

M&M Financial | BUY

Strong quarter despite migrating to 90DPD

MMFS reported PAT of INR 780mn in 2Q18 (vs. JMFe of PAT Rs1.39bn) as credit costs remained elevated at 396bps (vs.313bps in 2Q17) due to migration to 90DPD – this resulted in additional provisions of INR 177mn and income reversal of INR 70mn; adjusting for which PAT stood at INR 2.43bn (156% YoY). Asset quality witnessed signs of improvement as Gross NPL (on 120DPD) on an absolute basis increased by just 8% YoY and GNPL ratio (on 120DPD) improved 72bps YoY to 10.5%. GNPL ratio stood at 12.6% (on 90DPD) while coverage ratio remained stable at 51% (vs. 51.8% on 120DPD) despite migrating to 90DPD. AUM growth remained stable at 14% YoY while margins (NII/AUM) increased 15bps YoY due to 87bps decline in funding cost. We believe MMFS is well placed to benefit from rural recovery driven by improvement in higher farm related cash flows and increase in government spending. Maintain BUY with Mar'19 TP of INR 500.

- **Stable AUM trends:** AUM growth remained stable at 14% YoY driven by healthy disbursement growth in the tractor segment (12% YoY) while CV/CE disbursement was sluggish (-8% YoY). Overall disbursement growth remained muted during the quarter due to GST related disruption. We expect AUM CAGR of 16% over FY17–20E.
- **Coverage ratio remained stable at 51% despite migrating to 90DPD:** Asset quality witnessed signs of improvement as Gross NPL (on 120DPD) on an absolute basis increased by just 8% YoY while Net NPL declined 4% YoY. On like to like basis, GNPL ratio (on 120DPD) improved 72bps YoY to 10.5%. GNPL ratio stood at 12.6% (on 90DPD) while coverage ratio remained stable at 51% (vs. 51.8% on 120DPD) despite migrating to 90DPD. Credit costs remained elevated at 396bps (vs.313bps in 2Q17) as company made provisions of INR 177mn due to migration excluding which it improved 75bps YoY to 240bps. Number of NPL contracts declined to 165K (vs. 178K in 2Q17) on 120DPD and 211K on 90DPD. With migration challenges behind us and asset quality showing signs of improvement, we factor credit costs of 230/200bps in FY18-19E (vs. 306bps in FY17).
- **Margins (NII/AUM) increased 15bps YoY:** NII increased 16% YoY, while margins (NII/AUM) increased 15ps YoY to 7.5% due to i) increase in tractor proportion ii) decline in funding cost by 87bps YoY and iii) lower incremental slippages YoY. However, excluding the impact of migration, margins increased 72bps YoY to 8.05%. We expect a CAGR of 21% in NII over FY17–20E.
- **Tier I down to 12.4%; expect MMFS to raise capital in 2HFY18:** Tier-1 ratio declined to 12.4% (vs. 13.2% in 2QFY17). With the MMFS board approving capital raise of INR 22.5bn, we are factoring a dilution of 9.4% in FY18E at a price of Rs 425 per share
- **Forecast earnings recovery from FY18; Maintain BUY with TP of Rs500:** We expect earnings CAGR of c.60% (on a lower base) over FY17–20E and with RoA improving to 2.4% and RoE of 15% by FY20E. We are factoring in a dilution of 9.4% in FY18E. We value MMFS standalone at 2.4x Mar'20 BV, implying value of INR 448. We value MRHF at INR 34 per share, while MIBL at INR 22 per share, implying Mar'19 TP of Rs500.



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Recommendation and Price Target

Current Reco.	BUY
Previous Reco.	BUY
Current Price Target (12M)	500
Upside/(Downside)	22.3%
Previous Price Target	480
Change	6.3%

Key Data – MMFS IN

Current Market Price	INR409
Market cap (bn)	INR232.5/US\$3.6
Free Float	44%
Shares in issue (mn)	564.1
Diluted share (mn)	
3-mon avg daily val (mn)	INR990.4/US\$15.3
52-week range	456/244
Sensex/Nifty	33,043/10,295
INR/US\$	64.9

Price Performance

%	1M	6M	12M
Absolute	1.3	20.1	14.8
Relative*	-3.1	8.9	-2.4

* To the BSE Sensex

Financial Summary

Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E
Net Profit	6,726	4,002	9,201	12,899	16,134
Net Profit (YoY) (%)	-19.1%	-40.5%	129.9%	40.2%	25.1%
Assets (YoY) (%)	12.8%	16.2%	16.0%	16.4%	17.1%
ROA (%)	1.8%	0.9%	1.9%	2.2%	2.4%
ROE (%)	11.5%	6.4%	11.6%	13.2%	14.9%
EPS	11.9	7.1	14.9	20.9	26.1
EPS (YoY) (%)	-19.2%	-40.5%	110.2%	40.2%	25.1%
PE (x)	34.3	57.7	27.5	19.6	15.7
BV	107	114	151	166	184
BV (YoY) (%)	7.2%	6.3%	32.4%	9.7%	11.0%
P/BV (x)	3.81	3.58	2.70	2.47	2.22

Source: Company data, JM Financial. Note: Valuations as of 25/Oct/2017

JM Financial Research is also available on:
Bloomberg - JMFR <GO>,
Thomson Publisher & Reuters
S&P Capital IQ and FactSet

Please see Appendix I at the end of this report for Important Disclosures and Disclaimers and Research Analyst Certification.

