CA Bhavya Gandhi
bgandhi@mfglobal.com

Date: 26th July 2011

MF Global Sector **NBFC**

Future Capital (FCH)

Initiating Coverage: Buy

CMP: Rs 161

Target: Rs 234

Investment Highlights

Future Capital Holdings Limited (FCH) an NBFC promoted by Pantaloon Retail India Limited, is in the business of lending

Key Rational:

Will capitalize on India consumption story- Lending focus towards secured retail book: FCH is planning to grow its retail secured lending business. In past FCH retail business was largely consumer durable loans and personal loans. The new management is focusing on scaling up loan against gold and loan against property as new business lines in the retail segment

Branch expansion in pipeline: FCH currently has 40 branches each for gold loans and property loans independent of the Future Group format stores. Currently majority of the business is generated from these existing branches. FCH plans to expand the branch network to 200 branches in FY12E mainly by leveraging the existing future network.

Business restructuring released some capital: FCH originally had a corporate structure where the retail credit business was carried out in its subsidiary – Future Capital Financial Services Ltd (FCFS). The debt mobilised in the subsidiary typically required guarantees by parent hence consume capital of FCH. Over past six months, the Company has merged FCFS into FCH thereby making all the cross-guarantees unnecessary and releasing the capital

Carry from divested private equity business will be earning booster: While FCH has divested its stake in its private equity firm, it will still be entitled to the future carry of the existing AUMs. When FCH divested its stake in the JV, the JV had AUMs of USD800mn. As and when the exits would happen from the existing investments, FCH will be entitled to 40% of the carry. We have not modelled for the expected cash flow from the carry, which we believe will be a good booster for the profitability.

Valuation: Based on our forecasts, we estimate FCH earnings to grow at a CAGR of 64% over FY11E-FY13E. This growth would primarily be driven by strong balance sheet growth that, in turn, with the aggressive POS expansion plan. We initiate coverage on the stock with a Buy recommendation with one-year **target price of Rs. 234** that implies a P/ABVPS of 1.7x & 1.5x for FY12E & FY13E.

Sensex	18872
Nifty	5680

Stock Data	
BSE Code	532938
NSE Code	FCH
Bloomberg	FCHL IN
Reuters	FCHL BO
Shares Issued (mn)	64.80
Market Cap (Rs mn)	10410
52 Wk H/L (Rs)	302/127
Face Value (Rs)	10
Avg. daily vol. (12M)	90949

Return (%)	**1m**	**3m**	**12m**
Absolute	21	(3)	30
Rel. to Sensex	18	1	(34)

Key Financial	**FY11**	**FY12E**	**FY13E**
NII	864	1,756	2,516
NIM (%)	3.1	3.9	4.1
Adj PAT	491	917	1,269
Adj EPS	7.6	12.3	17.0
P/E (x)	21.2	13.1	9.5
P/BV (x)	1.4	1.1	1.0
RONW (%)	6.9	10.2	11.4

About the company – Upper deck revamped

Future Capital Holdings Limited (FCH) was incorporated in 2005 and was promoted by Pantaloon Retail India Limited, one of India's leading organized multi-format retailers, its Managing Director Kishore Biyani, and Sameer Sain, a former Managing Director at Goldman Sachs International. The three primary lines of business at the time of incorporation were investment advisory and asset management, retail financial services and wholesale (corporate) lending. The focus was predominantly investment advisory and asset management. In FY10 FCH was carved into two separate lines of work, with the investment advisory and asset management business being spun off as Ever stone Capital, which came under Mr. Sameer Sain. FCH retains an economic interest (40% in carry and 10% in Fees) in the funds raised pre demerger. During FY11, FCH has seen a reshuffle in the top management Mr. V Vaidyanathan, has joined as Vice chairman and Managing Director, with equity stake in the form of convertible warrants. Prior to joining FCH, Mr. Vaidyanathan was CEO and MD of ICICI Prudential Life Insurance. Prior to that, as the ED of ICICI Bank, he built and managed its retail banking business, including branches, retail liabilities, retail loans, SME loans and Rural Banking between FY00-FY09. The senior management team that has joined him includes - Mr. Apul Nayyar (ex Citigroup, India Info line), Mr.Shailesh Shirali (ex DSP Merrill, Rabo India) Mr. Ashok Shinkar (ex SSKI, JM Morgan Stanley and Wan bury) and Mr.Pankaj Sanklecha (ex ICICI Bank, Standard Chartered Bank), Over past 12 months, FCH has focused its energies on retail lending against gold and property and wholesale lending against collateral.

