

# Muthoot Finance

*Worth its weight in 'gold'*

**OUTPERFORMER**

8 January 2015

BSE Sensex: 26909

Sector: Financials

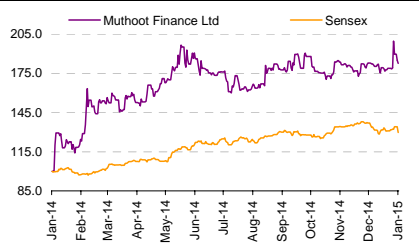
## Stock data

CMP (Rs)	195.6
Mkt Cap (Rsbn/USDbn)	77.7/ 1.2
<b>Target Price (Rs)</b>	290
Change in TP (%)	NA
<b>Potential from CMP (%)</b>	+48.0

Bloomberg code	MUTH IN
1-yr high/low (Rs)	222/107
6-mth avg. daily volumes (m)	0.337
6-mth avg. daily traded value (Rsm/US\$m)	63.88 / 1.01
Shares outstanding (m)	397.1
Free float (%)	25.0
Promoter holding (%)	75.0

*Stock Price as on 7 January 2015*

## Price performance – relative and absolute



(%)	3-mth	6-mth	1-yr
Muthoot Finance	1.0	3.1	82.1
Sensex	2.4	3.1	30.0

**Muthoot Finance (Muthoot) is India's largest, niche gold finance company. We believe the gold finance segment is ripe for a turnaround as: a) regulatory concerns have largely receded, b) international gold prices have fallen substantially, c) loan growth should revive with economic growth, and d) most of the asset quality pain is likely over. Muthoot, being the largest incumbent with 4,265 branches, Rs218bn of loans and strong asset quality, is best positioned to benefit from the improving business sentiment. We expect 13% loan CAGR, higher NIMs and 16-19% RoE over FY15-17E. At 1.3x FY16E P/BV and 8.4xP/E, the stock is among the few value picks in the sector. We initiate coverage with Outperformer and a 12-month price target of Rs290 – 48% upside from CMP.**

**Regulatory concerns largely behind; loan growth picking up:** Recent RBI guidelines for NBFCs had little changes for gold financing NBFCs, indicating a largely stable regulatory regime ahead. Post a prolonged period of decline, Muthoot's loan book has grown modestly in Q2FY15 (+2% qoq). We expect loan growth to pick up to 10-12% over the next 12-18 months, driven by stability in gold prices, economic revival and a rationalization of the competitive landscape.

**Better NIMs, operating leverage should drive RoE higher:** NIMs (8.75% in FY14) are set to expand in the medium term as cost of funding eases and realized loan yields improve. Operating leverage will also increase with a growing loan book, leading to lower cost-income ratios. We believe the worst of asset quality pain is over and credit costs should stabilize going forward, leading to expansion in RoE to 19% by FY17E.

**Among the few value picks in the sector; Outperformer:** At 1.3x FY16E P/B, valuations are reasonable. We initiate coverage on Muthoot with Outperformer and a price target of Rs290 (2.0x FY16E P/BV) and is our top pick in the NBFC segment. A sudden, sharp reduction in gold prices and delayed growth recovery are the key risks.

## Key financial ratios

As on 31 March	FY13	FY14	FY15E	FY16E	FY17E
Net Profit	10,043	7,801	7,310	9,233	11,616
EPS (Rs)	27.0	21.0	19.0	23.3	29.3
EPS growth (%)	4.8	(22.3)	(9.4)	22.3	25.8
PE (x)	7.3	9.3	10.3	8.4	6.7
P/BV (x)	2.0	1.7	1.5	1.3	1.2
P/Adj BV (x)	2.2	1.9	1.7	1.5	1.3
P/PPOP (x)	4.6	5.9	6.3	5.0	4.0
RoA (%)	3.8	2.8	2.8	3.2	3.5
RoE (%)	30.2	19.5	15.6	16.9	18.7
Dividend Yield (%)	2.3	3.1	3.2	3.2	3.3

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**"Important disclosures appear at the back of this report"**

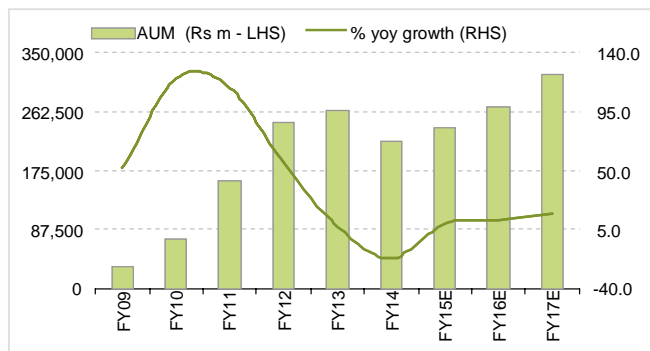
# MUTHOOT FINANCE: WORTH ITS WEIGHT IN 'GOLD'

Regulatory environment stabilized; we expect growth to pick up gradually

## Changes in norms for loans against gold jewellery

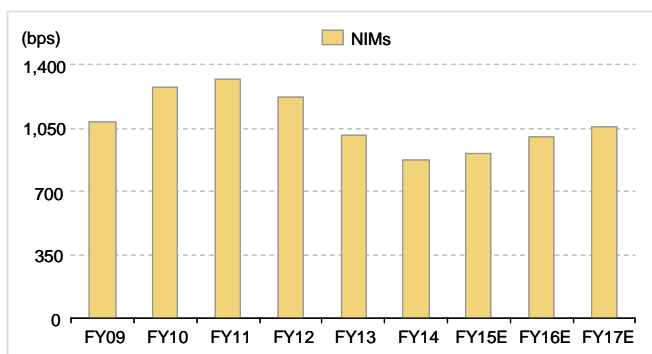
Norms	Mar-12 to Sep-13	Since Sep-13
LTV	60%	75% (since Jan-14)
Pricing	Not specified	Last 30 days average price of 22 carat gold as quote by Bombay Bullion Association
Mode of disbursement	Not specified	Disbursements above Rs100,000 to be done through cheque
Risk weights	100%	100%
NPL recognition	180 days	180 days now, to move to 90 days by Mar-18
Tier 1 capital ratio	12%	12%

