

Magma Fincorp

Q1FY11 Update

19 July 2010

Buy

Target Price: Rs579

CMP: Rs294*

Upside: 96%

*as on 19 July 2010

Robust growth; maintain Buy

Magma Fincorp reported strong growth in Q1FY11 with PAT growing 61% YoY to Rs182mn on account of better margins, AUM growth and lower credit costs. We remain positive on the company given its improving loan mix, excellent operating metrics and lowering credit costs.

- **Disbursements tilting towards high-yield assets:** The proportion of disbursements in high-yield assets increased to 16% during Q1FY11 vs 13% recorded during FY10. This growth is inline with the management's guidance of 20% higher-yield assets in FY11E and 30% in FY12E.
- **Margins improve:** NIM in Q1FY11 expanded 60bp QoQ to 5.7%. We expect margins to improve further in the coming quarters due to the shift in the loan mix towards higher yielding assets.
- **Better collection, lower credit costs:** Magma recorded a collection efficiency ratio in excess of 100% which helped reduce credit costs. Aided by the improved collections, write-off ratio has come down to ~0.42%.
- **Return ratios improving:** Return ratios continue to be positive with RoA at 1.6%. (~ 1.4% adj for QIP issuance) and RoE at ~ 15%.
- **Reiterate Buy:** The stock currently trades at 1.3 x FY11E Adj BV. We believe there is potential for further upside on account of continued improvement operating metrics and the management's execution being on track with the strategy. We reiterate our Buy rating with a target price of Rs579, valuing the stock at 2.2 x FY12E Adj BV.

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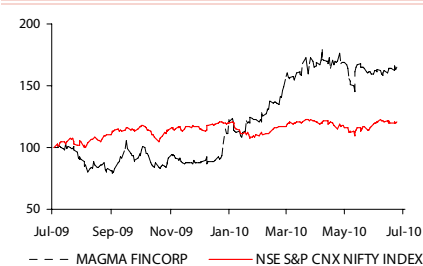
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Key Data

Bloomberg Code	MGMA IN
Reuters Code	MAGM.BO
Current Shares O/S (mn)	25.9
Diluted Shares O/S (mn)	25.9
Mkt Cap (Rsbn/USDmn)	7.6/162.4
52 Wk H / L (Rs)	324/137
Daily Vol. (3M NSE Avg.)	111,137
Face Value (Rs)	10

USD = Rs47.1

One Year Indexed Stock Performance



Price Performance (%)

	1M	6M	1Yr
Magma Fincorp	1.9	39.1	66.6
NIFTY	2.3	3.0	23.0

Source: Bloomberg, Centrum Research
*as on 19 July 2010

Y/E March (Rsmn)	Q1FY11	Q1FY09	YoY (%)	Q4FY10	QoQ (%)
Interest from Operations	1,790	1,448	23.6	2,165	(17.3)
Interest Cost	733	664	10.5	887	(17.4)
Net Interest Income	1,057	785	34.8	1,278	(17.2)
Other Income	4	11	(68.4)	8	(55.3)
Total Operating Income	1,061	796	33.3	1,286	(17.5)
Opex excl Dep & Write/off	612	444	37.9	643	(4.9)
Deprecation	73	85	(14.2)	78	(6.3)
Total Operating Expenses	685	529	23.8	721	(11.2)
C/I Ratio (%)	64.6	66.4	-	56.1	-
PPOP	376	267	40.6	564	(33.4)
Write-off	99	97	2.2	142	(30.3)
PBT	277	171	62.5	423	(34.4)
Provisions for Tax	95	58	64.7	158	(39.6)
Effective Tax Rate (%)	34.4	33.9	-	37.4	-
PAT	182	113	61.3	265	(31.3)

Source: Company, Centrum Research

Y/E Mar (Rsmn)	NII	Non Int. Inc.	PAT	YoY (%)	EPS (Rs)	P/E (x)	Adj BV (Rs)	P/Adj BV (x)
FY08	2,947	63	505	27.2	17.8	16.6	121.5	2.4
FY09	3,410	21	398	(21.2)	15.0	19.6	138.1	2.1
FY10	3,943	37	713	79.2	29.1	10.1	164.0	1.8
FY11E	5,138	59	950	33.2	31.3	9.4	219.5	1.3
FY12E	6,730	77	1,390	46.3	47.1	6.3	263.2	1.1

