Prabhudas Lilladher
POWERING YOUR FINANCIAL GROWTH

# Mahindra & Mahindra Financial Services

## Operational miss; business growth momentum picking up

Q4FY18 Result Update

**April 26, 2018**

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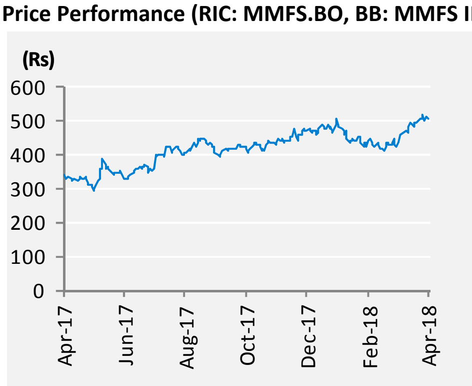
| | |
|---|---|
| Rating | **Accumulate** |
| Price | Rs507 |
| Target Price | Rs553 |
| Implied Upside | 9.1% |
| Sensex | 34,501 |
| Nifty | 10,571 |

***(Prices as on April 26, 2018)***

| **Trading data** | | | |
|---|---|---|---|
| Market Cap. (Rs bn) | | | 311.7 |
| Shares o/s (m) | | | 614.5 |
| 3M Avg. Daily value (Rs m) | | | 898.7 |
| **Major shareholders** | | | |
| Promoters | | | 51.19% |
| Foreign | | | 29.41% |
| Domestic Inst. | | | 11.57% |
| Public & Other | | | 5.71% |
| **Stock Performance** | | | |
| **(%)** | **1M** | **6M** | **12M** |
| Absolute | 15.8 | 21.8 | 53.5 |
| Relative | 10.0 | 17.4 | 38.3 |
| **How we differ from Consensus** | | | |
| **EPS (Rs)** | **PL** | **Cons.** | ***% Diff.*** |
| 2019 | 24.2 | 21.8 | *11.1* |
| 2020 | 30.6 | 28.0 | *9.3* |

**Price Performance (RIC: MMFS.BO, BB: MMFS IN)**




*Source: Bloomberg*

***MMFS earnings were in-line with estimates with PAT at Rs4.2bn (PLe: 4.4bn) on the back of lower provisioning as collections & recoveries were better than expected. Operational miss was from lower income from yield pressure despite better than expected AUM growth of ~18% YoY and on higher opex due to one-off expenses. Management remains optimistic on improving rural cash flow and improving infra activity which should lead to growth of 18-20% in FY19 across segments and will lower provisioning requirement. Rural recovery should agur well for growth and recovery from NPAs can bring tailwind to earnings helping deliver ROA of 2.6-2.8% by FY20. We retain Accumulate with revised TP of Rs553 (up from Rs530) based on 3.3x Mar-20 ABV (rolled from Sep-19) inclusive of Rs69 as value of subsidiaries.***

- **Better AUM growth but yields slightly under pressure:** AUM growth was better than expected with growth of 18% YoY on strong disbursement in tractor/CVs/pre-owned vehicles and SME, while was modest in Cars & UVs. MMFS continue to improve its market share in many segments, while remaining leader in M&M/Maruti especially in rural. Change in mix has been leading to some pressure in yields and partly by geography as well but tailwinds from cost of funds is still helping lower cost of funds. Incrementally, cost of funds have inched up but should be passed on to some loan segments, keeping NIMs stable.

- **Operationally slight miss but collections/recoveries help:** Operating performance was slightly lower than expected on lower top line relatively and higher opex on non-recurring performance incentives and gratuity re-alignment. But credit cost was lower as collections & recoveries were much better helping asset quality improvement and helping in-line earnings.

- **Rural poised to improve return ratios:** MMFS completely remains focused on rural penetration and positioning maintaining its market leadership. With buoyancy on loan growth and cash flow improvement tailwinds on asset quality can help it deliver 2.5-2.7% ROA, 15-18% ROE and 30-40% earnings growth over FY19-FY20, but earnings & asset quality recovery has been factored in +3.0x multiples on FY20 and hence we maintain Accumulate stance.

