

17 January 2012

Magma Fincorp

We cut estimates & price target due to lower NII, but retain a Buy

On lower net interest income, Magma's 3QFY12 net profit fell 63.3% yoy to ₹113m. We cut our estimated EPS for FY12, FY13 and FY14 by ~29%, 14.2% and 12.1%, respectively, due to lower NII, given MTM forex losses on borrowings and subdued securitization in FY12 (with consequent higher cost of funds). We lower our price target from ₹80 to ₹73, yet retain a Buy as we expect improved FY13/14 profitability to drive up valuations.

- **Reported PAT declined 63% yoy** to ₹113m mainly due to lower net interest income. However, comparable proforma PAT (consistent accounting policy and same off-book loan proportion to AUM) for 9MFY12 was ₹1.1bn, vs. ₹772mn in 9MFY11, up 48.5% yoy.
- **Net interest income declined due to one-offs.** NII was pulled down by: 1) changes in accounting policy for securitization income, 2) MTM forex losses of ₹50m on preference debt, 3) back-ended loan growth during the quarter (lower earning yields) and, 4) lower securitization activity and rising interest rates pushing up cost of funds. We expect softening interest rates and higher securitization in 4QFY12 to lead to better net-interest-income growth than in 3QFY12 (but, lower than our earlier estimate).
- **Business growth and asset quality continue robust.** Disbursements grew 50% yoy in 3QFY12, to ₹19bn and the share of high-yield loans was 25% vs. 23% in 2QFY12. Asset quality is robust, with collection efficiency of 100% in 9MFY12 and credit cost at 0.22% of average AUM (the lowest since FY07).
- **Valuation.** We expect return ratios to improve on higher securitization income in FY13/14, driving valuations up. At our revised price target of ₹73, the stock would trade at PBV of 1.3x FY12e and 1.1x FY13e.
Risks: Economic slowdown and thereby slower loan growth and high NPAs; regulatory changes.

Key financials (YE Mar)	FY10	FY11	FY12e	FY13e	FY14e
Net interest income (₹m)	3,203	4,519	4,340	6,968	9,390
Net profit (₹m)	665	1,144	764	1,694	2,457
EPS (₹)	6.1	8.8	4.0	8.9	13.0
Growth (%)	70.2	44.5	(54.3)	121.8	45.0
PE (x)	9.0	6.2	13.7	6.2	4.2
PABV (x)	1.7	1.2	1.0	0.9	0.7
RoE (%)	20.6	24.8	9.2	14.6	18.5
RoA (%)	1.7	2.2	1.0	1.7	2.0
Dividend yield (%)	1.1	1.8	1.8	2.2	2.5
Net NPA (%)	-	-	-	-	-

Source: Company, Anand Rathi Research

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Rating: **Buy**

Target Price: ₹73

Share Price: ₹55

Key data	MGMA IN / MAGM .BO
52-week high / low	₹87 / ₹48
Sensex / Nifty	16384 / 4934
3-m average volume	US\$0.2m
Market cap	₹10bn / US\$0.2bn
Shares outstanding	189.6m

Shareholding pattern (%)	Dec-11	Sep-11	Jun-11
Promoters	33.7	30.0	29.3
- of which, pledged	11.4	13.5	13.9
Free float	66.3	70.0	70.7
- Foreign institutions	29.2	30.8	29.3
- Domestic institutions	27.8	29.4	29.3
- Public	9.3	9.8	12.1

Estimates revision (%)	FY12e	FY13e	FY14e
Net interest income	-12.6	-5.7	-5.1
PAT	-29.3	-14.2	-12.1
RoE	-465bps	-165bps	-125bps
Target multiple (x)	-0.1x	-0.2x	NA

Financials (YE: Mar)	FY12e	FY13e
Net interest income (₹m)	4,340	6,968
Net profit (₹m)	764	1,694
EPS (₹)	4.0	8.9
Growth (%)	(54.3)	121.8
PE (x)	13.7	6.2
PABV (x)	1.0	0.9
RoE (%)	9.2	14.6
RoA (%)	1.0	1.7
Dividend yield (%)	1.8	2.2
Net NPA (%)	-	-

