

Manappuram Finance Ltd

INR 98

KRChoksey INSTITUTIONAL

Scalable and profitable franchise

BUY

With a huge beat on PAT at INR 1924 mn (sturdy 20% sequential growth), Manappuram Finance (MGFL) recorded an all-round performance for Q2FY17. Product diversification strategy and rising gold loan volumes (gold holdings up 15% Y-o-Y; leveraging the on-line gold loan product) coupled with improved gold loan quality hinging upon reduction in auction losses and greater thrust on collections emerging from rapidly improving microfinance segment have boosted the earnings for the quarter. Strong loan book traction (clocking 11% Q-o-Q, 40% Y-o-Y growth) and best-in-class asset quality (gross NPAs at 0.9% at 90 dpd).

Therefore, with legacy issues behind and regulatory environment turning favorable in turn aiding traction in gold portfolio, MGFL's strategy of foraying into higher yielding non-gold products such as microfinance and home finance will form the key levers to growth sustainability ahead. With structural growth story in place and operating leverage flowing through, MGFL stands geared to build a scalable and profitable model. Capital sufficiency (Tier 1 at 21.4%, CAR at 21.8%) with lower gearing levels (leaves ample scope for increase and in turn fuel growth), rating upgrades from agencies and healthy return profile further reinforces our confidence in the company prompting us to MAINTAIN BUY.

Business momentum - sustainable: The AUMs as at the end of Q1 stood at INR 145 bn registering 11.3% Q-o-Q growth buoyed by healthy 11% Q-o-Q growth in gold loans, staunch micro finance business traction at (191%+ Y-o-Y growth, albeit on a small base), followed by equally healthy traction in vehicle and home loan segments.

The gold holdings at 65.9 tonnes observed an increase of 4% Q-o-Q and 15% Y-o-Y driven by volume increase. The declining auction losses and the company migrating to short tenure loan assets (3 month products with maximum LTV of 75%) and traction in online gold product (online gold loan product which forms 5.4% of total gold collateral) have aided MGFL's gold business momentum.

The product diversification strategy with intent to minimize credit concentration risks has proved to be the bedrock of a scalable and profitable business model for MGFL.

The RoA accretive microfinance business records continued traction that can be largely attributed to increased efforts to grow into a pan-India player (penetrated into 14 states now) leveraging upon existing MGFL network, AUM accretion from new states, and greater emphasis on collections and ratings upgrade. The microfinance AUMs at INR 15.7 bn today has grown three-fold over the past one year. Against this backdrop, we envisage microfinance business to swell into one of the largest profit contributors recording 50% CAGR over next two years. Besides, the home loan and commercial loans of INR 2.1 bn+ each stood equally strong during the quarter gone by.

The share of new businesses (microfinance, mortgage and housing and commercial vehicle financing) increased to 12% in Q1FY17 of overall AUMs that's expected to expand to 25% by FY18 as MGFL leverages upon its operational capabilities processing; large volumes, small ticket lending transactions in the hinterland markets.

The share of incremental business has risen to 15% of the overall AUMs. The 50% of the loans being rolled over the same day, 40% of the business emerging from the existing customer base and 10% from the new additions strongly evidences the upbeat business volumes for the company.

Consequently, the yields moved higher to 24.5% (Q2FY17) as against 21.8% the corresponding quarter previous year and in turn boosted the margins to as high as 15.8% during Q2FY17 from 12.0% a year ago. Moreover, the robust borrowings mix (benefits accruing from falling interest rate scenario with 62% of borrowings emerging from bank finances, investment grade rating benefits) also supported the margins momentum with cost of funds declining to 10.1% in Q2FY17 from 11.1% in Q2FY16 (and 10.4% in Q1FY17). A robust asset mix and strong margins translated into healthy NII for the quarter at INR 5.4 bn reporting sturdy 77.6% Y-o-Y and 13.6% Q-o-Q growth.

