

MUTHOOT FINANCE

Growth picks up as regulatory landscape settles

India Equity Research | Banking and Financial Services



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Ideas create, values protect

Muthoot Finance reported a healthy set of numbers for Q3FY13 with PAT at INR2.7bn, in line with expectations, on the back of ~8% QoQ growth in AUMs at INR257bn. The growth comes after 2 quarters, as gold loan NBFCs, struggled under uncertain regulatory environment. Calculated yields moderated by ~30bps, though still at a robust 22%, leading to 15-20bps decline in NIMs to 10.5%. GNPA, though technical in nature still continues in the 1% plus range for third quarter in a row. Overall, we would like to re-iterate our positive stance on gold loan NBFCs expecting sustainable RoA/RoE of 3.5%/20% plus. The current quarter is a reflection of stability returning to the business and with the KUB Rao Committee report filed we believe the stage is set for growth to return. The quality of Muthoot Finance's operations as reflected in its employees, risk management practices and high branch productivity is also an advantage. Maintain 'BUY' with a target price of INR287.

Growth signaling return to normal; FY14 to reap full benefits

AUM grew by 8.3% QoQ to INR257bn. Adjusting for the run down in the assigned portfolio, the growth is higher at 10% QoQ. AUM growth YTD has been 4% and the management is guiding for a year end number of 10% thereby implying a modest asking rate of 5-6% since with the KUB Rao report being tabled a major overhang over the sector has been removed. In tonnage terms the growth is of 4% to 132 tonnes of gold implying some portion of the growth is led by increase in AUM/gram.

Branch expansion to gain pace FY14 onwards

Another 61 branches got added in Q3FY13 (236 branches in 9MFY13) to take the total tally to 3,914. We expect it to add another 65-70 branches in Q4FY13 and pace of branch addition will pick momentum in FY14-15 once the clarity emerges on final guidelines. In our estimates, we are building in loan growth of 18% over FY13-15E led by improved productivity from branches added in last 18-24 months.

Outlook and valuations: Rolling on growth; maintain 'BUY'

The current fiscal will be a year of consolidation for the industry as well as Muthoot, however, with the KUB Rao Report pointing to manageable business impact the stage is all set for growth to return in FY14. This we believe will lead to rerating of Muthoot to 2.2x FY14E P/BV from the current 1.7x. We maintain 'BUY/Sector Outperformer'.

	(INR mn)								
Financials	Year to March	Q3FY13	Q3FY12	Growth (%)	Q2FY11	Growth (%)	FY12	FY13E	FY14E
Net oper. Inc.		6,497	5,558	16.9	6,316	2.9	21,581	26,276	30,771
PAT		2,700	2,509	7.6	2,680	0.7	8,920	10,675	12,626
BV per share (INR)							78.7	102.4	130.4
Diluted EPS (INR)							24.0	28.7	34.0
Price/Book (x)							2.8	2.2	1.7
Diluted P/E (x)							9.2	7.7	6.5

EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Outperformer
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Overweight

MARKET DATA (R: MUTT.BO, B: MUTH IN)

CMP	: INR 220
Target Price	: INR 287
52-week range (INR)	: 246 / 106
Share in issue (mn)	: 371.7
M cap (INR bn/USD mn)	: 82/ 1,500
Avg. Daily Vol.BSE/NSE('000)	: 559.4

SHARE HOLDING PATTERN (%)

	Current	Q2FY13	Q1FY13
Promoters *	80.1	80.1	80.1
MF's, FI's & BK's	3.6	4.2	4.3
FII's	6.9	6.3	5.9
others	9.4	9.4	9.7
* Promoters pledged shares (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Banks and Financial Services Index
1 month	10.2	3.0	10.6
3 months	20.1	6.5	4.7
12 months	38.2	24.5	22.7

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Margins moderate a bit given reduced yield on assets

Yields moderated by ~30bps to 22% due to slight mix change between schemes and also due to some amount of interest income reversals on GNPA's. This reflected in NIM decline as well to the tune of 15-20bps to 10.5%, while the cost of funds stayed steady. Incrementally, we expect the margin profile to settle at the current levels and anticipate no major downside hereon.

