

MUTHOOT FINANCE

Beat on earnings led by yield improvement

India Equity Research | Banking and Financial Services



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Muthoot Finance reported a PAT of INR2.86bn in Q2FY13, up 24% YoY and 5% QoQ – better than the Street’s expectation of INR2.4bn. Beat to consensus estimate was mainly led by a 70bps NIM improvement since yields increased by 60bps, further aided by 10bps decline in cost of funds. Gold loan AUMs grew ~2% QoQ to INR234bn (13% YoY); this is despite a 60% QoQ run-down in assigned portfolio. While the company auctioned loans worth INR880mn (compared to INR170mn in Q1FY13), gross NPLs continued at elevated levels of 1.38% (though technical in nature). We are revising earnings estimate by 11-12% for FY13-14E to factor in better NIM performance and higher than anticipated growth. Valuation at 1.5x FY14E book prices in near term regulatory risks and we maintain ‘BUY’.

NIMs expand, supported by increase in lending yields

While we were anticipating the company to surprise positively on yields as our branch visits had indicated that Muthoot did raise lending rates in some of its product schemes, the run-down of high yielding AUMs in Q1FY13 led to lower than expected yields. However, the benefit seemed to have flowed in Q2FY13 and lending yields improved 60bps QoQ to 22.1% as proportion of high yielding schemes went up. This, further aided by 10bps decline in cost of funds, led to 70bps improvement in NIMs.

Gold loan AUMs up 2% QoQ despite 60% run-down in assignments

As was guided by the management, moderation in branch expansion and regulatory changes resulted in gold loan AUMs increasing at a modest pace of 1.5% QoQ (13% YoY) to INR234bn. However, quantum of gold pledged fell 2% QoQ to 127tonnes, implying 4% QoQ increase in AUM/gm at INR1,850 (with rising gold prices, the highest LTV offered was also raised to INR2,200 per gram). In the absence of the assignment route, off balance-sheet AUMs ran down 60% QoQ to INR7.1bn.

Outlook and valuations: Valuation prices in risks; maintain ‘BUY’

The current fiscal will be a year of consolidation for the industry as well as Muthoot (flat AUM and earnings growth). However, post the consolidation phase (FY14 onwards), we expect it to retrace back to 20% growth profile with RoA/RoE in excess of 3.5%/25%. Branch visits make us more confident on the merits of Muthoot’s business model and execution capabilities. We maintain ‘BUY/Sector Outperformer’.

Financials		(INR mn)						
Year to March	Q2FY13	Q2FY12	Growth (%)	Q2FY11	Growth (%)	FY12	FY13E	FY14E
Net oper. Inc.	6,316	5,532	14.2	5,939	6.3	21,581	26,003	30,001
PAT	2,680	2,156	24.3	2,345	14.3	8,920	10,228	12,521
BV per share (INR)						78.7	101.4	129.2
Diluted EPS (INR)						24.0	27.5	33.7
Price/Book (x)						2.4	1.8	1.4
Diluted P/E (x)						7.7	6.7	5.5

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 186
Target Price	: INR 225
52-week range (INR)	: 218 / 106
Share in issue (mn)	: 371.7
M cap (INR bn/USD mn)	: 69/ 1,283
Avg. Daily Vol.BSE/NSE('000)	: 462.2

SHARE HOLDING PATTERN (%)

	Current	Q1FY13	Q4FY12
Promoters %	80.1	80.1	80.1
MF's, FI's & BK's	4.2	4.3	3.5
FII's	6.3	5.9	6.3
others	9.4	9.7	10.1
* Promoters pledged share (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Banks and Financial Services Index
1 month	3.7	(1.8)	10.6
3 months	39.9	7.7	4.7
12 months	1.1	4.4	22.7

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October 31, 2012

Branch roll-out to continue at 300-400 branches per annum

It added 73 branches in Q2FY13 (those that were ready to be rolled out prior to regulatory changes) to take the total tally to 3,853 branches. The management indicated that in the next six months, the company will open a similar number of branches as H1FY13 (~175 branches or more) and will continue to add 300-400 branches a year. It expects 10%-15% AUM growth by the end of FY13 with the pick-up to steady state levels of 20%-25% from FY14E.

