MANAPPURAM FINANCE LTD.

A brief about the company and its mainstay business of gold loans

Abstract

Accounting for about 65 percent of its consolidated business, gold loans have the dominant share in the company's business mix. Today, among India's non-banks, it is the second-largest player in gold loans, a business with a proven record of resilience to economic downturns.

April 04, 2020

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COMPANY PROFILE

Manappuram Finance Ltd. is one of India's leading NBFCs focused mainly on gold loans. Promoted by Mr. V.P. Nandakumar (current MD & CEO), its origins go back to 1949 when it was founded in the coastal village of Valapad (Thrissur, Kerala) by his late father Mr V.C. Padmanabhan. The firm was involved in pawnbroking, and money lending carried out on a modest scale. Mr. Nandakumar took over the reins in 1986 after his father expired. Since then, it has been a story of unparalleled growth with many milestones crossed. Incorporated in 1992, Manappuram Finance Ltd. has grown at a rapid pace. Today, the company has a pan-India presence with 4,623 branches across 28 states and UTs and with Assets under Management (AUM) of ₹240,999.5 million. The company's net worth stood at ₹54,132.7 million as of December 31, 2020.

Notable achievements

Soon after commencing operations, the company gathered several "firsts" to its credit. The first non-banking financial company (NBFC) in Kerala to receive a Certificate of Registration issued by the RBI, it was also among the earliest to go for an IPO in 1995. In 2007, it became first Kerala based NBFC to receive investment from foreign institutional investors (FIIs) when the celebrated P.E. fund, Sequoia Capital, invested Rs.700 million along with Hudson Equity Holdings. Received sizable foreign investment of Rs.12,450 million during two QIPs in 2010. The second QIP in November 2010, which raised Rs.10,000 million remains the single largest foreign investment in U.S. dollar terms received by any company in Kerala to this date. Manappuram Finance Ltd. became the first NBFC in Kerala to undergo credit rating in 1995 and later obtain the highest short-term credit rating of A1+ from ICRA.

Wealth creator

Manappuram Finance Ltd. and Mr V.P. Nandakumar, its M.D. & CEO, are widely hailed in India's stock market circles as one the leading wealth creators for investors. In January 2017, MoneyLife magazine compiled a list of the top 20 wealth creators in the stock market over the preceding decade, and Manappuram Finance was ranked thirteenth, having delivered compounded annual shareholder returns of 48 per cent during the decade. In December 2019, Fortune India listed the company among the top wealth creators over the last five years while the Economic Times ET500 Companies list named Manappuram Finance Limited and its MD & CEO, Mr. V.P. Nandakumar, as the leading wealth creator in India for 2019 among companies with a market capitalisation of over Rs.50,000 million.

Recent diversification

In recent years, the company has diversified into promising new areas like microfinance, home and vehicle finance, SME lending, insurance broking etc. The entry into microfinance followed the acquisition in 2015, and subsequent turnaround, of the Chennai based Asirvad Microfinance Private Limited. From an AUM of less than Rs.3,000 million, Asirvad's portfolio has grown manifold to over Rs.50,000 million in the five years after the acquisition. Today, Manappuram's new businesses contribute nearly 35 per cent to the total business.

Ownership

Manappuram Finance Ltd. is a professionally run company promoted by Mr. V.P. Nandakumar whose family has been involved in gold loans since 1949. The promoters hold approximately 35 percent of the total equity of the company. A similar share is held by various Indian and foreign private equity funds while the balance is dispersed among the public. The shares of the company are traded on both the BSE and NSE. The company is managed by a Board of Directors headed by Mr. Jagdish Capoor, Chairman. Mr. Capoor is a former Deputy Governor of the RBI. Mr. V.P. Nandakumar is the MD & CEO of the company.

GOLD LOANS, THE MAINSTAY

Accounting for 65 percent of total business, gold loans have the dominant share in the company's business mix. Today, Manappuram Finance is the second-largest player in gold loans among India's non-banks. In fact, for many years after its inception in 1992, the company was focussed almost exclusively on gold loans as serious diversification began only in 2014.

Historically, Manappuram's roots in gold loans back to the earliest days of its founder V.C. Padmanabhan, who started with money lending and pawnbroking. Over the years, as the inheritor of that legacy, Manappuram Finance Ltd. has built on that deep familiarity with the nitty-gritty of this tradition-bound trade and succeeded in scaling up the business to an extent once considered unimaginable.

To understand how this was achieved, and why gold loans continue to hold promise in India, we look at the historical context and the recent trends in the business.

