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Manappuram Finance

NSE Code: MANAPPURAM, BSE Code: 531213, ISIN Code: INE522D01027

2018-09-30

Current price: 72.4 / Target price: 154 / Target date: June 2021

Expected forward return: 32% CAGR

by

Rajeev Agrawal, CFA

(SEBI Registered Investment Adviser)

Executive Summary

Manappuram is India's second largest gold loan company. They have been lending for more than two decades and have earned the trust of their borrowers.

Gold loan business is a highly lucrative business as demonstrated by the following:

- Major gold loan companies enjoy high margins – NIM (Net Interest Margin) of 10%+
- Major gold loan companies enjoy high returns on capital as well as high return on overall assets – they have an average ROA (Return on Assets) of 3%+ and ROE (Return on Equity) of 15%+.

Headwinds

The two big Gold loan companies grew very well till FY 2012. A series of regulatory changes in CY 2012, distress in rural economy and drop in gold prices impacted their growth between FY 2012 and FY 2015. As they were recovering from the setbacks, demonetization in CY 2016 created another setback.

The road ahead

Indian government is focusing on doubling the rural income by 2022. The expected increase in buying power is expected to drive growth in gold loan market for the foreseeable future.

It is estimated that organized (tax paying) gold loan segment is only 30-40% of the total gold loan business. Remaining segment is dominated by local moneylenders and pawnbrokers who charge much higher interest rates. With digitization, better information availability and broader coverage we expect that organized players will continue to take away market share from the unorganized players.

New growth engines

In FY 15 Manappuram started its journey of identifying additional businesses which can enable it to better leverage and expand its customer segment. Company has focused on the following additional businesses:

- Housing finance with customer in mid-to-low income group
- Vehicle financing
- Micro finance using collateral free, joint liability model

These new businesses have scaled up well and now (FY 18) contribute as much as 26% of its total AUM.

It is expected that these businesses will continue to grow at a fast pace thus enabling Manappuram to grow its overall AUM and profitability at CAGR of 15% over the foreseeable future.

Management

Manappuram is headed by V P Nandakumar – MD & CEO of the company. Mr. Nandakumar started the company in 1992 and the company was listed on stock exchange in 1995. Over the last 23 years (since company has been listed), it has delivered a CAGR of 27% to its investor v/s 11% provided by Sensex.

V P Nandakumar owns 35.14% (after recent buying) of the company. Over the last few weeks he has buying shares in his own account at an aggressive pace from the stock market.

Valuation

Manappuram trades at 7-8x expected FY 19 earnings and 1.53x book value (Q1 FY 19). This is for a business which has good return on capital (ROE of 17.5% and ROA of 3.9% in FY 18) and is expected to grow at CAGR of 15% over the foreseeable future.

Management seems to agree that it is cheap. In the last 6 months, CEO and his relatives have bought 4.3 Million shares at different times from the market at around 88.7 Rs/share. In the last 6 months, a major financial institution – Quinag Acquisition has bought 27.3 Million shares at 105.3/share and increased its stake from 6.61% to 9.94%.

Basic Facts

Industry	NBFC (Non-Banking Financial Corporation)
Price (27th Sept 2018)	**72.4 Rs/share**
Market Cap (INR/$ = 72)	**$847 MM/INR 60,997 MM**
Valuation	**Price/Book: 1.53x** **Price/Earnings (ttm): 8.52x**
Capital Adequacy Ratio (CAR)	**Basel III: 25.5%**
Quality of Assets (Standalone)	**Gross NPA: 0.7%** **Net NPA: 0.3%**
Ownership	**Promoter Holding: 5.14%** **Foreign Portfolio Investor (FPI): 37.83%**
Management – CEO/Promoter	**V P Nandakumar** (Promoted the company in 1992)
Liquidity (Listed on NSE & BSE)	**~$4 MM/day**

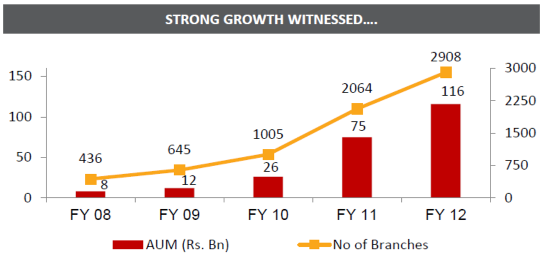
Company Background

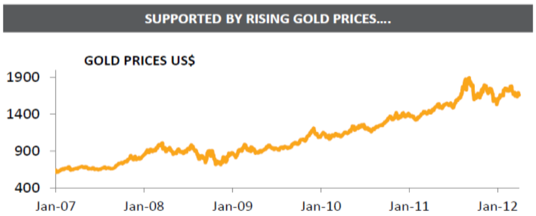
Manappuram's origins go back to 1949 when it was founded by the late V.C. Padmanabhan, father of Mr. Nandakumar. In those days its activity was money lending carried out on a modest scale at Valapad. Mr. Nandakumar took over the reins of this one branch business in 1986 after his father expired.

