

# MAHINDRA & MAHINDRA FINANCIAL SERVICES

## Core steady; NPL transitioning hits earnings

India Equity Research | Banking and Financial Services



Mahindra & Mahindra Financial Services' (MMFS) Q2FY18 PAT of INR780mn was lower than our estimate. The miss was on account of higher credit costs, as it transitioned to 90dpd recognition (versus 120dpd earlier). The transition optically led to GNPLs rising to 12.5% (up 220bps QoQ, lower than earlier guidance of transition impact, suggesting improving underlying trend). Having said that, growth was softer, disbursement were flat YoY (impact of GST) but lower repayment trend pushed AUM growth to 14% YoY. Management is optimistic on improving rural cash flows, which is likely to spur growth in second half (seasonally strong anyways). The stock is trading at 2.85x core FY19E P/ABV (ascribing INR 40 per share to housing & insurance broking business) and we maintain 'HOLD'.

### Asset quality steady; underlying trend improving

GNPAs rose to INR62.2bn (up 24% QoQ) as MMFS transitioned to 90dpd. But, underlying asset quality seems to be improving as: a) On a like-to-like basis GNPLs were flat (10.3% vs. 10.5% in Q1FY18, contrast to historical trend wherein GNPLs rise in Q2); and b) Transition impact was restricted to 220bps (earlier guidance of 300-350bps). Transition led to higher credit cost by INR2.5bn (INR700mn of interest income reversal & INR1.77bn of principal provision), which impacted earnings. Collection efficiency was ~95% (higher than historical trend seen in Q2). Despite transition, MMFS maintained coverage of 51%.

### Growth momentum softer, improvement holds key

Growth momentum was soft as disbursements stood at INR75.7bn (flat YoY) on dual impact of: a) GST; and b) Higher competition in which MMFS didn't participate (viz. auto & tractors). However, lower repayments (11% versus run-rate of 15% in past 6 quarters) pushed AUM to INR499bn, up 14% YoY. MMFS is optimistic on improving rural cash flows and expects growth momentum to improve. Given its brand presence and customer relationships, we believe that MMFS will continue to be the first choice of manufacturers looking to penetrate rural markets, leading to better growth going forward.

### Outlook and valuations: Volatile earnings profile; maintain 'HOLD'

We repose faith in MMFS — strong brand, business relationships, geographical depth, product diversification — but volatile rural cash flows & earnings vulnerability keep us guarded. On better growth and controlled credit costs, we estimate >50% EPS CAGR over FY17-19E (on low base). But, RoE will be curtailed at <12% following capital raising (we have built in INR20bn). Maintain 'HOLD/SU' with TP of INR443 (3x core FY19E P/ABV).

#### Financials

	(INR mn)							
Year to March	Q2FY18	Q2FY17	Growth %	Q1FY18	Growth %	FY17	FY18E	FY19E
Net revenue	9,331	8,071	15.6	8,704	7.2	33,801	38,765	46,404
Net profit	780	948	(17.7)	474	64.6	4,002	6,543	10,789
Dil. EPS (INR)	1.4	1.7	(17.4)	0.8	66.3	7.0	10.6	17.5
Adj. BV (INR)						94.2	119.3	134.3
Price/Adj book (x)						4.4	3.5	3.1
Price/Earnings (x)						59.2	39.2	23.8

#### EDELWEISS 4D RATINGS

Absolute Rating	HOLD
Rating Relative to Sector	Performer
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Overweight

#### MARKET DATA (R: MMFS.BO, B: MMFS IN)

CMP	: INR 417
Target Price	: INR 443
52-week range (INR)	: 456 / 244
Share in issue (mn)	: 568.8
M cap (INR bn/USD mn)	: 232 / 3,579
Avg. Daily Vol.BSE/NSE('000)	: 2,571.3

#### SHARE HOLDING PATTERN (%)

	Current	Q1FY18	Q4FY17
Promoters *	51.2	51.9	51.9
MF's, FI's & BK's	10.2	10.5	11.8
FII's	32.0	30.5	30.4
Others	6.5	7.2	5.9
* Promoters pledged shares (% of share in issue)			NIL

#### PRICE PERFORMANCE (%)

	Stock	Nifty	EW Banks and Financial Services Index
1 month	1.3	4.3	4.2
3 months	2.4	3.3	2.1
12 months	14.8	18.5	24.4

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October 26, 2017

### Mahindra Rural Housing Finance

- Provides loans for home construction, extension, purchase and improvement to customers in rural and semi-urban India and has presence across 12 states and 1 Union Territory.
- Disbursements during the quarter stood at ~INR5.8bn (up 28% YoY), leading to loan growth of 40% to INR54.3bn.
- Asset quality continued to be soft with GNPA's further rising to 13.3% (12.8% in Q1FY18 and 9.7% in FY17). Management attributed this rise to seasonality (self-employed segment) and expects GNPA's to improve going ahead (also supported by improving cash flows).

