Stock Update

MAS Financial Services Ltd.

October 19, 2022

RETAILRESEARCH

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MAS Financial Services Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
NBFC	Rs.806	Buy between Rs.800-812 & add more on dips of Rs.717	Rs.880	Rs.941	2-3 quarters

HDFC Scrip Code	MASFIN
BSE Code	540749
NSE Code	MASFIN
Bloomberg	MASFIN IN
CMP Oct 18, 2022	578.8
Equity Capital (Rs Cr)	54.7
Face Value (Rs)	10
Equity Share O/S (Cr)	5.5
Market Cap (Rs Cr)	4277.9
ABook Value (Rs)	278
Avg. 52 Wk Volumes	110153
.52 Week High	843
52 Week Low	469

Share holding Pattern % (Jun, 2022)	
Promoters	73.71
Institutions	10.93
Non Institutions	15.36
Total	100.00

* Refer at the end for explanation on Risk Ratings

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Our Take:

MAS Financial Services Limited (MFSL) is an Ahmedabad-based Non-Banking Finance Company (NBFC). It has a diversified product portfolio that includes micro enterprise loans, SME loans, home loans (through subsidiary), two-wheeler loans, used car loans and commercial vehicle loans. It has a track record of more than Rs.15,000 Cr cumulative disbursement with total loss less than 0.5% over a decade across various tough periods. Despite the slowdown in the industry due to covid, MFSL has been able to maintain strong growth in almost all its verticals while maintaining its asset quality profile.

We feel that the worst in terms of demand growth and asset quality has been over for the sector and the tailwinds are blowing which along with the company's strategy of growth i.e. shift to direct sourcing channel, liquidity management etc. could lead to the rerating for the stock. There has been healthy overall credit growth in the system and the sectors in which the company lends are also showing strong signs of revival. Government support for the sector will have a positive second order impact for company lending to the MSME segment. Auto sales are picking up and chip shortage scenario has also been majorly resolved; in fact we feel the pent up demand as well as festival season will keep the sales numbers high at least until next quarter.

We had issued Initiating Report on MFSL on 7th May, 2021 and stock update report on 31st May, 2022 (Link). The targets for both of these reports were achieved during the given time frame. We feel that the room for upside in the stock price is still there looking at the growth opportunities.

Valuation & Recommendation:

MFSL has proven track record of more than 25 years with AUM CAGR of 36.38% and PAT CAGR of 40.58%. We believe that sustainable growth rate with the stable asset quality is a key differentiator for MFSL. The management has said that they are looking to double the loan book in next three to four years while keeping the asset quality stable (being the main goal). Housing finance subsidiary is scaling up and has huge opportunity for the growth. The company is planning to expand presence into newer geographies, which could keep opex high for near term, however as the economy of scale kicks in there will be meaningful improvement in the AUM growth rate and a fall in cost to Income ratio. We expect MFSL to grow its Asset Under management (AUM) at 27% CAGR while NII and Net profit are expected to grow at 29% and 33% CAGR respectively over FY22-24E. ROAA is estimated to improve to 3.4% in FY24E from current 2.8% in FY22. The company is available at a valuation of 2.7 FY24E ABV, which though not cheap has a potential for growth from hereon. **We believe that investors can buy MAS Financial Services Limited at 800-812 (2.7xFY24 ABV) and add more at Rs.717 (2.4xFY24E ABV) for the base case fair value of Rs.880 (2.95xFY24E ABV) and for the bull case fair value of Rs.941 (3.15xFY24E ABV) over the next two to three quarters.**

Financial Summary (Standalone)

Particulars (Rs Cr)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY20	FY21	FY22	FY23E	FY24E
NII	75	58	28.3	69	9.3	283	219	250	319	413
PPOP	71	64	11.1	61	17.0	311	271	246	322	434
PAT	47	37	26.3	43	9.6	167	144	158	206	279
EPS (Rs)						30	26	29	38	51
ABV (Rs)						171	207	227	257	299
P/E (x)						26.5	30.7	27.9	21.4	15.8
P/ABV (x)						4.7	3.9	3.6	3.1	2.7
RoAA (%)						4.0	2.9	2.8	3.1	3.4
RoAE (%)						18.1	13.3	12.7	14.7	17.5