Subsequently, V P Nandakumar promoted Manappuram in 1992. Today it is a publicly-listed entity headquartered in Thrissur, Kerala, India. It now has a Pan India presence with branches across 28 states and 4 Union Territories of India.

The best way to understand Manappuram evolution is to break down its recent history into multiple phases.

Phase 1: FY 2008 – 2012





Source - Bloomberg

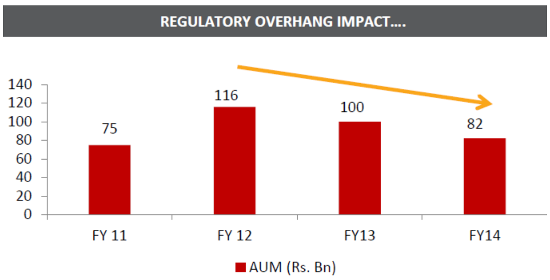
High growth rates were driven by:

- Higher Loan To Value (LTV) up to 85%
- Lower Cost of Funds due to eligibility under Priority Sector lending
- Supported by buoyant economic growth
- Long tenure products supported by rising Gold prices
- Strong Competitive Positioning – Better LTV, Lower interest rate compared to Moneylenders, Prompt Disbursement, Convenience of Place/time

Company's financial and operational metrics were completely transformed with:

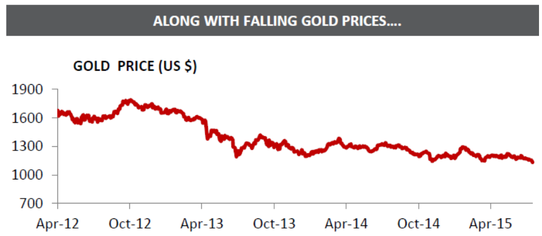
- AUM CAGR of ~95% over FY08 - FY12.
- Branch Network grew by 7x over FY08 - FY12.

Phase 2: FY 2012 – 2015



Regulatory Changes by RBI

- Mar 2012: Removal of Priority Sector lending Status – led to higher Borrowing Cost.
- Mar 2012: Cap on LTV to not exceed more than 60%
    - Weakened the competitive positioning vis-à-vis banks and moneylenders.



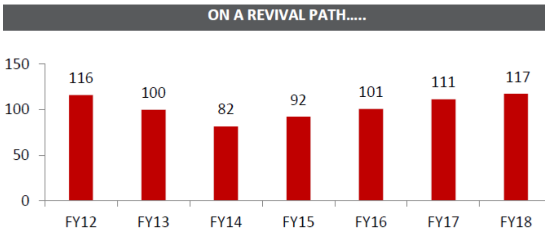
Source - Bloomberg

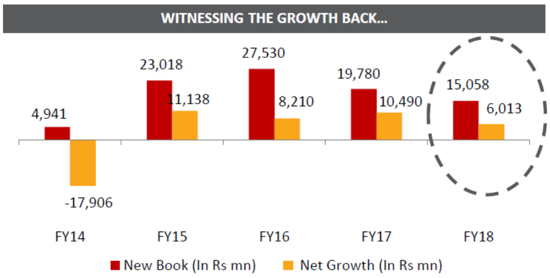
- Higher LTV focused customers moved to moneylenders whereas interest rate sensitive customers moved to banks.
- Cap on Maximum Borrowing up to Rs. 2.5 Mn.

Company's financial and operational metrics were hurt with:

- Fall in Gold prices and peak LTV of 85% limiting ability to lend to borrowers.
- Negative operating leverage resulted in fall in return ratios and profitability.

Phase 3: FY 2015 onwards





Note - * Net Growth = New Book - Auction

Sept – 2013: Regulatory Changes by RBI

- Increased the loan-to-value (LTV) ratio for gold loans to 75% providing level playing field for NBFCs and banks.

June – 2014: De-Linked loans from Gold Prices

- Shifted from long tenure products to short tenure products (3 to 9 Months)
- Recalibrated loan to value (LTV) ratio to link it to the tenure of the loan. Maximum permissible LTV of 75% to be available on loans of shorter tenure rather than one year.

Company's financial and operational metrics are improving with:

- Risk of loss from gold price fluctuation brought down to close to nil
- Operational efficiency and digitization helping with the margins
- AUM growth picking up as company enters into adjacent businesses (not shown in the above graphs) and they start providing meaningful contribution to the total AUM.

Business Segments

Company started entering new businesses in FY 15-16 to enhance its offering to the existing customer segment and grow into new segments. This effort has enabled company to grow its AUM by 17% over the last two years even though the core business (Gold loan) growth has been muted at 8%.

