Muthoot Finance

**Gold loan growth remain muted; Margin recovery still elusive**

- MUTH’s 2QFY23 results were characterized by: a) muted gold loan growth of 3% YoY to INR565b (PY:547b); b) maturity of much higher interest rate gold loans (disbursed prior to the introduction of teaser rate gold loans), keeping the yield improvement muted; c) retirement of higher cost liabilities, aiding benign borrowing costs (CoB) in a rising rate environment, and d) lower reported operating expenses, translating into an inline PPoP.

- Standalone PAT declined ~13% YoY to ~INR8.7b (in-line), led by a 13% YoY decline in NII. Standalone yields (calc.) increased marginally ~8bp QoQ to 17.5%, while the CoB declined ~8bp QoQ, leading to a ~15bp/30bp sequential improvement in spreads and margins, respectively. Both the yield improvement and the margin recovery were below expectations.

- The trade-off between loan growth and margin, which has been evident in the last five quarters, will continue to persist in the foreseeable future. We expect the continued aggression of Banks and FinTechs to eventually make Gold loan NBFCs pivot their business models to lower spreads and margin (than they did in the past), complemented with steady gold loan growth.

- Delivering on the guided 10% YoY gold loan growth in FY23 will be difficult, in our view. This is backed by our hypothesis that MUTH and others are unlikely to pursue loan growth at the cost of profitability. Moreover, we expect elevated run-off from the maturity of higher-ticket gold loans for MUTH in 4QFY23 and now model standalone AUM growth of ~3% in FY23.

- We estimate standalone AUM CAGR of 7% over FY22-FY24, with spreads improving marginally to ~10%. We model an RoA/RoE of 4.9%/17%, respectively, in FY24. Given the improving margin, we expect elevated run-off from the maturity of higher-ticket gold loans for MUTH in 4QFY23 and now model standalone AUM growth of ~3% in FY23.

- We reiterate our Neutral rating with a TP of INR1,130 (based on 1.9x FY24E P/BV).

**Gold loans growth muted, with a decline in gold holdings**

- Gold loan AUM was flat QoQ and grew 3% YoY to ~INR565b, while the consolidated AUM at INR644b grew ~6% YoY. The MFI subsidiary (Belstar) reported a 53% YoY growth (albeit on a small base) in AUM to ~INR51.4b.

- Gold tonnage declined 1% YoY and QoQ to 177tonne. The number of gold accounts declined ~7% YoY and grew 1% QoQ to 8.16m, while the number of active customers also grew ~1% YoY to 8.16m.

- The average monthly disbursement of INR88b in 2QFY23 (v/s INR127b in 1QFY23) suggests that Gold-NBFCs like MUTH have now gravitated toward lower-ticket gold loans.

- The company shared that all teaser loans have been migrated to higher spreads (though they did in the past), complemented with steady gold loan growth.

- Expect elevated run-off from the maturity of higher-ticket gold loans for MUTH in 4QFY23 and now model standalone AUM growth of ~3% in FY23.

- We estimate standalone AUM CAGR of 7% over FY22-FY24, with spreads improving marginally to ~10%. We model an RoA/RoE of 4.9%/17%, respectively, in FY24. Given the lack of loan growth visibility and a structural change in Gold loan NBFC business models that we foresee, we expect limited upside catalysts for the stock. We reiterate our Neutral rating with a TP of INR1,130 (based on 1.9x FY24E P/BV).

**Yield expansion will remain slow; opex likely to be higher in 3Q/4QFY23**

- The company shared that all teaser loans have been migrated to higher interest rate loans (upwards of 10%) and this is expected to contribute toward an expansion in yields in the subsequent quarters.
Opex stood at INR4.5b (18% lower than MOFSLe), mainly driven by lower employee expenses and a moderation in the advertising/publicity costs, which stood at INR238m (PQ: INR467m and PY: INR288m) in 2QFY23.

