Stock Update

Mahindra & Mahindra Financial Services Ltd.

14-Jun-2021

RETAIL RESEARCH

Mahindra & Mahindra Financial Services Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
NBFC	Rs.169	Buy at LTP and add more at Rs.150	Rs.187	Rs.200	2 quarters

HDFC Scrip Code	MAHFIN
BSE Code	532720
NSE Code	M&MFIN
Bloomberg	MMFS
CMP Jun 11, 2021	169
Equity Capital (Rsmn)	2470
Face Value (Rs)	2
Equity Share O/S (mn)	1235.5
Market Cap (Rs bn)	208.9
Adj. Book Value (Rs)	99.7
Avg. 52 Wk Volumes	13014184
52 Week High	224.2
52 Week Low	89.7

Share holding Pattern % (Mar, 2021)	
Promoters	52.16
Institutions	36.93
Non Institutions	10.91
Total	100.0

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Our take

Mahindra & Mahindra Financial Services Limited ("MMFS") is a well-established financial services player with diversified business portfolio. It has strong market presence in the Utility Vehicle and tractor financing segments. With existence of over two-and-a-half decades the company has been able to catch strong market share and has built a formidable ecosystem of semi-urban and rural financing. Being part of Mahindra & Mahindra, it enjoys strong linkages and has relationship with the dealer network of M&M and it is a preferred financier for most of its dealer network. As of FY21 almost 45% of AUM is from M&M Assets. The company has strong liquidity profile and adequate capital buffer.

The second COVID wave poses risk to the pace of collections and business growth, with the rural segment also being impacted this time. However, management expects that growth could come back to normal in H2FY22 and they could get aggressive growth position post-September on the back of normal monsoon and festival season backed rural recovery. The digital finance vertical poses strong growth prospects.

We had issued Initiating Report on MMFS on 20th October, 2020 and recommended Buy at LTP and add on dips to Rs.115-117 band, for base case target of Rs.144 and bull case target of Rs.152 over the next two quarters. The stock achieved our Bull case target of Rs.152 yielding return of 17% on 18th November, 2020.

https://www.hdfcsec.com/hsl.research.pdf/M&M%20Fin-%20Initiating%20Coverage-20102020.pdf

Valuation and recommendation:

With likely muted pick up in disbursement and recovery amidst a second pan-India COVID wave, we have envisaged 12% CAGR in Net Interest Income and 8% CAGR in operating profit over FY21-FY23E. Further, we build in an AUM CAGR of 10% over same time frame, likely to materialize only from H2FY22. Management has guided for maintaining 4% NNPA in line with RBI's suggestion. RoAA is estimated at 2.1% for FY23.

Mahindra & Mahindra Financial Services Ltd.

MMFS remains a superior liability franchise compared to peers. It derives strength from ability to tap into liquidity from its parent M&M Limited. MMFS is the largest financier for M&M's vehicles. In the medium term, credit cost normalisation and cost control remain the key RoA and RoE drivers.

We are betting on a revival in the rural economy in the next two quarters and when that happens, MMFS will be one of the key beneficiaries. Positive news flow could follow performance in the stock price.

We believe that investors can buy Mahindra & Mahindra Financial Services Ltd. at LTP (1.2xFY22E ABV + Rs 21 value of subsidiaries) and add more at Rs.150 (1.0xFY22E ABV + Rs 21 value of subsidiaries) for the base case fair value of Rs.187 (1.3xFY22E ABV + Rs 21 value of subsidiaries) and for the bull case fair value of Rs.200 (1.44xFY22E ABV + Rs 21 value of subsidiaries) over the next two quarters.

