

Muthoot Finance

Industry: Financials

IPO Note

“Subscribe”

Key Highlights

Muthoot Finance Ltd. (MFL) has a strong presence in under-served rural and semi-urban markets (2,611 branches), with a dominant presence with 67% of its branch strength and 75% of asset strength in South India (a market which drives 70% of the gold demand)

Market leadership (25%), with over 70 years of operations and sustained RoE of 30% plus with net npas <1% over the past 5 years, in the gold loan market expected to grow at 35-40% CAGR over the next 3 years.

Relatively lower cost of funds - a function of borrowing mix, strong promoter and financial track record and healthy credit rating (P1+ for short term & AA- for long term) that MFL is able to maintain based on CAR

Collateralized lending reduces risk and maintains asset quality - Short maturity profile of loans (4-6 months), small ticket size of (~₹31,553 per loan) and a built in margin (15-30% of asset value).

At the upper band of ₹175 per share MFL is valued at P/ABV of 2.3x FY12 on our ABV of ₹75.6 and at the lower band of ₹160 per share at 2.1x on FY12 ABV. We recommend 'subscribe' to the MFL issue.

Pre – IPO allotment

The company has raised ₹1.3 bn through allotment of 7.7 mn shares, or 15% of the total offering of 51.5 mn shares, to anchor investors at ₹170 on April 16,2011 (pre- IPO). The anchor investors include Citigroup Global Markets Mauritius, Abu Dhabi Investment Authority, Goldman Sachs India Fund and Baring India Private Equity Fund among others.

Competitive Positioning

Rural demand to drive growth in under penetrated gold loan market

India is one of the largest markets for gold (March 2010), accounting for ~10% of the total world gold stock with an annual demand of ~700 tonnes (Source: IMaCS Industry Report -2010).

Issue Details

Opening Date	18 April, 2011
Closing Date	21 April, 2011
Prive Band (₹)	160 - 175
Face Value (₹)	10
Share on Issue (mn shares)	51.5
Issue size (₹mn)	8,420.0 – 9,012.5
Equity shares prior to issue (mn shares)	320
Equity shares post issue (mn shares)	372
Dilution (%)	13.7
Post issue market capitalization (₹ bn)	59.5 - 65.0
Lead Managers	ICICI Securities Ltd, Kotak Mahindra Capital Company Ltd.

IPO Grading	CRISIL IPO Grading 4/5 (Above Average fundamental)
	ICRA IPO Grading 4/5 (Above Average fundamental)

The objects of the Issue:

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

Chaitra Bhat

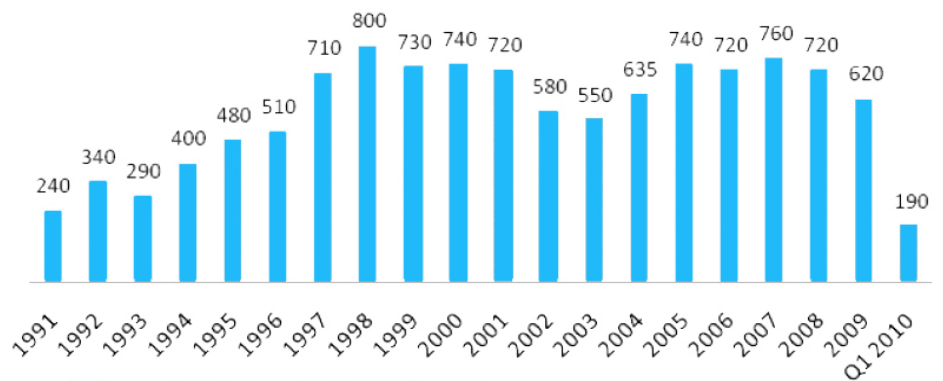
chaitra_bhat@lkpsec.com

+91 22 6635 1211

Disclaimer:

The information in this document has been printed on the basis of publicly available information, internal data and other reliable sources believed to be true and is for general guidance only. While every effort is made to ensure the accuracy and completeness of information contained, the company makes no guarantee and assumes no liability for any errors or omissions of the information. No one can use the information as the basis for any claim, demand or cause of action. LKP Securities Ltd., and affiliates, including the analyst who have issued this report, may, on the date of this report, and from time to time, have long or short positions in, and buy or sell the securities of the companies mentioned herein or engage in any other transaction involving such securities and earn brokerage or compensation or act as advisor or have other potential conflict of interest with respect to company/ies mentioned herein or inconsistent with any recommendation and related information and opinions. LKP Securities Ltd., and affiliates may seek to provide or have engaged in providing corporate finance, investment banking or other advisory services in a merger or specific transaction to the companies referred to in this report, as on the date of this report or in the past.