Highlights from the management commentary
- The company had received RBI approval for opening 150 new branches. About 24 new branches were opened until Sep’22 and the company expects to open all the remaining branches by Dec’22.
- The company guided for margins in the range of 11-12% and is reasonably confident in its ability to maintain CoF at its current levels of ~8% in 3QFY23 despite rising interest rates.
- Muthoot Finance has applied to the RBI for approval of credit cards business, but the company has not heard back from the regulator as yet.

Valuation and view
- As highlighted earlier, there is a tradeoff between spreads/margins and growth in Gold loans. Gold loan NBFCs have now reverted to restoring spreads and margins. We believe this will translate into muted gold loan growth. Striking an appropriate balance between loan growth and margin is important.
- We have cut our FY23/FY24 EPS by 2%/4% to factor in a moderation in our gold loan growth estimates. We see limited upside catalysts, given the concerns around Gold loan growth and the need to evolve the Gold loan NBFC business model. We reiterate our Neutral rating with a TP of INR1,130 (based on 1.9x FY24E BVPS).
### Quarterly Performance (INR M)

<table>
<thead>
<tr>
<th>Y/E March</th>
<th>FY22</th>
<th>FY23E</th>
<th>FY22</th>
<th>FY23E</th>
<th>Act v/s Est. (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1QFY22</td>
<td>2QFY22</td>
<td>3QFY22</td>
<td>4QFY22</td>
<td>1QFY23</td>
</tr>
<tr>
<td>Income from operations</td>
<td>26,837</td>
<td>27,920</td>
<td>28,394</td>
<td>26,410</td>
<td>24,816</td>
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<tr>
<td>Other operating income</td>
<td>301</td>
<td>385</td>
<td>288</td>
<td>289</td>
<td>223</td>
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<tr>
<td><strong>Total Operating Income</strong></td>
<td>27,138</td>
<td>28,304</td>
<td>28,682</td>
<td>26,699</td>
<td>25,039</td>
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<tr>
<td>YoY Growth (%)</td>
<td>13.8</td>
<td>9.6</td>
<td>3.7</td>
<td>-5.5</td>
<td>-7.7</td>
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<tr>
<td>Other income</td>
<td>11</td>
<td>29</td>
<td>36</td>
<td>85</td>
<td>54</td>
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<tr>
<td><strong>Total Income</strong></td>
<td>27,149</td>
<td>28,333</td>
<td>28,718</td>
<td>26,784</td>
<td>25,093</td>
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<tr>
<td>YoY Growth (%)</td>
<td>13.8</td>
<td>9.6</td>
<td>3.4</td>
<td>-5.3</td>
<td>-7.6</td>
</tr>
<tr>
<td>Interest Expenses</td>
<td>9,822</td>
<td>9,794</td>
<td>9,533</td>
<td>9,208</td>
<td>9,416</td>
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<tr>
<td>Net Income</td>
<td>17,327</td>
<td>18,539</td>
<td>19,185</td>
<td>17,575</td>
<td>16,577</td>
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<tr>
<td>Operating Expenses</td>
<td>3,989</td>
<td>4,397</td>
<td>4,519</td>
<td>5,357</td>
<td>5,435</td>
</tr>
<tr>
<td><strong>Operating Profit</strong></td>
<td>13,338</td>
<td>14,142</td>
<td>14,666</td>
<td>12,218</td>
<td>10,241</td>
</tr>
<tr>
<td>YoY Growth (%)</td>
<td>17.0</td>
<td>16.8</td>
<td>5.5</td>
<td>-10.2</td>
<td>-23.2</td>
</tr>
<tr>
<td>Provisions</td>
<td>337</td>
<td>744</td>
<td>889</td>
<td>-700</td>
<td>-577</td>
</tr>
<tr>
<td><strong>Profit before Tax</strong></td>
<td>13,001</td>
<td>13,398</td>
<td>13,777</td>
<td>12,918</td>
<td>10,818</td>
</tr>
<tr>
<td><strong>Net Profit</strong></td>
<td>9,712</td>
<td>9,940</td>
<td>10,289</td>
<td>9,603</td>
<td>8,020</td>
</tr>
<tr>
<td>YoY Growth (%)</td>
<td>15.5</td>
<td>11.1</td>
<td>3.8</td>
<td>-3.6</td>
<td>-17.4</td>
</tr>
</tbody>
</table>

