

Stock Update Manappuram Finance Ltd.

October 25, 2021





| Industry | LTP | Recommendation | Base Case Fair Value | Bull Case Fair Value | Time Horizon |
|-------------|--------|--------------------------------------------------------------|----------------------|----------------------|--------------|
| BFSI - NBFC | Rs 200 | Buy in Rs 197-202 band & add more on dips to Rs 173-178 band | Rs 218 | Rs 240 | 2 quarters |

| | |
|------------------------|------------|
| HDFC Scrip Code | MAGFIN |
| BSE Code | 531213 |
| NSE Code | MANAPPURAM |
| Bloomberg | MGFL IN |
| CMP Oct 22, 2021 | 199.7 |
| Equity Capital (Rs cr) | 169.3 |
| Face Value (Rs) | 2 |
| Equity Share O/S (cr) | 84.6 |
| Market Cap (Rs cr) | 16843.3 |
| Book Value (Rs) | 86.5 |
| Avg. 52 Wk Volumes | 71,71,000 |
| 52 Week High (Rs) | 218.0 |
| 52 Week Low (Rs) | 139.1 |

| Share holding Pattern % (Sep, 2021) | |
|-------------------------------------|-------|
| Promoters | 35.1 |
| Institutions | 48.4 |
| Non Institutions | 16.6 |
| Total | 100.0 |



HDFCsec Retail research
stock rating meter

for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings

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Our Take:

Manappuram Finance (MFL) has prioritized asset quality over growth and was cautious in lending during the second wave of the pandemic. Consequently, its AUM declined in Q1FY22. The gold loan book is fully secured (gold being a fairly liquid asset) with LTV of 65% as on Q1FY22 (v/s 71% in Q4FY21). In gold loan, repayment schedules are short and the asset is easily auctioned if there's a default. Gold loan NBFCs have historically been able to generate 20%+ RoE. Gold loan companies in the past have not suffered through volatility in asset quality like banks and other non-bank lenders, this is mainly on the back of sentimental value attached to the collateral of Indian households. Going forward, companies like MFL can be a good get on increasing formalization of gold loan business in India.

The non-gold loan book which accounts for ~30% of the AUM remains to be a cause of concern. However, recent collection efficiency trend shows a sharp improvement across all businesses. The company expects further improvement in collection efficiencies and has started disbursements. Further, with the arbitrage available for the banks of 90% LTV gone (vs 75% for NBFCs), the gold loan AUM is likely to witness strong growth.

MFL has sufficient liquidity, it is well capitalized (34% Tier 1 ratio), with strong ALM and access to diversified sources of funds. The company had laid out a roadmap for FY25 where it has guided for 10-15% AUM growth for Gold loans with 25% cross cycle ROE and a focus on new channels including door-step, DSA and online channels (this is likely to improve segment RoA by 100-150bps); MFI loans AUM growth of 20% p.a.; Standalone RoA of 2% over time for vehicle finance, housing finance and MSME and overall the target is to achieve 20-25% tier-1 ratio.

On July 12, 2021, we had released a Stock Update report ([Link](#)) with a recommendation to 'Buy at LTP (Rs 177.6) and add on dips to Rs 157-159 band' for base case fair value of Rs 198 and bull case fair value of Rs 211. The stock achieved our base case target on July 22 and bull case target on July 27, 2021.

Valuation & Recommendation:

We expect the consolidated loan book of the company to grow at a CAGR of ~13% over FY21-FY24. PAT is expected to grow at ~19% CAGR as provisioning requirement would moderate going forward. MFL generates return ratios in excess of 20% consistently – much ahead of other category NBFCs. High sustained RoEs (>22%), negligible credit costs, resumption of steady state AUM growth once lockdowns are lifted, possibility of spinoff/listing of Asirvad Finance are some other triggers that are likely to play out over the next few quarters. MFL



historically has got a lower multiple (vis-à-vis its Gold loan peers) mainly on asset quality challenges in the non-gold business. If MFL can maintain steady growth in non-gold business and improve its asset quality over a period of time, it can be re-rating candidate. We feel investors could buy the stock in Rs 197-202 band and add on dips to Rs 173-178 band (1.2x Sep-23E ABV) for base case fair value of Rs 218 (1.5x Sep-23E ABV) and bull case fair value of Rs 240 (1.65x Sep-23E ABV) over 2 quarters.