Benefit from reduced cost of borrowing from the wholesale markets can flow in if the company ramps up borrowings from Commercial Paper route which stands at a low of 1% of the total borrowings. A major chunk of borrowings at 43% is via the banking channels. Currently more than a third of the total borrowings at INR87.5bn are via the Secured NCD route (unlisted). While we await further clarity on the final guidelines post the KUB Rao Committee report, a mention of reviewing exemption available to secured debentures from the definition of "deposit" can be an area of concern.

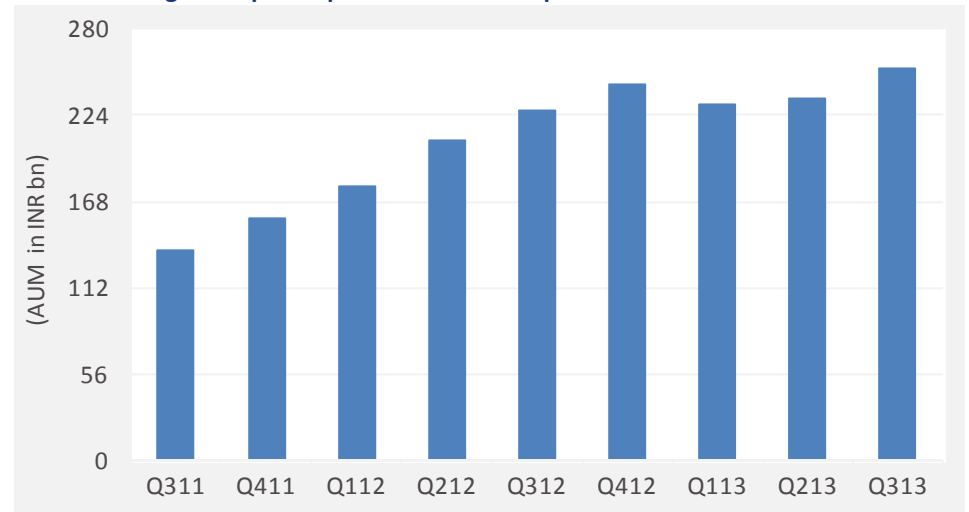
NPA continues to hold above the 1% mark due to technical reasons

GNPA at 1.5% continues to be relatively higher for the third quarter in a row. We believe once the auctions pick up the numbers will ease in the presence of 100% realizable collateral value NPA profile for the business. With the steady gold prices the loss given default will be negligible.

Other highlights

- To meet the minimal non-promoter holding requirement of 25% by May 2014, it will go in for fresh issue of equity shares and has passed an enabling resolution to that extent

Chart 1: AUM growth picks up after two muted quarters



Source: Company, Edelweiss research

Chart 2: Off-book AUMs to run down fully by the end of the fiscal

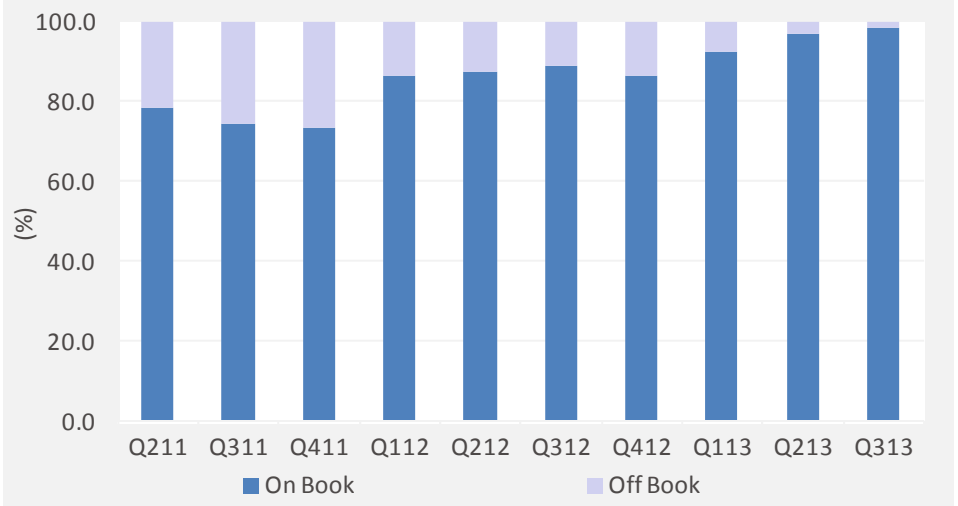


Chart 3: Given that 40% of existing branches was added in the last two years, a ramp up would further support AUMs

