

OCTOBER 31, 2011

#### RESULT

Coverage view: **Attractive**

Price (Rs): **180**

Target price (Rs): **230**

BSE-30: **17,805**

**Strong results; retain BUY.** Muthoot Finance reported PAT of Rs2.15 bn, up 90% yoy and 4% above estimates. Strong (81% yoy) growth in loan book, marginal yoy improvement in NIM and somewhat lower tax rates were key growth drivers although operating expenses were higher than expected. Retain BUY with price target of Rs230. Sharp decline in gold prices poses a risk to growth and earnings.

#### Company data and valuation summary

Muthoot Finance

##### Stock data

52-week range (Rs) (high,low) 199-150

Market Cap. (Rs bn) 66.8

##### Shareholding pattern (%)

Promoters 80.1

FIs 4.8

MFs 1.1

##### Price performance (%)

	1M	3M	12M
Absolute	10.6	(3.8)	0.0
Rel. to BSE-30	2.6	(0.4)	0.0

##### Forecasts/Valuations

	2011	2012E	2013E
EPS (Rs)	15.7	21.6	26.7
EPS growth (%)	108.4	37.1	23.7
P/E (X)	11.4	8.3	6.7
NII (Rs bn)	12.7	20.1	25.5
Net profits (Rs bn)	4.9	8.0	9.9
BVPS	35.9	81.6	108.3
P/B (X)	5.0	2.2	1.7
ROE (%)	51.5	36.7	28.1
Div. Yield (%)	0.0	0.0	0.0

#### Strong loan growth continues

**Loan growth remains high.** Muthoot Finance reported loan book (including loans sold down) of Rs209 bn, up 81% yoy. On a qoq basis the company added Rs29 bn, up 17% qoq; this compares with Rs20 bn added in 1QFY12. Thus, loan growth was 31% on a YTD basis. We are modeling 58%, 25% and 13% loan growth in FY2012E, FY2013E and FY2014E, respectively, as compared to over 100% growth in the past two years. The company will likely need to raise capital if its growth traction remains strong and the regulatory proposals are finalized (as discussed later).

**Gold prices volatile.** Gold prices have been volatile during the past few months. Gold prices had increased 27% qoq between June and September 2011; however, the yellow metal has already corrected by 17% from its peak. The decline in international gold prices was somewhat offset by depreciation in the Indian Rupee; thus, the decline in India was less severe.

**Muthoot well-placed to manage decline in gold prices.** While gold prices increased by 27% qoq, Muthoot's average ticket size was up only 9% (higher than 3% growth reported in 1QFY12). The management highlighted that (1) they have not fully considered the rise in gold prices in valuing underlying gold for loan disbursements during the quarter and (2) average holding per customer was stable at about 25 grams. Based on this, the average LTV declined to 58% in September 2011 from 63-68% in the past. Thus, while sharp decline in gold prices poses a risk to gold loan companies, Muthoot has been fairly conservative on this front.

**Retain BUY rating.** We retain BUY rating on Muthoot with a price target of Rs230 (29% upside). At our target price, Muthoot will trade at 8.6X PER and 2.1X PBR FY2013E for 25% EPS CAGR between FY2011 and FY2014E and 28-30% RoE.

#### QUICK NUMBERS

- PAT up 90% yoy
- Loan book up 81% yoy

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### NIM improves as well

Muthoot reported NIM of 11.4% in 2QFY12 as compared to 11.2% in 1QFY12 and 10.9% in 2QFY11. The company had raised lending rates in 3QFY11 and 2QFY12 to offset 170 bps rise in borrowings costs in the past four quarters. After adding back the one-time cost of the recent NCD issuance to its interest expenses, NIM appears stable qoq.

The removal of agriculture priority-sector status for gold-loan NBFCs has raised concerns on financial flexibility of gold-loan NBFCs. Muthoot has not faced any significant pressure as yet. The company has been selling down loans to banks (without PSL benefits) over the past few months. Loans outside balance sheet have increased to Rs26 bn in September 2011 from Rs24 bn as of June 2011. We, however, believe that the company will find it challenging to sell down loans if the proposed revised draft securitization guidelines are implemented by RBI; the regulator proposes to ban loan sell-down for assets that have bullet repayment and increase minimum holding period for loans sold down by NBFCs to banks.