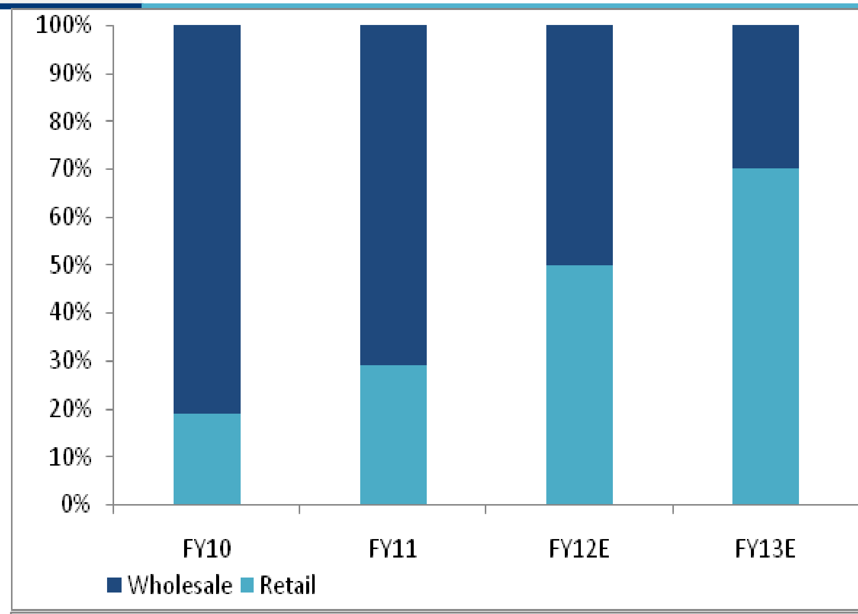
Line of Business					
Loan against Property	Loan against Gold	Consumer Durable loan	Wholesale credit	Wholesale loan syndication	Wealth management and Broking

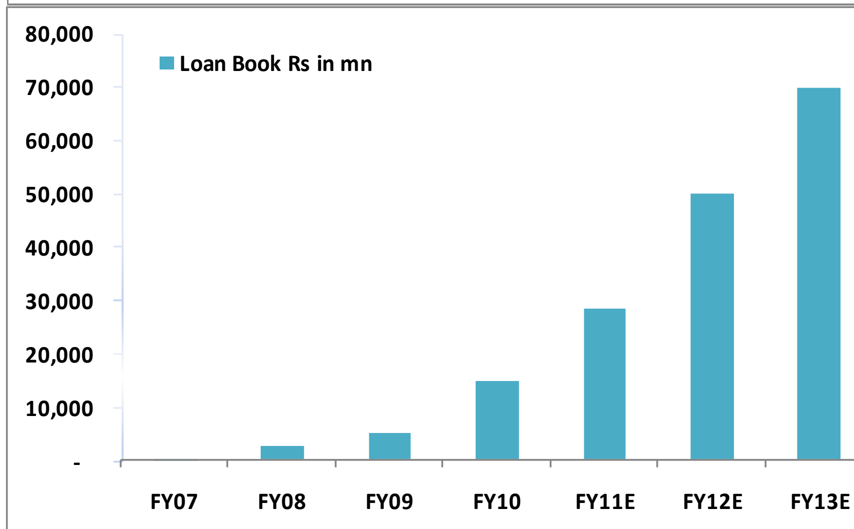
Source: Company, MF Global PCG research

Investment Rationale:

Will capitalize on India consumption story- Lending focus towards secured retail book: FCH is planning to grow its retail secured lending business. In past FCH retail business was largely consumer durable loans and personal loans. The new management is focusing on scaling up loan against gold and loan against property as new business lines in the retail segment. In the retail segment, the company evaluates cash flow of the underlying borrower in addition to taking property/gold as collateral. Presently, the Company has Close to 40 branches across India that provide loan against property and 40 dedicated loan against gold branches. Additionally the company has 18 broking and wealth management branches and 5 branches built as a “store in store” within the Big Bazaar Store. During the year FY12 the company is planning to add 100 branches as “store in stores”. Thus the Company is likely to have approx. 200 branches across India by the end of this year. We believe that the initiative to increase in POS (point of sale), will give traction in the high yielding retail book growth which enables the company to reach a retail book size by 6x from current Rs 8140mn. FCH has discontinued personal loans.

