

BUY

TP: Rs 875 | ▲ 17%

MUTHOOT FINANCE

| NBFC

| 14 February 2020

Rate increase, better resource mobilisation buoy margins

Muthoot Finance's (MUTH) gold AUM increased 19% YoY to Rs 377bn in Q3FY20 due to better resource mobilisation. Demand uptick and robust collections largely offset incremental borrowing cost, keeping spreads buoyant at 15.8%. Despite a one-time rise in opex and credit cost, PBT surged 38% YoY to Rs 10.8bn. We increase FY20 earnings estimates by 5% to bake in better NIM, while broadly maintaining FY21-FY22 estimates. Our Mar'21 TP stands revised to Rs 875 (vs. Rs 825 earlier).

Shubhramshu Mishra
 research@bobcaps.in

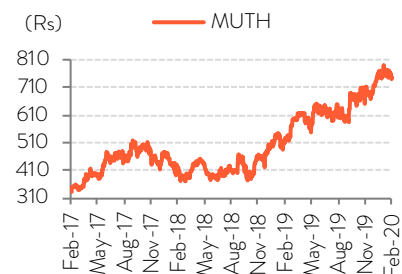
Gold AUM up 19%: Gold loan AUM increased 19% YoY to Rs 377bn as the company had better resource mobilization through foreign debt markets. Gold tonnage was flat QoQ at 173t as customers pledged lower amounts of collateral due to higher gold prices. Aided by higher collections and rate increase, yields (calc.) spiked ~370bps YoY to 24.9%.

Ticker/Price	MUTH IN/Rs 747
Market cap	US\$ 4.2bn
Shares o/s	401mn
3M ADV	US\$ 10.5mn
52wk high/low	Rs 796/Rs 543
Promoter/FPI/DII	73%/15%/8%

Source: NSE

Diversified borrowings mix aids healthy spreads: MUTH reduced liability raising from banks and instead accessed foreign debt markets and retail NCDs. Calculated spreads increased ~410bps YoY to 15.8%. We believe better treasury management and repricing of CPs will lower the cost of funds, thus keeping spreads stable.

STOCK PERFORMANCE



Source: NSE

PBT surges despite uptick in opex and credit cost: MUTH's expense ratio increased ~90bps YoY to 5.1% due to the hedging cost of foreign borrowings and provisioning expense on expected credit loss (ECL). Though credit cost was at a seven-quarter high of ~70bps owing to Rs 329mn in write-offs, PBT increased 38% YoY to Rs 10.8bn. A lower tax rate of 25.6% supported PAT growth of 66% YoY to Rs 8bn.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	42,707	45,202	52,642	58,289	66,344
NII growth (%)	27.7	5.8	16.5	10.7	13.8
Adj. net profit (Rs mn)	17,776	19,721	26,792	29,392	33,858
EPS (Rs)	44.4	49.2	66.9	73.4	84.5
P/E (x)	16.8	15.2	11.2	10.2	8.8
P/BV (x)	3.8	3.1	2.6	2.2	1.9
ROA (%)	5.8	5.7	6.7	6.5	6.5
ROE (%)	24.8	22.4	25.0	23.1	22.7

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.

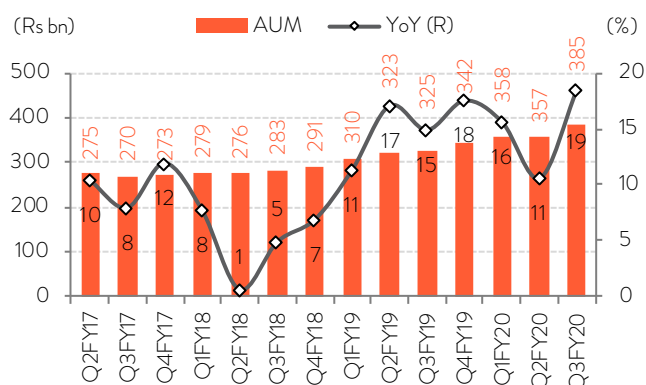


FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	9MFY20	9MFY19	YoY (%)
Interest Income	22,806	16,827	36	21,057	8	62,138	49,251	26
Interest expenses	6,938	5,889	18	6,699	4	20,052	16,258	23
Net Interest Income	15,869	10,938	45	14,358	11	42,085	32,993	28
Other Operating Income	325	344	(5)	348	(7)	986	751	31
Total Income	16,194	11,282	44	14,707	10	43,072	33,744	28
Operating Expenses	4,751	3,440	38	3,969	20	12,692	10,847	17
Operating Profit	11,443	7,842	46	10,738	7	30,380	22,897	33
Provisions and Cont.	640	19	3,256	265	142	937	71	1,221
Profit before Tax	10,803	7,823	38	10,473	3	29,442	22,826	29
Tax Provisions	2,769	2,971	(7)	1,894	46	7,529	8,220	(8)
Net Profit	8,034	4,852	66	8,579	(6)	21,914	14,606	50

