



MUTHOOT FINANCE LIMITED

Issue Details

Muthoot Finance Limited (MFL) proposes to launch an Initial Public Offering (IPO) through an issue of 5.15 crore equity shares with a face value Rs. 10 with a premium that will be determined through a book-building process. The offers will constitute 13.85% of the fully diluted, post-issue, paid-up equity share capital of the company. Following the IPO, the shareholding of the promoters of the company will reduce from 93% to 80.12%. The offer would be made through the 100% book-building route. Of the net offer, 50% is reserved for Qualified Institutional Buyers (QIBs) while 15% and 35%, respectively, are reserved for non-institutional investors and retail investors. Post the IPO, the shares will be listed on the National Stock Exchange (NSE) and the Bombay Stock Exchange (BSE).

Proposed Use of IPO Proceeds

The objective of the offer is to augment the capital base of MFL in order to support its capital requirements arising out of anticipated growth in assets and for also compliance with regulatory capital adequacy requirements.

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IPO Grading

ICRA has assigned an 'IPO Grade 4', indicating above-average fundamentals to the proposed Initial Public Offering of Muthoot Finance Limited (MFL). ICRA assigns an IPO grading on a scale of IPO Grade 5 through IPO Grade 1, with Grade 5 indicating 'strong fundamentals' and Grade 1 indicating 'poor fundamentals'.

An ICRA IPO Grade is a symbolic representation of ICRA's current assessment of the fundamentals of the issuer concerned. The fundamental factors assessed include, business and competitive position; financial position and prospects; management quality; corporate governance and compliance and litigation issues, if any.

Disclaimer: Notwithstanding anything to the contrary, an ICRA IPO grade is a statement of the current opinion of ICRA; and is not a statement of appropriateness of the graded security for any of the investors. An ICRA IPO grade is assigned with due care and caution on the basis of analysis of information and clarifications obtained from the issuer concerned and also other sources considered reliable by ICRA. However, ICRA makes no representation or warranty, express or implied, as to the accuracy, authenticity, timelines, or completeness of such information. An ICRA IPO grade is not (a) a comment on the present or future price of the security concerned (b) a certificate of statutory compliance and/or (c) a credit rating. Further, the ICRA IPO grade is not a recommendation of any kind including but not limited to recommendation to buy, sell, or deal in the securities of such issuers nor can it be considered as an authentication of any of the financial statements of the company and ICRA shall not be liable for any losses incurred by users from any use of the grade in any manner. It is advisable that professional assistance be taken by any prospective investor in the securities of the company including the fields of investment banking, tax or law while making such investments. All services and information are provided by ICRA on an "as is" basis, without representations and warranties of any nature.

Website:

www.icra.in

Strengths

- Strong franchise and leading market position of the company in the niche gold loan segment in the southern Indian States of Kerala, Tamil Nadu, Andhra Pradesh and Karnataka
- Large branch network and focus on increasing penetration in new geographies to support the company in tapping the growth potential arising on account of large holdings of gold ornaments by Indian households
- Good appraisal and market knowledge, collection and risk management systems have enabled the company to maintain robust pace of expansion while maintaining good control over operations
- Demonstrated ability to generate good risk adjusted returns (PAT/ Net worth of 48.9%); although this could come down with decline in leveraging level (currently 10.46 times¹) following the public offering of the company; over the medium term, MFL should be in a position to maintain good return on net worth
- Good financial flexibility to grow portfolio with access to funding through banks and institutional investors; MFL enjoys high credit ratings (of LAA- and A1+ by ICRA), which should enable it to raise funding at competitive rates. Furthermore, the company enjoys access to funding through retail sources on account of healthy franchise in southern India
- Comfortable liquidity position with a well-matched, asset-liability position

Challenges

- Mono-line business model resulting in limited revenue diversification; fee income accounts for only 0.83% of the total income of the company
- Business model exposed to adverse movement of gold prices and a marginal borrower profile; however, the company has been able to mitigate the risks so far through active monitoring of the portfolio and through auctioning of ornaments of overdue contracts
- Higher operational risks associated with the large volume of transactions involving cash and gold jewellery; these risks, however, are partly mitigated by MFL's good internal control and audit functions
- Portfolio interest spreads of MFL could get impacted as competitive pressures from banks and other NBFCs increases. Furthermore interest spreads could also be impacted with an increase in bank funding costs (estimated at 100-150 bp) following RBI's notification which removed agriculture classification for Gold Loans originated by NBFCs; however the overall interest spreads of MFL are expected to remain at healthy levels, which along with improving operating efficiencies should enable MFL to maintain a healthy earnings profile and shareholder returns.
- The company is exposed to regulatory risks with respect to state government statutes on money lending activities. Any adverse regulatory rulings would impact growth prospects of the company

