IPO Note

December 15 2023

Muthoot Microfin Limited

Issue Snapshot:

Issue Open: December 18 – December 20, 2023

Price Band: Rs. 277 –291 (Discount of Rs 14 per share for all eligible employee)

*Issue Size: Rs 960 cr (Fresh Issue of Rs 760 cr + Offer for sale of Rs 200 cr)

Reservation for:

QIB	upto	50% eq sh
Non-Institutional	atleast	15% eq sh

((including 1/3rd for applications between Rs.2 lakhs to Rs.10 lakhs))

Retail	atleast	35% eq sh

Face Value: Rs 10

Book value: Rs 127.61 (September 30, 2023)

Bid size: - 51 equity shares and in multiples thereof

100% Book built Issue

Capital Structure:

Pre Issue Equity:	Rs.	144.36 cr
*Post issue Equity:	Rs.	170.47 cr

Listing: BSE & NSE

Book Running Lead Managers: ICICI Securities Limited, Axis Capital Limited, JM Financial Limited, SBI Capital Markets Limited

Sponsor Bank: Axis Bank Ltd. and ICICI Bank Ltd.

Registrar to issue: KFin Technologies Limited

Shareholding Pattern

Shareholding Pattern	**Pre issue %**	**Post issue %**
Promoter and Promoter Group	69.08	55.47
Public & Employees	30.92	44.53
Total	100.0	100.0

*=assuming issue subscribed at higher band

Source for this Note: RHP

Background & Operations:

Muthoot Microfin Limited (MML) is a microfinance institution providing micro-loans to women customers (primarily for income generation purposes) with a focus on rural regions of India. It is the fifth largest NBFC-MFI in India in terms of gross loan portfolio as of March 31, 2023 and also the third largest amongst NBFC-MFIs in South India in terms of gross loan portfolio, the largest in Kerala in terms of MFI market share, and a key player in Tamil Nadu with an almost 16% market share, as of March 31, 2023. As of September 30, 2023, its gross loan portfolio amounted to Rs.108,670.66 million. Its business model helps in driving financial inclusion, as it serves customers who belong to low-income groups. As of September 30, 2023, it had 3.19 million active customers, who are serviced by 12,297 employees across 1,340 branches in 339 districts in 18 states and union territories in India. It has built its branch network with an emphasis on under-served rural markets with growth potential, in order to ensure ease of access to customers. Its branches are connected to its IT networks and are primarily located in commercial spaces which is easily accessible by its customers.

MML is a part of the Muthoot Pappachan Group, a business conglomerate with presence across financial services, automotive, hospitality, real estate, information technology infrastructure, precious metals and alternate energy sectors. Its wide range of lending products are aimed at catering to the life-cycle needs of rural households. It primarily provides loans for income generating purposes to women customers living in rural areas. Its loan products comprise (i) group loans for livelihood solutions such as income generating loans, Pragathi loans (which are interim loans made to existing customers for working capital and income generating activities), individual loans and Suvidha loans (which are digital loans accessible through the *Mahila Mitra* application and made to existing customers to enable quick access to funds); (ii) life betterment solutions including mobile phones loans, solar lighting product loans and household appliances product loans; (iii) health and hygiene loans such as sanitation improvement loans; and (iv) secured loans in the form of gold loans and its Muthoot Small & Growing Business ("MSGB") loans. As of September 30, 2023, the gross loan portfolio of its income generating loans amounted to Rs.102,118.73 million, representing 93.97% of its total gross loan portfolio. It primarily adopts a joint liability group model which caters exclusively to women in lower income households and is premised on the fact that if such individuals are given access to credit, they may be able to identify new opportunities and supplement and grow their existing income.

Over the past few years, MML has significantly implemented the use of technology across its microfinance operations. It has an in-house information technology team that has built its technology platform into a business tool, which helps it in achieving and maintaining high levels of customer service, enhancing operational efficiency and creating competitive advantages for the organization. To improve underwriting capabilities using technology, it has developed a unique credit score card along with Equifax to evaluate the creditworthiness of customers by assigning individual credit scores to the customers. Further, to expand digital collections infrastructure, it launched a proprietary application, called "*Mahila Mitra*", in 2021, which facilitates digital payment methods such as QR codes, websites, SMS-based links and voice-based payment methods. As of September 30, 2023, 1.50 million customers have downloaded the *Mahila Mitra* application, and 2.46 million customers have transacted digitally with it (through the *Mahila Mitra* application and other digital payment methods). The Company is also in the process of developing a *Super App* along with the Muthoot Pappachan Group, which it plans to use to integrate its *Mahila Mitra* application with all of the Muthoot Pappachan Group's products and databases on to a single platform, allowing customers to access all the Group's loan offerings on a single platform, thereby maximizing its cross-selling opportunities.

In addition, with the aim to cater to the healthcare needs and priorities of MML's customers, it has since December 2021, offered digital healthcare facilities to its customers through "e-clinics". As of September 30, 2023, it had set up 460 e-clinics across 460 of its branches, representing 34.33% of its total branches. As of September 30, 2023, 14.40% of its customers have enrolled in e-clinics, and it has facilitated 98,844 medical consultations and 65,878 teleconsultations. Further, to protect customers from the risks of natural calamities, it has, since May 2020, also provided natural calamity insurance to its customers to whom it disburses loans across branches in India. As of September 30, 2023, it has provided 23.23% of its clients with natural calamity insurance.

Objects of Issue:

The Offer comprises the Fresh Issue and the Offer for Sale.

The Offer for Sale

The Selling Shareholders shall be entitled to their respective portion of the proceeds of the Offer for Sale after deducting their proportion of Offer expenses and relevant taxes thereon. MML will not receive any proceeds from the Offer for Sale and the proceeds received from the Offer for Sale will not form part of the Net Proceeds.

