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Initiating Coverage

Manappuram Finance Ltd.

12-October-2020

RETAIL RESEARCH

Manappuram Finance Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
BFSI – NBFC	Rs 166.2	Buy at LTP and add on dips to Rs 141-143 band	Rs 183	Rs 193	2 quarters

HDFC Scrip Code	MANPUR
BSE Code	531213
NSE Code	MANAPPURAM
Bloomberg	MGFL IN
CMP Oct 09, 2020	166.2
Equity Capital (cr)	169.2
Face Value (Rs)	2
Eq- Share O/S (cr)	84.6
Market Cap (Rs cr)	14058.7
Adj. Book Value (Rs)	66.7
Avg.52 Wk Volume	89,69,095
52 Week High	194.80
52 Week Low	74.25

Share holding Pattern % (Jun, 2020)	
Promoters	35.04
Institutions	48.22
Non Institutions	16.74
Total	100.0

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Our Take:

Manappuram Finance Ltd. (MFL) has been following a conservative approach with its average LTV (Loan to Value) at 57%. Rising gold prices provide sufficient room for the company to grow. Most of the gold loans are short tenor loans (average tenor days at 47 in FY20) resulting in low credit loss in gold product. Within the NBFC space, MFL has one of the best-in-class NIMs. Its 5-Year average NIM stood at 16% which is mainly on the back of high pricing power in the gold financing business. Also on the asset quality side, NPA is not a major issue for gold finance companies as these are secured loans with highly liquid underlying asset. MFL Gold Finance AUM grew at CAGR 11% FY11-20 while as on Q1FY21 it stood at Rs 17736Cr contributing 70% of its total AUM. MFL has slowed down lending in the non-gold business as the pandemic and the subsequent moratorium has led to increased stress levels resulting in higher NPA. Focus is now on improving collection efficiencies. Monsoon have been above average which should help in reviving the lending activity in H2FY21.

Technology related initiatives has resulted in significant savings in operating expenses. The company has a comfortable liquidity position with ~Rs 5000cr as cash and cash equivalents and ~Rs 1000cr undrawn lines as of June end.

Valuations & Recommendation:

We expect the consolidated loan book of the company to grow at a CAGR of 15.3% over FY20-FY22. PAT is expected to grow at 14.4% CAGR as higher delinquencies in the non-gold business would lead to higher write offs/provisioning requirement. MFL generates return ratios in excess of _20% consistently – much ahead of other category NBFCs. MFL quotes at a discount to Muthoot Finance due to its smaller5 size and more diversified loan book. We feel investors could look at buying the stock at the LTP and add on dips to Rs 141-143 band (1.4xFY22E ABV) . We feel the base case fair value of the stock is Rs 183 (1.80x FY22E ABV) and bull case fair value is Rs 193 (1.9x FY22E ABV) over 2 quarters. At the CMP of Rs 166.2, it quotes at 1.63xFY22E ABV.

Manappuram Finance Ltd.

Financial Summary

Particulars (Rs cr)	Q1FY21	Q1FY20	YoY-%	Q4FY20	QoQ-%	FY19	FY20	FY21E	FY22E
NII	892	764	*16.8*	891	*0.1*	2693	3385	3822	4399
PPoP	638	451	*41.4*	657	*-2.9*	1473	2245	2544	2990
PAT	368	272	*35.2*	398	*-7.6*	929	1480	1497	1956
EPS (Rs)	4.4	3.2	*36.2*	4.7	*-6.8*	10.9	17.4	17.8	23.2
P/E (x)						15.1	9.5	9.4	7.2
P/ABV (x)						3.1	2.5	2.1	1.6
RoAA (%)						5.0	6.0	4.9	5.8

(Source: Company, HDFC sec)

Q1FY21 Financials

Net interest income grew by 16.8% yoy to Rs 892cr in Q1FY21 driven by 33.4% yoy growth on gold loans. NIMs contracted by 130bps yoy to 14.1% as higher NPAs led to interest reversal while cost of borrowing also increased by ~9bps. Operating expenses decreased 11.8% yoy to Rs 312cr on account of decrease in security charges as well as employee expenses. Higher provisioning on account of Covid-19 related additional provision in the microfinance subsidiary was offset partially by lower tax rate resulting in 36.5% growth in PAT to Rs 368cr.