Grading Rationale

The above-average fundamental '**IPO Grade 4**' factors in the high growth prospects of MFL in the niche loan against gold ornament segment, wherein the scope for expansion is significant in view of the large holdings of gold ornaments by households and relative under-penetrated market. MFL is well-positioned to leverage the robust growth potential in the segment on the back of its strong market knowledge; well-established systems and processes and good track record in scaling up operations while maintaining a tight control on asset quality and sustaining good profitability. The company has expanded its branch network from 551 branches to 1605 branches over the last three years ending March 31, 2010, resulting in a portfolio CAGR of 73%. During the same period, credit losses on gold loans have been minimal. In FY 2010, credit losses were at Rs. 0.67 crore or less than 0.01% of average managed advances, thus supporting a healthy return on equity (RoE) of 48%. Strong growth in portfolio has been facilitated by investments towards expansion of branch network in traditional loan against gold ornaments geographies, that is, southern India as well as the relatively under-tapped new geographies in northern India. MFL's large and geographically spread branch network (numbering 2038 in September 2010) and its ability to provide a higher level of service viz.a.viz banks with respect to quicker disbursement , turnaround time and higher advance rates per gram (Loan to value ratios) are competitive factors in its favor. At the same time, MFL is exposed to adverse movements in gold prices and operational risks associated with the gold loan segment. Nevertheless, MFL has strong and established risk management, internal audit, monitoring and surveillance systems to mitigate any risks; and has been able to maintain good control over operations and asset quality while growing at a robust pace. Nevertheless, the company operates a mono-line business model and is, therefore, exposed to concentration risks. MFL enjoys good financial flexibility and raises funds at relatively competitive rates from banks and institutional investors. MFL enjoys the high credit ratings of LAA- and A1+ from ICRA, which support its ability to raise funds at competitive rates. Furthermore, the strong franchise and the group's long track record in Kerala enable MFL to tap retail

¹ Treating assignment book as debt

funding sources (accounting for about 33% of total funding in September 2010). Roll over rates on retail borrowings have historically been high, thus supporting the liquidity profile of the company. With the augmentation of the company's capital base through its proposed IPO, MFL should be in a position to leverage the same to expand its portfolio. As on December 2010, the capital adequacy of MFL was at 15.19% (Tier 1 of 10.69%). The company raises subordinate debt (which classifies as Tier 2 capital, subject to a maximum of 50% of Tier I capital) placed primarily to its retail investors. MFL currently has limited headroom to raise additional Tier 2 capital in the form of subordinate debt but has headroom (of Rs. 590 Crore) to raise Tier 2 capital in the form of preference shares to meet its regulatory capital adequacy requirements of 15% (with effect from March 2011). ICRA expects fresh equity mobilised through the proposed IPO to create additional headroom for MFL to raise Tier 2 capital, thereby expanding its capacity to lend. The company enjoys a strong earnings profile (PAT/ Avg. Net worth of 48.90% and PAT/ Avg. Managed Assets of 3.76% in September 2010) on the back of its healthy gross interest spreads and low credit costs. ICRA has also taken note of the RBI notification of February 2011, which removes the eligibility of gold loans sourced by NBFCs from classification as agriculture advances. Consequently, the incremental cost of funding to MFL from banks could increase, as the existing bank borrowings availed under the agriculture classification get converted to higher-cost (by around 100-150 bps) non-agriculture limits. Nevertheless, ICRA expects the company's access to banking credit to remain healthy and facilitate portfolio growth. As on December 31, 2010, around 37% of the total assets of MFL were funded out of banking limits (including assignment portfolios) classified as agriculture lending. As a result, the incremental net interest margins could come down to the extent of around 50 bps. Nevertheless, ICRA expects interest margins of the company to remain healthy, which along with improving operating efficiencies should enable MFL to maintain a healthy earnings profile and returns to shareholders.