### Mahindra Insurance Brokers

- Undertakes insurance broking in life, non-life and reinsurance businesses.
- Gross premium came in at INR4.4bn (up ~57% YoY), however profitability was restricted to INR85mn.

**Table 1: Key takeaways from Q2FY18 earnings**

(INR mn)	Q2FY18	Q2FY17	YoY (%)	Q1FY18	QoQ (%)	Comments
Interest income	16,608	14,916	11.3	15,924	4.3	
Interest expense	7,498	7,086	5.8	7,327	2.3	
Net interest income	9,110	7,830	16.3	8,597	6.0	Nil growth momentum sustained, supported by healthy AUM traction & improved margins
Non-interest income	221	241	(8.2)	107	106.3	
Net revenues	9,331	8,071	15.6	8,704	7.2	
Operating expenses	3,694	3,567	3.6	3,810	(3.0)	Controlled opex, benefiting from improvement in productivity
-Staff expense	1,862	1,710	8.9	1,980	(5.9)	
-Depreciation	107	107	(0.6)	111	(3.5)	
-Other opex	1,725	1,749	(1.4)	1,720	0.3	
Operating profit	5,636	4,504	25.1	4,894	15.2	
Provisions	4,446	3,042	46.2	4,258	4.4	Elevated credit costs, due to transition to 90dpd (from 120dpd). This lead to higher credit cost by INR2.5bn (INR700mn of interest income reversal and INR1.77bn of principal provision), which impacted earnings
Profit before tax	1,190	1,462	(18.6)	636	87.2	
Tax expense	410	514	(20.2)	162	153.1	
Profit after tax	780	948	(17.7)	474	64.6	Subdued earnings, primarily on back of higher provisions
EPS (INR)	1.4	1.7	(17.4)	0.8	66.3	

Source: Company, Edelweiss research

Table 1: Key takeaways from Q2FY18 earnings (Contd...)

(INR mn)	Q2FY18	Q2FY17	YoY (%)	Q1FY18	QoQ (%)	Comments
<b>Key Metrics</b>						
AUM	4,99,180	4,75,757	4.9	4,75,757	4.9	AUM traction held on, management believes that there is a bounce back of rural story, given positive sentiments and the fact that cash flows have held up well. This should lead to sustained AUM growth
Disbursements	75,665	76,399	(1.0)	76,399	(1.0)	Disbursements were soft as July/August was dogged by GST/DeMon (inventory was dealership was higher though retail enquiry was high by that didn't convert) which colored the growth to some extent. Having said that growth in September standalone was 15% which gives management confidence that growth will perk up in H2FY18
GNPA	51,313	50,142	2.3	50,142	2.3	Higher collection efficiency (~95%) led to better-than-historical Q2 performance on asset quality
NNPA	22,012	19,810	11.1	19,810	11.1	
GNPA (%)	12.5	10.5	NA	10.5	NA	The GNPLs rise was following transition to 90dpd recognition. On like-to-like basis GNPLs were flat (10.3% versus 10.5% in Q1FY18, in contrast to historical trend wherein GNPLs rise in Q2)
NNPA (%)	6.5	4.4	NA	4.4	NA	Despite transition the company maintained > 50% coverage
Cost/income (calc., %)	39.6	44.2	NA	43.8	NA	Investments in technology to benefit cost/income ratio going forward

Table 2: Despite soft disbursements (flat YoY), lower repayments resulted in ~14% YoY AUM traction

	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18
AUM (INR bn)	384.3	402.8	409.3	416.6	438.5	457.1	467.8	475.8	499.2
Q-o-Q growth (%)	2.3	4.8	1.6	1.8	5.3	4.2	2.3	1.7	4.9
Y-o-Y growth (%)	7.7	10.4	11.0	10.9	14.1	13.5	14.3	14.2	13.8
Disbursement (INR bn)	58.7	79.7	68.1	65.6	75.4	91.8	83.8	76.4	75.7
Q-o-Q growth (%)	(3.2)	35.9	(14.6)	(3.6)	14.9	21.6	(8.7)	(8.8)	(1.0)
Y-o-Y growth (%)	1.5	18.8	8.1	8.4	28.6	15.1	23.0	16.4	0.3
On-book/AUM (%)	96.2	96.3	96.6	97.0	97.2	97.7	98.2	98.6	98.4
Off-book/AUM (%)	3.8	3.7	3.4	3.0	2.8	2.3	1.8	1.4	1.6

Table 3: Soft disbursements on dual impact of GST and higher competition in some segments

(%)	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18
Auto/Utility vehicles	31.0	31.0	30.0	29.0	28.0	28.0	28.0	28.0	27.0
Tractors	15.0	16.0	15.0	17.0	17.0	20.0	17.0	21.0	19.0
Cars	23.0	23.0	22.0	22.0	22.0	23.0	22.0	21.0	21.0
Commercial vehicles and Construction equipments	11.0	10.0	11.0	13.0	12.0	11.0	12.0	11.0	11.0
Others	20.0	20.0	22.0	19.0	21.0	18.0	21.0	19.0	22.0
<b>Disbursements (INR bn)</b>	<b>58.7</b>	<b>79.7</b>	<b>68.1</b>	<b>65.6</b>	<b>75.4</b>	<b>91.8</b>	<b>83.8</b>	<b>76.4</b>	<b>75.7</b>