Gold loan AUM rose by 33% yoy, while the non-gold business witnessed 10.4% yoy growth. Asset quality deteriorated with standalone GNPA increasing by 40bps to 1.3% while it rose to 9.9% for vehicle finance and 5.1% for home finance. MFL made an additional provision of Rs 75cr in the quarter taking the total Covid related provisioning to Rs 130cr.

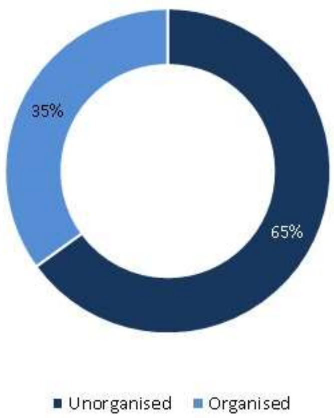
Gold loans business witnessed healthy value-led AUM growth (4.5% qoq/33% yoy) and large shift towards on-line gold loans (63% of book).

Long term Triggers

Gold loan market poised to witness strong growth

India's gold loan market is expected to reach Rs 461,700cr by 2022 growing at a five-year CAGR (FY18 to FY22) of 13.4%, according to a report by KPMG. Organised gold loan penetration remains significantly low which provides ample opportunity for organised financiers' loan book growth. Overall gold loan stock with the organised sector forms a minuscule part of the total gold stock in the economy. However, this has been increasing at a steady overall pace. The organised gold loan market comprising banks (public, private, small finance and co-operative), non-banking finance company (NBFCs) and nidhi companies contribute to nearly 35 per cent of the Indian gold loan market.

Gold loan market growth

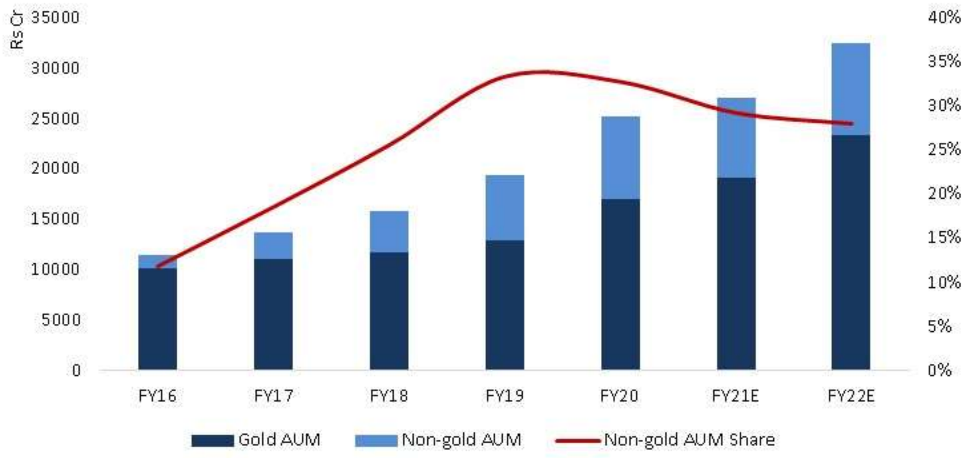


(Source: KPMG, HDFC sec)

Non-gold business to pick-up in H2FY21

Non-Gold lending book of MFL registered a growth of CAGR 48% over FY17-20. Vehicle financing, the fastest growing space (AUM Q1FY20-Rs1270Cr ;3-Yr AUM CAGR growth 64%) was impacted by slowdown in the CV while other lending activities had also been under pressure post Covid resulting in the share on non-gold AUM falling from 34.2% in Q1FY20 to 30% in Q1FY21. Apart from Vehicle financing, MFL has significant presence in Microfinance (AUM- Q1FY21-Rs 5038Cr; 3-Yr AUM CAGR growth 45%) and Affordable housing finance (AUM-Q1FY21-Rs 627Cr; 3-Yr AUM CAGR growth 27%) through its subsidiary Asirwad (it holds controlling stake of 93%) and Mannapuram Home Finance (100% subsidiary). Also it has diversified in SME and corporate financing with a focus to serve underserved segment which are not adequately covered by Banks. Lockdown due to the Covid-19 pandemic has further hampered the growth of non-gold business while gold loans have witnessed strong growth. We expect the lending activity in the non-gold business to pick-up in H2FY21. However due to the strong growth in the gold loan business, the share of non-gold business would continue to decline in the coming few quarters.