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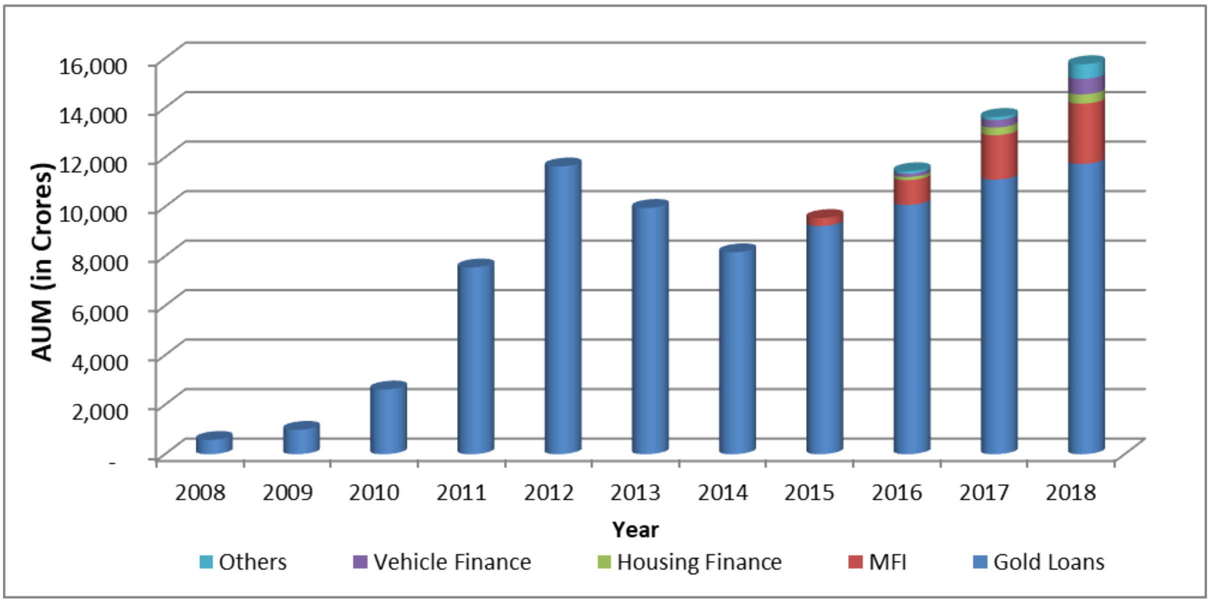
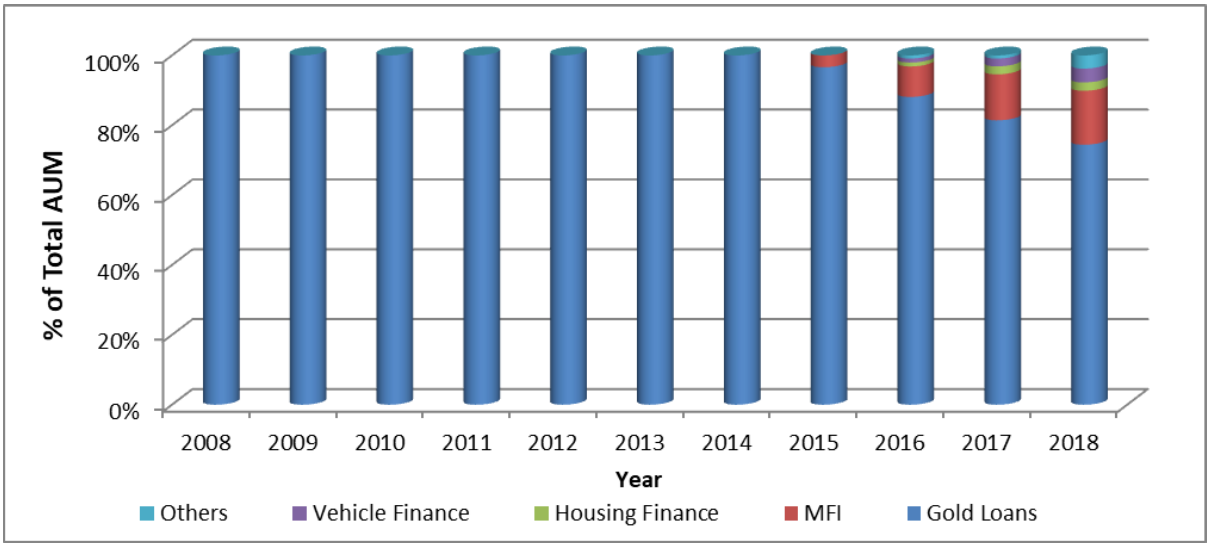
Faster growth in alternative businesses has allowed company to reduce dependence on Gold loan business to 74% of the total AUM in FY 18. Company expects that new businesses will continue to grow at a fast pace over the next many years. This coupled with faster growth in Gold loan business should enable company to deliver 15%+ CAGR in total AUM over the foreseeable future.

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	CAGR (Inception)	CAGR (from 2016)
Gold Loans	578	987	2,618	7,549	11,631	9,956	8,163	9,225	10,081	11,100	11,735	35%	8%
MFI								322	999	1,796	2,437	66%	56%
Housing Finance									129	310	375	70%	70%
Vehicle Finance									130	306	625	119%	119%
Others									101	120	593	142%	142%
Total	578	987	2,618	7,549	11,631	9,956	8,163	9,547	11,440	13,632	15,765	39%	17%





Let us now look at each of these segments to better understand company's operations.

