MANAPPURAM FINANCE LIMITED

Make Life Easy

Jun-2016

2 JUNE

2016 INITIATING COVERAGE

I SECTOR: FINANCE

Manappuram Finance

STOCK INFO.	**BLOOMBERG**
BSE Sensex :	MGFL:IN
26843 S&P	**REUTERS CODE** MNFL.NS
CNX : 8219	

Y/E MARCH	FY16	FY17E	FY18E (INR CR)
NII (INR Cr.)	1,402	1,697	2,005
PPP (INR Cr.)	593	754	925
NP (INR Cr.)	353	451	558
EPS (Rs)	4.2	5.4	6.6
EPS Growth (%)	30%	28%	24%
ABV/Share (Rs)	32.0	34.5	38.2
P/E (x)	12.6	9.9	8.0
P/BV (x)	1.6	1.5	1.3
RoE (%)	12.8	15.3	17.3
RoA (%)	3.0	3.3	3.4
Div yld (%)	3.4%	3.4%	3.4%

KEY FINANCIALS

Shares Outstanding (Cr)	84.12
Market Cap. (INR Cr)	4,463
Market Cap. (US$ M)	666
Past 3 yrs NII Growth (%)	10
Past 3 yrs NP Growth (%)	19
Dividend Payout (%)	43

STOCK DATA

52-W High/Low Range (INR)	56/2
0 Major Shareholders (as of Mar'16)	
Promoter	33.7
Non Promoter Corp Holding	40.1
Public & Others	26.3
Average Daily Turnover(6 months)	
Volume	3,570,909
Value (INR cr)	12.9
1/6/12 Month Rel. Performance (%)	31/101/72
1/6/12 Month Abs. Performance (%)	35/103/68

Maximum Buy Price: INR60

CMP: INR53 | **TP: INR75 (+41%)** | **Buy**

INVESTMENT ARGUMENT:

Revamped the business model to de-risk gold loan business: Post the FY12-14 period, when the gold loan industry faced regulatory challenges coupled with steep decline in gold prices, Manappuram re- aligned its business model to de-risk it from volatility in gold prices. The key changes it made to the core gold loan business were: (a) introduced shorter duration products of 3-6 months (12 month earlier) and recalibrated LTV to link it to product tenure i.e. lower LTV for higher tenure and vice versa and (b) adopted push approach instead of pull earlier - started reaching out to customers through enhanced marketing and branch activation efforts and linked employee incentives to sourcing business, timely recovery and default rates. The new business model built around lower LTVs and branch activation should lead to a revival in earnings growth.

Synergistic diversification into new businesses: Manappuram has forayed into synergistic non-gold businesses - microfinance, home loans, CV loans and LAP. The objectives behind this diversification are (a) to reduce dependence on gold loans and gold price fluctuation, (b) to capitalise on its proven operational capability to process large volume, small ticket transactions with semi-urban and rural customers, (c) to leverage its strong 19.3 lac retail customer base and retail network of 3,293 branches, (d) to utilize excess capital (CAR of 24.0%) and (e) to leverage upon Manappuram's existing brand image.

Recovery in ROE on the back of higher operating and financial leverage: Earlier, AUM de-growth led by regulatory issues resulted in a decline in return ratios due to fixed Opex costs. With focus on improving productivity, Manappuram has not increased gold branches post FY13 to boost operating leverage. We thus expect Opex to AUM ratio to decline as AUM growth improves thereby driving ROA from 3.0% in FY16 to 3.4% by FY18E. Along with increase in leverage from 4.5x to 5.6x, RoE is set to improve from 12.8% in FY16 to 17.4% by FY18E.

Valuations not factoring in the changed business model and expansion in new businesses: With a change in the gold loan business model and expansion in new businesses, we expect increased earnings visibility with stable asset quality and improvement in return ratios. The measures taken by Manappuram over the last 15 months to turn around its business prospects should enable it to post 26% earnings CAGR over FY16-18E. We value the standalone business at 1.8x FY18 ABV (lower than 2.1x commanded by asset financiers like SHTF and MMFS having inferior return ratios and asset quality); the microfinance business at 3.0x FY18E ABV (25% discount to our target multiple for SKSM) and housing finance business at 2.0x FY18 ABV (at 40% discount to industry). Consequently, our SOTP value for the company is at INR 75. The stock provides for a dividend yield of 3%.