Stable Wholesale credit: In the wholesale credit segment, the focus will continue to be primarily on medium term loans to promoters against liquid shares and project financing with defined takeout by escrow of project cash flows. The focus area will be to contract medium to long term loan assets which are fully secured and which give yields between 15%-16%. This book has grown from Rs.12bn to ~.Rs.20.40bn over FY11. The management is contemplating grow this book by ~Rs.5bn during the year and thereafter this book is likely to stabilize at of Rs. 25bn by FY13, which as a percentage of total book size comes to 30% by FY13E as compared to 72% in FY11. Being medium term, this book shall be churned regularly to generate good fee based income and interest income. We believe that as the ticket size in this segment is higher which may lead to the client concentration risk, so the initiative to maintain this segment of book at 30-40% of the total assets looks positive.

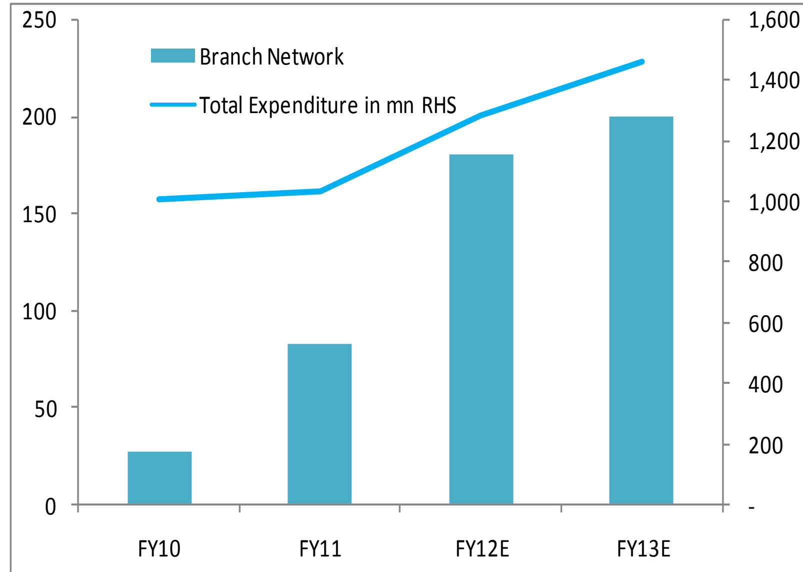




Source: Company MF Global PCG Research

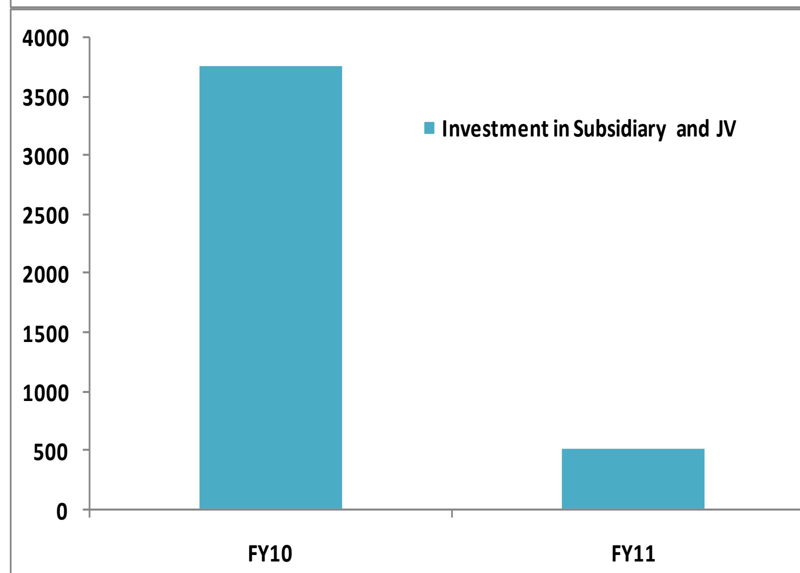
Investment Rationale:

Branch expansion in pipeline: FCH currently has 40 branches each for gold loans and property loans independent of the Future Group format stores. Currently majority of the business is generated from these existing branches. FCH plans to expand the branch network to 200 branches in FY12E mainly by leveraging the existing future network. FCH will open close to 100 financial superstores within Big Bazaar stores each measuring approx.150-200 square feet. These stores would not only originate FCH's loan products, but will also be used to distribute other financial products like life insurance, mutual funds and fixed income securities which generate fee income. The cost of opening the branches is also expected to be very economical at just Rs4-5lacs per location. We have modelled for capital expenditure of Rs 80mn for FY12-13E on this account.



Business restructuring released some capital: FCH originally had a corporate structure where the retail credit business was carried out in its subsidiary – Future Capital Financial Services Ltd (FCFS). However, to grow this business it required more equity and debt. The debt mobilised in the subsidiary typically required guarantees by parent hence consume capital of FCH. Further the Company was constrained from putting more equity capital in the Company due to prudent concentration norms. This resulted in higher risk weighted assets without adding anything to the revenues. Over past six months, the Company has merged FCFS into FCH thereby making all the cross-guarantees unnecessary and releasing the capital.

FCH has also brought down its investments. FCH had a JV with Centrum where each had a 50% stake in the two businesses. viz. Forex and Wealth management and broking. The Company has exited from the JV by selling its 50% stake in the Forex business (FCH Centrum Direct Limited), which is non-core and has acquired the 50% stake of Centrum in the Wealth Management and Broking. As a result of all these corporate events, the CAR of FCH has increased and is now over 23%. FCH has a capital of Rs7.5bn on March 11.



Source: Company MF Global PCG Research

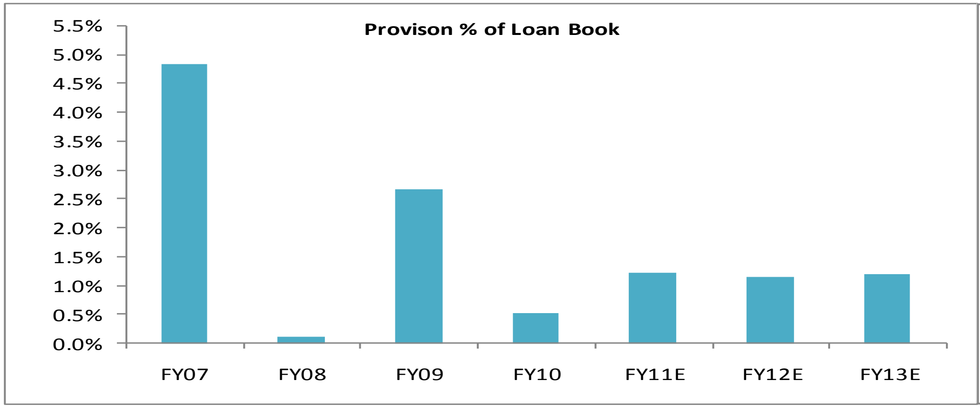
Investment Rationale:

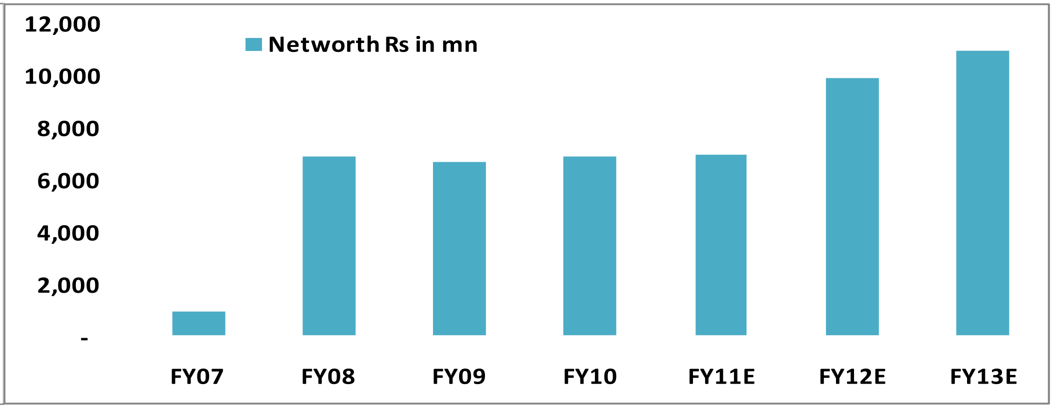
Pending warrants to further add to capital adequacy: In January 2011, FCH issued 10mn warrants- to Mr Kishore Biyani (8mn), as well to the new VC and MD, Mr. Vaidyanathan (2mn). The warrants have been issued at exercise price of Rs237, thereby adding total Rs2,370 mn to the capital upon conversion. Both the parties have already paid ~25% of the total amount with balance Rs1778mn payable over eighteen month period ending by March 12. With this conversion and a little of Tier II capital FCH can manage its balance sheet growth for FY13E without further dilution. We have modelled a growth of book from Rs.28.55bn currently to ~Rs 50bn by end of FY12 and ~Rs.70bn by end of FY13.

Carry from divested private equity business will be earning booster: While FCH has divested its stake in its private equity firm, it will still be entitled to the future carry of the existing AUMs. When FCH divested its stake in the JV, the JV had AUMs of USD800mn. As and when the exits would happen from the existing investments, FCH will be entitled to 40% of the carry. We have not modelled for the expected cash flow from the carry, which we believe will be a good booster for the profitability.

Stringent credit appraisal policy led stable asset quality: The Company is concentrating on secured lending with an average loan to value of 40-50% and lending is also based on commensurate cash flow of borrower for repayment of debt. Additionally, the Company has separate verticals for Credit and Sales which shall be a driver for better credit quality whilst achieving growth. We believe that these policies shall enable the Company to keep the net NPAs low. We still remain conservative in our provision forecast and have modelled it at ~1.35-1.40% of total average assets for FY12-13E vs an average provision cost of 0.8% of total average assets from FY07-11.

Riskier assets provided: While the FCH had high NPAs as on March 2010 (3.7% gross and 1.6% net), predominantly on account on higher unsecured book. In the year FY11 FCH has either collected or written them off through the reserves merger of retail lending subsidiary with itself. As on March 2011, FCH had net NPAs of Rs18mn or 0.06%. The same is expected to be virtually zero by FY12E.We further believe that as the company is majorly concentrating on increasing secured book the credit loss will remain low. Irrespective of that we modelled for higher provision cost





Source: Company MF Global PCG Research

Key Financials Drivers

Stable NIM: We believe that as the management's thrust is more towards retail so it enable it to improve its NIM . Over a period of next two years company is planning to have an mix of 70:30 for retail: wholesale as compare to current 29:71.

Leveraging led to expand in return ratio: FCH's RoEs are currently hampered by the low leverage on book and complex organization structure till now. Even for FY11, FCH reported a RoE of just 6.4%.With the leverage in the book expected to go up to 5.5x in FY13E from just about 3.8x in FY11, the RoEs are also set to expand to 13% by FY13E.

Traction in other Income: FCH is planning to concentrating on mass market by adding more and more POS across cities. With the increase in footfall gives opportunity to FCH to do cross selling of Financial product (like mutual fund, Insurance, brokerage account) which over a period gives visibility for good other income. Further the robust increase in disbursement gives one time processing fees. Further we are conservative in assuming fee income, we have factored a fee income of 25-35% of Net interest income as compare to 55% in FY11.

Stringent provision policy keeps provision cost higher: During the year FY11 company have stringent its provision policy like 100% w/off for consumer / personal loan above 180 days overdue., for LAP above 750 days (vs. 1800 days for FY10). We believe its as a positive conservative approach, so we model higher provision cost in our model for FY12-13E.

