

# Manappuram Finance

9 February 2017

Reuters: MNFL.BO; Bloomberg: MGFL IN

## Profitability Beats Expectations Amid Some Spike In Loan Delinquency

Strong Profit & Loss numbers with net interest income or NII growth of 53% (10% above our estimate) and PAT growth of 102% (15% above our estimate) in 3QFY17 of Manappuram Finance or MFL is impressive, but at the same time gross non-performing assets or GNPA's increased by 140bps sequentially to 2.3% as auctions were delayed on account of volatility in gold prices and shortage of liquidity. The management expects GNPA's to normalise over the next quarter as it auctions the delinquent loan portfolio. MFL has not used the Reserve Bank of India or RBI dispensation on non-performing assets and voluntarily shifted to 90-day asset quality recognition during the earlier quarters.

Assets under management or AUM rose 38% YoY (slightly above our estimate of 35%) and 0.5% QoQ. A major portion of the growth was driven by the gold loan segment which grew 27% YoY and still accounted for 84% of overall loan book. Gold holdings grew 15%, whereas per gram they rose 13%. The number of customers grew 3% QoQ, but gold holdings fell 1% QoQ as old customers had taken lower disbursement. LTV was flattish at 71%. Microfinance institution or MFI segment (Asirvad Microfinance) grew 136% YoY and accounted for 11% of overall loan book. Other segments (housing loan, commercial vehicle loan and loan against property) grew exponentially on a lower base. The management has targeted the non-gold segments to account for 25% of AUM by FY18 and touch 50% eventually.

Net interest margin or NIM expanded 140bps YoY and 10bps QoQ to 15.9%. The expansion in NIM can be largely attributed to higher net yield of 24.6% against 23.8% in 3QFY16 and 24.5% in 2QFY17. Cost of funds eased to 9.9% from 10.6% in 3QFY16 and 10.1% in 2QFY17. Operating expenses grew only 9%, which led the cost-to-AUM ratio to improve 200bps YoY to 6.4% as growth in gold loan business was achieved without the need to expand branches. The management expects the cost-to-AUM ratio to ease to 5.0% over the medium term. Operating profit grew 109%, which was 22% above our estimate. Credit costs (annualised) increased to 97bps as against 51bps in the previous quarter.

We have conservatively increased our GNPA estimates by 60bps/40bps for FY17/FY18 to 1.7%/1.6%, respectively. We have cut our ABV estimates by 3% each for FY17/FY18. We have retained Buy rating on MFL with a target price of Rs140 (from 145 earlier), valuing the stock at 3.0x P/ABV September 2018E financials.

**Valuation and outlook:** With the worst-case scenario behind, regulatory environment turning favourable and gold prices stable, MFL is targeting healthy growth going forward. Increase in loan delinquency post demonetisation needs to be managed well. MFL's de-risking strategy has helped it in keeping 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 along with no need to raise capital for the next two years. MFL has potential to deliver RoA ~4% on a consistent basis.

## BUY

Sector: NBFC

CMP: Rs93

Target Price: Rs140

Upside: 51%

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### Key Data

Current Shares O/S (mn)	841.6
Mkt Cap (Rsbn/US\$bn)	78.4/1.2
52 Wk H / L (Rs)	107/26
Daily Vol. (3M NSE Avg.)	5,498,338

