Muthoot Finance Limited

ICRA has assigned an 'IPO Grade 4', indicating above-average fundamentals to the proposed Initial Public Offering of Muthoot Finance Limited (MFL). ICRA assigns an IPO grading on a scale of IPO Grade 5 through IPO Grade 1, with Grade 5 indicating 'strong fundamentals' and Grade 1 indicating 'poor fundamentals'. Muthoot Finance Limited (MFL) proposes to launch an Initial Public Offering (IPO) through an issue of 5.15 crore equity shares with a face value Rs. 10 with a premium that will be determined through a book-building process. The offers will constitute 13.85% of the fully diluted, post-issue, paid-up equity share capital of the company. Following the IPO, the shareholding of the promoters of the company will reduce from 93% to 80.12%. The offer would be made through the 100% book-building route. Of the net offer, 50% is reserved for Qualified Institutional Buyers (QIBs) while 15% and 35%, respectively, are reserved for non-institutional investors and retail investors. Post the IPO, the shares will be listed on the National Stock Exchange (NSE) and the Bombay Stock Exchange (BSE). The objective of the offer is to augment the capital base of MFL in order to support its capital requirements arising out of anticipated growth in assets and for also compliance with regulatory capital adequacy requirements.

The above-average fundamental grading factors in the high growth prospects of MFL in the niche loan against gold ornament segment, wherein the scope for expansion is significant in view of the large holdings of gold ornaments by households and relative under-penetrated market. MFL is well-positioned to leverage the robust growth potential in the segment on the back of its strong market knowledge; well-established systems and processes and good track record in scaling up operations while maintaining a tight control on asset quality and sustaining good profitability. The company has expanded its branch network from 551 branches to 1605 branches over the last three years ending March 31, 2010, resulting in a portfolio CAGR of 73%. During the same period, credit losses on gold loans have been minimal. In FY 2010, credit losses were at Rs. 0.67 crore or less than 0.01% of average managed advances, thus supporting a healthy return on equity (RoE) of 48%. Strong growth in portfolio has been facilitated by investments towards expansion of branch network in traditional loan against gold ornaments geographies, that is, southern India as well as the relatively under-tapped new geographies in northern India. MFL's large and geographically spread branch network (numbering 2038 in September 2010) and its ability to provide a higher level of service viz.a.viz banks with respect to quicker disbursement , turnaround time and higher advance rates per gram (Loan to value ratios) are competitive factors in its favor. At the same time, MFL is exposed to adverse movements in gold prices and operational risks associated with the gold loan segment. Nevertheless, MFL has strong and established risk management, internal audit, monitoring and surveillance systems to mitigate any risks; and has been able to maintain good control over operations and asset quality while growing at a robust pace. Nevertheless, the company operates a mono-line business model and is, therefore, exposed to concentration risks. MFL enjoys good financial flexibility and raises funds at relatively competitive rates from banks and institutional investors. MFL enjoys the high credit ratings of LAA- and A1+ from ICRA, which support its ability to raise funds at competitive rates. Furthermore, the strong franchise and the group's long track record in Kerala enable MFL to tap retail funding sources (accounting for about 33% of total funding in September 2010). Roll over rates on retail borrowings have historically been high, thus supporting the liquidity profile of the company. With the augmentation of the company's capital base through its proposed IPO, MFL should be in a position to leverage the same to expand its portfolio. As on December 2010, the capital adequacy of MFL was at 15.19% (Tier 1 of 10.69%). The company raises subordinate debt (which classifies as Tier 2 capital, subject to a maximum of 50% of Tier I capital) placed primarily to its retail investors. MFL currently has limited headroom to raise additional Tier 2 capital in the form of subordinate debt but has headroom (of Rs. 590 Crore) to raise Tier 2 capital in the form of preference shares to meet its regulatory capital adequacy requirements of 15% (with effect from March 2011). ICRA expects fresh equity mobilised through the proposed IPO to create additional headroom for MFL to raise Tier 2 capital, thereby expanding its capacity to lend. The company enjoys a strong earnings profile (PAT/ Avg. Net worth of 48.90% and PAT/ Avg. Managed Assets of 3.76% in September 2010) on the back of its healthy gross interest spreads and low credit costs. ICRA has also taken note of the RBI notification of February 2011, which removes the eligibility of gold loans sourced by NBFCs from classification as agriculture advances. Consequently, the incremental cost of funding to MFL from banks could increase, as the existing bank borrowings availed under the agriculture classification get converted to higher-cost (by around 100-150 bps) non-agriculture limits. Nevertheless, ICRA expects the company's access to banking credit to remain healthy and facilitate portfolio growth. As on December 31, 2010, around 37% of the total assets of MFL were funded out of banking limits (including assignment portfolios) classified as agriculture lending. As a result, the incremental net interest margins could come down to the extent of around 50 bps. Nevertheless, ICRA expects interest margins of the company to remain healthy, which along with improving operating efficiencies should enable MFL to maintain a healthy earnings profile and returns to shareholders.