Entity Profile

Muthoot Finance Ltd (MFL) is the flagship company of 'The Muthoot Group' based in southern India. The group has a presence in diverse businesses including financing, healthcare, real estate, education, hospitality, forex, wealth management services, money transfer services, power generation and entertainment. MFL is registered as a Non-Banking Financial Company - Non Deposit taking - Systemically Important (NBFC-ND-SI); and is engaged in the loan against gold ornament segment with a managed advance base of Rs. 11,550 Crore as on September 30, 2010. The lending operations of the Group were commenced in 1939 by Late. Mr. M. George Muthoot. Ever since, 'loan against gold ornaments' has remained the core business of the Group. Until 1997, the business operated under 'Muthoot Bankers', a partnership firm. 'Muthoot Finance Pvt. Ltd' was incorporated in March 1997. In November 2001, the company received its NBFC registration from the RBI and the business was gradually transferred to it. The company was converted into a public limited company in FY 2009 and its name was changed to 'Muthoot Finance Limited' (MFL). MFL is classified as an NBFC- ND- SI (Systemically Important, Non-Deposit Taking NBFC). Although the company is a non-deposit accepting NBFC, it does accept retail debentures (not considered as public deposits), which accounted for close to 33% of the company's total funding as on September 30 2010.

As on December 31, 2010, the promoters of MFL held a 93% stake in the company. The promoters diluted their stake from 100%, following issue of fresh shares to the extent of 6% of their shareholding during H1, 2011 to private equity investors— Matrix Partners, Baring India Private Equity, Kotak India Private Equity, Kotak Investment Advisors Limited and the Wellcome Trust Limited. Subsequently the promoters sold 1% of their shareholding to the Wellcome Trust Limited. As on December 31, 2010, the company had a capital adequacy of 15.19% and a Tier 1 Capital of 10.69%. MFL for the financial year ended March 31, 2010 reported a PAT of Rs. 227.6 Crore on a managed asset base of Rs. 8451 Crore as compared to a PAT of Rs. 97.7 Crore on a managed asset base of Rs. 4578 Crore during the previous financial year. During the half year ended September 30, 2010, MFL registered a 167% y-o-y growth in PAT to Rs. 198 Crore as compared with Rs. 74 Crore during the corresponding period in the previous financial year.

Promoters and Management

MFL is closely held by the promoters and family members of the Muthoot family. As on December 31, 2010, the promoters owned a 93% stake in the company; this stake would come down to 80.12%, following MFL's IPO. The promoter's family has been engaged in the gold loan business since 1939 and has strong knowledge, experience and understanding of the market.

The Managing Director of the company, Mr. George Alexander Muthoot, is closely involved in the operations of the company and has strong knowledge and understanding of the market. Under the current Managing Director, MFL registered a strong portfolio and managed a geographic expansion. The Executive Director of MFL, Mr. Padmakumar joined the company in March 2005 after retiring as the Chairman and Managing Director of Federal Bank. Mr. Padmakumar has 36 years of experience in commercial banking.

Corporate Governance

The Board of Directors of MFL currently has 8 Directors (including 4 independent directors and 4 promoter directors) and is in compliance with the requirements of Clause 49 of the Listing Agreement, that is, (i) not less than 50% constituted by non-executive Directors and (ii) at least 50% constituted by Independent Directors. The Chairman of the Board is Mr. M.G. George Muthoot, who is from the promoter's family. Independent directors include Mr. George Joseph (former Chairman and Managing Director of Syndicate Bank) and Mr. K. John Mathew (Retd. Judge of the Kerala High Court).

The Board of Directors of the company meets once a quarter for review of performance and to consider any other business related matters.

Compliance and Litigation

Accounting Policy: The financial statements of MFL are prepared on accrual basis, following the historical cost convention in accordance with the generally accepted accounting principles.

Litigation: There are 32 civil proceedings and 15 consumer complaints filed against MFL. These cases are pending before various forums in respect of approx. Rs. 9 lakhs. Such proceedings primarily pertain to customers seeking permanent injunction against MFL from disposing pledged ornaments against overdue loans availed by them.

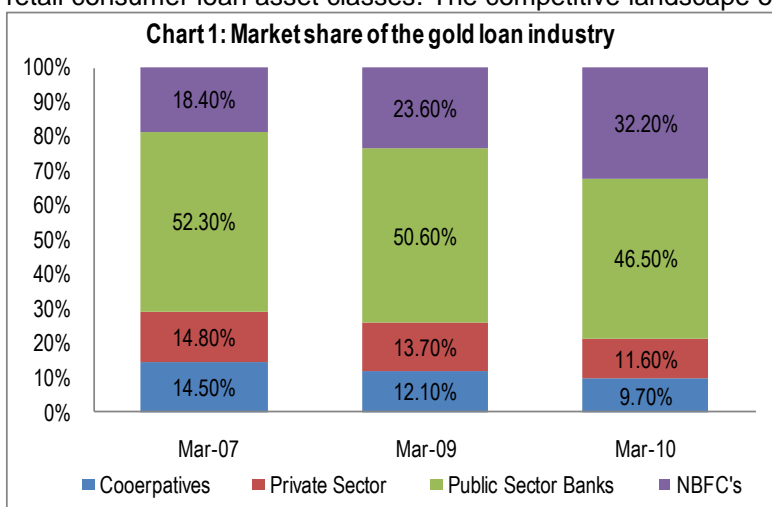
MFL has been issued show cause notices from the Government Authorities of Kerala and Gujarat in relation to compliance with relevant money lending statutes issued by the respective State governments. Please refer to Page 7 for more information on the same.

