

## MANAPPURAM THESIS

## MANAPPURAM GROWTH DRIVERS :

1. **Gold Price** – Increase in gold prices play an important role in increasing the AUM as well as customer base of gold lending as seen between periods 2008-2013 & 2019-2021 (Chart Below). It can be said it is an important driver of growth in gold loan AUM and customer base.
2. **Branch Network** – In the standalone entity of the group MFL the branch network, AUM & gold price were as below:

YEAR	BRANCHES	STANDALONE AUM (Including Other Segments in Standalone Entity)	GOLD PRICE
2009	522	439 Crore	13500
2011	2064	6375 Crore	22500
2013	3295	9946 Crore	30300
2019	3372	15900 Crore	33300
2022	3524	22500 Crore	50500

The above indicates that the management was aggressive in opening branches until 2013 as it saw an opportunity in growing the business when it added 2773 branches in just 4 years and post that has added only 229 branches in 9 years. This implies that the company opened the branches in an aggressive manner when growth opportunity was there and then stuck to optimizing the AUM per branch which has gone up from 3 Crore in 2013 to 6.40 Crore today. Still low compared to Muthoot's 12-13 Crore per branch.

This would also mean that when the management is aggressive in opening branches in some years it would mean they are bullish on the business and should follow years of optimization of AUM per branch as can be seen in Asirvad right now as per below table:

YEAR	BRANCHES	ASIRVAD AUM
2016	346	860 Crore
2018	832	2116 Crore
2020	1030	4344 Crore
2022	1526	5426 Crore (Gold 300 Cr Included)

With new regulation coming in in 2022 wherein NBFC-MFI can have 25% other lending company has added 300 gold lending branches in Asirvad in 2022 (Included in the branch count above).

3. **Vehicle & Home Finance** – Both businesses started operations in 2015-16 & has been 6 years of operations till FY2022. Both verticals still need to go through the seasoning cycles to fully get a grip of the business. One seasoning happened during COVID when delinquencies shot up in both verticals as well as MFI.

Vehicle finance is operating through 242 branches of MFL of the total 3524 branches in the standalone entity with an AUM of 1600 Crores and Home Finance has its own 73 branches with an AUM of 832 Crores as of March 2022.

Vehicle finance will be an easier business to grow as it is from the same branches and is a much easier business to grow compared to home finance. Also, with the branch network of 3500+ branches there is a lot of scope to grow vehicle finance further.

4. **MSME Lending** – This is a new vertical started in 2019 and the management is optimistic to take the AUM to 5000 Crores in 5 years.
5. **Huge Data Leveraging** – The Manappuram group has a big database of customers along with their history of borrowing, repayments, periods when they could not pay back, employment history, CIBIL scores, etc. over long periods of time. This data if utilized correctly can be used to grow non-gold verticals in a more efficient way.
6. **Management Quality** – This is the biggest comfort for me as an investor in the company. Mr. Nandakumar from what I have gathered is a man driven by passion for his business and ability to change business model when required, this has been demonstrated many times through different actions he has taken.  
When in 2012 RBI changed multiple regulations, priority sector lending was removed for gold loans in 2011 ; then it reduced the LTV to 60% in 2012 ; thirdly gold prices crashed in 2013 by 15%. These all things lead to bad loans of 80 Crore in 2013 & 50 Crore in 2014. After this management decided to shift gold portfolio to 90 day loan renewal cycle wherein gold price to loan ratio eligibility would change every 90 days. And diversified in 2015 to not be dependent on a single product for its business. It bought Asirvad in 2015 and started vehicle finance & home finance simultaneously. The ability of the management to create these verticals from scratch which is now 33% of AUM in 6 years until FY 2022 is a positive.  
The management's ability to install a proper management structure & hierarchy for each of these verticals efficiently as the businesses scale-up is something I personally appreciate.  
This is the 2<sup>nd</sup> time the company has changed its business model successfully. It was into vehicle finance up until 2005 and stopped that. It started with gold loans only after 2000-01 in Manappuram Finance & merged it with its private company in 2009 when it saw a big potential there and started scaling it up. At that time, it stopped it's other verticals.

