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Despite challenges, MGFL is attractive

FE Bureau

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Manappuram General Finance and Leasing (MGFL) is one of India's largest gold finance companies with $1.7billion in assets under management (AUM) as per March 2011 data. It had a 6.8% market share in the mainstream sector. It's AUM recorded a 93% CAGR in FY07-11, and we forecast a 43% CAGR in FY11-13.

While competition in the segment is increasing, we think MGFL is attractive as it has advantages over the non-banking financial companies (NBFCs) from its brand and branch network. It also has a shorter turnaround time and lower costs per loan compared to the banks.

On February 2, the Reserve Bank of India (RBI) removed the agricultural classification for bank loans to NBFCs (for loans against gold jewellery), and followed it with the removal of priority sector status on all bank loans to NBFCs. This will raise funding costs — we assume MGFL's cost of funds will increase 300bps in FY12. We estimate NIM will decline from 14.1% in FY11 to 12.5% in FY12.

We estimate average ROA/ROE of 4.4%/23% in FY12-13 as we expect NIMs to decline. However, given 59% of its branches are less than two years old, there could be strong productivity gains once growth normalises in the medium term.

We believe strong growth in MGFL's balance sheet and operating income will attract investor attention to the stock. We forecast a 43% FY11-13 CAGR for its AUM (which is one of the highest in the sector), driven by improving productivity at its new branches. Given under-penetration in the market, we do not expect a cyclical increase in rates and a slowdown in growth to impact MGFL's expansion.

Regulatory changes (the biggest risk for all NBFCs, in our view) could remain an overhang for MGFL. However, given our outlook for its medium-term growth and ROE, we think the risk-reward is attractive. We base our R155.00 price target on a residual income model, which implies 2.8x FY12E book.