Business and Competitive Position

MFL has an established track record in the niche Gold loan segment, and has a gold loan portfolio of Rs. 11,550 crore as on September 30 2010. The Muthoot Group enjoys strong market knowledge and a good franchise in southern India on the back of significant experience of the promoters of the Group since 1939. The growth of the company is also aided by the fact that gold loans are commonly a accepted form of financing amongst households in southern India. The gold loan asset class is characterised by small ticket size loans (average ticket size of around Rs. 30,600 for MFL) secured typically against gold ornaments. While the contractual tenure of the loan contract is 12 months, the loan tenure is typically around 3-4 months.

Strong growth prospects buoyed by large household gold holdings and specialisation of NBFCs in the segment

The participants in the organised gold loan market include public/private sector Banks, NBFCs and co-operatives as compared to other retail consumer loan asset classes. The competitive landscape of the gold loan segment is relatively fragmented on account of the specialised nature of business and underwriting skills required and the voluminous nature of transactions on account of smaller ticket sizes. Based on IMAcs report, the share of NBFCs in the gold loan segment has been steadily increasing from ~18% in Mar-07 to ~32% in Mar-10, while the share of public sector banks declined from ~52% to ~46% and private sector banks from ~15% to ~12%. NBFCs have gained market share during this



Source: IMAcs Industry Report (2010 Update)

period as they leveraged their specialized knowledge of the segment while adopting a focused growth approach targeting semi-urban regions, where customers typically have lower access to financing. Furthermore NBFCs through quicker turn-around time; higher product flexibility and higher advance rate per gram (higher Loan to Value Ratios) have been able to register strong portfolio growth over the past few years.

Table 1: Gold Loan Portfolio outstanding of various financiers

	Mar-10	Mar-09	Mar-07
Muthoot Finance Limited	7342	3300	1420
Manappuram General Finance and Leasing Limited	2560	1200	480
Muthoot Fincorp Limited	2220	1180	470
India Overseas Bank	5220	3100	1690
Indian Bank	3920	3250	1700
South Indian Bank	2350	1500	600
State Bank of Travancore	1930	1600	1140
Andhra Bank	1400	900	400
Federal Bank	860	1070	600
Three-year CAGR - Market	43%		
Three-year CAGR - NBFCs	72%		
Three-year CAGR - MFL	73%		

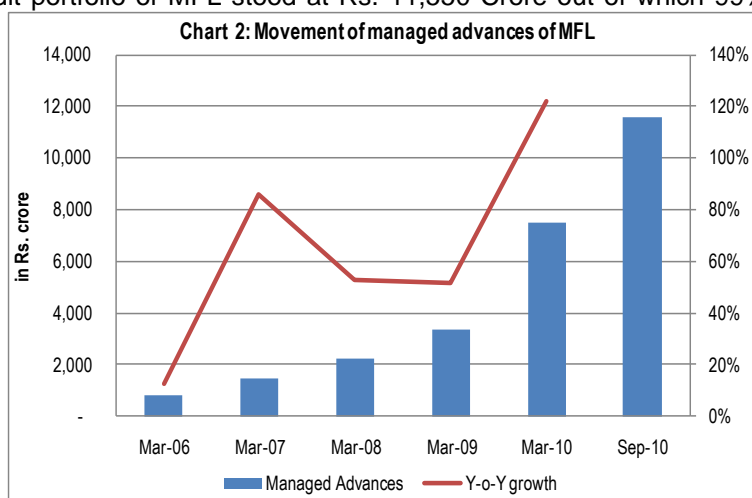
Note: Amounts are presented in Rs. Crore

Source: DRHP - IMAcs Industry Report (2010 Industry Update)

As per IMaCs industry report the growth in the gold loan market size has been significant over the past few years- registering a three-year CAGR of ~43% for the period ended March 31, 2010 to around Rs. 35,000-Rs. 40,000 crore. During this period, growth in NBFCs was much higher at 72% while the portfolio of MFL grew at a three-year CAGR of 73%. Going forward future market size growth prospects are expected to remain significant. The private gold holdings of Indian households are significant- as per the world gold council, the stock of gold holdings (net of central bank gold stock) is around 17,500 tons², against which the market value would as of March 2010 be around Rs. 27,40,000 crore. This translates into a market penetration of only 1.3%, which leaves substantial scope for future expansion.

