10 June 2010 | 11 pages

Manappuram General Finance and Leasing Limited (MGFL.BO)

Analyzed Non-Rated Snapshot

- **Company Overview** — MGFL is a niche financial services provider, specializing in providing loans against gold jewelry to retail customers. The company has a large customer base in South India (90% of business) and has total AUMs of over Rs25bn. The promoters have significant experience in the gold lending business; MGFL was incorporated in 1992, went public in 1995 and has been professionally managed since inception.

- **Business Strategy** — a) Secured lending with gold jewelry as collateral (98% of loans); b) Target lending only to families and against home use jewelry; c) Focus on strong growth in assets, through distribution expansion and geographical diversification; and d) Strong risk management systems – both operational (cash management, appraisal skills, frauds) and financial (asset quality, asset liability mismatch, leverage).

- **Strengths** — a) Healthy asset quality: NPL ratios are quite low in gold loans (0.39% currently); b) High growth trajectory: AUM growth of 100% CAGR over the last 5yrs; c) Strong return profile: ROEs of over 30% in FY10 with an ROA of 7.5%; and d) Low leverage levels: current debt / equity of 3.0x; can increase up to 6.5-7.0x over the medium term.

- **Weaknesses** — a) Single product focus: could lead to concentration risks; b) Scalability: difficult to ascertain market size, lack of diversification could constrain current high growth rates; c) Wholesale funding: cost of funding can rise sharply in a tight liquidity / high interest rate environment; d) Relatively high operating costs: cost/income ratio is around 43%, likely to remain stable due to aggressive distribution expansion and customer acquisition costs.

Price (09 Jun 10)	Rs69.50
Shares Outstanding	340M
Free Float (%)	58
Fiscal Year End	31 Mar
Market Cap	Rs23,657M US$505M

Price Performance (RIC: MGFL.BO, BB: MGFL IN)

Figure 1. MGFL: Statistical Summary

Year to March	Net Profit (Rs Mils.)	Adj EPS (Rs)	EPS Growth (%)	P/E (X)	Adj BVPS (Rs)	P/BV (X)	RoAE (%)	ROAA (%)
2005	27	0.4	5.6	168.6	2	35.8	25.2	3.3
2006	40	0.5	27.3	132.4	2	29.1	25.8	3.9
2007	106	0.7	34.2	98.7	2	37.3	46.0	7.9
2008	210	0.3	(52.0)	205.7	2	46.4	34.7	9.3
2009	303	1.4	319.7	49.0	8	8.8	23.2	6.4
2010	1197	3.5	146.8	19.9	18	3.9	30.8	7.5

Source: Company Reports

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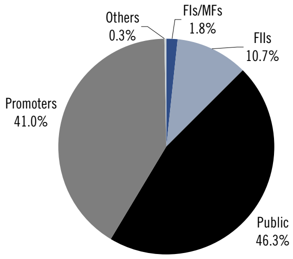
Key Takeaways from Management Meeting

Figure 2. Manappuram: Shareholding Pattern (Mar10)



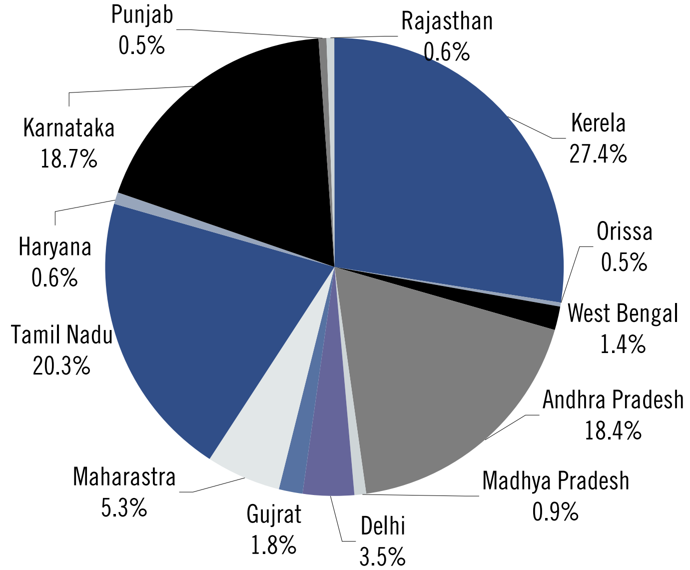
Source: Company Reports

- **Industry Overview** — a) Dominated by unorganized lenders: recently however, banks and other non-bank finance companies have started gaining market share; b) Seasonal: linked to cropping season, festival season and marriages; c) Growth: reasonably strong as organized sector gains market share; and d) Asset Quality: Low NPLs, as lending is secured and low defaults on gold jewelry by families, expect asset quality to remain healthy.