## Muthoot – AUM trend

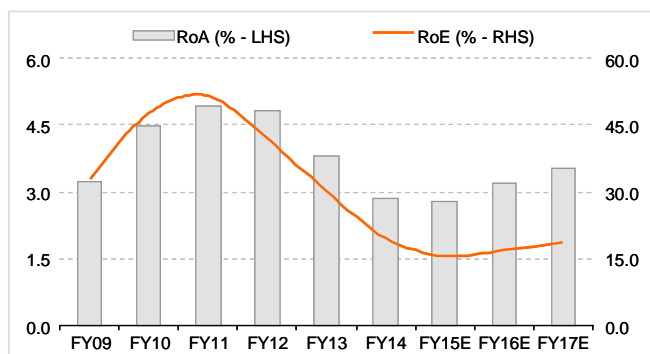


## NIM improvement should drive return ratios higher

### NIM trend

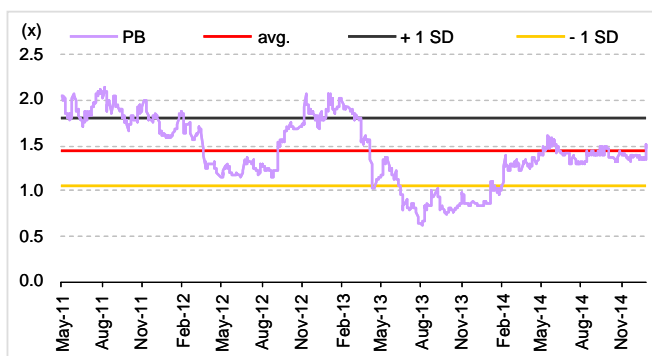


### Return ratios

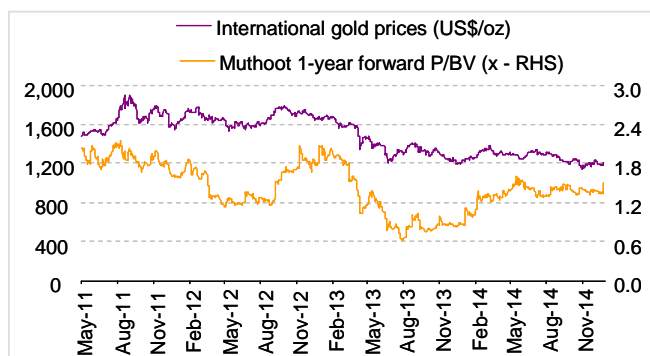


## Valuations attractive; expect stock performance to track pace of growth

### 1-year forward P/B



### Correlation of P/BV multiples with gold prices



**Our target price of Rs290 offers 48% upside from CMP**

Source: Company, IDFC Securities Research

## INVESTMENT ARGUMENT

- Muthoot is India's largest, niche gold finance NBFC with 4,265 branches, Rs218bn of loans and strong asset quality
- Regulatory environment has stabilized with gold finance NBFCs already complying with relatively stricter norms compared to other NBFCs
- Loan growth is showing signs of a pick-up with positive growth in 2QFY15 (+2% qoq), though near-term growth should remain modest, we expect loan growth to improve to 10-12% in the next 12-18 months
- Muthoot had a strong RoE of 19.5% in FY14, despite the challenging industry environment over the last couple of years; should dip in FY15E due to new capital infusion and lower profitability, and then expand to over 19% in FY17E on account of lower cost of funds, better operating leverage and credit cost stabilization
- At 1.3x FY16E P/B and 8.4x earnings, we initiate coverage on Muthoot with Outperformer and a price target of Rs290 (based on 2.0x FY16E book value). It is our top pick in the NBFC segment

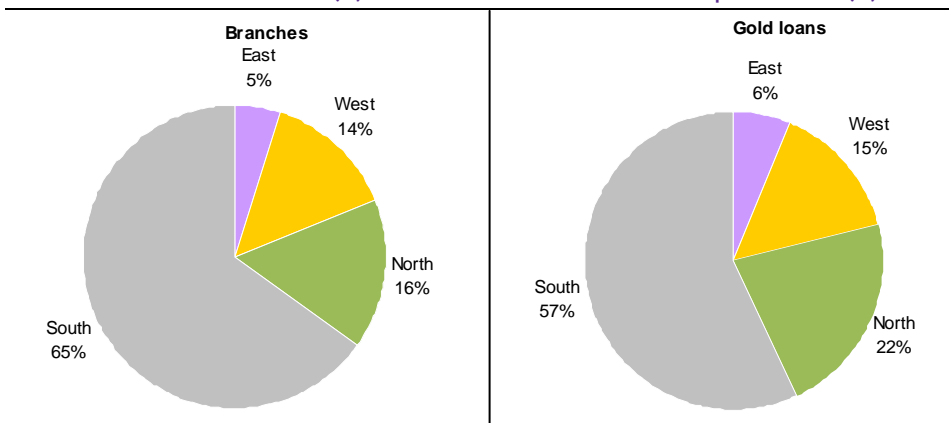
### Muthoot Finance: India's largest gold loan company

*India's largest gold finance company with 4265 branches and over 7m customers*

Muthoot is India's largest, niche gold finance company with an AUM of ~Rs218bn in Sep-14, with a robust 45% CAGR over FY09-14. Headquartered in Kochi (Kerala), the company is majority owned by the Muthoot family (75% stake as of Sep-14). It currently has 4,265 branches and presence across 26 states in the country. However, its footprint is concentrated mostly in the South with ~65% of the branches and 57% of total loans concentrated in the four southern states of Kerala, Andhra Pradesh, Tamil Nadu and Karnataka.

Muthoot has ~7m customers with an average ticket size per loan of ~Rs40,000. While loans are typically disbursed with tenure of 6-12 months, most of the loans are repaid within six months – implying average duration of close to six months for the loans.

Exhibit 1: Muthoot – Branch mix (%)\*



Source: Company, IDFC Securities Research; \*As of Q2FY15

Portfolio loan-to-value ratio (LTV) for Muthoot stands at ~70%, with LTV on individual loans varying from 50-75%. Interest rates on loans range between 16-24% with higher interest rates for loans having higher LTV. Overall portfolio yield for Muthoot is at ~19%.

### Gold loans: Stability after turmoil

*A steep decline in gold price, regulatory changes and slowing growth have hit gold finance players*

India's gold loan industry has seen significant upheavals in the past 18-24 months with plunging international and domestic gold prices, changing regulations, slowing growth and asset quality concerns leading to most gold-financing players shrinking their loan books over the period.

*Economic revival to boost demand for loans, led by towns and rural centres*

However, we believe the industry has started to stabilize and is poised to return to growth over the next few quarters as – (a) the regulatory environment has stabilized over the last few months with gold financing NBFCs following relatively more stringent regulatory norms than most other asset financing NBFCs; (b) competitive intensity has also rationalized with many smaller players exiting this segment and market shares starting to consolidate with fewer and larger banks and non-banking finance companies; (c) international gold prices have already declined substantially and may stabilize soon; (d) domestic economic revival is likely to boost demand for loans again, especially in the small and mid-sized towns and rural centres; and (e) asset quality concerns have stabilized as most of the pain is over and should abate over the medium term.

#### □ Regulatory regime stabilizing...

We believe regulations for the gold financing industry have largely stabilized – recent RBI regulations on NBFCs (November 2014) had little changes for gold finance companies as they already conform to relatively stricter guidelines than most other NBFCs.

*Regulations largely same for all lenders, but gold finance players subject to higher capital adequacy norms*

Regulatory guidelines for gold financing NBFCs are now aligned with the banking industry (pricing and valuation of gold, and 75% cap on loan-to-value ratios) and other asset financing NBFCs. This has led to a more uniform and level playing field. Gold financing NBFCs, however, still have to comply with higher capital adequacy norms than other asset financing NBFCs (12% Tier 1 capital vs 10% Tier 1 requirement for other asset financing NBFCs) and have higher risk weightages on gold loans than banks (100% vs 0-20% for banks). We look at some of the key regulations, changes and comparisons with banks:

Exhibit 2: Changes in norms to loan against gold jewellery

Norms	Mar-12 to Sep-13	Since Sep-13	For banks (current)
LTV	60%	75% (since Jan-14)	75%
Pricing	Not specified	Last 30days average price of 22 carat gold as quote by Bombay Bullion Association	Last 30days average price of 22 carat gold as quote by Bombay Bullion Association
Mode of disbursal	Not specified	Disbursals above Rs100,000 to be done through cheque	Entirely through Cheque
Risk weights	100%	100%	0-20% for loans below 75% LTV
NPL Recognition	180 days	180 days now, to move to 90 days by Mar-18	90 days
Tier 1 capital ratio	12%	12%	6.125% by Mar-15, increasing gradually to 8% by Mar-18