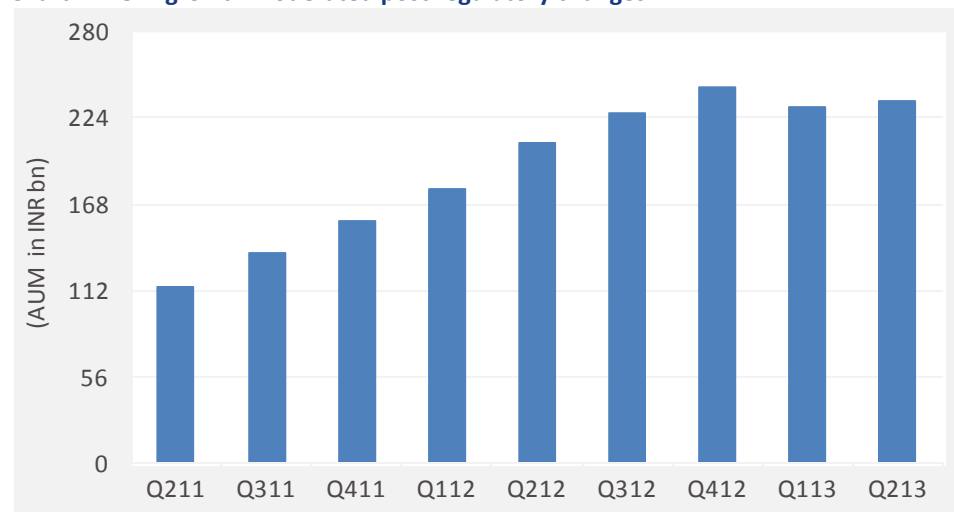
Gross NPLs remain at 1.37%; auctions INR880mn worth loans

Gross NPLs spiked to 1.38% in Q1FY13 (from 0.56% in FY12) due to not so aggressive follow up/auction that remained at the same level in Q2FY13 as well (1.37% - INR3.26bn). While it auctioned loans worth INR880mn in Q2FY13 (compared to INR170mn in Q1FY13 and INR2bn for the full year FY12), no respite in NPLs implies that loans auctioned would not be from the sub-standard category. The outstanding stock of NPLs is still more technical in nature and will probably get upgraded throughout the current fiscal. Moreover, it has jewellery as collateral which will cap any loss given the default reflected in a miniscule credit loss of INR32mn in H1FY13 (0.01% of gold loans).

Other highlights

- To meet minimal the 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
- Average ticket size – INR 40k (compared to INR 37k in Q1FY13)
- Proportion of loans above INR0.1mn is 40% and above INR0.3mn is 12%
- Of the liabilities, 50% would be fixed in nature and 50% floating

