HDFC securities

INSTITUTIONAL RESEARCH

RESULTS REVIEW 1QFY19 | 31 JUL 2018

Mahindra & Mahindra Financial Services

BUY

INDUSTRY	NBFCs
CMP *(as on 30 Jul 2018)*	Rs 513
Target Price	Rs 590
Nifty	11,320
Sensex	37,494
KEY STOCK DATA	
Bloomberg	MMFS IN
No. of Shares (mn)	618
MCap (Rsbn) / ($ mn)	317 / 4,621
6m avg traded value (Rsmn)	828

STOCK PERFORMANCE (%)

52 Week high / low	Rs 538/386		
	3M	6M	12M
Absolute (%)	(2.8)	8.6	27.8
Relative (%)	(9.4)	4.5	11.8

SHAREHOLDING PATTERN (%)

Promoters	51.19
FIs & Local MFs	12.36
FPIs	28.10
Public & Others	8.35

Source : BSE

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On the growth track

The pullback in asset quality sustained as MMFS reported a sizable reduction in the gross stage III NPAs (9.4% vs. 14.5% YoY). The usual 1Q hiccup was also curbed as sequential stress accretion was lower than previous years (270/150bps in FY17/18). The spike is credit cost is primarily due to higher provisioning on stage I and II under the ECL methodology as per IND AS. Robust growth (+23% coupled with steady margins (despite the rise in CoF) led to an earnings beat.

While the focus on collections has evidently yielded benefits, MMFS is geared up to capture any growth opportunities that come its way. A comfortable capital position (CRAR of 21.9% post the fund raise) should also help. Given the deep presence (1284, 108 opened in the last 12 months) and rural focus, MMFS will be the biggest beneficiaries of improving rural macros and a good monsoon. Maintain BUY with a TP of Rs 590 (3.5x Mar-20 ABV of Rs 163 + Rs 18 for MIBL).

Highlights of the quarter

- Disbursal growth remained strong at ~35% (albeit down ~12% QoQ). This growth was primarily driven by strong disbursals in the CV/CE (+109%) and pre-owned (+35%) segments. This and relatively lower repayments (12.2% vs. 16.5% QoQ and 14.6% YoY) led to a robust AUM growth of ~23/7% YoY/QoQ. We believe MMFS is a leveraged rural play and will benefit from improving macros. Hence we have factored in an AUM CAGR of ~20% over FY18-20E.
- Though NPAs have spiked sequentially, it is largely a 1Q phenomenon for MMFS. While the gross stage III jumped 40bps QoQ to 9.4%, the deterioration is significantly lesser than previous years (270bps in FY17 and 150bps in FY18). We believe the improvement in asset quality should re-emerge hereon as MMFS reaps the benefits of structured collection efforts (bucket wise teams formed) and a decent monsoon. We have factored in GNPAs of 8.0/8.3% for FY19/20E.
- **Near Term Outlook:** The stock should do well given the robust set on numbers.

Financial Summary

(Rs mn)	1QFY19	1QFY18	YoY (%)	4QFY18	QoQ (%)	FY17	FY18	FY19E	FY20E
Net Interest Income	10,771	7,427	*45.0*	13,050	*(17.5)*	29,120	36,816	48,699	57,685
PPOP	7,060	4,260	*65.8*	8,261	*(14.5)*	19,291	25,344	33,851	39,977
PAT	2,691	2,014	*33.6*	4,245	*(36.6)*	4,002	8,269	14,180	17,127
EPS (Rs)	4.3	3.6	*21.4*	6.9	*(37.4)*	7.1	14.5	23.1	27.9
ROAE (%)						6.4	11.3	14.5	15.8
ROAA (%)						0.94	1.78	2.39	2.44
Adj. BVPS (Rs)						86.3	119.3	141.6	163.4
P/ABV (x)						5.74	4.15	3.50	3.03
P/E (x)						69.9	34.1	21.5	17.8