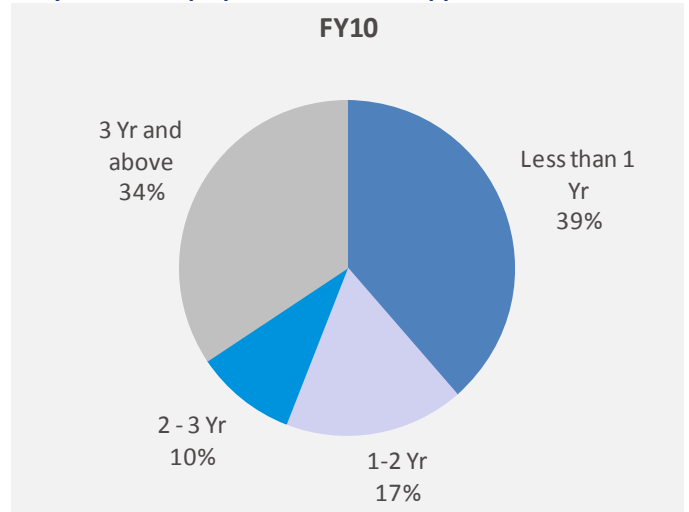
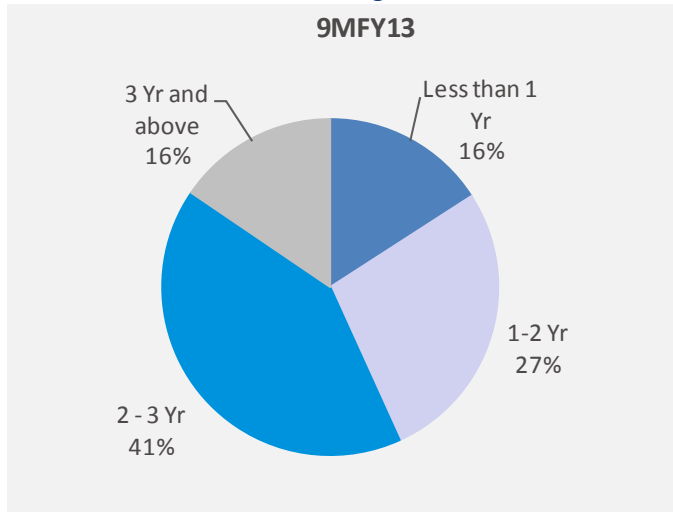
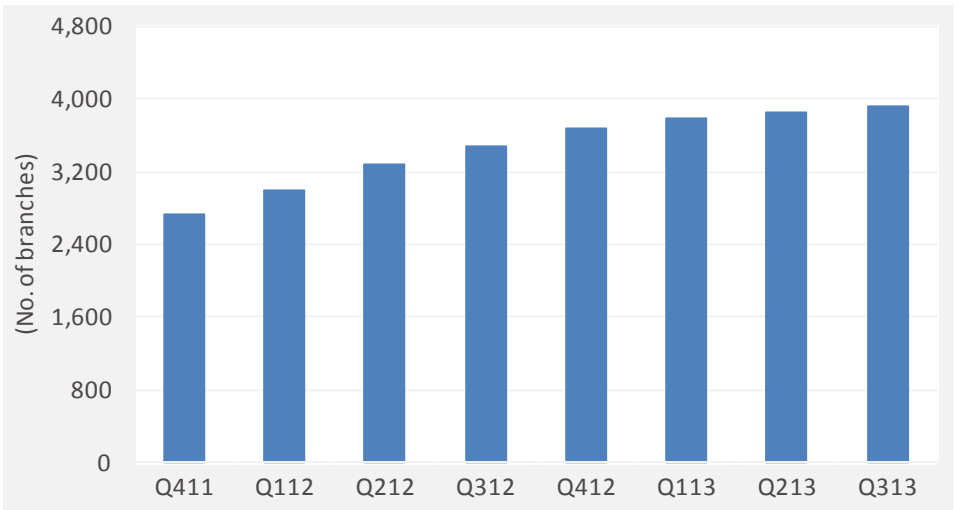