With gold loan segment pacing up led by rising volumes backed up with online gold facility and steady prices coupled with the new short tenure loan focused strategy and the diversified non-gold portfolio mix with micro-finance on acceleration mode, we tweak our AUM estimates for FY17 and FY18. While the non-gold portfolio together is likely to form almost 25% of total AUMs (by FY18E) driving the AUM traction over FY16-18E, we envisage overall AUMs to grow at 29% CAGR for FY17-18E.

Target Price (INR): 130

Potential Upside : 33%

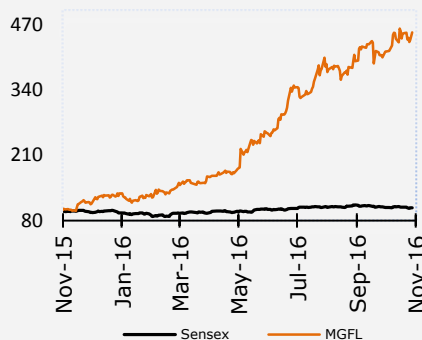
Market Data

Shares outs (Mn)	841
EquityCap (INR Mn)	1683.2
Mkt Cap (INR Mn)	85970.7
52 Wk H/L (INR)	107/22
Volume Avg (3m K)	6005.41
Face Value (INR)	2
Bloomberg Code	MGFL IN

Market Info:

SENSEX	27518
NIFTY	8526

Price Performance



Share Holding pattern (%)

Particulars	Sep16	Jun16	Mar16
Promoters	34.4	34.36	33.69
FII's	35.53	35.85	36.71
DII's	5.28	4.98	3.35
Others	24.79	24.82	26.24
Total	100	100	100

Source: BSE

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Asset quality - unblemished: With stressed legacy gold portfolio behind and MGFL focusing on shorter tenure products, laying greater emphasis upon regular interest collections and tightened recognition norms, the asset quality stands as one of the best in the industry.

The gross NPAs have improved to 0.9% of AUM; despite MGFL moving to 90 dpd recognition norm and net NPAs declining to 0.7%; company adopting 40 bps provisioning norm as per RBI guidelines. Recalibration of the troubled gold loan portfolio, introduction of shorter tenure loans, decreasing auction amounts and 2/3rd of customers having moved to online gold product facility have aided enrichment of asset quality. Going forward, while we incorporate tad higher NPAs over FY17-18E in the range of 1.1-1.2% due to challenging operating environment, we are not unduly worried on the asset quality performance of MGFL and stand confident of the improvement in the same.

Earnings traction/ return ratios - trending higher: Advantages emerging from strong retail customer base and rich retail franchise, improving cost matrix (improved opex/AUM dropping to 6.9% in Q2FY17 from 8.2% a year ago; that is estimated to come down to 5% levels ahead), gearing at 3.8x leaving ample scope to increase leverage that should aid the non-gold business growth, capital sufficiency (21.8% Total CAR) should boost earnings momentum with PAT expected to clock 30%+ CAGR over FY17-FY18E. Consequently, MGFL should record higher RoEs in the range of 17% to 20% over FY17-18E from lower levels of 8% to 10% between FY13-FY15.

Valuation & Recommendation:

Catering to the bottom-of-the pyramid and niche presence spread across the lucrative gold loan and MSME portfolios with increased focus on home loan segment should go a long way in driving the value growth. The product diversification strategy with intent to minimize credit concentration risks has proved to be the bedrock of a scalable and profitable business model for MGFL. Moreover, robust capital base at healthy 21%+ and relatively lower gearing levels (3x - 4x) provide substantial headroom to boost future growth and enhanced return ratios (20% RoEs by FY18E). Moreover, the consistent dividend payout records is icing on the cake.