HISTORICAL CONTEXT

When speaking of gold, India is often mentioned as holding the worlds' largest stock of privately held gold with estimates ranging from 20 to 25,000 tonnes. Along with China, India is the largest consumer of gold and accounted for 23 percent of global demand between 2009-2018. Further, its physical stock Is supplemented every year by the largest import of gold, averaging about 700 to 800 tonnes per annum.

Historically, Indians have for ages had a particular affinity for gold. Gold jewellery takes pride of place in social and cultural occasions, and there is an emotional attachment to family gold jewellery, which often gets passed on from one generation to another.

Not surprisingly, rural India holds the bulk of India's gold estimated at 60 to 65 percent of the total gold and 2/3rds of aggregate demand for gold comes from rural areas. What is more, gold in the Indian household usually belongs to the women (referred to as *"Stridhana")* and thus a source of empowerment for them. Lacking access to formal financial institutions (the banking network has limited reach in rural areas), gold is the preferred outlet for parking household savings in times of surplus. In times of need, gold is pledged to draw money. This is the origin of the age-old business of pawnbroking or lending against used household gold jewellery.

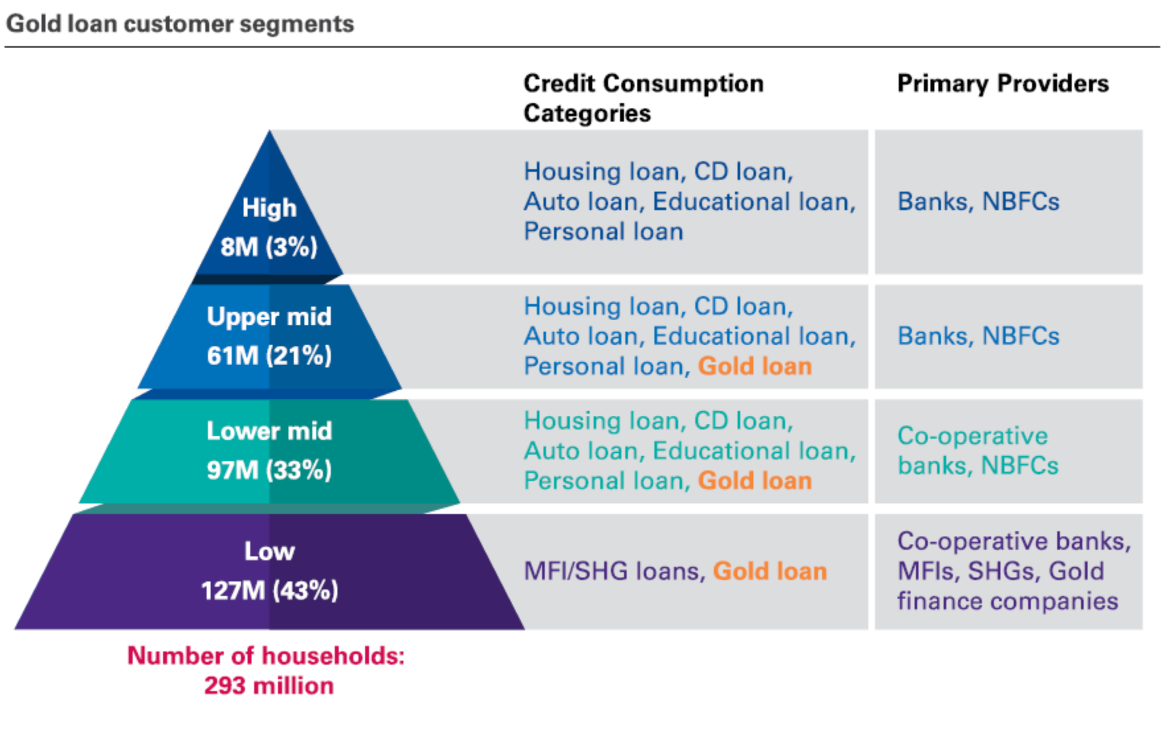


Figure 3[4]: Household income per annum prices by income segment - low < USD4000 (< INR2.5 lakh), lower middle- USD4000 to USD8500 (INR2.5 lakh to INR5.5 lakh), upper-middle USD8500 to USD40000 (INR5.5 lakh to INR27.5 lakh), high > USD40000 (INR27.5 lakh).

