Manappuram Finance (MGFL IN)

Rating: ACCUMULATE | CMP: Rs176 | TP: Rs195

Transforming into a full-fledged NBFC model

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Company Initiation

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Transforming into a full-fledged NBFC model

We are initiating coverage on Manappuram Finance (MGFL) with an Accumulate rating given strong moat in gold loan business (11%CAGR over FY20-22, secured lending, brisk asset liquidation) and rising scalability of non-gold business. MGFL stands in a sweet spot underpinned by low leverage (<5x) and effective asset liability management (ALM). We estimate 20% AUM CAGR, operating leverage (~145bps cost-income decline) and prudent asset quality (~0.8% GNPA/credit costs) over FY20-22E. The recent valuation uptick has been factoring in the higher yielding business (87% of total) expansion that is expected to fetch higher returns (5.1%RoA/18.9%RoE: FY22E). However, any further re-rating is function of non-gold business scalability and delinquency control across new business cycles. Hence, we recommend Accumulate rating valuing consolidated business at 1.9x PABVSep'21E arriving at price target of Rs 195.

In a sweet spot: MGFL stands in a sweet spot underpinned by (a) opportunity to tap the gold lending market expansion at 11%CAGR (b) low levered business (<5x), (c)effective ALM (~90% assets maturing < 1 year), (d) gold lending business moat (self-liquidating, secured) and (e)anticipated non-gold business share scaling up to 46% (current 33%) by FY22.

AUMs to grow at 20%CAGR over FY20-22E: We expect steady 11% gold AUM CAGR over FY20-22E led by business recalibration (100% short tenure assets; 43% online gold) and book granularity (steady ticket sizes: Rs35,300; steady yields at 25% reflecting pricing power). Going forward, the incremental book expansion is expected to be largely driven by high profitable businesses of micro finance, vehicle and housing finance. Led by consistent customer addition and cross sell initiatives, we expect micro finance business to record 40% AUM CAGR, affordable housing and vehicle finance each to record 30% CAGR over FY20-22E. Blended AUMs to grow at 20%CAGR to Rs334bn by FY22E.

Guarded gold asset quality; non-gold closely monitored: We expect MGFL to restrict both GNPAs and credit costs below 0.8% by FY22E on the back of (a) seasoned gold business (0.7%NPA) with reduced auctions, regular interest collections (b) robust risk matrix, collection infrastructure across non-gold. We incorporate weakness in vehicle/home finance on account of low portfolio seasoning and forecasts (a) elevated 2% vehicle Finance NPA (b) declining housing finance NPA to 3.3% & (c) stable 0.6% micro finance NPAs by FY22E.

Operating metrics strengthening: MGFL's higher yielding business (87%: gold+micro finance) and gradual operating leverage (~145bps cost-income decline) offsetting funding costs pressures (10.7%: FY22) should translate into 21% operating profit CAGR over FY20-22E. The higher yielding business (87% of total) uptick is expected to maintain high return profile (5.1%RoA/18.9%RoE: FY22E).

Key Financials - Consolidated

Y/e Mar	FY19	FY20E	FY21E	FY22E
Net Int.Inc. (Rs m)	27,763	31,507	38,366	44,862
Growth (%)	*16.5*	*13.5*	*21.8*	*16.9*
Op. Profit (Rs m)	14,109	16,202	21,043	24,345
PAT (Rs m)	9,295	12,049	15,069	17,242
EPS (Rs.)	11.0	14.1	17.4	19.8
Gr. (%)	*37.5*	*27.5*	*23.8*	*13.7*
DPS (Rs.)	2.2	2.9	4.0	4.8
Yield (%)	*1.3*	*1.6*	*2.3*	*2.7*
Margin (%)	*15.8*	*14.8*	*15.0*	*14.6*
RoAE (%)	*22.3*	*22.6*	*21.4*	*18.9*
RoAA (%)	*5.0*	*5.3*	*5.4*	*5.1*
PE (x)	15.9	12.5	10.1	8.9
P/ABV (x)	3.3	2.5	1.9	1.5

Key Data	MNFL.BO | MGFL IN
52-W High / Low	Rs. 178 / Rs. 89
Sensex / Nifty	41,575 / 12,246
Market Cap	Rs. 149 bn/ $ 2,083 m
Shares Outstanding	845m
3M Avg. Daily Value	Rs. 1301.88m

Shareholding Pattern (%)

Promoter's	35.12
Foreign	43.21
Domestic Institution	5.99
Public & Others	15.68
Promoter Pledge (Rs bn)	1.76

Stock Performance (%)

	1M	6M	12M
Absolute	10.0	25.8	95.6
Relative	8.6	19.8	68.4

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Company Background

Transforming into a full-fledged NBFC model

NBFCs have been casualties of liquidity and confidence crisis alike since ILFS mess unfolded in Sep'18. In such times, few players have truly emerged as winners due to uniqueness of business and demonstration of capabilities.

The second largest gold financier by asset size (Rs226.8bn), Manappuram Finance (MGFL) with 67% business concentrated in lending against gold (Rs152bn) is now transforming into a full-fledged NBFC player.

With an objective to bring stability to balance sheet and reduce business concentration risks, the company kick-started product diversification drive back in 2015 foraying to micro finance, vehicle and housing finance portfolios (these form 33.1% of overall AUMs). Proven operating systems, huge customer base (4.7mn), established brand name, ready business team and robust risk management practices place MGFL favorably to enter next phase of growth led by non-gold business segments. The product diversification strategy is beginning to pay off in light of the current rout in NBFC environment, the latest Kerala-political warfare and the volatility in gold price fluctuations.

While the gold financing business stands on strong footing, the non-gold diversification into vehicle, housing and micro-finance expected to form growth engines ahead. With steadfast customer addition and operating leverage gradually playing out, MGFL stands in a sweet spot.

Exhibit 1: Evolution of business strategy over the years

Current Business Strategy
Strengthen Core business- Gold Loan business
(1) De-linking gold biz from gold prices
(2) Focus on branch activations through increased incentives & performance scorecard
(3) Enhanced marketing initiatives
Addition of Synergistic new biz segments
(1) Leveraging strong brand equity & existing retail customer base
(2) Addition of new synergistic product segs- microfin, mortgage & Hsg fin, CV lending
Diversification
Microfinance Segment
(1) Acquired majority stake (85%) in Asirvad Microfinance Pvt Ltd,
one of the leading microfinance institutions in TN in Feb 2015
(2) 8-year old NBFC-MFI with operations in TN, Kerala and Karnataka
(3) Current loan portfolio at INR 5388 mn as on Sep 2015
(4) Credit rating improved from BBB- to A-.
(5) Focus on low income borrower
(6) To expand into other states leveraging Manappuram's network
It has extended its presence to five new territories, Madhya Pradesh, Chhattisgarh, Punjab, Haryana, Chandigarh and UP.
Their credit rating has gone up by three notches to A- from
BBB- with an improved access to lower cost capital
Mortgage & Housing segment
(1) Started commercial operations in January 2015
(2) Current loan PF stood at INR 866 mn as on Sep 2015
(3) Recently started LAP segment
(4) Focus on affordable housing for mid to low income group
(5) To open more branches in urban & semi-urban locations in South & West India
Commercial vehicles segment
(1) Launched loans for CVs, selectively in Southern & Western India
(2) Current loan PF: INR 591 mn -Sep 2015
(3) Focus on Under-served category of customers who do not have access to formal banking system
(4) To open more branches in rural and semi-urban locations

Source: Company, PL

Gold lending business per se offers business moat and higher RoA; MGFL stands poised to continue to grow its gold business side steadily

Investment Thesis

In a sweet spot

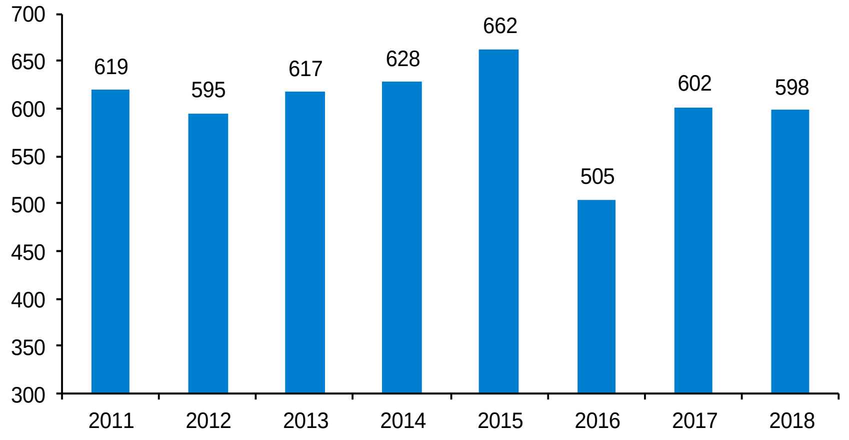
NBFCs have been casualties of liquidity and confidence crisis since ILFS mess unfolded in Sep'18. Amidst the market headwinds, Manappuram Finance (MGFL) stands out led by

- Gold financing presenting a structural opportunity
- MGFL having a strong moat in gold financing
- MGFL's non-gold business gaining scale

Gold financing – a structural opportunity

India stands amongst top gold consuming nations globally with second largest consumer of gold jewelry next to China. Indian households possess abundant gold to the tune of over ~20,000 tonnes worth >USD800bn.

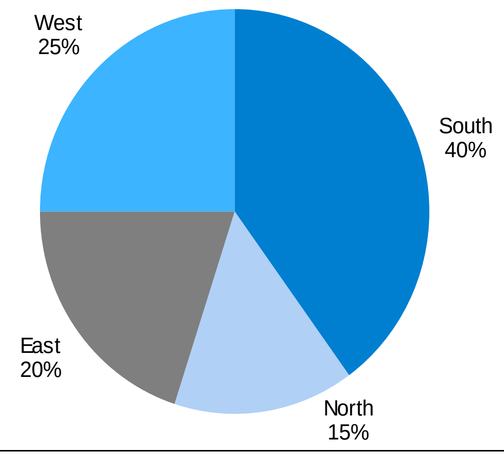
Exhibit 2: Robust Indian Gold demand and investment (in tonnes)



Source: Company, PL

While south dominates gold demand followed by west, rural India contributes 65% to the gold stock in India. With gold being a good hedge against inflation and being highly liquid, meaningful savings flow into gold.

Exhibit 3: Regional distribution



Source: Company, PL

Unabated gold demand in traditional India, flourishing flexible gold-led NBFC business models and low default rates prove as key enablers for gold credit demand sustainability

Given the robust consumption, gold lending demand is here to stay largely led by:

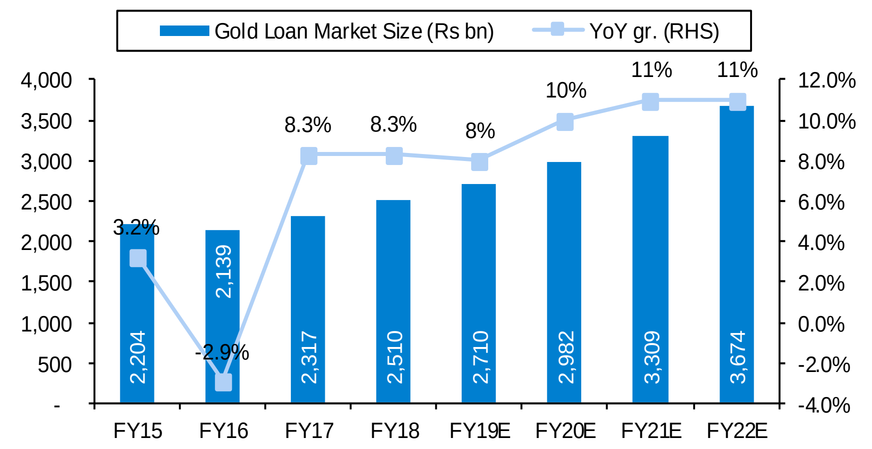
Exhibit 4: Gold lending demand to stay led by strong drivers

Inability to get credit
High economic correlation
Mitigation of taboos
Untapped geographic potential
Gold held by rural India
Flexible lending terms
Low default rates

Source: Company, PL

With industry challenges behind, the gold lending market stands poised to grow. We expect the formal gold loan market to expand to Rs3673.5bn recording 11% CAGR over FY20-22E. As industry harmonizes to accommodate more organized players, we reckon the overall gold loan industry AUM stands poised to climb to Rs8950bn by FY20-end.

Exhibit 5: Gold loan market to expand to Rs3674bn @ 11% CAGR for FY20-22



Source: Company, PL

Flight to safety associated with yellow metal investments, expansion of differentiated NBFC businesses and loan against gold proving as a lucrative funding opportunity ensure high potential gold lending market expansion ahead

While gold loan market stands dominated by unorganized players accounting for 60-70% share, non-banking finance companies (NBFCs) have an edge. Led by differentiated business model, strong footprint, effective underwriting skills and customer centricity, NBFCs' share as part of organized market (37%) is expected to increase further.

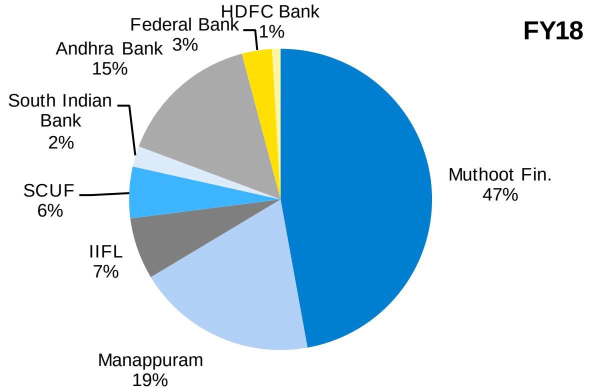
Exhibit 6: ..making them better placed over banks and unorganized mkt

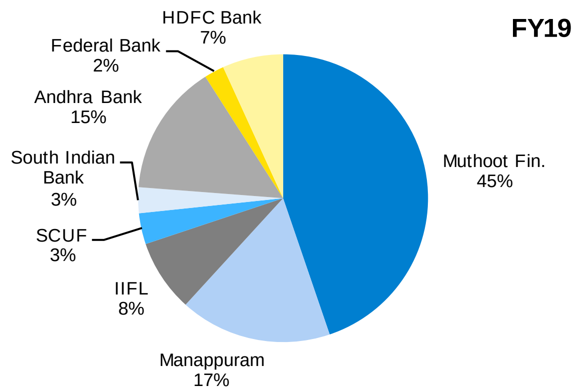
Competitive Advantage to Gold loan NBFC's	Gold Loan NBFC	Banks	Money Lenders
LTV	Upto 75%	Lower LTV	Higher than 75%
Processing Fees	None/ Minimal	Higher	None
Interest Charges	18%-26% pa	12-15% pa	36%-60% pa
Penetration	High	Select Branches	High
Mode of Disbursal	Cash/ Cheque	Cheque	Cash
Working Hours	beyond banking hours	Typical Banking Hours	beyond banking hours
Regulated	RBI	RBI	Not regulated
Office infra	Branch dedicated network	Proper Branch	No fixed place
Customer Service	High- Gold loans is a core Focus	Non-Core/opportunistic	Core focus
Documentation Requirement	Minimal Documentation, ID Proof	Entire KYC Compliance	Minimal Documentation
Repayment Structure	Flexible Re Payment Options. Borrowers can pay both interest and principal at the closure. No prepayment charges	EMI Compulsorily consists of interest and principal. Pre-payment penal is charged	-
Turnaround Time	10 minutes	1-2 Hours	10 minutes

Source: Company, PL

MUTH and MGFL continues to dominate organized gold finance market with 45% and 17% market share as at the end of FY19. We expect MGFL to maintain 19-20% and MUTH closer to 50% market share in the coming years.