Changes since our last report

| (Rs cr) | Old Estimate | | New Estimate | | | Variation (%) | |
|---------|--------------|-------|--------------|-------|-------|---------------|-------|
| | FY22E | FY23E | FY22E | FY23E | FY24E | FY22E | FY23E |
| NII | 4539 | 5224 | 4479 | 5056 | 5808 | -1.3 | -3.2 |
| PPoP | 3164 | 3749 | 3144 | 3599 | 4222 | -0.6 | -4.0 |
| PAT | 2061 | 2513 | 2039 | 2398 | 2876 | -1.1 | -4.6 |
| EPS | 24.4 | 29.8 | 24.2 | 28.4 | 34.1 | -0.9 | -4.6 |

(Source: Company, HDFC sec)

Financial Summary

| Particulars (Rs cr) | Q1 FY22 | Q1 FY21 | YoY (%) | Q4 FY21 | QoQ (%) | FY21 | FY22E | FY23E | FY24E |
|---------------------|---------|---------|---------|---------|---------|------|-------|-------|-------|
| NII | 1029 | 892 | 15.3 | 1051 | -2.1 | 3971 | 4479 | 5056 | 5808 |
| PPoP | 709 | 638 | 11.1 | 729 | -2.8 | 2756 | 3144 | 3599 | 4222 |
| PAT | 437 | 368 | 18.7 | 468 | -6.7 | 1725 | 2039 | 2398 | 2876 |
| EPS (Rs) | 5.2 | 4.4 | 18.4 | 5.5 | -6.8 | 20.4 | 24.2 | 28.4 | 34.1 |
| P/E (x) | | | | | | 9.8 | 8.3 | 7.0 | 5.9 |
| P/ABV (x) | | | | | | 2.4 | 1.9 | 1.5 | 1.2 |
| RoAA (%) | | | | | | 5.7 | 6.2 | 6.6 | 7.0 |

(Source: Company, HDFC sec)

NII grows despite decline in AUM

Consolidated net interest income grew by 15% YoY to Rs 1029cr despite a 2% contraction in AUM as interest expenses fell by 13%. Standalone (gold loans) AUM declined 7% to Rs 16540cr on account of decline in tonnage (down 15.9% yoy and 11.1% qoq) amid covid-led disruptions and auctions (4.5 tonnes; ~Rs 1500cr). Among the non-gold loan portfolio, microfinance loans witnessed 20% yoy growth although it was muted sequentially. Similarly vehicle finance book de-grew 18% yoy but remained flat qoq. Yield on advances expanded 30bps yoy to 23.4% while cost of borrowing narrowed 80bps to 9% resulting in ~170bps expansion in NIM to 15.8%.