### Price Performance (%)

	1 M	6 M	1 Yr
Manappuram Finance	29.9	2.0	219.9
Nifty Index	6.4	0.7	18.7

Source: Bloomberg

Y/E March (Rsmn)	3QFY17	3QFY16	2QFY17	YoY (%)	QoQ (%)
Interest income	8,977	6,130	8,393	46.4	7.0
Interest expenses	3,174	2,345	2,959	35.4	7.3
<b>Net interest income</b>	<b>5,803</b>	<b>3,785</b>	<b>5,434</b>	<b>53.3</b>	<b>6.8</b>
<b>NIM (%)</b>	<b>15.9</b>	<b>14.5</b>	<b>15.8</b>	<b>140bps</b>	<b>10bps</b>
Fee & other income	75	77	97	(2.6)	(22.7)
<b>Operating income</b>	<b>5,878</b>	<b>3,862</b>	<b>5,531</b>	<b>52.2</b>	<b>6.3</b>
Staff costs	1,252	1,138	1,317	10.0	(4.9)
Other operating expenses	1,133	1,053	1,087	7.6	4.2
Total operating expenses	2,385	2,191	2,404	8.9	(0.8)
Cost-to-income (%)	40.6	56.7	43.5	(1,616 bps)	(289bps)
Cost-to-AUM (%)	6.4	8.4	6.9	(200bps)	(50bps)
<b>Operating profit</b>	<b>3,493</b>	<b>1,671</b>	<b>3,127</b>	<b>109.0</b>	<b>11.7</b>
Provisions	352	97	175	262.9	101.1
<b>Credit costs (%)</b>	<b>1.0</b>	<b>0.4</b>	<b>0.5</b>	<b>60bps</b>	<b>46bps</b>
<b>PBT</b>	<b>3,141</b>	<b>1,574</b>	<b>2,952</b>	<b>99.6</b>	<b>6.4</b>
Tax	1,116	571	1,028	95.4	8.6
-Effective tax rate	35.5	36.3	34.8	(75bps)	71bps
<b>PAT</b>	<b>2,025</b>	<b>1,003</b>	<b>1,924</b>	<b>101.9</b>	<b>5.2</b>
<b>EPS (Rs)</b>	<b>2.4</b>	<b>1.2</b>	<b>2.3</b>	<b>101.5</b>	<b>5.2</b>
<b>BV (Rs)</b>	<b>38.2</b>	<b>32.3</b>	<b>36.4</b>	<b>18.0</b>	<b>4.9</b>
<b>AUM (Rsmn)</b>	<b>145,544</b>	<b>105,790</b>	<b>144,861</b>	<b>37.6</b>	<b>0.5</b>

Source: Company, Nirmal Bang Institutional Equities Research

## Exhibit 1: Financial summary

Y/E March (Rsmn)	FY14	FY15	FY16	FY17E	FY18E
Net interest income	10,908	14,016	21,508	24,705	28,865
Pre-provision profit	4,419	5,907	12,188	13,259	14,700
PAT	2,715	3,552	7,305	7,834	8,860
EPS (Rs)	3.2	4.2	8.7	9.3	10.5
ABV (Rs)	30.2	31.9	36.5	42.9	49.8
P/E (x)	28.8	22.0	10.7	10.0	8.8
P/ABV (x)	3.1	2.9	2.5	2.2	1.9
Gross NPAs (%)	1.1	0.9	1.7	1.6	1.7
Net NPAs (%)	0.9	0.7	1.4	1.2	1.2
RoA (%)	2.4	2.9	4.9	4.1	3.7
RoE (%)	10.6	13.2	24.2	22.0	21.3