Exhibit 7: MUTH and MGFL continue to dominate the gold loan market led by banks/NBFCs





Source: Company, PL

MGFL's gold lending business enjoys strong moat

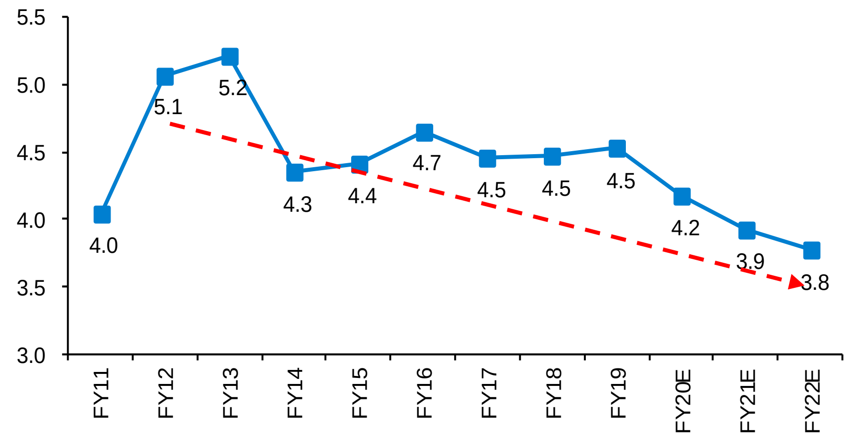
Secured and self-liquidating asset, emotional value associated with underlying security and easier/faster credit against the asset continue to prove key business drivers for gold financiers

Gold loans inherently carry a moat: A secured lending product like gold loan backed by high liquid asset makes it attractive as against other lending products. Around two-thirds of the customers close the accounts within the loan duration itself given the emotive value associated with the pledged ornaments as collateral. Therefore, the possibility of willful defaults based on prices of gold is ruled out. The average life of gold loan being 72 days and borrowers striving to avoid delinquencies makes this credit product self-liquidating. As MGFL's 67% of the business centred around this secured loan asset, the company has faced lower delinquencies and faster asset resolution.

Higher churn rate and with MGFL focusing on 3-month tenure loans, gold lending business proves to be a highly low levered business releasing internal capital for continued business expansion

MGFL's gold is a low levered business: Gold loan business being secured backed by self-liquidating underlying asset poses lower asset side risk for gold financiers. Such a capital accretive business enables to maintain low lever model leaving significant headroom for growth. We expect MGFL's leverage to stay closer to 3.8x levels over next two years.

Exhibit 8: Low leverage levels despite active capital deployment (Update)



Source: Company, PL

MGFL has cut-out strategy wrt capital allocation across key non-gold businesses in-line with the risk factors associated with each

… enabling effective capital allocation: Gold business being capital accretive, MGFL has been in position to diversify and effectively deploy the excess capital towards faster growing micro finance and other businesses. The capital deployment strategy stands in place with 50% capital allocation inclined towards gold loan business, 20% to small ticket mortgages, affordable housing, SME lending and another 15% to vehicle finance business. Cognizant of the inherent unsecured nature of the micro finance (MFI) business, the company has restricted capital allocation of 10% besides an external funding that stands underway. Following exhibit elucidates MGFL's continued support to fast growing MFI subsidiary indicative of effective capital distribution.

A fresh round of capital stands underway to maintain the high growth traction of the MFI business

Exhibit 9: Consistent capital infusion into high growing MFI business

Period	Provided By	Instrument/	Amt (Rs. Mn)
FY16	Manappuram	Equity Capital	999.9
FY16	Manappuram	Corporate Loan	500
FY17	Various Institutions	Tier 2 Debt	1150
FY17	Manappuram	Corporate Loan	750
FY18	Manappuram	Equity Contribution	501.5
FY19	Manappuram	Equity Contribution	3621.22

Source: Company, PL

Amidst ILFS fiasco and liquidity crunch, MGFL's matched ALM structure prove as another key enabler positioning the company favorably for sustained asset growth expansion

Short tenor gold lending aids effective asset liability management (ALM): Retail-NBFCs' asset-liability maturities generally carry positive cumulative mismatches in the near-term bucket of less than one year. Therefore, NBFCs in the consumer, SME, gold loan space have stood relatively unscathed amidst the ongoing liquidity turmoil owing to focus on shorter tenure loans that automatically bring ALM discipline on shorter tenure side. By virtue of high churn and short term collateralized businesses, MGFL has been able to maintain sufficient liquidity and manage ALM risks on balance sheet.

Exhibit 10: Gold financiers better placed on ALM for <1year tenure

Cum mismatch as % of overall outflows	FY15	FY16	FY17	FY18	FY19
MGFL	42%	32%	56%	33%	24%
MUTH	53%	54%	45%	50%	56%
SCUF	86%	85%	49%	65%	50%
BAF	18%	18%	25%	33%	0%
LTFH	-22%	-51%	-41%	148%	-75%
MAGMA	15%	25%	28%	33%	28%

Source: Company, PL

With contractual tenure of gold loans being three months, ~60% of gold loans stand rolled over as fresh loans on or before the respective maturity dates.

88% of MGFL's book stands focused on short-term loans and 92% of assets come up for maturities in less than one-year time frame. Therefore, the ALM cumulative mismatch gap has stood higher than regulatory threshold (-15%) positioning MGFL stronger vis-à-vis other NBFCs.

Exhibit 11: Closer to 90% of assets and liabilities mature in <1 year

	Less Than 1 Year				
ALM	**FY15**	**FY16**	**FY17**	**FY18**	**FY19**
Advances	100%	98%	98%	93%	92%
Borrowings	93%	87%	79%	88%	88%

Source: Company, PL

Exhibit 12: Quick snapshot of MGFL's historical trends of effective ALM in <1 year bucket

Particulars (Rs Mn)	FY15	FY16	FY17	FY18	FY19
Cum Assets	92,260	1,01,036	1,12,781	1,20,085	1,38,029
Cum Liabilities	65,130	76,821	72,102	90,136	1,11,731
Gap	27,130	24,215	40,678	29,949	26,299
(as % of Liabilities)	**42%**	**32%**	**56%**	**33%**	**24%**

Source: Company, PL

Smoother roll over of borrowings and transmission of higher costs pressures backed by pricing power have ensured continued fund flow for MGFL

… **ensuring smoother funds resourcing:** MGFL, with a recalibrated business model, positive ALM, high capital adequacy, and strong internal accruals stands in a strong position to roll over borrowings at relatively better marginal costs. This has ensured sustenance of pricing power backed by a high liquid collateral, ensuring easier access to bond markets as well as bank funding.

Adequately capitalized, headroom for further leveraging

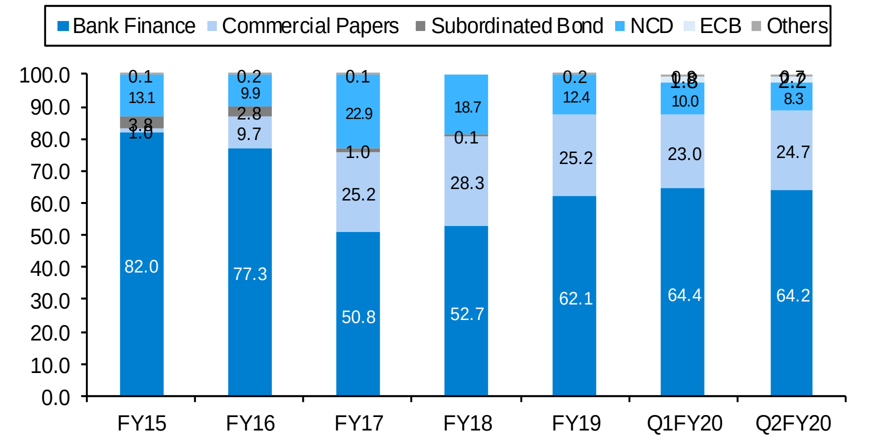
Headroom for further leveraging	FY15	FY16	FY17	FY18	FY19
Overall Borrowings	83,920	88,031	93,740	1,13,596	1,43,081
Cash and bank balances	7921	6059	5893	7241	11642
Tangible Net worth	1,10,194	1,15,399	1,26,847	1,51,740	1,84,230
Capital gearing	4.4	4.7	4.5	4.5	4.5

Source: Company, PL

MGFL's effective liability structure leaves meaningful headroom for another 20% book growth run

MGFL's liability mix has stood fairly stable with 64% overall borrowings emerging from banks including 46% of short term credit such as cash credit, overdraft and working capital liabilities and remainder 19% from pure long term bank loans. NCD and bonds carry smaller proportion at 8.3% of overall mix, however, commercial paper (CP) of predominantly 60-90 day at 25% stands slightly on the higher side. Said that, with continued roll over and borrowing repayments in place coupled with anticipated reduction in CP share ahead hold the liability structure healthy. Moreover, MGFL holds diversified funding lines, with banking lineup (Rs 10.7bn), IFC funds (recent raise USD75mn), NABARD (Rs7bn), retail NCDs and foreign currency bonds. Additionally, micro and commercial vehicle finance portfolios stand eligible for securitization, further widening the funding sources for MGFL.

Exhibit 13: Diversified liability mix



Source: Company, PL

MGFL's non-gold business gaining scale

Industry- specific, business concentration specific and excess capital on BS warrant an opportune time for MGFL like businesses to focus on diversification of product profile

Industry specific challenges (price fluctuations), business volatility (volatile growth and higher interest rates), regional concentration and availability of capital cushion prompted gold financiers to tap opportunities in emerging businesses of micro finance, SME, affordable housing and vehicle finance back in 2015.

Gold finance business models have undergone change for good with diversification into profitable businesses; MGFL being front-runner

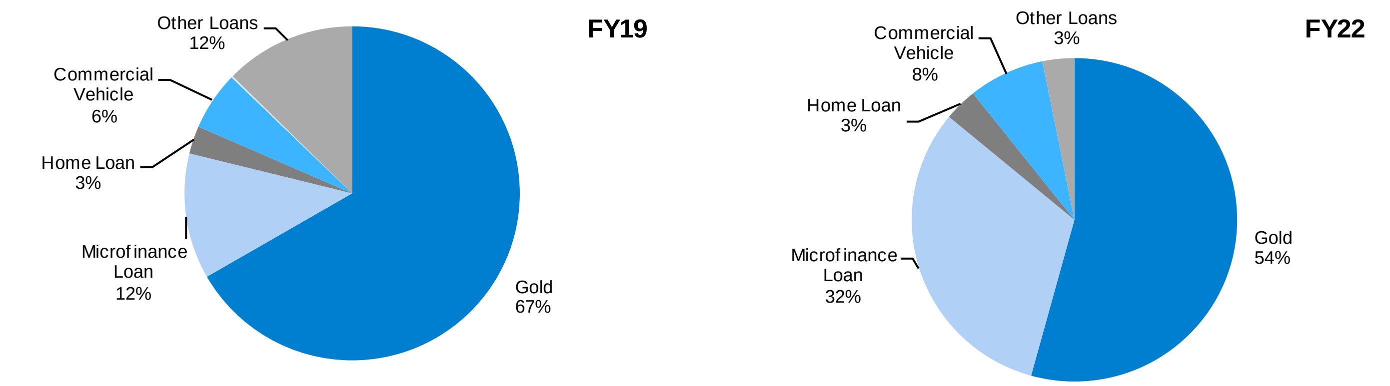
Exhibit 14: Gradual expansion of non-gold business for both MGFL & MUTH

	FY15	FY16	FY17	FY18	FY19
MGFL					
Gold loan AUM mix	100%	88%	81%	74%	67%
Non-gold AUM mix	0%	12%	19%	26%	33%
MUTH					
Gold loan AUM mix	89%	87%	84%	82%	79%
Non-gold AUM mix	11%	13%	16%	18%	21%

Source: Company, PL

Weeding away business concentration risks associated with single-line businesses, MGFL expects to clock non-gold share of 50% of overall mix ahead led by consistent customer addition and cross sell initiatives.

Exhibit 15: Non-gold share FY19 VS FY22

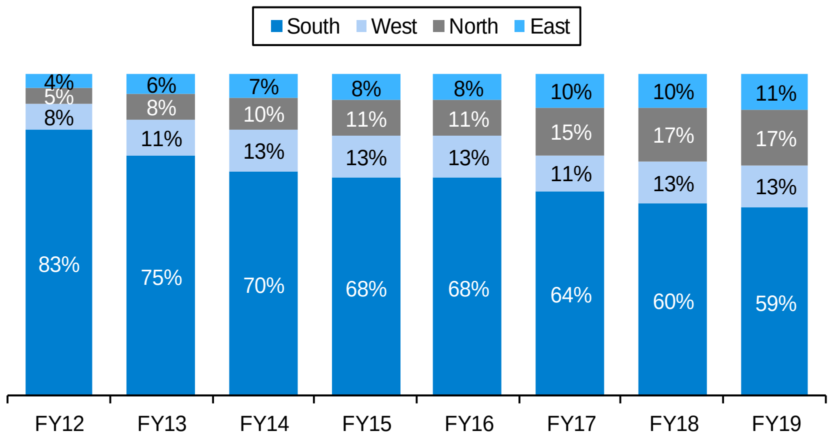


Source: Company, PL

Opportune time for MGFL to expand outside home turf as gold business at home reaches saturation & non-gold requires expansion of portfolios

MGFL has been gradually shedding its regional business image. South based business share declined to 58% in Sep'19 from 68% three years ago. Strategic expansion into relatively unbanked geographies of northern and eastern region of Assam, Tripura, Odisha, Bihar, Uttar Pradesh and Madhya Pradesh offer higher gold loan appetite given lower competition.

Exhibit 16: Shedding regional focus; non-South network catching up



Source: Company, PL

MGFL's foray into high profitable businesses of micro finance, vehicle finance can provide sufficient levers to overall business traction

Cognizant of the frequent gold price fluctuations and the consequent business volatility, MGFL diversified into other products back in FY15. MGFL first forayed into micro finance business through acquisition of one of the top-5 micro finance institutions, Asirvad Micro finance ltd. Further, in 2015 MGFL expanded into higher yielding vehicle and risk guarding home finance businesses as part of its diversification drive.

Exhibit 17: Successful foray into non-gold businesses

	MFI	Vehicle Finance	Housing Finance
Capable Management Team	Mr. Raja Vaidhyanathan Managing Director-MFI **Background:** Erstwhile promoter of Asirvad Microfinabce and an IIT IIM Alumni with over 33 years of experience across industries	Mr. K. Senthil Kumar Head- Commercial Vehicle **Background:** >21 years of experience with organizations such as Fullerton India, Citi Bank, HDFC Bank, etc.	Mr.Jeevandas Naraynan MD- Housing Finance **Background:** Erstwhile MD of State Bank of Travancore and >37 years of experience in financial services industry.
Commencement of Business	Feb-15	Jan-15	Jan-15
Pan-India presence	Branches- 1027 States- 22	Branches- 229 States- 22	Branches- 46 States- 6
Customer profile	Provides Income generating loans, SME Loans & Product loans to low-income populations in rural and semi-urban India.	Focus on Undeserved Category of customers who do not have access to Formal Banking System	Focus on affordable housing for Mid to Low income Group
Average Ticket Size	Rs21,212	0.74 Mn	1 Mn
Yields	19.5%	19.8%	14.9%
AUM in Mn	47242.5	13177.6	5679.3

Source: Company, PL

AUMs to grow at 20% CAGR over FY20-22E

That a gold finance business stands prone to gold price fluctuations is rightly reflected in the AUM traction across cycles (depicted in chart below) for the top two players in the industry.