Chart 4: Added 236 branches in 9MFY13



Source: Company

Chart 5: Rationalized employee strength by going slow in fresh recruitments

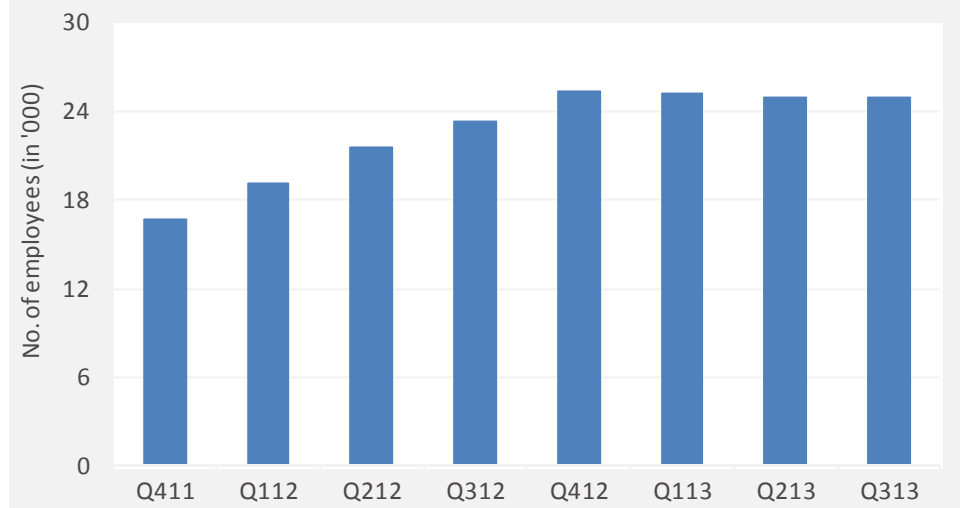


Chart 6: Drop in yields though still at a healthy 22% pulls down NIMs a bit

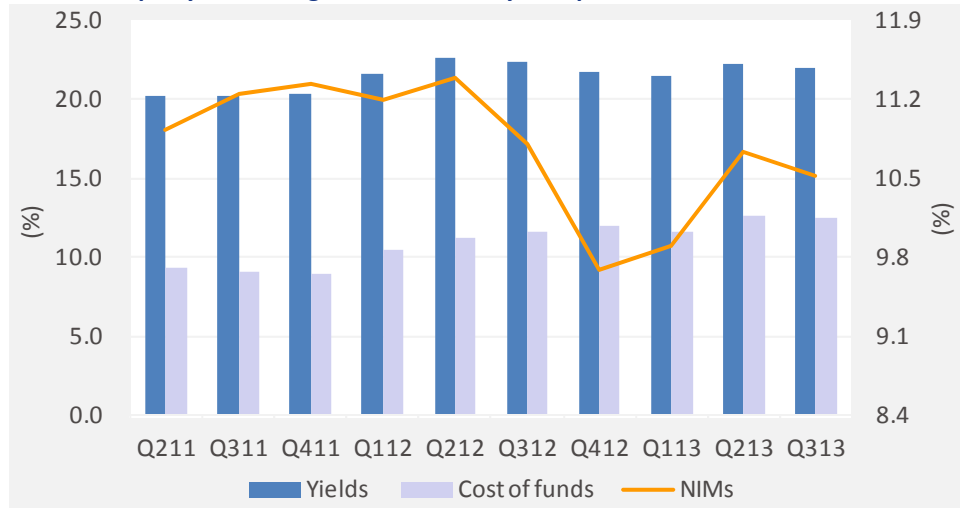
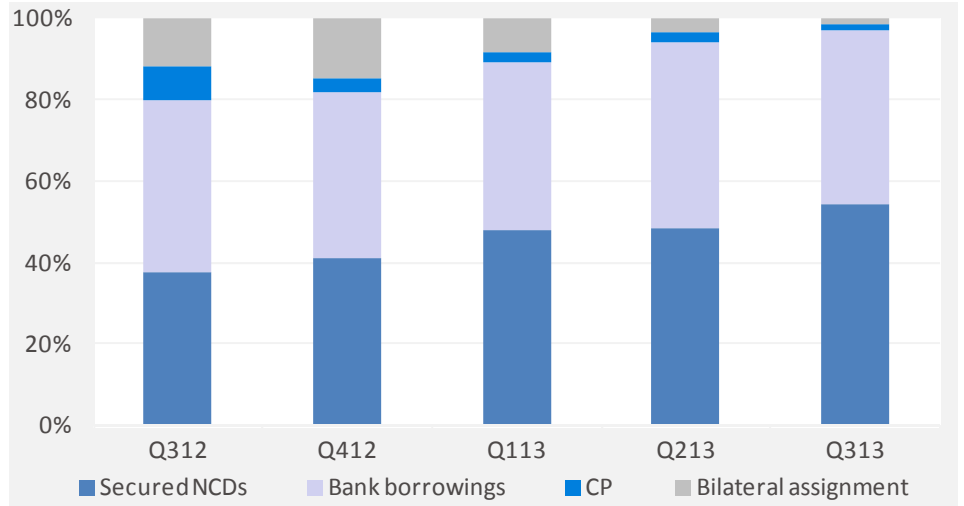
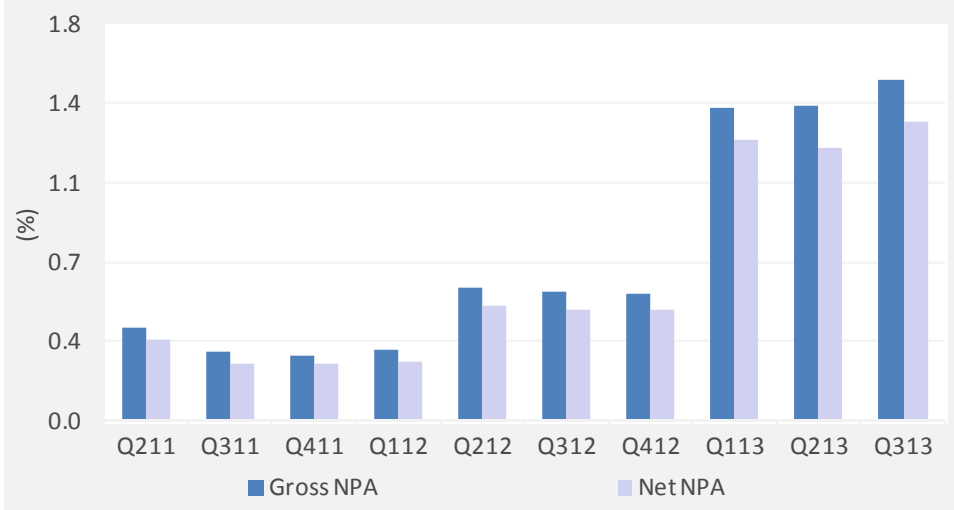