| Key Financials (Y/e March) | 2017 | 2018 | 2019E | 2020E |
|---|---|---|---|---|
| Net interest income (Rs m) | 31,971 | 40,682 | 50,345 | 59,630 |
| *Growth (%)* | *6.3* | *27.2* | *23.8* | *18.4* |
| Non-interest income (Rs m) | 636 | 590 | 637 | 688 |
| Operating Profit (Rs m) | 19,292 | 25,344 | 32,612 | 39,174 |
| PAT (Rs m) | 4,002 | 8,269 | 14,850 | 18,802 |
| EPS (Rs) | 7.1 | 14.0 | 24.2 | 30.6 |
| *Growth (%)* | *(40.5)* | *97.9* | *72.4* | *26.6* |
| Net DPS (Rs) | — | 2.2 | 3.4 | 5.6 |

| Profitability & valuation | 2017 | 2018 | 2019E | 2020E |
|---|---|---|---|---|
| *Spreads / Margins (%)* | *8.2* | *9.1* | *9.5* | *9.5* |
| *RoAE (%)* | *6.4* | *10.5* | *15.4* | *17.7* |
| *RoAA (%)* | *1.0* | *1.8* | *2.8* | *3.0* |
| P/E (x) | 71.6 | 36.2 | 21.0 | 16.6 |
| P/BV (x) | 4.4 | 3.2 | 3.1 | 2.8 |
| P/ABV (x) | 5.9 | 4.0 | 3.8 | 3.4 |
| *Net dividend yield (%)* | — | *0.4* | *0.7* | *1.1* |

*Source: Company Data; PL Research*

**Exhibit 1: MMFS Q4FY18: Better recoveries help lower provisions driving earnings**

| (Rs m) | Q4FY18 | Q4FY17 | YoY gr. | Q3FY18 | QoQ gr. |
|---|---|---|---|---|---|
| Interest Income | 20,600 | 18,255 | 12.8% | 18,340 | 12.3% |
| Interest Expenses | 7,550 | 7,137 | 5.8% | 7,629 | -1.0% |
| **NII (incl. securitisation)** | **13,050** | **11,117** | **17.4%** | **10,711** | **21.8%** |
| Other Income | 138 | 173 | -19.9% | 124 | 11.3% |
| **Total Income** | **13,188** | **11,290** | **16.8%** | **10,835** | **21.7%** |
| Total Operating Expenses | 4,927 | 4,037 | 22.0% | 4,282 | 15.1% |
| **Operating Profit (PPoP)** | **8,261** | **7,252** | **13.9%** | **6,553** | **26.1%** |
| Provisions & Write Offs | 1,572 | 3,614 | -56.5% | 1,989 | -21.0% |
| **PBT** | **6,688** | **3,638** | **83.8%** | **4,563** | **46.6%** |
| **Reported Profit** | **4,245** | **2,341** | **81.4%** | **2,770** | **53.3%** |
| | | | | | |
| **Assets Under Management** | **5,51,012** | **4,67,760** | **17.8%** | **5,17,820** | **6.4%** |
| Off-Balance Sheet AUM | 8,990 | 7,908 | 13.7% | 8,497 | 5.8% |
| **NIM - Calculated** | **9.77%** | **8.92%** | **0.8%** | **8.43%** | **1.34%** |
| | | | | | |
| **AUM (Rs m)** | **5,19,033** | **4,33,142** | **19.8%** | **4,86,620** | **6.7%** |
| Auto/ Utility vehicles | 1,40,139 | 1,29,943 | 7.8% | 1,36,254 | 2.9% |
| Tractors | 88,236 | 73,634 | 19.8% | 87,592 | 0.7% |
| Cars / Others | 1,14,187 | 99,623 | 14.6% | 1,11,923 | 2.0% |
| Commercial Vehicles | 72,665 | 56,308 | 29.0% | 63,261 | 14.9% |
| Used vehicles & Others | 1,03,807 | 73,634 | 41.0% | 87,592 | 18.5% |
| | | | | | |
| **Asset Quality** | | | | | |
| Gross NPAs | 46,987 | 41,827 | 12.3% | 60,228 | -22.0% |
| Net NPAs | 19,706 | 15,997 | 23.2% | 26,977 | -27.0% |
| Gross NPA (%) | 8.50% | 9.00% | -0.5% | 11.60% | -3.1% |
| Net NPA (%) | 3.67% | 3.55% | 0.1% | 5.28% | -1.6% |
| Coverage (%) | 58.06% | 61.75% | -3.7% | 55.21% | 2.9% |
| **Credit costs on loans - Calculated** | **1.23%** | **3.40%** | **-2.2%** | **1.66%** | **-0.4%** |
| | | | | | |
| **Balance sheet Details** | | | | | |
| Total Borrowed Funds | 4,03,130 | 3,54,907 | 13.6% | 3,70,048 | 8.9% |
| Loans & Advances & others | 5,10,044 | 4,25,234 | 19.9% | 4,78,123 | 6.7% |
| Total Assets | 5,42,022 | 4,59,852 | 17.9% | 5,09,323 | 6.4% |
| | | | | | |
| **Subsidiary Performance** | | | | | |
| Insurance Brokers PAT | 223 | 193 | 15.5% | 88 | 153.4% |
| Rural Housing PAT | 89 | 389 | -77.1% | 367 | -75.7% |