Source: Company, HDFC sec Inst Research; Note: 4QFY18 as per IGAAP

Five Quarters At A Glance

(Rs mn)	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	YoY Growth	QoQ Growth
Net Interest income (NII)	7,427	9,110	10,711	13,050	10,771	45.0%	-17.5%
Non-interest income	107	221	774	138	138	29.6%	0.2%
Total Net income	7,534	9,331	11,484	13,188	10,909	44.8%	-17.3%
Total Operating Expenses	3,274	3,694	4,282	4,927	3,849	17.5%	-21.9%
PPOP	4,260	5,636	7,202	8,261	7,060	65.8%	-14.5%
Provisions And Write Offs	1,269	4,446	1,989	1,572	2,938	131.6%	86.9%
PBT	2,991	1,190	5,213	6,688	4,122	37.8%	-38.4%
Tax Expense	977	410	1,793	2,443	1,432	46.5%	-41.4%
PAT	2,014	780	3,420	4,245	2,691	33.6%	-36.6%
OCI	(13)				(32)	150.7%	
PCT (incl. OCI)	2,001	780	3,420	4,245	2,659	32.9%	-37.4%
Other details							
Disbursements (Rs bn)	76.4	75.7	107.1	118.6	103.4	35.3%	-12.8%
Auto/UV (%)	*28.0*	*27.0*	*27.0*	*26.0*	*24.0*	-400 bps	-200 bps
Tractors (%)	*21.0*	*19.0*	*20.0*	*18.0*	*19.0*	-200 bps	100 bps
Cars, non-M&M UVs (%)	*21.0*	*21.0*	*21.0*	*20.0*	*21.0*	0 bps	100 bps
CV/CE (%)	*11.0*	*11.0*	*12.0*	*13.0*	*17.0*	600 bps	400 bps
Pre-owned and others (%)	*19.0*	*22.0*	*20.0*	*23.0*	*19.0*	0 bps	-400 bps
AUM (Rs bn)	475.8	499.2	517.8	551.0	587.1	23.4%	6.6%
Auto/UV (%)	*30.0*	*28.0*	*28.0*	*27.0*	*27.0*	-300 bps	0 bps
Tractors (%)	*17.0*	*17.0*	*18.0*	*17.0*	*17.0*	0 bps	0 bps
Cars, non-M&M UVs (%)	*23.0*	*22.0*	*23.0*	*22.0*	*22.0*	-100 bps	0 bps
CV/CE (%)	*13.0*	*12.0*	*13.0*	*14.0*	*14.0*	100 bps	0 bps
Pre-owned and others (%)	*17.0*	*21.0*	*18.0*	*20.0*	*20.0*	300 bps	0 bps
Borrowings (Rs bn)	359.0	381.5	370.0	403.1	428.9	19.5%	6.4%
CRAR (%)	17.4	19.3	23.5	22.0	21.9	450 bps	-10 bps
Tier I (%)	12.9	12.4	17.0	16.1	16.6	370 bps	50 bps
Profitability							
Yield on Advances (%) (calc)	13.5	13.6	14.4	15.4	13.5	4 bps	-188 bps
Cost of Funds (%) (calc)	8.2	8.1	8.1	7.8	8.2	-5 bps	35 bps
Spreads	5.3	5.5	6.3	7.6	5.4	8 bps	-223 bps
NIM (%) (calc)	7.3	7.5	8.4	9.8	7.6	28 bps	-220 bps
Cost-Income ratio (%)	43.8	39.6	37.3	37.4	35.3	-849 bps	-208 bps
Tax rate (%)	25.5	34.5	34.4	36.5	34.7	923 bps	-180 bps
Asset Quality							
Gross Stage III (Rs mn)	70,487	-	-	50,419	55,338	(21.5)	9.8
Net Stage III (Rs mn)	42,509	-	-	33,258	35,923	(15.5)	8.0
Gross Stage III (%)	14.5%	-	-	9.0%	9.4%	-510bps	40bps
Net Stage III (%)	9.3%	-	-	6.2%	6.3%	-300bps	10bps

Source: Bank, HDFC sec Inst Research; NOTE: Numbers for 2QFY18, 3QFY18 and 4QFY18 are as per I GAAP

