INDIA

Fin. Services

Magma Fincorp

Initiation **23 April 2010**

Buy

Target Price: Rs504

CMP: Rs305*

Upside: 65%

**as on 23 April 2010*

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Poised for positive inflection

Magma Fincorp (Magma), a leading Kolkata-based NBFC, represents a scale-up theme in a niche market. We expect meaningful turnaround in financials on the back of healthy business opportunities coupled with mature management. Increased contribution from high-yield products, robust collection efficiency and potential inflection in the business fundamentals makes us bullish on the company and we recommend Buy rating on the stock with a target price of Rs.504 implying potential upside of 65% from the current level.

- **Niche presence in high-growth under-penetrated financing segment:** Magma provides vehicle and equipment financing solutions to first-time buyers and small entrepreneurs. The company's unique business model, backed by offering a diversified basket of products principally in the rural and semi-urban markets, has enabled the company to deliver consistent performance over the years.

- **Healthy business opportunity:** We believe Magma is well-positioned to address the US$21bn asset financing market (FY09) which is expected to grow at ~10% over FY09-FY12E. Its main offerings – vehicle and construction equipment financing – account for 87% of business. Higher yield financing products in the verticals of tractors, used vehicles and SME finance account for the balance and these would be the key triggers in achieving higher margins.

- **Financial performance to improve:** Despite economic slowdown in FY09, Magma recorded 27% CAGR in disbursement over FY05-10E. In our opinion, Magma's financials are geared to improve in FY10-12E on the back of increasing traction in disbursements and up-tick in margins underpinned by easing funding costs, higher yields and superior collections.

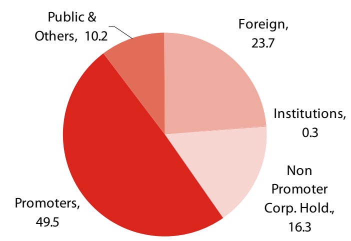
- **Excellent asset quality; superior collection efficiency:** Zero NNPLs over past 6 years, superior quality of origination and 99.8% collection efficiency is a reflection of the company's clean asset book.

- **Compelling valuations:** We believe the market has ignored the company's inherent profitability and current valuation of 1.3x FY12E P/ABV makes the stock very attractive. In our opinion, the stock merits a re-rating given the maturity demonstrated by the management over two decades, the company's steady growth and superior return ratios. We value the company at 2.2x FY12E P/ABV, translating into a target price of Rs504.

Key Data

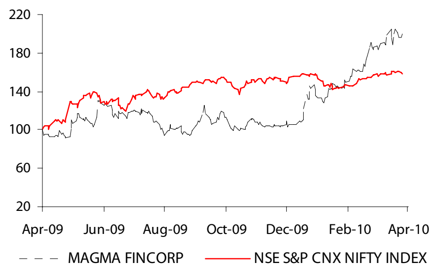
Bloomberg Code	MGMA IN
Reuters Code	MAGM.BO
Current Shares O/S (mn)	21.8
Diluted Shares O/S(mn)	21.8
Mkt Cap (Rsbn/USDmn)	6.6/148.9
52 Wk H / L (Rs)	322/122
Daily Vol. (3M NSE Avg.)	202,166
Face Value (Rs)	10
USD = Rs44.4	

Shareholding Pattern (%)



As on 31st December 2009

One Year Indexed Stock Performance



Price Performance (%)

	1M	6M	1Yr
Magma	10.6	83.1	115.5
NIFTY	0.8	5.4	53.9

Source: Bloomberg, Centrum Research
**as on 23 April 2010*

Y/E Mar (Rsmn)	NII	Non Int. Inc.	PAT	*YoY gr (%)*	EPS (Rs)	P/E (x)	Adj BV (Rs)	P/Adj BV (x)	*RoA (%)*	*RoE (%)*
FY08	2,947	63	505	*27.0*	18.5	16.5	121.5	2.5	*1.7*	*17.3*
FY09	3,298	105	388	*(23.0)*	14.6	20.9	135.2	2.3	*1.0*	*11.4*
FY10E	3,560	155	699	*80.0*	28.7	10.6	161.9	1.9	*1.7*	*19.3*
FY11E	4,955	201	950	*36.0*	30.2	10.1	186.7	1.6	*1.9*	*19.5*
FY12E	6,358	262	1,392	*47.0*	45.6	6.7	229.1	1.3	*2.3*	*23.3*

Source: Company, Centrum Research Estimates

Shareholding pattern (%)

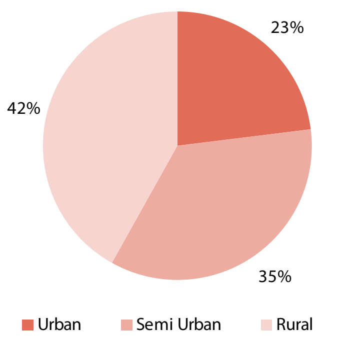
Y/E March	Q409	Q110	Q210	Q310
Promoter	49.0	49.2	49.5	49.5
FII	27.8	27.8	27.1	23.6
DII	15.9	15.7	15.8	16.6
Public & Others	7.3	7.3	7.6	10.3
Total	**100.0**	**100.0**	**100.0**	**100.0**

Source: BSE, Company

Company Background

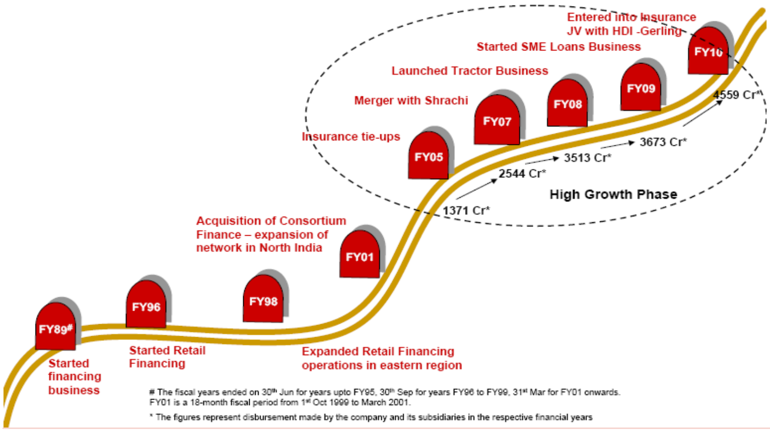
Magma Fincorp (formerly Magma Leasing) is a Kolkata-headquartered asset financing company. The company commenced operations in 1989 and over time has grown into a mid-scale financial services company. In early 2007, Magma acquired Shrachi Infrastructure Finance (SIFL), which enabled it expand its distribution network to a Pan-India India level. At present, Magma has 153 branches spread across 21 states. It offers financing solutions for commercial vehicles, cars, construction equipment, tractors and utility vehicles. Over 75% of the branches are located in rural and semi-urban markets, playing a crucial role in financial inclusion in these markets. Further, over 50% of Magma's customers have availed their first time loans from the organized financial lender. The company is eyeing a national footprint to leverage its diversified businesses by increasing its presence in western and southern India. Magma has a dedicated customer base of over 225,000 and has assets under management of approximately Rs87.6bn as at the end of Dec quarter FY10.

