Stock Update

Muthoot Finance Ltd.

October 22, 2021

RETAILRESEARCH

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Muthoot Finance Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
BFSI - NBFC	Rs 1532	Buy in Rs 1520-1540 band & add more on dips to Rs 1330-1350 band	Rs 1680	Rs 1805	2 quarters

HDFC Scrip Code	MUTFIN
BSE Code	533398
NSE Code	MUTHOOTFIN
Bloomberg	MUTH IN
CMP Oct 21, 2021	1531.5
Equity Capital (Rs cr)	401.3
Face Value (Rs)	10
Equity Share O/S (cr)	40.1
Market Cap (Rs cr)	61444
Book Value (Rs)	379.8
Avg. 52 Wk Volumes	16,72,000
52 Week High (Rs)	1638.9
52 Week Low (Rs)	1090.0

Share holding Pattern % (Sep, 2021)	
Promoters	73.4
Institutions	22.4
Non Institutions	4.2
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:

Muthoot Finance Ltd. (MFL) continues to be the No. 1 gold loan financier, driven by its strong business model led by its lean cost structure, high standards of collection and operational efficiencies. This has resulted in best-in-class margins along with negligible ALM (Asset Liability Management) & NPA issues. As normalcy is restored in the post Covid world and businesses resume activities, gold loan demand would return as customers with stressed cash flows and short term needs fall back on gold loans. MFL has a comfortable liquidity position with ~Rs 8250cr as cash and investments which when deployed would result in NIM expansion and higher return ratios.

The non-gold portfolios faced asset quality challenges due to the pandemic and the management had strategically decided to curtail disbursements resulting in de-growth in the housing loan and vehicle finance business. However the management expects these businesses to pick up Q2FY22 onwards.

On February 12, 2021, we had initiated coverage on the stock (Link) with a recommendation to 'Buy on dips to Rs 1220-1228 band and add further in Rs 1113-1121 band' for base case fair value of Rs 1325 and bull case fair value of Rs 1406. The stock entered our buying range on March 8 and achieved both the targets on June 2, 2021.

Valuation & Recommendation:

We expect the MFL to maintain strong RoEs of >25% and RoAs of >7% by FY23E. Margins are expected to improve on higher gold lending, lower cost of borrowing and deployment of surplus cash Given the fast growth in book values, high profitability, high return ratios and low balance sheet risk, gold loan companies deserve to be valued higher than other NBFCs. We have not gone for SOTP valuation of MFL but value the whole company on P/ABV. We feel investors could buy the stock in Rs 1520-1540 band and add on dips to Rs 1330-1350 band (2.2x Sep-23E ABV) for base case fair value of Rs 1680 (2.75x Sep-23E ABV) and bull case fair value of Rs 1805 (2.95x FY23E ABV) in 2 quarters. At CMP the stock is trading at 2.5x Sep-23E ABV.

Changes since our last report

(Rs cr)	Old Estimate		New Estimate			Variation (%)	
	FY22E	FY23E	FY22E	FY23E	FY24E	FY22E	FY23E
NII	7920	8958	7839	9161	10723	-1.0	2.3
PPoP	6031	6910	6098	7243	8610	1.1	4.8
PAT	4367	5006	4434	5269	6266	1.5	5.3
EPS	108.9	124.8	110.5	131.3	156.2	1.5	5.2

(Source: Company, HDFC sec)

Financial Summary

Particulars (Rs cr)	Q1 FY22	Q1 FY21	YoY (%)	Q4 FY21	QoQ (%)	FY21	FY22E	FY23E	FY24E
NII	1702	1445	*17.8*	1838	*-7.4*	6636	7839	9161	10723
PPoP	1334	1140	*17.0*	1361	*-2.0*	5101	6098	7243	8610
PAT	971	841	*15.5*	996	*-2.5*	3722	4434	5269	6266
EPS (Rs)	24.2	21.0	*15.5*	24.8	*-2.5*	92.8	110.5	131.3	156.2
P/E (x)						16.7	14.0	11.8	9.9
P/ABV (x)						4.2	3.4	2.8	2.3
RoAA (%)						6.5	6.5	6.9	7.2

(Source: Company, HDFC sec)

Recent Developments

Q1FY22 Result Update

MFL reported a muted performance in Q1FY22, a quarter impacted by staggered lockdowns due to second wave of Covid. Net interest income grew by 18% YoY but declined 7% on a sequential basis to Rs 1702cr. Consolidated AUM grew by 27.4% driven by 28.6% growth in gold loans to Rs 52,069cr while non-gold loans de-grew 31.9% YoY to Rs 545cr. On a sequential basis AUM was flat. LTV declined by ~390bps qoq to ~71%.