Exhibit 18: Gold price and AUM trends for MGFL & MUTH

Particulars	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19
Gold price (Rs/10 gram)	8515	9360	12110	15066	16300	20760	28075	29426	28619	26232	29080	28527	30630	31601
Manappuram Gold AUM in Bn	1.3	3.8	5.8	9.9	26.2	75.5	115.3	99.5	81.5	92.2	100.8	111.3	117.4	129.6
Manappuram Gold AUM growth %	*63%*	*186%*	*52%*	*71%*	*165%*	*188%*	*53%*	*-14%*	*-18%*	*13%*	*9%*	*10%*	*5%*	*10%*
Muthoot Finance Gold AUM in Bn	7.6	14.2	21.8	33.0	73.4	157.3	244.2	260.0	216.2	234.1	243.8	272.2	288.5	335.9
Muthoot Finance Gold AUM growth %		*88%*	*53%*	*51%*	*122%*	*114%*	*55%*	*6%*	*-17%*	*8%*	*4%*	*12%*	*6%*	*16%*

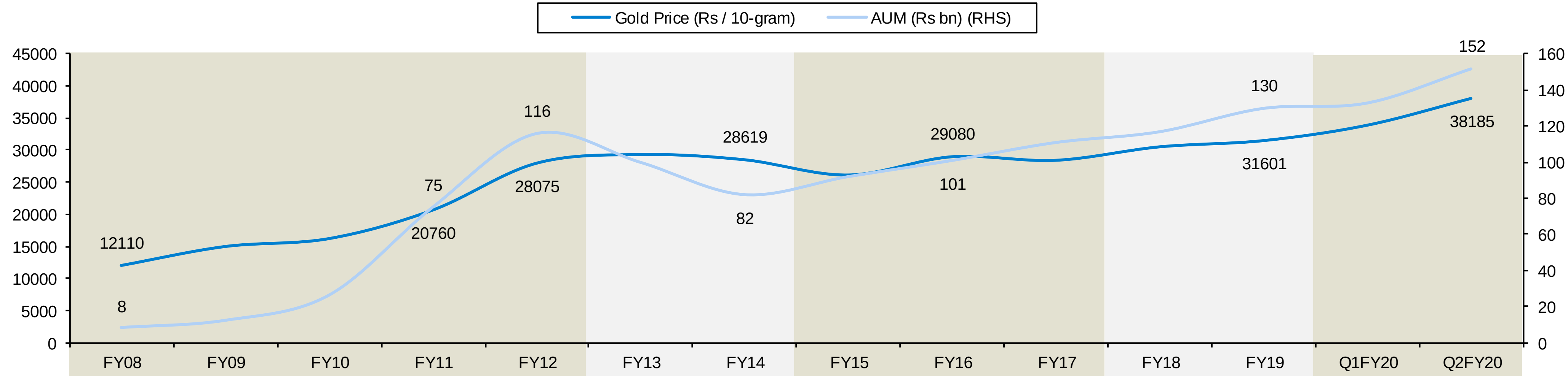
Source: Company, PL

Gold business traction has always moved in tandem with gold price increase; we closely monitor book growth sustainability ahead when chips are down

The continued increase in gold prices between **FY08-FY12** saw emergence of many gold loan NBFCs with few witnessing AUMs exceeding Rs100bn in FY12 as depicted in the data here above. The same period also saw MGFL recording buoyant **AUM growth (95% CAGR**), **stupendous NIMs (16%+)** supported by **higher yields, and lower costs. The branch network almost grew 7x** during the period backed by strong execution capabilities and well defined systems & processes. However, tables turned in FY12 as gold prices plunged, LTVs stood capped, cap on borrowings (maximum borrowing upto INR 2.5 mn) dampened the operating leverage and profitability of the company. NIMs declined to almost 8.5% and opex/AUM ratio stood at 7% levels hindered by waning AUMs (~30% fall in AUMs) during the turbulent period of FY12-14. This in turn depressed the return ratios and profitability. During FY15-FY17, AUM grew at 20% to Rs136.6bn backed by average 14.5% NIMs. While there was a slowdown in branch expansion during FY15-17, the company added ~200 branches during FY18-19. With addition to the branches, NIMs increased to ~16% level and AUM grew at Rs194.3bn with 23% YoY increase during FY19.

Following exhibit offers a quick glimpse of MGFL's business journey across cycles clearly illustrating business momentum across gold price and regulatory challenges

Exhibit 19: Across cycles, gold AUMs trajectory vis-à-vis gold price & industry challenges – price and business traction move in tandem



FY08–FY12

(1) Removal of Gold Loan from PSL by RBI that led to higher borrowing costs for NBFCs

(2) Imposition of LTV cap at 60% only applicable to NBFCs and not banks (75%) weakening competitive positioning of NBFCs as against banks and others

(3) Prohibition of lending against gold coins and bullions

(4) Maintenance of higher Tier 1 capital at 12% by 2014 by Gold Loan NBFCs

(5) Reduction of exposure ceiling by banks on a single NBFC, having gold loans to extent of 50% or more of its total financial assets, from existing 10% to 7.5% of banks' capital funds

FY13–FY14

(1) Imposition of cheque disbursements for high value loans, i.e., > Rs1lakh

(2) Mandatory RBI approval for branch openings

(3) Mandatory requirement of PAN Card of borrowers for transaction > Rs5 lakhs

(4) Increase in LTV of underlying gold collateral to 75% by RBI

(5) Rise in gold prices improved operating leverage and better profitability for gold finance NBFCs

FY15–FY17

(1) Revision of LTV calculations as per avg. closing price of 22 carat gold for preceding 30 days as quoted by Bombay Bullion Association

(2) Increase loan quantum to be granted under scheme, from Rs.1 lakh to Rs 2 lakhs

(3) Gold price fluctuations led to negative operating leverage and fall in return ratios and profitability for gold finance NBFCs

FY18–FY19

(1) Higher gold prices, robust monsoons and favourable macro-economic factors aided NBFC AUMs

(2) Change in gold deposit norms for banks -Banks may accept the deposit of gold at the designated branches, especially from the larger depositors. Banks may identify at least one branch in a State/Union Territory where they have presence to accept the deposits under the Scheme

Q1FY20–Q2FY20

Higher gold prices, robust monsoons and favourable macro-economic factors aided NBFC AUMs and profitability alike

Source: Company, PL

Gold Lending Business to grow at 11% CAGR

We expect steady 11% gold AUM CAGR over FY20-22E underpinned by

- focus on short tenure loans
- digital gold business expansion
- improving branch productivity

Focus on shorter tenure assets: To overcome constant price fluctuations, gold loan industry aligned gold loan tenures to LTVs with focus on periodical interest collections. This resulted in portfolio shifts towards relatively shorter tenure products leading to reduction in under recoveries for gold financiers.

We reckon gold business recalibration into shorter tenure focused model and digital gold should enable MGFL record steady-state 11% gold business CAGR despite any cyclical swings ahead

In Jun'14 ahead of competition, MGFL de-risked the gold business by migrating from the erstwhile 12-month product with 75% LTV to 3-month product. Such a re-alignment of the tenure of gold loans to LTVs ensured that the underlying security value stood higher than the outstanding borrower obligation at all price points minimizing losses. As depicted in the exhibit below, the principal+interest repayments stand lower for a shorter 3-month product vis-a-vis a long tenure 12-month product that should in turn minimize the quantum of losses in an event when gold price plummets and the customer defaults.

This recalibration of gold loan portfolio has proved win-win with lender being assured of reduced interest losses and portfolio remaining in-the-money with customer enjoying re-payment flexibility, higher LTVs at shorter tenures ensuring easy funds availability.

Exhibit 20: MGFL's focus on lucrative shorter tenure loans v/s the riskier 12 month product

Current Revised Scenario- 3 to 6 month short tenure products	Earlier Scenario - 12 month Long Tenure Products	3 Months Scenario	6 Months Scenario	9 Months Scenario	12 Months Scenario	
Gold Value	100	100	100	100	100	If the customer does not pay or close the loan, there is ample margin of safety to recover principal as well as interest. Also, Linkage to gold prices is negligible
LTV	75%	75%	70%	65%	60%	
Gold Loan	75	75	70	65	60	
Interest Rate	24%	24%	24%	24%	24%	
Interest Cost *	21	7.5	11.2	14.3	16.8	
Total Principal+ Interest*	96	82.5	81.2	79.3	76.8	

Source: Company, PL

Digital gold business expansion: Gold loan as a product offering today stands more as a marketing push product than a pull as observed in yesteryears. Digitalization has positioned gold financing as a competitive alternative to other retail lending and fintech offerings.

Exhibit 21: Technology replacing traditional means of doing gold business

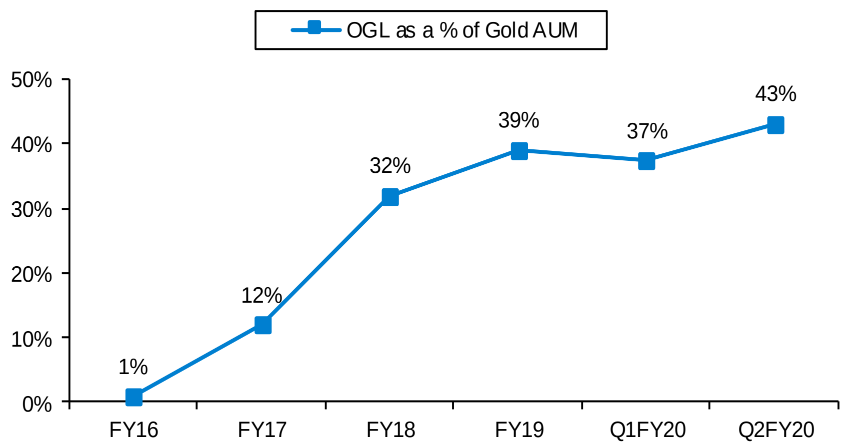
Process	Conventional method	Possible technology intervention
Lead generation	Branch walk-in Sales staff Call centre and website queries	Self-service kiosks in branch and public locations Mobile application based CRM for field sales staff
Gold evaluation	Manual valuation by employee or empaneled valuer Manual entry of weight and purity to loan system after valuation	Gold valuation machine without manual intervention Data can be directly passed to loan system for processing
Loan processing	Manual entry of consumer data Paper based KYC Physical photograph, signature/thumbprint	Tab/kiosk data can be directly used in loan system e-KYC using Aadhaar database Biometric authentication
Gold storage	Branch vault storage in zip-lock packets with tracking numbers Security guard, CCTV and alarm for security	Barcode or radio frequency identification (RFID) tags for easy tracking and retrieval E-surveillance system with centralised security monitoring
Loan disbursal	Cash disbursal for loans below INR20,000 and cheque/account disbursal for greater amounts	Disbursal in overdraft (OD) account with debit card for easy operations Small ticket loan in pre-paid wallets/cards
Collection	Branch based cash/cheque collection model Repayment via internet payment gateways	Banks/NBFC mobile application based payment through IMPS/UPI Doorstep collection using Governement of India's Bharat Interface for Money (BHIM) mobile application

Source: Company, PL

Digital proposition has enabled transformation from physical and time consuming procedures to safer processes with minimal human intervention bringing formalization to the gold lending business.

MGFL's foray into the digital platform has proved a game changer specially to tap dormant customer that otherwise would impact the gold holdings (tonnage) of the company. With an objective to gradually replace the traditional brick and mortar structure, MGFL launched online gold loan or OGL in Oct'15. One level up than the gold lending customer base with ticket size of Rs0.5mn, OGL allows customers with access to an internet enabled device requiring only one-time physical branch visit for pledging of gold. Thereafter, the customer can avail a gold loan anytime (@75% LTV) from anywhere in the world. The loan proceeds are instantaneously transferred to customer's bank account with free safe custody of their gold in any of the branches. Later, when the loan is repaid, the gold continues to remain with the branch for instant sanction of future loans whenever the need arises. The concept will now be extended further with launch of a co-branded debit card that would enable customers without access to bank accounts to withdraw the money from an ATM anywhere.

Exhibit 22: OGL as a share of overall gold lending business continues to rise



Source: Company, PL

MGFL undertook a pivoting initiative in 2018 by launching doorstep gold loan products. Such a facility completely eliminates requirement of customer's branch visit as the gold to be pledged gets collected from their homes followed by instant money transfer to respective accounts

With access to newer customer base, OGL has been proving effective tool to customer acquisition exercise for MGFL. With mere 1% share in overall gold AUMs in FY16, the OGL share to business moved swiftly to 43% in Q2FY20 in a span of less than five years.

Increasing branch productivity: While gold loan NBFCs observed aggressive footprint expansion over FY08-FY12, the period between FY13-FY14 was marked by branch consolidation. With an objective to reduce regional focus, MGFL has witnessed increased rest of India penetration over the years. With diversification drive pacing up, FY14-FY17 saw slower pace of branch expansion. While in FY16, 90% branch network stood dedicated to gold loan business, it's down to 75% in FY19.

Exhibit 23: Calibrated branch network expansion in-line with increasing non-gold share in business

Branch Network	FY15	FY16	FY17	FY18	FY19	Q1FY20	Q2FY20
Gold Business Branch Network	3293	3293	3293	3330	3372	3380	3463
YoY Inc.	-	0%	0%	1.1%	1.3%	1.5%	4.0%
Asirvad Micro Finance Branch Network	-	-	763	832	942	961	1027
YoY Inc.	-	-	-	9.0%	13.2%	14%	15%
Vehicle Finance Branch Network	-	-	50	76	168	198	229
YoY Inc..	-	-	-	52%	121%	40%	58%
Housing Finance Branch Network	-	-	35	35	35	35	46

Source: Company, PL

Channel checks suggest gold tonnage expansion to be gradual; in such a scenario steady-state branch business improvement and customer addition to drive incremental gold lending traction

Despite branch consolidation over past few years, the business augmented per branch has stood intact indicative of improving productivity metrics aiding AUM traction. With tapping outside home turf markets, the branch expansion run-rate has picked up from 1% during FY19 to 4% in H1FY20. We expect further strengthening of average portfolio per branch metrics ahead.