Branch Dynamics



Source: Company

Key events/timeline



Source: Company

Key management personnel

Name	Position	Profile
Sanjay Chamria	Vice Chairman and Managing Director	Anchors strategic policy formulation and execution, driving new business initiatives and leads management team in the achievement of goals
Ravi Todi	Joint Managing Director	Heads business operations and leads teams to achieve business targets
Ashutosh Shukla	Chief Operating Officer	Heads the entire sales and credit/operations and administration department. He has over 25 years of experience in the financial services industry
Guru Prasad Pattanaik	Chief Receivables Management	Heads the entire receivables function comprising of both 0-180 days past due and ARD division. Has over 30 years experience in the public and private sector
V. Lakshmi Narasimhan	Chief Financial Officer	Head of accounting and management reporting. Responsible for directing the financial strategies, planning and forecasts of the company. Has more than 24 years experience including 11 years as head of banking and legal in consortium finance
Swaraj Krishnan	CEO Designate- Insurance JV	CEO designate of the Insurance JV with HDI Gerling. Has more than 24 years of experience in the fields of General Insurance including risk and portfolio management in Insurance domain
S K Gupta	Head- Internal Audit	Oversees both onsite and offsite inspection and audit of process compliance and financial transactions and records. A former banker, Mr Gupta has spent over 40 years in leading public sector banks in India
Barun Roy	Chief Information Officer	Key responsibility includes development & maintenance of the company's all-India IT platform. Has over 40 years of overall corporate experience
Brahmajyoti Mukherjee	Chief People Officer	Responsible for the HR development function including organisation development, operations, recruitment, administration and training. Has over 30 yrs of corporate experience with about 20 yrs experience in HR & Personnel Management.

Source: Company

Investment Rationale

- Niche advantage in equipment and vehicle financing solutions to individuals and small businesses which have little or no access to banks/lending institutions.
- Strong credit rating coupled with good business acumen to aid robust business growth in a high-growth financing segment.
- Potential easing in funding costs and changing margin profile aided by increasing proportion of higher yielding assets are set to pitchfork Magma's RoAs to 2.3% by FY12E
- Valuations attractive and do not price in potential inflection in business fundamentals.

Dupont Analysis

Dupont Analysis	FY08	FY09	FY10E	FY11E	FY12E
% of Average assets					
Net-Interest Income	12.3	10.7	9.6	10.6	10.7
Non-Interest Income	0.3	0.3	0.4	0.4	0.4
Net Income	**12.5**	**11.0**	**10.0**	**11.1**	**11.1**
Operating Expenses	7.6	7.7	6.6	7.7	7.5
Operating Profit	**4.9**	**3.3**	**3.4**	**3.4**	**3.7**
Provisions & Contingencies	1.7	1.3	0.6	0.4	0.2
Taxes	1.1	0.7	0.9	1.0	1.1
Preference dividend	0.5	0.2	0.2	0.2	0.1
RoAA (%)	***1.7***	***1.0***	***1.7***	***1.9***	***2.3***
Avg.assets/avg equity (x)	9.7	9.0	8.7	9.5	10.1
RoAE (%)	***17.3***	***11.4***	***19.3***	***19.5***	***23.3***

Source: Company, Centrum Research Estimates

Summary Financial

Y/E March (Rsmn)	FY08	FY09	FY10E	FY11E	FY12E
Net Interest Income	**2,947**	**3,298**	**3,560**	**4,955**	**6,358**
Growth (%)	*52.1*	*11.9*	*8.0*	*39.2*	*28.3*
NIM (%)	4.1	3.6	4.7	5.4	5.8
Non Interest Income	**63**	**105**	**155**	**201**	**262**
Growth (%)	*164.8*	*67.4*	*48.0*	*30.0*	*30.0*
Total Income	**3,010**	**3,403**	**3,715**	**5,156**	**6,619**
Total Operating Expenses	**1840**	**2389**	**2452**	**3573**	**4435**
Pre-Prov Profits	**1,170**	**1,014**	**1,263**	**1,583**	**2,184**
Provisions & Contingencies	404	415	220	165	137
Provision for taxes	261	211	344	468	655
PAT	**505**	**388**	**699**	**950**	**1,392**
Adj. PAT (net off pref. dividend)	**387**	**318**	**624**	**869**	**1,311**
Growth (%)	*13.3*	*(21.0)*	*96.4*	*39.2*	*50.9*
Key Balance Sheet Data					
Share capital	218	218	218	288	288
Preference capital - 10-12% (cum & non cum)	1,161	1,161	1,161	1,161	1,161
Reserves & Surplus	2,428	2,728	3,309	5,085	6,305
Shareholders' fund	**3,807**	**4,107**	**4,688**	**6,534**	**7,754**
Borrowings	19,108	24,733	31,266	41,093	52,735
Current liabilities	5,962	4,198	5,186	4,456	6,264
Total Liabilities	**28,876**	**33,037**	**41,140**	**52,083**	**66,753**
Net block	2,244	2,382	2,453	2,527	2,628
Stock on Hire	18,670	19,803	25,744	32,179	40,385
Investments	776	421	455	492	536
Debtors	82	66	131	152	184
Cash & Bank	5,980	8,990	9,010	10,297	12,923
Loans & Advances	1,124	1,375	3,347	6,436	10,096
Total Assets	**28,876**	**33,037**	**41,140**	**52,083**	**66,753**
Key Ratios					
Capital Adequacy Ratios (%)					
Total CAR	15.3	17.3	15.5	18.8	18.8
Tier 1 CAR	8.9	9.2	8.9	10.6	10.6
Per share data					
Fully diluted EPS	18.5	14.6	28.7	30.2	45.6
Book Value per share	121.5	135.2	161.9	186.7	229.1
Valuations Ratios					
P/B (x)	2.5	2.3	1.9	1.6	1.3
P/E (x)	16.5	20.9	10.6	10.1	6.7

Source: Company, Centrum Research Estimates

Improving NIMs driven by changing disbursement mix and lower credit charges to boost the profitability going ahead.

Investment Argument

Economic recovery to boost non-banking finance sector

The growth of the non-banking financing industry is cyclical in nature and highly dependant on economic conditions. The industry witnessed massive de-growth in FY09, both in terms of volumes and sales, particularly in the commercial vehicle (CV) and passenger vehicle (PV) segment post the Lehman crisis.

However, with overall credit off-take improving, asset financing business volumes are also expected to increase faster. Further, government initiatives and improved demand should result in the industry registering high growth. The following reasons underpin our optimistic outlook for the financing industry for FY10-12E:

- The car segment is expected to register 15% YoY growth, while the commercial vehicle (CV) industry is expected to record over 15% growth.
- The increased focus on infrastructure development would boost demand for construction equipment.
- The SME industry would continue to grow above 20% annually as witnessed historically.
- Growth in tractor financing is forecasted at 15% levels.
- Growth in utility vehicle (UV) segment would be at current levels of 20%.