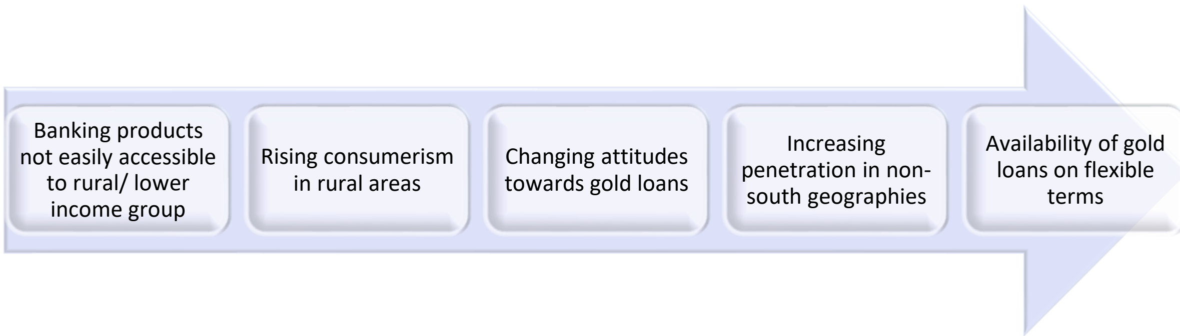
Source: Return of gold financiers in India's organised lending market, KPMG, 2020

In India, the business of lending against gold jewellery has existed for ages. Initially the preserve of the ubiquitous small-time pawnbrokers and moneylenders, the last two decades have seen larger organised players make significant inroads.

Why did the gold loans business evolve so well in India but no much in other countries? The answer has to do with idea of "bullion plus." Strictly speaking, lending against used household jewellery takes into account the value of the bullion content of the jewellery. However, the emotional connect that borrowers have with the jewellery works as an additional cushion for the lender, making the business of lending against gold jewellery different from, and more secure, than any ordinary kind of commodity lending. Besides, the lender also has the cushion of the making cost of the jewellery which is not financed. This explains why India is an especially fertile ground for gold loans with few parallels elsewhere.

SOME RELEVANT MACRO TRENDS & CHARACTERISTICS

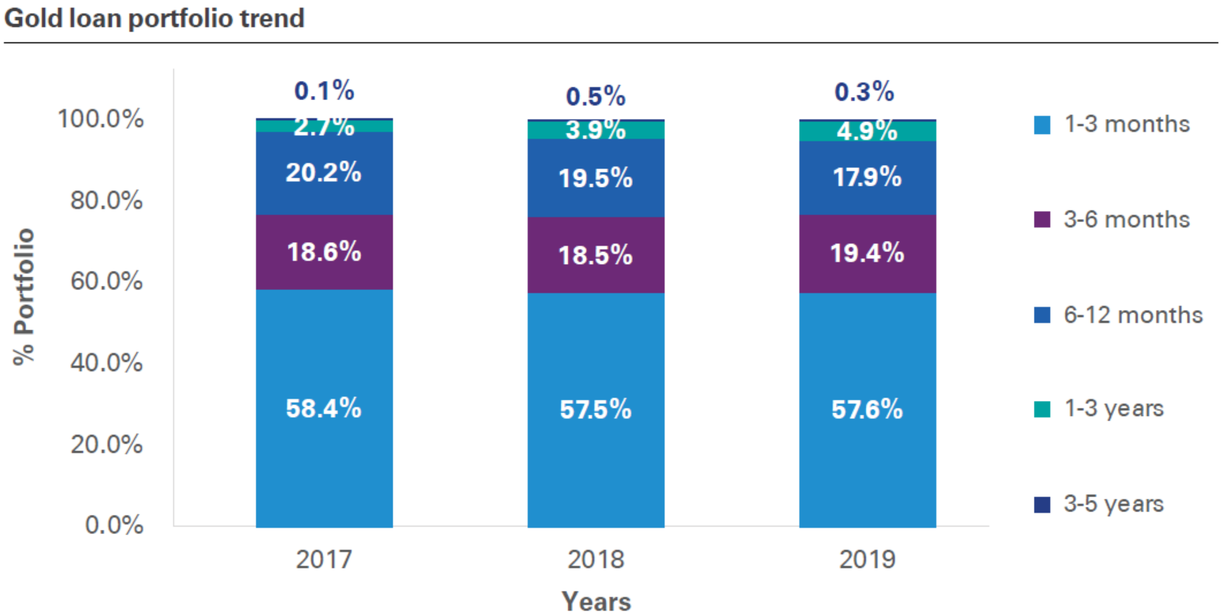
Demand drivers of gold loans



Another key demand driver of gold loan is that as income levels go up, the value that people attribute to their time goes up, and this increases the demand for gold loans (which can be availed instantaneously with minimum hassles) for meeting short term, small ticket needs. Put another way, the opportunity cost of alternative sources of finance (involving multiple visits to branches, considerable effort and time in compiling required documentation, etc.) increases.

