

## Rating Rationale

November 23, 2016 | Mumbai

### Muthoot Capital Services Limited

*Rated amount enhanced*

<b>Total Bank Loan Facilities Rated</b>	<b>Rs.12000 Million (Enhanced from Rs.8610 Million)</b>
<b>Long Term Rating</b>	<b>CRISIL A-/Stable (Reaffirmed)</b>

*(Refer to Annexure 1 for Facility-wise details)*

<b>Rs.500 Million Non Convertible Debentures</b>	<b>CRISIL A-/Stable (Reaffirmed)</b>
<b>Fixed Deposits</b>	<b>FA-/Stable (Reaffirmed)</b>
<b>Rs.300 Million Short Term Debt</b>	<b>CRISIL A1 (Reaffirmed)</b>

CRISIL ratings on the bank facilities and debt instruments of Muthoot Capital Services Ltd (MCSL; a part of Muthoot Pappachan Group) continues to reflect the benefits that MCSL derives from its linkages with Muthoot Fincorp Ltd (MFL; a flagship company of the group [rated 'CRISIL A-/CRISIL BBB/Stable/CRISIL A1']) and MCSL's healthy earnings profile. These strengths are partially offset by vulnerability of asset quality to the inherently weak credit risk profiles of its borrowers, and by geographic concentration in revenue profile.

CRISIL had downgraded its rating on the debt instruments and bank facilities of MCSL to 'CRISIL A-/FA-/Stable' from 'CRISIL A/FA/Stable' and the rating on the short-term debt was reaffirmed at 'CRISIL A1'. The downgrade was primarily on account of downgrade in ratings on the bank facilities and debt instruments of MFL. (Refer CRISIL's rating rationale dated November 18, 2016).

MCSL is an integral part of the Muthoot Pappachan group, also derives significant benefits from its linkages with the group's flagship company, MFL. MCSL is a vehicle for the group to diversify mainly into two-wheeler financing. MCSL and MFL have common shareholders and directors. Mr John Muthoot is the chairman of both companies, and there are other directors who are on both their boards. The two companies also have strong operational linkages. Besides its own sales force, who contribute significantly for origination of new loans, MCSL also utilises the wide branch network and large customer base of MFL for origination of new loans and for collection. CRISIL believes that MCSL, being an integral part of the Muthoot Pappachan group, will continue to receive operational and managerial support from MFL on an ongoing basis, and funding support in case of any distress.

MCSL has a healthy earnings profile, with a high return on average assets of 2.4% for the fiscal 2016. CRISIL believes that despite slight moderation in earnings and increased credit costs (as the portfolio seasons), earnings will remain healthy over the medium term.

However, MCSL's asset quality is vulnerable to risks associated with financing of two-wheelers, wherein borrowers' credit risk profiles are inherently weak. Despite this, the company has maintained delinquencies in the two-wheeler segment at below the industry average. Gross non-performing assets in the two-wheeler segment was 5.7% as on September 30, 2016 compared to 6.8% as on March 2016 (Based on 120 days norm for recognition of NPA). The absolute NPA level has dropped on account of certain measures taken by MCSL. On account of issues regarding asset quality, the company has temporarily discontinued three-wheeler financing.

Also, MCSL's operations are concentrated in Kerala, which accounted for about 50% of its advances as on September 30, 2016, though it reduced from 84% as on March 31, 2010. The proportion of disbursements in Kerala has remained at 48% over the past two years. However, MCSL has, recently, entered into northern and eastern part of India which could reduce its geographical concentration over the medium term.

The government's demonetisation move and the severe contraction of cash in circulation mean near-term liquidity management will be the key differentiator of credit profiles of CRISIL-rated companies. A prolonged disruption would impact their business and financial risk profiles, too, but this will depend on the extent of exposure to cash

transactions. In the near term, NBFCs may stave off liquidity pressures because of undrawn lines of credit from banks and liquid assets. If normalcy is restored over the next few weeks, NBFCs would be able to absorb the disruption. In the meantime NBFCs have seen a significant drop in their collection efficiencies. CRISIL believes that NBFCs are working with borrowers to improve collections by using their own field staff to get demonetised currency notes exchanged. However, if the disruption prolongs beyond 2 months, asset quality pressures could manifest. CRISIL believes that MCSL's liquidity position is adequate to meet the upcoming loan repayments over the next two months, supported by undrawn bank lines of around Rs.2.5 billion.