The Objects of the Fresh Issue

The Company proposes to utilise the Net Proceeds from the Fresh Issue towards augmenting its capital base to meet future capital requirements

- to undertake existing business activities;
- to undertake the activities proposed to be funded from the Net Proceeds.

Further, the Company expects to receive the benefits of listing of the Equity Shares on the Stock Exchanges, including to enhance brand image among existing and potential customers and creation of a public market for the Equity Shares in India.

Competitive Strengths

Market leadership with a pan-India presence: MML is a microfinance institution providing micro-loans to women customers (primarily for income generation purposes) with a focus on rural regions of India. It is the fifth largest NBFC-MFI in India in terms of gross loan portfolio as of March 31, 2023 and the third largest amongst NBFC-MFIs in South India in terms of gross loan portfolio, the largest in Kerala in terms of MFI market share, and a key player in Tamil Nadu with an almost 16% market share, as of March 31, 2023. Its business model helps in driving financial inclusion, as it serves customers who belong to low-income groups. It has 3.19 million active customers, as of September 30, 2023.

MML has a well-diversified portfolio across 339 districts in 18 states and union territories in India, as of September 30, 2023. As of September 30, 2023, its gross loan portfolio in its top three states, namely Kerala, Karnataka and Tamil Nadu, together accounted for 51.36% of total gross loan portfolio. Over the past five years, it has expanded its operations in North, East and West India, which has allowed to diversify its customer base and gross loan portfolio and increase its revenue from operations. It derives numerous benefits from its leadership position, including its ability to secure capital at competitive costs, recruit and retain skilled employees, retain existing customers, add new customers, expand into new regions and grow portfolio of products from time to time.

Rural focused operations, with a commitment towards health and social welfare of customers: MML has a history of serving rural markets with high growth potential in the microfinance segment, and has maintained a track record of financial performance and operational efficiency through consistently high rates of customer acquisition and retention and expansion into underpenetrated areas. Its connection with its rural customers has been largely driven by its focus on continuously improving its understanding of the financial needs of the rural customer segment and commitment to consistent engagement with the communities it serves. Further, its digital capabilities, which facilitate online onboarding, paperless loan processing, seamless cashless disbursements, cashless collections, timely query resolution and access to online financial literacy resources, among other things, have allowed it to deliver superior customer services to its rural customers. Its customer-centric model and ability to leverage extensive distribution network in rural markets across India, makes MML well placed to offer an increasing variety of financial products in areas where financial services penetration remains limited.

In addition, MML acts as a master policy holder for credit linked life insurance policies for its customers, to protect them from financial risks arising from death of income earners within the household. Further, to protect its customers from the risks of natural calamities, it has, since May 2020, also provided natural calamity insurance to its customers to whom it disburses loans across its branches in India. As of September 30, 2023, it has provided 23.23% of its clients with natural calamity insurance. As a result of global climate change, India has experienced natural calamities such as floods, cyclones, earthquakes, tsunamis and droughts in the past, including floods in the south Indian state of Kerala in 2018 and 2019 and a cyclone in Tamil Nadu in 2018. In this background, purchasing natural calamity insurance for its customers is a significant value-add to them as it protects their businesses and assets at home.

Brand recall and synergies with the Muthoot Pappachan Group: MML is a part of the Muthoot Pappachan Group, a business conglomerate with presence across financial services, automotive, real estate, healthcare, information technology, precious metals and alternate energy sectors. The Muthoot Pappachan Group has a history of over 50 years in the financial services business. It is the second largest company under the Muthoot Pappachan Group, in terms of AUM for the Financial Year 2023. Its relationship with the Muthoot Pappachan Group provides it with brand recall and significant marketing and operational benefits. Several companies forming part of the Muthoot Pappachan Group are in the financial services sector including microfinance, gold finance, two wheeler finance and housing finance. The financial services companies within the Muthoot Pappachan Group together service 8.7 million unique customers, as of September 30, 2023.

Robust risk management framework leading to healthy portfolio quality: Risk management forms an integral part of MML's business and it recognize the importance of risk management towards its long term success. It has implemented well-defined key risk management policies which primarily focus on addressing credit risk, operational risk and financial risk.

Credit Risk: The Company seeks to ensure effective appraisal, disbursement, collection and delinquency management resulting from streamlined approval and administrative procedures. It has established underwriting norms which ensure that customer selection is done after evaluating repayment capacity and detailed cash flows analysis. It uses technology across its business processes, including sourcing, underwriting, disbursement and collection, in order to ensure accuracy and authenticity of information.

Operational Risk: Before establishing a branch in a new location, MML conducts due diligence and market surveys to understand key details relating to the new location, including, among others, economic activity, target market growth potential and extent of microfinance services already provided. It also has a systematic hiring criteria, and perform employment verifications, review credit bureau reports and police verification reports of each potential employee before hiring them. It also has established training processes for its newly hired staff, including training on policies, processes, systems and culture of the Company.

Financial Risk: MML adopts conservative policies aimed at ensuring there is no asset liability mismatch, liquidity risk or interest risk. It ensures that it engage in external borrowings in a manner that is compliant with its board-approved borrowing policies. Its borrowing committee works under the supervision of its Board to ensure that its cost of borrowings, interest rates for its borrowings and draw-downs on its loan facilities are well managed. Its investment committee seeks to ensure that its treasury operations are optimal, including by selecting appropriate short term savings instruments for the deployment of cash collected.