Source: RBI, IDFC Securities Research

### ❑ Competition has rationalized

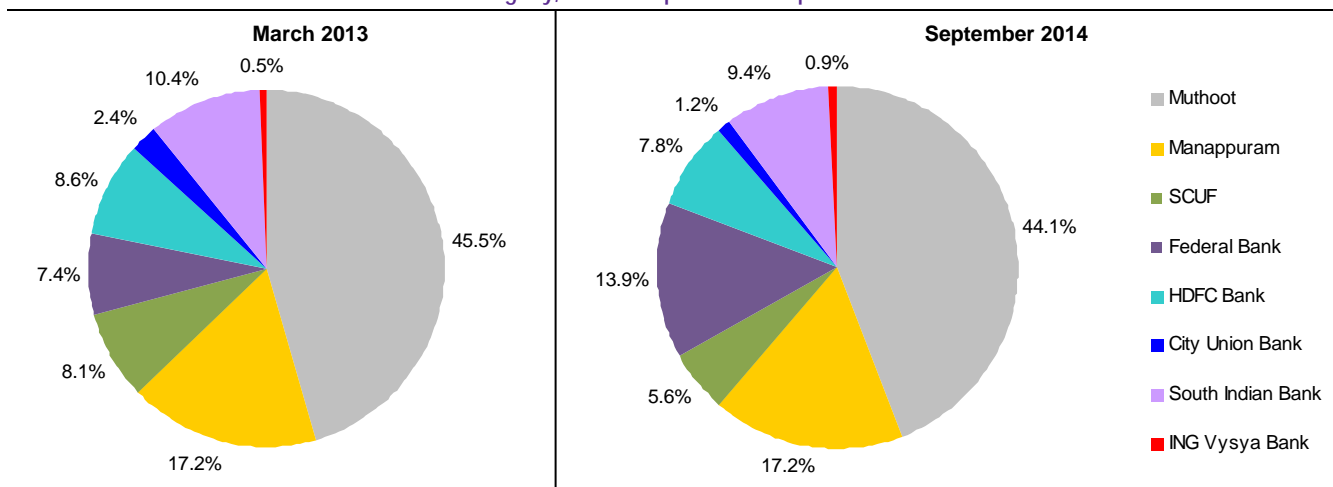
Competitive intensity was at a high and increasing during the heady growth period of 2008-12 with the entry of many new players into this segment – most notably larger banks. However, during the recent growth slowdown, several players have reduced focus or have exited this segment. We believe this will lead to a consolidation in the industry and benefit stronger players like Muthoot Finance.

Among the key private sector players in the gold financing segment, Muthoot remains the largest, followed by Manappuram and then some of the private banks (excluding agriculture loans by public sector banks, which are collateralized by gold).

**PSU banks stepping up agri loan disbursals with gold as collateral; a key challenge**

In the medium term, one of the key challenges for private sector players, especially gold financing NBFCs, could come from public sector banks which have turned aggressive on collateralizing agricultural loans with gold as additional collateral and also from the expected entry of small finance banks, which could erode market shares for non-banking finance companies.

Exhibit 3: Muthoot's market share has declined slightly, should improve as competition rationalizes



Source: Company, IDFC Securities Research

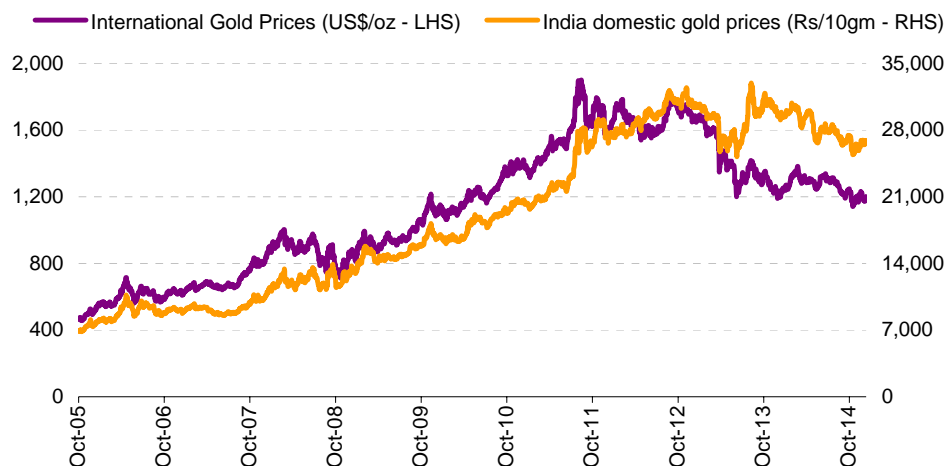
### ❑ Gold prices have already seen a substantial decline

Global gold prices are down 38% from their peak of ~US\$1,900/oz over the past 18 months, while domestic gold prices are ~19% lower from the peak to ~Rs26,600. While prices have already fallen sharply and we believe should stabilize medium term, predicting a bottom for global gold prices is a challenging task. A sharp fall in gold prices, especially in a 3-6 month period, remains a key risk for the sector.

**Gold price decline largely a growth risk rather than asset quality risk for strong players like Muthoot**

Notwithstanding the risk of a fall in gold prices, we take comfort in Muthoot's strong asset quality over the last couple of years despite the sharp fall in gold prices and a material shrinkage in its loan book. Falling gold prices, we believe, are more a growth risk than an asset quality risk for stronger players like Muthoot.

Exhibit 4: Trends in global and domestic gold prices



Source: Bloomberg, IDFC Securities Research

Exhibit 5: Trends in gold loans for key banks/ NBFCs

Gold loans (Rs m)	FY13	FY14	% yoy growth	H1FY15	% growth over Mar-14
Muthoot	263,868	218,615	(17.1)	218,020	(0.3)
Manappuram	99,558	81,621	(18.0)	85,180	4.4
Shriram City Union	47,161	25,145	(46.7)	27,520	9.4
Federal Bank	42,630	59,620	39.9	68,520	14.9
HDFC Bank	49,650	40,420	(18.6)	38,600	(4.5)
City Union Bank	13,830	8,151	(41.1)	6,025	(26.1)
South Indian Bank	60,310	50,130	(16.9)	46,530	(7.2)
ING Vysya Bank	2,750	3,467	26.1	4,214	21.6
<b>Total</b>	<b>579,756</b>	<b>487,168</b>	<b>(16.0)</b>	<b>494,609</b>	<b>1.5</b>

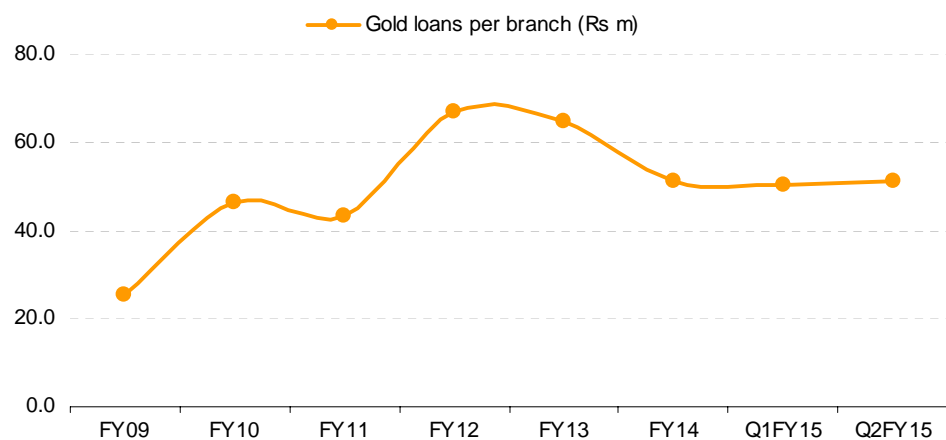
Source: Company, IDFC Securities Research

### Near-term growth modest; expect a gradual upturn

**AUMs fell 17% in FY14 due to change in regulations, gold price decline and economic slowdown...**

Muthoot's AUM declined 17% yoy in FY14 as the company grappled with change in gold loan regulations, decline in domestic gold prices and slower economic growth impacting demand for new loans.

