

# MUTHOOT FINANCE

## Growth tailwinds outweigh Kerala disruption

India Equity Research | Banking and Financial Services

Muthoot Finance's (Muthoot) operations in its home town Kerala have been disrupted following politically motivated employee protests. Management is now planning to gradually scale down operations in the state—of the 608 branches therein, closure of 43 has already been announced. No doubt, disruption in the home state will weigh on the business outlook. However, we believe: a) the impact will be contained given Muthoot's diversified and pan-India presence with Kerala contributing mere 4-5% to AUM, ~13% employees/branches and 10% of borrowing through gold bonds; b) though closure of Kerala operations will question collection efficiency, LGD will be negligible given secured nature of gold; and c) recent sharp uptick in gold prices will have tailwinds intact for 95% of its operations and growth will settle around guided 15-17%. We expect improved growth tailwind to outweigh uncertainty in Kerala operations and earnings will be intact. Maintain 'BUY' with TP of INR692.

### Disruption in home town business; diversified book to limit impact

Defying employee compensation-related allegations, management has decided to scale down business in phased manner in Kerala which will certainly lead to disruption. However, we expect the impact to be limited as the state's contribution has been slipping consistently—now at ~4.5% of AUM (INR16bn) compared to South India's ~50%. Moreover, Kerala's productivity metrics are not encouraging—per branch outstanding at INR26mn (compared to INR86mn for pan-India), this is also reflected in 200 branches being closed in Kerala over last 2 years.

### Rising gold prices will provide growth tailwinds

Sharp rally in gold prices in the previous quarter along with improved gold loan demand outlook will aid AUM growth (AUM per gram will see 10-15% uptick). Consequently, despite disruption in Kerala, we expect growth to settle in the guided 15-20% range. Even after considering cost attached to business discontinuation and higher credit cost, earnings will still remain intact (refer table 1 for more granular details).

### Outlook & valuation: Tailwinds outweigh disruption; retain 'BUY'

Medium-term improved outlook for Muthoot is marginally disrupted by the near-term disruption in home town operations. However, business fundamentals remain strong with steady growth, limited LGD and stable funding cost. We maintain 'BUY/SO'.

#### Financials

(INRmn)

Year to March	FY18	FY19	FY20E	FY21E
Net revenue	43,024	46,439	51,494	57,322
Net profit	17,203	19,721	21,977	24,862
Diluted EPS (INR)	43.0	49.3	54.9	62.2
Adj. BV (INR)	162.8	216.8	254.9	298.6
Price/ Adj book (x)	3.6	2.7	2.3	2.0
Diluted P/E (x)	13.6	11.9	10.7	9.4
ROE (%)	24.1	23.3	22.1	21.3

#### EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Outperform
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Overweight

#### MARKET DATA (R: MUTT.BO, B: MUTH IN)

CMP	: INR 585
Target Price	: INR 692
52-week range (INR)	: 657 / 356
Share in issue (mn)	: 400.7
M cap (INR bn/USD mn)	: 235 / 3,272
Avg. Daily Vol.BSE/NSE('000)	: 1,233.6

#### SHARE HOLDING PATTERN (%)

	Current	Q4FY19	Q3FY19
Promoters *	73.5	73.5	73.5
MF's, FI's & BK's	8.4	9.8	11.1
FII's	13.9	12.4	11.0
Others	4.3	4.3	4.4
* Promoters pledged shares (% of share in issue)	:	NIL	

#### PRICE PERFORMANCE (%)

	Stock	Nifty	EW Banks and Financial Services Index
1 month	0.9	(0.6)	(5.0)
3 months	(5.3)	(7.7)	(12.7)
12 months	48.4	(5.6)	(2.7)

