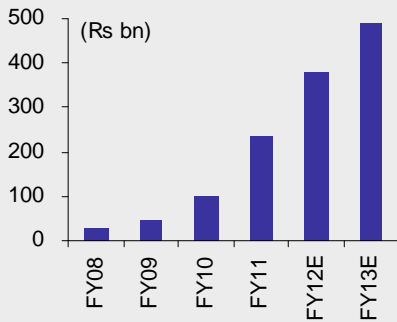
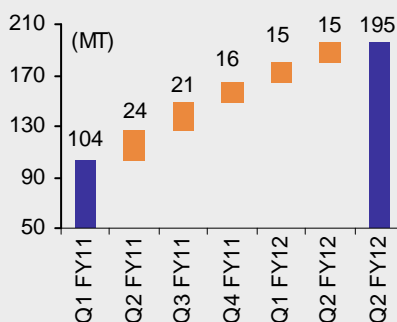


Combined AUM growth trajectory of Manappuram and Muthoot



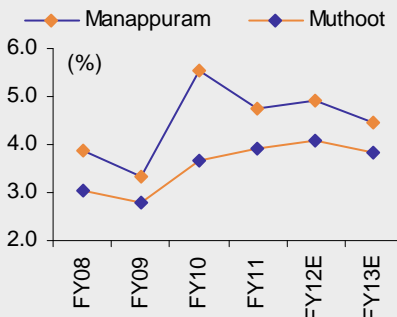
Source: Company, India Infoline Research

Quarterly addition (combined) in gold stock has been moderating



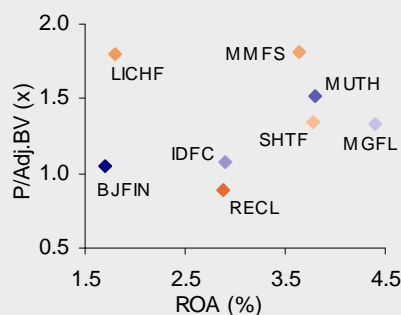
Source: Company India Infoline Research

Higher RoAs would be sustained



Source: Company, India Infoline Research

Valuation of gold loan companies more attractive than other NBFCs



Source: Company, India Infoline Research

We attempted a broad analysis to understand the impact of a sustained gold price correction on business growth and profitability of gold loan companies. Our effort revealed that gold price decline would accelerate volume growth as the customer fund requirement remains unchanged; implying that asset growth of gold loan companies would not fall off the cliff. Margins could expand in this scenario as customers naturally shift to higher LTV loans. Therefore, profits may only decline marginally despite higher provisioning and the RoA would remain largely unchanged (also aided by a lower base). We believe that this business is inherently richly profitable and should be able to generate 3%+ RoA even in the longer term.

Despite factoring a gold price decline from hereon, we estimate Manappuram and Muthoot to deliver robust earnings growth of 60% and 52% respectively over FY11-13. RoA of both the companies would remain in the range of 4-4.5%. Lackluster absolute stock performance over the past six months suggests that street is unduly concerned about a gold price correction. Q3 FY12 earnings performance is likely to beat expectations as in the previous two quarters. Re-iterate BUY on Manappuram and Muthoot.

Business growth resilient to gold price correction

Looking at the robust AUM growth of gold loans companies, a common misnomer that gets build is that substantial asset growth is being driven by the rally in gold prices. We believe that loan is essentially a function of the borrower's requirement of fund at that time (either to meet urgencies or cash flow mismatches) which is not influenced by gold prices. Of course, increasing gold prices enhances borrowers comfort to take a loan as the requirement would be bridged through a lower LTV/interest rate loan. From the company's perspective, the book profile becomes safer with reducing average LTV. In such a scenario, the AUM growth is stronger than volume growth.

In case of sustained gradual correction in gold prices, we believe that volume growth accelerate as customers fund requirement remains unchanged. As bulk of the gold loan customers are based in rural and semi-urban areas, alternative means of funding is either not accessible or more costly. So the asset growth would not fall off-the-cliff if gold prices start correcting though it would be materially below the volume growth. Due to declining gold prices, the customers would be forced to migrate to higher LTV loans associated with higher interest rates. This enhances asset quality risk for lenders as average LTV increases.

Presently, both Manappuram (114% yoy and 17% qoq) and Muthoot (81% yoy and 17% qoq) are witnessing exceptional AUM growth. However, quarterly addition in pledged gold has come-off (volume growth has decelerated) in the past five quarters despite substantial network expansion. This explains the inverse relationship between gold prices and volume growth as customers fund requirement is inelastic. With penetration fast increasing in the key Southern market, this correlation would assume more strength. We expect AUM growth of gold loan companies to be healthy even if gold prices were to correct driven by acceleration in volume growth. By assuming an 18% decline in gold prices over Q3 FY12-Q4 FY13, we estimate brisk 35% and 28% AUM growth for Manappuram and Muthoot respectively in FY13.