Even with the recent ED raid the company came out with clarifications and did an investor call to calm the markets. Highlighting the case a little, when the regulator told the company to return the deposit taken under Mana Agro Farms in 2012 the

promoter immediately sold shares in the market and repaid the depositors. Liquidating equity by the promoter instead of finding other ways to repay is something less seen by Indian promoters.

7. **Promoter Buy Backs** – The promoter family has always bought back stock whenever they felt the price was favorable. Out of the 12 years from 2011 till 2022 promoter family has bought back stock from open market in 8 years. This gives comfort in the promoter family's confidence in the business model.
8. **Focus on Training & Recruiting From Within To Senior Roles** – Over the years it has been seen that the company's focus on training has increased; from online training courses to international university tie-ups for its senior management.

It can also be seen that the senior management roles are filled up with internal promotions which is firstly a big motivational factor for the employees loyal to the company. Out of the top 10 employees (AGM 2022) 6 are with the company for more than 8 years.

9. **Listing Subsidiaries Separately on Stock Exchange**– The management has spoken about raising external capital first in Asirvad and then listing it on the stock exchange. This will unlock value for shareholders. Maybe the management thinks about listing Manappuram Home Finance as well one day when the business becomes sizable.
10. **Focus on CSR** – The company is very serious about CSR activities which can be seen with the level of diversified fields where the company contributes i.e. education, medical, overall development of areas in & around Thrissur district. To me this explains a lot about the nature of the promoters of how sensitive they are to social issues. Is CSR only a regulatory obligation for promoters or is it something they work on passionately is something important for me.
11. **New RBI regulation for Microfinance** – I think this has best been explained in 2point2 capital's investor letter of Q4 FY 2022. Below is the link- <https://2point2capital.com/blog/index.php/a2022/04/10/microfinance-3-0/>

#### **WEAK POINTS:**

1. **Succession Failure** – Recently Mr. Nandakumar has inducted his daughter into an executive role & made her an executive director. It is to be seen whether she takes the top job or business is professionalized.

Sometimes shoes too big to fill becomes a problem for companies as the next-gen leader is only looking up to do what his/her predecessor did.

- 2. High Attrition At Ground-Level** – The attrition rate is pretty high almost 25% for a few years now specially at the lower level team. The reason needs to be understood more in depth; is it pressure on ground-staff to bring new customers because old customers shifting to banks or other NBFC's, is our company's pay scale poor or are they unhappy with the working environment. Very high attrition leads to a lot of resources being spent on training and development of teams.
- 3. Gold Loan & Competition From Banks** – Gold loan if we look at the AUM has grown exponentially only in periods when gold prices have gone up 2007-2012 & 2019-2021. During stable gold prices AUM growth has been muted 2014-2018 and during declines AUM reduced in 2013-2014. This is a very clear reading from the gold AUM numbers of 2007-2022. Increased prices also mean more competition from banks & other NBFCs and less competition during stable or reducing price of gold.

I don't see this business growing more than 6-8% in the long term unless there is some drastic change in business model or gold prices overshoot.

On the downside if gold prices reduce it will lead to reduction in gold AUM and will hit competition harder.

- 4. Other Verticals Scale-up** – The diversification that Manappuram started in 2015 is only 7 years old; the Microfinance business has gone through tough times of demonetization, IL&FS crisis, two COVID waves. The management has learnt the problems of unsecured lending. It is a high margin business but at the same time is the first lending activity to get affected if any economic or political issue arises. Therefore, the company has said it will not go beyond 15% of Equity allocation to unsecured lending and secondly it has realized not to over concentrate on any one region and maintain a diversified AUM across states, cities and individual districts.

For other verticals it needs to be seen how the company scales up its operations and if they can innovate in competitive fields like vehicle and home financing where you already have big NBFC's and banks operating.

