Manappuram Finance

15 April 2019

Reuters: MNFL.BO; Bloomberg: MGFL IN

Management Meet Update

Innovation Continues In The Background

We recently met a comprehensive top management line-up from Manappuram Finance (MFL) that included (1) V.P. Nandkumar, MD & CEO (2) Bindu A.L., CFO (3) Jeevandas Narayan, MD, Home Finance (4) K Senthil Kumar, CEO, Vehicle Finance (5) Mayank Thatte, CFO, Asirvad MFI and (6) Sushil Kumar Mishra, DGM, Treasury and gleaned incremental insight into the strategy of the company. *We share our detailed takeaways below*. We marginally revise our estimates upward for FY20/FY21 and retain Buy rating, revising upward our target price to Rs154 (from Rs141 earlier), valuing the stock at 2.0x FY21E (2.4x FY20E) P/BV. *We prefer MFL over Muthoot Finance and, currently, have an Accumulate Rating on the latter.*

On liquidity situation

- **Recent capital raises**
  - MFL has recently raised Rs 4bn via NCDs, Rs 7.75bn from NABARD and Rs 5bn from Corporation Bank.
  - IFC will also be infusing Rs 5.4bn within a month.
- The rise in cost of funds has been passed on by MFL to borrowers.
- **Risk weight regulation**
  - The risk weight for bank lending to MFL has declined from 100% to 30%, given MFL is rated in the broad AA category.
- **Cost of borrowings**
  - The commercial paper rate for MFL, which was ~9.7% a while ago, has declined to ~8%.
  - Expect cost of borrowings is expected to come down further by about 20-25 bps in 1QFY20.
  - Cost of borrowings can decline by upto 60 bps on a steady state basis.

On broad factors affecting demand for Gold-backed financing

- MFL does not see microfinance eating into gold-backed finance as a major factor.
- What was and still is a major factor is the capping of LTV for gold loan NBFCs at 75% since the unorganised lenders are able to lend at much higher LTV.
- MFL has gotten around this hit to demand by improving client servicing via technology.
  - The cost to the customer has declined due to the advent of online gold loans.
  - Also, the safety of the MFL locker is a big draw for women clients.

Operating Expenses

- MFL is targeting a cost to income ratio of ~33% on standalone basis.
- The opex to AUM which is about 8% can be brought down to 7.5% for the parent.
- There is scope to bring it down by 100 bps over a period of time.
- The security costs have been brought down by Rs 700mn on annualised basis.
- MFL is targeting a Rs 1bn cost reduction in FY20.

(The takeaways are continued from page 2 onwards).

BUY

Sector: NBFC

CMP: Rs127

Target Price: Rs154

Upside: 21%

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Key Data

Current Shares O/S (mn)	842.8
Mkt Cap (Rsbn/US$bn)	106.7/1.5
52 Wk H / L (Rs)	130/66
Daily Vol. (3M NSE Avg.)	3,935,815

Price Performance (%)

	1 M	6 M	1 Yr
Manappuram Finance	6.3	73.1	5.9
Nifty Index	2.7	10.8	11.0

Source: Bloomberg

Operating expenses (continued from page 1)

- **How exactly Security Costs were brought down through innovation**
  - There was an overhauling of the storage system for collateral. Earlier standardised safes with 2-3 shelves were used. Now, each safes has 100 separate cases.
  - This increases the time taken by a robber to execute a robbery and the time taken for robbery is of critical importance.
  - There is a central monitoring system with the help of which the police is informed quickly.
  - So, (a) time taken by robbers to execute robbery has increased and (b) time taken by police to arrive has decreased. This has reduced the requirement for human security personnel.
  - GPS tracking devices have also been introduced
    - This has helped catch robbers in UP.
    - Firstly, these robbers could not steal a significant portion of what was contained in the safe they opened.
    - Whatever they stole was largely recovered.
- **Cost-cutting through centralisation**
  - There are plans to further rationalise cost through centralisation and establishing a strong back-end team.
  - This will enable the delegation of several tasks to lower levels on the back-end.
  - The requirement for headcount would reduce.
- Manappuram Comptech
  - This subsidiary is already operational and the intention is to run this entity as a profit centre after it has duly performed its duties towards MFL.