Chart 1: AUM growth moderated post regulatory changes



Source: Company, Edelweiss research

Chart 2: Off-book AUMs running down due to absence of assignment route

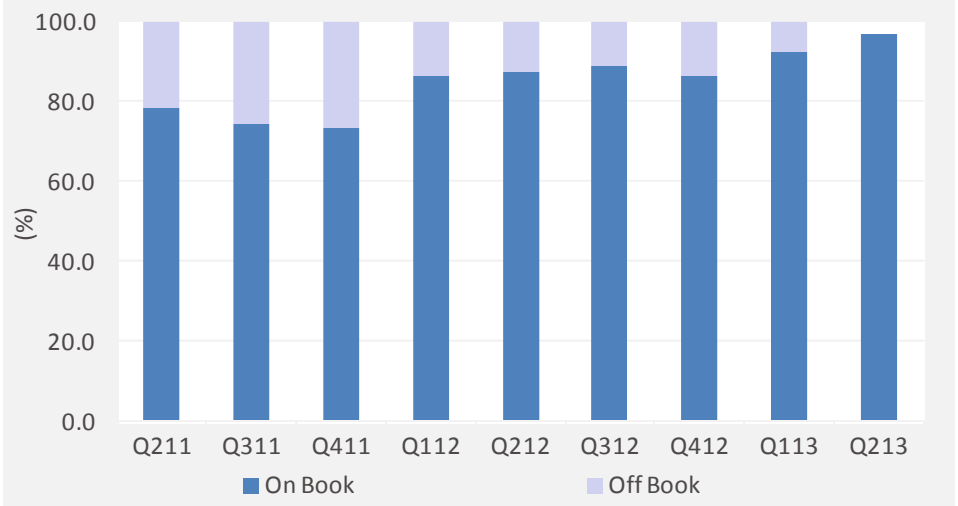


Chart 3: Given that 60% of existing branches was added in the last two years, a ramp up would support AUMs

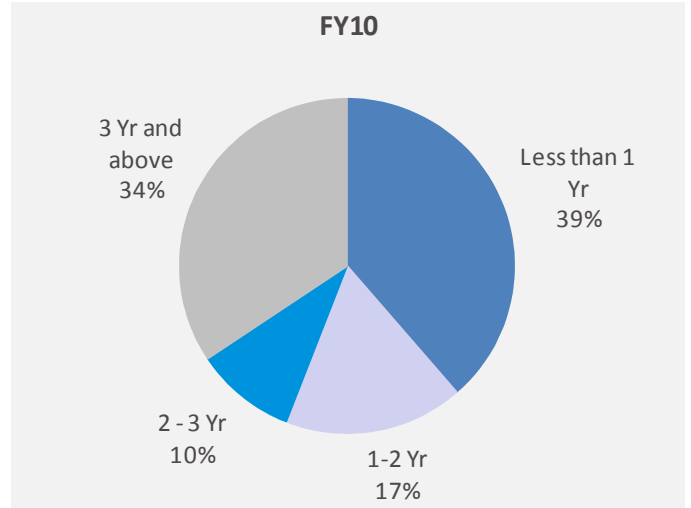
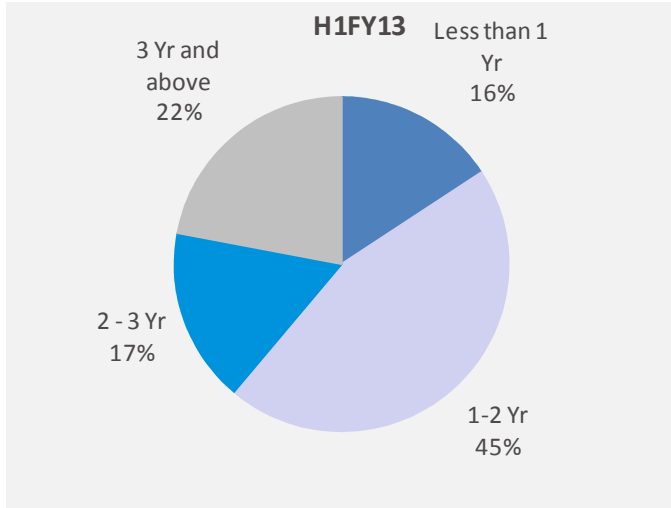
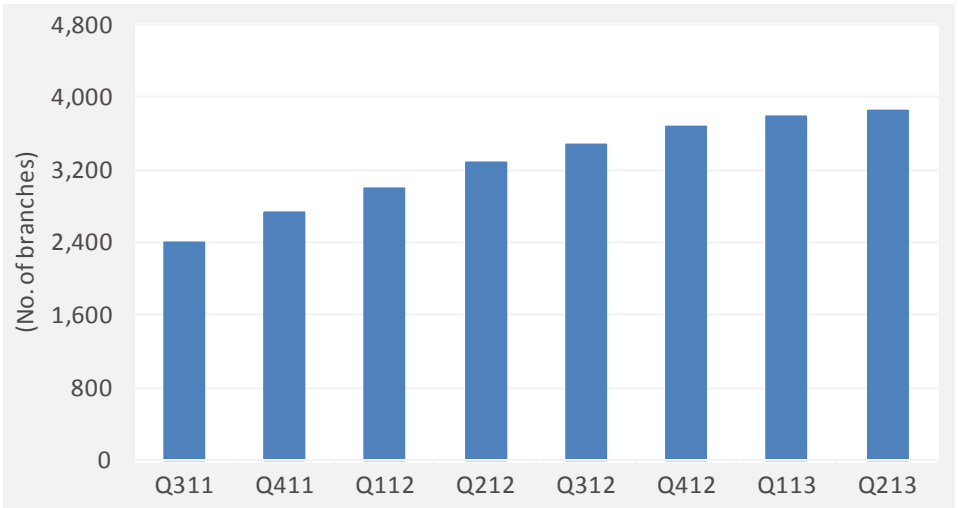


