

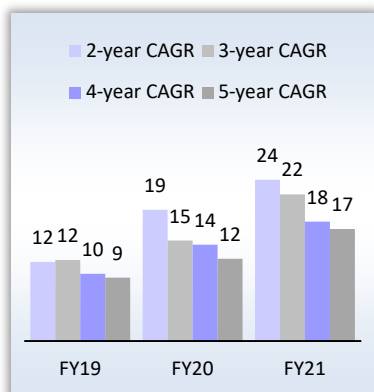
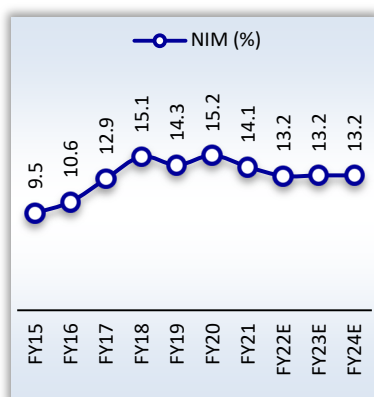
# Muthoot Finance

**BSE SENSEX**  
55,469

**S&P CNX**  
16,606

**Stock Info**

Bloomberg	MUTH IN
Equity Shares (m)	401
M.Cap.(INRb)/(USDb)	557.3 / 7.4
52-Week Range (INR)	1723 / 1120
1, 6, 12 Rel. Per (%)	1/-5/-4
12M Avg Val (INR M)	1598
Free float (%)	26.6

**MUTH: 2/3/4/5 year Gold loan CAGR at different points in time**

**Expect yield pressure to ease and NIM to stabilize at current levels**

**CMP: INR1,389**
**TP: INR1,750 (+26%)**
**Buy**
**Will continue to stand tall despite the many challengers**

Muthoot Finance ('MUTH') is our top pick for CY22 in the NBFC Lending space. Our investment idea is premised on our thesis of a structural opportunity in Gold lending as the market pie expands with customers evolving, taboo around Gold loans fading away, and apprehensions regarding Gold loans addressed through customer education. In this report, we list MUTH's competitive strengths vis-à-vis its peers and some of the challengers like Fintech Gold loan NBFCs. MUTH is well placed to build on its competitive heft and continues to create strong value for its stakeholders.

- Key investment thesis for Gold Finance is the 13%-15% CAGR in Gold loans over the next five years, with MUTH best positioned to deliver across economic cycles.
- Around 55% of its Gold loan portfolio has a ticket size of over INR100k, which leads to higher stickiness and lesser churn feeding into Gold loan growth.
- The management has built in adequate safeguards through appropriate combinations of tenure and LTV (average Gold loan tenure is in the six-to-nine months range), which protects it against any significant volatility in gold prices.
- Over the last decade, MUTH has delivered average credit costs of 40bp. We expect credit costs of 25-30bp over the next two years.
- Given the kind of RoE that MUTH is able to churn out (relative to loan growth), it is able to generate surplus cash, which can be deployed for diversification into non-Gold product segments. We expect the proportion of non-Gold businesses to improve to 14-15% (v/s 10% at present) over the next three years.
- Over the past five years, MUTH has exhibited an improvement in efficiency, with AUM per branch rising to ~INR110m in FY21 from ~INR60m in FY16. This traction in operating efficiency has led to higher growth in revenue (relative to AUM growth). We model in 15% PAT CAGR over FY22-24E and a RoA/RoE of 6%/22% in FY24E.

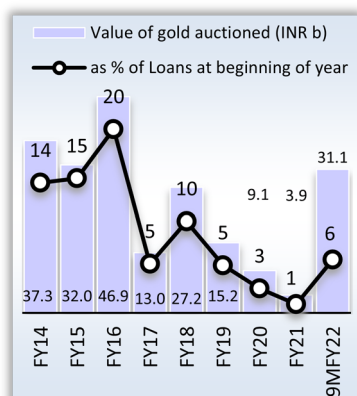
**Strong brand with enviable execution; expect 15% AUM CAGR over FY22-24E**

Standalone AUM clocked 17% CAGR over FY16-21. Even before the COVID-19 outbreak and the sharp run-up in gold prices in FY21, MUTH had delivered a two/three/four year CAGR of 19%/15%/14% as of Mar'20. Though higher gold price aid demand for Gold loans, franchises like MUTH have a strong brand and well-entrenched distribution that it will help it gain incremental share in the expanded market pie for Gold loans.

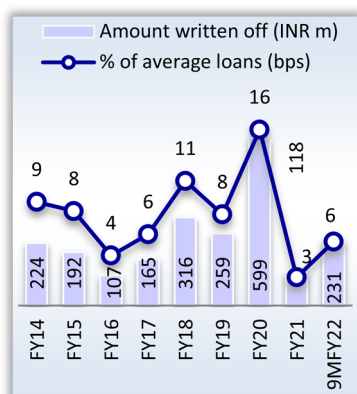
**Riding on improved operational efficiency to mitigate any NIM pressure**

MUTH has achieved a remarkable improvement in operating efficiency. While it has not been adding branches/employees aggressively, AUM/employee has almost doubled to INR20.3m over FY16-21. The same is equally true for AUM/branch as well. We believe current cost ratios of ~3.3% (as a percentage of average loans) are sustainable over FY23-24E. Though NIM has already

### Auctions were elevated in 3QFY22 with loans disbursed at peak of gold prices coming up for maturity/auctions



### Write-offs stood at 3-16bp over FY14-21



witnessed a sharp contraction due to the burgeoning challengers (particularly aggressive Banks and Fintechs) in Gold Financing, we believe the same has bottomed out at current levels of ~13% and should remain stable in the near-to-medium term.

### Builds cushions to guard against volatility in gold prices

Longer-tenured Gold loans act as a hedge against volatile gold prices. With shorter-tenured Gold loans (especially those to be repaid within three-months), volatility in gold prices has the potential to trigger high auctioning, which can adversely impact both AUM growth as well as result in losses on the accrued interest portion on the non-performing Gold loans. **With a six-to-twelve month Gold loan product and an appropriate combination of LTV, MUTH has built adequate safeguards to guard against volatility in gold prices.**

### Expect pristine asset quality; credit costs in the 25-30bp range

Gold Finance emerged as the safest product segment during the COVID-19 outbreak given the liquid nature of the collateral. MUTH is always perceived as the most liberal and empathetic lender, offering additional time to borrowers to repay their loans. This also enhances customer confidence, who feel reassured to pledge their gold jewelry with MUTH. While Stage 2 and 3 could periodically appear elevated, leading to higher auctions, *actual economic losses (write-offs)* have historically been in the 7-10bp range and average *credit costs (including provisions)* over the last decade were ~40bp. We expect *credit costs of ~25-30bp* over FY23-24E.

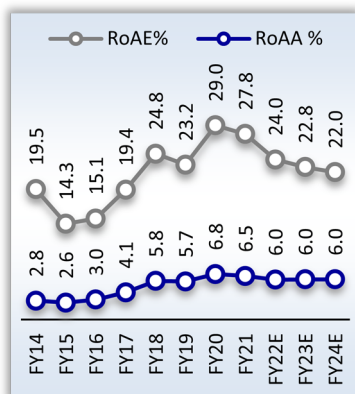
### Operationally intensive nature of the business and a strong brand provide business moats

During FY21, Gold loan NBFCs saw higher aggression from Banks, led by rising gold prices as also the regulatory arbitrage of ~90% LTV on Personal Gold loans until 31<sup>st</sup> Mar'21. Over the last 18 months, this segment has witnessed quite a few Gold Lending Fintechs work closely with Banks and try to disrupt the competitive landscape for Gold loan NBFCs. However, MUTH, with its strong brand presence, a loyal client base, and deep and wide distribution network in semi-urban and rural centers, has built business moats that are difficult to replicate. Both MUTH/MGFL also offer online Gold loans (OGL). Despite all the hype surrounding digital lending in Gold loans, there will always be an important element of physical evaluation/deposit/withdrawal of the gold jewelry, which will keep it relatively insulated from challengers in this space.

