

Muthoot Finance Ltd.

SECTOR: NBFC



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Issue Snapshot	
Issue Open	18-Apr-11
Issue Close	20-Apr-11
Price Band (INR)	160-175
Issue Size (INR Bn)	8.24 - 9.01
Market Cap (INR Bn)	59.47 - 65.05
Issue Size (No. of Shares)	51,500,000
Fresh Issue (No. of Shares)	51,500,000
Offer for Sale (No. of Shares)	0
QIB	18,025,000
Non-Institutional	7,725,000
Retail	25,750,000
Face Value (INR)	10
Book Value as of 30.11.10 (INR)	35.33
Capital Structure	
Pre Issue Equity (INR Mn)	3202
Post Issue Equity (INR Mn)	3717

Shareholding Pattern	Pre Issue (%)	Post Issue (%)
Promoter & Promoter Groups	93.00%	80.12%
Other Institutions	7.00%	7.00%
Public	0	12.88%
Total	100%	100.00%
Total Shares	320,212,768	371,712,768

Objects of the Issue	INR Mn.
Augment Capital Base to meet future capital requirements arising out of growth in business	[.]
Total	[.]

Website: www.muthootfinance.com

Muthoot Finance Limited primarily provides loan against household used gold jewellery; and offers other products and services like money transfer, insurance, securities, foreign exchange, vehicle, and asset finance services. Headquartered in Kerala, Muthoot Finance Ltd is a non-deposit taking 'systemically important' non-banking finance company (NBFC) incorporated in 1997. It has the largest branch network among gold loan providers in India with 2,611 branches and a strong presence in the under-served rural and semi-urban markets.

Investment Rationale**Largest Gold Financing company in India**

Muthoot Finance Ltd (MFL) is the largest gold finance company in India, in terms of Loan Book, Branch presence as well as market share, as per IMAcS report. MFL has the largest Branch network for LAG business, with 2611 branches as on February'11.

Efficient Fund raising

MFL has been able to garner good confidence of retail investors as well as PE investors alike, who have subscribed to the capital of MFL in the form of NCDs called Gold Bonds to the tune of INR 33bn and PE investors who contribute 7% of equity of MFL.

Healthy Profitability, Return ratios

MFL has demonstrated healthy Spreads on its Loan book, which coupled with increased branch efficiency and decreased Operating Cost ratios have added to the Return Ratios growth. Going forward, however, we expect the spreads to start tapering off due to likely increase in Cost of Funds and also compression in Yields due to regulatory changes.

Investment Concerns

- Dependence on single line of business; regional concentration
- Increasing competition to lower gold loan yields to put pressure on margins
- Regulatory Hiccups for MFL with respect to state government statutes like State Money Lenders Act, any adverse regulatory rulings would impact growth prospects of the company
- Potential risk of brand dilution due to use of the moniker 'Muthoot' by other gold loan financiers, may have a brand dilutive effect

Valuation

MFL, being the largest Gold Loan provider in the country, would likely grow in line with the industry growth and we expect it to post an EPS of INR 14.81 and ABV of INR 50.19 for FY11E. At higher price band, MFL would trade at 12x and 3.5x its P/E and P/ABV respectively. We believe the current pricing captures the likely growth of MFL, we recommend "SUBSCRIBE".

Investment Rationale

Largest Gold Financing company in India

Muthoot Finance Ltd (MFL) is the largest gold finance company in India, in terms of Loan Book, Branch presence as well as market share, as per IMAcS report. MFL has the largest Branch network for LAG business, with 2611 branches as on February'11.

Gold Loans Provider	Estimated Gold Loans Portfolio (Rs. Billion)			Gold Loans Market Share (%)		
	FY 07	FY 09	FY 10	FY 07	FY 09	FY 10
Muthoot Finance	14.2	33.0	73.42	11.0%	13.4%	19.5%
Muthoot Fincorp	4.7	11.8	22.2	3.6%	4.8%	5.9%
Manappuram *	4.8	12.0	25.6	3.7%	4.9%	6.8%
Indian Bank	17.0	32.5	39.2	13.2%	13.2%	10.4%
Indian Overseas Bank	16.9	31.0	52.2	13.1%	12.6%	13.9%
Federal Bank	6.0	10.7	8.6	4.7%	4.3%	2.3%
South Indian Bank	6.0	15.0	23.5	4.7%	6.1%	6.3%
State Bank Of Travancore	11.4	16.0	19.3	8.9%	6.4%	5.1%
Andhra Bank	4.0	9.0	14.0	3.1%	3.6%	3.7%