Chart 4: Added 175 branches in H1FY13 (ready for roll out prior to regulatory changes)



Source: Company

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

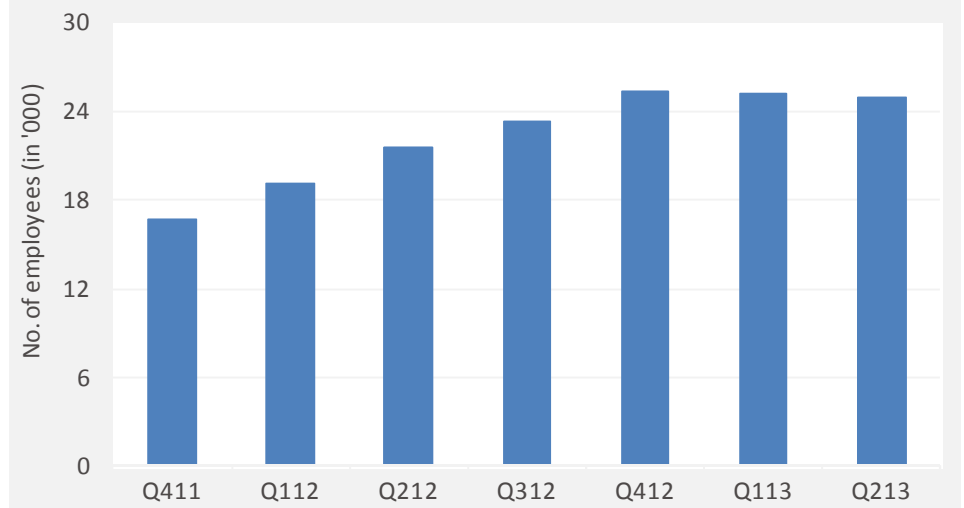


Chart 6: Increase in yields aids NIM improvement

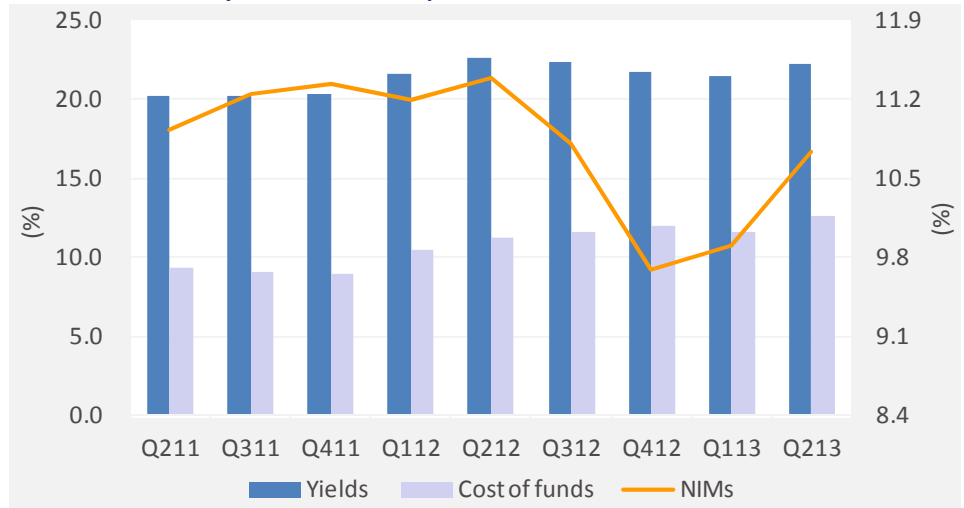
