

Magma Fincorp

Q2FY12 Result update/ Estimate change 20 Oct 2011

Buy

Target Price: Rs117

CMP: Rs65*

Upside: 80%

*as on 19 Oct 2011

A mixed bag

Magma's Q2FY12 numbers were characterized by continued strong disbursement growth, healthy asset quality and sharp NIM contraction. It should be noted that the recent change in accounting policies renders YoY comparison inconclusive and misleading. As we factor in lower securitization benefit, steeper NIM contraction (55 bps YoY in FY12) and lower valuation multiple (due to challenging operating environment), we lower our target price to Rs117 (from Rs125 earlier). We retain Buy rating.

- **Strong disbursements growth momentum continues:** Disbursements in Q2FY12 grew by a healthy 37% Y-o-Y led by a jump in lending to Cars & Utility segment and consistently strong growth in high yielding segments. The mix of the high-yielding assets increased to 23% in Q2FY12 vs 18% in Q2FY11. The strong growth in Cars & Utility segment, despite moderation in overall auto sales volumes in recent months, stems from Magma's 1) rural and semi-rural focus where demand remains healthy and 2) new branch additions.
- **Spread contracts as costs increase outpaces yield expansion:** Reported NIM contracted to ~4.2% in Q2FY12 from 4.6% in Q1FY12, led by a sharp jump in cost of funds which more than offset the gains on blended yields. Importantly, Magma's credit ratings were upgraded recently and this should accrue benefit in terms of competitive cost of funds over the medium term.
- **Collection efficiency at 99.5%:** Collection efficiency remains strong at 99.5% for Q2FY12 though marginally below 100.1% in Q1FY12. The strong collection efficiency and healthy credit quality of the book helped contain the provisions at Rs87mn (flatish QoQ). However, the secular improving trend in write-off ratio has reversed in Q2FY12 as write-off ratio inched up to 0.24% in Q2FY12 from 0.2% for Q1FY12.
- **Cheap valuations, Reiterate Buy:** We continue to like the stock due to cheap valuations, large potential for growth, and a seasoned senior management team that has seen multiple cycles and has a clear focus on containing risks. Its current multiple of 0.9x FY13 BVPS, Magma trades at a significant discount to its peers and factors in potential risks amply. We reiterate Buy.

Bhavesh Kanani

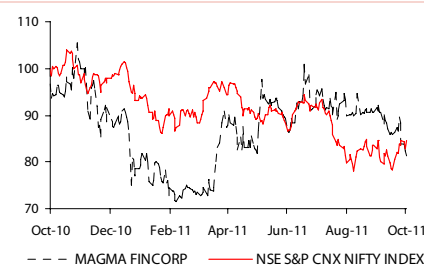
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Key Data

Bloomberg Code	MGMA IN
Reuters Code	MAGM.BO
Current Shares O/S (mn)	179.7
Diluted Shares O/S (mn)	179.7
Mkt Cap (Rsbn/USDmn)	11.7/237.2
52 Wk H / L (Rs)	87/56
Daily Vol. (3M NSE Avg.)	406,427
Face Value (Rs)	2

1 USD = Rs49.1

One Year Indexed Stock Performance



Price Performance (%)

	1M	6M	1Yr
Magma Fincorp	(11.4)	(7.7)	(15.9)
NIFTY	2.1	(10.5)	(14.7)

Source: Bloomberg, Centrum Research
*as on 19 Oct 2011

Y/E March (Rsmn)	Q2FY12	Q2FY11	YoY (%)	Q1FY11	QoQ (%)
Income from operations	2,371	1,850	28.2	2,044	16.0
Other Operating Income	148	136	9.0	156	(5.5)
Interest from Operations	2,519	1,985	26.9	2,200	14.5
Interest Cost	1,447	870	66.3	1,208	19.8
Net Interest Income	1,072	1,116	(3.9)	993	8.0
Other Income	1	5	(84.4)	11	(92.7)
Total Operating Income	1,073	1,121	(4.3)	1,003	6.9
Opex excl Dep & Write/off	621	610	1.8	600	3.5
Depreciation	62	68	(8.2)	65	(4.1)
Total Operating Expenses	683	678	0.8	665	2.8
C/I Ratio (%)	63.7	60.5		66.3	
PPOP	389	443	(12.0)	339	15.0
Net Provisions	87	48	81.9	85	2.6
PBT	302	395	(23.4)	254	19.2
Provisions for Tax	90	131	(31.8)	82	8.5
Effective Tax Rate (%)	29.6	33.2		32.5	
PAT (before minority)	213	264	(19.2)	171	24.3