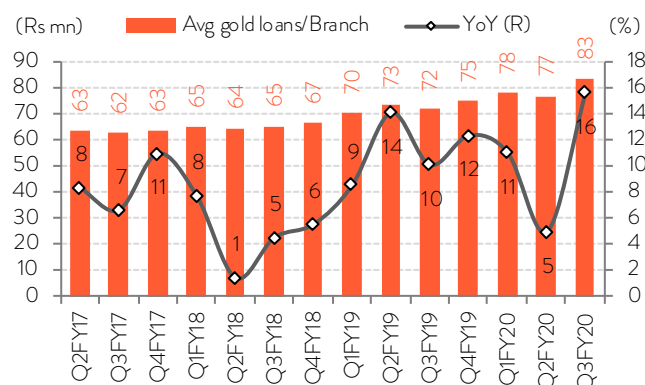
Source: Company, BOBCAPS Research

FIG 2 – TOTAL AUM GROWTH WAS AT 19% YOY...



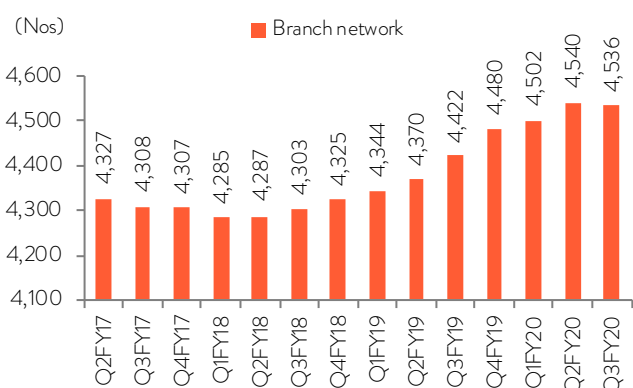
Source: Company, BOBCAPS Research

FIG 3 – ...WITH BETTER PRODUCTIVITY (+16% YOY)