Exhibit 24: Widening branch/customer footprint aiding gold business productivity

Productivity parameters	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20
AUM/branch	32.6	32.6	34.1	35.3	37.4	37.8	37.4	38.4	39.3	43.8
PAT/Customer	894	774	785	737	746	803	878	885	878	1,287
Business/Customer	51,082	48,913	51,487	51,022	54,196	52,470	52,187	54,006	53,170	58,340

Source: Company, PL

43% of MGFL's gold lending on digital platform, small ticket lending focus, continued renewals offer pricing power to MGFL; growth and margins of this business will stay intact

Both book recalibration and online gold focus have brought out flexibility in terms of repayment and renewals enabling lower turnaround (TAT), faster disbursals thereby improving productivity allowing MGFL maintain pricing power in gold loan market. MGFL's short tenure gold loan product embedded with digital proposition has enabled loan traction despite steady ticket sizes. Clear focus on small ticket high churning gold products that can be renewed both offline and online every 3 months at higher LTVs has brought up renewed interest in gold lending as a lucrative loan offering. *(Refer Annexure for our channel checks for gold business)*

Exhibit 25: AUM traction led by customer addition

Gold loan business dynamics	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E	FY22E
Ticket size (unit in Rs '000)	30.4	32.5	33.6	32.6	32.9	34.0	33.0	34.0
Customer Base (unit in no.)	1.8	1.9	3.4	3.8	4.3	5.1	6.1	7.2
Yields of Gold loan Business (%)	22.2%	22.3%	27.5%	24.3%	25.3%	24.0%	23.5%	23.0%
AUM Growth (%)	16.8%	19.9%	19.5%	15.4%	23.3%	19.5%	20.3%	19.5%

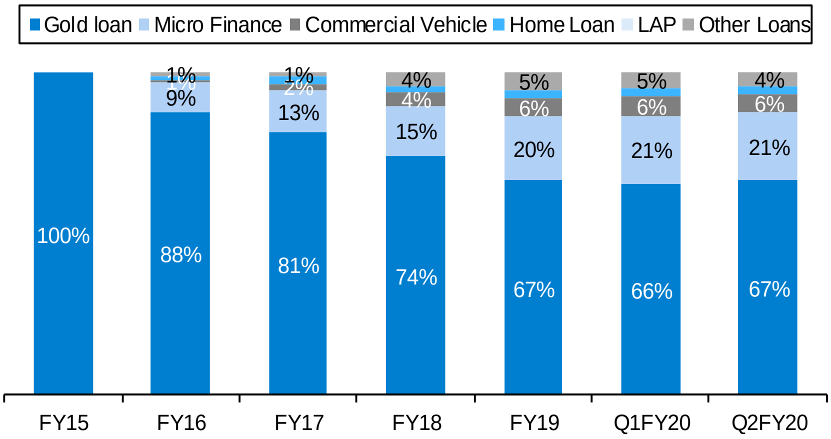
Source: Company, PL

We expect MGFL's non-gold business to form 46% of the overall mix growing at 34% CAGR over FY20-FY22

Non-gold lending business to grow at 34% CAGR

Non-gold businesses carry higher potential to boost overall growth and profitability. Proven operating systems, huge customer base, established brand name, capable business team and robust risk management practices place MGFL favorably to chase next phase of growth. *(refer Annexure for business-wise details)*

Exhibit 26: Diversified product mix tilting towards non-gold



Source: Company, PL

Preparedness to expand non-gold in terms of team, customer traction, improving branch dynamics and parent brand image ensures MGFL's capability to scale up

The synergistic RoE accretive non-gold businesses carry potential to record 34% AUM CAGR over FY20-22E underpinned by:

- Leveraging existing customer base
- Branch expansion and productivity

Leveraging existing customer base: MGFL boasts of live customer base of around 4.7 million (Q2FY20) spread across both gold loan as well as microfinance largely led by cross selling of related products. While gold business initiatives continue to aid steady business traction, MGFL's diversification into micro finance loans have enabled build a repeat customer base that is cost effective. 15% of the micro finance customers emerge from gold loan customer base and this is expected to expand with increasing customer reach. Moreover, two-wheeler, affordable housing and secured Micro SME loans (secured against the lender property of the Micro SME customers) continue to drive cross sell initiatives aided by existing customer base. Thus, increased cross sell aggression and marketing push initiatives have led to MGFL adding almost 4000 new customers to its network on a daily basis.

Controlled asset quality and customer base expansion prove as key catalysts for micro finance business traction; Asirvad's business expertise, low PAR & higher CAR will ensure micro finance proving as strongest business driver for MGFL

Branch expansion and productivity: The non-gold book expansion called for increased branch footprint. Asirvad with 1027 branches boast of wide spread presence across 23 states witnessing increased branch addition run-rate at 15% YoY. With decline in Southern concentration from 73% in Q1FY17 to 39% of overall network in Q2FY20, Asirvad has maintained district-wise expansion. Vehicle finance business has observed rapid increase in footprint from 6 states in FY15 to 22 states in Q2FY20. Co-located with gold business, vehicle finance branch count has now been normalizing to 50% increase YoY during H1FY20 as against 100%+ increase in FY19. The steady branch metrics improvement for both micro finance and vehicle finance business have also translated into better productivity levels.

Exhibit 27: Increased business per branch across non-gold businesses indicative of improving productivity & scalability

	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20
Asirvad Micro Finance										
Branch	778	813	830	832	840	893	928	942	961	1027
AUM/branch	23.5	24.2	25.4	29.3	29.0	30.6	34.4	40.8	43.7	46.0
Vehicle Finance										
Branch	67	59	73	76	141	145	157	168	198	229
AUM/branch	51.3	71.0	68.5	82.3	51.0	56.4	62.1	66.3	62.0	57.5
Housing Finance										
Branch	35	35	35	35	35	35	35	35	35	46
AUM/branch	91.4	93.3	97.8	107.0	116.1	127.9	136.6	148.2	154.8	123.5

Source: Company, PL

Incremental book expansion for MGFL should be largely led by micro finance business (Asirvad Microfinance) that is expected to record robust 40% AUM CAGR backed by pan-India spread, 30% housing finance AUM CAGR with focus on affordable housing and similar 30% vehicle finance AUM CAGR led by cross sell over FY19-22E.

Expect Micro finance to grow at 40% AUM CAGR

A high order RoA business, micro finance offers meaningful growth opportunities; however, we factor equally high NPA risks associated with the inherent nature of the business

Despite high growth trajectory in the micro finance business (73% CAGR: FY15-FY19), the company has maintained asset quality (GNPA:0.9%) led by better collection efficiency (~100%) and robust risk matrix over the years.

Barring quarterly aberrations over three quarters of demonetization periods, Asirvad has clocked robust 72% earnings CAGR in-line with AUM CAGR of 73% over FY15-19. This higher order growth trajectory can be mainly attributed to customer additions as average ticket size continues to remain close to the historical level of Rs23,000 per loan.

Exhibit 28: Steady ticket size but increased customer traction drives the AUM for MFI business

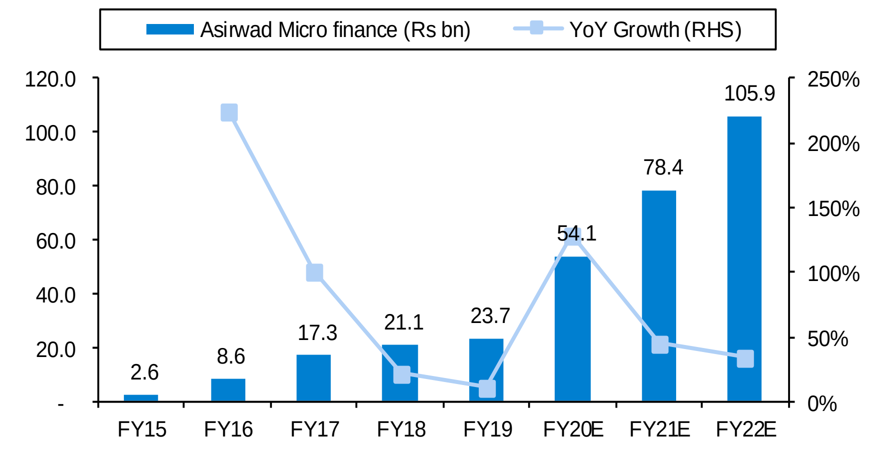
Asirvad MFI	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20
Customer base (no units)	1.3	1.4	1.4	1.5	1.5	1.6	1.7	1.8	1.9	2.0
AUM (Rs bn)	18.3	19.6	21.1	24.4	24.4	27.3	31.9	38.4	41.9	47.2
AUM YoY gr. (%)	*47.7*	*25.1*	*27.9*	*35.7*	*33.4*	*38.9*	*51.3*	*57.6*	*72.2*	*73.1*

Source: Company, PL

While the vehicle finance business being in infantry stages have remained largely insulated from the current auto slowdown, we closely watch the momentum in light of industry and competitive challenges

Going forward, we expect a 40% loan book CAGR through FY20-FY22E to be driven by high capital adequacy (26%), diversified borrowings (banks:30%, NCD/others:30%, NBFCs:16%, securitization:10%), healthy customer addition run-rate (~1,00,000 customer addition per month), and controlled costs (~25% C/I, 0.3% credit costs).

Exhibit 29: Asirvad book to grow steady to Rs106bn over FY21-FY22E

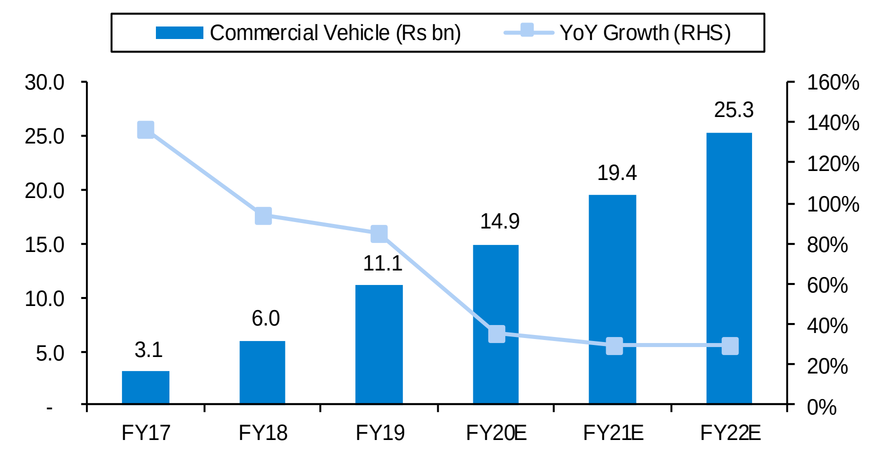


Source: Company, PL

Expect Vehicle finance to grow at 30% AUM CAGR

MGFL's vehicle finance business stands more slightly seasoned with controlled early delinquencies and improved credit underwriting processes over the years. Leveraging on parent's distribution capabilities, team at helms, credit bureau checks and anticipated replacement cycle pick-up, we expect the business to grow at 30% AUM CAGR over FY20-22E.

Exhibit 30: Vehicle finance to clock 30% CAGR to grow to Rs25bn book FY22



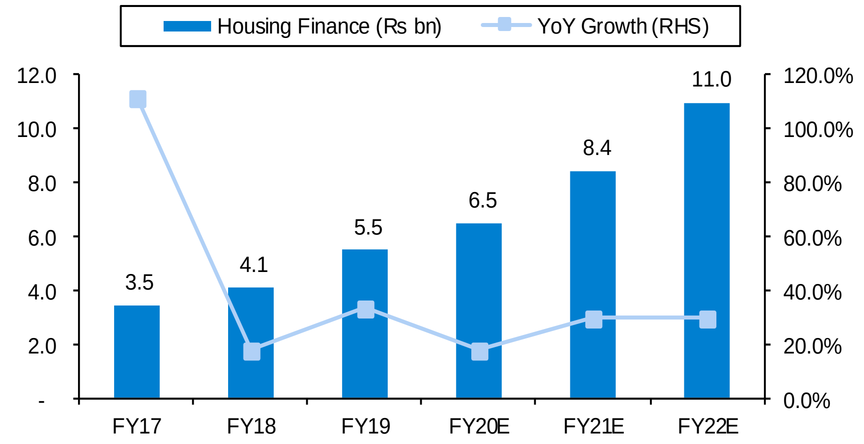
Source: Company, PL

Expect housing finance to grow at 30% AUM CAGR

A low RoA but risk averse business of housing finance to guard balance sheet of MGFL; we expect further improvement on NPAs for housing business as the portfolio matures

Combating competition and market headwinds, MGFL has been focusing on soft bucket resolutions and lowering ticket sizes across home and LAP portfolios (ATS down to Rs1mn now) to maintain asset quality. While this is expected to translate into 150bps improvement in NPA by FY22 from peak of FY18, we closely continue to watch the elevated (3-4% NPA range) levels. As we expect the book to season across cycles ahead, we reckon the housing finance business stands geared to grow at 30% AUM CAGR over FY20-22E.

Exhibit 31: Housing finance to grow to Rs11bn book at 30% CAGR FY20-22E



Source: Company, PL

Against this backdrop, we expect high growth pan-India focused micro finance business to record 40% AUM CAGR, affordable housing led housing finance business and cross sell led vehicle finance business to expand by 30% AUM CAGR each over FY20-22E.

Guarded gold asset quality; non-gold closely monitored

We stand confident of the gold business asset quality owing to lower delinquency issues associated with the business given the high liquid and collateralized nature of the underlying asset. Moreover, recalibration of gold loan business with MGFL's primary focus on 3-month loan products (100% of overall gold loan portfolio), the 90dpd has stood range bound at 0.5-0.7% over past 8 quarters now.

Historically while gold loan NPAs have more or less remained under control the non-gold businesses have seen their fair share of delinquencies. Asirvad Microfinance observed NPA decline to 0.9% as at Sep'19-end from 2.3% in Mar'18 and 4.7% as on Mar'17. While company undertook sizeable write-offs to the tune of Rs1480mn during FY18, recoveries weakened post demonetisation. NPAs in the housing and vehicle finance segments stand elevated at ~5% and ~3% levels respectively as at Sep'19-end. Going forward, steady-state non-gold business growth traction and controlled delinquencies would aid better profitability.

Exhibit 32: Asset quality across non-gold businesses to be closely monitored

NPA across business categories	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20
Parent GNPA	1.10	1.20	0.70	0.70	0.60	0.70	0.60	0.50	0.70	0.55
Gold Finance	1.10	1.20	0.70	0.69	0.60	0.70	0.60	0.50	0.70	0.60
Asirvad MFI	6.93	-2.20	3.80	2.33	1.73	1.62	0.79	0.48	0.68	0.86
Vehicle Finance	1.7	1.9	3.5	18.2	2.9	2.6	2.4	1.9	2.5	2.8
Housing Finance				14.90	4.60	4.70	4.90	3.90	4.60	4.80

Source: Company, PL

MGFL's asset quality stands intact underpinned by

- faster asset liquidation and stringent auction plan for gold assets
- robust risk matrix & collection infrastructure across business segments
- dedicated in-house staff

Gold lending asset quality stands least of the worries for MGFL with complete control on delinquencies today

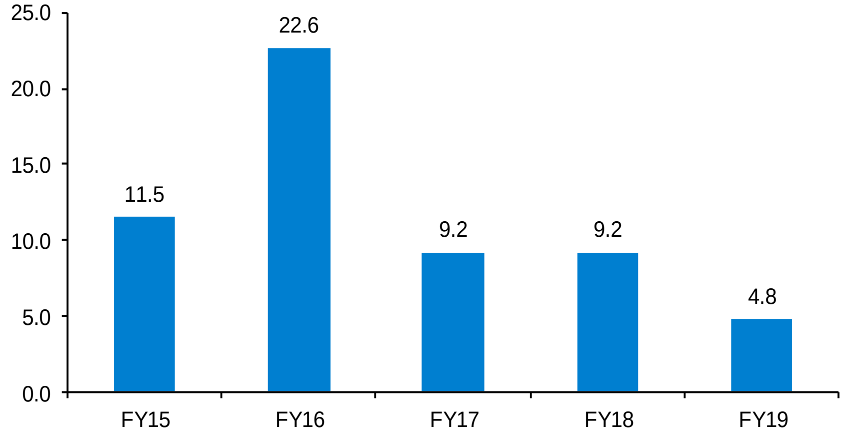
Stringent auction plan and dedicated in-house team

A typical repayment failure of customer w.r.t principal plus interest on gold loans calls for auctioning of collateral by the company to recover its dues. The recovery amount at the time of auction is determined by the price of the underlying gold jewellery stock. Although the loans are backed by high liquid collateral (gold) resulting in relatively higher recovery and low loss given default, the price risk associated with the collateral impacts the ultimate recovery. Hence, gold financiers have been preferring short tenure loans as lower tenure ensures that at any point of time, value of security is higher than obligation of borrower and losses are minimized on timely recovery through auction. *(refer Annexure B)*

Despite steady gold business expansion, auctions per year have only declined backed by improved recoveries

MGFL's 100% transitioning onto shorter tenure gold financing has curbed auction losses. Such a high churning has reduced the risk of non-collection of full interest and principal at the time of auction. The 3-month product leaves ample margin of safety for recoveries as against a one-year product where probability of willful default stands higher with price fluctuations. A typical 3-month gold product customer enjoys 30 days grace period after due date for renewal.