Source: Company, Centrum Research Estimates

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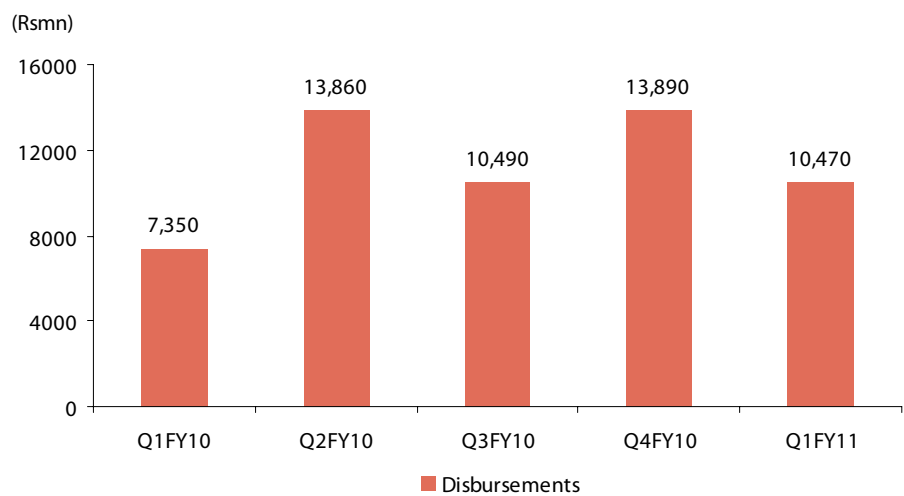
Growth in earnings momentum continues; Reiterate BUY

Magma Fincorp reported robust business growth and improvement in bottom-line with lower credit costs in Q1FY11, inline with expectations. We remain positive on the stock on account of the improving loan mix, excellent operating metrics and declining credit costs. We reiterate our Buy rating, valuing the stock at 2.2 x FY12E Adj BV, translating into a target price of Rs579.

Disbursements tilting towards high-yield assets

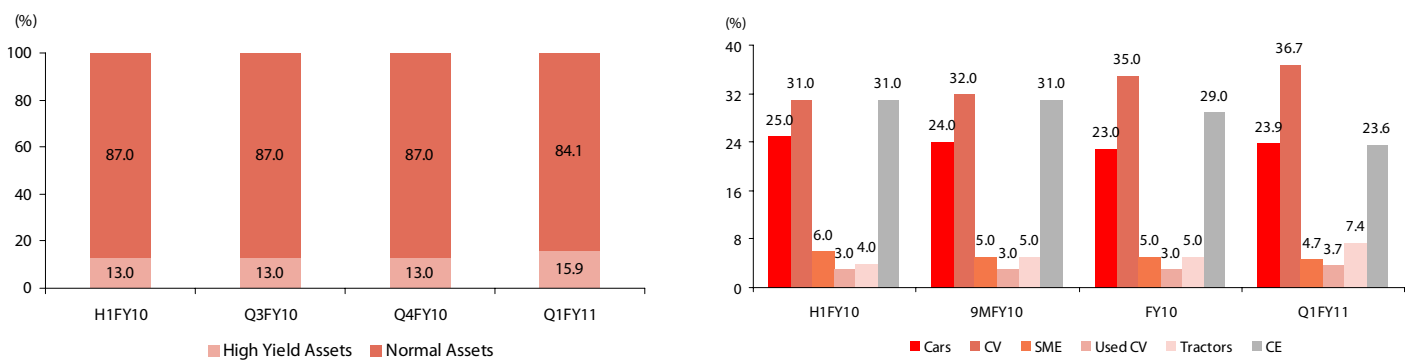
Loan disbursements grew at a robust 42% YoY to Rs10.47bn in Q1FY11 vs Rs7.35bn in Q1FY10. The disbursements were skewed towards higher yielding products (higher yielding products accounted for 16% of the total disbursements in Q1FY11 vs 13% in the FY10). We believe the management is on track to achieve its target of 20% disbursement in high-yielding assets in FY11E and 30% in FY12E. As the mix improves, we expect the yield on advances to outpace the rise in the funding costs resulting in spread expansion.

Exhibit 1: Robust growth in disbursements ...