Gold Demand in Tons



Source: Company, LKP Research

Gold is viewed by Indian as an important savings instrument mainly because it is liquid and can be converted into cash instantly to meet urgent cash requirements. Thus Gold Loans have emerged as key gold based financial products. The organized Gold Loans market in India was estimated at between ₹350 - ₹400 bn (March 2010) grown at a CAGR of ~40% FY02-10.

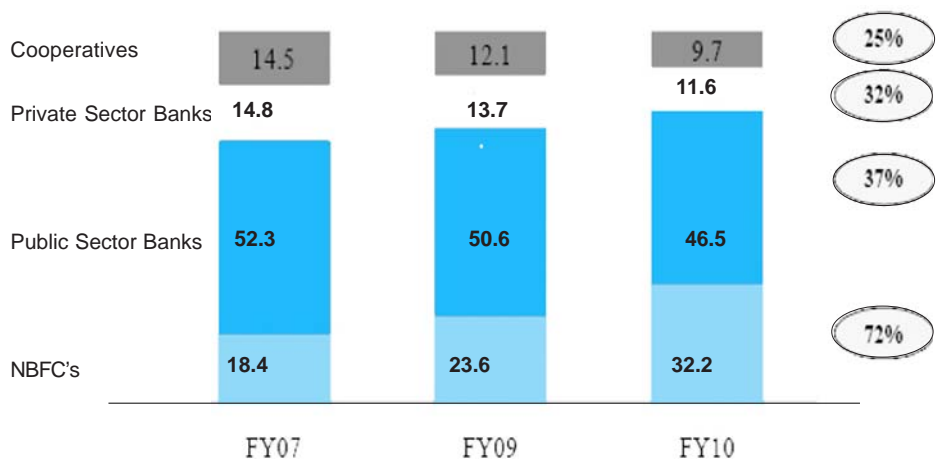
The Gold Loans market is significantly under-penetrated and is expected to continue growing at the rate of 35-40% in the future (Source: IMaCS Industry Report (2010 Update)). The southern region of India accounts for 85-90% of the Gold Loans market in India and the company has benefited with 67% of its branch network and 75% of its loan book exposure to the Southern market (November 2010).

The Gold Loans market is expected to grow at between 35 - 40% over the next three years. The branch expansion and marketing initiatives of various specialized NBFCs are anticipated to give a strong boost to the acceptability of Gold Loans and lead to further growth in the under penetrated Gold Loans market.

Player profitability: in favour of specialized NBFCs

The Gold Loans market has been dominated by SCBs (with presence in southern India) and NBFCs with market shares of approximately 58% and 32%, respectively March 2010 (Source: IMaCS Industry Report (2010 Update)).

Market share of Gold Loan lenders and respective growth rates



Source: IMaCS Industry Report (2010 Update)

NBFCs operating in the gold loan market as their primary business have an edge over SCBs due to better operational efficiencies (quick turnaround time, better value assessment skills and higher interest rates). Thus the objective and specialized skills put them in a better position than PSU Banks.

- NBFCs offer a higher LTV of 70-80% v/s 55-65% by banks
- The interest rates charged by the banks vary from 8-10% in case of loans for agricultural purposes and approximately 12-13% on loans for non-agricultural purposes v/s 22 - 26% charged by NBFCs (Source: IMaCS Industry Report 2009).