Driven by robust AUM growth of ~23% and stable margins; the sequentially dip is lower than previous years

The spike is due to higher provisioning on gross stage I and II assets under the ECL methodology viz. the std asset provision of 40bps under I GAAP

Disbursement grew 35% YoY as CV/CE doubled while Cars (+35%) and pre-owned vehicles (+35%) grew strongly

Robust AUM growth in all the segment, led by pre-owned (+45%), CV/CE (+33%) and tractors (+23%)

The mgt sees minimal impact if the new axle-load norms as they is applicable only to a small fraction of the total vehicles

While yields are lower sequential, it is only optical wowing to the change in income recognition under IND AS

On a reported basis, the net spread was stable sequentially

The focus on collection is evident as Gross stage III NPAs have dropped significantly YoY and risen marginally QoQ despite the seasonally weak qtr

Disbursements grew ~35% YoY, as CV/CE more than doubled YoY

Mgmt hinted of gaining M-Share on Auto, UV and CV segments

Growth was also supported by Cars (+35%) and pre-owned vehicles (+35%).

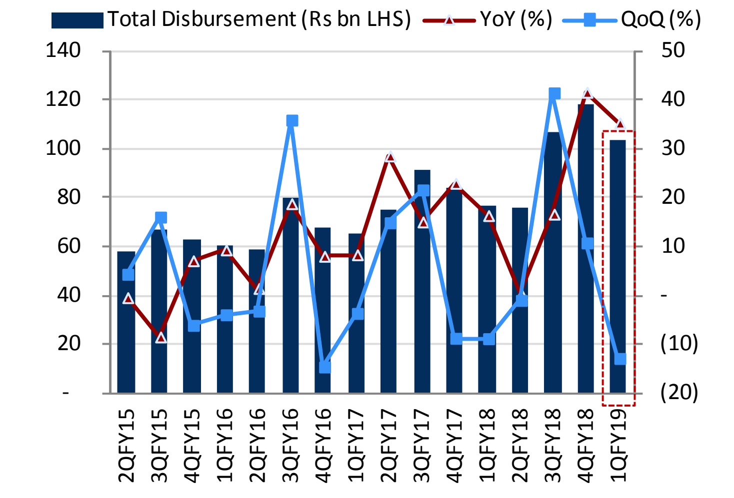
The share of pre-owned vehicles has jumped to ~20% vs 17% YoY

AUM growth of 23/7% YoY/QoQ driven by pre-owned (+45%), CV/CE (+33%) and tractors (+23%) YoY

The mgt foresees no pressure on growth and expects an AUM growth of 15-20% for FY19

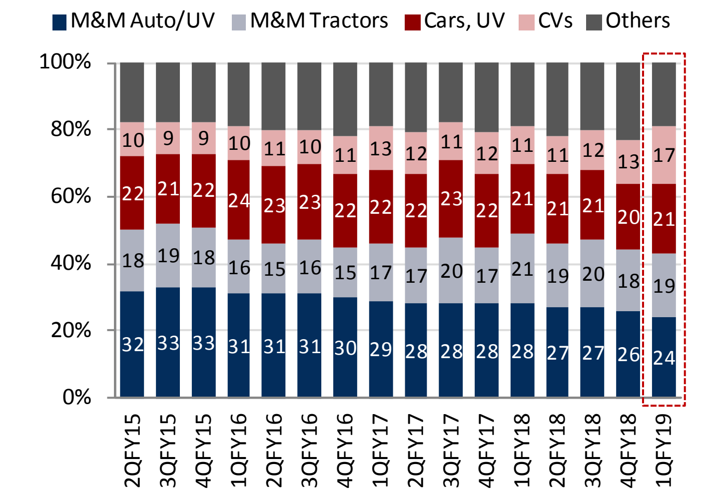
Repayments dipped to 12.2% vs. 16.5% QoQ and 14.6% YoY

