

Manappuram Finance

11 August 2017

Reuters: MNFL.BO; Bloomberg: MGFL IN

Accelerated Provisioning In Microfinance Hurts Profitability

Manappuram Finance (MFL) posted strong net interest income or NII growth of 19% YoY (2% above our estimate) in 1QFY18, whereas PAT declined 3% YoY (15% below our estimate) on account of accelerated provisioning in microfinance business. MFL has made an additional provision of Rs340mn over and above what is required by regulations. Despite an increase in gross non-performing assets or GNPA by 50bps sequentially to 2.5%, net non-performing assets or NNPA eased 60bps sequentially to 1.1% backed by higher provisioning. GNPA in gold loan segment eased 90bps sequentially to 1.1% which partly compensated for the rise in GNPA in microfinance segment by 230bps to 6.9%.

Assets under management (AUM) growth were lower at 3% (against our estimate of 9%) and declined 2% QoQ. A large part of slower growth can be attributed to weak underlying demand in the aftermath of demonetisation and higher auctions during the quarter. As a result, there was a decline of 5% in gold loan segment, but it constitutes 80% of AUM. Gold holdings fell 6%, whereas per gram they were flattish. The management sounded confident of growing its gold loan business by 10%-20% in FY18. MFI segment (Asirvad Microfinance) grew 48% YoY and accounted for 14% of overall loan book. Other segments (housing loan, commercial vehicle loan & loan against property) grew exponentially, albeit on a lower base. Net interest margin or NIM expanded 102bps YoY to 16.7%. The expansion in NIM can be largely attributed to lower easing in the cost of funds to 9.7% from 10.2% a year ago. Lending yields are largely maintained at 24.3%. Operating expenses grew 29% as higher expenses were incurred to beef up security at branches. As a result, cost-to-AUM ratio deteriorated 140bps to 8.7%. The management expects the cost-to-AUM ratio to ease to 5.0% over the medium term. Operating profit grew 18% YoY, which was 5% above our estimate. Credit costs (annualised) increased to 240bps versus 50bps YoY because of accelerated provisioning in MFI segment.

For FY17/FY18, we have increased our GNPA estimates by 30bps/40bps to 2.5%/2.6%, respectively. We have cut our ABV estimate by 1% for FY19E. We have retained Buy rating on MFL with a target price of Rs120, valuing the stock at 2.5x P/ABV of FY19E financials.

Valuation and outlook: With the worst-case scenario behind, regulatory environment turning favourable and stable gold prices, MFL is targeting healthy growth going forward. However, increase in loan delinquency post demonetisation needs to be managed well. MFL's de-risking strategy has helped it to keep credit costs at a low level. Diversification into other segments will enable faster utilisation of excess capital on its balance sheet and avoid any undesirable treatment from the regulator for being a single-product company. Tier I capital of 22% ensures unhindered growth and there is no need to raise capital for the next two years. MFL has the potential to deliver RoA of ~4% and RoE of ~20% on a consistent basis, in our opinion.

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BUY

Sector: NBFC

CMP: Rs95

Target Price: Rs120

Upside: 26%

Hatim Broachwala, CFA

Research Analyst

hatim.broachwala@nirmalbang.com

+91-22-3926 8068

Key Data

Current Shares O/S (mn)	841.9
Mkt Cap (Rsbn/US\$bn)	78.6/1.2
52 Wk H / L (Rs)	110/58
Daily Vol. (3M NSE Avg.)	5,276,284

Price Performance (%)

	1 M	6 M	1 Yr
Manappuram Finance	(4.1)	(5.7)	10.0
Nifty Index	0.3	11.7	14.3

Source: Bloomberg

Y/E March (Rsmn)	1QFY18	1QFY17	4QFY17	YoY (%)	QoQ (%)
Interest income	8,300	7,433	8,959	11.7	(7.4)
Interest expenses	2,587	2,649	2,904	(2.3)	(10.9)
Net interest income	5,713	4,784	6,055	19.4	(5.6)
NIM (%)	16.7	15.7	17.1	102bps	(31bps)
Fee & other income	271	74	96	266.1	182.2
Operating income	5,984	4,858	6,151	23.2	(2.7)
Staff costs	1,409	1,206	1,254	16.8	12.4
Other operating expenses	1,429	989	1,430	44.5	(0.1)
Total operating expenses	2,838	2,195	2,684	29.3	5.7
Cost-to-income (%)	47.4	45.2	43.6	224bps	379bps
Cost-to-AUM (%)	8.7	7.3	7.5	140bps	120bps
Operating profit	3,146	2,663	3,467	18.1	(9.3)
Provisions	807	159	406	407.5	98.8
Credit costs (%)	2.4	0.5	1.1	184bps	122bps
PBT	2,339	2,504	3,061	(6.6)	(23.6)
Tax	787	901	1,055	(12.6)	(25.4)
-Effective tax rate	33.7	36.0	34.5	(233bps)	(81bps)
PAT	1,552	1,603	2,006	(3.2)	(22.6)
EPS (Rs)	1.8	1.9	2.4	(5.5)	(23.7)
BV (Rs)	41.2	34.7	39.9	18.7	3.1
AUM (Rsmn)	1,33,798	1,30,139	1,36,571	2.8	(2.0)