(Source: Company, HDFC sec)

Change in estimates:

	FY23E			FY24E		
	Old	New	% Change	Old	New	% Change
Loan Book	5760	5829	1%	7315	7403	1%
NII	303	319	5%	381	413	8%
PPOP	303	322	7%	396	434	10%
PAT	191	206	8%	251	279	11%
EPS (Rs.)	35	38	8%	46	51	11%
ABV (Rs.)	254	257	1%	291	299	3%

Recent Developments

Q1FY23 Result Update

The company has reported yet another strong quarter result. The Net Interest Income rose by 28.3%/9.3% YoY/QoQ. The NIM improved by 50bps QoQ at 6.5%. Strong fee income has resulted in healthy growth of non-interest income at Rs.31 Cr (+52% YoY, +43% QoQ). Operating expenses were again at the elevated levels only due to expansion. The C/I ratio increased by ~30bp QoQ to ~33%. The PPOP was grew by 17% QoQ, while higher provisions has impacted the growth rate of net profit (up 26% YoY/9.6% QoQ).

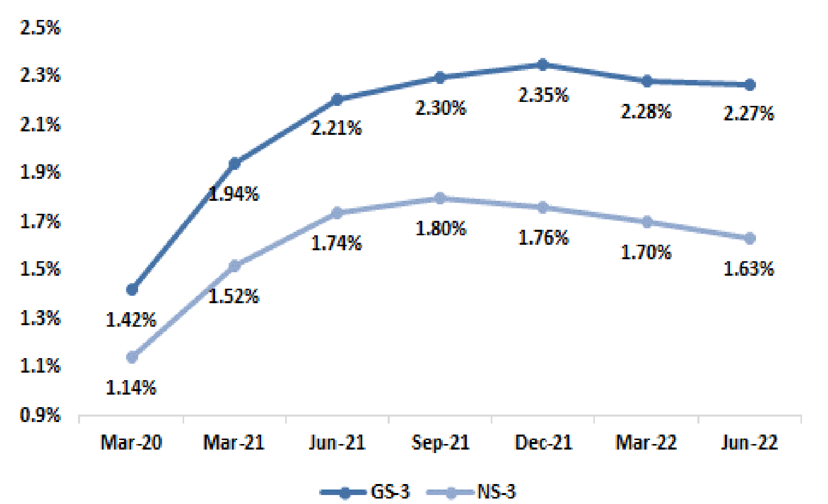
AUM stood at Rs.6,684 Cr, which is up 30% YoY and 7% QoQ. This was on the back of strong disbursements growth, which almost doubled YoY and up 10% QoQ. Around 89% of the AUM came from micro enterprise loans and SME loans and 2-wheels was around 11%. Housing subsidiary AUM rose 16% YoY. The share of off balance sheet was at 18%, declined by ~100 bps QoQ.

The company has strong capitalization level to fund the expected growth. Capital Adequacy stood at 25.28% with Tier I Capital Adequacy at 22.49% & Tier II Capital Adequacy of 2.79%. During the quarter, it raised Rs.620 Cr term loan (average tenor of 3-5 years) and now it has positive ALM across all the time bucket.