Low penetration

Notwithstanding the rapid growth achieved by the organised players in gold loans (particularly the gold loan focussed non-banks), the market penetration is still quite low. Most private gold remains locked up in safes and vaults. Only a fraction of the gold has been monetised. Total gold loans outstanding in the organised sector in 2019 is estimated at just 5.5 percent of the household gold holdings in India, hinting at the potential of a large and mostly untapped market. With the increasing ease in monetising gold and growing economic activity in rural India, demand for gold loan will inevitably increase.

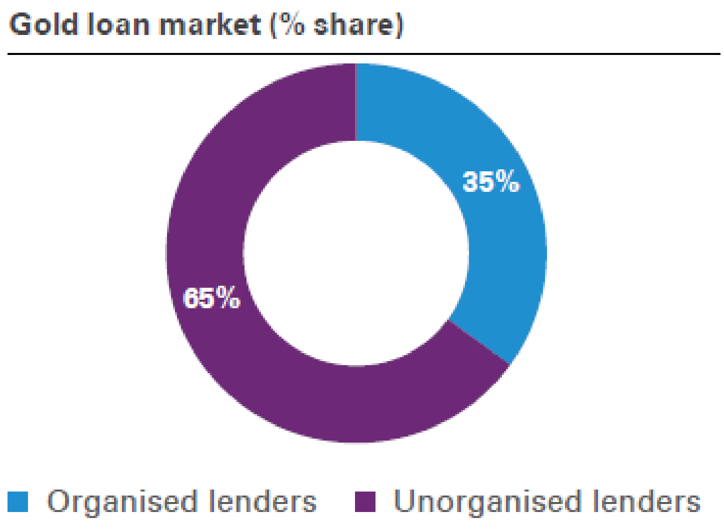


Gold Loan portfolio mix of Top-2 Gold Loan NBFCs

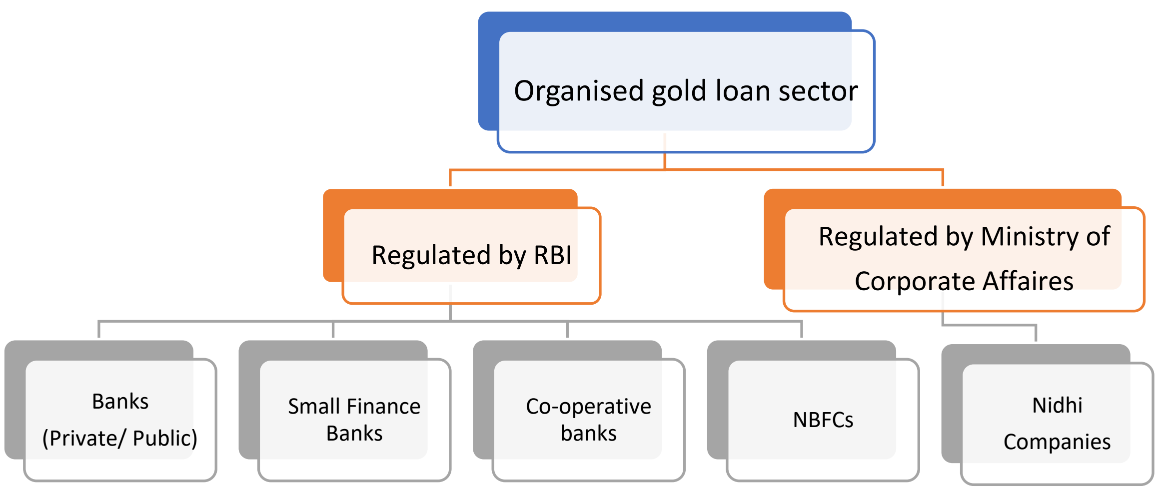
Source: Return of gold financiers in India's organised lending market, KPMG, 2020

Unorganised players dominate

The Gold loan sector continues to be dominated by unorganised players who still command an estimated 65 percent market share. This is partly due to the fact that organised players were relatively late entrants and they could make an impact only in the last two decades with the rise of gold-loan focussed non-banks. Also, with the bulk of gold being held in rural areas, beyond the reach of the banking network, moneylenders and pawnbrokers operating in lanes and by-lanes could remain in business and flourish. However, with developments in recent years such as Demonetisation (2016) and the nation-wide rollout of GST (2017) hastening the pace of formalisation of India's economy, organised sector gold loan players have a better opportunity to grow business by taking market share away from unorganised players.