Therefore, incorporating business growth (tweaked gold loan annual growth to 20% and microfinance 100% Y-o-Y on a lower base for FY17) and subsequent higher earnings, we tweak our multiples and **value MGFL at SoTP valuations, with gold business at 3.0x P/BV, micro-finance at 4.2x P/B FY18E. Subsequently, our target price stands maintained at INR 130; especially post the recent run-up. At CMP, the stock is trading at 2.4x P/ABV FY18E. Maintain conviction BUY.**

Key Financials

INR mn	FY14	FY15	FY16	FY17E	FY18E
Net Interest Income	10,494	10,908	14,016	17,088	21,635
Pre-provision profits	3,899	4,419	5,933	8,325	11,132
Net Profit	2260	2713	3534	5108	6862
EPS (INR)	2.7	3.2	4.2	6.1	8.2
EPS growth	8.5	20.1	30.2	44.6	34.3
BVPS (INR)	28.7	30.3	31.9	35.7	40.8
Price to earnings (x)	36.4	30.3	23.3	16.1	12.0
Price to book (x)	3.4	3.2	3.1	2.7	2.4

Source: KRChoksey Research

Impact of demonetization of currency notes by GoI on Manappuram business in the words of Management:

The company observes this as a lucrative opportunity foreseeing shift of gold loans from unorganised sector to the organized sector.

MGFL stands quite prepared for the transition process.

The cash disbursements under gold loan portfolio are restricted up to INR 1 lakh. 50% of the gold loan disbursements happen seamlessly through NEFT.

The company is aggressively promoting the online gold loan product which forms 5.4% of total gold collateral.

MGFL is developing new age fintech business opportunity which should aid streamlining of collections without glitches.

Many customers are already using the same even for repayment purposes.

Some issues with demonetized currency can be settled in next 10 days and hence overall no negative impact.

70% of the customers being bankable streamlining of processes such as repayments or collections can be seamless through technology.

Also, 2/3rd of customers have already moved to online gold product facility making the demonetization impact negligible.

All-in-all the demonetization impact should remain transient and the processes should normalize in a week's time.

Q2FY17 Earnings

INR in mn	Q2FY17	Q1FY17	Q2FY16	Q-o-Q	Y-o-Y
Income Statement					
Interest income	8,393	7,433	5,480	12.9%	53.1%
Interest expense	2,959	2,649	2,421	11.7%	22.2%
Net interest income	5,434	4,784	3,059	13.6%	77.6%
Non interest income	97	75	86	29.7%	12.8%
Total Net Income	5,530	4,858	3,145	13.8%	75.8%
-- Employee costs	1,317	1,207	1,054	9.2%	25.0%
-- Other operating expenses	1,087	988	1,015	10.0%	7.1%
Operating expenses	2,404	2,195	2,069	9.5%	16.2%
Pre-provision profits	3,126	2,663	1,077	17.4%	190.4%
Provisions	187	169	82	10.6%	126.7%
Profit before tax	2,939	2,495	994	17.8%	195.7%
Tax expense	1,016	891	364	13.9%	179.1%
Net profit	1,924	1,603	630	20.0%	205.3%
Balance Sheet summary					
Networth	30,602	29,182	26,640	4.9%	14.9%
Borrowings	109,026	110,784	87,668	-1.6%	24.4%
Advances	143,779	129,638	102,602	10.9%	40.1%

Source: KRChoksey Research

Financials

Income Statement

INR in mn	FY14	FY15	FY16	FY17E	FY18E
Income Statement					
Net interest income	10,494	10,908	14,016	17,088	21,635
Other operating income	245	182	113	217	300
Non-interest income	114	70	136	175	176
Operating income	10,852	11,160	14,264	17,480	22,112
Operating expenses	6,953	6,741	8,332	9,155	10,979
Pre-provisioning profits	3,899	4,419	5,933	8,325	11,132
Provisions for contingencies	469	282	517	574	650
PBT	3,430	4,137	5,484	7,751	10,482
Tax	1,170	1,422	1,932	2,597	3,512
PAT	2,260	2,713	3,534	5,108	6,862