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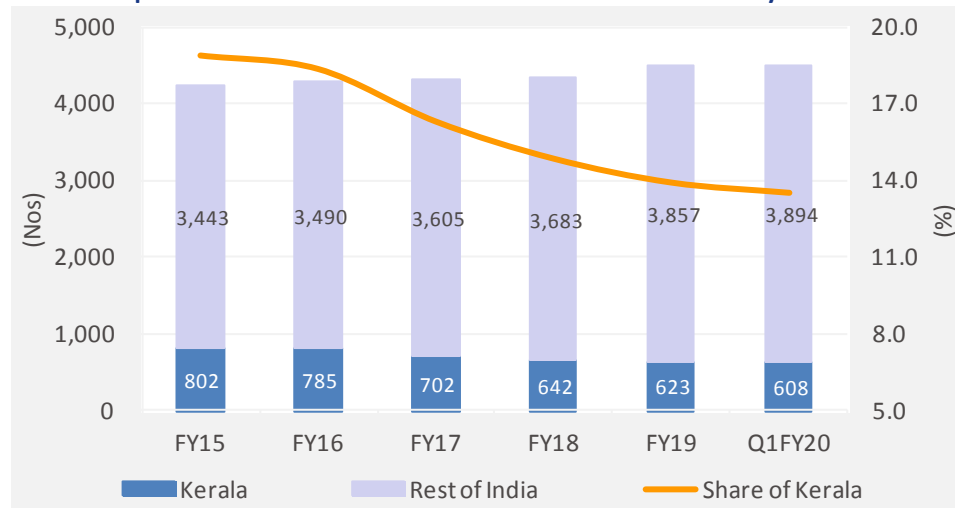
## Banking and Financial Services

**Table 1: Detailed financial impact on overall earnings post disruption in Kerala – PAT remains intact**

INR mn	Ex-Kerala			Kerala			Overall		
	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E
AUM	3,19,853	3,83,798	4,46,262	16,000	8,957	6,891	3,35,853	3,92,755	4,53,154
AUM growth (%)		20.0	16.3		(44.0)	(23.1)		16.9	15.4
AUM proportion (%)	95.2	97.7	98.5	4.8	2.3	1.5			
Branches (nos.)	3,857	4,007	4,147	623	373	298	4,480	4,380	4,445
Branches proportion (%)	86.1	91.5	93.3	13.9	8.5	6.7			
Employees (nos.)	21,744	22,840	23,845	3,000	1,641	1,192	24,744	24,481	25,037
Employees proportion (%)	87.9	93.3	95.2	12.1	6.7	4.8			
Employees/branch (x)	5.6	5.7	5.8	4.8	4.4	4.0	5.5	5.6	5.6
AUM/branch (INR)	83	96	108	26	24	23	75	90	102
AUM/gm (INR)	1,983	2,181	2,334	1,983	2,181	2,334	1,983	2,181	2,334
AUM (in tonnes)	161	176	191	8	4	3	169	180	194
AUM (kgs)/branch	42	44	46	13	11	10	38	41	44
Cost/employee (INR)	3,46,862	3,74,611	4,04,580	3,23,058	4,18,683	4,14,496	3,40,061	3,67,265	3,96,647
Rent/branch (INR)	4,48,362	4,66,296	4,84,948	4,48,362	4,66,296	4,84,948	4,48,362	4,66,296	4,84,948
Interest income		74,718	86,066		2,650	1,643		77,368	87,709
Interest expenses		26,423	30,998		472	479		26,894	31,477
Net interest income		48,296	55,068		2,178	1,165		50,474	56,232
Fee income		997	1,073		23	17		1,020	1,090
Net revenues		49,292	56,141		2,201	1,181		51,494	57,322
Employee cost		8,351	9,444		972	587		9,322	10,031
Rent expenses		1,833	1,977		232	163		2,066	2,140
Other costs		4,518	5,078		658	460		5,176	5,538
PPoP		34,590	39,642		340	(28)		34,930	39,614
Provisions		1,286	1,474		90	182		1,377	1,656
PBT		33,304	38,168		249	(211)		33,553	37,958
Tax		11,490	13,168		86	(73)		11,576	13,095
PAT		21,814	25,000		163	(138)		21,977	24,862
RoA (%)		6.2	6.0		1.3	(1.7)		6.0	5.9
GNPLs	8,700	9,710	11,157	435	896	1,378	9,135	10,606	12,535
GNPLs (%)	2.7	2.5	2.5	2.7	10.0	20.0	2.7	2.7	2.8
Prov coverage (%)	20.0	22.0	24.0	20.0	25.0	30.0	20.0	22.3	24.7
Provisions	1,740	2,136	2,678	87	224	413	1,827	2,360	3,091
Net NPLs	6,960	7,574	8,479	348	672	965	7,308	8,246	9,444
Net NPLs (%)	2.2	2.0	1.9	2.2	7.5	14.0	2.2	2.1	2.1

