

Muthoot Finance Ltd.

Price Band	: Rs160-175 per share	April 18, 2011
Minimum Bid Lot Size	: 40 Equity Shares	
IPO open during	: Apr. 18-21, 2011 (for QIBs issue closes on Apr. 20, 2011)	
Book Running Lead Manager	: ICICI Securities and Kotak Investment Banking	
To list on	: NSE & BSE	
IPO Grading	: 4 / 5 (CRISIL & ICRA)	
PE	: 21.1x (based on base price)*	
	: 23.1x (based on cap price)*	
Market Cap post-listing	: Rs6505Cr or \$1.5bn (based on the cap price)	
Market Cap of Free Float	: Rs1294Cr or \$292mn (based on the cap price)	

*Based on FY10 EPS

IPO of 51.50mn equity shares of Rs10 each, aggregating to Rs901Cr or \$203.5mn (at the cap price).

Shareholding Pattern

	Pre-Issue		Post-Issue	
	No. of Shares	% Holding	No. of Shares	% Holding
Promoter	29,77,97,872	93.0%	29,77,97,872	80.1%
Pre-IPO Investors	2,24,14,896	7.0%	2,24,14,896	6.0%
QIBs excl. Mutual Funds	-	0.0%	2,48,48,750	6.7%
Mutual Funds	-	0.0%	9,01,250	0.2%
Non-Institutional Investors	-	0.0%	77,25,000	2.1%
Public	-	0.0%	1,80,25,000	4.8%
Total	32,02,12,768	100.0%	37,17,12,768	100.0%

Executive Summary

- Incorporated in March 1997, Muthoot Finance Ltd. (MFL) is the largest gold financing company in India in terms of loan portfolio, according to IMAcS Industry Report (2010 Update). It provides personal and business loans secured by gold jewellery, or gold loans.
- According to the IMAcS Industry Report (2010 Update) MFL's branch network was the largest among gold loan NBFCs in India. The company's gold loan portfolio as of November 2010 comprised approximately 4.1mn loan accounts in India that was serviced through 2,263 branches. MFL has increased its branch network to 2,611 to serve an average of 67,953 customers per day in the month of February 2011.
- India is one of the largest markets for gold and as of FY10, it accounts for approx. 10% of the total world gold stock with an annual demand of approx. 700 tonnes. Several gold based financial products have been made available to retail consumers in the Indian market from time to time with a view to bring the gold holdings to the core financial market.
- Based on the assessment of the emerging dynamics and competitive landscape, the Gold Loans market is expected to grow at between 35% and 40% over the next three years.

Our View

MFL is catering to niche market of lending on gold having huge growth potential. MFL's strong NIMs reflect its early mover advantage. We recommend investors to subscribe the IPO which is valued at 12.5x annualized earnings.

Company Background

Muthoot Finance Ltd. (MFL) was incorporated in March 1997 with the name “The Muthoot Finance Private Ltd.” The name of the company was subsequently changed to Muthoot Finance Private Ltd. in May 2007. Further, the company went public in November 2008 and changed its name to Muthoot Finance Ltd. in December 2008.

MFL has merged with Muthoot Enterprises Private Ltd. with effect from April 2004. With the successful implementation of the Scheme of Amalgamation, the undertaking of Muthoot Enterprises Private Ltd. along with its assets and liabilities was transferred to and vested in MFL.

MFL is a “Systemically Important Non-deposit taking NBFC” headquartered in the southern Indian state of Kerala. Its operating history has evolved over a period of 70 years since M George Muthoot founded a gold loan business in 1939 under the heritage of a trading business established by his father, Ninan Mathai Muthoot, in 1887. Since its formation, they have broadened the scale and geographic scope of their retail lending operations that as of March 2010, they were India’s largest provider of Gold Loans.

Promoters and Management

M. G. George Muthoot is the Chairman and Wholetime Director of Muthoot Finance. He is the National Executive Committee Member of the Federation of Indian Chamber of Commerce and Industry (“FICCI”) and the current Chairman of FICCI-Kerala State Council.

George Alexander Muthoot is the Managing Director of the company. He has a vast experience in the field of chartered accountancy and financial services. He has served as the Chairman of the Kerala Non-banking Finance Companies Welfare Association from 2004 to 2007 and is currently its Vice Chairman.

