

Manappuram Finance

Worst is priced in

Manappuram is a story which went badly wrong, from a high growth sector with >25% ROE and enterprising management, to a declining loan book, falling ROE, a more hostile regulatory environment and concerns raised around governance. But with the stock trading at a discount to book and our expectation of the loan book growing from hereon, we think the stock merits another look. Our industry sources suggest regulatory clarity will be received this calendar year, after which we expect the stock to start to re-rate. We upgrade our stand to BUY and increase our fair value from Rs39 to Rs45, 25% upside.

Regular source of disappointment

Manappuram has been a regular source of disappointment for the market over the past 12+ months, with the company in news for all the wrong reasons (from regulatory to governance). The recent disappointment on NIMs (declined 250bps QoQ) was yet another blow to the stock, leading to it falling >10% in the last month. All this has led to it trading at a 50% discount to its peer Muthoot.

We think we have reached the bottom

We turned Neutral after the change in regulation on the gold loan industry as we expected yields to decline to 23% and the loan book to decline 5% for the year. In line with that hypothesis, yields have already declined to 23.5% and we think that yields could decline by a further 50bps from here. However, we could have seen the bottom in terms of loan book and profit in this quarter, hence we expect the company to generate at least 18% ROE in FY13E and then stabilise at around 19% FY15E onwards.

Clarity may emerge on regulations: Although the KUB Rao committee report was according to the RBI due out some time ago, noises from our industry contacts and the media suggest the report may come out before the calendar year end, and may not be negative for gold loan companies ([see link attached](#)). In our opinion even if the tone is slightly negative, it would at least give clarity around the gold loan industry and funding flow can improve from the CP route and institutions. This can lead to not only faster growth but also a reduction in borrowing cost for the company, which is currently around 13%.

Can double from here: We have been very conservative on our valuation of this stock and have priced in another 100 bps reduction in yields, with cost of funds stabilising at 12% and growth rates at 15% even in FY14E. If the environment improves and management is able to deliver on its promise of c.24% yields and 20% growth rate, our valuation model suggests that the stock could double from here in next couple of years (see table 1)

Valuations: risk reward seems favorable

Manappuram is trading at 0.9x FY14E BV, a 50% discount to its closest peer Muthoot. Our excess return model values the stock at Rs.45, 25% upside from current levels implying a 1.2x FY14E BV. In the bull case (based on management expectations), the fair value of the stock could be Rs.66, suggesting 84% upside from current levels. While in the bear case, the downside is limited to 18% (see Table 1).

Accounting & corporate governance	AMBER
Franchise Strength	AMBER
Earnings Momentum	AMBER

BUY 25% upside
Fair Value Rs44.54

Bloomberg ticker	MGFL IN
Share Price	Rs35.65
Market Capitalisation	Rs29,985.33m
Free Float	55%

INR m Y/E 31-Mar	2011A	2012A	2013E	2014E
NII	8,335	15,264	14,166	15,353
Total Income	8,496	15,667	14,610	15,819
Staff Cost	1,605	3,090	3,466	3,468
Other operating costs	2,439	3,322	3,482	3,879
Total operating costs	4,044	6,413	6,948	7,347
PBT	4,239	8,772	7,179	7,989
PAT	2,827	5,915	4,810	5,353
EPS	3.4	7.0	5.7	6.4

Y/E 31-Mar	2011A	2012A	2013E	2014E
P/E (x)	10.5	5.1	6.2	5.6
P/BV (x)	1.5	1.3	1.1	0.9
ROA (%)	6%	6%	4%	4%
ROE (%)	22%	27%	19%	18%
Dividend Yield (%)	2%	4%	2%	4%

Share Price Performance



Source: Espirito Santo Investment Bank Research, Company Data, Bloomberg

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Table 1 Scenario analysis

	Bear Case	Base Case (Our expectations)	Bull Case (Management expectations)
Yields	23% for FY13, 22% FY14 onwards	23.5% for FY13, 23% for FY14, 22.5% FY15 onwards	23.5% for FY13, 23% FY14 onwards
Cost of funds	12.50% in FY13, 12.25% FY14 onwards	12.3% in FY13 and 12% FY14 onwards	12.3% in FY13, 12% FY14 11.75% FY15 onwards
Loan book growth	0% in FY13, 10% in FY14 onwards	15% in FY14 & FY14, 12.5% FY14 onwards	20% in FY14 & FY14, 15% FY14 onwards
Fair Value	27	45	66
FY14E P/B	0.81	1.25	1.83
Upside/Downside	-23%	25%	84%