Streamlined operating model with effective use of technology: MML recognizes that establishing and growing a successful microfinance business in India involves the significant challenge of addressing a customer base that is quite large and typically lives in remote locations in India. To address this challenge, it has designed a streamlined and scalable operating model and developed technology-led systems and solutions for its operations. As at September 30, 2023, it had 102 members in its information technology team, who are responsible for, among other things, developing and maintaining its in-house information technology systems, data security systems, and technological infrastructure and applications. All of its applications have been developed in-house by its information technology team, and its team is also able to implement amendments to its applications required pursuant to regulatory or other operational changes in an efficient and quick manner. Its systems operate in a secure, cloud based technological environment with a robust internal software platform. Leveraging on its technology initiatives, it is able to achieve quicker turn-around times for its loan approval and disbursement processes. It has also increased the average number of customers served per loan officer from 407.63 as of March 31, 2021 to 410.64 as of March 31, 2022, 442.00 as of March 31, 2023 and 426.19 as of September 30, 2023.

Access to diversified sources of capital and effective cost of funds: MML has a well-diversified funding profile that underpins its liquidity management system, credit rating and brand equity. It received an upgraded credit rating of A+/Stable by CRISIL on October 19, 2022, which was reaffirmed on January 19, 2023. As of September 30, 2023, it had outstanding debt in principal amount of Rs.63,104.87 million from 65 banks, financial and other lending institutions, including securitization and external commercial borrowings and Rs.14,356.23 million from 14 NCDs (including market-linked debentures) issuances and one commercial paper. It also leverages on its loan portfolio in order to enter into direct assignment transactions with banks. Such transactions also allow it to efficiently utilize its capital as assigned portfolios do not require any risk weightage on its balance sheet. In addition, as an NBFC-MFI, subject to certain conditions being met, it is eligible to access external commercial borrowings. In addition to such funding, it has the ability to fund the growth of its operations and loan portfolio through issuances of debt securities such as redeemable NCDs (including market-linked debentures), commercial paper, loans with various maturities raised from domestic and international banks, financial and other institutions. It is one of the youngest NFBC-MFI players with a relatively strong credit rating of CRISIL "A+", and it has also been graded as "M1C1" in capacity assessment and code of conduct assessment by CRISIL which is the highest available grading on an eight-point scale for microfinance capacity assessment and the highest available grading on a five-point scale for code of conduct assessment.

Experienced and Professional Management, with Strong Corporate Governance and support from Promoters and Investors: MML's Board, Promoters and Senior Management is composed of experienced professional, industry experts and management professionals. Its Board consists of 10 directors (including 3 directors from the Muthoot Pappachan Group), of which five are independent directors. Its independent Board has provided it with diverse perspectives for it to continue to grow thr Company. Its Senior Management team consists of qualified, seasoned professionals with an average experience of over 16 years across a variety of sectors. Its Senior Management team comprise a majority of members who have been associated with the Muthoot Pappachan Group for over ten years.

Business Strategy:

Expand geographical footprint and sourcing platform across India: As of December 31, 2022, India's Northern and Western regions had relatively low financial penetration as compared to the pan-India average penetration, indicating probable growth potential from India's Northern and Western regions that have a relatively lower penetration. While its operations have historically been concentrated in South India, MML has in recent years expanded into North, East and West India and has a total of 707 branches across North, West and East India as of September 30, 2023, representing 52.76% of its total branches as of September 30, 2023. Moving forward, it is expected that a significant portion of its future geographic expansion will include rural areas in these regions of India and intends to grow its branches in four key states: Uttar Pradesh, Bihar, Rajasthan, and Punjab, which are underpenetrated or moderately penetrated states that may have potential for growth and customer expansion, as of March 31, 2023. In its mature states, which are also its core markets, it intends to continue focusing on customer retention, increasing its wallet share using technology and offering innovative products which cater to the needs of its customers. In other states across the rest of India, which are also potential growth markets, it intends to open new branches, acquire new customers and selectively expand its operations to locations where MML expects that customers are underserved, have lower penetration by micro-finance companies, and where there could be an opportunity for it to service an increased customer base.

Additionally, MML will also evaluate strategic acquisitions on an opportunistic basis as a means of inorganic growth to expand into new geographies or to increase its branch networks in existing geographies. Further, it may also enter into a co-lending partnership arrangement to grow its portfolio in potential growth markets.

Continue to Enhance Information Technology with a Focus on Customer Service, Operational Efficiency and Cost Optimization: MML will continue to invest in its technology platform to increase operational efficiencies as well as ensure customer credit quality. Its information technology infrastructure will not only enable it to reap the benefits of digitalizing business processes, but will also become a key source of incremental business for its as it continues to utilise the underwriting capabilities of its unique credit score card to increase the amount of loans that it disburses to customers that it classifies as low risk and very low risk. As MML continues to expand its geographic reach and scale of operations, it intends to furthers develop and invest in technology to support growth, improve the quality of services and achieve superior turnaround time in its operations. It endeavours to use technology and automation across the business processes, including, among others, sourcing, underwriting, disbursement and collection.

Superior customer service is an integral part of MML's value proposition to its customers. It intends to leverage information technology to improve customer's experience from sourcing, know-your-customer procedures and appraisal to post sales service stage. To improve risk management by reducing risks associated with cash transactions, it intends to continue to expand and grow its digital collections infrastructure. Going forward, it intends to continue expanding and grow its digital collections infrastructure to increase the number of its customers that transact digitally with it, in order to reduce its customer acquisition costs, as well as minimize the operational risks associated with cash collections. Further, MML is also in the process of developing a Super App along with the Muthoot Pappachan Group, which it plans to use to integrate its Mahila Mitra application with all of the Muthoot Pappachan Group's products and databases on to a single platform, thereby providing it with access to a wide customer base and in-depth data about its customers.

