

BUY

TP: Rs 825 | ▲ 27%

MUTHOOT FINANCE

| NBFC

| 13 November 2019

Demand uptick to offset lower liability mobilisation

Muthoot Finance's (MUTH) gold AUM increased 11% YoY to Rs 357bn in Q2FY20, the slowest growth in the last five quarters as the company calibrated LTV to 68%. Lower liability mobilisation led to lower disbursements. Demand uptick and robust collections largely offset incremental borrowing cost, keeping spreads buoyant at 14.4%. Stable expenses and low credit cost aided a 40% YoY increase in PBT to Rs 10.5bn. We largely retain FY20-FY22 estimates. Despite rolling valuations over, our Mar'21 TP remains at Rs 825.

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LTV calibration dampens loan growth: Gold loan AUM increased 11% YoY (the slowest pace in the last five quarters) to Rs 357bn as the company calibrated its LTV due to increasing gold prices. Gold tonnage came off by 3% QoQ to 171t as customers pledged lower amounts of gold. Due to higher collections, yields (calc.) spiked ~270bps QoQ to 23.9%.

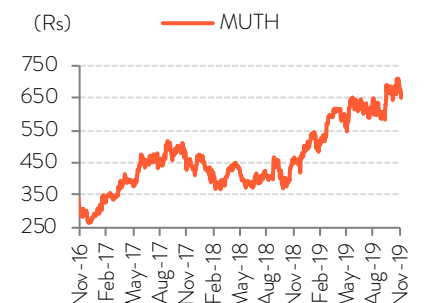
Foreign borrowing to weigh on borrowing cost: Reduced liability mobilisation from banks led MUTH to access foreign debt markets. The company has raised US\$ 450mn at a higher cost than the domestic cost of funds (of ~9.5%). Calculated spreads increased ~240bps YoY to 14.4%. We believe the demand uptick will largely offset the incremental cost of funds, keeping spreads stable.

Strong expense control, credit cost in check: MUTH's expense ratio remained close to the 18-quarter average at 4.4% due to stable employee expense and rent. Though credit costs surged 25bps YoY owing to Rs 141mn in write-offs, PBT increased 40% YoY to Rs 10.5bn.

Ticker/Price	MUTH IN/Rs 650
Market cap	US\$ 3.6bn
Shares o/s	401mn
3M ADV	US\$ 8.2mn
52wk high/low	Rs 719/Rs 543
Promoter/FPI/DII	73%/15%/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)	14.6	13.2	10.2	8.8	7.7
P/BV (x)	3.3	2.7	2.2	1.9	1.6
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

BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda

Important disclosures, including any required research certifications, are provided at the end of this report.