Chart 7: Relying more on NCD; though guidelines awaited on retail NCDs from branch



Source: Company

Chart 8: NPLs continues at elevated levels (technical in nature)



Source: Company

Financial snapshot

(INR mn)

Year to March	Q3FY13	Q3FY12	% change	Q2FY13	% change	YTD13	FY13E	FY14E
Operating income	13,578	12,261	10.7	13,100	3.7	39,581	55,739	62,347
Interest expanded	7,081	6,703	5.6	6,784	4.4	20,828	29,463	31,576
Net operating income	6,497	5,558	16.9	6,316	2.9	18,752	26,276	30,771
Other income	75	46	63.0	66	14.2	176	250	275
Total income	6,572	5,604	17.3	6,381	3.0	18,928	26,526	31,046
Operating expenses	2,321	1,717	35.2	2,242	3.5	6,573	9,533	11,401
Pre-provision profit	4,252	3,887	9.4	4,140	2.7	12,355	16,993	19,646
Provisions & write-offs	115	57	101.8	42	173.8	377	513	232
Operating profit	4,137	3,830	8.0	4,098	0.9	11,978	16,480	19,414
Depreciation	115	86	33.7	116	(0.9)	333	427	427
Profit before tax	4,022	3,744	7.4	3,982	1.0	11,645	16,053	18,987
Tax	1,322	1,235	7.0	1,301	1.5	3,804	5,378	6,361
PAT	2,700	2,509	7.6	2,680	0.7	7,841	10,675	12,626
Diluted EPS (INR)	7.3	6.0	21.4	7.2	0.8	7.3	28.7	34.0
Branches (No.)	3,914	3,480		3,853		3,914	3,978	4,428
Employees (No.)	24,846	23,219		24,857		24,846	24,863	27,454
AUM	257,127	228,851		237,436		257,127	271,737	320,410
Gross NPA - Gold loan	3,870	1,304		3,261		3,870	3,804	3,524
Net NPA - Gold loan	3,406	1,123		2,855		3,406	3,233	2,907
Tax rate (%)	32.9	33.0		32.7		32.9	33.5	33.5

Company description

Muthoot is the largest gold financing NBFC with operating history of more than 70 years when M George Muthoot (the father of Promoters) founded a gold loan business in 1939. At present, it is a closely held family-owned business with promoters (sons of M. George Muthoot and their family) continuing to hold substantial stake of 80%. Headquartered in Kerala, the gold loan NBFC has a network of 3,900 branches, 64% located in South India as of Dec, 2012. Muthoot has created leadership position in lending against gold jewellery with ~INR260bn AUMs (market share estimated at ~20% of the organised market, Source: IMAcS) comprising more than 60mn loan accounts.

