

Magma Fincorp

BUY

CMP (Rs)	335
Target price (Rs)	452
Potential upside	35%

Stock data

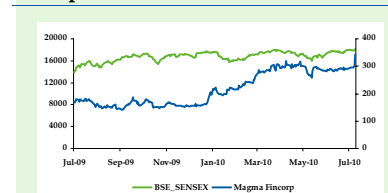
No. of shares (cr)	2.6
FV (Rs)	10
Market cap (Rs cr)	871
52 week high/low (Rs)	356 / 137
Avg. daily vol.* (shares)	361,946
BSE Code	524000
NSE Code	MAGMA
Bloomberg code	MAGMA IN
Reuters Code	MAGM.BO

* BSE & NSE 6 monthly

Shareholding (%)

	June -10	QoQ Chg
Promoter	41.8	(7.9)
FII's	38.8	18.2
MFs / UTI	1.7	1.4
Banks / Fis	0.1	-
Others	17.6	(11.7)

Price performance



Source: Cline, ENAM Direct Research

Company background

Magma Fincorp Ltd (MFL) is a Kolkata based non-banking financing company (NBFC). It provides financing of CV, construction equipment, cars, utility vehicles, tractors, SME loans and insurance distribution. It has a pan-India presence with 157 branches across 20 states and 1 union territory with an employee base of ~4700. It mainly targets rural and semi-urban markets and has a niche in financing first time buyers and small entrepreneurs.

We expect Magma to see strong business fundamentals from (1) an upturn in automobile sector and (2) government support to rural initiatives that has improved rural cash-flows and allows the company to maintain pricing power and lending growth.

Investment argument

- **Buoyant demand from user industry:** The expected growth in construction equipment and vehicle financing (which account for major chunk of its business) should augur well for Magma. We expect higher than industry growth for the company.
- **Playing the rural theme:** Magma Fincorp has a significant experience of the rural and semi-urban areas (which contributes 77% of Magma's overall disbursements)
- **Filling the void between a bank and a money-lender:** Simple documentation, prompt loan approvals and presence in areas with minimal banking infrastructure makes Magma a preferred play compared to banks. Also with lower interest rates and transparency Magma out-scores the traditional money-lender.
- **Asset quality to be stable, though we feel the trough has been crossed:** Magma possesses strong expertise in collection & recovery practices. While the company has an excellent record of collections and low NPAs, we feel that with a focus on high yield segment, we feel asset quality might be under pressure. Moreover it fully provides for all NPAs in the books
- **Entry into General Insurance sphere:** Magma has entered in a JV with HDI Gerling of Germany, which is likely to add value by leveraging its existing client base and network.

Valuation

Improving NIMs couple with steady collections and 'Nil' NPAs makes the stock an attractive proposition to invest. At the CMP of Rs 335, it is currently trading at 6.5x PER and 1.5x PB FY2012E. We feel that the company's valuation should be re-rated, from its historic P/B multiple of 1.7x. **Hence we recommend a BUY with a price target of Rs 452, which implies a FY12E P/Adj BV of 2x.**

Financial summary

Y/E March	Adj PAT (Rs Cr)	FDEPS (Rs)	Change (YoY %)	P/E (x)	Adj. BV (Rs)	P/Adj. BV (x)	RoA (%)	Net NPA (%)
2009	39.0	15.0	-	22.3	136.2	2.5	1.3	0
2010	66.6	28.9	92.7	11.6	161.8	2.1	1.7	0
2011E	94.7	35.3	22.1	9.5	183.0	1.8	2.0	0
2012E	139.7	51.5	45.9	6.5	226.2	1.5	2.5	0