Share of non-gold AUM expected to decline



(Source: Company, HDFC sec)

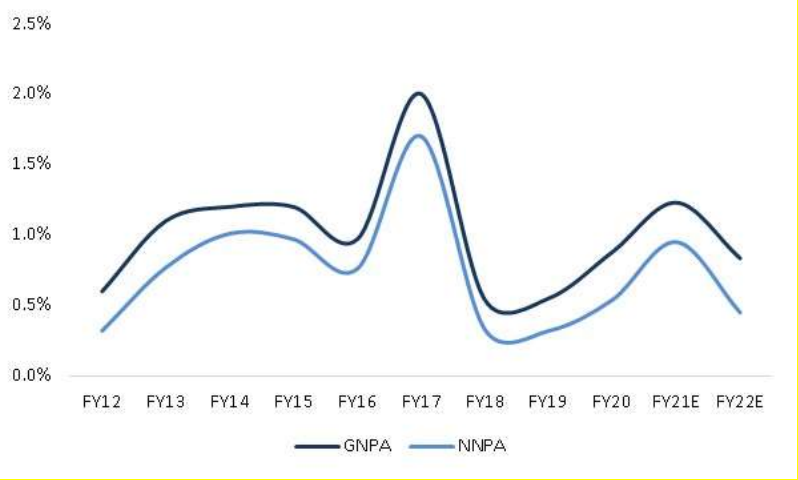
Higher gold prices could drive incremental lending

Prices of gold have rallied in the recent past and companies can lend more amount to their customers. Although the demand has still not reached the pre-Covid state, existing customers are borrowing more, compensating for the slowdown in new customers. As of Q1FY21 MFL had a LTV ratio of 57% which means most of the customers have a lot of room to borrow more against their gold mortgage.

Asset quality to improve as collection efficiency recovers

MFL has fine-tuned its collections strategy and launched various initiatives to ensure it is well prepared and among the earliest to capitalize on the opportunities post lifting of lockdown. It has ramped up its digital collections infrastructure and capabilities to enable its customers to make payments digitally. Collection efficiency has been improving and was at ~70-75% in July from ~40-50% in the months of April and May. Loans under moratorium have come down from ~85% in May to ~30% in July.

Asset quality to improve in FY22



(Source: Company, HDFC sec)

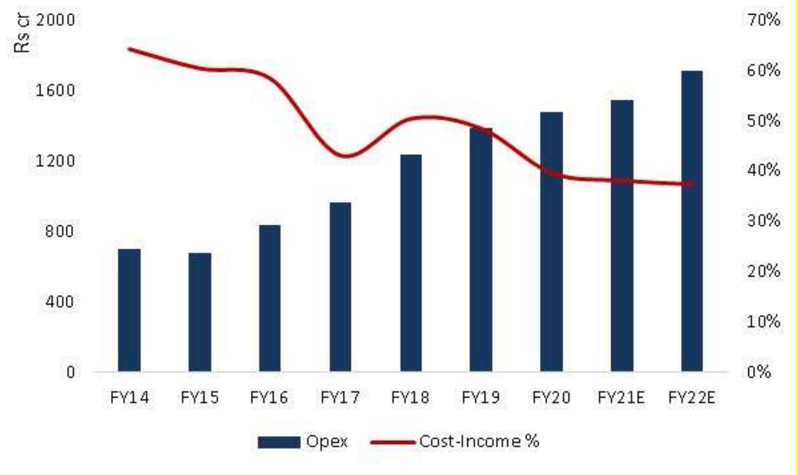
Asset quality is expected to deteriorate in FY21 mainly on account of the non-gold business. However the company is carrying an additional provision of Rs 130cr over and above the standard provisioning which should provide some cushion going forward.

While the GNPA ratio for gold financiers has fluctuated over time, eventual credit losses have been minimal due to low LTVs and short loan repayment cycles.