Competitive positioning of MFL supported by its strong franchise in southern India as well as a large and geographically diversified branch network

As on September 30, 2010, the credit portfolio of MFL stood at Rs. 11,550 Crore out of which 99% was in the form of loans against gold and the balance in the form of loans against MFL's own Non-Convertible Debentures. The Muthoot Group has been engaged in the gold loan segment since 1939 and enjoys a strong franchise particularly in the four southern Indian States (of Kerala, Karnataka, Andhra Pradesh and Karnataka), where gold loans are an accepted form of financing. MFL has expanded its portfolio at a three-year CAGR of 73% on the back of its strong franchise and increasing popularity of the product within and outside South India



Source: Company

Table 2: Year-wise movement of MFL's branch network and Managed Portfolio

	# of branches	Managed Portfolio	Y-o-Y growth
Mar-08	707	2179	53%
Mar-09	985	3300	51%
Mar-10	1605	7342	122%
Sep-10	2038	11447	160%

Note: Amounts in Rs. Crore

Source: Company

The strong pace of expansion of the portfolio of MFL has been supported over the past few years by a robust augmentation of its branch network to 2038 branches in September 2010 from 707 branches in March 2008. MFL has the largest branch network amongst the NBFCs operating in the gold loan space. The company has taken concerted efforts to increase its penetration in the four southern India and also expand its presence in new geographies in northern and western India. As on September 30, 2010, MFL had a branch presence in 25 states across the country and has been able to diversify its geographic spread with the proportion of advances and branches outside South India increasing to 25% and 31%, respectively, in September 2010 from 18% and 9%, respectively, in March 2008. Strong and widespread branch network puts MFL in a good position to tap the huge growth potential in the gold loan segment.

² Total estimated gold stock holdings of 18,000 tons less central bank holdings of 558 tons

Table 3: Percent shares of Total Managed Advances by Region

Region	Sep-10	Mar-10	Mar-09	Mar-08
South	75%	75%	80%	82%
North	14%	15%	14%	13%
West	8%	8%	5%	4%
East	3%	2%	1%	1%
% of total branches				
South	69%	70%	88%	91%
North	17%	17%	3%	2%
West	11%	10%	8%	6%
East	3%	3%	2%	1%

Source: DRHP and Company

Strong market knowledge, good appraisal and risk management systems have supported MFL in managing growth

The gold loan business is inherently safe as compared to other financing businesses as the security (gold ornament) pledged is in possession with the financier. However, the product is exposed to the risk of a sharp and sustained decline in the price of gold, leading to decrease in the value of the security and the risk of incorrect assessment of gold purity at the branch level. While MFL does lend at incremental LTVs ranging from 60-90% (average LTV of around 70%), it has put in place the following mitigants and processes so as to maintain good control over operations while pursuing robust expansion in the scale of its operations.

a) Tracking of the Value of Contracts and Auctioning Policy

The company's track record of collections in the gold loan segment has been good, and has been supported by good portfolio monitoring systems; borrower's sentimental attachment towards the pledged gold ornaments and rising gold prices. The company monitors the market value of the outstanding security against each of its contracts; and has the option to auction gold ornaments in case borrowers fail to repay their loans. The following are the details of auctions of the company:

Table 4: Auctioning of gold ornaments by MFL

		H1 2011		2009-10		2008-09		2007-08	
		Amount	%*	Amount	%*	Amount	%*	Amount	%*
Principal outstanding against loans auctioned		26	1.2%	91	2.8%	52	2.4%	22	1.6%
Loss on Auction		0		0		0		0	

*: amount auctioned as percentage portfolio outstanding with 1 year lag

Note: Amounts in Rs. Crore;

Source: Company

As can be seen from the above table, MFL auctioned loan contracts with principal outstanding aggregating to around 2.8% of its portfolio. MFL has not incurred any loss on auction of gold ornaments during this period. Furthermore, on account of the above reasons, the overall delinquency of the portfolio of MFL has remained at manageable levels.

