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Weekly Newsletter

STOCK STUDY

MUTHOOT FINANCE: The Golden Elephant

Entry at CMP*	585.25
Target	615/640
Upside (from CMP)	5.1%/9.4%
Time Frame	1-2 months

*Closing price as on Sep 6

Liquidity crisis in the non-banking finance companies (NBFC) space has led to a sharp fall in loan disbursements during the first quarter of FY20. According to data compiled by Finance Industry Development Council, overall disbursements for the sector has fallen 30% year over year during the said quarter. However, few sectors continued to witness growth. One such sector is gold loan financiers, disbursements for which grew 22% year over year to Rs 8375 crore in the quarter under review.

Notably, banks have become largely risk averse to lending to the NBFC space ever since the default by Infrastructure Leasing and Financial Services. However, according to an Economic Times article, gold lenders exhibit “low leverage, pricing power and a highly liquid collateral”, which help them to enjoy relatively easier access to bond markets as well as bank funding.

We believe Kochi-based **Muthoot Finance Limited** is a relatively good bet for investors looking to gain exposure to the NBFC space. Despite the turmoil in equity markets, especially in the NBFC space, shares of Muthoot Finance have gained 13.3% year to date. Moreover, it has outperformed the SENSEX, which registered a mere 2.5% rise during the same period.

Quarterly Performance & Outlook

The gold-loan financier recorded 8% year over year rise in net profits to Rs 556 crore in the first quarter of FY20. Consolidated loans grew 18% year over year to Rs 40,228 crore, with gold loans rising 16% year over year to Rs 35816 crore. Going ahead, asset under management is expected to grow at 15%, with an additional growth of 2-3% subject to bank funding. Further, the company has been raising money via NCDs in the wake of limited bank funding. Recently, the company issued an NCD of Rs 800 crore in the parent company and Rs 200 crore NCD by home finance subsidiary to secure growth capital. Moreover, it expects bank funding to resume over the next 2-3 months.

While the cost of funding has edged up 100 bps to 9.2-10% for Muthoot, the company is able to pass on the higher cost to its customers. For FY20, Muthoot expects to maintain spread above 12% and NIM at 13%. Operating expenses to asset ratio will come within 4-4.5%.

While asset quality has been showing mild deterioration sequentially, it is not a major cause of concern for Muthoot, given high provision of Rs 8.1 billion against requirement of Rs 6.9 billion. Further, Tier 1 capital remains robust at 24%. Additionally, rising gold loan prices has been acting as a tailwind for the company.

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Downside

On the downside, however, the company has been contemplating notable branch closures in Kerala owing to reduced business in the region. Recently, the company announced the closure of 15 branches, and is likely to close a total of 300 over the coming quarters. This is likely to affect business operations in Kerala, which constitutes nearly 4.5% of the company's total business. As such, it is expected to act as a near-term headwind for the Muthoot's share performance.

Stock Performance

Based on the closing price of Rs 585.25 as of Sep 6, 2019, the stock is trading at a Price to Book Value of 2.0 and 1.8 for FY20E and FY21E, respectively. (Estimates are taken from IDBI Capital research report dated Aug 14)

Technical Analysis