Source: Company

**Table 4: AUM traction healthy, with optimistic management outlook going forward**

(%)	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18
Auto/Utility vehicles	31.0	31.0	31.0	31.0	30.0	31.0	30.0	30.0	28.0
Tractors	18.0	17.0	17.0	17.0	17.0	18.0	17.0	17.0	17.0
Cars	23.0	24.0	24.0	24.0	23.0	24.0	23.0	23.0	22.0
Commercial vehicles and Construction equipments	12.0	12.0	12.0	13.0	13.0	13.0	13.0	13.0	12.0
Others	16.0	16.0	16.0	15.0	17.0	14.0	17.0	17.0	21.0
<b>AUM (INR bn)</b>	<b>384.3</b>	<b>402.8</b>	<b>409.3</b>	<b>416.6</b>	<b>438.5</b>	<b>457.1</b>	<b>467.8</b>	<b>475.8</b>	<b>499.2</b>

**Table 5: Borrowing profile - Instrument-wise**

(%)	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18
Bonds/NCDS	32.4	33.9	34.9	39.5	43.4	44.9	46.2	49.4	52.4
Bank Loans	35.5	33.3	35.1	33.1	30.3	26.1	27.3	24.3	23.8
Securitisation/Assignment	5.1	4.9	4.6	4.0	3.7	3.0	2.3	1.8	2.1
Fixed Deposits	17.1	16.2	15.5	15.0	14.0	13.2	12.3	11.2	9.4
CP, ICD	9.9	11.7	9.9	8.4	8.6	12.8	11.9	13.3	12.3
<b>Total borrowing (INR bn)</b>	<b>291.0</b>	<b>303.3</b>	<b>308.5</b>	<b>312.0</b>	<b>333.9</b>	<b>344.6</b>	<b>354.9</b>	<b>359.0</b>	<b>381.5</b>

**Table 6: Borrowing profile - Investor-wise**

(%)	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18
Banks	42.5	40.6	42.0	40.3	45.9	43.2	46.1	39.8	36.8
Mutual Fund	18.4	21.6	18.9	18.6	20.8	24.1	21.2	25.0	31.3
Insurance & Pension Funds	16.9	16.7	18.0	21.6	8.4	8.2	7.8	13.3	14.5
FIs & Corporates	5.1	4.9	4.6	4.0	11.3	11.5	12.1	10.0	8.1
Others	17.1	16.2	16.5	15.5	13.7	13.0	12.8	11.9	9.3
<b>Total borrowings (INR bn)</b>	<b>291.0</b>	<b>303.3</b>	<b>308.5</b>	<b>312.0</b>	<b>333.9</b>	<b>344.6</b>	<b>354.9</b>	<b>359.0</b>	<b>381.5</b>

**Table 7: NIMs at 7.5%, benefiting from funding cost advantage**

(%)	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18
Yields	15.0	14.2	16.5	13.2	14.0	13.3	15.8	13.5	13.6
Cost of funds	9.1	9.0	8.8	8.9	8.8	8.8	8.2	8.2	8.1
NIM	8.1	7.4	9.9	6.5	7.3	6.7	9.6	7.3	7.5

**Table 8: GNPA's rise on 90-day transitioning; better collection efficiency (~95%) restricts seasonal rise on like-to-like basis**

	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18
Gross NPA (INR bn)	35.3	39.9	32.2	44.1	47.5	50.6	41.8	50.1	62.2
Gross NPA to total assets (%)	9.4	10.1	8.0	10.7	11.0	11.1	9.0	10.5	12.5
Net NPA (INR bn)	16.5	17.0	12.4	21.1	22.9	22.1	16.0	19.8	30.4
Net NPA to Total Assets (%)	4.6	4.6	3.2	5.4	5.6	5.2	3.6	4.4	6.5
Coverage ratio (%)	53.4	57.3	61.7	52.3	51.9	56.4	61.8	60.5	51.1

Note: Q2FY18 NPAs based on 90dpd norm

**Table 9: Healthy tier-1 ratio at 12.4%**

(%)	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18
Capital adequacy	18.2	17.8	17.3	19.5	18.1	17.9	17.2	17.4	19.3
Tier I	15.5	15.0	14.6	14.3	13.2	13.3	12.8	12.9	12.4
Tier II	2.7	2.8	2.7	5.2	4.9	4.6	4.4	4.5	6.9
Book Value (INR)	104.0	105.2	107.0	108.2	109.9	109.7	113.9	114.8	113.0