Concerns:

Competition remains key challenge We believe that the competition in each of FCH's business is increasing. For example, in gold loans, the south based banks besides NBFCs like Muthoot and Manappuram are aggressively expanding their books. In loans against property, PSU banks remain key competitor as they can give even overdraft limits against properties unlike EMI based products offered by NBFCs. In such scenario customer retention will become tough.

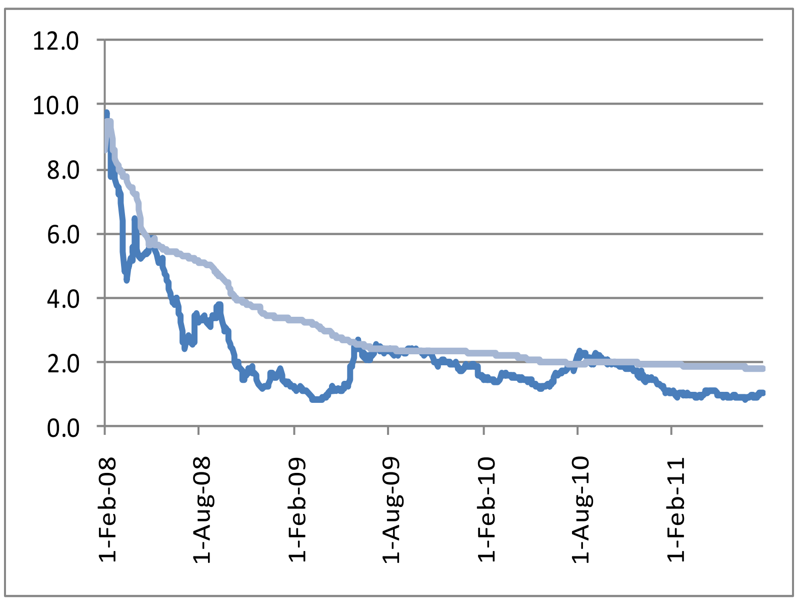
Execution risk: Post 2008 company has been unable to deliver profit growth . The experience of new team to initiate business under new set up where in the location reach is more important to grow. Any deferment in execution of branch location could temper the aggressive loan book growth assumption

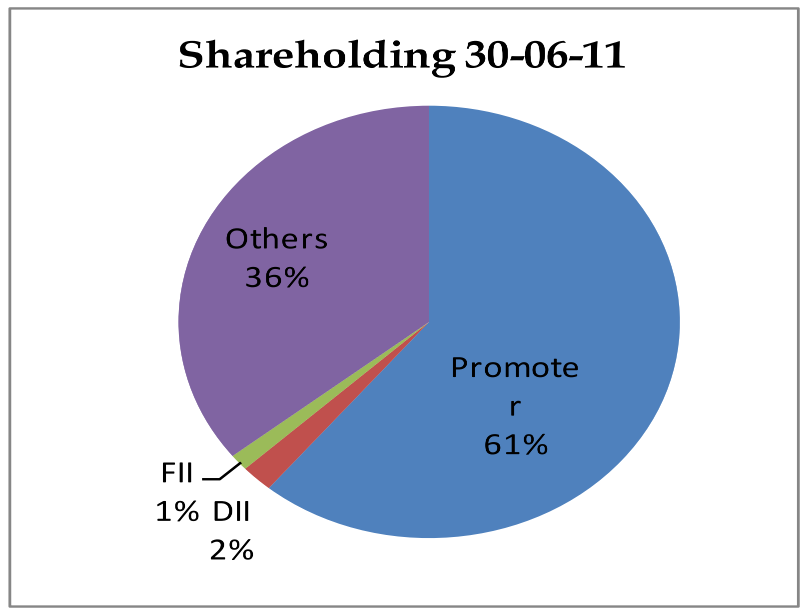
Source: Company MF Global PCG Research

Valuation:

Based on our forecasts, we estimate FCH earnings to grow at a CAGR of 64% over FY11E-FY13E. This growth would primarily be driven by strong balance sheet growth that, in turn, with the aggressive POS expansion plan. At our current book value estimate of Rs 141& Rs 156, the stock is trading at a P/ABVPS of 1.1x & 0.95x respectively for FY12E and FY13E.. We believe that the company is in growing phase with an adequate capital with give better cushion to the company to grow up balance sheet without further dilution, So we believe that with current capital (post factoring warrant conversion by promoter and management) company can grow its balance sheet at a CAGR of 44% FY11E-13E. We initiate coverage on the stock with a Buy recommendation with one-year target price of Rs 234 that implies a P/ABVPS of 1.7x & 1.5x for FY12E & FY13E.