Source: Anand Rathi Research

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Net interest income	3,203	4,519	4,340	6,968	9,390
NII growth (%)	12.8	41.1	(3.9)	60.5	34.8
Non-interest inc	665	573	542	666	819
Total income	3,868	5,092	4,882	7,634	10,209
Total income growth (%)	13.7	31.7	(4.1)	56.4	33.7
Op. expenses	2,437	3,032	3,183	3,884	4,792
Operating profit	1,431	2,060	1,699	3,751	5,417
Operating profit growth (%)	40.8	44.0	(17.5)	120.7	44.4
Provisions	400	355	559	1,222	1,750
PBT	1,030	1,705	1,140	2,529	3,667
Tax	366	561	376	835	1,210
PAT	665	1,144	764	1,694	2,457
PAT growth (%)	70.2	72.2	(33.2)	121.8	45.0
FDEPS (₹/share)	6.1	8.8	4.0	8.9	13.0
DPS (₹/share)	0.6	1.0	1.0	1.2	1.4

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Share capital	1,379	1,728	1,848	1,848	1,848
Reserves & surplus	3,267	5,493	10,560	11,872	13,901
Borrowings	35,671	44,084	73,757	91,212	110,684
Current liab. & prov.	5,266	5,451	5,992	6,626	7,349
Minority interests	-	-	-	-	-
Total liabilities	45,583	56,757	92,158	111,557	133,783
Advances	31,816	42,837	78,050	97,553	119,659
Investments	302	299	329	362	398
Cash & bank bal	9,685	10,043	10,153	9,963	10,433
Fixed & other assets	3,780	3,578	3,627	3,679	3,293
Total assets	45,583	56,757	92,158	111,557	133,783
No. of shares (m)	109	130	190	190	190
Borrowings growth (%)	44.3	23.6	67.3	23.7	21.3
Advances growth (%)	60.7	34.6	82.2	25.0	22.7

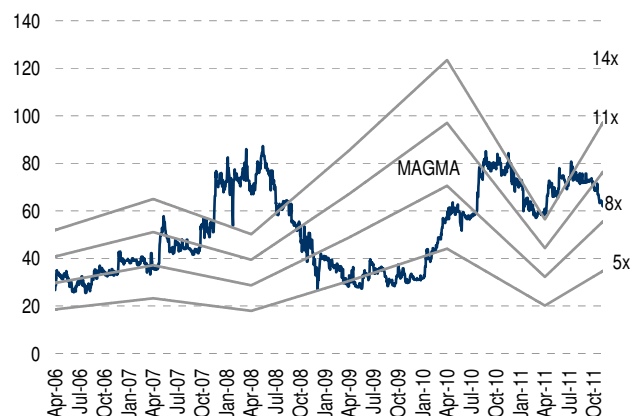
Source: Company, Anand Rathi Research

Fig 3 – Key ratios

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
NIM (%)	8.9	9.4	6.1	7.0	7.8
Other inc. / total inc. (%)	17.2	11.3	11.1	8.7	8.0
Cost-Income (%)	63.0	59.5	65.2	50.9	46.9
Provision coverage (%)	-	-	-	-	-
Dividend payout (%)	7.8	1.3	2.1	2.6	1.6
Borrowings-loans (%)	112.1	102.9	94.5	93.5	92.5
Investment-deposit (%)	-	-	-	-	-
Gross NPA (%)	-	-	-	-	-
Net NPA (%)	-	-	-	-	-
BV (₹)	32.0	44.3	57.7	64.6	75.3
Adj. BV (₹)	32.0	44.3	57.7	64.6	75.3
CAR (%)	14.9	18.2	16.0	15.5	14.9
RoE (%)	20.6	24.8	9.2	14.6	18.5
RoA (%)	1.7	2.2	1.0	1.7	2.0
Dividend yield (%)	1.1	1.8	1.8	2.2	2.5