### Cognizant of the importance of product diversification, but treading cautiously in non-Gold loans

Non-Gold subsidiaries contribute ~10% to the consolidated AUM of MUTH, with their contribution to consolidated profit ~1% in 9MFY22. Gold loan growth has historically tended to be volatile due to: a) regulatory disruptions, and b) fluctuation in gold prices. The management realizes the importance of diversification into the non-Gold product segments. MUTH has been relatively insulated, despite the vulnerability seen in Vehicle/ Housing Financiers after the COVID-19 outbreak. It will continue to tread cautiously in the non-Gold product segments. We expect it to

### Healthy RoA/RoE of 6%/22% over the next two years



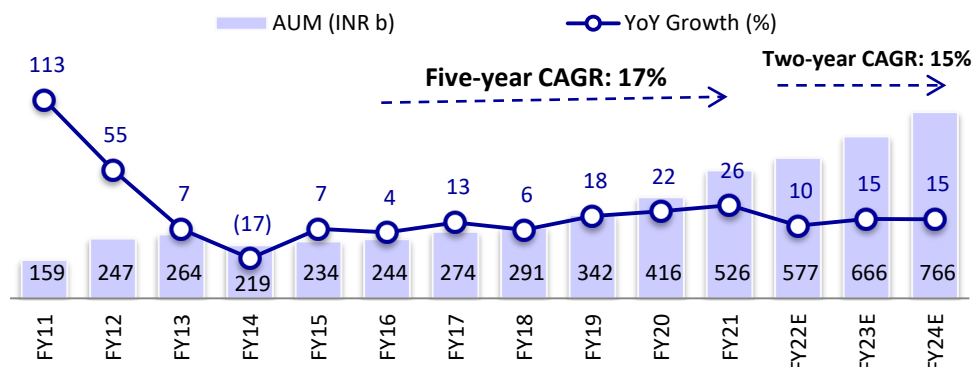
grow its non-Gold segments to 14-15% (of consolidated AUM) over the next three years. The Gold loan business of MUTH is a high RoE (22-23%) generating business, which creates surplus retained earnings and, if required, can be used to meet the growth capital requirements of its non-Gold subsidiaries.

### Leading the way for Gold Financing in India, with a healthy return profile; Top Pick among lending NBFC

MUTH ticks all the right boxes for us: a) Strong execution track record of the management and the next generation of the family being groomed to take up leadership positions in the future; b) Strong brand presence and deep penetration, which enhances customer confidence in the franchise; c) Robust risk management control and processes to further scale up the operationally intensive Gold Lending business; d) The credit rating of AA+ and consequently lower cost of borrowings will enable it to offer competitive interest rates to customers; and e) Ability to keep driving operating efficiencies can lead to 15% AUM and PAT CAGR over FY22-24E. The company appears strongly positioned to deliver standalone RoA/RoE of ~6%/22% over the medium term. MUTH is our top pick among NBFCs, with a TP of INR1,750 (2.7x FY24E standalone BVPS) and a potential upside of ~26%.

## Strong brand with enviable execution; expect 15% AUM CAGR over FY22-24E

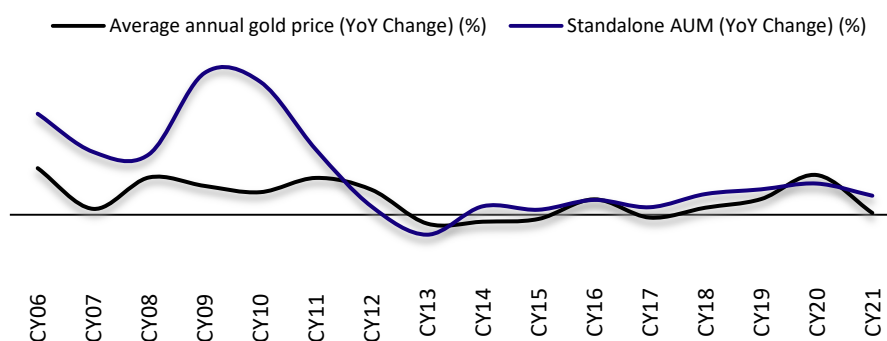
Exhibit 1: Expect 15% loan CAGR to sustain across economic cycles



Source: Company, MOFSL

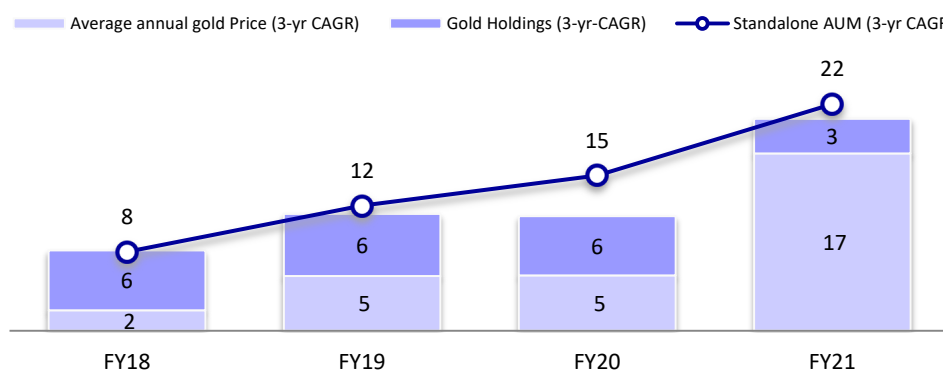
- There is no shying away from the fact that higher prices of the yellow metal feed into greater demand for Gold loans, which consequently results in a strong loan book growth for Gold lenders. From the graph below, there appears to be a strong correlation between gold prices and Gold loan growth.

Exhibit 2: Strong correlation between gold prices and loan growth

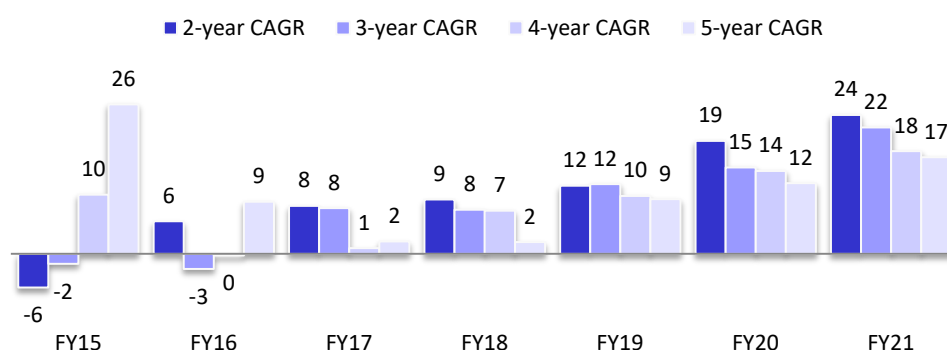


Source: Company, MOFSL

- MUTH delivered a three-year CAGR of ~6% in its gold holdings in each of FY18, FY19 and FY20. The three-year CAGR in average annual gold prices was 2% in FY18 and 5% each in FY19/FY20.
- We highlight this period as the lending landscape for Gold loan NBFCs witnessed a lot of regulatory uncertainty and changes over CY11-13. This period saw RBI coming out with detailed and standardized guidelines on Gold lending in Sep'13. It subsequently raised the LTV cap to 75%, thereby creating a level playing field for all the organized players in Gold financing.

**Exhibit 3: Loan growth seems a combination of an increase in gold prices and gold holdings**


- Gold holdings are also a function of gold prices. While higher gold prices result in a lower quantity of gold holdings that need to be pledged for the same amount of loan, it also translates into higher loan eligibility. While customers have to pledge a smaller quantity of gold ornaments, if and when they renew/rollover their loans, it also leads to higher demand for Gold loans since the loan amount eligible for the same quantity of gold ornaments goes up.
- **Over the last two-three years, MUTH has focused on reducing the tightly coupled nature of loan growth with the increase in gold prices.** It has raised productivity of its existing branches/employees; spent on advertising/promotions, with targeted campaigns to further improve its brand recall, reinforced customer confidence in its franchise, and continues to remain empathetic towards its customers (v/s some of its peers), which translates in a higher share of repeat customers.