Financial Summary (standalone)

Particulars (Rs.mn)	Q4FY21	Q4FY20	YoY-%	Q3FY21	QoQ-%	FY19	FY20	FY21	FY22E	FY23E
NII	14749	13033	*13*	13538	*9*	46700	51130	55338	59219	68923
PPP	10573	9666	*9*	9980	*6*	30177	33983	41573	42774	48076
PAT	1500	2209	*-32*	-2741	*LP*	15572	9065	3352	13233	18149
EPS (Rs)						25.3	14.7	2.7	10.7	14.7
ABV						123.9	120.2	98.9	108.9	124.6
P/E (x)						6.7	11.5	62.1	15.7	11.5
P/ABV (x)						1.4	1.4	1.7	1.6	1.4
RoAA (%)						2.6	1.3	0.4	1.7	2.1

(Source: Company, HDFC sec)

Recent Developments

Q4FY21 Result Update

Net interest income increased 13% YoY in Q4FY21 on back of lower interest costs. Employee expenses were up 32% YoY in Q4 due to lower base. PPOP was up 9% YoY but higher provisioning has brought down the net profit at Rs.1500 mn, down 32% YoY. AUM grew by just 5.9% YoY at Rs.8168.9 mn due to muted disbursements. Despite a diversified portfolio, MMFS's disbursals are still at ~56% of pre-COVID levels (Rs.60bn vs average of Rs.106bn in FY20). Reasons for weaker disbursements continue to be supply side constraints, faced competition in tractors, cars/UV, cautiously slowed down in tractor segment and lack of demand from taxi aggregators, tourist operators and buses. Management guided for subdued growth outlook for next two quarters. During the concall management has given disbursement target of Rs.150-200 bn over the next three years for the digital finance vertical. This vertical focuses on small ticket personal or durable loans for 12-18 months to existing customers. The product has already achieved 5-7% penetration of the existing customer base. Success in Cross-sell initiatives and ability to mine existing customers remain key monitorables going forward. A pickup in H2FY22 remains the key. Agri segment is expected to be better with normal monsoon prediction while new digital business will be in focus, wherein it provides personal loans, consumer durable loans, etc, to existing customers. MMFS currently serves ~2.5 million customers of which large customers can be targeted over 1-2 years.

Management has informed that the April crop was good and they expect good cash flow from agriculture segment. They believe that the farming community would continue to do well and don't see any pressure from that side. Moreover, the India Meteorological Department (IMD) has released that its 2021 monsoon forecast is 101% of the Long Period Average (LPA), meaning most parts of the country can expect to get normal to above normal rainfall. Management believes that if this happens, the company could get strong business growth and also post-monsoon, the festival season ending up to March would be a very exciting time to look at. They expect that growth could come back to normal and they could get aggressive growth position post-September.

Key beneficiary of rural revival:

MMFS has grown and transformed from being primarily a financing entity for vehicle purchases (from parent M&M) to a leading multiproduct auto finance non-banking financing company (NBFC) with a pan-India presence, deep penetration and a strong, rural-focused network. Going ahead, we believe that normalization of credit costs (MMFS has taken significant upfront provision in FY2021; credit costs would normalise in FY22E), pick-up in AUMs in FY22E and FY23E (aided by rise in auto sales), GDP growth and an improved capex cycle leading to disbursement growth) will drive up MMFS' earnings and RoE. We expect MMFS to bounce back in FY2022E and FY2023E from the challenges to growth and asset quality from COVID-19 and economic slowdown. The rural segment has been resilient and rising government spends, increased sowing and ample reservoir levels augur well for rural-focused players such as MMFS.

Asset Quality

Gross NPA at stage 3 levels stood at 8.96% vs. 8.44% in Q4FY20. The company has created higher provisions in the quarter. Elevated provisioning has shored up PCR to a healthy level of 58% compared to 37% in Q3FY21. This has brought down the Net NPA at 4%. As per management, the elevated provisioning is in line with the regulator's recommendation to bring NNPA below 4% and management has guided to maintain it at this level going forward. It is carrying Covid provisions of 1.5%, but with second Covid wave we expect credit cost to continue to remain high in FY22 and start to fall in FY23. MMFS's stressed asset pool (Gross Stage II + III) dipped during the quarter to ~21.5% of AUM vs 24.1% in Q3FY21, largely on account of write-offs, along with ~14% of the borrowers under moratorium (Q3FY21:16%) not making any payment since Sep'20. However, the second COVID wave poses risk to the pace of collections, with the rural segment also being impacted this time. The high base of ECL (Expected credit loss) will now buffer credit costs going forward. MMFS will probably have highest ECL coverage amongst its peers.