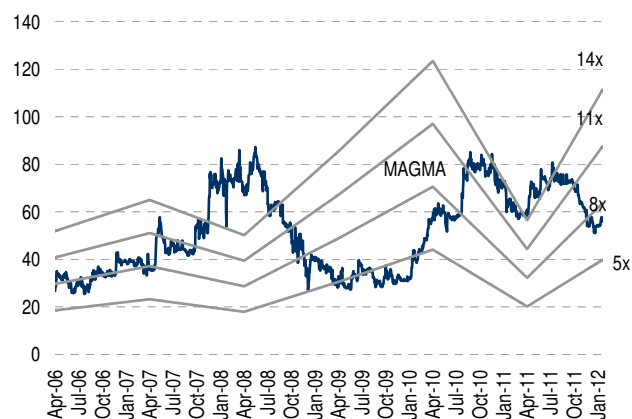
Source: Company, Anand Rathi Research

Fig 4 – PE band



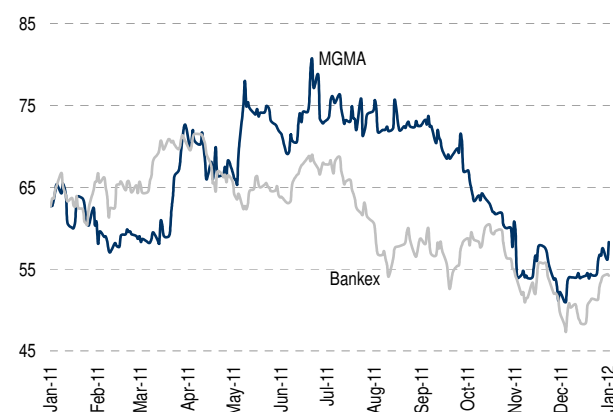
Source: Bloomberg, Anand Rathi Research

Fig 5 – Price-to-book band



Source: Bloomberg, Anand Rathi Research

Fig 6 – Magma vs BANKEX



Source: Bloomberg

Results review

On lower net interest income, Magma's 3QFY12 net profit fell 63.3% yoy to ₹113m. We cut our FY12/FY13/FY14 estimated EPS ~29%/14.2%/12.1%, owing to lower NII growth given the MTM forex losses on borrowings and subdued securitization in FY12 (with consequent higher cost of funds). We lower our price target from ₹80 to ₹73, yet retain a Buy as better FY13/14 profitability would drive up valuations.

Reported PAT declined 63% yoy

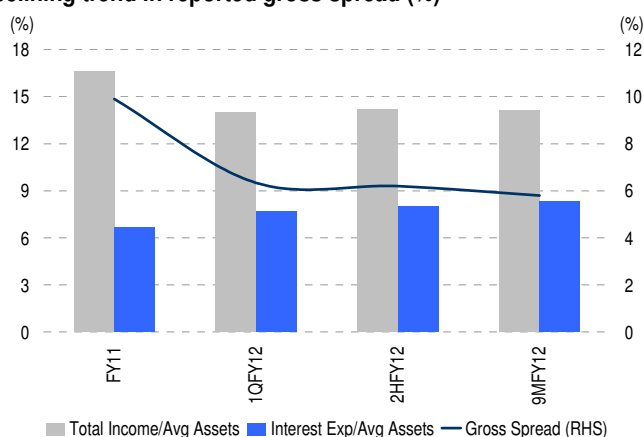
Magma's reported PAT declined 63% yoy to ₹113m mainly on account of lower net interest income. Reported PAT was affected by the lower level of securitization; hence, the increase in market-rate borrowings and lower securitization income due to a change in accounting policy. However, comparable proforma PAT (consistent accounting policy and same off-book loan proportion to AUM) for 9MFY12 was ₹1.1bn, vs. ₹772m in 9MFY11, up 48.5% yoy.

Net interest income declined due to one-offs

NII was weighed down by 1) changes in accounting policy for securitization income – amortization of gains over the period of the loans rather than upfront accounting, 2) MTM forex losses of ₹50m on preference debt, 3) back-ended loan growth during the quarter (lower earning yields) and 4) lower securitization activity and rising interest rates pushing up the cost of funds.

Magma securitized ~12% of its incremental disbursement in 9MFY12, compared to 52% in 9MFY11. The same level of securitization would have added ₹573m to the reported PBT. Higher securitization would have resulted in less reliance on borrowed funds. Currently, the difference between the yield on loans sold down and market borrowings is ~300bps. This has resulted in an increase in borrowing costs.

Fig 7 – Declining trend in reported gross spread (%)

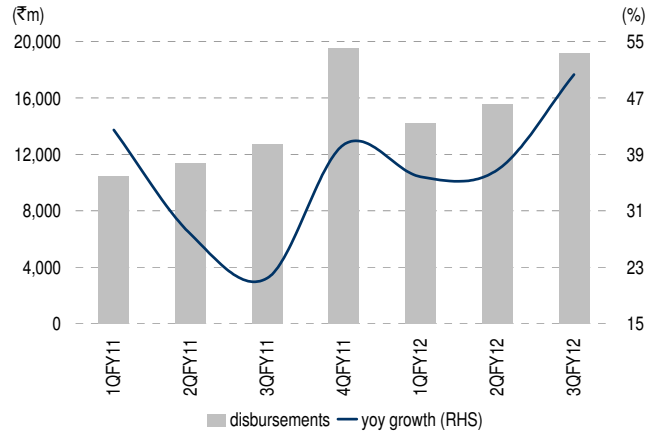


Source: Company

Business growth and asset quality continue robust

Disbursements grew 50% yoy in 3QFY12, to ₹19bn, and the share of high-yield loans was 25%, vs. 23% in 2QFY12. Assets under management were ₹11.8bn and off-book loans as proportion of AUM was 30% in 3QFY12.

