.9	15.1
Provisions	2,397	275	1,122	1,182	1,326
PBT	28,447	30,768	40,023	40,349	46,458
Tax	10,671	11,047	10,086	10,168	11,707
<b>Reported net profit</b>	<b>17,776</b>	<b>19,721</b>	<b>29,937</b>	<b>30,181</b>	<b>34,750</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>17,776</b>	<b>19,721</b>	<b>29,937</b>	<b>30,181</b>	<b>34,750</b>

### 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	114,877	136,003	160,328
Net worth	78,120	97,927	118,883	140,010	164,335
Deposits	0	0	0	0	0
Borrowings	211,670	268,332	295,698	332,670	379,195
Other liabilities & provisions	18,132	14,428	17,314	20,777	24,932
<b>Total liabilities and equities</b>	<b>307,923</b>	<b>380,687</b>	<b>431,895</b>	<b>493,457</b>	<b>568,462</b>
Cash & bank balance	4,870	17,355	16,641	22,589	35,370
Investments	3,954	9,826	11,299	12,994	14,943
Advances	295,068	349,329	399,192	452,431	511,913
Fixed & Other assets	2,062	2,154	2,369	2,606	2,867
<b>Total assets</b>	<b>307,923</b>	<b>380,687</b>	<b>431,895</b>	<b>493,457</b>	<b>568,462</b>
Deposit growth (%)	NA	NA	NA	NA	NA
Advances growth (%)	5.5	18.4	14.3	13.3	13.1

### Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
EPS	44.4	49.2	74.7	75.3	86.7
Dividend per share	10.0	12.0	18.7	18.8	21.7
Book value per share	195.3	244.4	296.7	349.4	410.2

Source: Company, BOBCAPS Research

**Valuations Ratios**

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
P/E	13.6	12.3	8.1	8.0	7.0
P/BV	3.1	2.5	2.0	1.7	1.5
Dividend yield (%)	1.7	2.0	3.1	3.1	3.6

**DuPont Analysis**

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	14.0	13.1	14.0	12.8	12.7
Non-interest income	0.4	0.4	0.4	0.3	0.3
Operating expenses	4.3	4.5	4.2	4.2	4.0
Pre-provisioning profit	10.1	9.0	10.1	9.0	9.0
Provisions	0.8	0.1	0.3	0.3	0.2
PBT	9.3	8.9	9.9	8.7	8.7
Tax	3.5	3.2	2.5	2.2	2.2
ROA	5.8	5.7	7.4	6.5	6.5
Leverage (x)	4.3	3.9	3.7	3.6	3.5
ROE	24.8	22.4	27.6	23.3	22.8

**Ratio Analysis**

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
<b>YoY growth (%)</b>					
Net interest income	27.7	5.8	25.8	4.2	13.8
Pre-provisioning profit	40.0	0.6	32.5	0.9	15.1
EPS	50.4	10.8	51.8	0.8	15.1
<b>Profitability &amp; Return ratios (%)</b>					
Net interest margin	14.9	14.0	15.2	13.9	14.0
Fees / Avg. assets	0.0	0.0	0.0	0.0	0.0
Cost-Income	29.9	33.2	29.4	31.6	30.8
ROE	24.8	22.4	27.6	23.3	22.8
ROA	5.8	5.7	7.4	6.5	6.5
<b>Asset quality (%)</b>					
GNPA	4.4	2.7	2.5	2.4	2.3
NNPA	6.2	2.3	2.1	1.9	1.8
Provision coverage	14.8	13.9	16.7	19.0	21.2
<b>Ratios (%)</b>					
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	27.3	28.1	28.6
Tier-1	25.5	25.6	26.8	27.6	28.1

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)

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B – Buy, A – Add, R – Reduce, S – Sell

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