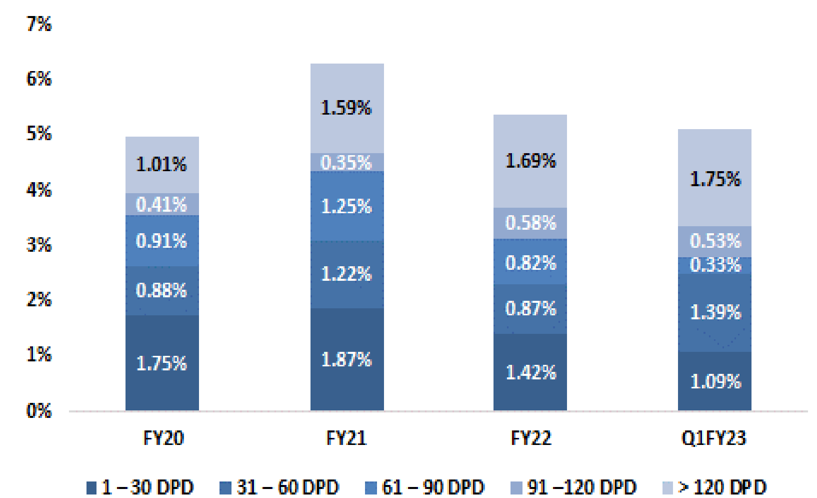
Well Maintained Asset Quality

Customised credit analysis procedures and extensive credit monitoring process helps the company in maintaining the asset quality throughout different credit cycles. Even during the times of covid or RBI's new circular on NPA stamping there was marginal impact on the asset quality. As of Q1FY23, the Gross stage 3 (GS3) and the Net Stage 3 (NS3) were at 2.27% and 1.63% respectively, which is almost at a similar level compared to the last quarter. The company has Rs.23.7 Cr or 0.35% of the AUM worth of restructured book outstanding. As of Q1FY23, the 1 – 30 DPD is at 1.09% while 31 – 60 DPD is at 1.39%. Segment wise GS3 is 2.58% for 2 wheeler 2.35% for CV, 1.48% SME and 1.53% MSME. The company continues to carry management overlay of Rs.34 Cr (~0.62% of on-book assets) and plans to utilize the same gradually.

Gross Stage 3 & Net Stage 3 trend



AUM- Credit Quality



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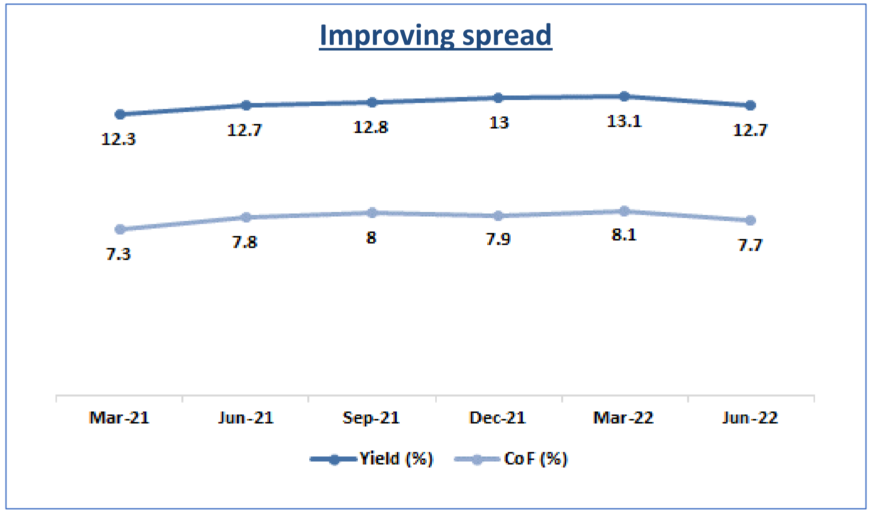
Concall highlights