Exhibit1: Industry scenario

Particulars (FY09)	Commercial vehicles	Construction Equipment	Car & Utility vehicles	Tractors	Unsecured SME Loans
Market size (US $ bn)	6.5	2.3	8.5	2.7	1.3
Expected Industry CAGR (%)	*6.8*	*24*	*12.3*	*5*	*15*
Co. direct addressable opportunity (%)	65-70	50-60	~70	55	80-100
Company's AUM* (US $ mn)	632	449	411	24	26

Note: AUM implies companies on book and off-balance sheet assets.

Source: Company, CRISIL, Centrum Research

CRISIL estimates the current size of the financing industry at about US$21bn for FY09 is expected to grow over 10% for the forthcoming year. Key verticals such as construction equipment and unorganized SME finance expected to log high double-digit growth in FY11.

In terms of customer base, strategic partnerships and product mix, Magma is well-positioned to capitalize on India's robust economic growth. Based on our discussions with the management and analysis of the various products offered, we believe Magma is well-poised to straddle growth opportunities across the US$21bn market. This is already evident in Magma's higher market share in eastern and northern belt owing to its presence in these regions.

Niche presence in high-growth underpenetrated financing segment

Magma primarily caters to the financial needs of rural and semi-urban entrepreneurs who are unable to effectively access organized banking. Over two decades of operations has helped the company cement its position as a preferred financier. With product offerings spanning passenger cars, CVs, construction equipment and tractors, the company has systematically covered most segments where small businesses and entrepreneurs scout for credit support.

A presence in financing of diversified basket of products distinguishes Magma Fincorp from other companies in its industry, which are mostly operating in their niches. It also helps in diversifying business risk.

Magma has preferred lending partner agreements with various auto and equipment manufacturers, such as Tata Motors, Mahindra & Mahindra, Hyundai, Ashok Leyland, JCB and Eicher. These agreements make it easier for Magma to sell its loan offerings. For instance, Magma finances 20% of construction equipment manufactured by JCB and 14% of equipment manufactured by Telcon, Tata Motors' construction equipment division.

Multi-tier strategy (for growth and higher margins)

Historically, Magma is known to be a conservative financier, best illustrated by the measured growth in assets and profitability. But going forward, we believe this is set to change, given the company's intention:

- To tap growth opportunities in high-yielding products – SME, tractor and used CV financing.
- To re-orient its product mix to boost margins and shore up profitability
- To boost capital base in line with the balance sheet growth and gradually reduce reliance on securitization.

Exhibit 2: Magma's business strategy

Product Portfolio	(a) Overall business growth higher than market growth (b) Share of high-yield products, Used CV, tractors & SME loans to increase
Market Positioning	(a) Strong presence in under banked/ un-contested customer segments, comprising first time users and small entrepreneurs. (b) Deepen presence in semi urban and rural market
Strategic Initiatives	(a) General insurance underwriting via a JV with HDI-Gerling (b)Leverage collections capabilities to generate fee income by offering collection management services to large banks
Financials	(a) Drive RoE/RoA enhancement through Higher NIM and business volumes (b) Greater contribution from high yield products (c) Improved operating efficiency

Source: Company, Centrum Research

In the current year the management has diligently taken several initiatives aimed at improving the quality of origination; increasing the net interest margins and sustaining growth through both organic and inorganic routes thereby enhancing shareholder value.

Distinguishing Magma's business model vis-à-vis competition – banks and peer group

Exhibit 3: Magma v/s Banks

Particulars	Banks	Magma
Nature	Deposit-taking entity	Non-deposit taking entity
Unbanked and underserviced customers	Banks do not fund customers with (a) no bank accounts (b) No track record	Niche segment for funding (a) Local knowledge (b) Tailor made processes
Collection challenges	(a) Poor outreach to target customers (b) Bound by procedural and other limitations	(a) Strong outreach leading to deep penetration (b) Large field force provides customer service and door-step collection
Cost of operations	(a) Core functions are often out-sourced (b) Higher operating costs	(a) Core functions are in-house (b) Better operating efficiency
Cost of funds	(a) Lower cost of funds (200-300bps) (b) Advantage of CASA deposits	(a) Higher cost of funds (b) Reliance on banks/MFs (c) Lower operating costs offsets the disadvantage

Source: Company, Centrum Research

Exhibit 4: Magma v/s peers

Parameters	Magma v SHTF	Magma v MMFS	Magma v SCUF
Product Portfolio	Financing of Used CV and CV products have been the forte of SHTF. Magma on the other hand offers bouquet of products at competitive rates	MMFS is the dominant player in the tractor and car financing segment primarily catering to the Mahindra & Mahindra customers that leaves other asset products untouched wherein Magma is eyeing to capture the market	SCUF asset mix spans to financing of consumers durables, 2-wheelers, Used and new 3-wheelers and gold loans segment wherein Magma has no presence.
Market Positioning/ Geography	(a) Used CV segment is dominated by SHTF with wide presence wherein even Magma operates. However, eastern belt is dominated by Magma's presence that SHTF lacks (b)That said, SHTF market share accounts for 40% in the used CV segment which leaves 60% of market size to be tapped by Magma in the said segment.	(a) MMFS operates in specific circles unlike Magma that enjoys wide pan-India presence. (b) MMFS accounts for 30-40% of financing of its own tractors of the overall market share. This implies Magma has the market opportunity of almost 60% to leverage upon	Magma has dominant presence in northern and eastern belt unlike SCUF
Credit monitoring	Both the groups stand on a similar footing with respect to Credit monitoring mechanisms and have stable asset quality.	MMFS has suffered asset quality pressures historically; Magma on the contrary has recorded zero NNPLs over the years.	The credit mechanism for Magma remains stronger which is reflection of a superior collection model.

Source: Company, Centrum Research

Note: SHTF: Shriram Transport Finance, MMFS: Mahindra and Mahindra Financial services, SCUF: Shriram City Union Finance

Robust business dynamics

Magma's unique business model of focusing on the underpenetrated rural and semi-urban markets has enabled it to deliver consistent and sustained performance over the years. It dealt with the economic slowdown during 2008-09 by adopting a series of initiatives, including introduction of additional business and collection verticals, increased focus on maintaining asset quality, effective management of treasury and operating costs and strengthening its robust collection mechanism.

In our opinion, Magma's financials are geared to improve in FY10-12E on the back of increased traction in disbursements and improvement in margins underpinned by easing funding costs, higher yields and superior collections.

Margin enhancement underpinned by higher yields and easing funding costs

Magma is predominantly engaged in financing construction equipment and passenger cars, utility vehicles and commercial vehicles (CVs).These business verticals accounted for 87% of the company's disbursements in 9MFY10. Of late, the company has ventured into high-yield segments, viz; financing of used CVs, tractors and SME loans. The yields tend to be higher on such loans as other financers/lenders shy away from these markets, because credit appraisal of clients is extremely difficult.

