

# Manappuram Finance

10 August 2018

Reuters: MNFL.BO; Bloomberg: MGFL IN

## Gold Lending Saturation Theory Debunked

Manappuram Finance (MFL) reported its 1QFY19 results with the key strategic pointers being: (1) Gold loan AUM growth was 6.2% QoQ, which was the third straight quarter of robust QoQ growth (2) MFI AUM growth looked optically muted QoQ due to seasonality but year-end AUM target of Rs35bn remains intact. (3) Entry into used car segment and earlier acquisition of education lender underline MFL's diversification DNA, which is positive for scalability. (See [comprehensive conference call takeaways below](#); see [initiating coverage report here](#)). Per se, on the results front, MFL posted NII growth of 11.9% YoY and 3.2% QoQ at Rs6,415mn, PPOP growth of 4.8% YoY and 1.8% QoQ at Rs3,248mn and PAT growth of 18.7% YoY and 8.8% QoQ at Rs1,982mn. We have revised our estimates for FY19/FY20 and retained Buy rating on MFL, revising our target price to Rs142 (from Rs133 earlier), valuing the stock at 2.3x FY20E P/BV.

**Sustained gold loan AUM growth over last 3 quarters debunks concerns regarding generic saturation:** Gold loan AUM growth was 6.2% QoQ in 1QFY19 following 5.3%/3.6% growth QoQ in 3QFY18/4QFY18. Thus, absolute growth in 3 quarters was 15.8%, which is fairly attractive for loans against gold, given it is a business of high sustainable margin and low credit costs and, thus of high steady state RoA. Management stated LGD for the business is just 63 bps. Macro conditions for gold lending should support this financial year, given (1) a third consecutive normal/near-normal monsoon has been forecast and (2) the central government should augment rural spending going into election year aiding the rural economy to which gold lending is linked.

**MFI business' muted sequential growth is seasonal in nature:** Management clarified that flat MFI AUM QoQ is seasonal in nature after a strong fourth quarter. They stated that the year-end target of Rs35bn AUM remains intact for this business. Asirvad continues to diversify away from Tamil Nadu and share of the state would fall to ~25% by year-end. Funding opportunities for Asirvad are improved after the transition of several key NBFC-MFIs to banking structures and now, banks have a smaller pool of NBFC-MFIs to pursue to meet PSL requirements.

**Entry into used car segment and earlier acquisition of education lender underline MFL's diversification DNA:** Entry into used car segment is another logical addition to MFL's product portfolio given rural reach and customer set. Acquisition of education lender, ISFC, is also a positive step given that it (a) is a fast-growing business with its ~Rs6.5bn book slated to growth to ~Rs10bn by FY19 (b) high tight risk management approach and (c) is expected to deliver RoA of ~3-4%. Share of non-gold AUM is expected to rise to ~28% by year-end from 25% currently. We believe a wide product suite is positive for scalability, especially given MFL's large network and wide brand recall.

**Valuation and outlook:** We have revised our NII estimates by 0.7%/1.8%, PPOP estimates by 1.3%/3.7% and PAT estimates by 1.3%/3.9% for FY19/FY20, respectively. We have retained Buy rating on MFL, valuing the stock at 2.3x FY20E P/BV and revising our target price to Rs142 (from Rs133 earlier).

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**BUY**
**Sector:** NBFC

**CMP:** Rs113

**Target Price:** Rs142

**Upside:** 26%

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### Key Data

Current Shares O/S (mn)	842.5
Mkt Cap (Rsbn/US\$bn)	95.1/1.4
52 Wk H / L (Rs)	130/82
Daily Vol. (3M NSE Avg.)	3,826,635