Exhibit 6: Muthoot – gold loan per branch trend



Source: Company, IDFC Securities Research

**... but ease of monetization and economic rebound would unlock strong underlying demand for gold loans**

While near-term growth outlook for the industry remains modest, we believe underlying demand/ potential for gold loans remains healthy over the medium term given: a) a large and rising stock of investment-related gold with Indian households, b) ease of monetizing gold with a loan against jewellery, and c) higher economic activity leading to increased demand for small ticket loans.

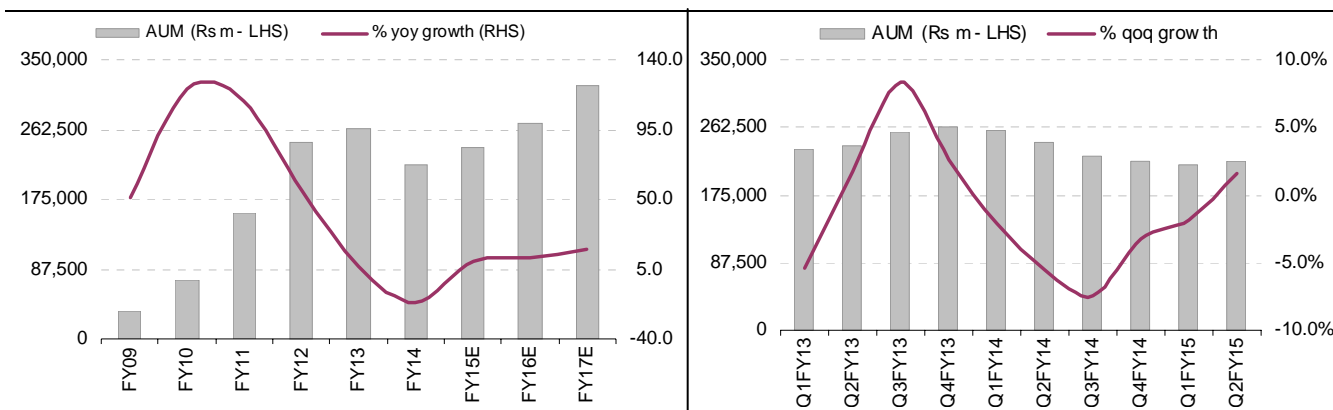
Muthoot's core strategy of positioning gold loans as a quick source of cash remains in good stead. Also, the company is focusing on introducing gold loans as a source of margin funding for other large-ticket purchases such as consumer durables, two wheelers, small ticket home loans, etc. The management believes that this strategy is likely to drive healthy volumes for gold loans in the medium term from customer segments which hitherto were relatively more skeptical of pledging household jewellery, e.g. urban middle class customers.

We expect Muthoot's growth uptick to remain contingent on the improvement in economic environment, especially for the small and medium enterprises segment, domestic gold price movement and competitive intensity in the industry. In the longer term, market share shift from the unorganized gold pawning market (to local jewelers and money lenders) to organized financiers is expected to result in sustainable healthy growth for the industry.

**We expect AUM growth to gradually increase to 10% in FY15E and to 18% in FY17E**

Over the last couple of quarters, the sequential decline in Muthoot's AUM has been arrested with a modest +2% qoq increase seen in Q2FY15. We expect growth to pick up gradually with a 10% increase in AUM in FY15E and improving to 18% yoy growth in FY17E.

Exhibit 7: Muthoot – AUM trend



Source: Company, IDFC Securities Research

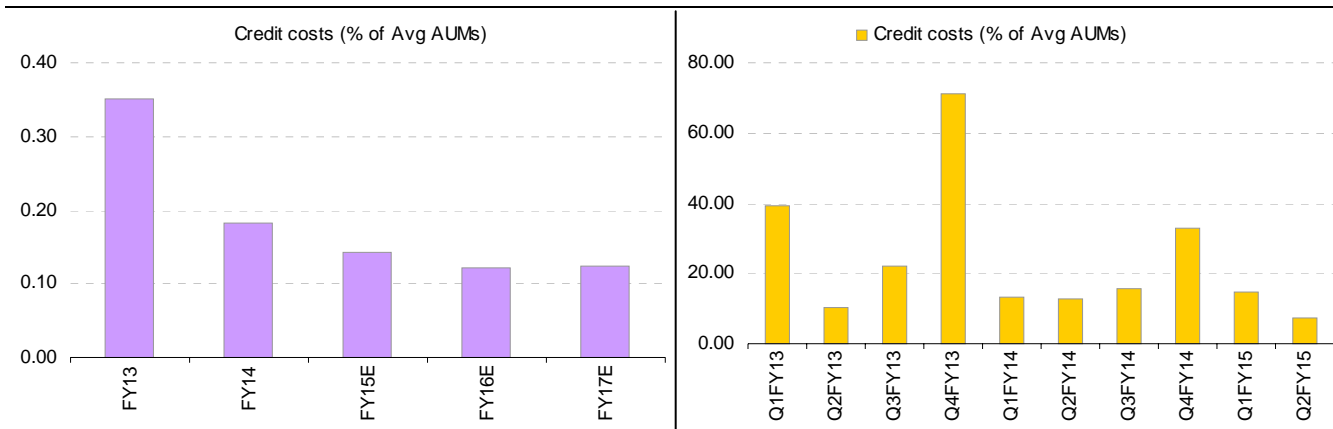
### Asset quality: The worst is over, credit costs to stay low

**Lower LTVs for the last two years likely to reduce stress creation over the next few quarters**

Muthoot’s NPLs have remained relatively more stable at ~2% levels for the last six quarters (2.1% as of Sep-14) after a steep jump in Q4FY13 (up 50bp qoq to 2%). We believe the underlying asset quality risk for gold loan companies is stabilizing given that LTVs have been capped at 75% or lower for the last 18-24 months. While the sharp decline in gold prices has been negative for the sector, lower LTVs over the last couple of years are likely to reduce stress creation over the next few quarters.

Muthoot’s credit costs have remained low at 30bp (average credit costs over FY10-14) as eventual loss of principal on gold loans has been low given the strong and liquid nature of the collateral. However, most of the asset stress is reflected in haircuts on realized interest, which has seen a hit in the last few quarters and is down to 19% recently (vs 23-24% on a normalized portfolio).