George Thomas Muthoot is the Wholetime Director of Muthoot Finance and has over 30 years of experience in managing businesses operating in the field of financial services.

Industry Overview

Overview of the Indian Consumer Credit Market

The consumer credit market in India has undergone a significant transformation over the last decade and experienced rapid growth due to consumer credit becoming cheaper, more widely available and increasingly a more acceptable avenue of funding for consumers. The consumer credit market has developed in India due to the following factors:

- Increased focus by banks and financial institutions on consumer credit resulting in a market shift towards regulated lenders from unregulated moneylenders/financiers;
- Increasing trend of Indian consumers to acquire assets such as cars, goods and houses on credit;
- Fast emerging middle class and growing number of households in the company’s target segment;
- Improved terms of credit as interest rates in India fall in line with global interest rates;
- Legislative changes that offer greater protection to lenders against fraud and potential default increasing the incentive to lend;
- Growth in assignment and securitisation arrangements for consumer loans has enabled non deposit based entities to access wholesale funding and compete solely on their ability to originate, underwrite and service consumer loans.

A variety of financial intermediaries in the public and private sectors participate in India's consumer lending sector, including the following:

- Commercial banks;
- Long-term lending institutions;
- NBFCs, including housing finance companies;
- other specialized financial institutions and state-level financial institutions;
- Lenders in the unorganized sector.

Gold Finance Industry in India

India is one of the largest markets for gold and as of fiscal 2010, it accounts for approx. 10% of the total world gold stock with an annual demand of approx. 700 tonnes (Source: IMAcS Industry Report (2010 Update)). Several gold based financial products have been made available to retail consumers in the Indian market from time to time with a view to bring the gold holdings to the core financial market.

Lending against gold has been one of the most popular instruments based on gold, and it works well with the Indian rural population, which typically views gold as an important savings instrument that is liquid and can be converted into cash instantly to meet their urgent cash requirements. Moreover, traditionally gold owners in southern India are more open than elsewhere in the country to accept and exercise the option of pledging gold to borrow money.

The low level of financial inclusion and poor access to financial products and services make gold a safe and attractive investment proposition. In an effort to tap the market for gold related investment and services, companies in the financial sector have launched several products such as gold coins and bars, exchange traded gold funds and lending against gold.

Gold Demand in India

- **Demand is relatively price in-elastic:** Demand for gold has not been adversely impacted by rising prices. Despite increases in gold prices from Rs15,026 to Rs51,150 per ounce during the period from 2002 to 2009, the demand for gold has risen from 580 tonnes in 2002 to 620 tonnes in 2009.
- **South India constitutes the largest market for gold:** Southern India has been the largest market accounting for approximately 40% of the gold demand, followed by the western region at approximately 25%, the northern region at 20-25%, and the eastern region at approximately 10-15% of India's annual gold demand.
- **Demand is further concentrated in rural pockets of India:** Rural India is estimated to hold around 65% of total gold stock as this section of the population views gold as a secure and easily accessible savings vehicle along with its consumption purpose.

Drivers of Growth in Gold Loans Market in India

- **Regulatory incentives to lenders:** The prescribed risk weight on Gold Loans has been approx. 50% for commercial banks, further reducing the associated capital costs.
- **Policy focus:** The Government of India views Gold Loans as an effective means to meet the potential micro-finance demand in India. In fiscal 2007, the Government of the state of Tamil Nadu set a jewellery loans target of Rs60bn (75% of the total loan disbursement target) for co-operatives in Tamil Nadu.
- **Increasing interest of the lenders in the segment:** Considering the recent rise in default rates (expected to vary from 8-10% in fiscal 2009) in personal loans, banks have started focusing on the Gold Loans segment because it offers attractive returns (although lower than personal loans) with very low levels of defaults. Several private sector banks have started participating in the segment by getting into bilateral sale agreements with NBFCs that specialize in Gold Loan. A few private sector banks have also initiated efforts to tap into such segments.
- **High levels of indebtedness:** The National Sample Survey Organisation (NSSO) 2003 survey on situational assessment of farmers' indebtedness in the country has estimated that 60.4% of rural households in India were farmer households, out of which 48.6% were indebted. The incidence of indebtedness was highest in the state of Andhra Pradesh (82%) followed by Tamil Nadu (74.5%), Punjab (65.4%), Kerala (64.4%), Karnataka (61.6%) and Maharashtra (54.8 %).
- **Changing customer attitudes and preferences:** Indian customers have demonstrated a change in their traditionally debt-averse psychology, promoting the creation of assets through growth in financial liabilities which has been reflected in an annual growth of more than 30-35% in retail credit between fiscal 2002 and fiscal 2009.

