Moody's assigns first-time Ba2 CFR to Muthoot Finance

October 10, 2019

Related Issuers

Muthoot Finance Limited

Singapore, October 10, 2019 -- Moody's Investors Service has assigned a first-time Ba2 corporate family rating (CFR) to Muthoot Finance Limited (Muthoot).

The rating outlook is stable.

RATINGS RATIONALE

The Ba2 CFR takes into account the company's (1) leading franchise and well established track record in lending against the gold jewelry segment in India, and (2) strong solvency metrics, including asset quality, capital and profitability.

However, these strengths are somewhat offset by Muthoot's modest funding and liquidity, due to a heavy reliance on short-term wholesale funding.

Incorporated in 1939, Muthoot is the largest financier of lending against gold jewelry (gold loans) in India, with a market share of about 18% among banks and non-banks at 31 March 2018. The company has a long operating history of more than 80 years in the segment.

Muthoot's operations are concentrated in gold loans, which represented about 88% of the company's loans at 31 March 2019. Over the past two to three years, Muthoot started to diversify into mortgage loans, microfinance and vehicle finance. The company has also acquired a majority stake in a non- bank financial institution in Sri Lanka, Asia Asset Finance Plc.

The gold loan business is operated through the holding company, Muthoot Finance Limited. The other segments are operated from separated legal entities, which are all Muthoot subsidiaries.

Based on management's plans, gold loans will continue to dominate the company's loan portfolio and account for 80%-85% of total loan assets over the next 2-3 years.

Muthoot's loans are also concentrated in southern India, such as Karnataka, Tamil Nadu, Andhra Pradesh, Telangana and Kerala, which represent close to 50% of total gold loans. Nevertheless, the share of loans to borrowers in the country's southern states has fallen from about 80% in 2009, as the company seeks to diversify its operations across India.

Muthoot's reported asset quality performance has been volatile and is impacted by the general repayment profile of gold loans, as well as the tightening of nonperforming loan (NPL) classification norms by the Reserve Bank of India. At 31 March 2019, IND-AS stage 3 assets represented 2.7% of the gold loan segment and 2.4% for the consolidated entity. Stage 3 loans for the gold loan segment increased to 3.2% in June 2019.

Despite the volatile NPL performance, the underlying credit costs have remained fairly low, at about 0.7% of consolidated gross loans in the past three years. Furthermore, the company incurs minimal losses on gold loans that turn into NPLs that are ultimately auctioned. Based on auction data over the past five years, the company recovered the entire principal amount of the loans outstanding, and the resultant losses were only limited to the loss of interest.

In addition, Muthoot incurs some losses on bad debt through burglary, staff fraud or spurious gold. Since 2011, average bad debt written off represented about 0.06% of total gold loans.

Notwithstanding the historical performance, the company's asset quality performance remains susceptible to adverse and sharp movements in gold prices.

Muthoot's profitability has improved steadily in recent years, as it leveraged its vast physical network to scale up its operations. Its consolidated return on assets was 5.0% in 2019; increasing over the years and proving one of the highest among finance companies in India.

Capitalization is a key strength of the company, with consolidated tangible common equity as a percentage of total managed assets of 24% at 31 March 2019, supported primarily by steady and strong profitability. In the past five years, the company's dividend payout ratio has ranged between 20% and 35%.

Somewhat offsetting these strengths is the company's weak funding and liquidity. Like its industry peers, Muthoot relies fully on wholesale sources for its funding needs, and has limited liquid assets that can be mobilized to overcome refinancing issues.

Nonetheless, some of the liquidity risk is mitigated by the company's policy to closely match the maturities of its assets and liabilities, its diversified wholesale funding base, and good access to liquidity from banks and debt market investors.

In addition, for the gold loan segment, monthly collections and the disbursement of loans are fairly matched; limiting any pressure on the company's liquid assets for balance sheet growth.

CFR

The CFR is assigned to a corporate family as if it had a single class of debt and a single consolidated legal entity structure. Consequently, if a single security class of debt represents the clear majority of a family's total debt, the rating assigned to that debt will equal the CFR.

Given that the majority of Muthoot's outstanding debt is secured by the company's financing receivables, Muthoot's CFR is assigned to the company's secured debt class.

A significant proportion of Muthoot's assets are encumbered for secured borrowings. Consequently, Moody's expects a higher loss-given-default for senior unsecured creditors than secured creditors.

Muthoot's CFR does not benefit from affiliate and government support.

WHAT COULD CHANGE THE RATING UP

Moody's could upgrade Muthoot's CFR if the company displays a meaningful and sustained improvement in its funding and liquidity profile.

WHAT COULD CHANGE THE RATING DOWN

Conversely, a meaningful increase in Muthoot's NPL formation rates and a material deterioration in its loss-absorbing buffers could put downward pressure on the company's standalone credit profile. A deterioration in the company's funding and liquidity, as demonstrated by its inability to rollover its maturity liabilities will add pressure to its rating.

The principal methodology used in this rating was Finance Companies published in December 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Headquartered in Kochi, Muthoot Finance Limited reported total consolidated assets of INR428 billion as of 30 June 2019.

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