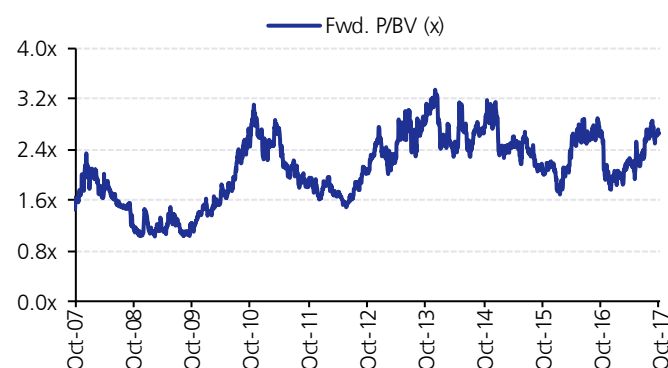
- **Cost-asset ratio improved to 3.1% due to lower branch addition:** Despite adding 1800 employees in the last one year, cost-asset improved to 3.1% (vs. 3.4% in 2QFY17) due to lower branch addition. We expect it to remain stable at 3.2% by FY20E.
- **Subsidiary performance:**
 - a) **Mahindra Rural Housing Finance (MRHF)'s healthy loan growth trend continues; some pressure on asset quality:** During 2Q18, MRHF profit stood at Rs 345mn (73% YoY). There was some pressure on asset quality as GNPL increased to 13.3% (vs. 10.2% in 2Q17). Healthy loan growth momentum continued as loan book increased 40% YoY to Rs54.3bn, while disbursements increased 29% YoY. We expect strong loan book growth to continue with c.25% of business coming from the semi-urban market (where ticket size would be significantly higher as compared to rural ticket size; ticket size of Rs1mn vs. c.Rs0.12mn in the rural market).
 - b) **Mahindra Insurance Brokers (MIBL)'s** profit remained flat YoY at INR 85mn in 2Q18 due to the impact of INR 45mn on account of ESOP related expenses this quarter.

Exhibit 1. MMFS SOTP Valuation

MMFS SOTP	Holding	Valuation Methodology	Value Per Share	Contribution to TP (%)
MMFS - Standalone	100.0%	2.4x FY20E BV	448	90%
Mahindra Rural Housing	87.5%	2.4x FY20E BV	34	7%
Mahindra Brokers Limited	80.0%	15.0x FY20E EPS	18	3%
Total			500	100%

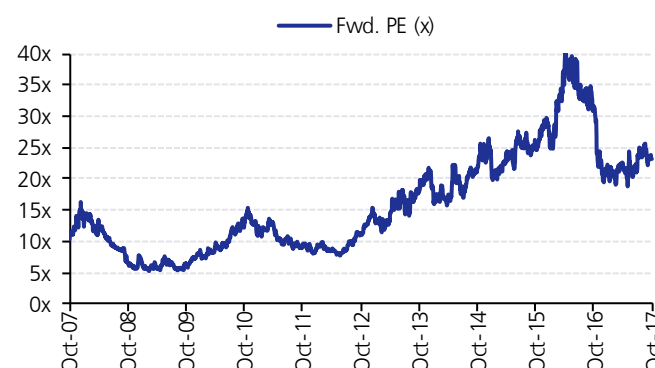
Source: Company, JM Financial

Exhibit 2. MMFS: One-year forward P/BV (x)



Source: Company, JM Financial

Exhibit 3. MMFS: One-year forward P/E (x)



Source: Company, JM Financial

- MMFS reported profit of INR 780mn (vs. JMFe of INR 1.39bn) due to higher provisioning of INR 4.45bn (vs. JMFe of INR 3.4bn) as company migrated to 90DPD during Q2. Adjusting for the impact of migration to 90DPD, PAT stood at INR 2.4bn (157% YoY). Consequently, Gross NPLs was up 31% YoY on absolute basis, Net NPL was up 33% YoY on absolute basis, coverage ratio remained stable at 51% despite migrating to 90DPD (vs. 51.9% in 2Q17 on 120DPD). On like to basis (on 120DPD), gross NPL was up 8% YoY while Net NPL declined 4% YoY. Operating profit was healthy at 25% YoY (2% above JMFe).

Exhibit 4. MMFS: Actual vs. estimates

P/L Rs mn	2Q18E	2Q18A	A/E (%)
Net Interest Income	9,550	9,110	-4.6%
Total Operating Expenses	4,150	3,694	-11.0%
Operating Profit (PPP)	5,550	5,636	1.6%
Total Provisions	3,413	4,446	30.3%
Reported Profit	1,389	780	-43.9%