Adequate capital buffer

MMFS has strong liquidity profile and adequate capital buffer. The capital adequacy ratio (CAR) stood at 26% and tier-1 at 22.2%, well above regulatory requirement. Strong parentage helps it in raising the capital at reasonable cost. Overall, the healthy capitalisation is expected to be maintained over the medium term, driven by substantial accruals and expected support from M&M group, if required. The company has not been aggressive on the growth front and maintained a well-matched ALM, which should help it sail through the currently challenging operating environment. MMFS completed a 1:1 rights issue of Rs.3088 cr at Rs.50 in July/August 2020.

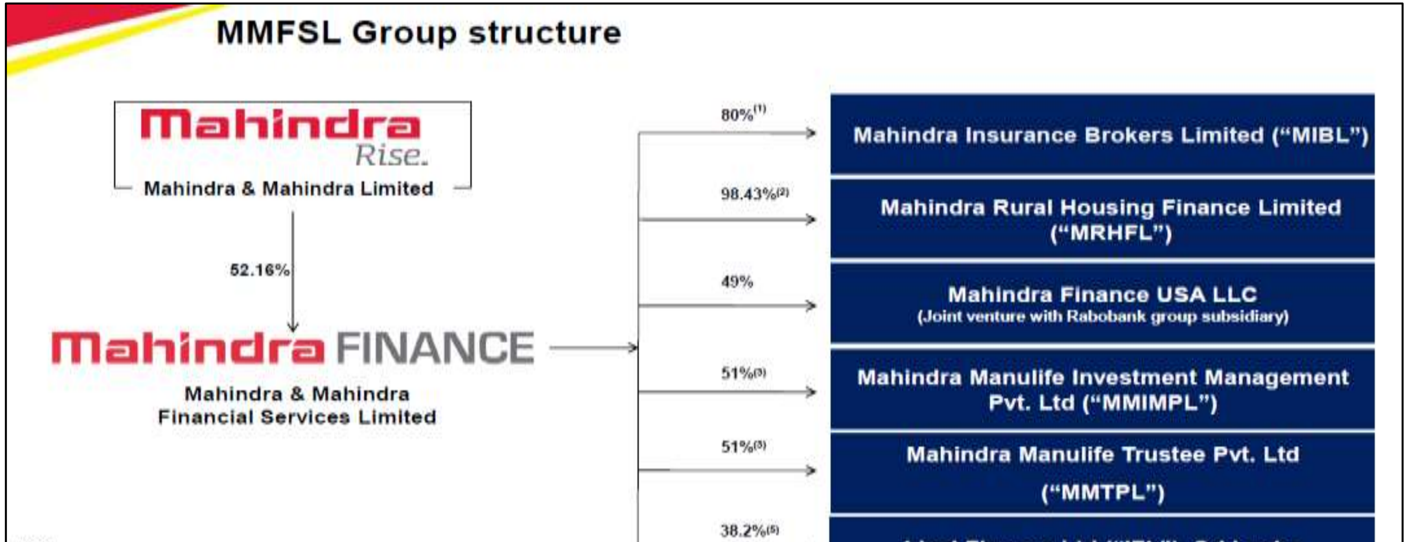
New Technology Initiatives

MMFS has enhanced its digital capabilities and use of technology to improve efficiency and function normally in current scenario. Through tablets and mobile applications connected by GPRS to the central server, they are able to transfer data which provides complete information to handle customer queries with transaction security, MIS of on-line collection and many more internal checks & controls. This helps them in promoting digital/ non-cash collections. We believe that in long run this elevated level of focus on technology will create an edge for the company in many ways like reducing turn-around times and transaction costs, building a scalable operating model, uniformity in operations and enhance customer experience.

Established payer with diversified business portfolio

Being part of Mahindra & Mahindra and presence of over two-and-a-half decades the company has been able to catch strong market share in the utility vehicle and tractor financing segments. It has built a formidable ecosystem of semi-urban and rural financing by identifying key trends early, gathering deep local insight, making relevant investments, and steadily growing its footprint nationally. This experience also helps company to navigate through all the ups and downs of credit cycles. Being a subsidiary of M&M, it enjoys strong linkages and has relationship with the dealer network of M&M and it is a preferred financier for most of its dealer network. As of FY21 almost 45% of AUM is from M&M Assets. The company is also strategically important subsidiary for the parent as it gives access to finance to their customers in rural and semi urban areas.