Leverage existing branch network to expand customer base and gross loan portfolio: MML endeavours to leverage its existing branch network to further increase its gross loan portfolio. As of September 30, 2023, its gross loan portfolio per branch for its mature states and other states across the rest of India (excluding mature states) was Rs.89.90 million and Rs.73.21 million, respectively. Going forward, the Company aims to increase its gross loan portfolio per branch in these other states across the rest of India, with the endeavour to bring this in line with the gross loan portfolio per branch in the mature states. It aims to achieve this through cross-selling additional loan products to its existing customers, acquisition of new customers through existing branches and the increasing loan ticket sizes to low-risk, existing customers. As part of growth strategy, MML has commenced the offering of additional financing products such as gold loans, individual loans, bicycles and home appliances to customers who have a positive repayment record with it. Further, it expects to derive benefits from economies of scale as there is limited incremental sourcing cost for existing customers, and they are eligible to borrow higher loan amounts from it since they have progressed to higher loan cycles and they have been its customers for a number of months or years. It also intends to reduce its reliance on net interest margins alone, and shift to a combination of net interest margin and fee based income.

Diversifying Sources of Funds: MML has been able to access cost-effective debt financing and reduce its average cost of borrowings over the years due to its stable credit history and improving credit ratings, diversification of borrowings and enhancement of the scale of its business. The Company has historically secured, and seeks to continue to secure, cost effective funding through a variety of sources, including public sector banks, private sector banks, small finance banks, foreign banks other non-banking financial institutions, developmental financial institutions and public investors, together with NCDs, pass through certificates, and direct assignment of loans. It also seeks to raise long term debt through ECBs. Further, it also seeks to utilize off-balance sheet funding such as pass through certificates and direct assignment of loans.

Industry:

Outlook for Indian Microfinance Industry

Rising penetration to support continued growth of the industry

Although India's household credit penetration on MFI loans has increased, it is still on the lower side. There is a huge untapped market available for MFI players. As of end of FY2023, the microfinance industry had clocked a CAGR of 21% between financial year 2018-23. With economic revival and unmet demand in rural regions, CRISIL MI&A Research expects the overall portfolio size to reach Rs.4.9 trillion by the end of the financial year 2025. CRISIL MI&A Research expects the MFI industry to log 18-22% CAGR during FY 2023-2025. During the period, NBFCMFIs are expected to grow at a much faster rate of 25-30% compared with the MFI industry. Key drivers behind the superior growth outlook include increasing penetration into the hinterland and expansion into newer states, faster growth in the rural segment, expansion in average ticket size, and support systems like credit bureaus. The presence of self-regulatory organisations like MFIN and Sa-Dhan is also expected to support sustainable growth of the industry going forward. Microfinance sector in India is regulated by the RBI. The RBI's new regulatory regime for microfinance loans effective April 2022 has done away with the interest rate cap applicable on loans given by NBFC-MFIs, and also supports growth by enabling players to calibrate pricing in line with customer risk.

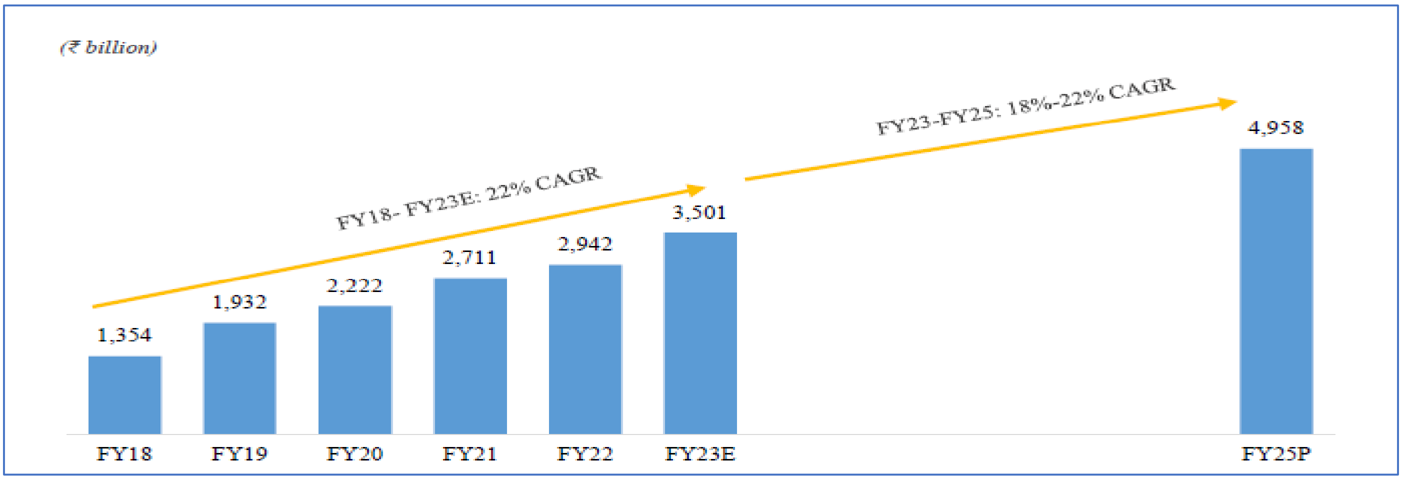
Key enablers for growth of microfinance industry

Digitalisation is expected to bring down costs, improve collection efficiency and profitability for MFIs. CRISIL MI&A Research expects that the lower cost of servicing customers, better productivity and lower credit costs through the use of technology will help MFIs improve their profitability