Source: Company, Nirmal Bang Institutional Equities Research

## Conference-call highlights

- Gold holdings stood at 65.1tn against 65.9tn in the previous quarter.
- Total customers at year-end were 2.25mn, with 70,000 customers added in the previous quarter, which indicates the underlying demand for gold loan is high.
- Non-cash disbursement, as a proportion to total disbursement, rose to 65% in November 2016 versus 53% in October 2016.
- Currently, 9.7% of gold loan book is in online form as against 6% in the previous quarter.
- Ashirvad MFI AUM was Rs16.5bn, up 5% QoQ and 136% YoY. PAT was Rs139mn, which is an increase of 135% YoY. It currently has 1.08 mn customers, 697 branches and RoA of 3.5%.
- Despite demonetisation, MFI has collected 98% dues of November 2016 and 92% dues of December 2016.
- MFI collections were lower in WestUttar Pradesh, Maharashtra and Karnataka.
- Home loan book is up 23.3% QoQ (Rs2.63bn) and operates in 35 locations.
- Commercial vehicle loans amount to Rs2.53bn and the company operates in 46 locations.
- Average cost of borrowing is 9.9%, while incremental cost of borrowing is 8.7%.
- Currently has 3,293 branches and 21,039 employees (3.1% increase QoQ).
- While employee costs are down, administrative costs increased slightly.
- GNPA's are at 2.3% against 0.9% in the previous quarter as auctions were delayed on account of volatility in gold prices and shortage of liquidity. These effects are likely to be reversed in 4QFY17. Gold auctions for the quarter stood at Rs810mn (416kg).
- RBI dispensation was not availed during 3QFY17.
- Recognition of NPAs was 90 days versus the RBI requirement of 120 days.
- Demonetisation raised two separate issues-firstly on repayment and secondly on disbursement. Small-ticket size loans in cash could not be disbursed to those who did not have a bank account.
- MFL has taken many steps to shift customers to the digital platform. The benefit to customers is in the form of services they can avail rather than monetary gains. Customers are now able to avail loans from any branch, irrespective of the branch where their gold is pledged.
- Average LTV stood at ~71%.
- Overall disbursement was down 25% to Rs126bn because of existing customers not coming back for more loans
- Provided 40bps for standard assets, loss/theft at 9bps.

- Provisions were high because of pending auctions following the volatility in prices and liquidity problems. However, these auctions have been consciously deferred and will take place in 4QFY17. Hence, the provisions will be reversed.
- Ashirvad MFI had no NPAs, and collection efficiency stood at 98% in November 2016 and 92% in December 2016.
- The management emphasised that lending to customers in the gold loan segment is against the cash flow and not against collateral. Average security size of gold is 15gm and most customers are small and micro entrepreneurs.
- 90% of all disbursements were rollovers by existing customers and 10% by new customers. In case the gold price had changed, the customer is required to pay the outstanding interest and the difference in LTV before any new disbursement is made.
- Management expects the growth rate to normalise to pre-demonetisation level from the next quarter.
- Despite interest reversal on NPAs, net yield was strong because of the rise in gross yield.
- Only 13% of customers with average loan ticket size of over Rs1,00,000 are outstanding.
- Accrued interest was ~3.4% of the loan book (Rs4.14bn).

## Exhibit 2: Actual performance versus our estimates

(Rsmn)	3QFY17	3QFY16	2QFY17	YoY (%)	QoQ (%)	3QFY17E	Devi. (%)
Net interest income	5,803	3,785	5,434	53.3	6.8	5,284	9.8
Pre-provision profit	3,493	1,671	3,127	109.0	11.7	2,869	21.7
PAT	2,025	1,003	1,924	101.9	5.2	1,756	15.3

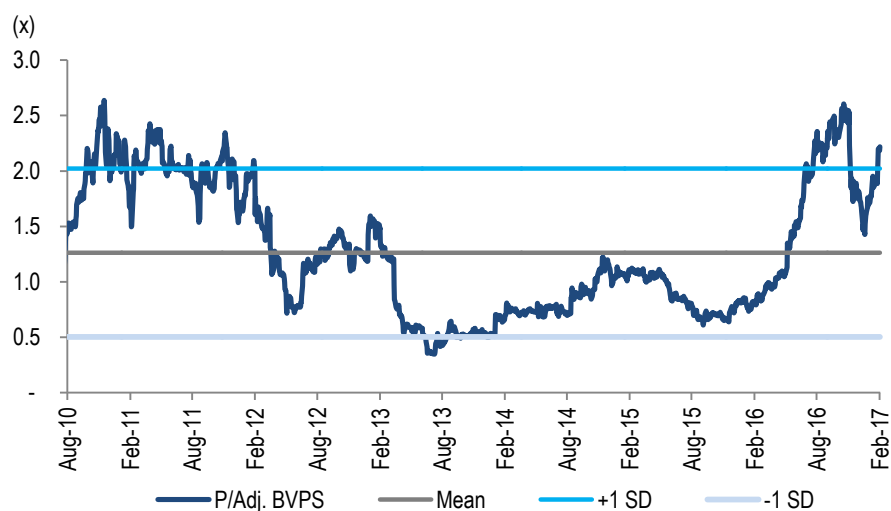
Source: Company, Nirmal Bang Institutional Equities Research