Role of NBFC's in the gold finance industry in India

A typical Gold Loan customer expects high loan-to-value ratios, easy access, low levels of documentation and formalities, quick approval and disbursement of loans, lockers to ensure safety of their pledged gold and a team of expert valuers. Specialized NBFCs have created a niche in the Gold Loans capabilities by meeting these requirements of the typical Gold Loan customers, who require Gold Loans primarily to meet their urgent cash requirements.

NBFCs specializing in Gold Loans continue to perform strongly in the Gold Loans market and the overall statistics demonstrate that the relative share of traditional gold finance NBFCs in the market has not changed significantly over the last three years. In fiscal 2010, the Gold Loans market was largely concentrated between two categories of lenders: south India based SCBs and NBFCs specializing in Gold Loans which held approximately 58% and 32%, respectively, of the total market. The rest of the Gold Loans portfolio was held by several small co-operative banks.

Outlook of the Gold Loans Market in India

Based on the assessment of the emerging dynamics and competitive landscape, the Gold Loans market is expected to grow at between 35% and 40% over the next three years. Moreover, as the market is currently under-penetrated, it is expected that the Gold Loans market will offer enough opportunities for portfolio expansion and retain attractive margins for all existing specialised NBFCs, banks and new entrants.

The branch expansion and marketing initiatives of various specialized NBFCs are anticipated to give a strong boost to the acceptability of Gold Loans and lead to further growth in the Gold Loans market.

Business Operations

Muthoot Finance Ltd. (MFL) is the largest gold financing company in India in terms of loan portfolio, according to IMaCS Industry Report (2010 Update). It provides personal and business loans secured by gold jewellery, or gold loans, primarily to individuals who possess gold jewellery but could not access formal credit within a reasonable time, or to whom credit may not be available at all, to meet unanticipated or other short-term liquidity requirements.

According to the IMaCS Industry Report (2010 Update) MFL's branch network was the largest among gold loan NBFCs in India. The company's gold loan portfolio as of November 2010 comprised approximately 4.1 million loan accounts in India that was serviced through 2,263 branches. MFL has increased its branch network to 2,611 to serve an average of 67,953 customers per day in the month of February 2011.

Being India's largest provider of Gold Loans in the years ended March 2008, 2009 and 2010, and in the eight months ended November 2010 revenues from their Gold Loan business constituted 95.97%, 96.71% , 98.08% and 98.50%, respectively, of the total income. In addition to its Gold Loans business, MFL also provides money transfer services through its branches as sub-agents of various registered money transfer agencies, and recently have commenced providing collection agency services.

MFL provides retail loan products, primarily comprising Gold Loans. It also disburses other loans, including those secured by Muthoot Gold Bonds which has a maximum 12 month term. As per its restated audited financial statements, MFL's average disbursed Gold Loan amount outstanding was Rs.31,553 per loan account as of November 2010. In the year ended March 2010, its retail loan portfolio earned, on average, 1.67% per month, or 19.94% per annum, and in the eight months ended November 2010 its retail loan portfolio earned, on average, 1.57% per month, or 18.92% per annum.

Services

Money transfer services: MFL provides fee based services including money transfer and foreign exchange services. As per its restated audited financial statements, in the years ended March 2008, 2009, 2010 and in the eight months ended November 2010 money transfer services business generated Rs.5.11 cr., Rs.6.29 cr., Rs.6.41 cr., and Rs.3.99 cr., respectively, or 1.39%, 1.01% and 0.59%, and 0.31% respectively, of the total income. It acts as

sub-agents to Indian representatives and enters into representation agreements for inward money transfer remittance. Under these agreements, MFL is entitled to receive a commission for the services provided depending on the number of transactions or the amount of money transferred and the location from which the money is transferred to the company.