Research Analyst

Rajiv Mehta

research@indiainfoline.com

Sustainable 3%+ RoA and 20%+ RoE business in longer term

Another objective of our analysis was to assess the impact of gold prices correction on the profitability (RoA sensitivity) of the business. It has to be recognized movement in gold prices has a holistic impact on the business ie on volume growth, risk profile, margin, operating leverage and provisioning. Our broad working shows that RoA would be more or less unchanged or even marginally improve in a scenario of gold prices decline. This is logically explained by the increase in risk level of the business. As mentioned before, gold price correction would most likely lead to higher average LTV and therefore improved margin in a stable funding cost scenario. On the other side, operating leverage would slightly deteriorate and provisioning could be higher (if companies conservatively provide). Our analysis reveals that profit in the price decline scenario would only be marginally lower than price rise scenario but the RoA could be better on account of lower base. Therefore, we expect current high RoAs of Manappuram (4.5-5%) and Muthoot (4-4.5%) to not contract significantly even if gold prices start reversing. Increasing competition could only drive RoAs structurally lower but in the longer term. We estimate this business to have a sustainable RoE of 20-23%.

Margin resilience has been heartening; imminent rate-cut cycle to support margin

It has been impressive that both Manappuram and Muthoot have been able to largely sustain margin despite substantial increase in funding cost in the past three quarters. They were adversely impacted by removal of PSL benefit on gold loans, sharp increase in bank lending rates (borrowing is Base Rate linked) and higher short-term rates. Most surprising was that these companies were successful (in the face of increasing competition offering lower rates) in partially passing higher cost to customers by taking rate hike. Their funding mix shifted away from banks during H1 FY12 as they tapped other options such as NCDs and CPs. In August-September, Manappuram and Muthoot successfully completed primary NCD issues of worth Rs4.4bn and ~Rs6bn respectively.

As we enter CY12, we are likely to witness a long rate-cut cycle which will benefit gold loan companies as they rely heavily (50-60%) on bank funding. The funding mix would also move towards banks as appetite for NCDs decline with falling rates and as lackluster equity markets limit capital raising. It is also likely that in the initial phase of rate reversal, margins of gold loan companies may marginally expand as they are unlikely to cut their lending rates instantly. Therefore, we expect stable NIMs for Manappuram and Muthoot in the near term. In the longer term, margins could structurally correct due to competitive pressures.

Deserve better valuations; re-iterate BUY on Manappuram and Muthoot

Quarterly performance of gold loan companies has been robust (well ahead of expectations) and Q3 FY12 will be no different, in our view. We would most likely see a 15% qoq AUM and earnings growth. In stark contrast, the stock prices have delivered negative returns with street trying to pre-empt a gold bear market. The stocks have been badly punished during intermittent correction in gold prices, virtually ignoring robust earnings growth delivered by these companies. We believe that Manappuram and Muthoot could deliver 25-30% earnings growth and impressive RoA/RoE in FY13 notwithstanding a sustained gold price decline from hereon. We believe that current prices represent an extremely attractive opportunity to invest both from short and longer term perspective. Given the inherent/sustainable profitability/growth of the business, these companies deserve to trade at substantially higher P/adj.BV multiple (at least 2x on FY13 basis). With high conviction we re-iterate BUY on Manappuram and Muthoot.

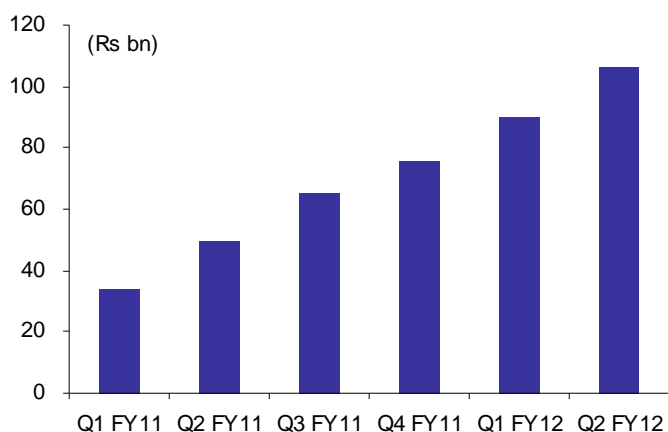
Growth and profitability of the business under various gold price scenarios (Hypothetical Study)