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 1: Financial summary

Y/E March (Rsmn)	FY15	FY16	FY17	FY18E	FY19E
Net interest income	10,908	14,016	22,076	24,293	27,745
Pre-provision profit	4,419	5,907	12,750	12,773	13,073
PAT	2,715	3,552	7,585	7,316	7,672
EPS (Rs)	3.2	4.2	9.0	8.7	9.1
ABV (Rs)	30.2	31.9	37.3	42.6	48.2
P/E (x)	29.4	22.5	10.5	10.9	10.4
P/ABV (x)	3.1	3.0	2.5	2.2	2.0
Gross NPAs (%)	1.1	0.9	2.3	2.5	2.6
Net NPAs (%)	0.9	0.7	1.6	1.5	1.4
RoA (%)	2.4	2.9	5.4	4.3	3.7
RoE (%)	10.6	13.2	24.8	20.4	18.8

Source: Company, Nirmal Bang Institutional Equities Research

Conference-call highlights

- Consolidated AUM was up 2.8% YoY, while gold holdings declined 2.8% QoQ to 59.4tn.
- Auctions stood at Rs5,710mn or 2.6tn.
- Online business accounted for 12.4% of the total business versus 11.9% in the previous quarter.
- MFI business:
 - AUM stood at Rs18bn, up 1.7% QoQ and 47% YoY.
 - Loan disbursements were muted.
 - Loss stood at Rs322mn.
 - There was an increase in provisioning to Rs720mn on account of providing fully against loans overdue on 120DPD and providing 50% against loans overdue on 90DPD.
 - The company did not avail the Reserve Bank of India or RBI dispensation and as such provisioning is up.
 - 87% of loan disbursements were cashless.
 - As of 1QFY18-end, there were 1.27mn customers, 771 branches and 4,119 employees.
 - CAR stood at 17.5%.
 - There was interest reversal of Rs60mn.
 - PAR60 is at 7.6% and PAR30 at 9.2%.
- Home loan business:
 - AUM stood at Rs3,198mn with 35 branches in 6 states.
 - 20% of new business came from housing segment.
 - GNPA stood at ~3%.
- Underlying demand continues to be weak in the aftermath of demonetisation, leading to muted growth.
- Higher auctions also pulled down the gold loan business.
- Average cost of borrowing was down 30bps QoQ to 9.4% while incremental cost of borrowing stood at 8.3%. A rating upgrade during the quarter should lead to even lower costs.
- Security charges were higher on account of reinstating all security personnel. Large branches were also allotted night guards leading to higher costs. Armed guards deployed at some branches also pushed up costs.
- The management gave 10-20% growth guidance in respect of gold loan business for the year.
- Other income was slightly higher on account of one-time input credit availed because of implementation of GST.

- Provision reversal of 10%-15% is likely in the next quarter.
- Loan disbursement of Rs0.1mn or more constituted ~60% of total loans.

Exhibit 2: Actual performance versus our estimates

(Rsmn)	1QFY18	1QFY17	4QFY17	YoY (%)	QoQ (%)	1QFY18E	Devi. (%)
Net interest income	5,713	4,784	6,055	19.4	(5.6)	5,585	2.3
Pre-provision profit	3,146	2,663	3,467	18.1	(9.3)	2,983	5.5
PAT	1,552	1,603	2,006	(3.2)	(22.6)	1,825	(15.0)

