Manappuram Finance Ltd. INR 35

KRChoksey INSTITUTIONAL

Rise to crescendo BUY

Catering to the short-term needs of the informal credit market, Manappuram Finance Ltd. (MGFL) is the second largest non-banking finance company in India. With legacy issues behind and regulatory environment turning favorable, MGFL's core gold loan business is poised to bask in steady growth territory hereon. Besides, diversification into non-gold synergistic product segments; viz, microfinance, mortgage and vehicle finance, should aid MGFL mitigate business concentration risks and drive value growth. De-risking the gold loan portfolio, leveraging upon the strong brand equity, capitalizing on widespread customer base and rich retail network and utilizing surplus capital funds for foraying into newer markets and product segments should translate into superior growth revival and enhanced earnings profile for MGFL.

Re-engineering legacy gold loan business: With unabating gold demand especially triggered by rural and Southern India (here MGFL has stronghold), regulatory environment turning favorable, volatility in gold loan portfolio overdone and the recalibration of gold loan portfolio largely supported by increased marketing initiatives, MGFL is already basking in the steady growth trajectory.

By virtue of MGFL's location demographics that widen the opportunity size for MGFL and the under-penetrated organized gold loan market at mere 3% will continue to ensure unabated gold loan demand in India. Besides, the new regulatory norm leading to higher revision of loan-to-value (LTV) ratio to 75% has resulted in level-playing field for NBFCs vis-à-vis banks. More importantly, the re-calibration of the legacy gold loan portfolio by de-linking it to gold prices and aligning it to the tenure of the loans has proved to be the final nail in the coffin. This migration from the erstwhile long tenure products (12 month product with 75% LTV) to shorter tenure products (3, 6, 9 and 12 month products) with higher LTVs for shorter tenures.

Therefore, with the major gold loan worries overdone, MGFL's gold loan portfolio has met with success with prompt disbursements and lower turnaround time, reduction in interest losses as a result of shift to short tenure products, flexibility of re-payment options and discretionary utilization of such gold loan funds for end user consumption. This together should translate into steady-state 10-12% Y-o-Y growth in gold loan AUMs over FY16-18E.

Diversifying from Gold to Gold+: From being a single product NBFC to to a diversified product franchise, MGFL expects almost 50% of AUM to emerge from non-gold products over next five years. MGFL's smart foray into synergistic RoE accretive product segments by utilization of surplus funds coupled with marketing push strategy places the company at the point of inflection.

Leveraging upon strong brand equity and existing retail customer base and utilizing surplus capital, MGFL has diversified into synergistic non-gold or Gold+ products, viz; microfinance, mortgage & housing finance, commercial vehicle lending. The company aims to mitigate business concentration risks and capitalize on its proven operational capabilities with complete focus on small ticket lending in the semi-urban and rural markets.

We reckon, the diversified non-gold loan mix that currently stands 8.6% of overall AUMs is likely to clock 24% Y-o-Y growth forming almost 25% of the total AUMs by FY19E. The steady gold loan traction and the robust non-gold mix should drive overall AUMs that are estimated to grow at strong 17-19% CAGR over FY16-18E.

Target Price (INR): INR 52

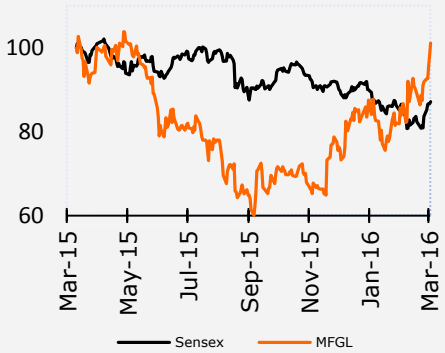
Potential Upside : 49%

Market Data	
Shares outs (Mn)	841
Equity Cap (Mn)	1682.4
Mkt Cap (INR Mn)	29399.9
52 Wk H/L (INR)	38/19.75
Vol(No-shares)	578733
Face Value (INR)	2
Bloomberg Code	MGFL IN

Market Info:

SENSEX	24804
NIFTY	7539

Share Price Performance



Share Holding pattern (%)

Particulars	Dec15	Sep15	Jun15
Promoters	32.57	32.31	32.19
FIIs	39.95	42.91	46.88
DIIs	8.88	7.65	7.33
Public	18.60	17.13	13.60
Total	100	100	100

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Enhancing operating efficiencies; driving earnings momentum: The golden period of FY08-12 was characterized by buoyant growth (95% AUM CAGR), stupendous NIMs (16%+) supported by higher yields, and lower costs. However, tables turned in FY12 as the gold prices plunged, cap on LTV, cap on borrowings (maximum borrowing upto INR 2.5 mn) dampening the operating leverage and the profitability of the company. NIMs declined to almost 10.4%, spreads narrowed down to 8.5% and opex/AUM ratio stood at 7% levels hindered by waning AUMs (~30% fall in AUMs) during the turbulent period of FY12-14.

Going forward, we expect intermittent margin pressures on account of diversification of product mix should be rightly compensated by reduction in cost funds (benefits accruing from falling interest rate scenario with 72% of borrowings emerging from bank finances, investment grade rating benefits) and lower incremental slippages. With the gold portfolio being de-linked to price fluctuations and thrust on small ticket loans and the diversification strategy, the slippages and auction losses should mark declining trend. With stressed legacy gold portfolio stands cleansed (Q2FY16 witnessed an aberration with entire legacy gold portfolio being auctioned, the gold auctioned to disbursements stood as high as 10%), the gold auctioned/disbursements have normalized at 5% and the run-rate of gold auctions in near term should remain steady at INR 4.5-5.0 bn as cited by the Management. While the gross NPAs have stood at 150 dpd at 1% of AUMs, these NPAs have predominantly been technical in nature. Going forward, as the company progresses with its product expansion drive coupled with negligible technical NPAs due to 90-dpd migration, we expect the gross NPAs to climb to 1.2-1.3% over FY16-18E.

Delivering superior return ratios:
Traversing through the troubled waters, MGFL witnessed volatility in return ratios with RoAs plummeting to 2% levels in FY15 from higher levels of 5% in FY12. However, with business turnaround post FY15, MGFL should observe greater benefits flowing through operating leverage and business expansion. Besides steady 10 to 12%+ gold loan growth, the new business additions; viz, micro finance portfolio that should put out 62%+ CAGR growth, CV finance projected to report 134% CAGR growth and home loans which is expected to report 113% CAGR growth over next two years.

While strong retail customer base and rich retail franchise, improving cost matrix, lower leverage and decreasing auction amounts should continue to drive the asset franchise for MGFL; high capital adequacy (Total CAR at 25.4% in Q3FY16) that should aid the non-gold business growth and stable asset-liability mismatch profile, together should boost earnings momentum translating into higher RoEs in forthcoming periods. Against this backdrop, we envisage, MGFL to clock staunch 16% CAGR in net profits translating into RoEs at 14-15% and RoAs to step-up to 2.7% over FY16-18E.

Valuation & Outlook: While the worst stands behind for MGFL, the recalibration of gold loan portfolio and widening of the product base should go a long way in driving the value growth. Moreover, robust capital base at healthy 25.6% and relatively lower leverage at 3.3x provides substantial headroom to boost future growth and enhance return ratios. Moreover, the consistent dividend payout records is icing on the cake.

We initiate coverage with a BUY recommendation on the stock with a target price of INR 52. We value MGFL at SoTP valuations, the core business (gold business) being valued at 1.4x P/ABV FY18E, micro-finance at 2.6x P/ABV FY18E and housing finance at 1.4x P/ABV FY18E. Notably, the sizeable increase in the microfinance business that is expected to grow at ~40% AUM CAGR from current 5 bn to INR 20 bn over next two years, per se should prove a substantial valuation trigger for MGFL. At CMP, the stock is trading at compelling valuations (for the core business) at 1.0x FY18E P/B and we reckon that MGFL definitely forms a re-rating candidate.

Key Financials:

INR mn	FY14	FY15	FY16E	FY17E	FY18E
Net Interest Income	10,494	10,908	13,508	15,873	18,231
Pre-provision profits	3,899	4,419	5,406	6,432	7,494
Net Profit	2260	2713	3225	3784	4327
EPS (INR)	2.7	3.2	3.8	4.5	5.2
EPS growth	8.5	20.1	18.9	17.3	14.4
BVPS (INR)	28.7	30.3	31.8	33.7	36.1
Price to earnings (x)	11.9	9.9	8.3	7.1	6.2
Price to book (x)	1.2	1.2	1.1	1.0	1.0

Source: Company, KRChoksey Research

Company Brief

Incorporated in July 1992, Manappuram Finance Ltd (MGFL) is a Non-banking Finance Company, which provides wide range of fund-based and fee-based services such as gold loans, micro finance loans, vehicle loans, mortgage loans, money exchange facilities, etc. Promoted by Mr. V.P. Nandakumar, CEO & MD, MGFL carries strong brand equity built over the years and high standards of corporate governance.

BUSINESS OVERVIEW

Business Model

One of the largest listed players in the gold finance business, MGFL boasts of strong brand image and rich history since inception. With proven operational capabilities, MGFL has replaced the pawn brokers, local money lenders by penetrating deep into rural and semi-urban markets bringing steady shift in the legacy gold finance business.

Capitalizing on the existing customer base, the company in recent periods has forayed into the non-gold synergistic business segments; viz, microfinance, housing finance and commercial vehicle finance providing small ticket loans to a non-bankable customer base.

Competitive Edge

Leveraging upon strong distribution network of 3293 Branches.

Banking upon strong brand image especially in the Southern states and widespread customer base of ~ 1.85 mn.

Utilization of surplus capital on balance sheet for diversification into synergistic asset classes.

Rural market expertise with strong presence in rural and semi-urban areas wherein 60% of the gold in Inc

Reduction in size of existing branches to small loan kiosks deriving operating leverage.

Lower gearing levels at 3.3x providing substantia increase in leverage.

Technological innovations (such as 24 hour, 365 Days online payment for customers, online product schemes) that help strengthen business processes, prompt disbursements and faster turnaround time coupled with minimal documentatior and flexible repayment options.

No asset-liability mismatch

Rich dividend player since early years.

Financial Structure

Total AUM has grown from INR 75,491 mn in FY11 to INR 95,935 mn in FY15; Closing AUM at INR 105.79 b , up 3.5% Q-o-Q.

Disbursements have grown from INR 1,80,569 mn in FY11 to INR 2,46,830 mn in FY15.

Capital Adequacy Ratio in FY15 stood at 25.7%.

Total Income from Operations, Net Interest Income and PAT in FY15 were INR 19,864 mn, INR 11,090 m & INR 2,713 mn respectively.

Return ratios: ROA –2.4% in FY15, ROE –10.6% in FY

Key Competitors

Muthoot Finance, SCUF

Industry Revenue Drivers	Gold holdings at 58.5 tonnes–an increase of 1.9% Q-o-Q and 16.4% Y-o-Y is indicative of volume increase in turn should spur gold loan demand. 70% of MGFL's network being entrenched in Southern belt that contributes ~40% of the gold demand in India and ~31%+ of the network spread across rural India that per se holds 65% of total gold stock provides a huge market potential. With greater focus on low income borrowers and branch expansion into other states leveraging upon Manappuram's network, micro finance portfolio has a huge potential growth. Increased focus on affordable housing for mid to low income group and expansion drive into South and west of India is likely to provide bigger market potential for housing finance segment of MGFL. Penetration into unbanked category of customers in the rural and semi-urban locations of Southern and Western India should provide ample opportunity for CV lending traction.
Current business strategy	(1)Leveraging strong brand equity & existing retail customer base. (2)Addition of new synergistic product segments-micro finance, mortgage & housing fin, CV lending. (3)Marketing push and enhanced customer reach. While the gold loan business worries stand behind with regulatory hurdles subsiding and company switching to smaller tenure products and strategy to diversify into new non-gold lending products relevant to the existing customer base is expected to augur well for the company.

Source: Company, KRChoksey Research

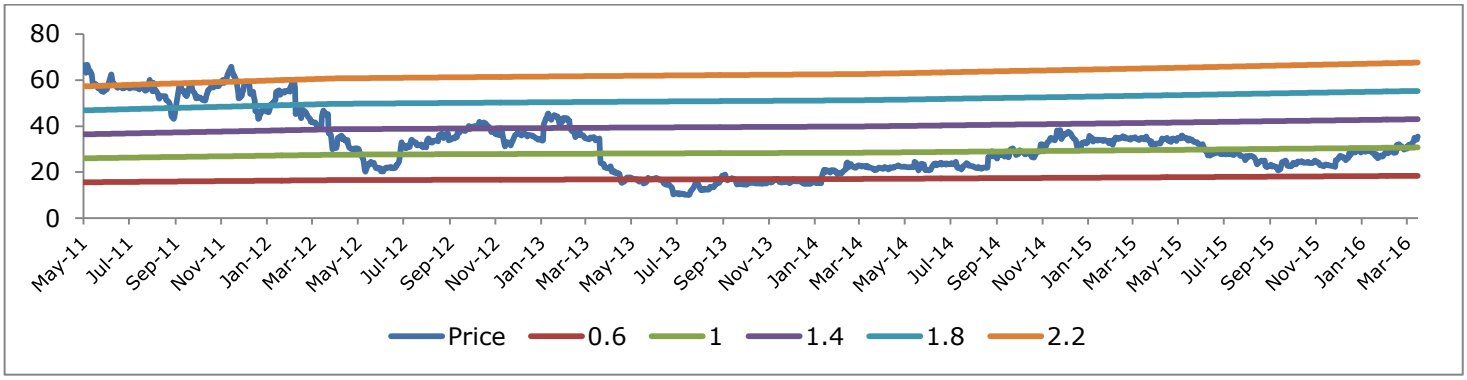
Valuation Analysis:

We reckon, the diversified non-gold loan mix that currently stands 8% of overall AUMs is likely to clock 24% Y-o-Y growth forming almost 25% of the total AUMs by FY19E. The steady gold loan traction and the robust non-gold mix should drive overall AUMs that are estimated to grow at strong 17-19% CAGR over FY16-18E.