Gold Price Scenarios	Q1 FY1	Q2 FY1	Q3 FY1	Q4 FY1	Q1 FY2	Q2 FY2	Q3 FY2	Q4 FY2
I) Stable Gold Prices								
Gold Stock (MT)	30.0	32.1	34.3	36.8	39.3	42.1	45.0	48.2
Volume Growth (QoQ)	-	7.0	7.0	7.0	7.0	7.0	7.0	7.0
Price/10gm (Rs)	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000
Pricing Growth (QoQ)	-	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Value of Gold Stock (Rs mn)	60,000	64,200	68,694	73,503	78,648	84,153	90,044	96,347
LTV (%)	70.0	70.0	70.0	70.0	70.0	70.0	70.0	70.0
AUM (Rs mn)	42,000	44,940	48,086	51,452	55,053	58,907	63,031	67,443
NIM (%)	12.0	12.0	12.0	12.0	12.0	12.0	12.0	12.0
NII (Rs mn)	-	-	-	-	1,456	1,558	1,667	1,783
Opex/AUM (%)	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
Opex (Rs mn)	-	-	-	-	728	779	833	892
Prov/AUM (%)	-	-	-	-	0.5	0.5	0.5	0.5
Prov (Rs mn)	-	-	-	-	61	65	69	74
PBT (Rs mn)	-	-	-	-	667	714	764	817
Tax (Rs mn)	-	-	-	-	200	214	229	245
PAT (Rs mn)	-	-	-	-	467	500	535	572
II) Rising Gold Prices								
Gold Stock (MT)	30.0	32.1	34.3	36.8	39.1	41.5	43.8	46.0
Volume Growth (QoQ)	-	7.0	7.0	7.0	6.5	6.0	5.5	5.0
Price/10gm (Rs)	20,000	20,000	20,000	20,000	21,000	22,050	23,153	24,310
Pricing Growth (QoQ)	-	-	-	-	5.0	5.0	5.0	5.0
Value of Gold Stock (Rs mn)	60,000	64,200	68,694	73,503	82,194	91,482	101,339	111,727
LTV (%)	70.0	70.0	70.0	70.0	68.8	67.5	66.3	65.0
AUM (Rs mn)	42,000	44,940	48,086	51,452	56,509	61,750	67,137	72,622
NIM (%)	12.0	12.0	12.0	12.0	11.8	11.6	11.4	11.2
NII (Rs mn)	-	-	-	-	1,453	1,547	1,642	1,737
Opex/AUM (%)	6.0	6.0	6.0	6.0	5.9	5.8	5.8	5.7
Opex (Rs mn)	-	-	-	-	728	779	833	892
Prov/AUM (%)	0.5	0.5	0.5	0.5	0.3	0.3	0.3	0.3
Prov (Rs mn)	-	-	-	-	37	40	43	47
PBT (Rs mn)	-	-	-	-	688	728	765	799
Tax (Rs mn)	-	-	-	-	206	218	230	240
PAT (Rs mn)	-	-	-	-	482	510	536	559
III) Declining Gold Prices								
Gold Stock (MT)	30.0	32.1	34.3	36.8	39.5	42.7	46.3	50.5
Volume Growth (QoQ)	-	7.0	7.0	7.0	7.5	8.0	8.5	9.0
Price/10gm (Rs)	20,000	20,000	20,000	20,000	19,000	18,050	17,148	16,290
Pricing Growth (QoQ)	-	-	-	-	(5.0)	(5.0)	(5.0)	(5.0)
Value of Gold Stock (Rs mn)	60,000	64,200	68,694	73,503	75,065	77,016	79,384	82,203
LTV (%)	70.0	70.0	70.0	70.0	71.3	72.5	73.8	75.0
AUM (Rs mn)	42,000	44,940	48,086	51,452	53,483	55,837	58,546	61,652
NIM (%)	12.0	12.0	12.0	12.0	12.2	12.4	12.6	12.8
NII (Rs mn)	-	-	-	-	1,456	1,562	1,679	1,810
Opex/AUM (%)	6.0	6.0	6.0	6.0	6.1	6.2	6.3	6.3
Opex (Rs mn)	-	-	-	-	728	779	833	892
Prov/AUM (%)	0.5	0.5	0.5	0.5	0.8	0.8	0.8	0.8
Prov (Rs mn)	-	-	-	-	95	101	107	113
PBT (Rs mn)	-	-	-	-	633	682	739	805
Tax (Rs mn)	-	-	-	-	190	205	222	241
PAT (Rs mn)	-	-	-	-	443	478	518	563

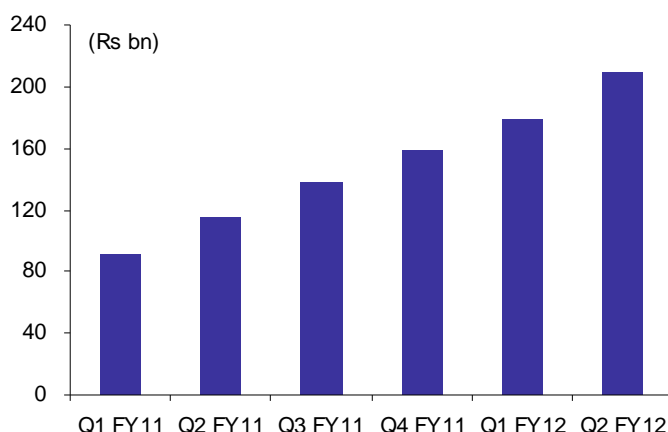
Particulars for FY2	Gold Price Scenarios		
	Stable Prices	Rising Prices	Declining Prices
Volume Growth (%)	31.1	25.1	37.3
AUM Growth (%)	31.1	41.1	20.0
PAT (Rs mn)	2,074	2,086	2,002
RoA (%)	3.1	3.0	3.2
RoE (%) at 7x Leverage	22.0	21.2	22.3