### Price Performance (%)

	1 M	6 M	1 Yr
Manappuram Finance	9.4	8.1	14.3
Nifty Index	5.7	9.7	15.8

Source: Bloomberg

Y/E March (Rsmn)	1QFY19	1QFY18	4QFY18	YoY (%)	QoQ (%)
Interest income	9,358	8,314	8,898	12.6	5.2
Interest expenses	2,943	2,580	2,681	14.1	9.8
<b>Net interest income</b>	<b>6,415</b>	<b>5,734</b>	<b>6,217</b>	11.9	3.2
<b>Calculated NIM (%)</b>	<b>15.9</b>	<b>16.8</b>	<b>16.5</b>	(86bps)	(54bps)
Fee & other income	114	249	114	(54.4)	(0.4)
<b>Operating income</b>	<b>6,529</b>	<b>5,983</b>	<b>6,331</b>	9.1	3.1
Staff costs	1,698	1,447	1,623	17.4	4.6
Other operating expenses	1,582	1,437	1,516	10.1	4.3
Total operating expenses	3,280	2,884	3,139	13.7	4.5
Cost-to-income (%)	50.2	48.2	49.6	204bps	66bps
Cost-to-AUM (%)	8.4	8.7	8.6	(30bps)	(20bps)
<b>Operating profit</b>	<b>3,248</b>	<b>3,099</b>	<b>3,192</b>	4.8	1.8
Provisions	155	550	432	(71.9)	(64.2)
Credit costs (%)	0.4	1.6	1.1	(123bps)	(76bps)
<b>PBT</b>	<b>3,094</b>	<b>2,549</b>	<b>2,759</b>	21.4	12.1
Tax/ Minority Interest	1,112	879	938	26.4	18.6
-Effective tax rate	35.9	34.5	34.0	143bps	195bps
<b>Adjusted PAT</b>	<b>1,982</b>	<b>1,670</b>	<b>1,822</b>	18.7	8.8
Other comprehensive income	6	5	-	21.7	NA
<b>Total Comprehensive Income</b>	<b>1,988</b>	<b>1,674</b>	<b>1,822</b>	18.7	9.1
<b>EPS (Rs)</b>	<b>2.4</b>	<b>2.0</b>	<b>2.2</b>	20.8	9.2
<b>AUM (Rsmn)</b>	<b>1,66,179</b>	<b>1,33,798</b>	<b>1,57,648</b>	24.2	5.4

NB: 1QFY19 and 1QFY18 figures are as per Ind AS Source: Company, Nirmal Bang Institutional Equities Research

Please refer to the disclaimer towards the end of the document.

## Comprehensive Conference Call Takeaways

- Management pointed out that a one-off amount of Rs.1900mn was booked under other income in 1QFY18, which was absent in 1QFY19.
- On the funding side, the management is planning to undertake public issue of NCDs. The last one took place in 2014.
- The management stated that in gold loans, they can pass on the rising COF to the customers.
- MFL has acquired India School Finance Co. which caters to the education segment. The management is expecting good traction from this segment.
- Average LTV for gold loans stood at 67%.
- The management stated that MFL provided Rs.240mn in excess to RBI norms of provisioning in this quarter.
- The management stated that the flat QoQ growth of the MFI business was due to huge growth experienced in the last quarter and a subdued first quarter in this year as it happens traditionally.
- In the MFI business, 4QFY18 saw higher disbursements of Rs.9bn. In the current quarter the collections roughly equalled the disbursements amounting to Rs.6.7bn. In the month of July, MFL disbursed about Rs.3.3bn and collected Rs.2.3bn with an AUM addition of Rs.1bn. Management guided for a net AUM addition run rate of Rs.750-1000mn per month, through which they will reach their target of Rs.34-35bn AUM by year end.
- Proportion of floating rate loans is insignificant in their MFI loan portfolio. The management stated that any new loans will be disbursed with an added interest rate of 10 bps.
- MFL has increased salaries for their low level employees resulting in a 17% YoY growth in employee costs. Here on, sustained growth in employee costs will be 10%.
- For the full year of FY19 management is expecting gold loan book to grow by 15%, MFI book will grow to Rs.35bn, vehicle book will grow to Rs.12-13bn, housing book will grow to Rs.7bn and other loans will grow to Rs.7.5bn.
- The management is targeting share of non gold loans to reach 28% of the total loan book by year end.
- Standalone provisions in balance sheet stood at Rs.950mn as of this quarter end. Standard asset provisioning stood at 0.4% of total standard assets. The management stated that ECL as per Ind AS is less than RBI mandated provisions, which they have followed.
- Vehicle loans majorly comprises of CV loans. Size of 2W portfolio amounted to ~Rs.1bn. Rs.250mn comes from recently entered used car financing segment. Average ticket size is about Rs.0.7mn. Weighted average yield on the book stood at 18.5%. The management stated that they managed to maintain NPA level better than the industry and will stay at these levels.
- Gross NPA on the housing segment fell by 20 bps QoQ. The management has developed a three-pronged strategy consisting of soft bucket resolution, legal recourse and negotiated settlement. This will bring the NPA level substantially down and are expected to reach the market level by year end.
- The management stated that alternate products to gold lending won't impact them much.
- The management is expecting a double-digit growth in their gold loan book for the next 3-5 years.
- PD on gold loan book is 18% and LGD is 0.63%.
- MFL has benefitted from many MFIs turning into SFBs. It has opened up funding sources from banks as SFBs are no longer targets for bank lending.
- The management stated that they continued to grow their MFI business when other players had pulled back. Last year the industry grew by 26%-28% YoY while Asirvad grew by ~30% in FY18. The management is expecting Asirvad to grow by 40%-42% in FY19 on a YoY basis.
- Asirvad had earlier moved to 100% bank disbursement model.