Source: Return of gold financiers in India's organised lending market, KPMG, 2020



International gold price on the rise

After the sharp correction in the gold price in 2013, prices remained depressed for a couple of years. However, from 2016 onwards (especially after the Brexit vote and the U.S. election) gold prices have steadily gained. While the general impression attributes it to the unsettled global order following the ascension of Donald Trump as U.S. President (after all, gold is traditionally a safe haven asset), we believe there is a more fundamental force at work. This has to do with the continuing inability of the U.S. Fed and other central banks of the advanced economies to come out of the unprecedented easy money policies introduced in 2008-09 to counter the global financial crisis which keeps the opportunity cost (of holding gold) low. As of now, there seems to be no end in sight to central banks pushing for low-interest rates and that will surely support gold prices.

Is the gold loan business dependent on increasing the gold price to grow its loan book? Undeniably, a scenario of rising prices does give a temporary boost to the business mainly because people can borrow more against their existing jewellery. However, very soon, this becomes the new normal, and it becomes business as usual. Our experience is that growth in gold loans is a function of the demand for credit, especially among the weaker sections with limited access to formal credit.

Resilient to economic downturns

Better placed to ride out global financial storms: A significant part of the demand for gold loans is derived from and dependent upon economic activity levels in rural areas, especially from agriculture and micro-enterprises. A slowdown in economic activity will certainly affect demand for gold loans on this account. However, our experience is that in periods of acute economic slowdown or crisis, the wider financial services sector (banks and non-banks) is also put to stress such that their lending activity slows down drastically. The appetite for risk and disbursing new loans falls. At this point, gold loans become the natural fall-back for borrowers denied access to their regular channels, and this new demand more than compensates for the loss of demand from traditional sources.

Further, the tendency among governments and central banks to respond to such crises by easy money policies and fiscal stimulus drives gold prices higher. In India, where the gold prices depend on the international price as well as the USD/ INR exchange rate, the rupee is generally seen to depreciate during crisis periods when a risk-off phase leads to withdrawal of foreign portfolio investments. Given this natural impetus towards higher gold prices, it becomes an additional boost for the gold loans business.

And that was how, during the Global Financial Crisis of 2008-09, Manappuram Finance Ltd. (at the time, the only listed gold loan company in India) was able to record uninterrupted growth and profitability during this period. Sequoia Capital, one of the first PE investors in the company (in 2007, just before the meltdown), was able to exit in 2010 having grown their investment five-fold.

Unscathed by India's NBFC crisis: In late 2018, India's NBFC sector was thrown into crisis when one of the largest NBFCs with the highest credit rating involved in infrastructure finance (IL&FS) went into default. With banks becoming wary of lending further to NBFCs, liquidity dried up, and it was soon revealed that many prominent NBFCs were facing acute ALM mismatches. The outlook for NBFCs had suddenly darkened and share prices of NBFCs across the sector suffered severe erosion. However, it was not long before the market woke up to the fact that NBFCs focussed on gold loans dealt predominantly in short term loans and therefore comfortably placed in respect of ALM. Once this realisation came about, the shares of these companies recovered and outperformed the market.

COMPETITIVE ADVANTAGE IN GOLD LOAN

Advantage NBFCs

As mentioned above, with the faster pace of formalisation of the economy now, the organised gold loan players can expect to gain market share from the unorganised players. However, compared to the banks, the focussed non-banks are better placed here because their low-cost model makes it easier to open new branches in rural and semi-urban areas. Since banks have much higher operating cost, they would hesitate to venture in these parts given the limited potential for other business.

Another key demand driver of gold loan is that as income levels go up, the value that people attribute to their time goes up, and this increases the demand for gold loans (which can be availed instantaneously with minimum hassles) for meeting short term, small ticket needs. Put another way, the opportunity cost of alternative sources of finance (involving multiple visits to branches, considerable effort and time in compiling required documentation, etc.) increases.

Parameters	Gold loan NBFCs	Banks	Moneylenders
LTV	Up to 75 per cent	Up to 75 per cent	>75 per cent
Processing fee	Nil or minimal processing fee; No appraisal fee	• No processing fee and nil/minimal the appraisal fee is charged for small-ticket loans; • Both processing and appraisal fees are charged for high-ticket loans	Nil
Interest rate	11-24 per cent p.a.	7 per cent-15 per cent p.a.; 4% p.a. for agriculture loans	25-50 per cent p.a.
Max loan amount	No particular limit	INR3 lakh for agriculture loans	No particular limit
Penetration	High	Low	High
Mode of disbursal	Cash payment up to INR20,000; above that amount, direct transfer to customer account	Customer must have an account in the bank to avail of gold loan	Cash
Working hours	Open beyond banking hours	10 a.m. to 5 p.m.	Open beyond banking hours