Source: Company, Centrum Research

Exhibit 2: ... with skew towards high-yield products

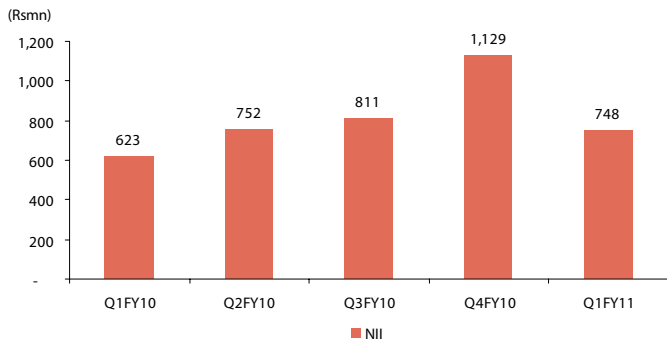


Source: Company, Centrum Research

Margin improvement continues

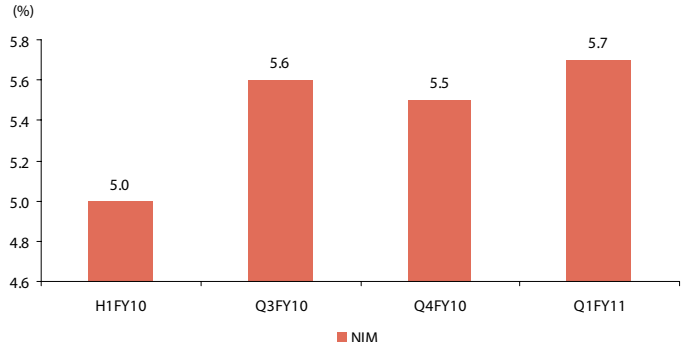
Inline with the management’s guidance, NIM increased to 5.7% in Q1FY11. The expansion was mainly on account of a spike in high-yield loan assets and partially due to the capital infusion (positive impact of ~5bp), which happened during the quarter. Despite the one- off pertaining to QIP, we believe that the margin expansion is on upswing. Net interest income grew 20% YoY despite the fall in the over all yields due to increase in the advance book. With the expected improvement in the loan mix towards high yield assets, we expect NIMs to be in excess of ~5.3% for the next few quarters.

Exhibit 3: Changing asset book helps boost NII growth ...



Source: Company, Centrum Research

Exhibit 4: ... and expand NIMs

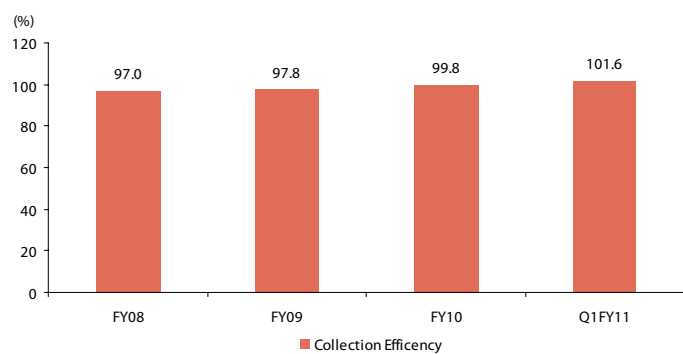


Source: Company, Centrum Research

Improved collections result in lower credit costs

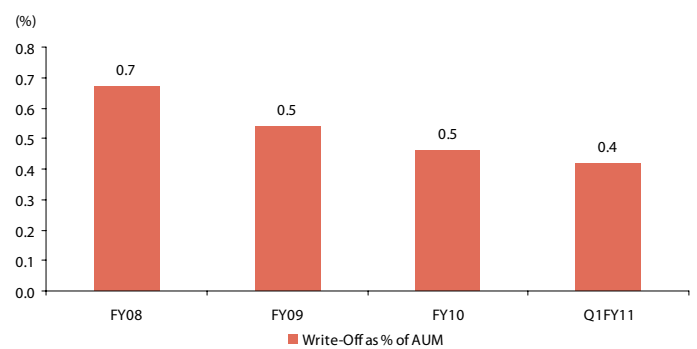
The collection efficiency at ~102% was the highest recorded for any quarter indicating excellent credit recoveries during the quarter. The recoveries led to a drop in the net write-off ratio to ~0.4%. We, however, believe that as the loan book seasons, especially in the high-yield segments, credit costs would be a key parameter to be monitored for sustainability of RoA.

Exhibit 5: As collections efficiencies improve.....