- The management stated that the exposure of MFI AUM to Tamil Nadu will get reduced to 25% by year end.
- Auctions amounted to Rs.620mn in this quarter, one of the lowest for MFL.
- The management stated that the team managing the education loan segment is well equipped in terms of understanding of business. They have scoreboards and good risk management practices. They are expecting an ROA of 3%-4% for this business. Current AUM is Rs.6.5bn and is expected to reach Rs.10bn by year end.
- The management stated that they are facing supply side constraints in their housing loan segment. However, they are targeting their own customer base of 4mn. The management is expecting an AUM addition of Rs.50-100mn per month in this book for the year of FY19.

## Exhibit 1: Financial summary

Y/E March (Rsmn)	FY16	FY17	FY18	FY19E	FY20E
Net interest income	14,016	22,075	23,937	27,422	30,570
Pre-provision profit	5,907	12,749	12,224	14,288	15,933
PAT	3,552	7,584	6,813	8,527	9,244
EPS (Rs)	4.2	9.0	8.1	10.1	11.0
BV (Rs)	31.9	37.3	44.4	50.7	58.5
P/E (x)	26.7	12.5	13.9	11.1	10.3
P/BV (x)	3.5	3.0	2.5	2.2	1.9
Gross NPAs (%)	0.9	2.3	1.1	1.7	1.9
Net NPAs (%)	0.7	1.6	0.6	1.1	1.2
RoA (%)	2.9	5.4	4.2	4.5	4.0
RoE (%)	13.2	24.8	18.9	20.5	19.1

Source: Company, Nirmal Bang Institutional Equities Research

## Exhibit 2: Actual performance versus our estimates

(Rsmn)	1QFY19	1QFY18	4QFY18	YoY (%)	QoQ (%)	1QFY19E	Devi. (%)
Net interest income	6,415	5,734	6,217	12	3	6,198	4
Pre-provision profit	3,248	3,099	3,192	5	2	3,208	1
PAT	1,982	1,670	1,822	19	9	1,901	4

Source: Company, Nirmal Bang Institutional Equities Research

## Exhibit 3: Change in our estimates

	Revised estimate		Earlier estimate		% Revision	
	FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
Net interest income (Rsmn)	27,422	30,570	27,244	30,026	0.7	1.8
Net interest margin (%)	15.9	14.7	15.9	14.7	-	-
Operating profit (Rsmn)	14,288	15,933	14,102	15,363	1.3	3.7
Profit after tax (Rsmn)	8,527	9,244	8,421	8,899	1.3	3.9

Source: Company, Nirmal Bang Institutional Equities Research

## Exhibit 4: One-year forward P/BV



Source: Company, Nirmal Bang Institutional Equities Research

## Financials

### Exhibit 5: Income statement

Y/E March (Rsmn)	FY16	FY17	FY18	FY19E	FY20E
Interest income	23,490	33,762	34,231	39,835	45,477
Interest expenses	9,474	11,687	10,294	12,413	14,906
<b>Net interest income</b>	<b>14,016</b>	<b>22,075</b>	<b>23,937</b>	<b>27,422</b>	<b>30,570</b>
Non-interest income	249	326	550	753	911
<b>Net revenues</b>	<b>14,265</b>	<b>22,401</b>	<b>24,487</b>	<b>28,175</b>	<b>31,482</b>
Operating expenses	8,358	9,652	12,262	13,887	15,549
-Employee expenses	4,327	5,026	6,213	6,931	7,897
-Other expenses	4,031	4,626	6,049	6,957	7,652
<b>Operating profit</b>	<b>5,907</b>	<b>12,749</b>	<b>12,224</b>	<b>14,288</b>	<b>15,933</b>
Provisions	423	1,093	1,844	1,170	1,711
PBT	5,484	11,656	10,380	13,118	14,222
Tax	1,932	4,072	3,568	4,591	4,978
<b>PAT</b>	<b>3,552</b>	<b>7,584</b>	<b>6,813</b>	<b>8,527</b>	<b>9,244</b>

Source: Company, Nirmal Bang Institutional Equities Research

### Exhibit 7: Balance sheet

Y/E March (Rsmn)	FY16	FY17	FY18	FY19E	FY20E
Share capital	1,682	1,684	1,685	1,685	1,685
Reserves & surplus	25,898	31,934	36,678	43,216	50,358
<b>Net worth</b>	<b>27,580</b>	<b>33,618</b>	<b>38,364</b>	<b>44,901</b>	<b>52,043</b>
Borrowings	96,379	1,09,861	1,25,935	1,53,011	1,85,771
Other liability & provisions	4,432	8,042	8,024	9,407	12,144
<b>Total liabilities</b>	<b>1,28,391</b>	<b>1,51,521</b>	<b>1,72,322</b>	<b>2,07,645</b>	<b>2,50,360</b>
Fixed assets	1,948	1,869	2,746	3,158	3,631
Investments	490	50	51	51	51
Loans	1,13,853	1,38,417	1,55,805	1,88,159	2,27,869
Cash	6,045	5,227	7,107	7,526	8,659
Other assets	6,055	5,958	6,614	8,752	10,150
<b>Total assets</b>	<b>1,28,391</b>	<b>1,51,521</b>	<b>1,72,322</b>	<b>2,07,645</b>	<b>2,50,360</b>

