

UNDER REVIEW **Manappuram Finance**

Quick Insight

Takeaways from meeting with management

Stock Information

Bloomberg Code:	MGFL IN
CMP (Rs):	34
TP (Rs):	UR
Mcap (Rs bn/US\$ mn):	29/539
3M ADV (₹ mn/US\$ mn):	166/3.1

Stock Performance (%)

	1M	3M	12M	YTD
Absolute	(5)	(3)	(22)	2
Rel. to Sensex	(3)	(3)	(32)	3

Source: Bloomberg, Ambit Capital research

Ambit Estimates (Rs bn)

	FY12	FY13E	FY14E
NII	15.4	UR	UR
PAT	5.9	UR	UR
BVPS (Rs)	28.3	UR	UR

Source: Bloomberg, Ambit Capital research

MGFL's net profit had declined 22% QoQ in 3QFY13 in the wake of income reversal of ~Rs390mn due to the realizable value of the collateral (gold pledged) being lower than the principal plus accrued interest. Given that gold prices have fallen further by 5% over the last two months, we met Mr Unnikrishnan, ED of Manappuram Finance, to understand the impact of the gold price fall on the interest reversal going forward. Following are the key takeaways from the meeting:

Interest rate reversal could be higher than earlier guidance: During 3QFY13 earnings conference call management had guided towards further under recoveries of ~Rs400-500mn spread over 4QFY13 and 1QFY14 on the higher LTV portfolio originated between Aug'11-Jan'12. However, with gold prices falling by a further 5% over the last two months, the quantum of interest income reversal could increase vs the earlier guidance given by management. Moreover, on some portions of the loan portfolio originated in Nov-Dec'11 the company seems likely to have to stop booking income during the current quarter as the collateral value associated with these loans would be less than principal plus accrued interest.

The portfolio originated between Aug'11-Jan'12 is a source of concern: Before the company started originating loans at ~60%-75% LTVs from Feb'12 onwards (in the wake of the RBI capping LTVs at 60%), a sizeable part of the loans originated between Aug'11-Jan'12 were at 85% LTVs. Around 5%-10% of such loans are still to be repaid. With gold prices remaining flat between 2HFY12 to the current period, the collateral value associated with these loans look likely to be less than the principal and accrued interest hitting the profitability of the company in both 4QFY13 and 1QFY14.

All of that being said, once this legacy portfolio is out of Mannapuram's book, such instances of income reversal should not recur due to lower LTVs and lower interest rates on the loans issued post Feb'12 (unless gold prices fall by more than 10% within a year).

Where do we go from here? While interest income reversals are a part of the gold lending business (because of the agreed tenure of the loans being ~12months and bullet payment nature of the repayments), it's impact has historically not been visible in MGFL's profitability because: (i) the loan book was doubling every year and hence the disbursements made a year ago were a smaller part of the total loan book; (ii) gold prices were rising rapidly and hence were enough to cover the principal and the accrued interest despite higher LTVs; and (iii) the auctioning process was relatively easy for the company (as there were no RBI restrictions applied to the auctioning process).

However, over the past year, MGFL's loan book has been declining (in the wake of the company trying to adjust to the new LTV restrictions imposed by the RBI), gold prices have stagnated, and the RBI has made auctioning more cumbersome. This triple whammy has resulted in the impact of interest income reversals becoming more pronounced.

Given that interest reversal/interest lost on the loan portfolio originated prior to Feb'12 is expected to be higher than earlier estimates, we put our earnings estimates and valuation under review as we try to get further colour from the management on the extent of possible income reversal going forward and the steps taken by the management to improve its risk management practices.

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DAILY

Updates

Manappuram Finance (UNDER REVIEW)

Takeaways from meeting with management

Coverage stocks with more than 25% upside/(downside)

BUYs	TP (Rs)	Upside (%)	FY14 P/E
Torrent Power	336	102	10
J Kumar	375	89	6
KNR Construction	165	88	9
Adani Power	80	73	10
Motilal Oswal	143	66	7
Ashoka Buildcon	325	64	9
Voltas	135	61	9
Magma Fincorp	130	58	6
Greaves Cotton	103	57	10
Engineers India	250	47	10
Gujarat Pipavav*	71	45	19
Maruti Suzuki	1,950	43	12
VA Tech	750	42	11
Redington	119	42	8
Sadbhav	160	41	47
Ashok Leyland	32	40	10
Tata Steel	484	39	8
Gujarat State Petro	88	38	9
Bajaj Electrical	243	35	16
Bajaj Auto	2,420	34	14
Petronet LNG	195	33	11
GAIL	415	32	10
Cadila Healthcare	973	32	16
NALCO	49	28	13
ONGC	400	26	10
SELLs	TP (Rs)	Downside (%)	FY14 P/E
HDFC	500	(38)	30
REC	137	(37)	5
Wipro	312	(28)	17
Jubilant Foodworks	911	(28)	42
Infosys	2,095	(27)	18
Indraprastha Gas	197	(26)	17

Source: Company, Ambit Capital research
Note: * indicates December ending

Analyst Notes: BFSI: Will rate cuts allay the infra concerns of banks? Krishnan ASV, +91 22 3043 3205

Whilst a 25bps repo rate cut appears to be the consensus expectation from the RBI's mid-quarter monetary policy today, we believe that a meaningful transmission to end-borrowers would not be immediate due to the structural liquidity deficit facing banks. Even when transmission is meaningful, it is worth deliberating whether lower interest rates can by themselves revive the viability of non-operational infrastructure assets. Further, what proportion of such assets could hit the books of the banking system as either restructured loans or NPLs during 2013? Is the recent spate of news flow around raising of equity through sale of non-core assets meaningful in addressing the stress for developers and sponsors? What evidence should we be watching out for to assess whether or not the stress in the infrastructure sector has abated?

To discuss these issues in greater detail, we are hosting experts from India Ratings at 3.30PM India time on Wednesday, 20 March 2013.

Source: Ambit Capital research

Explanation of Investment Rating

Investment Rating	Expected return (over 12-month period from date of initial rating)
Buy	>5%
Sell	≤5%

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