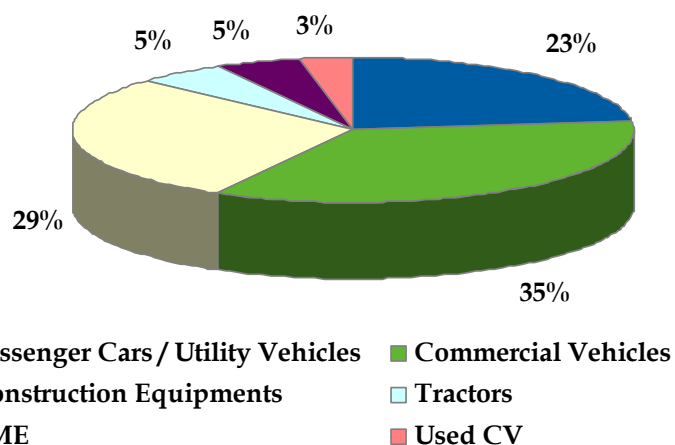
Source: Company, ENAM Direct estimates.

COMPANY OVERVIEW

Asset-backed products leading to lower risk profile

Magma Fincorp has been a relatively conservative player, financing asset-backed products. Unlike many companies, Magma does not deal in personal loans. MFL offers financing to a broad spectrum of segments viz. Commercial Vehicle (CV) Finance, Construction Equipment (CE) Finance, Car & Utility Vehicle Finance, Used Car Finance, SME loans and Tractor Finance. We are of the opinion that most of these segments are seeing a buoyant demand and Magma with its effective collections is a proxy play to these growing sectors in India.

FY10 - Product wise disbursements



Source: Company, ENAM Direct Research

Product Profile

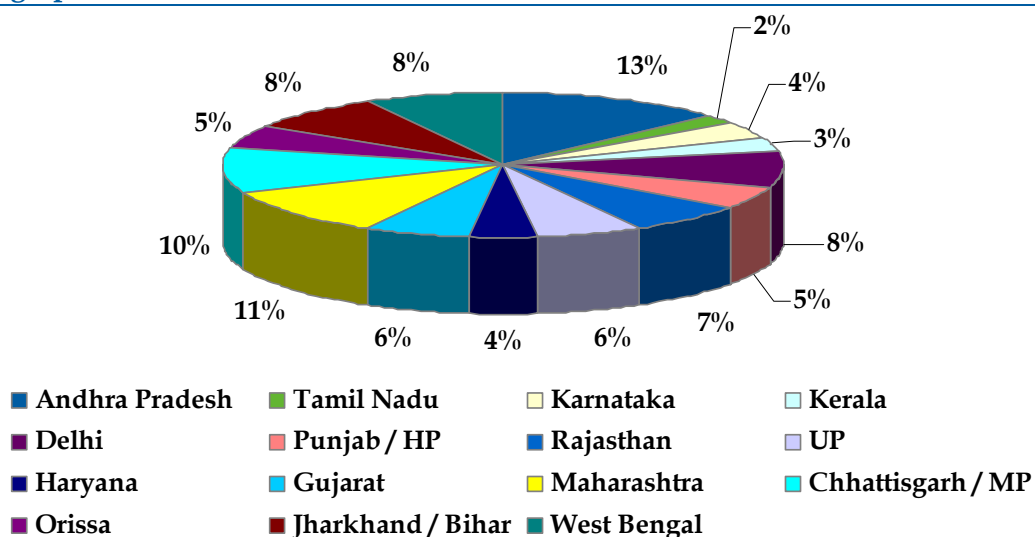
Product	Avg. Ticket Size (Rs lakhs)	Loan - Book Value %	Tenure (Months)	Net IRR %
Cars	2.8	67%	43	13.3%
CV	13	88%	43	12.9%
Construction Equipments	18.3	78%	35	13.6%
Strategic Const Equipments	116.5	86%	41	11.3%
Used CV	4	72%	33	19.7%
SME Loans	17.8	N.A	31	17.0%
Tractors	3.1	65%	49	21.5%
Total	6.8	79%	40	13.8%

Source: Company, ENAM Direct Research

Pan India presence

Magma Fincorp has a pan-India presence with a branch network of 157 branches, spread across 21 states. In order to strengthen its presence, the company plans to add 15-20 branches annually. The company's focus has pre-dominantly been on the under-banked areas with semi urban / rural branches constituting ~ 77% of the total.