Source: Company

**Financial snapshot**
**(INR mn)**

Year to March	Q2FY18	Q2FY17	% change	Q1FY18	% change	YTD18	FY18E	FY19E
Operating income	16,608	14,916	11.3	15,924	4.3	32,532	70,347	82,117
Interest exp	7,498	7,086	5.8	7,327	2.3	14,825	32,242	36,423
Other income	221	241	(8.2)	107	106.3	328	660	710
Net revenues	9,331	8,071	15.6	8,704	7.2	18,035	38,765	46,404
Staff costs	1,862	1,710	8.9	1,980	(5.9)	3,842	8,029	9,622
Depreciation	107	107	(0.6)	111	(3.5)	217	533	611
Other expenses	1,725	1,749	(1.4)	1,720	0.3	3,445	8,210	9,434
Operating expenses	3,694	3,567	3.6	3,810	(3.0)	7,504	16,772	19,667
Pre prov profit (ppp)	5,636	4,504	25.1	4,894	15.2	10,531	21,993	26,737
Provisions & writeoff	4,446	3,042	46.2	4,258	4.4	8,704	12,124	10,465
Profit before tax	1,190	1,462	(18.6)	636	87.2	1,826	9,869	16,272
Provision for taxes	410	514	(20.2)	162	153.1	573	3,326	5,484
PAT	780	948	(17.7)	474	64.6	1,254	6,543	10,789
Diluted EPS (INR)	1.4	1.7	(17.4)	0.8	66.3	2.2	10.6	17.5

**Ratios**

Cost/income (%)	39.6	44.2		43.8		41.6	43.3	42.4
Provisions / PPP	78.9	67.5		87.0		82.7	55.1	39.1
Tax rate (%)	34.5	35.2		25.5		31.35	33.7	33.7

**Asset Quality**

Gross NPA	62,196	47,481	31.0	50,142	24.0	51,313	52,890	53,852
Gross NPA (%)	12.5	11.0		10.5		10.3	10.5	9.3
Net NPA	30,426	22,862	33.1	19,810	53.6	22,012	21,156	18,848
Net NPA (%)	6.5	5.6		4.4		4.7	4.2	3.1
Coverage ratio (%)	51.1	51.9		60.5		57.1	60.0	65.0

**Valuation metrics**

B/V per share (INR)							143.3	155.7
Adj book value / share							119.3	134.3
Price/ Book (x)							2.9	2.7
Price/ Adj. book (x)							3.5	3.1
Price/ Earnings							39.2	23.8

\*Note: Q2FY18 GNPLs are on 90dpd basis

### Q2FY18 earnings concall - key takeaways

#### Management commentary

- Management believes that it is a bounce back of rural story, given positive sentiments and the fact that cash flows have held up well
  - o Q3 and Q4 could be an infrastructure story in some states, mainly in states where there are impending election in coming years
  - o The average plus monsoon over the country this year suggest that H2FY18 will be better. Every OEM the company talks to suggest that growth will come from rural market.
  - o The company believes that it will be beneficiary of the growth - people added over time, company closer to customer and strong relation with OEMs will ensure strong growth.
- July/August was dogged by GST/DeMon (inventory was dealership was higher though retail enquiry was high by that didn't convert) which that colored the growth to some extent. Thus disbursement this quarter should not mask the growth outlook (September standalone growth was 15%). Management expects the growth to perk up in H2FY18.
- The company is not seeing any product segment wherein they are facing higher competition which has forced them to reduce the volume.
- Of the various geographical locations the improvement is seen in MP, UP, Maharashtra, Rajasthan, Bihar among others. On the other hand two geographies which continue to see some pressure are Karnataka and Tamil Nadu.

#### Asset quality

- After a long time the company has seen declining trend in Q2 (over Q1), that has enabled the company to transition to 90dpd recognition. With H2FY18, likely to be better off the company expects further improvement to play through. Having said that, the deterioration in asset quality post transition has been lower.
- The collection efficiency was >94% (this has been at historically better level of what company has experienced historically in second quarter). The company expects that H2FY18 being better collection efficiency should ideally improve by further by 3 to 4 percentage points. Consequently GNPLs should ideally be 9-10% with 60% coverage levels.
- Of the NPLs contract: on 120 day basis the accounts were 1.57K (versus 1.68K as on Q1FY18), however transition has added another 30K contracts.
- The company would have written-off ~15K contracts during the quarter (generally company write-off fully provided accounts in September to gain tax benefits) versus 9K contracts during Q2FY17.
- Of the total credit cost of INR8.7bn in H1FY18, the write-off is INR3.5bn (including termination loss). The company hinted that credit cost should not exceed 2.5%.
- Write-off movement during the quarter : NR2.6bn (INR1.38bn in Q2FY17) and termination losses at INR980mn (INR570mn in Q2FY18)
- During the quarter the Interest income reversal was of INR700mn and principal provision of INR1.77bn.