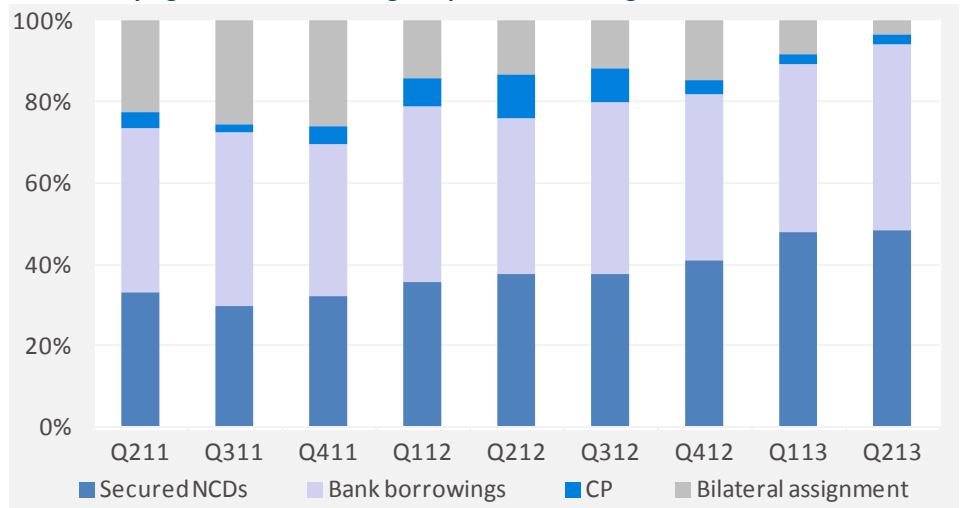
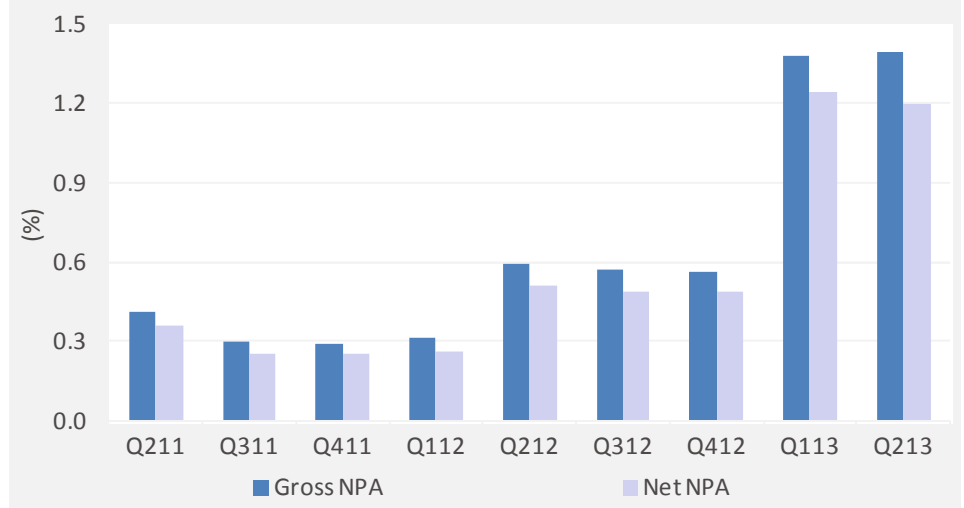


Chart 7: Relying more on NCD; assigned portfolio running down



Source: Company

Chart 8: NPLs at elevated levels despite better auctions (technical in nature)



Source: Company

Financial snapshot

(INR mn)