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)
FY10	3,943	37	713	79.2	5.8	11.2	32.8	2.0
FY11	5,200	17	1,221	71.2	8.8	7.4	44.1	1.5
FY12E	5,822	20	1,285	5.2	6.3	10.2	61.7	1.1
FY13E	8,120	20	2,188	70.3	11.1	5.8	72.0	0.9
FY14E	9,901	25	2,720	24.3	13.9	4.7	84.8	0.8

Source: Company, Centrum Research Estimates

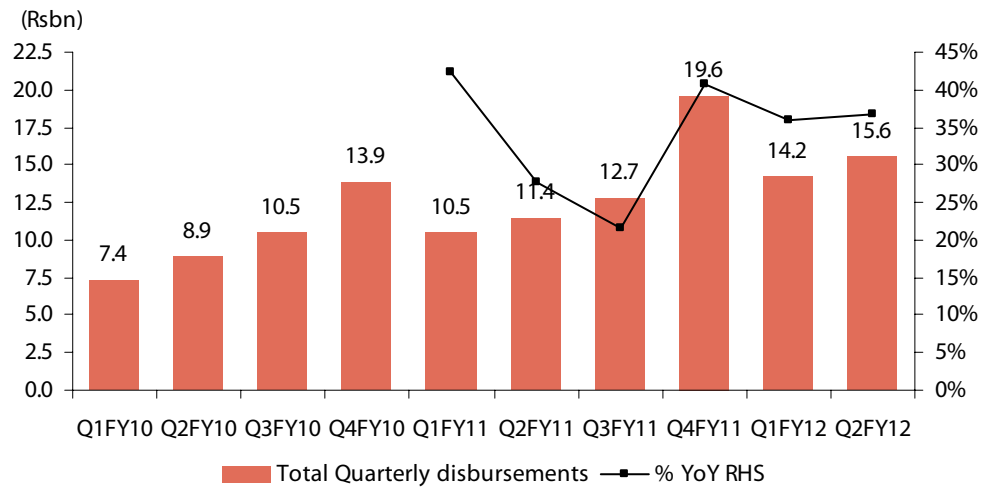
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Strong disbursements growth continues

Disbursement momentum continued in Q2FY12 (up 37% Y-o-Y) led by sharp jump in disbursements to Cars and UV Segment (up 80% Y-o-Y) and consistently strong growth in disbursements to high yielding segment (up 76% Y-o-Y). Share of high yielding segment for Q2FY12 was 23% (vs 18% in Q2FY11). The disbursement momentum for CV slackened further but CE segment has seen gradual improvement in business momentum.

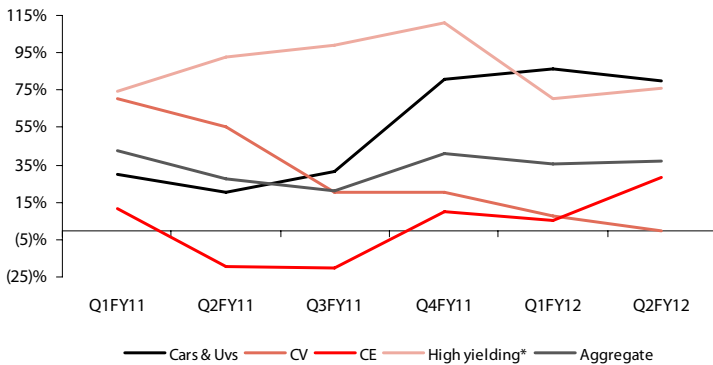
The management expects the disbursement growth momentum to accelerate further in H2FY12 to 50% driven by continued strong momentum in Cars & UV segment with special focus on high yielding assets. The diverse product mix hedges the disbursement growth against slowdown in any single segment. The company reiterated its plan of expanding high yield assets portfolio aggressively with a view to shore up its contribution to 25% by end of FY12.