Disbursement Grew ~35% YoY, Down 13% QoQ



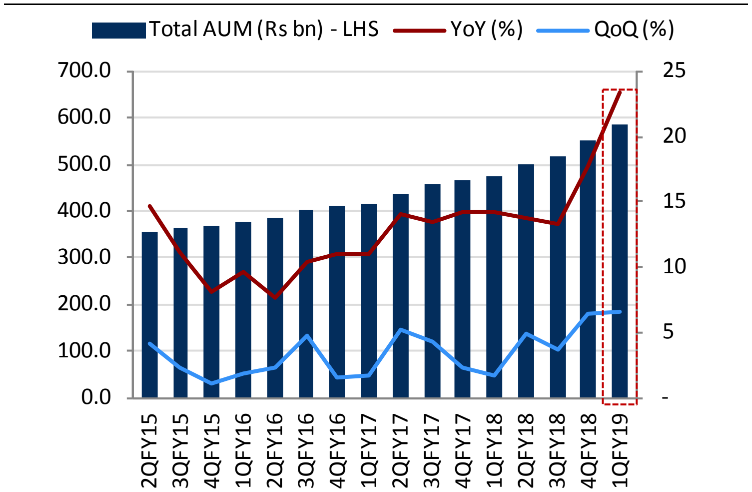
Source: Company

Disbursements Break-up: Strong Growth In CV/CE



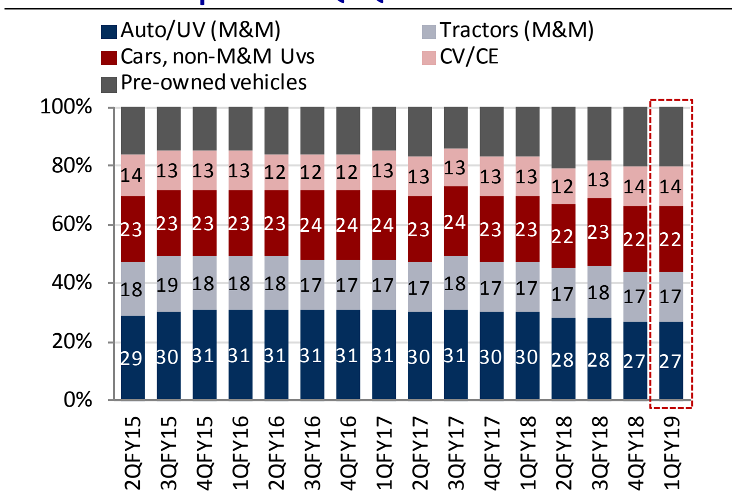
Source: Company

AUM Grew ~23/7% YoY/QoQ



Source: Company

AUM Break-up: Stable QoQ



Source: Company

The dip in yields and NIMs is only optical due to the change in income recognition under IND AS

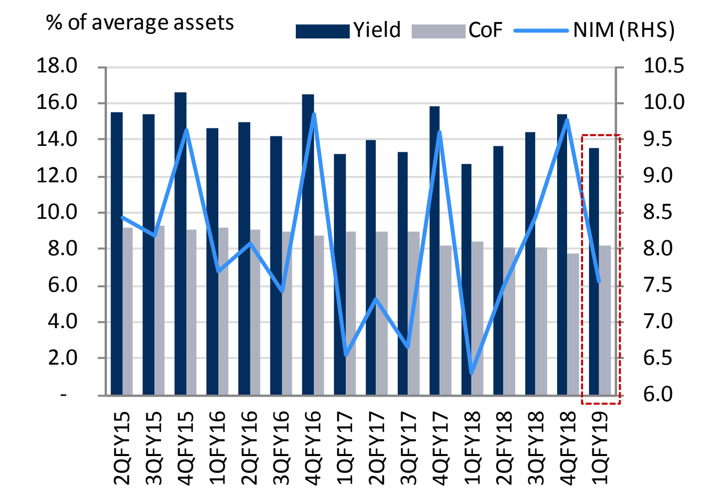
With pricing power the mgt believe that NIMs will remain stable over FY19 even as CoF rises

