

IPO Note
Muthoot Finance Ltd

Recommendation	SUBSCRIBE	
Price Band	Rs. 160-175	
Bidding Date	18th Apr – 21th Apr	
Book Running Lead Manager	ICICI Sec, Kotak Mahindra	
Registrar	Link Intime India Pvt Ltd	
Sector	NBFC	
Retail Application- Detail At Cut off Price		
Number of Shares	1120	
Application Money	Rs. 196000	
Amount Payable	Rs. 196000	
Discount to retail	0%	
Financials (Rs in Crs)	FY10	8MFY11
Total Income (NII+ OI)	1,089	1,301
PBT	346	441
PAT	228	291
Valuations	Lower Band	Upper Band
EPS*	11.74	11.74
Book Value*	52.61	54.68
P/E ratio*	13.63	14.91
P/BV*	3.04	3.20
*calculated on diluted equity		
Post Issue Shareholding Pattern		
Promoters	80%	
Institutions	6%	
Public	14%	
Offer structure for different categories		
QIB (Including Mutual Fund)	50.0%	
HNI	15.0%	
Retail	35.0%	
Post issue Equity (Rs. in crore)	371.7	
Issue Size (Rs. in crore)	824-901	
Face Value (Rs.)	10	
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Background

Muthoot Finance Ltd (MFL) is a non-deposit taking NBFC (non-banking finance company) incorporated in 1997. It is the largest gold financing NBFC in India; engaged in the business of providing personal loans and business loans against used household jewellery. In 2001, MFL received the NBFC license from the RBI.

Over the years the company has expanded its portfolio by expanding the branch network all over the India. Currently it has the largest branch network among gold loan providers in India with 2,611 branches and a strong presence in the under-served rural and semi-urban markets. The main customers of MFL are typically small businessmen, vendors, traders, farmers and salaried individuals, who for reasons of convenience, accessibility or necessity, avail of company's credit facilities by pledging their gold jewellery rather than by taking loans from banks and other financial institutions. MFL has a market share of 19.5% amongst the top 10 organized players (organized players account for ~25% share of the market) as of FY 2010.

In 2010, it received a fund infusion of Rs 2.5 bn from 3 private equity players for a 6% stake in the company. In 2011, Welcome Trust picked up an additional 1% stake from the promoters, taking the total stake of private equity investors to 7%. The last PE transaction took place at around Rs.173.5 per share.

During FY06 to FY10, MFL's AUM increased at a CAGR of 74% driven by the rise in pledged gold and a spurt in gold prices. It reported gross AUM of Rs 7400 crs and PAT of Rs 230 crs on a total income of Rs 1100 crs in FY10. The average yield on the AUMs during the same period was 19.9%. In FY10 asset quality remained strong with gross NPA of only 0.46%, the capitalization level was comfortable with a capital adequacy ratio of 14.8%.

Objects of the Issue

- Augment its capital base to meet its future capital requirements to provide for funding of loans to the customers
- General corporate purpose
- Reap the benefits of listing on the stock exchanges like easy access to funds and lower cost of accessing funds

Post issue the promoters holding in the bank would fall from 93% to 80%. Anchor Investors are offered the issue at Rs.170 per share.

Business

MFL's primary business comprises of providing personal loans and business loans against used household jewellery. These loans size are typically small ticket loans collateralized by gold jewellery. MFL generally lend between 60% - 85% of value of the gold. These loans have a maximum term of 12 months. However, customers may redeem the loan at any time, and these gold loans are generally redeemed between 3-6 months. Interest is paid only when the principal is repaid which could be from few days to few months.

The main USP of MFL is that it can disburse loan within 5 minutes from the time the gold is tendered to the appraiser. Similarly, the loan can be repaid and gold can be collected within 3 minutes. MFL's current ticket size stands Rs 31,553 per loan account as of November 2010 and the company had 97.6 tons of gold jewellery held as security for gold loans.

