FIRSTPOST.

There's gold in the gold loans business for Manappuram

Rajanya Bose Jul 15, 2011

From Rs 43 crore to Rs 1,178 crore in four years is a tremendous scale-up. That's the power of gold at work.

With banks not too happy about lending against unconventional assets and with microfinance institutions in the doldrums, loans against gold have taken off like a rocket. That's how Manappuram Finance (or MGFL, short for Manappuram General Finance & Leasing) is growing in leaps and bounds.

In the past few years, companies specialising in lending against gold have been in overdrive, as Indians have a collective gold hoard of 15,000 tonnes, of which less than 5 percent is in government hands. Icra Management Consulting Services (Imacs) estimates that the total gold loan market is worth $8 billion (Rs 36,000 crore) and it grew at a compound rate of 40 percent between 2002 and 2010.

MGFL says this may be an underestimate, and the potential gold loan market could be worth $40 billion.

The market is currently skewed towards the South which accounts for 90 percent of gold loans. Manappuram has 75 percent of its branches there. Its growth came through a 79 percent expansion in branch network and a doubling of the employee headcount. A sustained rally in gold prices also played a critical role in swelling the loan book, two qualified institutional placements in 2009-10 and 2010-11 of Rs 245 crore and Rs 1,000 crore helped finance this growth.

The major risks in this business include volatility of gold prices, and regulatory challenges posed by the Reserve Bank of India. Non-banking financial companies have recently been left out of the definition of priority sector lending, which means they cannot access loans from banks as cheaply as they used to before.

Increasing competition from existing players like Muthoot Finance and the entry of new players will surely dent Manappuram's future growth and profitability. *Firstpost* talked to VP Nandakumar, Executive Chairman, Manappuram Finance, to get his views on the future of the gold loans business and his own company's trajectory.

Q: *What is your cost of funds?* How will it be impacted following the change in the RBI's norms regarding priority sector lending?

A: Our cost of funds was around 8-10 percent. After losing the tag (of being priority sector) we will acquire funds at around 11-12 percent. We are funded by equity, debt and even non-convertible debentures (NCD). We will launch another NCD in a month's time, and hopefully raise Rs 500 crore from the market.

Q: *What kind of growth are you planning for the company in the next couple of years?*

A: We have managed revenues worth Rs 1,170 crore in last financial year. And in terms of net profit, we stand at Rs 282 crore. There is a huge opportunity in the market, and we see ourselves growing at a 40 percent compound rate for the next four to five years. We should be able to get Rs 500 crore of profits this year. In terms of branches, we have 2,400. This year we can add another 200-300.

Q: *Almost 90 percent of your revenue comes from South India. So will your next phase of expansion be in the North?*

A: We do not get less revenue from the North because there is less opportunity. Even the concentration of branches here (in the South) does not prove that we want our presence to be limited here. It is just that we are based out of Kerala and this is where we started off. Now we will diversify more into the North, East and West.

Q: *You also have roped in some of the most popular faces like Akshay Kumar to endorse your brand. How much do you spend on advertising?*

A: In the beginning, advertising was of prime importance as we needed to build the brand and gain customer confidence. We spent Rs 130 crore last year for it. But now we have built the brand name, and this year we should keep it below Rs 100 crore.

Q: *How do you decide on the value of the loan on a specific amount of gold?*

A: We do not give loans for any business purpose. It is only on family gold, that is, jewellery. We have gold appraisers in each branch who evaluate the quality and price of gold. We expect 24 carat and lower carats of gold as well. Depending on the value, we generally give loans for 80-85 percent of the value. The average ticket size is around Rs 50,000.

Q: *Do you see a concentration of demand in some parts of the country, depending on whether it is a town or village? Also, is demand concentrated in a particular period of the year?*

A: Loans are concentrated in terms of geography. Forty percent of our business comes from metros, 35 percent from semi-urban areas and 25 percent from rural areas. But our branches are equally divided across geographies. In terms of timing, though emergency loans lead to demand all through the year, there will be increased demand during the wedding season or the beginning of the academic year when parents want money for admissions.

Q: *How do you manage defaults and how do you protect yourself against a fall in gold prices?*

A: Defaults are very rare for us. We maintain a capital adequacy ratio of 30 percent instead of the 15 percent that the RBI mandates. But since families have a great attachment to family gold, they generally do not default. Our credit period is usually for one year. Three months after that year (if the loan is unpaid), we use the asset to recover our money. We also give clients a chance to renew the loans. The remaining assets or money, after deducting our principal and interest, is returned.
As for a fall in gold prices, such a risk remains in any commodity business. We have been doing this business for decades and the family gold sentiment guards us against defaults if gold prices crash.