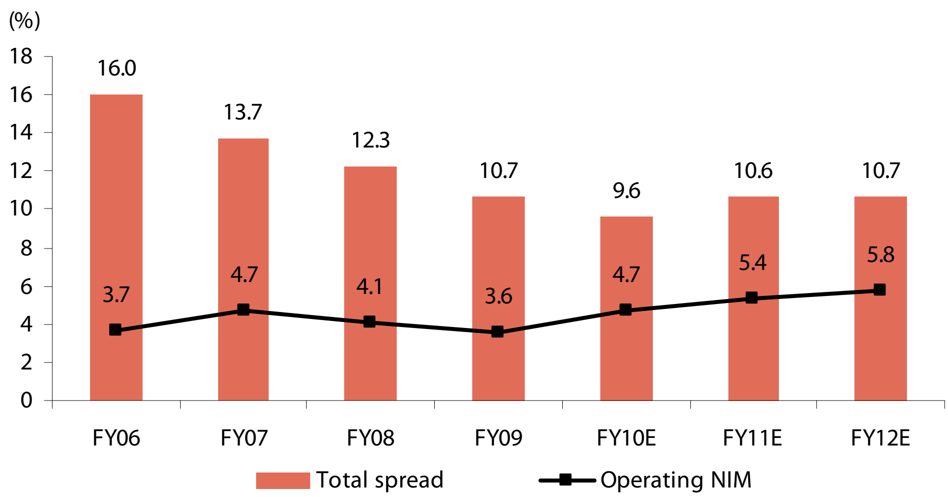
Exhibit 5: Indicative yields across product spectrum

	YTD Dec 2009
Asset category	**Indicative Yields (%)**
Car	15.25
CV	13.60
CE/SCE	13.75
Suvidha	21.00
Tractor	22.00
SME Loan	18.00

Source: Company, Centrum Research

It is worth mentioning that the contribution of higher yielding products to total disbursements accounted for 13.5% at the end of 3rd quarter FY10 and is expected to gain increased traction from the current levels thereby boosting margins (To elucidate; Magma reported 5.6% NIM during 9MFY10). At this level, the NIMs are on the higher side and inline with the industry. In our opinion, the growing share of high-yielding assets would be a critical driver in boosting NIMs over FY10-12E, thereby resulting in a robust bottom line.

Exhibit 6: NIM to improve in FY10-12E



Source: Company, Centrum Research Estimates

Easing funding costs

Funding mix: Magma has developed long-standing relationships with major banks and financial institutions in the country. These relationships helped it remain self-sufficient in terms of liquidity, even during the slowdown in 2009. Further, a substantial part of its loans (almost 73%) are to the priority sector. Hence, the company is able to access bank funds at competitive rates.

Magma funds its business through a balanced mix of long-term debt funds such as term loans/ debentures, securitization and working capital. The availability of adequate funding and consistent high investment grade rating of Magma's debt instruments is testimony to the company's strong fund-raising capability.

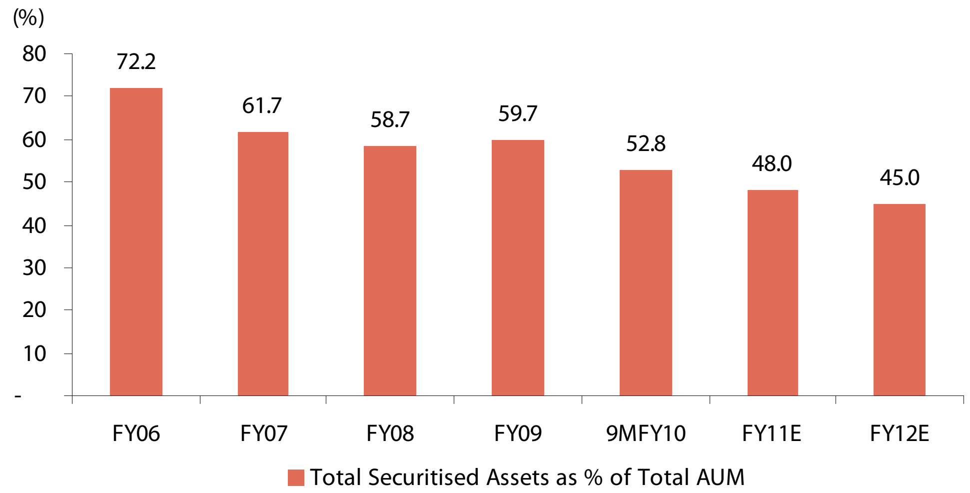
Exhibit 7: Funding profile

Particulars	Sources of Funds	Percentage mix
Working Capital facilities	Major banks part of consortium	4%
Term Loans	Banks and Financial Institutions (FIs) like SIDBI & IREDA	32%
Debentures	Banks and Financial Institutions (FIs) like SIDBI & IREDA	10%
Securitization of Receivables	Banks / Mutual Funds / FIs	52%
Tier I and Tier II funds	AA- rated, subscribed to by Banks and Mutual Funds	2%

Source: Company, Centrum Research

Magma's strategy of reducing the proportion of securitized assets as a source of funding and the augmentation of capital base commensurate with the balance sheet growth demonstrates the prudent asset-liability management of the company. We expect the securitized asset funding to drop down to 45% by FY12E in anticipation of lower incremental securitized proportion year-on-year.

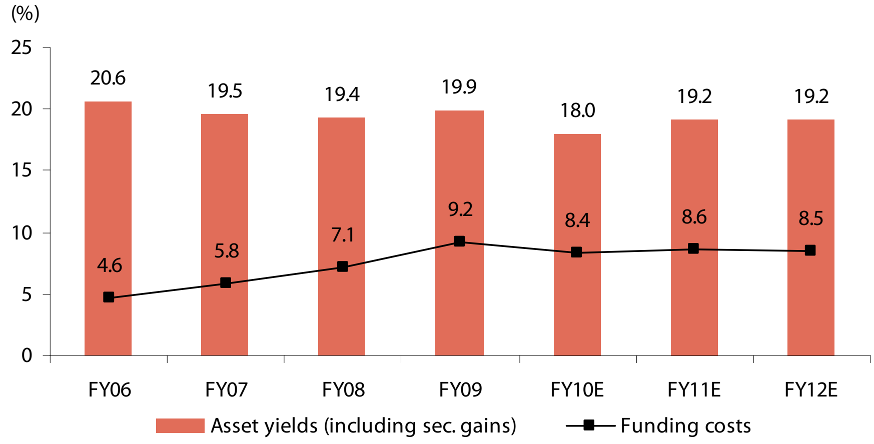
Exhibit 8: Securitized Assets as % of Total AUMs



Source: Company, Centrum Research

Funding costs: We believe, the continued availability of adequate funding lines at competitive rates has enabled Magma to keep its funding costs in check. We expect cost of funds to dip to 8.5% by FY12E from 9.2% in FY09 on the back of (a) high investment grade rating of the company's debt instruments (b) the company's Basel II rating enabling lower risk weight of 20% and (c) the significant portion of company's assets that qualify under priority sector lending (PSL) for banks keeping the funding costs lower.