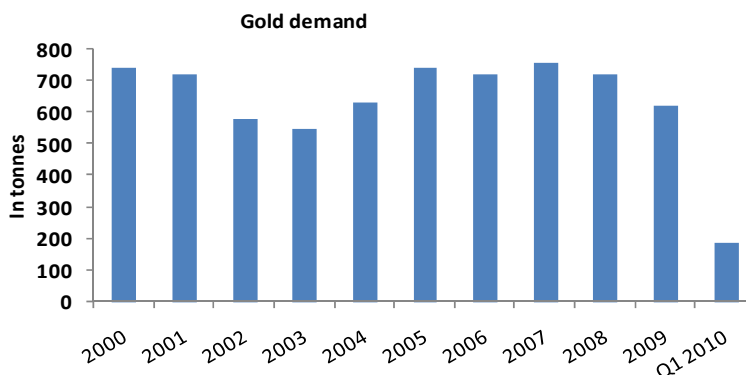
Investment Rationale

✓ **Strong growth in gold loan business**

India is one of the largest markets for gold and as of fiscal 2010, India accounted for approximately 10% of the total world gold stock with an annual demand of approximately 700 tones (*Source: IMAcS Industry Report (2010 Update)*).

Based on the assessment of the emerging dynamics and competitive landscape, the gold loans market is expected to grow at between 35% and 40% over the next three years. Moreover, as the market is currently under-penetrated, it is expected that the gold loans market will offer enough opportunities for portfolio expansion and retain attractive margins for all existing specialized NBFCs, banks and new entrants (*Source: IMAcS Industry Report 2009*).

Overall, market share of NBFCs engaged in gold finance business has increased from 23.6% in FY09 to 32% in FY10. Even though the gold loan portfolio of banks has grown over the years, it had been largely driven by bilateral assignments with NBFCs to meet their direct priority sector lending targets (benefit no longer available post new RBI regulation). Yet banks have lost market share with NBFCs growing at ~2x the industry growth. We believe that MFL being the largest player in the industry will benefit from these growth opportunities.



Source: IMAcS Industry Report (2010 Update)

✓ **Largest player with strong network**

Over the years MFL has grown its business robustly and expanded its market share from 11% in FY 2007 to 20% in FY 2010. Currently MFL enjoys the highest market share amongst the organized players.

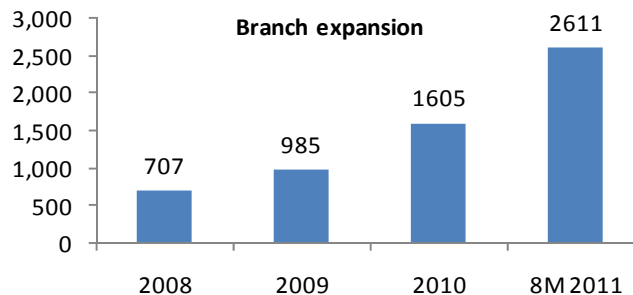
Market share of top 10 organized players

Company	Market share (%)		
	FY07	FY09	FY10
Muthoot Finance	11%	13%	20%
Indian Overseas Bank	13%	13%	14%
Indian Bank	13%	13%	10%
Manappuram	4%	5%	7%
South Indian Bank	5%	6%	6%
Muthoot Fincorp	4%	5%	6%
State Bank of Travancore	9%	6%	5%
Andhra Bank	3%	4%	4%
Federal Bank	5%	4%	2%

Source: Company data

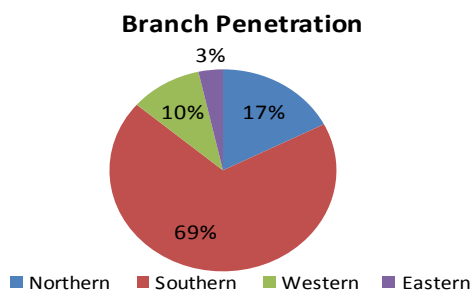
✓ **Geographic diversification and increase in branch network**

MFL has been able to maintain its leadership position in the gold loan industry due to the aggressive branch expansion strategy of the management. The number of branches has increased from 707 in 2008 to 2611 in 8M 2011.