Exhibit 8: Muthoot – credit costs trend

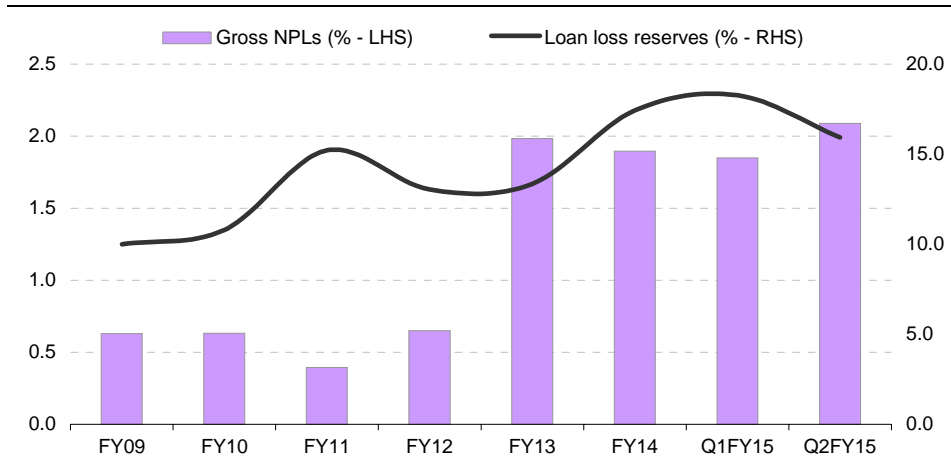


Source: Company, IDFC Securities Research

**Lower losses on stressed loans and economic recovery to keep credit costs low; a sharp fall in gold price a key risk**

Muthoot’s loan loss coverage too remains low at 16% of NPLs as of Sep-14. Given low eventual losses on stressed loans and a likely recovery in the economy, we expect Muthoot’s credit costs to remain low in the medium term. A sharp fall in global gold prices, especially in a relatively shorter period of time, remains the key risk to Muthoot’s asset quality.

Exhibit 9: Muthoot – GNPLs and loan loss coverage trends



Source: Company, IDFC Securities Research



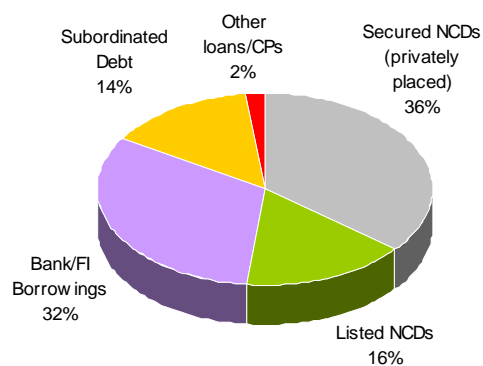
## NIMs to benefit from lower wholesale funding costs

Muthoot's NIMs have been gradually trending lower from a peak of ~13.2% in FY11 to 10.1% in FY13 and further declined to 8.75% in FY14 due to interest income reversals. We believe Muthoot's NIMs are likely to improve in the medium term with: a) lower wholesale funding costs, and b) reduction in asset quality stress leading to better loan yield realizations as interest haircuts on stressed assets reduce.

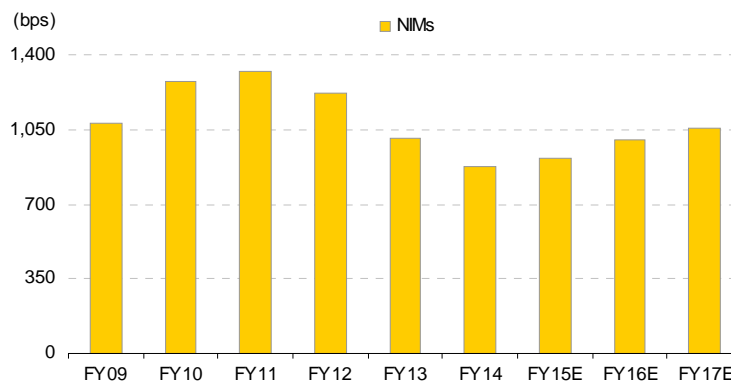
**Muthoot's average funding cost stands at 11.25% and incremental cost of funding is lower at 10.5%**

Muthoot's funding mix is dominated by bonds (52% of the total funding), and it is likely to be a key beneficiary of lower wholesale funding costs. While the average cost of funding for Muthoot is ~11.25%, its incremental cost of raising funds through bonds has reduced to 10.5% (down 75bp YTD FY15). At ~32% of its funding mix, bank/ FI loans are another key source of borrowings for Muthoot and any reductions in interest rates over the next 6-12 months will be a key benefit for Muthoot's net interest margins.

Exhibit 10: Muthoot – funding mix (as of Q2FY15)



NIM trend



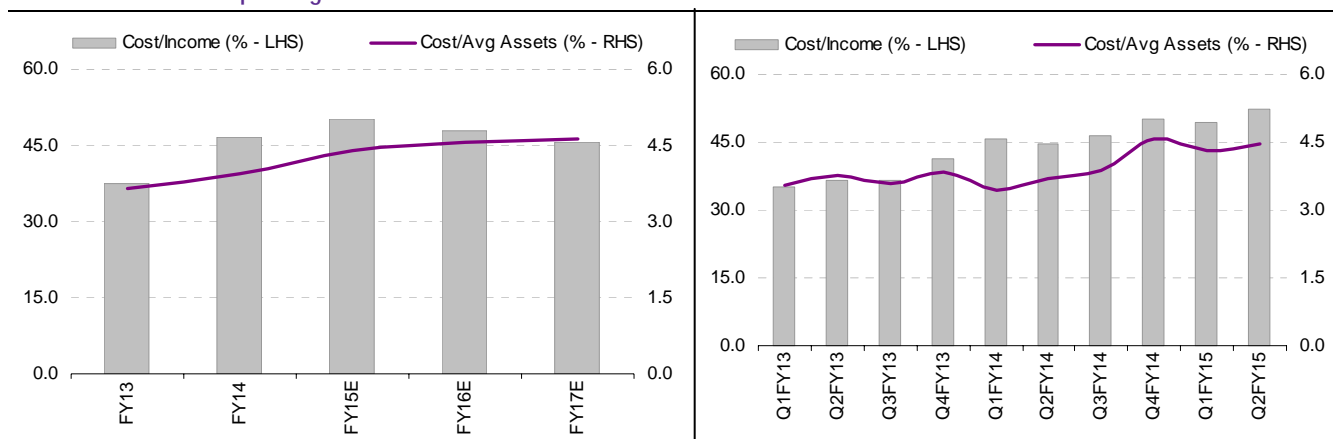
Source: Company, IDFC Securities Research

The management believes that competition from banks (where lending rates on gold loans are 14-15%) is unlikely to impact Muthoot's portfolio yield as a quick turnaround time and relatively lower documentation requirements are key strengths for NBFCs in the gold loan business. According to the management, ~500bp interest rate differential between NBFCs and banks on a Rs40,000 loan reduces the outgo for a borrower, if borrowed from a bank, by Rs500 (assuming repayment over three months). Due to the small absolute difference in the value of interest repayment, this is unlikely to swing the borrowing decision in favour of the bank given the higher turnaround time and stricter compliance procedures required by banks.