Regulatory body	RBI	RBI	Not regulated
Turnaround time	5 to 10 minutes	1 hour	>10 minutes
Repayment plans	Predominantly, a monthly interest payment with the principal payment towards the end of the tenure or EMI-based schemes	Predominantly, interest and principal paid in lump sum towards the end of tenure	Monthly repayment, daily repayment
Customer service	Core focus	Non-core	Core focus

Source: Return of gold financiers in India's organised lending market, KPMG, 2020

The competitive position of Gold Loan NBFCs vs. Banks

Parameters	**Specialised NBFCs**	**South-based banks**	**New NBFC entrants**	**New bank entrants**	**Cooperative banks**
Strategic stance and focus					
Focus on the segments	High	Medium	Medium	Low to Medium	Medium
Willingness to expand in non-south regions	High	Low	High	Medium	Low
Ability to provide accessibility					
Size of existing branch network	High	Medium	Medium	Medium	Low
Flexibility to add branches	High	Low	High	Low	Low
Ability to provide flexibility					
Understanding of target customer segment	High	Medium	Medium	Low	Medium
Ability to provide a wide range of products -eg. High LTV loans	Medium	Medium	Medium	Medium	Medium
Competitive advantage on account of flexibility - eg. Long hours, cash disbursals	High	Low	Medium	Low	Low
Source: IMaCs Industry report 2012	Regulatory stress points for various categories of lenders				
	Potential threats to competitive positioning of specialised NBFCs				

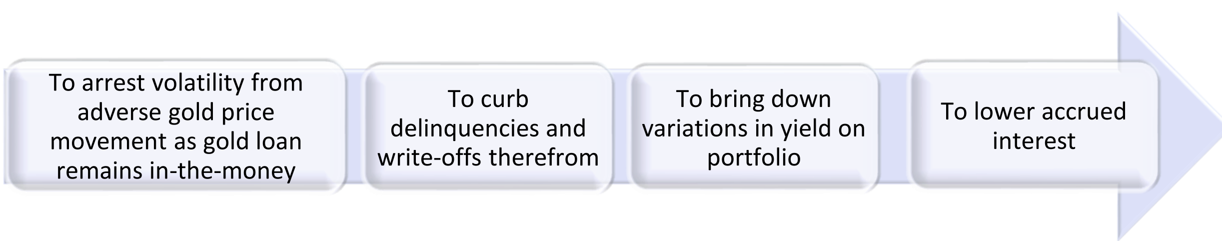
Source: Return of gold financiers in India's organised lending market, KPMG, 2020

Advantage Manappuram

Short-term gold loans

Traditionally, gold loans were sanctioned for a tenure of one year, and borrowers were allowed to make bullet payments of interest and principal. This makes it very flexible for the borrower. However, the downside of this became visible in 2013 when a sudden and sharp correction in gold prices led to higher defaults and credit losses. In response, the industry as-a-whole shifted to periodic (monthly) collection of interest to preserve its lending margins. However, Manappuram Finance decided to break from convention and went further to launch short term gold loan products, mainly of three and six months tenure. Over the years since, the company has succeeded in shifting the bulk of its gold loans to the short-term buckets, which minimises the price risk. The changeover had to be managed carefully, and customers were educated about the advantages of renewing the loan every three months as against the risk of having compounding interest pile up over a year.

The rationale for short-term loan

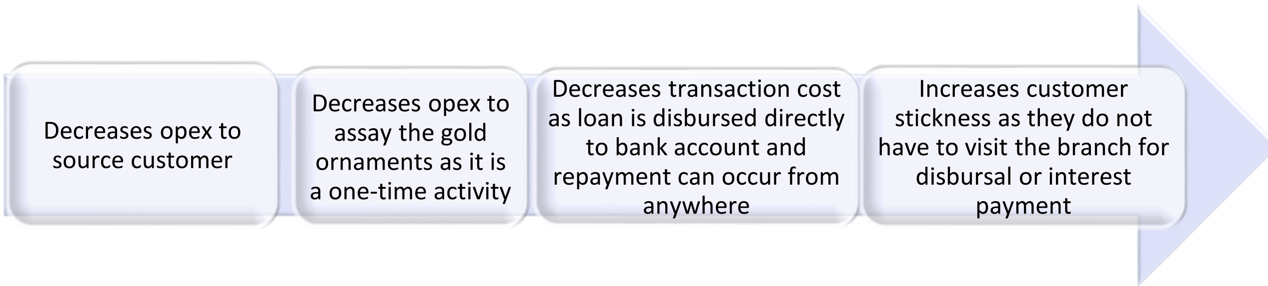


(Rs.)	Earlier	Now			
	Single product offering	3 months	6 months	9 months	12 months
Gold value	100	100	100	100	100
LTV (%)	75	75	70	65	60
Gold loan	75	75	70	65	60
Interest rate (%)	24	24	24	24	24
Interest cost	21	7.5	11.2	14.3	16.8
Total Principal +Interest	96.0	82.5	81.2	79.3	76.8
Margin of safety (%)	4.0	17.5	18.8	20.7	23.2