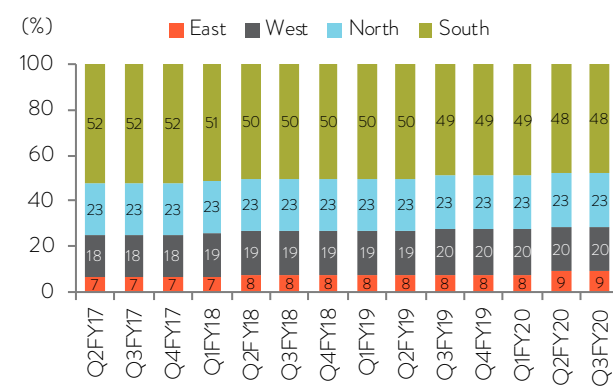
Source: Company, BOBCAPS Research

FIG 4 – NETWORK GREW BY ~100 BRANCHES YOY



Source: Company, BOBCAPS Research

FIG 5 – AUM MIX LARGELY SIMILAR YOY



Source: Company, BOBCAPS Research

FIG 6 – DETAILED QUARTERLY PERFORMANCE

	FY18			FY19				FY20			Variation (%)	
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	QoQ	YoY
Profit and Loss (Rs mn)												
Total Income	16,619	15,914	17,025	16,330	16,501	17,171	18,804	18,587	21,405	23,132	8	35
Interest expenses	4,933	4,725	4,535	5,016	5,354	5,889	6,111	6,416	6,699	6,938	4	18
Net income	11,686	11,190	12,490	11,314	11,148	11,282	12,694	12,171	14,707	16,194	10	44
Total Opex	3,119	3,254	3,699	3,738	3,669	3,440	4,547	3,972	3,969	4,751	20	38
Employees	1,947	1,889	2,130	2,169	2,086	1,980	2,741	2,295	2,327	2,580	11	30
Rent	425	474	511	475	493	503	503	527	533	548	3	9
Depreciation and Amrt	106	115	114	91	100	110	119	96	103	110	7	(0)
Others	641	776	945	1,003	991	847	1,184	1,054	1,006	1,514	50	79
Operating profits	8,567	7,936	8,791	7,577	7,478	7,842	8,147	8,199	10,738	11,443	7	46
Provisions and write offs	1,170	505	596	27	25	19	205	33	265	640	142	3,256
Profit before tax	7,397	7,431	8,195	7,550	7,453	7,823	7,942	8,166	10,473	10,803	3	38
Taxes	2,940	2,645	3,112	2,634	2,615	2,971	2,827	2,866	1,894	2,769	46	(7)
Profit after tax	4,457	4,787	5,083	4,916	4,838	4,852	5,115	5,300	8,579	8,034	(6)	66
Asset quality (Overall) (Rs mn)												
Gross Stage 3	19,353	21,481	12,872	8,835	6,170	6,372	9,326	11,474	12,267	9,769	(20)	53
GS3 (%)	7.0	7.6	4.4	2.9	1.9	2.0	2.7	3.2	3.4	2.5	(89bps)	58bps
ECL Provisions	6,673	7,089	6,089	5,892	5,795	5,835	6,359	6,896	7,014	7,178	2	23
ECL Provisions (%)	2.4	2.5	2.1	1.9	1.8	1.8	1.9	1.9	2.0	1.9	(10bps)	6bps
Provisions outstanding in books	7,197	7,640	8,096	8,096	8,096	8,096	8,096	8,095	8,213	8,377	2	3
Ratios (Calc, %)												
Yields	24.0	22.6	23.0	21.7	20.8	21.2	22.5	21.2	23.9	24.9	100bps	370bps
Cost of funds	8.9	8.7	8.6	9.0	9.0	9.5	9.4	9.3	9.5	9.1	(38bps)	(42bps)
NIMs	16.9	16.0	17.4	15.1	14.1	13.9	15.2	13.9	16.4	17.5	101bps	352bps
Spreads	15.1	13.9	14.4	12.7	11.8	11.7	13.2	11.9	14.4	15.8	138bps	412bps
Cost income ratio	26.7	29.1	29.6	33.0	32.9	30.5	35.8	32.6	27.0	29.3	235bps	(115bps)
Cost to average AUM	4.5	4.7	5.2	5.0	4.6	4.2	5.5	4.5	4.4	5.1	68bps	87bps
AUM profile												
Gold stock holding (tonnes)	152	153	155	161	168	166	169	176	171	173	1	4
Avg gold loans per branch (Rs mn)	64	65	67	70	73	72	75	78	77	83	8	16
Overall AUM (Rs bn)	276	283	291	310	323	325	342	358	357	385	8	19
Other details (%)												
CAR	26.5	27.7	26.6	26.4	25.9	25.7	26.1	24.7	27.1	26.5	(60bps)	77bps
Tier I	23.6	25.5	24.8	24.8	25.3	25.2	25.7	24.3	26.7	26.2	(56bps)	96bps
Tier II	2.9	2.1	1.8	1.7	0.6	0.5	0.4	0.4	0.4	0.3	(4bps)	(19bps)
Book value (x)	183	195	194	207	219	231	244	243	264	284	7	23
Leverage (x)	3.2	2.9	3.0	3.0	2.9	2.7	2.7	2.9	2.6	2.7		

Source: Company, BOBCAPS Research

Earnings call highlights

Business update

- Healthy gold loan growth in Q3 stemmed from better resource mobilisation by accessing foreign debt markets and retail NCDs.
- The company had raised rates in Jun'19 and collects penal fees regularly, aiding higher yields.
- Other expenses increased due to higher rental cost and ECB hedging requirements of Rs 210mn. Other opex spiked on ECL provisioning.
- Advertisement cost will keep growing in line with other expenses.
- Employee expense is guided to increase due to higher variable payout as the business grows.
- Management indicated a low overlap between NCD and gold loan customers.
- To compete against fintechs, MUTH has started a pilot in certain districts to make its product more attractive to customers who want doorstep delivery.
- The company is not looking at any acquisitions in the near term.
- Balance sheet churn is 3-3.5x in a year.
- Kerala accounts for only 3% of AUM.

Liquidity

- MUTH has been drawing all bank limits as cash and will continue to maintain bank lines fully drawn.
- As the liquidity coverage ratio (LCR) regime is about to set in, the company is maintaining a higher liquidity buffer of 6-7% of the balance sheet.
- Management indicated that incremental cost of borrowings will be in the range of 9.2-9.3%.
- Commercial paper (CP) rates are cooling off, so repricing of paper will reduce borrowing cost.