Key Ratios (as a % of average assets)	Specialised NBFCs*	Banks- Gold Loans for agri**	Banks- Gold Loans for non-agri***
Interest Income	22-23%	10% (includes govt subvention)	11-12%
Interest Expense	11-12%	7-8%	7-8%
Net Interest Margin	11%	2-3%	4% (approx)
Operating Expenses	5.5% (approx)	1.5%	1.5%
Provisions for bad debts	0.2%	0.1%	0.1%
Return on Assets (post tax)	3.3-3.5%	0.4-1.4%	2.2 % (approx)
Return on Net Worth	27-30%	2-7%	16-18% (approx)

Source: IMaCS Industry Report (2010 Update)

MFL enjoys market leadership: benefitted by strong network

MFL has a market share of 25.4% (March 2010), almost 3.7 times and 1.8 times ahead of the next largest NBFC and banking player in the gold loan market. Over the past 4-5 years players such as Muthoot finance and Manappuram have been expanding their business in the south and also other parts of the country. Below is an estimation of their market share as compared to other players (banks) in the industry.

Gold Loans Provider	Estimated Gold Loans Portfolio (Rs. Billion)			Gold Loans Market Share (%)		
	FY 07	FY 09	FY 10	FY 07	FY 09	FY 10
Muthoot Finance	14.2	33.0	73.42	11.0%	13.4%	19.5%
Muthoot Fincorp	4.7	11.8	22.2	3.6%	4.8%	5.9%
Manappuram *	4.8	12.0	25.6	3.7%	4.9%	6.8%
Indian Bank	17.0	32.5	39.2	13.2%	13.2%	10.4%
Indian Overseas Bank	16.9	31.0	52.2	13.1%	12.6%	13.9%
Federal Bank	6.0	10.7	8.6	4.7%	4.3%	2.3%
South Indian Bank	6.0	15.0	23.5	4.7%	6.1%	6.3%
State Bank Of Travancore	11.4	16.0	19.3	8.9%	6.4%	5.1%
Andhra Bank	4.0	9.0	14.0	3.1%	3.6%	3.7%

*Including Manappuram Finance Tamil Nadu Limited (MAFIT)

Source: IMaCS Industry Report (2010 Update)

The company has a distribution network of 2611 branches across 20 states in India with dominance in southern regions. MFL, with a 25% (highest) market share in the gold loan market, serves an average of 67,953 customers on a daily basis through its branches and 15,000 plus employees. The company has a strong presence in under-served rural and semi-urban markets. A large portion of the rural population has limited access to credit either because of their inability to meet the eligibility requirements of banks (documentation and mere lack of banking habits) or because of lack of credit disbursement in a timely manner, this is where MFL steps in.

Diversified sources of funds: maintains lower cost of funds

Despite rising interest rate environment, we expect MFL to enjoy relatively lower cost of funds. This is mainly a function of borrowing mix, strong promoter and financial track record and healthy rating that MMFSL is able to maintain based on CAR. Proposed IPO would create additional headroom for MFL to raise Tier 2 capital, thereby expanding its capacity to lend.

Borrowing profile (₹ mn)	Mar-08	Share (%)	Mar-09	Share (%)	Mar-10	Share (%)	Nov-10	Share (%)
Muthoot Gold Bonds	12,403	53	19,020	48	27,193	37	33,645	27
Banks	5,885	25	11,068	28	21,279	29	47,085	38
Other Borrowings	865	4	1,569	4	4,334	6	10,099	8
Sell down of receivables under bilateral assignment	4,341	18	8,130	20	20,083	28	32,465	26
Total borrowings	23,494	100	39,786	100	72,888	100	123,294	100

Source:RHP MFL

The strong track record of the promoters and the healthy CAR of 15.1% (November 2010) has translated into a rating of stable (AA-) by CRISIL which makes MMFSL's bonds attractive. The strong franchise and the group's long track record in Kerala enable MFL to tap retail funding sources. The company privately placed Secured Non-Convertible Debentures of ₹33,645 mn (November 2010). Although the company has a high reliance on bank funds and subordinated debt (74%), sell down of receivables (26%) reduces pressure on cost of funds. The priority sector attractiveness of Muthoot Finance's loan book enables it to churn its portfolio. However, RBI has discouraged banks to buy out portfolios to meet agricultural priority sector targets; we believe that gold loans will still have a place for overall priority sector targets which will benefit borrowing cost.