Commercial vehicles business

- **Size and growth of the business**
  - This book has grown to about Rs 9.75bn as of December-end.
  - It is growing at the rate of ~20% QoQ.
  - The target for FY19-end is Rs 12bn.
  - The run rate per month is about Rs 0.9-1bn.
  - The intention is to grow this book to Rs 30bn in 3 years.
- **Nature of business**
  - 85-90% of the business is pre-owned vehicles.
  - The business initially started with significantly old vehicles of about 10-years vintage.
  - About 2 years back, the business pivoted and is targeting vehicles that are 6-7 years old.
  - The business mostly targets small first-time buyers who plan to own 1-2 vehicles.
  - The average ticket size in this business is Rs 0.7mn.
  - 2W business is also conducted and used cars are also cross sold to 2W customers.
- **Yield on the business**
  - This business is competitive on interest rates, service offerings and turnaround times.
  - This business is currently generating an yield of ~19.5%.
  - One of the key competitors focused on truck financing is yielding 17% but that is primarily due to their pivot to financing new vehicles.

- **Operating leverage**
  - The business is currently operating in 150 locations.
  - The outlets are co-located with existing gold loan branches.
  - Apart from paying for the table and chair, there is no fixed cost for the vehicle finance business.
  - It may be noted, though, that the proportion of CV business sourced via branches would be less than 10%.
  - The proportion of 2W business sourced via branches, on the other hand, would be high.
- **Sourcing**
  - The sourcing team comprises specialists who have experience in this field. (The vehicle finance sourcing is not dependent on gold loan personnel.)
  - DSA and other channel partners are also involved in sourcing.
- **Collection**
  - The collection team is separate from the sourcing team.
  - However, the branch manager oversees both sourcing and collection.
- **Geographical breakup**
  - There is no concentration in any given state and exposure to Kerela is about 5% of book.
  - The business is operative in 22 states.
  - The business' entry into East India is more recent.
  - The share of West and South India is roughly similar.
- **Asset quality and analytics**
  - The GNPA ratio of this business should stabilise at 2.5%.
  - MFL has piloted a scoring card in a few locations.
  - Also, automation of credit delivery will reduce turnaround time.
- **On the general slowdown in vehicle sales**
  - MFL sees this as a lull before the elections and essentially a temporary phenomenon.
  - The impact on MFL due to this is, in any case, minimised since they are primarily into pre-owned segment.
  - MFL also sees demand coming in due to BS norms. This would be for larger fleets first and then trickle down to other sections.
- **Competition**
  - Mahindra Finance's customers are largely a different set compared with that for MFL.
  - Cholamandalam, on the other hand, is beginning to target MFL's core segment more aggressively.
- **Tractor business**
  - This business is relatively new and, currently, this book stands at ~Rs 150mn.
  - MFL has identified some districts and are focusing on them.
  - The idea is to focus on well-irrigated districts which are not dependent on the vagaries of the monsoon.

Housing business

- **Asset quality**
    - The housing business has had some issues with some high value loans in certain centres.
    - MFL has acted to reduce ticket size as well as loan to value ratio.
    - For the key stressed accounts, SARFAESI has been initiated.
    - The centres which have led to some trouble include Surat, Madurai and Trichy and MFL is now more cautious there.
    - Aspects pertaining to self construction
        - While the land and constructed house is collateral, liquidation can become and issue, especially if completion is low and buyers are only found if a haircut is effected.
        - Hence, MFL now generally finances those cases where 30-40% of the construction is already complete.
        - Furthermore, MFL focuses on self occupied property to minimise propensity of default.
    - The GNPA is currently ~5% but could close the year at sub 4%.
- **Key aspects about the business**
    - The yield on this business is about 15%.
    - The average ticket size of this business is about Rs 0.9mn.
    - Business mix
        - Most of the book, i.e. about 70%, comprises financing of self constructed homes.
        - The remaining is mostly resale properties.
- **Geographical presence**
    - Maharashtra, Tamil Nadu and Gujarat constitute about 2/3rd of this book.
    - Other southern states Kerela, Karnataka and Andhra Pradesh are some of the other key states.
- **Sourcing**
    - 15-20% sourcing is done by DSA.
    - The remaining proportion is sourced by direct sales team.
    - In a few places, the housing business shares a common branch with the gold loan business.
- **Prepayment rate**
    - Earlier, this was 4-5% but has declined to 1%.
    - The balance transfer is mostly to other NBFCs. Lately, there has been some transfer to banks as well.
    - Bank of Baroda has become more active in Gujarat.
    - MFL has increased prepayment fee to 4% although, as per regulation, this is not applicable to floating rate loans.
- **Profitability**
    - FY19 will be the first year of profit for the housing business.
    - The idea is to first achieve an RoE of 15% in the next 3 years.
    - Over the long-term, an RoE of 20% may be possible.