The mgt expects a 15-20bos rise in CoF over FY19

MMFS will raise rates in certain geographies and some products

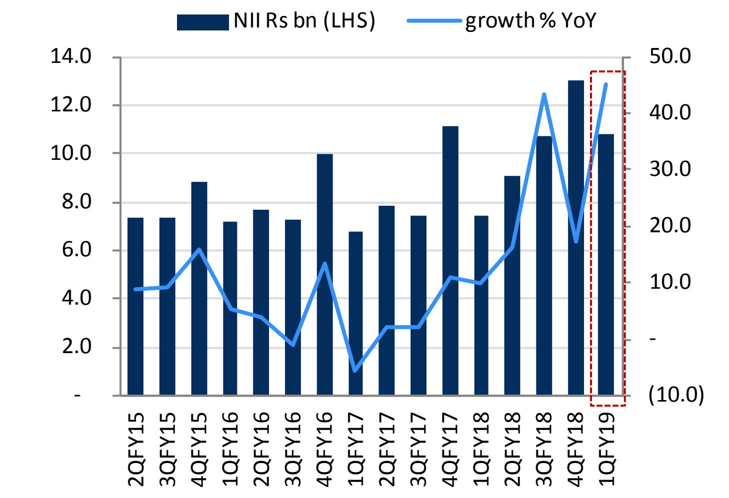
C-I ratio would improved ~208bps QoQ, as opex dipped 22% QoQ