Collateralized lending reduces risk and maintains asset quality

Asset quality

(₹ mn)	2007	2008	2009	2010
Loans fully secured	13,644	17,812	25,380	53,921
Loans against personal security	225	142	195	353
Loans considered doubtful or bad	23	93	161	344

Source:RHP MFL

Collateral risk arises from the decline in the value of the gold collateral due to fluctuation in gold prices. MFL lends at an average LTV of 70-80% of the asset value with average maturity 4-5 months at an average ticket size ₹31,553 per loan. This largely mitigates the risk of asset value due to price fluctuations. Additionally, the company builds in 15%-30% margin while calculating the value of the asset.

MFL's appraisal method excludes production, design and gemstones costs associated with making the item and the value of the collateral is solely based on the weight of its gold content.

If a customer defaults post the expiry of the loan tenure, the item as collateral is auctioned off. The margin of 15-30% enables the company to recover the amount due.

Quality of assets

	FY08	FY09	FY10	Nov-10
Gross npas	92.6	161.1	343.6	461
Provisions	9.3	16.1	37.1	50.1
Net npas	83.3	145	306.4	410.9
Net Retail loans	17,922	2,560	54,298	97,572
Net npas/Net retail loans (%)	0.46	0.57	0.56	0.42
Gross retail loans	22,263	33,690	74,382	13,0037
Gross npa/Gross retail loans (%)	0.42	0.48	0.46	0.35
Amounts written off			6.2	2.9

Source:RHP MFL

Key risks**MFL loan portfolio not classified as 'agri' priority sector advances by the RBI**

A recent notification issued by the RBI in February 2011, has stipulated that loans sanctioned to NBFCs for on lending to individuals or other entities against gold jewellery would not be eligible for classification as priority sector advances in the context of agricultural lending targets. According to RBI guidelines, priority sector targets are 40% of credit outstanding and of this agricultural lending is 10%. This is likely to put some pressure on the cost of funds for MFL.

Major concentration in southern India

As on February 28, 2011, 1753 out of its 2,611 branches are located in the southern states of Tamil Nadu (593 branches), Kerala (607 branches), Andhra Pradesh (316 branches), Karnataka (230 branches) and Union Territory of Pondicherry (7 branches). Moreover, southern states as on November, 2010 accounted for 75.28% of its total gold loan portfolio. Any slowdown in the southern Indian economy could affect business and profitability.

Exposed to an event risk – Kerala Money Lender's Act

MFL is exposed to an event risk- 'Kerala Money Lender's Act' (KML), which empowers the state government to regulate lending rates of money lenders operating in the state and requires money lenders to register branches with the state authorities apart from other things. The matter is subjudice at the Supreme Court. Any adverse ruling in this case could impact the growth prospects of the company in the state of Kerala, which accounted for around 16% of its portfolio as on September 30, 2010. However, the impact on asset quality may not be significant as the company can auctions the pledged gold ornaments.

Management and operational details

Muthoot Finance Ltd. (MFL) is a “Systemically Important Non-deposit taking NBFC” headquartered in Kerala. It has an operating history of over 70 years. Gold Loan Business of MFL was founded by Late. M George Muthoot (father of the current promoter) under the heritage of trading business established by his father, Ninan Mathai Muthoot.

MFL provides personal and business loans secured by gold jewellery, or Gold Loans, primarily to individuals who possess gold jewellery but could not access formal credit within a reasonable time, or to whom credit may not be available at all, to meet unanticipated or other short term liquidity requirements. On an average, the company services 67,953 customers per day through its various branches. The customers are typically small businessmen, vendors, traders, farmers and salaried individuals. The principal loan amounts we disburse usually range from ₹2,000 - 100,000 while interest rates on Gold Loans range between 12% - 30% p.a. The yield on retail loan portfolio in March 2010 and November 2010 was 19.94% and 18.92% p.a. respectively.

In addition to Gold Loans business, the company provides money transfer services, and recently has commenced providing collection agency services. They also operate 3 windmills in the state of Tamil Nadu.

Branches and employees

Branches (nos.)	1921
North	465
West	297
South	1753
East	96
Employees	15,664
Employees per Branch	8.2

Source:RHP MFL

Gold Loan portfolio as of November 2010 comprised approximately 4.1 mn loan accounts serviced through 2,611 branches across 20 states and two union territories in India. Southern Indian states of Tamil Nadu, Kerala, Andhra Pradesh and Karnataka constituted 75.3% of total Gold Loan portfolio.