Source: Company, JM Financial

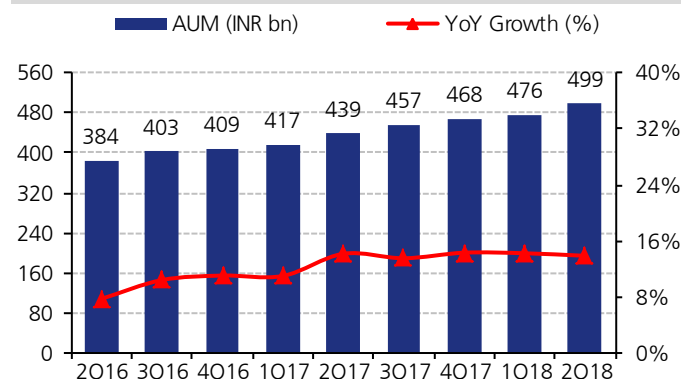
MMFS – 2Q18 trends

Exhibit 5. MMFS: 2Q18 - Results summary

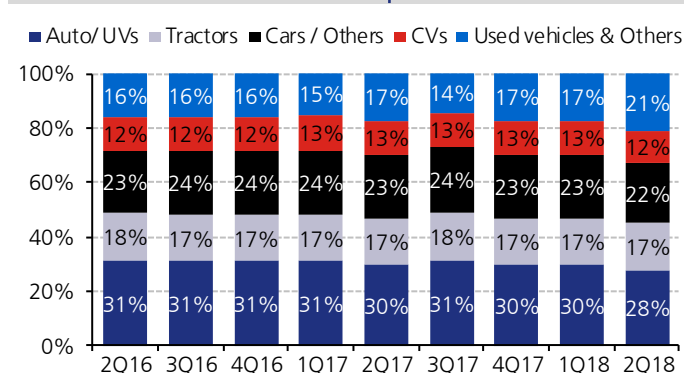
Earnings Table (Rs mn)	2Q'17	1Q'18	2Q'18	YoY (%)	QoQ (%)
Net Interest Income	7,830	8,597	9,110	16.3%	6.0%
Total Income	8,071	8,704	9,331	15.6%	7.2%
Total Operating Expenses	3,567	3,810	3,694	3.6%	-3.0%
Operating Profit (PPP)	4,504	4,894	5,636	25.1%	15.2%
Provisions & Write Offs	3,042	4,258	4,446	46.2%	4.4%
PBT	1,462	636	1,190	-18.6%	87.2%
Tax	514	162	410	-20.2%	153.1%
PAT (Pre-Extraordinaries)	948	474	780	-17.7%	64.6%
Extraordinaries (Net of Tax)	0	0	0	NA	NA
Reported Profit	948	474	780	-17.7%	64.6%
Loans (Rs bn)					
Assets Under Management	439	476	499	13.8%	4.9%
Disbursements	53	53	53	0.3%	-1.0%
Loans	399	438	460	15.3%	5.0%
Ratios Analysis (%)					
Cost to Income (%)	44.2%	43.8%	39.6%	-4.60%	-4.18%
Effective Tax Rate (%)	35.2%	25.5%	34.5%	-0.68%	8.99%
Asset Quality					
Gross NPAs (120 days overdue) (INR Mn.)	47,481	50,142	51,310	8.1%	2.3%
Gross NPAs (90 days overdue) (INR Mn.)	NA	NA	62,196	NA	NA
Net NPAs (120 days overdue) (INR Mn.)	22,862	19,810	22,012	-3.7%	11.1%
Net NPAs (90 days overdue) (INR Mn.)	NA	NA	30,420	NA	NA
Gross NPA (120 days overdue) (%)	11.21%	10.70%	10.48%	-6.4%	-2.0%
Gross NPA (90 days overdue) (%)	NA	NA	12.64%	NA	NA
Net NPA (120 days overdue) (%)	5.73%	4.52%	4.78%	-16.5%	5.8%
Net NPA (90 days overdue) (%)	NA	NA	6.61%	NA	NA
Coverage Ratio (120 days overdue) (%)	51.9%	60.5%	57.1%	10.1%	-5.6%
Coverage Ratio (90 days overdue) (%)	NA	NA	51.1%	NA	NA
Capital Adequacy (%)					
Tier I (%)	13.2%	12.9%	12.4%	-0.8%	-0.5%
CAR (%)	18.1%	17.4%	19.3%	1.2%	1.9%
Du-pont Analysis (%)					
NII / Avg. Assets (%)	7.5%	7.4%	7.6%	0.0%	0.2%
Non-Interest Inc. / Assets (%)	0.2%	0.1%	0.2%	0.0%	0.1%
Op. Cost / Assets (%)	3.4%	3.3%	3.1%	-0.4%	-0.2%
PPP / Assets (%)	4.3%	4.2%	4.7%	0.4%	0.5%
Provisions / Assets (%)	2.9%	3.7%	3.7%	0.8%	0.0%
ROA (%)	0.9%	0.4%	0.6%	-0.3%	0.2%
ROE (%)	6.1%	2.9%	4.8%	-1.3%	1.9%

Source: Company, JM Financial

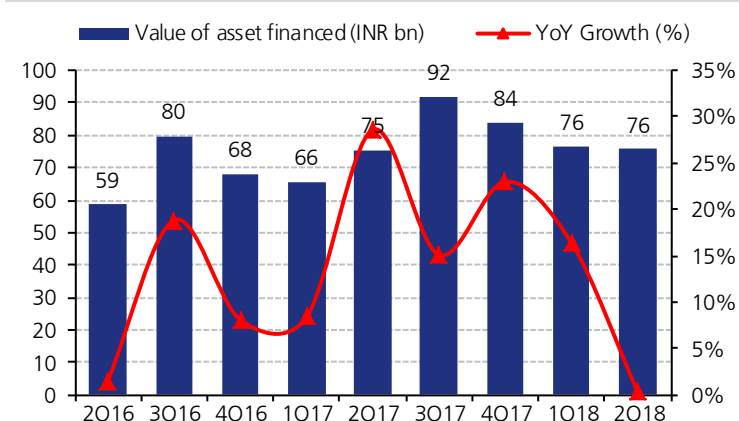
- AUM growth remained stable at 14% YoY driven by healthy disbursement growth in the tractor segment (12% YoY) while CV/CE disbursement was sluggish (-8% YoY). Overall disbursement growth remained muted during the quarter due to GST related disruption.