**Exhibit 4: Two/three/four/five year Gold loan CAGR at different points in time for MUTH**


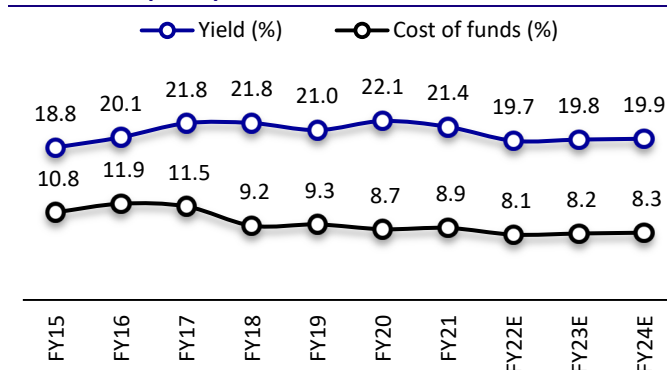
Source: Company, MOFSL

- The current management team led by MD and CEO Mr. George Alexander Muthoot has an enviable execution track record. It is already grooming the next generation of the family to take up leadership positions in the future. Unless there is a sharp correction in gold prices (which is unlikely and has been covered later in the report), we believe MUTH has all the elements to deliver ~15% loan CAGR over the next two years.

## Riding on improved operational efficiency to mitigate any NIM pressure

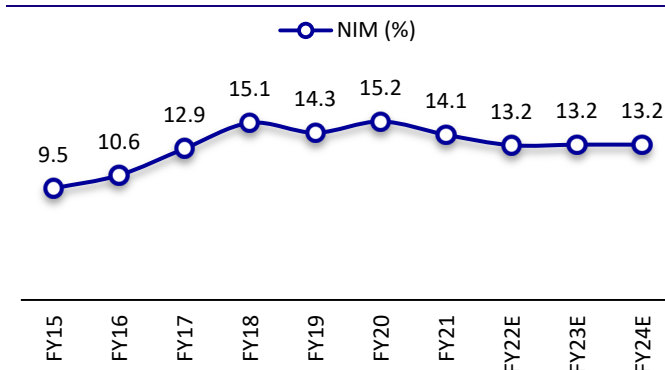
- With the advent of Gold loan Fintechs and the aggression of Banks in this space, there could be a possibility that MUTH might find it difficult to maintain structural spreads of 11.5-12% in the Gold lending business. This could lead to a structural compression in margin going ahead. Part of the current NIM compression today is because of the negative carry from the higher liquidity buffers that the company has been holding after the COVID-19 outbreak. In case, the management decides to structurally pare down the excess liquidity on its Balance Sheet, there could be an improvement in NIM from our current estimate.

Exhibit 5: Expect spreads to bottom out in FY22E



Source: Company, MOFSL

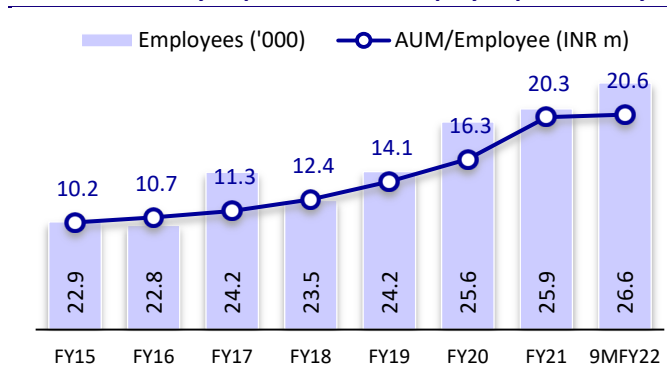
Exhibit 6: NIM should remain stable at current levels



Source: Company, MOFSL

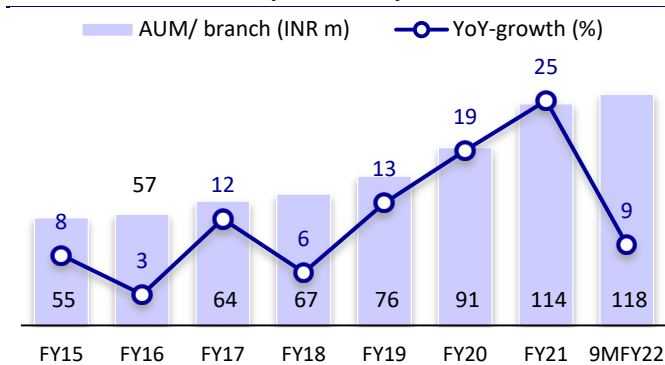
- MUTH has effectively used levers in its operating expenses to mitigate the compression in NIM. It has demonstrated a sustainable improvement in its productivity metrics, with AUM/employee improving to ~INR21m in 9MFY22 from ~INR12m in FY18 and AUM/branch improving to INR118m from INR67m over the same period.

Exhibit 7: Healthy improvement in employee productivity...



Source: Company, MOFSL

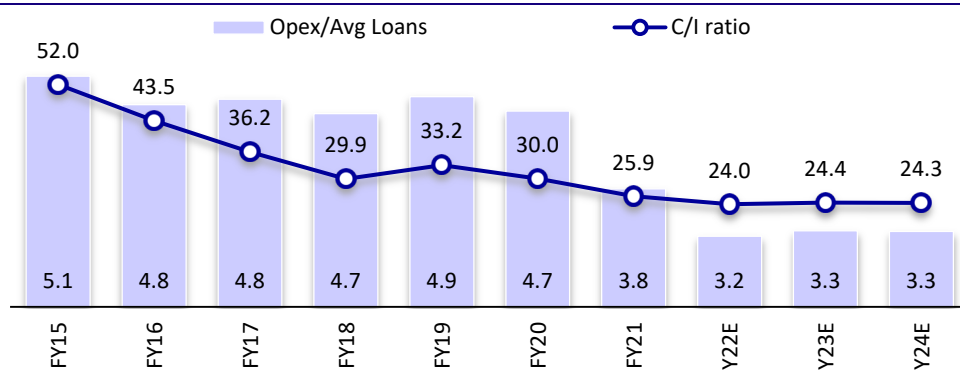
Exhibit 8: ...and branch productivity



Source: Company, MOFSL

- We expect MUTH to sustainably deliver a cost-to-income ratio of 24-25% (v/s 30-33% over FY18-20) and cost-to-average AUM of 3.3% over FY23-24E (v/s 4.7-4.9% over FY18-20).

**Exhibit 9: Conservatively build in a stable opex ratio, despite MUTH having levers to effect reduction in the same**

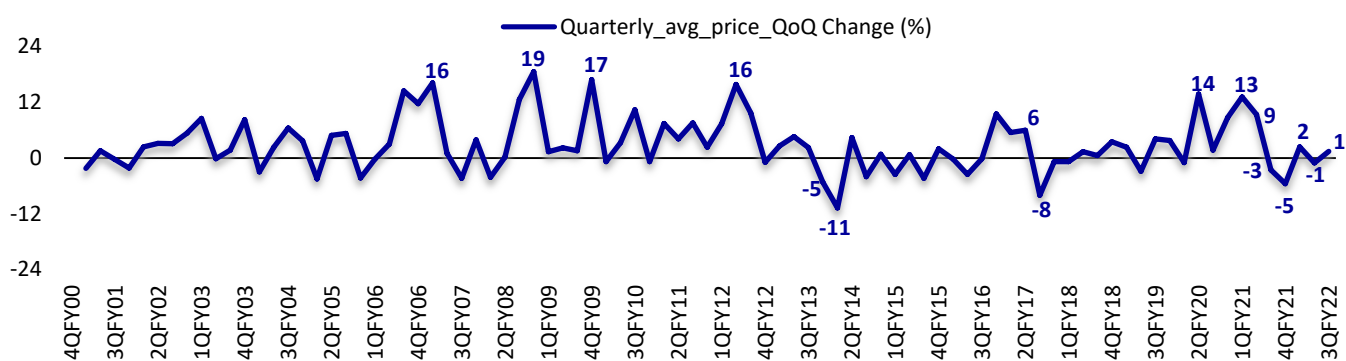


Source: Company, MOFSL

### Builds cushions to guard against volatility in gold prices

- As the underwriting in Gold loans is based on the gold offered as collateral and not primarily on the borrower's repayment ability, the bigger moving variable that the Gold Financiers have to guard against is the volatility in gold prices. Most Gold Financiers, including MUTH, have designed their Gold loan products in such a way so as to guard against any volatility in gold prices. Their business model is susceptible only when there is a sharp and sustained correction in gold prices, which has a very low probability.
- We plotted the quarterly average gold prices for the last two decades and realized that only during a single quarter was there a QoQ decline of over 10%. Only on three other occasions there was a QoQ decline between 5% and 10%.