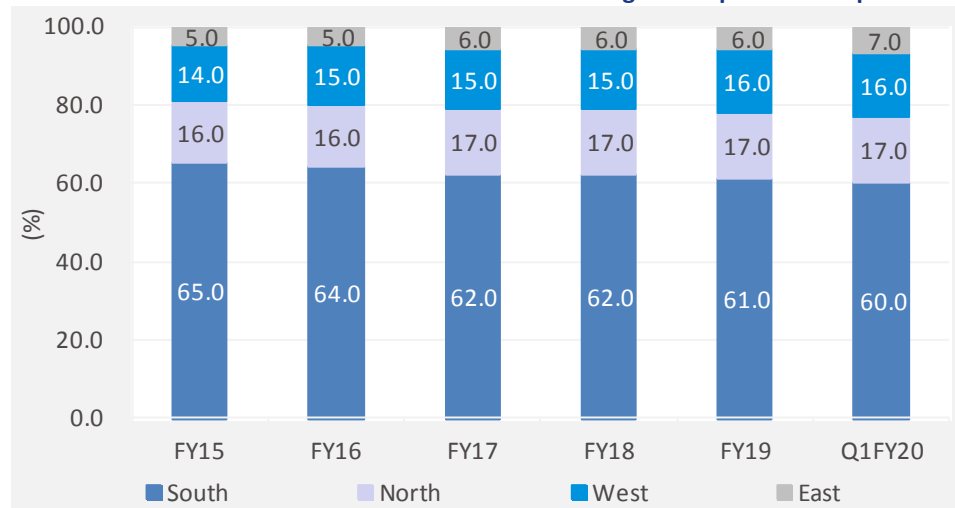
Source: Company, Edelweiss research

**Chart 1: Unproductive branches in Kerala have been closed over the years**



Source: Company

**Chart 2: Branch contribution of South has been declining due to pan-India expansion**



Source: Company

### Muthoot Finance business earnings call: key takeaway

#### What has happened?

- A few employees have joined a trade union (CITU; has support of the ruling party and union). Given the negligible number of employees joining the union, the company does not have to recognise it as per the current law. These employees have declared an indirect strike and prevented other employees from opening branches. Of the overall branches, 300 plus are being threatened and unable to operate.

#### Muthoot's response

- Management has stated that all the branches that will face threats will be closed. ***Muthoot closed down 15 branches on September 5 and other 28 branches on September 6; rationale for further closures will be productivity and profitability.***

#### What will be the impact?

- Muthoot commenced its business in Kerala and within eight decades the company also expanded outside the state. ***Business in Kerala accounts for mere 4.5% (on gold, 611 branches), 13.5% of branches and 3,000 employees. Productivity is much lower in Kerala at INR26.1mn per branch (INR85.7mn outside the state).***
- The ***rationale for having branches in Kerala was that it was the home state and till 2013 the company was doing gold bond debenture.*** Over the past four-five years, Muthoot has been using NCD through public issuance (physical presence not required).
- The 43 branches that are slated to be shut have gold loan AUM of INR1bn. Hence, their closure will not affect the bottom line. They will be closed after three months; till then they will service loans.
- ***Management highlighted that three years ago Muthoot had 800 branches in Kerala and it has closed 190 (unproductive branches) branches over the past three years.*** Management wants to send out a strong message that if the CITU workers continue their threats, more branches will be closed (never said that all the branches will be closed).
- Customers can do remittances through mobile apps and other nearby branches. They will not face challenges in closing the loan amount. In the strike-affected branches as well, employees are opening them after 5 P.M. to service loans.
- Labour payment (much higher than minimum requirement; has given bonus and hikes) regulations are being complied with.