Source: KRChoksey Research

Balance Sheet

INR in mn	FY14	FY15	FY16	FY17E	FY18E
Balance sheet					
Equity capital	1682	1682	1682	1682	1682
Reserve & Surplus	23,235	24,849	26,110	29,721	34,477
Net worth	24,917	26,532	27,792	31,403	36,160
Borrowings	77,954	86,320	83,674	128,508	168,254
Current liabilities and provisions	5,513	3,311	16,925	4,732	5,902
Total	108,385	116,163	128,392	164,289	209,961
Loan book	82,420	96,221	113,853	149,694	193,343
Investments	7956	2169	491	551	651
Fixed assets	2067	2066	2303	1726	1332
Deferred tax assets	289	310	434	310	310
Current assets, loans and advances	15,653	15,397	11,311	12,009	14,326
Total	108,385	116,163	128,392	164,289	209,961

Source: KRChoksey Research

	FY14	FY15	FY16	FY17E	FY18E
Growth (Y-o-Y)					
Borrowed funds	-20.6%	10.7%	-3.1%	55.2%	30.9%
Advances	-18.0%	16.8%	19.9%	30.2%	29.3%
Total assets	-14.8%	7.2%	10.5%	28.0%	27.8%
NII	-0.7%	4.0%	28.5%	21.9%	26.6%
Non-interest income	75.7%	-29.8%	-1.3%	57.7%	21.4%
Operating expenses	1.0%	-3.0%	23.6%	9.9%	19.9%
Operating profits	0.1%	13.3%	34.3%	40.3%	33.7%
Provisions including write-offs	-43.4%	-39.8%	83.5%	11.0%	13.2%
Reported PAT	8.4%	20.1%	30.2%	44.6%	34.3%

	FY14	FY15	FY16	FY17E	FY18E
Spreads / margins					
Lending spread	12.1%	11.1%	11.0%	10.6%	11.2%
NIM	11.3%	12.1%	13.7%	12.9%	12.6%
Profitability					
ROA	1.9%	2.4%	3.0%	3.5%	3.7%
ROE	9.2%	10.6%	12.8%	17.4%	20.5%
Opex/AUM	7.7%	7.6%	7.9%	7.0%	6.4%
Assets quality					
Gross NPAs	1.2%	1.1%	1.0%	1.1%	1.2%
Net NPAs	1.0%	0.9%	0.7%	0.8%	0.8%
Capital adequacy					
Tier I (%)	26.7%	25.1%	23.5%	18.6%	16.4%
CAR (%)	27.7%	25.6%	24.0%	21.3%	18.7%
Du Pont analysis					
NII / assets	9.7%	9.4%	10.9%	10.4%	10.3%
Other income / assets	0.1%	0.1%	0.1%	0.1%	0.1%
Total income / assets	10.0%	9.6%	11.1%	10.6%	10.5%
Cost to assets	6.4%	5.8%	6.5%	5.6%	5.2%
Provisions / assets	0.4%	0.2%	0.4%	0.3%	0.3%
ROA	2.1%	2.3%	2.8%	3.1%	3.3%
Per share Data					
Earnings per share (Rs)	2.7	3.2	4.2	6.1	8.2
Dividend per share (Rs)	1.8	1.8	1.8	2.0	2.2
Book value per share (Rs)	28.7	30.3	31.9	35.7	40.8
Price to earnings (x)	36.4	30.3	23.3	16.1	12.0
Price to book (x)	3.4	3.2	3.1	2.7	2.4
Dividend payout ratio (%)	66.9%	55.7%	42.8%	32.9%	26.9%

Source: KRChoksey Research

Date	CMP (INR)	TP (INR)	Recommendation
11-Nov-16	98	130	BUY
10-Aug-16	88	130	BUY
13-May-16	50	72	BUY
15-Mar-16	35	52	BUY

Rating Legend	
Our Rating	Upside
Buy	More than 15%
Accumulate	5% - 15%
Hold	0 - 5%
Reduce	-5% - 0
Sell	Less than -5%

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