Exhibit 1: Robust growth in disbursements



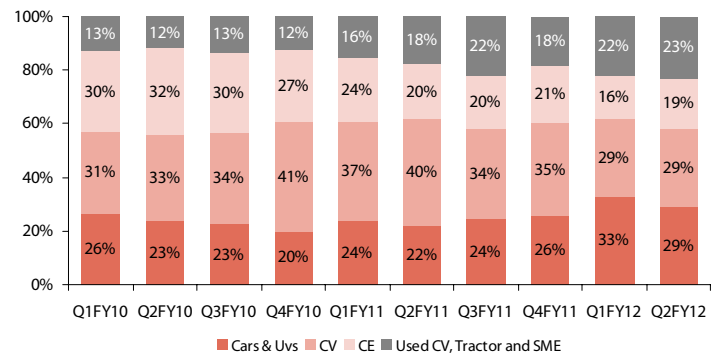
Source: Company, Centrum Research

Exhibit 2: Disbursements to high-yielding segment has outpaced other segments



Source: Company, Centrum Research

Exhibit 3: Changing mix in favour of high yield segment



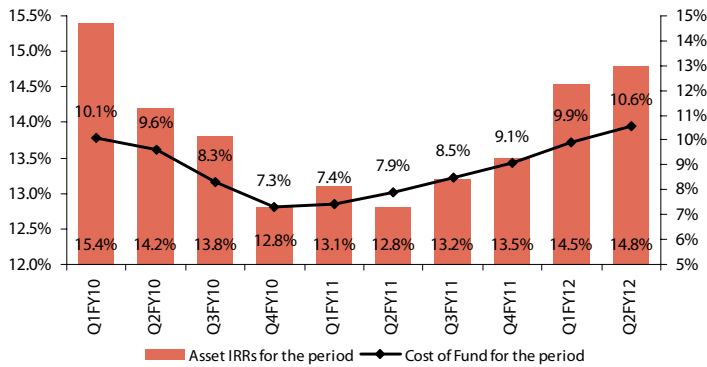
Source: Company, Centrum Research

Reported spreads contract materially, as expected

Reported spreads contracted during the quarter by ~40 bps QoQ to 4.2% led by a sharp rise in cost of funds, which outpaced the benefit of higher lending rates. Going forward, we expect NIM to be under pressure in H1FY12 due to the adverse interest environment and hawkish stance adopted by RBI. Over all we are factoring in NIM of *5.3% for FY12 – a contraction of 55 bps YoY, as higher proportion of disbursement from high yielding loans gets off-set by hardening of cost of funds and a competitive landscape which would prevent higher costs being passed on to customers.

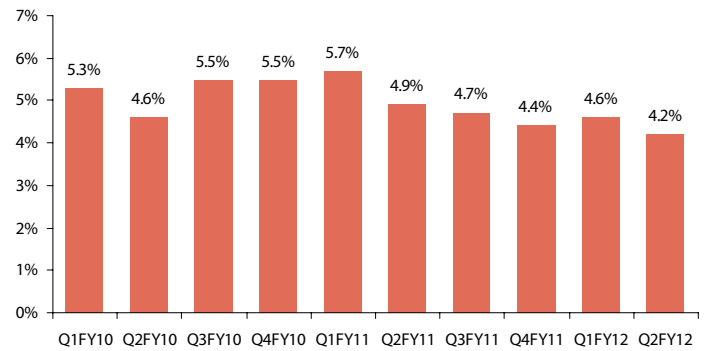
*Not comparable with NIM reported by company due to different base