#### Other highlights

- Muthoot has seen positive action from banks after the RBI's measures. While availability of funds has increased, the cost has not dipped significantly (expects this to fall in ensuing quarters).
- Current rate is up to INR2,400/gm.

### Company Description

Muthoot is the largest gold-financing NBFC with an operating history of more than 70 years when M George Muthoot (father of promoters) founded a gold loan business in 1939. At present, it is a closely held family-owned business with promoters (sons of M. George Muthoot and their family) continuing to hold a substantial stake. Headquartered in Kerala, the gold loan NBFC has a network of 5,092 branches, with majority located in southern India. Muthoot has created a leadership position in lending against gold jewellery with AUMs of ~INR358bn.

The Muthoot group has interests in diversified businesses in areas of hospitality, media, education, healthcare, information technology, etc. However, gold loans continue to be the mainstay; hence Muthoot Finance continues to be the flagship company.

### Investment Theme

Medium-term improved outlook for Muthoot is marginally disrupted by the near-term disruption in home town operations. However, business fundamentals remain strong with steady growth, limited LGD and stable funding cost. We maintain **'BUY/SO'**.

### Key Risks

Gold loan dynamics in regions beyond South India are different.

Growth might come under pressure in case of slower ramp-up of branches or decline in gold price.

## Financial Statements

## Key Assumptions

Year to March	FY18	FY19	FY20E	FY21E
<b>Macro</b>				
GDP(Y-o-Y %)	7.2	6.8	6.8	7.1
Inflation (Avg)	3.6	3.4	4.0	4.5
Repo rate (exit rate)	6.0	6.3	5.3	5.0
USD/INR (Avg)	64.5	70.0	72.0	72.0
<b>Sector</b>				
Credit growth	12.0	14.0	17.0	17.0
Deposit growth	12.0	13.0	14.0	14.0
Bank's base rate (%)	9.0	9.0	9.0	9.0
Wholesale borr. cost (%)	8.5	8.5	8.5	8.5
G-sec yield	6.5	7.0	7.1	7.1
<b>Company</b>				
Yield on advances	22.0	21.7	21.2	20.7
Cost of funds	9.2	9.5	9.7	9.9
Net interest margins	15.1	14.3	13.4	13.0
- employee cost	3.3	9.4	12.0	5.0
- advertisement	3,538.6	5.0	5.0	5.0
- rent	5.2	1.2	4.0	4.0
Tax rate (%)	37.6	35.9	34.5	34.5
Number of branches	4,325	4,480	4,380	4,455
Gold loan tenure	2.6	2.6	2.6	2.6
AUMs (in tonnes)/branch	35.8	37.8	41.4	43.6
Average INR per gm	1,861.0	1,983.1	2,181.0	2,334.0
Average LTV	0.7	70.8	71.0	71.0
Gross NPLs	7.0	2.7	2.7	2.8
Prov Cov	11.7	20.0	22.3	24.7

## Income statement

(INR mn)

Year to March	FY18	FY19	FY20E	FY21E
Interest income	61,763	67,857	77,368	87,709
Interest expended	19,399	22,368	26,894	31,477
Net interest income	42,364	45,489	50,474	56,232
- Fee & forex income	660	950	1,020	1,090
Net revenues	43,024	46,439	51,494	57,322
Operating expense	13,057	15,396	16,563	17,709
- Employee exp	7,288	8,414	9,322	10,035
- Depn /amortisation	439	421	410	374
- Other opex	5,330	6,560	6,831	7,299
Preprovision profit	29,967	31,043	34,930	39,614
Provisions	2,397	275	1,377	1,656
Profit Before Tax	27,571	30,768	33,553	37,958
Less: Provision for Tax	10,368	11,047	11,576	13,095
Profit After Tax	17,203	19,721	21,977	24,862
Reported Profit	17,203	19,721	21,977	24,862
Shares o /s (mn)	400	400	400	400
Basic EPS (INR)	43.0	49.3	54.9	62.2
Diluted shares o/s (mn)	400	400	400	400
Adj. Diluted EPS (INR)	43.0	49.3	54.9	62.2
Dividend per share (DPS)	10.0	12.0	13.0	14.0
Dividend Payout Ratio (%)	23.3	24.3	23.7	22.5