- **Competitive Analysis** — a) Estimated market shares: according to industry estimates, banks have 15-25% market share, non-banking finance companies around 10-15%; b) Increasing competition from banks: banks (both public and private sector banks) are increasingly getting more comfortable with lending in this segment; c) Low barriers to entry: no regulatory / scale restrictions; and d) Pressure on lending rates: increasing competitive intensity pressuring loan yields (seen to be coming off by ~200bps), though still remain high (banks have lower lending rates of 14-15% vs. 25% for NBFCs).

- **MGFL: Distribution** — a) Over 1000 branches: MGFL had 1,005 branches as at March 2010, b) Concentration in South India: 85% of branches in South, company expanding more in other regions; c) Growing in West and East: Gujarat, Maharashtra, West Bengal and Orissa seen as growth states; d) High employee attrition: 40-50% churn for junior employees and 20% for senior employees at branch levels (close to 7000 employees currently) and e) Increasing urban bias: Distribution and portfolio mix is increasingly getting more biased in urban centres.

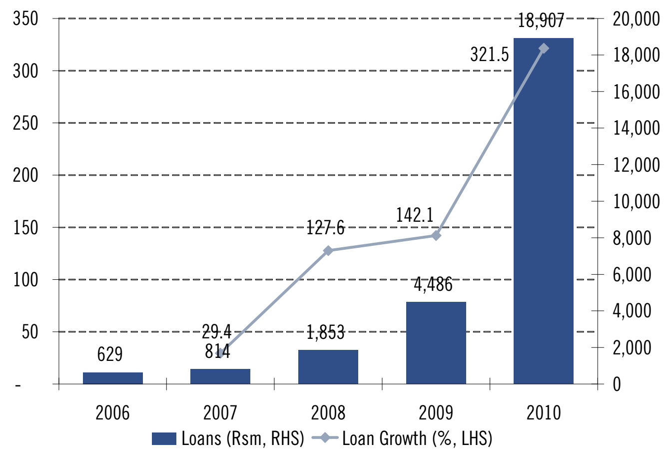
Figure 3. Manappuram: State Wise Branch Distribution



Source: Company Reports

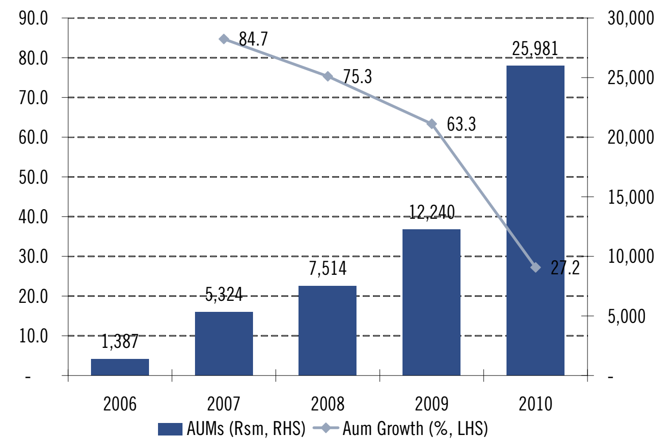
- **Lending Profile and Growth** — a) Gold lending primary segment: comprises 98% of total loans; b) Strong growth rates: AUM growth of 100% CAGR over last 5 yrs, management confident of maintaining over 70% growth over next 2-3yrs; c) 1yr contracted maturity of loans: however, average duration of 3.5-4.0 months as customers typically pre-pay (no pre-payment penalty); d) Lump sum payments: customers typically pay principal and interest in a lump sum rather than monthly; e) Loan yields close to 30%: likely to come down, however, as competitive intensity increases; f) Average ticket size is small: only Rs25,000 per loan, but has an average of 2 loans outstanding per customer (80% repeat customers in a mature branch); and g) No end use monitoring: believes collateral is a significant enough deterrent to defaults.