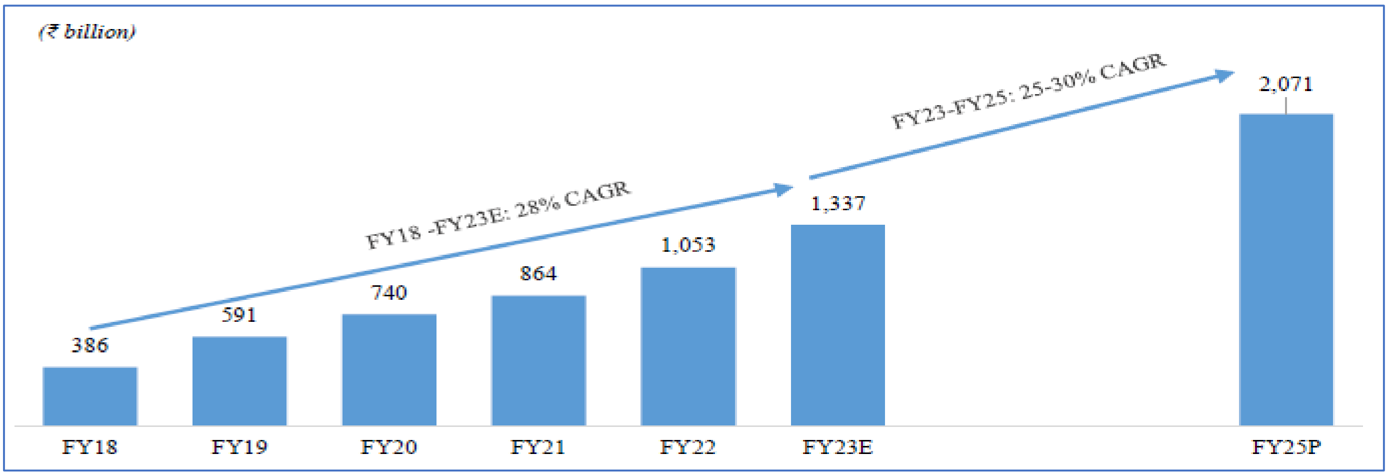
MFIs have built a large distribution network in urban and rural India. Now these MFIs are leveraging this network to distribute financial and non-financial products, including insurance and product financing of other institutions to members at a cost lower than competition

New regulations will help further deepen the penetration of microcredit in the nation. With enhancement of the household income threshold, MFIs are expected to reach many more households, and with a level playing field and increased competition, the end customer will benefit from this.

MFI industry GLP to grow at 18-22% CAGR between FY23 and FY25



GLP of NBFC-MFI industry to grow faster than industry



While growth of the MFI industry and NBFC-MFI portfolio is considerably lower than historical growth, incremental industry growth would be driven by continuous expansion in the client base of MFIs and increased penetration in rural areas. The share of NBFC-MFIs is expected to increase to 41% by fiscal 2025.

KEY SUCCESS FACTORS

Ability to attract funds/raise capital and maintain healthy capital position

The microfinance industry has seen rapid growth over the past few years owing to the small ticket size and doorstep disbursement. Despite the rapid growth, a large portion of the market remains underpenetrated, making it necessary for MFIs to raise funds at regular intervals to sustain growth. This remains a challenge for several MFIs owing to perceived risk of the borrower segment, their susceptibility to socio-political issues, and volatility in asset quality. The ability of MFIs to raise funding from diverse sources and maintain a capital position much higher than the prescribed regulatory minimum is vital for long-term sustainability.

Geographically diversified portfolio helps MFIs mitigate risks

A large, well-diversified portfolio in different geographies enables players to mitigate risks associated with a concentrated portfolio. Apart from this, a wider scale of operation helps them cut down on operating expenses as a percentage of outstanding loans. Rural areas are still under-penetrated in India; hence, players operating in and focused on rural areas would see faster growth in their portfolios.

Ability to control asset quality and ageing of NPAs

The vulnerability of MFIs' portfolios to local issues and events that impact the repayment ability of borrower households make it critical for them to have a strong hold on asset quality and regularly engage with borrowers to control ageing of NPAs. MFIs, thus, need to put in place methods and use analytics to understand and predict the quality of the portfolio, and minimise the frequency and size of asset quality-related risks.

MFIs are focused on technology enablement

MFIs play a crucial role in providing financial access to underserved segments in the country. There is a huge potential for providing products and services to consumers at the bottom of the pyramid. Considering the challenges, and also the latent growth opportunities in meeting consumer needs, it would be beneficial for MFIs to enter into partnerships with fintech companies and tap the digital medium for financial inclusion.

Digitalisation to bring down costs, improve collection efficiency and profitability for MFIs

Digitalisation has impacted almost all aspects of the financial services industry. However, it is far more critical to the MFI industry as lower operating cost can result in higher financial inclusion and increased benefits for customers. The use of technology has helped MFIs grow at a fast pace, improve efficiency, lower cash usage and turnaround times, develop new products, provide better services to customers, and use analytics for portfolio monitoring and credit appraisal. As confirmed from the MFin report, In the first quarter of the financial year 2024, approximately 47 out of 53 NBFC-MFIs have reported 100% of their disbursement through cashless mode.

CRISIL MI&A Research expects that the lower cost of servicing customers, better productivity and lower credit costs through the use of technology will help MFIs improve their profitability.

Credit risk mitigation by credit bureaus

Credit bureaus, such as Equifax and Highmark, collect data from several MFIs and build a comprehensive database that captures the credit history of borrowers. These databases are updated weekly. The presence of credit bureaus ensures that MFIs have access to more data on their borrowers, helping them make informed lending decisions over the long run.