### Other highlights of the quarter

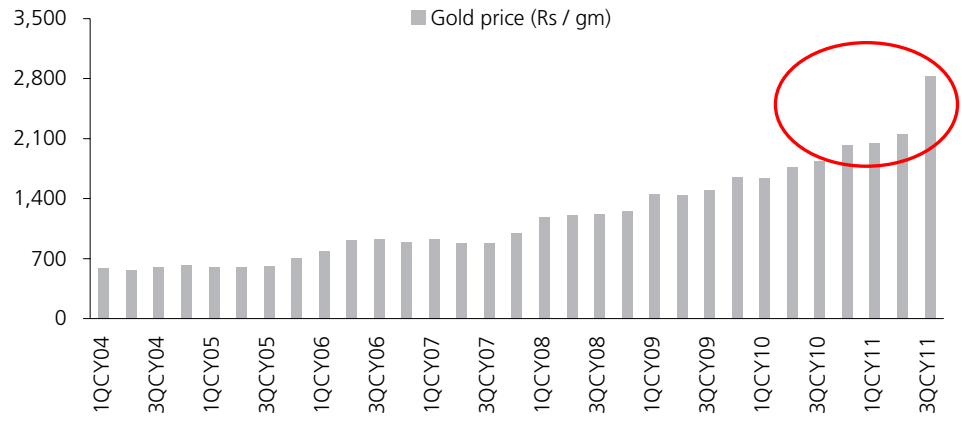
- ▶ Gross NPLs increased to 0.6% from 0.31%; the management highlighted that NPLs are at seasonally high levels and expect the ratio to improve over the next two quarters.
- ▶ Operating expenses ratio increased to 4.6% of average assets from 4.2% in 1QFY12. The company has set up 277 branches in 2QFY12 (541 in 1HFY12); higher expenses of these branches have affected the ratio for the quarters.
- ▶ As of September 2011, capital adequacy was 18.24%, down from 19.2% in June 2011. In case annual growth exceeds 60-70%, the company will need to tap the capital markets over the next 4-6 quarters.

**Muthoot Finance: Quarterly sheet**  
 1QFY11- 2QFY12 (Rs mn)

	1Q11	2Q11	1Q12	2Q12	YoY (%)	2Q12E	Actual vs KS (%)
Interest income	3,791	5,223	9,141	10,984			
Interest expenses	1,721	2,412	4,407	5,452			
<b>Net interest income</b>	<b>2,070</b>	<b>2,811</b>	<b>4,734</b>	<b>5,532</b>	<b>97</b>	<b>5,059</b>	<b>9</b>
Provisions (including standard assets)	-	22	104	166	672	100	66
<b>NII post provisions</b>	<b>2,070</b>	<b>2,789</b>	<b>4,630</b>	<b>5,366</b>	<b>92</b>	<b>4,959</b>	<b>8</b>
Other income	36	50	56	65	31	50	30
Operating expenses	836	1,120	1,786	2,249	101	1,840	22
Admin expenses	386	530	911	1,190	125	930	28
Employee expenses	416	569	815	985	73	850	16
Depreciation	34	43	60	74	74	60	23
<b>PBT</b>	<b>1,270</b>	<b>1,719</b>	<b>2,900</b>	<b>3,182</b>	<b>85</b>	<b>3,169</b>	<b>0</b>
Tax	422	586	995	1,027	75	1,093	(6)
<b>PAT</b>	<b>848</b>	<b>1,133</b>	<b>1,905</b>	<b>2,155</b>	<b>90</b>	<b>2,076</b>	<b>4</b>
Loan book	68,853	90,914	155,490	183,530	102		
Retail loans	68,532	90,537					
Others	321	376					
Current assets	9,535	8,502					
Cash and bank	7,933	5,792					
Other current assets	1,602	2,711					
Investments	75	75					
Fixed assets	1,605	1,788					
<b>Total assets</b>	<b>80,068</b>	<b>101,279</b>					
Current liabilities and provisions	4,344	5,159					
Loans	69,045	85,737					
Networth	6,679	10,383	23,960	26,115	-		
Share Capital	3,010	3,202					
Reserves and surplus	3,672	7,184					
Miscellaneous expenses	3	3					
<b>Total liabilities</b>	<b>80,068</b>	<b>101,279</b>					
<b>Key highlights</b>							
Loans outside balance sheet (Rs mn)	22,507	24,587	24,000	25,875			
<b>Total loans under management (Rs mn)</b>	<b>91,360</b>	<b>115,500</b>	<b>179,490</b>	<b>209,405</b>	<b>81</b>	<b>200,000</b>	<b>5</b>
Average loans under management (Rs mn)	83,030	103,430	169,436	194,448		189,745	
Borrowings +loans sold down (Rs mn)	91,552	110,324	24,000	25,875			
Yield on loans (%)	18.3	20.2	21.6	22.6			
Cost of borrowings (%)	8.4	9.6	10.4	11.2			
<b>Spread (%)</b>	<b>9.9</b>	<b>10.6</b>	<b>11.1</b>	<b>11.4</b>			
<b>NIM (KS- calc %)</b>	<b>10.0</b>	<b>10.9</b>	<b>11.2</b>	<b>11.4</b>	<b>4.7</b>	<b>10.7</b>	
Opex/ average assets (%)	4.0	4.3	4.2	4.6			
RoA (%)	4.1	4.4	4.5	4.4			
RoE (%)	54.2	53.1	40.9	34.4			
Gross NPLs (%)	0.42	0.41	0.31	0.59			
Capital adequacy (%)							
Branches (#)	1,763.0	2,038.0	2,997.0	3,274.0	60.6		
Loan accounts ( # mn)	3.2	3.8	5.2	5.5	46.8		
Gold (weight in tons)	76	90	120	130	44		
Value of gold (Rs mn)	135,170	16,230	247,350	340,000	1,995		
Gold price (Rs/ gm)	1,765	1,799	2,060	2,625	46		
Average ticket (Rs)	27,925	30,570	34,764	37,765	24		
Value of gold/borrower (assuming 25/ gms per loan)	44,125	44,975	51,500	65,625	46		
Average ticket (Rs)	27,925	30,570	34,764	37,765	24		