Source: RHP

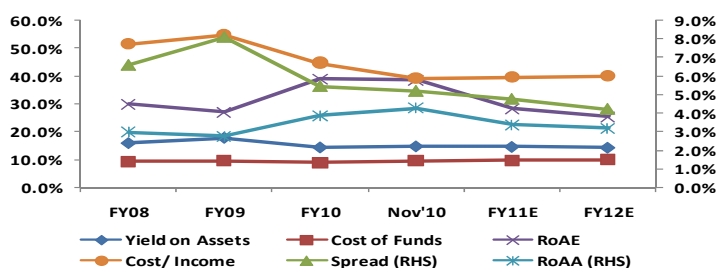
Efficient Fund raising

MFL has been able to garner good confidence of retail investors as well as PE investors alike, who have subscribed to the capital of MFL in the form of NCDs called Gold Bonds to the tune of INR 33bn and PE investors like Matrix Partners, Baring India Private Equity, Kotak India Private Equity, Kotak Investment Advisors Limited and the Wellcome Trust Limited have subscribed to equity of MFL to the tune of 7% of pre-issue capital ie 22mn shares.

Healthy Profitability, Return ratios

MFL has demonstrated healthy Spreads on its Loan book, which coupled with increased branch efficiency and decreased Operating Cost ratios have added to the Return Ratios growth. Going forward, however, we expect the spreads to start tapering off due to likely increase in Cost of Funds and also compression in Yields due to RBI notification for change in status of loan assets - now no longer being qualified as Priority Sector Loans (PSL) form ~ 27% of its total AUM of INR 130bn as on Nov'10.

Profitability Ratios



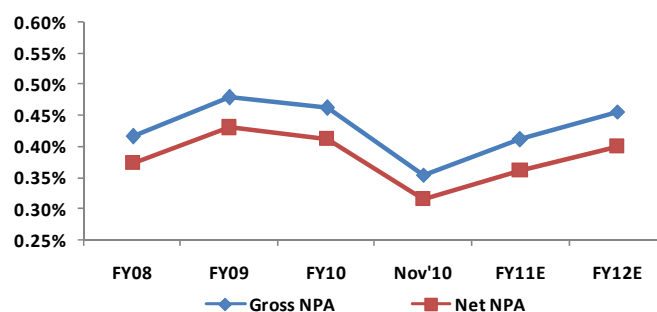
Source: SPA Research

Strong Brand presence and Management Expertise

MFL has an operating history of over 70 years which lends it huge experience, skills and goodwill acquired by its Promoters that is difficult to replicate/ acquire by competitors. With strong entrepreneurial skills at operational levels as well growing the business book by CAGR of ~24% in last 4 years, to raising efficient capital; the management team of MFL remains a good backbone to the robust business model of MFL.

Asset Quality - remains healthy

MFL has been able to maintain a healthy asset quality despite the robust growth in its AUMs. We believe, MFL should likely continue to display good health in its asset book going forward too, however with slightly higher incremental NPAs.



Source: RHP, SPA Research

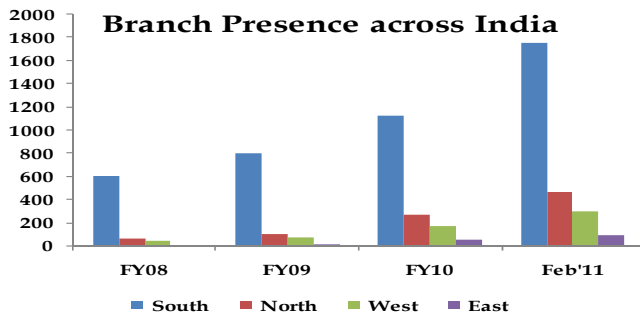
Investment Risks

- **Dependence on single line of business; regional concentration** - MFL derives 98% of revenues from the gold loan business and its concentration in South India, which accounts for 75% of AUMs poses a concentration risk.
- **Increasing competition to lower gold loan yields**, thereby putting margin pressure.
- **Regulatory Hiccups** for MFL with respect to state government statutes like State Money Lenders Act on money lending activities. Any adverse regulatory rulings would impact growth prospects of the company.
- **Potential risk of brand dilution** - Although Muthoot Finance is a strongly entrenched brand name in gold loan financing, the use of the moniker 'Muthoot' by other gold loan financiers, may have a brand dilutive effect.

Company Background

Muthoot Finance Ltd is a non-deposit taking 'systemically important' non-banking finance company (NBFC) incorporated in 1997. The company founded in 1887 and based in Ernakulam, is a subsidiary of Muthoot Capital Services Ltd. It has the largest branch network among gold loan providers in India with 2,611 branches and a strong presence in the under-served rural and semi-urban markets and is primarily in the business of lending against used household gold jewellery to individuals.

With a concentrated branch presence in South, now MFL has decided to foray in other geographies, including plans to foray with its business outside India too.