Source: Company, Nirmal Bang Institutional Equities Research

### Exhibit 6: Key ratios

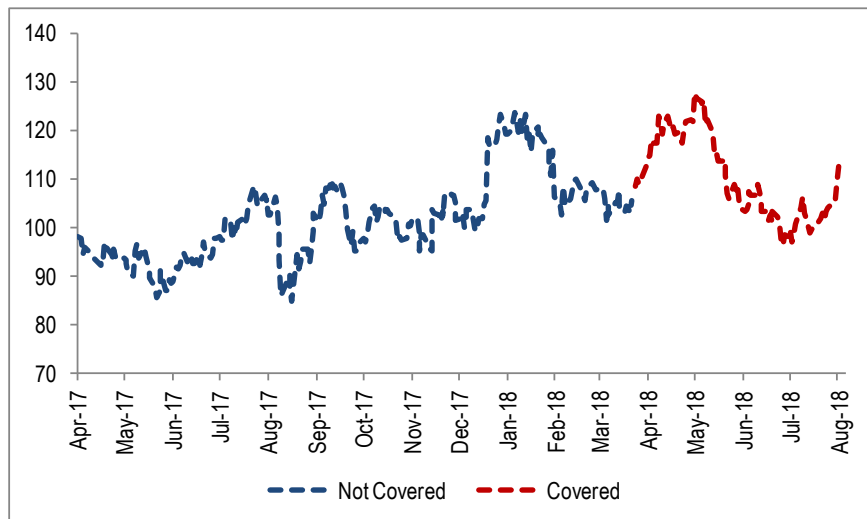
Y/E March (Rsmn)	FY16	FY17	FY18	FY19E	FY20E
<b>Growth (%)</b>					
Net interest income	28.5	57.5	8.4	14.6	11.5
Operating profit	33.7	115.8	(4.1)	16.9	11.5
Profit after tax	30.8	113.5	(10.2)	25.2	8.4
<b>Business (%)</b>					
Advances growth	18.3	21.6	12.6	20.8	21.1
<b>Spread (%)</b>					
Yield on loans	22.4	26.8	23.3	23.2	21.9
Cost of borrowings	10.4	11.3	8.7	8.9	8.8
Spread	12.0	15.4	14.5	14.3	13.1
NIM	13.3	17.5	16.3	15.9	14.7
<b>Operational efficiency (%)</b>					
Cost-to- income	58.6	43.1	50.1	49.3	49.4
Cost- to-assets	8.0	7.7	8.3	8.1	7.5
<b>Productivity (Rsmn)</b>					
AUM per branch	31.1	33.8	36.9	40.6	43.5
AUM per employee	6.1	6.3	6.5	7.6	8.1
Employee per branch	5.1	5.4	5.7	5.3	5.4
<b>CRAR (%)</b>					
Tier I	23.5	25.7	26.5	24.2	23.2
Tier II	0.5	0.4	0.5	0.6	0.6
Total	24.0	26.1	27.0	24.8	23.8
<b>Asset quality (%)</b>					
Gross NPAs	0.9	2.3	1.1	1.7	1.9
Net NPAs	0.7	1.6	0.6	1.1	1.2
Specific provision coverage	22.7	29.7	43.8	34.3	37.4
Credit costs (excluding std. assets)	0.2	0.9	1.3	0.6	0.7
Credit costs (including std. assets)	0.4	0.9	1.4	0.7	0.8
<b>Return ratios (%)</b>					
RoE	13.2	24.8	18.9	20.5	19.1
RoA	2.9	5.4	4.2	4.5	4.0
<b>Per share (%)</b>					
EPS	4.2	9.0	8.1	10.1	11.0
BV	32.8	39.9	45.5	53.3	61.8
ABV	31.9	37.3	44.4	50.7	58.5
<b>Valuation (x)</b>					
P/E	26.7	12.5	13.9	11.1	10.3
P/BV	3.4	2.8	2.5	2.1	1.8
P/ABV	3.5	3.0	2.5	2.2	1.9

Source: Company, Nirmal Bang Institutional Equities Research

## Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
26 March 2018	Buy	106	128
9 February 2018	Buy	114	133
10 August 2018	Buy	113	142

## Rating track graph



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