- 5. Company is rural & semi-urban focused** – The company has always said it is focused on the bottom of the pyramid/unbanked segment of the country which definitely has a lot of room to grow but at the same time it is a segment which gets affected the most when there is an economic or political crisis. Its gold loan focuses on smaller ticket size loans, vehicle finance focuses on majorly pre-owned commercial vehicles, housing finance focuses 10-15 lac loans and MSME focuses on small enterprise loans. All segments cater to similar clientele which is good also as it makes the Manappuram brand a one-stop-shop for that segment, the flip side is it's over dependence on a particular category of clients.

**6. Frauds at branches** – This is a big concern, every year since company has started gold loan as a single product (2007 onwards) every year there has been a fraud by the branch staff or security lapses leading to robbery at branches. After being in the business for such a long time the company has still not been able to devise a strategy around this which secures it from such frauds. In 2018 & 2019 security & insurance cost went up to 180 Crore and 120 Crore respectively due to security concerns at branches from 65 crores in 2017 and settled at 30 crores in 2022. If theft and fraud persists for a longer time and any big incident happens it can lead to loss of reputation and trust from customers.

**7. Compliance Issues** – This is a concern which has popped up every now and then.

- In 2012 RBI issued a notice of warning to company for taking customer deposits at Manappuram Finance branches and issuing receipts of Manappuram Agro which is a privately held entity of promoters.
- In 2013 the company gave out price sensitive information to Ambit Capital and was in violation of UPSI. SEBI imposed a fine of 5.25 Crore on the company and some senior directors/executive of the company settled the case in 2020 by giving the fine.
- In November 2020, RBI imposed a penalty of 5 lacs for non-compliance of rules related to ownership verification of gold jewelry.
- In April 2022 again RBI imposed a penalty of 17.60 Lacs for non-compliance of rules related to KYC of customers for wallets (Prepaid Payment instruments-PPI).

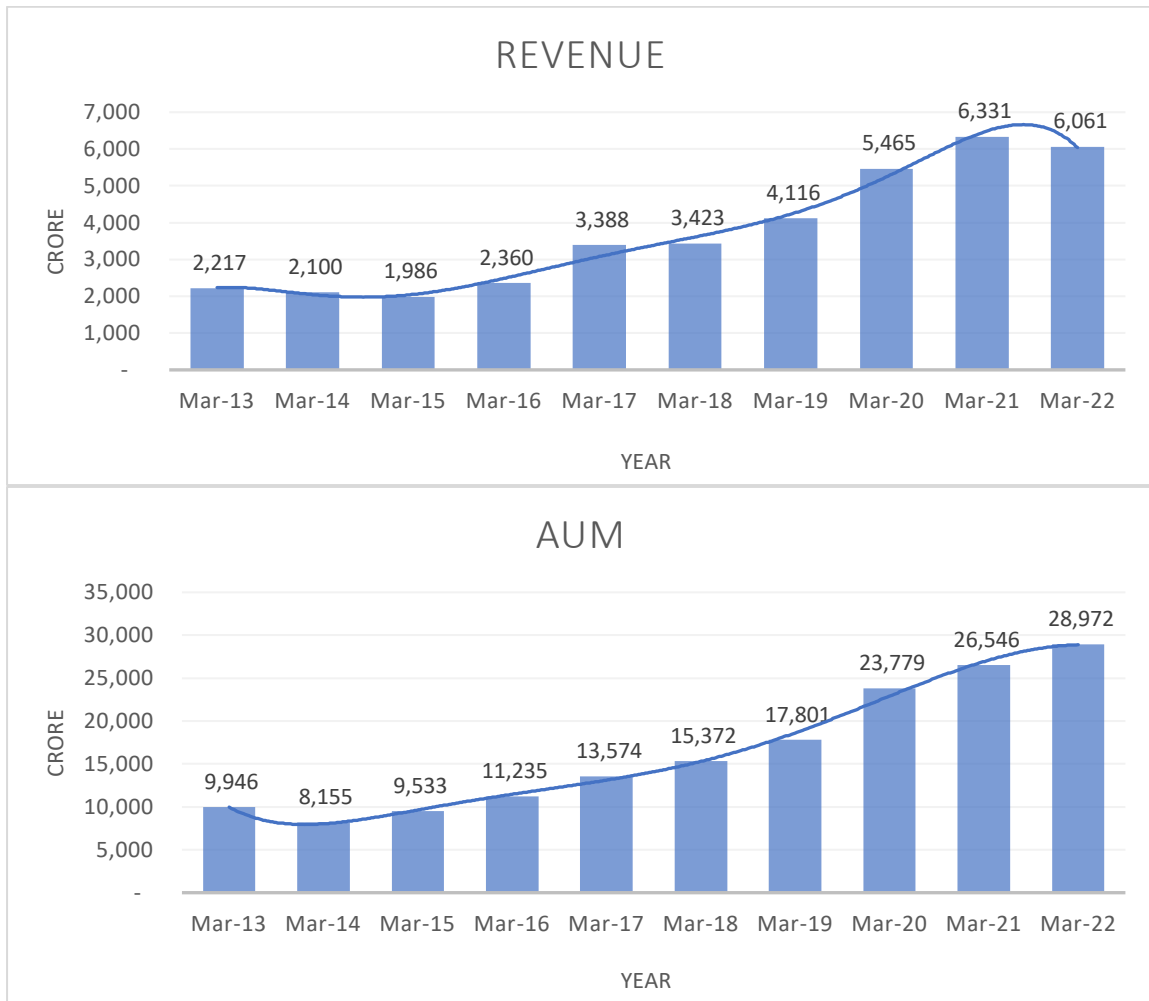
I would like to highlight that compliance lapses have always been taken as a priority and the company has taken immediate action to make changes but too often compliance issues can lead to RBI & SEBI increasing their vigilance on the company. Compliance issue was the reason for the ED raid.