Business parameters	2008	2009	2010
Gold loan business (%)	95.7	96.7	98
Gold loan AUM (₹ mn)	21,790.10	33,000.70	73,417.30
Quantity (tons)	30.1	38.9	65.5
Gross npas (%)	0.42	0.48	0.46
EPS	2.57	3.49	7.59
RoE (%)	29.59	27.08	39.12

Source:RHP MFL

MFL's Gold loan portfolio is financed by mix of secured and unsecured instruments raised from a mix of financiers. “Muthoot Gold Bonds”, non-convertible debentures, issued on a private placement basis form 37% of the borrowing mix. The company also raised capital by selling a portion of its loan receivables under bilateral assignment agreements with various banks.

Borrowing profile (March'10)	₹ mn	Share (%)
Muthoot Gold Bonds	27,193	37.3
Bank borrowings and subordinated debt	25,613	35.1
Sell down of receivables under bilateral assignment	20,083	27.6
Total borrowings	72,888	100.0

Source:RHP MFL

Management

The promoters are the Muthoot family who hold a 93% stake in the company. The promoters diluted their stake from 100%, following issue of fresh shares to the extent of 6% of their shareholding during H1, 2011 to private equity investors– Matrix Partners, Baring India Private Equity, Kotak India Private Equity, Kotak Investment Advisors Limited and the Wellcome Trust Limited. Subsequently the promoters sold 1% of their shareholding to the Wellcome Trust Limited. The operating history has evolved over a period of 70 years since M George Muthoot founded a gold loan business in 1939. We believe that the experience, skills and goodwill acquired by the Promoters over these years cannot be easily replicated by competitors. M. G. George Muthoot is the Whole Time Director and Chairman and George Alexander Muthoot is the Managing Director of the company.

Promoter Group shareholding

	Pre issue	Post Issue
George Alexander Muthoot	13.9	12.0
"George Jacob" Muthoot"	13.9	12.0
"George Thomas" Muthoot"	13.9	12.0
Susan Thomas	9.4	8.1
Elizabeth Jacob	4.7	4.0
George M. Jacob	4.7	4.1
Anna Alexander	4.7	4.0
Sara George	4.2	3.6
Eapen Alexander	2.4	2.0
"George M." Alexander"	2.4	2.0
George M. George	2.1	1.8
"Alexander M." George"	2.1	1.8
Total	93.0	80.1

Financial Summary

Income statement

(₹ mn)	FY06	FY07	FY08	FY09	FY10	Nov-10	FY11E	FY12E
Interest Income	1,428	2,236	3,579	6,062	10,775	12,893	22,395	36,392
Interest Expense	648	999	1,798	3,098	4,737	5,826	12,526	18,966
Nil	780	1,237	1,781	2,965	6,037	7,068	9,868	17,425
Non interest income	52	104	107	142	119	123	154	203
Operating income	832	1,341	1,888	3,106	6,157	7,191	10,022	17,629
Operating expense	419	671	919	1,625	2,701	2,780	3,874	6,815
PBT	413	670	970	1,482	3,456	4,411	6,148	10,814
Tax	142	230	334	505	1,180	1,496	2,099	3,668
PAT	271	440	636	977	2,276	2,915	4,049	7,146
Restated PAT	269	439	631	979	2,285	2,915	4,049	7,146
Growth (%)	-	63	44	55	133	-	77	76