Geographic Diversification - FY10

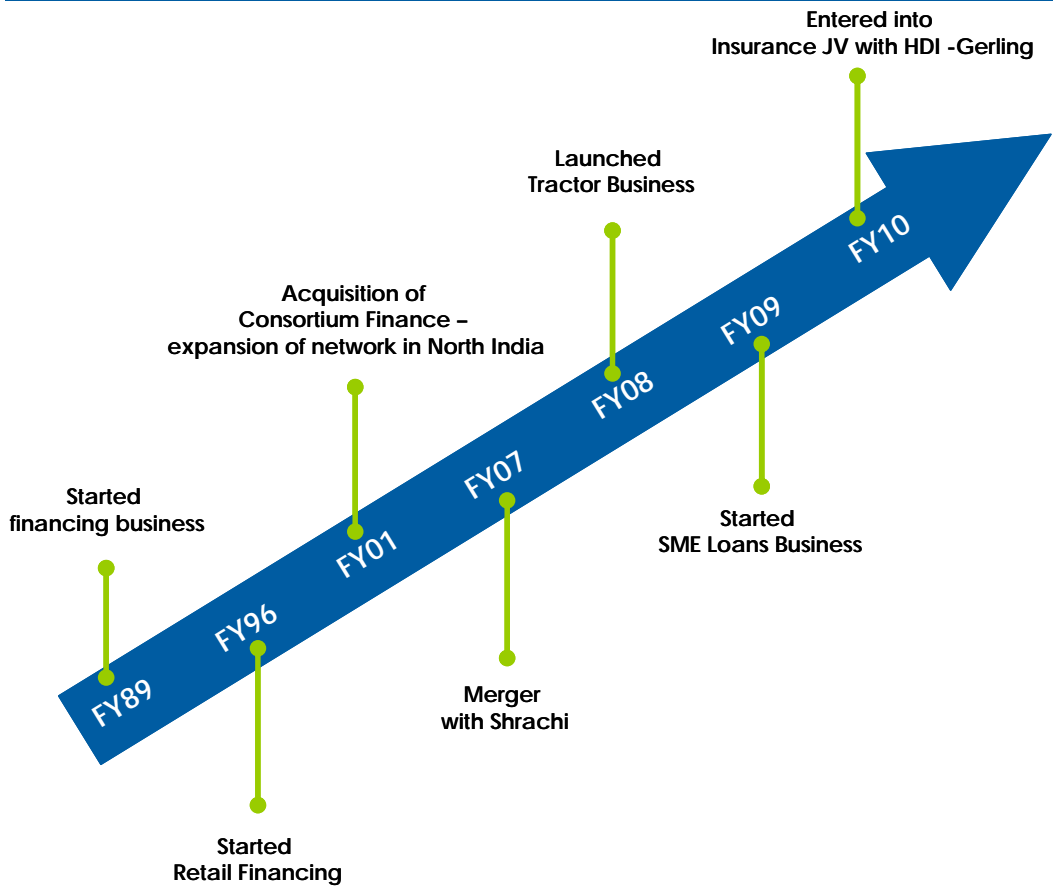


Source: Company, ENAM Direct Research

The wide array of the product suite and geographical diversification makes Magma an NBFC with the most potential to cater to the growing needs of the rising middle class in the semi-urban and rural India.

Magma has been one of the few successful NBFCs which despite having a pan-India presence has been able to curtail its non-performing assets due to its strong processes and systems.