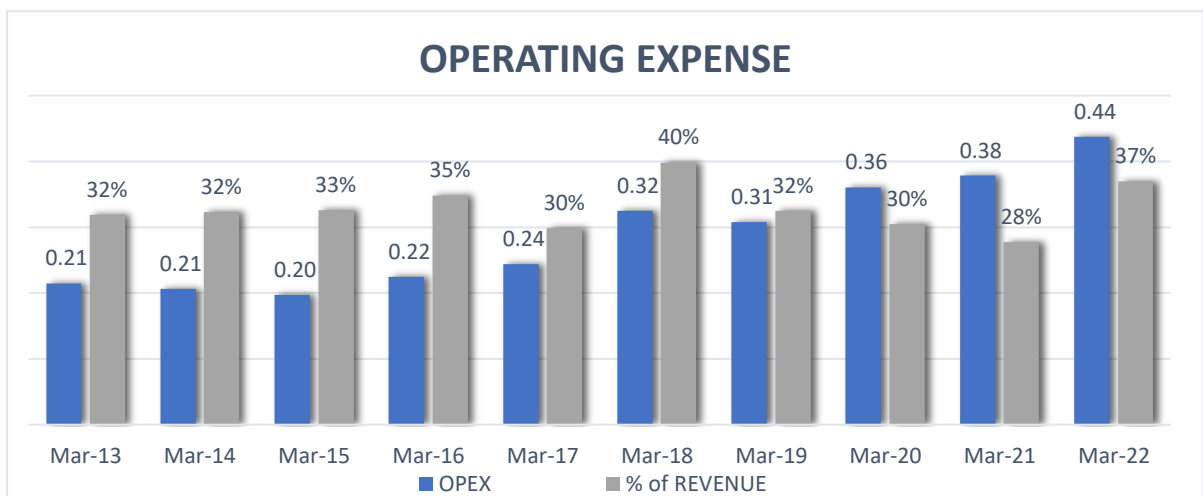
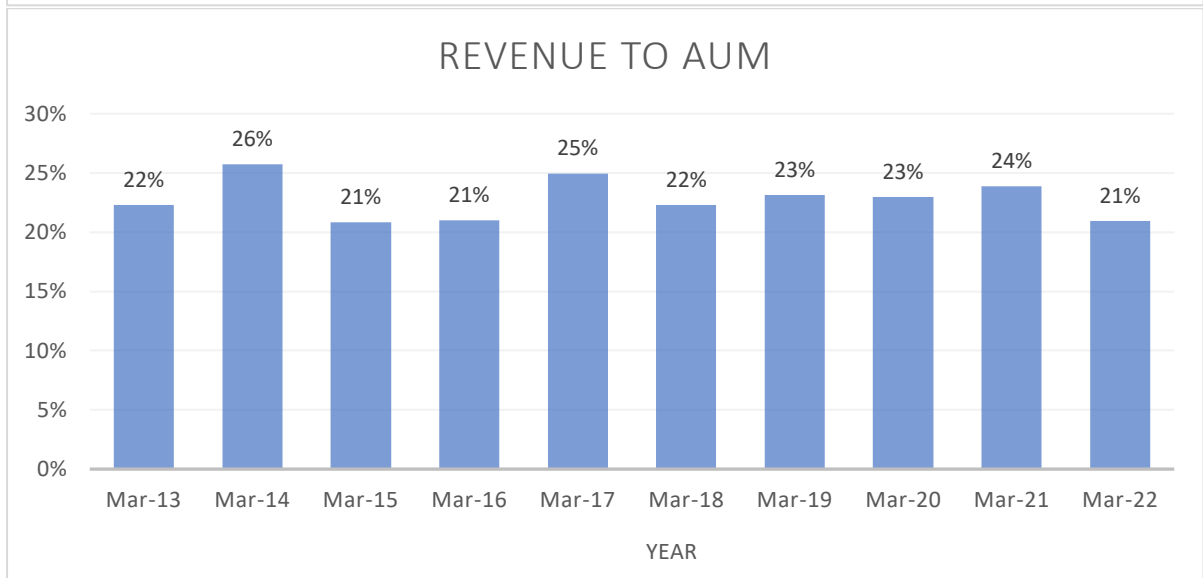
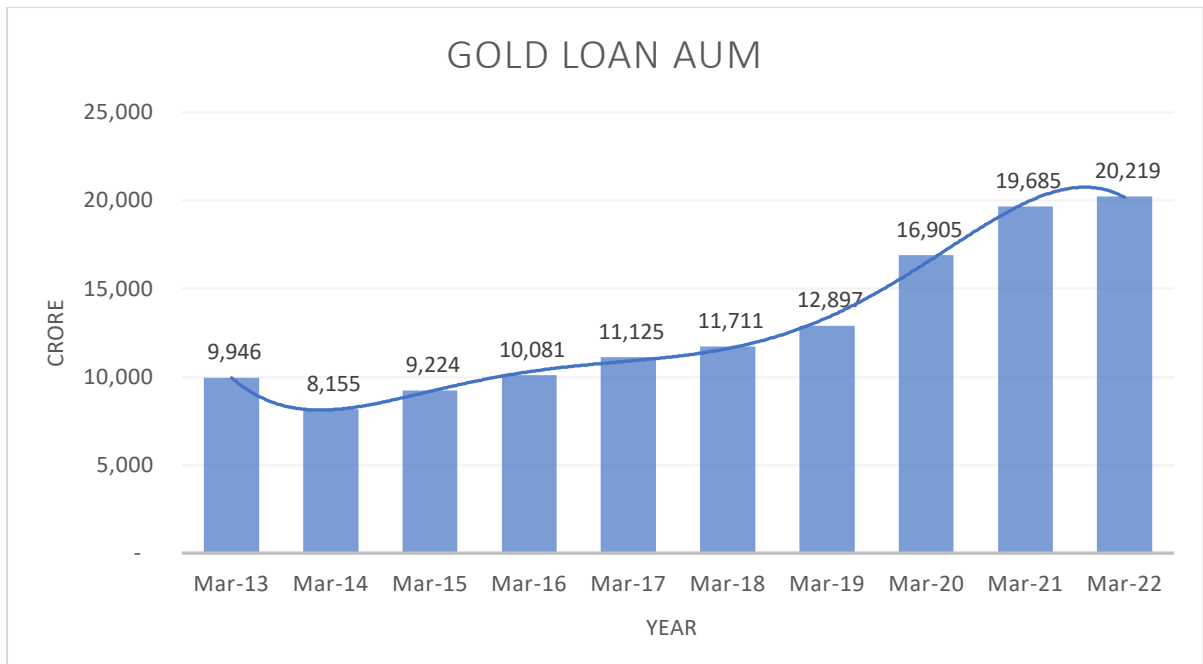
Due to these compliance lapses standalone entity has still not received the approval of the RBI for opening new branches whereas Muthoot has got it in FY 2023.