Competitive dynamics

CRISIL MI&A Research expects NBFC-MFIs to grow at a much faster rate vis-a-vis SFBs, on account of increasing focus of the latter towards product suites beyond the MFI loan portfolio and improving liquidity for NBFCs in the system. Players tapping newer states and districts to widen client base CRISIL MI&A has seen a significant jump in the number of MFIs operating in Uttar Pradesh, Rajasthan and Gujarat. Total number of branches in these states has significantly increased in recent years, leading to a jump in GLP for these states. The availability of borrower credit related data from credit information companies also ensured that MFIs have access to more data on borrowers, helping them make informed lending decisions.

Rural segment to drive MFI business

CRISIL MI&A Research expects the share of rural segment in MFI business to remain higher, with increasing demand expected from this segment. Despite 65% of population and 45% of GDP contribution, the rural segment's share in credit remains fairly low at 9% of the bank credit outstanding as of December 2022, thereby opening up a huge opportunity for savings and loan products.

Although the rural economy has been adversely affected by the second wave of the Covid-19, it is structurally far more resilient and is expected to bounce back strongly. And, with the government's focus on financial inclusion, financial institutions are opening new branches in unbanked areas. CRISIL MI&A Research has observed that demand for loans is higher in rural areas. As of December 2022, the share of rural segment in overall MFI portfolio increased to 42% of the GLP from 35% in fiscal 2018. In case of NBFC-MFIs, the rural share increased to 45% as of December 2022 from 35%. This is due to less competition, lower credit penetration and less migration in rural areas. It also benefitted from overall better credit behaviour and, in turn, lower delinquency rates.

The significant under penetration of credit in rural areas offers strong potential for growth, and given the relatively deeper reach, existing client relationships and employee base, MFIs are well placed to address this demand, which is currently being met by informal sources such as local money lenders.

Advantages in Rural Focused Business

- Huge market opportunity in the rural segment – Despite its larger contribution to GDP of 45%, however, their share is abysmally low at 9% of total credit as of December 2022. This provides a huge market opportunity for MFI players present in the segment.
- Less competition – In remote areas, informal credit channels have a major presence. In other words, there is a huge section of unbanked population with low competition. MFI players are better placed to tap this market.
- Geographic diversification – With increased focus on diversifying their portfolio and expanding their reach, MFI players are expected to log higher growth as they tap newer geographies.
- Ability to manage local stakeholders – With their microfinance experience, they have the ability to manage local stakeholders and maintain operational efficiency.
- Lower delinquency rates – Asset quality of rural regions is better than urban and semi-urban regions since fiscal 2017 due to better risk profile of customers and better credit discipline.
- Loan recovery and control on aging NPAs –

Challenges in Rural-Focused Business

The microfinance industry mainly caters to the poor or marginalised section of the society, because of which it faces inherent challenges, especially in rural areas:

High cost of reaching the customers – Providing microfinance loans in rural India requires reaching people in remote and sparsely populated regions, where deploying manpower and requisite infrastructure for disbursing loans and for recovery can often be expensive. The high cost of reaching the customers, and the small volume and ticket size of transactions lengthens the breakeven period.

Lack of financial awareness – Lack of financial and product awareness is a major challenge for institutions in rural areas. They are faced with the task of educating people about the benefits of financial inclusion, product and services offered by them, and need to establish trust before selling a product.

Vulnerability of household income to local developments – Uncertainty and unpredictability faced by low-income households, and vulnerability of their incomes to local developments affect their repayments. High proportion of cash collections – Despite a large proportion of loans disbursed through the cashless mode, collections in unbanked and rural areas are still in cash. This leads to increased time spent on reconciliation, risk involved in handling cash, and higher turnaround time from the financier's perspective.

However, the rural economy proved to be resilient during the pandemic. India witnessed above-normal, timely and largely welldistributed monsoon since 2019, thus benefitting the agriculture industry in particular and rural India in general. Further, increase in the agriculture credit target and allocation of infrastructure fund for the development of Agriculture Produce and Livestock Market Committee reiterate the government's commitment to boost rural India.

NBFC-MFI — Regulation Guidelines

Potential harmonisation of regulations for MFI lending. In February 2021, the RBI outlined the need to harmonise regulations governing the MFI lending industry, for which it had to reframe the regulatory framework. A potential harmonisation of regulations for MFI lending will positively impact NBFCMFIs as banks and small finance banks (SFBs) will also be governed by the same regulations, hence eliminating the competitive edge they currently enjoy. The key proposals include (i) a common definition of microfinance loans for all regulated entities, (ii) a Board-approved policy for household income assessment, (iii) capping the outflow on account of repayment of loan obligations of a household to 50% of the household income, (iv) greater flexibility of repayment frequency for all microfinance loans, (v) no pre-payment penalty and no requirement of collateral, (vi) introduction of a standard simplified fact sheet on pricing of microfinance loans for better transparency, (vii) alignment of pricing guidelines for NBFC-MFIs with guidelines for NBFCs, and (viii) withdrawal of guidelines currently applicable to only NBFC-MFIs, including withdrawal of the two-lender norm for lending by NBFC-MFIs and withdrawal of all pricing-related instructions applicable to NBFC-MFIs. The new regulatory regime levels the playing field and benefits NBFC-MFIs The RBI, in its master directions on microfinance loans, released in March 2022, has done away with the interest rate cap applicable on loans given by NBFC-MFIs. Entities providing microfinance loans will have to put in place a Board-approved policy for the pricing of loans. The policy should include the interest rate model, range of spread of each component for categories of borrowers, and ceiling on interest rate and all other charges on MFI loans. The RBI's move levels the playing field, with both NBFC-MFIs and banks/SFBs providing microfinance loans now being subject to the same rules, which was not the case in the earlier regime. This move is expected to positively impact NBFC-MFIs. The increase in annual household income cap for microfinance borrowers (to Rs.3,00,000 in both urban and rural areas), removal of the two-lender norm for lending by NBFC-MFIs, and allowing NBFC-MFIs greater flexibility to offer non-MFI loans (MFI loans required to account for 75% of total assets for NBFC-MFIs, as per the new regulations) will increase the market opportunity available to MFIs and enable them to create a more balanced portfolio.