Source: Espirito Santo Investment Bank Research, Company Data

Figure 1 Old vs New

Rs mn	Old		New		% Change		Comments
	FY13	FY14	FY13	FY14	FY13	FY14	
AUM	119,310	137,206	119,488	137,411	0%	0%	AUM declined due to no assignments going forward
YoY Growth	-15%	15%	3%	15%			
Loan Book	108,464	124,733	119,488	137,411	10%	10%	
YoY Growth	-11%	15%	23%	15%			
Interest Income	27,284	26,351	26,700	29,543	-2%	12%	Interest income has declined due to reduction in yields
Yield	24.0%	23.0%	23.5%	23.0%			We have reduced our Yield expectation for H2 to 23%. Management has guided 24%.
Financial costs	12,462	11,179	12,533	14,190	1%	27%	We have increased the cost of borrowings and growth expectations for FY14
Cost of borrowings	12.0%	11.0%	12.3%	12.0%			We have increased our FY12 cost of borrowing by 200bps
NII	15,000	15,358	14,610	15,819	-3%	3%	
NIM	13.0%	12.5%	12.4%	12.3%			Marginally lower yield together with higher borrowing costs meant that our FY14 NIM decreased by 30bps
Operating profit	7,572	7,663	7,677	8,561	1%	12%	
Operating margin	51%	51%	54%	56%			
Operating Cost/AUM	2.9%	3.0%	2.9%	3.0%			
Personnel Cost/AUM	2.8%	3.0%	2.9%	2.7%			We expect the personnel cost to reduce due to higher loan book growth expectations.
Net Profit	4,964	4,896	4,810	5,353	-3%	9%	
EPS	6.0	5.9	5.7	6.4			

Source: Espirito Santo Investment Bank Research, Company Data

Valuation Methodology

We have used excess return on equity method to calculate the fair value of Manappuram Finance, using a cost of equity of 16%. Our model is a two stage model with a time horizon of twenty years, first ten years of explicit forecast and next ten years of declining RoEs to CoEs on a straight line basis.

Figure 2 Valuation methodology disclosures for Manappuram Finance

Manappuram Finance excess return on equity calculation																				
Cost of Equity	16.0%																			
Shares in Issue	841																			
	Rs. Mn	Rs./share																		
Free cash flow to equity NPV	37,461	45																		
Rs. Mn	Mar-13	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23	Mar-24	Mar-25	Mar-26	Mar-27	Mar-28	Mar-29	Mar-30	Mar-31	Mar-32
Beginning book Value	23,810	27,783	31,584	35,373	39,799	44,970	50,995	58,008	66,137	75,441	86,159	99,864	115,316	132,658	152,033	173,577	197,420	223,682	252,466	283,858
Net Profit	4,810	5,353	5,812	6,789	7,931	9,241	10,755	12,468	14,270	16,437	18,274	20,603	23,123	25,833	28,725	31,791	35,016	38,379	41,856	45,417
Cost of Equity	3,810	4,445	5,053	5,660	6,368	7,195	8,159	9,281	10,582	12,071	13,785	15,978	18,451	21,225	24,325	27,772	31,587	35,789	40,395	45,417
ROAE	20%	19%	18%	19%	20%	21%	21%	22%	22%	22%	21%	21%	20%	19%	19%	18%	18%	17%	17%	16%
Excess Return	1,000	907	758	1,129	1,563	2,045	2,596	3,187	3,689	4,367	4,489	4,624	4,673	4,607	4,400	4,019	3,428	2,590	1,461	-
Discount Factor	1.0	0.8	0.7	0.6	0.5	0.5	0.4	0.3	0.3	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Present Value	950	743	536	688	821	926	1,013	1,072	1,069	1,091	967	859	748	636	524	412	303	197	96	-