MMFS has well diversified product portfolio both in auto and non-auto segments, which helps the company in hedging against downturns in specific segments and access multiple growth avenues. The company also has well diversified geographic presence (North/ East/ West/ South and Central India comprised of 29%/27%/15%/19% and 10% of total AUM), customers profile (small traders, neo-entrepreneurs, teachers, drivers and farmers) and resource profile (both in terms of investor base and instrument type).



Note:
1. Balance 20% with Inclusion Resources Pvt. Ltd. (IRPL), subsidiary of AXA XL Group
2. Balance 1.57% held by MRHFL Employee Welfare Trust and employees
3. Manulife Investment Management (Singapore) Pte. Ltd. holds 49% of the shareholding of MMIMPL and MMTPL.
4. Mahindra Finance CSR Foundation is a wholly owned subsidiary to undertake all CSR initiatives under one umbrella
5. The Company has entered into a subscription agreement to acquire 58.26% of IFL and has remitted an amount of Rs.44 crores towards acquiring 38.2% of its equity share capital

Risks and concerns

- The retail financing business is highly competitive due to its nature of attractive yield. It has always faced competition from small finance banks, banks and other NBFCs. Banks with wider branch and distribution network and cheaper cost of funds have greater competitive advantage. The stiff competition from banks may pose increasing challenges by way of lower-than-expected loan growth and lower NIM.

- MMFS' performance has faced several challenges over the past few years including economy slowdown, transition from BSIV to BSVI and IL&FS crisis led to poor performance in FY20 while COVID led to weakest FY21. It seems that MMFS' business model is a hugely cyclical one with a large dependence on continued rural prosperity and stability in regulations.

- The second wave and subsequent lock down has also impacted rural India. This is major cause of worry as the company derives majority of revenue from semi-urban and rural areas. We expect a couple of soft quarter performance. We believe that the rural economy recovery is now largely dependent on good agriculture season, which again relies on good monsoon. Slower-than-expected pick-up in the rural economy could impact the growth of the company’s Assets Under Management. Delayed recovery in economic activity will affect growth and profitability, further it has exposure to the SME segments which may be vulnerable if economic recovery is delayed.

- The key risks to our thesis are lower-than-expected loan growth and more-than-expected asset quality deterioration. MMFS’ historic trends suggest that recoveries are volatile and tend to be back-ended in the year, typically after the winter crop.

- The company has over dependence on parent- M&M Ltd. As of FY21 almost 45% of AUM is from M&M Assets.

- Cyclically 1Q is MMFS’ weakest quarter.