P/ABVPS





Source: MF Global PCG Research, capital line

Financial Statements: (Rs. In millions)

Income Statement	FY09	FY10	FY11	FY12E	FY13E
Interest Earned	850	1,344	2,659	5,165	7,690
Interest Expended	347	808	1,796	3,409	5,174
NII	503	537	864	1,756	2,516
Non – Interest Income	984	1,146	1,172	931	1,035
Net Total Income	1,487	1,683	2,036	2,687	3,550
Personal Expenses	884	542	494	644	838
Other Expenses	748	461	377	419	442
Total Expenses	1,632	1,003	871	1,064	1,280
PPP	(145)	680	1,165	1,623	2,270
Provisions	136	79	326	294	403
PBT	(281)	602	839	1,329	1,867
Tax	**40**	**9**	**347**	**412**	**597**
Net Profit	**(321)**	**593**	**491**	**917**	**1,269**
EPS	(5.1)	9.3	7.6	12.3	17.0

Balance Sheet	FY09	FY10	FY11	FY12E	FY13E
Equity capital	635	635	648	748	748
Reserves	6,041	6,274	7,353	9,833	10,943
Revaluation Reserve	-	-	-	-	-
Shareholder Fund	6,676	6,909	7,409	10,581	11,691
Deposits & Borrowing	4,750	11,798	27,050	45,433	63,081
Other Liability & Prov.	632	866	1.182	601	421
Total Eq & Liability	12,058	19,573	36,233	56,614	75,193
Investments	5,531	3,164	2,833	2,054	3,054
Net Advances	5,106	14,668	28,021	52,450	71,350
Net fixed assets	1,039	895	918	872	726
Total current Assets	373	757	4,400	1,190	33
Net Deferred Tax	12	93	61	48	29
Total Assets	12,061	19,575	36,233	56,614	75,193
ABVPS (Rs)	105	109	114	142	156

Financial Statements (Rs. In millions)

Growth (YoY %)	FY09	FY10	FY11	FY12E	FY13E
Net Interest Income	-	7	61	103	43
Non – Interest Income	8	17	2	(21)	11
Total Operating Income	64	13	21	32	32
Total expenses	40	(39)	(13)	22	20
Pre Provision profit	-	-	71	39	40
Total Provision	-	-	315	(10)	37
Net Profit	12	-	(17)	87	38
EPS	11	-	(19)	62	38
Balance Sheet					
Loan & Advances	106	187	91	87	36
Net current assets	-	-	-	(82)	(166)
Investments	10	-	(10)	(27)	49
Shareholders Equity	(3)	3	7	43	10
Loan Liability	117	148	129	68	39
Total Assets	15	64	87	60	33

Key Ratios (%)	FY09	FY10	FY11	FY12E	FY13E
Yield on advances	16.8	11.5	9.5	11.2	12.2
Average cost of fund	10.0	9.8	9.2	9.4	9.5
Difference	6.8	1.7	0.2	1.8	2.7
NIM	10.3	5.0	3.1	3.9	4.1
Opt Exp/Tol Income	109	60	43	39	36
Debt/ Equity (x)	0.7	1.7	3.7	4.3	5.4
Gross NPA/TAA	-	3.0	0.2	0.4	0.3
Net NPA /TAA	-	1.3	0.1	0.3	0.2
Du Pont Analysis %of Avg Earning Assets					
Net Interest Income	5.2	4.1	3.3	4.0	4.0
Non Interest Income	8.7	7.0	4.3	1.9	1.5
Operating Expenses	15.3	6.7	3.2	2.3	2.0
Total Provisions	1.3	0.5	1.2	0.6	0.6
ROAA	-	3.9	1.8	2.0	1.9
ROE	-	8.7	6.9	10.2	11.4

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