FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Manappuram Finance at 'BB-'; Outlook Stable

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Fitch Ratings - Singapore/Mumbai - 04 Sep 2023: Fitch Ratings has affirmed India-based Manappuram Finance Limited's (MFIN) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'BB-'. The Outlook is Stable.

KEY RATING DRIVERS

Standalone Profile Drives Ratings: MFIN's ratings reflect its moderate franchise in semi-urban and rural consumer lending, particularly in gold-backed loans, which constitute 56% of the consolidated portfolio. The ratings also reflect steady asset quality from the liquid collateral and generally stable funding access. This is balanced by a shifting business mix that reflects a high risk appetite and a history of regulatory compliance findings.

Improved Sector Risk Operating Environment (SROE): Fitch has revised the SROE score for Indian finance and leasing companies (FLCs) to 'bb+', from 'bb', reflecting improved governance, risk and liquidity management frameworks, due partly to regulatory strengthening in the past few years, and the easing of Covid-19 and commodity shocks on medium-term growth prospects, despite lingering global growth and inflation risks. We expect resilient GDP expansion (financial year ending March 2024 (FY24): 6.3%, FY25: 6.5%) to provide adequate headroom for FLCs to expand profitably in the medium term.

Moderate Franchise: MFIN has a moderate franchise in financing against gold jewellery, with a pan-India branch network and reasonable penetration in the interior rural markets. MFIN has not been able to benefit from its long presence in the gold loan business, with low gold assets under management to branch ratio compared with the industry leader. The business model is evolving, with the non-gold loan segments expanding at a faster pace than core gold loans.

Developing Governance: MFIN's history of compliance lapses relating to customer practices suggest greater governance risk relative to higher-rated peers. This is reflected in the company's ESG Relevance Scores for Customer Welfare and Governance Structure. Further regulatory findings could damage the company's reputation and see it lose its business franchise and funding access. However, the company is taking steps to improve governance and operational practices under board oversight, which should reduce these risks.

MFIN's credit profile is also weighed down by key-person risk, although it has recently implemented a succession plan relating to the founding shareholder, who is also the managing director.

High Risk Appetite: MFIN has a high risk appetite, as evidenced by its rapid growth outside its core segment, along with elevated operational risk from its decentralised branch-led operation. MFIN has pursued higher growth in recent years in riskier non-gold rural segments - microfinance, auto loans and small business loans. This was also spurred by rising market competition in gold loans. The company plans to reduce the share of gold loans in the consolidated portfolio to 50% in the medium term.

Resilient Economy Supports Asset Quality: Gold loans underpin MFIN's steady asset quality due to the security of liquid gold collateral, which can be auctioned fairly reliably. A regulatory loan/value ceiling of 75%, standardised jewellery valuation based on pure gold content and real-time monitoring of gold collateral value mitigate the risk of under-recovery due to gold price declines.

The asset quality of the non-gold portfolio has benefited from an improved economic environment. MFIN's gross non-performing loan ratio fell to 1.9% by end-June 2023, against 2.8% at FYE22. While the rising proportion of non-gold loans could increase asset quality volatility in the long term, we expect asset quality to remain stable in the near to medium term.

High Yields Support Profitability: MFIN's business model benefits from high yields. This is characteristic of lenders with a mostly rural or semi-urban borrower profile. The improved net interest margin of 14.2% in 1QFY24 underpins the lender's healthy pre-tax profit of 6.8% of assets in 1QFY24 (FY23: 5.6%). A rising mix of non-gold loans could lift credit costs, but higher yields from products such as microfinance should mitigate the impact of higher credit costs.

Moderate Leverage: Debt/tangible equity of 2.9x at end-June 2023 (FYE23: 3.0x) benefits from adequate internal capital generation. Leverage is likely to rise modestly in the medium-term along with loan growth, although we expect it to remain generally commensurate with the current rating over the next two years.

Steady Funding: MFIN is wholesale funded, but has adequate borrowings access, as lenders gain confidence from its granular lending portfolio. Bank loans reached 69% of FY23 borrowings (FY22: 50%), due to fewer capital market issuances in a rising interest-rate environment, along with the maturity of its dollar-denominated bonds, which comprised 10% of borrowings at FYE22. MFIN's asset-liability profile is adequately matched, supported by short-tenor gold loans. This could change amid faster growth in long-tenor products, but MFIN plans to maintain its well-matched asset and liability profile.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

The rating may be downgraded in the event of a material increase in MFIN's risk appetite, possibly from aggressive growth in its non-gold loan segments. A sustained rise in debt/tangible equity beyond 4.5x or higher losses from reputational, compliance or operational risks than we expect would also be negative for the ratings.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

There is limited near-term upside, but an upgrade may be possible in the longer-term if the company demonstrates robust regulatory compliance, a strengthened business profile - indicated by higher gold-loan growth relative to non-gold loan segments - along with sustained healthy asset-quality in non-gold segments. This is provided that other credit indicators remain consistent with a higher rating.

DEBT AND OTHER INSTRUMENT RATINGS: KEY RATING DRIVERS

The rating on MFIN's US-dollar medium-term note (MTN) programme is at the same level as its Long-Term Foreign-Currency IDR.

The borrowings of Indian non-bank financial institutions (NBFI) are typically secured, and we believe that non-payment of senior secured debt would best reflect the uncured failure of an entity. NBFIs can issue unsecured debt in the overseas market, but such debt is likely to constitute a small portion of funding and thus cannot be viewed as a primary financial obligation.

DEBT AND OTHER INSTRUMENT RATINGS: RATING SENSITIVITIES

The rating on the MTN programme is sensitive to MFIN's Long-Term Foreign-Currency IDR. Any change in the Long-Term Foreign-Currency IDR will drive similar rating action on the MTN programme.

ADJUSTMENTS

Standalone Credit Profile Adjustments

The 'bb+' sector risk operating environment score is above the 'b' implied score due to the following reasons: size and structure of economy (positive) and economic performance (positive).

The 'bb+' earnings and profitability score is below the 'bbb' implied score due to the following reason: portfolio risk (negative).

The 'bb-' funding, liquidity and coverage score is above the 'ccc' implied score due to the following reason: funding flexibility (positive).

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579

Sources of Information

The principal sources of information used in the analysis are described in the applicable criteria.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

MFIN has an ESG Relevance Score of '4' for Customer Welfare - Fair Messaging, Privacy and Data Security, due to a history of customer-related business practices that did not fully comply with regulatory norms. The score reflects our assessment that customer-related practices appear weaker than at rated peers, raising regulatory and reputational risk for MFIN. This has a negative impact on the credit profile and is relevant to the ratings in conjunction with other factors.

MFIN has an ESG Relevance Score of '4' for Governance Structure, due to its history of customer-related business practices that did not fully comply with regulatory norms, which implies that the company has gaps in its governance structure. The score reflects our assessment that governance practices appear weaker than at rated peers, raising regulatory and reputational risk for MFIN. This has a negative impact on the credit profile and is relevant to the ratings in conjunction with other factors.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/topics/esg/products#esg-relevance-scores

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Manappuram Finance Limited	LT IDR	BB- Rating Outlook Stable	Affirmed	BB- Rating Outlook Stable
	LC LT IDR	BB- Rating Outlook Stable	Affirmed	BB- Rating Outlook Stable

senior secured	LT	BB-	Affirmed	BB-

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Country-Specific Treatment of Recovery Ratings Criteria (pub. 04 Mar 2023)

Non-Bank Financial Institutions Rating Criteria (pub. 06 May 2023) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Manappuram Finance Limited	EU Endorsed, UK Endorsed

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