Source: Espirito Santo Investment Bank Research, Company Data

Figure 3 Relative Valuation NBFCs

HFCs	Rating	Fair Value (Rs)	CMP (Rs)	Mar. Cap (Rs bn)	Mar. Cap (\$mn)	RoA FY13E	RoA FY14E	RoE FY13E	RoE FY14E	P/E FY13E	P/E FY14E	P/B FY13E	P/B FY14E
HDFC	NEUTRAL	838	778	1,089	21,781	2.5%	2.5%	23%	23%	25	21	5.2	4.5
LICHF	BUY	308	245	113	2,252	1.4%	1.5%	18%	20%	11	9	1.9	1.6
DHFL	BUY	287	190	20	404	1.4%	1.4%	19%	20%	5	5	1.0	0.8
						1.8%	1.8%	20%	21%	14	11	2.7	2.3
NBFCs	Rating	Fair Value (Rs)	CMP (Rs)	Mar. Cap (Rs bn)	Mar. Cap (\$mn)	RoA FY13E	RoA FY14E	RoE FY13E	RoE FY14E	P/E FY13E	P/E FY14E	P/B FY13E	P/B FY14E
MMFS	NOT RATED		994	94	1,879	3.4%	3.3%	24%	23%	13	11	2.8	2.3
SUF	NOT RATED		977	49	986	3.0%	3.1%	20%	20%	13	11	2.4	2.1
MGFL	BUY	45	36	27	545	3.9%	3.8%	19%	18%	6.3	5.7	1.1	1.0
Muthoot	NOT RATED		205	69	1,388	3.5%	3.2%	29%	25%	8	7	2.0	1.6
SHTF	BUY	681	630	130	2,594	3.4%	3.3%	21%	21%	10	9	2.0	1.7
LTFH	BUY	64	75	117	2,337	1.9%	2.0%	13%	15%	20	15	2.4	2.1
						3.2%	3.1%	21%	20%	12	10	2.1	1.8

Source: Espirito Santo Investment Bank Research, Company Data



Risks to Fair Value

The KUB Rao committee's recommendations are still awaited and could present a significant risk to our fair value on either side. Secondly, we assume constant gold prices in our model and if gold prices decline from current levels, then loan book growth could be lower than our expectations.

Table 9 Traffic Lights: criteria for judgement

Parameter	Traffic signal	Reasons
Accounting & governance	AMBER	We did not find any red flag in the accounting practices used by the company. However, we are assigning Manappuram an AMBER rating due to a combination of a) poor communication with the market by the management in the past; and b) acceptance of deposits from promoter entity through MGFL's branch.
Franchise strength	AMBER	The company has a strong branch network with more than 2600 branches in India. It has a very strong presence in South and West India. However, with recent regulations, the operating environment has deteriorated significantly leading to a decline in franchise strength.
Earnings momentum	AMBER	We see room for consensus downgrades due to recent disappointment in NIMs.

Source: Espirito Santo Investment Bank Research for estimates



Manappuram Finance

Recommendation:

Fair Value:

BUY
INR 44.5

Share Price:
Upside / Downside

INR 35.65
25%

3 Month ADV (\$m)
Free Float
52 Week High / Low

5
55%
INR 71 - 28

Bloomberg:
Model Published On:

MGFL IN
26 November 2012

Shares In Issue (mm)
Market Cap (Rs bn)
Market Cap (\$ mn)

841
30
577

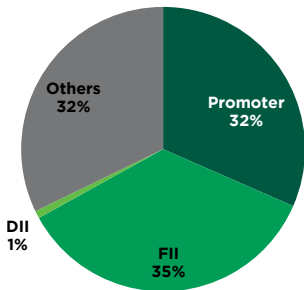
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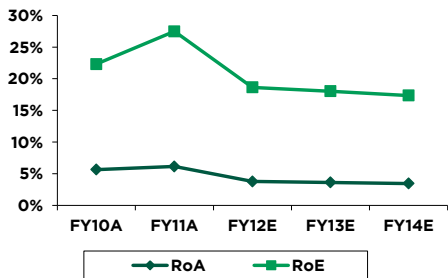
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Shareholding Pattern



RoE and RoA



Valuation Metrics	2011	2012	2013E	2014E	2015E
P/E (x)	10.5	5.1	6.2	5.6	5.2
P/BV (x)	1.5	1.3	1.1	0.9	0.8
ROA (%)	5.6%	6.1%	3.8%	3.6%	3.5%
ROE (%)	22%	27%	19%	18%	17%
Dividend Yield (%)	2%	4%	2%	4%	6%
Implied P/E (x)	13.1	6.3	7.8	7.0	6.4
Implied P/BV (x)	1.9	1.6	1.3	1.2	1.1

