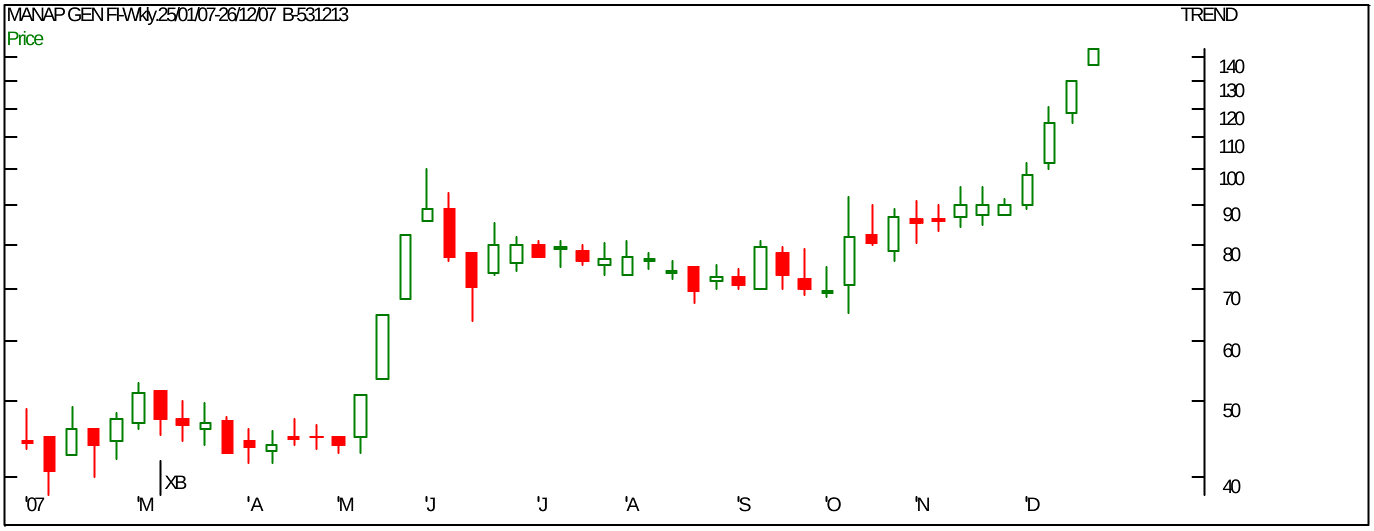
Stock Note

Manappuram General Finance & Leasing Ltd (MAGFIL) (CMP: Rs 143.35) December 27, 2007

Upsides of a Micro Finance Stock, but with lower risks due to secured advances
Buy in the Rs.143-151 band and add on declines to Rs.114-121 band for a 12M target of Rs.204

Price Chart:



Triggers:

Engaged in small value, high margin business of gold loans: Indians are the largest holders of gold. Excluding RBI's holdings, Indians' hold Rs.12,50,000 cr of gold, which can be theoretically used for borrowing money. Almost 85% of MAGFIL's portfolio consists of loans against gold. The average ticket size of such loans is Rs. 15,000 and the average loan period is about four months. The combined size of the loan portfolio (of MAGFIL and Manappuram Finance (Tamil Nadu) Pvt Ltd) could be Rs. 750 cr., (inclusive of off-balance sheet items) as of March 2008. As per the method of accounting followed by MAGFIL, Interest received/accrued on account of gold loan receivables assigned to its institutional lenders is credited to interest account net of interest paid/credited to these lenders on accrual basis. This portfolio size could increase by 30%+ in the coming year i.e. FY09. The average cost of funds for advancing gold loans is close to 12% and the average interest earned is around 21% - 23%. This leads to a healthy spread of 9% - 11%. The main sources of funds for MAGFIL are debentures, bank overdraft, term deposits, subordinate bonds and securitised advances. Fullerton India (a non-banking finance company, is a subsidiary of Asia Financial Holdings Ltd, a wholly owned subsidiary of Temasek Holdings, Singapore) is one of its main institutional lenders lenders accounting for almost 75% of sanctions as on Mar 2007. As on Mar 2007, MAGFIL's capital adequacy was 20% compared to statutory minimum of 15%.

Diversifying into fee based activity of Insurance broking to tap into its 1.5 million customer base: MAGFIL set up a 100% subsidiary Manappuram Insurance Brokers Pvt Ltd in 2006, which carries out life and non-life insurance broking business. The subsidiary has received the insurance Broking licence from the Insurance Regulatory and Development Authority (IRDA). The main concentration is currently on life insurance. Its main principals are Reliance Life, Kotak Life, LIC, Birla Sun Life, etc. In FY07, the subsidiary earned revenue of Rs. 0.55 cr, PBT of Rs. 0.29 cr and PAT of Rs. 0.19 cr. MAGFIL is planning to push its fee-based activities by tapping its captive 1.5 million customer base. The insurance business could earn PBT of Rs. 1 cr in FY08 and this could grow by about 150% in FY09.