*Source: Company Data, PL Research*

# MMFS Key Q4FY18 Concall Highlights:

## Commentary/Outlook:

- Have increased market share in every product segment. Some NBFCs have slowed down in rural and hence will help MMFS increase market share further. Maintaining market share at 30-35% in Mahindra products and in Maruti at 8-10%. Also strong growth was seen in pre-owned vehicles in cars, UVs & pick-up vehicle segment and also CV/CE and SME has seen better growth. **Outlook**: Disbursements could likely grow at 20% in H1FY19 & 25% in H2FY19 depending on monsoon which can lead to AUM of 20-22% in FY19 from ~18% in FY18.
- Not coming yet to the urban market as rural market continues to remain buoyant and pan India presence remains strength and penetration remains the strategy. Have added presence in 30,000-40,000 villages from the 100,000 villages identified. Have been working with now 5,000 dealers and almost all the OEMs.
- Election remains a business booster with elections in 4-5 states and then going in to general elections.
- Cash flow has improved in rural India and hence took at view not to repossess assets and recover/settle/closure of A/cs by engagement. Local level infrastructure and expected onset of monsoon helping rural sentiments.
- **Geographies -** TN/Karnataka has not participated in growth but is not seeing any major collections issue. Kerala has been performing stable. East India has been growing but contribution to growth is quite less. Northern states have been big booster for growth especially UP.

## Capacity building/Opex:

- **Opex –** Employee expenses was higher on adjustment in actuarial valuations on gratuity, hence, had impact of Rs140-150mn and performance based incentives were given out which had impact of Rs200mn, both of which are non-recurring.
- **Branches –** Have added 100 branches this year which are set to start soon which will contribute to the growth going ahead.

## Margins/Spreads:

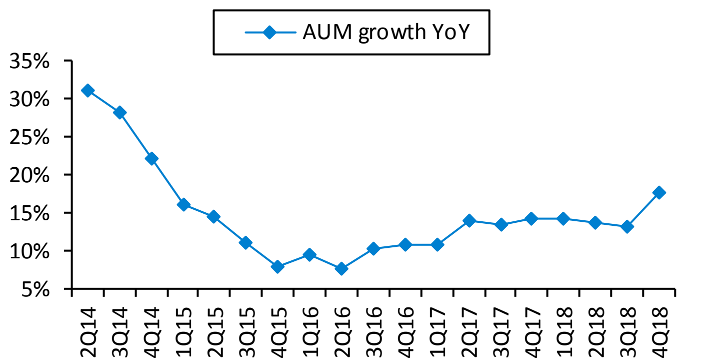
- Yields remain much comfortable and no pressure seen in medium term and yield range would remain between 15-17%, however company hinted of some funding cost pressure and can be passed to selective geography and selective product segments on keeping spreads stable.

## Asset quality/Collections:

- **Asset quality – Outlook** – GNPAs could likely come off to 7% levels suggesting shorter cycle of NPAs from peak levels. NPAs in the rural housing should reduce in-line with MMFSL, will take another two quarters as Maharashtra has improved in cash flow and which will translate towards recoveries.

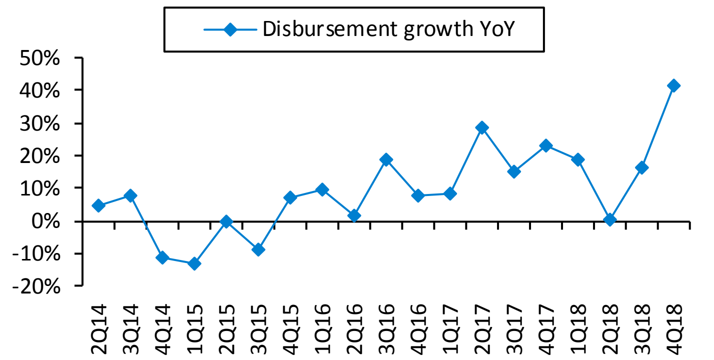
- **Credit cost & write-off –** MMFS wrote-off Rs3.2bn (Rs3.1bn in Q4FY17) which was 100% provided & matured in NPA bucket, while had Rs2.57bn credit cost on repossession & disposal losses.
- **Repossessions & collections –** Vehicles under repossession remained stable at 11,596 QoQ but recoveries have helped reduced live NPA cases to 6.4% (from 7.2% in FY17).