Exhibit 4: Sequential rise in cost of funds has outpaced expansion in IRRs



Source: Company, Centrum Research

Exhibit 5: ...leading to qoq contraction in spreads

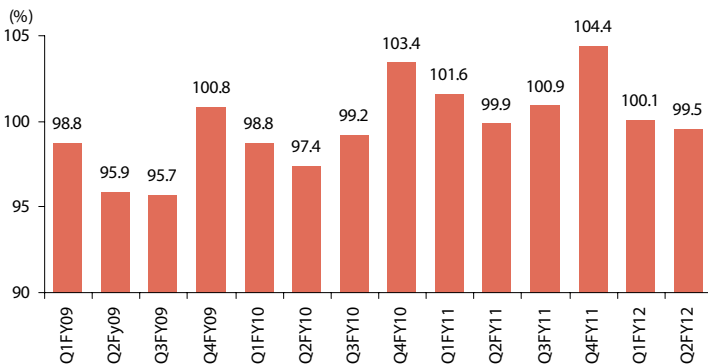


Write-off rate off the all time low but remains robust

Collection efficiency dipped sequentially to 99.5%, though still remains strong. It should be noted that 99.5% collection efficiency in the last seven quarters clearly points to some stress build up led by moderation in general economic activity. Going forward, we expect the collection efficiency to remain below 100% level as a weak macro starts filtering into micro indicators.

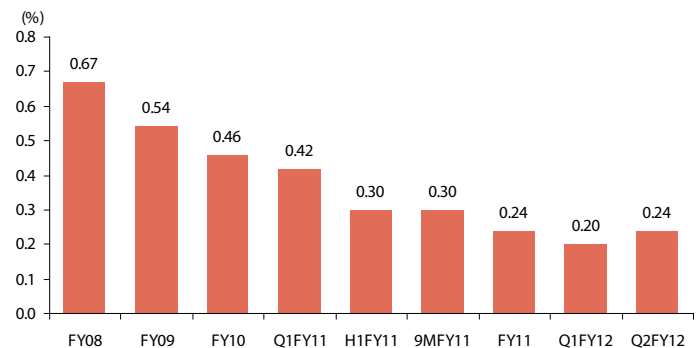
Write-offs as a percent of AUM inched up to 0.24% for Q2FY12 compared to 0.20% for Q1FY12 and 0.24% for FY11. Having said that, the write off rate for Magma remains quite healthy led by its strong recovery mechanism (a must for NBFCs operating in under banked locations). Conservatively, we continue to maintain higher credit costs in our assumptions for FY12 (0.45%) and FY13 (0.5%) to factor in likely higher NPA arising out of the high yield loan book that the company is currently building.

Exhibit 6: Strong collection efficiency though below the 100.1% level seen during previous quarter



Source: Company, Centrum Research

Exhibit 7: Uptick in write-off rate (annualised) indicating gradual build up of stress



Source: Company, Centrum Research

Estimate revisions

We have revisited our estimates following the Q2FY12 results. As we factor in a sharper contraction in NIM during FY12 and near absence of securitization benefits, we lower our FY12 and FY13 BVPS estimate by 2% each.

More importantly, the RoA is likely to dip going forward as the company retains more assets on the book (vs earlier strategy of 50% off-balancesheet). With share of off-balancesheet book likely to come down to 10%-15%, the on-book balancesheet growth would be faster during FY12 which in turn would suppress the RoA.

Against the backdrop of anticipated dip in RoA as well as intensifying macro challenges (on growth and quality front), we are lowering our fair value multiple for Magma to 1.5x from 1.7x earlier. At 1.5x, Sep-12 BVPS implies a fair value estimate of Rs117.

Exhibit 8: Key revisions in estimates

	Earlier		Revised	
	FY12E	FY13E	FY12E	FY13E
NII (Rsmn)	6,283	8,258	5,822	8,120
PPP (Rsmn)	2,777	4,041	2,347	3,946
PAT (Rsmn)	1,573	2,247	1,285	2,188
NIM (%)	5.7	5.9	5.3	5.90
RoA (%)	1.8	1.7	1.5	1.6
RoE (%)	22.9	17.9	19.0	17.8
BVPS (Rs)	63.1	73.6	61.7	72.0

Source: Company, Centrum Research Estimates

Cheap valuations, Reiterate Buy

At current market price, Magma trades at 0.9x FY13E BVPS. Clearly, the current valuations are very attractive on absolute and relative basis (30% discount to the average valuation commanded by Indian NBFCs). We believe that consistent improvement in RoA from current level over the next two years would be the key valuation catalyst in the medium term for Magma. We value Magma based on 1.5x FY13E BVPS implying a target price of Rs117. We reiterate our Buy recommendation on the stock.