Gold Loan

Gold loan is the mainstay of the company. Company has been able to scale itself of the back of robust offering in this segment.

As one of the oldest forms of secured lending, gold pawning has been prevalent in India for centuries. Given the liquidity it offers, gold helps both the borrower and lender to complete transactions faster than all other forms of financing.

Gold lending business has some unique characteristics:

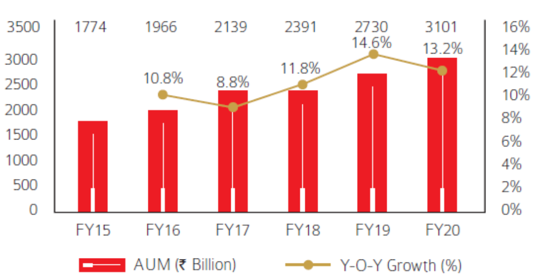
- Unlike traditional lending, in gold loan business it is the borrower who needs to trust the lender. Thus brand (and trust) plays a big part in where the borrowers go for loan.
- Most of the borrowers who use gold loan can't borrow through formal channels because they don't have regular income, proof of income and credit history.
- It is a highly secure business. Company has estimated that in case a customer defaults, LGD (Loss Given Default) is only 0.63%.
- Gold loans have a quick turnaround time. A borrower gets a loan within 10 mins of the time they walk in one of their branches.

There are two main categories of gold loan lenders in India:

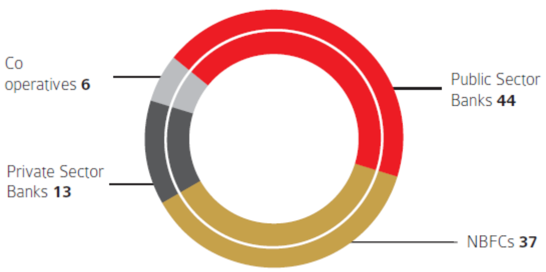
- Formal (Organized) sector (banks, NBFCs, cooperatives) – regulated by RBI.
- Informal sector (pawnbrokers, local moneylenders) – unregulated.

As per WGC (World Gold Council) estimates informal sector accounts for 60-70% of the total gold loan market in India. We expect that informal sector will continue to lose market share to the formal sector due to lower interest rates with better transparency and clear processes.

Organised gold loan market projection



Share of organised gold loan market (%)



KPMG did a study of gold loan market in December 2017. They expect that organized gold loan market will have a three year CAGR of 13.17% and will grow to INR 3,101 Bn by 2020.

Within the formal (organized) sector, banks provide gold loans at lowest rates. However, banks are not able to compete with NBFC in terms of TAT (Turnaround Time).

In addition, many of the borrowers are borrowing small amount which is operationally expensive for banks. For NBFC this is their core business and they have structured themselves accordingly.

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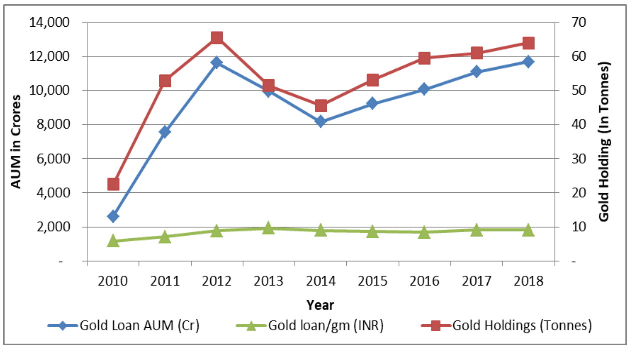
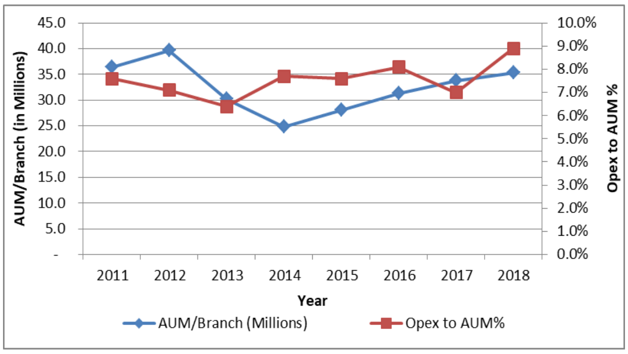
Manappuram's Gold loan business

Gold loan is at the core of Manappuram's operations. Manappuram identified this niche and has been able to ride it to scale up its operations



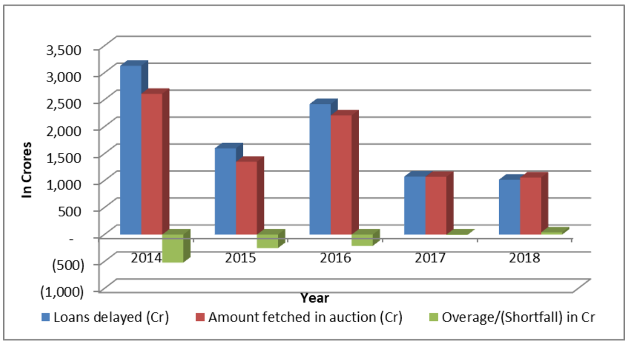
Company Gold loan AUM closely tracks the Gold jewelry deposited by its customer (tracked through Gold holdings in Tons).