Interest spread declined by 34bps to 12.9% led by ~190bps compression in yield on advances. Total borrowings increased by 4% qoq, leading to an absolute increase in interest expenses (up 3% qoq) in Q1FY22. Consequently NIMs compressed 101/134 bps YoY/QoQ to 12.9%. PAT grew by ~16% YoY, but fell 2% QoQ to Rs 971cr on account of lower NII and higher provision, slightly mitigated by lower opex (down 23% QoQ). As a matter of prudence it has been maintaining higher liquidity on balance sheet leading to near term drag but acts as a cushion in case the funding environment deteriorates.

Stage III loans increased during the quarter to 1.2% vs 0.9% QoQ. Average monthly disbursement stood at Rs 5200cr. Despite COVID-related lockdowns, MFL added ~115k new loan accounts in Q1FY22. ATS (Average Ticket Size) has largely remained stable (with a declining bias) over the last three quarters. Muthoot's subsidiaries, engaged in microfinance, housing finance and auto loans, contributed ~10% to its overall consolidated AUM. The company reported 5.9% gross stage-3 in home finance, 18% in vehicle finance and 3.7% in microfinance. Collections remained weak and concerning in microfinance, down to 66% in June 2021 from 71% in May 2021 and 89-94% over March-April 2021.

Management continues to guide gold loan growth to 15% YoY for FY22 on a conservative basis. It expects AUM growth to gradually pick up from Q2FY22 led by a gradual rise in branch footfall. In Non gold portfolio, management expects good disbursal in homes loans and in vehicle finance it will restart its business from Q2FY22 onwards. MFL rationalized 7 branches net in Q1FY22 taking the total gold loan branch network to 4625 branches.

Key Triggers

Gold loans continue to witness strong momentum

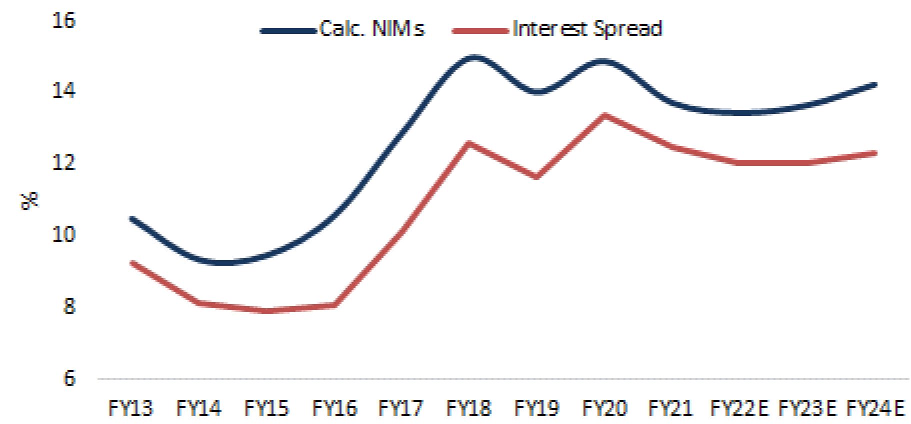
The COVID-19 pandemic brought a paradigm shift in the gold loan market as people started realising that gold is an instrument of credit rather than an instrument of savings, particularly in India. Demand for gold loans remained strong and increased by 26.5% in FY21 for the company. Gold loans are one of the easiest ways for people facing financial difficulties to access cash as it is a fairly liquid asset and has lower scope of loss.