Source: Company data

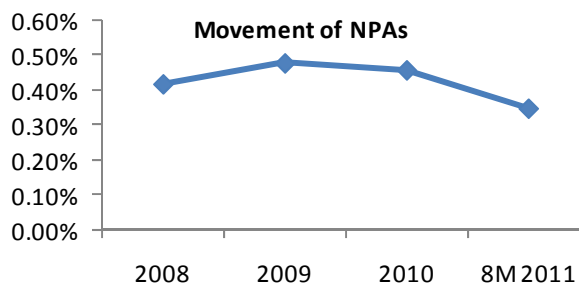
Moreover, MFL is improving its branch penetration and exploring new regions. After expanding aggressively in western India, the company is looking to expand in other regions like North and East. This strong expansion strategy will help the company to grow more robustly and maintain leadership position.



Source: Company data

✓ **Healthy asset quality**

MFL's asset quality has remained healthy with Gross NPAs at 0.46% and 0.35% as on FY10 and Nov'10 respectively. The company does not have NPAs technically as gold is sold by end of 17th month. Most of the NPAs reported are on account of extension given to borrowers (those who have not defaulted previously and enjoy a strong relationship with the company).



Source: Company data

✓ **Stable NIMs and Margins**

The company has maintained a stable NIM of between 10-12% over last few years. Even during the time of rising interest rates the company has managed to maintain a healthy NIM at around 10.5%. This is because MFL has been able to pass on the higher borrowing costs to the customers.

RBI has asked banks not to classify loans to non-banking finance companies (NBFCs) on-lending against gold jewellery as priority sector. This move will increase the cost of borrowing of NBFC from Banks from 7% to around 9.5%. However Management is confident of maintaining its NIM above 10% by passing on some cost to the customers and improving efficiency.

✓ **CARE and CRISIL Rating**

CARE as well as CRISIL has assigned a “**IPO Grade 4**” out of 5, to the proposed IPO of Muthoot Finance Ltd. CARE and CRISIL’s IPO Grade 4 indicates ‘above average fundamentals’. In addition ICRA has assigned “**A1+**” for its commercial paper and for short-term non-convertible debentures of Rs 200 crs. CRISIL has assigned “**P1+**” rating for short term debt instruments of Rs 1,000 cr. These ratings are of the highest grade and suggest strong fundamentals of the company.

Key Concerns

✓ **Increasing competition from public sector banks and other NBFCs in the same line of business**

One of the major risk factor for MFL is the renewed interest rates put forward by public and private sector banks for their gold loans which are much cheaper than the rates provided by the private gold loan companies like MFL and Manappuram Finance. Banks have already started encouraging these portfolios as they are unable to lend to private gold loan companies for meeting their own priority sector requirements. Therefore, the increasing competition is likely to affect yields and spreads.

✓ **Volatility in gold prices**

MFL provides loans with gold jewellery as collateral by the customer. A sharp downward movement in the price of gold could result in a fall in collateral values. In such a case customers pay default in repaying the loans which may adversely impact the financial performance of the company.

✓ **Concentration in specific regions**

MFL has approximately 2600 branches all throughout the country out of which 69% of the branches are located in Southern India. Also out of its branches, 1119 branches are located in southern states of Tamil Nadu, Kerala, and Andhra

Pradesh & Karnataka With such a high concentration in a particular region any uncertain or adverse economic condition developing in that particular region can hamper the operations and growth prospects of the company.

✓ **Regulatory Change**

The company is also exposed to regulatory and geo-political risk. Any regulatory change by RBI may impact the company's growth prospects. Also the change in political power in South may bring about a change in policy like we saw in the MFI industry. These factors can impact the company's top-line and margins going forward.