Advantages emerging from strong retail customer base and rich retail franchise, improving cost matrix, higher leverage that should aid the non-gold business growth, decreasing auction amounts should boost earnings momentum translating into higher RoEs in forthcoming periods. We expect MGFL to clock RoEs at 14-15% and RoAs to step-up to 2.5%+ over FY16-18E. While the worst stands behind for MGFL, the recalibration of gold loan portfolio and widening of the product base should go a long way in driving the value growth. Moreover, robust capital base at healthy 25.6% and relatively lower leverage at 3.3x provides substantial headroom to boost future growth and enhance return ratios. Moreover, the consistent dividend payout records is icing on the cake.

We initiate coverage with a BUY recommendation on the stock with a target price of INR 52. We value MGFL at SoTP valuations, the core business (gold business) should attract value of 1.3x P/ABV FY17E, micro-finance at 2.5x P/ABV FY17E and housing finance at 1.3x P/ABV FY17E. Therefore, the sizeable increase in the microfinance business that is expected to grow at ~40% AUM CAGR from current 5 bn to INR 20 bn over next two years, per se should prove a substantial valuation trigger for MGFL. At CMP, the stock is trading at compelling valuations (for the core business) at 0.93x FY17E P/B and we reckon that MGFL definitely forms a re-rating candidate.

MGFL is a turnaround story – Price to fwd BV trend



Source: Company, KRChoksey Research

Peer Comparison

Particulars	Muthoot Finance					Manappuram Finance				
	FY11	FY12	FY13	FY14	FY15	FY11	FY12	FY13	FY14	FY15
Assets Under Management (AUMs) (INR mn)	**158,684**	**246,736**	**263,868**	**218,615**	**234,085**	**75,491**	**1,16,308**	**99,563**	**81,631**	**95,358**
Growth Y-o-Y %	*113*	*55*	*7*	*-17*	*7*	*190*	*54*	*3*	*-18*	*17*
Gold Loan AUMs (INR mn)	**157,281**	**244,173**	**260,004**	**216,179**	**233,499**	**74,665**	**1,15,145**	**99,458**	**81,552**	**92,245**
Growth Y-o-Y %	*114*	*55.2*	*6.5*	*-16.9*	*8.0*	*144.7*	*51.0*	*3.4*	*-18.0*	*13.1*
PAT (INR mn)	**4942.0**	**8920.0**	**10042.0**	**7801.0**	**6705.0**	**2826.6**	**5914.7**	**2084.3**	**2259.8**	**2713.2**
Growth Y-o-Y %	*117.2*	*80.5*	*12.6*	*-22.3*	*-14.0*	*136.1*	*109.2*	*-64.8*	*8.4*	*20.1*
No of branches	2733	3600	4000	4200	4245	2064	2908	3295	3293	3293
RoA	**4.2**	**4.4**	**4.1**	**3.2**	**3.0**	**0.0**	**6.0**	**1.7**	**1.9**	**2.4**
RoE	**51.5**	**41.9**	**30.2**	**19.5**	**14.4**	**0.0**	**27.5**	**8.6**	**9.2**	**10.6**
Capital Adequacy Ratio (%)	15.8	18.3	19.6	24.7	24.8	29.1	23.4	22.7	27.7	25.6
GNPA	0.3	0.6	2.0	1.9	2.2	0.3	0.6	1.2	1.2	1.1
NNPA	0.3	0.5	1.7	1.6	1.9	0.0	0.2	0.8	1.0	0.9
Earnings Per Share (INR)	15.8	24.3	27.0	21.0	17.0	3.8	7.0	2.5	2.7	3.2
Book Value per share (INR)	41.7	78.7	100.5	114.7	127.6	25.9	28.4	29.1	29.7	31.3
P/BV	**4.2**	**2.2**	**1.8**	**1.5**	**1.4**	**1.2**	**1.2**	**1.1**	**1.0**	**1.0**

Source: Company, KRChoksey Research

Investment Rationale:

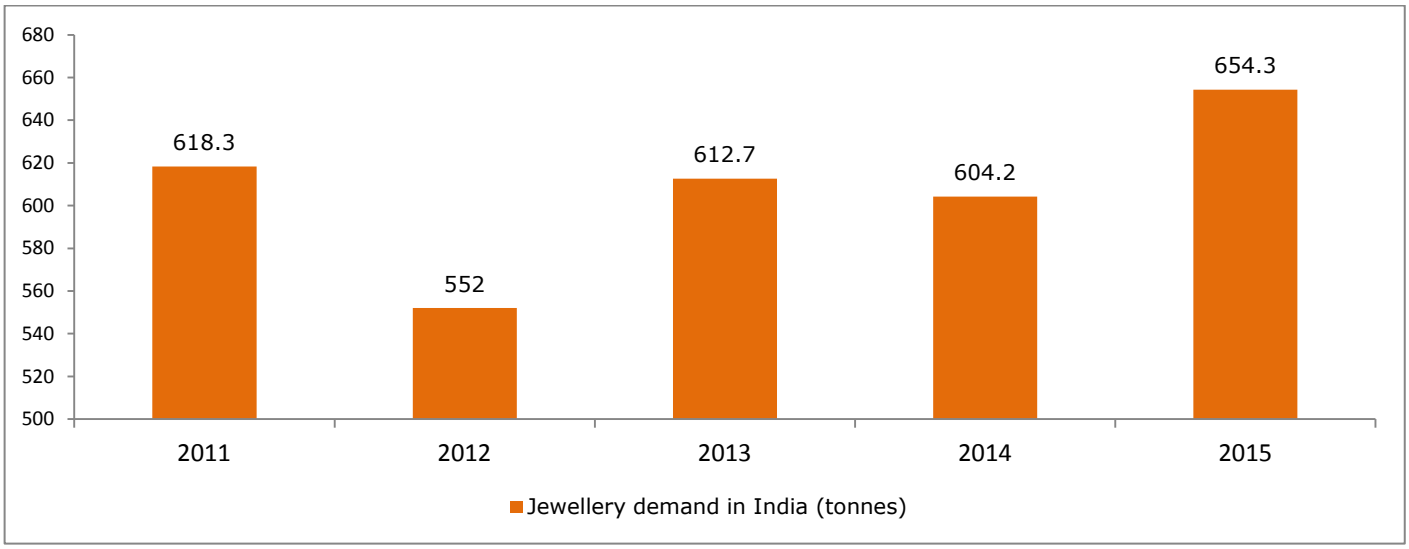
Large untapped market potential and re-orientation of the legacy gold loan portfolio:

With unabating gold demand especially triggered by rural and Southern India (here MGFL has stronghold), regulatory environment turning favorable, volatility in gold loan portfolio overdone and the recalibration of gold loan portfolio, MGFL is already basking in the steady growth trajectory.

Unabating gold demand; huge market potential:

India is known to possess large stocks of gold, estimated at about 23% of global gold stock as at the end of FY15. By end-December 2015, the gold holding for India stood at staggering 557.7 tonnes (as per the World Gold Council statistics). The nation is the largest consumer of gold jewellery in the world, together with China, and makes up over half the global consumer demand for gold. Such vast stock of gold in private hands offers ample opportunities for growth in gold loan business.

Buoyant gold jewellery demand

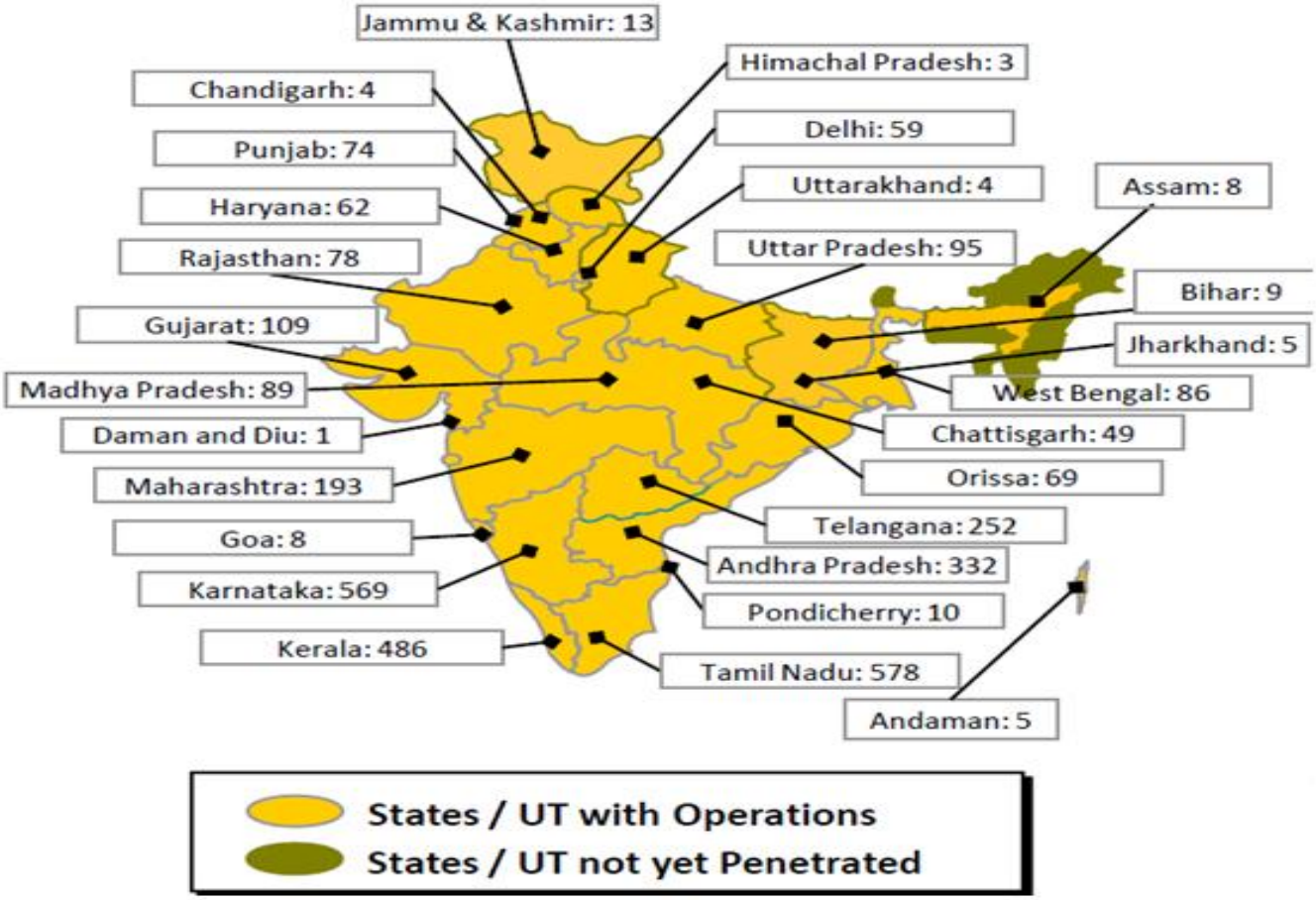


Source: Thomson Reuters GFMS, World Gold Council, KRChoksey Research

Besides, India's organized gold loan market of USD 800 bn largely lies under-penetrated at mere 3% providing a huge market potential for the gold credit push.

Pan-India branch network; location advantage

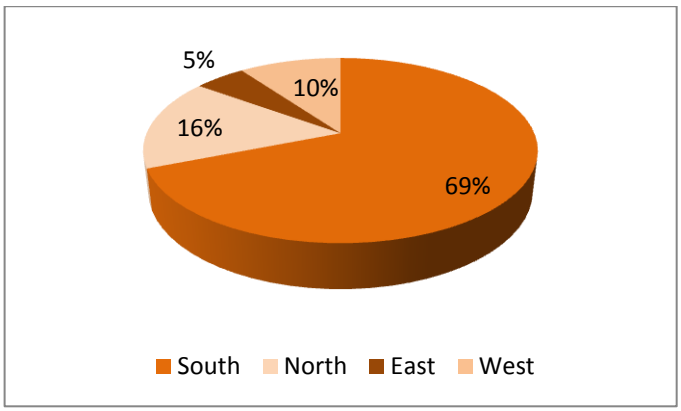
MGFL enjoys extensive pan-India presence through 3,293 branches spread across 23 states and 4 UTs in India. The company boasts of a strong presence in rural and semi-urban markets as more than 60% of the Gold is held in Rural India. Such a widespread distribution network has proved to be a key enabler for AUM diversification with Southern region contributing 66% of the total assets as against 87% in FY11.

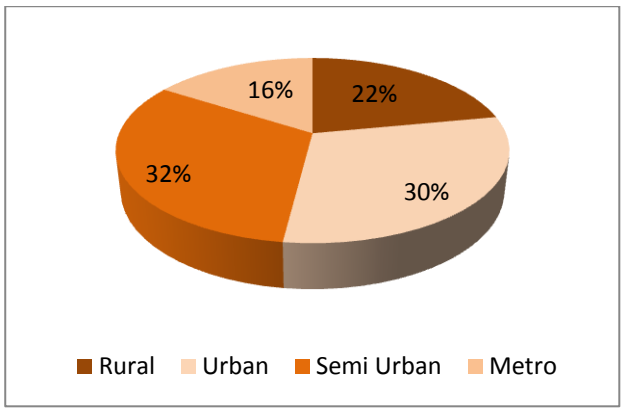


Source: Company, KRChoksey Research

Moreover, by virtue of MGFL's favorable location demographics; i.e, 69% of MGFL's network being entrenched in Southern belt that contributes ~40% of the gold demand in India and ~31%+ of the network spread across rural/semi-urban India that per se holds 60% of total gold stock, widens the opportunity size provides for MGFL.

Niche location advantage favoring gold loan business





Source: Company, KRChoksey Research

Focused Gold loan financiers maintain niche positioning:
The niche gold loan financiers (such as Manappuram and Muthoot) enjoy competitive advantage particularly in terms of their last mile connectivity, availability vis-à-vis the other organized lenders in the market. The benefits that these niche financiers enjoy primarily due to focused nature of their business, outnumber the other financiers in the organized lending market.