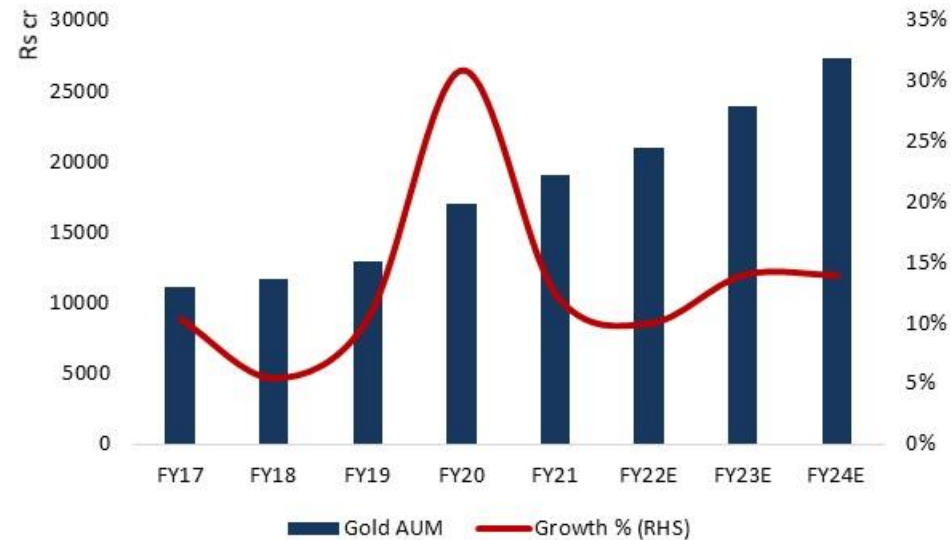


Gold Loans to resume growth

Gold loans, which account for ~70% of the business witnessed a 13% sequential de-growth in Q1FY22 as branch operations were impacted due to Covid related lockdowns and auction of ~Rs 1500cr worth of gold. With the Covid situation improving across the country and easing of restrictions, businesses are resuming operations and demand for gold loans is set to increase. Demand for gold loans tend to be inelastic as it is easily available against a very liquid collateral.

Decline in gold prices in Q4FY21 resulted in LTVs of many accounts increasing to more than 80%. Over the last 2 quarters company has brought down its high LTV portfolio (>80%) from 53% in Q4FY21 to 6% in Q1FY22. Consequently, overall LTV has also fallen from 71% in Q4FY21 to 65% in Q1FY22, giving more headroom to the company for lending. We expect gold loans to grow at CAGR of 13% over FY21-FY24.

Gold Loans growth



(Source: Company, HDFC sec)

NIMs to remain stable

NIMs of the company are expected to remain stable in the coming years as the company has surplus liquidity across all businesses and does not require to avail new facilities. Consolidated borrowing cost have declined 80/10bps yoy/qoq in Q1FY22 to 9.0%. We expect borrowing



costs to moderate further as higher cost debt gets rolled over. MFL is likely to pass on the cost savings in order to compete with other NBFCs/Banks.

New products introduced

The management shared that it has launched special schemes targeting high ticket borrowers on competitive terms and conditions. This segment with loans of Rs 1 lakh and above, had seen higher attrition in the recent past. Although this could have an impact on yields it will be compensated by higher AUM growth.

Deterioration in non-gold loan asset quality

While the non-gold loan book was largely flat sequentially, all the verticals witnessed a deterioration in asset quality. The MFI, Housing, and Vehicle segments saw 110/100/60bps increase in GNPA levels to 3.6/7.0/5.6% respectively. Gold loan GNPA was stable at 2.0%. Consolidated credit costs stood at 1.9% (annualized), largely due to the MFI segment, which reported credit costs of 6% (annualized).

Collection efficiency improves

Collection efficiency has been improving across businesses as easing of restrictions by states allows branches to operate normally. Collection efficiency in MFI/Vehicle/Housing improved from 59/87/79% to 70/105/87% in June. Overall collection efficiency was 75% in Q1FY22 which has already improved to 95% in July-2021.

Risk & Concern

- Fluctuation in gold prices – A fall in these could lead to higher LTV and lower margin of safety.
- Overdependence on Gold loans – Despite its attempts to bring down dependence on Gold loans, Gold loan AUM is still 67% in June 2021.
- Regulatory changes by Centre/State governments/RBI.
- Increase in delinquency in non-gold business leading to higher NPA – MFI, Housing Finance and Vehicle finance typically have higher slippages in difficult economic conditions.
- Emerging competition from other NBFCs and Banks who are entering Gold loan space – Gold loans seems to be the safest and most profitable businesses to most lenders and hence more and more of them keep entering it from time to time.