Exhibit 6. MMFS: Trend in AUM

Source: Company, JM Financial

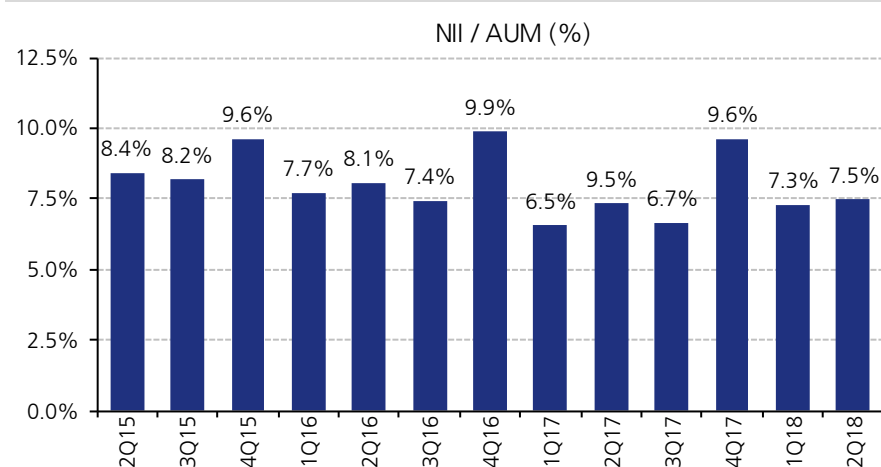
Exhibit 7. MMFS: Trend in AUM composition

Source: Company, JM Financial

Exhibit 8. MMFS: Value of Asset Financed

Source: Company, JM Financial

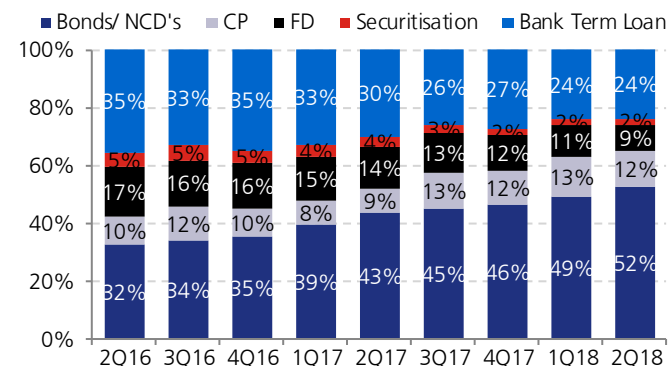
- NII increased 16% YoY, while margins (NII/AUM) increased 15ps YoY to 7.5% due to i) increase in tractor proportion ii) decline in funding cost by 87bps YoY and iii) lower incremental slippages YoY. However, excluding the impact of migration, margins increased 72bps YoY to 8.05%.

Exhibit 9. MMFS: Trend in NII/AUM (%)

Source: Company, JM Financial

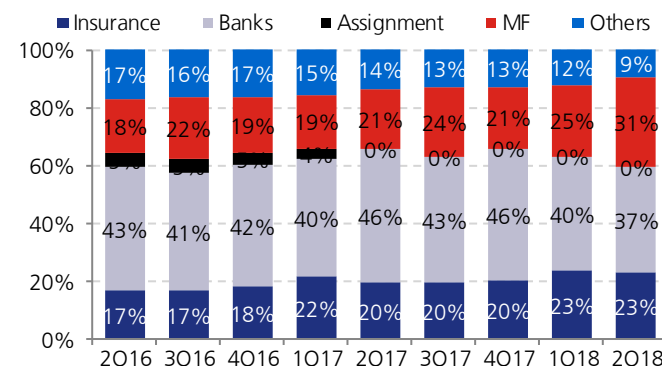
- Proportion of bank loans declined to 24% in 2Q18 vs 30% in 2Q17.

Exhibit 10. MMFS: Trend in borrowing mix – Source wise



Source: Company, JM Financial

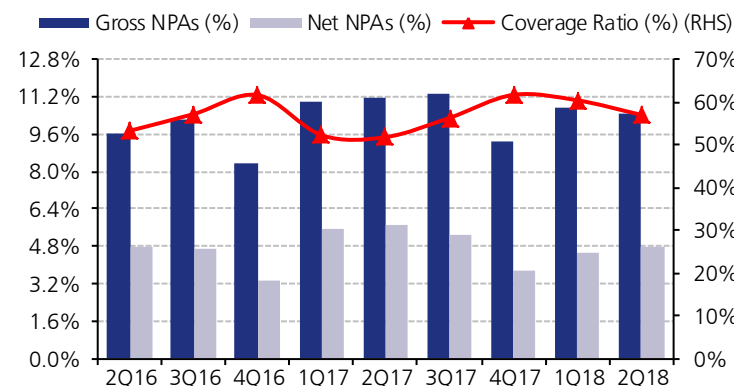
Exhibit 11. MMFS: Trend in borrowing mix – Investor profile wise



Source: Company, JM Financial

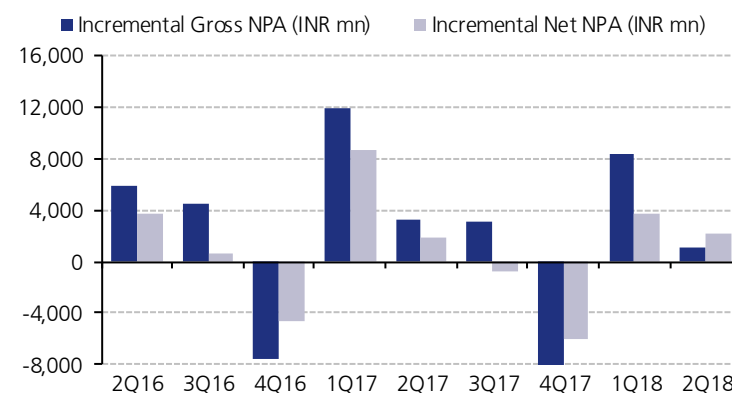
- Asset quality witnessed signs of improvement as Gross NPL (on 120DPD) on an absolute basis increased by just 8% YoY while Net NPL declined 4% YoY. On like to like basis, GNPL ratio (on 120DPD) improved 72bps YoY to 10.5%. GNPL ratio stood at 12.6% (on 90DPD) while coverage ratio remained stable at 51% (vs. 51.8% on 120DPD) despite migrating to 90DPD. Credit costs remained elevated at 396bps (vs. 313bps in 2Q17) as company made provisions of INR 177mn due to migration excluding which it improved 75bps YoY to 240bps. Number of NPL contracts declined to 165K (vs. 178K in 2Q17) on 120DPD and 211K on 90DPD. With migration challenges behind us and asset quality showing signs of improvement, we factor credit costs of 230/200bps in FY18-19E (vs. 306bps in FY17).