**Exhibit 10: Quarterly average gold price: Only once was there a QoQ price decline of more than 10%**

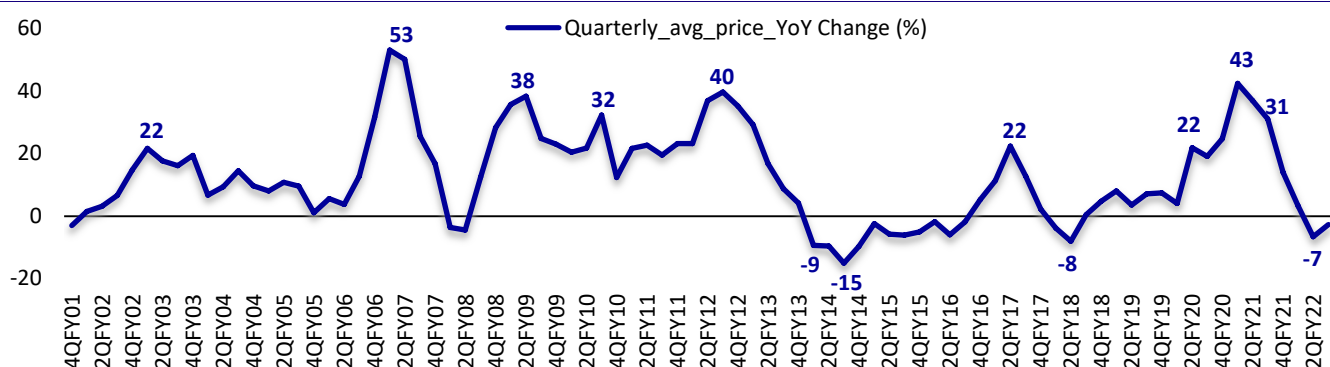


Source: MOFSL, WGC

- As Gold loans are typically for three-to-twelve months, we plotted the average quarterly gold prices for the last two decades and computed the YoY change in prices. We observed that only during one quarter was there a YoY price decline of 15%. In nine other quarters, the YoY decline was between 5% and 10%.



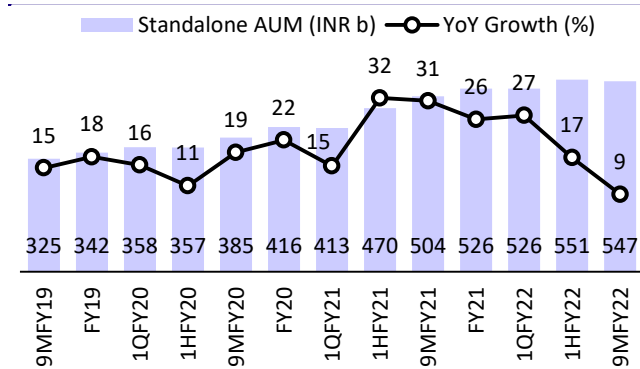
Exhibit 11: Quarterly average gold price: Only once was there a YoY price decline of more than 15%



Source: MOFSL

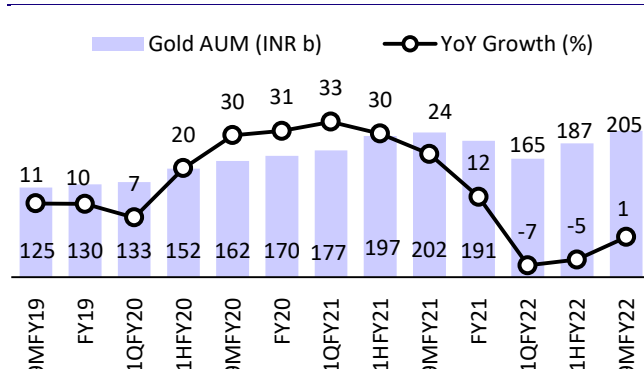
- While this is only empirical evidence and one can always argue that even in 1QFY14, when there was a QoQ decline of over 10%, and 3QFY14, when there was a YoY decline of ~15%, it occurred for the first time. **While the possibility of a sharp and sustained correction in the gold prices (like any other asset class) cannot completely be ruled out, empirical evidence does suggest a low probability of that event occurring.**
- The jury is still out on whether a three-month Gold loan tenure is better than a six-to-twelve month business model. We believe the answer lies in the outlook one has on gold prices. If one believes that there will be limited volatility in gold prices and that prices will recover after a sharp correction, then the six-to-twelve month business model will score over the three-month one. However, if there is a sustained (and sharp) decline in the gold prices over three-to-four quarters, then a lender who would have squared off these loans (through closures/auctions) would tend to benefit. We believe that longer tenured Gold loans do not require one to take a view on short-term gold price volatility.
- Moreover, with the regulatory cap of 75% LTV on Gold loans, lenders are relatively protected from a volatility perspective. Even though MUTH disseminates Gold loans with an average tenure of six-to-twelve months, it incentivizes customers to regularly pay (monthly/quarterly/semi-annually) the accrued interest by offering a better (lower) interest rate.**

Exhibit 12: Lower auctioning (until Sep'21) supported AUM growth for MUTH



Source: Company, MOFSL

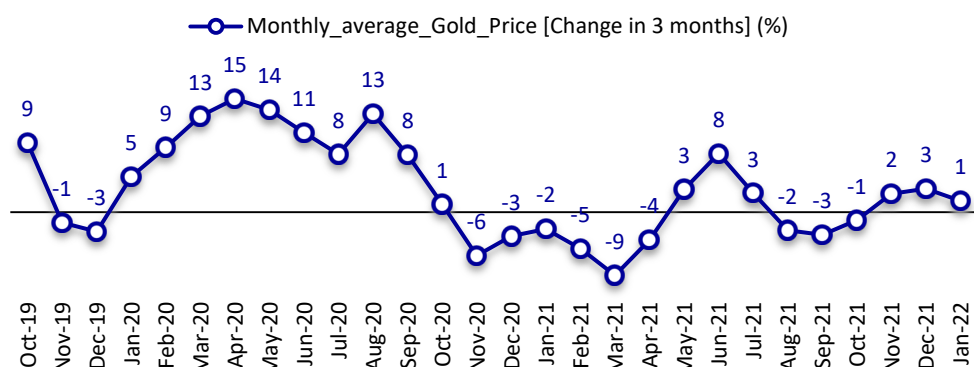
Exhibit 13: Elevated auction levels led to a sharp QoQ decline in loan book for MGFL in 4QFY21 and 1QFY22



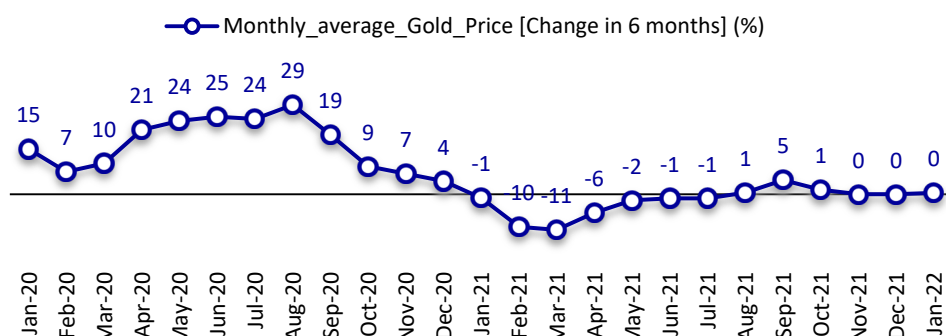
Source: Company, MOFSL



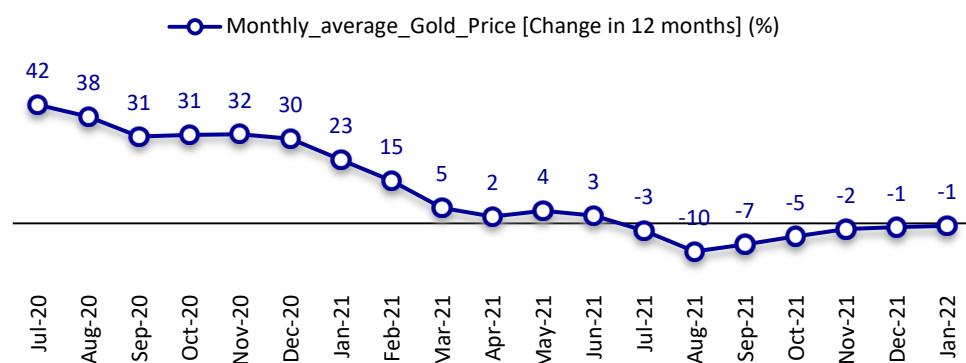
- MGFL witnessed higher auctions in Jan-Apr'21 (4QFY21 and 1QFY22) as there was a significant correction in gold prices during this period. Loans disbursed during Aug-Sep'21, when gold prices were at their peak, matured after three months, which coincided with a correction in gold prices. So, customers were asked to close their loan or roll it over. The remaining was auctioned.