Exhibit 33: Auction as a percentage of accounts decline 440bps in 2 years



Source: Company, PL

Loan recoveries stand upbeat with a reminder call made to every customer on 28th of every month. Unpaid interest gets carry forward to following month at compounding interest rate calculation.

With regular interest collection and a strong incentive structure for branch level employees, auction losses have been coming off since FY17. Only ~5% of its loan accounts came up for auction in FY19 vs.12% in FY15.

Exhibit 34: Auction trends improving each year

(Rs. Mn)	FY15	FY16	FY17	FY18	FY19
Number of Loan Accounts (in Units)	347845	702038	305439	332767	181555
Growth YoY %	*(38.6)*	*101.8*	*(56.5)*	*8.9*	*(45.9)*
Principal amount o/s	11887	19319	9290	9045	4194
Interest amount o/s	4117	4890	1466	1127	565
Total amount o/s	**16004**	**24209**	**10756**	**10172**	**4759**
Value Fetched	**13545**	**22095**	**10704**	**10586**	**5155**

Source: Company, PL

With business today standing immune to gold price fluctuations, under-recoveries have declined enabling reduced auction losses for MGFL

MGFL has been able to curb auction losses owing to a dedicated trained in-house team. MGFL has structured employee incentive plans linked to gold tonnage growth and customer acquisition run-rate. A typical collection exercise of the company comprises of personal visits by branch heads to defaulters' home for loan ticket values upto Rs 5 lacs, Area Head takes responsibility for ones > Rs 5 lacs. Despite above efforts, in case of any further payment failure leads to auctioning of gold at the company's auction office. While collections and business sourcing team stands same bringing in ownership and discipline, the in-house team also stands trained for collateral value assessment, customer centricity and credit underwriting.

Robust Risk matrix and collection infra across business segments

MGFL has built risk metrics and collection infrastructure for non-gold businesses. While the non-gold businesses are yet to observe business cycles, the Asirvad micro finance maintained collection efficiencies during the tough demonetization periods. While hard bucket delinquencies did catch up, the micro finance business' asset quality returned to normalcy in FY19.

Exhibit 35: Robust Risk Matrix across non-gold businesses

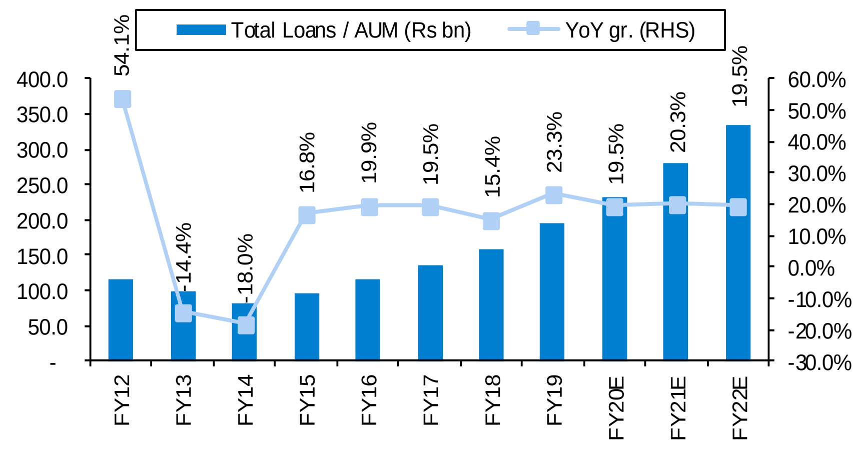
Asirvad Micro finance	Vehicle finance	Housing finance/LAP
Separate teams for disbursement and collections	Periodic assessment of portfolio	Direct branch interaction with customers led by dedicated direct sales team who stay close to the market where transactions happen
Field officers disburse as well as collect	Separate risk analytics department	CIBIL data check
In-house trained collections team	Risk assessment geography and asset wise	Credit appraisal process involves meeting with customers, understanding cash flows
Set-up new teams to handle 60dpd+ collections	Score card analytics for customer on-boarding	Independent RCU verifications and intense focus on timely collections
Central processing unit	Preliminary assessment of markets to assess potential business, competition, risks and customer behavior	
	CIBIL data check (in terms of delinquencies in terms of specific PIN codes).	

Source: Company, PL

Strengthening operating metrics – a good sign

We stand comfortable with steady-state traction in gold business that largely stands prone to business and price cyclicality. However, we keenly watch-out for growth expansion in non-gold businesses that stand crucial to drive the incremental book expansion for MGFL. **We expect overall AUM CAGR at 20% over FY20-22E** led by (1) **Gold loan:** steady 11%CAGR(FY20-22E) (2)**Vehicle financing (30%CAGR:FY20-22E):** expected to grow from Rs13bn in Q2FY20 to Rs25bn by FY22E led by cross sell and pan India spread (3) **Housing finance (30%CAGR:FY20-22E)** is expected to grow from Rs5.7bn in Q2FY20 to Rs11bn by FY22E with focus on affordable housing segment with ticket size of <Rs10lakhs avg. (4) **MFI business (40%CAGR:FY20-22E)** is expected to expand from Rs47bn (Q2FY20) to Rs106bn by FY22E with focus on ticket size of Rs25000-30000 ensuring Asirvad being first or second lender but per state exposure to be restricted to 10%.

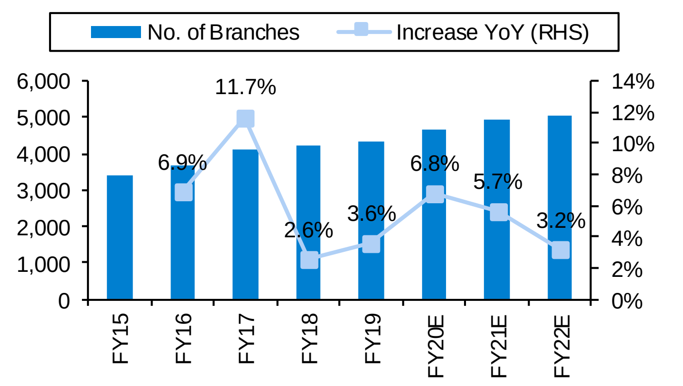
Exhibit 36: Overall loans to grow to 333bn at 20% CAGR FY20E-22E



Source: Company, PL

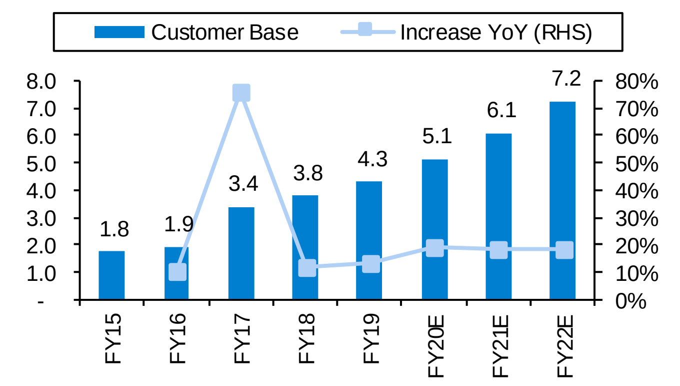
Penetrating newer markets and digital initiatives through OGL aiding customer base expansion.

Exhibit 37: …led by increased footprint expansion



Source: Company, PL

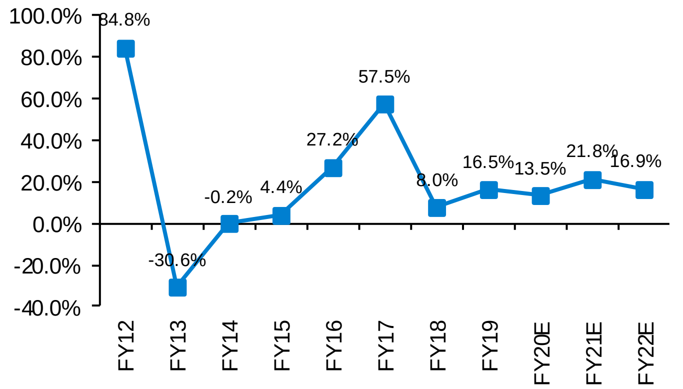
Exhibit 38: … and expanding customer base to 7mn



Source: Company, PL

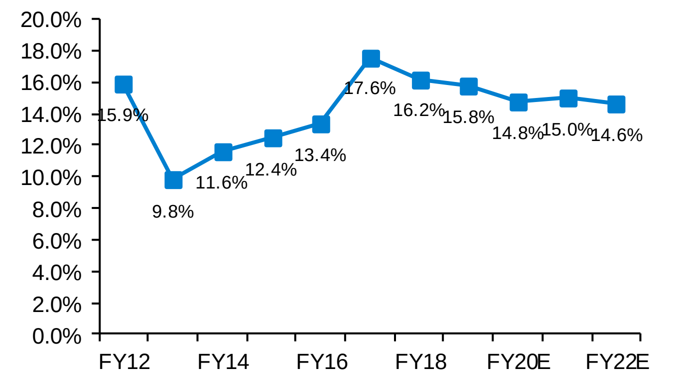
Steady gold AUMs at 11% CAGR but stronger non-gold traction at 34% CAGR to drive 19% NII CAGR over FY20-22E. Spreads should stay stable supported by higher proportion of business backed by self-liquidating assets and ability to raise higher CPs.

Exhibit 39: …translating into equally strong NII (Update)



Source: Company, PL

Exhibit 40: NIMs to stabilize at 14%+ (Update)



Source: Company, PL

NIMs should stabilize at 14% levels led by (a) regulatory advantage where lenders risk-weighted assets (RWA) has decreased enabling 3x increase in loan with same capital (b) Net yield on gold holding up with passing of increased funding costs and reduction in rebate schemes and shift towards high yielding non-gold mix (c) recent CRISIL ratings upgrade aiding funding costs improvement

Market headwinds prompt us to place confidence in NBFCs with healthy liability management. Although MGFL does not stand completely insulated from the liquidity headwinds that emerged post Sep'18 crisis, the company's borrowing costs 9.3-9.4% have stood higher for over four quarters in a row. Said that, MGFL fits the bill with maintenance of 5% liquid assets on balance sheet, no funding challenges from banks, recent ratings upgrade (from AA- to AA by CRISIL) and positive mismatch across shorter buckets. The gradual shift in portfolio towards slightly long tenure assets (2-3 years), liquidity maintenance has become a priority and MGFL is well positioned to transmit the increased funding cost pressures.

Exhibit 41: Recent ratings upgrade is expected to aid resource funding ahead

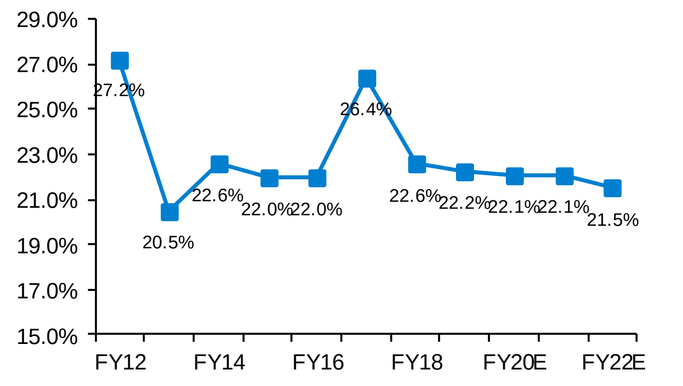
Long term Credit Rating	CRISIL				ICRA				CARE			
	FY18	FY19	Q1FY20	Q2FY20	FY18	FY19	Q1FY20	Q2FY20	FY18	FY19	Q1FY20	Q2FY20
Manappuram Finance	AA- (Stable)	AA- (Positive)	AA- (Positive)	AA (Stable)	AA- (Stable)	AA- (Stable)	AA- (Stable)	AA (Stable)	AA (Stable)	AA (Stable)	AA (Stable)	AA (Stable)

Source: Company, PL

Historically (FY14-FY17), MGFL has reported elevated levels of ~12% avg. cost of funds. While FY18 was marked by best periods for resource funding, the costs climbed to 9.5% in FY19 and continued to stay 9.3%-9.5% until H1FY20. While we retain our confidence in the MGFL's effective ALM and diversified liability profile, we build-in conservatism into our funding costs estimates. We expect MGFL to report 10.7% funding costs over FY20-22E with 27% liabilities (term loans + NCDs) priced at higher levels of 8.2% - 10.75% coupled with uncertain funding scenario.

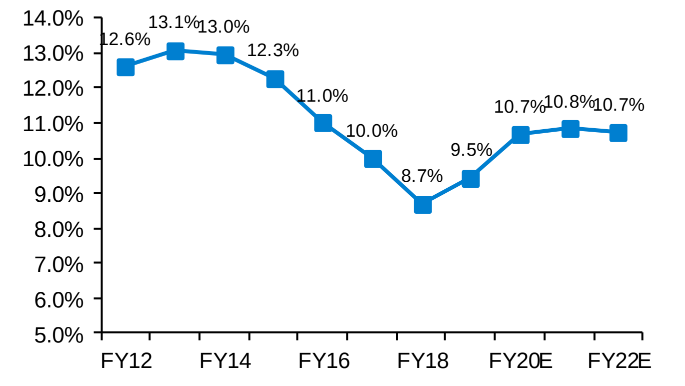
Historically, MGFL has maintained yields closer to 25% levels led by single-focused higher yielding gold business. While more than one-third of the business today stands focused towards lower yielding portfolios (vehicle finance portfolio, housing portfolio and micro-finance portfolio is 13.2%, 15.3% and 22.3% respectively), we forecast moderation in yields over FY20-22E. Said that, easier transmission of increased funding costs, reduced rebate schemes on gold businesses and faster growing micro finance business are expected to aid stabilization in yields at 21%+ levels over FY21-22E.

Exhibit 42: …led by stabilizing yields



Source: Company, PL

Exhibit 43: … partially offsetting increased cost of fund pressures



Source: Company, PL

MGFL is expected to enjoy operating leverage benefits flowing through increased focus on low cost online gold business model and declining security costs. Online and digital gold offerings as against traditional brick and mortar branch model have reduced security issues pertaining to handholding of physical collateral, multiple customer visits to branches, heavy physical paperwork aiding operating efficiencies.