Exhibit 12. MMFS: Trend in asset quality



Source: Company, JM Financial

Exhibit 13. MMFS: Trend in asset quality



Source: Company, JM Financial

Subsidiary performance

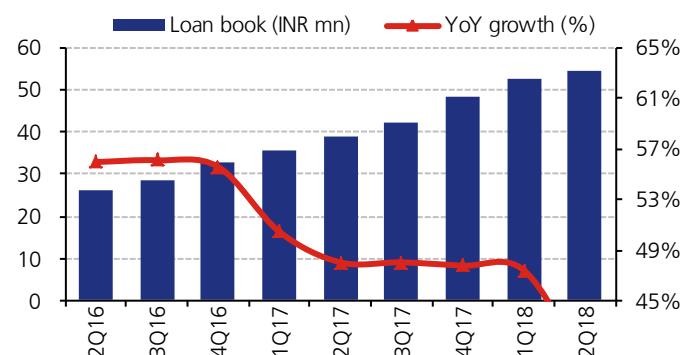
MRHF – 2Q18 trends

Exhibit 14. MRHF: 2Q18 - Results summary

Earnings Table (Rs mn)	Q2FY17	Q1FY18	Q2FY18	YoY (%)	QoQ (%)
Total Income	1,680	1,985	2,365	40.8%	19.1%
PBT	306	44	530	73.2%	1104.5%
PAT	199	29	345	73.4%	1089.7%
No. of Customer Contracts	34,428	40,620	36,808	6.9%	-9.4%
Loans	38,818	52,443	54,324	39.9%	3.6%
Disbursements	4,535	5,978	5,827	28.5%	-2.5%

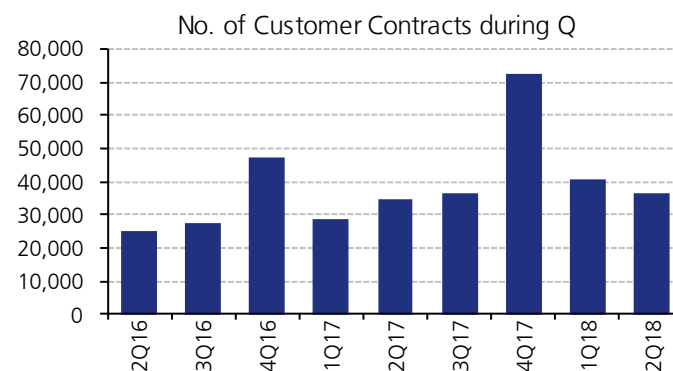
Source: Company, JM Financial

Exhibit 15. MRHF: Trends in loan book



Source: Company, JM Financial

Exhibit 16. MMFS: No. of customers acquired during the quarter



Source: Company, JM Financial

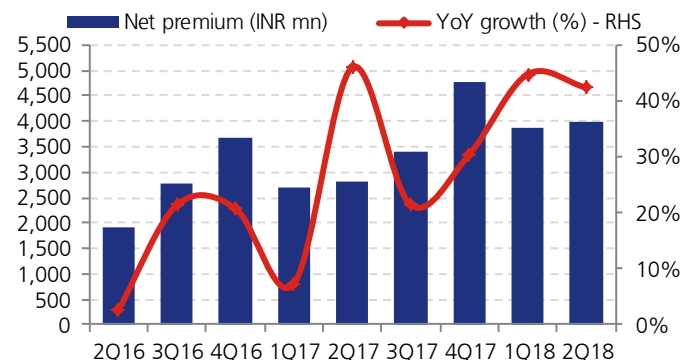
MIBL – 2Q18 trends

Exhibit 17. MIBL: 2Q18 - Results summary

Earnings Table (Rs mn)	2Q'17	1Q'18	2Q'18	YoY (%)	QoQ (%)
Total income	378	445	505	33.6%	13.5%
Gross premium	NA	4,000	4,275	NA	6.9%
Net premium	2,797	3,879	NA	NA	NA
PBT	132	211	126	-4.5%	-40.3%
PAT	85	134	85	0.0%	-36.6%
No. of employees (nos.)	912	1,014	1,019	11.7%	0.5%