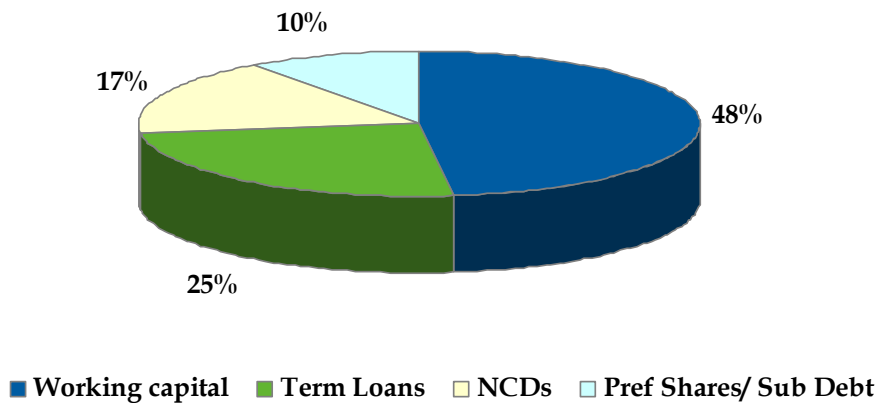
Key milestones



Source: Company, ENAM Direct Research

Sourcing of credit from banks: The company has consistently enjoyed a good credit rating enabling it to borrow funds at competitive rates. The company enjoys a limit to borrow upto Rs 2,500 cr from a consortium of 19 banks. This limit is further expected to be enhanced to Rs 3,800 cr post the equity infusion via the QIP

Borrowing Profile (FY10) - Rs 3,770 cr

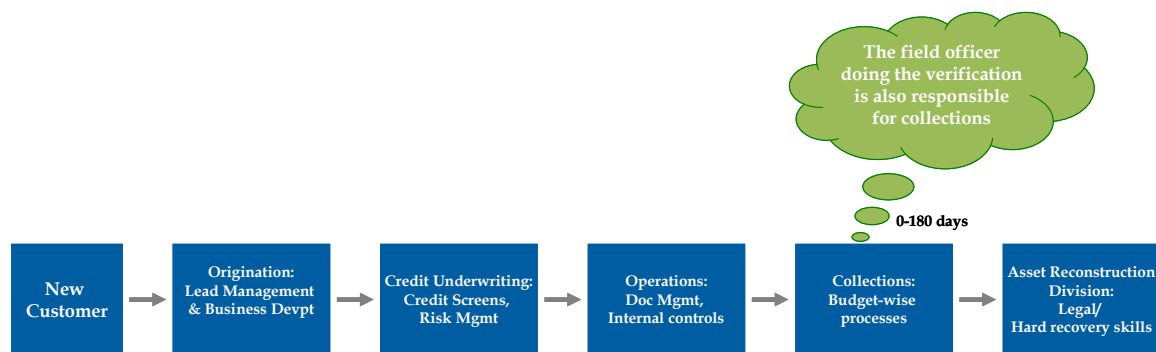


Source: Company, ENAM Direct Research

BUSINESS MODEL

The field officer who does the verification is also responsible for the 16 months of collections. With 40% of the salary being variable, the onus lies with these field officers to ensure loan disbursements as well has a healthy collection.

A typical loan process



Source: Company, ENAM Direct Research

Niche Presence in the high-growth under-penetrated financing segment

Magma focuses on under-banked rural and semi urban population. The company targets people who are unable to get access the organised banking system, due to lack of proper documentation and bank accounts. The company uses its strong network, thereby ensuring minimum competition from the established banks. With transparent processes and lower interest rates, an NBFC is better positioned than a moneylender.

The company has forayed into areas, which entail higher cash collections – a disincentive for banks. Typically 60-70% of the collections comprises of cash, making it difficult for banks to tap these segments. Most CV and tractor owners receive payments by way of cash and hence prefer paying their loan instalments in cash. Moreover they lack the requisite documentation and collateral, which restricts the banks to enter these segments. Magma has developed a credible team supported by state of the art information technology and superior processes, thereby making it one of the best-placed NBFCs in terms of collection efficiencies and reducing the delinquencies.

Hence a NBFC like Magma Fincorp fills up the void between a commercial bank and a moneylender.