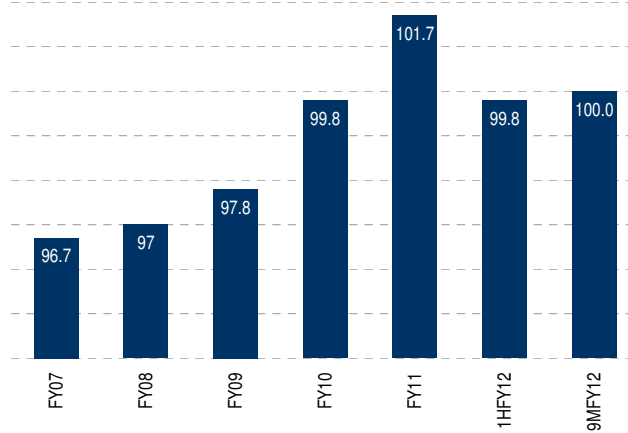
Fig 8 – Strong disbursements in 3QFY12



Source: Company

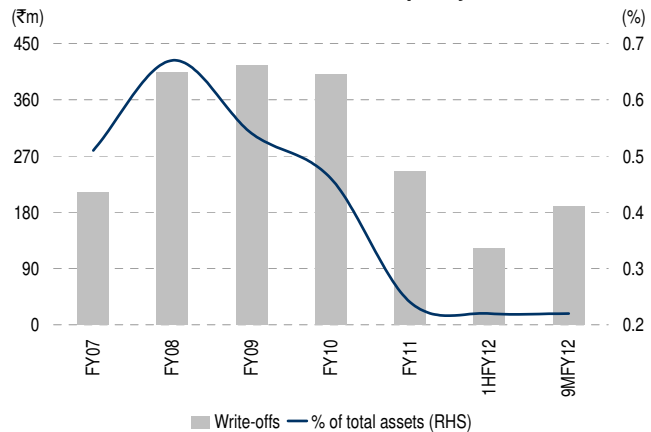
Asset quality is robust, with collection efficiency of 100% in 9MFY12 and credit cost at 0.22% of average AUM (the lowest since FY07).

Fig 9 – Best-in-class collection efficiency



Source: Company

Fig 10 – Lower credit costs due to robust asset quality



Source: Company

Fig 11 – Estimate revisions

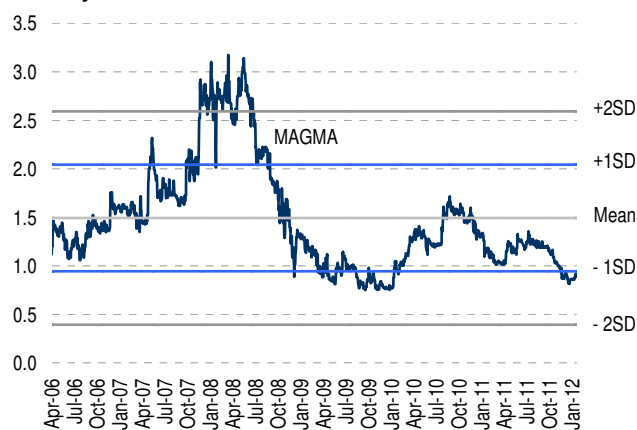
(₹m)	From			To			% change		
	FY12e	FY13e	FY14e	FY12e	FY13e	FY14e	FY12e	FY13e	FY14e
Net interest income	4,965	7,387	9,895	4,340	6,968	9,390	-12.6	-5.7	-5.1
Non-interest income	691	851	1,048	542	666	819	-21.6	-21.7	-21.8
Operating cost	3,335	4,068	5,020	3,183	3,884	4,792	-4.6	-4.5	-4.5
Provisions	559	1,222	1,750	559	1,222	1,750	0.0	0.0	0.0
PAT	1,081	1,975	2,796	764	1,694	2,457	-29.3	-14.2	-12.1
EPS (₹)	5.7	10.4	14.7	4.0	8.9	13.0	-29.3	-14.2	-12.1
Book value (₹)	58.9	68.3	80.8	57.7	64.6	75.3	-2.0	-5.4	-6.8
RoE (%)	13.8	16.3	19.8	9.2	14.6	18.5	(465)bps	(164)bps	(126)bps

Source: Anand Rathi Research

Valuation

We cut our FY12/FY13/FY14 estimated EPS ~29%/14.2%/12.1%, owing to lower NII growth, given the MTM forex losses on borrowings and subdued securitization in FY12, leading to higher cost of funds. We lower our price target from ₹80 to ₹73, yet retain a Buy as we expect improved profitability in FY13/14 to drive up valuations.