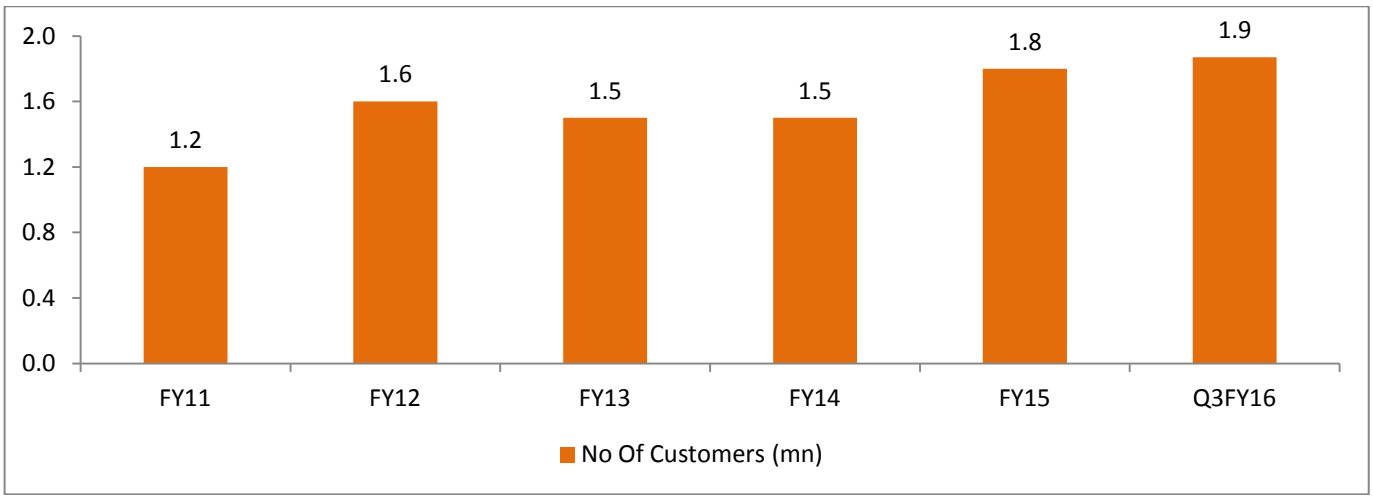
Gold loan NBFCs have an edge over other organized lenders

Parameter	Gold loan NBFC's	Banks	Moneylenders
LTV	Up to 75%	Lower LTV than NBFC's	Higher than 75%
Processing Fees	No / Minimal Processing Fees	Processing charges are much higher compared to NBFC's	No Processing Fees
Interest Charges	~18% to 24% p.a	~12% to 15% p.a	Usually in the range of 36% to 60% p.a.
Penetration	Highly Penetrated	Not highly penetrated. Selective Branches	Highly Penetrated
Mode of Disbursal	Cash/Cheque (Disbursals More than Rs. 0.1 mn in Cheque)	Cheque	Cash
Working Hours	Open Beyond Banking Hours	Typical Banking Hours	Open Beyond Banking Hours
Regulated	Regulated by RBI	Regulated by RBI	Not Regulated
Fixed Office place for conducting transactions	Proper Branch with dedicated staff for gold loans	Proper Branch	No fixed place for conducting business
Customer Service	High –Gold Loan is a Core Focus	Non Core	Core Focus
Documentation Requirement	Minimal Documentation, ID Proof	Entire KYC Compliance	Minimal Documentation
Repayment Structure / Flexibility	Flexible Re-Payment Options. Borrowers can pay both the Interest and Principal at the closure. No Pre-Payment Charges.	EMI compulsorily consists of interest and principal. Pre-Payment Penalty is Charged.	-
Turnaround Time	10 minutes	1-2 hours	10 minutes

Source: Company, KRChoksey Research

Enhanced marketing initiatives to augment gold loan customer base:
During the golden period of business boom (era of high gold prices), the company witnessed direct walk-in customers without any marketing push. However, with the fall which came by due to stringent regulations, volatility in gold prices, the customer footfall only declined. With business back in reckoning in FY15, MGFL modified its marketing strategy ensuring branch activations across key markets. January 2014 onwards, MGFL switched to customer pull strategy enhancing branch activation and marketing initiatives. With MGFL franchise turning more customer friendly, the increased marketing efforts and improved branch level performance augured well for customer augmentation. Over the past five years, MGFL has witnessed 10% CAGR in customer addition.

Marketing push strategy leading to customer accretion



Source: Company, KRChoksey Research

Favorable Regulatory environment and Re-calibration of gold loan portfolio:
Having witnessed the turbulent times for couple of years, gold loan NBFCs regained their footing and succeeded in making their business resilient to gold price volatility in FY15. The September 2015 quarter, in particular, marked the turnaround with gold loan business back on track. While the gold price volatility had dampened the enthusiasm for gold loans among banks that turned less aggressive then, NBFCs gained some market share post FY15.

With MGFL being no exception, the business turnaround for the company was marked by:

(a) Stability on the regulatory front: With regulatory overhang subsiding in 2013, the change regulatory stance in September 2013 brought huge respite setting the stage of revival for the gold loan sector as a whole. The loan-to-value (LTV) ratio of NBFCs was revised higher to 75% (earlier 60%) that resulted in level-playing field for NBFCs vis-à-vis banks.

Regulatory changes across cycles and the ramifications on the MGFL's gold loan business

Phase 1: Strong growth witnessed supported by rising gold prices	Phase 2: Regulatory overhang impact along with falling gold prices	Phase 3: On a revival path; witnessing the growth back
Higher LTV up to 85%	**March 2012:** Removal of PSL status-	**Sep 2013: Regulatory changes by RBI**
Lower CoF due to eligibility under PSL	Led to higher borrowing cost	Increased the LTV ratio for gold loans to 75%:
Supported by buoyant economic growth	**March 2012:** Cap on LTV to not exceed >60%-	Resulting into level playing field for NBFCs vis-à-vis commercial banks
Long tenure products supported by rising gold prices	Weakened competitive positioning vis-à-vis	
	banks & moneylenders	**Jan 2014: Reaching out to the customers**
Strong competitive positioning:	Higher LTV focused customers moved to moneylenders	Through enhanced marketing & branch activation initiatives
Better LTV, Lower RoI vis-à-vis moneylenders,	whereas interest rate sensitive customers moved to banks	
Prompt disbursement, convenience of palce/time	Cap on maximum borrowing upto INR 2.5 mn	**Jun 2014: De-linking to gold prices:**
	Fall in Gold Prices	Shift from long tenure products to short tenure (3-9 months)
	Peak LTV was 85% for FY12 & long tenure PF	Recalibrated LTV ratio to link it to the loan tenure:
		Maximum permissible LTV of 75% to be available on loans of shorter tenure rather than 1 year
		Shifted 2/3rd of total gold loans PF to these shorter tenure products

Source: Company, KRChoksey Research

(b) Re-calibration of the gold loan portfolio that brought about operating efficiencies and positive earnings for the company.

By de-linking it to gold prices and aligning it to the tenure of the loans, MGFL insulated its gold loan portfolio form the volatility of the gold price fluctuations. The migration from the erstwhile long tenure products (12 month product) to shorter tenure products (3, 6 and 9 month products) with higher LTVs for shorter tenures and tad lower for long tenure products has ensured growth with quality for the legacy business of MGFL.

MGFL strategy in order to strengthen core gold loan business:

STRENGTHENING THE CORE BUSINESS – GOLD LOAN BUSINESS RE-ALIGNMENT STRATEGY

Introduction of shorter tenure products

Re-calibration of LTVs by linking it to tenures of the products

Focus on Branch Activations, employee performance & marketing initiatives

Source: Company, KRChoksey Research

In the erstwhile 12-month product with 75% LTV, the Principal + Interest component used to turnout 93% of gold value leaving meager margin of safety. Many times, thanks to the gold price correction, the principal+interest payment component exceeded the pledged value of the gold leading the 12-month product to run out-of-the-money in 8-month itself. Furthermore, if the customer failed to honor his payments by the end of 12-month period, then another 2-month auction period would imply additional interest loss for the company.

Gold Loan product metamorphosis

	Earlier Scenario	**Current Revised Scenario- 3 to 6 month Short Tenure products**			
Particulars	**12-month Long Tenure single product**	**3-month long tenure product**	**6-month long tenure product**	**9-month long tenure product**	**New-12-month long tenure product**
Gold Value	100	100	100	100	100
LTV	75%	75%	70%	65%	60%
Gold Loan	**75**	**75**	**70**	**65**	**60**
Interest Rate	24%	24%	24%	24%	24%
Interest Cost	**18**	**4.5**	**8.4**	**11.7**	**14.4**
Total Principal + Interest	**93**	**79.5**	**78.4**	**76.7**	**74.4**
	If the customer does not pay or close the loan, then there is likely loss of interest for 2 months during auction	If the customer does not pay or close the loan, then there is a ample margin of safety to recover principal as well as interest. Also, linkage to gold prices is negligible.			

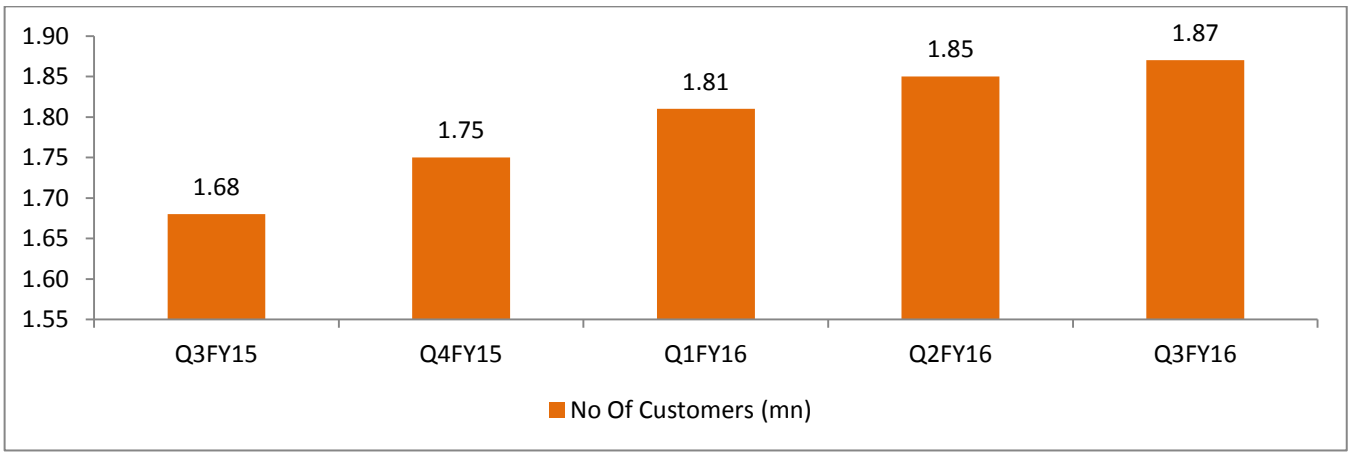
Source: Company, KRChoksey Research

To combat such losses, in June 2014, MGFL discontinued the earlier long tenure single product. The company strategically chose to shift its entire gold loan product to new products with shorter tenures of 3, 6 and 9 months to insulate the business from sharp fluctuations in gold prices and thereby improving margin of safety. With shift to the short tenure products with average tenure now being 3 to 4-months as against 4 to 5-months earlier, left ample margin of safety to recover principal+interest component. While the LTVs now stand higher at 75% for shortest tenure product (i.e. 3 –month), with every quarter extension for loan repayment, the LTV reduces by 5.2%. The average LTV stands at around 70% and the maximum LTV ratio stands capped at 75%. With these measures in place, MGFL has witnessed timely recoveries, increased collections and has succeeded in guarding the portfolio from the price volatility.

Re-calibration of gold loan portfolio – increased customer base

Besides the benefit to the lender, such short tenure products also have proved to be customer friendly in the sense that the interest-sensitive customers can now choose to lower interest product, LTV sensitive customers can choose higher LTV product in lieu of longer tenure loan schemes of yesteryears. This is rightly testified by the fact that the company added almost 2.93 lakh new customers (with average LTV of 70%) taking the total count to staggering 18.72 lakh as at the end of December 2015 quarter.

Customer additions trend



Source: Company, KRChoksey Research

Re-calibration of gold loan portfolio – reduction in auctions; improved collections

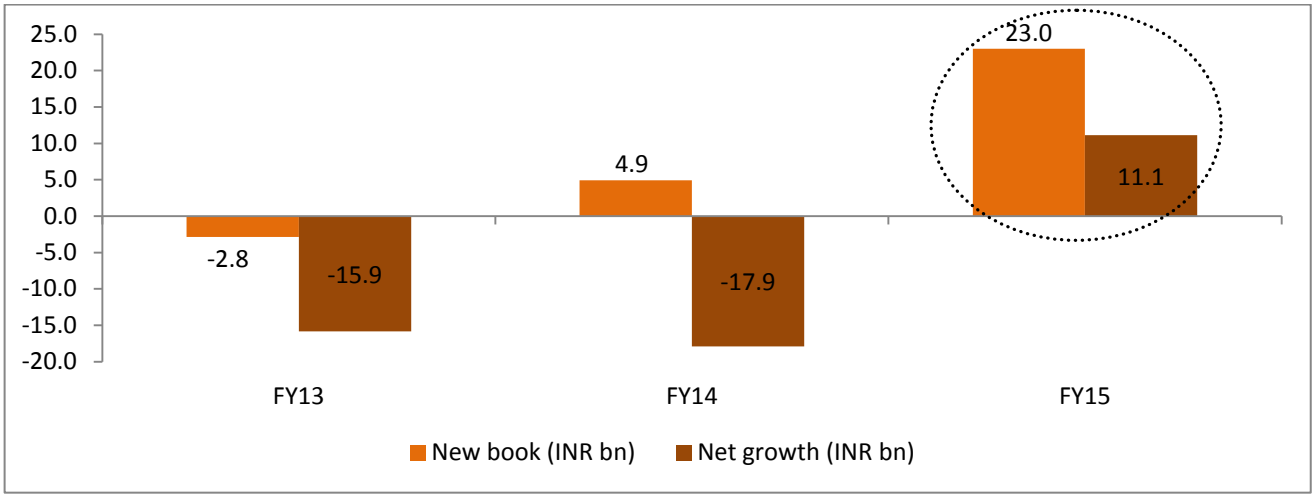
Fluctuations in gold prices led to higher auctions of pledged ornaments in the past. Post paring down of the legacy long tenure gold loan portfolio back in June 2015, the auctions number witnessed sharp decline thereafter. The September quarter 2015 turned out to be crucial for MGFL in the sense that the company witnessed an aberration during the period with entire legacy gold portfolio being auctioned; the gold auctioned-to-disbursements ratio climbing as high as 10% then.