Leveraging technology to reduce operating expenses

Post the incidence of robberies at some of its branches, MFL has rolled out cellular vaults in the last few years which has reduced the need of security guards and brought down its security costs. Automation of recurring manual activities by 'bots' has helped keep operating costs low. The company is focusing on technology inclusion into every line of business where things can be executed with more precision and less overhead costs. In the next step MFL plans to consolidate its IT infrastructure across group companies and move to a modern, secure cloud. It has chosen Oracle's second-generation cloud infrastructure and expects to realise 2-3 times improvement in performance vis-à-vis current IT setup, in addition to achieving substantial in cost savings over the next five years.

Operating expenses under control



(Source: Company, HDFC sec)

What could go wrong

Fluctuation in gold prices

Wide fluctuations in gold prices could lead to disruptions in LTV resulting in higher NPAs. It might also lead to higher costs due to slower recoveries and increasing auctions.

Overdependence on Gold loans

Although MFL is diversifying to other areas of lending, Gold loans still account for more than 70% of its AUM. Given the large AUM of Gold loans, the non-gold loan portfolio will take time to reach a decent proportion of the overall AUM.

Regulatory risk

MFL largely caters to the poorer segment through gold loans and microfinance where the regulations are stringent. It was hit by adverse regulation in gold loans by RBI during FY12-14. Any such regulatory changes by Centre/State governments could derail its growth prospects.

Increase in delinquency in non-gold business leading to higher NPA

In order to accelerate its lending business MFL had ventured in adjacent segments of Non-Gold financing. However in the current scenario emerging post covid-19 there have been concerns with the asset quality of non-gold businesses. Though MFL is comfortable with its NPA levels in gold loan business due to the high margin of safety and shorter duration of loans, the non-gold business could witness higher risks increasing the consolidated NPA levels. NPA in the CV and home finance business stood at 4% and 3.9% respectively at the end of Q1FY21 as compared to 1.3% in gold loan business.

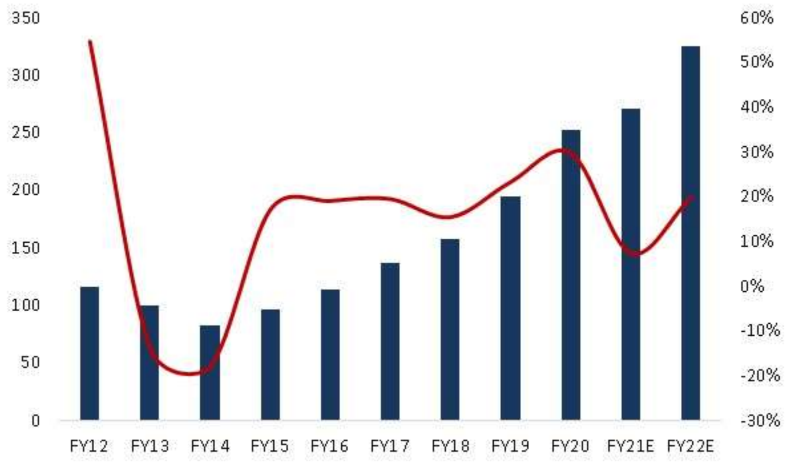
Emerging competition from other NBFCs and Banks who are entering Gold loan space. However Gold loan companies have quicker turnaround time, niche customer base, easy accessibility of a large branch network focused only on gold loans and flexible repayment schedules.

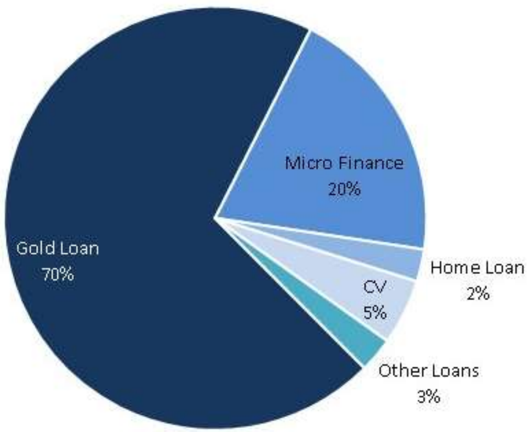
Recently, the RBI increased the cap on gold loan LTV for banks from 75% to 90% for loans disbursed until 31st Mar’21, post which, it would revert to 75%. However, the cap remains at 75% for NBFCs. This would not affect prospects for Gold Financiers as most customers were taking loans at 60-65% LTV despite the 75% LTV cap, banks may not be willing to lend up to 90% LTV from a risk management perspective, and other benefits of a Gold financier discussed elsewhere.