Year to March	Q2FY13	Q2FY12	% Change	Q1FY13	% Change	FY12	FY13E	FY14E
Operating income	13,100	10,984	19.3	12,903	1.5	45,280	54,563	58,337
Interest expanded	6,784	5,452	24.4	6,963	(2.6)	23,699	28,560	28,336
Net operating income	6,316	5,532	14.2	5,939	6.3	21,581	26,003	30,001
Other income	66	65	1.0	35	87.2	210	250	275
Total income	6,381	5,597	14.0	5,974	6.8	21,791	26,253	30,276
Operating expenses	2,242	2,175	3.1	2,127	5.4	7,800	9,756	10,850
Pre-provision profit	4,140	3,422	21.0	3,848	7.6	13,992	16,497	19,426
Provisions & write-offs	42	166	(74.7)	220	(80.9)	351	689	183
Operating profit	4,098	3,256	25.8	3,628	12.9	13,641	15,808	19,242
Depreciation	116	74	56.8	102	13.7	329	427	414
Profit before tax	3,982	3,182	25.1	3,526	12.9	13,312	15,381	18,829
Tax	1,301	1,026	26.8	1,181	10.2	4,392	5,153	6,308
PAT	2,680	2,156	24.3	2,345	14.3	8,920	10,228	12,521
Diluted EPS (INR)	7.2	5.6	28.9	6.6	8.9	24.0	27.5	33.7
Branches (No.)	3,853	3,274		3,780		3,678	3,978	4,278
Employees (No.)	24,857	21,543		25,103		25,351	26,255	27,379
AUM	237,436	209,405		233,166		244,173	259,684	295,695
Gross NPA - Gold loan (%)	3,261.0	1,233.0		2,990.0		1,389.0	3,116.2	3,252.6
Net NPA - Gold loan (%)	2,855.0	1,059.0		2,600.0		1,208.0	2,337.2	2,439.5
Tax rate (%)	32.7	32.2		33.5		33.0	33.5	33.5

Change in Estimates

	FY13E			FY14E			Comments
	New	Old	% change	New	Old	% change	
NII	26,003	23,762	9.4	30,001	27,518	9.0	Yield not compressing as was anticipated
PPOP	16,070	14,311	12.3	19,012	17,053	11.5	
Provisions	689	507	35.8	183	293	(37.5)	
PAT	10,228	9,180	11.4	12,521	11,145	12.3	
NIMs	9.9	9.2		10.3	9.6		Upgrade led by NIM improvement

Muthoot Finance – Q2FY13 earnings call takeaways

- Lot of negative perception was there for gold loan companies between March to July 2012 but in last 2-3 months it has subsided.
- Disbursements in Q2FY13 have been INR 250 bn – almost similar to that of Q1FY13
- **Auctions in Q2FY13 was INR 880 mn (compared to INR170mn in Q1FY13), but gross NPLs still continued at elevated levels of 1.37%.** It is providing 10% on NPLs. More than 12 months overdue would be 6%.
- Loans falling in NPL category are dynamic in nature and not a loss making NPLs. Credit losses have been INR 32.5 mn (0.01% of gold loans).
- NIMs have gone up as proportion of high yielding schemes has gone up.
- KUB Rao Committee report is under discussion at RBI after submission of report in August.
- To meet minimal **non-promoter holding requirement of 25% by May 2014, it will go in for fresh issue of equity shares.** Have passed an enabling resolution to that extent.

Outlook

- Without any further regulatory strictures, **growth could be 10-15% by FY13. After FY13, sustainable growth rate should be 20-25%**
- In next 6 months, will open similar number of branches as H1FY12 (~175 branches or more). Will continue to add 300-400 branches every year.
- NIMs will be maintained between 9.5-10.5%.
- **RoAs to be maintained at 4%**

Datapoints

- Avg ticket size – INR 40k (compared to INR 37k in Q1FY13).
- Number of loan account: 59 lacs
- # of Employees: 24,857
- **LTV on portfolio basis: 50% (on new valuation methodology)**
- Of the liabilities, 50% would be fixed in nature and 50% floating
- **For Q2FY13, Yield on advances: 22.16% (22.6%), cost of borrowings 11.53% (11.22%), NIMs 10.63% (11.38%), opex to assets: 3.88%**
- Less than 10% of branches will be with AUM <INR 40 mn
- **Proportion of loans above 1 lacs is 40% and above 3 lacs will be 12%**
- Lowest AUM touched in H1FY13 was INR 223 bn
- Tier 1 ratio: 14%

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 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 3,853 branches, 64% located in South India as of June 2012. Muthoot has created leadership position in lending against gold jewellery with INR234bn AUMs (market share estimated at ~20% of the organised market, Source: IMAcS) comprising more than 60 mn 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). However, post the consolidation phase (FY14 onwards), we expect it to retrace back to 20% growth profile with RoA/RoE in excess of 3.5%/25%. Branch visits make us more confident on the merits of Muthoot's business model and execution capabilities.