Source: Company, India Infoline Research

AUM growth - Manappuram

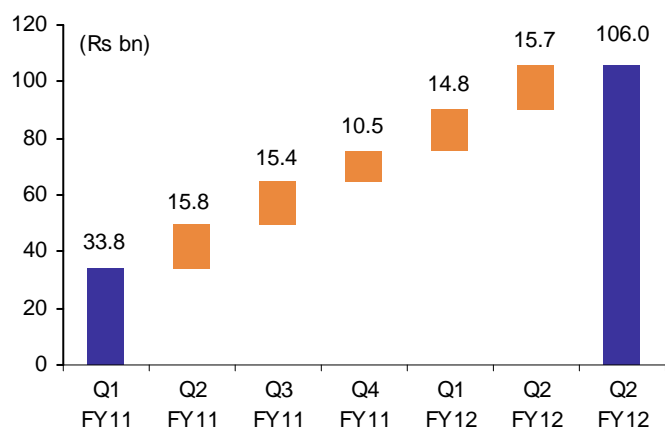


AUM growth - Muthoot

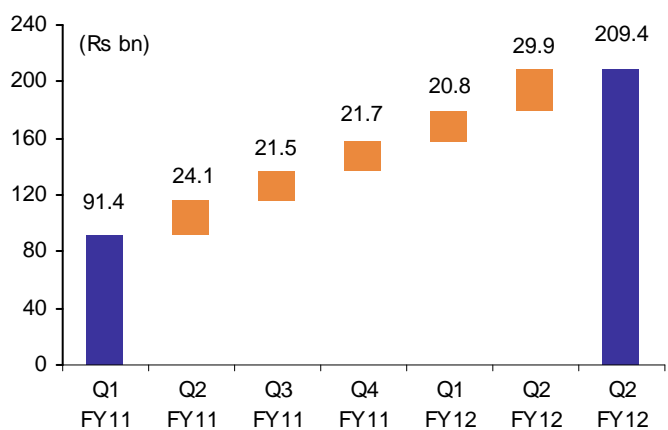


Source: Company, India Infoline Research

Quarterly AUM addition - Manappuram

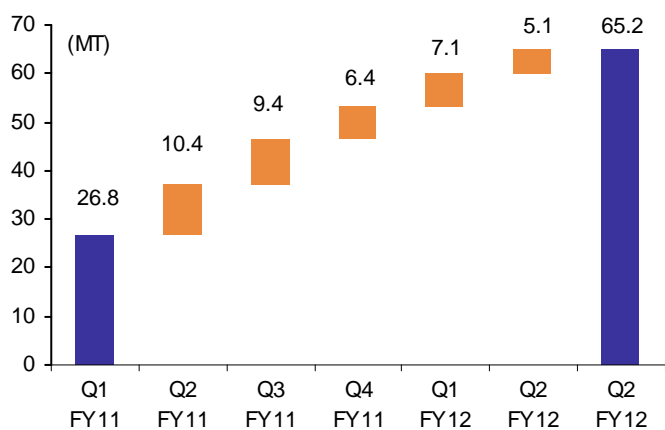


Quarterly AUM addition - Muthoot

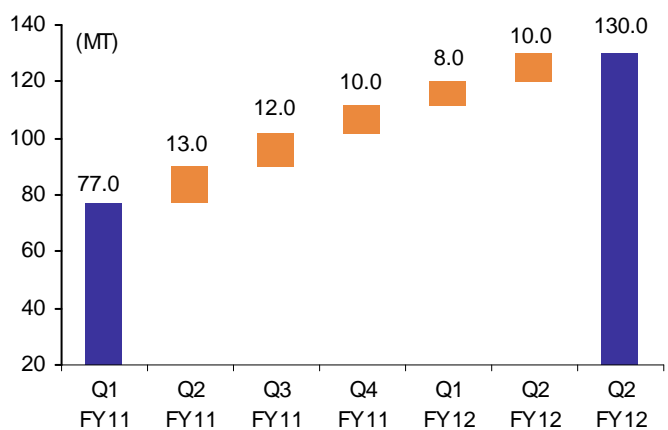


Source: Company, India Infoline Research

Quarterly gold stock addition - Manappuram

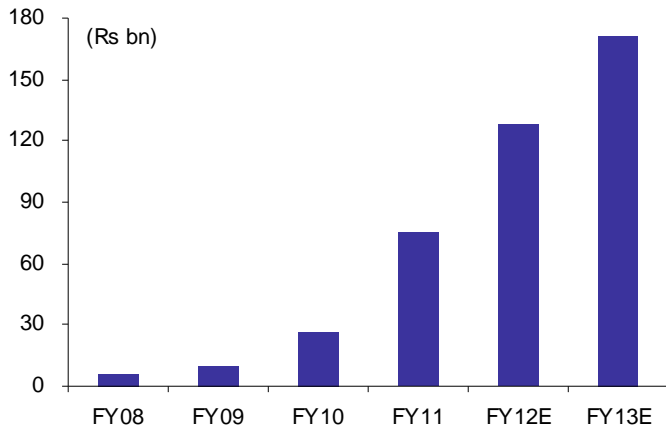


Quarterly gold stock addition - Muthoot

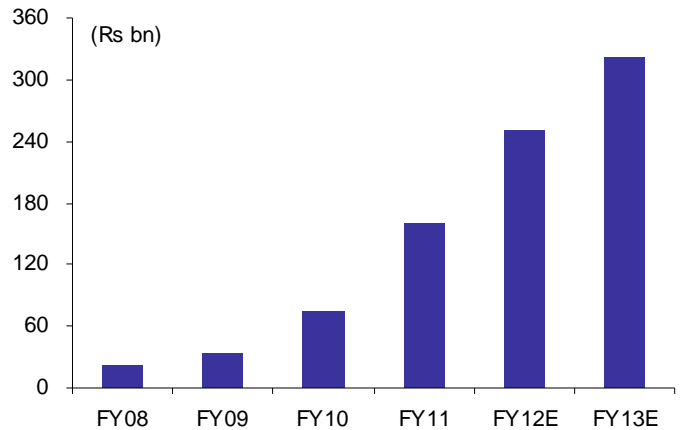


Source: Company, India Infoline Research