However, post the clean-up and re-alignment of the gold portfolio, the gold auctioned-to-disbursements ratio recuperated meaningfully normalizing at 5% levels. The shift from long tenure to shorter tenure products left marginal leeway for the customers to default resulting into abatement of auctions for MGFL. Unlike the bullet payments made earlier at the end of 12-month period, the customers today are obliged to pay across 3 to 4-months time frame which in turn has translated into lower auctions and improved collections for the company. With higher thrust on interest collections, MGFL has introduced regular, periodical collections across branches.

Therefore, de-risking the gold portfolio and making it resilient to corrections in gold prices, MGFL has witnessed decline in auctions by staggering 50% Q-o-Q to INR 3.9 bn (December 2015) from 8 bn in the September quarter 2015. Meaningful reduction in auction in FY15 brought the MGFL book growth back into the positive territory. Going forward, the run-rate of gold auctions in near term should remain steady at INR 4.5-5.0 bn as cited by the Management.

As depicted in the following exhibit, while the new book expanded, the net growth (Net growth = New book – Auction) improved and stood positive with reduction in auctions.

Return of growth – reduction in number if auctions

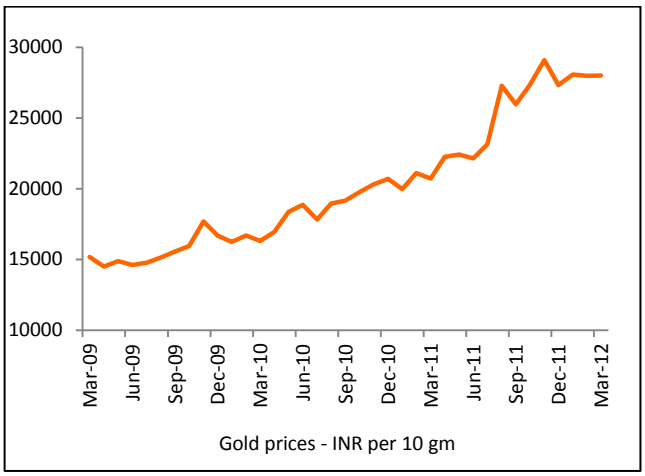


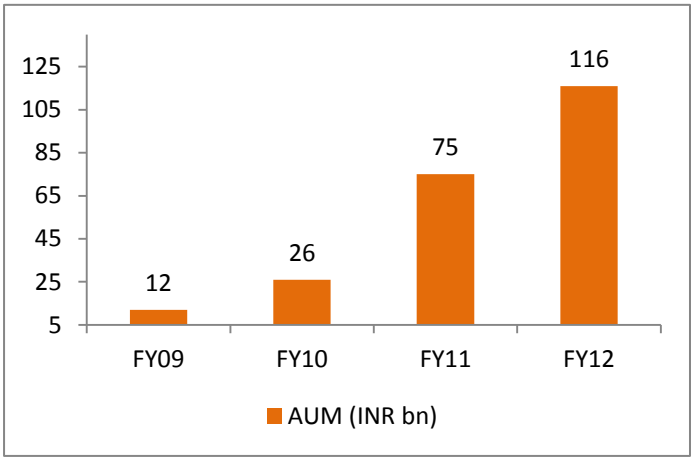
Source: Company, KRChoksey Research

Re-calibration of gold loan portfolio – upsurge in pledged gold; AUM traction

The golden period of FY08-12 was characterized by buoyant growth (95% AUM CAGR), stupendous NIMs (16%+) supported by higher yields, and lower costs. The branch network almost grew 7x during the period backed by strong execution capabilities and well defined systems & processes.

Period between FY09-FY12: The golden period: Higher gold prices, higher AUMs

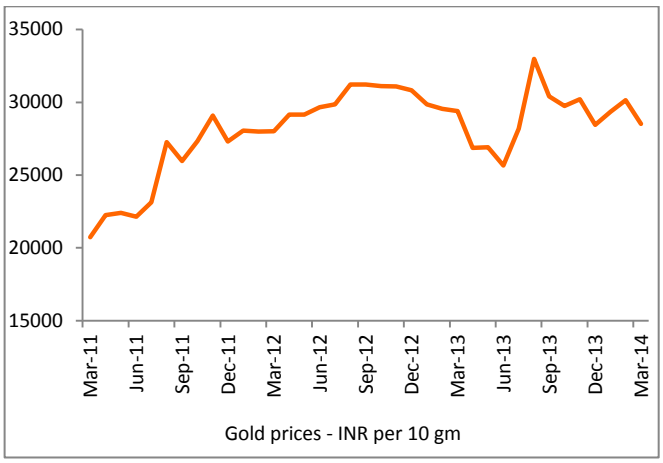


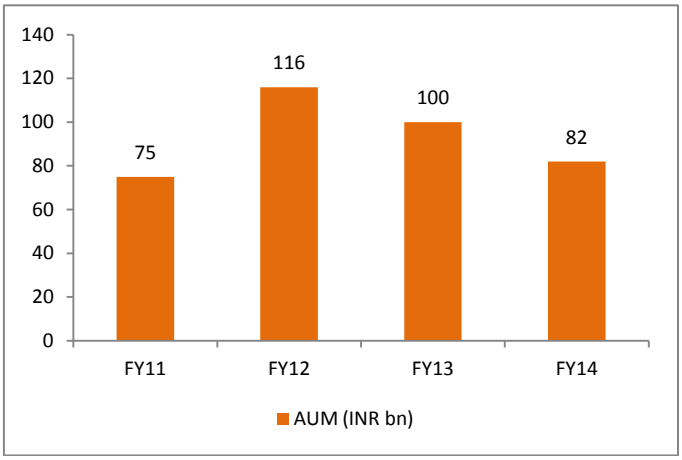


Source: Company, KRChoksey Research

However, tables turned in FY12 with gold prices plunge, cap on LTV, cap on borrowings (maximum borrowing upto INR 2.5 mn) dampening the operating leverage and the profitability of the company. NIMs declined to almost 10.4%, tapered to 8.5% and opex/AUM ratio stood at 7% levels hindered by waning AUMs (~30% fall in AUMs) during the turbulent period of FY12-14. This in turn depressed the return ratios and profitability.

Period between FY11-FY14: The turbulent period: Gold prices plunge, AUMs decline

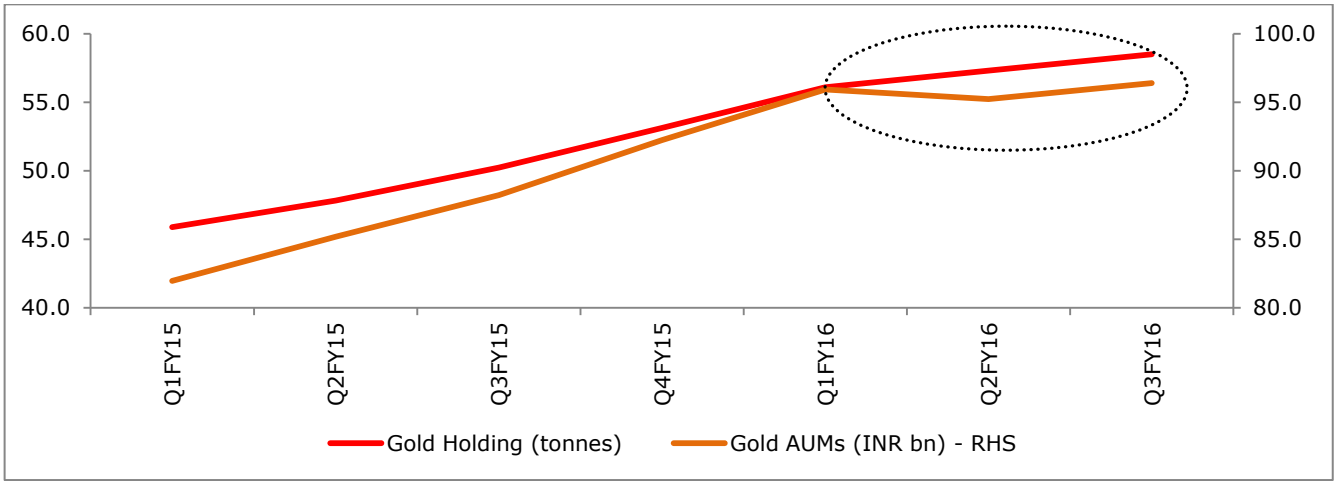




Source: Company, KRChoksey Research

Today, with major gold loan worries overdone, MGFL's gold loan portfolio has met success with prompt disbursements and lesser turnaround time, reduction in auction losses as a result of shift to short tenure products, flexibility of re-payment options and discretionary utilization of such gold loan funds for end user consumption. Post re-engineering of the legacy business, the customer base has surged by nearly 3 lakh, while the gold security pledged with the company too has risen to 58.5 tonnes (December 2015 quarter) from 50.2 tonnes (in corresponding quarter a year ago).

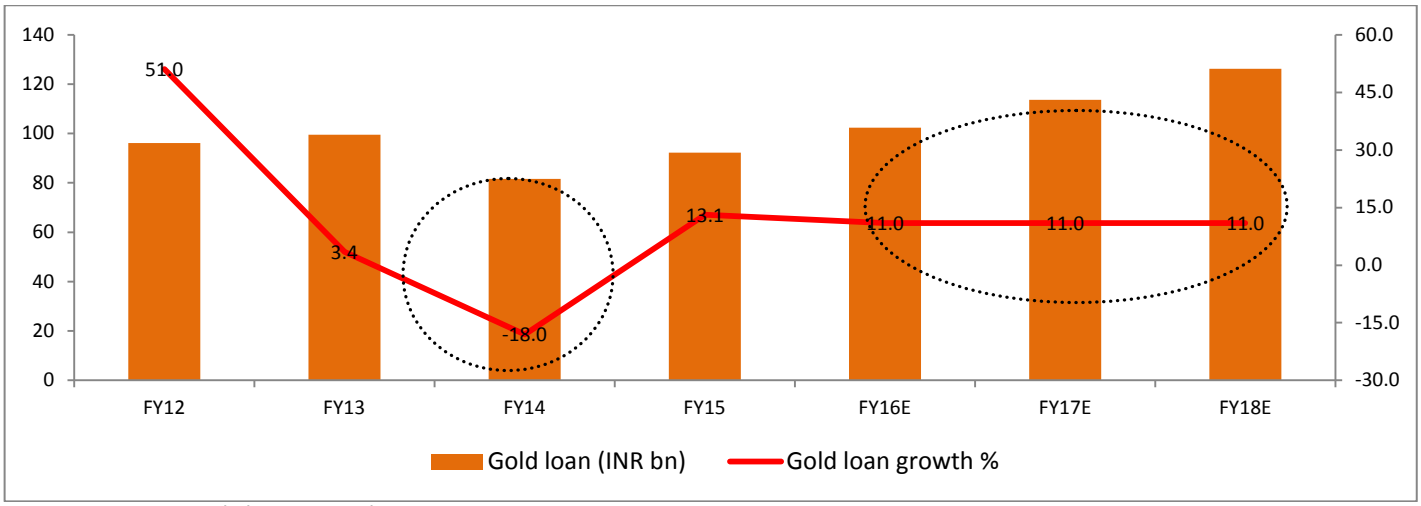
Gold AUMS – back in reckoning



Source: Company, KRChoksey Research

Today, with increased collateral, improved collections and upsurge in shorter tenure loans the gold loan portfolio is expected to maintain steady-state performance clocking sustainable 10-12% Y-o-Y AUM growth over FY16-18E.

Worries overdone, re-engineered gold loan portfolio in place, gold loan AUMs should exhibit steady show ahead



Source: Company, KRChoksey Research

Diversified product strategy – Move from Gold to Gold+

Reducing reliance on single and volatile product, MGFL diversified its business into synergistic RoE accretive product segments by utilization of surplus funds coupled with marketing push strategy. From being a single product NBFC to a diversified product franchise, MGFL expects almost 50% of AUM to emerge from non-gold products over next five years.

Why Gold+ ? The rationale to diversify into non-gold product segments stems from the following factors

NEW SYNERGISTIC GOLD + BUSINESS

Strategy to utilise surplus capital to build or acquire new lending products
Objective to reduce business concentration risks and climb up the value chain
Leveraging upon existing retail customer base, retail branch network and the strong brand equity
Leveraging upon operational capabilities to process large volume, small ticket lending in the semi-urban and rural markets
Enhancement of revenue matrix and thereby improvement in return profile of the company

Source: Company, KRChoksey Research

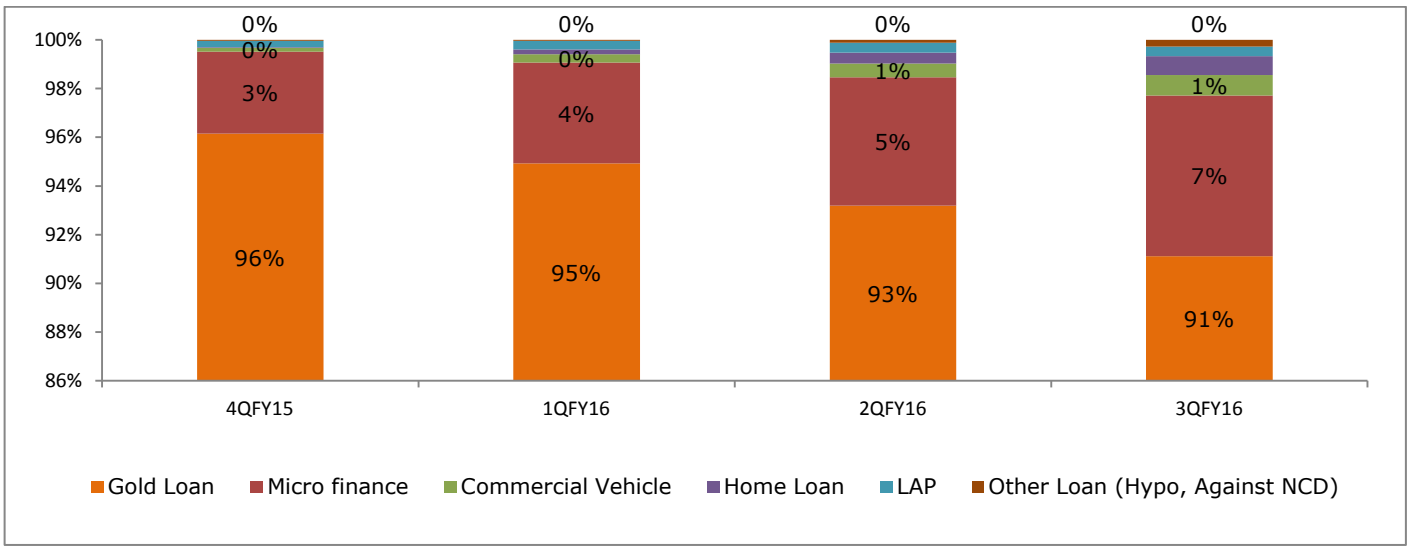
Leveraging upon strong brand equity and existing retail customer base and utilizing surplus capital, MGFL has diversified into synergistic non-gold or Gold+ products, viz; microfinance, mortgage & housing finance, commercial vehicle lending. The company aims to mitigate business concentration risks and capitalize on its proven operational capabilities with complete focus on small ticket lending in the semi-urban and rural markets.