## Cost ratios to improve as branch expansion stabilizes

Muthoot's cost-income ratio jumped sharply in FY14 to 46.7% (against 37.6% in FY13 and 37.5% on average during FY11-13) due to its slower income growth. Going forward, we expect cost-income ratio to normalize gradually as most of the fixed costs have already been incurred and additional expansion costs will be lower. We expect cost efficiencies to be led by: a) continued slowdown in branch expansion, b) rationalized workforce, and c) higher focus on increasing branch efficiency and productivity.

Exhibit 11: Muthoot – operating cost ratios



Source: Company, IDFC Securities Research

**Staff rationalization and shift in focus from branch expansion to productivity to boost cost efficiencies**

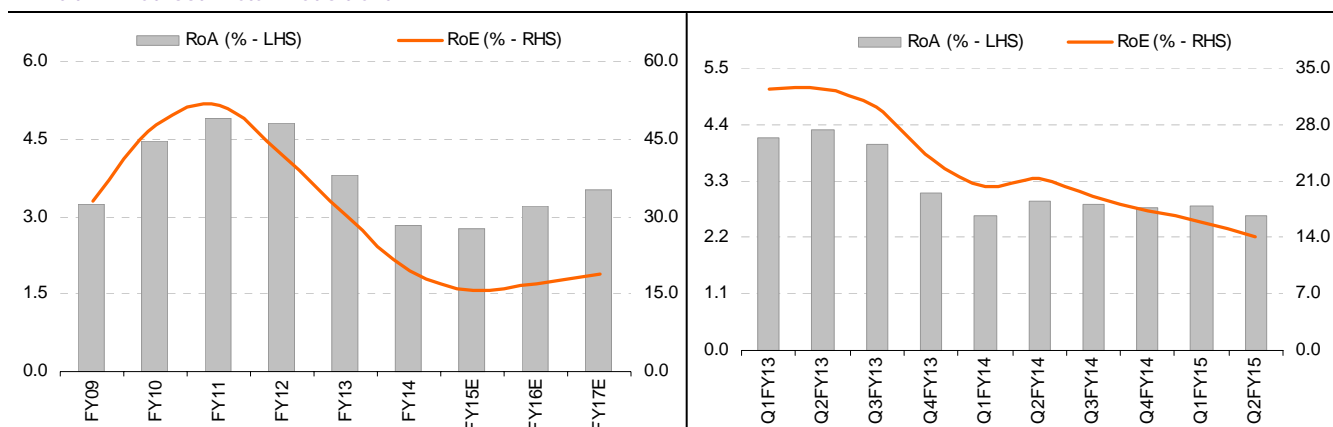
Muthoot's employee strength has already declined by ~9% yoy to 23,390 employees from the peak in Q2FY14. Its loans per branch declined from a peak of Rs67m in FY12 to Rs51m currently. We believe that the number of branches is unlikely to go up significantly over the medium term as the company focuses on improving productivity of the existing branches. However, the management has indicated that there will be some incremental branch expansion, especially in the non-southern regions where its presence is relatively lesser.

**RoA to improve to ~330bp by FY17E; RoE expected at 18-19% in FY16-17E**

## Profitability remains strong; should improve further

Despite the significant challenges faced in the last couple of years, Muthoot's profitability has remained robust with RoA of 280bp and RoE of 19.5% in FY14. While we expect ROE to moderate to 15.6% in FY15E (due to recent capital raising and lower NIMs), we believe ROA is likely to remain stable near term and should improve to ~350bp in FY17E driven by: a) higher realized loan yields as asset stress stabilizes, b) lower cost of funding, c) lower cost-income ratio, and d) stable credit costs. We expect RoE to also improve to 17-19% by FY16-17E with upside risk in a faster loan growth environment.

Exhibit 12: Muthoot – return ratio trend



Source: Company, IDFC Securities Research

Exhibit 13: Muthoot – quarterly earnings trend

(Rs m)	3Q14A	4Q14A	1Q15A	2Q15A	3Q15E	4Q15E
Interest Income	11902	11461	10802	10488	10984	11662
Interest Expense	(6,277)	(5,666)	(5,354)	(5,085)	(5,203)	(5,508)
<b>Net Interest Income</b>	<b>5,625</b>	<b>5,795</b>	<b>5,448</b>	<b>5,403</b>	<b>5,781</b>	<b>6,154</b>
Fee-Based Income	105	130	118	127	64	55
Non Interest Income	105	130	118	127	64	55
<b>Operating Income</b>	<b>5,730</b>	<b>5,925</b>	<b>5,566</b>	<b>5,530</b>	<b>5,845</b>	<b>6,208</b>
Operating Expenses	(2,657)	(2,959)	(2,756)	(2,891)	(2,955)	(3,032)
<b>Pre-Provision Profit</b>	<b>3,073</b>	<b>2,966</b>	<b>2,810</b>	<b>2,639</b>	<b>2,890</b>	<b>3,176</b>
Charges for Bad Debts	(91)	(182)	(80)	(40)	(99)	(111)
<b>Operating Profit</b>	<b>2,982</b>	<b>2,784</b>	<b>2,730</b>	<b>2,599</b>	<b>2,791</b>	<b>3,065</b>
Pre-Tax Profit	2,982	2,784	2,730	2,599	2,791	3,065
Tax	(1,040)	(974)	(928)	(892)	(949)	(1,106)
<b>Net Profit</b>	<b>1,942</b>	<b>1,810</b>	<b>1,802</b>	<b>1,707</b>	<b>1,842</b>	<b>1,960</b>
<b>EPS</b>	<b>5.2</b>	<b>4.9</b>	<b>4.5</b>	<b>4.3</b>	<b>4.6</b>	<b>4.9</b>

Source: Company, IDFC Securities Research

Exhibit 14: Muthoot – RoA Tree

% of Average AUMs	FY09	FY10	FY11	FY12	FY13	FY14	FY15E	FY16E	FY17E
<b>Net interest income</b>	<b>10.6</b>	<b>11.2</b>	<b>10.8</b>	<b>10.6</b>	<b>10.0</b>	<b>9.5</b>	<b>9.9</b>	<b>10.7</b>	<b>11.2</b>
Fee income	0.5	0.2	0.2	0.1	0.1	0.1	0.2	0.2	0.2
Trading profits	-	-	-	0.0	-	0.0	-	-	-
<b>Net operating income</b>	<b>11.1</b>	<b>11.4</b>	<b>11.0</b>	<b>10.8</b>	<b>10.1</b>	<b>9.6</b>	<b>10.1</b>	<b>10.9</b>	<b>11.4</b>
Operating expenses	(5.8)	(4.9)	(4.1)	(4.0)	(3.8)	(4.5)	(5.1)	(5.2)	(5.2)
<b>Pre-provisioning profits</b>	<b>5.3</b>	<b>6.4</b>	<b>6.8</b>	<b>6.8</b>	<b>6.3</b>	<b>5.1</b>	<b>5.0</b>	<b>5.7</b>	<b>6.2</b>
Provisions for bad debts	(0.0)	(0.1)	(0.3)	(0.2)	(0.4)	(0.2)	(0.1)	(0.1)	(0.1)
Other provisions	-	-	-	-	-	-	-	-	-
<b>Profit before tax</b>	<b>5.3</b>	<b>6.4</b>	<b>6.5</b>	<b>6.6</b>	<b>5.9</b>	<b>4.9</b>	<b>4.9</b>	<b>5.5</b>	<b>6.0</b>
Taxes	(1.8)	(2.2)	(2.3)	(2.2)	(2.0)	(1.7)	(1.7)	(1.9)	(2.1)
<b>Profit after tax (RoA)</b>	<b>3.5</b>	<b>4.2</b>	<b>4.2</b>	<b>4.4</b>	<b>3.9</b>	<b>3.2</b>	<b>3.2</b>	<b>3.6</b>	<b>3.9</b>
Leverage (on AUMs) (x)	9.4	11.3	12.1	9.5	7.7	6.0	4.9	4.7	4.7
<b>RoE (%)</b>	<b>32.9</b>	<b>47.6</b>	<b>51.5</b>	<b>41.9</b>	<b>30.2</b>	<b>19.5</b>	<b>15.6</b>	<b>16.9</b>	<b>18.7</b>