According to the World Gold Council, Indian consumers have US$1.5tn of gold, mostly in the form of jewellery. Overall financing penetration against this is about US$150bn (ie, 10%), per estimates. The World Gold Council expects the gold loans market to grow at an annual rate of 15.7% and reach Rs 4.62 lakh crore in FY22, from 3.45 lakh crore rupees in FY20. Consulting firm KPMG said in a 2020 report that the total gold loans outstanding in the organized sector in 2019 was estimated at 5.5% of the total household gold holdings in India. Organized lenders are estimated to account for 35% gold loan market share, with unorganized lenders accounting for the remaining 65%. This presents the organized players with a huge opportunity for growth. The management is targeting to achieve Rs 1 lakh crore of gold loan book by FY25 which implies CAGR of 17.4% over FY21-FY25. This could be achieved by targeting more than 2 cr of its old, inactive customers for driving new loans, increasing the ticket size - as gold loans are being borrowed by small businesses for working capital purposes and tapping the underpenetrated north and east India by opening new branches every year in these regions..

NIMs to expand driven by lower borrowing cost

Despite increasing competition from Banks, who lend at lower rates, MFL has been able to sustain its NIM. This has been mainly on account of reach of the company, deeper local knowledge, quick turnaround time and trust built over the years. Borrowers tend to stick with the company due to small ticket size and short duration loans. We expect NIMs of the company to improve in the coming years as rating upgrade in Feb-21 by Crisil (from AA/Positive to AA+/Stable) would enable the company to borrow at lower rates. Further the company has ~11.3% of its assets in cash which when deployed would provide a higher return, aiding yield on assets. We have built in 50bps NIM improvement over FY21-FY24.

Lower borrowing cost and cash deployment to drive NIM expansion



(Source: Company, HDFCsec)

Unwinding of high liquidity to be margin accretive

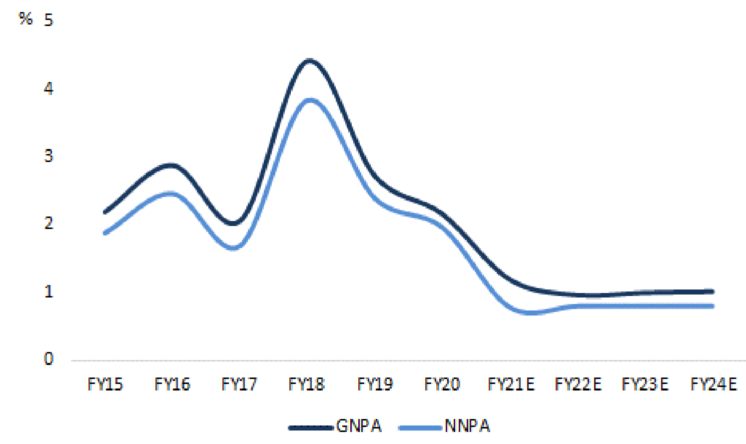
Muthoot has been running significantly high cash balances due to the slowdown in lending and caution in the time of pandemic, which has been impacting its NIMs and return ratios. It had ~11.3% of its assets in cash and cash equivalents as of FY21. Deployment of surplus cash for lending would be margin accretive for the company in the near term as it would have to borrow lesser funds. It has also been raising funds at very competitive rates and the cost of funds is expected to decline further, which is positive for NIM expansion.

Credit costs to remain negligible

Gold financing is a high 20%+ yield business which is fully secured against gold which is a very liquid asset. Thus NPA is not of any concern as the company maintains sufficient collateral against its lending. MFL lends at max 75% of the value of gold and has a 25% margin of safety. The GNPA are merely a technical classification as the outstanding amount is fully recoverable from the collateral. MFL gives sufficient time to the borrowers to make the payment and auctions gold only as a last resort. In FY21, it auctioned Rs 171cr worth of gold, most of which were for loans originated in 2016-2018.

MFL is carrying Rs 650cr of expected credit loss provision in the books, which exceeds regulatory requirement by Rs 295cr. Also most of the loans of the company are repaid in 6 months while the liabilities are relatively of longer term in nature resulting no ALM issues for the company. We believe write-off to remain negligible mainly related to theft and counterfeits.