Figure 4. Loans (Rsm) and Loan Growth (%)



Source: Company Reports

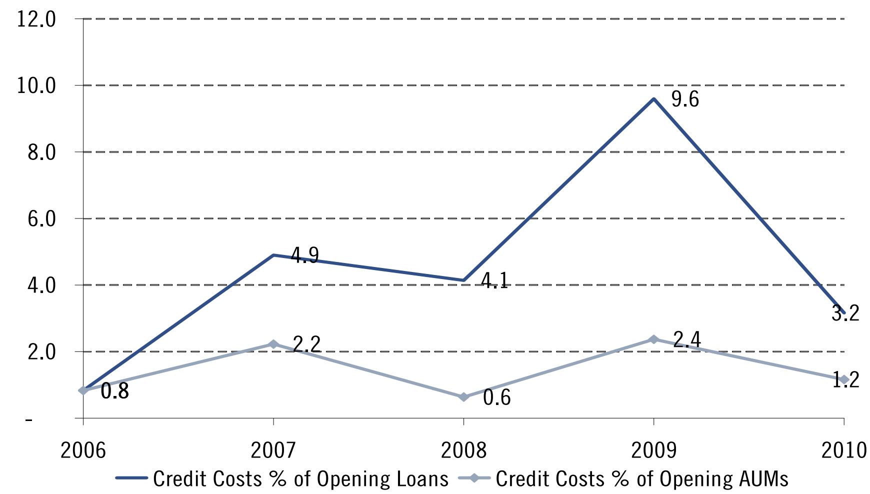
Figure 5. AUM (Rsm) and AUM Growth(%)



Source: Company Reports

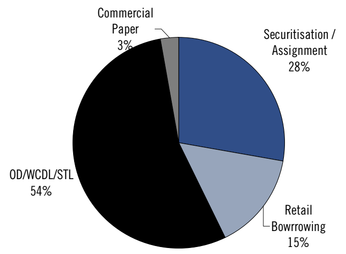
- **Risk Management and Asset Quality** — a) Appraising gold quality: employees are trained to appraise quality, technology improvement is another comfort; b) Gold storage: insurance on stored gold, adequate security at branches; c) Customer profiling: insists on profiling customers and lends only to families; d) Employee rotation: annual rotation of employees, diversity in employee backgrounds; e) Low LTVs: 70-80% of market value of gold; f) Low NPLs: 0.4% for gold loans, 1.15% overall, LLR are, however, low at 43% and g) NPL recognition: 6 months overdue, in-line with regulatory norms.

Figure 6. Manappuram: Credit Costs as Percent of Opening Loans and Opening AUMs (Percent)



Source: Company Reports

Figure 7. Manappuram: Sources of Funding



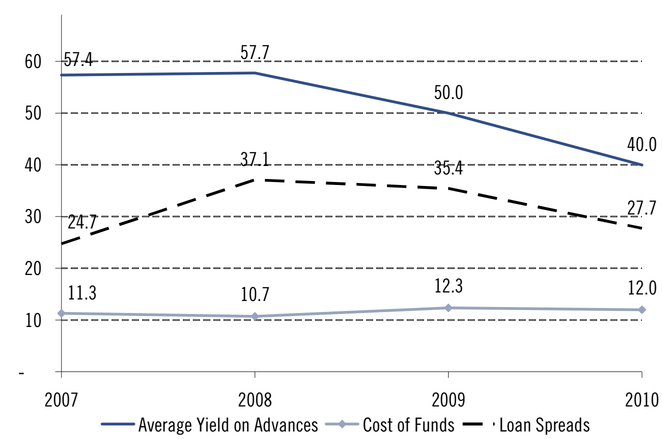
Source: Company Reports

- **Funding Profile** — a) Wholesale funded: limited retail deposit franchise, primarily wholesale funded; b) Funding mix: Commercial Paper (3% of total funding); Retail in the form of NCDs (15%); Banks (55%) and Securitisation (28%); c) Average Funding cost: 8.5% currently; d) Low interest rate sensitivity: average asset duration is only 3-4 months, but does have competitive risks; e) Priority sector status: Rural loans classified as agriculture credit and urban loans as micro credit; Securitization is a key source of funding: No ALM mismatch, lowers capital requirements.

- **Leverage** — a) Debt / equity: currently comfortable at 3.0x, can go up to 6.5-7.0x; b) AUM / equity: 4.3x currently, still below most non-banking finance companies; c) Could raise capital medium term: current growth rates quite high, would potentially need to raise capital within next 12 months; and d) Capital adequacy: 28.0% overall capital adequacy with a comfortable 25.9% in Tier 1 capital.