Source: Company, IDFC Securities Research

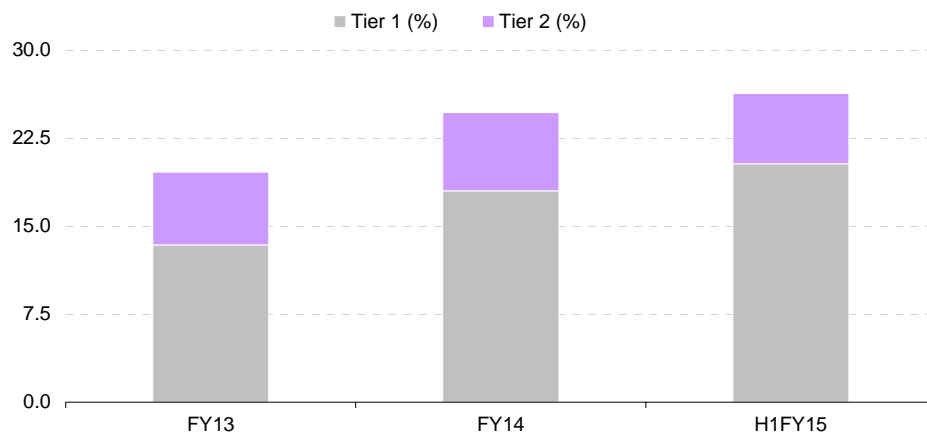
## Well capitalized; room to increase leverage

Muthoot raised Rs4.2bn through the IPP route in May-14 at a price of Rs165 per share. Post the capital raising, Muthoot's Tier 1 capital adequacy improved to a healthy 20.3% (overall capital adequacy at 26.3%).

We see significant headroom for Muthoot to increase leverage on its balance sheet (AUM-to-equity at 4.5x as at Sep-14) and deliver superior RoE in the medium term.

### Exhibit 15: Muthoot – capital adequacy ratios

**Tier-1 capital adequacy of 20.3% implies significant room for higher leverage**



Source: Company, IDFC Securities Research

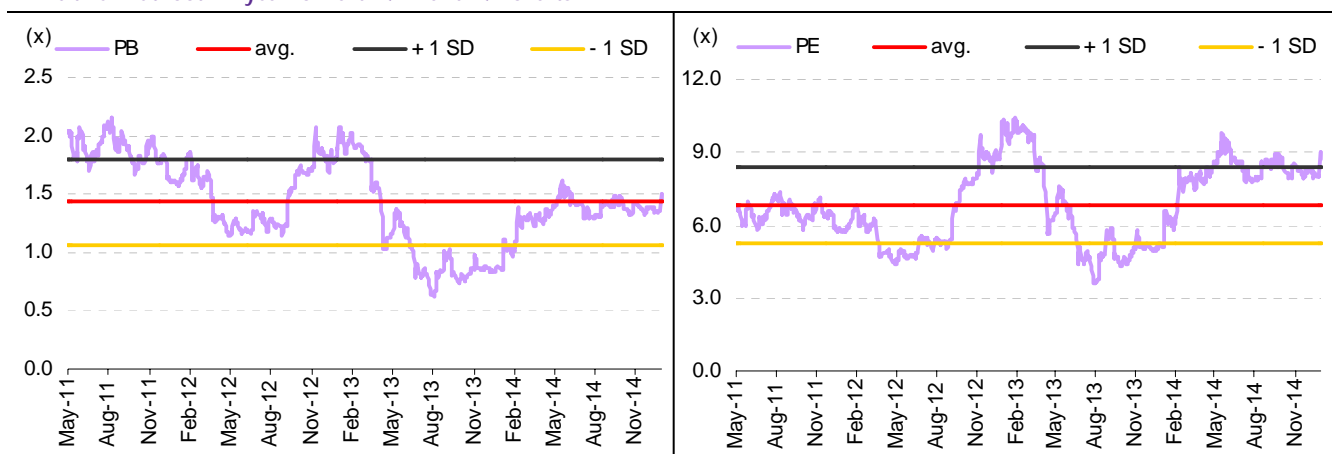
## Reasonable valuations; Stock among the few value picks

**Target price of Rs290 implies 48% upside from CMP; Muthoot is our top pick in the NBFC space**

With a more stable regulatory environment, healthy RoE of ~19%, expected improvement in RoA, low asset quality risk and a gradual pick-up in loan growth in the medium term, we believe Muthoot's valuations (1.3x FY16E P/B and 8.4x earnings) are quite attractive. Moreover, its dividend yields are also healthy at close to 3%.

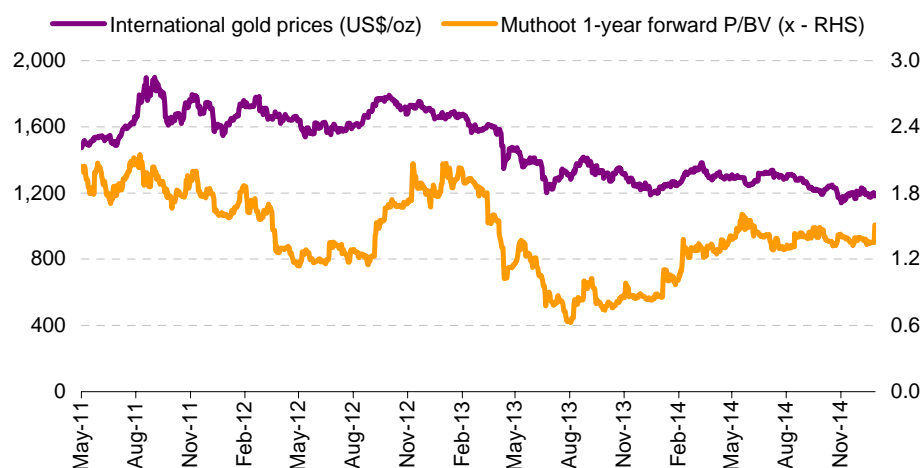
The stock trades at a discount to its historical average and also relative to other asset financing NBFCs. We initiate coverage on the stock with Outperformer and a target price of Rs290 based on 2.0x FY16E P/BV (implying 12.5x FY16E earnings), which is at a 20-30% discount to other large, diversified asset financing NBFCs in India. With a 48% upside from CMP, Muthoot is our preferred pick in the non-banking finance sector.