Manappuram's AUM to grow 2.3x over FY11-13

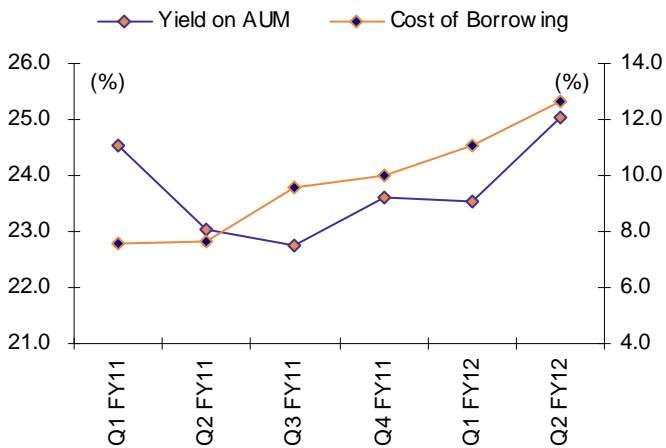


Muthoot's AUM to grow 2x over FY11-13

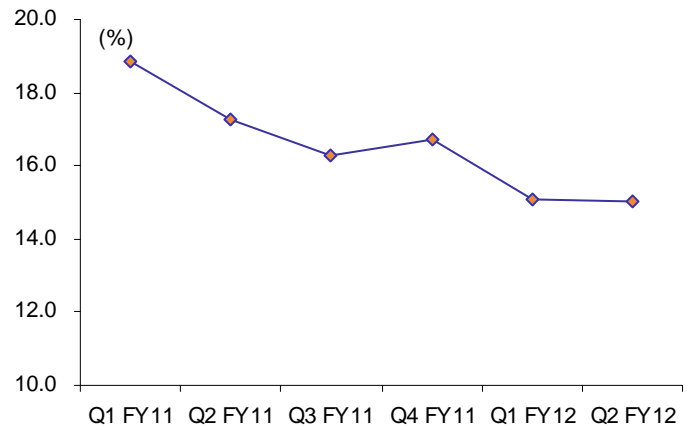


Source: Company, India Infoline Research

Step increase in borrowing cost for Manappuram in the past three quarters

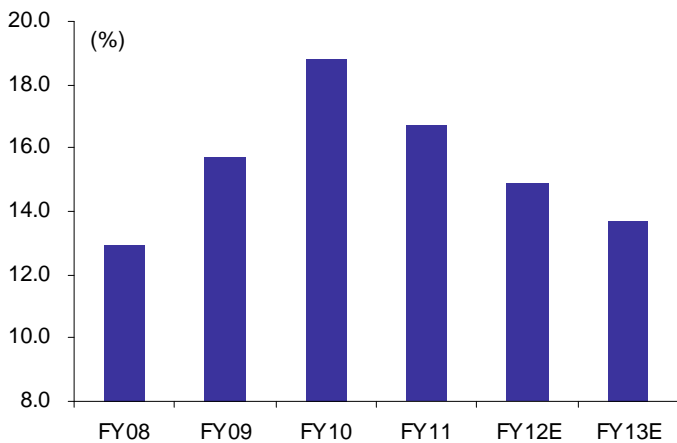


Company's NIM has been resilient though aided by lending rate hike

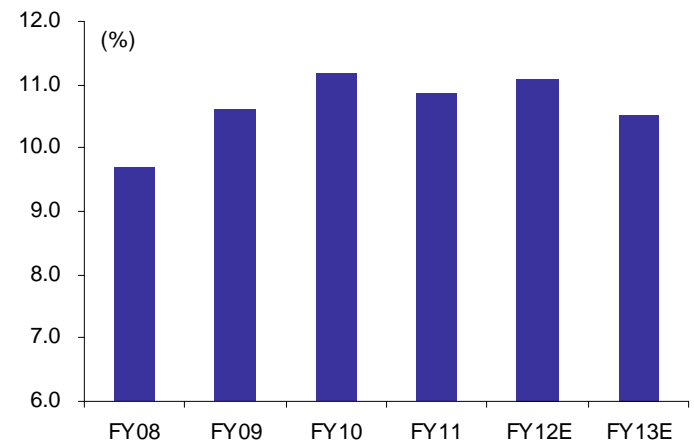


Source: Company, India Infoline Research

NIM trend - Manappuram

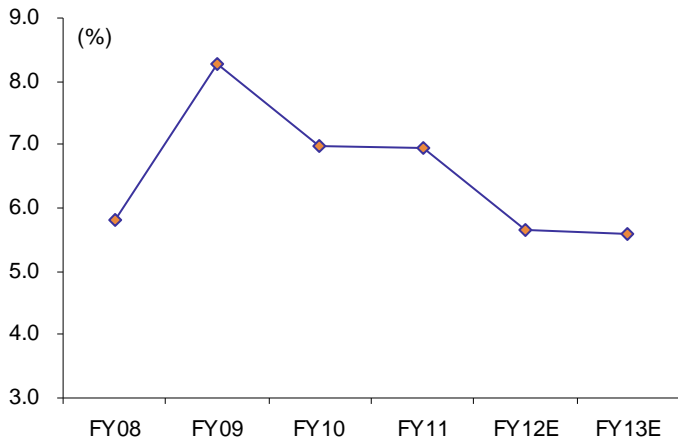


NIM trend - Muthoot

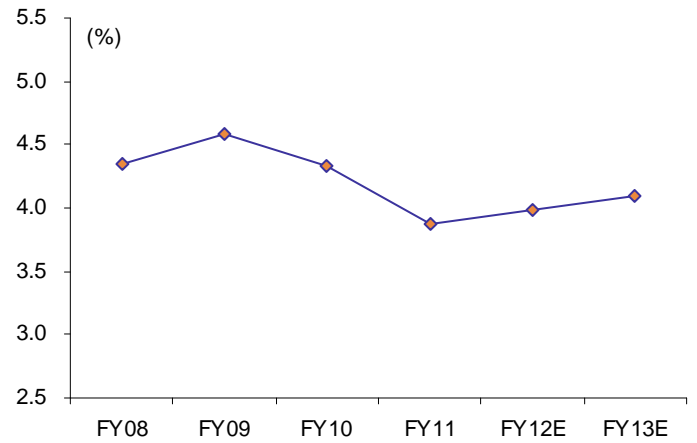