FIG 1 – QUARTERLY PERFORMANCE

	FY18				FY19				FY20		Variation (%)	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	QoQ	YoY
Profit and Loss (Rs mn)												
Income from operations	13,599	16,431	15,652	16,339	16,108	16,316	16,827	18,319	18,274	21,057	15.2	29.1
Other operating income	173	186	150	135	216	179	338	478	294	312	6.0	73.8
Total operating income	13,773	16,616	15,802	16,474	16,325	16,495	17,165	18,797	18,568	21,369	15.1	29.5
Other Income	1	2	112	552	5	6	6	7	19	37	96.0	507.1
Total Income	13,773	16,619	15,914	17,025	16,330	16,501	17,171	18,804	18,587	21,405	15.2	29.7
Interest expenses	5,121	4,933	4,725	4,535	5,016	5,354	5,889	6,111	6,416	6,699	4.4	25.1
Net income	8,652	11,686	11,190	12,490	11,314	11,148	11,282	12,694	12,171	14,707	20.8	31.9
Total Opex	3,103	3,119	3,254	3,699	3,738	3,669	3,440	4,547	3,972	3,969	(0.1)	8.2
Employees	1,858	1,947	1,889	2,130	2,169	2,086	1,980	2,741	2,295	2,327	1.4	11.6
Rent	503	425	474	511	475	493	503	503	527	530	0.6	7.5
Depreciation and Amrt	104	106	115	114	91	100	110	119	96	103	7.2	2.6
Others	637	641	776	945	1,003	991	847	1,184	1,054	1,009	(4.2)	1.9
Operating profits	5,550	8,567	7,936	8,791	7,577	7,478	7,842	8,147	8,199	10,738	31.0	43.6
Provisions and write offs	126	1,170	505	596	27	25	19	205	33	265	702.5	943.3
Profit before tax	5,424	7,397	7,431	8,195	7,550	7,453	7,823	7,942	8,166	10,473	28.3	40.5
Taxes	1,975	2,940	2,645	3,112	2,634	2,615	2,971	2,827	2,866	1,894	(33.9)	(27.6)
Profit after tax	3,449	4,457	4,787	5,083	4,916	4,838	4,852	5,115	5,300	8,579	61.9	77.3
Asset quality (Overall)												
Gross Stage 3	14,320	19,353	21,481	12,872	8,835	6,170	6,372	9,326	11,474	12,267	6.9	98.8
GS3 (%)	5.1	7.0	7.6	4.4	2.9	1.9	2.0	2.7	3.2	3.4	23bps	152bps
ECL Provisions	6,131	6,673	7,089	6,089	5,892	5,795	5,835	6,359	6,896	7,014	1.7	21.0
ECL Provisions (%)	2.2	2.4	2.5	2.1	1.9	1.8	1.8	1.9	1.9	2.0	3bps	17bps
Provisions o/s in books	6,071	7,197	7,640	8,096	8,096	8,096	8,096	8,096	8,095	8,215	1.5	1.5
Ratios (Calc, %)												
Yields	20.0	24.0	22.6	23.0	21.7	20.8	21.2	22.5	21.2	23.9	-	-
Cost of funds	9.5	8.9	8.7	8.6	9.0	9.0	9.5	9.4	9.3	9.5	-	-
NIMs	12.6	16.9	16.0	17.4	15.1	14.1	13.9	15.2	13.9	16.4	-	-
Spreads	10.5	15.1	13.9	14.4	12.7	11.8	11.7	13.2	11.9	14.4	-	-
Cost income ratio	35.9	26.7	29.1	29.6	33.0	32.9	30.5	35.8	32.6	27.0	-	-
Cost to average AUM	4.5	4.5	4.7	5.2	5.0	4.6	4.2	5.5	4.5	4.4	-	-
AUM related												
Gold Stock Holding (tonnes)	152	152	153	155	161	168	166	169	176	171	(2.8)	1.8
Avg gold loans per branch (Rs mn)	65	64	65	67	70	73	72	75	78	77	(1.5)	5.0
Overall AUM (Rs bn)	279	276	283	291	310	323	325	342	358	357	(0.2)	10.6
Other details												
CAR	25.6	26.5	27.7	26.6	26.4	25.9	25.7	26.1	24.7	27.1	-	-
Tier I	22.7	23.6	25.5	24.8	24.8	25.3	25.2	25.7	24.3	26.7	-	-
Tier II	3.0	2.9	2.1	1.8	1.7	0.6	0.5	0.4	0.4	0.4	-	-
Book Value	172	183	195	194	207	219	231	244	243	264	-	-
Leverage (x)	3.3	3.2	2.9	3.0	3.0	2.9	2.7	2.7	2.9	2.6	-	-

Source: Company, BOBCAPS Research

Earnings call highlights

Business

- MUTH's entire gold AUM is on bullet repayment basis, though customers have the provision to pay on a monthly basis.
- Interest income without collections reduced by Rs 2bn in Q2FY20. This can be treated as a one-off for the quarter.
- Kerala contributes 3.4% of AUM. A total of 42 branches in the state will be closed, with Rs 1bn being run down at these branches.
- The increase in gold prices meant customers had to pledge a lower quantum of gold. Hence, gold tonnage came off by 5t QoQ during the quarter.
- Lack of funding led to lower disbursements.
- Average LTV stood at 68%.
- Advertising expense will go up in H2FY20. MUTH did not advertise aggressively in H1 due to funding constraints.
- Management is comfortable with a maximum leverage of 5x.