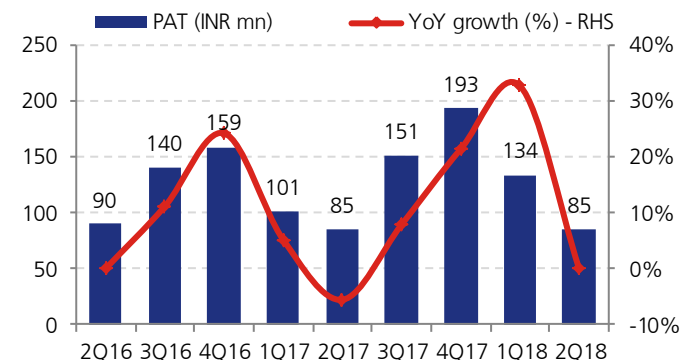
Source: Company, JM Financial

Exhibit 18. MIBL: Trends in net premium



Source: Company, JM Financial

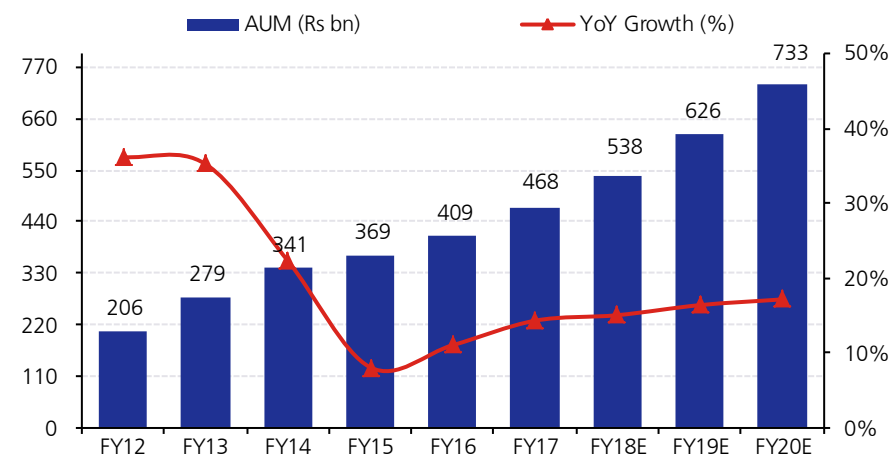
Exhibit 19. MIBL: Trends in profitability



Source: Company, JM Financial

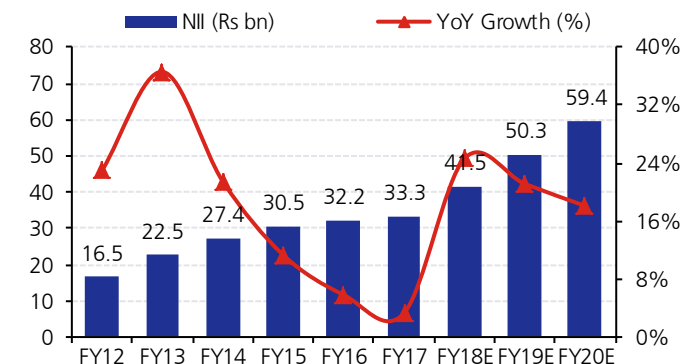
MMFS – Annual Trends

Exhibit 20. MMFS: Trend in AUM (Rs bn)



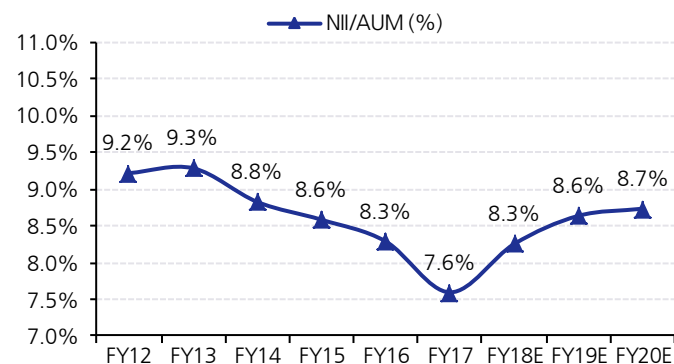
Source: Company, JM Financial

Exhibit 21. MMFS: Trend in NII (Rs bn)



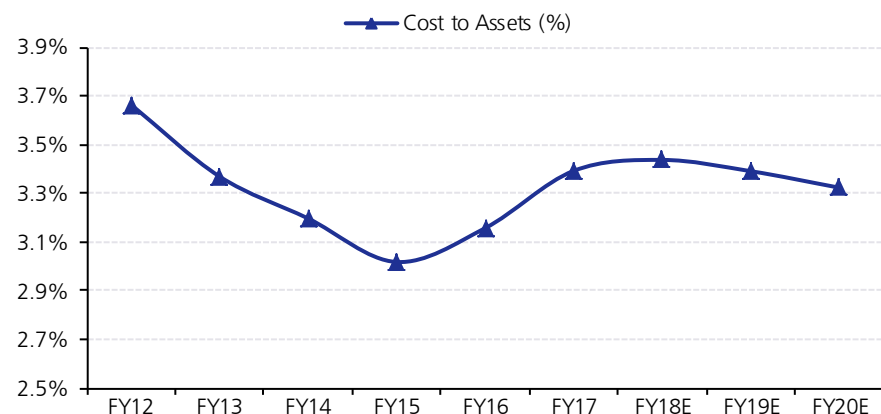
Source: Company, JM Financial

Exhibit 22. MMFS: Trend in NII/AUM (%)



