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Muthoot Finance Limited

Issue Opens	Issue Closes
18th Apr'11	21st Apr'11

Muthoot Finance Ltd (MFL) is an NBFC (SI-ND) promoted by M George Muthoot 72 years back. It primarily provides loan to individuals who possess gold jewellery and have short term requirement but don't have access to formal credit or within reasonable time. It is the largest gold financing company in India in terms of loan portfolio which as at end of November 2010 stood at Rs 13,003 cr of which gold loan portfolio was 12,898 cr. With estimated market share of ~ 19.5% (FY10), MFL enjoys a strong brand name. Post the IPO the promoters stake would come down from 93% to 80%.

An Overview

Co is primarily concentrated in south India accounting for 75% of its loans. As on 28 February 2011, Co had a network of 2,611 branches with nearly 67% of branches concentrated in the south. Co has expanded very rapidly in the FY10 and FY11 and has increased its branches by 165%.

MFL's gold loan business comprises more than 98% of its total revenue. The gold loan asset class is characterised by small ticket size loans -average ticket size of around Rs. 30,600 for MFL- secured typically against gold ornaments. While the contractual tenure of the loan contract is 12 months, the loan tenure is typically around 3-4 months. Loan to value is between 60-90% of the internally assessed gold value. Its customers are typically small businessmen, vendors, traders, farmers and salaried individuals. The Co can generally disburse an average loan ticket size of Rs 20,000 within five minutes from the time the gold is tendered to the appraiser.
AUM of MFL has grown at a four-year CAGR of 74% to Rs 7400 cr in FY10 while gross NPAs have been contained to less than 0.5% in the past three years (0.35% as of Nov 2010).

The primary sources of funds include term loan and cash credit from banks, sale of loans to banks, issuance of commercial paper, non-convertible debentures and equity. Although the company is a non-deposit accepting NBFC, it does accept retail debentures (not considered as public deposits), which accounted for close to 37% of the company's total funding as on November 30, 2010.

Based on IMaCs report, the share of NBFCs in the gold loan segment has been steadily increasing from ~18% in Mar-07 to ~32% in Mar-10, while the share of public sector banks declined from ~52% to ~46% and private sector banks from ~15% to ~12%. CRISIL as well as CARE have given 4 out of 5 Grade to the IPO.

Recommendation

Invest ☆☆★★★

Issue Summary

Price Band (Rs)*	160	175
Bid Lot	40 shares	
Face Value	Rs.10	
Total no of shares to be raised	5.15 cr	

Pre-issue share capital	Rs 320.2 cr	
Post-issue share capital	Rs 371.7 cr	
Issue Size	Rs 842 cr	Rs 901.25 cr
Post Issue Market Cap	Rs 5947 cr	Rs 6505 cr
P/E on FY10	12.9	14.1

Shareholding Pattern

Net Issue	No. of Shares	%
QIB's	<= 2.575 crs	50%
Non Institutional	>=0.7725 crs	15%
Retail	>= 1.8025 crs	35%
Employees	n.a	n.a
Total	5.15 crs	100%

Objects of the Issue

The primary reason for raising funds is to expand into new markets and open new branches in the existing regions.

- to augment our capital base to meet future capital requirements to provide for funding of loans to our customers; and
- general corporate purposes.

Book Running Lead Managers

- **ICICI Securities Limited**
- **Kotak Mahindra Capital Company Limited**

Investment Positives

- **Big Market for Gold Loan** - India is one of the largest markets for gold and as of fiscal 2010, accounts for approximately 10% of the total world gold stock with an annual demand of approximately 700 tonnes. With good amount of savings being diverted to gold, lending against gold has been quite popular in rural India, especially in South. At end of FY10 , the organized Gold Loans market was estimated at between Rs 350 billion and Rs 400 billion with a CAGR of approximately 40% during fiscal 2002 to fiscal 2010. This market is significantly under-penetrated and is expected to continue growing at the rate of 35-40% in the future.

Gold financing business may not have entry barriers but trust, goodwill and brand matters.

The business has potential for sustainability

- **Aggressive expansion making it a leader in the Gold Loan** – Despite being in business for 70 years, the Co has gained its leadership through aggressive expansion in the last few years. It market share has improved from 11% in 2008 to 19.5% in 2010. Co has a large branch network of 2611 and plans to expand it futher to sustain growth.