Liquidity

- Fully hedged cost of foreign borrowings is higher than domestic borrowings.
- Cost of borrowings stood at 9.17% in Q1FY20 and 9.3% in Q2. This is guided to increase to 9.5% in FY20 as banks are still cautious on lending and are attaching a risk premium to loans.
- Cash as a percentage of the balance sheet will be similar to Q2FY19 levels in 2HFY20.

Asset quality

- Loans of more than 15 months vintage were classified as GNPA.
- Auctions of Rs 580m were held in Q2.
- MUTH will hold excess provisions intact as RBI may come up with a circular on provisions. ECL provisions totalled Rs 7.01bn.

Subsidiaries

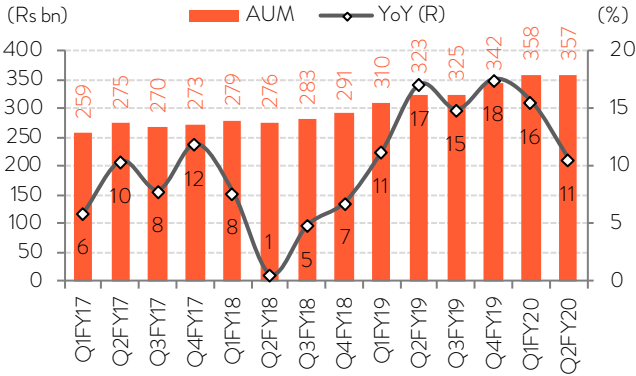
- Management is cautious on the home finance business and hence disbursing to houses that are 85% complete. ROA improved because of securitisation.

Guidance

- 15% gold loan growth for FY20; 21% average yield from Q3FY20 onwards.

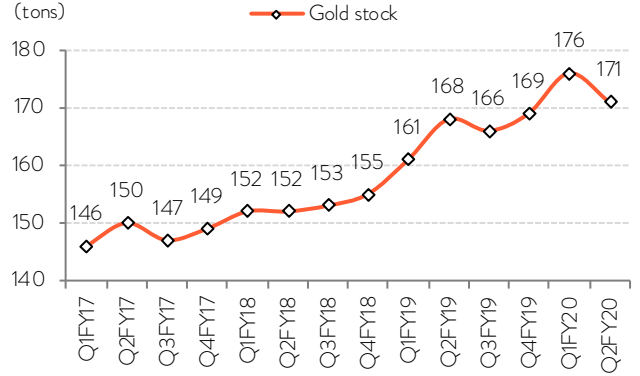
STORY IN CHARTS

FIG 2 – AUM GROWTH TAPERED DOWN...



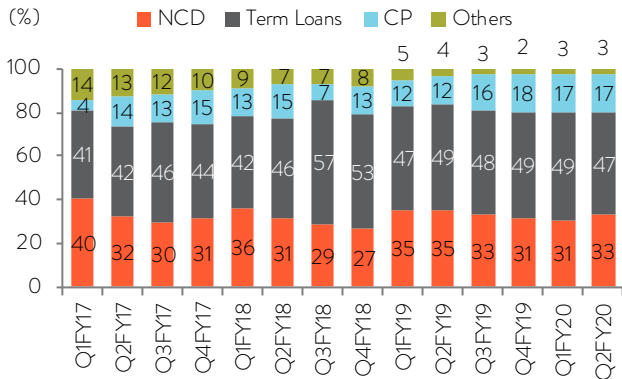
Source: Company, BOBCAPS Research

FIG 3 – ...AS VOLUME GROWTH DECLINED DUE TO LOWER GOLD PLEDGING



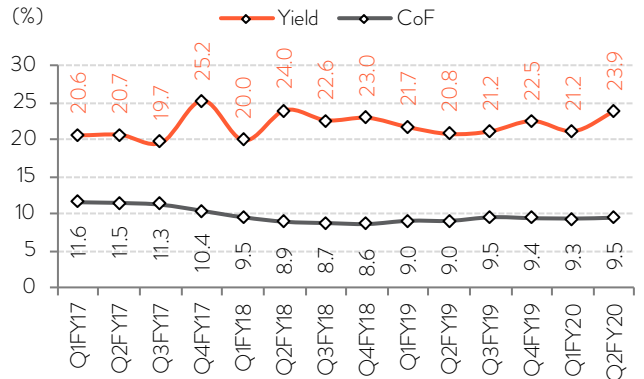
Source: Company, BOBCAPS Research

FIG 4 – DESPITE FUNDING CRUNCH...