- With rising share of fintech partners and scaling up of the direct distribution channel, the management estimates that the company could grow AUM at ~25% CAGR on a steady state basis. It is also trying to increase the ticket size. Housing finance subsidiary is expected to grow at ~30-35% CAGR (lower base) over the medium term.
- In the Q1FY23, the company has done Rs.200 Cr worth of disbursement via fintech originations.
- In terms of the product distribution, the company will continue to focus on MSME where 90% of the business comes from micro, small and medium enterprises.
- The NIMs could stay in the range of 6.75-7.25% for foreseeable future, after counting the impact of rate hikes. The cost of borrowing for the quarter has been stable at 8.64%. In the current increasing interest rates scenario, management envisages that cost of borrowing to remain stable at with the increasing trend remaining between 25 bps to 40 bps.
- The distribution network of the current states in operation will be strengthened and endeavor will be to provide one of the most efficient financial services which it terms as the Power of Distribution. The company will also explore the potentiality of entering into new geographies.
- Around 85% of the portfolio is MSME loans which qualifies as Priority Sector Lending. The company aims to maintain around 20%-25% of AUM as off book through Direct assignment and Co-lending transactions.
- MFSL is looking to obtain an insurance and broking license, which could add fee based income and could also help the company diversify further. Furthermore, the company will also try to explore opportunities to improve fee income within its own SME customer base.
- As per management the opex has peaked and going forward they expect the economy of scale could kick in and improve ROA. The company has guided for ROA between 2.75-3.25% which could translate into RoE in the range of 15-18% for FY23.

Margin should improve

As explained in the earlier note, the Net Interest Margin (NIM) of the company was under pressure in last few quarters due to higher liquidity and a slower growth in AUM growth. Now that the management has been observing higher demand and bright outlook, they are aiming to reduce liquidity. This could help the company improve margins going ahead. The management has guided that NIMs could hover around 6.75-7.25%. As of Q1FY23, the calculated NIM was at 6.5% compared to 6% in the last quarter. The company have 70% of the asset on floating rate, to which it can pass on the rate hike easily, while the borrowing is MCLR based, so the borrowing cost does not correspond immediately to the rate hike. This is ideal scenario in the rising interest rate times. The management is confident that the company will be navigating these rate hikes without causing much stress on NIM and hence the ROA.



Shift to direct sourcing channel

MFSL has a unique sourcing business model, wherein it partners with smaller NBFCs to originate loans. It has done partnership with more than 150 NBFCs and via this channel the company has cumulatively distributed around Rs.17,000 Cr worth of distribution over a decade with the loss driven default of less than 1%. Since last few quarters, the company has changed strategy a bit and now focusing more on shifting to the direct distribution model. Currently the share of direct distribution is close to 55% as compared to 45% last year. Going forward, the management has guided that the share will gradually increase as the company is looking to expand its geographical footprint by increasing its branch network. It has added ~20 branches taking the branch count to 145 compared to 125 in FY22. It aims to take this number up to 160 by the end of FY23 and up to 250 in next three years. So far the focus areas are majorly Gujarat, Maharashtra and Madhya Pradesh but now the company is looking to expand the network to nearby regions i.e. namely Delhi NCR, Chhatisgarh, Telangana and Andhra Pradesh. Further, as per management the branches are smaller in size with lower monthly costs so it could turn in to profit within 9-12 month time period from commencing operations. We believe that this could increase the opex in near term, but looking at the larger picture this change of strategy could bring sustainable growth in the business.

Strengthening housing finance division

The housing finance subsidiary has started sowing positive signs of growth. During the quarter, the AUM grew by 16.5% while net worth further improved by 7% YoY. Net Interest Income and Net profit rose by 30% and 14% YoY respectively. This division has negligible NPAs with GS3 at 0.54% and NS3 at 0.38%. Capital adequacy ratio, as on 30th June 2022 is 46.43% against regulatory norms of 15%. Tier I capital is 33.43%. Tier II capital is 13%. The company has guided that the loan book could grow at 25-30% YoY in the housing finance business for FY23 and aims to grow at 30-35% post 3-4 years.