Asset quality to remain stable

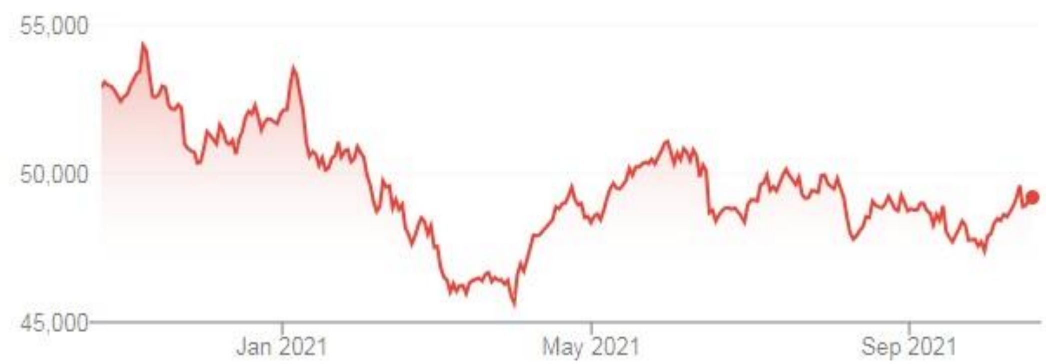


(Source: Company, HDFCsec)

Rise in gold prices could allow higher lending by MFL (and growth in AUM) without seeking additional collaterals.

Gold price have been trading in a range for the past few months. Any increase in the gold prices would allow the company to lend more to the same customer without seeking additional collaterals. This could drive higher AUM growth. As of Q1FY22 MFL had an LTV of 71%.

International ($/ounce) and domestic (Rs/10 gm) gold price trend

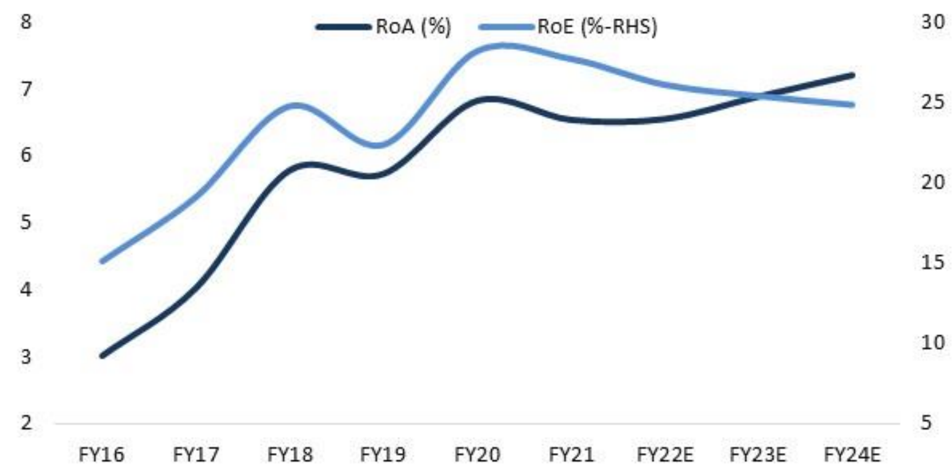


(Source: Investing.com, Goolge)

Healthy financial ratios

The company's earnings profile has been healthy in the past and, has improved further over the last few fiscals to outperform NBFCs and banks. Over the last 5 years its RoA/RoE has improved from 3.0/15.1% in FY16 to 6.5/27.8 in FY21. This superior profitability can be attributed to the company's ability to generate high interest margins while keeping operating expenses and provisioning requirements low. We expect the company to sustain these ratios going forward

Improvement in return ratios



(Source: Company, HDFCsec)

Risk & Concern

Sustained competition from other NBFCs and Banks

Emerging competition from other NBFCs, fintechs and Banks who are entering Gold loan space is a concern. However Gold loan companies have quicker turnaround time, lower ticket sizes, niche customer base, easy accessibility of a large branch network focused only on gold loans and flexible repayment schedules. With increasing competition from banks, a medium-term yield and NIM decline cannot be avoided. However, this may be partially offset by lower cost of funds.

Geographical concentration

Despite attempts for gradual diversification, Muthoot Finance's operations have a high degree of geographical concentration - South India accounts for 50% of the company's AUM and 60% of its branches as of FY21. Significant regional concentration renders the company to vulnerabilities of economic, social, and political disruptions in the region.