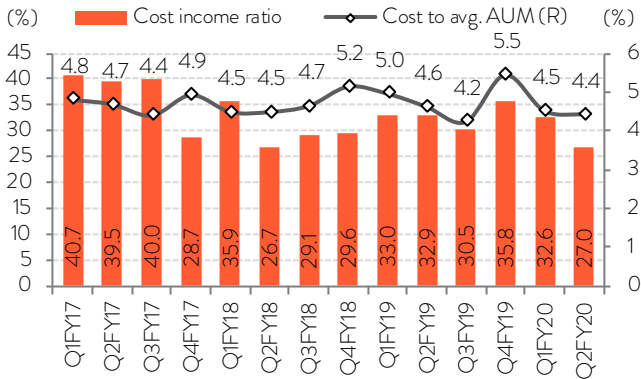
Source: Company, BOBCAPS Research

FIG 5 – ...SPREADS HAVE REMAINED RANGE-BOUND



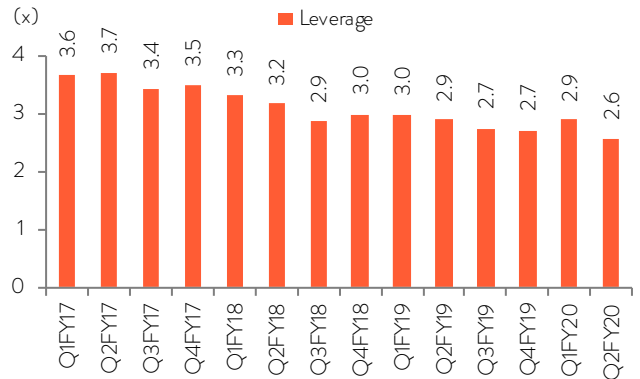
Source: Company, BOBCAPS Research

FIG 6 – COST CONTROL STRONG



Source: Company, BOBCAPS Research

FIG 7 – BUSINESS REMAINS LOW-LEVERED



Source: Company, BOBCAPS Research

Valuation methodology

MUTH is trading at 2.3x/0.9x FY20E/FY21E BV for ROE of 23.9%/23.4%. We believe its focused strategies to become the gold financier of choice have helped it cement leadership in gold finance. The 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%.

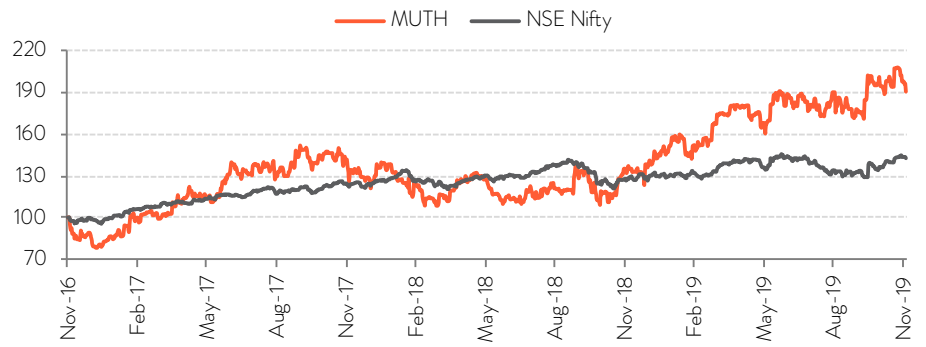
MUTH is the lowest cost gold financier in India and its expense ratio is forecast to remain at ~4.5% of AUM through to FY22. We expect the company to maintain market leadership in NBFC gold financing and yield steady-state ROA of ~6%, with leverage of ~3.5x. MUTH has diversified into home finance and 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.