SOTP Valuation

Entity/Segment	FY18 Adj. BV	Target P/B (x)	Value	Share
Standalone	30.5	1.8	55	73%
Microfinance (90% stake)	5.5	3.0	17	22%
Housing Finance	1.7	2.0	3	5%
Total			**75**	**100%**
CMP			53	
Returns			41%	

AUM growth of 24% over FY16-18E driven by non-gold businesses; non-gold book to form 25% of AUM by FY18E: Non-gold portfolio is expected to grow at 80% as against 14% for gold portfolio over FY16-18E and thus lead to overall AUM growth of 24% over the same period. We model non-gold portfolio to form 25% of overall AUM by FY18E as against 12% as on FY16.

Non-gold businesses (Asirwad Microfinance in particular) to create value in the long run: As on FY16, Manappuram had a loan book of INR 999cr in microfinance, INR 129cr in home Loans, INR 130cr in CV, INR 44cr in LAP and INR 51cr in other segments; aggregating to INR 1,352cr of non-gold loan book. Manappuram acquired 85% stake in Asirvad Microfinance in FY15, (when it had an AUM of INR 322 cr in March 2015) headquartered in TN with operations in T.N, Kerala and Karnataka. Manappuram intends to expand its business to more states. The 85% stake was purchased for a consideration of INR 136cr. Manappuram has further invested INR 100cr during FY16 in the subsidiary and currently holds a 90% stake. The microfinance sector has made a strong comeback in recent months and with a stable regulatory environment in place, future prospects are bright. As a subsidiary of Manappuram, Asirvad has already benefited substantially by access to lower cost funds (credit rating upgraded by 3 notches to A-) which, in turn, is enabling expansion to other states. With a loan book of INR 999cr, Asirvad has already generated ROA of 3.9% in FY16. In the coming quarters, microfinance will contribute significantly to Manappuram's growth along with other new businesses.

Auction losses subsiding, as legacy portfolio runs off: Manappuram's legacy portfolio (higher LTV product, with 1 year duration) ran off in June 2015 and the entire auction was done by August 2015. Auction-related losses, which led to decline in yields and lower NII growth, are now behind. As a result, gold yields increased 200bp QoQ in 3QFY16 and a further 40bp QoQ in 4QFY16 to 24.2%.

CONCERNS

Sharp decline in gold prices: Gold loans constitute more than 88% of total advances. Though the average LTV on the loan portfolio is 70% and most products are now shorter duration, a sharp decline in short time can lead to losses. An appreciation in INR would also lead to a decline in gold prices. Reduction in import duty (10%) can also lead to a correction in gold prices.

Competition: Increased competition from both banks and non-banks could lead to lower lending yields and growth, adversely impacting profitability.

BACKGROUND

Manappuram Finance was incorporated in 1992 and is now the second largest gold loan NBFC in India. The company is promoted by Mr VP Nandakumar, MD & CEO, whose family has been involved in the gold loans business since 1949. Manappuram's AUM stood at INR 114b as on March 2016. It has a pan- India presence, with 3,293 branches across 23 states and 4 union territories, through which the company serves 1.93m customers. Promoters, Mr VP Nandakumar and family hold ~33.7% in the company. Various DIIs and FIIs hold 40%. The senior management comprises professionals with significant experience in the financial services business.

IVRCL: Financials and Valuation

Financials and valuation

Profits to grow at a CAGR of 26% over FY16-18E on the back of strong loan growth, low OPEX and stable credit costs

Income Statement (Consolidated) (INR Cr)