On the flip side, the increase in annual household income threshold could increase the maximum permissible indebtedness limit of borrowers from Rs.1,25,000. While the limit on the loan repayment obligation will act as a safeguard against excessive leveraging, the increased permissible debt limit and possibility of divergences in household income assessment criteria across lenders still pose risks. Proper data infrastructure would be required to analyse and estimate household incomes, especially in rural areas. Subsequent to the RBI's revised regulations for MFI loans, effective October 1, 2022, some MFIs have increased interest rates for borrowers by 150-200 bps, especially those who are credit untested. CRISIL MI&A Research expects the rates to slowly stabilise as MFIs begin to adapt to the new regime and put in place processes for household income, leverage and risk capture based on the new guidelines. Competitive forces would prevent a substantial spurt in rates for MFI customers, especially those with a good repayment track record and credit behaviour.

Asset Quality

In fiscal 2021, the industry's asset quality deteriorated sharply, reflecting the adverse impact of Covid-19 on the industry. The industry's PAR>30 and PAR>90 shot up to 16.4% and 11.9%, respectively, in March 2021, and deteriorated to 15.8% and 14,3% respectively, December 2022 vs. 15.4% and 12.9% in March 2022. This could be attributed to slippages from the restructured book for various MFI players. CRISIL MI&A Research believes that going forward, timely recoveries and controlling incremental slippages would be critical for the MFIs to keep their asset quality under check. Among peer groups, NBFC-MFIs' PAR>30 and PAR>90 improved to 6.1% and 5.3% in the financial year 2020 from 9.7% and 9.0% in the financial year 2018, but again increased to 13.5% and 11.8% in March 2022 and has marginally improved to 12.5% and 11.5% in December of the year. Asset quality, although improving, remains moderate compared with the prepandemic level owing to additional slippages arising from the restructured portfolio. With collection efficiency back to prepandemic levels, asset quality is expected to improve in the coming fiscals. While portfolio quality has deteriorated across rural, semi-urban and urban areas, closer analysis of long-term cycles indicates that asset quality tends to be much better in rural areas than in urban and semi-urban areas owing to strong farm income, good monsoon and resilience.

Key Concerns

- The microfinance industry in India faces certain risks due to the category of customers that it services, which are not generally associated with other forms of lending. As a result, MML may experience increased levels of nonperforming assets and related provisions and write-offs that may adversely affect its business, financial condition and results of operations.

- Business is vulnerable to interest rate risk, and volatility in interest rates could have an adverse effect on MML's net interest income and net interest margin, thereby affecting its results of operations.

- MML is subject to certain conditions under its financing arrangements, which could restrict its ability to conduct business and operations in the manner it desire

- Concerns about terms of loans provided by MML may adversely affect its reputation and thereby the growth and the market acceptance of the products and services.

- MML may not be able to sustain the significant growth in its business and relatively high profit after tax that it recorded for the Financial Year 2023 in the future.

- The Company has experienced negative cash flows from operating, investing and financing activities in the past.

- MML has availed loans which may be recalled by the lenders, subject to the terms and conditions of their grant, at any time.

- Dependence on the recognition of the "Muthoot" brand, and failure to use, maintain and enhance awareness of the brand would adversely affect the ability to retain and expand base of customers.

- An increase in the level of non-performing assets or provisions may adversely affect the financial condition and results of operations.

- As a non-banking financial company – microfinance institution, MML is subject to periodic inspections by the Reserve Bank of India. Non-compliance with observations made by the Reserve Bank of India during these inspections could expose it to penalties and restrictions.

- MML faces the threat of cyber-fraud and cyber-attacks, such as hacking, phishing and theft of sensitive internal data or customer information

- The Company is unable to manage growth effectively, its business and reputation could be adversely affected. Further, it may not be able to sustain the growth rates it has had since its inception.

- Derives a significant portion of revenues from South India, and any adverse developments in the southern states of India may have an adverse effect on the business, results of operations, financial condition and cash flows.

- Any disruption in sources of funding or increase in costs of funding could adversely affect the liquidity and financial condition.

- MML is subject to laws and regulations governing the financial services industry in India and changes in laws and regulations governing it could adversely affect its business, results of operations and prospects.

- Any downgrade of credit ratings may constrain access to capital and debt markets and, as a result, may adversely affect its cost of borrowings and results of operations.

- To support and grow business, MML must maintain a minimum capital to risk weighted assets ratio, and lack of access to capital may prevent it from maintaining an adequate ratio.

- It may face various risks associated with large number of rural and semi-urban branches and widespread network of operations which may adversely affect the business, financial condition and results of operations.

- Competition from other micro-finance institutions, banks (including small finance banks) and financial institutions, as well as state-sponsored social programs, may adversely affect the profitability and position in the Indian microcredit lending industry.

- NPA recognised as a percentage of total loan portfolio was higher in the first half of the Financial Year 2023 as compared to the second half of the Financial Year 2023. Fluctuations in NPA recognised as a percentage of total loan portfolio across certain periods may adversely affect the cash flows, which in turn may adversely affect the business, financial condition and results of operations.

- Changes in the tenure of loan products could result in asset liability mismatches and expose to interest rate and liquidity risks, which may adversely affect the business, financial condition, results of operations and cash flows.