Asset quality

- Provisions spiked up due to extra provisions on the incremental book and the impact of burglary (provision of Rs 470mn of which Rs 320mn has been written off).

Subsidiaries

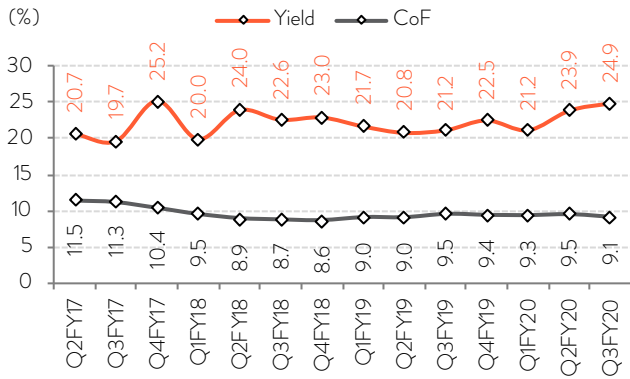
- Management expects the housing book to grow to Rs 20bn by FY20 with disbursements of Rs 7bn-8bn in FY21. The company has guided for a steady-state ROA of 2%. It presently sources loans through gold branches (~10%) and the open market (through own field force).
- GNPA levels in housing finance have peaked, as per management.

Guidance

- Gold loan growth is guided at 15% in FY21.
- ECL is expected at 1.33% on the incremental loan book and write-offs at 15bps.
- MUTH plans to add 100-200 branches per year and rationalise branches in certain locations.

