

Dear Member,

We are pleased to inform you that Value Pick of Sept 2018 is released by our team today on 02 Dec 2018. Value Pick stock of the month is Manappuram Finance Ltd (**BSE Code: 531213, NSE Code: MANAPPURAM**). Manappuram Finance has a market capital of Rs. 7273 crores and operates in NBFC sector.

IMP Note: We would like to inform our members that we will release Value Pick stock reports of Oct 2018 and Nov 2018 during this month / early next month. Similarly, we will release Value Pick stock report of Dec 2018 and Jan 2019 by Jan 2019 / early Feb 2019. As we informed earlier also, we find valuations of many mid cap companies attractive to very reasonable after significant correction in stock prices since Jan 2018. This is opportune time for long term investors to be aggressive by investing more into equities over next 2 to 6 months. The delay in release of reports was mainly on account of higher valuations of stocks in past and weakening macros, however post recent fall in crude oil prices, Indian currency gaining strength and inflation under control, we expect companies to perform much better in coming quarters. Hence, we decided to release 4 Value Pick stock reports i.e. of Oct 2018, Nov 2018, Dec 2018 and Jan 2019 over next 2 months so that you can allocate higher investments by investing in all these stocks available at reasonable to attractive valuations with significant upside potential over next 12 to 24 months.

1. Company Background:

Manappuram Finance was incorporated in 1992 and is now the second largest gold loan NBFC in India. The company is promoted by Mr VP Nandakumar, MD & CEO, whose family has been involved in the gold loans business since 1949.

Mr. V.P. Nandakumar holds a post graduate degree in Science, with additional qualifications in Banking & Foreign Trade. He began his career with the erstwhile Nedungadi Bank Limited, but in 1986 he resigned from the Bank to take over the family business upon the demise of his father, V.C. Padmanabhan. In 1992, he promoted Manappuram Finance Ltd. and since then has led the Company initially as Chairman & Managing Director and since 2012 as Managing Director & CEO.

As the company focused on gold loans, Manappuram Finance was prone to the concentration risk till FY14. Financial sector regulators in India have been expressing concern over the concentration risk inherent in the mono-line business model. To assuage their concerns, the company took initiatives to become a multi-product company.

The company has diversified into new business areas like microfinance, vehicle and housing finance, and SME lending. In February 2015, the company acquired Asirvad Microfinance Pvt. Ltd. with AUM a little short of Rs.3,000 million. Today, three year of its takeover, AUM has more than Rs.24,000 million after the subsidiary expanded operations

to new geographies like Madhya Pradesh, Chhattisgarh, Punjab, Haryana, Chandigarh, and UP. Accelerated growth is reported in the other new business segments too.

The overall AUM of Rs 15,765 crore as on March 31, 2018, includes gold loan (74%), microfinance (15%), commercial vehicle finance (4%), housing (2%), and others (4%). The gold loan portfolio is diversified across 28 states and union territories, whereas the microfinance, commercial vehicle, and housing portfolios are diversified across 20, 19, and 6 states, respectively.

2. Recent Developments:

i) Equity Infusion upto Rs. 250 crores in Subsidiary – Nov 2018

The board of directors at their meeting dated 06.11.2018 approved equity infusion up to Rs.150 crore in its subsidiary Asirvad Micro Finance Ltd and equity infusion up to Rs.100 Crores in its wholly owned subsidiary Manappuram Home Finance Ltd.

The capital infusion will facilitate in business growth of both the subsidiaries. Being the largest business after gold loans, microfinance is strategically important to the company. Moreover, given the strategic importance of affordable home finance to the company's future plans as it proceeds with the diversification of the range of its financial products, it is reasonable to expect strong support from the parent.

Both the businesses is scalable and profitable and hence will be key growth driver for Manappuram Finance.

ii) RBI rejects Manappuram's IFSC Stake Buy Proposal – Sept 2018

The Reserve Bank of India has not accepted the proposal for the acquisition of 85.39% stake in Indian School Finance Company by Manappuram Finance, according to a letter sent by the central bank dated September 12 to ISFC.