Sectorial tailwind

The growth rate in the MSME and SME segment was impacted due to covid-19 pandemic. However, as the economy has started to improve the growth rate seems to be coming back to the mean. During the Q1FY23, the company reported 30% YoY and 7% QoQ growth supported by healthy disbursements. Management has informed that the plan is to double the book in next three to four years. We factor in ~27.5% loan book CAGR over FY22-24E as we watch out for sustained improvement in disbursement trends. MFSL is looking to tap opportunity in the MSME sector. It plays a pivotal role in the economic and social development of the country. There is clear regulatory support for the MSME segment, which will have a positive second order impact for company lending to the MSME segment. There are many opportunities to offer simple innovative products backed by superior technology in the Rural and Semi-Urban areas of India.

We believe that worst in terms of demand de-growth has been over in auto financing sector and situation should improve from hereon. The head line economic numbers (IIP, eight core infra, manufacturing PMI etc.) are showing strong growth momentum. Auto sales are picking up and chip shortage scenario has also been majorly resolved; in fact we feel the pent up demand as well as festival season will keep the sales numbers high at least until next quarter. Going forward, we believe that lower base along with favourable environment like Government's infrastructure push, normal monsoon and rise in E-commerce activities etc. are the early indicators of an uptrend in CV segment. Government's significant ramp-up in investments in road infrastructure, along with GST and e-way bill implementation, is aiding higher operating efficiencies for fleet operators (lower commute time, higher mileage, lower wear and tear, etc.), narrowing the gap further with rail freight rates. In addition to volumes, price inflation in autos should further aid growth in loan book.

Risks & Concerns

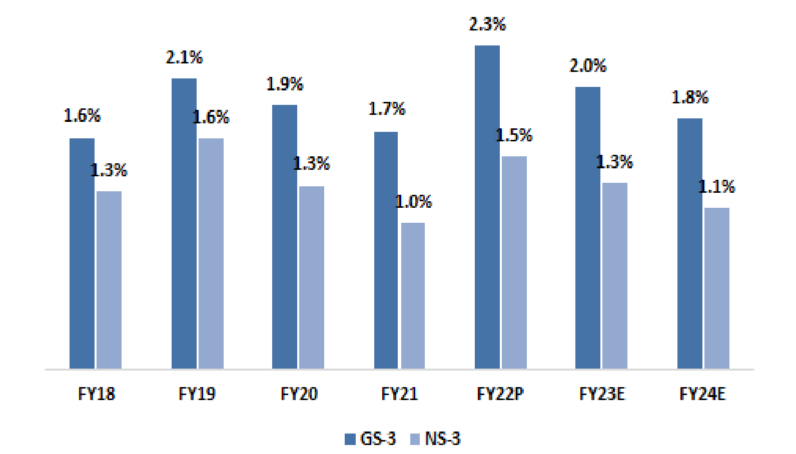
- A significant portion of MFSL's exposure is to its top-10 borrowers. As of Q1FY23, the top-10 exposure of MFSL accounted for ~66% of its consolidated tangible net-worth indicating relatively high borrower concentration risk.
- MFSL's lending activities are concentrated in seven states; out of these three states have just one branch. This brings geographic concentration risk for the company. However, significant amount of lending is done via NBFCs and NBFC-MFIs, which negates this risk.
- The company depends on direct assignment income. Assignment is upfronting of future income to today by selling down loans to Banks. This is a low cost funding source for NBFCs. In case there is any disruption in loans sell down, it could impact the profitability of the company.
- Major portion of lending is to micro enterprises in the informal sector which could face increased stress during economic slowdown and could result in higher NPA levels. These loans are unsecured and are susceptible to certain operational and credit risks which may result in increased levels of NPAs which may adversely affect company's growth prospects and financial condition.

- The company's inability to scale up housing finance subsidiary or maintaining its asset quality is another risk to our thesis.