**8. Change in Regulation** – This is an unforeseen risk that can affect the business. Gold loan has always been a highly regulated business because it involves gold pledging from poor. In 2011-12 RBI suddenly reduced LTV to 60% of gold value. In 2020 again it increased LTV for banks to 90% of gold value whereas for NBFCs it remained same at 75% LTV putting them at a great disadvantage. Also new branch opening approval need to be taken from RBI for both Manappuram & Muthoot due to their big existing network. In fact, currently branch expansion plan was submitted by both companies; Muthoot got an approval after 1 year and Manappuram has still not got citing compliance issues.

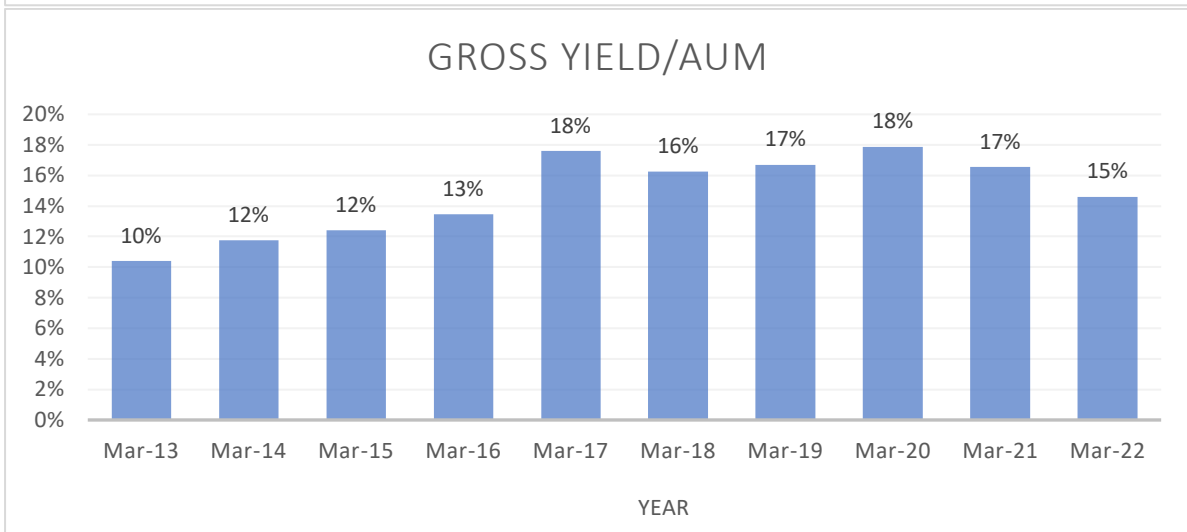
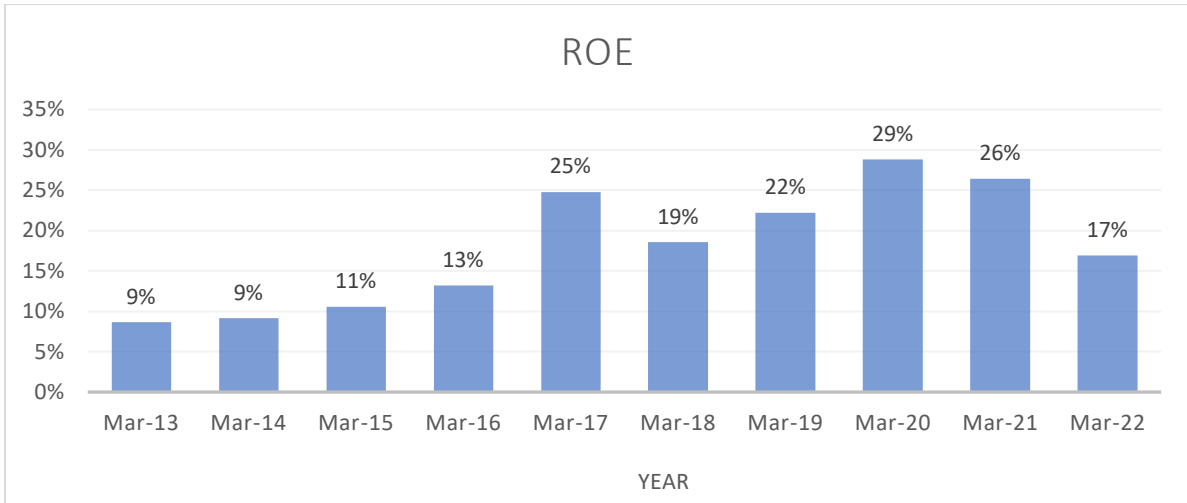
In my opinion RBI is not comfortable with a single product NBFC especially gold loan because it involves the poor and wants competition in the field that is why IIFL expanded branches in a big way in last 2-3 years, banks were given favorable LTV rates. This would not mean RBI would want them to shut shop, it means they would always want competition in the field so poor get the best bargain wherever they can.

