Manappuram Finance

CMP	Rs. 43	Absolute	Buy
Target	Rs. 70	Relative	Outperform

Rating: ▲ Target price: ◄► ABV: ◄►

UT report - No bad news is good news; Valuations are attractive, Upgrade to BUY

The report submitted by the Usha Thorat Committee on NBFCs has a few negatives for the sector as a whole, such as enhanced capital adequacy, tighter NPA accrual, higher provisioning requirements, maintenance of minimum liquidity and accounting convergence with that of banks leading to lesser manoeuvrability. But it has refrained from taking an aggressive stance of plugging regulatory arbitrages between banks and NBFCs in terms of reserve requirements, branch opening, end-use/ KYC norms, limitations on cash transactions, bank lending limitations, lending rate caps etc. It has instead chosen a middle path of calibrated use of prudential measures to better address the regulatory arbitrages and regulate the NBFCs. For Manappuram Finance (MGFL) specifically, we think the negatives mentioned above are largely immaterial though the requirement of accounting convergence wrt to revenue recognition, NPA accrual and provisioning can be open to interpretation, which remains our key risk.

We have been recommending a 'Stay on the sidelines' strategy on MGFL given this regulatory overhang. With the event risk subsiding, we are getting more constructive on the business and the stock. MFL enjoys rarely seen characteristics in a financing business model, diluted only marginally after the agri-PSL status withdrawal and the UT report- **(1)** A high growth, ~25% RoE and attractive high yield-low risk model with strong pricing power as an urgent short-term low ticket size financing need of the borrower is met, **(2)** Easily scalable given the replicable nature of the disbursal - fully secured, liquid &, easy-to-value collateral with high sentiment quotient as well as having possession, eliminating the need to understand borrowers' credit history **(3)** Strong competitive advantages over banks in this line of business given higher LTV, faster TATs, disbursement in cash, all day working hours, better reach through more branches, no social taboo and better brand recall and **(4)** Gold ownership, as an idle asset across the social spectrum, continues to grow at a rapid pace in India and low volatility of gold prices and the exchange movement as a natural hedge gives us more comfort. Gold has corrected >20% in US$ terms only 8 times since 1975 and only once in INR terms since 1983.

We think valuations at 1.5x FY12E ABV and 7x FY12E EPS are highly attractive for a business model, growth/ return profiles and economics of such quality. Upgrade to BUY and O-PF rating.

Financial summary

Year	NII (Rs. mn)	PAT (Rs. mn)	ROE (%)	ROA (%)	ABV (Rs.)	P/ABV (x)
FY11	8,314	2,827	22.3%	4.8%	23.0	1.9
FY12E	14,062	5,253	24.5%	4.8%	28.2	1.5
FY13E	17,513	6,544	24.7%	4.3%	34.7	1.2

Event Update

Date	Aug 29, 2011
Market Data	
SENSEX	15849
Nifty	4748
Bloomberg	MGFL IN
Shares o/s	834mn
Market Cap	Rs. 36bn
52-wk High-Low	Rs. 95-42
3m Avg. Daily Vol	Rs. 94mn
Index member	BSE 100
Latest shareholding (%)	
Promoters	36.5
Institutions	32.1
Public	31.5

Stock performance (%)

	1m	3m	12m
MGFL	-26	-22	-27
Sensex	-14	-11	-13
Bankex	-19	-13	-18

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Key Highlights of UT Recommendations

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Para	Area	Recommendation	Impact	Our View
6.2	Regulatory Arbitrage & Convergence	The Tier I capital for CRAR purposes should be specified as 12 per cent to be achieved in three years for all registered deposit taking and non-deposit taking NBFCs.	Neutral	Tier 1 capital for Manappuram is 22% as of Q1FY12 and we do not see it going below 15% as that can result in lower credit rating.
		The risk weights for NBFCs that are not sponsored by banks or that do not have any bank as part of the Group may be raised to 150 per cent for capital market exposures and 125 per cent for CRE exposures. In case of bank sponsored NBFCs, the risk weights for CME and CRE should be the same as specified for banks.	Neutral	MGFL is not present in any of the segments therefore no impact.
		The asset classification and provisioning norms (including standard asset provisioning norms) should, in a phased manner, be made similar to that of banks for all registered NBFCs irrespective of size.	Negative	1. **Asset Classification-** Currently, NPA for MGFL are identified 180 days past due which will be changed to 90 days past due. The key difference being banks past due count begins from the date of disbursal of the loan while that of MGFL starts 1 year after date of disbursement. If RBI allows NBFCs to maintain this stance on past due the impact will be minimal, else can have significant impact. 2. **Standard Asset Provisioning:** MGFL makes 0.25% standard assets provisioning while banks provide 0.4% towards standard assets. MGFL will have to make up for the difference 3. **Loan Loss Provisioning:** Loan loss coverage for NBFCs are lower in each of the buckets.
		The tax treatment for provisions made by NBFCs for regulatory purposes should be similar to that for banks.	Positive	Though the commentary is positive; to get such tax breaks multiple sign-offs from tax authorities will be necessary.
		Whenever RBI implements any macro prudential measures to address systemic risk, such measures should be made applicable to NBFCs as well.	Positive	Currently banks have a risk weight of 50% for gold loans which if extended to NBFC will help in freeing up of capital.