Online Gold Loan (OGL)

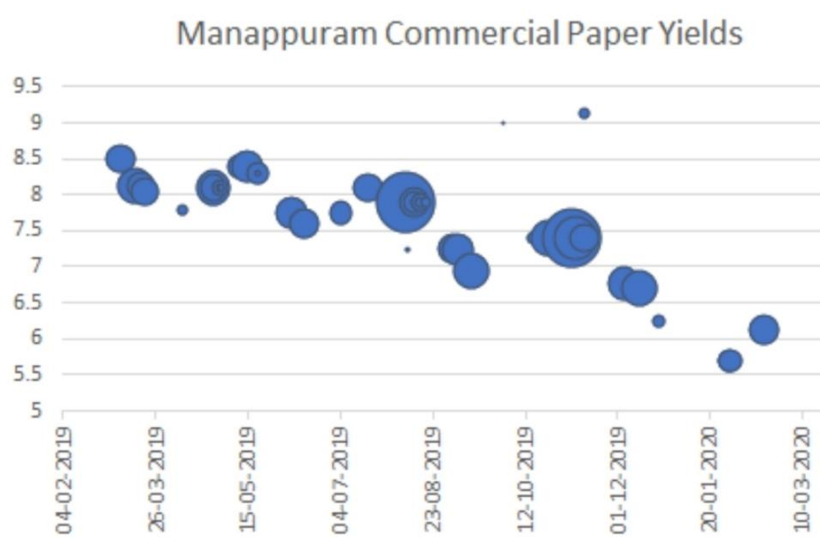
In October 2015, Manappuram Finance became the first to launch an online gold loan (OGL) product that frees borrowers of the need to make repeated visits to the branches while transacting in gold loans. The OGL product is potentially a game-changer because it adds unprecedented convenience to the gold loan process and therefore makes it attractive to borrowers from a higher socio-economic profile who otherwise would not have considered a gold loan. Today, OGL accounts for about 44 per cent of its total gold loan AUM.

OGL helps churn customers at lower Op-Ex



Long term funds raised

Notwithstanding its comfortable ALM position, the company has proactively sought to increase the share of long-term funds in its funding mix and achieved remarkable success. In March 2019, India's premier lending institution, NABARD, sanctioned a term loan of Rs. 7,700 million meant to be deployed for onward lending to the MSME and microfinance sectors. In June 2019, the International Finance Corporation (IFC), a subsidiary of World Bank, sanctioned a 3-year term loan of US$75 million, the first-ever external commercial borrowing (ECB) availed by the company. This was IFC's very first gold loan focused investment. In January 2020, the company raised US$300 million by way of senior secured fixed rate notes issuance for a three-year tenor. The issue was placed with a coupon of 5.90 per cent and was the first such issuance by the company in the global bond market, tapping investors in Asia and Europe, Middle East and Africa (EMEA). While long term funds come at a higher cost, it imparts stability to the company's funding sources and is therefore considered worthwhile. Besides, gold loans being small ticket and short-term loans, it is easier to pass on an increase in the cost of funds, should this become necessary.



Source: Data from F-TRAC, FIMMDA, February 2020

Even as the company has sought to raise more long-term funds, its recent short-term borrowing cost shows a declining trend:

Short-term borrowing cost (interest rate on commercial papers) have been coming down over the past few quarters. In February 2020, Manappuram raised short fund at an annualised rate of 6.2 per cent.

Proven resilience to financial sector crises

Accounting for 65 percent of total business, gold loans have the dominant share in the company's business mix. Today, Manappuram Finance is the second-largest player in gold loans among India's non-banks. What will be the likely impact on the gold loan business of the company from a recession or severe slowdown in economic activity arising from disruptive measures to contain the current COVID-19 pandemic?

For a likely answer, it's worth going back to the days of the global financial crisis in 2008-2009 when major economies went into recession, stock markets around the world crashed, and there was concerted action by central banks and governments to revive the global economy by resort to easy money and fiscal stimulus. The following table shows the performance of the company during the period from FY 2003 to FY 2010. As will be seen, the company recorded good growth even during the crisis period.