In addition to gold loan business, it also provides money transfer services through branches as sub-agents of various registered money transfer agencies, and recently has commenced providing collection agency services as well. Its other recent initiatives include sale of gold coins and insurance products amongst various other services.

The Muthoot group has interests in a diverse range of business in areas of hospitality, media, education, healthcare, information technology etc. However, gold loans continue to be the mainstay and hence Muthoot Finance continues to be the flagship company.

Investment rationale

The current fiscal will be a year of consolidation for the industry as well as Muthoot (flat AUM and earnings growth). We would like to re-iterate our positive stance on gold loan NBFCs expecting sustainable RoA/RoE of 3.4-4%/20-25%. The current quarter is a reflection of stability returning to the business and with the KUB Rao Committee report filed we believe the stage is set for growth to return. The quality of Muthoot Finance's operations as reflected in its employees, risk management practices and high branch productivity is also an advantage.

Key Risks

- Risk of ownership split in future between four promoter -brothers cannot be ruled out
- Gold loan dynamics of regions beyond South India is bit different
- Pressure on growth in case of slower ramp up of new branches or decline in gold prices
- Difficult to call an end of regulatory actions till final guidelines are out

Financial Statements

Key Assumptions

Year to March	FY12	FY13E	FY14E	FY15E
Macro				
GDP(Y-o-Y %)	6.5	5.5	6.5	7.0
Inflation (Avg)	8.8	7.8	6.0	6.0
Repo rate (exit rate)	8.5	7.5	6.8	6.0
USD/INR (Avg)	47.9	54.5	54.0	52.0
Sector				
Credit growth	17.1	17.0	16.0	17.0
Deposit growth	13.4	15.0	14.0	17.0
Bank's base rate (%)	4.8	4.3	4.3	4.3
Wholesale borrowing cost (%)	24.0	23.0	23.0	23.0
G-sec yield	8.5	7.8	7.4	7.5
Company				
Yield on advances	22.4	21.6	21.1	20.4
Net interest margins	10.1	9.8	9.9	9.9
Cost of funds	12	12	12	11
- employee cost	18.0	12.0	10.0	10.0
- advertisement	(0.5)	0.2	0.2	0.0
- rent	16.9	0.2	0.1	0.1
Tax rate (%)	33.0	33.5	33.5	33.5
Number of branches	3,678	3,978	4,428	4,928
Disbursement growth	112.5	20.0	22.6	9.5
Gold loan tenure	2.6	2.6	2.6	2.6
Securitized portfolio	13.7	-	-	-
AUMs (in tonnes)/branch	37.2	34.5	36.0	38.0
Average INR per gm	1,782.3	1,980.0	2,010.0	2,010.0
Average LTV	64.9	60.0	60.0	60.0
Gross NPLs	0.6	1.4	1.1	1.1
Prov Cov	13.0	15.0	17.5	20.0

Income statement

(INR mn)

Year to March	FY12	FY13E	FY14E	FY15E
Interest income	45,280	55,739	62,347	71,103
Interest expended	23,699	29,463	31,576	34,677
Net interest income	21,581	26,276	30,771	36,426
- Fee & forex income	210	250	275	275
Net revenues	21,791	26,526	31,046	36,701
Operating expense	8,129	9,960	11,828	13,991
- Employee exp	4,145	5,491	6,670	8,099
- Depreciation /amortisation	329	427	427	445
- Other opex	3,655	4,042	4,731	5,447
Preprovision profit	13,663	16,566	19,219	22,710
Provisions	351	513	232	427
Profit before tax	13,312	16,053	18,987	22,283
Provision for tax	4,392	5,378	6,361	7,465
Profit After Tax	8,920	10,675	12,626	14,818
Reported PAT	8,920	10,675	12,626	14,818
Basic EPS (INR)	24.0	28.7	34.0	39.9
Shares outstanding (mn)	372	372	372	372
Diluted EPS (INR)	24.0	28.7	34.0	39.9
Dividend per share (INR)	4.0	4.3	5.1	6.0
Dividend payout (%)	16.7	15.0	15.0	15.0