**Exhibit 14: Monthly average gold price – Change in the last three months**


Source: MOFSL, WCG

**Exhibit 15: Monthly average gold price – Change in the last six months**


Source: MOFSL, WCG

**Exhibit 16: Monthly average gold price – Change in the last 12 months**


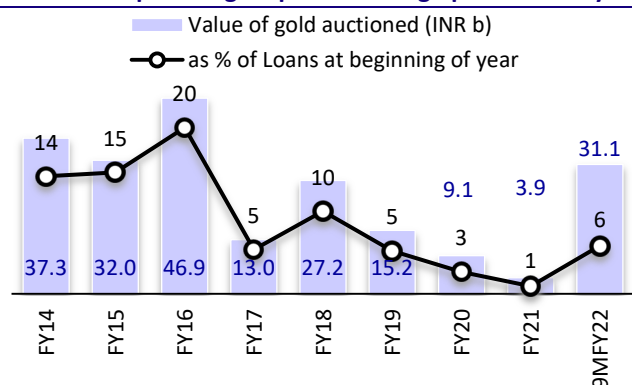
Source: MOFSL

- MUTH, with average Gold loan tenure of six-to-twelve months, saw a marginal recovery in gold prices in Apr-May'21. Gold prices remained in a narrow range until Oct'21 before recovering in Nov'21-Dec'21. This is why there was higher auctioning of INR28b in 3QFY22. MUTH recovered the entire principal outstanding and had to only marginally write-off a portion of the accrued interest. Total write-offs in 9MFY22 stood at ~4bp (annualized).

## Expect pristine asset quality; credit costs in the 25-30bp range

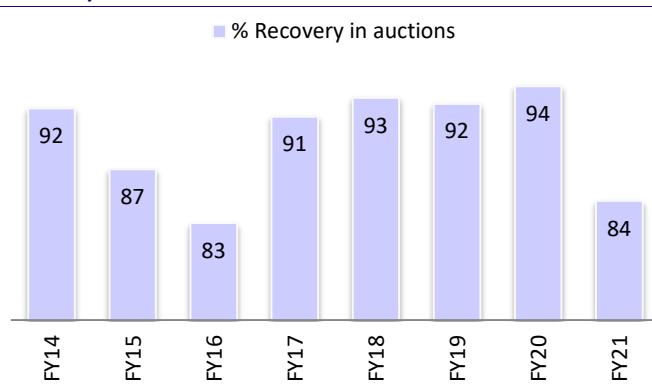
- We believe what worked in MUTH's favor throughout the pandemic was the relatively lower proportion of non-Gold products in its consolidated AUM mix. Peer MGFL exhibited vulnerability in MFI, Vehicle, and Housing Finance segments. While the non-Gold product segment typically gets overlooked/ ignored for Gold NBFCs, the impact on Vehicle/Housing Finance segments of MUTH/MGFL from RBI's asset classification and the NPA circular of 12<sup>th</sup> Nov'21 becomes particularly important. This despite RBI coming out with a clarification allowing NBFC/HFC time until Sep'22 to implement its circular.
- Actual write-off and economic losses on the principal component of Gold loans is usually very low. Gross Stage 3/2 numbers were elevated as on Dec'21 because MUTH offers relatively more time to its customers to repay their loans. Gold loan auctions for MUTH were elevated (at INR28b) in 3Q and are expected to remain so in 4QFY22 as well.

**Exhibit 17: Auctions were elevated in 3QFY22 with loans disbursed at peak of gold prices coming up for maturity**



Source: Company, MOFSL

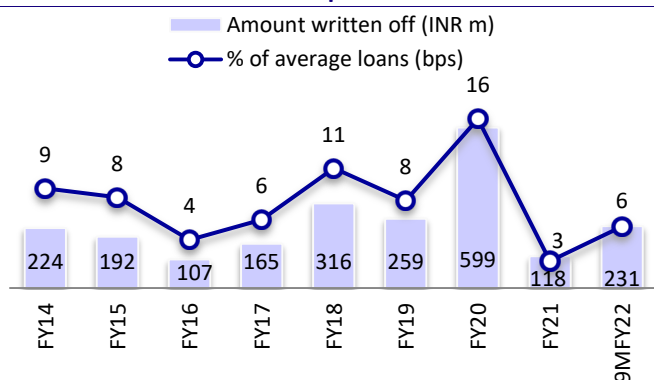
**Exhibit 18: Recoveries from gold auctions have typically been between 83-94% of the outstanding (including accrued interest)**



Source: Company, MOFSL

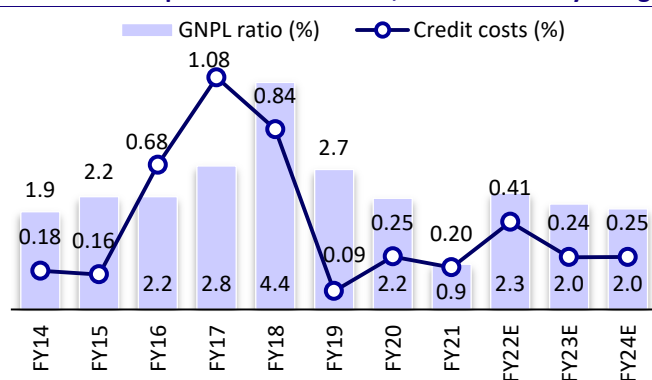
- As we infer from Exhibit 18, recoveries from gold auctions have been upwards of 80% on all occasions in the last eight fiscal and was over 90% in five out of the last eight years.

**Exhibit 19: Write-offs at 3-16bp over FY14-21**



Source: Company, MOFSL

**Exhibit 20: Despite elevated GNPLs, credit costs stay benign**



Source: Company, MOFSL

- With MUTH offering additional time to its customers to repay their loans, we can occasionally see reported GS3 (and/or GS2) staying elevated for a few quarters, but the quantum of write-offs and credit costs have always remained benign. Over the last decade, MUTH has delivered average credit costs of ~40bp and we estimate credit costs of ~25bp over FY23-24E.

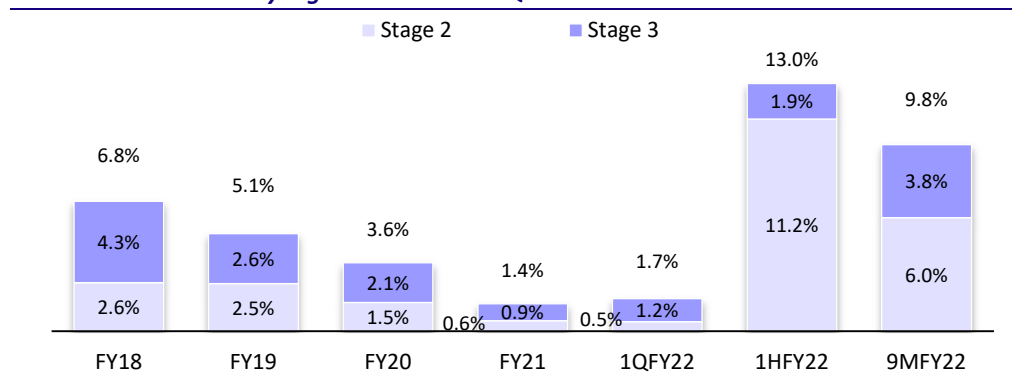
**Exhibit 21: Simulation of effective LTV on Gold loans in Stage 3 suggests that only in a handful of exposures will there be a partial loss on the interest accrued**

	Aug'20	Sep'20
Monthly average gold price/gm (INR)	4,727	4,543
Monthly average gold price/10 gm (INR)	47,269	45,429
LTV at disbursement	75%	75%
Loan Principal	35,452	34,072
Interest rate	20%	20%
Accrued Interest [15 months]	8,863	8,518
Total principal + accrued interest	44,315	42,590
<b>15 months later</b>	<b>Nov-21</b>	<b>Dec-21</b>
Monthly average gold price/gm (INR)	4,359	4,336
Monthly average gold price/10 gm (INR)	43,593	43,361
<b>Effective LTV for loans flowing into Stage 3 (%)</b>	<b>101.7</b>	<b>98.2</b>

Source: Company, MOFSL;

Note: This scenario assumes bullet repayment of principal and interest at the end of loan tenure

**Exhibit 22: 30+dpd was elevated in 2Q/3QFY22 but we expect it to decline sharply after culmination of relatively higher auctions in 4QFY22**



Source: Company, MOFSL

- With gold prices increasing (v/s levels in Jan'22) in the current uncertain global environment, we believe that MUTH will use the opportunity to further minimize any losses on the accrued interest. Buoyancy in the gold prices could also persuade a section of the customers (who had earlier deserted their gold jewelry) to repay their outstanding loans rather than have it auctioned.