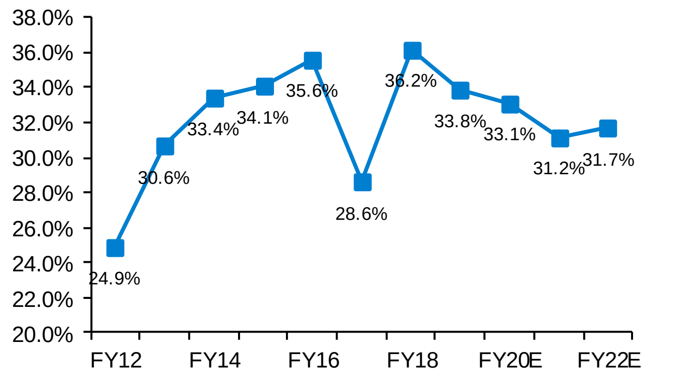
New storage system (installation of celluloid technology in >60% of branches) and electronic security replacing the physical manpower is already reflecting in the declining costs for MGFL.

Exhibit 44: One-fourth reduction in security costs over past two years

Particulars (Rs	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20
Security Expense	410	440	440	370	354	300	220	170	156	124
QoQ gr.		*7.3%*	*0.0%*	*-15.9%*	*-4.3%*	*-15.3%*	*-26.7%*	*-22.7%*	*-8.2%*	*-20.5%*
YoY gr.					*-13.7%*	*-31.8%*	*-50.0%*	*-54.1%*	*-55.9%*	*-58.7%*

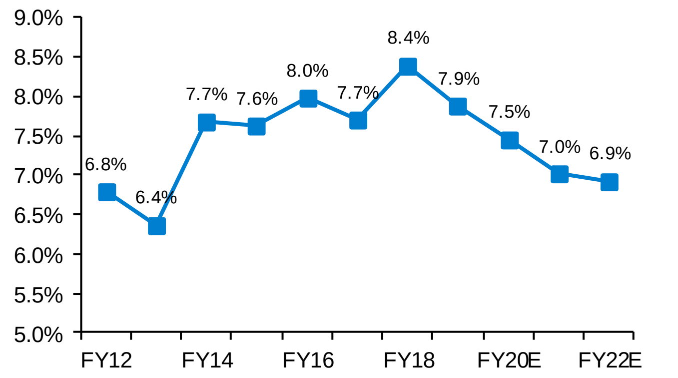
Source: Company, PL

Exhibit 45: …will reflect in cost-income improvement



Source: Company, PL

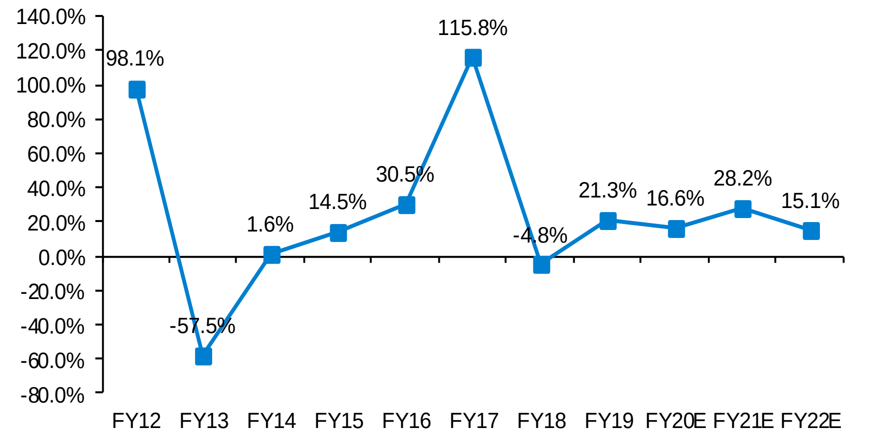
Exhibit 46: ...and also improvement in cost to assets



Source: Company, PL

Cost efficiencies coupled with increased productivity are expected to bolster operating profitability with the latter expected to report 21% CAGR over FY20-22E.

Exhibit 47: …boosting operating profitability

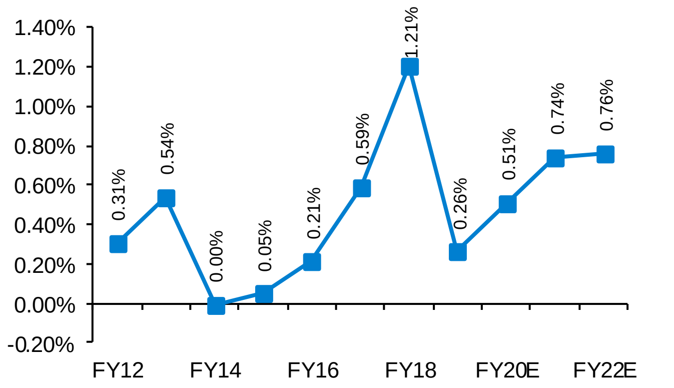


Source: Company, PL

We expect MGFL's overall asset quality to stand stable marked by both GNPAs and credit costs to be restricted to below 0.8% levels by FY22E.

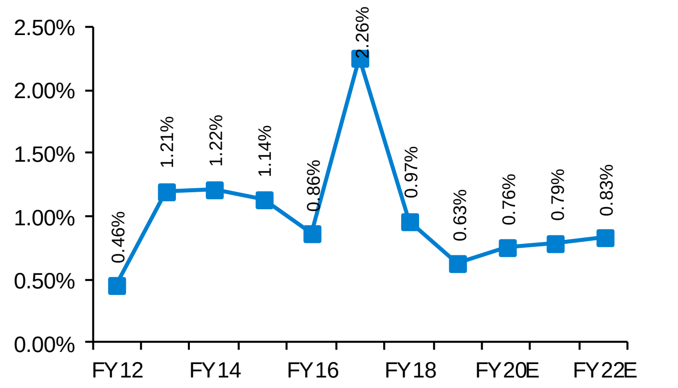
While stringent auction plan, faster asset liquidation is expected to ensure steady asset quality (0.66% for FY21-22E) for gold business, we incorporate weakness in the vehicle and home finance segments on account of low portfolio seasoning. Against this backdrop, we foresee (a) vehicle Finance NPA to stay slightly elevated at ~2% given riskiness associated with self-employed customer base and auto slowdown (b) housing finance NPA declining to 3.3% by FY22E from 3.9% in FY19 with focus on self-constructed properties, SARFAESI implementation, affordable housing (c) micro finance NPAs stabilizing at 0.6% by FY22E with robust collection infrastructure in place post demonetization shocks.

Exhibit 48: Credit costs to stabilize to 0.8%



Source: Company, PL

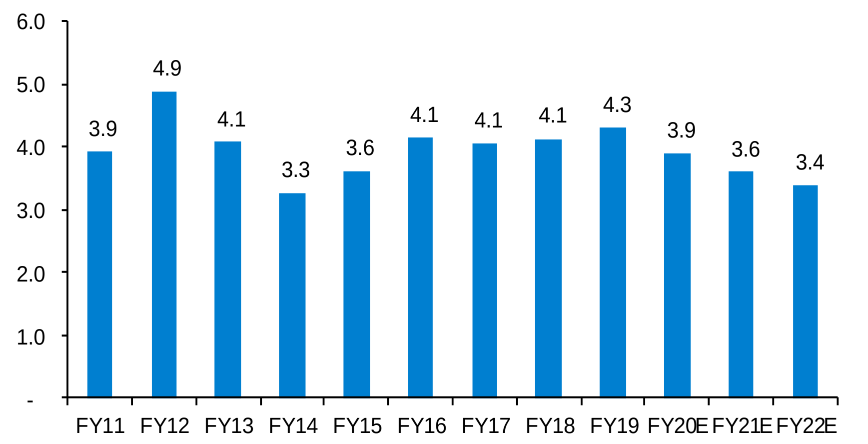
Exhibit 49: GNPA should stand restricted to <0.8%



Source: Company, PL

Reducing risk element associated with balance sheet have witnessed retention of profits and net worth as well as capital structure improvement. The following trends of AUM/net worth continued accruals to net worth indicative of strong balance sheet and the ability to absorb losses arising from unfavorable events, especially, gold price fluctuations.

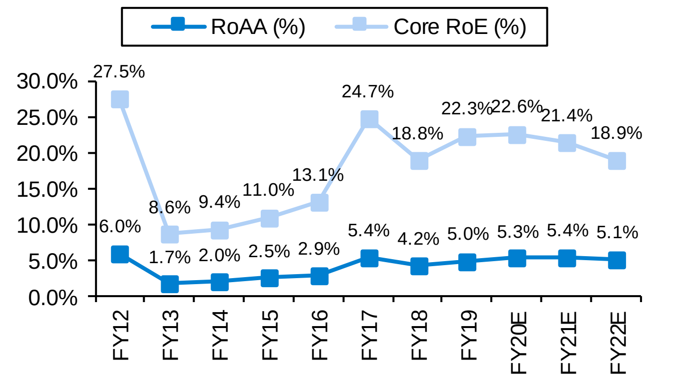
Exhibit 50: ..resulting in built-up of stronger balance sheets: AUM/net worth



Source: Company, PL

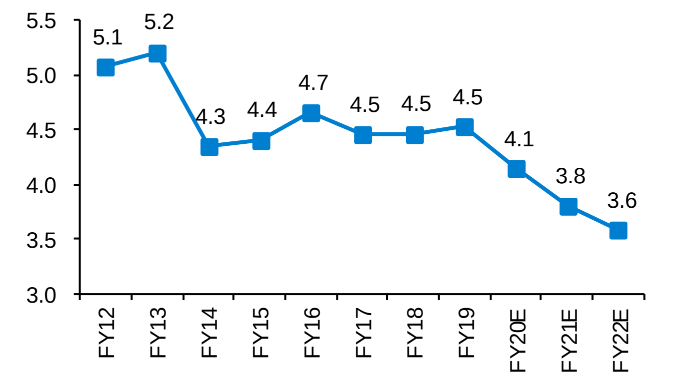
While a typical higher yielding business like gold and micro finance (87% of total) carry inherent potential to fetch higher returns (5.1%RoA/ 18.9%RoE: FY22E), it's the core business efficiency and effective capital deployment that would largely determine the quality of the balance sheet.

Exhibit 51: .. translating into high order return profile



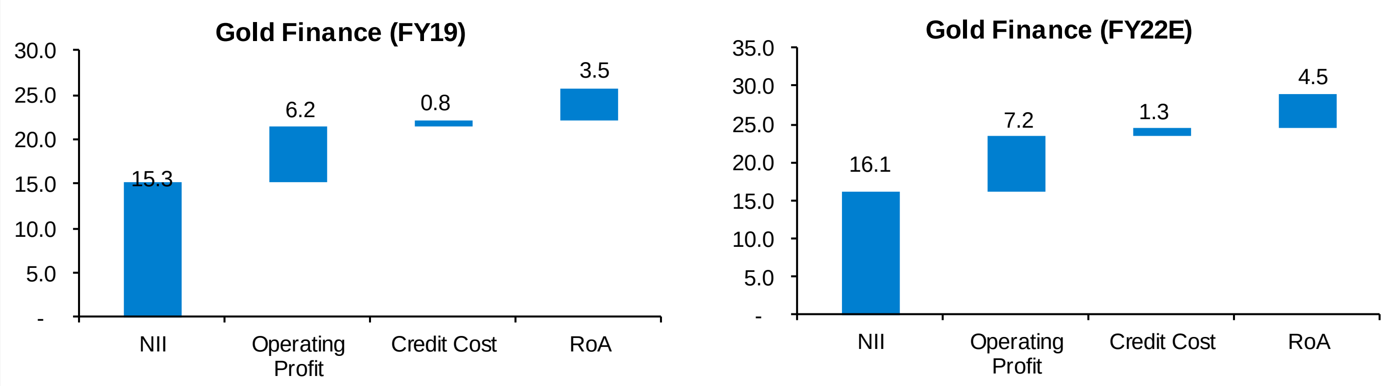
Source: Company, PL

Exhibit 52: .. at low leverage



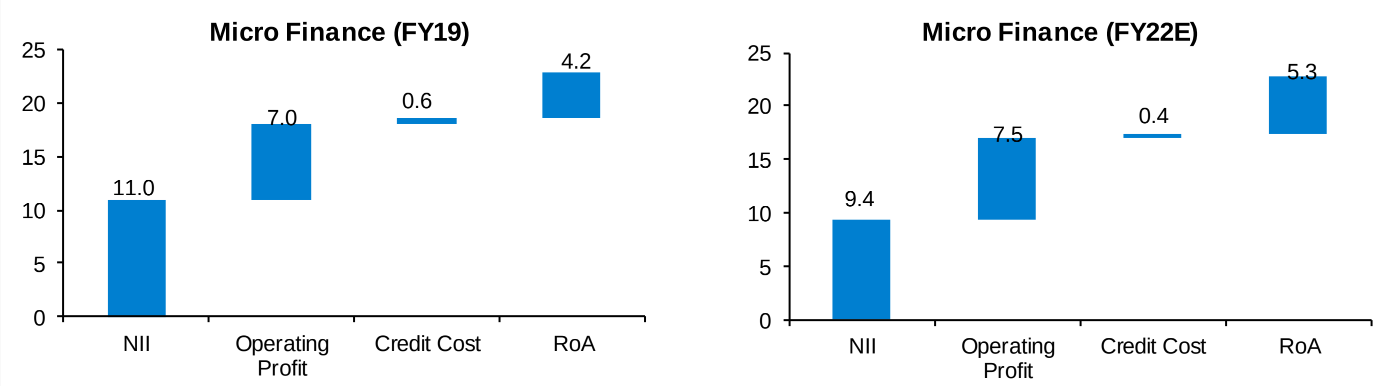
Source: Company, PL

Exhibit 53: led by strong operating metrics by individual businesses: Gold finance poised for 4%+ RoA



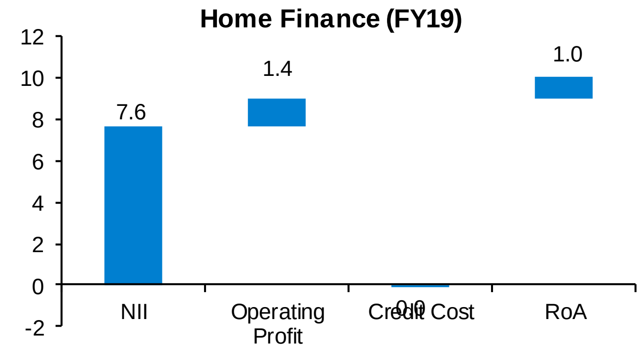
Source: Company, PL

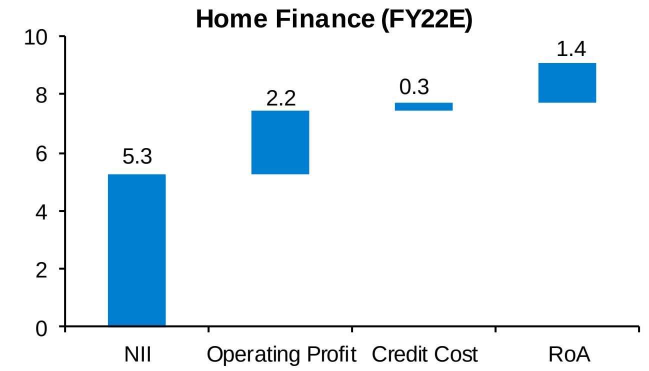
Exhibit 54: … followed by micro finance RoAs which should exceed 5%