#### Other highlights

- Management stated that it will raise capital (at appropriate time) to ensure growth (not for asset quality issue). The bank has approval in place to raise INR25bn capital and with growth outlook looking up the management indicated that capital might have to be raised during the quarter.
- The company has not seen any spread compression (ex-interest income reversal) on
- **Rural Housing subsidiary:** They work in same operating as MMFS and thus are impacted by lower rural cash flow. Having said that management expects this to benefit
- **Insurance brokers:** valued at INR13bn and from this MMFS gets INR650mn which will come in this quarter.
- Cost/asset ratio should ideally improve as productivity plays through, having said that the management expects this to range in 2.9-3.2% levels.

### Q1FY18 earnings concall - key takeaways

#### Management commentary

- Management believes that it is a bounce back of rural story, given positive sentiments and the fact that cash flows have held up well
  - Q3 and Q4 could be an infrastructure story in some states, mainly in states where there are impending election in coming years
- Growth is expected to remain strong given low dealership inventory levels, festive months (Sep, Oct) and settling of regulatory issues
  - Excluding impact of inventory clearing prior to GST implementation, normalized growth was 13-14%
  - Growth in disbursements was contributed from all geographies and products
- Management is betting on using the analytics piece to drive growth going forward
  - Investment in technology will see productivity move up during the year

#### Asset quality

- During Q1FY18, the company made additional provisions of ~INR834mn towards 100% provision cases which were 24 months overdue
  - This is to compensate for the lower provisions last year wherein MMFS used the estimated realizable value method
  - Additionally, the company also made 10% provisions on loans where part installments were made, which led to higher provisions
  - Consequently, provision coverage has improved to ~60% levels
- In contract to historical trend wherein GNPA's rise by 30-35% during Q1, GNPA's increase in Q1FY18 was restricted to 14%
  - Collection efficiency (~95%) is 4-5% higher than normally seen in 1<sup>st</sup> quarter of any year
  - Contracts under NPAs stood at 171,776 (vs. 138,357 in Q4FY17)

- Contracts below and above the 12 month (12m) bucket will be roughly equal in terms of value
  - In terms of number, contracts below 12m would be roughly ~70,000-80,000, with remaining above the 12m bucket
- **Every vertical, except tractors, has shown improvement in NPA recovery as compared to Q1FY17**
  - **In the case of tractors, states of Maharashtra and Madhya Pradesh saw some stress due to transactional pressure**
  - Customers in these 2 states were affected by lack of disbursements by cooperative banks who could not participate in demonetisation
- **On moving to 90dpd recognition norms during the year, management aims to retain NPAs at current levels**
  - In comparison to 120dpd norms, transition towards 90dpd norms will increase NPAs by ~300bps
- **Management aims to restrict credit losses in the range of 2-2.2%**
- **Going forward, repossession would not be the solution for tackling NPAs**
  - Consequently, disposal losses will not be a repeat story going ahead
  - Repossessed assets (out of NPAs) stood at 12,730 (vs. 13,185 in Q4FY17)
- Of the total NPA provisions of INR30.3bn, income reversal was to the tune of INR7.3bn

### Other highlights

- Lower income reversal and funding cost benefits have led to improved margins
  - Given AAA rating, fall in market rates will continue to benefit borrowing costs
- **Housing finance book is expected to grow at 30-40% going forward**
  - Given high margins (~10-12%), rural RoAs in this space is in the range of 5-6%

MMFS will look at raising growth capital going forward



## Company Description

MMFS, a subsidiary of M&M with ~51.2% promoter ownership, is a leading NBFC offering a range of financial services in rural and semi-urban areas. The company finances purchase of utility vehicles, tractors, cars, commercial vehicles, used vehicles as well as construction equipment. It has a strong network of 1178 branches spread across 27 states and 4 union territories in India. Collection executives also use GPRS-enabled handheld devices, which help the company locate payments. In the backdrop of strong customer relationships, the company is also engaged in other businesses as follows:

- Providing loans for buying and renovating homes in rural India through Mahindra Rural Housing Finance. The business started operations in 2008.
- Offering insurance solutions to retail customers as well as corporations through Mahindra Insurance Brokers.

It has been in operation since 1993, initially financing M&M dealers for tractor purchases and then into retail tractor financing. In 2002, it started financing non-M&M vehicles as well.

## Investment Theme

Unpleasant GNPA surprises in recent past had resulted in volatile earnings. It is perplexing to evaluate a stock wherein earnings trajectory has been weak with a series of downgrades during a down cycle, but it still retains premium valuations. MMFS' consequent vulnerability keeps us guarded; moreover, valuations at 3.1x FY19E P/ABV capture near-term cyclical uptick. Hence, maintain 'HOLD'.

## Key Risks

MMFS's business model is directly linked to demand for underlying auto segments - hence earnings will be subject to the seasonality and cyclicity of the same. >40% of MMFS's loan book is accounted for by M&M vehicles. This dependency links its performance to that of M&M. Hence, weak performance by the latter's models can affect disbursements.

Along with the rising footprint of banks in rural areas, expansion of other NBFCs like Shriram City Union Finance, Tata Finance, Sundaram Finance, Bajaj Finance, and Kotak Prime is a cause of concern for the company due to their aggressive growth strategies.