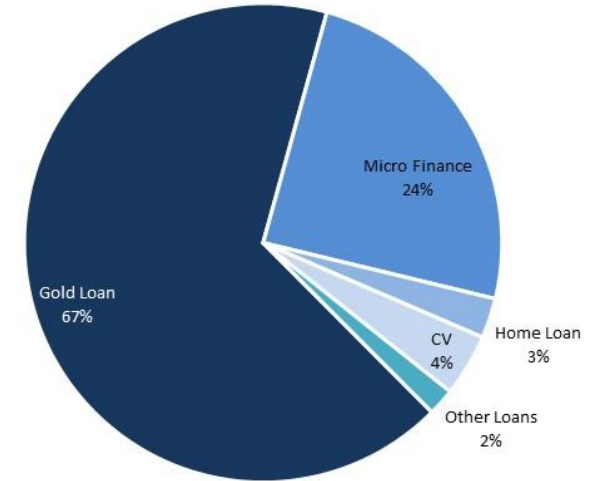
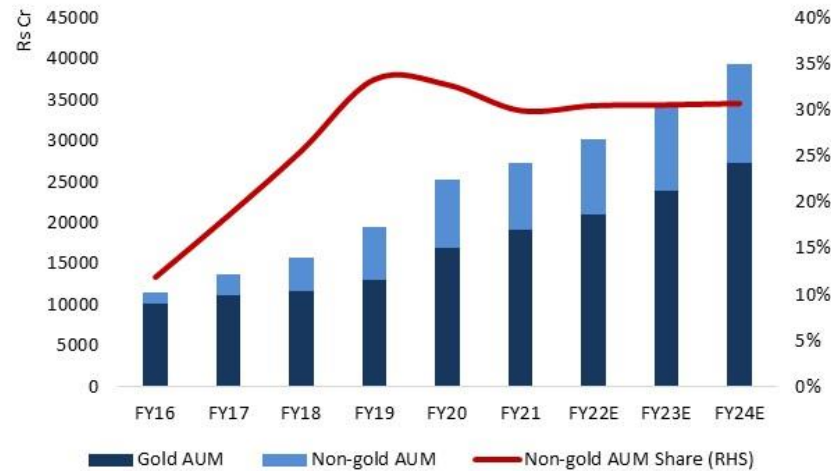


Company Background:

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.

MFL is the second largest Gold loan company in India with a 5% market share in organized gold loan market. Organised Gold loan market is 35% of the total gold loan market. There is a scope for shift of the market gradually from unorganised to organised going forward. Rise in gold prices allows higher lending on the same quantity of gold keeping the LTV intact.

AUM growth and breakup

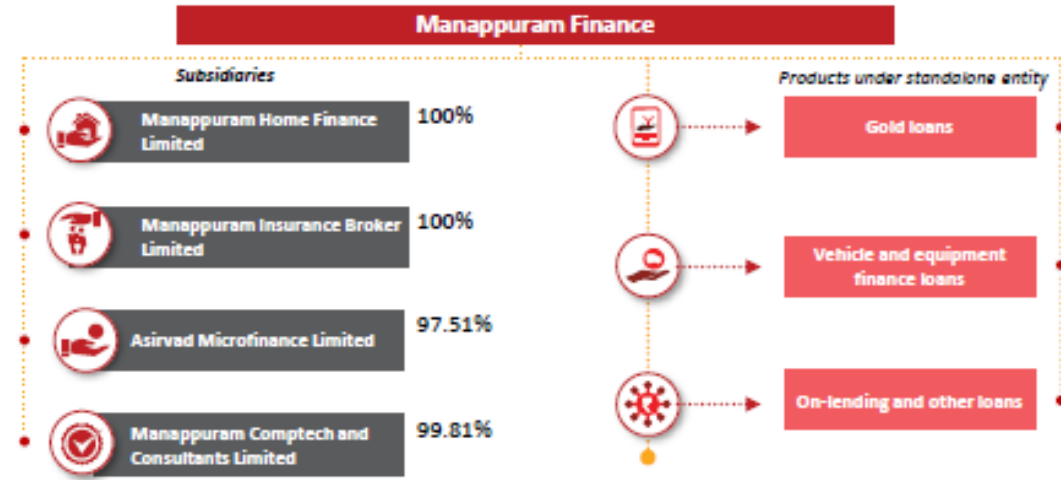
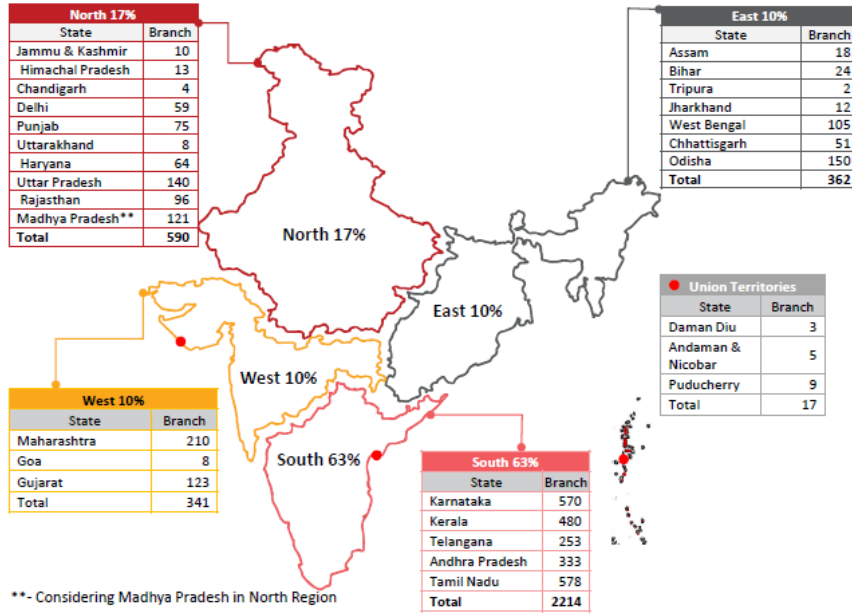