Source: Company, Centrum Research

Exhibit 6: ... write-offs continue to decline

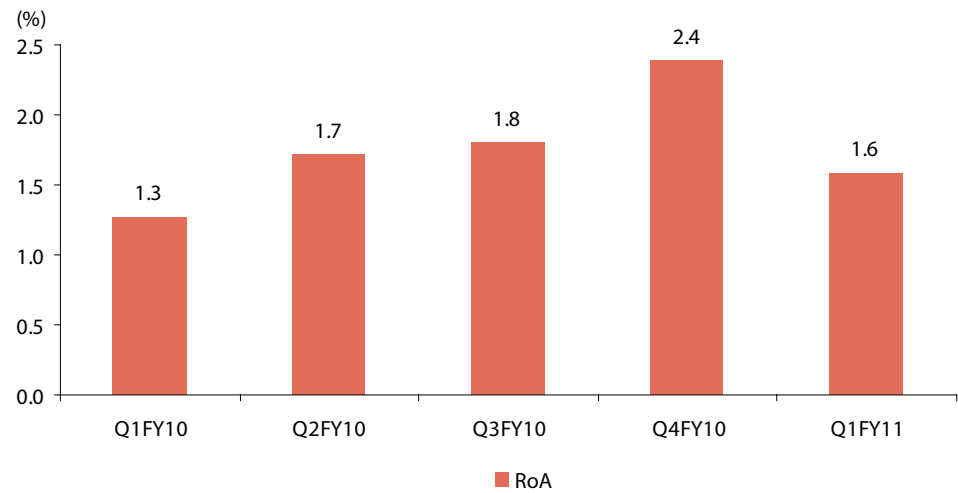


Source: Company, Centrum Research

Return ratios on the uptick

RoA expanded to 1.6% in Q1FY11 vs 1.28% in Q1FY10. This spike was partly on account of lower interest outgo due to QIP-related funding (Positive impact of ~20 bps). However, we expect the underlying uptrend in the RoA to continue for the next few quarters. We expect RoA to move up to 1.9% by end of FY11 and 2.1% by FY12.

Exhibit 7: RoAs on the up-swing



Source: Company, Centrum Research

Financials

Exhibit 8: Income Statement

Y/E March (Rsmn)	FY08	FY09	FY10	FY11E	FY12E
Interest Income	4,655	6,291	7,194	9,101	11,861
Interest Expense	1,708	2,880	3,250	3,962	5,131
Net Interest Income	2,947	3,410	3,943	5,138	6,730
YoY Growth (%)	52	16	16	30	31
Non Interest Income	63	21	37	59	77
YoY Growth (%)	165	(67)	78.7	60	30
Total Income	3,010	3,431	3,980	5,198	6,807
Total Operating Expenses	1,840	2,406	2,467	3,482	4,519
YoY Growth (%)	46.9	30.7	2.6	41.1	29.8
Pre-provision Profit	1,170	1,026	1,513	1,715	2,289
Provisions	404	415	408	367	331
Profit Before Tax	766	610	1,105	1,348	1,958
Taxes	261	212	391	398	568
Net Profit	505	398	713	950	1,390

Source: Company, Centrum Research Estimates

Exhibit 9: Balance Sheet

Y/E March (Rsmn)	FY08	FY09	FY10	FY11E	FY12E
Share capital	218	218	218	278	278
Preference capital - 10-12 (cum & non cum)	1,161	1,180	1,161	1,511	1,511
Reserves & Surplus	2,428	2,789	3,357	5,824	7,039
Shareholders' fund	3,807	4,187	4,736	7,613	8,828
Borrowings	19,108	25,066	36,543	41,164	58,234
Current liabilities	5,962	4,273	5,350	6,850	10,583
Total Liabilities	28,876	33,526	46,629	55,628	77,645
Net block	2,244	2,382	2,080	2,205	2,293
Stock on Hire	18,670	20,459	33,014	40,607	55,632
Investments	776	290	191	227	249
Debtors	82	-	-	-	-
Cash & Bank	5,980	9,025	9,709	10,558	15,021
Loans & Advances	1,124	1,369	1,636	2,030	4,451
Total Assets	28,876	33,525	46,630	55,628	77,645

Source: Company, Centrum Research Estimates

Exhibit 10: Key Ratios

Y/E March	FY08	FY09	FY10	FY11E	FY12E
Loan Growth	75.0	9.8	58.7	23.1	40.9
Assets Growth	50.2	16.1	39.1	19.3	39.6
Funds Growth	74.1	29.5	43.7	13.2	40.0
Operating Ratios (%)					
NIM	4.1	3.6	5.1	5.3	5.7
Non-int. inc/Net income	2.1	0.6	0.9	1.1	1.1
Cost/Income	61.1	70.1	62.0	67.0	66.4
Operating cost growth	46.9	30.7	2.6	41.1	29.8
Total prov as of avg. loans	2.6	2.0	1.4	1.0	0.6
Tax Rate	34.0	34.8	35.4	29.5	29.0
Capital Adequacy Ratios (%)					
Total CAR	15.3	17.3	14.9	16.0	17.0
Tier 1 CAR	8.9	9.2	8.6	11.0	9.4
Profitability Ratios (%)					
RoAE	21.7	13.8	21.7	19.6	20.7
RoAA	2.1	1.3	1.8	1.9	2.1
Valuations Ratios					
BVPS (Rs)	121.5	138.1	164.0	219.1	263.2
Price/BV (x)	2.4	2.1	1.8	1.3	1.1
EPS (Rs)	17.8	15.0	29.1	31.3	47.1
P/E (x)	16.6	19.6	10.1	9.4	6.3
DPS (Rs)	2.3	1.2	2.4	2.2	3.4
Dividend yield (%)	0.8	0.4	0.8	0.8	1.1

Source: Company, Centrum Research Estimates

Appendix A

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