MGFL product dynamics:

MGFL Product profile	Customer profile	AUMs (Q3FY16, INR mn)	% of total AUMs	Loan ticket size (INR lakhs)	Loan tenure (months)	LTV (%)	IRR (%)	RoA (%)	No. of States	Branch network	Key competitors
Gold	Just above the bottom of the pyramid like vegetable vendors, hawkers, small traders, clerks & blue collar workers. Reason for taking gold loan - 1/3rd for need, 1/3rd for working capital & 1/3rd for consumption	96,392	91.1%	0.3	4 to 5	67%	22-23%	2.5%	23	3293	NBFC's - Muthoot Finance, Shriram City Union, Muthoot Fincorp, etc. Banks -South-based banks such as Federal Bank & South Indian Bank
Microfinance	Target Segment - Bottom of the pyramid. Loans provided mainly to womens group (JLG) for income generating purposes.	6,983	6.6%	0.2	12 to 24		24%	4.0%	271	12	Equitas, Janalakshmi Financial, Ujjivan Financial Services, ESAF Microfinance, etc
Commercial Vehicle fina	First time buyers having prior driving experience & now wants to start on his own. Target geographies: semi-urban areas & outskirts of cities in south & west. (70% of the portfolio is used vehicles)	895	0.8%	6.2	36 to 48	75-80%	18-19%	Business is nascent stage right now. They would take some time to turn profitable. Company expects ~1.5% ROA by FY18	31	4	Shriram Transport Finance, Cholamandalam, India Infoline, etc
Mortgage finance									24	8	
LAP	Business Needs of SME's	414	0.4%	25.0	60 to 72	70-75%	15%	Business is nascent stage right now. They would take some time to turn profitable. Company expects ~1% ROA by FY18			
Home Loan	Affordable housing for the mid to low income group. Self employed person such as Traders, shop keepers, etc in semi urban & city outskirts. These are people who generally don't get loans from banks.	815	0.8%	15.0	180 to 240	70%	14%	Business is nascent stage right now. They would take some time to turn profitable. Company expects ~1% ROA by FY18			Aptus, Equitas, Aspire HFC and AU Financiers, etc

Source: Company, KRChoksey Research

The AUM mix depiction for MGFL post diversification



Source: Company, KRChoksey Research

Micro finance Industry Overview - resurgence

With the catastrophic Andhra Pradesh microfinance situation of 2010 behind and the favorable regulatory intervention by the RBI, the microfinance sector has been witnessing growth in loan portfolio.

Dominated by five large micro finance institutions (MFIs), the top five accounted for approximately 57% of the overall MFIs' loan portfolio (outside Andhra Pradesh and Telangana). Bandhan Financial Services, which received an approval from the Reserve Bank of India to commence banking operations, led with a loan portfolio of INR 9,530 crore, followed by SKS Microfinance Limited (INR 4,171 crore), Janalakshmi Financial Services (INR 3,773 crore), Ujjivan Financial Services (who recently received a small finance bank license) (INR 3,274 crore) and Equitas Microfinance (INR 2,144 crore).

According to the CARE Report, the Indian microfinance sector has traversed through three broad tumultuous phases in the past – (a) high growth (till 2010), (b) high volatility (2010-11) and (c) consolidation (2011-13). Post 2013, the industry has entered into the fourth phase characterized by a more stable regulatory environment, steady availability of funds, improving profitability with comfortable asset quality and capital adequacy and relatively lesser impact of concentration risk.

Post AP crisis, the most positive development for the Micro finance space emerged from the clarity from Reserve Bank of India (RBI) that helped stream-line the business models of MFIs. Amongst other crucial developments, capping the borrowing limit per person and restricting the number of MFIs a person can borrow from should go a long way in benefitting the existing micro finance players. Besides, it has become mandatory now for MFIs to submit data to credit information bureaus with credit performance report which should help guard their asset quality in a big way.

Positive regulatory developments

NBFC–MFIs	Qualifying assets to constitute not less than 85% of its total assets (excluding cash and bank balances) At least 50% of loans for income generation activities
Qualifying Assets Criteria*	**Norms**
Income of Borrower's Family	Rural : <=Rs.100,000 Non-Rural : <=Rs. 1,60,000
Ticket Size	<= 60,000 –1stcycle <= Rs.100,000 –Subsequent cycle
Indebtedness	<= Rs. 100,000
Tenure	If loan amt. > Rs.30,000, then >= 24 months
Collateral	Without Collateral
Repayment Model	Weekly, Fortnightly and Monthly
Interest Rate	A. Margin cap –10% above cost of borrowings B. Avg. base rate of top 5 commercial banks X 2.75 Lower of the A and B.
Processing Fees	<= 1% of loan amt
Insurance Premium	Actual cost of insurance can be recovered from borrower and spouse Administrative charges can be recovered as per IRDA guidelines
Penalty	No penalty for delayed payment
Security Deposit	No security deposit/ margin to be taken

Source: RBI, KRChoksey Research

The microfinance industry in India posted strong growth in FY15 with an increase in new loan disbursements, Gross Loan Portfolio, clients, employees and branches as depicted in the matrix hereunder.

Microfinance industry- resurgence

Particulars	FY14	FY15	% increase
Disbursements (INR crs)	35118	54591	55.5
Gross Loan Portfolio (INR crs)	24862	40138	61.4
No. of clients (Unit - crs)	2.4	3.1	29.2
No. of employees	66959	80097	19.6
No. of branches	9741	10553	8.3

Source: MFIN Micrometer 2015, KRChoksey Research

Not just the growth profile but micro finance industry has also showcased robust credit profile of MFIs on account of improving funding profile, control in operating expenses, improving margins post removal of interest rate cap and moderate leverage levels. The credit quality of MFIs stand supreme with Portfolio at Risk (PAR) figures (PAR 30,90,180 days) remaining under 1% for FY15. With credit bureaus; viz, Equifax and Highmark in place, 95% of MFIs now use CB reports for disbursements.

Micro finance business for MGFL- key value trigger for overall business growth

With change in competitive landscape in the microfinance industry and the regulatory environment turning favorable, MGFL foray into the industry comes at an opportune time. Acquiring 84.98% stake back in February 2015 in one of the leading MFIs of India based out of Tamil Nadu; namely, Asirvad Microfinance Private Ltd (refer the matrix hereunder for overview of quality of the microfinance subsidiary), MGFL focuses on lower income group falling in the bottom of the pyramid catering primarily to the women's group (JLG) for income generating purposes. While the average loan ticket size stands at INR 20,000, few such loans stand well collateralized as against rental property or at times against gold (in instances wherein the women opt for additional finance for funding say child education, marriage, etc) guarding asset quality. Moreover, the micro finance arm of MGFL stands in full compliance with the regulatory norms.

Business Snapshot – Asirvad Microfinance – superior performance trends

Particulars	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15
Operational Metrics								
No. of members enrolled	6092	57276	147850	334135	387535	426489	531760	700628
No. of Active Members	6092	48425	126483	219043	173109	113416	211260	277615
No. of Centres	235	2152	6137	12380	15205	17375	25958	36083
No. of Branches	2	19	49	85	78	64	94	141
No. of Districts covered	2	7	14	22	21	20	30	44
No. of States covered	1	1	1	1	1	1	4	5
Headcount metrics								
Total Staff	19	130	327	531	416	280	351	553
Cumulative LTD disbursals (INR lakhs)	305	2570	11889	31487	46067	59551	84009	122933
O/S Gross Portfolio (INR lakhs)	286	1509	6243	10101	7937	10246	18882	32200
Delinquency Metrics								
PAR (Portfolio at risk) (INR lakhs)	-	-	2	63	1	0	5	27

Source: MFIN Micrometer 2015, KRChoksey Research

The Management maintains supreme confidence in traction in microfinance segment, rightly corroborated by the encouraging words of the Managing Director, Mr. S.V. Raja Vaidyanathan:

"During FY15, Asirvad Microfinance started operations in the state of Karnataka and in the Union territory of Puducherry thereby deepening our presence. The branch network grew by 50% during the current year, which will serve as a springboard for our growth in the forthcoming years. The portfolio grew without any undue spurt in delinquencies, which shows the process efficiency and strict compliance of the organization to the regulations laid down by the Central bank". (Source: Annual Report 2014-15, Asirvad Microfinance Private Ltd.)

As at the end of December 2015 quarter, the micro finance assets under Management (AUMs) stood to the tune of INR 6.9 bn forming 6.6% of the overall AUM mix. MGFL aims to grow micro finance asset book at robust 50%+ CAGR over FY16-18E. This strong feet achievement will hinge upon following key drivers:

(a) Expansion of Micro finance footprint from three states (Kerala, Tamil Nadu and Karnataka) prior to acquisition to across 11 states, viz; Madhya Pradesh, Chhattisgarh, Punjab, Haryana, Chandigarh, Uttar Pradesh, Bihar, Jharkhand post acquisition. Leveraging upon the rich MGFL network, such an expansion drive will not only aid AUM traction but also will go a long way in mitigating geographic concentration risks in lines of the AP crisis.

(b) Strong capital adequacy in the micro-finance subsidiary; however, MGFL plans for capital infusion the next fiscal given the aggressive growth targets.

(c) Upgradation of credit rating post acquisition on the back of MGFL's patronage. This should bring cost efficiencies and credibility.

(d) Conversion of major MFIs into small finance banks leaving immense opportunities for growth for players such as MGFL.

With AP crisis behind, and the acquisition of a quality business in disguise of Asirvad finance, the micro finance business is poised to deliver robust traction and superior returns over the next two to three years.

Micro finance Business- biggest value driver for MGFL- poised to deliver 60%+ CAGR over next two years

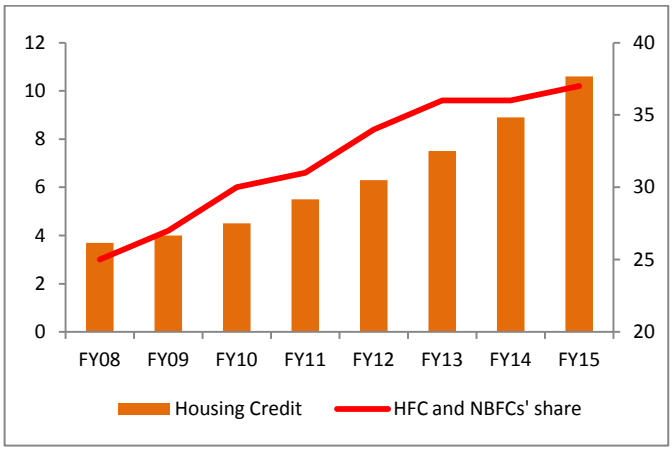
	FY15	FY16E	FY17E	FY18E
Microfinance Loan (INR mn)	**2642.8**	**7399.8**	**12727.6**	**19346.0**
Growth Y-o-Y	-	*180.0%*	*72.0%*	*52.0%*
% of Overall Loan mix	*2.8%*	*6.6%*	*9.5%*	*12.0%*

Source: Company, KRChoksey Research

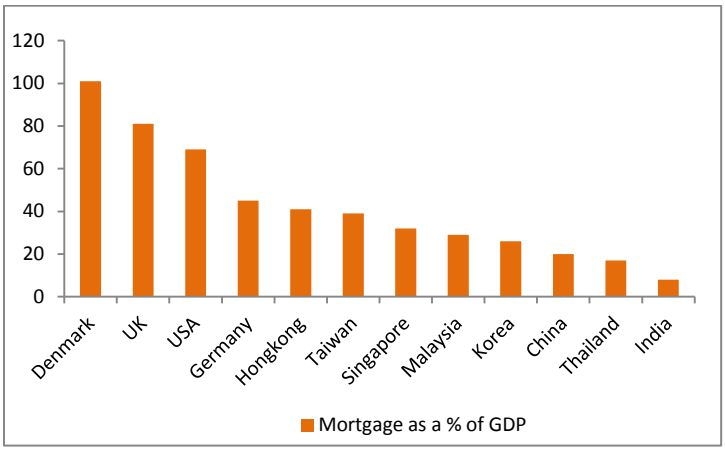
Mortgage Finance Industry Overview -

Largely dominated by private banks and few NBFCs, the home finance segment has witnessed a robust 26.6% CAGR over FY10-14. Indian Mortgage industry continues to grow at 19-21% in FY16 and is poised to expand further. Besides, India's mortgage finance market stands largely under-penetrated vis-a-vis the rest of the world providing ample opportunity for housing financiers to step-up their housing credit.