(Source: Company, HDFC sec)

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 8,217cr of non-gold loans. Overall, non-gold businesses contributed 33% of the total business as of Q1FY22.

Pan India presence & Distribution network (Gold loan branches- Q1FY22)

Group Structure



(Source: Company)



Financials

Income Statement

| (Rs cr) | FY20 | FY21 | FY22E | FY23E | FY24E |
|----------------------------|-------------|-------------|-------------|-------------|-------------|
| Interest Income | 5217 | 6190 | 6842 | 7600 | 8607 |
| Interest Expenses | 1832 | 2219 | 2363 | 2543 | 2798 |
| Net Interest Income | 3385 | 3971 | 4479 | 5056 | 5808 |
| Non interest income | 334 | 185 | 196 | 222 | 253 |
| Operating Income | 3719 | 4156 | 4675 | 5278 | 6061 |
| Operating Expenses | 1474 | 1400 | 1531 | 1679 | 1840 |
| PPoP | 2245 | 2756 | 3144 | 3599 | 4222 |
| Prov & Cont | 238 | 440 | 407 | 380 | 362 |
| Profit Before Tax | 2007 | 2316 | 2737 | 3219 | 3860 |
| Tax | 527 | 591 | 698 | 821 | 984 |
| PAT | 1480 | 1725 | 2039 | 2398 | 2876 |
| Adj. PAT | 1468 | 1724 | 2042 | 2403 | 2883 |

Balance Sheet

| (Rs cr) | FY20 | FY21 | FY22E | FY23E | FY24E |
|--------------------------|--------------|--------------|--------------|--------------|--------------|
| Share Capital | 169 | 169 | 169 | 169 | 169 |
| Reserves & Surplus | 5577 | 7138 | 8975 | 11136 | 13725 |
| Shareholder funds | 5746 | 7307 | 9144 | 11305 | 13894 |
| Minority Interest | 58 | 47 | 50 | 55 | 62 |
| Borrowings | 20917 | 22716 | 24547 | 26836 | 29698 |
| Other Liab & Prov. | 2230 | 1267 | 557 | 496 | 136 |
| SOURCES OF FUNDS | 28951 | 31338 | 34298 | 38693 | 43790 |
| Fixed Assets | 770 | 898 | 814 | 783 | 750 |
| Goodwill on Cons. | 36 | 36 | 36 | 36 | 36 |
| Investment | 90 | 338 | 325 | 338 | 386 |
| Cash & Bank Balance | 3646 | 2912 | 2662 | 2701 | 2700 |
| Advances | 23189 | 26508 | 29574 | 33757 | 38569 |
| Other Assets | 1220 | 646 | 887 | 1080 | 1350 |
| TOTAL ASSETS | 28951 | 31338 | 34298 | 38693 | 43790 |