## Operationally intensive nature of the business and a strong brand provide business moats

- Unlike other product segments, Gold loans require safe custody of the gold ornaments (collateral) with the lender. This is a key point of consideration for the customer when it comes to choosing a lender. Gold loans are operationally much more intensive than some other product segments like Personal loans, Housing Finance, and SME loans as there is the element of keeping safe the collateral. This requires robust risk management processes, safety vaults, security arrangements, and process to guard against counterfeit jewelry and frauds, which could be perpetrated by employees in connivance with customers.
- As we can see from the table below, a large proportion of frauds in Gold Lending are perpetrated by employees and that's why it is imperative to have strong safeguards to protect the organization against such frauds.

**Exhibit 23: A large proportion of frauds in Gold lending are perpetrated by employees**

Fraud data	FY18	FY19	FY20	FY21
Total fraud (INR m)	35.1	38.3	25.9	35.7
Fraud by employees (INR m)	25.9	33.5	23.2	31.4
<i>As a percentage of employee frauds</i>	<i>73.7</i>	<i>87.5</i>	<i>89.4</i>	<i>87.9</i>

Source: Company, MOFSL

The management acknowledges the intense competition within this space from other organized financial institutions such as Banks/Gold Fintechs and even from other unsecured products. It also recognizes the need to reach untapped markets, which at times lie in the remote corners of India, but can be effectively tapped by leveraging its digitized operations. Despite being a leader among Gold Finance NBFCs, it feels incumbents will have to raise their investments in technology to capture the untapped market of tech-savvy customers and widen customer access to Gold loan instruments.

Huge technology interventions are being made. Some of these have been implemented while others are still a work-in-progress

- **MUTH has introduced a slew of mobile applications** right from lead creation, loan repayment, loan top-up, customer onboarding, customer engagement, collections, and a few others. It is also leveraging WhatsApp for customer alerts and systems integration to deliver a smoother KYC experience to customers.
- **Data enrichment:** MUTH is working on a project to effectively leverage its data assets. This will enable it to apply business intelligence (BI)/analytics to generate actionable insights.
- **KYC data capture and validation:** MUTH customers can now complete their KYC formalities without having to physically visit a branch. This facility empowers customers to opt for its Loan at Home (L@H) service. It has also implemented customer bank account verification using the penny drop integration.
- **Smart EYE:** MUTH has implemented a powerful video surveillance system, which uses AI capabilities, to enhance physical security at its branches. While this was a pilot in select branches, it is now being implemented across all branches.

## Exhibit 24: Digital interventions by MUTH led to various positives across sales, KYC, and collections

### iMuthoot

Allows customers to manage and repay loan interest online anytime and anywhere via their mobile phones. It is redesigning the user interface and overall navigation to make it more intuitive and customer friendly



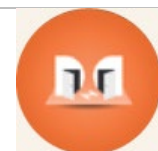
### Loan@Home

Enables customers to avail Gold loans from the comfort of their homes. Aids in the swift processing and quick sanctioning of loans, leading to improvements in its loan portfolio



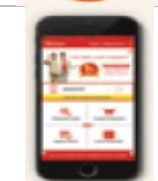
### Collection mobile application

The app enables MUTH to collect payment from the customers' doorstep at their convenience. MUTH has extended this application to approved third-party (agencies) for collecting payments



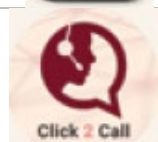
### SalesNext

This app enabled MUTH to strengthen its marketing initiatives by allowing lead creation on the spot. It is also using the app to set targets for sales executives and for admin users to monitor their movements



### Click to Call

This app enables branch employees to contact customers and to follow-up on various campaigns. This app was recently extended to its various subsidiaries



### Muthoot online

This is an online payment system, which facilitates customers to make online repayments and apply for the top-up loans

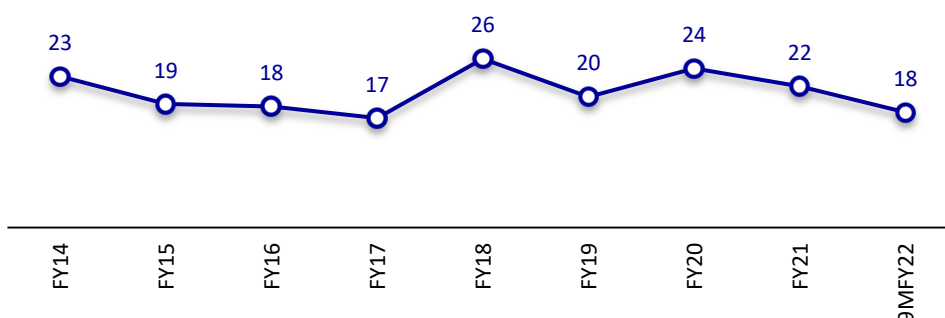


Source: Company, MOFSL

- In addition to the interest rate being offered by the lender, there are two other considerations which act as 'pull' drivers for customers to decide from whom to opt for a Gold loan. These are: a) how empathetic is the lender and how patient it will be with an overdue customer, b) confidence in the brand while submitting their gold ornaments as collateral.
- MUTH has invested in building a very strong brand, which customers can immediately connect with. It also has a very strong brand recall. Advertising and business promotions, which used to be in the 18-20% range over FY15-17, has increased to 22-26% over FY18-21 in light of the strong brand building measures undertaken by the company.

## Exhibit 25: Continues to invest in brand building through advertisements and promotions

—○— Advertisement and Business Promotion as % of other cash expenses



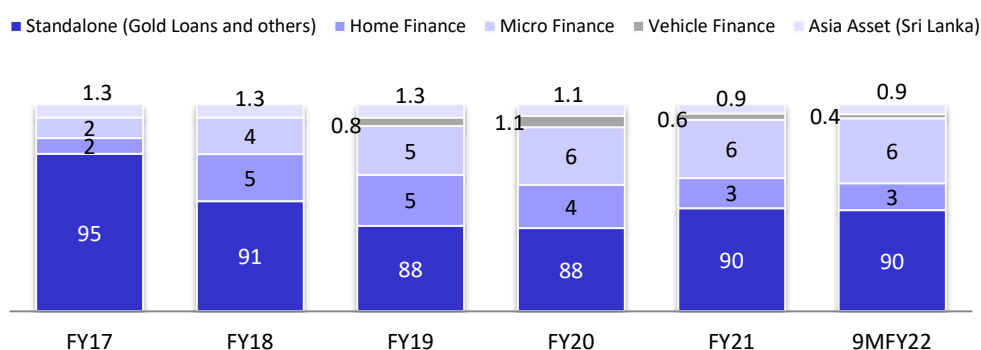
Source: Company, MOFSL

- In the past and even now, MUTH continues to run various marketing campaigns with Mr. Amitabh Bachchan. Past campaigns like 'Gold Loan is Good', which was an integrated marketing campaign created to address and eliminate the taboo and apprehensions prevailing among common people regarding Gold loans, and 'Sunheri Soch: golden thoughts' were well received by its target audience.