**Exhibit 2: AUM growth of 17.8% YoY was a positive surprise**



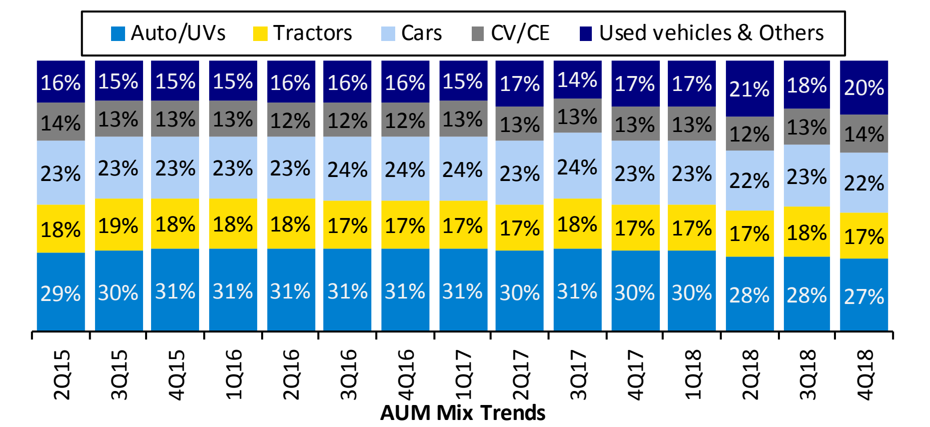

*Source: Company Data, PL Research*

**Exhibit 3: Disbursements were strong led by pre-owned vehicles**



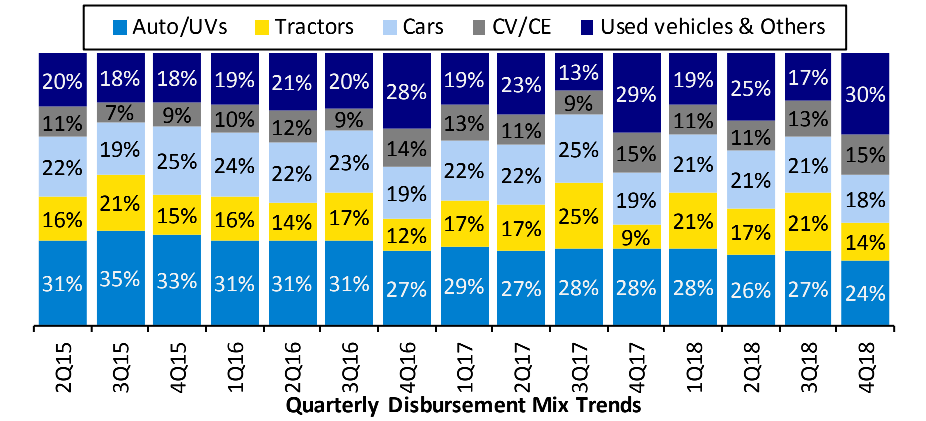

*Source: Company Data, PL Research*

**Exhibit 4: AUM mix - sees better growth in CV/CE, pre-owned & SME segments**



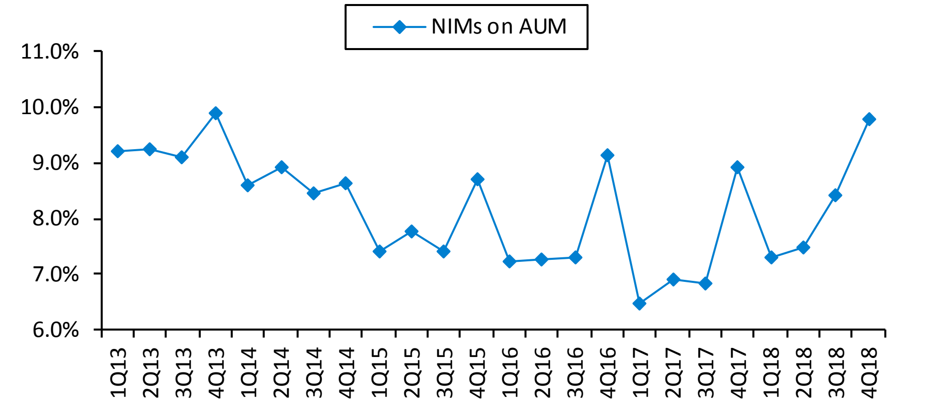

*Source: Company Data, PL Research*

**Exhibit 5: Disbursements was better for all segments especially pre-owned vehicles**



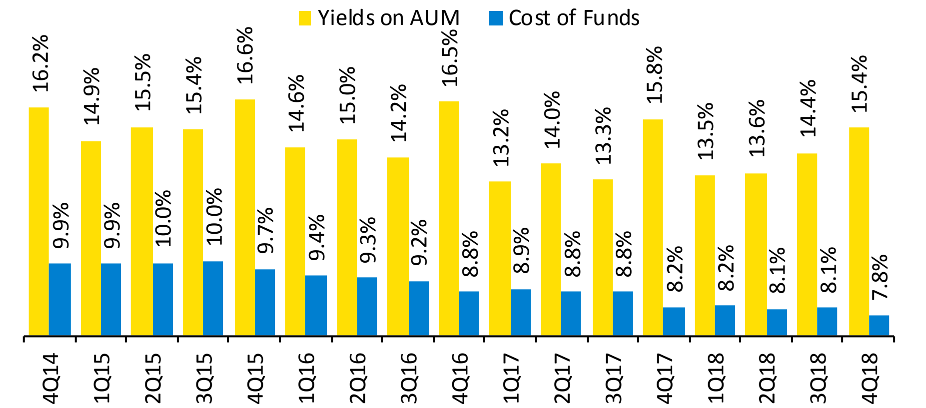

*Source: Company Data, PL Research*

**Exhibit 6: Margins saw uptick on high yielding products and lower interest reversals**



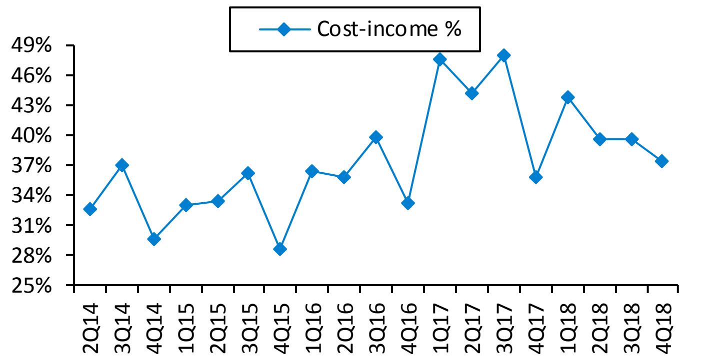

*Source: Company Data, PL Research*

**Exhibit 7: Yields have improved on high yielding products and cost of funds can see some pressure going ahead**



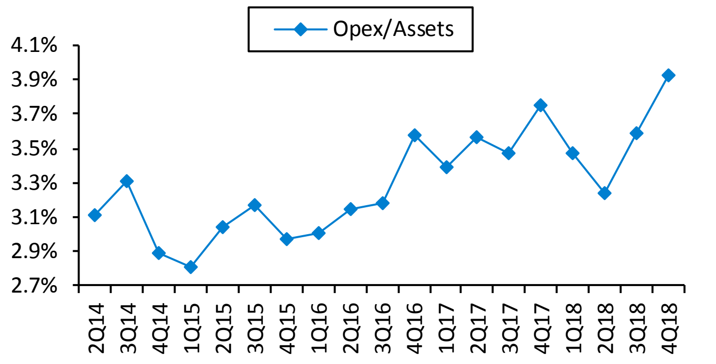

*Source: Company Data, PL Research*

**Exhibit 8: C/I ratio improved on higher total income despite higher opex**



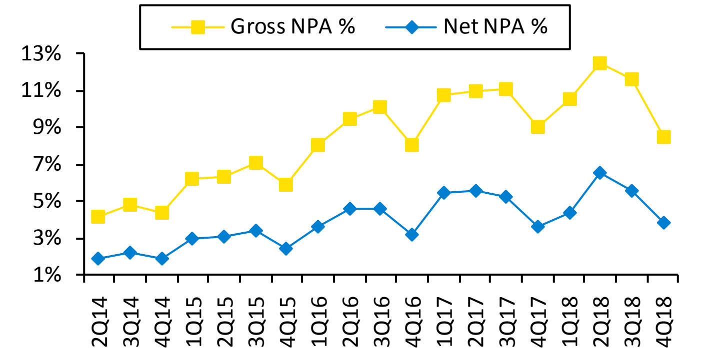

*Source: Company Data, PL Research*

**Exhibit 9: Opex/assets rises on non-recurring performance incentives and change in gratuity assumptions**



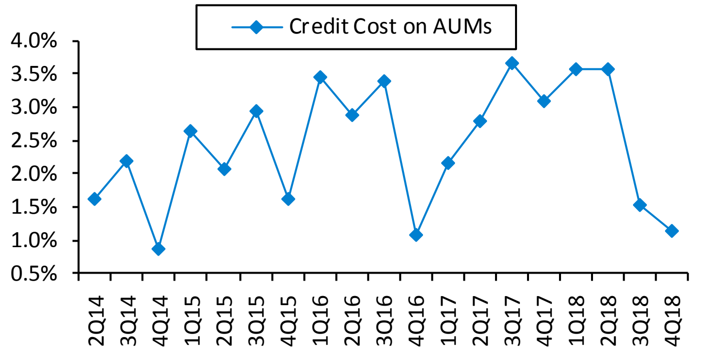