Exhibit 16: Muthoot – 1-year forward P/BV and P/E charts



Source: Bloomberg, IDFC Securities Research

Exhibit 17: Correlation of P/B with gold prices



Source: Bloomberg, IDFC Securities Research

Exhibit 18: Muthoot – comparative valuations

	Mkt cap		IDFC	TP	P/B (x)		P/E (x)		RoAE (%)		RoAA (%)		Div. yield (%)	
	Price (Rs)	(USD m)			Rating	(Rs/sh)	FY15E	FY16E	FY15E	FY16E	FY15E	FY16E	FY15E	FY16E
<b>Muthoot Finance</b>	<b>196</b>	<b>1,246</b>	<b>OP</b>	<b>290</b>	<b>1.5</b>	<b>1.3</b>	<b>10.3</b>	<b>8.4</b>	<b>15.6</b>	<b>16.9</b>	<b>2.8</b>	<b>3.2</b>	<b>3.2</b>	<b>3.2</b>
HDFC	1,099	27,321	N	1,125	5.9	5.2	27.4	23.4	22.0	23.6	2.6	2.6	1.5	1.7
LIC Housing Finance	457	3,648	OP	370	2.9	2.5	15.5	12.5	18.9	20.9	1.4	1.5	1.1	1.3
M&M Financial Services	313	2,815	UP	245	2.9	2.6	18.1	14.9	17.9	18.8	2.8	2.9	1.3	1.4
Shriram Transport Fin.	1,040	3,731	OP	1,140	2.5	2.1	16.4	13.7	16.3	16.9	2.8	3.0	0.7	0.9
L&T Finance Holdings	66	1,793	N	74	1.7	1.5	15.5	12.3	13.3	13.0	1.7	1.6	1.2	1.5

Source: Company, IDFC Securities Research

## Income statement

Year to 31 Mar (Rs m)	FY13	FY14	FY15E	FY16E	FY17E
<b>Net Interest Income</b>	<b>25,447</b>	<b>22,817</b>	<b>22,786</b>	<b>27,272</b>	<b>33,000</b>
yoy growth (%)	17.9	(10.3)	(0.1)	19.7	21.0
Fee Income	230	359	363	397	453
Trading Profits	-	38	-	-	-
Non Interest income	230	397	363	397	453
Net Operating Revenue	25,677	23,214	23,149	27,668	33,453
yoy growth (%)	17.8	(9.6)	(0.3)	19.5	20.9
Operating Expenses	(9,667)	(10,841)	(11,635)	(13,234)	(15,312)
yoy growth (%)	20.0	12.1	7.3	13.7	15.7
<b>PPOP</b>	<b>16,010</b>	<b>12,374</b>	<b>11,514</b>	<b>14,435</b>	<b>18,141</b>
yoy growth (%)	16.6	(22.7)	(6.9)	25.4	25.7
Provisions for Bad Debts	(895)	(438)	(329)	(307)	(368)
<b>Profit Before Tax</b>	<b>15,115</b>	<b>11,936</b>	<b>11,185</b>	<b>14,127</b>	<b>17,774</b>
Tax	(5,072)	(4,135)	(3,875)	(4,894)	(6,157)
<b>Profit After Tax</b>	<b>10,043</b>	<b>7,801</b>	<b>7,310</b>	<b>9,233</b>	<b>11,616</b>
yoy growth (%)	12.6	(22.3)	(6.3)	26.3	25.8

## Balance sheet

As on 31 Mar (Rs m)	FY13	FY14	FY15E	FY16E	FY17E
Customer Loans	263,868	218,615	239,624	270,081	318,106
yoy growth (%)	23.7	(17.1)	9.6	12.7	17.8
Investments	825	354	323	295	271
Cash & bank balances	13,420	20,489	15,977	15,673	17,802
Fixed Assets	3,030	3,270	3,597	3,957	4,352
Other Assets	13,019	13,211	13,861	14,543	15,260
Total assets	294,163	255,939	273,381	304,549	355,791
Networth	37,356	42,646	51,351	57,681	66,277
Borrowings	217,788	168,492	175,383	198,191	238,603
Other Liabilities	39,019	44,801	46,647	48,677	50,910
Assets under management	263,868	218,615	239,624	270,081	318,106

## Key financial ratios

Year to 31 Mar (%)	FY13	FY14	FY15E	FY16E	FY17E
RoA	3.8	2.8	2.8	3.2	3.5
RoE	30.2	19.5	15.6	16.9	18.7
Tier I Capital adequacy	13.4	17.9	19.6	19.5	19.0
Gross NPL	2.0	1.9	2.1	1.9	1.6
Net NPL	1.7	1.6	1.8	1.7	1.4
Loan Loss Coverage	13.3	17.4	14.2	14.3	14.9
AUM/Equity	7.1	5.1	4.7	4.7	4.8
Assets / Equity	7.9	6.0	5.3	5.3	5.4
Dividend Payout	16.7	28.6	32.6	26.9	22.2

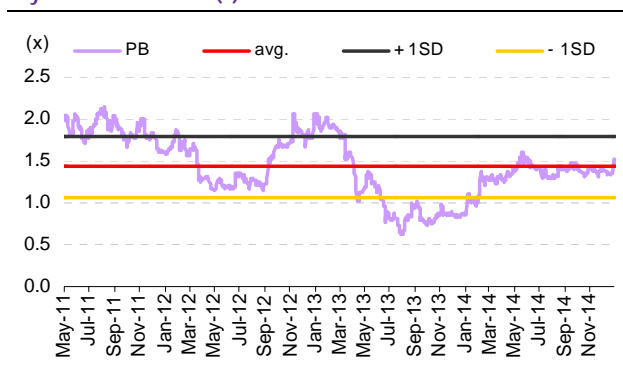
## Valuation metrics

Year to 31 Mar	FY13	FY14	FY15E	FY16E	FY17E
Net Profit	10,043	7,801	7,310	9,233	11,616
EPS (Rs)	27.0	21.0	19.0	23.3	29.3
EPS growth (%)	4.8	(22.3)	(9.4)	22.3	25.8
PE (x)	7.3	9.3	10.3	8.4	6.7
P/BV (x)	2.0	1.7	1.5	1.3	1.2
P/Adj BV (x)	2.2	1.9	1.7	1.5	1.3
P/PPOP (x)	4.6	5.9	6.3	5.0	4.0
RoA (%)	3.8	2.8	2.8	3.2	3.5
RoE (%)	30.2	19.5	15.6	16.9	18.7
Dividend Yield (%)	2.3	3.1	3.2	3.2	3.3

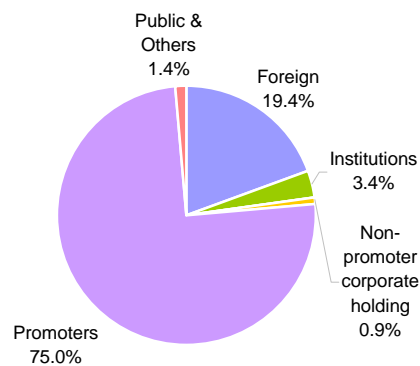
## Operating ratios

Year to 31 Mar (%)	FY13	FY14	FY15E	FY16E	FY17E
Net Interest Margin	1,011	875	914	1,000	1,054
Non Interest Income /					
Operating Income	0.9	1.7	1.6	1.4	1.4
Cost/Income	37.6	46.7	50.3	47.8	45.8
Operating Expense/Avg assets	3.7	3.9	4.4	4.6	4.6
Credit Costs / Avg Loans	0.4	0.2	0.1	0.1	0.1
Effective Tax Rate	33.6	34.6	34.6	34.6	34.6
Net Interest Margin (AUM)	997	946	994	1,070	1,122

## 1-year forward P/BV (x)



## Shareholding pattern



As of September 2014

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