Fig 12 – Past one-year-forward PBV



Source: Bloomberg, Anand Rathi Research

Risks

- A slowdown would hit the rural economy and lead to slower loan growth and more delinquencies.
- Any regulatory changes regarding SLR/CRR requirements and sector caps could impact the company.

Financials

We expect a 40.8% CAGR in Magma's loan book over FY11-FY14, with a 29% CAGR in net profit.

Fig 13 – Income statement (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Interest income	6,365	7,900	10,115	14,969	18,980
Interest expended	3,162	3,381	5,774	8,001	9,590
Net interest income	3,203	4,519	4,340	6,968	9,390
Growth (%)	12.8	41.1	(3.9)	60.5	34.8
Non-interest income	665	573	542	666	819
Total income	3,868	5,092	4,882	7,634	10,209
Non-interest income / total income (%)	17.2	11.3	11.1	8.7	8.0
Operating expenses	2,437	3,032	3,183	3,884	4,792
Employee expenses	1,053	1,346	1,414	1,725	2,104
Other expenses	1,384	1,685	1,769	2,159	2,688
Pre-provisioning profit	1,431	2,060	1,699	3,751	5,417
Growth (%)	40.8	44.0	(17.5)	120.7	44.4
Provisions	400	355	559	1,222	1,750
Profit before tax	1,030	1,705	1,140	2,529	3,667
Taxes	366	561	376	835	1,210
Tax rate (%)	35.5	32.9	33.0	33.0	33.0
Profit after tax	665	1,144	764	1,694	2,457
Growth (%)	70.2	72.2	(33.2)	121.8	45.0
Number of shares	109	130	190	190	190
Earnings per share	6.1	8.8	4.0	8.9	13.0

Source: Company, Anand Rathi Research

Fig 14 – Balance sheet (₹m)

Year-end: Mar	FY10	FY11	FY12e	FY13e	FY14e
Share capital	1,379	1,728	1,848	1,848	1,848
Reserves and surpluses	3,267	5,493	10,560	11,872	13,901
Net worth	4,646	7,221	12,409	13,720	15,749
Borrowings	35,671	44,084	73,757	91,212	110,684
Deposits	5,266	5,451	5,992	6,626	7,349
Total loans	40,937	49,535	79,749	97,838	118,033
Total liabilities	45,583	56,757	92,158	111,557	133,783
Advances	31,816	42,837	78,050	97,553	119,659
Investments	302	299	329	362	398
Cash & bank balances	9,685	10,043	10,153	9,963	10,433
Fixed & other assets	3,780	3,578	3,627	3,679	3,293
Total assets	45,583	56,757	92,158	111,557	133,783

Source: Company, Anand Rathi Research

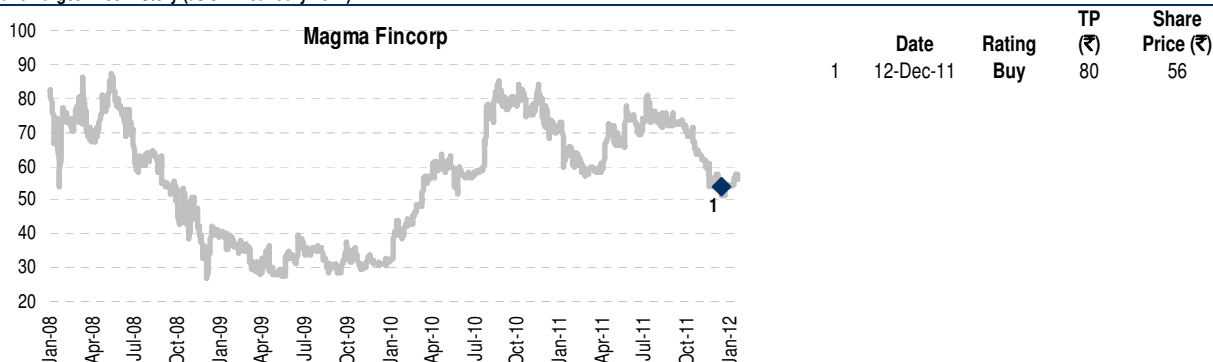
Appendix 1

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Mid/Small Caps (<US\$1bn)	>30%	10-30%	<10%

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% who are investment banking clients	6%	5%	0%

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