Calc.NIM Dipped 220bps QoQ



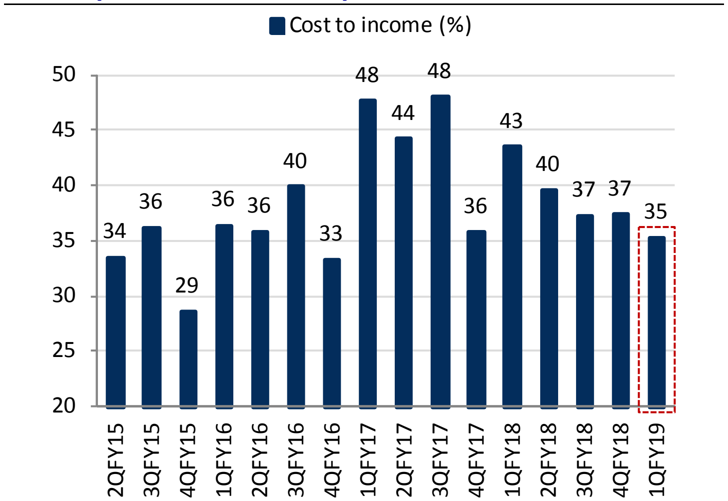
Source : Company

NII Grew 45% YoY



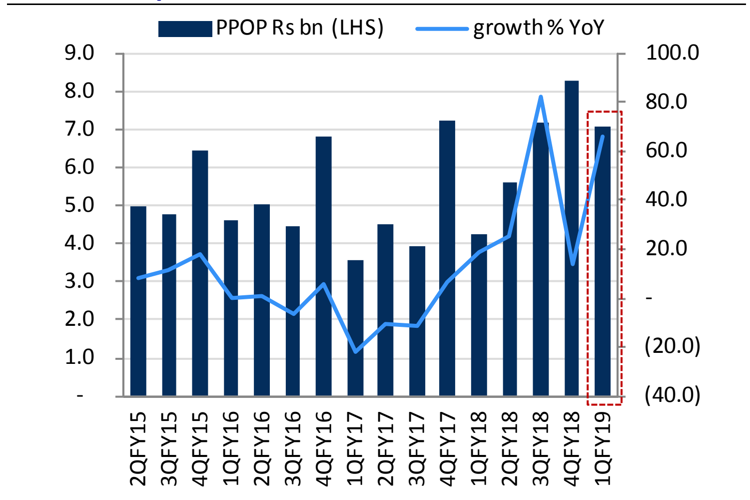
Source : Company

C-I Improved ~850/210bps YoY/QoQ



Source : Company

PPOP Jumped ~66% YoY



Source : Company

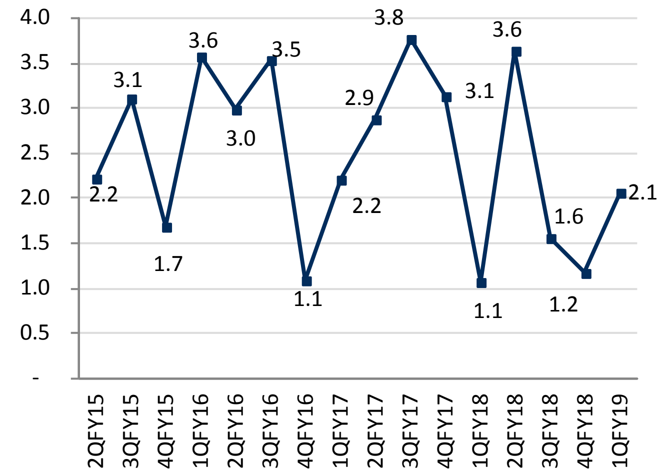
Provisions jumped (on a comparable basis) as MMFS transitioned into the ECL method

As per IND AS Gross Stage III stood at ~9.4% vs. 14.5% YoY and Net Gross Stage III stood at ~6.1% vs. 8.8% YoY

Gross stage III coverage stands at 33% vs 36% YoY.

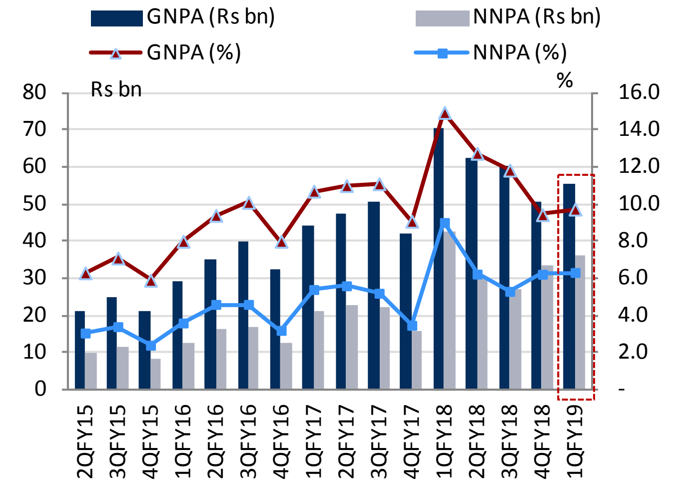
In a seasonally weak qtr, the Gross Stage III rise was a mere 40bps