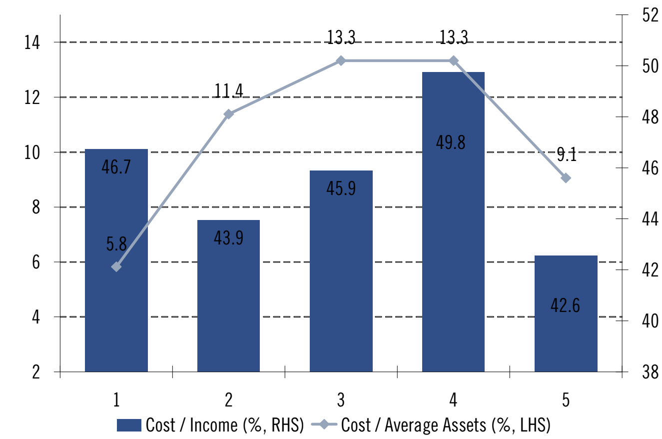
- **Profitability** — a) Net Interest Margins: High at 20% levels currently, likely to be under pressure as loan yields reduce and funding costs increase; b) Operating costs: cost/income at 43% for FY10, relatively high cost of customer acquisition, will likely remain high medium term as management investing in distribution expansion; c) Credit costs: relatively low at 1.2% (of opening AUMs), do not expect significant increase in provisioning levels; and d) Robust return profile: strong return profile with 7.5% ROAs and over 30% ROEs in FY10, expect return profile to remain high near term, sustainable ROEs close to 25% levels.

Figure 8. Yield on Advances, Cost of Funds, Spreads (%)



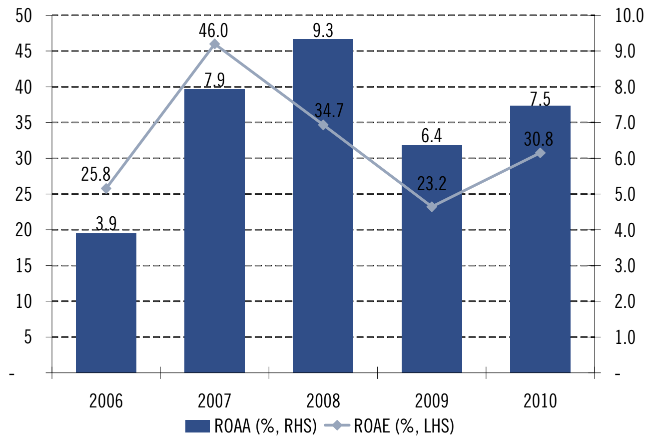
Source: Company Reports

Figure 9. Cost/Income and Cost/ Avg Assets (Percent)



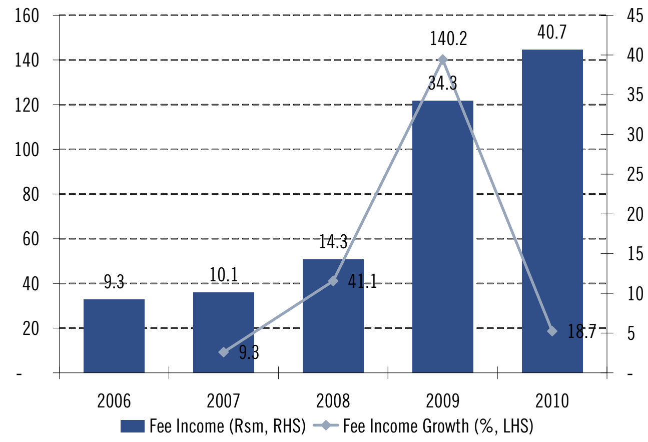
Source: Company Reports

Figure 10. Return on Average Assets and Average Equity (%)



Source: Company Reports

Figure 11. Fee Income and Growth (Rsm, Percent)



Source: Company Reports

- **Recent Results** — MGFL reported net profits of Rs1197m in FY10, an increase of 151% yoy. Key highlights of the results were: a) Increase in lending spreads due to reduction in cost of funds; b) Reduction in cost/income ratio to 43% vs. 50% in FY09; and c) Lower credit costs due to reduction in NPL levels to 1.15% from 1.63% in FY09.