The amount of loan that they are extending per gram of Gold has remained at a similar level over the last many years demonstrating a conservative approach.



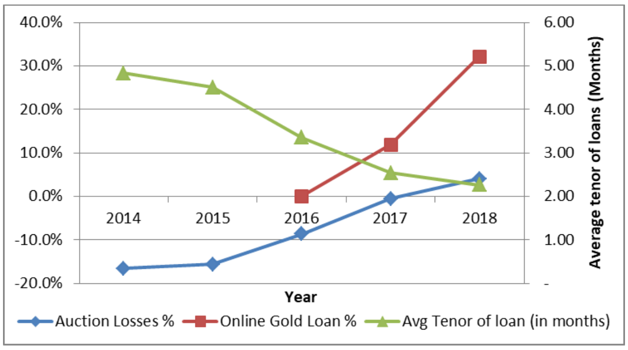
Company has struggled to grow its AUM/Branch. It fell dramatically after regulatory restrictions in FY 14 and has since come back.

Company's Opex to AUM has been stable. It went up in 2018 due to need for higher security in its branches. Company expects to mitigate this cost by leveraging technology.



Company had to forego interest and principal for loans that were not repaid in 2014. This is reflected by the shortfall.

However, since then company has moved to shorter tenor loans (up to 90 days). This has enabled company to recover the amount due to them in auctions.



In 2014 average tenor of loans was close to 5 months. This impacted them as gold price fluctuated and LTV (Loan to value) was also high (85%).

Company has now moved to 3 month loans with maximum LTV of 75%.

These initiatives are enabling company to recover outstanding amount due to them.

To improve operational efficiency company is moving to Online Gold loan – in these loans, customer deposits their jewelry with the company. Whenever, they need money they can borrow up to a maximum pre-determined amount based on the jewelry that is kept with the company.

Below metrics clearly demonstrate that Gold loan has been a great business for Manappuram with high returns on capital, low NPA and high capital adequacy (RBI requires minimum capital adequacy of 15%). One obvious concern is that Gold loan AUM growth has been weak.

	2013	2014	2015	2016	2017	2018
Gold loan AUM (Cr)	9,956	8,163	9,224	10,081	11,100	11,700
Net Yield %	20.5%	22.7%	22.3%	23.0%	24.8%	24.0%
Net Interest Spread %	10.4%	11.3%	12.2%	13.7%	16.6%	15.3%
PAT	208.4	226	270.7	337.2	726	700.2
ROE %	7.9%	9.2%	10.6%	12.6%	21.9%	19.7%
ROA %	1.6%	1.9%	2.4%	2.9%	5.8%	5.3%
GNPA %	1.1%	1.2%	1.2%	1.0%	2.0%	0.5%
NNPA %	0.8%	1.0%	1.0%	0.7%	1.7%	0.3%
Capital Adequacy %	22.5%	27.7%	25.6%	24.0%	26.1%	27.0%

Company has initiated various new initiatives to grow the Gold loan business including:

- Providing loans directly to customer bank accounts.
- Mobile apps to enable withdrawal/payment of loans.
- Providing gold loans at customer doorstep

Apart from these, Online Gold loan, cross-selling across various businesses and improvement in rural economy is likely to drive the growth in Gold loan business. We expect that company can grow Gold loan business at around 8-10% CAGR over the next many years (though company has promised higher growth rate).

Gold loan continues to be the crown jewel of Manappuram and is the cash cow which is enabling management to seed and grow new businesses.

Microfinance (MFI) – Asirvad

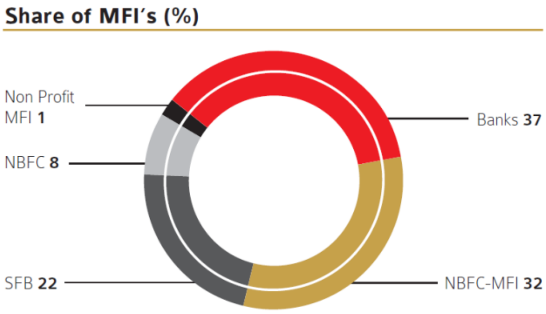
Company entered the MFI business by acquiring Asirvad Microfinance in Feb 2015 with an AUM of 322 Crs. As an established gold loan NBFC, company had long dealt with the segment just above the bottom of the pyramid, i.e. those who possess some amount of gold. With this acquisition they have entered an adjacent segment.

MFI caters to those at the bottom of the social pyramid by providing loans through collateral-free, joint liability group (JLG) model. Thus, unlike gold loans these are unsecured loans and hence have significantly higher risk.

In MFI segment, company gives loan with a tenor of up to 24 months for the following purposes:

- Income generating program (IGP) loan
- Product loan
- Small and Medium enterprise (SME) loan

MFI industry in India is expected to be 6 Lakh Crore of which organized lenders account for 28%.