Growth ratios (%)

Year to March	FY12	FY13E	FY14E	FY15E
Revenues	70.8	21.7	17.0	18.2
NII growth	71.5	21.8	17.1	18.4
Opex growth	69.1	22.5	18.7	18.3
PPP growth	71.8	21.2	16.0	18.2
Provisions growth	2.7	46.1	(54.8)	83.9
Net profit	80.5	19.7	18.3	17.4

Operating ratios

Year to March	FY12	FY13E	FY14E	FY15E
Yield on advances	22.4	21.6	21.1	20.4
Net interest margins	10.1	9.8	9.9	9.9
Cost of funds	12.2	12.4	11.6	10.9
Spread	10.2	9.2	9.4	9.5
Cost-income	37.3	37.5	38.1	38.1
Tax rate	33.0	33.5	33.5	33.5

Balance sheet		(INR mn)			
As on 31st March	FY12	FY13E	FY14E	FY15E	
Equity capital	3,717	3,717	3,717	3,717	
Reserves & surplus	25,540	34,342	44,752	56,970	
Shareholders funds	29,257	38,059	48,469	60,687	
Short term debt	131,348	174,482	205,049	238,405	
Long term debt	62,417	74,778	87,878	102,174	
Borrowings	193,764	249,259	292,928	340,579	
Deferred tax liability	(4)	(4)	(4)	(4)	
Sources of funds	223,018	287,315	341,393	401,262	
Total net fixed assets	2,682	2,585	2,676	2,806	
Non current investments	75	75	75	75	
Current Investments	900	-	-	-	
Cash and equivalents	7,950	11,549	16,021	18,820	
Loans and advances	214,699	271,737	320,410	376,401	
Other current assets	7,412	13,679	15,197	17,121	
Total current assets (ex cash)	230,961	296,965	351,628	412,342	
Others current liabilities	10,700	12,310	12,985	13,962	
Total current liabilities &	10,700	12,310	12,985	13,962	
Net current assets (ex cash)	220,260	284,655	338,642	398,380	
Uses of funds	223,018	287,315	341,393	401,262	

RoE decomposition (%)				
Year to March	FY12	FY13E	FY14E	FY15E
Net interest income/assets	10.1	9.8	9.9	9.9
Non interest income/assets	0.1	0.1	0.1	0.1
Net revenues/assets	10.2	9.9	10.0	10.0
Operating expense/assets	(3.8)	(3.7)	(3.8)	(3.8)
Provisions/assets	(0.2)	(0.2)	(0.1)	(0.1)
Taxes/assets	(2.1)	(2.0)	(2.0)	(2.0)
Total costs/assets	(6.0)	(5.9)	(5.9)	(5.9)
ROA	4.2	4.0	4.1	4.0
Equity/assets	10.0	12.5	13.9	14.8
ROAE (%)	41.9	31.7	29.2	27.2

Valuation parameters				
Year to March	FY12	FY13E	FY14E	FY15E
Diluted EPS (INR)	24.0	28.7	34.0	39.9
Y-o-Y growth (%)	55.5	19.7	18.3	17.4
Book value per share (INR)	78.7	102.4	130.4	163.3
Diluted PE (x)	9.2	7.7	6.5	5.5
Price/ BV (x)	2.8	2.2	1.7	1.3

Peer comparison valuation

Name	Market Cap	Diluted PE (X)		Price/ABV (X)		ROAE (%)	
		FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
Muthoot Finance	1,501	7.7	6.5	2.2	1.7	31.7	29.2
HDFC	23,333	25.8	21.5	5.4	3.8	22.4	22.5
Infrastructure Development Finance Co	4,890	14.5	11.8	1.9	1.7	14.0	15.3
LIC Housing Finance	2,620	14.2	10.3	2.0	1.8	16.3	18.2
Mahindra & Mahindra Financial Services	2,337	14.2	12.2	3.0	2.6	25.3	24.3
Manappuram General Finance	681	6.6	5.7	1.3	1.1	21.3	20.4
Multi Commodity Exchange of India	1,326	22.4	19.4	5.9	4.9	23.0	19.9
Power Finance Corp	5,021	6.6	5.6	1.3	1.1	19.2	19.6
Reliance Capital	2,237	6.2	5.4	0.4	0.4	6.4	6.9
Rural Electrification Corporation	4,536	6.8	6.1	1.5	1.3	23.4	22.5
Shriram City Union Finance	1,055	12.9	10.5	2.8	2.3	23.6	23.9
Median	2,337	14.2	10.5	2.5	2.1	21.3	20.4
AVERAGE	4,503	13.4	11.2	2.0	1.7	17.9	17.8