### **Outlook: Stable**

CRISIL believes that MCSL will maintain its healthy earnings profile, and will remain an integral part of the Muthoot Pappachan group and will benefit from linkages with the group's flagship company, MFL, over the medium term. The outlook may be revised to 'Positive' in case of a similar revision in CRISIL's rating outlook on MFL. Conversely, the outlook may be revised to 'Negative' if there is a similar revision in CRISIL's rating outlook on MFL, or in case of a decline in MCSL's credit and earning profile or importance of MCSL to the Muthoot Pappachan group.

### **About the Company**

Set up in 1994, MCSL is a deposit-taking, systemically important, non-banking financial company. It started with financing two-wheelers; later, it began offering business loans. In the late 1990s, on account of intense competition, the company exited these businesses and shifted to gold loans. Subsequently, as the group scaled up its gold financing business in MFL, MCSL entered the two-wheeler financing segment once again in fiscal 2008 and gradually exited the gold loan business. MCSL is listed on the Bombay Stock Exchange and the National Stock Exchange and is the only listed company in the group. As on September 30, 2016, its advances portfolio of Rs 11.7 billion comprised 90% two-wheeler loans and 10% other loans.

For fiscal 2016, MCSL reported a profit after tax (PAT) of Rs 229 million on a total income of Rs 2.3 billion; it had reported a PAT of Rs 223 million on a total income of Rs 1.9 billion for fiscal 2015. PAT for the first half of fiscal 2017 was Rs 125 million on a total income of Rs 1.34 billion.

MFL, set up in 1997, is a non-deposit-taking, systemically important non-banking financial company engaged in lending against gold. It is the flagship company of the Muthoot Pappachan group, which has diverse business interests, such as hospitality, real estate, and power generation. The company also distributes mutual funds, and general and life insurance products, and operates in the money-transfer segment. MFL had an advance book of Rs 92.7 billion (including microfinance advances of Rs 12.8 billion), a networth of Rs 14.2 billion, and gearing of 6.7 times as on March 31, 2016. It had 3699 branches as on March 31, 2016.

For fiscal 2016, MFL reported a PAT of Rs 874 million on a total income of Rs 20.9 billion; it had reported a PAT of Rs 838 million on a total income of Rs 19.6 billion for fiscal 2015. PAT for the first quarter of fiscal 2017 was Rs 299 million on a total income of Rs 4.7 billion.

## Annexure 1 - Details of various bank facilities

Current facilities			Previous facilities		
Facility	Amount (Rs.Million)	Rating	Facility	Amount (Rs.Million)	Rating
Cash Credit	3155	CRISIL A- /Stable	Cash Credit	3155	CRISIL A- /Stable
Long Term Loan	250	CRISIL A- /Stable	Long Term Loan	250	CRISIL A- /Stable
Proposed Long Term Bank Loan Facility	3580	CRISIL A- /Stable	Proposed Long Term Bank Loan Facility	190	CRISIL A- /Stable
Working Capital Demand Loan	4045	CRISIL A- /Stable	Working Capital Demand Loan	4045	CRISIL A- /Stable
Working Capital Term Loan	970	CRISIL A- /Stable	Working Capital Term Loan	970	CRISIL A- /Stable
<b>Total</b>	<b>12000</b>	<b>--</b>	<b>Total</b>	<b>8610</b>	<b>--</b>

### Links to related criteria

[CRISILs Bank Loan Ratings - process, scale and default recognition](#)

[Rating Criteria for Finance Companies](#)

[Criteria for Notching up Stand Alone Ratings of Companies based on Group Support](#)

[Criteria for rating Short-Term Debt \(including Commercial Paper\)](#)

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