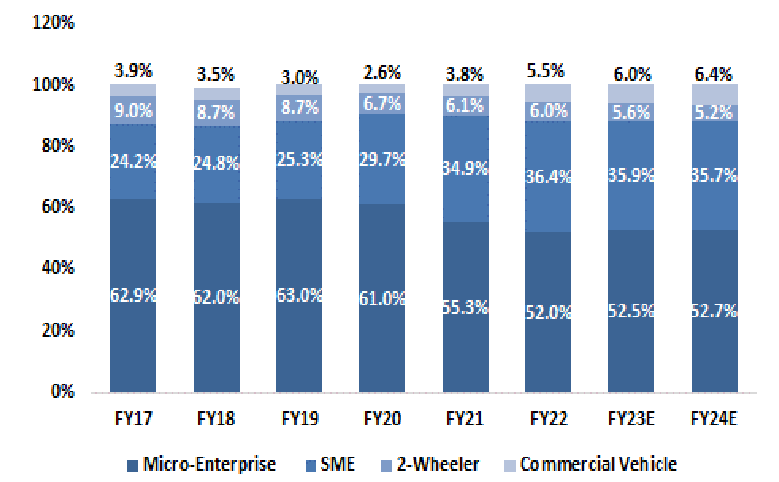
Company Background:

MAS Financial Services Limited (MFSL) is an Ahmedabad-based diversified Non-Banking Finance Company (NBFC) registered with the Reserve Bank of India (RBI). Incorporated in 1995, the Company is engaged in providing specialised retail financing services to the lower income and middle-income groups of the society. Since over two decades, the Company primarily caters to the financially underserved masses spread across urban, semi-urban, and rural areas in the formal and informal sectors. The Company offers a wide range of retail finance products such as micro enterprise loans, SME loans, home loans(through subsidiary), two-wheeler loans, used car loans and commercial vehicle loans to satisfy the varied needs of customers. MRHMFL (MAS Rural Housing & Mortgage Finance Ltd. – subsidiary of MFSL) aims at serving the middle income and the lower income sector of the economy, especially in the semi urban and rural areas. It also extends loans to developers for the construction of affordable housing projects.

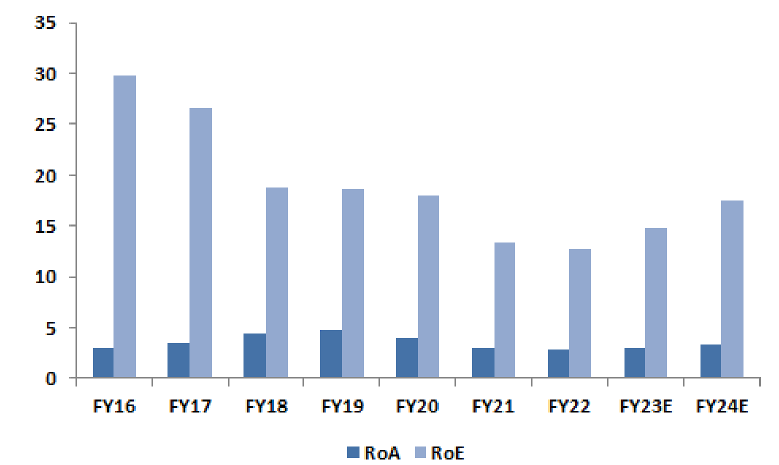
NPA Trend



AUM Mix (%)



Return ratios (%)



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Financials (Standalone)

Income Statement

(Rs Cr)	FY20	FY21	FY22	FY23E	FY24E
Interest Income	555	483	570	732	939
Interest Expenses	272	264	320	413	526
Net Interest Income	**283**	**219**	**250**	**319**	**413**
Non interest income	117	109	86	106	137
Operating Income	**400**	**328**	**337**	**322**	**434**
Operating Expenses	90	58	92	105	118
PPP	**310**	**270**	**244**	**321**	**432**
Prov & Cont	82	78	34	47	60
Profit Before Tax	227	191	210	274	373
Tax	62	49	54	70	95
PAT	**166**	**142**	**157**	**206**	**279**