Source: Company, India Infoline Research

Opex/Avg. Assets - Manappuram

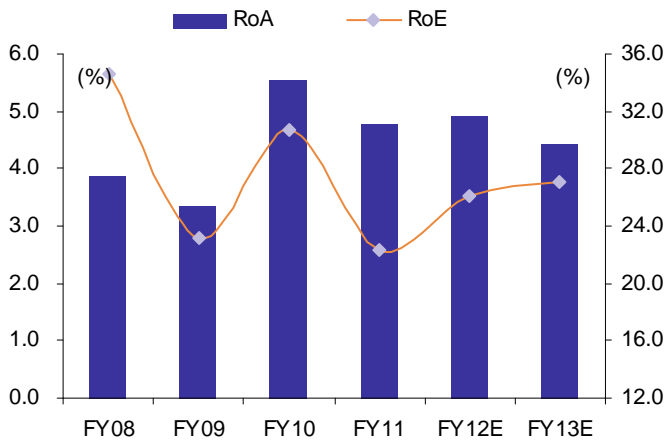


Opex/Avg. Assets - Muthoot

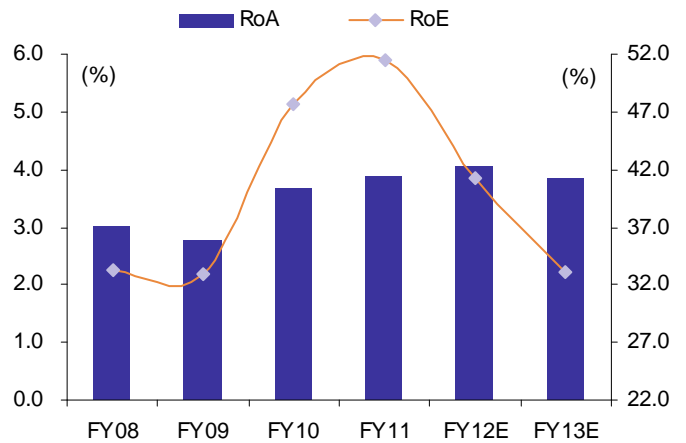


Source: Company, India Infoline Research

RoA and RoE trend - Manappuram



RoA and RoE trend - Muthoot



Source: Company, India Infoline Research

Sector: NBFC

Sensex:	15,728
CMP (Rs):	47
Target price (Rs):	71
Upside (%):	50.7
52 Week h/l (Rs):	78 / 42
Market cap (Rscr) :	3,903
6m Avg vol ('000Nos):	1,598
No of o/s shares (mn):	841
FV (Rs):	2
Bloomberg code:	MGFL IB
Reuters code:	MGFL.BO
BSE code:	531213
NSE code:	MANAPPURAM