About the company

Promoted by Shri. V.P. Nandakumar, Manappuram Finance Ltd (MFL) was incorporated in 1992 and today is the second largest gold loan company in India. The Manappuram Group was started in 1949 by Late Mr. V. C. Padmanabhan, with focus primarily on money lending activities. To reduce its concentration risk in gold loans, MFL since FY16, has diversified into new business areas like microfinance, vehicle and housing finance, and SME lending. In February 2015, the company acquired Asirvad Microfinance Pvt. Ltd. which is one of the lowest cost microfinance lenders in India.

AUM growth and breakup (Rs Bn)



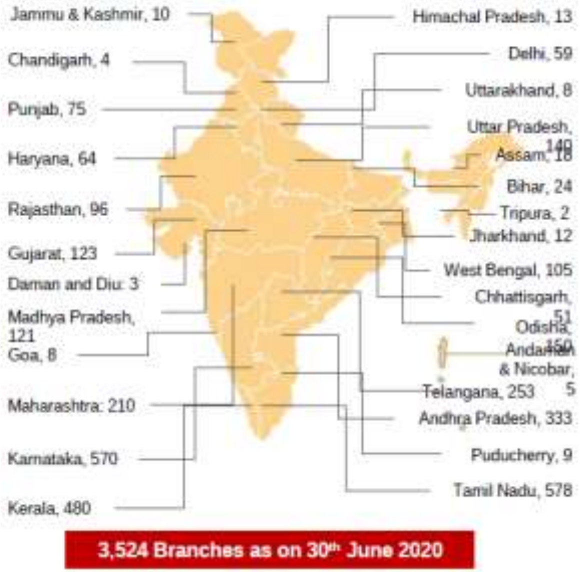


(Source: Company, HDFC sec)

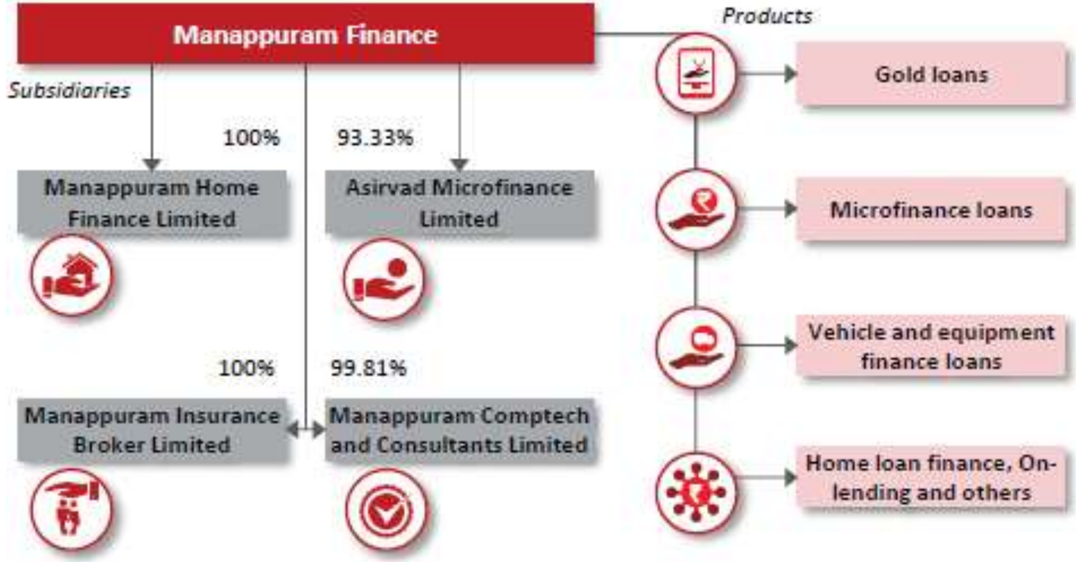
RETAIL RESEARCH

Besides microfinance, the company has also diversified into commercial vehicle loans, housing finance and SME loans with promising results. Put together, MFL had an AUM of Rs 7609cr of non-gold loans. Overall, non-gold businesses contributed 30% of the total business as of Q1FY21.