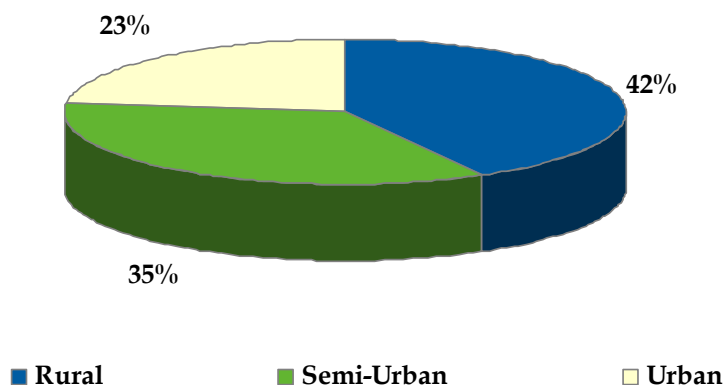
	Money-Lender	NBFC	Bank
Cost of funds	High	Medium: Reliance on Banks and MFs. However operating efficiencies to negate the marginal higher cost of borrowings	Relatively Low due to CASA deposits
Documentation	Nil/ Low	Low/ Medium: More stress on knowing the credentials of the client	High: Do not fund people without bank accounts and proper documentation
Processing Time	Low	Within days	Several weeks
Mode of Instalment	Cash	70-80% Cash	Cheque/ other channels

BUSINESS DRIVERS

The big picture for Magma remains extremely strong - Proxy on the immense potential of India's rural and semi-urban areas

In FY10, 77% of the company's disbursements were from rural and semi-urban areas. With its strong distribution network in these areas, MFL is uniquely positioned to leverage on the growing domestic economy. The company is one of the largest financiers of commercial vehicles, tractors and cars in rural and semi-urban India. The company has gone relatively slow on loan disbursals in order to protect itself from higher delinquencies and also on account of the credit contraction due to the recent financial crisis. However, with the improving macroeconomic climate, it is once again focusing on a 25-30% business growth.

Focus on Rural & Semi-Urban Areas



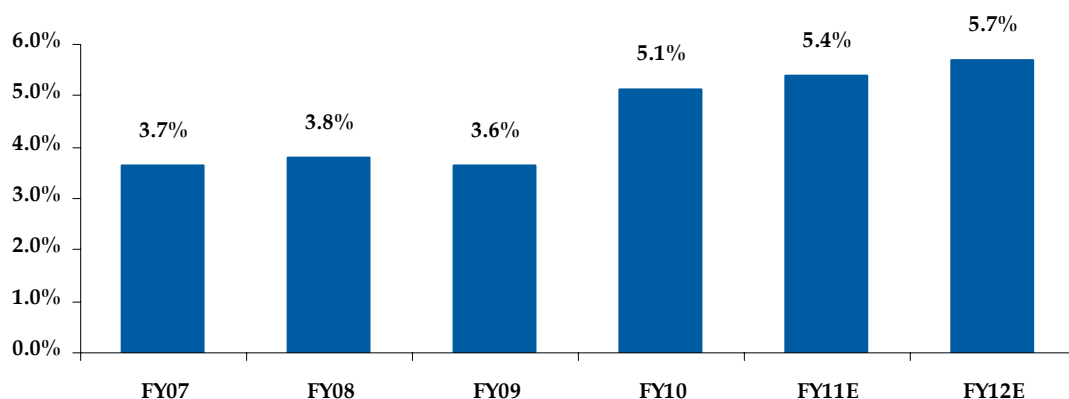
Source: Company, ENAM Direct Research

Higher Net Interest Margins (NIMs) due to changing product profile:

Historically the company has maintained superior NIMs. Going forward, we believe the NIMs would improve because of the shift towards high yielding assets (used CVs, SME loans and tractors). Yields on these segments would be significantly higher as traditional lending institutions like banks shy away due to non availability of the requisite documents like bank accounts as also because of the higher proportion of risk associated with it. We have factored a 60 bps improvement in NIMs over FY10-FY12E.

As of June 2010 high yielding segments contribute ~ 16% of the total disbursements. A combination of new branches and high yielding products being introduced in the existing branches, we believe the ratio of high yield products would improve to 20% by FY11E and further to 25% by FY12E. However considering the conservative management we do not expect the proportion of these high yield assets to increase over 25-30% of the overall disbursements.