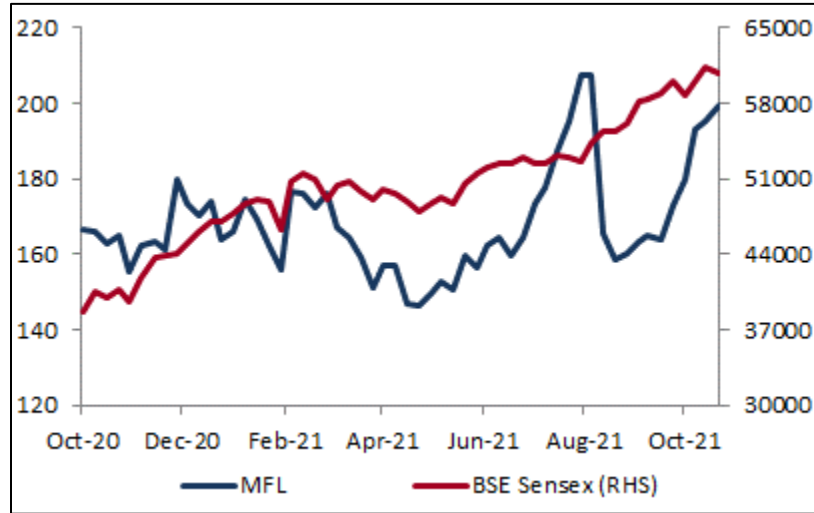
Ratio Analysis

| As at March (Rs cr) | FY20 | FY21 | FY22E | FY23E | FY24E |
|---------------------------------|------|------|-------|-------|-------|
| Return Ratios (%) | | | | | |
| Calc. Yield on adv | 25.4 | 24.9 | 24.4 | 24.0 | 23.8 |
| Calc. Cost of borr | 10.1 | 10.2 | 10.0 | 9.9 | 9.9 |
| Calc. NIM | 16.5 | 16.0 | 16.0 | 16.0 | 16.1 |
| RoAE | 28.6 | 26.4 | 24.8 | 23.5 | 22.9 |
| RoAA | 6.0 | 5.7 | 6.2 | 6.6 | 7.0 |
| Asset Quality Ratios (%) | | | | | |
| GNPA | 0.9 | 1.5 | 1.3 | 1.2 | 1.1 |
| NNPA | 0.5 | 1.4 | 1.1 | 0.9 | 0.9 |
| Growth (%) | | | | | |
| Advances | 30.2 | 14.3 | 11.6 | 14.1 | 14.3 |
| Borrowings | 36.8 | 8.6 | 8.1 | 9.3 | 10.7 |
| NII | 25.7 | 17.3 | 12.8 | 12.9 | 14.9 |
| PPoP | 52.4 | 22.8 | 14.1 | 14.5 | 17.3 |
| PAT | 59.3 | 16.5 | 18.2 | 17.6 | 19.9 |
| Per Share (Rs) | | | | | |
| EPS | 17.4 | 20.4 | 24.2 | 28.4 | 34.1 |
| Adj. BVPS | 66.7 | 83.0 | 104.4 | 130.2 | 160.5 |
| Dividend | 2.2 | 2.0 | 2.4 | 2.8 | 3.4 |
| Valuation Ratios | | | | | |
| P/E (x) | 11.5 | 9.8 | 8.3 | 7.0 | 5.9 |
| P/ABV (x) | 3.0 | 2.4 | 1.9 | 1.5 | 1.2 |
| Dividend Yield (%) | 1.1 | 1.0 | 1.2 | 1.4 | 1.7 |
| Other Ratios | | | | | |
| Cost-Income (%) | 39.6 | 33.7 | 32.8 | 31.8 | 30.4 |
| Leverage (x) | 4.0 | 3.6 | 3.2 | 3.0 | 2.8 |
| Opex-AUM | 5.8 | 5.1 | 5.1 | 4.9 | 4.7 |

(Source: Company, HDFC sec)



Price Chart





HDfC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicity of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

Disclosure:

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