Adverse regulatory developments and slowdown in rural economy are other vectors to look out for.

## Financial Statements

## Key Assumptions

Year to March	FY16	FY17	FY18E	FY19E
<b>Macro</b>				
GDP(Y-o-Y %)	7.9	6.6	6.8	7.4
Inflation (Avg)	4.9	4.5	4.0	4.5
Repo rate (exit rate)	6.8	6.3	5.8	5.8
USD/INR (Avg)	65.5	67.1	65.0	66.0
<b>Sector</b>				
Credit growth	9.3	9.0	12.0	14.0
Borrowings growth (%)	8.6	14.0	12.0	13.0
Bank's base rate (%)	9.5	9.0	9.0	9.0
Wholesale borr. cost (%)	8.5	8.5	8.5	8.5
G-sec yield	7.5	6.5	6.5	6.5
<b>Company</b>				
<b>Op. metric assump. (%)</b>				
Yield on advances	16.2	15.8	15.9	15.9
Cost of funds	9.7	9.3	9.1	8.9
Net interest margins	9.7	9.1	9.0	9.3
Employee cost growth	21.7	21.8	17.9	19.8
Other opex growth	14.3	25.2	13.4	14.9
Tax rate (%)	35.2	35.5	33.7	33.7
<b>Balance sheet assumption (%)</b>				
Disbursement growth	7.8	18.5	17.3	19.1
Repayment/prepay. rate	202.7	12.6	20.4	19.1
Gross NPLs	8.0	9.0	10.5	9.3
Prov Cov	61.7	61.8	60.0	65.0
Net NPLs	3.2	3.6	4.2	3.1

## Income statement

(INR mn)

Year to March	FY16	FY17	FY18E	FY19E
Interest income	58,091	61,765	70,347	82,117
Interest expended	26,393	28,574	32,242	36,423
Net interest income	31,698	33,191	38,105	45,693
- Fee & forex income	960	610	660	710
Net revenues	32,658	33,801	38,765	46,404
Operating expense	11,781	14,509	16,772	19,667
- Employee exp	5,588	6,809	8,029	9,622
- Depn /amortisation	409	460	533	611
- Other opex	5,784	7,240	8,210	9,434
Preprovision profit	20,877	19,292	21,993	26,737
Provisions	10,495	13,091	12,124	10,465
Profit Before Tax	10,382	6,201	9,869	16,272
Less: Provision for Tax	3,656	2,198	3,326	5,484
Profit After Tax	6,726	4,002	6,543	10,789
Reported Profit	6,726	4,002	6,543	10,789
Shares o /s (mn)	569	569	616	616
Basic EPS (INR)	11.8	7.0	10.6	17.5
Diluted shares o/s (mn)	569	569	616	616
Adj. Diluted EPS (INR)	11.8	7.0	10.6	17.5
Dividend per share (DPS)	4.0	1.8	2.7	4.4
Dividend Payout Ratio(%)	39.8	29.3	29.3	29.3

## Growth ratios (%)

Year to March	FY16	FY17	FY18E	FY19E
Revenues	5.8	3.5	14.7	19.7
NII growth	5.6	4.7	14.8	19.9
Opex growth	17.0	23.2	15.6	17.3
PPP growth	0.3	(7.6)	14.0	21.6
Provisions growth	26.8	24.7	(7.4)	(13.7)
Adjusted Profit	(19.1)	(40.5)	63.5	64.9

## Operating ratios

Year to March	FY16	FY17	FY18E	FY19E
Yield on advances	16.2	15.8	15.9	15.9
Cost of funds	9.7	9.3	9.1	8.9
Net interest margins	9.7	9.1	9.0	9.3
Spread	7.3	7.0	6.9	7.2
Cost-income	36.1	42.9	43.3	42.4
Tax rate	35.2	35.5	33.7	33.7

Balance sheet		(INR mn)			
As on 31st March	FY16	FY17	FY18E	FY19E	
Share capital	1,129	1,130	1,606	1,606	
Reserves & Surplus	59,751	63,642	86,736	94,369	
Shareholders' funds	60,881	64,772	88,342	95,975	
Short term borrowings	92,538	112,600	119,504	139,937	
Long term borrowings	215,922	262,733	278,843	326,521	
Total Borrowings	308,460	375,333	398,347	466,458	
Long Term Liabilities	9,093	8,264	10,240	11,886	
Def. Tax Liability (net)	(5,853)	(7,316)	(8,090)	(9,365)	
<b>Sources of funds</b>	<b>372,581</b>	<b>441,054</b>	<b>488,840</b>	<b>564,955</b>	
Gross Block	2,898	3,498	4,098	4,698	
Net Block	1,082	1,068	1,240	1,230	
Capital work in progress	5	5	5	5	
Intangible Assets	48	47	55	55	
Total Fixed Assets	1,135	1,120	1,301	1,290	
Non current investments	10,009	12,446	12,626	12,806	
Cash and Equivalents	9,524	12,222	31,243	24,783	
Loans & Advances	356,359	392,455	456,508	541,512	
Current assets (ex cash)	7,368	13,301	8,035	9,174	
Other assets	24,560	42,566	20,088	22,935	
Trade payable	6,923	6,291	7,796	9,049	
Other Current Liab	29,451	26,765	33,165	38,496	
Total Current Liab	36,373	33,057	40,961	47,545	
Net Curr Assets-ex cash	(29,006)	(19,756)	(32,925)	(38,371)	
<b>Uses of funds</b>	<b>372,581</b>	<b>441,054</b>	<b>488,840</b>	<b>564,955</b>	
BVPS (INR)	107.0	113.9	143.3	155.7	