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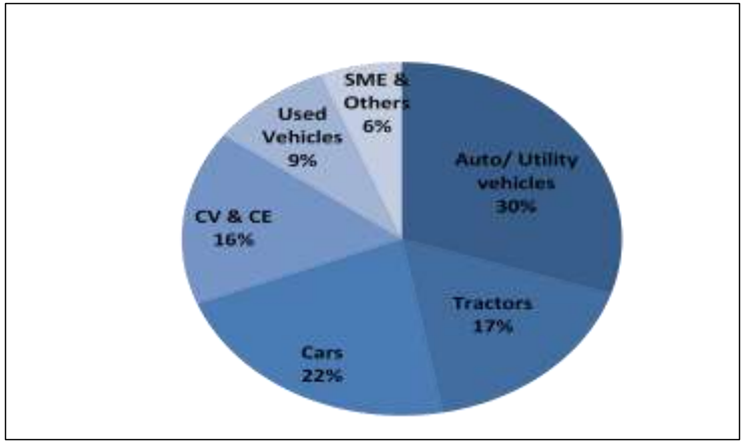
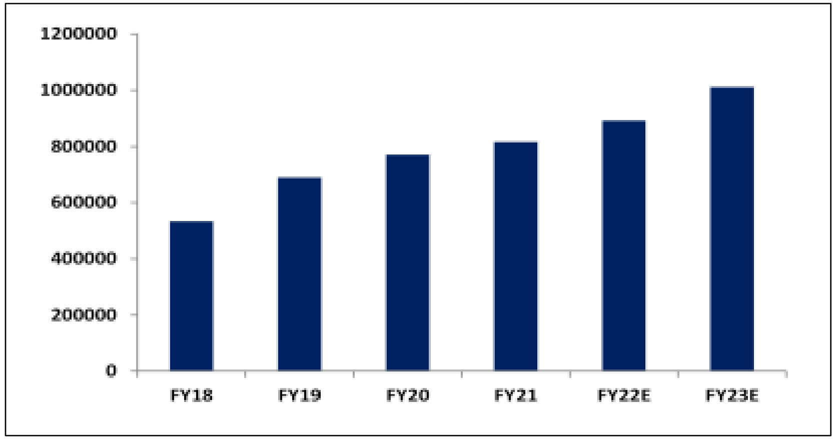
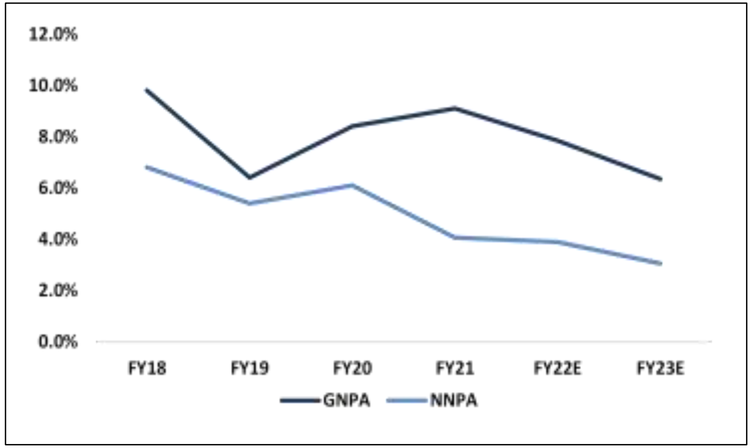
Loan Book Mix (%)



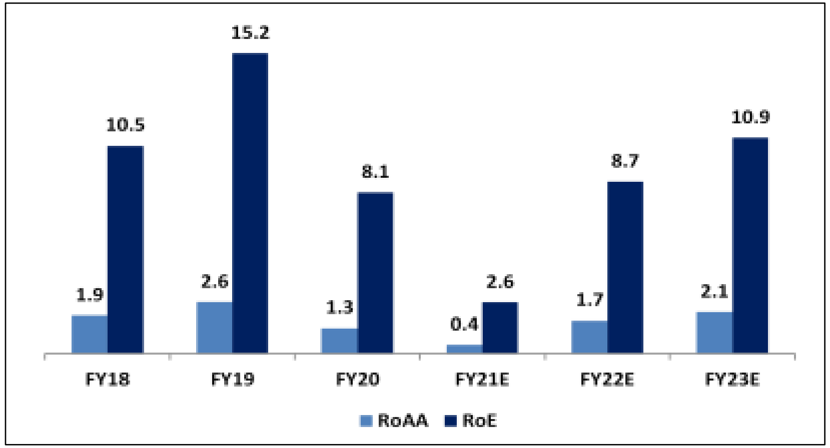
Gradual Improvement in AIUM



Asset Quality Trend



Return Ratio%



RETAIL RESEARCH

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Financials (standalone)

Income Statement

(Rs mn)	FY19	FY20	FY21	FY22E	FY23E
Interest Income	86146	99417	102670	105631	118286
Interest Expenses	39446	48287	47332	46413	49363
Net Interest Income	**46700**	**51130**	**55338**	**59219**	**68923**
Non interest income	1084	1561	1283	880	773
Other Income	869	1473	1277	1291	1097
Operating Income	**48653**	**54164**	**57898**	**61390**	**70793**
Operating Expenses	18476	20181	16325	18616	22717
PPOP	**30177**	**33983**	**41573**	**42774**	**48076**
Prov & Cont	6352	20545	37348	24522	23180
Profit Before Tax	23825	13438	4225	18253	24896
Tax	8254	4374	873	5019	6747
PAT	**15572**	**9065**	**3352**	**13233**	**18149**