Source: Company, Kotak Institutional Equities estimates

Gold price - at all time highs  
1QCY04- 3QCY12 (US\$/oz)



Source: Bloomberg

**Muthoot Finance: Key ratios**  
March fiscal year-ends, 2010-2014E (%)

	2010	2011	2012E	2013E	2014E
<b>Growth in key parameters (%)</b>					
<b>Profit and loss statement - yoy (%)</b>					
Interest income	78	113	87	31	17
Interest costs	53	118	122	35	16
Net interest income	104	110	59	27	17
Net total income	98	108	58	27	17
Provisioning expenses	297	1089	54	-31	17
Net income (post provisions)	98	104	58	28	17
Operating expenses	65	83	47	36	19
Staff expenses	78	89	47	41	30
Other operating expenses	58	85	46	32	8
Depreciation expenses	49	21	48	17	13
PBT post extraordinary	133	120	61	24	16
Tax	134	126	58	24	16
PAT	133	117	62	24	16
<b>Balance sheet - yoy (%)</b>					
Gold loans	112	115	94	25	13
Gold loans (incl sell down)	121	113	58	25	13
Fixed assets	19	53	28	17	13
Other current assets	-22	141	47	27	11
Total assets	71	117	85	25	13
Borrowings	67	126	84	24	10
Current liabilities	151	-14	114	20	20
Total liabilities	72	116	80	24	10
Share capital	514	6	16	0	0
Reserves and surplus	-10	258	162	37	31
Shareholders funds	61	128	127	33	28
<b>Key ratios (%)</b>					
Interest yield (incl loans sold down)	19.9	19.7	21.0	20.0	19.8
Interest cost (incl loan sold down)	8.4	8.8	11.3	11.3	11.3
Spreads	11.5	10.9	9.7	8.7	8.5
Nil/ loans under management	11.2	10.9	9.8	9.0	8.9
Operating costs/ net income (post provision):	43.6	39.1	36.3	38.4	39.0
Cash/ total assets + loan sold down	6.8	7.6	5.8	6.0	5.9
Tax rate	34.1	35.1	34.5	34.5	34.5
Debt/ equity (X)	9.0	8.9	7.2	6.8	5.8
<b>Du Pont analysis</b>					
(% of average assets including loans sold down)					
Net interest income	9.3	9.5	8.7	8.0	7.9
Other income	0.2	0.1	0.1	0.1	0.1
Credit costs	0.0	0.2	0.2	0.1	0.1
Operating expenses	4.1	3.7	3.1	3.1	3.1
PBT post extraordinary	5.3	5.7	5.3	4.8	4.7
1-tax rate	0.7	0.6	0.7	0.7	0.7
<b>RoA</b>	<b>3.5</b>	<b>3.7</b>	<b>3.5</b>	<b>3.1</b>	<b>3.1</b>
Average assets / average equity (X)	13.8	13.9	10.6	9.0	8.2
<b>RoE</b>	<b>48.1</b>	<b>51.5</b>	<b>36.7</b>	<b>28.1</b>	<b>24.9</b>