*Source: Company Data, PL Research*

**Exhibit 10: Asset quality improved on 90dpd on strong collections**




*Source: Company Data, PL Research*

**Exhibit 11: Credit cost was lower on better recoveries collections**




*Source: Company Data, PL Research*

**Exhibit 12: ROA tree – Factoring in `18% ROE in FY20 with capital infusion**

| ROE Decomposition | FY13 | FY14 | FY15 | FY16 | FY17 | FY18E | FY19E | FY20E |
|---|---|---|---|---|---|---|---|---|
| Net Interest Income/AUM | 8.3% | 8.1% | 7.8% | 7.7% | 7.3% | 8.0% | 8.4% | 8.4% |
| Fees/AUM | 0.2% | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% |
| **Net revenues/AUM** | **9.4%** | **8.9%** | **8.7%** | **8.4%** | **7.7%** | **8.3%** | **8.6%** | **8.6%** |
| Operating Expense/AUM | 3.1% | 2.9% | 2.8% | 3.0% | 3.3% | 3.3% | 3.2% | 3.1% |
| Provisions/AUM | 1.2% | 1.6% | 2.3% | 2.7% | 3.0% | 2.4% | 1.7% | 1.5% |
| Taxes/AUM | 1.6% | 1.5% | 1.2% | 0.9% | 0.5% | 0.9% | 1.3% | 1.4% |
| **ROA** | **3.5%** | **2.9%** | **2.3%** | **1.7%** | **0.9%** | **1.6%** | **2.5%** | **2.7%** |
| Equity/AUM | 15.3% | 15.4% | 15.2% | 15.1% | 14.3% | 15.5% | 16.1% | 15.1% |
| **ROE** | **23.1%** | **18.6%** | **15.5%** | **11.4%** | **6.4%** | **10.5%** | **15.4%** | **17.7%** |

*Source: Company Data, PL Research*