Pan India presence & Distribution network (Q1FY21)



Group Structure



(Source: Company)

Peer Comparison

FY20	CMP (Rs)	Mcap (Rs cr)	Total AUM (Rs cr)	NII (Rs cr)	PAT (Rs cr)	EPS (Rs)	ABV (Rs)	P/E (x)	P/ABV (x)	RoNW (%)
Manappuram	166.2	14059	25225	3633.1	1467.8	17.4	66.7	9.6	2.5	28.6
Muthoot	1142.5	45832	46871	6504.2	3138.3	78.2	268.6	14.6	4.3	26.5

Manappuram Finance Ltd.

Financials

INCOME STATEMENT

(Rs cr)	FY18	FY19	FY20	FY21E	FY22E
Interest Income	3354	4012	5217	6055	6925
Interest Expenses	1030	1319	1832	2234	2526
Net Interest Income	**2324**	**2693**	**3385**	**3822**	**4399**
Non interest income	125	167	334	297	317
Operating Income	**2449**	**2859**	**3719**	**4119**	**4717**
Operating Expenses	1235	1386	1474	1574	1727
PPoP	1214	1473	2245	2544	2990
Prov & Cont	177	46	238	544	375
Profit Before Tax	1037	1427	2007	2001	2615
Tax	361	498	527	504	659
PAT	**676**	**929**	**1480**	**1497**	**1956**
Adj. PAT	**677**	**922**	**1468**	**1502**	**1961**

BALANCE SHEET

(Rs cr)	FY18	FY19	FY20	FY21E	FY22E
Share Capital	169	169	169	169	169
Reserves & Surplus	3645	4356	5577	6862	8565
Shareholder funds	**3813**	**4525**	**5746**	**7031**	**8734**
Minority Interest	29	46	58	63	68
Borrowings	12607	15295	20917	23094	26431
Other Liab & Prov.	580	588	2230	1398	1020
SOURCES OF FUNDS	**17030**	**20454**	**28951**	**31587**	**36252**
Fixed Assets	275	332	770	663	567
Goodwill on Cons.	36	36	36	36	36
Investment	5	174	90	131	157
Cash & Bank Balance	724	1164	3646	3149	2517
Advances	15244	17812	23189	26243	31465
Other Assets	747	937	1220	1365	1510
TOTAL ASSETS	**17030**	**20454**	**28951**	**31587**	**36252**

RATIO ANALYSIS

As at March (Rs cr)	FY18	FY19	FY20	FY21E	FY22E
Return Ratios (%)					
Calc. Yield on adv	23.1	24.3	25.4	24.5	24.0
Calc. Cost of borr	8.7	9.5	10.1	10.2	10.2
Calc. NIM	16.0	16.3	16.5	15.5	15.2
RoAE	18.9	22.1	28.6	23.5	24.9
RoAA	4.2	5.0	6.0	4.9	5.8
Asset Quality Ratios (%)					
GNPA	0.54	0.55	0.88	1.23	0.83
NNPA	0.33	0.32	0.54	0.95	0.45
Growth Ratios (%)					
Advances	10.1	16.8	30.2	13.2	19.9
Borrowings	14.8	21.3	36.8	10.4	14.4
NII	4.8	15.9	25.7	12.9	15.1
PPoP	-4.8	21.3	52.4	13.3	17.5
PAT	-10.9	37.5	59.3	1.1	30.7
Valuation Ratios					
EPS (Rs)	8.0	10.9	17.4	17.8	23.2
P/E (x)	20.7	15.2	9.6	9.4	7.2
Adj. BVPS (Rs)	44.8	53.1	66.7	80.3	101.7
P/ABV (x)	3.7	3.1	2.5	2.1	1.6
Dividend per share (Rs)	2.0	2.2	2.2	2.5	3.0
Dividend Yield (%)	1.2	1.3	1.3	1.5	1.8
Other Ratios					
Cost-Income (%)	50.4	48.5	39.6	38.2	36.6
Leverage (x)	4.0	3.9	4.0	3.7	3.6

(Source: Company, HDFC sec)

Manappuram Finance Ltd.

Price Chart

Disclosure:

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