### Cognizant of the importance of product diversification, but treading cautiously in non-Gold loans

- The kind of spreads between AUM growth and RoE seems to suggest that MUTH will always have surplus retained earnings to be deployed/infused in its non-Gold subsidiaries.
- Given the cyclical nature (driven predominantly by regulatory changes and gold prices) that have historically been seen in Gold loan growth, the management realizes the importance of product diversification. It knows that if it does not offer products like Housing/Vehicle Finance, its own customers will avail such loans from other lenders.
- MUTH has been relatively insulated, despite the vulnerability seen in Vehicle/Housing Financiers after the COVID-19 outbreak. That is because the non-Gold product segment contributes only ~10% to its consolidated AUM mix.

#### Exhibit 26: Non-Gold product segments contribute ~10% to the consolidated AUM mix



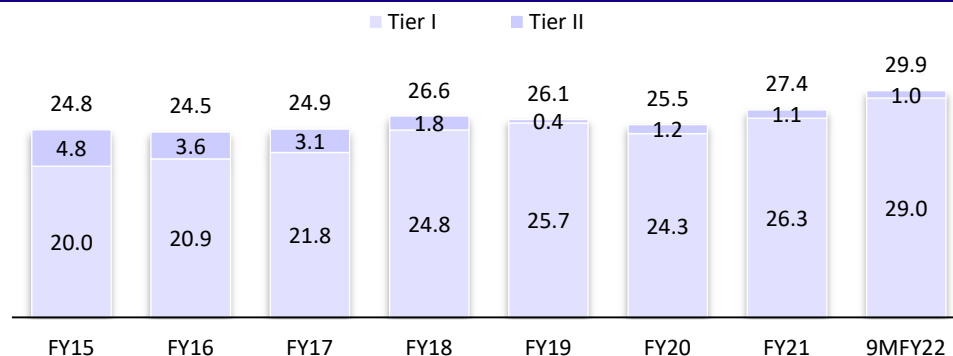
Source: Company, MOFSL

- Belstar Micro Finance is the only significant non-Gold subsidiary of MUTH. It recently raised INR2.75b in equity capital primarily from two private equity companies: Arum Holdings (INR2.25b) and MAJ Invest. After this infusion, MUTH's stake in Belstar will shrink to 60.7%, MAJ Invest will own 10.5%, and Arum Holdings 14.5%. On a trailing basis, the infusion occurred at a valuation of 2.4x P/BV (pre-money) and 2.0x P/BV (post-money).
- MUTH will continue to tread cautiously in the non-Gold product segments. We expect it to grow its non-Gold segments to 14-15% (of consolidated AUM) over the next three years. The Gold loan business of MUTH is a high RoE (22-23%) generating business, which creates surplus retained earnings and, if required, can be used to meet the growth capital requirements of its non-Gold subsidiaries.

## Leading the way in Gold Financing, with a healthy return profile; our top pick among lending NBFCs

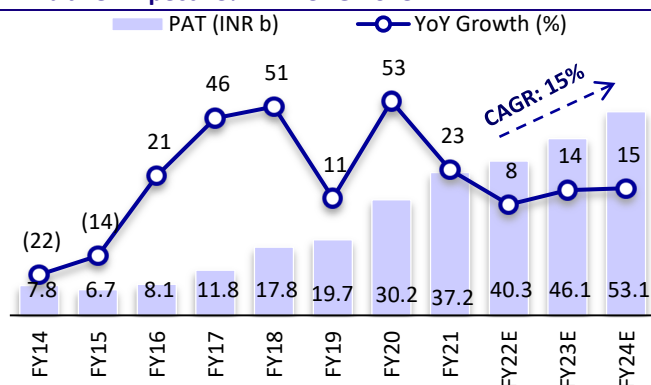
- MUTH has always maintained capital adequacy in excess of ~25%, a large part of which is Tier I capital.

**Exhibit 27: Healthy capital adequacy all through**



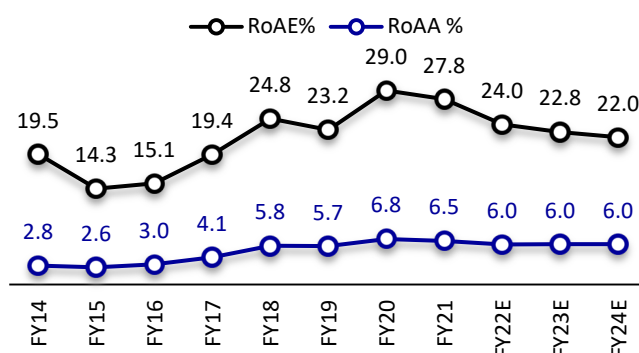
Source: Company, MOFSL

**Exhibit 28: Expect 15% PAT CAGR over FY22-24E...**



Source: MOFSL, Company

**Exhibit 29: ...with a very healthy return profile**



Source: MOFSL, Company

### MUTH ticks all the right boxes for us:

- Strong execution track record of the management and the next generation of the family being groomed to take up leadership positions in the future.
- The credit rating of AA+ and consequently lower cost of borrowings will enable it to offer competitive interest rates to customers.
- Operating leverage levers to mitigate some of the impact on margin/spreads.
- Strong brand presence and deep penetration, which enhances customer confidence in the franchise.
- Robust risk management control and processes to further scale up the operationally intensive Gold Lending business.

Ability to keep driving operating efficiencies can result in 15% AUM and PAT CAGR over FY22-24E. Higher Gold loan auctions in 3Q and concerns around elevated levels of auctions in 4QFY22 impacting MUTH's gold loan growth has weighted on the stock's performance over the last three-to-four months. The stock now trades at attractive valuations of 2.1x FY24E P/BV, given its strong positioning to deliver standalone RoA of ~6% and RoE of 22-23% over the medium term.

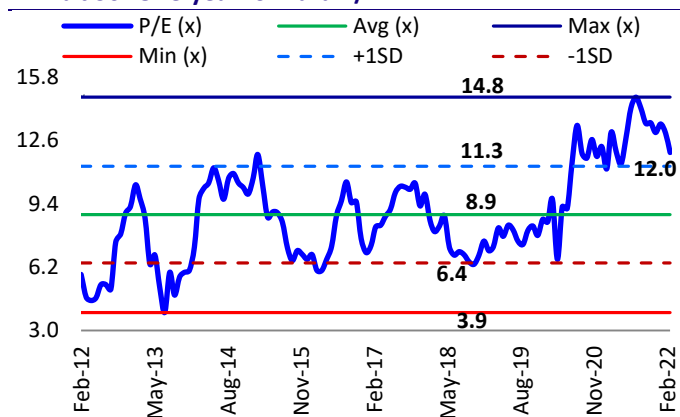
**MUTH is our top pick among NBFCs, with a TP of INR1750 (2.7x FY24E standalone BVPS) and a potential upside of ~26%.**



## Key risks to our thesis

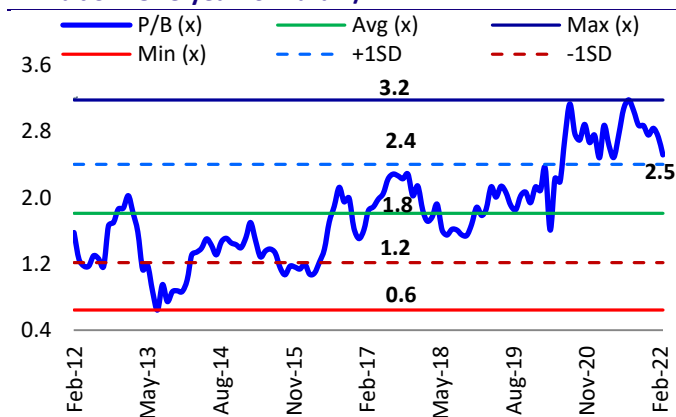
- A sharp and sustained correction in gold prices can derail both loan growth as well as result in a deterioration in asset quality.
- **Concentration risk:** Over 50% of MUTH's Gold loan portfolio as well as branches are concentrated in South India. Any adverse events in the larger southern states expose the company to social and political risk.
- **Competitive intensity could impact spreads/margin:** Banks have been aggressive in Gold Lending. Gold Lending Fintechs are being touted as potential disruptors, but we believe they will cater to a slightly different customer segment than Gold loan NBFCs.
- **Regulatory risk:** What transpired in CY12-13 had a telling impact on the business and operations of Gold Lending NBFCs. While the regulatory landscape has been largely benign over the last few years (except for the LTV increase to 90% of Personal Gold loans by Banks temporarily until Mar'21), any regulatory changes in terms of spread caps or stringent processes/validations can have a negative impact on MUTH.