Source: RHP, SPA Research

As on December 31, 2010, the promoters of MFL held a 93% stake in the company. The private equity investors- Matrix Partners, Baring India Private Equity, Kotak India Private Equity, Kotak Investment Advisors Limited and the Wellcome Trust Limited hold 7% stake in MFL.

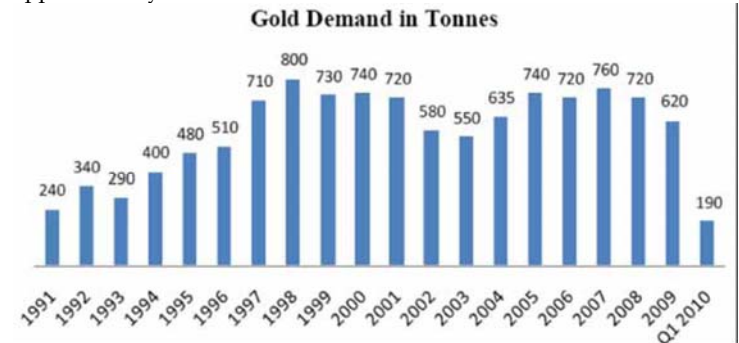
The lending operations of the Group were commenced in 1939 by Late. Mr. M. George Muthoot and 'loan against gold ornaments' remained the core business of the Group. Until 1997, the business operated under 'Muthoot Bankers', 'Muthoot Finance Pvt. Ltd' was incorporated in March 1997. In November 2001, 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). 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 30 2010.

Due to vibrancy in gold holdings as well as gold prices globally, we expect the underlying Gold loan market to grow domestically at a healthy CAGR of ~35% for the period FY11E to FY13E, hence offering huge growth opportunities for players like MFL.

Industry Dynamics

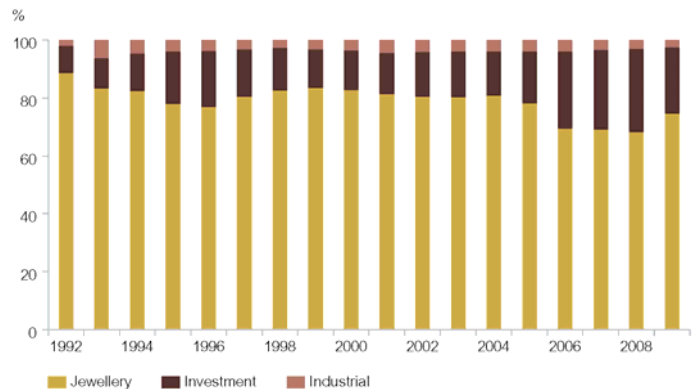
India - robust gold market

India is one of the largest markets for gold and as of fiscal 2010, accounts for approximately 10% of the total world gold stock with an annual demand of approximately 700 tonnes



Source: IMAcS Report, RHP

Gold jewellery accounted for around 75% of total Indian gold demand in 2009, the remainder being investment (23%) and decorative and industrial (2%). Indian consumers also regard gold jewellery as an investment and are well aware of gold's benefit as a store of value.



Source: IMAcS, GMFC

Organized Market - 1.2% of total value of gold

Organized Gold Loans portfolio account for merely 1.2% of the value of total gold stock in India. Indian jewellery consumption intensity is still relatively low at just 0.4 grams in 2009. The Gold Loans market is significantly under-penetrated and is expected to continue growing at the rate of 35-40% in the future.

Peer Comparison

Peer Comparison	CMP (INR)	M-Cap (INR Mn)	EPS (INR)	BV (INR)	RoE (%)	RoA (%)	P/E (x)	P/BV (x)
Muthoot @ 160	160	59474	14.81	52.28	28.33%	3.38%	10.80	3.06
Muthoot @ 175	175	65050	14.81	52.28	28.33%	3.38%	11.81	3.35
MAGFIL	127	43315	6.20	47.09	20.07%	6.03%	20.54	2.70

* All the above figures are for FY11E

Outlook and Valuation

MFL, being the largest Gold Loan provider in the country, would likely grow in line with the industry growth and we expect it to post an EPS of INR 14.81 and ABV of INR 50.19 for FY11E. At higher price band, MFL would trade at 12x and 3.5x its P/E and P/ABV respectively. As compared to its listed peer, MFL fares better on its Return on Equity largely due to leverage differential on the balance sheet among both the companies. Having the benefit of sheer size, we believe MFL deserves a better multiple on its book value. However, we believe the current pricing captures the likely growth of MFL, we recommend "SUBSCRIBE".