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Key Highlights of UT Recommendations(Contd)

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Para	Area	Recommendation	Impact	Our View
4.2	Principal Business	The twin criteria of assets and income for determining the principal business of a company need not be changed. However, the minimum percentage threshold of assets and income should be increased to 75 per cent. Accordingly, the financial assets of an NBFC should be 75 per cent or more (as against more than 50 per cent) of total assets and income from these financial assets should be 75 per cent or more (as against more than 50 percent) of total income	Neutral	MGFL has almost all the income generated from financing activity
9.4	Liquidity Management	All registered NBFCs – deposit taking and non deposit taking - should maintain high quality liquid assets in cash, bank deposits maturing within 30 days, government securities, treasury bills eligible for repos, investment in money market instruments maturing within 30 days equal to the gap between total net cash inflows and outflows over the 1 to 30 day time bucket as a liquidity coverage requirement.	Negative	The impact can be miniscule as generally asset turnover is higher than that of liabilities for gold loan companies. The impact though not material will be there for MGFL.
10.2	Corporate Governance	Compensation guidelines when finalized for banks may also be issued to NBFC	Neutral	Helps in protecting the interest of minority share holders
11.2	Disclosures by NBFCs	NBFCs with assets of Rs 1.0 bn and above should, in addition disclose their provision coverage ratio, liquidity ratio, Asset Liability profile, extent of financing of parent company products, movement of NPAs, details of all off-balance sheet exposures, structured products issued by them as also securitizations/assignments.	Positive	Reduces opacity of the financial statements of the company and helps in better business evaluation.

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Financial Summary

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Abridged Financial Statements				
Rs.mn	FY10	FY11	FY12E	FY13E
Profit & Loss				
Net Interest Income	3,306	8,314	14,062	17,513
Other Income	107	181	178	176
Total Income	3,413	8,496	14,240	17,689
Operating Expenses	1,595	3,874	5,888	7,316
Pre-Provisioning Opertaing Profit	1,961	4,622	8,352	10,373
Provisions	142	383	522	606
PBT	1,819	4,239	7,829	9,767
PAT	1,197	2,827	5,253	6,544
Balance Sheet				
Networth	6,106	19,240	23,710	29,272
Paid Up Capital	340	834	834	834
Reserves	5,765	18,406	22,876	28,438
Others Capital Instruments	-	-	-	-
Borrowings	18,356	56,539	95,049	136,548
Total Liabilities & Networth	24,462	75,779	118,758	165,820
Advances	18,907	64,140	108,793	151,324
Fixed Assets	534	1,388	1,597	1,477
Net Current Assets	1,878	4,948	7,551	9,925
Total Assets	24,462	75,779	118,758	165,820
Off Balance Sheet Assets	7,077	11,183	12,647	8,246
Total AUM	31,539	86,962	131,405	175,746
Shares outstanding (mn)	681	834	834	834
Current market price (Rs.)		43		
Market capitalisation (Rs. mn)	29,274	35,851	35,851	35,851
Earnings per share (Rs.)	1.8	3.4	6.3	7.8
Dividend per share (Rs.)	0.02	0.30	0.95	1.18

Key Metrics				
	FY10	FY11	FY12E	FY13E
Growth ratios				
ABV per share	58%	161.4%	22.5%	23.3%
Advances	312%	239.2%	69.6%	39.1%
Borrowings	245%	208.0%	68.1%	43.7%
NII	97%	151.5%	69.1%	24.5%
PAT	156%	136.1%	85.8%	24.6%
EPS	118%	92.7%	85.8%	24.6%
Asset-Liability Profile				
Leverage (x)	3.7	4.0	4.5	5.4
Leverage (x) (Incl Off B/S)	5.5	4.7	5.1	5.8
Core Tier 1- CAR	21.2%	24.0%	18.5%	17.4%
Profitability and Efficiency				
Net Interest Margin	16.7%	16.2%	14.3%	12.5%
ROA	7.4%	5.6%	5.4%	4.6%
RoAUM	5.1%	4.8%	4.8%	4.3%
ROE	27.8%	22.3%	24.5%	24.7%
Dupont Analysis				
NII/Total AUM	14.0%	14.0%	12.9%	11.5%
TI/Total AUM	14.4%	14.3%	13.0%	11.6%
Opex/Total AUM	6.7%	6.5%	5.4%	4.8%
PPOP/Total AUM	7.7%	7.8%	7.6%	6.8%
Provisions/Total AUM	0.6%	0.6%	0.5%	0.4%
PAT/Total AUM	5.1%	4.8%	4.8%	4.3%
Valuation				
Book Value per share (Rs.)	9	23	28	35
Adj Book Value per share (Rs.)	9	23	28	35
P/ABV (x)	4.9	1.9	1.5	1.2
P/E (x)	24.4	12.7	6.8	5.5

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Absolute Rating Interpretation	
BUY	Stock expected to provide positive returns of > 15% over a 1-year horizon
ADD	Stock expected to provide positive returns of <=15% over a 1-year horizon
REDUCE	Stock expected to fall <=15% over a 1-year horizon
SELL	Stock expected to fall >15% over a 1-year horizon
Relative Rating Interpretation	
OUTPERFORM	Stock expected to outperform sector index /sector peers in our coverage
UNDERPERFORM	Stock expected to underperform sector index/ sector peers in our coverage

Recommendation History

Date	CMP	Target price	Absolute Rating	Relative Rating
07-Apr-11	65	70	ADD	O-PF
o2-May-11	66	70	ADD	O-PF
29-Jun-11	55	70	ADD	O-PF

Analyst Certification

The Research Analyst(s) who prepared the research report hereby certify that the views expressed in this research report accurately reflect the analyst(s) personal views about the subject companies and their securities. The Research Analyst(s) also certify that the Analyst(s) have not been, are not, and will not be receiving direct or indirect compensation for expressing the specific recommendation(s) or view(s) in this report.

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