**Exhibit 13: Change in estimates table – We revise our earnings to factor in slightly lower opex cost and credit costs and improve asset quality and also factor in extraordinary income**

| (Rs mn) | Old | | Revised | | *% Change* | |
|---|---|---|---|---|---|---|
| | FY19E | FY20E | FY19E | FY20E | *FY19E* | FY20E |
| Net interest income | 49,492 | 57,752 | 51,073 | 60,403 | *3.2* | *4.6* |
| Operating profit | 32,459 | 38,155 | 32,612 | 39,174 | *0.5* | *2.7* |
| Net profit | 14,374 | 18,028 | 14,850 | 18,802 | *3.3* | *4.3* |
| EPS (Rs) | 23.4 | 29.3 | 24.2 | 30.6 | *3.3* | *4.3* |
| ABVPS (Rs) | 125.8 | 147.4 | 131.8 | 151.1 | *4.8* | *2.5* |
| **Price target (Rs)** | **530** | | **553** | | **4.3** | |
| **Recommendation** | **ACCUMULATE** | | **ACCUMULATE** | | | |

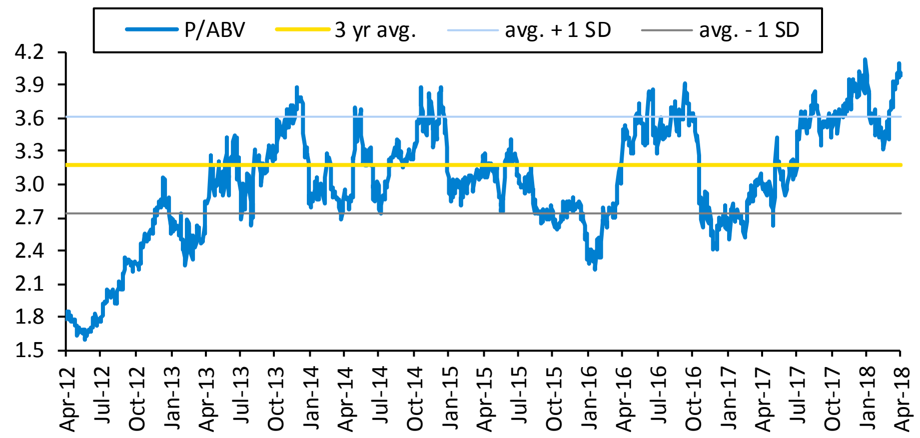
*Source: Company Data, PL Research*

**Exhibit 14: We maintain ACCUMLATE with TP of Rs530 (from Rs553) based on 3.2x P/ABV Mar-20 on rollover from Sep-19**

| | |
|---|---|
| Fair price – EVA | 495 |
| Fair price - P/ABV | 472 |
| **Average of the two** | **484** |
| **Subsidiary Value** | **69** |
| **Target Price** | **553** |
| Target P/ABV | **3.2** |
| Target P/E | **15.8** |
| Current price, Rs | 507 |
| **Upside (%)** | **9%** |
| Dividend yield (%) | 1% |
| **Total return (%)** | **10%** |