Collection services: MFL recently commenced providing collection agency services to its clients. It acts as a collection agent by receiving money for and on behalf of its clients who issue invoices to their customers for goods sold or service rendered. MFL receives commission for each invoice for which remittance by a customer is made and money is collected by the company. The collection services business is commenced in the current fiscal, and accordingly has not generated any revenues in prior financial years. As per its restated audited financial statements, in the eight months ended November 2010, it generated Rs.0.11 cr.

Wind mills business: MFL also operates three windmills of 1.25 MW each in the southern Indian state of Tamil Nadu. As per its restated audited financial statements, in the years ended March 2008, 2009, 2010 and for the eight months ended November 2010, income was Rs.1.74 cr., Rs.2.21 cr., Rs.25.1 cr. and Rs.2.14 cr., respectively, or 0.47%, 0.36%, 0.23% and 0.16% , respectively, of the total income.

Strengths

Largest gold financing company

MFL is the largest gold financing company in India in terms of loan portfolio, according to IMAcS Industry Report (2010 Update). The loan portfolio of the company as of March 31, 2010 and November 30, 2010 comprised approx. 2.8mn and 4.1mn, respectively, loan accounts in India with Gold Loans outstanding of Rs73,417.3mn and Rs128,977.7mn, respectively.

Largest branch network among gold loan NBFCs

MFL has the largest branch network among gold loan NBFCs, according to the IMAcS Industry Report (2010 Update). As of March 31, 2010, the company operated 1,605 branches across 19 states, the national capital territory of Delhi and two union territories in India. The branch network of MFL has expanded significantly in recent years from 373 branches as of March 31, 2005 to 2,611 branches as of February 28, 2011, comprising 465 branches in northern India, 1,753 branches in southern India, 297 branches in western India and 96 branches in eastern India covering 20 states, the national capital territory of Delhi and four union territories in India. In the month of February 2011, MFL served an average of 67,953 customers daily.

Recognized brand in the rural and semi-urban markets

Due to early entry, MFL has built a recognizable brand in the rural and semi-urban markets of India, particularly in the southern Indian states of Tamil Nadu, Kerala, Andhra Pradesh and Karnataka. As of March 31, 2010 and November 30, 2010, the southern Indian states of Tamil Nadu, Kerala, Andhra Pradesh, Karnataka and the Union Territory of Pondicherry constituted 75.38% and 75.28%, respectively of total Gold Loan portfolio of MFL.

Strong presence in under-served rural and semi-urban markets

MFL has a strong presence in under-served rural and semi-urban markets. A large portion of the rural population has limited access to credit either because of their inability to meet the eligibility requirements of banks and financial institutions because credit is not available in a timely manner, or at all. The company has positioned itself to provide loans targeted at this market.

Varied product range

MFL offer products with varying loan amounts, advance rates (per gram of gold) and interest rates. The principal loan amounts it disburses usually range from Rs2,000 to 100,000 while interest rates on the Gold Loans range between 12.00% to 30.00% per annum.

Objects of the Issue

The objects of the Issue are

- To augment capital base to meet future capital requirements to provide for funding of loans to the customers
- General corporate purposes.

Fund Raising Programme

The company plans to raise funds through IPO proceeds.

Investment Risks

(Please refer to the RHP for a complete listing of risk factors)

1. Capital intensive business
2. Interest Rate risk
3. Loan default risk
4. Increasing competition

Restated Profit & Loss Statements

(RsCr)