Regulatory changes

The permissible loan to value (LTV) in gold lending is capped at 75% by the Reserve Bank of India. Any adverse changes related to the permissible LTV or caps on lending rates/ NIMs could impact the company negatively.

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.

Fluctuation in gold prices

Wide fluctuations or a sharp fall in gold prices could lead to lower growth in advances in the gold loan business.

Increasing NPA in subsidiary

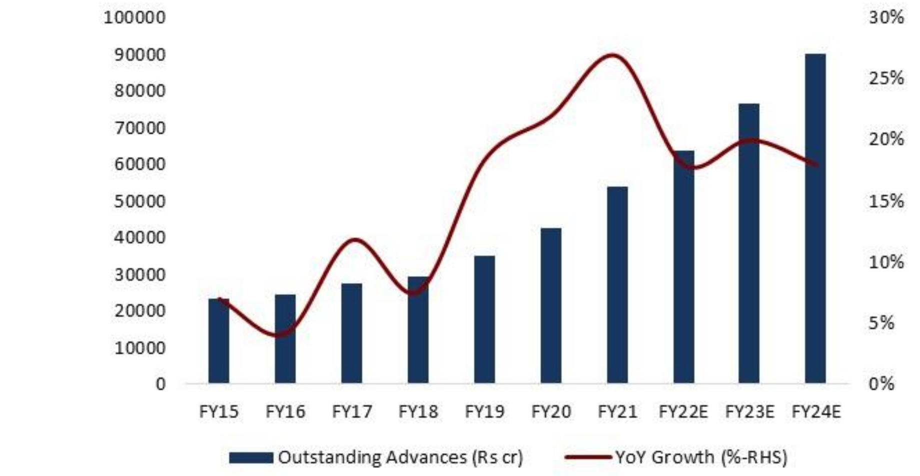
There has been a sharp increase in GNPA in Muthoot Homefin and Muthoot Money (wholly-owned subsidiaries of MFL) in Q1FY22. In percentage terms it has increased from 4% to 5.9% for Muthoot Homefin and from 2.4% to 3.7% for Muthoot Money.

Company Background:

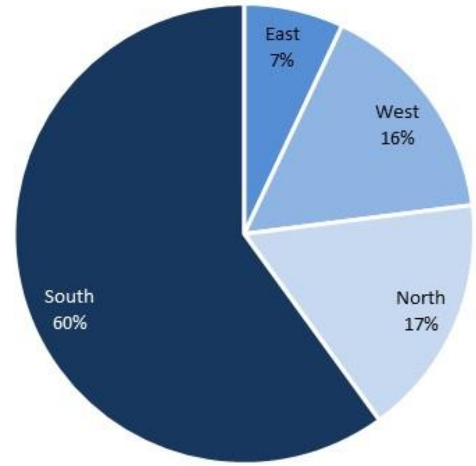
Muthoot Finance Ltd is India's largest, niche gold finance company with a gold loan AUM of ~Rs 52,068cr as of Jun-21 and consolidated AUM of ~Rs 58,135cr. Headquartered in Kochi (Kerala), the company is majority owned by the Muthoot family (73.4% stake as of Jun-2021). It currently has 4,625 gold loan branches and presence across 29 states/union territory in the country. However, its footprint is concentrated mostly in the South with ~60% of the branches. While loans are typically disbursed with tenure of 6-12 months, most of the loans are repaid within six months – implying average duration of close to six months for the loans.

Besides gold loans, the company has also diversified into micro finance, housing finance, SME loans, vehicle loans and insurance broking with promising results. Overall, non-gold businesses contributed ~10% of the consolidated business in FY21 and 2.5% of consolidated PAT.