Table 5: Movement of MFL's delinquencies

	180+ dpd %
Mar-09	0.74%
Mar-10	1.05%
Sep-10	1.07%

Note: Delinquencies are based on a 12-month lag basis

Source: Company

b) Internal Audit

The internal audit team of the company consists of 500 members and is spread out in different locations. The company conducts regular audits of branches to check the efficacy of the gold assessment quality of the branches and other operational processes of the branches.

c) *Insurance and Surveillance*

MFL is exposed to operational risks, as its transactions mainly involve gold jewellery and cash. MFL maintains its gold ornaments in strong rooms that are insured against fire, theft and employees frauds. The company is also in the process of rolling out the installation of CCTV across its branch network in order to reduce the risk of theft.

Applicability of State Government regulations could affect the growth prospects of MFL

MFL has been issued show cause notices from the Government Authorities of Kerala and Gujarat in relation to compliance with relevant money lending statutes issued by the respective State governments. In the case of the State of Kerala, Kerala Money Lender's Act (KML), apart from other things, empowers the State Government to regulate lending rates of money lenders operating in the State and requires money lenders to register their branches with the State authorities. Issue of applicability of the KML Act to NBFCs (including MFL) is sub-judice at the Supreme Court and any ruling that requires NBFCs to comply with the KML Act could have an adverse impact on the earnings and growth prospects of the company in the State of Kerala, which accounted for around 16% of its portfolio as on September 30, 2010. Nevertheless, the impact on asset quality may not be significant, as the company can auction the gold ornaments.

Financial Position

Healthy access to funding sources; financial flexibility supported by MFL's strong franchise in southern India enabling access to retail funding

Table 6: Funding Profile of MFL

	Sep-10	%	Mar-10	%	Mar-09	%	Mar-08	%
Bank Loans	4506	41%	2128	29%	1059	27%	547	23%
Non-convertible Debentures	3175	29%	2719	37%	1902	48%	1240	53%
Subordinated Debt – Muthoot Family Shareholders	40	0%	40	1%	110	3%	40	2%
Subordinated Debt- Retail	395	4%	285	4%				
Loan from directors & relatives/Shareholder Deposits	40	0%	57	1%	47	1%	35	2%
CP/NCD	416	4%	50	1%				
Others	2	0%	2	0%	47	1%	51	2%
Total Borrowings	8574	77%	5281	72%	3166	80%	1914	82%
Assignment	2497	23%	2008	28%	813	20%	434	18%
Total Funding	11071		7289		3979		2348	
Net worth	1038		584		362		214	

Note: Amounts in Rs. Crore

Source: Company

MFL has been able to leverage the strong demand for gold loans and grow its portfolio on account of its healthy access to funding. MFL enjoys strong banking relationships availing credit and assignment sanction limits from 19 banks, aggregating to Rs. 8000 crore. The company also enjoys high credit ratings of LAA- and A1+, which supports its ability to raise funds at relatively competitive rates.

Furthermore, MFL enjoys a strong franchise in Kerala and is, therefore, able to raise funding through retail debentures/ NCDs, which account for 33% of total funding for MFL. The roll over rates of retail NCDs have historically been fairly high, which bring stability to the funding profile of the company.

Impact of RBI's notification removing agriculture classification from Gold Loans sourced by NBFCs

The Reserve Bank of India (RBI), through its notification dated February 2, 2011, has clarified that banks can no longer consider loan against gold sourced by NBFCs as agricultural advances. Furthermore, banks are no longer permitted to treat investments in securitised pools and portfolios purchased through assignment of 'loan against gold jewellery receivables' originated by NBFCs as agriculture advances. MFL has in the past been raising a part of its bank funding at competitive rates, as such loans were being considered under agriculture lending classification. However as a consequence of this notification incremental cost of funding to MFL from banks could increase, as existing bank borrowings availed under the agriculture classification get converted to higher costing (by around 100-150 bps) non agriculture borrowings. Nevertheless, ICRA expects the company's access to banking credit to remain healthy and thus facilitate portfolio growth. As of December 2010, around 37% of the total assets of MFL were funded out of banking limits (including assignment

portfolios) classified as agriculture lending; as a result, incremental net interest margins could come down to the extent of around 50 bps. Nevertheless, ICRA expects the earnings profile and returns to shareholders of MFL to remain at healthy levels on the back of improving operating efficiencies.

Impact of RBI's draft guidelines on securitization transactions

In June 2010, the Reserve Bank of India (RBI) came out with draft guidelines with respect to minimum holding period required for securitised portfolios. Under these proposed guidelines, issuers would be required to hold loans (with contractual maturity of upto 24 months and with a bullet repayment) for a minimum period of 12 months before becoming eligible to be securitised.