Muthoot Finance Co - IPO Note
Financials

Income Statement (INR Mn.)						Balance Sheet (INR Mn.)					
	FY08	FY09	FY10	Nov'10	FY11E		FY08	FY09	FY10	Nov'10	FY11E
Interest Earned	3579	6062	10775	12893	24251	Share capital	50	490	3,010	3,202	3,254
Interest Expenses	1798	3098	4737	5826	12398	Reserves	2,174	3,212	2,835	8,115	13,759
NII	1781	2965	6037	7068	11852	Misc Exp w.off	(93)	(88)	(4)	(3)	(2)
Other Income	107	142	119	123	153	Net Reserves	2,081	3,124	2,832	8,112	13,757
Total income	1888	3106	6157	7191	12005	Net worth	2,131	3,614	5,842	11,315	17,011
Operating Expenses	919	1625	2701	2780	4711	Secured loans	18,400	30,087	45,471	80,330	110,365
Personnel expenses	49	121	192	128	192	Unsecured loans	753	1,568	7,334	10,499	15,380
SG & A Exp	796	1405	2360	2547	4362	Total Debts	19,153	31,656	52,805	90,829	125,745
Depreciation	74	99	149	105	158	TOTAL	21,284	35,270	58,647	102,144	142,756
PP Profits	970	1482	3456	4411	7294	Net block	993	1,162	1,242	1,481	1,204
Provisions	0	0	0	0	0	CWIP	94	131	291	510	650
Profit before tax	970	1482	3456	4411	7294		1,086	1,293	1,533	1,991	1,854
Provision for tax	334	505	1180	1496	2474	Investments	183	85	75	75	75
Tax rate %	34.4%	34.1%	34.1%	33.9%	33.9%	Net DTA	(42)	(38)	(25)	(24)	(35)
Net Profit	636	977	2276	2915	4820	Net Curr Assets	20,056	33,930	57,064	100,102	140,862
						TOTAL	21,284	35,270	58,647	102,144	142,756

Cash Flow Statement (INR Mn.)	FY08	FY09	FY10	Nov'10	FY11E
Net Cash - Operating	(2,768)	(6,634)	(23,866)	(41,247)	
Net Cash - Investing	(541)	(124)	(348)	(487)	
Net Cash - Financing	5,327	13,003	21,149	40,581	
Net Cash Flow	2,017	6,245	(3,065)	(1,153)	
Opening C&CE	563	2,580	8,825	5,760	
Closing C&CE	2,580	8,825	5,760	4,607	

Asset Quality	FY08	FY09	FY10	Nov'10	FY11E
Gross NPA	0.42%	0.48%	0.46%	0.35%	0.41%
Net NPA	0.37%	0.43%	0.41%	0.32%	0.36%
PCRatio	10.04%	9.99%	10.80%	10.87%	12.00%

Profitability	FY08	FY09	FY10	Nov'10	FY11E
Yield on Assets	15.99%	17.90%	14.42%	14.81%	14.62%
Cost of Funds	9.39%	9.79%	8.97%	9.62%	9.86%
Spread	6.60%	8.12%	5.45%	5.19%	4.76%
RoAE	29.83%	27.04%	38.96%	38.64%	28.33%
RoAA	2.99%	2.77%	3.88%	4.28%	3.38%
Cost/ Income	51.57%	54.80%	44.74%	39.33%	39.75%

Key Data	FY08	FY09	FY10	Nov'10	FY11E
EPS	127.16	19.94	7.56	9.10	14.81
BV	426.21	73.76	19.41	35.33	52.28
ABV	407.69	70.48	18.27	33.89	50.19
P/E @ 160 (x)	1.26	8.02	21.16	17.58	10.80
P/E @ 175(x)	1.38	8.78	23.15	19.22	11.81
P/ BV @ 160(x)	0.38	2.17	8.24	4.53	3.06
P/ BV @ 175 (x)	0.41	2.37	9.02	4.95	3.35
P/ABV @ 160(x)	0.39	2.27	8.76	4.72	3.19
P/ ABV @ 175 (x)	0.43	2.48	9.58	5.16	3.49

Efficiency Ratios	FY08	FY09	FY10	Nov'10	FY11E
No of Branches	707	985	1605	2263	2841
Revenues	3579	6062	10775	12893	24251
Avg Rev/ branch	5.06	4.89	5.25	5.23	6.54
Avg Cost/ branch	0.45	0.80	0.96	2.09	2.58
Average Profits	636	806	1626	2595	3867
Avg Profit / branch	0.90	0.82	1.01	1.15	1.36
Total AUM	22388	33866	74700	130570	165872
Average AUM	22388	28127	54283	102635	148221
Avg AUM /branch	31.67	28.55	33.82	45.35	52.17

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Disclosure of Interest Statement

1. Analyst ownership of the stock - No
2. Group/Directors ownership of the stock - No
3. Broking relationship with company covered - No

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