Balance sheet

(₹ mn)	FY06	FY07	FY08	FY09	FY10	Nov-10	FY11E	FY12E
Share capital	40	50	50	490	3,010	3,202	3,202	3,717
Reserves and surplus	864	1,542	2,081	3,124	2,832	8,112	9,246	24,890
Shareholders equity	904	1,592	2,131	3,614	5,842	11,315	12,449	28,607
Loan funds	8,059	13,827	19,153	31,656	52,805	90,829	108,925	145,894
Secured borrowings	7,370	13,118	18,400	30,087	45,471	80,330	96,334	129,030
Unsecured borrowings	688	709	753	1,568	7,334	10,499	12,591	16,864
Current Liabilities	323	459	1,225	1,806	4,524	4,071	4,882	6,539
Provisions	119	214	349	524	1,230	1,547	1,855	2,485
Total liabilities	9,405	16,092	22,858	37,600	64,401	107,762	128,111	183,525
Fixed assets	512	632	1,086	1,293	1,533	1,991	2,223	2,578
Investments	123	242	183	85	75	75	77	89
Loans and Advances	7,947	13,893	18,047	25,736	54,617	98,105	117,650	162,285
Current Assets	853	1,372	3,583	10,524	8,202	7,615	13,332	27,609
Sundry Debtors	13	22	35	41	33	69	83	111
Cash and Bank Balances	369	563	2,580	8,825	5,760	4,607	4,966	13,767
Other Current Assets	471	787	968	1,658	2,408	2,940	3,137	4,722
Deferred tax (net)	(30)	(47)	(42)	(38)	(25)	(24)	(25)	(27)
Total assets	9,405	16,092	22,858	37,600	64,401	107,762	128,111	183,525

Key Ratios

(₹ mn)	FY06	FY07	FY08	FY09	FY10	Nov-10	FY11E	FY12E
Yield on advances	18.0	20.5	22.4	27.7	26.8	15.0	26.0	26.0
Cost of Funds	8.0	9.1	10.9	12.2	11.2	6.4	11.5	13.0
NIMs	18.8	21.7	20.3	21.5	25.4	13.8	21.6	25.0
Net npas	na	na	83.3	145.0	306.4	410.9	494.1	519.1
Net npas(%)	na	na	0.5	0.6	0.6	0.4	0.4	0.5
RoE	29.7	35.1	33.9	34.1	48.3	34.0	34.1	34.8
RoA	2.9	3.4	3.3	3.2	4.5	2.7	3.4	4.6
EPS	67.3	87.7	126.1	20.0	7.6	9.1	12.6	19.2
Diluted EPS	0.7	1.2	1.7	2.6	6.1	7.8	10.9	19.2
BV	226.3	318.4	426.2	73.8	19.4	35.3	38.9	77.0
ABV	na	na	409.6	70.8	18.4	34.1	37.3	75.6
Lower Band =160								
PE	219.2	135.2	93.5	60.9	26.1	20.4	14.7	8.3
P/BV	0.7	0.5	0.4	2.2	8.2	4.5	4.1	2.1
P/ABV	na	na	0.4	2.3	8.7	4.7	4.3	2.1
Upper Band =175								
PE	239.8	147.9	102.3	66.6	28.6	22.3	16.1	9.1
P/BV	0.8	0.5	0.4	2.4	9.0	5.0	4.5	2.3
P/ABV	na	na	0.4	2.5	9.5	5.1	4.7	2.3

Research Team

S. Ranganathan	Head of Research	Pharmaceuticals , Agriculture	6635 1270	s_ranganathan@lkpsec.com
Ashwin Patil	Research Analyst	Automobiles & Telecom	6635 1271	ashwin_patil@lkpsec.com
Chaitra Bhat	Research Analyst	Banking & Financial Services	6635 1211	chaitra_bhat@lkpsec.com
Ami Shah	Research Analyst	Cement & Sugar	6635 1247	ami@lkpsec.com
Deepak Darisi	Research Analyst	Energy	6635 1220	deepak_darisi@lkpsec.com
Dwaipayan Poddar	Technical Analyst		6635 1272	dwaipayan_poddar@lkpsec.com

Institutional Equities

Pratik Doshi	Director	98210 47676	-	pratik_doshi@lkpsec.com
Hardik Mehta	Sales	98190 66569	6635 1246	hardik_mehta@lkpsec.com
Varsha Jhaveri	Sales	93241 47566	6635 1296	varsha_jhaveri@lkpsec.com
Hitesh Doshi	Sales	93222 45130	6635 1281	hitesh_doshi72@lkpsec.com
Kalpesh Vakharia	Dealing	98193 08082	6635 1267	kalpesh_vakharia@lkpsec.com
Gurdarshan Singh	Dealing	93228 61461	6635 1246	gurdarshan_singh@lkpsec.com
Bharat Shah	Dealing	98337 97256	6635 1210	bharat_shah@lkpsec.com