Exhibit 9: Funding cost easing plus asset yields improving

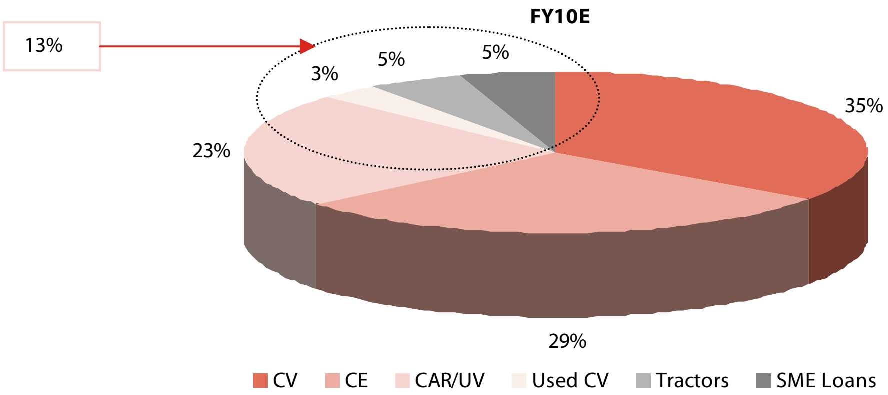


Source: Company, Centrum Research Estimates

Increasing traction in disbursements coupled with improved disbursement mix

Disbursement mix: Magma's well-diversified disbursement mix and de-risked business strategy makes it well-positioned to reap long-term benefits of economic growth. During FY10E, 35% of advances are expected for CVs, 23% for PVs and UVs, 29% for construction equipment, 5% for SMEs, 5% for tractors and 3% for used CVs (as cited by the Management) and the higher traction in business is a reflection of this disbursement mix.

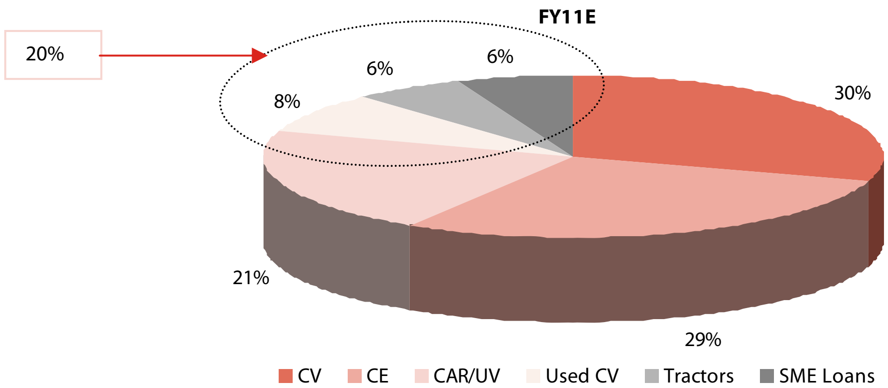
Exhibit 10: Product-wise disbursement mix



Source: Company, Centrum Research Estimates

The share of high-yielding assets (used car/CV finance, tractor financing and SME financing) currently account for 13% of the total disbursement mix and is expected to rise to 20% by FY11E. All these segments are relatively yield-inelastic and would provide Magma the opportunity to earn higher yields in an environment of lower funding costs, thereby boosting margins.

Exhibit 11: Mix changing in favour of high-yielding products

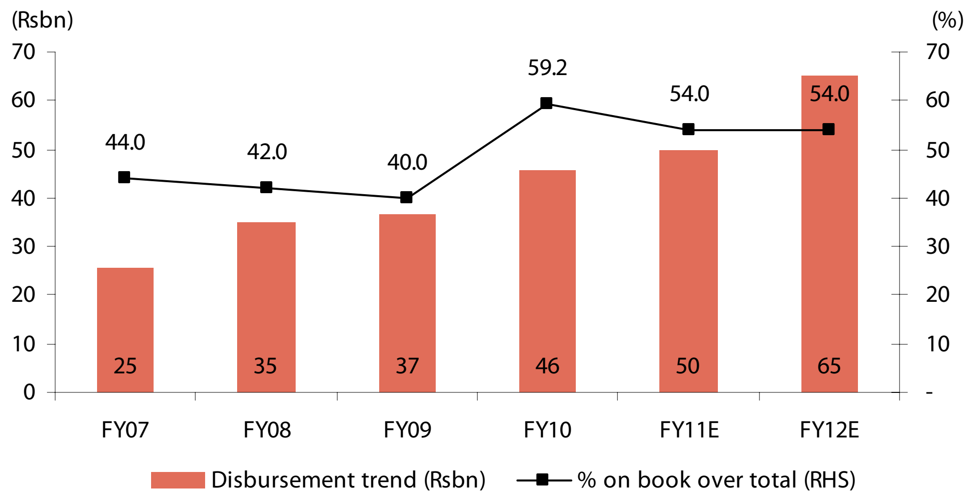


Source: Company, Centrum Research Estimates

Disbursement growth: Magma recorded 27% CAGR in disbursements to Rs 46bn over FY05-10E, which is indicative of the company's higher growth trajectory. The company witnessed 18% QoQ growth in disbursals to Rs10.5bn in Q3FY10. The management is confident that going forward, the company will be able to substantially increase disbursals in all products and market segments, while maintaining focus on NIM and bottom line.

The company expects overall disbursements to register over 25% growth between FY10-12E, although with growing share of on-book disbursements, the fillip to on-book asset growth is likely to be markedly higher. The higher proportion of on-book assets provides cushion in an event of slowdown in disbursals.

Exhibit 12: 21% CAGR in disbursements over FY07-FY12E, on-book retentions to spike to 54%



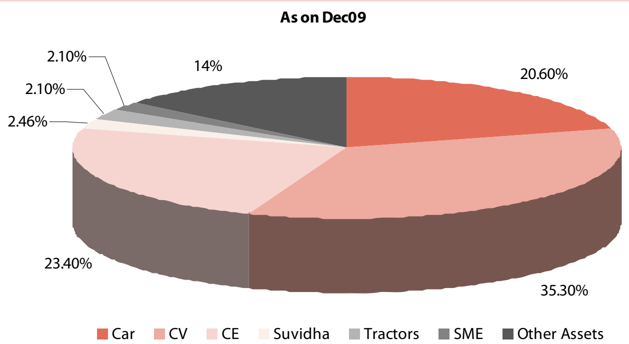
Source: Company, Centrum Research Estimates

Consistent asset growth

The company has witnessed robust asset growth levels. To illustrate, loan growth was observed at 50% CAGR over last 5 years (FY04-09) despite the slowdown in FY09. Most of its lending segments (particularly in CVs and passenger cars) have garnered substantial business over the preceding quarters. The average growth in AUMs for the period FY07-10E would be recorded at 30%. Given the consistent performance in asset growth, the Company can maintain healthy AUM growth rates of 25-30% in the near term.