- **Funding profile**
  - The main source of funding is bank borrowing, most of it of 7 years' duration.
  - Only one CP issuance has been carried out, the quantum being ~Rs 250mn.
  - The cost of borrowings is currently ~9.2%. The same had gone up to ~9.8%.
- **Capital adequacy**
  - With a capital infusion of Rs 2bn, the CAR has gone up to ~40%.
  - MFL can triple the housing book before capital is required again.
- **Supply side issues**
  - MFL has not witnessed any major supply side issues in their housing business.
  - Organised players are increasingly moving into this space.
  - In Karnataka, they do not operate in Bangalore (where Can Fin Homes has cited supply side issues in the past). They are present in 2 cities including Hubli.

Microfinance

- **Growth**
  - This business is executing a rough monthly run rate of Rs 4.5bn worth of disbursements.
  - The target for disbursements in FY20 is Rs 55.5bn. 55% growth is expected in FY20.
  - 55% of incremental customers are new.
- **Nature of business**
  - The incremental ticket size is Rs 32,000.
  - The book churns in about 18 months.
  - **Lending model**
    - The JLG model is following for 100% of the business.
    - The lending is done to groups of 10 women.
- **No concentration risk**
  - 65-70% of customers in Tamil Nadu, Asirvad's largest state, are repeat customers, which is higher than the ratio in the rest of India.
  - When Asirvad was acquired, Tamil Nadu contributed ~95% to business but this has since declined to ~25%.
  - However, Asirvad's market share in Tamil Nadu is still only 4%.
  - Nevertheless, the board has mandated that the share of Tamil Nadu would be brought down to ~20-21% by FY20-end.
  - In a few years, this share would come down to 15-16% of book
  - The second largest state is West Bengal with a share of 12% in total Asirvad book.
- Asirvad will be adding 150 branches.
- **Asset quality**
  - The hit rate with the credit bureau is high.
  - The share of first time borrowers is very low.
  - Asirvad allows a limit of 2 MFIs + 1 Small Finance Bank.
  - 95% of customers have a total indebtedness of less than Rs 0.1mn.
  - 99% of customers have a total indebtedness of less than Rs 0.15mn.

- **Capital adequacy**
    - There would be a Rs 2.56bn capital infusion.
    - The Capital Adequacy ratio will be north of 25% and capital will not needed for the next 2-2.5 years
    - Over and above this, there is also a USD 100mn capital infusion by a private equity player that is on the cards in the next 2-3 quarters.

