

Magma Fincorp Ltd

Visit Note

15 December 2010

Buy

Target Price: Rs116

CMP: Rs73*

Upside: 58%

*as on 14 December 2010

Positive Vibes

We met with senior and mid level management teams of Magma Fincorp recently. We continue to remain positive on the stock on account of strong execution capabilities of the company and optimism on business growth. We are not changing any of our estimates post the meeting and maintain BUY on the stock with a TP of Rs 116 at 2.2X FY12E BV.

BUSINESS TAKEAWAYS

- **Optimistic on strong business growth:** The management has indicated the possibility of doubling AUM over the next couple of years led by optimism over strong business growth. According to them growth in most segments, especially in the tractors division, has been good in the last few quarters. They expect strong credit demand in the next couple of years.
- **Near term spreads to come down marginally:** The management expects marginal reduction in the spreads in the near term owing to the spike in borrowing costs and a time lag in transferring rate hikes. However, this will be partially negated by increasing share of high yield products in its portfolio.
- **Evaluating product expansion:** The management has indicated that they were on a continuous lookout to expand product portfolio to ensure sustained growth for Magma.

Takeaways from management meets

- **Seasoned senior management team with cross functional capabilities:** All senior management team members who head both front end and backend businesses have been with the firm for nearly a decade. The team members have strong understanding of the firm having worked in various functions including HR, Sales, recovery and credit. Their cross functional capabilities have helped in building excellent policies aligned with the firm's interests.
- **Existing management and operating bandwidth sufficient to support 2X business:** In our assessment, confirmed by various business heads, the existing bandwidth of the management and infrastructure are sufficient to double the business. This flexibility should enable the firm to maintain a high growth trajectory in the near to medium term.
- **Strong risk culture:** Our interactions with various business heads suggest the persistence of a strong risk culture across the firm.

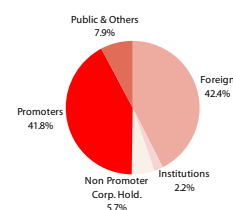
Key Data

Bloomberg Code	MGMA IN
Reuters Code	MAGM.BO
Current Shares O/S (mn)	129.8
Diluted Shares O/S (mn)	129.8
Mkt Cap (Rsbn/USDmn)	9.6/211.1
52 Wk H / L (Rs)	88/30
Daily Vol. (3M NSE Avg.)	451,774
Face Value (Rs)	2

USD = Rs45.2

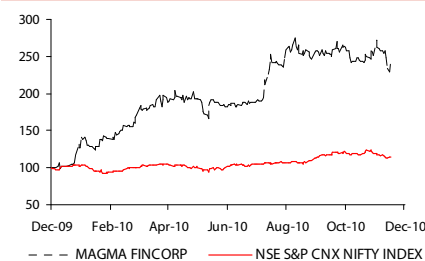
Source: Bloomberg ; * As on 14 Dec 2010

Shareholding Pattern (%)



As on 30 September 2010

One Year Indexed Stock Performance



Price Performance (%)

	1M	6M	1Yr
Magma	(12.7)	27.6	137.3
NIFTY	(3.4)	13.2	17.5

Source: Bloomberg, Centrum Research
*as on 14 December 2010

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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 (%)
FY09	3,410		21	398	(21.2)	3.0	24.3	27.6	2.6	1.28	14.1
FY10	3,943		37	713	79.2	5.8	12.5	32.8	2.2	1.78	21.7
FY11E	4,845		62	968	35.7	6.4	11.5	43.9	1.7	1.71	20.0
FY12E	6,271		69	1,418	46.6	9.6	7.6	52.7	1.4	1.89	21.1
FY13E	7,591		83	1,711	20.6	11.7	6.2	63.5	1.2	1.83	21.1

Source: Company, Centrum Research Estimates

Please refer to important disclosures/disclaimers in Appendix A

Key Takeaways

Meeting with MD

We met with Mr Sanjay Chamria Vice-Chairman and MD of Magma. The following are our takeaways from the meeting

- Optimistic about growth outlook over the next two years in most segments. Magma is looking to grow its AUM to ~Rs. 220bn by FY13E indicating 32% CAGR between FY10-13E on the back of growth opportunities. In our estimates currently, we are factoring in only 19% CAGR in the AUM between FY10-13E resulting in AUM of ~Rs 160bn by FY13E.
- Magma is continuously evaluating new products which can be added to the current portfolio.
- The management is not worried about near term funding costs. They expect increasing high yield products to help mitigate spread compression.

Meeting with Recovery Team

We met with Mr.G. P Pattanaik, senior Vice-President who heads the recovery division of Magma. He has been with the firm for more than 10 years with experience in sales and credit divisions.

- The recovery team is organized on the basis of zones/states and is product agnostic except in the case of SMEs which has a separate vertical.
- It has nearly 2400 members working at various levels and does not use any external collection agencies.
- At the mid & senior management levels there is sufficient bandwidth to double the assets under management (AUM). Feet on street will be the only addition that the company needs to add to double the AUM
- The recovery team has incentive schemes which link salaries to performance of the team. Typically, the variable component is to the tune of 40% of the annual salary.

Meeting with the CFO

We met Mr. Laxmi the CFO of Magma Fincorp. He has been associated with Magma for over a decade and has worked across various functions including HR.