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

As on September 30, 2010 MFL's credit portfolio was Rs. 11,550 crore out of which 99% was in the form of loans against gold and the balance in loans against Non Convertible Debentures issued by MFL. The company's branch network is spread across 21 states and four union territories. Gold loans traditionally have been prominent in South India as a means to raise immediate short term funding by pledging of household gold ornaments. Average ticket sizes in the segment are low at ~Rs. 30,580 for MFL in Sep-10. While the gold loans have a contractual maturity of 12 months these are pre-closed and an estimated 75% of the portfolio is re-paid within 4 months. Given the popularity of the product in South India 75% of the company's portfolio and 69% of branches in Sep-10 were in the South. MFL however has over the past few years focussed on expanding outside the south and the share of portfolio of the company from these states has increased to 25% in Sep-10 against 16% in Mar-07. Going forward the company is expected to continue to expand the scale of its operations by leveraging its existing branches and also by increasing its geographic penetration.

About the Company

Muthoot Finance Ltd (MFL) is the flagship company of 'The Muthoot Group' based in southern India. The group has a presence in diverse businesses including financing, healthcare, real estate, education, hospitality, forex, wealth management services, money transfer services, power generation and entertainment. MFL is registered as a Non-Banking Financial Company - Non Deposit taking - Systemically Important (NBFC-ND-SI); and is engaged in the loan against gold ornament segment with a managed advance base of Rs. 11,550 Crore as on September 30, 2010. The lending operations of the Group were commenced in 1939 by Late. Mr. M. George Muthoot. Ever since, 'loan against gold ornaments' has remained the core business of the Group. Until 1997, the business operated under 'Muthoot Bankers', a partnership firm. 'Muthoot Finance Pvt. Ltd' was incorporated in March 1997. In November 2001, the company received its NBFC registration from the RBI and the business was gradually transferred to it. The company was converted into a public limited company in FY 2009 and its name was changed to 'Muthoot Finance Limited' (MFL). MFL is classified as an NBFC- ND- SI (Systemically Important, Non-Deposit Taking NBFC). Although the company is a non-deposit accepting NBFC, it does accept retail debentures (not considered as public deposits), which accounted for close to 33% of the company's total funding as on September 302010.

As on December 31, 2010, the promoters of MFL held a 93% stake in the company. The promoters diluted their stake from 100%, following issue of fresh shares to the extent of 6% of their shareholding during H1, 2011 to private equity investors– Matrix Partners, Baring India Private Equity, Kotak India Private Equity, Kotak Investment Advisors Limited and the Wellcome Trust Limited. Subsequently the promoters sold 1% of their shareholding to the Wellcome Trust Limited. As on December 31, 2010, the company had a capital adequacy of 15.19% and a Tier 1 Capital of 10.69%. MFL for the financial year ended March 31, 2010 reported a PAT of Rs. 227.6 Crore on a managed asset base of Rs. 8451 Crore as compared to a PAT of Rs. 97.7 Crore on a managed asset base of Rs. 4578 Crore during the previous financial year. During the half year ended September 30, 2010, MFL registered a 167% y-o-y growth in PAT to Rs. 198 Crore as compared with Rs. 74 Crore during the corresponding period in the previous financial year.