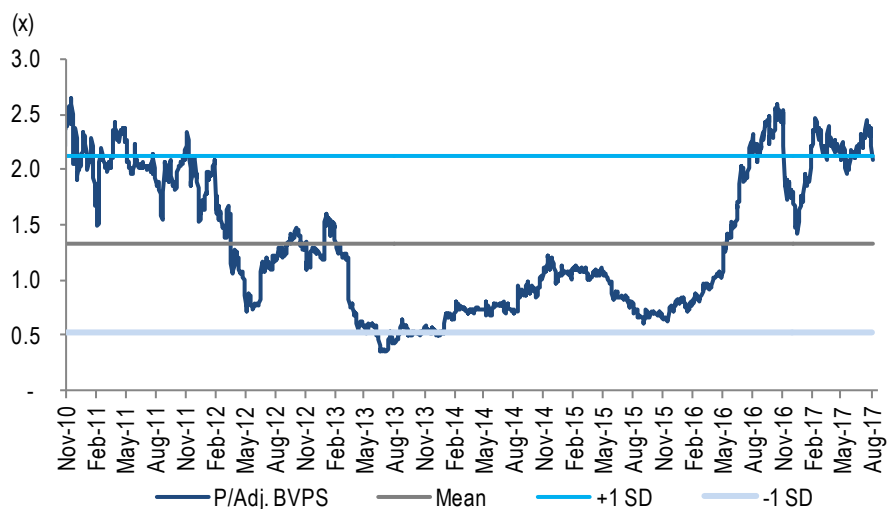
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Change in our estimates

	Revised estimate		Earlier estimate		% Revision	
	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Net interest income (Rsmn)	24,293	27,745	24,143	27,638	0.6	0.4
Net interest margin (%)	15.9	14.9	15.8	14.9	10bps	6bps
Operating profit (Rsmn)	12,773	13,073	12,659	13,165	0.9	(0.7)
Profit after tax (Rsmn)	7,316	7,672	7,724	8,104	(5.3)	(5.3)
EPS (Rs)	8.7	9.1	9.2	9.6	(5.3)	(5.3)
ABV (Rs)	42.6	48.2	42.8	48.6	(0.5)	(0.7)

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: One-year forward P/ABV



Source: Company, Nirmal Bang Institutional Equities Research

Financials

Exhibit 5: Income statement

Y/E March (Rsmn)	FY15	FY16	FY17	FY18E	FY19E
Interest income	19,682	23,490	33,762	36,121	42,320
Interest expenses	8,774	9,474	11,686	11,828	14,575
Net interest income	10,908	14,016	22,076	24,293	27,745
Non-interest income	252	249	342	583	513
Net revenues	11,160	14,265	22,418	24,876	28,258
Operating expenses	6,741	8,358	9,668	12,103	15,185
-Employee expenses	3,145	4,327	5,029	6,304	8,516
-Other expenses	3,596	4,031	4,639	5,799	6,669
Operating profit	4,419	5,907	12,750	12,773	13,073
Provisions	282	423	1,092	1,517	1,270
PBT	4,137	5,484	11,658	11,256	11,803
Tax	1,422	1,932	4,073	3,940	4,131
PAT	2,715	3,552	7,585	7,316	7,672

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Balance sheet

Y/E March (Rsmn)	FY15	FY16	FY17	FY18E	FY19E
Share capital	19,682	23,490	33,762	36,121	42,320
Reserves & surplus	8,774	9,474	11,686	11,828	14,575
Net worth	10,908	14,016	22,076	24,293	27,745
Borrowings	252	249	342	583	513
Other liability & provisions	11,160	14,265	22,418	24,876	28,258
Total liabilities	6,741	8,358	9,668	12,103	15,185
Fixed assets	3,145	4,327	5,029	6,304	8,516
Investments	3,596	4,031	4,639	5,799	6,669
Loans	4,419	5,907	12,750	12,773	13,073
Cash	282	423	1,092	1,517	1,270
Other assets	4,137	5,484	11,658	11,256	11,803
Total assets	1,422	1,932	4,073	3,940	4,131