Outstanding loan book growth



Diversified pan-India presence, Branch-wise Break-up



(Source: Company, HDFC sec)

Financials

Income Statement

(Rs cr)	FY20	FY21	FY22E	FY23E	FY24E
Interest Income	8564	10329	12108	13956	16095
Interest Expenses	2791	3692	4269	4796	5372
Net Interest Income	**5773**	**6636**	**7839**	**9161**	**10723**
Non interest income	158	246	235	273	318
Operating Income	**5932**	**6882**	**8073**	**9434**	**11041**
Operating Expenses	1779	1780	1975	2191	2431
PPoP	4153	5101	6098	7243	8610
Prov & Cont	96	95	147	171	199
Profit Before Tax	4057	5007	5951	7072	8411
Tax	1039	1284	1518	1803	2145
PAT	**3018**	**3722**	**4434**	**5269**	**6266**

Balance Sheet

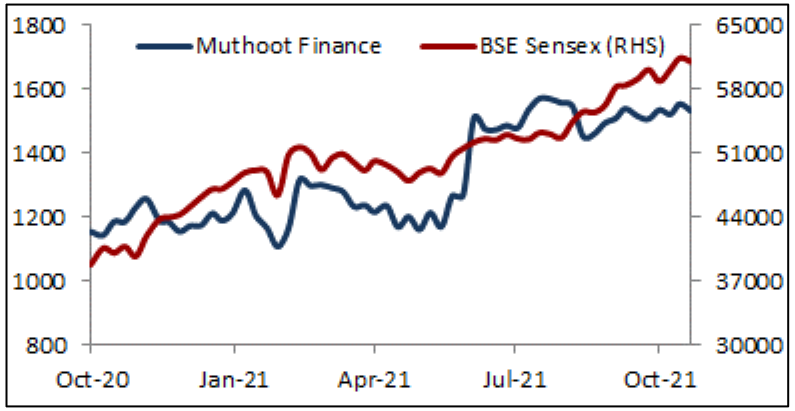
(Rs cr)	FY20	FY21	FY22E	FY23E	FY24E
Share Capital	401	401	401	401	401
Reserves & Surplus	11171	14838	18269	22334	27196
Shareholder funds	**11572**	**15239**	**18670**	**22735**	**27597**
Borrowings	37130	45946	52185	58700	66962
Other Liab & Prov.	1758	2280	1127	-304	-1634
SOURCES OF FUNDS	**50460**	**63465**	**71981**	**81131**	**92925**
Fixed Assets	257	285	314	345	380
Investment	1438	1590	1708	1834	1889
Cash & Bank Balance	5641	7190	6325	5136	4292
Advances	42604	54063	63254	73375	85849
Other Assets	520	336	380	440	515
TOTAL ASSETS	**50460**	**63465**	**71981**	**81131**	**92925**

Ratio Analysis

As at March (Rs cr)	FY20	FY21	FY22E	FY23E	FY24E
Return Ratios (%)					
Calc. Yield on adv	22.1	21.4	20.6	20.4	20.2
Calc. Cost of borr	8.7	8.9	8.7	8.7	8.6
Calc. NIM	14.9	13.7	13.4	13.4	13.5
RoAE	28.3	27.8	26.2	25.5	24.9
RoAA	6.8	6.5	6.5	6.9	7.2
Asset Quality Ratios (%)					
GNPA	2.2	1.2	1.0	1.0	1.1
NNPA	2.0	0.8	0.8	0.8	0.8
Growth (%)					
Advances	22.0	26.9	17.0	16.0	17.0
Borrowings	38.4	23.7	13.6	12.5	14.1
NII	27.7	14.9	18.1	16.9	17.1
PPoP	33.8	22.8	19.5	18.8	18.9
PAT	53.0	23.3	19.1	18.8	18.9
Valuation Ratios					
EPS (Rs)	75.3	92.8	110.5	131.3	156.2
P/E (x)	20.3	16.5	13.9	11.7	9.8
Adj. BVPS (Rs)	268.5	369.8	452.7	552.1	670.8
P/ABV (x)	5.3	4.0	3.3	2.7	2.2
Dividend per share (Rs)	15.0	20.0	25.0	30.0	35.0
Dividend Yield (%)	1.0	1.3	1.6	2.0	2.3
Other Ratios					
Cost-Income (%)	30.0	25.9	24.5	23.2	22.0
Leverage (x)	3.7	3.5	3.4	3.2	3.1

(Source: Company, HDFC sec)

Price chart


Muthoot Finance
BSE Sensex (RHS)
1800
1600
1400
1200
1000
800
65000
58000
51000
44000
37000
30000
Oct-20
Jan-21
Apr-21
Jul-21
Oct-21

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 cyclicality 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.

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