## Growth ratios (%)

Year to March	FY18	FY19	FY20E	FY21E
Revenues	24.6	7.9	10.9	11.3
NII growth	23.4	7.4	11.0	11.4
Opex growth	4.4	17.9	7.6	6.9
PPP growth	36.1	3.6	12.5	13.4
Provisions growth	(14.9)	(88.5)	400.9	20.2
Adjusted Profit	45.8	14.6	11.4	13.1

## Operating ratios

Year to March	FY18	FY19	FY20E	FY21E
Yield on advances	22.0	21.7	21.2	20.7
Cost of funds	9.2	9.5	9.7	9.9
Net interest margins	15.1	14.3	13.4	13.0
Spread	12.8	11.9	10.9	10.3
Cost-income	30.3	33.2	32.2	30.9
Tax rate	37.6	35.9	34.5	34.5

Balance sheet		(INR mn)			
As on 31st March	FY18	FY19	FY20E	FY21E	
Share capital	4,000	4,000	4,000	4,000	
Reserves & Surplus	73,604	87,709	103,603	121,914	
Shareholders' funds	77,604	91,709	107,603	125,913	
Long term borrowings	63,804	77,610	89,223	101,767	
Short term borrowings	148,876	181,090	208,186	237,455	
Total Borrowings	212,680	258,700	297,409	339,222	
Long Term Liabilities	14,187	15,114	16,475	17,581	
Def. Tax Liability (net)	(340)	(340)	(340)	(340)	
<b>Sources of funds</b>	<b>304,130</b>	<b>365,183</b>	<b>421,148</b>	<b>482,377</b>	
Gross Block	6,216	6,757	6,423	6,688	
Net Block	1,962	2,082	1,338	1,229	
Capital work in progress	57	-	-	-	
Intangible Assets	43	44	28	26	
Total Fixed Assets	2,062	2,126	1,366	1,254	
Non current investments	3,838	4,138	4,438	4,738	
Cash and Equivalents	4,868	16,919	15,977	16,500	
Loans & Advances	288,480	335,853	392,755	453,154	
Current assets (ex cash)	9,611	11,184	12,102	12,591	
Trade payable	757	806	879	938	
Other Current Liab	3,972	4,232	4,613	4,923	
Total Current Liab	4,729	5,038	5,492	5,860	
Net Curr Assets-ex cash	4,882	6,146	6,611	6,730	
<b>Uses of funds</b>	<b>304,130</b>	<b>365,183</b>	<b>421,148</b>	<b>482,377</b>	
BVPS (INR)	194.3	229.6	269.3	315.2	

RoE decomposition (%)					
Year to March	FY18	FY19	FY20E	FY21E	
Net int. income/assets	15.1	14.3	13.4	13.0	
Non int. income/assets	0.2	0.3	0.3	0.3	
Net revenues/assets	15.3	14.6	13.7	13.2	
Operating expense/assets	(4.7)	(4.8)	(4.4)	(4.1)	
Provisions/assets	(0.9)	(0.1)	(0.4)	(0.4)	
Taxes/assets	(3.7)	(3.5)	(3.1)	(3.0)	
Total costs/assets	(9.2)	(8.4)	(7.9)	(7.5)	
ROA	6.1	6.2	5.9	5.7	
Equity/assets	25.4	26.6	26.5	26.9	
ROAE (%)	24.1	23.3	22.1	21.3	