Spreading its network to 450+ from less than 220 as of Mar 2007 with large presence in Kerala, Tamil Nadu, Andhra Pradesh, Karnataka: MAGFIL has increased its number of offices from less than 220 as on March 2007 to 450+ across 12 states in India. MAGFIL plans to tap other states like Orissa, West Bengal and Maharashtra.

Merging its group company i.e. Manappuram Finance (Tamil Nadu) Pvt Ltd (MFPL) engaged in similar business into itself w.e.f April 01, 2008: MAGFIL is planning to merge one of its group companies, Manappuram Finance (Tamil Nadu) Pvt Ltd (MFPL). MFPL is also into similar business (gold loans) like MAGFIL, the only difference being the former is a non-deposit taking company and MAGFIL, a deposit taking company. These two companies together constitute more than 90% of the business of the Manappuram Group and the balance is from the business of the Nidhi company (Manappuram Benefit Fund Ltd). The rationale for merging these two companies is to remove overlapping of business, benefit out of synergies and gain size. This merger could be effective from April 01, 2008.

Received convertible funds of Rs.70 cr into both these companies from private equity players like Sequoia and Hudson: MAGFIL has arranged a fund infusion of Rs 70 crore from Sequoia Capital India Investment Holding and Hudson Equity Holdings Ltd. Sequoia Capital and Hudson Equity will invest Rs 35 crore each in two tranches to bankroll Manappuram's expansion plans for MAGFIL and other group companies. The association of such names could give more credibility to MAGFIL and improve valuations on a medium term basis. The fund infusion will help to lift the networth on a combined basis to close to Rs. 135 cr from the current about Rs. 24 cr for MAGFIL only. This will also improve the capital adequacy and enable much larger business. Compulsorily convertible preference shares worth Rs.46.8 cr have been allotted to the listed company (MAGFIL) and the rest i.e. 23.2 cr to the unlisted company (MFPL). These are convertible at a minimum Rs. 100 and a maximum of Rs. 145 based on a particular multiple of FY08 earnings. Post the merger, both the investors; Sequoia Capital and Hudson Equity would hold equity of about 11% each in the merged company.

Hoping to get main agent licence for its Money Transfer Business from RBI that could dramatically increase revenues from this business: As a part of the progressive financial sector liberalization of foreign exchange transactions, RBI issued AD-II licences to MAGFIL, which would enable it to effect a wide range of non trade remittances, apart from conducting currency exchange transactions. MAGFIL is the only NBFC in Kerala to receive this permission. Currently MAGFIL is involved in buying and selling of foreign currencies like US Dollars, Pound Sterling, UAE Dirham, Saudi Riyal, Bahrain Dinar and Omni Riyal. MAGFIL plans to open liaison offices in Middle East and Europe. Currently MAGFIL acts a sub-agent of companies like UAE Xchange, Wall Street Finance and Money Gram. As a sub-agent, MAGFIL receives one-third of the commission (as it is involved in one of the three legs of the transaction i.e. receiving, managing and paying). MAGFIL has approached RBI for licence for being a main agent of Money Transfer and is hopeful of getting the same. The revenues from this business have grown from Rs.57 lacs in FY07 to Rs.100 lacs in FY08 (E). As a sub-agent, MAGFIL's business could grow by another 50% in FY09. But if MAGFIL succeeds in becoming a main Money Transfer agent, it could grow by 3-4 times as not only the volumes would grow, its share in the pie would increase from one-third to 50%.

Financials:

Consolidated Financials of MAGFIL

Rs. Cr	Q2FY08	Q2FY07	% Chg	Q1FY08	% Chg	H1FY08	H1FY07	% Chg	FY07	FY06	% Chg
Income from Operations	15.3	8.4	80.8	17.9	-14.9	33.1	14.3	131.6	43.3	19.5	121.6
Other Income	0.1	0.1	-40.0	0.0	0.0	0.1	0.2	-30.0	0.4	0.2	76.2
Total Income	15.3	8.5	79.4	17.9	-14.6	33.3	14.5	129.4	43.7	19.7	121.1
Expenditure	6.3	3.5	81.8	7.5	-16.6	13.8	5.9	133.0	17.4	6.7	160.9
% of sales	*41.2*	*41.0*	*0.5*	*42.0*	*-1.9*	*41.8*	*41.5*	*0.6*	*40.2*	*34.2*	*17.7*
Operating Profit	**9.0**	**5.1**	77.8	**10.4**	-13.1	**19.4**	**8.6**	126.9	**25.9**	**12.9**	101.2
OPM %	*59.2*	*60.2*		*57.9*		*58.6*	*59.9*		*59.8*	*65.8*	
Interest	2.8	1.8	53.0	2.9	-3.8	5.6	3.5	60.2	8.8	7.1	24.5
Depreciation	0.5	0.3	96.0	0.3	48.5	0.8	0.4	107.7	1.1	0.5	122.9
PBT	5.8	3.0	91.1	7.2	-19.6	13.0	4.7	178.9	16.0	5.3	202.1
PBTM %	*37.8*	*35.8*		*40.0*		*39.2*	*32.5*		*36.9*	*27.1*	
Tax	2.0	1.0	97.0	2.4	-18.1	4.4	1.6	181.5	5.8	2.2	169.1
Effective Tax Rate %	*34.5*	*33.4*		*33.8*		*13.3*	*11.0*		*36.5*	*41.0*	
PAT	**3.8**	**2.0**	88.1	**4.8**	-20.4	**8.6**	**3.1**	177.6	**10.1**	**3.1**	225.0
PATM %	*24.8*	*23.8*		*26.5*		*25.8*	*21.5*		*23.4*	*16.0*	
Equity	11.0	5.5	100.0	11.0	0.0	11.0	5.5	100.0	11.0	11.0	0.0
EPS	**3.4**	**3.7**	**-6.0**	**4.3**	**-20.4**	**7.8**	**5.6**	**38.8**	**9.2**	**2.8**	**225.0**

(Source: Capitaline Plus)

Extract of Balance Sheet of MAGFIL for FY07 and FY06

SOURCES OF FUNDS:	FY07	FY06	APPLICATION OF FUNDS:	FY07	FY06
Share Capital	15.0	7.5	Gross Block	13.4	6.7
Reserves Total	13.1	10.5	Less: Accumulated Depreciation	2.7	1.6
Total Shareholders Funds	28.1	18.0	Net Block	10.7	5.1
Secured Loans	51.2	47.4	Investments	3.1	2.1
Unsecured Loans	42.1	18.3	Current Assets, Loans & Advances		
Total Loan Funds	93.3	65.6	Stock on hire	10.3	0.2
Deferred Tax Liability	0.1	0.1	Cash and Bank Balances	21.6	34.1
Total	**121.5**	**83.8**	Other Current Assets	30.7	5.4
Amt. In Rs. Cr			Loans and Advances	81.4	62.9
			Total Current Assets	144.0	102.7
			Less:		
			Current Liabilities	21.8	19.9

Provisions	14.4	6.2
Total Current Liabilities	36.2	26.1
Net Current Assets	107.8	76.7
Total	**121.5**	**83.8**

(Source: Capitaline Plus)

Segment wise performance of MAGFIL for FY07 and FY06 is as under:

Particulars	Hire Purchase/ Hypothecation			Gold Loan			Fee Based Activities			Unallocable Items		
(Amt. Rs. Cr)	H1FY08	FY07	FY06	H1FY08	FY07	FY06	H1FY08	FY07	FY06	H1FY08	FY07	FY06
Revenue	3.3	9.6	5.5	10.3	32.0	13.3	0.3	0.6	0.5	0.6	1.4	0.5
Expense	1.8	4.6	2.2	5.6	16.0	9.1	0.1	0.0	0.0	1.8	6.7	2.3
Result	1.4	4.9	3.3	4.7	16.1	4.2	0.3	0.6	0.4	2.4	-5.3	-1.8

(Source: Capitaline Plus, Annual Report 2006-07)

Post merger, based on expectation of allotment of equity shares at the higher band, we expect the two private equity players to hold about 11% each in the equity, while the promoters could hold close to 50% equity (up from the current 43%). The combined equity could be close to Rs.23 cr. We expect MAGFIL to end FY08 with a PAT of close to Rs.25 cr (on a combined basis) and grow this number by 60% in the coming year i.e.FY09. At the current price of Rs.143.35, the stock is valued at 13.2 times FY08 (E) EPS on a fully diluted basis and 8.2 times its FY09 (E) EPS on a fully diluted basis.

Recommendation:

The finance space in India is receiving attention for the kind of volume growth and shift to the organized segment happening over the past few years. MAGFIL is one of the key players in the finance segment in South India. The loan size dealt with by MAGFIL qualifies it to be called a Micro Finance company. A lot of private equity deals have happened in the recent past giving attractive valuations to such companies based on the potential of this business in India. MAGFIL has an added advantage in the sense; all its loans are secured by a security (i.e. Gold), which can be easily liquidated. We think MAGFIL is on track to accelerate its speed of growth in business, topline and bottomline following recent developments. It could also get better valuations following induction of well-known private equity players.