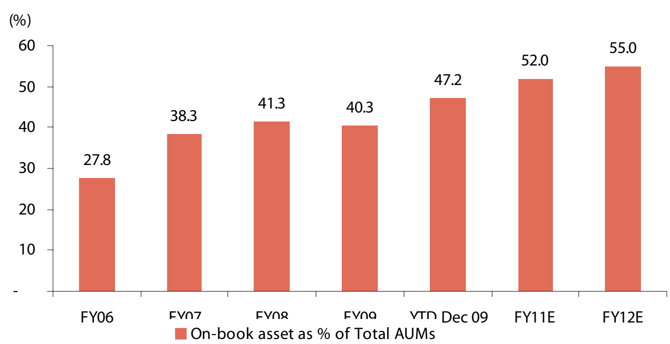
Given the consistent asset growth and comfortable capital base, we believe the proportion of securitized assets is set to minimize, while the on-book assets are to rise to 55% by FY12E which would mark strengthening of qualitative asset growth; thereby bolstering the balance sheet.

Exhibit 13: Product-wise AUM split



Source: Company, Centrum Research Estimates

Exhibit 14: On-book asset proportion to rise to 55% by FY12E



Source: Company, Centrum Research Estimates

Financial Analysis

Financial metrics to escalate on growth trajectory

Despite economic slowdown in FY09, Magma recorded stupendous 27% CAGR disbursement growth over FY05-10E. For the 9-month period FY10, the disbursements for the company stood at Rs 31.7bn and the total AUM was at Rs 87.6bn. Moreover, the company reported robust bottom-line with PAT of Rs 427 mn during the same period.

Q3 Earnings highlights: The Company has posted an impressive growth for the quarter ended 31st Dec FY10. The company has reported a net profit of Rs179mn, a staggering growth of 161% over the corresponding period last year. The company increased disbursements by 19% over the same quarter last year and 18% over the previous quarter and 43% over the first quarter of the current fiscal year. The Net Interest Margin rose to 5.1% in the 9-month period of FY10 from 3.6% last year. Collection efficiency has also improved to 99.2% for Q3FY10 and we expect the company to record 100% collection efficiency towards the end of financial year which is the best in the industry.

Exhibit 15: Profitability matrix

Rsmn	Q3FY10	*QoQ (%)*	*YoY (%)*	9MFY10	Q4FY10E	FY10E
Interest earned	1,659	*6.6*	*17.7*	4,463	2,212	6,676
Interest expended	848	*2.3*	*8.5*	2,325	791	3,115
NII	**811**	***11.5***	***29.0***	**2,139**	**1,422**	**3,560**
Other Income	160	*(8.7)*	*8.8*	508	(353)	155
Total Income	**971**	***7.6***	***25.2***	**2,647**	**1,068**	**3,715**
Operating cost	698	*2.6*	*3.5*	1,998	674	2,672
PBT	**273**	***22.6***	***169.1***	**649**	**394**	**1,043**
Tax	93	*21.8*	*171.5*	222	122	344
PAT	**180**	***23.1***	***161.0***	**427**	**272**	**699**

Source: Company, Centrum Research Estimates

In our opinion, Magma's financials are geared to improve in FY10-12E on the back of traction in disbursements, enhancement in margins underpinned by easing funding costs and higher yields and superior collection model.

Exhibit 16: Positive inflection in financials

Dupont Analysis	FY06	FY07	FY08	FY09	FY10E	FY11E	FY12E
% of Average assets							
Net-Interest Income	16.0	13.7	12.3	10.7	9.6	10.6	10.7
Non-Interest Income	(0.9)	0.2	0.3	0.3	0.4	0.4	0.4
Net Income	**15.1**	**13.9**	**12.5**	**11.0**	**10.0**	**11.1**	**11.1**
Operating Expenses	9.5	8.9	7.6	7.7	6.6	7.7	7.5
Operating Profit	**5.6**	**5.0**	**4.9**	**3.3**	**3.4**	**3.4**	**3.7**
Provisions & Contingencies	1.6	1.5	1.7	1.3	0.6	0.4	0.2
Taxes	1.4	0.7	1.1	0.7	0.9	1.0	1.1
Preference dividend	0.3	0.4	0.5	0.2	0.2	0.2	0.1
RoAA (%)	***2.3***	***2.4***	***1.7***	***1.0***	***1.7***	***1.9***	***2.3***
Avg.assets/avg equity (x)	11.1	10.9	9.7	9.0	8.7	9.5	10.1
RoAE (%)	***20.6***	***22.3***	***17.3***	***11.4***	***19.3***	***19.5***	***23.3***

Source: Company, Centrum Research Estimates

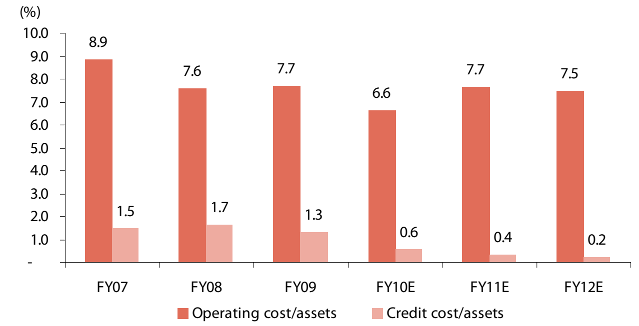
Operating efficiency - on the radar: The management is sanguine about superior operating cost leverage. The company scores on the costs front on the back of in-house core functions and better operating efficiency. The rationalization of offices, resizing of team bandwidth and convergence of business activities has aided Magma to curtail incremental costs. On the conservative note, we assume 24% average spike in operating costs for the period from FY10-12E leaving enough room for the company to better its operating cost leverage.

Exhibit 17: Operating efficiency: a closer look

Particulars (Rsbn)	FY09	9mFY10
Personnel Cost	1.00	0.79
Other ops & admin expenses	0.60	0.37
Total Operating expenditure (exclu w/offs)	1.60	1.16
Total Business	36.73	31.70
Operating Efficiency (%)	**4.3**	**3.7**

Source: Company, Centrum Research

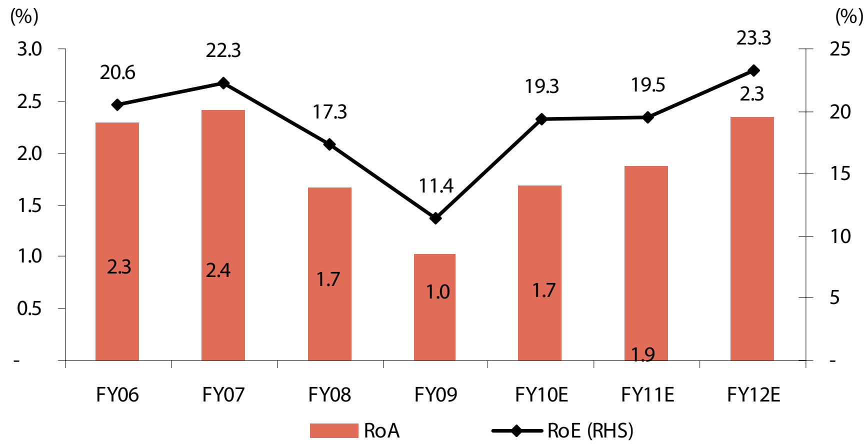
Exhibit 18: Credit costs to climb down, Operating costs needs improvement



Source: Company, Centrum Research Estimates

Superior return ratios: Notwithstanding the higher implicit risks in financing segments that are non-bankable, Magma's profitability metrics (ROA at 1.8%, ROE at 18.8% for Q3FY10) and robust income growth of average 34% for FY05-10E bear testimony to a mature strategy in tapping a lucrative financing opportunity of the under-banked population. We believe, easing funding costs, changing asset profile, higher on-book retentions are set to pitchfork Magma's ROA as high as 2.3% and 23.3% RoE in FY12E which is one of the highest in the industry.