NIM Growth



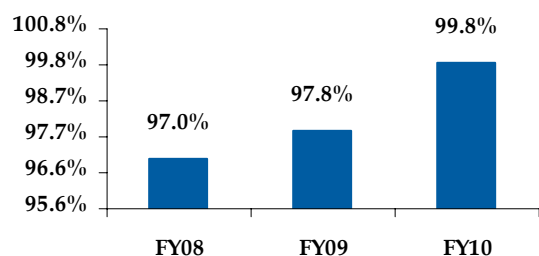
Source: Company, ENAM Direct Research

Robust risk management systems in place leading to efficient collections & lower write-offs

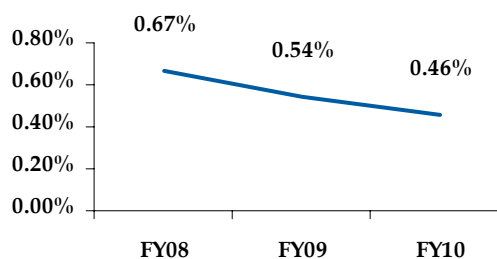
Healthy asset quality remains the key to Magma's balance sheet. Over the years the company has displayed its ability to maintain strong collections. This is despite a large proportion of collections made in cash and from first time users. The company has put in systems in place and has built a team, which ensures higher collections. Of the 4,600 workforce the company has 64% as 'feet on street' employees.

The field officer who does the verification is also responsible for the 16 months of collections. With 40% of the salary being variable, the onus lies with these field officers to ensure loan disbursements as well as a healthy collection. Over the years the company has had a very good collection ratio and has been in a position to curtail its non-performing assets.

High collection efficiency



...leading to lower write-offs



Source: Company, ENAM Direct Research

Large untapped business opportunities

Passenger cars, Commercial vehicles and construction equipments account for nearly 87% of the FY10 disbursements. The market size for these 3 asset financing products is close to Rs 80,000 cr, which is expected to grow at ~15%.

Securitization helps in maintaining a lean balance sheet

70-75% of the Magma's loan portfolio falls under the priority sector lending. There is a huge demand from banks by way of securitization. Magma securitizes 30-40% of its portfolio, thereby striking a balance between risk mitigation and higher profitability.

'Preferred Financing Partner' provides Magma with a ready client base

Magma has been granted the 'Preferred Financing Partner' for most of the manufacturers. Magma has entered into tie ups with several manufacturers to finance their vehicles/products. This provides Magma with an access to a large captive customer base.

Strong relations with vendors



Source: Company, ENAM Direct Research

VALUATIONS AND VIEW

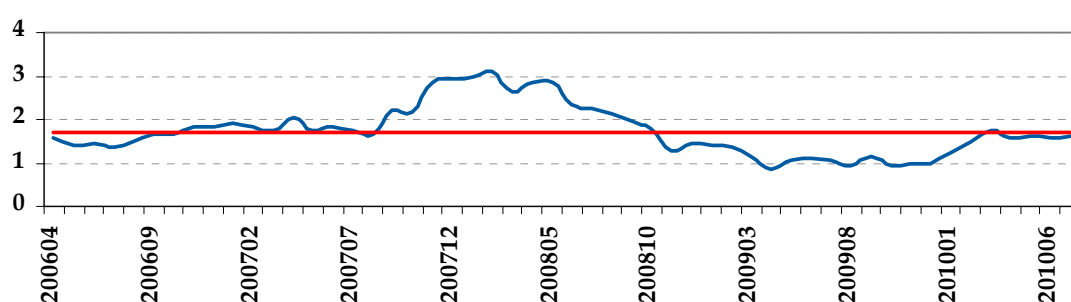
Relative valuations

Company	Price	EPS (Rs)		P/E		BV (Rs)		P/BV (x)		ROA(%)	
	(Rs)	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E
Shriram Trans. Fin	600	48.9	60.7	12.3	9.9	208	258	2.9	2.3	3.8	4
M & M Fin.	500	40.7	47.7	12.3	10.5	206	238	2.4	2.1	4.1	4.1
Magma FinCorp	335	35.3	51.5	9.5	6.5	183	226	1.8	1.5	1.9	2.5
Manappuram Gen	76	6.1	9.1	12.5	8.4	24	33	3.2	2.3	5.2	5.5
Shriram City Union	500	46.5	57.8	10.8	8.7	237	296	2.1	1.7	3.5	3.6