Balance Sheet

(Rs Cr)	FY20	FY21	FY22	FY23E	FY24E
Share Capital	55	55	55	55	55
Reserves & Surplus	926	1118	1254	1427	1662
Shareholder funds	**981**	**1173**	**1308**	**1481**	**1717**
Borrowings	2580	3294	4232	5421	6884
Other Liab & Prov.	1011	711	535	508	498
SOURCES OF FUNDS	**4572**	**5178**	**6075**	**7410**	**9099**
Fixed Assets	62	61	65	71	78
Investment	38	235	538	816	1110
Cash & Bank Balance	1027	997	831	578	360
Advances	3348	3805	4554	5829	7403
Other Assets	98	79	87	117	148
TOTAL ASSETS	**4572**	**5178**	**6075**	**7410**	**9099**

(Source: Company, HDFC sec)

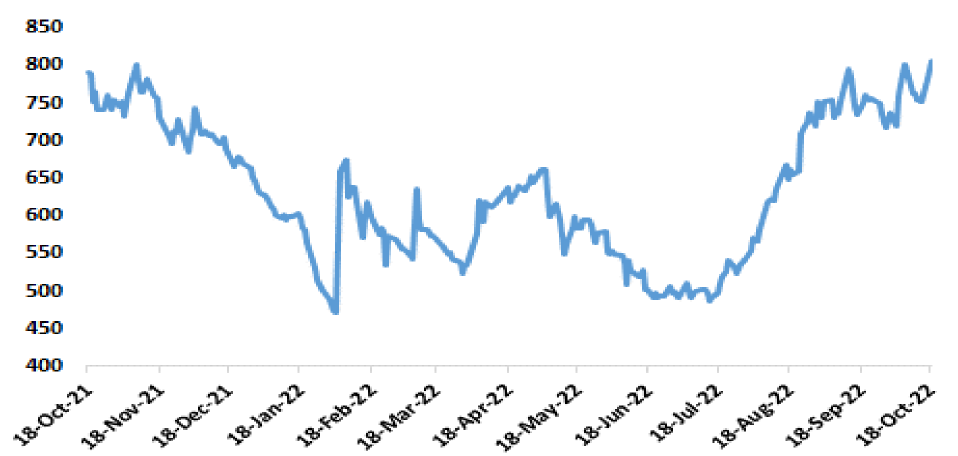
Key Ratio

	FY20	FY21	FY22	FY23E	FY24E
Return Ratios					
Calc. Yield on advance	17.0%	13.5%	13.6%	14.1%	14.2%
Calc. Cost of borrowing	11.8%	9.0%	8.5%	8.6%	8.6%
NIM	8.7%	6.1%	6.0%	6.2%	6.2%
RoAE	18.1%	13.3%	12.7%	14.7%	17.5%
RoAA	4.0%	2.9%	2.8%	3.1%	3.4%
Asset Quality Ratios					
GNPA	1.9%	1.7%	2.3%	2.0%	1.8%
NNPA	1.3%	1.0%	1.5%	1.3%	1.1%
PCR	30%	39%	34%	34%	36%
Growth Ratios					
Advances	5.3%	13.6%	19.7%	28.0%	27.0%
Borrowings	27.7%	27.7%	28.5%	28.1%	27.0%
NII	8.6%	-22.7%	14.4%	27.6%	29.5%
PPP	7.7%	-12.7%	-9.3%	31.1%	34.5%
PAT	9.5%	-13.8%	10.1%	30.1%	35.7%

Key Ratio

	FY20	FY21	FY22	FY23E	FY24E
Valuation Ratios					
EPS	30.5	26.3	28.9	37.6	51.1
P/E	26.5	30.7	27.9	21.4	15.8
Adj. BVPS	171.4	207.3	226.8	256.9	298.5
P/ABV	4.7	3.9	3.6	3.1	2.7
Dividend per share	8.0	1.5	3.0	6.0	8.0
Dividend Yield (%)	1.0	0.2	0.4	0.7	1.0
Other Ratios					
Cost-Income	22.4	17.6	27.3	24.5	21.4
Leverage	3.4	3.2	3.5	3.9	4.3

One Year Price Chart



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HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

Disclosure:

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