The bank after careful examination of the issues involved with changes in shareholding and change of management due to the proposed acquisition of shares/CCPS/CCDs by Manappuram Finance, has not found the proposal as acceptable.

iii) Acquisition of Indian School Finance Company Pvt Ltd – July 2018

Manappuram Finance Limited reported that it has entered into an agreement to acquire 85.39% stake in Indian School Finance Company Private Ltd (ISFC) for a consideration of Rs. 212.2 crores. ISFC is a NBFC which extends loans to affordable educational institutions with assets under management of Rs.523 crore as on March 31, 2018. The acquisition aims to provide Manappuram Finance with a diversification into a niche

segment. The acquisition is expected to be completed within 8 months, post regulatory approvals.

Post-acquisition of stake in ISFC, the company's gearing at the group level is unlikely to materially increase from 3.3 times as on March 31, 2018. Also, Manappuram Finance would be comfortably placed to infuse the growth capital required by ISFC. In view of the above, CRISIL's outstanding ratings on the company and its subsidiaries remain unaffected by this development.

The ratings continue to reflect the strong track record of the promoters in financing against gold jewellery, which accounts for around 74% of the overall loan portfolio. Capitalisation is adequate because of a consolidated networth of Rs.3836 crore and low gearing of 3.3 times, as on March 31, 2018. The funding profile is also expected to remain stable. These strengths are partially offset by geographical concentration in revenue and challenges associated with the non-gold product segments.

CRISIL has outstanding ratings on three companies of the group - Manappuram Finance Limited, Asirvad Microfinance Limited, Manappuram Home Finance Limited.

3. Financial Performance:

Manappuram Finance consolidated net profit rises 40.66% in the Sept 2018 quarter

Net profit of Manappuram Finance rose 40.66% to Rs 224.00 crore in the quarter ended Sept 2018 as against Rs 159.25 crore during the previous quarter ended Sept 2017. Sales rose 22.13% to Rs 1014.44 crore in the quarter ended Sept 2018 as against Rs 830.62 crore during the previous quarter ended Sept 2017.

Manappuram Finance consolidated net profit rises 20.92% in the June 2018 quarter

Net profit of Manappuram Finance rose 20.92% to Rs 199.99 crore in the quarter ended June 2018 as against Rs 165.39 crore during the previous quarter ended June 2017. Sales rose 12.56% to Rs 935.82 crore in the quarter ended June 2018 as against Rs 831.38 crore during the previous quarter ended June 2017.

4. Investment Rationale:

i) Manappuram Finance established itself in the gold loan business however to de-risk the company from high concentration on gold loan book, company's management decided to diversify its business by adding new asset classes that were complementary to its gold loan business. Since FY15 the company is now engaged in 3 new business segments i.e. Microfinance, Housing Loans and Commercial Vehicle Loans. The objectives behind this

diversification is to mainly reduce dependence on gold loan business and capitalise its proven operational capability to process large volume, small ticket transactions with semi-urban and rural customers.

ii) Diversification in other businesses has helped the company to leverage on its strong brand equity, existing retail customer base and wide branch network. The company utilized its surplus capital to build new products relevant to the existing customer base. Moreover, low gearing levels and high capital adequacy leaves ample scope of growth for the company for increase in leverage

iii) The company is planning to achieve its target of having less than 5% branch exposure and less than 10% AUM exposure in any particular state. In line with this strategy, within gold loan business, company has reduced its assets under management exposure in southern region from 65% in FY16 to 60% currently. Branches stood at 3331 as compared to 3293 in FY16.

iv) Manappuram Finance had increased its security expense after theft and robbery were reported in few of its branches during demonetization. Due to this, security expense went up from around 50 crore in FY17 to around 200 crore in FY18 mainly on account of deploying more security guards in all its branches. The company is now planning to install cellular storage technology via Godrej by which company expects to reduce quarterly security expense to 12 crores. We expect operational expenditure to AUM ratio to reduce by 100 basis point by FY20, hence resulting in higher profitability.

v) Equity infusion up to Rs.150 crore in its subsidiary Asirvad Micro Finance Ltd and equity infusion up to Rs.100 Crores in its wholly owned subsidiary Manappuram Home Finance Ltd will facilitate business growth of subsidiaries of the company. As per management, the capital infusion is a related party transaction and will be made at arm's length, no governmental/regulatory approvals are required for the proposed capital infusion and the time period for the transaction will be five months.