- Improving business scenario:** We maintain our positive stance on Magma Fincorp on the back of the improving macro scenario in rural India that drives growth and collection efficiency for the company coupled with a comfortable interest rate environment for NBFCs. The company has a significant presence in interior India and over the long term would be a key beneficiary of rising rural demand.

Over the past 5 years, Magma has recorded zero NPAs in its books due to collection and recovery practices and prudent accounting norms; wherein all dues outstanding for more than 180 days are fully provided for. The company has registered strong business growth in the past, with disbursements growing at a CAGR of 22% over FY07-10. We have projected a modest increase in disbursements which is expected to grow at a CAGR of ~23% over FY10-12E.

Magma Fincorp - 12mth fwd P/BV (x)



Source: Company, ENAM Direct Research

- Valuations remain inexpensive:** Improving NIMs couple with steady collections and nil NPAs makes the stock an attractive proposition to invest. It is currently trading at 6.5x PER and 1.5x PB FY2012E. With a shift towards high yielding assets, we expect NIMs to improve to 5.7%. Moreover the company has proven its resilience even during the downturn by displaying higher profitability and maintaining its asset quality. We feel that the company's valuation should be re-rated given the scalable business model coupled with stable earnings growth and hence arrive at a price target of Rs 452, implying a FY12E P/Adj BV of 2x.

COMPANY FINANCIALS

Income statement (Rs cr)

	FY09	FY10	FY11E	FY12E
Income Operations	615.2	689.5	858.2	1,054.0
-Income Receivables	569.3	636.5	802.6	987.3
-Other Interest Income	45.9	53.0	55.6	66.8
Interest Expenses	285.4	316.2	371.5	458.8
Net Interest Income	329.8	373.3	486.8	595.3
Non-Interest Income	10.3	13.5	14.2	15.6
Net Operating Income	340.1	386.8	500.9	610.8
Operating Expenses	238.2	243.6	297.2	328.4
Employee Exp	99.9	105.3	131.7	144.8
Other Op Exp	138.3	138.2	165.5	183.5
Operating Profit	101.9	143.2	203.7	282.5
Provision & Write Off	41.8	40.0	61.3	73.9
Profit Before Tax	60.1	103.2	142.5	208.6
Tax	21.1	36.6	47.7	68.8
Profit after Tax	39.0	66.5	94.7	139.7

Balance sheet (Rs cr)

	FY09	FY10	FY11E	FY12E
Net Worth	296.5	348.5	532.8	658.8
Equity Capital	21.8	21.8	28.8	28.8
Reserves & Surplus	274.7	326.7	504.0	630.0
Loan Funds	2506.6	3567.1	4377.8	5280.4
Secured	1985.4	2864.0	3584.2	4315.5
Unsecured	521.2	703.1	793.6	964.9
Current Liab & Prov	377.6	478.9	554.4	631.7
Total Liabilities	3352.5	4558.5	5586.3	6692.2
Net Block	238.2	208.0	239.2	275.0
Investments	29.0	30.2	22.9	29.8
Receivables	2045.9	3181.6	4126.7	5364.7
Debtors	6.6	7.4	8.5	10.7
Cash & Bank	902.5	968.5	1001.6	786.1
Other current assets, Loans & Advances	130.3	162.6	187.4	225.9
Total Assets	3352.5	4558.5	5586.3	6692.2

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1. Analyst ownership of the stock	No
2. Firm ownership of the stock	No
3. Directors ownership of the stock	Yes
4. MBD Relationship	No
5. Broking relationship	No

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