P&L Summary	2011	2012	2013E	2014E	2015E
Interest Income	11,654	26,155	26,700	29,543	33,236
Interest Expense	3,320	10,891	12,533	14,190	16,169
Net Interest Income	8,335	15,264	14,166	15,353	17,068
Other Income	161	403	443	465	489
Total Income	8,496	15,667	14,610	15,819	17,556
Staff cost	1,605	3,090	3,466	3,468	3,988
Other operating expenses	2,439	3,322	3,482	3,879	4,387
Total operating expenses	4,044	6,413	6,948	7,347	8,375
Operating Profit	4,452	9,255	7,662	8,472	9,181
Depreciation	213	483	483	483	507
Profit before Tax	4,239	8,772	7,179	7,989	8,674
Taxes	1,412	2,857	2,369	2,636	2,862
Profit after tax	2,827	5,915	4,810	5,353	5,812
EPS	3.4	7.0	5.7	6.4	6.9
DPS	0.6	1.5	0.9	1.6	2.1

Balance Sheet Summary	2011	2012	2013E	2014E	2015E
Networth	19,240	23,810	27,783	31,584	35,373
Loan Funds	56,540	93,204	110,592	125,906	143,571
Total Liabilities	75,780	117,014	138,375	157,490	178,944
Fixed Assets	1,448	2,384	2,450	2,450	2,450
Deferred Tax Assets	87	189	189	189	189
Investments	403	2,182	600	600	600
Loans & Advances	64,142	97,144	119,488	137,411	158,022
Current assets					
Cash & Bank Balance	6,664	8,177	8,177	8,995	9,445
Other Current Assets	4,948	10,691	11,226	11,787	12,376
Current Liabilities	0	0	0	0	0
Net Current assets	11,611	18,868	19,403	20,782	21,821
Total Assets	77,691	120,768	142,129	161,431	183,082
BVPS	23	28	33	38	42

DuPont	2011	2012	2013E	2014E	2015E
NII	17.0%	16.3%	11.4%	10.7%	10.4%
Salaries and Allowances	3.2%	3.2%	2.7%	2.3%	2.4%
Administrative Cost	4.9%	3.4%	2.7%	2.6%	2.5%
Depreciation	0.4%	0.5%	0.4%	0.3%	0.3%
Provisions	0.0%	0.0%	0.0%	0.1%	0.1%
Profit before tax	8.5%	9.1%	5.6%	5.4%	5.2%
Profit after tax	5.6%	6.1%	3.8%	3.6%	3.5%
RoE	22.3%	27.5%	18.6%	18.0%	17.4%
Leverage (x)	4.0	4.5	5.0	5.0	5.0

Other Ratios	2011	2012	2013E	2014E	2015E
Yield on Loans	24.4%	27.9%	23.6%	23.0%	22.5%
Cost of Funds	5.9%	11.7%	12.3%	12.0%	12.0%
Spread	18.6%	16.2%	11.3%	11.0%	10.5%
NIMs	16.8%	16.4%	12.4%	12.3%	11.9%
AUM per branch (Mn)	36.5	40.0	37.9	41.1	45.0
Gold stock per branch (Kg)	26	23	19	21	23
AUM growth	190%	54%	3%	15%	15%

Source: Company filings, Espirito Santo Investment Bank Research





Report date	Recommendation	Fair value	Share price
2012 April 19	Neutral	Rs39.00	Rs31.00
2011 November 8	Buy	Rs80.00	Rs61.00
September 26	Buy	Rs70.00	Rs54.00
February 17	Buy	Rs140.00	Rs62.20
2010 November 24	Sell	Rs160.00	Rs178.00

Source: Bloomberg, Espirito Santo Investment Bank Research

Please visit our website at www.EspiritoSantoIB.co.uk for up to date recommendation charts.

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BUY	Analyst expects at least 10% upside potential to fair value, which should be realized in the next 12 months
NEUTRAL	Analyst expects upside/downside potential of between +10% and -10% to fair value, which should be realized in the next 12 months
SELL	Analyst expects at least 10% downside potential to fair value, which should be realized in the next 12 months

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	Recommendation	Count	% of Total	Count	% of IBC	% of Total
12 Month Rating:						
Buy		227	47.5%	22	62.9%	4.6%
Neutral		170	35.6%	11	31.4%	2.3%
Sell		81	16.9%	2	5.7%	0.4%
Restricted		0	0.0%	0	0.0%	0.0%
Under Review		0	0.0%	0	0.0%	0.0%
Trading Rating:						
Trading Buy		0	0.0%	0	0.0%	0.0%
Trading Sell		0	0.0%	0	0.0%	0.0%
Total recommendations		478	100%	35	100%	7.3%

For further information on Rating System please see "Definitions and distribution of ratings" on: <http://www.espiritosantoib-research.com>.

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