Robust housing credit



... lowest mortgage penetration



Source: Company, KRChoksey Research

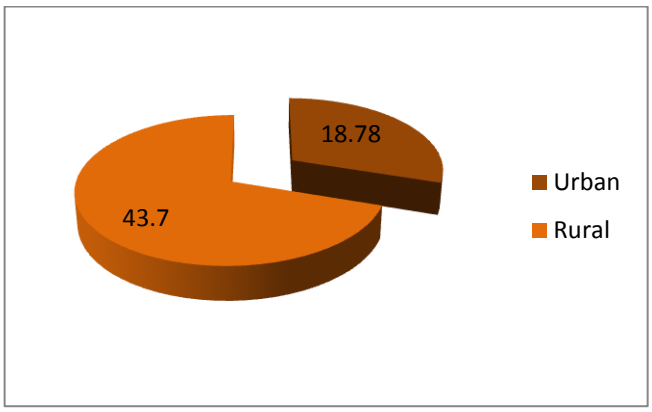
Affordable housing finance segment: key value driver for housing finance traction

Affordable housing finance is a focus area of the incumbent government given its objective of financial inclusion. The government has launched numerous schemes to promote housing finance in the lower income segment. As per the National Housing Bank (NHB) data, the overall size of housing finance market stands at INR 8.8 tn; whereas the size of organized lower income housing market stands at around INR 11 trillion, paving way for credit boost especially for companies with exclusive lower income segment focus.

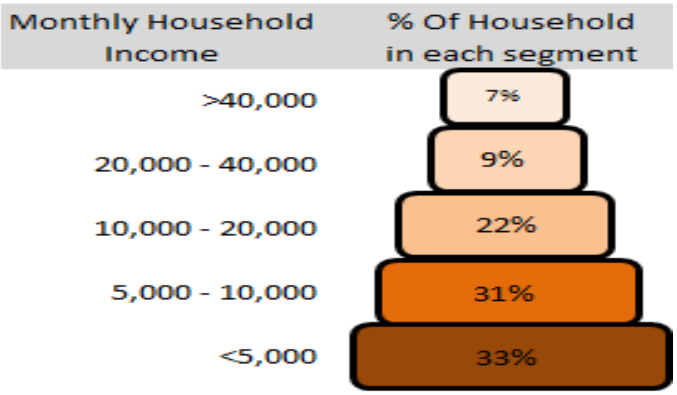
Furthermore, the lower income segment lies largely untapped with huge potential to expand predominantly due to:

(a) Unmet demand of housing
(b) Low penetration levels in the LMI segment provide significant potential for housing finance companies
(c) Borrowers in this segment generally have lesser access to institutional sources of housing finance
(d) Rising proportion of working age population (nearly 2/3rd of population is in the 15 to 64 years age group3) and increasing nuclearisation of families will further drive demand.

Unmet demand of housing (Mn Units) in 2012-17 ..



Market segments in housing finance



Source: Company, KRChoksey Research

Mortgage and Housing Finance business for MGFL – geared for growth

Commencing operations in January 2015, MGFL made headway into the competitive mortgage and housing finance market by acquiring Milestone Home Finance Company Pvt. Ltd. which later was re-named as Manappuram Home Finance Pvt. Ltd. (MAHOFIN). With focus on the affordable housing for mid to low income segment, MAHOFIN set the housing finance operation in motion from four branches; viz, Mumbai, Pune, Chennai and Madurai in the initial phase. The company aims to expand the housing footprint with more branches in urban and semi-urban markets of South and West India.

Given the buoyant demand particularly in the affordable low income housing finance segment, professional management, strong brand image, robust IT support, attractive home loan products, the company envisages to grow the housing finance business into a full-fledged asset portfolio of INR 6000+ mn FY18E. While MGFL is in the process of scaling up the housing finance business, the AUMs have already grown to staggering INR 1,229 mn in a year's time frame. Currently, the housing finance contributes 1% to the overall AUMs of the company and this share should only rise, climbing to 4% over next two years.

Home loans – robust CAGR of 100%+ expected over next two years

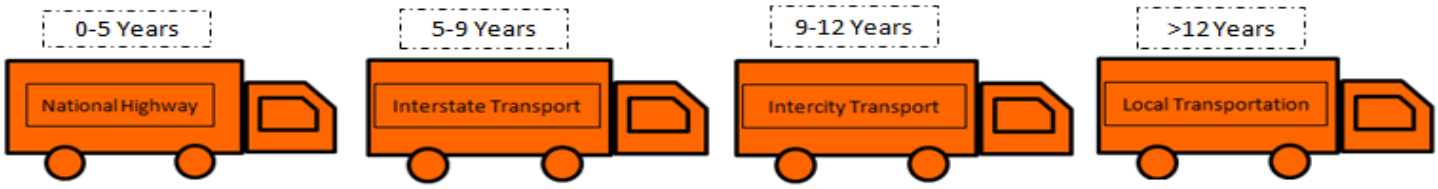
	FY15	FY16E	FY17E	FY18E
Home Loan (INR mn)	**21.7**	**1324.3**	**3112.1**	**6006.4**
Growth Y-o-Y	*NA*	*6000.0%*	*135.0%*	*93.0%*
% of Overall Loan mix	*0.0%*	*1.2%*	*2.3%*	*3.7%*

Source: Company, KRChoksey Research

Commercial Vehicle Finance Industry Overview

Across life cycles, Commercial Vehicles provide greater opportunities for vehicle financiers to step-up their credit depending upon the expertise of each.

CV Life Cycle: Multiple Financing Opportunities



Source: Company, KRChoksey Research

However, past three years have witnessed business slack for most of the CV financiers. Slowing economy coupled with issues such as mining ban that impacted freight availability, steep increase in diesel prices without adequate pass-through in freight rates impacting operator cash flows resulted in deceleration in demand for CVs over past few years.

Domestic Commercial Vehicles - Sales Trends

		FY09	FY10	FY11	FY12	FY13	FY14	FY15
Vehicles Sold (Industry Data)	LCV (Units)	200,699	287,777	361,846	460,831	524,887	432,233	382,206
	Growth Y-o-Y (%)		*43.4*	*25.7*	*27.4*	*13.9*	*-17.7*	*-11.6*
	MHCV	183,495	244,944	323,059	348,701	268,263	200,618	232,755
	Growth Y-o-Y (%)		*33.5*	*31.9*	*7.9*	*-23.1*	*-25.2*	*16.0*
	Total	**384,194**	**532,721**	**684,905**	**809,532**	**793,150**	**632,851**	**614,961**
	Growth Y-o-Y (%)		***38.7***	***28.6***	***18.2***	***-2.0***	***-20.2***	***-2.8***

Source: SIAM, Company, KRChoksey Research

Going ahead, with stronger recovery in CV segment led by IIP traction, recommencement of mining and pick-up in construction activities, falling diesel prices, freight capacity expansion (freight capacity is expected to grow at 1.25x GDP growth going forward), increased utilization levels and higher replacement demand should continue to trigger demand for Commercial Vehicle segment. While MHCV segment has already witnessed traction, the LCV segment recovery comes with a lag. The

However, going by the recent trends as depicted in the exhibit below, CV sales have entered the growth of positive territory with MHCV sales reporting robust 32% Y-o-Y growth for the 10-mont period of FY16. Overall, the CV sales have registered decent 9% Y-o-Y growth for the same period.

Domestic Commercial Vehicles - Sales Trends – MHCVs picking up faster

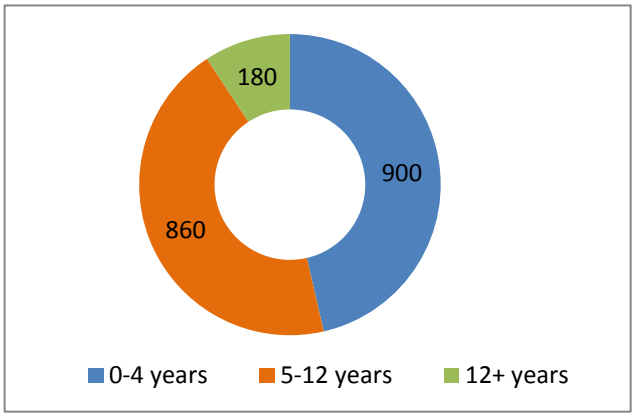
		Jan-15	Jan-16	10m FY15	10M FY16
Vehicles Sold (Industry Data)	LCV (Units)	27,924	29,957	280,055	269,100
	Growth Y-o-Y (%)		*7.3*		*-3.9*
	MHCV	18,363	25,119	153,738	202,501
	Growth Y-o-Y (%)		*36.8*		*31.7*
	Total	46,287	55,076	433,793	471,601
	Growth Y-o-Y (%)		*19.0*		*8.7*

Source: SIAM, Company, KRChoksey Research

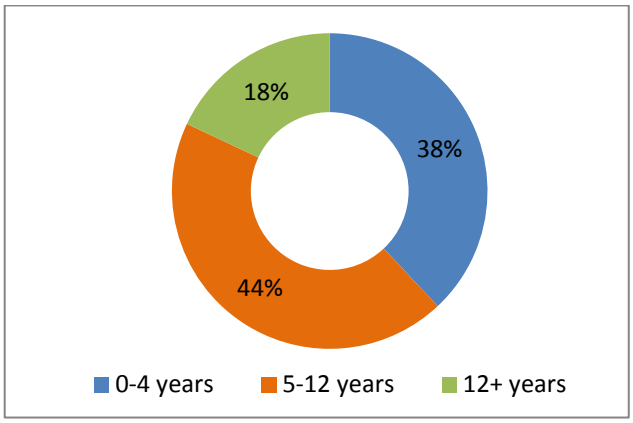
Commercial Vehicle finance market : huge opportunity ahead

Broadly, Commercial Vehicle (CV) financing market can be classified into new CV financing (estimated market potential INR 500 bn) and used CV financing (estimated market potential INR 1,940 bn). The market for used CV financing lies quite under-penetrated with 65-70% of the market with private financiers who charge higher interest rates.

Market potential (INR bn)



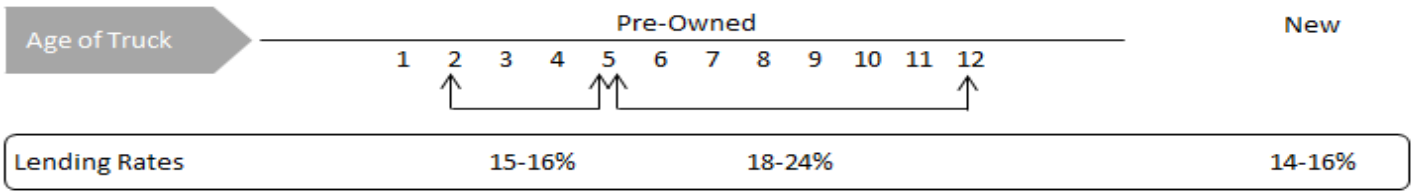
Trucks – opportunity size



Source: Company, KRChoksey Research

Moreover, the lower ticket sizes, elevated operating costs, higher credit costs given the limited credit history and erratic borrower cash flows of the used CV portfolios have refrained banks and other organized players to venture into this segment. Besides, the inherent used CV portfolio is perceived to be risky and entails higher yields (18-24%) vis-à-vis the new CVs (yields at 14-16%).

CV Finance portfolio-



Source: Company, KRChoksey Research

However, the demand for used CV portfolio stands less cyclical in comparison with the new CV segment primarily due to the former's lower ticket sizes and steady freights for shorter routes. In recent periods, the stricter emission norms and legislative pressures on banning >15 year old trucks have led to bump in replacement demand. This replacement demand in turn should trigger financing demand to the tune of almost INR 1083 bn for 1.35 mn new as well as used CVs.

Key dynamics of CV financing business

Particulars	New CV financing	Pre-owned CV financing
Dominance	Private sector banks, NBFCs	Unorganised private financiers, NBFCs
Financing focus	Manufacturer driven	Customer driven
Primary growth driven	Higher GDP growth, higher IIP growth, availability and increased freight rates	Increased freight rates, increasing aspiration of drivers
Target segment	Large operators, Medium Operators and Small Road Transport Operators (SRTOs)	SRTOs who own less than 4-5 trucks and First Time Users (FTUs)/Drivers upgrading to owners with underdeveloped banking habits
Average ticket size	Rs 0.4 mn for LCV; Its 1.2 mn for M&HCV	Its 0.3-0.4 mn
LTV	80-85%	60-65%
Loan tenure	4-5 years	3-4 years
Yields	Low (14-16%)	High (18-24%)
Loan loss	Low (0.5-1.5%)	High (2-2.5%)
Key players	HDFC Bank, Kotak Bank, IndusInd Bank, Sundaram Finance, Tata Finance, Chola Finance, Magma Fincorp, Manappuram Finance	Shriram Transport Fmance, Chola Finance, Induslnd Bank, Sundaram Finance, Magma Fincorp, Manappuram Finance

Source: Company, KRChoksey Research

Commercial Vehicle Finance Business – MGFL

Diversifying the AUM mix, MGFL launched Commercial Vehicle Finance segment primarily in Sothern and Western region of India. Laying major thrust on under-served customer category with negligible access to organized lending system, the company expects to expand its footprint in rural and semi-urban locations.

With 70% of the CV portfolio emerging from used CV category catering to the average 5-year old truck category, MGFL's CV financing AUMs stood at INR 895 mn as at the end of December 2015, contributing little less than 1% of the overall AUMs. With the expected scale-up of business operations, the CV AUMs are expected to surge to INR 5000 mn+ by FY18E contributing 3%+ to the overall AUM mix.