As of Dec 2017, among organized lenders, Banks hold largest share of portfolio in micro-credit with total loan outstanding of INR 45,649 crore.

NBFC-MFIs has loan outstanding of INR 39,916 crore. SFBs have a total loan amount outstanding of INR 7,506 crore.

Asirvad continues to be run by its founding Managing Director, SV Raja Vaidyanathan. As a subsidiary of Manappuram, Asirvad has benefited by accessing lower cost funds and adequate amount of capital. This has enabled MFI business to grow at a fast pace. It is now the 6th largest NBFC MFI in India.

	2015	2016	2017	2018	CAGR
AUM (Cr)	340	999	1,796	2,437	93%
Branches	130	346	763	832	86%
MFI Customers (Lakhs)	2.8	6.2	11.97	15	75%
Average Yields %	25.3%	23.5%	23.0%	22.0%	
PAT (Cr)	10	24	34	(32)	
ROA %	3.6%	3.9%	2.5%	-1.4%	
ROE %	22.8%	20.0%	13.9%	-11.7%	
Capital Adequacy %	34.8%	24.8%	20.6%	15.2%	
Gross NPA%	0.0%	0.1%	4.5%	2.3%	
Net NPA %	0.0%	0.1%	1.4%	0.2%	

In reviewing the key statistics we can conclude that:

- Asirvad has been able to grow it AUM by expanding its branches in additional states in India and reaching out to more customers in existing geographies.
- Average yields have come down as it has been able to leverage Manappuram's parentage to borrow at a lower rate. Under MFI regulation, company can have a maximum interest spread of 10%. Since cost of borrowing has come down, average yields have come down as well.
- Asirvad made losses in FY 18 as the full financial impact of demonetization was reflected on the books. Company has taken higher provisions than mandated by RBI. While this action penalized their earnings in FY 18, it has helped them clean their books and now (Q1 FY 19), Net NPA has come down to 0%.

MFI is a fast growing industry with a long runway given the weak penetration of organized players. Besides, as new opportunities emerge many borrowers are keen to take loan and build out new businesses. Thus, company expects to continue to grow at a fast pace for the foreseeable future. Management is expecting that AUM of Asirvad will reach 3,500Cr by end of FY 19.

Additional businesses

Besides MFI, company initiated a few additional businesses in FY 15.

Vehicle Finance

Company had ventured into vehicle finance in 2000's. However, given fast growth of their gold loan finance, they decided to focus on gold financing. As Gold loan growth came down, company once again started focusing on vehicle finance in FY 2015. In vehicle finance company is focusing on the following:

- Loans for new/preowned commercial vehicles and refinancing
- Financing customers which are largely from the unorganized sector and which are underserved by formal banking channels
- Minimum loans starting from INR 1 lakh
- 60-month maximum tenure
- Company is leveraging its existing gold loan branches to expand this business and hence will have to incur little expenditure in growing this business.

	2015	2016	2017	2018	CAGR
AUM (Cr)	16	130	306	625	239%
Branches	15	36	50	76	72%
Average loan size (Lakhs)	6.2	6.1	7	8.7	
Average Yields %	19%	18.90%	18.7%	18.2%	
GNPA%	0.0%	0.0%	1.5%	2.7%	

- Company has been able to grow its AUM very aggressively over the last few years. This is due to combination of new branches, serving more customers from existing branches, funding more expensive vehicles and expanding the types of vehicles on which company is providing loans.
- In FY 17, company commenced the financing of two-wheelers. Two-wheeler loan book has now scaled to INR 64.6 crore in FY18. Company will continue to grow the two-wheeler financing business by leveraging its existing customers in other adjacent businesses.
- As the loan book has scaled, GNPA has also grown. Company is taking active steps to ensure that seasoning of the loan book doesn't cause significant deterioration in the asset quality of the book.

Housing Finance

Company provides home loans through its subsidiary – Manappuram Home Finance (MHF). MHF started its operation in January 2015. It focuses on affordable housing loans for mid-income to low-income groups mainly in tier-II, tier-III and outskirts of metropolitan cities. Company's primary focus is on South and West India.

The aggregate AUM of all AHFCs (Affordable Housing Finance Companies) is estimated to be INR 120,000 crore. Within this segment, large HFCs dominate the market, catering to borrowers in the formal sector who can produce documented proofs of income. Excluding the top three, who collectively account for more than 90% of the market share, all other AHFCs manage less than INR 500 crore of assets, individually.

The growth rate of housing finance industry over the last 7 years shows a CAGR of 18%. Affordable housing finance, albeit a recent entrant, promises to grow at a much higher rate.