Source: Company, PL

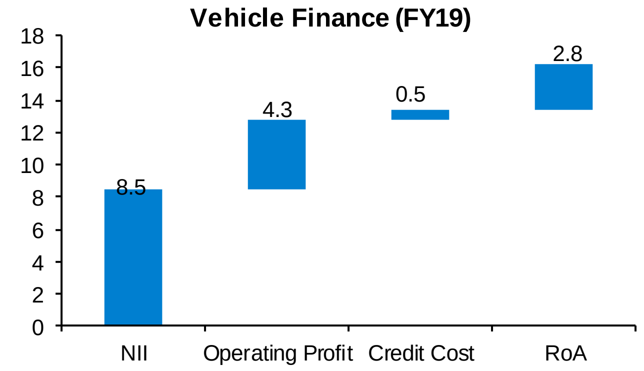
Exhibit 55: …with home finance RoA at 1.4% standing reasonable with focus on affordable housing

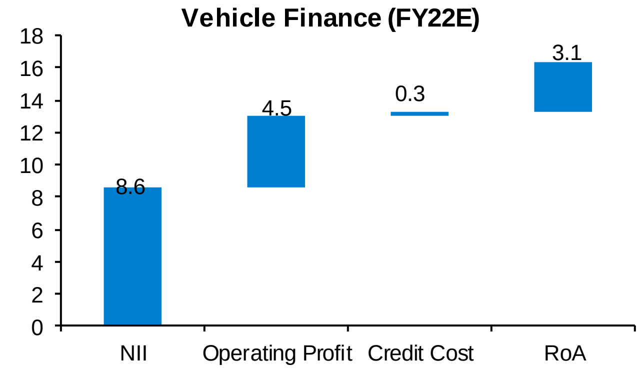




Source: Company, PL

Exhibit 56: … vehicle finance RoAs at 3% on a smaller book but defying macros





Source: Company, PL

Valuation Thesis

Transforming into a full-fledged NBFC model

INITIATE WITH ACCUMULATE, PRICE TARGET: Rs 195:

NBFCs have been casualties of liquidity and confidence crisis alike since ILFS mess unfolded in Sep'18. In such times, few players have truly emerged as winners due to uniqueness of business and demonstration of capabilities.

MGFL's business stands half of the closest peer's AUM; recalibrated gold business model and scaling up of non-gold offers the former ample scope to catch-up on business and valuations

The second largest gold financier by asset size (Rs226.8bn), Manappuram Finance (MGFL) with 67% business concentrated in lending against gold (Rs152bn) is now transforming into a full-fledged NBFC player. Combatting industry challenges and intense competition, MGFL has emerged stronger with greater focus on short tenure high churning (3-month product forms 100% of gold loan) and digital gold lending products (43% of gold loan). With an objective to bring stability to balance sheet and reduce business concentration risks, the company kick-started product diversification drive back in 2015 foraying to micro finance, vehicle and housing finance portfolios (these form 37% of overall AUMs).

Proven operating systems, huge customer base (4.7mn), established brand name, ready business team and robust risk management practices place MGFL favorably to enter next phase of growth led by non-gold business segments. While the company has already witnessed five times increase in micro finance (Asirvad) book (Rs47bn) over past 4 years, the vehicle (Rs13bn) and housing finance (Rs6bn) businesses are rapidly scaling up too. Asirvad Micro finance figures among the top 5 MFIs in the country with better productivity, improving asset quality and high growth business.

Higher capital base, control over asset quality and operating leverage benefits will ensure strong return metrics for MGFL

We expect the gold lending business to record steady 11% business CAGR over FY20-22E led by recalibrated business model and online gold (~40% of overall gold). Moving out of its core competency, non-gold business expansion is expected to be led by leveraging existing brand, consistent customer addition and cross sell initiatives. MGFL should possibly take the non-gold share to 50% of overall mix in four years from current 37%. We expect micro finance to record 40% AUM CAGR, affordable housing and vehicle finance 30% CAGR each over FY20-22E. While a typical higher yielding business (87% of total) fetch higher returns (5.1%RoA/18.9%RoE: FY22E), we lay higher focus on operating metrics which we foresee improving for MGFL over next three years. MGFL has been strengthening core operating metrics and stabilizing balance sheet driven by prudent risk profile with comfortable capitalisation, healthy profitability and adequate liquidity. This is rightly reflected in anticipated healthy 20% blended AUM CAGR, operating efficiencies (~145bps cost-income decline) and guarded asset quality (<1% GNPA/0.8% credit costs) over FY20-22E. However, we closely monitor the steady expansion of unsecured mix in overall portfolio with limited seasoning as on today.

Uncertain times, NPA-prone businesses expansion prompt us to watch shaping up of non-gold businesses for MGFL

MGFL today stands in a sweet spot given a low levered book (4.5x: FY19), liquidity sufficiency and higher business potential. The stock has been showing strengths given the favorable gold price dynamics and preparedness to expand non-gold business ventures. However, we closely watch out the scaling up of non-gold business franchise and portfolio seasoning in light of new business cycles.

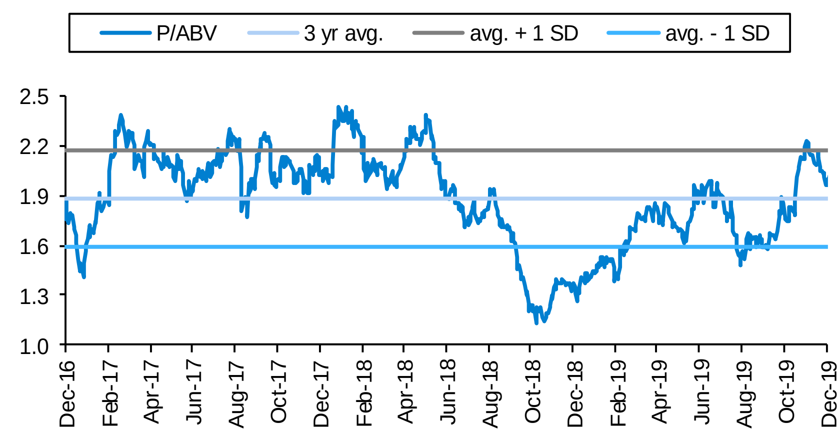
While non-gold business scalability and growth sustainability is the key, MGFL has already caught up on valuation with the forward multiple closer to nearest peer MUTH (double the size of MGFL). Against this backdrop, we initiate with Accumulate rating on the stock. We value the consolidated business at 1.9x PABV Sep'21E arriving at price target of Rs 195.

Exhibit 57: MGFL's business scale-up v/s MUTH's formidable franchise

Key Financial Parameters	MGFL				MUTHOOT			
	FY19	FY20E	FY21E	FY22E	FY19	FY20E	FY21E	FY22E
Key Business metrics								
AUM (Rs mn)	1,94,384	2,32,276	2,79,428	3,33,991	3,83,036	4,51,096	5,11,372	5,81,645
AUM (growth YoY %)	23.3	19.5	20.3	19.5	20.0	17.8	13.4	13.7
Key operating metrics								
NII (Rs mn)	27,763	31,507	38,366	44,862	48,805	57,747	66,123	74,327
NII (growth YoY %)	16.5	13.5	21.8	16.9	8.8	18.3	14.5	12.4
NIM (%)	15.8	14.8	15.0	14.6	13.9	13.8	13.7	13.6
Operating profit (Rs mn)	14,734	17,181	22,023	25,354	30,745	35,666	40,602	45,075
Operating profit (growth YoY %)	*21.3*	*16.6*	*28.2*	*15.1*	7.0	16.0	13.8	11.0
PAT (Rs mn)	9,295	11,851	14,671	16,675	21,030	27,731	31,583	35,236
PAT (growth YoY %)	*37.5*	*27.5*	*23.8*	*13.7*	17.9	31.9	13.9	11.6
ROE (%)	22.3	22.6	21.4	18.9	23.4	23.8	23.0	22.1
ROA (%)	5.0	5.3	5.4	5.1	5.5	7.0	7.1	7.0
Asset quality								
GNPA (%)	0.6	0.7	0.8	0.8	2.7	2.6	2.4	2.3
Capital Adequacy								
CAR	23.7	27.0	27.1	26.5	26.1	27.7	29.4	30.5
Valuations								
Book value (Rs)	53.6	70.7	92.2	116.8	247.9	288.3	341.8	408.0
P/ABV (x)	3.3	2.5	1.9	1.5	3.1	2.7	2.2	1.9
P/E (x)	16.0	12.6	10.2	8.9	14.6	11.9	10.4	9.1
LLP	461	1,071	1,910	2,287	2,713	1,574	1,818	2,187

Source: Company, PL

Exhibit 58: MGFL poised for re-rating: non-gold scale-up to be watched



Source: Company, PL

Exhibit 59: Gold financing have had a good run past 1 year in line with gold price momentum

Company Name	CMP	1 Month	3 Month	6 Month	1 year	REL_1M	REL_3M	REL_6M	REL_1YR	REL_YTD
MUTHOOT FINANCE LTD	758	4.7	11.1	8.1	51.1	-0.4	1.4	3.8	30.1	18
MANAPPURAM FINANCE	176	-1.7	30.8	16.8	89.9	-6.6	19.4	12.2	63.5	52.4

Source: Company, PL

Key downside risks to our estimates are:

- unsustainable growth in non-gold
- significant increase in credit costs for the vehicle finance and other on-lending businesses, and weak collections in home finance
- event risk in the microfinance business
- regulatory tightening on margins
- Continued higher exposure to short term wholesale funding

Annexure:

Glimpse of non-gold business

Micro finance – primary driver to non-gold business

MGFL forayed into microfinance business with acquisition of 85% stake in Asirvad Microfinance for Rs 1.1bn in FY15 and further in FY16 with overall stake in latter rising to 90.4%. The highly scalable business continues to receive financial and managerial support from the parent MGFL. Asirvad Microfinance stands amongst the top five micro finance institutions (MFIs) in the country spread across 1027 branches and 23 states with active customer base of 1.99mn. At 8% of the overall industry AUMs (Rs568.3bn), the company stands poised to tap the massive growth potential in the rural/semi-urban markets led by joint liability group (JLG) model.

While the inherent nature of business makes it to prone to politico-socio headwinds (demonetisation, cyclones and floods, farm debt loan waivers, local issues), MGFL has been focusing on divergent customer profile that stand distinct to gold franchise and district-wise expansion in non-southern markets. While South-west portfolio of Maharashtra, Tamil Nadu, Gujarat, Karnataka, and Kerala contributes 90% to overall business, the company has been reducing geographic concentration risks by tapping markets of Rajasthan, Madhya Pradesh, Sikkim and Goa. This should be led by varied product offerings (viz; income generating loans, SME loans) and investments into technology, operations, teams and controls aided by parent support. While the average ticket size has stood at ~Rs32000-35000 over past five years, the entry levels size stands at Rs25,000.

Exhibit 60: Micro finance business dynamics

AUM	Size: Rs47243mn	Incremental ticket size: Rs32000	Largely fixed rate loans	
Business details	Customer base: 1.99mn	JLG Model; women group of 7-10	55% of incremental customers stand new	100% disbursements: non-cash
Geographical spread	Presence: 23 States; Maharashtra, TN, Gujarat, Karnataka, Kerala: 90%of business	Branch network: 1027	Spread: 39% South, 34%: East, 26: North/East	Incremental branch addition: 150 by FY20-end
Customer profile	Low income customer in rural/semi-urban			
Yields and rates	3rd lowest in terms of interest rates	Avg yield: 21%		
Asset quality	GNPA: 0.86%	Collection efficiency: ~99.6%		
Risk management	Geopolitical risks: geographic diversification; TN share target 20-21% by FY20-end	Borrower limit: 2 MFIs + 1 SFB	Low first time borrowers	95% of customers with total indebtedness of <Rs 0.1mn; 99% of customers wit total indebtedness of <Rs 0.15mn

Source: Company, PL

Vehicle finance – second key growth engine

With mere 6% business share in overall mix, MGFL's vehicle finance business carry huge potential to ride upon market opportunity stemming from continued government investments in the roads sector, expected finalisation of the scrappage policy and higher budgetary spends for the rural area. CRISIL expects vehicle finance portfolio of NBFCs to grow 300 bps faster over the three fiscals to 2020, clocking a CAGR of 15% compared with 12% seen in the past three fiscals.

Launched in Jan'15, vehicle finance operations have been expanding in South and west India and stand co-located with gold loan branches catering predominantly to underserved unbanked customers. The division started with focus on commercial vehicles (75% of the portfolio; 88% of which is used vehicle financing of which 75% is focused on HCVs, 19-20%:LCVs, 5-6%:SCVs) and 25% two-wheeler loans (100% new vehicle financing) and was later ramped up to diversify into construction equipment (CE), auto loans. The product bouquet is expected to expand further into electric two-wheelers, three wheelers and used two-wheeler financing.

Exhibit 61: Vehicle Finance Business Dynamics

AUM	Size: Rs 15228mn	Growth: Avg 20% since past 4 quarters	Run-rate per month: Rs900-1000mn	FY22E: ~27bn @ 33% CAGR FY19-22E
Loan details	Max tenure: 60months	Min loan size: Rs 100000	ATS: Rs 0.7mn	
Geographical spread	Presence: 21 states	Branch network: 229/co-located with gold branches	Network spread: Widespread barring north-east; South:40%	Run-rate / Q: 30 in H1FY20
Customer profile	Underserved unbanked customer	Small first time buyers with 1-2 owned vehicles		
Product profile	80%: used vehicle; 20%: new	10 year vintage focus initially now 6-7	Used cars cross sold to 2w customers	Tractors: focus on proper irrigated districts
Yields and rates	Avg yield: 19.5%	2-wheelr at 24% IRR; used cars yields: 22%		
Asset quality	GNPA: 2.8%	Avg GNPA: 2.5%	Score card evauation	
Risk management	periodic assessmnt	risk analytics	geographic assessment	bureau data checks
Collections	Collection & sourcing team separate	Branch Manager : highest supervision	Flood/cyclone impact: 1-2month payments delay	Constant customer interactions

Source: Company, PL

Housing finance – scaling up rapidly

In a quest to expand footprint into retail credit business and stability to balance sheet, MGFL's foray into housing finance with AUMs today at Rs5679mn contributing 3% to the AUMs. MGFL's focus segment of affordable housing finance offers meaningful business potential with huge shortfall for housing units in EWS / LIG segment in India. Increase in affordability driven by sustained GDP growth rate and stable property prices should continue to boost affordable finance traction. Catering to the niche self-employed non-professional segment that constitutes 89% of the overall customer base, MGFL focuses on micro markets of affordable housing with ticket size as low as Rs1.1mn.