We think MAGFIL can be bought in the Rs.143-151 band and added on declines to Rs.114-121 band for a 12 month target of Rs.204 i.e.12 times its FY09 (E) EPS.

Company Background:

Manappuram General Finance & Leasing Ltd (MAGFIL) was established in 1992 in the wake of economic reforms launched by the Government of India mainly to take advantage of the importance assigned to Leasing as a vehicle to promote decentralized pattern of Economic Growth through small and medium enterprises. MAGFIL is an NBFC promoted by the Manappuram group with its headquarters at Valapad, Thrissur district, Kerala. MAGFIL went public in August 1995. Manappuram group has 450 offices spread across the country with a customer base of 1.5 million +. MAGFIL has most of its offices in South India as majority of clients are from the southern states. MAGFIL has one-third of its offices i.e. 150 offices in Kerala, 105 in Tamil Nadu, 75 in Andhra Pradesh, 50 in Karnataka and the remaining in other cities of the country.

MAGFIL's portfolio constitutes of 84% of gold financing, 2% - 3% of vehicle financing, 0.5% of business loans and the remaining constitutes of fee-based activities like insurance broking, money transfer and buying and selling of foreign exchange. Vehicle loans are mainly given for first hand passenger three wheeler vehicles. Less than half percent of gold loans constitutes NPAs (net Performing Assets) and less than 1% of the total loan constitutes NPAs. For FY07, a sum of Rs.1.33 cr was provided as provision for NPA accounts and the closing provision was Rs.1.66 cr.

With the trust and commitment extending over 58 years, Manappuram Group has emerged as a force to reckon with under the stewardship of Mr. V.P. Nandakumar, the Chairman & Managing Director of the Group with various companies under its flagship viz., MAGFIL, Manappuram Benefit Fund Ltd (Nidhi Company), Manappuram insurance Brokers Pvt Ltd (MAGFIL's 100% subsidiary), Manappuram Chits India Ltd, Manappuram Computech & Consultants Pvt Ltd and Manappuram Finance (Tamil Nadu) Pvt Ltd.

Industry Overview:

- CRISINFAC estimates the current retail lending portfolio in the country to be ~USD 44 bn and expects the same to touch ~USD 150 bn FY 09. Banks and NBFCs constitute 80% and 20% of the market respectively
- With increasing competition from banks, NBFCs have begun to move to more niche markets as non metros and high yielding businesses such as second hand CVs, sub prime home loans, sub prime personal and vehicle finance loans, resulting in higher Net Interest Margins and higher ROEs
- Key Success factors for an NBFC in today's scenario is its reach and network, knowledge of local markets and credit needs, experience in recovery, expertise in handling large volumes of cash, strong risk assessment and management capabilities and flexibility in terms of loan size and tenor

- Retail lending sector is witnessing a growth of 15% per annum owing to the robust economic growth and is expected to grow at a CAGR of 18% for the next 5 years. Growth in retail credit, coupled with growing economic activity has led to a 23.3% growth in bank credit in 2005-06
- Growth in consumer credit has been fuelled by change in demographics (younger population), rising income levels and changing mindset towards borrowing. The favourable demographic profile would only help sustain the growth and momentum in the retail lending sector
- India is the world's largest consumer of gold accounting for typically 20% of global gold off-take in any one year. World Gold Council (WGC) has estimated the annual Indian demand for gold in the recent years has been in excess of 800 tonnes. This acts as a trigger for companies like MAGFIL whose main business is from that of gold financing.

Risks & concerns:

- Competition from commercial banks/pawn brokers on retail gold loans could be a concern for MAGFIL in the coming years, although in terms of focus, MAGFIL could score over its competitors.
- Gold loans, which amounts for a majority of MAGFIL's portfolio has a price risk attached to itself. The prices of gold are market driven and due to volatility in the market, the realizable value of Gold could fluctuate leading to risk of NPAs.
- There is a limit of volume of Gold loans that can be advanced within the local area of each office, as it is dependent on the value of Gold mortgaged.
- MAGFIL faces risk of fraud, burglary, and infidelity from its staff or customers. However, the risk from this concern is minimized due to set processes, insurance, training, vigilance and audit mechanisms.
- Delays/rollback of the proposed merger and/or material variation in the terms of merger could affect the valuation of MAGFIL going forward.

Analyst: Sneha Venkatraman (hdfcsecretailresearch@hdfcsec.com)

RETAIL RESEARCH Tel: (022) 6661 1700 Fax: (022) 2496 5066 Corporate Office
HDFC Securities Ltd. Trade World, C. Wing, 1st Floor, Kamala Mills Compound, Senapati Bapat Marg,
Lower Parel, Mumbai 400 013 Phone: (022) 66611700 Fax: (022) 2496 5066 Website: www.hdfcsec.com
Email: hdfcsecretailresearch@hdfcsec.com