Manappuram Finance Ltd. – Performance during the Global Financial Crisis

Fiscal Year	Gold AUM (Rs. Million)	No. of Branches	Employee Count	Avg. price of gold (INR/10gm)
2002-03	410	20	--	5,332.36
2004-05	810	42	246	6,145.38
2006-07	3,800	237	613	9,240.32
2008-09	12,600	645	4686	12,889.74
2009-10	26,170	1005	7645	15,756.09

More recently, as mentioned elsewhere in this document, in late 2018, India's NBFC sector was thrown into crisis when one of the largest NBFCs with triple AAA rating (IL&FS) went into default. Banks then became wary of lending to NBFCs and liquidity dried up. It came to light that many prominent many NBFCs were faced with severe ALM mismatches because during the preceding low interest rate regime, they were borrowing short and lending long. When the going was good, they reported faster growth and higher profitability, but once the tide turned it was not such a good idea. The outlook for NBFCs became gloomy and share prices of NBFCs across the sector suffered severe erosion.

However, it was not long before the market woke up to the fact that NBFCs like Manappuram Finance were predominantly into short term loans – the company's gold loans are typically of three months tenure and microfinance loans usually get repaid in about a year — and therefore comfortably placed in respect of ALM. Once this realisation came about, the company's share price recovered and outperformed the market. In December 2019, the Economic Times newspaper named Manappuram Finance Ltd. as the top wealth creator among ET500 companies with a market capitalisation of over Rs.50,000 million!

KEY RISKS TO GOLD FINANCING

Today, among the gold loan focused NBFCs, Manappuram Finance is the only player to have made the transition to short term gold loans. Importantly, while this minimises the downside risks (price risk from falling gold price), the upside gains continue to remain in play. This is to say, in a scenario of rising gold prices, customers who renew their loan every three months will get the benefit of higher loan to value, and business sentiment gets a positive boost. Moreover, with the compulsion to renew the pledge periodically, there is less likelihood of unpaid interest compounding and piling up to unmanageable levels, and this has helped reduce the overall auction percentage. With the increasing acceptance of Online Gold Loan (OGL), a good part of the overall transactions happens online, where customers don't have to stir from their homes and offices. Going forward, this promises to make gold loans more attractive to a higher social demographic of the educated and relatively well-off.

GOLD LOANS, RECENT EVOLUTION

2008-12	2012	2013	2014	2016-17	2018-19
Phase 1: High growth • Rapid growth phase supported by the low cost of funds (eligibility under PSL) • Rise of India's middle class, consumerism and urbanisation • Positive economic macros: rising gold prices • Allowed to offer high Loan to Value (LTV) - up to 85 per cent • The convenience of access, quick disbursals and lower interest rates compared to moneylenders led to NBFCs becoming the customer's de facto choice • Gold loan NBFCs witnessed a CAGR of 95 per cent in AUM while branch networks grew 7-fold.	**Phase 2: Regulatory shock** • To stabilise the proliferation and books of gold loan NBFCs, the RBI intervened and released specific guidelines. - Removal of PSL status this immediately resulted in substantially higher borrowing cost - LTV capped at 60 per cent weakened the competitive advantage against commercial Banks -Restricted credit exposure to a single gold NBFC to 7.5 per cent from 10 per cent resulting in lower bank funding - Prohibition of the grant of loans against bullion and gold coins.	**Phase 3: Gold loses shine** • From the beginning of 2013, gold prices reduced drastically globally • With the price of gold going down, loan to value (LTV) of many gold loan accounts shot up. This resulted in many customers forsaking their pledged gold and thus increased NPAs for gold loan companies.	**Phase 4 A: Recovery** • The RBI increased the LTV to 75 per cent thus creating a level competing field for banks and NBFCs **Phase 4B: Growth trajectory** • Key players started leveraging technology (online gold loan), personalised loan schemes improved branding and targeted marketing • The essential action was to decouple the gold price volatility from business profitability. This was done by the introduction of shorter tenure products.	**Phase 5: Demonetisation** • Cash crunch in the market led to the immediate shortfall in business • The negative effect was short-lived with all significant players adapting to the digital payment model • The digital eco-system is leading to Increased credibility, tilting the scales of the gold loan business in favour of specialised gold loan NBFCs	**Phase 6: NBFC liquidity stress** • The NBFC liquidity stress led to a a slowdown in disbursals among small players as they were fund starved • Cost of funds for large gold loan players and banks remained relatively stable but increased for smaller players • The prevailing liquidity crunch in India means that the demand for gold loans remains strong as consumers are looking to meet their short-term fund requirements • Emergence of new age fintech and online gold loan companies is transforming the way, the traditional way of doing the gold loan business to a highly digitised model.

(Source: Return of gold financiers in India's organised lending market, KPMG, 2020)