## Exhibit 3: Change in our estimates

	Revised estimate		Earlier estimate		% Revision	
	FY17E	FY18E	FY17E	FY18E	FY17E	FY18E
Net interest income (Rsmn)	21,508	24,705	20,913	24,526	2.8	0.7
Net interest margin (%)	16.2	14.5	15.6	14.1	56bps	33bps
Operating profit (Rsmn)	12,188	13,259	11,448	12,993	6.5	2.0
Profit after tax (Rsmn)	7,305	7,834	7,022	7,774	4.0	0.8
EPS (Rs)	8.7	9.3	8.3	9.2	4.0	0.8
ABV (Rs)	36.5	42.9	37.5	44.2	(2.7)	(3.1)

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	FY17E	FY18E	FY19E
Interest income	19,682	23,490	33,530	40,027	47,626
Interest expenses	8,774	9,474	12,021	15,322	18,761
<b>Net interest income</b>	<b>10,908</b>	<b>14,016</b>	<b>21,508</b>	<b>24,705</b>	<b>28,865</b>
Non-interest income	252	249	334	417	512
<b>Net revenue</b>	<b>11,160</b>	<b>14,265</b>	<b>21,842</b>	<b>25,123</b>	<b>29,377</b>
Operating expenses	6,741	8,358	9,654	11,863	14,676
-Employee expenses	3,145	4,327	5,180	6,628	8,551
-Other expenses	3,596	4,031	4,474	5,235	6,125
<b>Operating profit</b>	<b>4,419</b>	<b>5,907</b>	<b>12,188</b>	<b>13,259</b>	<b>14,700</b>
Provisions	282	423	949	1,207	1,070
PBT	4,137	5,484	11,239	12,052	13,630
Tax	1,422	1,932	3,934	4,218	4,771
<b>PAT</b>	<b>2,715</b>	<b>3,552</b>	<b>7,305</b>	<b>7,834</b>	<b>8,860</b>

Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 7: Balance sheet**

Y/E March (Rsmn)	FY15	FY16	FY17E	FY18E	FY19E
Share capital	1,682	1,682	1,682	1,682	1,682
Reserves & surplus	24,646	25,898	31,140	36,695	43,067
<b>Networth</b>	<b>26,328</b>	<b>27,580</b>	<b>32,822</b>	<b>38,377</b>	<b>44,749</b>
Borrowings	86,320	96,379	132,598	167,829	207,390
Other liability & provisions	3,515	4,432	5,330	6,234	7,757
<b>Total liabilities</b>	<b>116,163</b>	<b>128,391</b>	<b>171,001</b>	<b>212,743</b>	<b>260,259</b>
Fixed assets	1,737	1,948	2,143	2,464	2,834
Investments	2,169	490	490	490	490
Loans	96,221	113,853	151,858	189,599	232,565
Cash	7,926	6,045	9,112	11,376	13,954
Other assets	8,110	6,055	7,398	8,815	10,416
<b>Total assets</b>	<b>116,163</b>	<b>128,391</b>	<b>171,001</b>	<b>212,743</b>	<b>260,259</b>

Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 6: Key ratios**

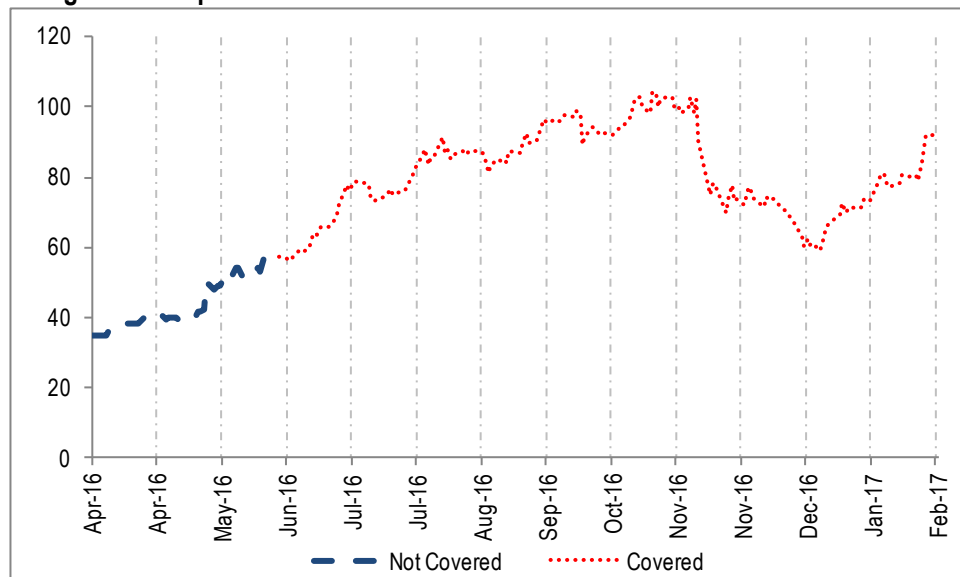
Y/E March (Rsmn)	FY15	FY16	FY17E	FY18E	FY19E
<b>Growth (%)</b>					
Net interest income	4.0	28.5	53.5	14.9	16.8
Operating profit	13.3	33.7	106.3	8.8	10.9
Profit after tax	20.1	30.8	105.7	7.2	13.1
<b>Business (%)</b>					
Advances growth	16.7	18.3	33.4	24.9	22.7
<b>Spreads (%)</b>					
Yield on loans	22.0	22.4	25.2	23.4	22.6
Cost of borrowings	10.7	10.4	10.5	10.2	10.0
Spread	11.4	12.0	14.7	13.2	12.6
NIM	12.2	13.3	16.2	14.5	13.7
<b>Operational efficiency (%)</b>					
Cost to income	60.4	58.6	44.2	47.2	50.0
Cost to assets	7.5	8.0	7.3	6.9	7.0
<b>Productivity (Rsmn)</b>					
AUM per branch	27.9	31.1	37.3	42.7	46.7
AUM per employee	5.9	6.1	7.0	7.9	8.6
Employee per branch	4.7	5.1	5.3	5.4	5.4
<b>CRAR (%)</b>					
Tier I	25.1	23.5	21.9	20.5	19.5
Tier II	0.6	0.5	0.6	0.6	0.6
Total	25.6	24.0	22.5	21.2	20.2
<b>Asset quality (%)</b>					
Gross NPAs	1.1	0.9	1.7	1.6	1.7
Net NPAs	0.9	0.7	1.4	1.2	1.2
Provision coverage	17.0	22.7	15.1	24.8	29.1
Credit cost (excluding std asset)	0.3	0.2	0.6	0.6	0.4
Credit cost (including std asset)	0.3	0.4	0.7	0.7	0.5
<b>Return ratios (%)</b>					
RoE	10.6	13.2	24.2	22.0	21.3
RoA	2.4	2.9	4.9	4.1	3.7
<b>Per share (%)</b>					
EPS	3.2	4.2	8.7	9.3	10.5
BV	31.3	32.8	39.0	45.6	53.2
ABV	30.2	31.9	36.5	42.9	49.8
<b>Valuation (x)</b>					
P/E	28.8	22.0	10.7	10.0	8.8
P/BV	3.0	2.8	2.4	2.0	1.7
P/ABV	3.1	2.9	2.5	2.2	1.9

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

## Rating Track Graph



## Disclaimer

### Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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