Provisons Jump Sharply



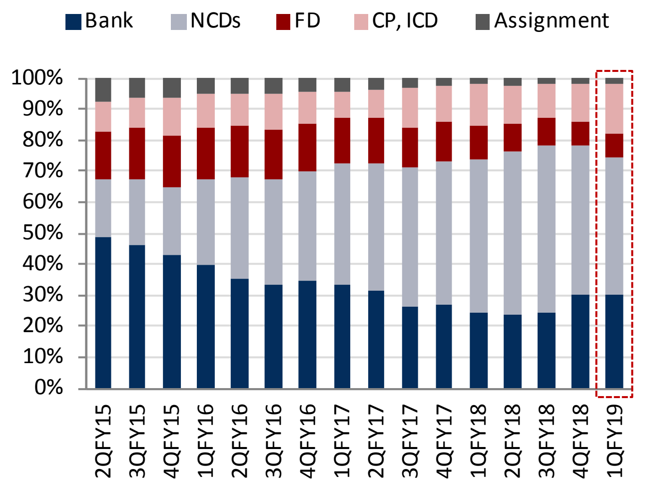
Source : Company

Asset Quality Improves YoY



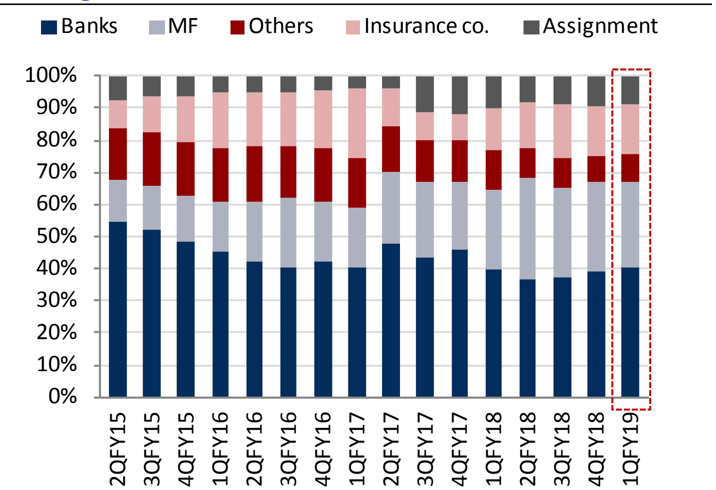
Source : Company

Funding Mix Segment-wise



Source : Company

Funding Mix Investor-wise



Source : Company

Change In Estimates

Rs mn	FY19E			FY20E		
	Old	New	*Change*	Old	New	*Change*
NII	48,803	48,699	*-0.2%*	57,312	57,685	*0.7%*
PPOP	34,217	33,851	*-1.1%*	39,610	39,977	*0.9%*
PAT	14,455	14,180	*-1.9%*	17,076	17,127	*0.3%*
Adj. BVPS (Rs)	142	142	*-0.2%*	163	163	*0.0%*

Source: HDFC sec Inst Research

Peer Set Comparison

NBFC	Mcap (Rs bn)	CMP (Rs)	Rating	TP (Rs)	ABV (Rs)			P/E (x)			P/ABV (x)			ROAE (%)			ROAA (%)		
					FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18P	FY19E	FY20E
SHTF	321	1,416	BUY	1,773	499	601	709	20.5	13.4	11.0	2.84	2.36	2.00	12.7	16.7	17.7	1.92	2.51	2.63
MMFS#	**317**	**513**	**BUY**	**590**	**119**	**142**	**163**	**34.1**	**21.5**	**17.8**	**4.15**	**3.50**	**3.03**	**11.3**	**14.5**	**15.8**	**1.78**	**2.39**	**2.44**
LICHF	269	532	BUY	636	237	275	318	13.5	11.3	9.6	2.24	1.94	1.67	16.7	17.4	17.8	1.23	1.29	1.33
CIFC	225	1,436	BUY	1,764	287	355	441	23.1	18.1	14.8	5.00	4.05	3.26	20.6	21.8	22.0	2.77	2.85	2.91
REPCO	38	614	BUY	683	192	232	273	18.6	15.4	13.4	3.19	2.65	2.25	16.7	17.3	17.0	2.17	2.30	2.25

Source: Company, HDFC sec Inst Research; # Adjusted for subsidiary

Income Statement

(Rs mn)	FY16	FY17	FY18	FY19E	FY20E
Interest Earned	53,935	57,694	66,820	84,911	102,631
Interest Expended	26,393	28,575	30,004	36,212	44,946
Net Interest Income	**27,542**	**29,120**	**36,816**	**48,699**	**57,685**
Other Income	**5,116**	**4,681**	**5,242**	**4,920**	**5,501**
Total Income	**32,658**	**33,801**	**42,057**	**53,619**	**63,186**
Total Operating Exp	11,781	14,509	16,714	19,768	23,209
PPOP	**20,877**	**19,291**	**25,344**	**33,851**	**39,977**
Provisions & Contingencies	10,495	13,091	12,266	12,366	14,027
PBT	**10,382**	**6,200**	**13,078**	**21,484**	**25,951**
Provision For Tax	3,656	2,198	4,809	7,305	8,823
PAT	**6,726**	**4,002**	**8,269**	**14,180**	**17,127**