Exhibit 30: One-year forward P/E



Source: MOFSL, Company

Exhibit 31: One-year forward P/B



Source: MOFSL, Company

## Financials and valuations

## Income Statement

(INR m)

Y/E MARCH	FY16	FY17	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
Interest Income	47,995	56,369	62,021	67,570	85,644	1,03,285	1,11,546	1,26,110	1,45,286
Interest Expense	22,577	22,938	19,314	22,368	27,909	36,924	38,741	43,780	50,497
<b>Net Interest Income</b>	<b>25,418</b>	<b>33,431</b>	<b>42,707</b>	<b>45,202</b>	<b>57,735</b>	<b>66,361</b>	<b>72,805</b>	<b>82,330</b>	<b>94,789</b>
Change (%)	17.9	31.5	27.7	5.8	27.7	14.9	9.7	13.1	15.1
Other income	755	1,098	1,310	1,236	1,584	2,458	1,368	1,546	1,763
<b>Net Income</b>	<b>26,173</b>	<b>34,529</b>	<b>44,017</b>	<b>46,438</b>	<b>59,319</b>	<b>68,819</b>	<b>74,173</b>	<b>83,877</b>	<b>96,552</b>
Change (%)	18.0	31.9	27.5	5.5	27.7	16.0	7.8	13.1	15.1
Operating Expenses	11,381	12,503	13,174	15,394	17,787	17,804	17,801	20,445	23,482
<b>Pre Provision Profit</b>	<b>14,792</b>	<b>22,026</b>	<b>30,843</b>	<b>31,044</b>	<b>41,531</b>	<b>51,015</b>	<b>56,372</b>	<b>63,432</b>	<b>73,070</b>
Change (%)	38.9	48.9	40.0	0.6	33.8	22.8	10.5	12.5	15.2
Provisions	1,624	2,816	2,397	275	957	950	2,318	1,554	1,789
<b>PBT</b>	<b>13,168</b>	<b>19,210</b>	<b>28,447</b>	<b>30,768</b>	<b>40,574</b>	<b>50,065</b>	<b>54,054</b>	<b>61,878</b>	<b>71,280</b>
Tax	5,072	7,411	10,671	11,047	10,391	12,843	13,784	15,779	18,176
Tax Rate (%)	38.5	38.6	37.5	35.9	25.6	25.7	25.5	25.5	25.5
<b>PAT</b>	<b>8,096</b>	<b>11,799</b>	<b>17,776</b>	<b>19,721</b>	<b>30,183</b>	<b>37,222</b>	<b>40,270</b>	<b>46,099</b>	<b>53,104</b>
Change (%)	20.7	45.7	50.7	10.9	53.0	23.3	8.2	14.5	15.2
Proposed Dividend	2,393	2,397	4,010	4,812	6,016	8,021	8,799	9,853	11,577

## Balance Sheet

(INR m)

Y/E MARCH	FY16	FY17	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
Equity Share Capital	3,990	3,995	4,000	4,007	4,010	4,012	4,012	4,012	4,012
Reserves and Surplus	52,202	61,170	74,120	88,151	1,11,708	1,48,377	1,79,848	2,16,094	2,57,622
<b>Net worth</b>	<b>56,192</b>	<b>65,164</b>	<b>78,120</b>	<b>92,158</b>	<b>1,15,718</b>	<b>1,52,389</b>	<b>1,83,860</b>	<b>2,20,106</b>	<b>2,61,634</b>
<b>Borrowings</b>	<b>1,85,670</b>	<b>2,09,855</b>	<b>2,11,670</b>	<b>2,68,332</b>	<b>3,71,300</b>	<b>4,59,463</b>	<b>5,01,854</b>	<b>5,65,954</b>	<b>6,50,847</b>
Change (%)	-4.5	13.0	0.9	26.8	38.4	23.7	9.2	12.8	15.0
<b>Other liabilities</b>	<b>28,625</b>	<b>32,112</b>	<b>18,132</b>	<b>20,198</b>	<b>17,578</b>	<b>22,798</b>	<b>26,217</b>	<b>28,839</b>	<b>31,723</b>
Change (%)	27.2	12.2	-43.5	11.4	-13.0	29.7	15.0	10.0	10.0
<b>Total Liabilities</b>	<b>2,70,487</b>	<b>3,07,131</b>	<b>3,07,923</b>	<b>3,80,687</b>	<b>5,04,597</b>	<b>6,34,649</b>	<b>7,11,932</b>	<b>8,14,899</b>	<b>9,44,203</b>
<b>Loans</b>	<b>2,45,241</b>	<b>2,74,242</b>	<b>2,95,068</b>	<b>3,49,329</b>	<b>4,26,042</b>	<b>5,40,634</b>	<b>5,94,697</b>	<b>6,79,144</b>	<b>7,81,016</b>
Change (%)	4.2	11.8	7.6	18.4	22.0	26.9	10.0	14.2	15.0
<b>Investments</b>	<b>983</b>	<b>2,091</b>	<b>3,954</b>	<b>9,826</b>	<b>14,383</b>	<b>15,903</b>	<b>17,493</b>	<b>19,242</b>	<b>21,167</b>
Net Fixed Assets	2,274	2,182	1,922	1,867	2,227	2,416	2,657	2,923	3,215
Other assets	21,990	28,615	6,978	19,666	61,944	75,697	97,084	1,13,589	1,38,805
<b>Total Assets</b>	<b>2,70,487</b>	<b>3,07,131</b>	<b>3,07,923</b>	<b>3,80,687</b>	<b>5,04,597</b>	<b>6,34,649</b>	<b>7,11,932</b>	<b>8,14,899</b>	<b>9,44,203</b>

E: MOFSL estimates

## Financials and valuations

Ratios	(%)								
Y/E MARCH	FY16	FY17	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
<b>Spreads Analysis (%)</b>									
Avg. Yield on loans	20.1	21.8	21.8	21.0	22.1	21.4	19.7	19.8	19.9
Avg. Cost of funds	11.9	11.6	9.2	9.3	8.7	8.9	8.1	8.2	8.3
Spreads on loans	8.2	10.2	12.7	11.7	13.4	12.5	11.6	11.6	11.6
NIM on AUM	10.6	12.9	15.1	14.3	15.2	14.1	13.2	13.2	13.2
<b>Profitability Ratios (%)</b>									
RoE	15.1	19.4	24.8	23.2	29.0	27.8	24.0	22.8	22.0
RoA	3.0	4.1	5.8	5.7	6.8	6.5	6.0	6.0	6.0
Cost to Income	43.5	36.2	29.9	33.2	30.0	25.9	24.0	24.4	24.3
Empl. Cost/Op. Exps.	56.4	61.1	59.4	58.3	57.8	56.5	56.0	56.0	56.1
<b>Asset-Liability Profile (%)</b>									
GNPL ratio (%)	2.2	2.8	4.4	2.7	2.2	0.9	2.3	2.0	2.0
Debt/Equity ratio (x)	3.3	3.2	2.7	2.9	3.2	3.0	2.7	2.6	2.5
Average leverage	3.6	3.3	2.9	2.8	3.1	3.1	2.9	2.6	2.5
<b>Valuations</b>									
Book Value (INR)	141	163	195	230	289	380	458	549	652
<b>Price-to-BV (x)</b>					<b>4.8</b>	<b>3.7</b>	<b>3.0</b>	<b>2.5</b>	<b>2.1</b>
EPS (INR)	20.3	29.5	44.4	49.2	75.3	92.8	100.4	114.9	132.4
EPS Growth (%)	20.4	45.6	50.4	10.8	52.9	23.3	8.2	14.5	15.2
<b>Price-to-Earnings (x)</b>					<b>18.5</b>	<b>15.0</b>	<b>13.8</b>	<b>12.1</b>	<b>10.5</b>
Dividend	6.0	6.0	10.0	12.0	15.0	20.0	21.9	24.6	28.9
<b>Dividend Yield (%)</b>					<b>1.1</b>	<b>1.4</b>	<b>1.6</b>	<b>1.8</b>	<b>2.1</b>

E: MOFSL estimates

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

\*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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