Financials

Exhibit 9: Income Statement

Y/E March (Rsmn)	FY10	FY11	FY12E	FY13E	FY14E
Interest Income	7,194	8,723	12,516	19,807	25,895
Interest Expense	3,250	3,523	6,694	11,688	15,994
Net Interest Income	3,943	5,200	5,822	8,120	9,901
YoY Growth (%)	15.6	31.9	12.0	39.5	21.9
Non Interest Income	37	17	20	20	25
YoY Growth (%)	78.7	(54.3)	18.3	-	25.0
Total Income	3,980	5,217	5,842	8,140	9,926
Total Operating Expenses	2,467	3,039	3,495	4,194	5,033
YoY Growth (%)	2.6	23.2	15.0	20.0	20.0
Pre-provision Profit	1,513	2,178	2,347	3,946	4,893
Provisions	408	356	429	680	834
Profit Before Tax	1,105	1,822	1,918	3,266	4,060
Taxes	391.4	600.6	632.8	1,077.8	1,339.6
Net Profit	713	1,221	1,285	2,188	2,720

Source: Company, Centrum Research Estimates

Exhibit 10: Balance Sheet

Y/E March (Rsmn)	FY10	FY11	FY12E	FY13E	FY14E
Share capital	218	260	379	379	379
Preference capital	1,161	1,594	1,594	1,594	1,594
Reserves & Surplus	3,357	5,463	11,326	13,264	15,692
Shareholders' fund	4,736	7,316	13,299	15,237	17,665
Borrowings	36,543	45,924	91,397	133,368	171,275
Current liabilities	5,350	5,676	6,243	6,868	7,555
Total Liabilities	46,629	58,917	110,940	155,474	196,494
Net block	2,080	1,871	2,058	2,264	2,491
Stock on Hire	33,014	45,201	91,397	133,368	171,275
Investments	191	114	100	125	125
Debtors	-	-	-	-	-
Cash & Bank	9,709	10,075	17,384	19,716	22,604
Loans & Advances	1,636	1,656	1,700	1,800	1,900
Total Assets	46,630	58,917	110,940	155,474	196,494

Source: Company, Centrum Research Estimates

Exhibit 11: Key Ratios

Y/E March	FY10	FY11	FY12E	FY13E	FY14E
BS Structure Ratios (%)					
Loan Growth	61.4	36.9	102.2	45.9	28.4
Assets Growth	39.1	26.3	88.3	40.1	26.4
Funds Growth	15.1	16.6	29.6	22.7	16.6
Operating Ratios (%)					
NIM	5.16	5.88	5.32	5.90	6.03
Non-interest income/Net income	0.94	0.33	0.34	0.25	0.25
Cost/Income	62.0	58.3	59.8	51.5	50.7
Operating cost growth	2.6	23.2	15.0	20.0	20.0
Total prov as % of avg. loans	0.5	0.4	0.5	0.6	0.6
Tax Rate (%)	35.4	33.0	33.0	33.0	33.0
Capital Adequacy Ratios (%)					
Total CAR	14.9	18.1	18.0	15.3	14.1
Tier 1 CAR	8.6	10.8	11.7	9.8	9.1
Profitability Ratios (%)					
RoAE	21.7	26.3	19.0	17.8	17.1
RoAA	1.8	2.3	1.5	1.6	1.5
Valuations Ratios					
BVPS (Rs)	32.8	44.1	61.7	72.0	84.8
Price/BV (x)	2.0	1.5	1.1	0.9	0.8
EPS (Rs)	5.8	8.8	6.3	11.1	13.9
P/E (x)	11.2	7.4	10.2	5.8	4.7
DPS (Rs)	0.47	0.60	0.57	0.89	1.11
Dividend yield (%)	0.7	0.9	0.9	1.4	1.7

Source: Company, Centrum Research Estimates

Appendix A

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