Source: Edelweiss research

Additional Data

Directors Data

M G George Muthoot	Chairman	George Alexander Muthoot	Managing Director
George Thomas Muthoot	Whole Time Director	George Jacob Muthoot	Whole Time Director
George Joseph	Non-Executive Independent Director	P George Varghese	Non-Executive Independent Director
John K Paul	Non-Executive Independent Director	K John Mathew	Non-Executive Independent Director

Auditors - Rangamani & Co.

**as per last annual report*

Holding – Top10

	Perc. Holding		Perc. Holding
SBI Funds Management Pvt Ltd.	2.63	IDFC Asset Management Co. Pvt Ltd.	1.10
BNP Paribas Investment Partners Asia Ltd.	0.36	Alliance Bernstein LP	0.33
BNP Paribas Asset Management (France) SAS	0.19	Fidelity Management & Research Co.	0.16
Mellon Capital Management Corp.	0.10	Jupiter Asset Management Ltd.	0.09
Alliance Bernstein Ltd.	0.05	BNP Paribas Asset Management India Pvt Ltd.	0.04

**in last one year*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
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No Data Available

**in last one year*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
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No Data Available

**in last one year*

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Allahabad Bank	BUY	SP	M	Axis Bank	BUY	SO	M
Bank of Baroda	BUY	SP	M	Federal Bank	BUY	SO	L
HDFC	HOLD	SU	L	HDFC Bank	HOLD	SP	L
ICICI Bank	BUY	SO	L	Indian Overseas Bank	HOLD	SU	M
IndusInd Bank	BUY	SP	L	Infrastructure Development Finance Co Ltd	BUY	SO	L
ING Vysya	BUY	SO	L	Karnataka Bank	BUY	SO	M
Kotak Mahindra Bank	REDUCE	SU	M	LIC Housing Finance	BUY	SO	M
Mahindra & Mahindra Financial Services	BUY	SO	M	Manappuram General Finance	BUY	SO	M
Multi Commodity Exchange of India	BUY	SO	M	Muthoot Finance	BUY	SO	M
Oriental Bank Of Commerce	BUY	SO	L	Power Finance Corp	BUY	SO	M
Punjab National Bank	HOLD	SU	M	Reliance Capital	BUY	SO	M
Rural Electrification Corporation	BUY	SO	M	Shriram City Union Finance	BUY	SO	M
South Indian Bank	HOLD	SP	M	State Bank of India	BUY	SO	L
Union Bank Of India	BUY	SO	M	Yes Bank	BUY	SO	M

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

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Coverage group(s) of stocks by primary analyst(s):

Allahabad Bank, Axis Bank, Bank of Baroda, Federal Bank, HDFC, HDFC Bank, ICICI Bank, Infrastructure Development Finance Co Ltd, IndusInd Bank, Indian Overseas Bank, Karnataka Bank, Kotak Mahindra Bank, LIC Housing Finance, Multi Commodity Exchange of India, Manappuram General Finance, Mahindra & Mahindra Financial Services, Muthoot Finance, Oriental Bank Of Commerce, Punjab National Bank, Power Finance Corp, Reliance Capital, Rural Electrification Corporation, State Bank of India, Shriram City Union Finance, South Indian Bank, Union Bank Of India, ING Vysya, Yes Bank

Recent Research

Date	Company	Title	Price (INR)	Recos
15-Jan-13	Axis Bank	Performance beat street; <i>Result Update</i>	1,424	Buy
14-Jan-13	ING Vysya Bank	Re-rating underway; <i>Company Update</i>	565	Buy
09-Jan-13	Indusind Bank	Asset quality in check; margins boost show; <i>Result Update</i>	435	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	118	46	17	181
* - stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	117	57	7	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

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