Valuation parameters					
Year to March	FY18	FY19	FY20E	FY21E	
Adj. Diluted EPS (INR)	43.0	49.3	54.9	62.2	
Y-o-Y growth (%)	45.6	14.6	11.4	13.1	
BV per share (INR)	194.3	229.6	269.3	315.2	
Adj. BV per share (INR)	162.8	216.8	254.9	298.6	
Diluted P/E (x)	13.6	11.9	10.7	9.4	
P/B (x)	3.0	2.5	2.2	1.9	
P/ABV (x)	3.6	2.7	2.3	2.0	

## Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		P/B (X)		ROAE (%)	
		FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Muthoot Finance	3,272	10.7	9.4	2.2	1.9	22.1	21.3
Aavas Financiers	1,706	53.6	40.0	5.9	5.2	11.7	13.8
HDFC	49,147	22.9	17.2	2.4	2.2	14.1	15.2
Indiabulls Housing Finance	2,539	5.7	5.3	1.1	1.0	20.6	19.7
LIC Housing Finance	2,809	7.6	6.4	1.1	1.0	15.3	16.1
Mahindra & Mahindra Financial Services	2,793	17.1	12.4	1.8	1.6	10.6	13.9
Manappuram Finance	1,389	11.8	10.2	2.0	1.7	18.2	18.3
RepcO Home Finance	277	7.3	6.4	1.1	1.0	16.4	16.2
Shriram City Union Finance	1,238	7.8	6.9	1.2	1.1	16.6	16.4
Shriram Transport Finance	3,149	8.3	7.0	1.3	1.1	17.0	17.4
Median	-	9.6	8.2	1.6	1.4	16.5	16.3
AVERAGE	-	16.1	13.1	2.2	1.9	16.2	16.8

Source: Edelweiss research

## Additional Data

### Directors Data

M. G. George Muthoot	Chairman	George Alexander Muthoot	Managing Director
George Thomas Muthoot	Joint Managing Director	George Jacob Muthoot	Joint Managing Director
George Joseph	Independent Director	John K. Paul	Independent Director
K John Mathew	Independent Director	Pamela Anna Mathew	Independent Director
Alexander Muthoot George	Deputy Managing Director	K George John	Independent Director

Auditors - Rangamani & Co.

*\*as per last annual report*

### Holding - Top 10

	Perc. Holding		Perc. Holding
Tata Asset Management	1.22	Reliance Nippon Life Asset Management	1.21
Dimensional Fund Advisors	1.16	Aditya Birla Sun Life Trustee	1.05
UTI Asset Management	0.93	Vanguard Group	0.86
ICICI Prudential Asset Management	0.80	Mirae Asset Global Investments	0.75
AllianceBernstein	0.74	SBI Funds Management	0.72

*\*as per last available data*

### Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

*\*in last one year*

### Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
15 Feb 2019	George Alexander Muthoot	Sell	19500.00
30 Jan 2019	George Alexander Muthoot	Sell	20900.00
24 Dec 2018	George Alexander Muthoot	Sell	31700.00

*\*in last one year*



Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Aavas Financiers	HOLD	SP	M	Aditya Birla Capital	BUY	SO	H
Axis Bank	HOLD	SP	M	Bajaj Finserv	REDUCE	SU	L
Bank of Baroda	REDUCE	SU	M	DCB Bank	HOLD	SP	M
Equitas Holdings	BUY	SO	M	Federal Bank	BUY	SO	L
HDFC	BUY	SO	L	HDFC Bank	BUY	SO	L
ICICI Bank	BUY	SO	L	IDFC Bank	BUY	SP	L
Indiabulls Housing Finance	HOLD	SU	M	IndusInd Bank	BUY	SO	L
Kotak Mahindra Bank	BUY	SP	M	L&T Finance Holdings	HOLD	SU	M
LIC Housing Finance	BUY	SP	M	Magma Fincorp	BUY	SP	M
Mahindra & Mahindra Financial Services	BUY	SP	M	Manappuram Finance	BUY	SP	H
Max Financial Services	BUY	SO	L	Multi Commodity Exchange of India	HOLD	SU	M
Muthoot Finance	BUY	SO	M	Power Finance Corp	BUY	SP	M
Punjab National Bank	REDUCE	SU	M	Reliance Capital	BUY	SP	M
Repco Home Finance	BUY	SP	M	Rural Electrification Corporation	HOLD	SU	M
Shriram City Union Finance	BUY	SP	M	Shriram Transport Finance	BUY	SO	M
South Indian Bank	BUY	SP	M	State Bank of India	BUY	SO	L
Union Bank Of India	HOLD	SU	M	Yes Bank	HOLD	SU	M

## ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

## RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

## RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

## SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

Edelweiss  
Ideas create, values protect



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## Coverage group(s) of stocks by primary analyst(s): Banking and Financial Services

Aavas Financiers, Aditya Birla Capital, AU Small Finance Bank Ltd, Axis Bank, Bharat Financial Inclusion, Bajaj Finserv, Bank of Baroda, Capital First, DCB Bank, Dewan Housing Finance, Equitas Holdings Ltd., Federal Bank, HDFC, HDFC Bank, ICICI Bank, ICICI Lombard General Insurance Company Ltd, IDFC Bank, Indiabulls Housing Finance, IndusInd Bank, Karnataka Bank, Kotak Mahindra Bank, LIC Housing Finance, L&T FINANCE HOLDINGS LTD, Max Financial Services, Multi Commodity Exchange of India, Manappuram General Finance, Magma Fincorp, Mahindra & Mahindra Financial Services, Muthoot Finance, Punjab National Bank, Power Finance Corp, Reliance Capital, Rural Electrification Corporation, Repco Home Finance, State Bank of India, Shriram City Union Finance, Shriram Transport Finance, South Indian Bank, Union Bank Of India, Yes Bank

### Recent Research

Date	Company	Title	Price (INR)	Recos
05-Sep-19	<b>BFSI Week</b>	A Financial Travelogue: From Branch to Boardroom; <i>Sector Update</i>		
30-Aug-19	<b>Banking</b>	Consolidation: The wait is over; <i>Sector Update</i>		
16-Aug-19	<b>Repco Home Finance</b>	Growth challenges persist, revival key; <i>Result Update</i>	302	Buy

### Distribution of Ratings / Market Cap

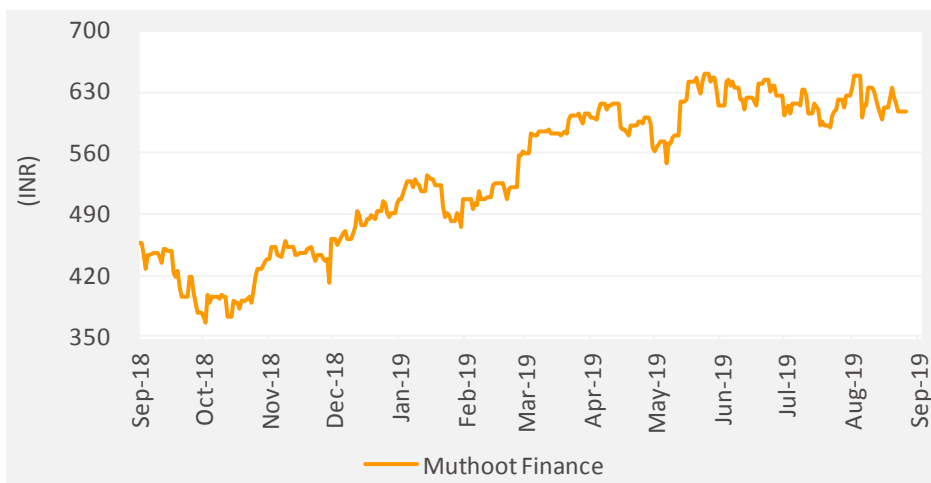
#### Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

### Rating Interpretation

Rating	Expected to
<b>Buy</b>	appreciate more than 15% over a 12-month period
<b>Hold</b>	appreciate up to 15% over a 12-month period
<b>Reduce</b>	depreciate more than 5% over a 12-month period

One year price chart



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