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Key ratios

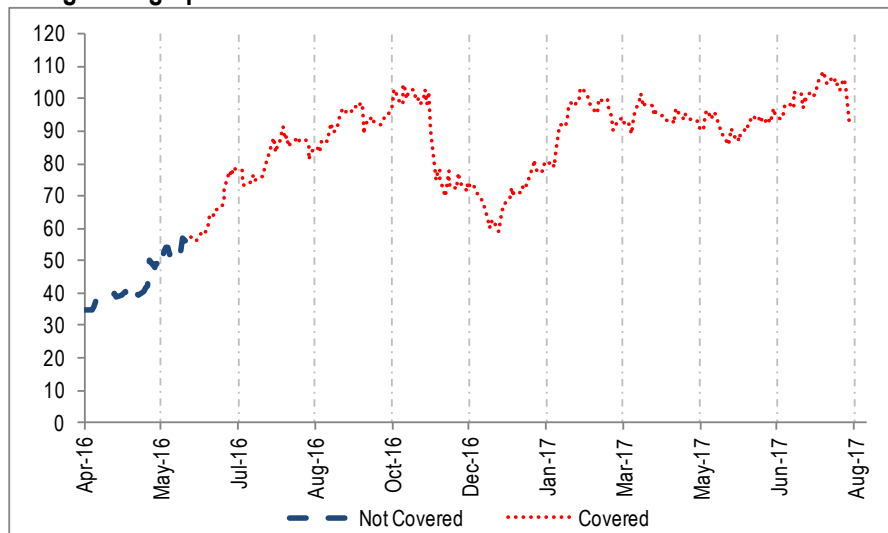
Y/E March (Rsmn)	FY15	FY16	FY17	FY18E	FY19E
Growth (%)					
Net interest income	4.0	28.5	57.5	10.0	14.2
Operating profit	13.3	33.7	115.8	0.2	2.4
Profit after tax	20.1	30.8	113.5	-3.5	4.9
Business (%)					
Advances growth	16.7	18.3	21.7	20.2	23.2
Spreads (%)					
Yield on loans	22.0	22.4	26.8	23.7	22.8
Cost of borrowings	10.7	10.4	11.3	9.6	9.5
Spread	11.4	12.0	15.4	14.1	13.3
NIM	12.2	13.3	17.5	15.9	14.9
Operational efficiency (%)					
Cost to income	60.4	58.6	43.1	48.7	53.7
Cost to assets	7.5	8.0	7.7	7.9	8.2
Productivity (Rsmn)					
AUM per branch	27.9	31.1	33.9	38.4	42.3
AUM per employee	5.9	6.1	6.3	6.7	7.1
Employee per branch	4.7	5.1	5.4	5.7	6.0
CRAR (%)					
Tier I	25.1	23.5	24.6	23.3	21.5
Tier II	0.6	0.5	0.6	0.6	0.6
Total	25.6	24.0	25.2	23.9	22.1
Asset quality (%)					
Gross NPAs	1.1	0.9	2.3	2.5	2.6
Net NPAs	0.9	0.7	1.6	1.5	1.4
Provision coverage	17.0	22.7	30.1	42.6	46.1
Credit costs (excluding std. assets)	0.3	0.2	0.8	0.9	0.6
Credit costs (including std. assets)	0.3	0.4	0.9	1.0	0.7
Return ratios (%)					
RoE	10.6	13.2	24.8	20.4	18.8
RoA	2.4	2.9	5.4	4.3	3.7
Per share (%)					
EPS	3.2	4.2	9.0	8.7	9.1
BV	31.3	32.8	39.9	45.5	51.7
ABV	30.2	31.9	37.3	42.6	48.2
Valuation (x)					
P/E	29.4	22.5	10.5	10.9	10.4
P/BV	3.0	2.9	2.4	2.1	1.8
P/ABV	3.1	3.0	2.5	2.2	2.0

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
9 June 2016	Buy	58	85
10 August 2016	Buy	87	130
11 November 2016	Buy	100	145
9 February 2017	Buy	93	140
14 February 2017	Buy	98	140
26 May 2017	Buy	89	120
11 August 2017	Buy	95	120

Rating track graph



Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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Team Details:			
Name		Email Id	Direct Line
Rahul Arora	CEO	rahul.arora@nirmalbang.com	-
Girish Pai	Head of Research	girish.pai@nirmalbang.com	+91 22 3926 8017 / 18
Dealing			
Ravi Jagtiani	Dealing Desk	ravi.jagtiani@nirmalbang.com	+91 22 3926 8230, +91 22 6636 8833
Pradeep Kasat	Dealing Desk	pradeep.kasat@nirmalbang.com	+91 22 3926 8100/8101, +91 22 6636 8831
Michael Pillai	Dealing Desk	michael.pillai@nirmalbang.com	+91 22 3926 8102/8103, +91 22 6636 8830
Atul Vitha	Dealing Desk	atul.vitha@nirmalbang.com	022-3926 8071 / 022 -3926 8226

Nirmal Bang Equities Pvt. Ltd.

Correspondence Address

B-2, 301/302, Marathon Innova,
 Nr. Peninsula Corporate Park,
 Lower Parel (W), Mumbai-400013.

Board No. : 91 22 3926 8000/1; Fax. : 022 3926 8010