### Key Operating Parameters (%)

| Yield on loans (Cal) | 20.6 | 21.0 | 20.9 | 18.9 | 17.5 | 17.5 | 18.1 | 18.5 |
| Cost of funds (Cal) | 8.4 | 8.1 | 7.9 | 7.6 | 7.9 | 7.8 | 8.0 | 8.4 |
| Spreads (Cal) | 12.3 | 12.9 | 12.9 | 11.4 | 9.6 | 9.7 | 10.1 | 10.1 |
| NIMs (Cal) | 13.2 | 13.8 | 14.0 | 12.5 | 10.9 | 11.2 | 11.5 | 11.6 |
| Credit Cost | 0.3 | 0.6 | 0.6 | -0.5 | -0.4 | -0.1 | 0.0 | 0.3 |
| Cost to Income Ratio | 23.0 | 23.7 | 23.6 | 30.5 | 34.7 | 28.2 | 30.0 | 32.9 |
| Tax Rate | 25.3 | 25.8 | 25.3 | 25.7 | 25.9 | 25.3 | 25.8 | 26.2 |

### Balance Sheet Parameters

| AUM (INR b) | 526 | 551 | 547 | 581 | 567 | 572 | 587 | 600 |
| Change YoY (%) | 27.4 | 17.3 | 8.5 | 10.3 | 7.7 | 3.8 | 7.4 | 3.3 |
| **Gold loans (INR b)** | 521 | 547 | 542 | 575 | 562 | 565 | 576 | 592 |
| Change YoY (%) | 28.6 | 18.3 | 9.1 | 10.8 | 7.9 | 3.3 | 6.3 | 3.0 |
| Gold Stock Holding (In tonnes) | 171 | 178 | 178 | 187 | 178 | 177 |
| Avg gold loans per branch (INR m) | 113 | 118 | 117 | 125 | 122 |
| **Borrowings (INR b)** | 478 | 488 | 471 | 499 | 454 | 468 | 487 | 497 |
| Change YoY (%) | 23.0 | 15.6 | 1.2 | 8.4 | -5.0 | -4.1 | 3.3 | -0.3 |
| **Borrowings Mix (%)** | | | | | | | | |
| Listed secured NCDs | 27.8 | 26.2 | 26.2 | 24.7 | 27.0 | 24.2 |
| Term loans | 43.6 | 46.9 | 52.2 | 55.5 | 51.4 | 55.9 |
| Commercial Paper | 9.1 | 8.0 | 1.8 | 2.0 | 0.0 | 0.0 |
| Others | 3.9 | 3.7 | 4.0 | 2.7 | 4.2 | 2.5 |
| Debt/Equity (x) | 2.7 | 2.7 | 2.4 | 2.4 | 2.3 | 2.2 |

### Asset Quality Parameters (%)

| GS 3 (INR m) | 6,408 | 10,213 | 20,908 | 17,372 | 12,078 | 9,558 |
| Gross Stage 3 (% on Assets) | 1.2 | 1.9 | 3.8 | 3.0 | 2.1 | 1.7 |
| **Total Provisions (INR m)** | 9,455 | 10,129 | 10,951 | 10,173 | 9,548 | 9,380 |

### Return Ratios

| RoAUM (Rep) | 7.4 | 7.4 | 7.5 | 6.8 | 5.6 | 6.1 |
| RoE (Rep) | 25.4 | 25.0 | 24.4 | 21.5 | 17.5 | 18.5 |