RoE decomposition (%)		FY16	FY17	FY18E	FY19E
Year to March					
Net int. income/assets	9.7	9.1	9.0	9.3	
Net revenues/assets	10.0	9.3	9.2	9.4	
Operating expense/assets	(3.6)	(4.0)	(4.0)	(4.0)	
Provisions/assets	(3.2)	(3.6)	(2.9)	(2.1)	
Taxes/assets	(1.1)	(0.6)	(0.8)	(1.1)	
Total costs/assets	(8.0)	(8.2)	(7.6)	(7.2)	
ROA	2.1	1.1	1.5	2.2	
Equity/assets	18.0	17.3	18.1	18.7	
ROAE (%)	11.4	6.4	8.5	11.7	

Valuation parameters		FY16	FY17	FY18E	FY19E
Year to March					
Adj. Diluted EPS (INR)	11.8	7.0	10.6	17.5	
Y-o-Y growth (%)	(19.1)	(40.5)	50.9	64.9	
BV per share (INR)	107.0	113.9	143.3	155.7	
Adj. BV per share (INR)	91.8	94.2	119.3	134.3	
Diluted P/E (x)	35.2	59.2	39.2	23.8	
P/B (x)	3.9	3.7	2.9	2.7	
Price/ Adj. BV (x)	4.5	4.4	3.5	3.1	
Dividend Yield (%)	1.0	0.4	0.6	1.1	

#### Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		P/B (X)		ROAE (%)	
		FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Mahindra & Mahindra Financial Services	3,579	39.2	23.8	2.9	2.7	8.5	11.7
Dewan Housing Finance	2,796	15.7	13.4	2.1	1.9	14.2	15.1
Indiabulls Housing Finance	8,361	15.8	13.1	4.1	3.6	27.3	29.2
LIC Housing Finance	4,816	15.1	13.5	2.4	2.1	18.8	18.4
Manappuram General Finance	1,264	10.0	8.7	2.3	2.0	24.5	24.3
Muthoot Finance	3,006	13.5	11.8	2.6	2.2	20.5	20.1
Power Finance Corp	5,761	5.5	5.4	0.9	0.8	17.8	16.1
Reliance Capital	2,233	11.6	9.3	0.8	0.8	7.5	8.7
Repco Home Finance	595	18.4	15.0	2.9	2.5	17.0	17.8
Rural Electrification Corporation	4,992	5.7	5.1	0.9	0.8	16.0	15.8
Shriram City Union Finance	2,100	16.2	11.5	2.4	2.0	15.6	19.0
Shriram Transport Finance	3,816	14.4	9.3	2.0	1.7	14.5	19.2
Median	-	14.7	11.7	2.3	2.0	16.5	18.1
AVERAGE	-	15.0	11.6	2.2	1.9	16.9	18.0

Source: Edelweiss research

## Additional Data

### Directors Data

Dhananjay Mungale	Chairman	Ramesh Iyer	Vice Chairman & Managing Director
V. Ravi	Executive Director & CFO	Piyush Mankad	Director
Rama Bijapurkar	Director	V. S. Parthasarathy	Director
C. B. Bhawe	Director	Anish Shah	Director
M. G. Bhide	Director		

Auditors - B. K. Khare & Co.

### Holding - Top 10

	Perc. Holding		Perc. Holding
BlackRock	4.10	SBI Funds Management	3.12
Temasek Holdings	2.49	UTI Asset Management	2.48
Vanguard Group	2.47	Franklin Resources	2.39
J P Morgan Chase	2.09	Valiant Mauritius Partners	1.26
Blackrock Glo Asian D Fund	1.18	Amansa Capital	1.09

*\*as per last available data*

### Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

*\*in last one year*

### Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
04 Nov 2016	Rama Bijapurkar	Sell	16169.00