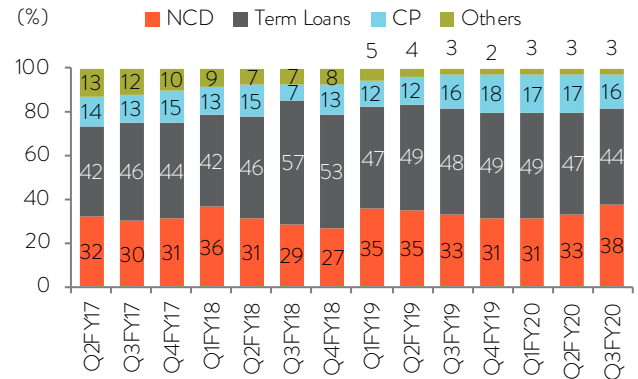
Story in charts

FIG 7 – YIELDS IMPROVING DUE TO RATE HIKE



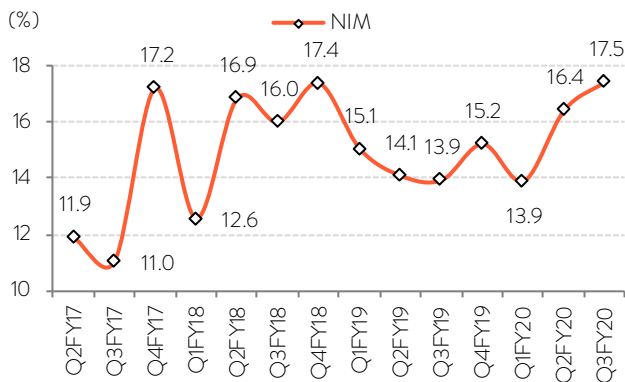
Source: Company, BOBCAPS Research

FIG 8 – HEALTHY MIX HAS KEPT BORROWING COST IN CHECK



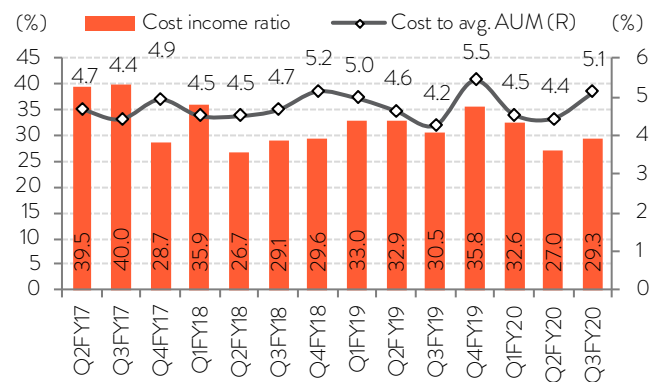
Source: Company, BOBCAPS Research

FIG 9 – NIM (CALC.) EXPANDS ~350BPS YOY



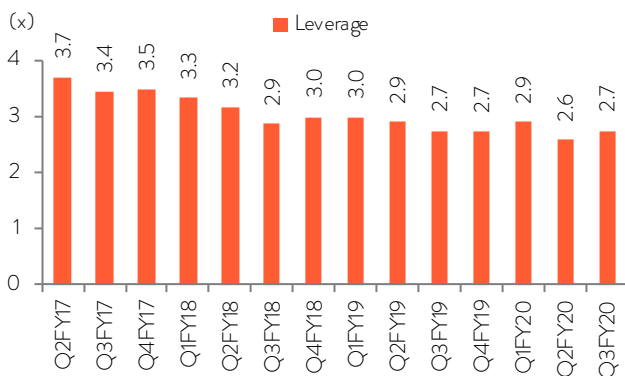
Source: Company, BOBCAPS Research

FIG 10 – OPEX UP YOY DUE TO ECB HEDGING COST



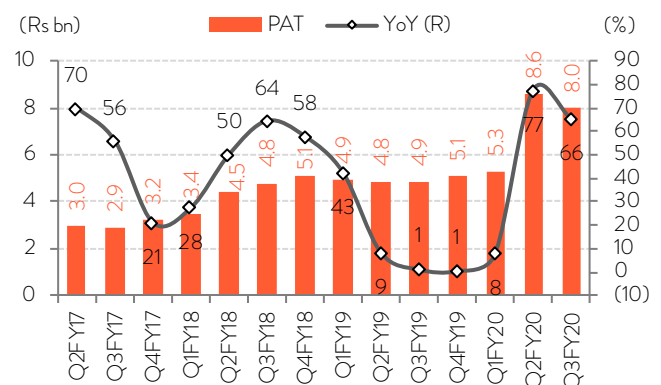
Source: Company, BOBCAPS Research

FIG 11 – BUSINESS REMAINS LOW LEVERED



Source: Company, BOBCAPS Research

FIG 12 – PAT GREW 66% DUE TO LOWER TAX RATE



Source: Company, BOBCAPS Research

Valuation methodology

MUTH is trading at 2.6x/2.2x FY20E/FY21E BV for ROE of 25.0%/23.1%. 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.

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.

Following the improved margin performance in Q3FY20, we raise our FY20 earnings estimate by 5%, while keeping FY21-FY22 estimates largely unchanged. Our Mar'21 target price stands revised to Rs 875 (vs. Rs 825 earlier). Our target is derived using the SOTP method as follows: (a) Rs 820/sh for the standalone book based on 2.2x 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 13 – REVISED ESTIMATES

(Rs bn)	Old			New			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
NII	50.8	58.3	66.3	52.6	58.3	66.3	3.7	-	-
Other Income	1.4	1.5	1.6	1.5	1.5	1.6	7.0	-	-
Net Income	52.1	59.8	68.0	54.1	59.8	68.0	3.7	-	-
Operating Expenses	17.1	19.1	21.2	17.3	19.3	21.4	1.1	1.1	1.1
Operating Profits	35.1	40.7	46.8	36.8	40.5	46.6	5.0	(0.5)	(0.5)
Provisions	1.0	1.2	1.3	1.0	1.2	1.3	3.8	-	-
PBT	34.1	39.5	45.5	35.8	39.3	45.3	5.0	(0.5)	(0.5)
Tax	8.6	10.0	11.5	9.0	9.9	11.4	5.0	(0.5)	(0.5)
PAT	25.5	29.6	34.0	26.8	29.4	33.9	5.0	(0.5)	(0.5)
Loans	393	445	504	393	445	504	-	-	-
Borrowings	291	327	373	291	327	373	-	-	-
Spread (%)	11.3	11.4	11.5	11.8	11.4	11.5	50bps	0bps	0bps
RoA (%)	6.3	6.5	6.5	6.7	6.5	6.5	31bps	(5bps)	(4bps)
RoE (%)	23.9	23.4	22.9	25.0	23.1	22.7	110bps	(28bps)	(23bps)