E: MOFSL estimates
Highlights from the management commentary

Spreads and NIM
- Portfolio gold loan yields stood at 17.3%: Yields in 2QFY23 was a function of very high rate gold loans (disbursed prior to introduction of teaser-rate loans) getting redeemed and which were offset by new loans (in 2QFY23) at interest rates which were higher than teaser rate loans.
- Yields are improving but they have not reached the levels which were there prior to the introduction of teaser rate loans. Company has migrated all teaser-rate loans to higher interest rates (upwards of 10%). Drag from teaser-rate loans on the yields will not be there from next quarter onwards.
- ECB of USD450m retired in Oct’22; Borrowing costs stood at 7.98% in 2QFY23. Expects borrowing costs to remain around the same ball park in the Dec’22 quarter.

Guidance
- Guided for NIM in the range of 11-12%
- Company guided that it hopes to achieve the guided gold loan growth of 10% in FY23

Liquidity and Liability
- As far as the level of bank borrowings are concerned, it will depend on the availability and the cost of the funding from the respective sources.
- Liquidity levels as on Sep’22 were kept higher because the first tranche of ECB bonds of USD450m were due for maturity in Oct’22. It has brought down the levels of liquidity in the ongoing quarter. Company does not want to keep a higher liquidity and bear a higher negative carry. It will prune its liquidity to reasonable levels while maintaining their LCR.
- Next tranche of ECB Bonds are due for maturity on Sep 1, 2023

Newer Branches
- Company had received RBI approval for the first tranche of 150 branches. 24 new branches were opened until Sep’22 and it expects all the remaining branches to be opened until Dec’22.
- It takes a year or two for a new branch to stabilize and gain good traction. It depends on the locality of the branch and need of the customers in the vicinity and the mindset of such customers to take gold loans.
- A branch becomes profitable (or achieves break-even) within 12 months

Others
- The company does not plan to reduce the advertisement and promotion expenses and expects them to remain at the current levels in subsequent quarters.
- Company started the Milligram Gold Program - First such gold reward program for all its customers.
- Auctions were the highest in 2016 because there was a steep decline in the gold prices. Gold auctions are not lumpy anymore and some gold auctions are business as usual.

- NBFCs are not permitted to lend to customers who pool gold ornaments from other individual customers.
- Muthoot Finance has applied to the RBI for approval for credit cards business but the company has not heard back from the regulator as yet.
Key exhibits

Exhibit 1: Standalone AUM grew 4% YoY

- Standalone AUM (INR b) - YoY Growth (%)

<table>
<thead>
<tr>
<th>Quarter</th>
<th>1QFY20</th>
<th>1HFY20</th>
<th>9MFY20</th>
<th>FY20</th>
<th>1QFY21</th>
<th>1HFY21</th>
<th>9MFY21</th>
<th>FY21</th>
<th>1QFY22</th>
<th>1HFY22</th>
<th>9MFY22</th>
<th>FY22</th>
<th>1QFY23</th>
<th>1HFY23</th>
</tr>
</thead>
<tbody>
<tr>
<td>AUM (INR b)</td>
<td>358</td>
<td>357</td>
<td>385</td>
<td>416</td>
<td>413</td>
<td>504</td>
<td>526</td>
<td>526</td>
<td>551</td>
<td>547</td>
<td>581</td>
<td>567</td>
<td>572</td>
<td></td>
</tr>
<tr>
<td>YoY Growth (%)</td>
<td>16</td>
<td>11</td>
<td>19</td>
<td>22</td>
<td>15</td>
<td>32</td>
<td>31</td>
<td>26</td>
<td>27</td>
<td>17</td>
<td>10</td>
<td>8</td>
<td>4</td>
<td></td>
</tr>
</tbody>
</table>