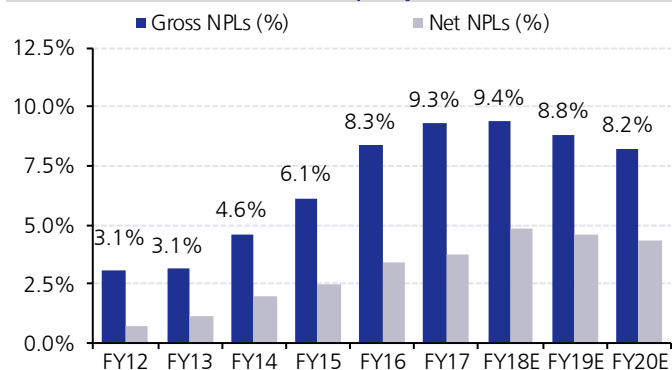
Source: Company, JM Financial

Exhibit 23. MMFS: Trend in cost to assets



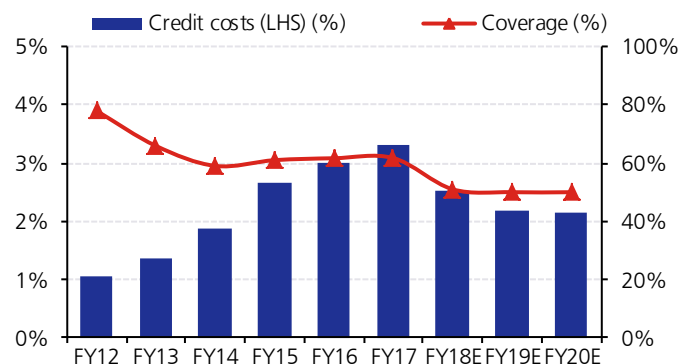
Source: Company, JM Financial

Exhibit 24. MMFS: Trend in asset quality



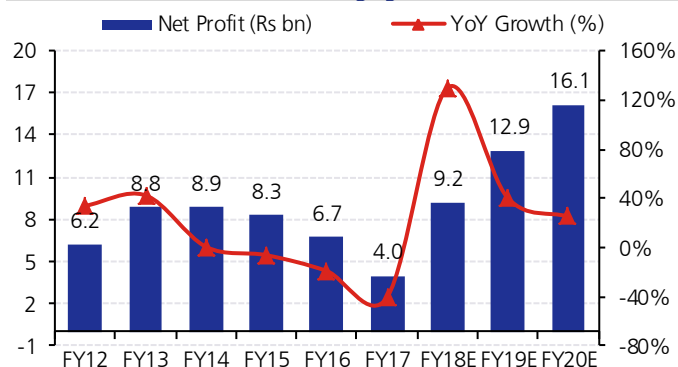
Source: Company, JM Financial

Exhibit 25. MMFS: Trend in credit costs



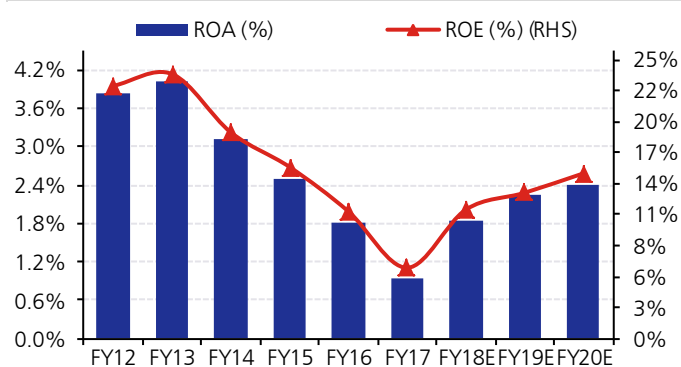
Source: Company, JM Financial

Exhibit 26. MMFS: Trend in earnings growth



Source: Company, JM Financial

Exhibit 27. Trend in return ratios



Source: Company, JM Financial

Financial Tables (Standalone)

Profit & Loss					(INR mn)
Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E
Net Interest Income	32,246	33,299	41,492	50,261	59,353
Profit on Investments	11	10	750	130	150
Exchange Income	0	0	0	0	0
Fee & Other Income	402	492	565	650	748
Non-Interest Income	412	502	1,315	780	898
Total Income	32,658	33,801	42,808	51,041	60,250
Operating Expenses	11,781	14,509	17,064	19,557	22,375
Pre-provisioning Profits	20,877	19,292	25,744	31,484	37,875
Loan-Loss Provisions	10,495	13,091	11,588	11,639	13,244
Provisions on Investments	0	0	0	0	0
Others Provisions	0	0	0	0	0
Total Provisions	10,495	13,091	11,588	11,639	13,244
PBT	10,382	6,201	14,156	19,844	24,631
Tax	3,656	2,198	4,955	6,946	8,498
PAT (Pre-Extraordinaries)	6,726	4,002	9,201	12,899	16,134
Extra ordinaries (Net of Tax)	0	0	0	0	0
Reported Profits	6,726	4,002	9,201	12,899	16,134
Dividend paid	2,713	1,610	2,760	3,870	4,840
Retained Profits	4,013	2,392	6,441	9,029	11,293

Source: Company, JM Financial

Key Ratios					
Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E
Growth (YoY) (%)					
Advances	11.3%	16.0%	15.1%	16.4%	17.1%
Total Assets	12.8%	16.2%	16.0%	16.4%	17.1%
NII	5.8%	3.3%	24.6%	21.1%	18.1%
Non-interest Income	2.5%	21.7%	162.0%	-40.7%	15.1%
Operating Expenses	17.0%	23.2%	17.6%	14.6%	14.4%
Operating Profits	0.3%	-7.6%	33.4%	22.3%	20.3%
Core Operating profit	-13.3%	-39.9%	125.4%	40.2%	22.3%
Provisions	26.8%	24.7%	-11.5%	0.4%	13.8%
Reported PAT	-19.1%	-40.5%	129.9%	40.2%	25.1%
Yields / Margins (%)					
Interest Spread	6.54%	5.86%	6.38%	6.67%	6.86%
NIM	8.80%	7.95%	8.54%	8.90%	9.00%
Profitability (%)					
Non-IR to Income	1.3%	1.5%	3.1%	1.5%	1.5%
Cost to Income	36.1%	42.9%	39.9%	38.3%	37.1%
ROA	1.80%	0.94%	1.85%	2.24%	2.40%
ROE	11.5%	6.4%	11.6%	13.2%	14.9%
Assets Quality (%)					
Slippages	0.00%	0.00%	0.00%	0.00%	0.00%
Gross NPA	8.34%	9.27%	9.36%	8.80%	8.22%
Net NPAs	3.37%	3.76%	4.81%	4.61%	4.29%
Provision Coverage	61.7%	61.8%	51.0%	50.0%	50.0%
Specific LLP	0.00%	0.00%	0.00%	0.00%	0.00%
Net NPAs / Networth	20.4%	24.8%	25.2%	25.6%	25.1%
Capital Adequacy (%)					
Tier I	14.59%	12.80%	17.14%	16.19%	15.38%
CAR	17.29%	15.20%	19.67%	18.68%	17.83%