vi) In Q1 and Q2, there is a rise of 10 bps in average borrowing costs. During current quarter, the company is expecting an increase of 30-40 bps. This can be passed on because gold loan comprises 75% of company's portfolio. It is a short-term loan. The gold loan, even though granted for a period of three months gets an average of 60 days time and it is also below Rs 13,000. So, passing on 30-40 bps will not be an issue for the company. The other factor is micro finance which is around 15% of company's consolidated portfolio. In other businesses also, 30-40 bps can be absorbed. Overall, the company do not expect much NIM pressure because the cost escalation is 50 bps.

vii) We expect there will be liquidity pressure for NBFCs as around Rs 70,000 crore of commercial papers (CPs) is coming for renewal in the short term. The companies borrowing short and lending long would be concerned due to meaningful impact on

raising funds. However, as Manappuram Finance borrow slightly long term, the average borrowing is longer term and lending is short term. So, we do not see any challenges for the company in getting the short-term as well as long-term borrowings renewed from the banking system as well as the market.

viii) The asset quality remained stable and healthy with the gross and net NPAs for the gold loan business at 0.7% and 0.3%. The gross NPAs in micro finance business was 1.7% , the same in housing finance was 4.6% while that in the vehicle finance was 2.9%. The asset quality in the housing finance business remains a key monitorable. However, on the back of expected recoveries across businesses, the NPA levels will decline further.

ix) Due to conservative approach, in case of non-repayment of gold loan, company auction the gold within 6-7 months of loan disbursement date, realizing quick and strong recovery of principal and interest from all loans. In case of Asirvad (MFI business), collection efficiency stood at close to 100%. Company's focus on becoming a diversified player with better product line and geographical expansion augurs well in terms of risk management for the company.

x) As on Sept 2018, promoter's shareholding in the company is at 35.14%. Institution shareholding in the company is high at 44.93%. During last quarter, Promoter & Director of the company, Mr. V. P. Nandakumar has bought shares worth Rs. 38 crores which indicates confidence of management towards robust growth prospects of the company. The company has paid uninterrupted dividend, dividend yield at current price is at 2.32%.

xi) As per our estimates, Manappuram Finance can deliver PAT of 915 crores for full financial year 2019-20 with estimated book value of Rs. 71. At current price of Rs. 86.30, stock is available at price to book of 1.2X which makes it attractively valued at current levels. Assigning P/B ratio of 1.9 on estimated book value for FY19-20, we arrive at price target of Rs. 135.

5. Key Concerns & Risks:

i) Any regulatory change to curb gold loan tickets or disbursement can adversely impact the overall growth of the company.

ii) Incremental slippages in housing finance or vehicle finance or slower loan growth in any of the business segment may affect the future performance of the company.

6. Saral Gyan Recommendation:

Over the next few years, Manappuram Finance Ltd. hopes to become a leading player in the financial services sector catering to the requirements of the mass market with a suite of products ranging from home loans, vehicle finance, microfinance, and MSME loans, besides its core offering of gold loans

The company is growing at a healthy pace with a gradual increase in contribution from non-gold business, we expect company will continue to report higher profitability with return on equity well above 20 percent. Considering company's strong track record in gold loan business and proper diversification into micro finance, CVs and home loan segment, robust growth outlook and attractive valuation of the company compared to peers, Saral Gyan team recommends **"Buy"** on **Manappuram Finance Ltd** at current market price of Rs. 86.30 for target of 135 over a period of 12 to 24 months.

Buying Strategy:

- 75% at current market price of 86.30
- 25% at price range of 60 – 70 (in case of correction in stock price in near term)

Portfolio Allocation: 3% of your equity portfolio.

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Definitions of Terms Used:

- a. Buy recommendation: This means that the investor could consider buying the concerned stock at current market price keeping in mind the tenure and objective of the recommendation service.
- b. Hold recommendation: This means that the investor could consider holding on to the shares of the company until further update and not buy more of the stock at current market price.
- c. Buy at lower price: This means that the investor should wait