Source: MOFSL, Company

Exhibit 2: Trend in productivity

- Avg Gold Loans/Branch (INR m) - YoY growth (%)

<table>
<thead>
<tr>
<th>Quarter</th>
<th>1QFY20</th>
<th>1HFY20</th>
<th>9MFY20</th>
<th>FY20</th>
<th>1QFY21</th>
<th>1HFY21</th>
<th>9MFY21</th>
<th>FY21</th>
<th>1QFY22</th>
<th>1HFY22</th>
<th>9MFY22</th>
<th>FY22</th>
<th>1QFY23</th>
<th>1HFY23</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gold Loans/Branch (INR m)</td>
<td>77</td>
<td>83</td>
<td>89</td>
<td>100</td>
<td>107</td>
<td>112</td>
<td>113</td>
<td>117</td>
<td>118</td>
<td>117</td>
<td>125</td>
<td>122</td>
<td>122</td>
<td></td>
</tr>
<tr>
<td>YoY Growth (%)</td>
<td>5</td>
<td>16</td>
<td>19</td>
<td>13</td>
<td>30</td>
<td>29</td>
<td>26</td>
<td>27</td>
<td>18</td>
<td>10</td>
<td>11</td>
<td>8</td>
<td>3</td>
<td></td>
</tr>
</tbody>
</table>

Source: MOFSL, Company

Exhibit 3: Regional mix of gold loans largely stable

- East - West - North - South

<table>
<thead>
<tr>
<th>Quarter</th>
<th>1QFY20</th>
<th>1HFY20</th>
<th>9MFY20</th>
<th>FY20</th>
<th>1QFY21</th>
<th>1HFY21</th>
<th>9MFY21</th>
<th>FY21</th>
<th>1QFY22</th>
<th>1HFY22</th>
<th>9MFY22</th>
<th>FY22</th>
<th>1QFY23</th>
<th>1HFY23</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gold Loans/Branch (INR m)</td>
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<td>49</td>
<td>49</td>
<td>49</td>
<td>49</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>48</td>
<td></td>
</tr>
<tr>
<td>YoY Growth (%)</td>
<td>23</td>
<td>23</td>
<td>23</td>
<td>23</td>
<td>23</td>
<td>22</td>
<td>22</td>
<td>22</td>
<td>22</td>
<td>22</td>
<td>22</td>
<td>22</td>
<td>23</td>
<td></td>
</tr>
<tr>
<td>Branches opened during the quarter</td>
<td>38</td>
<td>31</td>
<td>34</td>
<td>25</td>
<td>0</td>
<td>-6</td>
<td>-2</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>24</td>
<td></td>
</tr>
</tbody>
</table>

Source: MOFSL, Company

Exhibit 4: MUTH opened 24 new branches in 2QFY23

- Yields - CoF

<table>
<thead>
<tr>
<th>Quarter</th>
<th>1QFY20</th>
<th>1HFY20</th>
<th>9MFY20</th>
<th>FY20</th>
<th>1QFY21</th>
<th>1HFY21</th>
<th>9MFY21</th>
<th>FY21</th>
<th>1QFY22</th>
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<th>9MFY22</th>
<th>FY22</th>
<th>1QFY23</th>
<th>1HFY23</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yields</td>
<td>23.9</td>
<td>25.0</td>
<td>24.0</td>
<td>23.0</td>
<td>23.4</td>
<td>22.7</td>
<td>21.9</td>
<td>20.6</td>
<td>21.0</td>
<td>20.9</td>
<td>18.9</td>
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<td>17.5</td>
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<tr>
<td>CoF</td>
<td>9.5</td>
<td>9.3</td>
<td>8.8</td>
<td>9.2</td>
<td>9.1</td>
<td>8.5</td>
<td>8.2</td>
<td>8.4</td>
<td>8.1</td>
<td>7.9</td>
<td>7.6</td>
<td>7.9</td>
<td>7.8</td>
<td></td>
</tr>
</tbody>
</table>