Valuation and Peer Comparison

	Muthoot Finance Ltd (8MFY11)	Manappuram Finance (9MFY11)
Total income (Rs crs)	1,301	761
Net profit (Rs crs)	291	181
EPS (Rs)	11.74	5.79
Networth (diluted)	2032.7	1,920
Current BVPS (diluted)	54.68	46.09
Price (Upper Band)	175	130
P/E	14.91	22.46
P/BV	3.20	2.82
ROE	21.47%	12.56%
Number of branches	2,611	1,795
Loan ticket size (Rs. Crs)	31,553	63,704
AUM (Rs. Crs)	13,004	6,520
Employee per branch	6	8
No of employees	15,664	14,670

Source: Company data, Nirmal Bang Research

We have compared Muthoot Finance with Manappuram Finance. Muthoot Finance is almost double the size of Manappuram based on its AUM size. At the price band of Rs.160-175, MFL is priced at 13.6x/14.9x P/E of its FY11E annualized EPS of Rs 11.74 whereas 3.04x/3.20x P/BV of its post issue book value of Rs 52.61/54.68 respectively. Whereas its closest competitor Manappuram General Finance & Leasing is trading at 22.46x P/E of its FY11E annualized EPS of Rs. 5.79 and 2.82x P/BV of its BV of Rs. 46.09.

Considering the larger size, strong brand image of MFL, the bright prospects of gold financing in India, good track record of management and lower NPA levels, Muthoot Finance seems to be offered at comparatively attractive valuations as compared to its peers. Consequently, we recommend investors to **'SUBSCRIBE'** to the issue with a medium to long-term perspective.

Income Statement

Rs. In crs.	FY 2006A	FY 2007A	FY 2008A	FY 2009A	FY 2010A	8M FY11
Interest income	143	224	358	606	1,078	1,289
Interest expense	65	100	180	310	474	583
Net interest income	78	124	178	296	604	706
Other income	5	10	11	14	12	12
Total income	83	134	189	311	616	719
Operating expenses	42	67	91	162	268	277
Operating profit	41	67	98	149	348	442
Provision for NPAs	0	0	1	1	2	1
Profit before tax	41	67	97	148	346	441
Taxes	14	23	33	51	118	150
Net profit	27	44	64	98	228	291
Adjustments	0	0	-1	0	-1	0
Net profit as restated	27	44	63	98	227	291

(Source: Company & Nirmal Bang Research)

Balance Sheet

Rs. In crs.	FY 2006A	FY 2007A	FY 2008A	FY 2009A	FY 2010A	8M 2011
Total cash and bank balances	24	24	58	194	463	461
Investments	12	24	18	9	8	8
Advances	795	1,389	1,805	2,574	5,462	9,810
Fixed assets	51	63	109	129	153	199
Other assets	59	108	296	854	355	298
Total assets	941	1,609	2,286	3,760	6,440	10,776
Secured Loans	737	1,312	1,840	3,009	4,547	8,033
Unsecured Loans	69	71	75	157	733	1,050
Other liabilities and provisions	44	67	157	233	575	562
Total liabilities	850	1,450	2,073	3,399	5,856	9,645
Equity capital	4	5	5	49	301	320
Reserve	86	154	208	312	283	811
Total liabilities and equity	941	1,609	2,286	3,760	6,440	10,776

(Source: Company & Nirmal Bang Research)

Ratio Analysis

	FY 2008A	FY 2009A	FY 2010A	8M FY11
EPS	2.6	3.5	7.6	9.3
Yield on average loans	19%	21%	19%	19%
Cost of deposits	9%	10%	8%	9%
RONW*	30%	27%	39%	26%
NIM	8.2%	8.2%	9.3%	9.2%
Gross NPA	0.42%	0.48%	0.46%	0.35%
Net NPA	0.47%	0.57%	0.56%	0.42%

* Not annualized

(Source: Company & Nirmal Bang Research)

NOTE

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