*\*in last one year*

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Allahabad Bank	HOLD	SU	M	Axis Bank	BUY	SO	M
Bajaj Finserv	HOLD	SP	L	Bank of Baroda	BUY	SP	M
Bharat Financial Inclusion	BUY	SO	M	Capital First	BUY	SO	M
DCB Bank	HOLD	SP	M	Dewan Housing Finance	BUY	SO	M
Equitas Holdings Ltd.	BUY	SO	M	Federal Bank	BUY	SP	L
HDFC	HOLD	SP	L	HDFC Bank	BUY	SO	L
ICICI Bank	BUY	SO	L	IDFC Bank	HOLD	SP	L
Indiabulls Housing Finance	BUY	SP	M	IndusInd Bank	BUY	SP	L
Karnataka Bank	BUY	SP	M	Kotak Mahindra Bank	HOLD	SP	M
L&T FINANCE HOLDINGS LTD	BUY	SO	M	LIC Housing Finance	BUY	SP	M
Magma Fincorp	BUY	SP	M	Mahindra & Mahindra Financial Services	HOLD	SU	M
Manappuram General Finance	BUY	SO	H	Max Financial Services	BUY	SO	L
Multi Commodity Exchange of India	BUY	SP	M	Muthoot Finance	BUY	SO	M
Oriental Bank Of Commerce	HOLD	SP	L	Power Finance Corp	BUY	SO	M
Punjab National Bank	BUY	SP	M	Reliance Capital	BUY	SP	M
Repco Home Finance	BUY	SO	M	Rural Electrification Corporation	BUY	SO	M
Shriram City Union Finance	BUY	SO	M	Shriram Transport Finance	BUY	SO	L
South Indian Bank	BUY	SP	M	State Bank of India	BUY	SP	L
Union Bank Of India	HOLD	SP	M	Yes Bank	BUY	SO	M

## ABSOLUTE RATING

### Ratings

### Expected absolute returns over 12 months

Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

## RELATIVE RETURNS RATING

### Ratings

### Criteria

Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

## RELATIVE RISK RATING

### Ratings

### Criteria

Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

## SECTOR RATING

### Ratings

### Criteria

Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

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## Coverage group(s) of stocks by primary analyst(s): Banking and Financial Services

Allahabad Bank, Axis Bank, Bharat Financial Inclusion, Bajaj Finserv, Bank of Baroda, Capital First, DCB Bank, Dewan Housing Finance, Equitas Holdings Ltd., Federal Bank, HDFC, HDFC Bank, ICICI Bank, IDFC Bank, Indiabulls Housing Finance, IndusInd Bank, Karnataka Bank, Kotak Mahindra Bank, LIC Housing Finance, L&T FINANCE HOLDINGS LTD, Max Financial Services, Multi Commodity Exchange of India, Manappuram General Finance, Magma Fincorp, Mahindra & Mahindra Financial Services, Muthoot Finance, Oriental Bank Of Commerce, Punjab National Bank, Power Finance Corp, Reliance Capital, Rural Electrification Corporation, Repco Home Finance, State Bank of India, Shriram City Union Finance, Shriram Transport Finance, South Indian Bank, Union Bank Of India, Yes Bank

### Recent Research

Date	Company	Title	Price (INR)	Recos
25-Oct-17	<b>Kotak Mahindra Bank</b>	Growth perking up; asset quality stable; <i>Result Update</i>	1,011	Hold
25-Oct-17	<b>Banking</b>	Mega recapitalisation: The much needed succor; <i>Sector Update</i>		
25-Oct-17	<b>HDFC Bank</b>	On a strong footing; <i>Result Update</i>	1,867	Buy

### Distribution of Ratings / Market Cap

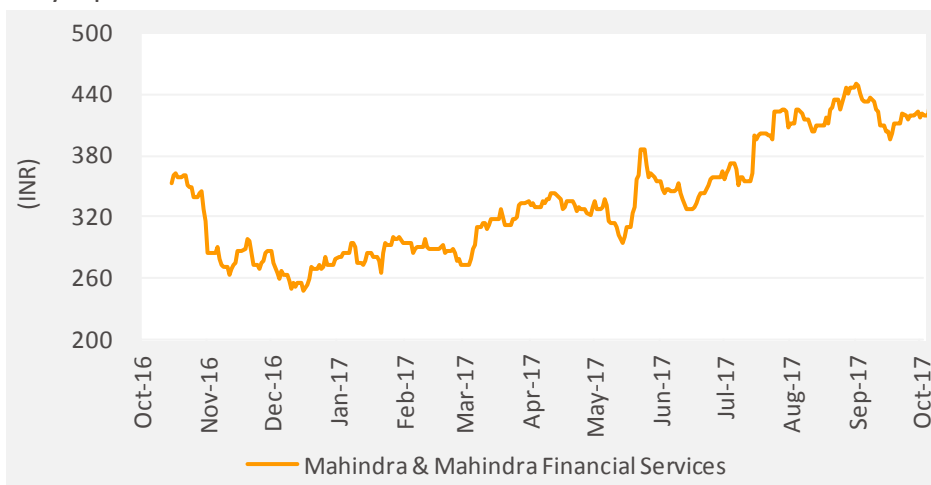
#### Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

### Rating Interpretation

Rating	Expected to
<b>Buy</b>	appreciate more than 15% over a 12-month period
<b>Hold</b>	appreciate up to 15% over a 12-month period
<b>Reduce</b>	depreciate more than 5% over a 12-month period

One year price chart



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