Balance Sheet

(Rs mn)	FY19	FY20	FY21	FY22E	FY23E
Share Capital	1230	1231	2464	2464	2464
Reserves & Surplus	107850	112408	143666	155667	172585
Shareholder funds	**109080**	**113639**	**146130**	**158131**	**175049**
Borrowings	528469	594623	585767	611976	687037
Other Liab & Prov.	33230	32451	38469	46964	57516
SOURCES OF FUNDS	**670780**	**740713**	**770366**	**817071**	**919602**
Fixed Asset	1631	3635	3115	3426	3769
Investments	37917	59110	116073	112591	124976
Cash & Bank Balance	9585	14258	32696	20641	18686
Advances	612496	649935	599474	658039	746780
Other Assets	9151	13775	19006	22373	25391
TOTAL ASSETS	**670780**	**740713**	**770366**	**817071**	**919602**

(Source: Company, HDFC sec Research)

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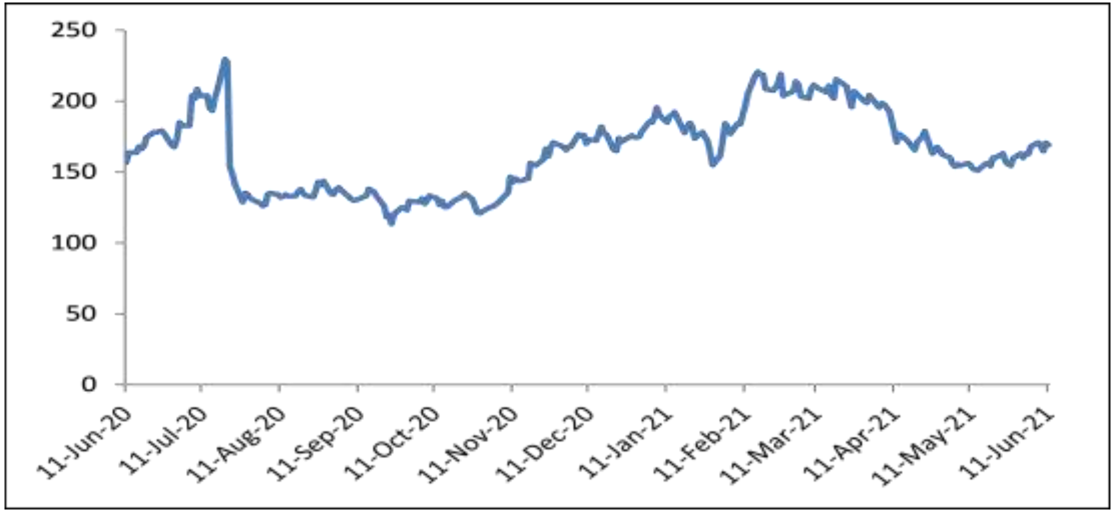
Key Ratios (%)

	FY19	FY20	FY21	FY22E	FY23E
Return Ratios%					
Calc. Yield on adv	15.7	15.8	16.4	16.8	16.8
Calc. Cost of borr	7.5	8.1	8.1	7.6	7.2
NIM	8.5	8.1	8.9	9.4	9.8
RoAE	15.2	8.1	2.6	8.7	10.9
RoAA	2.6	1.3	0.4	1.7	2.1
Asset Quality Ratios%					
GNPA	6.4	8.4	9.1	7.9	5.7
NNPA	5.4	6.1	4.1	3.6	2.9
PCR	19.2	31.0	57.9	53.8	49.4
Growth Ratios%					
Advances	26.2	6.1	-7.8	9.8	13.5
Borrowings	31.8	12.5	-1.5	4.5	12.3
NII	33.3	9.5	8.2	7.0	16.4
PPP	39.1	12.6	22.3	2.9	12.4
PAT	54.0	-41.8	-63.0	294.8	37.2

Key Ratios (%)

	FY19	FY20	FY21	FY22E	FY23E
Valuation Ratios					
EPS	25.3	14.7	2.7	10.7	14.7
P/E	6.7	11.5	62.1	15.7	11.5
Adj. BVPS	123.9	120.2	98.9	108.9	124.6
P/ABV	1.0	0.9	1.4	1.3	1.2
Dividend per share	6.5	0.0	0.8	1.0	1.0
Other Ratios					
Cost-Income	38.0	37.3	28.2	30.3	32.1
Avg Net worth/ Avg Total Assets	5.5	6.1	6.5	5.3	5.2

One Year Price Chart



Disclosure:

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Any holding in stock –No

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