Following the in-line performance in Q2FY20, we keep FY20-FY22 earnings estimates largely unchanged. Though we roll over to a Mar'21 TP, our fair value remains unchanged at Rs 825. Our target is derived using the SOTP method as follows (a) Rs 769/sh for the standalone book based on 2.0x 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%).

FIG 8 – SOTP VALUATION SUMMARY

SOTP FY22E based	Value (Rs bn)	Value (US\$ bn)	Value/sh (Rs)	% of total	Rationale
Core business	308	4.4	769	93.3	2.0x BV
Key Ventures					
Muthoot Homefin	19	0.3	47	5.8	4.0x BV based on last stake sale
Belstar Investment and Finance	9	0.1	22	2.7	2.5x BV
Total Value of Ventures	28	0.4	70	8.4	
Less: 20% holding discount	6	0.1	14	25.0	
Value of Key Ventures	22	0.3	56	6.7	
Target Value Post 20% Holding Co Disc	330	4.7	825	100.0	
CMP	261	3.7	652		
Upside (%)	26.5	26.5	26.5		

Source: Company, BOBCAPS Research

FIG 9 – RELATIVE STOCK PERFORMANCE

Source: NSE

Key risks

- Chunky delinquencies in high-ticket gold loans
- Weak collections in home finance
- 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	14.6	13.2	10.2	8.8	7.7
P/BV	3.3	2.7	2.2	1.9	1.6
Dividend yield (%)	1.5	1.8	2.4	2.8	3.3

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

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

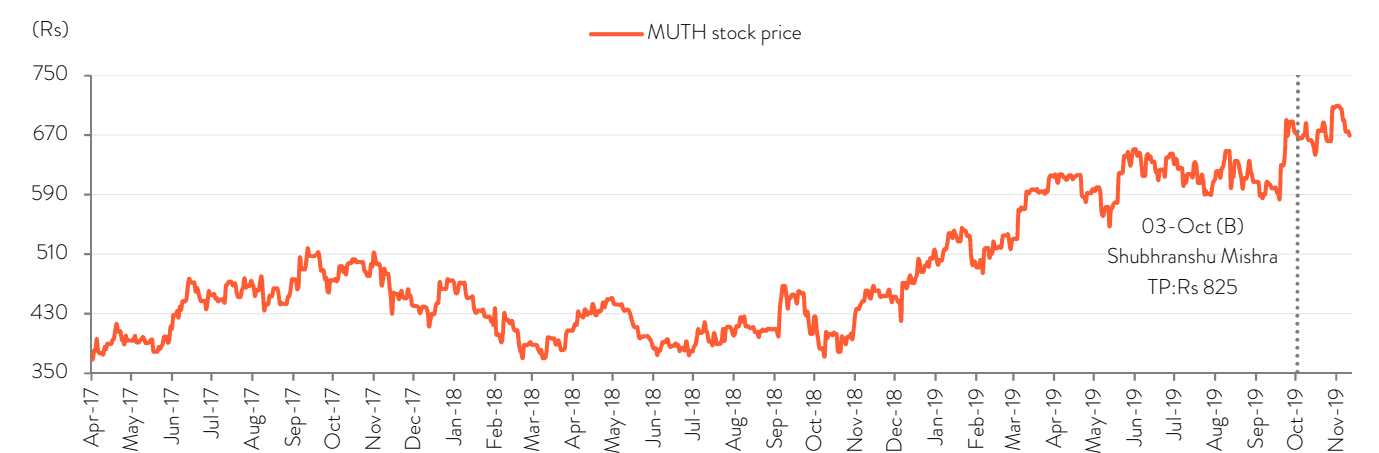
ADD – Expected return from >+5% to +15%

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)

HISTORICAL RATINGS AND TARGET PRICE: MUTHOOT FINANCE (MUTH IN)



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

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