- He expects near term pressure on the spreads as funding costs are going up ahead of lending rates. He expects to end the year with a spread tad less than 5.5% which was initially guided. In our estimates we have factored in a spread of 5.5% for FY11E.
- Will continue to use securitization as a tool to mitigate interest rate risk though in lesser proportion going forward. In our assumptions we have factored 45% securitization for FY11E.
- Credit off-take has been impressive in the last few quarters especially in the tractors segment.

Meeting with Credit and Operations team

We met Mr. Mahender Bagrodia who heads the credit & operations team of Magma. He has been with Magma for nearly a decade with previous experience in sales and other functions

- The credit team is structured on the basis of geographies, at the zonal level and then at state level with a team strength of nearly 140 members.
- He has a team of nearly 125 credit analysts generally with CA /MBA background. Magma is focused on getting new talent on board and retaining them.
- In credit evaluation especially of new customers, the two key criteria for credit decision apart from LTV ratios are past experience of the customer in using the asset and viability of the business in which the asset is to be deployed.

Meeting with MIS and Budgeting team

We met with Mr Dharendra Hota who heads the MIS/Budgeting team at Magma

- The firm uses internally developed ERP package in day to day operations.
- It generates firm level data on a day to day basis using more than 80 parameters which helps it to evaluate and implement incentive structures across the firm

Financials

Exhibit 1: Income statement

Y/E March (Rsmn)	FY09	FY10	FY11E	FY12E	FY13E
Interest Income	6,291	7,194	8,661	11,777	14,585
Interest Expense	2,880	3,250	3,816	5,505	6,994
Net Interest Income	3,410	3,943	4,845	6,271	7,591
YoY Growth (%)	15.7	15.6	22.9	29.4	21.0
Non Interest Income	21	37	62	69	83
YoY Growth (%)	(66.9)	78.7	67.8	10.5	20.5
Total Income	3,431	3,980	4,907	6,340	7,674
Total Operating Expenses	2,406	2,467	3,010	3,642	4,370
YoY Growth (%)	30.7	2.6	22.0	21.0	20.0
Pre-provision Profit	1,026	1,513	1,897	2,698	3,303
Provisions	415	408	409	581	750
Profit Before Tax	610	1,105	1,489	2,117	2,553
Taxes	212.4	391.4	521.1	698.6	842.5
Net Profit	398	713	968	1,418	1,711

Source: Company, Centrum Research Estimates

Exhibit 2: Balance Sheet

Y/E March (Rsmn)	FY09	FY10	FY11E	FY12E	FY13E
Share capital	218	218	279	279	279
Preference capital - 10-12% (cum & non cum)	1,180	1,161	1,511	1,511	1,511
Reserves & Surplus	2,789	3,357	5,836	7,067	8,566
Shareholders' fund	4,187	4,736	7,626	8,857	10,356
Borrowings	25,066	36,543	53,241	69,100	86,325
Current liabilities	4,273	5,350	5,618	5,898	6,193
Total Liabilities	33,526	46,629	66,485	83,855	102,874
Net block	2,382	2,080	2,288	2,517	2,768
Stock on Hire	20,459	33,014	57,500	73,246	91,505
Investments	290	191	250	250	250
Debtors	-	-	-	-	-
Cash & Bank	9,025	9,709	6,446	7,842	8,351
Loans & Advances	1,369	1,636	1,600	1,600	1,600
Total Assets	33,525	46,630	66,485	83,855	102,874

Source: Company, Centrum Research Estimates

Exhibit 3: Key Ratios

Y/E March	FY09	FY10	FY11E	FY12E	FY13E
Bal. Sheet Structure Ratios (%)					
Loan Growth	9.6	61.4	74.2	27.4	24.9
Assets Growth	16.1	39.1	42.6	26.1	22.7
Funds Growth	16.1	15.1	29.3	18.3	19.2
Operating Ratios (%)					
NIM	5.16	5.16	5.17	5.44	5.54
Non-interest income/Net income	0.61	0.94	1.28	1.09	1.09
Cost/Income	70.1	62.0	61.3	57.4	57.0
Operating cost growth	30.7	2.6	22.0	21.0	20.0
Total prov as % of avg. loans	0.6	0.5	0.5	0.6	0.6
Tax Rate (%)	34.8	35.4	35.0	33.0	33.0
Capital Adequacy Ratios (%)					
Total CAR	17.3	14.9	16.8	15.6	15.0
Tier 1 CAR	9.2	8.6	10.2	9.7	9.6
Profitability Ratios (%)					
RoAE	14.1	21.7	20.0	21.1	21.1
RoAA	1.3	1.8	1.7	1.9	1.8
Valuations Ratios					
BVPS (Rs)	27.6	32.8	43.9	52.7	63.5
Price/BV (x)	2.9	2.2	1.7	1.4	1.2
EPS (Rs)	3.0	5.8	6.4	9.6	11.7
P/E (x)	26.9	12.5	11.5	7.6	6.2
DPS (Rs)	0.23	0.47	0.51	0.77	0.94
Dividend yield (%)	0.3	0.6	0.7	1.1	1.3

Source: Company, Centrum Research Estimates

Appendix A

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