Exhibit 62: Housing finance dynamics

AUM	Size: Rs5673.3mn	ATS: Rs0.9mn; down from Rs1.3-1.4mn		
Business details	Turned profitable during FY19	Lower overlap with gold business network	RoE target of 15% in medium term	
Geographical spread	Largely in West & South	Maharashtra, Gujarat , TN form 75% of the book		
Customer profile	Mid to Low income Group.	self-employed non-professional customer: 89%; rest: salaried	Business sourcing: 80%: Direct Sales Team, rest: DSA	Balance transfer: 3-3.5%
Product profile	Focus on Affordable Housing	70%: self-constructed homes; rest: resale properties	Focused on financing wheer 30-40% construction stands complete	
Yields and rates	Avg Yields: 15%			
Asset quality	High ticket loans witnessed defaults	GNPA:4.8%	Decline in pre-payment rate from 4-5% to 1%	Soft bucket solutions in place
Risk management	SARFAESI initiatives in place	Repossession of assets picking up	LTV down to 49% from 56% a year ago aiding book de-risking	Credit underwriting: Personal discussions, credit officer visits, CF & profile assessment of customers

Source: Company, PL

Understanding Auction Process and Procedures

The following additional stipulations are made with respect to auctioning of pledged gold jewellery:

- When a customer defaults on a loan, a notice is issued to defaulter to repay, failing which the collateral is sold in a public auction.
- The auction should be conducted in the same town or taluka in which the branch that has extended the loan is located.
- While auctioning the gold the NBFC should declare a reserve price for the pledged ornaments. The reserve price for the pledged ornaments should not be less than 85% of the previous 30 day average closing price of 22 carat gold as declared by India Bullion Association Ltd. formerly known as The Bombay Bullion Association Ltd. and value of the jewellery of lower purity in terms of carats should be proportionately reduced.
- In case of a surplus from proceeds of the auction (that is pledged collateral fetched more than the amount outstanding), the excess amount is refunded to the customer.
- It will be mandatory on the part of the NBFCs to provide full details of the value fetched in the auction and the outstanding dues adjusted and any amount over and above the loan outstanding should be payable to the borrower.
- NBFCs must disclose in their annual reports the details of the auctions conducted during the financial year including the number of loan accounts, outstanding amounts, value fetched and whether any of its sister concerns participated in the auction]

Gold loan branch visits in Kerala and Maharashtra

We visited couple of gold loan branches in Aluva region of Ernakulum district during our Kerala visit and few branches in urban and semi-urban areas of Maharashtra.

Kerala business dynamics: MGFL boasts of 450 branches in Kerala with vintage of 9-10-year-old. Here are the KTAs: **Our interactions indicate MGFL gold finance business in particular stands in a sweet spot primarily on 2 counts: (a)** Higher gold price trajectory (b) Walk-ins post closure of Muthoot branches.

Yet gold loan AUM traction slowed at 6.6% YoY and 2.6% QoQ for Q1FY20 as against 16.2% YoY and 6.2% QoQ for Q1FY19. Our ground takeaways stood in-line with Mngt commentary wrt Kerala becoming a saturated market as competition catching up with local financiers such as KLM Finance, Kosamattom Finance, Max Value, Ahilya Finance and the likes of private lenders, namely; Federal Bank, SIB, CSB, Karnataka Bank and Muthoot Finance.

While new customer addition run-rate stands steady (1 customer addition per branch each day; added 205 new customers past 4 days in Ernakulum across 54 branches), the tonnage pledged stands lower to historical years; say ~20gms of gold as against 100gms in earlier times.

Minimal CITU impact: (a) Strong incentive structure: Rs 30000-50000 incentive / month > basic head salary of Rs 22000-23000 (b) Robust promotion structure (eligible candidate with satisfactory performance at end of the year)

Disbursements: Customers with nationalized/private bank accounts stand eligible for immediate disbursements. Minimum loan ticket size stands at Rs 1000, maximum at ~ Rs 50 lacs. High ticket value loans (> Rs 50 lacs) require Senior Management approval. Disbursement per branch on monthly basis stands at Rs 25-30 lakhs. Loan settlements through OGL/NEFT facilities requiring no branch visits.

Other products: Company has commenced unsecured lending from selective branches. Average ticket size stands at Rs1mn and target customers are traders.

Competition: In order to combat competition and boost gold holdings and AUMs, branch level focus stands 2-pronged: (a) provision of locker facility with complete security at zero charges. (b) online gold product (App based) that enables customer to avail gold loan from any part of globe with few clicks. (c) Besides continuous marketing activities, branch manager connects 6m-1year dormant customer to renew the old loans (d) As far as Co.'s product diversification strategy across MFI, vehicle and housing financing; a field executive stationed at every gold branch promoting non-gold products.

MGFL Gold loan attractive than bank gold loan:

- MGFL per gram rate (current Rs 2547) > bank's (Rs 1300-1400)
- Banks have min. gold retention period ranging between 1-5 year with 3% pre-withdrawal charges vis-à-vis MGFL's 3-month gold product, even single day product (1% int rate) and OGL facility with no requirement of physical branch visit
- Quick TAT of MGFL: existing customer – 10-15mins, new- 30mins vs tedious banking processes.
- Online gold: Branches we visited have recorded 45-47% of overall gold business emerging from OGL facility; OGL has huge potential with scope of increasing digital awareness.

Branch dynamics:

- Size and location determines the AUM of a branch (e.g latest AUM of Dombivli branch stands at Rs 10 crores, that of Thane at Rs 4.5 crores).
- Average staff strength per branch stands at 5-6.
- Distinction points of 1 branch over other rests on parameters like zero auctions, repledge, renewals.

- Customer base per branch stands at 2000.
- Customer profile: mix of high value (10-15% of total; business class) and rest low value customers (salaried class).
- With daily turnout number of 10-15 walk-ins daily basis, the conversion ratio stands at 90%.
- Daily morning meeting for employees for updates/targets.
- Rent is the major operating expenditure for MGFL contributing to 50% of the overall branch expenses. Other opex include phone bill, electricity bill, marketing expenses.
- Salary per employee of a typical Manappuram branch ranges from Rs 15,000-20,000. Incentive structure contingent upon customer acquisition and gold retention capabilities.
- Employees are mandated to educate old and existing customers of introduction of any new product.
- An area head typically manages 5 branches with specific targets for each branch

Branch security: Technology fully replaced security guards –

- Cellular cage (cellular racks powered by Godrej)
- Smoke detector
- Vibration censor
- Foot panic switch at safe entrance
- GPS tracker attached to every gold packet

Branch collections: (1) YTD collection efficiency: 81% (flood impact, yet incremental collections strong), MTD: 124%

- Zero auctions over past 1 year. Auction cases run-rate per branch on average stands at 4-5; any surplus amount through auction is paid to the customer through cheque.
- Collection activity begins on 28th day from loan initiation date with a message/call; 30-35th day: another call reminder, visit to high value customers within 35 days
- Collection incentive: Rs5/re-pledging for loans upto Rs25000, Rs25/re-pledging for loans >Rs1lkh.
- NPA run-rate for a typical Manappuram branch stands at 10.

Prudency measures – checks in place

- Stringent Loan to value ratio as compared to others at 70-75%; purity of gold pledged by the customer also formulated as net weight of gold is considered (ornaments with gemstones attached carry lower disbursement value)
- Vigilance on end consumption of loans (marriage, medical emergencies, business loss, business expansion, child education, foreign trip, repair and house renovation).

Income Statement (Rs m)

Y/e Mar	FY19	FY20E	FY21E	FY22E
Int. Inc. / Opt. Inc.	40,958	48,048	57,546	67,149
Interest Expenses	13,194	16,541	19,180	22,286
Net interest income	**27,763**	**31,507**	**38,366**	**44,862**
Growth(%)	*16.5*	*13.5*	*21.8*	*16.9*
Non-interest income	205	598	625	740
Growth(%)	*197.8*	*191.3*	*4.4*	*18.5*
Net operating income	27,969	32,106	38,991	45,602
Expenditures				
Employees	7,201	8,513	9,805	12,318
Other Expenses	5,907	6,600	7,311	8,065
Depreciation	752	791	831	874
Operating Expenses	13,108	15,113	17,116	20,383
PPP	**14,109**	**16,202**	**21,043**	**24,345**
Growth(%)	*22.1*	*14.8*	*29.9*	*15.7*
Provisions	461	1,090	1,900	2,328
Profit Before Tax	**14,273**	**16,090**	**20,124**	**23,026**
Tax	4,978	4,042	5,055	5,784
Effective Tax rate(%)	*34.9*	*25.1*	*25.1*	*25.1*
PAT	**9,295**	**12,049**	**15,069**	**17,242**
Growth(%)	*37.5*	*29.6*	*25.1*	*14.4*

Balance Sheet (Rs m)

Y/e Mar	FY19	FY20E	FY21E	FY22E
Source of funds				
Equity	1,686	1,686	1,686	1,686
Reserves and Surplus	43,529	57,936	75,986	96,723
Networth	45,215	59,621	77,672	98,409
Growth (%)	*18.6*	*31.9*	*30.3*	*26.7*
Loan funds	1,52,972	1,77,933	2,05,667	2,42,751
Growth (%)	*21.3*	*16.3*	*15.6*	*18.0*
Deferred Tax Liability	-	-	-	-
Other Current Liabilities	2,252	3,738	5,402	3,630
Other Liabilities	3,610	4,979	5,963	6,283
Total Liabilities	**2,04,508**	**2,46,927**	**2,95,758**	**3,52,693**
Application of funds				
Net fixed assets	3,675	2,585	1,538	584
Advances	1,78,673	2,32,576	2,79,729	3,34,294
Growth (%)	*16.8*	*30.2*	*20.3*	*19.5*
Investments	1,738	1,772	1,790	1,825
Current Assets	14,992	7,795	10,532	13,314
Net current assets	**12,740**	**4,057**	**5,130**	**9,684**
Other Assets	5,463	2,200	2,168	2,676
Total Assets	**2,04,540**	**2,46,927**	**2,95,758**	**3,52,693**
Growth (%)	*20.1*	*20.7*	*19.8*	*19.3*
Business Mix				
AUM	1,94,384	2,32,276	2,79,428	3,33,991
Growth (%)	*23.3*	*19.5*	*20.3*	*19.5*
On Balance Sheet	-	-	-	-
% of AUM	-	-	-	-
Off Balance Sheet	-	-	-	-
% of AUM	-	-	-	-

Profitability & Capital (%)

Y/e Mar	FY19	FY20E	FY21E	FY22E
NIM	15.8	14.8	15.0	14.6
ROAA	5.0	5.3	5.4	5.1
ROAE	22.3	22.6	21.4	18.9

Source: Company Data, PL Research

Quarterly Financials (Rs m)

Y/e Mar	Q3FY19	Q4FY19	Q1FY20	Q2FY20
Int. Inc. / Operating Inc.	10,554	10,517	11,440	12,445
Income from securitization	-	-	-	-
Interest Expenses	3,540	3,538	3,800	4,249
Net Interest Income	**7,014**	**6,979**	**7,640**	**8,196**
Growth (%)	*18.1*	*16.6*	*23.3*	*21.6*
Non-Interest Income	258	331	302	423
Net Operating Income	**7,272**	**7,311**	**7,942**	**8,619**
Growth (%)	*18.8*	*18.1*	*23.8*	*23.6*
Operating expenditure	3,502	3,637	3,538	3,654
PPP	**3,770**	**3,673**	**4,405**	**4,965**
Growth (%)	-	-	-	-
Provision	87	57	365	293
Exchange Gain / (Loss)	-	-	-	-
Profit before tax	3,878	3,801	4,144	5,144
Tax	1,407	1,218	1,422	1,068
Prov. for deferred tax liability	-	-	-	-
Effective Tax Rate	36.3	32.0	34.3	20.8
PAT	**2,472**	**2,583**	**2,722**	**4,077**
Growth	*44*	*43*	*36*	*82*
AUM	1,77,831	1,94,384	2,01,859	2,26,769
YoY growth (%)	21.4	23.3	21.5	31.9
Borrowing	1,42,668	1,52,972	1,61,662	1,83,462
YoY growth (%)	*24.0*	*21.3*	*20.3*	*30.8*

Key Ratios

Y/e Mar	FY19	FY20E	FY21E	FY22E
CMP (Rs)	176	176	176	176
EPS (Rs)	11.0	14.1	17.4	19.8
Book value (Rs)	53.6	70.7	92.2	116.8
Adj. BV(Rs)	53.8	69.9	91.0	115.4
P/E(x)	15.9	12.5	10.1	8.9
P/BV(x)	3.3	2.5	1.9	1.5
P/ABV(x)	3.3	2.5	1.9	1.5
DPS (Rs)	2.2	2.9	4.0	4.8
Dividend Payout Ratio(%)	-	-	-	-
Dividend Yield(%)	*1.3*	*1.6*	*2.3*	*2.7*

Asset Quality

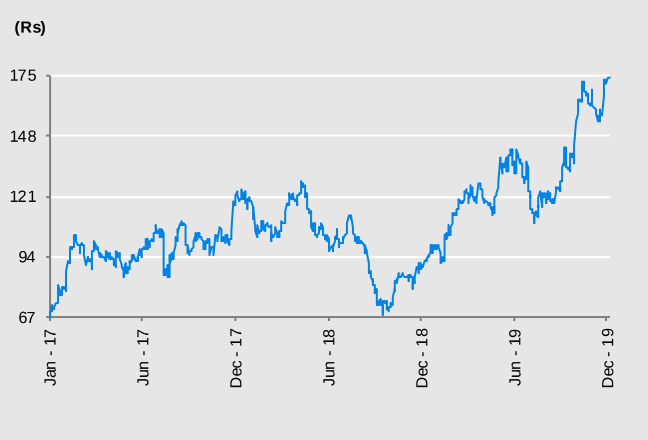
Y/e Mar	FY19	FY20E	FY21E	FY22E
Gross NPAs(Rs m)	1,227	1,754	2,217	2,769
Net NPA(Rs m)	(170)	680	939	1,186
Gross NPAs to Gross Adv.(%)	0.6	0.8	0.8	0.8
Net NPAs to net Adv.(%)	(0.1)	0.3	0.3	0.4
NPA coverage(%)	113.8	61.3	57.7	57.1

Du-Pont as a % of AUM

Y/e Mar	FY19	FY20E	FY21E	FY22E
NII	*14.3*	*13.6*	*13.7*	*13.4*
NII INCI. Securitization	14.3	13.6	13.7	13.4
Total income	14.4	13.8	14.0	13.7
Operating Expenses	6.7	6.5	6.1	6.1
PPOP	7.6	7.3	7.8	7.6
Total Provisions	0.2	0.5	0.7	0.7
RoAA	4.9	5.1	5.3	5.1
Avg. Assets/Avg. net worth	4.5	4.3	4.0	3.7
RoAE	22.3	22.6	21.4	18.9

Source: Company Data, PL Research

Price Chart



Analyst Coverage Universe

Sr. No.	Company Name	Rating	TP (Rs)	Share Price (Rs)
1	Bajaj Finance	BUY	4,668	4,050
2	Capital First	UR	-	495
3	Cholamandalam Investment and Finance Company	BUY	354	317
4	Edelweiss Capital	NR	-	276
5	HDFC	Accumulate	2,568	2,445
6	L&T Finance Holdings	Hold	88	86
7	LIC Housing Finance	Accumulate	409	373
8	Mahindra & Mahindra Financial Services	Accumulate	362	334
9	Shriram Transport Finance	BUY	1,441	1,125

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Buy : >15%
Accumulate : 5% to 15%
Hold : +5% to -5%
Reduce : -5% to -15%
Sell : < -15%
Not Rated (NR) : No specific call on the stock
Under Review (UR) : Rating likely to change shortly

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