*Source: Company Data, PL Research*

**Exhibit 15: MMFS: One year forward P/ABV trend**




*Source: Company Data, PL Research*

**Income Statement (Rs m)**

| Y/e March | 2017 | 2018 | 2019E | 2020E |
|---|---|---|---|---|
| Int. Inc. / Opt. Inc. | 60,545 | 70,686 | 86,933 | 103,898 |
| Interest Expenses | 28,574 | 30,004 | 36,588 | 44,268 |
| **Net interest income** | **31,971** | **40,682** | **50,345** | **59,630** |
| *Growth (%)* | *6.3* | *27.2* | *23.8* | *18.4* |
| Non interest income | 636 | 590 | 637 | 688 |
| *Growth (%)* | *22.5* | *(7.3)* | *8.0* | *8.0* |
| Net operating income | 33,801 | 42,057 | 51,710 | 61,091 |
| **Expenditure** | | | | |
| Employees | 6,809 | 8,517 | 9,795 | 11,264 |
| Other expenses | 7,240 | 7,754 | 8,840 | 10,165 |
| Depreciation | 460 | 442 | 464 | 487 |
| Total expenditure | 14,509 | 16,713 | 19,098 | 21,917 |
| **PPP** | **19,292** | **25,344** | **32,612** | **39,174** |
| *Growth (%)* | *(7.6)* | *31.4* | *28.7* | *20.1* |
| Provision | 13,091 | 12,266 | 9,941 | 10,468 |
| Other income | — | — | — | — |
| Exchange Gain / (Loss) | — | — | — | — |
| **Profit before tax** | **6,201** | **13,078** | **22,671** | **28,706** |
| Tax | 2,198 | 4,809 | 7,822 | 9,903 |
| *Effective tax rate (%)* | *35.5* | *36.8* | *34.5* | *34.5* |
| **PAT** | **4,002** | **8,269** | **14,850** | **18,802** |
| *Growth (%)* | *(40.5)* | *106.6* | *79.6* | *26.6* |

**Quarterly Financials (Rs m)**

| Y/e March | Q1FY18 | Q2FY18 | Q3FY18 | Q4FY18 |
|---|---|---|---|---|
| Int. Inc. / Operating Inc. | 15,924 | 16,608 | 18,340 | 20,600 |
| Income from securitization | — | — | — | — |
| Interest Expenses | 7,327 | 7,498 | 7,629 | 7,550 |
| **Net Interest Income** | **8,597** | **9,110** | **10,711** | **13,050** |
| *Growth* | *28.4* | *23.5* | *39.8* | *26.5* |
| Non interest income | 107 | 221 | 124 | 138 |
| **Net operating income** | **8,704** | **9,331** | **10,835** | **13,188** |
| *Growth* | *27.1* | *15.6* | *42.7* | *16.8* |
| Operating expenditure | 3,810 | 3,694 | 4,282 | 4,927 |
| **PPP** | **4,894** | **5,636** | **6,553** | **8,261** |
| *Growth* | *36.5* | *25.1* | *66.0* | *13.9* |
| Provision | 4,258 | 4,446 | 1,989 | 1,572 |
| Exchange Gain / (Loss) | — | — | — | — |
| Profit before tax | 636 | 1,190 | 4,563 | 6,688 |
| Tax | 162 | 410 | 1,793 | 2,443 |
| Prov. for deferred tax liability | — | — | — | — |
| *Effective tax rate (%)* | *25.5* | *34.5* | *39.3* | *36.5* |
| **PAT** | **474** | **780** | **2,770** | **4,245** |
| *Growth* | *(45.5)* | *(17.7)* | *(1868.9)* | *81.4* |