Figure 12. Manappuram: Quarterly Result Highlights (1QFY09 – 4QFY10, Rupees Million)

	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10
Interest Income	279	377	443	551	671	864	1320	1886
Interest Expense	49	70	124	143	170	317	370	512
Net Interest Income	**230**	**306**	**319**	**409**	**502**	**547**	**950**	**1374**
Non-Interest Income	8	1	8	-6	2	6	2	31
Operating Income	238	307	327	403	504	552	952	1405
Employee Expenses	-49	-75	-76	-77	-86	-92	-129	-230
Other Operating Expenses	-59	-79	-73	-114	-152	-150	-250	-306
Pre-provision Profit	**130**	**153**	**178**	**212**	**266**	**310**	**573**	**869**
Charges for Bad Debts	-33	-43	-40	-61	-40	-18	-30	-54
Other Operating Items	-6	-8	-8	-12	-9	-12	-15	-21
Profit Before Tax	91	102	130	139	217	281	527	794
Tax	-31	-36	-42	-51	-74	-96	-177	-273
Net Profit	**60**	**67**	**87**	**88**	**142**	**185**	**350**	**521**

Source: Company Reports

Figure 13. Manappuram: Income Statement (FY05-FY10, Rupees Million)

	FY05	FY06	FY07	FY08	FY09	FY10
Interest Income	158.0	188.1	426.4	782.3	1,626.8	4,741.4
Interest Expense	68.0	70.9	89.8	143.5	385.9	1,369.2
Net Interest Income	**90.0**	**117.2**	**336.6**	**638.8**	**1,240.9**	**3,372.1**
Other Operating Income	7.4	9.3	10.1	14.3	34.3	40.7
Operating Income	97.4	126.4	346.7	653.1	1,275.2	3,412.8
Employee Expenses	(19.6)	(20.0)	(60.6)	(116.4)	(284.0)	(536.4)
Other Operating Expenses	(26.9)	(34.3)	(81.0)	(165.1)	(316.9)	(858.7)
Operating Expenses	(46.6)	(54.3)	(141.7)	(281.5)	(600.8)	(1,395.1)
Pre-provision Profit	**50.8**	**72.2**	**205.0**	**371.6**	**674.4**	**2,017.6**
Charges for Bad Debts	(4.5)	(6.8)	(30.8)	(33.7)	(177.9)	(142.0)
Other Operating Items	(3.3)	(4.8)	(10.7)	(18.3)	(33.7)	(57.4)
Pre Tax Profit	43.1	60.6	163.5	319.6	462.8	1,818.3
Tax	(16.1)	(21.1)	(57.4)	(109.7)	(159.9)	(621.0)
Net Profit	**26.9**	**39.5**	**106.1**	**209.9**	**303.0**	**1,197.2**

Source: Company Reports

Figure 14. Manappuram: Balance Sheet (FY05-FY10, Rupees Million)

Year to 31 Mar	**FY05**	**FY06**	**FY07**	**FY08**	**FY09**	**FY10**
Assets						
Fixed assets	32	51	107	163	256	535
Cash and Bank balances	18	341	216	672	1134	2682
Investments	16	21	30	29	11	1407
Loans	814	629	814	1853	4486	18907
Other assets	49	57	410	203	713	1946
Total Assets	**930**	**1099**	**1577**	**2920**	**6601**	**25477**
Liabilities						
Secured Loans	479	474	512	1351	3712	16501
Unsecured Loans	177	124	263	123	152	691
Current liabilities	76	262	363	246	416	1015
Shareholders' Funds						
Shareholders funds	127	180	281	930	1679	6106
Equity capital	65	75	150	618	213	340
Reserves and surpluses	62	105	131	312	1466	5765
Subordinated debt	72	58	158	271	642	1165
Liabilities and Capital Resources	**930**	**1099**	**1577**	**2920**	**6601**	**25477**

Source: Company Reports

Figure 15. Manappuram: Financial Ratios (FY05-FY10, Percent)

	FY05	FY06	FY07	FY08	FY09	FY10
ROAA	3.3	3.9	7.9	9.3	6.4	7.5
ROAE	25.2	25.8	46.0	34.7	23.2	30.8
NPL / Total Loans	0.8	2.5	1.9	7.6	5.1	1.2
Equity / Loans (x)	0.2	0.3	0.3	0.5	0.4	0.3
Equity / Assets (x)	0.1	0.2	0.2	0.3	0.3	0.2
Loans / Assets (x)	0.9	0.6	0.5	0.6	0.7	0.7

Source: Company Reports

Figure 16. Manappuram: Operating Ratios (FY05-FY10, Percent)

	FY05	FY06	FY07	FY08	FY09	FY10
Tax Rate	37.5	34.8	35.1	34.3	34.5	34.2
Interest Exp. / Interest Income	43.1	37.7	21.1	18.3	23.7	28.9
Non Int. Income / Total Income	4.5	4.7	2.3	1.8	2.1	0.9
Cost / Income	51.2	46.7	43.9	45.9	49.8	42.6
Loan Loss Charges / Preprov. Profit	9.4	10.0	15.9	9.5	27.8	7.2

Source: Company Reports

Appendix A-1

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