	2015	2016	2017	2018	CAGR
AUM (Cr)	29	129	310	375	135%
Branches	4	24	35	35	106%
Revenue (Cr)	1	10	37	54	290%
PAT (Cr)	(1)	(5)	(1)	(1)	
Average loan size (Lakhs)	14	15	11	9	
Average Yields %	14.0%	14.2%	14.3%	14.9%	
GNPA%	0%	0%	1.5%	4.8%	
CAR	2318%	112.9%	46.6%	40.1%	

- Company has grown its AUM quite aggressively since its start. This has also translated into high revenue growth.
- In the initial years company is focusing on expanding its branch footprint which is leading to higher cost and hence company has been making minor losses.
- Company has been earning reasonable yields given that they focus on undocumented low to middle income customers.
- Management mentioned that they slowed the growth in FY 18 to improve their processes and address the GNPA issue. Management expects GNPA to come down to 2% by end of FY 19.

Other businesses

Company is also exploring a few new opportunities in the lending space. These include:

Corporate finance

Company is exploring lending to vendors and dealers of large, good-quality corporates. These segments are underbanked and have significant, unmet credit requirements. Many of the big lenders like PSU banks are not able to service these small companies. This is because PSU banks don't have agile processes (they assess these companies only once a year) and they are dealing with significant NPA issues.

Company will tie-up with large corporates and provide post shipment and inventory finance products to their vendors. Company will capture the cash flows provided by these large corporates to their vendors and dealers through the escrow account. Given the comfort from the anchor corporate and other credit comforts like collaterals where ever required, these vendors and dealers would be extended finance facility by the company thus reducing risk to the company.

Micro, Small and Medium Enterprises (MSME)

Introduce tailor-made products to meet working capital demands of MSME. Average loan size for this funding will be INR 30 – 50 lakhs

Project and Industrial finance

Company is looking to extend construction finance to ongoing projects in the affordable housing segment. Target clients will be local and mid-size developers. Exposure will be restricted to Real Estate Regulatory Authority (RERA) registered projects, which have started construction and launched sales.

Average ticket size of loans in this segment will be INR 5 – 10 crore. This offering will be launched in Maharashtra initially.

Overall

We believe that company's businesses can be broken into:

- **Mature business**: Gold loan business with low risk, high return on capital and slow growth.
- **New businesses**: Microfinance, Housing and Vehicle financing businesses. These businesses have high growth and as operating leverage kicks in, earnings growth will accelerate.
- **Seed stage business**: These are the business which are being conceptualized and tried out in the market. Based on company's experience in the next few years they can provide the next leg of growth.

Having looked at these businesses in depth, we feel quite confident that company will deliver earnings CAGR of 15%+ over the next many years.

Management

Management is a critical factor in the success of any investment. In an industry like finance, where leverage magnifies management actions, choosing the right management becomes critical.

V P Nandakumar (CEO & MD of Manappuram)

V P Nandakumar (VPN) is the CEO & MD of Manappuram. He promoted Manappuram in 1992. Prior to promoting Manappuram, VPN managed the money lending business that his father started in Valapad.

Manappuram was listed on stock exchange in 1995. Since then company has provide a CAGR of 27% to its investors in IPO. Thus VPN has created enormous wealth for himself and his investors.

VPN currently owns 34.8% of the company. His significant ownership in Manappuram ensures that his incentives are consistent with those of his investors. More importantly, VPN has regularly bought shares from the market (and has not sold any share). Over the last 6 months, VPN has bought 29 Lakh shares from the market at an average cost of 93.7/share.

S V Raja Vaidyanathan (MD of Asirvad – MFI)

Raja Vaidyanathan (RV) is an electrical engineer from IIT Chennai and MBA from IIM Calcutta. RV has 30 years of experience in financial services. RV setup Asirvad in 2007. It was subsequently acquired by Manappuram in 2015.

RV is the driving force behind Asirvad – 6th largest MFI in the country. RV has aspiration to make Asirvad among the top three MFI in the next few years.

Overall

Management has been shareholder friendly, pay regular dividend, don't reward themselves with options buy rather buy from markets, and, are well grounded. They are passionate about their business and have enough skin in the game.

Valuation

We will value Manappuram using our forward return analysis framework. In this method we will project earnings for a few years out and then apply reasonable multiples to come up with expected forward return.

PAT projection

- Company had consolidated PAT of Rs 671 Cr in FY 18. PAT was subdued in FY 2018 since company had taken higher provisions for bad debts in MFI to address issues due to demonetization. There was also reduction in economic activity due to introduction of GST.
- We expect that company should grow PAT by 15% CAGR over the next few years (management has guided for faster growth). This will be driven by:
    - Lower cost of provisions as Net NPA after Q1 FY 19 in MFI is 0%. Provisions in Gold loans are low because of low LGD.
    - New businesses are growing at a much faster pace and they are becoming a meaningful amount of the total business (26% of FY 18 AUM).
    - Pick-up in rural activity will drive growth in AUM.
- Company won't need to dilute equity to support this fast growth. Company has very high capital adequacy of 27% in FY 18 and 25.5% in Q1 FY 19. This coupled with the fact that company generates ROE of 17% will allow it to continue growing at 15% without any need for outside capital.
- Assuming PAT grows at 15% CAGR, we expect PAT in FY 21 to be 1,020Cr. Applying a multiple of 13x, we expect company to be worth **13,260Cr** by June 2021.
- In our mind 13x multiple is very reasonable for the following reasons:
    - Company is expected to have reasonable earnings CAGR of 15%.
    - Company has good ROE of 17%.
    - Company is owner operated and management is very passionate about the business.
    - Company has a long runway ahead of it given the huge need for finance and the trend of business moving from unorganized to organized sector.