**Balance Sheet (Rs m)**

| Y/e March | 2017 | 2018 | 2019E | 2020E |
|---|---|---|---|---|
| **Sources of funds** | | | | |
| Equity | 1,130 | 1,229 | 1,229 | 1,229 |
| Reserves & Surplus | 63,642 | 91,802 | 99,092 | 111,423 |
| Networth | 64,772 | 93,031 | 100,321 | 112,652 |
| *Growth (%)* | *6.4* | *43.6* | *7.8* | *12.3* |
| Loan funds | 346,016 | 394,035 | 476,217 | 570,470 |
| *Growth (%)* | — | — | — | — |
| Others | — | — | — | — |
| Minority Interest | — | — | — | — |
| Deferred Tax Liability | — | — | — | — |
| **Total** | **410,788** | **487,066** | **576,538** | **683,122** |
| **Application of funds** | | | | |
| Net fixed assets | 1,120 | 1,197 | 1,221 | 1,245 |
| Advances | 425,234 | 510,043 | 601,542 | 709,712 |
| *Growth (%)* | *16.0* | *19.9* | *17.9* | *18.0* |
| Net current assets | (42,899) | (51,413) | (55,831) | (60,066) |
| Investments | 18,895 | 18,732 | 20,605 | 22,665 |
| *Growth (%)* | *27.4* | *(0.9)* | *10.0* | *10.0* |
| Other Assets | 8,440 | 8,508 | 9,001 | 9,567 |
| **Total** | **410,789** | **487,066** | **576,538** | **683,122** |

*Source: Company Data, PL Research.*

**Key Ratios**

| Y/e March | 2017 | 2018 | 2019E | 2020E |
|---|---|---|---|---|
| CMP (Rs) | 507 | 507 | 507 | 507 |
| Eq. Shrs. O/s. (m) | 565 | 615 | 615 | 615 |
| Market Cap (Rs m) | 286,617 | 311,705 | 311,705 | 311,705 |
| Market Cap to AUM (%) | 69.8 | 64.0 | 54.1 | 45.6 |
| EPS (Rs) | 7.1 | 14.0 | 24.2 | 30.6 |
| Book Value (Rs) | 114.7 | 157.7 | 163.3 | 183.3 |
| Adjusted Book Value (Rs) | 86.4 | 125.7 | 131.8 | 151.1 |
| P/E (x) | 71.6 | 36.2 | 21.0 | 16.6 |
| P/BV (x) | 4.4 | 3.2 | 3.1 | 2.8 |
| P/ABV (x) | 5.9 | 4.0 | 3.8 | 3.4 |
| DPS (Rs) | — | 2.2 | 3.4 | 5.6 |
| Dividend Yield (%) | — | 0.4 | 0.7 | 1.1 |

**Asset Quality**

| Y/e March | 2017 | 2018 | 2019E | 2020E |
|---|---|---|---|---|
| Gross NPAs (Rs m) | 41,827 | 46,987 | 48,279 | 49,507 |
| Net NPAs (Rs m) | 15,997 | 19,706 | 19,312 | 19,803 |
| Gross NPAs to Gross Adv. (%) | 9.8 | 9.2 | 8.0 | 7.0 |
| Net NPAs to Net Adv. (%) | 3.7 | 3.8 | 3.2 | 2.8 |
| NPA Coverage (%) | 61.8 | 58.1 | 60.0 | 60.0 |

**Profitability (%)**

| Y/e March | 2017 | 2018 | 2019E | 2020E |
|---|---|---|---|---|
| NIM | 8.2 | 9.1 | 9.5 | 9.5 |
| RoAA | 1.0 | 1.8 | 2.8 | 3.0 |
| RoAE | 6.4 | 10.5 | 15.4 | 17.7 |

*Source: Company Data, PL Research.*

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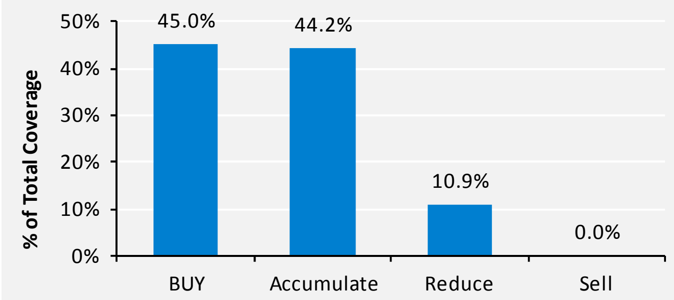


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| | | |
|---|---|---|
| **BUY** | : | Over 15% Outperformance to Sensex over 12-months |
| **Accumulate** | : | Outperformance to Sensex over 12-months |
| **Reduce** | : | Underperformance to Sensex over 12-months |
| **Sell** | : | Over 15% underperformance to Sensex over 12-months |
| **Trading Buy** | : | Over 10% absolute upside in 1-month |
| **Trading Sell** | : | Over 10% absolute decline in 1-month |
| **Not Rated (NR)** | : | No specific call on the stock |
| **Under Review (UR)** | : | Rating likely to change shortly |

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