**CHARTS:**

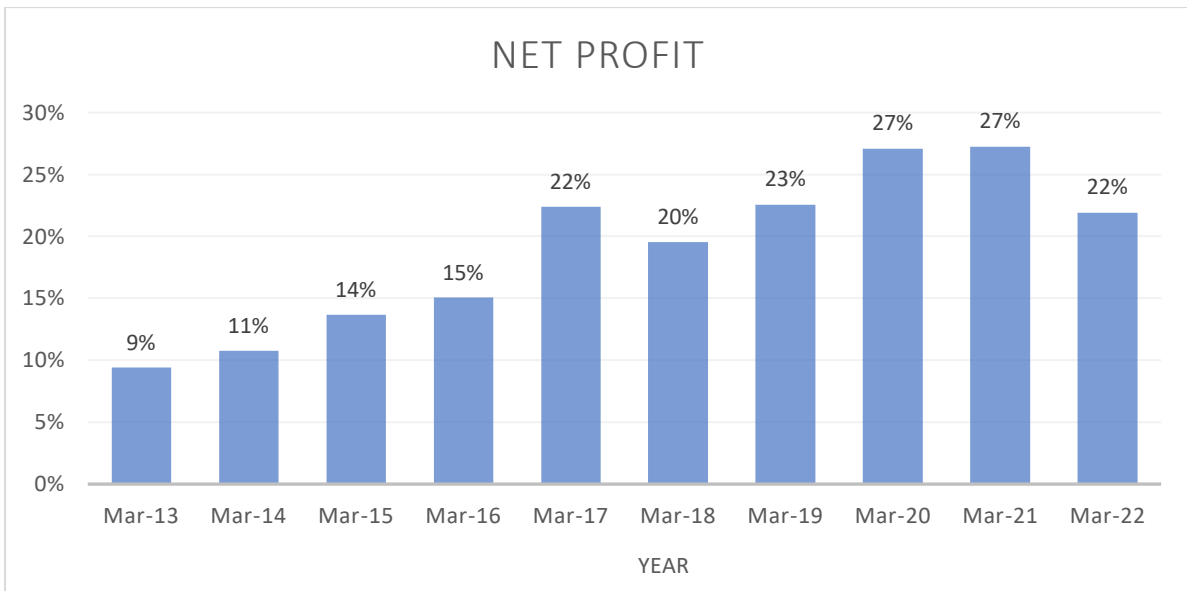




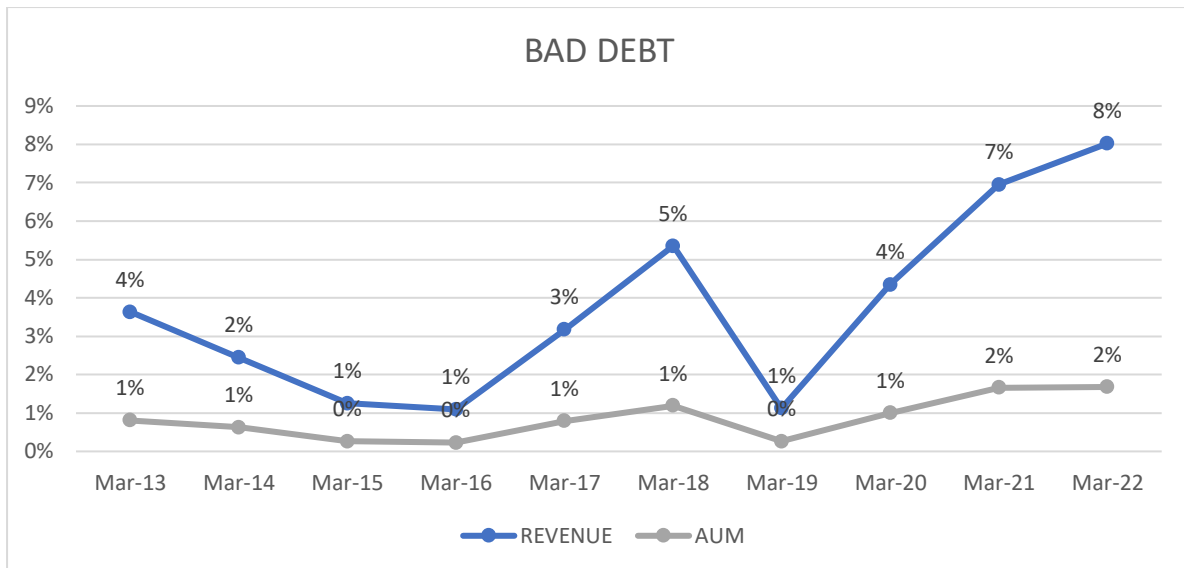
\*Including Credit Cost



\*Revenue-Interest Cost=Gross Yield







\*Bad Debt Expensed ratio to Revenue and AUM respectively

### CONCLUSION:

1. Gold loan AUM needs to improve going further even at a slower pace would be fine as long as it is able to grow at 5% annually I would be fine with it considering the amount of cash it generates for the company.
2. If gold prices crash the AUM will take a lot of time to recover and the recovery cycle will become more prolonged. On the flip-side it will be interesting to see what happens to competition in this scenario.
3. In some sorts gold loan is also an anti-cyclical business where when there is uncertainty in the economy and lenders become cautious in lending, the lower section of the society turns to pledging their gold for loans as other avenues shut off. However this perception is slowly changing & it is being used even during normal course of personal and business needs.
4. Non-gold verticals of the company need to keep doing well by increasing AUM and keeping credit cost in check. If it is able to do this consistently over 2-3 years the market will give it an upgrade and if it is not able to sustain the momentum it might not get the re-rating it is waiting for.
5. Asirvad credit cost as long as it stays within 3-4% range of AUM as this much the management has accepted will be there in unsecured lending and has built this up in the price it charges its customers.
6. If Asirvad raises outside capital and eventually gets listed this will be an additional value unlocking that takes place.
7. In standalone entity the AUM per branch is approximately 6.40 Crore as of March 2022. If they are able to increase this consistently over 3-5 years keeping credit cost in check it will lead to massive economies of scale per branch.
8. Currently company is available at book value which has a huge margin of safety incorporated in it as the company even in its worst times will generate 1000-1200 Crore of retained earnings from where it stands today.
9. Definitely the consolidated ROE's would not be the same as how it has been in the past but even if it is able to maintain 19-20% ROE's it should be good.