Source: Company, JM Financial

Balance Sheet						(INR mn)
Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E	
Equity Capital	1,129	1,130	1,236	1,236	1,236	
Reserves & Surplus	59,508	63,396	92,214	101,243	112,537	
Deposits	0	0	0	0	0	
Borrowings	294,523	346,704	383,455	452,476	535,958	
Other Liabilities	40,391	48,376	56,098	65,274	76,417	
Total Liabilities	395,795	459,852	533,253	620,486	726,409	
Investments	14,833	18,895	24,967	29,335	34,024	
Net Advances	366,578	425,234	489,552	569,613	667,130	
Cash & Equivalents	6,221	5,781	7,343	8,544	10,007	
Fixed Assets	1,135	1,120	1,299	1,511	1,769	
Other Assets	0	0	0	0	0	
Total Assets	395,795	459,852	533,253	620,486	726,409	

Source: Company, JM Financial

Dupont Analysis					
Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E
NII / Assets	8.64%	7.78%	8.36%	8.71%	8.81%
Other Income / Assets	0.11%	0.12%	0.26%	0.14%	0.13%
Total Income / Assets	8.75%	7.90%	8.62%	8.85%	8.95%
Cost / Assets	3.16%	3.39%	3.44%	3.39%	3.32%
PBP / Assets	5.59%	4.51%	5.18%	5.46%	5.62%
Provisions / Assets	2.81%	3.06%	2.33%	2.02%	1.97%
PBT / Assets	2.78%	1.45%	2.85%	3.44%	3.66%
Tax rate	35.2%	35.5%	35.0%	35.0%	34.5%
ROA	1.80%	0.94%	1.85%	2.24%	2.40%
RoRWAs	1.79%	0.90%	1.80%	2.24%	2.40%
Leverage	6.5	7.1	5.7	6.1	6.4
ROE	11.5%	6.4%	11.6%	13.2%	14.9%

Source: Company, JM Financial

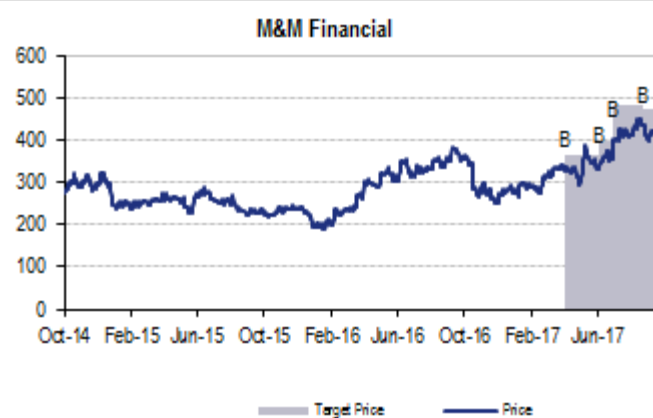
Valuations					
Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E
Shares in Issue	564.6	565.0	617.9	617.9	617.9
EPS (INR)	11.9	7.1	14.9	20.9	26.1
EPS (YoY) (%)	-19.2%	-40.5%	110.2%	40.2%	25.1%
PER (x)	34.3	57.7	27.5	19.6	15.7
BV (INR)	107	114	151	166	184
BV (YoY) (%)	7.2%	6.3%	32.4%	9.7%	11.0%
ABV (INR)	156	156	128	166	184
ABV (YoY) (%)	8.7%	0.0%	-18.2%	29.8%	11.0%
P/BV (x)	3.81	3.58	2.70	2.47	2.22
P/ABV (x)	2.62	2.62	3.20	2.47	2.22
DPS (INR)	4.8	2.8	4.5	6.3	7.8
Div. yield (%)	1.2%	0.7%	1.1%	1.5%	1.9%

Source: Company, JM Financial

History of Earnings Estimate and Target Price

Date	FY18E EPS (INR)	% Chg.	FY19E EPS (INR)	% Chg.	Target Price	% Chg.
26-Apr-17	29.5		40.7		362	
29-Jun-17	10.2	-65.5	14.1	-65.5	398	10.0
25-Jul-17	2.5	-75.8	3.4	-75.7	484	21.6
15-Sep-17	21.9	785.8	30.5	792.1	471	-2.7

Recommendation History



APPENDIX I

JM Financial Institutional Securities Limited

Corporate Identity Number: U65192MH1995PLC092522

Member of BSE Ltd. and National Stock Exchange of India Ltd. and Metropolitan Stock Exchange of India Ltd.

SEBI Registration Nos.: BSE - INZ010012532, NSE - INZ230012536 and MSEI - INZ260012539, Research Analyst – INH000000610

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Definition of ratings	
Rating	Meaning
Buy	Total expected returns of more than 15%. Total expected return includes dividend yields.
Hold	Price expected to move in the range of 10% downside to 15% upside from the current market price.
Sell	Price expected to move downwards by more than 10%

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