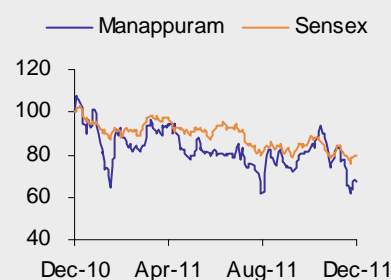
Prices as on 28 Dec, 2011

Shareholding pattern

September '11	(%)
Promoters	36.6
Institutions	33.2
Non promoter corp hold	1.1
Public & others	29.1

Performance rel. to sensex

(%)	1m	3m	1yr
Manappuram	(13.8)	(5.2)	(15.9)
Muthoot	(7.1)	1.1	-
STFL	(13.5)	(24.6)	(22.8)
M&M Fin	(5.7)	(2.0)	3.6

Share price trend

Fastest growing gold loan company; AUM to grow 2.3x over FY11-13

Manappuram is one of the fastest growing gold loan companies having increased its AUM 8x over FY09-11. The exceptional growth was driven by increased awareness/adoption of gold loans, robust branch expansion and handsome rally in gold prices. Even in H1 FY12, asset growth was robust at 40% YTD (on high base) driven by 23% volume growth. The company has added Rs15bn AUM in each of the past two quarters and is estimated to add equivalent assets in Q3 FY12 too. Working with the assumption of gradual gold price decline from hereon, we expect Manappuram to deliver 51% AUM CAGR over FY11-13 aided by 47% volume CAGR.

NIM to stabilize with funding cost peaked-out

Manappuram's margin has been resilient over the past three quarters despite sharp increase in the funding cost and its higher vulnerability to competition due to higher interest rate charged. NIM has corrected by lesser-than-expected 170bps over Q4 FY11-Q2 FY12. The company has displayed surprisingly strong pricing power by increasing its lending rate in June (calculated loan yield improved 150bps qoq in Q2 FY12). NIM is expected to remain flat in H2 FY12 as the funding cost has peaked-out. In FY13, we conservatively expect some decline (100-120bps) in margin due to intensified competition notwithstanding benefits from rate-cut cycle.

Earnings to witness 60% CAGR over FY11-13; RoA to be near 4.5%

Reaping the benefits of substantial branch expansion over the past two years, we expect AUM/Branch to increase significantly from Rs36mn to Rs53mn over FY11-13. This along with marginal increase in advertising spend would drive improvement in operating leverage. We estimate Opex/Avg.Assets ratio to decline from 7% in FY11 to 5.6% in FY13. On the other side, provisioning is likely to accelerate as declining gold prices increases average LTV. Despite this and margin decline, we estimate Manappuram to still deliver a robust 60% earnings CAGR over FY11-13. Therefore, RoA would remain materially above 4% while RoE would improve by 500bps with increasing financial leverage. Currently, the company has high Tier-1 capital at 21%.

Valuation compelling at 1.3x FY13 P/adj.BV

Manappuram stock price has corrected substantially by 30% from Rs67 on Nov 11th. The correction in gold prices along with perceived higher beta drove the sharp underperformance of the stock. With gold prices expected to be resilient in the medium term (our commodity analyst view) and lower-than-perceived business sensitivity to it, we believe it's an opportune time to buy Manappuram. Our 9-month target on the stock is Rs71 implying substantial 51% upside.

Financial summary

Y/e 31 Mar (Rs m)	FY10	FY11	FY12E	FY13E
Total operating income	3,413	8,496	15,220	20,588
Yoy growth (%)	167.6	148.9	79.2	35.3
Operating profit (pre-provisions)	1,907	4,373	8,776	11,469
Net profit	1,197	2,827	5,613	7,248
yoy growth (%)	295.2	136.1	98.6	29.1
EPS (Rs)	3.5	3.4	6.7	8.7
Adj.BVPS (Rs)	17.5	23.0	28.3	35.4
P/E (x)	13.4	13.9	7.0	5.4
P/BV (x)	2.7	2.0	1.7	1.3
ROE (%)	30.8	22.3	26.1	27.1
ROA (%)	5.6	4.8	4.9	4.4
CAR (%)	31.0	30.5	22.2	20.4

Source: Company, India Infoline Research

Sector: NBFC

Sensex:	15,728
CMP (Rs):	155
Target price (Rs):	206
Upside (%):	32.7
52 Week h/l (Rs):	198 / 150
Market cap (Rscr) :	5,736
6m Avg vol ('000Nos):	422
No of o/s shares (mn):	372
FV (Rs):	10
Bloomberg code:	MUTH IB
Reuters code:	MUTT.BO
BSE code:	533398
NSE code:	MUTHOOTFIN