Exhibit 19: Surge in ROA to 2.3% to drive ROE to 23.3% by FY12E



Source: Company, Centrum Research Estimates

Excellent asset quality – a feather in Magma's cap

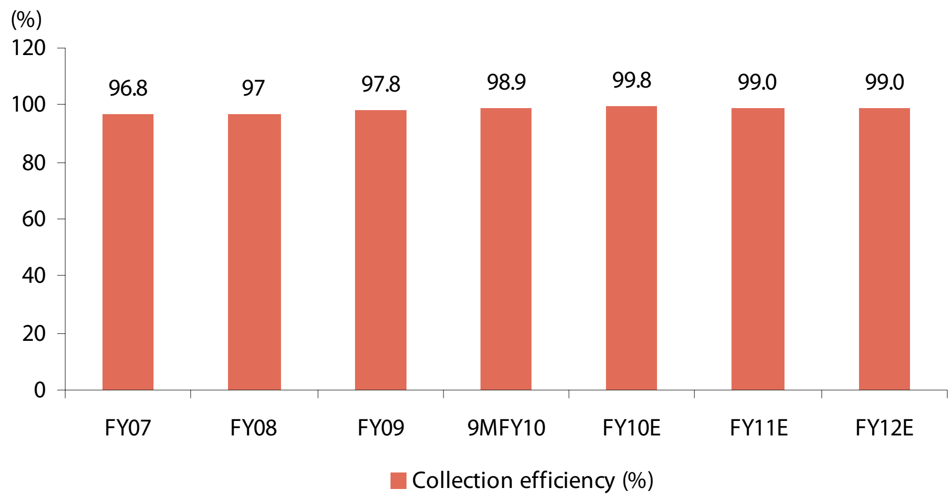
Magma witnessed 'NIL' NPA's on it books over past 5 years owing to superior risk management practices and prudent accounting policies followed by the company, wherein all contracts with more than 180 days past due are treated as loss assets and are written off as bad debts.

On the credit cost front, we have conservatively built in a rise in absolute terms as well as percentage terms owing to the company's aggressive write-off policies, which necessitate delinquencies to be written-off beyond 180 days. Magma has proved successful in containing write-offs to below 0.5% of total assets.

The strategy to segregate business vertical from the credit vertical has enabled the company strengthen the credit analysis by empowering the credit filters across all product categories thereby enriching their asset book.

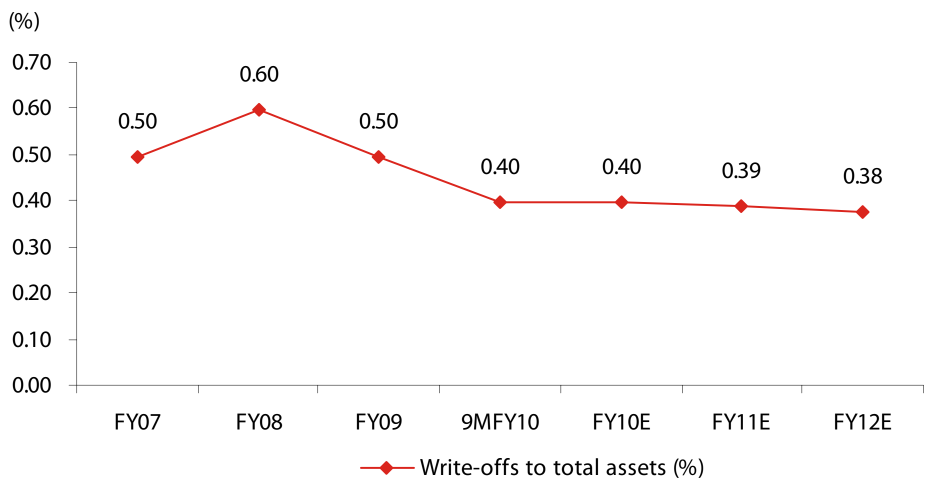
The company also formed a dedicated asset reconstruction division in April- May 2008 which would help focus on collections of the non performing assets. The collection efficiency also has improved from 96.2% during the first half of the last financial year to 99.2% in Q3FY10 and is expected to record closer to 100% levels in the ensuing quarter enabling the company to maintain its superior asset quality.

Exhibit 20: Superior Collection Efficiency is indicative of quality book



Source: Company, Centrum Research Estimates

Exhibit 21: … accordingly write-offs have been successfully contained within 0.5% to total assets



Source: Company, Centrum Research Estimates

Valuation Analysis

High-growth trajectory merits favourable investment decision

The market has ignored the inherent profitability strength of Magma and at CMP the stock trades at P/ABV of 1.3x FY11E, which is attractive. We believe the maturity the management has demonstrated over two decades and a steady growth in its niche business merit a re-rating.

Exhibit 22: Valuation comparison- Magma v/s peers

	FY10E				FY11E				FY12E			
(%)	ROE	ROA	P/BV(x)	P/E(x)	ROE	ROA	P/BV(x)	P/E(x)	ROE	ROA	P/BV(x)	P/E(x)
Magma	**19.3**	**1.7**	**1.9**	**10.6**	**19.5**	**1.9**	**1.6**	**10.1**	**23.3**	**2.3**	**1.3**	**6.7**
SHTF	28.2	2.7	3.9	16.1	25.5	2.6	3.1	13.7	25.6	2.7	2.5	10.9
MMFS	18.9	3.5	2.4	13.0	19.1	3.6	2.0	11.1	19.9	3.7	1.9	9.4
SCUF	22.4	3.3	2.3	11.1	21.5	3.4	2.0	10.0	21.4	3.5	1.7	8.2
MGFL	29.0	6.1	4.8	24.2	28.9	6.4	3.4	14.1	33.2	5.7	2.5	8.6

Source: Bloomberg, Centrum Research Estimates

Note: SHTF: Shriram Transport Finance, MMFS: Mahindra and Mahindra Financial services, SCUF: Shriram City Union Finance, MGFL: Manappuram General Finance and Leasing

We believe on a steady state basis, Magma should be able to sustain RoE of >18%. Our bullish stance stems from the fact that the company has reported increased contribution of high yielding products, robust collection efficiency and is poised to deliver potential inflection in the business fundamentals. We, therefore, expect the stock to command a valuation of 2.2x P/BV FY12E assuming perpetual growth of 6%. On FY12E book value of Rs 229, this implies one-year target price of Rs504 implying 65% upside from current levels.