Lending to other NBFCs

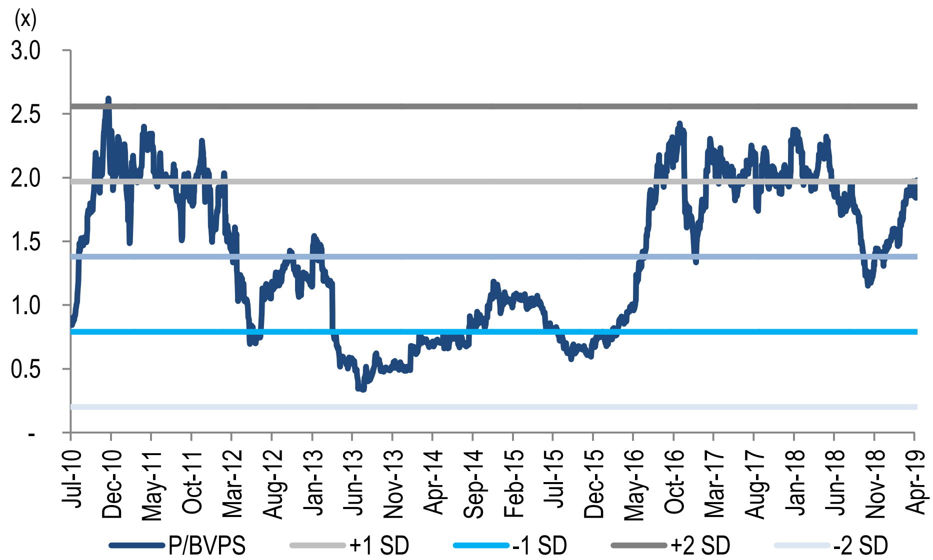
- This book is about Rs 5.7bn. The book size could rise to Rs 7.5bn by FY20-end.
- Half of this book is to other MFI institutions. The remaining is a mix of vehicle financiers, MSME lenders and HFCs.
- Margin and return ratio
    - The yield on this book is about 13.5%.
    - The rise in cost of funds could not be passed on fully to the NBFCs resulting in moderate margin compression.
    - This is a ~2.5% RoA business.
- Asset quality
    - The repayment is done on monthly EMI basis and there no delinquency in this book.
    - The NBFCs lent to have sound auditors.
    - Most of them are in fact under-written by IFMR.
    - The business model, the history and promoter quality is all looked at carefully.

Exhibit 1: Change in our estimates

	Revised estimate			Earlier estimate			*% Revision*		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	*FY19E*	*FY20E*	*FY21E*
Net interest income (Rsmn)	27,305	30,935	36,006	27,305	30,935	36,006	*0.0*	*0.0*	*0.0*
NIM (%)	*15.8*	*14.8*	*14.1*	*15.8*	*14.8*	*14.1*	*0 bps*	*0 bps*	*0 bps*
Operating profit (Rsmn)	15,069	16,872	21,069	15,069	16,844	21,024	*0.0*	*0.2*	*0.2*
Profit after tax (Rsmn)	9,315	10,416	13,046	9,315	10,398	13,017	*0.0*	*0.2*	*0.2*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: One-year forward P/BV



Source: Company, Nirmal Bang Institutional Equities Research

Financials

Exhibit 3: Income statement

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Interest income	33,762	34,092	40,525	46,486	55,106
Interest expenses	11,687	10,277	13,220	15,551	19,100
Net interest income	**22,075**	**23,815**	**27,305**	**30,935**	**36,006**
Non-interest income	326	673	1,697	927	1,278
Net revenues	**22,401**	**24,489**	**29,003**	**31,863**	**37,284**
Operating expenses	9,652	10,426	13,933	14,990	16,215
-Employee expenses	5,026	6,167	7,119	7,494	7,969
-Other expenses	4,626	4,259	6,815	7,496	8,246
Pre- provisioning operating profit	**12,749**	**14,063**	**15,069**	**16,872**	**21,069**
Provisions	1,093	3,893	515	847	998
PBT	11,656	10,170	14,554	16,025	20,071
Tax	4,072	3,486	5,239	5,609	7,025
PAT	**7,584**	**6,684**	**9,315**	**10,416**	**13,046**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Balance sheet

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Share capital	1,684	1,685	1,685	1,685	1,685
Reserves & surplus	31,934	36,677	43,882	52,182	63,063
Net worth	**33,618**	**38,362**	**45,567**	**53,868**	**64,748**
Borrowings	109,861	125,963	152,347	185,709	229,514
Other liability & provisions	8,042	8,000	8,671	10,235	11,384
Total liabilities	**151,521**	**172,325**	**206,933**	**250,246**	**306,218**
Fixed assets	1,869	2,746	3,158	3,631	4,176
Investments	50	51	51	51	51
Loans	138,417	156,634	188,585	228,970	280,814
Cash	5,227	6,986	7,543	8,701	10,671
Other assets	5,958	5,907	7,596	8,894	10,507
Total assets	**151,521**	**172,325**	**206,933**	**250,246**	**306,218**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Key ratios