Since the exponential rise in gold prices, the gold financing business has grown by leaps and bounds.

- **Strong Brand and rich experience** – A good track record, management expertise and promoter support, has helped the Co build the strong brand and goodwill in the market. Off late the Co is increasing the visibility of brand by sponsoring events and publicity. However we note that the Co does not own this brand name and may have to pay out royalty to promoters in future for the use of name.

- **Advantage over Commercial Banks –** i) Co can generally disburse an average loan ticket size of Rs 20,000 within five minutes from the time the gold is tendered to the appraiser. Since loans are all over-collateralized by gold jewellery, there are minimal documentary and credit assessment requirements. This shortens turnaround time while improving quality customer service. ii) Fills up the gap where due to the inability to meet the eligibility requirements of banks and financial institutions credit is not available in a timely manner iii) Gets to charge a premium for such loans

Marked advantage over other organised financiers allows the Co to charge decent premium. However gold mortgaged against loans allow good risk mitigation too.

- **Strong Financials** – MFL has developed good expertise of the business which has allowed it to post healthy returns with controlled loss. The adjusted EPS and adjusted book value of the company increased at a CAGR of 53% and 43% respectively over FY06-10. Co has been able to fund its growth comfortably due to healthy track record and resulting high credit rating.

Concerns

- **The company faces tough competition** – Historically, the gold loan sector in India has been largely unorganized and higher yields relative to risk, and increased demand from middle income group has increased competition.The steep growth in past may not be sustainable. Margins of the Co are at much lower level as compared to its peers and may face futher pressure.

With aggressive expansion MFL became market leader in a short span which proves that the competition risk can be high

- **General overall business risk –** Volatility in interest rates, difficulty in easy access to funds, volatility in gold prices, heavy mortagage inventory, regulatory risks etc will remain as general business risk for the Co as well as its peers. However in general the business is perceived to be risky one and Co at present has no material diversification to other sources of income.

The customer profile is such that the business per se is risky.

- **Impending Regulatory Hurdles** – i) MFL has been issued show cause notices from the Government Authorities of Kerala and Gujarat in relation to compliance with relevant money lending statues issued by the respective State governments. Kerala accounts for 16% of its portfolio where the Kerala Money Lender's Act (KML), apart from other things, empowers the State Government to regulate lending rates of money lenders. ii) Following the notification of the RBI which clarifies that banks can no longer consider their exposures backed by gold loans originated by NBFCs as agricultural advances, the cost of funds may face some pressure going forward

A cap on rates or any other measure taken by the State Govts can be very detrimental for the Co

Peers Comparison

FY10 (Rs in Cr)	Muthoot	Manappuram
3Yr CAGR AUM growth%	73	75
NIM %	11.2	19.3
RoAE %	48.3	44
RoA %	4.2	5.2
GNPA %	0.46	0.39
AUM (Feb 2011)	13,003	6,520*
Branches (Feb 2011)	2611	1795*
EPS	12.4^	6.8**
Book Value$	54.7	45.1
CMP	175	127
PBV x	3.2	2.8
PE x	14.1	18.7

* Dec 2010; ** Annualised 9M11, ^ annualised Nov 2010, $ post issue in case of Muthoot and post QIB in case of Manappuram

Financials

Profit and Loss Account (Rs in cr)

Particulars	FY 07	FY 08	FY 09	FY 10	Nov 10
Interest Income	224	358	606	1,077	1,289
Other Income	10	11	14	12	12
Total Income	234	369	620	1,089	1,302
EXPENDITURE					
Interest Expense	100	180	310	474	583
Other Exp	67	92	162	270	278
PBT	67	97	148	346	441
Provision for tax	23	33	50	118	150
PAT Restated	44	63	98	229	291
EPS (Pre Issue)	**87.71**	**126.13**	**19.97**	**7.59**	**9.10**
EPS (Post Issue)					7.84

Our View

MFL has a large network, good brand, rich experience, presence in the south which is main fort of gold finance and strong financials. The Co however has very concentrated business -99% gold business with 75% from South. Also there is increased competition in this business these days. Barring the concerns, the business has good potential to grow and sustain. Valuation wise we feel that the issue is suitably priced and is almost match its peers. Therefore we feel that investors should subscribe to the IPO for medium to long term returns.

We recommend investment in this IPO.

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