Key Risks

Higher-than-expected credit costs, slower-than-expected pick-up in disbursement volumes and NIM compression in a high-interest rate scenario are key risks to our profitability projections.

Recent updates

- **Management restructuring and expansion of management bandwith:** Magma has made top level management restructuring thereby creating a new position of Chief Operating Officer and Chief of Receivables Management. Ashutosh Shukla, a company veteran, has been appointed COO while G P Pattanaik will be the new Chief of Receivables Management. V Lakshmi Narasimhan has been appointed the new Chief Financial Officer of the company.

  In our opinion, the Management restructuring comes as a positive signal at a juncture wherein the company is garnering resources and gaining strength to reinforce its core competence.

- **Insurance foray:** The Company has recently signed a joint venture with HDI Gerling, part of Talanx Group, Germany's third largest insurance group to start a non-life insurance company in India in order to accentuate the fee income through Insurance. In the joint venture formed, Magma promoters hold a 74% stake, while HDI Gerling holds 26%. The initial paid-up capital of the company would be Rs 110cr. The new company will be head quartered in Kolkata and has obtained Reserve Bank of India approval and is currently awaiting the Insurance regulator IRDA approval for commencement of operations. The Management cited that the operations for the insurance company are likely to commence before September 2010.

  In our opinion, setting up of non-life insurance JV would augment the non-interest income of the company thereby boosting the topline performance of the bank.

- **Capital infusion on the anvil**: The promoters have decided to infuse capital to the tune of Rs500mn by way of warrants in order to boost the capital adequacy of the company to fuel the asset growth. Currently, the capital adequacy stands at 17.3% (FY09) against an industry norm of 10% (FY09), capital adequacy ratio is expected to be 15.5% for FY10E against the 12% norm for FY10.

Financials

Exhibit 23: Income Statement

Y/E March (Rsmn)	FY08	FY09	FY10E	FY11E	FY12E
Interest Income	4,655	6,152	6,676	8,949	11,408
Interest Expense	1,708	2,854	3,115	3,995	5,051
Net Interest Income	**2,947**	**3,298**	**3,560**	**4,955**	**6,358**
YoY Growth (%)	*52.1*	*11.9*	*8.0*	*39.2*	*28.3*
Non Interest Income	**63**	**105**	**155**	**201**	**262**
YoY Growth (%)	*164.8*	*67.4*	*48.0*	*30.0*	*30.0*
Total Income	**3,010**	**3,403**	**3,715**	**5,156**	**6,619**
Total Operating Expenses	**1,840**	**2,389**	**2,452**	**3,573**	**4,435**
YoY Growth (%)	*46.9*	*30.9*	*2.7*	*45.7*	*24.1*
Pre-provision Profit	**1,170**	**1,014**	**1,263**	**1,583**	**2,184**
Provisions	**404**	**415**	**220**	**165**	**137**
Profit Before Tax	**766**	**599**	**1,043**	**1,418**	**2,047**
Taxes	261	211	344	468	655
Net Profit	**505**	**388**	**699**	**950**	**1,392**

Source: Company, Centrum Research Estimates

Exhibit 24: Balance Sheet

Y/E March (Rsmn)	FY08	FY09	FY10E	FY11E	FY12E
Share capital	218	218	218	288	288
Preference capital - 10-12% (cum & non cum)	1,161	1,161	1,161	1,161	1,161
Reserves & Surplus	2,428	2,728	3,309	5,085	6,305
Shareholders' fund	**3,807**	**4,107**	**4,688**	**6,534**	**7,754**
Borrowings	19,108	24,733	31,266	41,093	52,735
Current liabilities	5,962	4,198	5,186	4,456	6,264
Total Liabilities	**28,876**	**33,037**	**41,140**	**52,083**	**66,753**
Net block	2,244	2,382	2,453	2,527	2,628
Stock on Hire	18,670	19,803	25,744	32,179	40,385
Investments	776	421	455	492	536
Debtors	82	66	131	152	184
Cash & Bank	5,980	8,990	9,010	10,297	12,923
Loans & Advances	1,124	1,375	3,347	6,436	10,096
Total Assets	**28,876**	**33,037**	**41,140**	**52,083**	**66,753**

Source: Company, Centrum Research Estimates

Exhibit 25: Key Ratios

Y/E March	FY08	FY09	FY10E	FY11E	FY12E
Balance Sheet Structure Ratios (%)					
Loan Growth	90.1	31.6	22.7	34.7	31.5
Assets Growth	70.5	28.7	19.8	25.7	27.5
Funds Growth	92.3	44.7	26.3	28.1	28.7
Operating Ratios (%)					
NIM	4.1	3.6	4.7	5.4	5.8
Non-interest income/Net income	2.1	3.1	4.2	3.9	4.0
Cost/Income	60.6	70.2	66.0	69.3	67.0
Operating cost growth	45.6	30.9	2.7	45.7	24.1
Total prov as % of avg. loans	2.6	2.0	0.9	0.5	0.3
Tax Rate (%)	33.3	35.2	33.0	33.0	32.0
Capital Adequacy Ratios (%)					
Total CAR	15.3	17.3	15.5	18.8	18.8
Tier 1 CAR	8.9	9.2	8.9	10.6	10.6
Profitability Ratios (%)					
RoAE	17.3	11.4	19.3	19.5	23.3
RoAA	1.7	1.0	1.7	1.9	2.3
Valuations Ratios					
BVPS (Rs)	121.5	135.2	162	187	229
Price/BV (x)	2.5	2.3	1.9	1.6	1.3
EPS (Rs)	18.5	14.6	28.7	30.2	45.6
P/E (x)	16.5	20.9	10.6	10.1	6.7

Source: Company, Centrum Research Estimates

Appendix A

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Key to Centrum Investment Rankings

Buy: Expected outperform Nifty by>15%, **Accumulate:** Expected to outperform Nifty by +5 to 15%, **Hold:** Expected to outperform Nifty by -5% to +5%, **Reduce:** Expected to underperform Nifty by 5 to 15%, **Sell:** Expected to underperform Nifty by>15%

Centrum Broking Private Limited

Member (NSE, BSE, MCX-SX), Depository Participant (CDSL) and SEBI registered Portfolio Manager

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CAPITAL MARKET SEBI REGN. NO.: BSE: INB 011251130, **NSE:** INB231251134
DERIVATIVES SEBI REGN. NO.: NSE: INF 231251134 (TRADING & SELF CLEARING MEMBER)
CDSL DP ID: 12200. **SEBI REGISTRATION NO.:** IN-DP-CDSL-20-99
PMS REGISTRATION NO.: INP000000456
MCX – SX (Currency Derivative segment) REGN. NO.: INE 261251134

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