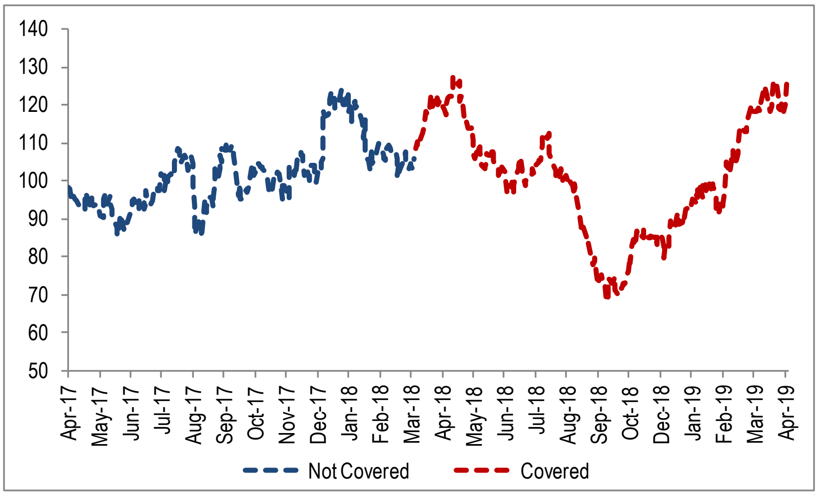
Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Growth (%)					
Net interest income	57.5	7.9	14.7	13.3	16.4
Operating profit	115.8	10.3	7.2	12.0	24.9
Profit after tax	113.5	(11.9)	39.4	11.8	25.2
Business (%)					
Advances growth	21.6	13.2	20.4	21.4	22.6
Spread (%)					
Yield on loans	26.8	23.1	23.5	22.3	21.6
Cost of borrowings	11.3	8.7	9.5	9.2	9.2
Spread	15.4	14.4	14.0	13.1	12.4
NIM	17.5	16.1	15.8	14.8	14.1
Operational efficiency (%)					
Cost-to- income	43.1	42.6	48.0	47.0	43.5
Cost- to-assets	7.7	7.1	8.1	7.2	6.4
Productivity (Rsmn)					
AUM per branch	33.8	37.1	41.8	45.2	52.5
AUM per employee	6.3	6.3	7.1	8.6	9.9
Employee per branch	5.4	5.9	5.9	5.3	5.3
CRAR (%)					
Tier I	25.7	26.6	24.5	23.9	23.4
Tier II	0.4	0.4	0.6	0.6	0.6
Total	26.1	27.0	25.1	24.4	24.0
Asset quality (%)					
Gross NPAs	2.3	0.4	1.8	1.9	2.0
Net NPAs	1.6	0.3	1.2	1.2	1.2
Specific provision coverage	29.7	38.5	33.7	36.9	39.1
Credit costs (excluding std. assets)	0.9	2.5	0.3	0.4	0.4
Credit costs (including std. assets)	0.9	2.6	0.3	0.4	0.4
Return ratios (%)					
RoE	24.8	18.6	22.2	21.0	22.0
RoA	5.4	4.1	4.9	4.6	4.7
Per share (%)					
EPS	9.0	7.9	11.1	12.4	15.5
BV	39.9	45.5	54.1	63.9	76.8
ABV	37.3	45.0	51.5	60.6	72.7
Valuation (x)					
P/E	14.1	16.0	11.5	10.3	8.2
P/BV	3.2	2.8	2.4	2.0	1.7
P/ABV	3.4	2.8	2.5	2.1	1.7

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
9 October 2018	Buy	68	103
9 November 2018	Buy	83	112
7 February 2019	Buy	97	127
8 April 2019	Buy	121	141
15 April 2019	Buy	127	154

Rating track graph



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