Source: Company, Kotak Institutional Equities estimates

**Muthoot Finance: Profit and loss and balance sheet**  
 March fiscal year-ends, 2010-2014E (Rs mn)

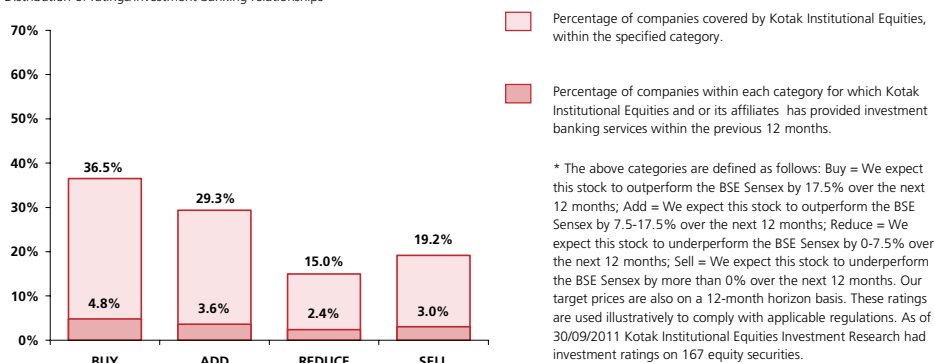
	2010	2011	2012E	2013E	2014E
<b>Income statement (Rs mn)</b>					
Interest income	10,774	22,983	43,040	56,440	65,771
Interest costs	4,737	10,326	22,931	30,965	36,030
Net interest income	6,037	12,657	20,109	25,475	29,742
Other income	119	175	192	214	250
Net total income	6,156	12,832	20,301	25,690	29,992
Provisioning expenses	27	323	496	343	402
Net income (post provisions)	6,129	12,509	19,805	25,346	29,589
Operating expenses	2,674	4,896	7,186	9,741	11,550
Staff expenses	1,169	2,209	3,253	4,576	5,940
Other operating expenses	1,355	2,508	3,666	4,854	5,260
Depreciation expenses	149	180	267	311	351
PBT post extraordinary	3,455	7,612	12,240	15,138	17,498
Tax	1,180	2,670	4,223	5,222	6,037
PAT	2,275	4,942	8,017	9,915	11,461
No of shares (mn)	301	314	371	371	371
EPS - adjusted for bonus (Rs)	7.6	15.7	21.6	26.7	30.9
BVPS - adjusted for bonus (Rs)	19.4	42.5	81.6	108.3	139.2
<b>Balance sheet (Rs mn)</b>					
<b>Assets</b>					
<b>Gold loans</b>	<b>54,298</b>	<b>116,821</b>	<b>226,099</b>	<b>281,860</b>	<b>317,574</b>
Other loans	319	697	-	-	-
Investments	75	75	75	75	75
Fixed assets	1,533	2,341	3,000	3,495	3,945
Current assets	8,202	19,729	28,930	36,869	41,017
Cash and bank balances	5,760	13,755	16,368	21,210	23,374
Cash for securitised transactions	1,037	2,162	1,297	1,617	1,822
Other cash balance	4,723	11,593	15,071	19,593	21,552
Other current assets	2,442	5,974	12,561	15,659	17,643
<b>Total assets</b>	<b>64,427</b>	<b>139,662</b>	<b>258,103</b>	<b>322,298</b>	<b>362,611</b>
<b>Liabilities</b>					
<b>Borrowings</b>	<b>52,805</b>	<b>119,385</b>	<b>219,493</b>	<b>272,114</b>	<b>298,976</b>
Retail NCDs	27,193	39,832	-	-	-
Bank borrowings	20,828	60,529	-	-	-
Loans from directors/ inter corporate loa	587	821	821	821	821
Subordinated debt	3,247	7,106	14,747	23,247	23,247
Current liabilities	4,524	3,878	8,291	9,950	11,939
Provisions	1,230	3,031	-	-	-
Deferred tax liability	25	25	-	-	-
<b>Total liabilities</b>	<b>58,584</b>	<b>126,319</b>	<b>227,784</b>	<b>282,064</b>	<b>310,916</b>
Share capital	3,010	3,202	3,714	3,714	3,714
Reserves and surplus	2,832	10,140	26,605	36,520	47,981
<b>Shareholders funds</b>	<b>5,842</b>	<b>13,342</b>	<b>30,319</b>	<b>40,234</b>	<b>51,695</b>
<b>Aggregate loan book (incl sell down)</b>					
Loan on books	54,298	116,821	226,099	281,860	317,574
Loans outside books	20,083	41,863	25,122	31,318	35,286
<b>Loans under management</b>	<b>74,381</b>	<b>158,684</b>	<b>251,221</b>	<b>313,178</b>	<b>352,860</b>
Loans outside books./ total loans (%)	27	26	10	10	10
<b>Total assets under management</b>	<b>84,509</b>	<b>181,525</b>	<b>283,225</b>	<b>353,616</b>	<b>397,897</b>

Source: Company, Kotak Institutional Equities estimates

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Distribution of ratings/investment banking relationships



Source: Kotak Institutional Equities

As of September 30, 2011

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