Source: MOFSL, Company

Exhibit 5: Spreads (calculated) improved by ~15bp QoQ (%)

- Term loans - NCD - CP - ECB - Others

<table>
<thead>
<tr>
<th>Quarter</th>
<th>2QFY20</th>
<th>3QFY20</th>
<th>4QFY20</th>
<th>1QFY21</th>
<th>2QFY21</th>
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<tr>
<td>NCD</td>
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<td>31</td>
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<td>CP</td>
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<td>52</td>
<td>55</td>
<td>51</td>
<td>56</td>
<td>56</td>
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<tr>
<td>ECB</td>
<td>17</td>
<td>14</td>
<td>10</td>
<td>13</td>
<td>11</td>
<td>16</td>
<td>16</td>
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<td>27</td>
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<tr>
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<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
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</tbody>
</table>

Source: MOFSL, Company

Exhibit 6: Borrowing mix increased towards bank loans%
Valuation and view

- As highlighted earlier, there is a tradeoff between spreads/margins and growth in Gold loans. Gold loan NBFCs have now reverted to restoring spreads and margins. We believe this will translate into muted gold loan growth. Striking an appropriate balance between loan growth and margin is important.
- We have cut our FY23/FY24 EPS by 2%/4% to factor in a moderation in our gold loan growth estimates. We see limited upside catalysts, given the concerns around Gold loan growth and the need to evolve the Gold loan NBFC business model. We reiterate our Neutral rating with a TP of INR1,130 (based on 1.9x FY24E BVPS).
Exhibit 11: Cut our FY23/FY24 EPS estimate by 2%/4% to factor in lower loan growth

<table>
<thead>
<tr>
<th>INR B</th>
<th>FY23</th>
<th>FY24</th>
<th>FY23</th>
<th>FY24</th>
<th>% Change</th>
<th>FY23</th>
<th>FY24</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nil</td>
<td>66.3</td>
<td>75.1</td>
<td>64.1</td>
<td>71.9</td>
<td>-3.2</td>
<td>-4.2</td>
<td></td>
</tr>
<tr>
<td>Other Income</td>
<td>1.5</td>
<td>1.5</td>
<td>1.5</td>
<td>1.5</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Income</td>
<td>67.7</td>
<td>76.6</td>
<td>65.6</td>
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Source: MOFSL, Company

Exhibit 12: One-year forward P/E ratio

Source: MOFSL, Company

Exhibit 13: One-year forward P/B ratio

Source: MOFSL, Company
## Financials and valuations

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### BALANCE SHEET

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E: MOFSL Estimates
## Financials and valuations

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<td>Price-Earnings (x)</td>
<td>14.7</td>
<td>11.9</td>
<td>11.2</td>
<td>13.2</td>
<td>13.2</td>
<td>11.8</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Dividend</td>
<td>6.0</td>
<td>6.0</td>
<td>10.0</td>
<td>12.0</td>
<td>15.0</td>
<td>20.0</td>
<td>20.0</td>
<td>19.5</td>
<td>20.4</td>
</tr>
<tr>
<td>Dividend Yield (%)</td>
<td>1.4</td>
<td>1.8</td>
<td>1.8</td>
<td>1.8</td>
<td>1.8</td>
<td>1.8</td>
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E: MOFSL Estimates
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<table>
<thead>
<tr>
<th>Investment Rating</th>
<th>Expected return (over-12 month)</th>
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<tbody>
<tr>
<td>BUY</td>
<td>&gt;=15%</td>
</tr>
<tr>
<td>SELL</td>
<td>&lt; -10%</td>
</tr>
<tr>
<td>NEUTRAL</td>
<td>&lt; - 10 % to 15%</td>
</tr>
<tr>
<td>UNDER REVIEW</td>
<td>Rating may undergo a change</td>
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<tr>
<td>NOT RATEd</td>
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