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

Financial Statements

Key assumptions

Year to March		FY10	FY11	FY12	FY13E	FY14E
Macro -	GDP(Y-o-Y %)	8.4	8.4	6.5	5.8	6.5
	Inflation (Avg)	3.6	9.9	8.8	7.8	6.0
	Repo rate (exit rate)	5.0	6.8	8.5	7.5	6.8
	USD/INR (Avg)	47.4	45.6	47.9	53.5	52.0
Company -	Loan growth	120.6	113.4	53.8	6.0	13.9
	Gross NPA	0.5	0.3	0.6	1.2	1.1
	Yield on advances	19.8	19.6	22.4	21.6	21.0
	Cost of funds	8.5	8.9	12.2	12.3	11.2
	NIMs	10.0	10.1	10.1	9.9	10.3

Income statement

(InR mn)

Year to March	FY10	FY11	FY12	FY13E	FY14E
Interest income	10,775	22,984	45,280	54,563	58,337
Interest expended	4,790	10,399	23,699	28,560	28,336
Net interest income	5,984	12,584	21,581	26,003	30,001
- Fee & forex income	119	175	210	250	275
Net revenues	6,104	12,760	21,791	26,253	30,276
Operating expense	2,621	4,806	8,129	10,183	11,264
- Employee exp	1,169	2,210	4,145	5,799	6,349
- Depreciation /amortisation	149	180	329	427	414
- Other opex	1,303	2,416	3,655	3,957	4,501
Preprovision profit	3,483	7,954	13,663	16,070	19,012
Provisions	27	342	351	689	183
Profit before tax	3,456	7,612	13,312	15,381	18,829
Provision for tax	1,180	2,670	4,392	5,153	6,308
Profit After Tax	2,276	4,942	8,920	10,228	12,521
Reported PAT	2,276	4,942	8,920	10,228	12,521
Basic EPS (INR)	7.6	15.4	24.0	27.5	33.7
Shares outstanding (mn)	301	320	372	372	372
Diluted EPS (INR)	7.6	15.4	24.0	27.5	33.7
Dividend per share (INR)	-	-	4.0	4.1	5.1
Dividend payout (%)	-	-	16.7	15.0	15.0

Growth ratios (%)

Year to March	FY10	FY11	FY12	FY13E	FY14E
Rev. growth (%)	101.0	109.1	70.8	20.5	15.3
NII growth	100.0	110.3	71.5	20.5	15.4
Opex growth	69.3	83.4	69.1	25.3	10.6
PPP growth	134.0	128.4	71.8	17.6	18.3
Provisions growth	-	-	2.7	96.2	(73.4)
Net profit	132.9	117.2	80.5	14.7	22.4

Operating ratios

Year to March	FY10	FY11	FY12	FY13E	FY14E
Yield on advances	19.8	19.6	22.4	21.6	21.0
Net interest margins	10.0	10.1	10.1	9.9	10.3
Cost of funds	8.5	8.9	12.2	12.3	11.2
Spread	11.3	10.8	10.2	9.3	9.8
Cost-income	42.9	37.7	37.3	38.8	37.2
Tax rate	34.1	35.1	33.0	33.5	33.5

Balance sheet

(INR mn)