- A significant portion of collections from customers is in cash, exposing MML to certain operational risks. Further, it may be subject to regulatory or other proceedings in connection with any unauthorized transactions, fraud or misappropriation by its representatives and employees, which could adversely affect the business and goodwill.

- Any deterioration in the performance of any pool of receivables assigned by MML and other institutions may adversely affect its financial condition and results of operations.

- Success depends, in large part, upon management team and skilled personnel and on ability to attract and retain such persons. Failure to train and motivate employees may lead to an increase in employee attrition rates and results of operations could be adversely affected as a result of any disputes with MML's employees.

- Business is subject to seasonality, which may contribute to fluctuations in results of operations and financial condition.

- Business, financial condition, cash flows and results of operations may be adversely affected by certain state regulations.

- MML faces challenges in operating its rural-focused business model, including challenges pertaining to the high cost of reaching customers, lack of financial awareness, vulnerability of customers' household income and high proportion of cash collections.

- Business is affected by prevailing economic, political and other prevailing conditions in India and the markets it currently serves.

- Currency exchange rate fluctuations may affect the value of the Equity Shares.

Profit & Loss

Particulars (Rs in million)	Q2FY24	FY23	FY22	FY21
Revenue from operations				
Interest income	9135.8	12906.5	7286.2	6227.8
Fee and commission income	160.0	173.2	61.6	32.1
Net gain on fair value changes	1084.1	1115.4	910.3	409.3
Income on investments	38.1	83.4	58.3	170.0
Sale of services	5.4	9.3	8.6	2.5
Other income	49.1	175.8	104.4	121.1
Total Revenue	**10472.4**	**14463.4**	**8429.4**	**6962.8**
Total Expenditure	**7726.3**	**12334.7**	**7782.2**	**6872.3**
Finance costs	4153.3	5490.1	3401.6	2993.3
Fees and commission expenses	132.5	275.4	178.5	97.4
Impairment on financial instruments	627.5	2233.2	1111.5	1322.2
Employee benefits expenses	2095.5	3225.6	2370.8	1870.9
Depreciation, amortisation and impairment	164.6	266.1	207.8	188.3
Other expenses	552.9	844.4	512.0	400.2
PBT	**2746.1**	**2128.7**	**647.2**	**90.6**
Tax (incl. DT & FBT)	**693.5**	**489.8**	**173.2**	**20.0**
Current tax	729.1	679.9	224.1	347.3
Deferred tax (net)	-35.6	-142.6	-56.1	-317.7
Tax relating to prior years	0.0	-47.5	5.3	-9.6
PAT	**2052.6**	**1638.9**	**474.0**	**70.5**
EPS (Rs.)	14.2	11.7	3.9	0.6
Face Value	10	10	10	10

Balance Sheet

Particulars (Rs in million) As at	Q2FY24	FY23	FY22	FY21
ASSETS				
Financial assets				
Cash and cash equivalents	5,579.2	7,594.6	7,058.3	5,190.8
Bank balances other than cash and cash equivalents	4,941.9	3,909.6	2,940.9	2,259.0
Other receivables	1,230.8	722.1	167.7	92.9
Loans	85,499.2	70,266.9	43,981.1	32,940.3
Investments	513.7	633.6	0.5	0.5
Other financial assets	52.7	40.6	33.7	23.9
TOTAL FINANCIAL ASSETS	**97,817.4**	**83,167.3**	**54,182.1**	**40,507.3**
Non-financial assets				
Current tax assets (net)	128.9	104.6	395.5	94.2
Deferred tax assets (net)	73.4	57.8	47.8	100.4
Property, Plant and Equipment	644.6	594.4	420.5	398.4
Right Of Use Assets	1,249.7	1,121.7	791.2	700.2
Other Intangible assets	2.7	2.9	0.8	1.3
Other non- financial assets	396.3	243.4	76.8	36.8
TOTAL NON FINANCIAL ASSETS	**2,495.6**	**2,124.7**	**1,732.5**	**1,331.2**
TOTAL ASSETS	**100,313.0**	**85,292.0**	**55,914.6**	**41,838.5**
LIABILITIES & EQUITY				
Trade payables				
total outstanding dues of micro enterprises and small enterprises	3.4	0.0	0.0	0.0
total outstanding dues of creditors other than micro enterprises and small enterprises	146.2	119.3	75.3	29.2
Debt securities	14,356.2	13,701.5	6,746.3	4,524.7
Borrowings (other than debt securities)	63,104.9	51,230.3	32,969.9	25,382.3
Subordinated Liabilities	0.0	0.0	250.0	249.6
Lease Liability	1,454.6	1,299.4	914.0	779.9
Other financial liabilities	2,664.7	2,582.7	1,492.8	1,888.6
TOTAL FINANCIAL LIABILITIES	**81,730.1**	**68,933.1**	**42,448.2**	**32,854.3**
Non-financial liabilities				
Provisions	64.9	36.1	49.4	46.4
Current tax liabilities (Net)	0.0	0.0	0.0	0.0
Other non-financial liabilities	97.1	64.2	51.2	38.9
TOTAL NON FINANCIAL LIABILITIES	**162.0**	**100.4**	**100.6**	**85.3**
Equity				
Equity share capital	1,402.0	1,402.0	1,333.3	1,141.7
Other equity	17,019.0	14,856.5	12,032.5	7,757.2
TOTAL EQUITY	**18,421.0**	**16,258.5**	**13,365.8**	**8,898.9**
TOTAL LIABILITIES AND EQUITY	**100,313.0**	**85,292.0**	**55,914.6**	**41,838.5**

Source: RHP

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