Commercial Vehicle Finance – Estimated staggering 130%+ CAGR over next two years

	FY15	FY16E	FY17E	FY18E
Commercial Vehicle Loans (INR mn)	153.7	922.4	2213.9	5047.6
Growth Y-o-Y	*NA*	*500.0%*	*140.0%*	*128.0%*
% of Overall Loan mix	*0.2%*	*0.8%*	*1.7%*	*3.1%*

Source: Company, KRChoksey Research

Enhanced operating efficiencies boost earnings momentum:

Manappuram Finance Ltd- Consolidated Entity- Snapshot (FY15)

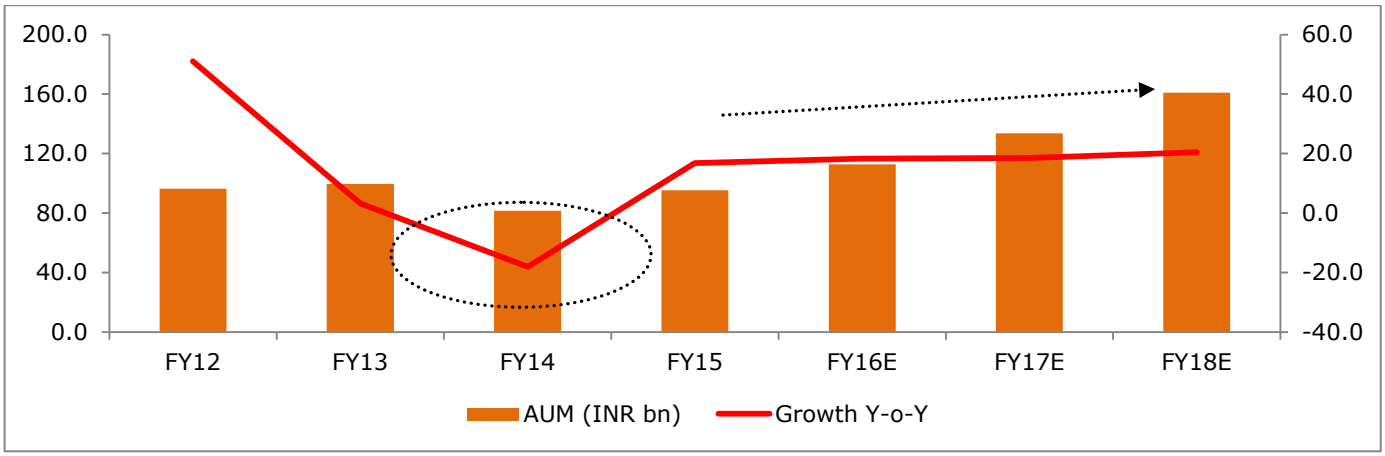
Entity	Net Assets (Total assets minus Total Liabilities)		Share in Profit and Loss	
	% of Consol. Net Assets	Amt (INR mn)	% of Consol. Net Assets	Amt (INR mn)
Manappuram Finance Limited	94.5	24871.8	99.5	2701.2
Manappruam Home Finance Company Private Limited	1.7	448.4	-0.2	-4.7
Asirvad Microfinance Private Limited	3.1	803.9	0.6	16.6
Minority Interest in subsidiary	0.8	203.9	0.1	1.6

Source: Company, KRChoksey Research

Robust AUM mix; strong growth visibility

The migration from longer tenure gold loan products to short tenure loan assets (3 to 9 month products instead of 12 months products with maximum LTV of 75%) and diversification of product mix has aided MGFL built economies of scale and revive business growth. The share of new businesses (microfinance, mortgage and housing and commercial vehicle financing) increased to 8.6% of overall AUMs in the December 2015 quarter from 6.7% in the preceding quarter. For the quarter ended December 2015, the overall AUM stood at INR 105.8 bn which is up by INR 3.6 bn; i.e. reporting 20% Y-o-Y growth buoyed by staunch micro finance business traction at 30% Q-o-Q growth (117% Y-o-Y growth). We reckon, The steady-state gold loan traction and the diversified non-gold portfolio mix comprising of micro-finance, commercial vehicle and home finance portfolio together is likely to grow at 24% YoY forming almost 25% of total AUMs (by FY19E) driving the AUM traction over FY16-18E. Against this backdrop, we expect overall AUMs to grow at 17-19% CAGR over FY16-18E.

Revival in business growth – Staunch AUM traction ahead



Source: Company, KRChoksey Research

Strengthened margins; NIMs should stabilize at average 12.5% levels

The turbulent years of business witnessed higher interest reversals on account of gold loan defaults consequently dragging down the yields for the company. The de-linking of the gold loan products to price fluctuations and shifting them to shorter tenures have ensured that these loans remain in-the-money (with reduction in auctions) thus leading to fuller realization of net income which in turn has provided impetus to the gold loan yields. Moreover, the diversification into higher yielding product segments mainly, micro finance and commercial finance continue to drive the yields for MGFL. For the quarter gone by, the yields moved higher to 23.8% (Q3FY16) as against 21.8% the preceding quarter primarily on the back of lessened loss of interest and savings on auctions. Therefore, going forward, we reckon, while the yields should propel to 22.7% in FY16E, the same should marginally decline and stabilize at around 22% levels by FY18E given the heightened competitive intensity and part transmission of lower interest rate benefits to customers.

On the other hand, MGFL's robust borrowings mix that is largely skewed towards bank borrowings (72% of borrowings emerging from bank finances) augurs well for benign cost of funds scenario especially in a falling interest rate environment. Moreover, MGFL continues to derive cost benefits through the investment ratings upgrades; namely, the re-affirmation of ratings by CRISIL and revision of ratings outlook for long term debt instruments and bank facilities from "Negative" to "Stable" back in 2014, and further in March 2015, CARE ratings upgrade for the NCD issue to A+.

Robust credit ratings – Snapshot (FY15)

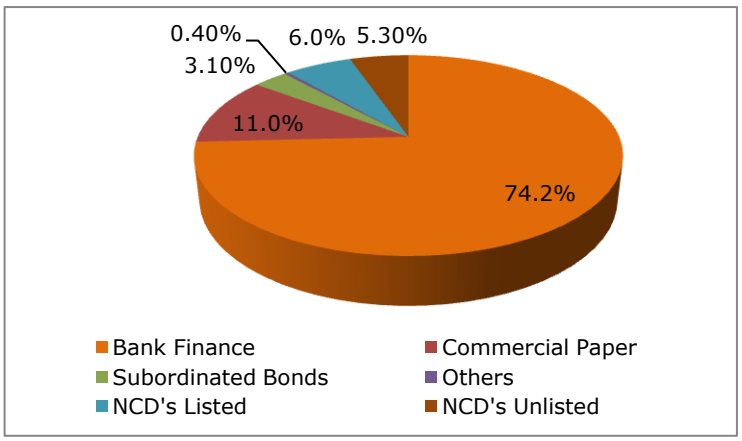
Credit rating Agency	Type of Facility	INR mn	Rating
Brickwork	Non-Convertible debentures	2,500	BWRA+ to BWR AA-
CRISIL	Bank Loan Facility	14,000	A+/ Stable
	Non-Convertible Debenture	24,470	A+/ Stable
	Short Term Debt	15,000	CRISIL A1+
ICRA	Non-Convertible Debentures	4,230	[ICRA]A+(Stable)
	Bank Loan Facility	17,860	[ICRA]A+(Stable)
	Short term fund based bank facilities	14,990	[ICRA]A1+
CARE	Non-Convertible Debentures	2,000	CARE A+

Source: Company, KRChoksey Research

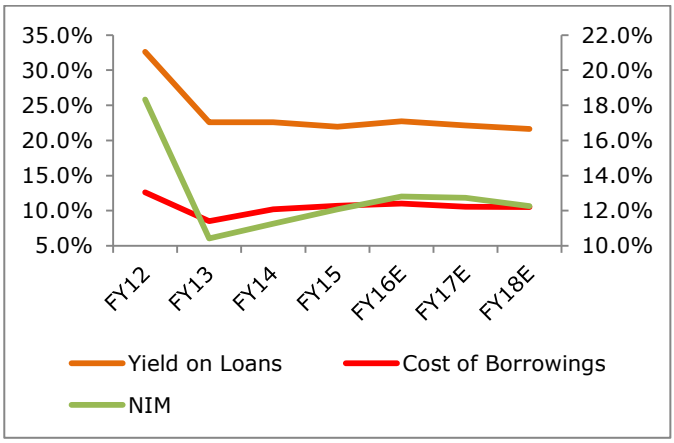
Thus, in the quarter gone by (Q3FY16), MGFL witnessed reduction in cost of funds to 10.6% from 11.1% in Q2FY16 (and 12.2% in Q3FY15). Going forward, we believe, while the funding costs should spike marginally to 11% in FY16E, and thereafter should continue to witness declining trend settling down to 10.5% by FY18E.

Better investment ratings upgrade, falling interest rate scenario, shift to higher yielding loan mix, lower slippages and reduced auctions augurs well for the margins sustenance going forward. While Q3FY16 already witnessed superior NIMs at 14.5% levels (12.0% in Q2FY16), MGFL has witnessed robust NIMs in the range of 12-13% for preceding four quarters. Going forward, while the NIMs should inch up to 12.8% in FY16E, the same should stabilize at average 12.5% levels over FY16-18E primarily on account of diversification of product mix. Given the robust asset mix and strong margins, we reckon, MGFL to clock sturdy 16.2% NII CAGR over FY16-18E.

Robust borrowings mix



Margins expansion imminent



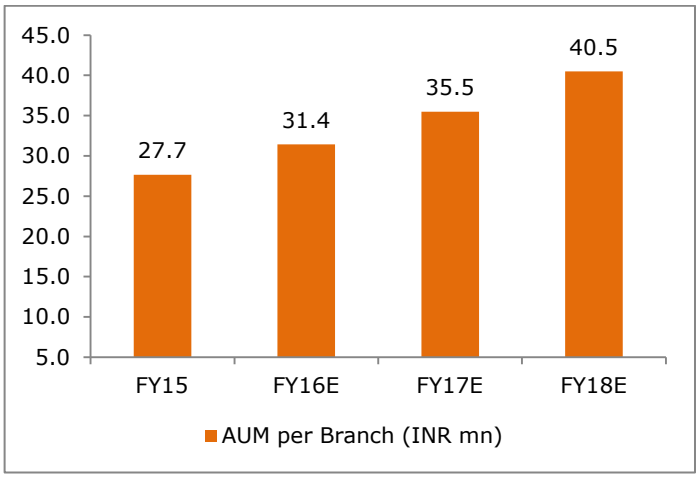
Source: Company, KRChoksey Research

Improved Operating leverage on the anvil

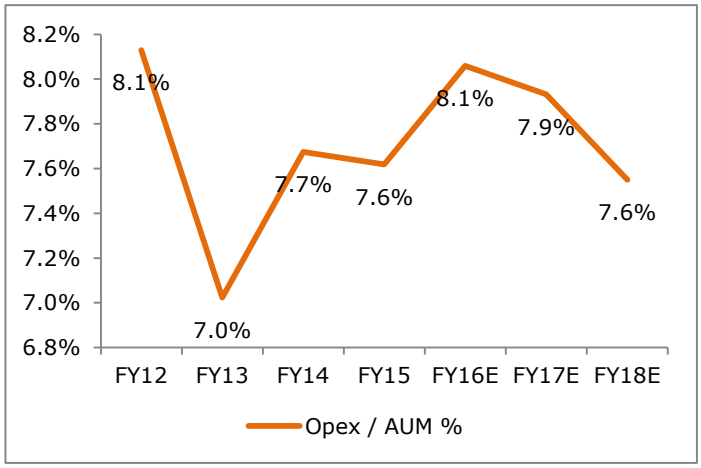
Gold loan being opex intensive business given the requirement of higher employee count and widespread branch network, historically opex/AUM has remained higher for MGFL. Moreover, the tumultuous period of gold price corrections observed higher auctions and interest losses with waning AUMs denting the operating leverage of the company. Consequently, the opex/AUM witnessed higher 8%+ levels and the AUM/branch ratio slipped to INR 30 to 40 mn during the tough period of FY12-FY15.

However, going forward, MGFL should witness improved operating leverage evidenced by product diversification, stability in core gold loan business and thereby accretion in AUMs which in turn should enhance in average AUM per branch ratio. That the employee headcount growth stands in commensurate with the AUM trajectory also manifests into better operating leverage for the company. Against this backdrop, we believe, the Opex/AUM should moderate going forward, declining to 7.6% by FY18E from current levels of 8%+.

AUM per Branch on the rise



Opex/AUM to decline



Source: Company, KRChoksey Research

Asset quality largely guarded:

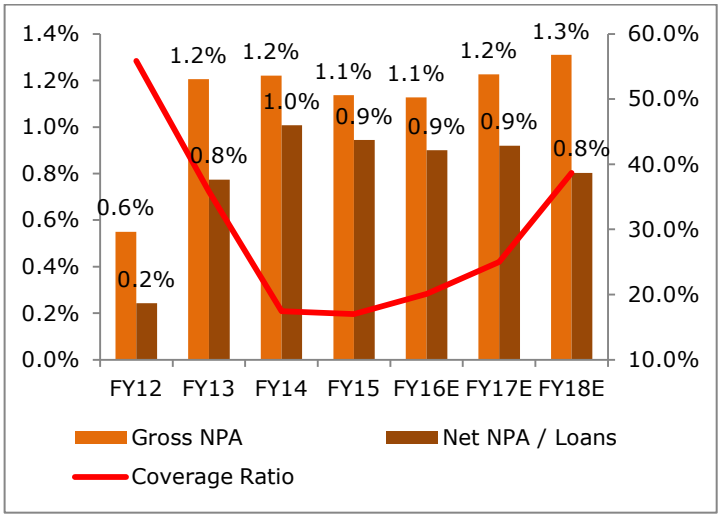
MGFL observed higher gold loan defaults during the testing times of gold price fluctuations leading to higher auctions of pledged ornaments. Many times the recovery amount exceeded the value of gold pledged leaving the loan product out-of-money.

With stressed legacy gold portfolio stands cleansed (Q2FY16 witnessed an aberration with entire legacy gold portfolio being auctioned, the gold auctioned to disbursements stood as high as 10%), the gold auctions have come down to INR 3.9 bn in Q3FY16 as against higher amount at INR 8 bn in the preceding quarter. While the gross NPAs have stood at 150 dpd at 1.1% of AUMs (tad deterioration from 1% in the previous quarter), these NPAs have predominantly been technical in nature. Besides, MGFL's total exposure to top four NPA accounts formed 7.25% of the book as the end of FY15, down from 7.5% in FY14.