While Gold loan offered by MFL have a contractual maturity of 12 months and have a bullet repayment schedule, MFL has so far availed funding through bilateral assignments (instead of through securitization), which currently do not come under the purview of this draft guideline and RBI's earlier regulations with respect to securitization transactions. However if the final guidelines were to apply to MFL's gold loan assignment transactions, its access to funding through this source would be restricted. As on September 30, 2010 around 23% of MFL's total funding was through the assignment route. In such a case company however should be in a position to tap funding through traditional lines of credit from banks although these may be at a higher cost higher than assignment funding. ICRA however expects MFL to continue to maintain good profitability in such a scenario.

Healthy capitalisation and headroom to augment Tier 2 provides scope to maintain capitalisation levels while improving shareholder returns

MFL has a good track record of raising capital to meet regulatory capital requirements while pursuing a robust portfolio expansion. In H1 2011 the company raised Rs. 256 Crore through issue of fresh equity to private equity investors. With the augmentation of the company's capital base through its proposed IPO, MFL should be in a position to leverage the same to expand its portfolio while meeting regulatory capital adequacy requirements over the medium term. As of December 2010, the capital adequacy of MFL was at 15.19% (Tier 1 of 10.69%). The company raises subordinate debt (which classifies as Tier 2 capital, subject to a maximum of 50% of Tier I capital) placed primarily to its retail investors. While MFL now has a limited headroom to raise additional Tier 2 capital in the form of subordinate debt, it has headroom (of Rs. 590 Crore) to raise Tier 2 capital in the form of preference shares to meet its regulatory capital adequacy requirements of 15% (with effect from March 2011). ICRA expects fresh equity mobilised through the proposed IPO to create additional headroom for MFL to raise Tier 2 capital, and thereby expand its capacity to lend.

Table 7: Capitalization levels of MFL

	Dec-10	Mar-10	Mar-09
Tier I Capital	1,180	584	362
Tier II Capital	497	292	110
Total Capital	1,677	876	472
Risk Weighted Assets	11,040	5,925	2,897
Reported Tier I Capital	10.69%	9.86%	12.51%
Reported Tier II Capital	4.50%	4.93%	3.79%
Reported CRAR	15.19%	14.79%	16.30%
Tier I Capital (Managed)	8.32%	7.61%	10.13%
Tier II Capital (Managed)	3.51%	3.80%	3.07%
CRAR	11.83%	11.41%	13.20%
Reported Gearing	8.60	9.04	8.74
Adj. Gearing (treating assigned book as debt)	11.57	12.30	10.62

Note: Amounts in Rs. Crore

Source: Company

Mono-line business model results in limited revenue diversification

MFL has a mono-line business model focussed almost entirely on the gold loan segment and has limited revenue diversification. MFL is, therefore, exposed to concentration risks because its revenue profile is almost entirely dependent on interest income with limited income through fee-based sources. MFL acts as a payment agent for several companies towards foreign inward remittance for personal purposes under the Money Transfer Service Scheme (MTSS) and has been appointed as a distributor

for the New Pension Scheme (NPS). However, its overall contribution from such sources is limited. ICRA takes into account the fact that fee income accounted for only 0.83% of the total income or 0.14% of average managed assets of MFL in H1, FY 2011.

Profitability and Earnings Profile

Table 8: Key Financial Ratio's

KEY RATIOS	Sep-10	Mar-10	Mar-09	Mar-08	Mar-07
Yield on Average Loans	18.51%	19.42%	21.13%	19.00%	19.45%
Yield on Average Earning Assets	17.47%	17.15%	17.59%	17.44%	18.43%
Cost of Average Interest Bearing Funds	8.99%	8.41%	9.79%	9.43%	8.80%
Lending Spreads	9.51%	11.01%	11.34%	9.57%	10.65%
Gross Interest Spread	8.47%	8.74%	7.80%	8.01%	9.62%
PROFITABILITY RATIOS					
Interest income /AMA	17.03%	16.54%	16.72%	16.35%	17.17%
Interest Expense / AMA	7.83%	7.27%	8.48%	8.13%	7.57%
Net Interest Margin /AMA	9.20%	9.27%	8.24%	8.22%	9.60%
Non- interest income/ AMA	0.14%	0.18%	0.24%	0.32%	0.54%
Operating expenses / AMA	3.61%	4.10%	4.43%	4.12%	5.03%
Operating Profit / AMA	5.73%	5.35%	4.05%	4.41%	5.11%
Credit Prov. & Write-offs /AMA	0.03%	0.04%	0.02%	0.03%	0.01%
PAT/ AMA	3.76%	3.49%	2.68%	2.88%	3.33%
PAT / Average Net worth	48.83%	48.08%	33.90%	34.01%	35.12%
Cost Income Ratio	38.69%	43.42%	52.26%	48.32%	49.63%