March 2011

For further details please contact:
Analyst Contacts:
Ms. Vibha Batra, (Tel. No. +91 124 4545302)
vibha@icraindia.com

Relationship Contacts:
Mr. Jayanta Chatterjee, ICRA Bangalore (Tel. No. +91-80-22597401)
jayantac@icraindia.com

Registered Office

ICRA Limited
1105, Kailash Building, 11th Floor, 26, Kasturba Gandhi Marg, New Delhi 110001
Tel: +91-11-23357940-50, Fax: +91-11-23357014

Corporate Office
Mr. Vivek Mathur
Mobile: **9871221122**
Email: vivek@icraindia.com

Building No. 8, 2nd Floor, Tower A, DLF Cyber City, Phase II, Gurgaon 122002
Ph: +91-124-4545310 (D), 4545300 / 4545800 (B) Fax; +91-124-4545350

Mumbai
Mr. L. Shivakumar
Mobile: **91-22-30470005/9821086490**
Email: shivakumar@icraindia.com

3rd Floor, Electric Mansion, Appasaheb Marathe Marg, Prabhadevi, Mumbai - 400 025
Ph : +91-22-2433 1046/ 1053/ 1062/ 1074/ 1086/ 1087
Fax : +91-22-2433 1390

Kolkata
Ms. Anuradha Ray
Mobile: **91-33-22813158/9831086462**
Email: anuradha@icraindia.com

A-10 & 11, 3rd Floor, FMC Fortuna, 234/ 3A, A.J.C. Bose Road, Kolkata-700020.
Tel: +91-33-2287 6617/ 8839/ 2280 0008
Fax: +91-33-2287 0728

Chennai
Mr. Jayanta Chatterjee
Mobile: **9845022459**
Email: jayantac@icraindia.com

Email: **Mr. K. Ravichandran**
Mobile: **91-44-45964301/ 9940008808**
Email: ravichandran@icraindia.com

5th Floor, Karumuttu Centre, 498 Anna Salai, Nandanam, Chennai-600035.
Tel: +91-44-2433 3293/ 94, 2434 0043/ 9659/ 8080, 2433 0724, Fax:91-44-24343663

Bangalore
Mr. Jayanta Chatterjee
Mobile: **9845022459**
Email: jayantac@icraindia.com

2 nd Floor. ,Vayudhoot Chambers, Trinity Circle, 15-16 M.G.Road, Bangalore-560001.
Tel:91-80-25597401/ 4049 Fax:91-80-25594065

Ahmedabad
Mr. L. Shivakumar
Mobile: **9821086490**
Email: shivakumar@icraindia.com

907 & 908 Sakar -II, Ellisbridge,
Ahmedabad- 380006
Tel: +91-79-26585494, 26582008,26585049, 26584924
TeleFax:+91-79- 2648 4924

Pune
Mr. L. Shivakumar
Mobile: **9821086490**
Email: shivakumar@icraindia.com

5A, 5th Floor, Symphony, S.No. 210, CTS 3202, Range Hills Road, Shivajinagar,Pune-411 020
Tel : (91 20) 2556 1194 -96; Fax : (91 20) 2556 1231

Hyderabad
Mr. M.S.K. Aditya
Mobile: **9963253777**
Email: adityamsk@icraindia.com

301, CONCOURSE, 3rd Floor, No. 7-1-58, Ameerpet, Hyderabad 500 016.
Tel: +91-40-2373 5061 /7251 Fax: +91-40- 2373 5152