For Period ended,	31.3.2006	31.3.2007	31.3.2008	31.3.2009	31.3.2010	30.9.2010
INCOME						
Interest Income	142.83	223.59	357.94	606.24	1,077.45	1,289.35
Other Income	5.24	10.38	10.70	14.16	11.93	12.32
Total Income	148.06	233.97	368.64	620.40	1,089.38	1,301.66
EXPENDITURE						
Interest Expense	64.82	99.90	179.80	309.77	473.73	582.56
Administrative Expenses	37.23	55.13	79.56	140.50	235.99	254.69
Directors Remuneration	1.29	4.89	4.89	12.09	19.223	12.8
Depreciation	3.39	7.10	7.41	9.88	14.89	10.50
Total Expenditure	106.73	167.01	271.66	472.23	743.83	860.55
Profit/(Loss) before Tax and Prior Period	41.34	66.96	96.98	148.17	345.55	441.12
Items						
Prior Period Items [Expenses / (Income)]	0.00	0.00	0.00	0.00	0.00	0.00
Net Profit/(Loss) before Tax	41.34	66.96	96.98	148.17	345.55	441.12
Provision for tax						
Current Tax	11.46	20.77	33.61	50.79	119.28	149.67
Deferred Tax Charge/(Credit)	2.44	1.77	-0.56	-0.39	-1.30	-0.04
Fringe Benefit Tax	0.31	0.44	0.33	0.04	0.00	0.00
Total Tax Expense/(Credit)	14.21	22.98	33.38	50.45	117.98	149.63
Net Profit/(Loss) before Adjustments	27.13	43.98	63.60	97.72	227.58	291.48
Net Adjustments	-0.24	-0.12	-0.53	0.15	0.94	-
Net Profit/(Loss) as Restated	26.89	43.86	63.07	97.87	228.52	291.48
Weighted average number of shares	19.64	21.69	24.57	28.01	30.10	31.33
Operating margin (%)	27.9%	28.6%	26.3%	23.9%	31.7%	33.9%
EPS (Rs)	1.37	2.02	2.57	3.49	7.59	9.30
Book Value (Rs)	4.60	7.34	8.67	12.90	19.41	36.12

KEYNOTE

Restated Balance Sheets

(RsCr)

As at	31.3.2006	31.3.2007	31.3.2008	31.3.2009	31.3.2010	30.9.2010
Fixed Assets						
Gross Block	58.23	64.64	121.53	148.27	169.11	203.46
Less : Accumulated Depreciation / Amortization	7.85	14.95	22.27	32.08	44.90	55.40
Net Block	50.38	49.69	99.25	116.19	124.21	148.05
Capital Work in Progress	0.84	13.54	9.36	13.12	29.07	51.04
Total Fixed Assets	51.22	63.23	108.62	129.31	153.27	199.09
Investments	12.29	24.22	18.34	8.53	7.51	7.51
Deferred Tax Assets (Net)	-2.96	-4.73	-4.17	-3.79	-2.48	-2.44
Current Assets, Loans and Advances						
Sundry Debtors	1.29	2.17	3.49	4.10	3.35	6.92
Cash and Bank Balances	36.93	56.32	258.04	882.53	575.99	460.66
Other Current Assets	47.11	78.71	96.79	165.89	240.81	293.95
Loans and Advances	794.66	1389.30	1804.66	2573.55	5461.70	9810.49
Total Current Assets	879.98	1526.50	2162.98	3625.99	6281.85	10572.02
Secured Loans	737.04	1311.75	1840.02	3008.75	4547.12	8033.00
Unsecured Loans	68.84	70.90	75.29	156.85	733.40	1049.93
Current Liabilities	32.29	45.91	122.49	180.56	452.44	407.11
Provisions	11.92	21.44	34.87	52.45	122.99	154.68
Total	850.09	1450.01	2072.66	3398.60	5855.95	9644.72
NET WORTH	90.43	159.20	213.11	361.45	584.19	1131.46
Net Worth Represented by						
Share Capital						
Equity Shares	4.00	5.00	5.00	49.00	301.00	320.21
Preference Shares	0.00	0.00	0.00	0.00	0.00	0.00
Reserves and Surplus						
Securities Premium	3.50	27.50	27.50	75.50	-	236.48
Statutory Reserve	12.79	21.59	34.31	53.85	99.37	157.66
Surplus/ (Deficit) in Profit and Loss Account	70.14	105.20	155.55	191.88	184.18	417.37
Misc. Expenditure (to the extent not written off)	-	-0.09	-9.25	-8.78	-0.35	-0.27
NET WORTH	90.43	159.20	213.11	361.45	584.19	1131.46

Keynote Capitals Ltd.

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