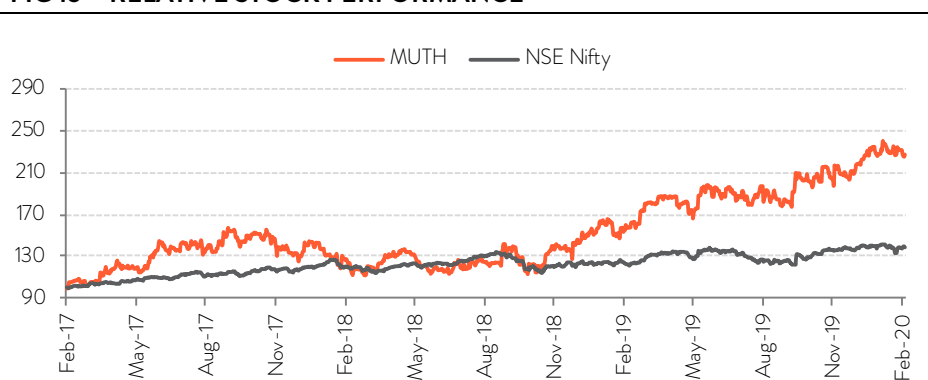
Source: BOBCAPS Research

FIG 14 – SOTP VALUATION SUMMARY

SOTP on FY22E (Rs)	Value (Rs bn)	Value (US\$ bn)	Value/ Sh. (Rs bn)	% of total	Rationale
Core business	328	4.7	820	93.6	2.2x BV
Key Ventures					
Muthoot Homefin	19	0.3	47	5.4	4.0x BV based on last stake sale
Belstar Investment and Finance	9	0.1	22	2.5	2.5x BV
Total Value of Ventures	28	0.4	70	7.9	
Less: 20% holding discount	6	0.1	14	25.0	
Value of Key Ventures	22	0.3	56	6.4	
Target Value Post 20% Holding Co Disc	351	5.0	875	100.0	
CMP	299	4.3	747		
Upside (%)	17.2	17.2	17.2		

Source: BOBCAPS Research

FIG 15 – 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
Net interest income	42,707	45,202	52,642	58,289	66,344
NII growth (%)	27.7	5.8	16.5	10.7	13.8
Non-interest income	1,310	1,236	1,453	1,491	1,638
Total income	44,017	46,438	54,095	59,780	67,982
Operating expenses	13,174	15,394	17,256	19,324	21,412
Operating profit	30,843	31,044	36,839	40,457	46,570
Operating profit growth (%)	40.0	0.6	18.7	9.8	15.1
Provisions	2,397	275	1,021	1,163	1,305
PBT	28,447	30,768	35,818	39,294	45,265
Tax	10,671	11,047	9,026	9,902	11,407
Reported net profit	17,776	19,721	26,792	29,392	33,858
Adjustments	0	0	0	0	0
Adjusted net profit	17,776	19,721	26,792	29,392	33,858

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	112,675	133,249	156,950
Net worth	78,120	97,927	116,682	137,256	160,957
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	424,840	485,270	558,922
Cash & bank balance	4,870	17,355	16,139	21,790	34,148
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	424,840	485,270	558,922
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	66.9	73.4	84.5
Dividend per share	10.0	12.0	16.7	18.3	21.1
Book value per share	195.3	244.4	291.2	342.6	401.7

Source: Company, BOBCAPS Research

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
P/E	16.8	15.2	11.2	10.2	8.8
P/BV	3.8	3.1	2.6	2.2	1.9
Dividend yield (%)	1.3	1.6	2.2	2.5	2.8

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	14.0	13.1	13.1	12.8	12.7
Non-interest income	0.4	0.4	0.4	0.3	0.3
Operating expenses	4.3	4.5	4.3	4.2	4.1
Pre-provisioning profit	10.1	9.0	9.1	8.9	8.9
Provisions	0.8	0.1	0.3	0.3	0.3
PBT	9.3	8.9	8.9	8.6	8.7
Tax	3.5	3.2	2.2	2.2	2.2
ROA	5.8	5.7	6.7	6.5	6.5
Leverage (x)	4.3	3.9	3.8	3.6	3.5
ROE	24.8	22.4	25.0	23.1	22.7

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Net interest income	27.7	5.8	16.5	10.7	13.8
Pre-provisioning profit	40.0	0.6	18.7	9.8	15.1
EPS	50.4	10.8	35.9	9.7	15.2
Profitability & Return ratios (%)					
Net interest margin	14.9	14.0	14.2	13.9	14.0
Fees / Avg. assets	0.0	0.0	0.0	0.0	0.0
Cost-Income	29.9	33.2	31.9	32.3	31.5
ROE	24.8	22.4	25.0	23.1	22.7
ROA	5.8	5.7	6.7	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	16.6	18.9	21.1
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	27.2	28.0	28.5
Tier-1	25.5	25.6	26.7	27.5	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

Rating distribution

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