As on 31st March	FY10	FY11	FY12	FY13E	FY14E
Equity capital	3,010	3,202	3,717	3,717	3,717
Reserves & surplus	2,832	7,775	25,540	33,973	44,297
Net worth	5,842	13,342	29,257	37,690	48,014
Secured loans	45,471	102,112	163,832	197,383	222,688
Unsecured loans	7,334	17,274	30,000	39,477	44,538
Deferred tax liability	25	25	(4)	(4)	(4)
Assignments	20,083	41,863	33,352	-	-
Total liabilities	78,755	174,616	256,437	274,546	315,236
Loans	54,617	117,518	211,718	259,684	295,695
Investments	75	75	75	75	75
Total current assets	8,202	19,729	19,243	24,242	28,962
Total current liabilities & provisions	5,754	6,910	10,633	12,039	12,014
Net current assets	2,447	12,819	8,610	12,203	16,949
Fixed assets	1,533	2,341	2,682	2,585	2,516
Assignments	20,083	41,863	33,352	-	-
Total assets	78,755	174,616	256,437	274,546	315,236
Loan growth	120.6	113.4	53.8	6.0	13.9
Deposit growth	66.8	126.1	62.4	22.2	12.8
EA growth	83.2	123.1	47.3	7.2	15.0

RoE decomposition (%)

Year to March	FY10	FY11	FY12	FY13E	FY14E
Net interest income/assets	10.0	10.1	10.1	9.9	10.3
Non interest income/assets	0.2	0.1	0.1	0.1	0.1
Net revenues/assets	10.2	10.2	10.2	10.0	10.4
Operating expense/assets	(4.4)	(3.9)	(3.8)	(3.9)	(3.9)
Provisions/assets	-	(0.3)	(0.2)	(0.3)	(0.1)
Taxes/assets	(2.0)	(2.1)	(2.1)	(2.0)	(2.2)
Total costs/assets	(6.4)	(6.3)	(6.0)	(6.1)	(6.1)
ROA	3.8	4.0	4.2	3.9	4.3
Equity/assets	7.9	7.7	10.0	12.7	14.7
ROAE (%)	48.1	51.5	41.9	30.6	29.2

Valuation parameters

Year to March	FY10	FY11	FY12	FY13E	FY14E
Diluted EPS (INR)	7.6	15.4	24.0	27.5	33.7
Y-o-Y growth (%)	116.7	104.1	55.5	14.7	22.4
Book value per share (INR)	19.4	41.7	78.7	101.4	129.2
Diluted PE (x)	24.6	12.0	7.7	6.8	5.5

Peer comparison valuation

	Price (INR)	Mcap (INR bn)	P/ABV		ROE (%)		P/E (x)	
			FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
HDFC Ltd	762	1,174	4.8	3.9	22.4	22.5	23.8	19.9
IDFC	162	246	1.8	1.6	14.0	15.3	13.4	10.9
LIC Housing Finance	243	123	1.7	1.5	16.3	18.2	12.2	8.8
Mahindra Finance	867	90	2.6	2.2	25.3	24.3	10.9	9.5
Manappuram Finance	37	31	1.1	0.9	21.6	20.7	5.4	4.7
MCX	1,405	72	5.9	4.8	28.7	27.2	22.5	19.5
Muthoot Finance	185	69	1.8	1.4	30.6	29.2	6.7	5.5
PFC	185	245	1.1	1.0	18.5	18.9	6.1	5.2
Reliance Capital	382	94	0.8	0.7	6.4	6.9	12.2	10.7
Rural Electrification Corp	215	213	1.3	1.1	21.8	20.9	6.3	5.7
Shriram City Union Finance	781	41	2.1	1.7	22.7	23.8	9.6	7.6

Source: Bloomberg, Edelweiss research



Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Allahabad Bank	HOLD	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
Sector Underperformer (SU)	Stock return < 1.25 x Sector return
	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): Banking and Financial Services

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
29-Oct-12	IDFC	Steady on asset quality; strong on growth ; <i>Result Update</i>	158	Buy
29-Oct-12	Indian Overseas Bank	Asset quality, margins let down; <i>Result Update</i>	74	Hold
26-Oct-12	Punjab National Bank	Asset quality struggle continues; <i>Result Update</i>	749	Hold

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	113	53	19	186
* 1 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	114	58	14	

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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