Y/E March	FY14	FY15	FY16	FY17E	FY18E
Interest Income	2,076	1,968	2,349	2,822	3,417
Interest Expenses	1,027	877	947	1,125	1,412
Net Interest Income	**1,049**	**1,091**	**1,402**	**1,697**	**2,005**
Change (%)	-1%	4%	28%	21%	18%
Non Interest Income	36	25	25	27	29
Net Income	**1,085**	**1,116**	**1,426**	**1,724**	**2,035**
Change (%)	1%	3%	28%	21%	18%
Operating Expenses	695	674	836	970	1,110
Pre - Provision Profits	**390**	**442**	**591**	**754**	**925**
Change (%)	0%	13%	34%	28%	23%
Provisions	47	28	42	60	61
PBT	**343**	**414**	**548**	**694**	**864**
Tax	117	142	193	236	294
Tax Rate (%)	34%	34%	35%	34%	34%
PAT before Min. Int.	226	271	355	458	570
Less: Min. Int.	-	0	2	7	12
PAT after Min. Int.	**226**	**271**	**353**	**451**	**558**
Change (%)	8%	20%	30%	28%	24%

Advances to grow at 24% in FY17E supplemented by higher gold prices; and at over 20% post FY17E given the rising mix of fast growing non-gold businesses

Balance Sheet (Consolidated) (INR Cr)

Y/E MARCH	FY14	FY15	FY16	FY17E	FY18E
Equity Share Capital	168	168	168	168	168
Reserves & Surplus	2,324	2,465	2,590	2,815	3,136
Net Worth	**2,492**	**2,633**	**2,758**	**2,983**	**3,304**
Min. Int.	-	15	21	28	40
Pref. Sh.	-	5	5	5	5
Borrowings	**7,795**	**8,632**	**9,638**	**12,393**	**15,298**
Other Liabilities	551	331	417	459	536
Total Liabilities	**10,838**	**11,616**	**12,839**	**15,867**	**19,183**
Cash & Bank balances	863	823	463	236	280
Investments	796	217	49	49	49
Loans	8,242	9,622	11,519	14,439	17,572
Net Fixed Assets	207	207	230	190	147
Other Current Assets	702	716	534	910	1,092
Deff Tax Asset	29	31	43	43	43
Total Assets	**10,838**	**11,616**	**12,839**	**15,867**	**19,183**

Asset quality to remain stable

Asset Quality (Consolidated) (%)

GNPA	99.6	108.4	100.8	129.5	157.4
NNPA	82.3	90.0	70.6	82.4	89.2
GNPA Ratio	1.2%	1.1%	1.0%	1.1%	1.2%
NNPA Ratio	1.0%	0.9%	0.7%	0.7%	0.7%
PCR	17%	17%	30%	36%	42%

IVRCL: Financials and Valuation

Expect yields to decline due to a gradual rise in competition

High capital adequacy to fuel advances growth without dilution

Stock trades at 1.3x FY18E P/ABV with advances/profit growth of 24%/26% over FY16-18E and ROE improving from 12.8% in FY16 to 17.3% in FY18E

Financials and valuation

Ratios (Consolidated)

Y/E March	FY14	FY15	FY16	FY17E	FY18E
Avg. Yield on loans	**22.9%**	**22.2%**	**22.4%**	**21.9%**	**21.5%**
Avg. Cost of Borrowings	12.9%	12.3%	11.0%	10.8%	10.8%
Spread	10.0%	9.9%	11.4%	11.1%	10.7%
Net Interest Margin	**11.3%**	**12.1%**	**13.2%**	**13.0%**	**12.5%**
Profitability Ratios (%) (Consolidated)					
RoE	9.2%	10.6%	12.8%	15.3%	17.3%
RoA	1.9%	2.4%	3.0%	3.3%	3.4%
Cost to Income	64.1%	60.4%	58.6%	56.3%	54.5%
CAR	27.7%	25.6%	24.0%	20.9%	19.1%
Valuation (Consolidated)					
Adj. Book Value Per Share (Rs)	28.7	30.3	32.0	34.5	38.2
Change (%)	2%	6%	6%	8%	11%
Price-BV (x)	-	-	**1.6**	**1.5**	**1.3**
EPS (Rs)	2.7	3.2	4.2	5.4	6.6
Change (%)	8%	20%	30%	28%	24%
Price-Earnings (x)	-	-	**12.6**	**9.9**	**8.0**
Dividend Per Share (Rs)	1.8	1.8	1.8	1.8	1.8
Dividend Yield (%)	-	-	**3.4%**	**3.4%**	**3.4%**

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