Expected Return

- Company's current market cap is 6,100Cr.
- Company's outstanding ESOP is 1.25% of the current share count. To be conservative we assume that there will be a share dilution of 2% till June 2021 due to exercise of ESOP.
- Thus market cap of 6,222Cr (assuming 2% dilution) will grow to 13,260Cr which gives us an expected forward return of **32%** CAGR.

Risks with the thesis

Apart from competition, which is always present in any industry, some of the key risks with the thesis include:

Lending business

Manappuram is in the business of lending money. Most of the surprises in lending are negative. New regulations from the regulators, black swan event like demonetization and loan waiver by government are some of the event risk with the thesis.

Manappuram's lending business relies heavily on collateral. Other than MFI, we expect that the above events may slow down the growth but are unlikely to reduce profitability. So to that extent we think the business model is quite resilient.

Unsecured lending – MFI

MFI caters to the low income group. Loans are given without any collateral. Thus there is a risk that these borrowers are not able to service their loans and lenders will not have any recourse to get their money back.

MFI lending practices have evolved over the last decade to significantly reduce the risk of defaults in this segment. All lending is done through JLG which means that multiple people are responsible for the loan. In addition, no borrower can take more than two loans. Lastly, credit data is now available for the borrower. Hence if a borrower defaults they are cut out from the formal lending channels (with lower interest rates) for a long time. Thus borrower has strong incentive to service the loan.

Key man risk

Manappuram has been promoted by VP Nandakumar. He is the face of the company and the force behind the business. While next layer of management has their niches, there is no obvious successor if something were to happen to him.

Manappuram has incorporated many new businesses in the last few years. This has brought in key talent into the organization. We expect that some of these new hands will mature and can help address the succession issue.

Overall

Manappuram offers a compelling case of:

- Heads we win with expected CAGR of 32% over the next three years.

- Tails we don't lose much. Even, if some of the unexpected events were to materialize, given that loan book is highly collateralized we don't expect significant losses.

Variant View

In this section we outline some of the reasons why Mr. Market is underpricing this company. We then provide our variant view of the same. This section has been put in the thesis to follow Charlie Munger's dictum, *"I never allow myself to have an opinion on anything that I don't know the other side's argument better than they do."*

While we don't claim that we know the other side of the argument better the next person, we sure as hell do try.

Mr Market View	Our Variant view
Company is very risky given that it caters to low-middle income segment of the borrowers which have least buffer for unfavourable event	Company does cater to the low-middle income segment. However, most of its lending is secured lending where the collateral more than covers for the principal and the interest. Even in MFI segment, which is not collateralized, lending is through JLG (Joint Lending Group). This coupled with better lending practices in MFI (discussed above) has reduced the risk in MFI segment.
Interest rates are moving up in India and all over the world. This will reduce margin for the company and reduce its earnings.	Manappuram businesses are unique in the sense that most of its customers are not very interest rate sensitive. This is because the alternative of borrowing from Manappuram or its competitors (who will all face the same issues with interest rate) is to borrow from money lenders, who charge exorbitant rates. Hence, we don't expect interest rate cycle will have much of an impact in the growth or profitability of the business.
Political Risk – India is getting ready for its national election due in the first half of CY 2019. This is likely to create volatility in the markets. So stay away!	We believe volatility is the friend of the investor. If we can assess a business and understand it, identify the incentives of the management and see a long run way in the business we are very comfortable buying more when markets give us an opportunity. So perceived political risk is giving us opportunity to buy a good business at a good price.
There is fierce competition among NBFC. This will reduce margins, growth and return on capital.	NBFC as a lending segment has grown at a brisk pace in the last decade. Specifically in the gold loan business many players entered in the last decade given the attractive business characteristics. However, they were not able to streamline their operations and get desired returns. Hence, most of them have left. So now the competition in Gold loans is only among a few NBFCs. So we don't expect too much competition in gold loan business. In the new businesses, Manappuram is leveraging adjacencies to its gold loan business and create cross-sell across businesses. So we believe that they should be able to maintain (and over time improve) margins, returns on capital and show better growth.
AUM growth and profit has slowed and hence stock is being priced cheaply.	AUM growth and profit growth were weak over the last few years because of issues discussed earlier. However, we expect that AUM and profit growth will pick up which will drive the re-rating of the business.

Trade Feasibility / Idea Practicality

Company's market capitalization is 6,365Cr or $884Million. Manappuram is listed on both NSE (National Stock Exchange) and BSE (Bombay Stock Exchange). Additional details are provided in the table below:

Attribute	NSE	BSE
Average Daily Volume (in '000s)	3,884 shares	608 shares
Average Daily Value Traded (in Rs Mn)	381	63

Thus there is enough liquidity across NSE and BSE to take advantage of this opportunity.

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