Source: MFL financial statements and ICRA research

- The return on net worth (RoNW) of MFL is very healthy at 48.90% as of September 2010 on the back of good profitability of MFL and its ability to maintain regulatory capitalisation by raising Tier 2 debt. While the return on equity (RoE) of MFL would come down post the IPO, ICRA expects MFL to be able to maintain its return on net worth at around 35% over the medium term.
- The yield on advances of MFL declined in H1, FY 2011, as the company launched a low IRR scheme during the period with the intention of increasing its customer base. As a result, the lending spreads of the company declined to 8.47% in September 2010 from 8.74% in March 2010. However, disbursements under this scheme have been brought down incrementally since H2, FY 2011 and the company is expected to expand in higher yielding schemes. However, ICRA expects incremental interest spreads of MFL to come down, following the notification of the RBI which clarifies that banks can no longer consider their exposures backed by gold loans originated by NBFCs as agricultural advances. As a result, the incremental cost of banking funding of MFL is expected to increase by 100-150 basis points (bps). Nevertheless, in light of the high credit ratings (of LAA- and A1+ assigned by ICRA), MFL is expected to be able to raise funding at relatively competitive rates from institutional investors and banks. While competitive pressures in the gold loan segment are likely to increase over the medium term, ICRA expects the lending spreads of MFL to remain at healthy levels.
- MFL added 620 and 433 branches, respectively, in FY 2010 and H1, FY 2011. However, the operating expenses of the company as percent of AMA declined to 4.10% in March 2010 and further to 3.64% in September 2010 from 4.43% in March 2009, as it has been able to increase its portfolio per branch to Rs. 5.69 Crore in September 2010 from around Rs. 3.42 Crore in March 2009. ICRA expects MFL to continue to benefit from cost efficiencies, as it leverages its branch network further.
- The provisions & write-offs of MFL have been insignificant in the past because of rising gold prices, good appraisal, collections and risk management systems.

In FY 2010 ended March 31 2010, MFL reported a profit after tax (PAT) of Rs. 227.6 Crore on a managed asset base of Rs. 8451 Crore as compared to a PAT of Rs. 97.7 Crore on a managed asset base of Rs. 4578 Crore in FY 2009. During the half-year ended September 30,2010, MFL registered a 167% y-o-y growth in PAT to Rs. 198 Crore as compared with Rs. 74 Crore during the corresponding period in the previous financial year.

March 2011

Fact Sheet: Muthoot Finance Limited

Company Profile

Constitution	Public Limited Company
Status	Systemically Important, Non-Deposit taking, Non-Banking Finance Company (NBFC – ND - SI)
Registered Office	2 nd Floor, Muthoot Chambers, Banerji Road, Kochi - 18
Share Capital (September 30, 2010)	Rs. 320 Crore
Net worth (30 September 30, 2010)	Rs. 1038 Crore
Balance Sheet Size (September 30 2010)	Rs. 12,625 Crore
Chairman	Mr. M. G. George Muthoot
Managing Director	Mr. George Alexander Muthoot
Auditors	M/s Rangamani & Co.

Source: Company

Shareholding Pattern as on September 30 2010

M.G.George Muthoot	15.01%
George Alexander Muthoot	14.10%
George Jacob Muthoot	14.10%
George Thomas Muthoot	14.10%
Anna Alexander	4.70%
Susan Thomas	9.40%
Sara George	4.26%
Elizabeth Jacob	4.70%
George M George	2.11%
George M Alexander	2.35%
Alexander M George	2.11%
George M Jacob	4.70%
Eapen Alexander	2.35%
Matrix Partners India Investments, LLC	2.45%
Baring India Private Equity Fund	2.00%
Kotak India Private Equity Fund	0.95%
Kotak Investment Advisors Limited	0.05%
The Wellcome Trust Limited	0.55%

Source: Company

Board of Directors

M.G. George Muthoot	Whole-time Director and Chairman
George Thomas Muthoot	Whole-time Director
George Jacob Muthoot	Whole-time Director
George Alexander Muthoot	Managing Director
Justice K. John Mathew (retired)	Independent Director
P. George Varghese	Independent Director
John K Paul	Independent Director
George Joseph	Independent Director

Source: Company

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