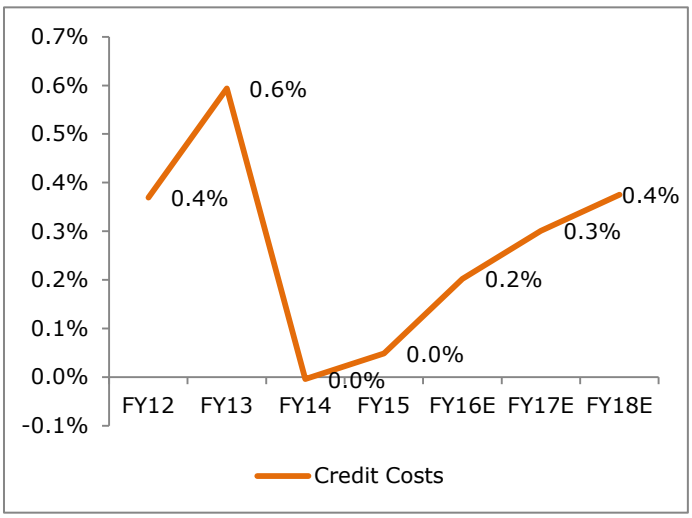
Today, while the gold business stands de-linked to price fluctuations and focus on small ticket loans, the slippages and auctions should mark declining trend thereby guarding the credit quality of the business from any negative surprises. Besides, MGFL boasts of superior risk management practices encompassing from alerting detection of risk prone loans, risk based classification of customers/loans, diligent KYC checks, portfolio monitoring at regular intervals that help maintain credit quality.

Going forward, as the company progresses with its product expansion drive coupled with negligible technical NPAs due to 90-dpd migration, we expect the gross NPAs to climb to 1.2-1.3% over FY16-18E. Subsequently, we also expect the credit costs should also trend higher going forward and spike to 0.4% levels by FY18E.

Asset quality trends – guarded book



Credit costs trends – credit costs to spike



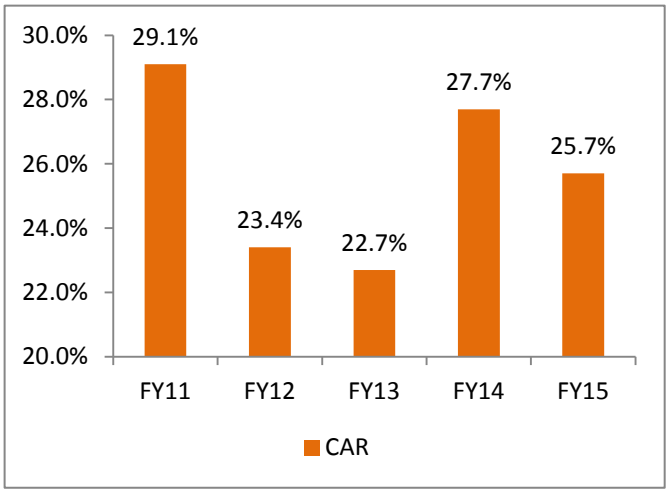
Source: Company, KRChoksey Research

Strong earnings visibility, robust capital adequacy to drive return profile

Traversing through the troubled waters, MGFL witnessed volatility in return ratios with RoAs plummeting to 2% levels in FY15 from higher levels of 5% in FY12. However, with business turnaround post FY15, MGFL should observe greater benefits flowing through operating leverage and business expansion. Besides steady 10 to 12%+ gold loan growth, the new business additions; viz, micro finance portfolio that should put out 62%+ CAGR growth, CV finance projected to report 134% CAGR growth and home loans which is expected to report 113% CAGR growth over next two years.

While strong retail customer base and rich retail franchise, improving cost matrix, lower leverage and decreasing auction amounts should continue to drive the asset franchise for MGFL; high capital adequacy (Total CAR at 25.4% in Q3FY16) that should aid the non-gold business growth and stable asset-liability mismatch profile, together should boost earnings momentum translating into higher RoEs in forthcoming periods. Against this backdrop, we envisage, MGFL to clock staunch 16% CAGR in net profits translating into RoEs at 14-15% and RoAs to step-up to 2.7% over FY16-18E.

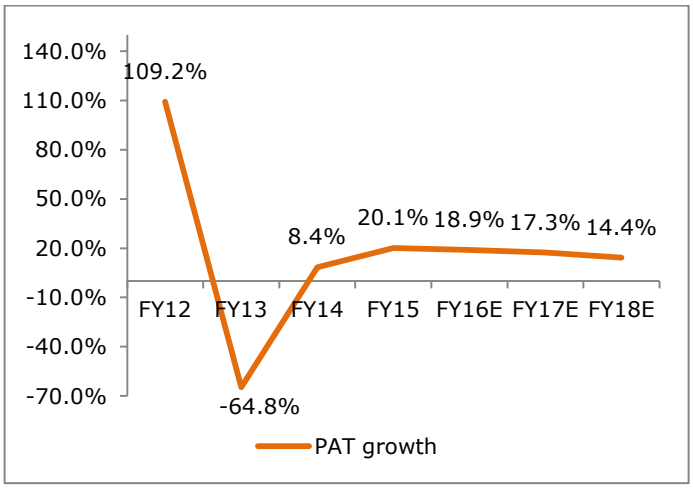
Capital sufficiency in place – to pursue ambitious growth targets



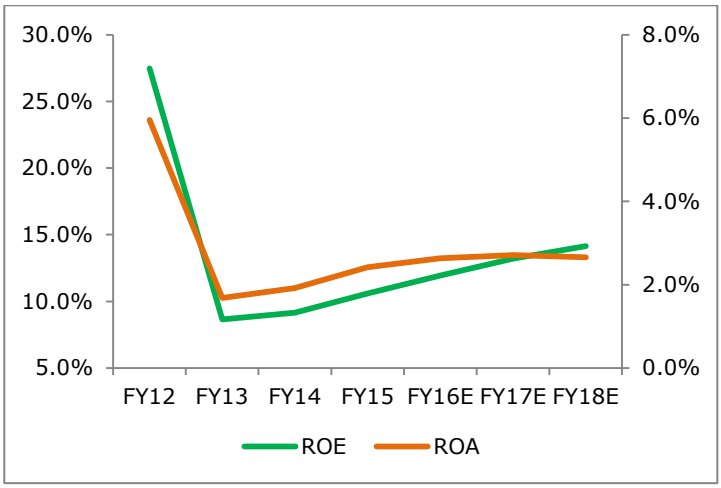
Stable Asset-Liability Mismatch

Source: Company, KRChoksey Research

Robust earnings momentum...



...should translate into superior return profile



Source: Company, KRChoksey Research

Annexure:

Management Team:

Name	Position	Experience
Mr. V. P. Nandakumar	Managing Director & CEO	Chief Promoter of Manappuram Group. Certified Associate of Indian Institute of Bankers.
Mr. B.N. Raveendra Babu	Executive Director	Director since July 1992. Worked in a senior role with Blue Marine International in U.A.E
Mr. Kapil Krishan	Chief Financial Officer	24 years experience with organizations such as CRISIL, HSBC, Standard Chartered, Hewitt Associates, India Infoline
Mr. Arun Raman	EVP –Operations	Worked with AHLI Bank, ICICI Bank, HSBC, CITI Bank, SBI Capital Markets and Emirates Bank group
Mr. Mohan Vizhakat	Chief Technology Officer	Associated with the Indian Government and leading companies of India and Middle East in Information Technology
Mr. Romin Farooq	CEO –Insurance	Over 20 years experience in Business Administration, Business Development, Claims and Key Management
Mr. Aloke Ghosal	CEO – Housing Finance	Over 23 years experience including leading the retail mortgage initiatives of large conglomerates
Mr. Raja Vaidhyanathan	MD-MFI	Erstwhile Promoter of Asirvad Microfinance IIT IIM Alumni with over 33 years of experience across industries
Mr. K Senthil Kumar	Head –Commercial Vehicle	Over 19 years experience in Business Development, Credit & Risk and Profit Centre operations.

Board of Directors

Name	Position	Experience
Mr. Jagdish Capoor	Chairman, Independent & Non-Executive Director	Former Chairman of HDFC Bank, former Deputy Governor of Reserve Bank of India, former Chairman of UTI and BSE Ltd
Mr. Shailesh J Mehta	Independent & Non-Executive Director	38 years of experience, Bachelor of Technology in mechanical engineering from IIT Mumbai, MSc in Operations Research from Case Western Reserve University and PhD degree.
Mr. E.A. Kshirsagar	Nominee Director	Fellow of the Institute of Chartered Accountants in England & Wales. Associated with the Management Consultancy division of A F Ferguson for over three decades and retired in 2004 as the Senior Partner
Mr. Pradeep Saxena	Nominee Director	Fellow of the Institute of Financial Services, London and Masters in Management Sciences, from University of Bombay. Worked in Senior Management Positions of various International Banks. Presently, he is engaged in the areas of Financial Services, Heavy Industry , Information Technology and Education
Mr. P. Manomohanan	Independent & Non-Executive Director	38 years of work experience in the RBI and in the regulatory aspects of NBFCs. Bachelor of Commerce from Kerala University, Diploma in Industrial finance from Indian Institute of Bankers and also a Certified Associate of the Indian Institute of Bankers.
Mr. Rajiven V. R.	Independent & Non-Executive Director	Bachelor of Science degree and has completed his LLB from Govt. Law College, Trivandrum. Wealth of experience in areas like Leadership and Staff management, Strategic Management, Financial Control / Budgeting, Team Development etc
Dr. Amla Samanta	Independent & Non-Executive Director	Over 23 years experience including leading the retail mortgage initiatives of large conglomerates
Mr V. R. Ramchandran	Independent & Non-Executive Director	32 years of work experience and is a civil lawyer enrolled with the Thrissur Bar Association, Bachelor of Science from the Calicut University and a Bachelor degree in law from the Kerala University
Mr. K Senthil Kumar	Head –Commercial Vehicle	Over 19 years experience in Business Development, Credit & Risk and Profit Centre operations.

Source: Company, KRChoksey Research

Profit & Loss Account:

INR in mn	FY14	FY15	FY16E	FY17E	FY18E
Income Statement					
Net interest income	10,494	10,908	13,508	15,873	18,231
Other operating income	245	182	195	217	231
Non-interest income	114	70	91	117	158
Operating income	10,852	11,160	13,795	16,207	18,620
Operating expenses	6,953	6,741	8,388	9,774	11,126
Pre-provisioning profits	3,899	4,419	5,406	6,432	7,494
Provisions for contingencies	469	282	434	594	777
PBT	3,430	4,137	4,973	5,838	6,717
Tax	1,170	1,422	1,716	1,985	2,284
PAT	2,260	2,713	3,225	3,784	4,327

Source: Company, KRChoksey research

Balance sheet					
Equity capital	1682	1682	1682	1682	1682
Reserve & Surplus	23,235	24,849	26,295	28,135	30,353
Net worth	24,917	26,532	27,977	29,817	32,036
Borrowings	77,954	86,320	99,746	118,410	143,455
Current liabilities and provisions	5,513	3,311	3,736	4,358	5,236
Total	**108,385**	**116,163**	**131,460**	**152,585**	**180,727**
Loan book	82,420	96,221	113,673	134,525	161,922
Investments	7956	2169	2169	2169	2169
Fixed assets	2067	2066	1786	1508	1189
Deferred tax assets	289	310	310	310	310
Current assets, loans and advances	15,653	15,397	13,522	14,073	15,137
Total	**108,385**	**116,163**	**131,460**	**152,585**	**180,727**

Growth (Y-o-Y)					
Borrowed funds	-20.6%	10.7%	15.6%	18.7%	21.2%
Advances	-18.0%	16.8%	18.3%	18.5%	20.5%
Total assets	-14.8%	7.2%	13.2%	16.1%	18.4%
NII	-0.7%	4.0%	23.8%	17.5%	14.9%
Non-interest income	75.7%	-29.8%	13.7%	16.4%	16.6%
Operating expenses	1.0%	-3.0%	24.4%	16.5%	13.8%
Operating profits	0.1%	13.3%	22.4%	19.0%	16.5%
Provisions including write-offs	-43.4%	-39.8%	53.8%	37.1%	30.7%
Reported PAT	8.4%	20.1%	18.9%	17.3%	14.4%

	FY14	FY15	FY16E	FY17E	FY18E
Spreads / margins					
Lending spread	12.1%	11.1%	11.5%	11.4%	11.0%
NIM	11.3%	12.1%	12.8%	12.7%	12.3%
Profitability					
ROA	1.9%	2.4%	2.6%	2.7%	2.7%
ROE	9.2%	10.6%	11.9%	13.2%	14.2%
Opex/AUM	7.7%	7.6%	8.1%	7.9%	7.6%
Asset quality					
Gross NPAs	1.2%	1.1%	1.1%	1.2%	1.3%
Net NPAs	1.0%	0.9%	0.9%	0.9%	0.8%
Capital adequacy					
Tier I (%)	26.7%	25.1%	20.9%	19.0%	16.9%
CAR (%)	27.7%	25.6%	23.9%	21.8%	19.5%
Du Pont analysis					
NII / assets	9.7%	9.4%	10.3%	10.4%	10.1%
Other income / assets	0.1%	0.1%	0.1%	0.1%	0.1%
Total income / assets	10.0%	9.6%	10.5%	10.6%	10.3%
Cost to assets	6.4%	5.8%	6.4%	6.4%	6.2%
Provisions / assets	0.4%	0.2%	0.3%	0.4%	0.4%
ROA	2.1%	2.3%	2.5%	2.5%	2.4%
Per share Data					
Earnings per share (Rs)	2.7	3.2	3.8	4.5	5.2
Dividend per share (Rs)	1.8	1.8	1.8	2.0	2.2
Book value per share (Rs)	28.7	30.3	31.8	33.7	36.1
Price to earnings (x)	11.9	9.9	8.3	7.1	6.2
Price to book (x)	1.2	1.2	1.1	1.0	1.0
Dividend payout ratio (%)	66.9%	55.7%	46.9%	44.4%	42.7%

Source: KRChoksey Research

ANALYST CERTIFICATION:

I, Shweta Daptardar (BCoM, MBA), research analyst, author and the name subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect my views about the subject issuer(s) or securities. I also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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