Prices as on 28 Dec, 2011

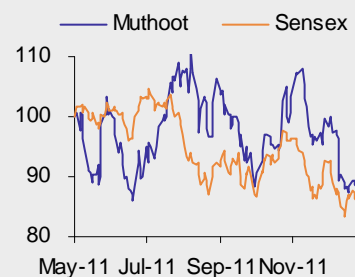
Shareholding pattern

September '11	(%)
Promoters	80.1
Institutions	9.9
Non promoter corp hold	0.8
Public & others	9.2

Performance rel. to sensex

(%)	1m	3m	1yr
Muthoot	(7.1)	1.1	-
Manappuram	(13.8)	(5.2)	(15.9)
STFL	(13.5)	(24.6)	(22.8)
M&M Fin	(5.7)	(2.0)	3.6

Share price trend



Largest gold loan company; AUM to double over FY11-13E

With an asset size of Rs210bn as at the end of H1 FY12, Muthoot is the largest organized gold loan player with 20%+ market share. Driven by robust branch expansion, significant marketing and largely uninterrupted rally in gold prices, company's AUM grew 4.7x over FY09-11. Quarterly AUM traction has been increasing with Muthoot adding ~Rs30bn in Q2 FY12. We expect similar addition in Q3 FY12 as gold prices have been buoyant. Over FY11-13, we estimate a strong 42% CAGR in AUM post factoring a sustained gradual decline in gold prices from hereon. Volume CAGR is expected to be 39%.

Latest NIM improvement driven by increase in average LTV

Against our expectation of margin decline, Muthoot's NIM improved over the past three quarters notwithstanding steep increase in funding cost. Margin headwinds were more than offset by substantial improvement in the loan yield (200-300bps); in-turn driven by increase in average LTV and rate hike taken by the company. In the medium term, margin is likely to be supported by the rate-cut cycle. We conservatively build marginal margin contraction (~50bps) for FY13 on account of competitive pressures. However, Muthoot is relatively less vulnerable to competition due to its significantly lower loan yield/margin (by 300/400bps) than Manappuram.

Earnings to witness 52% CAGR over FY11-13; RoA to be around 4%

We expect Muthoot's AUM/Branch to increase substantially from Rs58mn to Rs74mn over FY11-13. During Q2 FY12, the surprising increase in opex was mainly driven by higher professional & legal expenses on account of the large NCD issue in August. With branch productivity improving and advertising expenses increasing slowly, opex/avg.assets ratio is expected to revert towards 4% from 4.8% in Q2 FY12. Despite assuming rising provisioning, we estimate Muthoot's earnings to witness a strong 52% CAGR over FY11-13. RoA would likely remain around 4% in FY12 and FY13. Though modest Tier-1 capital at 13.5% raises some concern, it is estimated to be sufficient to support asset growth till FY13.

Valuation attractive in the light of impressive profitability

Sharp volatility in gold prices has weighed on the performance of Muthoot's stock. Though valuation is not as attractive as Manappuram, it is lower than many other NBFCs despite company's superior profitability. With earnings growth and return profile unlikely to be significantly impacted by gold price correction, we re-iterate BUY on Muthoot. Our 9-month target on the stock is Rs206 implying 32% upside.

Financial summary

Y/e 31 Mar (Rs m)	FY10	FY11	FY12E	FY13E
Total operating income	6,157	12,832	22,936	30,314
Yoy growth (%)	98.2	108.4	78.7	32.2
Operating profit (pre-provisions)	3,477	7,936	14,233	18,197
Net profit	2,276	4,942	8,888	11,365
yoy growth (%)	132.8	117.1	79.9	27.9
EPS (Rs)	7.6	15.4	23.9	30.6
Adj.BVPS (Rs)	18.4	40.5	77.5	103.2
P/E (x)	20.5	10.0	6.5	5.1
P/BV (x)	8.4	3.8	2.0	1.5
ROE (%)	47.6	51.5	41.3	33.0
ROA (%)	3.7	3.9	4.1	3.8
CAR (%)	14.8	15.8	17.2	17.2

Source: Company, India Infoline Research

In the year 2011 itself, we have received two reputed awards for being the Best Broker in India.

'Best Equity Broker of the Year' – Bloomberg UTV, 2011

IIFL was awarded the 'Best Equity Broker of the Year' at the recently held Bloomberg UTV Financial Leadership Award, 2011. The award presented by the Hon'ble Finance Minister of India, Shri Pranab Mukherjee. The Bloomberg UTV Financial Leadership Awards acknowledge the extraordinary contribution of India's financial leaders and visionaries from January 2010 to January 2011.

'Best Broker in India' – Finance Asia, 2011

IIFL has been awarded the 'Best Broker in India' by Finance Asia. The award is the result of Finance Asia's annual quest for the best financial services firms across Asia, which culminated in the Country Awards 2011

Other awards



Recommendation parameters for fundamental reports:

Buy – Absolute return of over +10%

Market Performer – Absolute return between -10% to +10%

Sell – Absolute return below -10%

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