Source: Company, HDFC sec Inst Research

Balance Sheet

(Rs mn)	FY16	FY17	FY18	FY19E	FY20E
SOURCES OF FUNDS					
Share capital	1,129	1,130	1,229	1,229	1,229
Reserves and surplus	59,752	63,642	91,802	101,358	112,900
Shareholders' Funds	**60,881**	**64,772**	**93,031**	**102,587**	**114,129**
Borrowings	221,574	279,814	308,354	368,188	446,186
Other Liabilities	113,340	115,266	142,293	171,160	203,306
Total Liabilities	**395,795**	**459,852**	**543,678**	**641,934**	**763,621**
APPLICATION OF FUNDS					
Advances	**366,577**	**425,292**	**510,043**	**614,602**	**731,376**
Investments	14,833	18,895	18,732	17,802	17,240
Fixed assets	1,135	1,120	1,197	1,256	1,319
Other Assets	13,249	14,546	13,707	8,273	13,685
Total assets	**395,795**	**459,852**	**543,678**	**641,934**	**763,621**

Source: Company, HDFC sec Inst Research

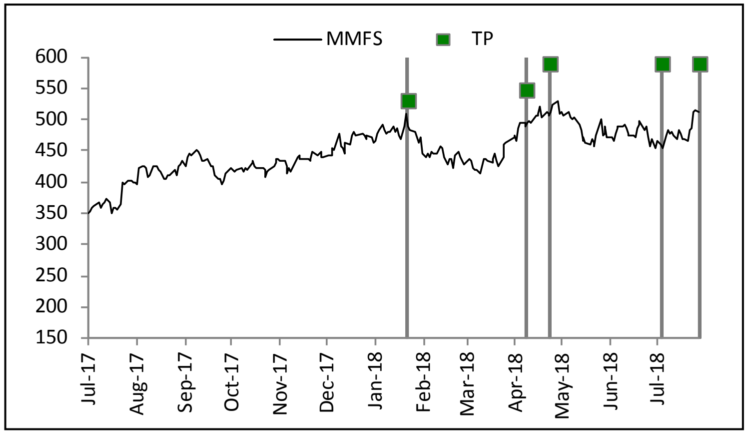
Key Ratios

	FY16	FY17	FY18	FY19E	FY20E
VALUATION RATIOS					
EPS (Rs)	11.9	7.1	14.5	23.1	27.9
Earnings Growth (%)	(19.1)	(40.5)	106.6	71.5	20.8
BVPS (Rs)	107.8	114.6	151.4	166.9	185.7
Adj. BVPS (Rs)	86.0	86.3	119.3	141.6	163.4
DPS (Rs)	4.0	2.4	4.0	6.5	7.8
ROAA (%)	1.80	0.94	1.78	2.39	2.44
ROAE (%)	11.4	6.4	11.3	14.5	15.8
P/E (x)	41.6	69.9	34.1	21.5	17.8
P/ABV (x)	5.76	5.74	4.15	3.50	3.03
P/PPOP (x)	13.4	14.5	12.0	9.0	7.6
Dividend Yield (%)	0.8	0.5	0.8	1.3	1.5
PROFITABILITY					
Yield On Advances (%)	15.17	14.27	14.03	15.10	15.25
Cost Of Funds (%)	9.14	8.55	7.75	8.00	8.25
Core Spread (%)	6.03	5.73	6.28	7.10	7.00
NIM (%)	7.92	7.35	7.87	8.66	8.57
OPERATING EFFICIENCY					
Cost/Avg. Asset Ratio (%)	3.2	3.4	3.3	3.3	3.3
Cost-Income Ratio	36.1	42.9	39.7	36.9	36.7
BALANCE SHEET STRUCTURE RATIOS					
Loan Growth (%)	11.3	16.0	19.9	20.5	19.0
Borrowings Growth (%)	12.8	18.4	13.6	19.9	20.8
Equity/Assets (%)	15.4	14.1	17.1	16.0	14.9
Equity/Loans (%)	16.6	15.2	18.2	16.7	15.6
Total CRAR	17.3	17.6	22.0	20.1	18.9
Tier I	14.6	13.2	16.1	14.6	13.7
ASSET QUALITY					
Gross NPLs (Rs mn)	32,242	41,827	46,987	49,169	55,144
Net NPLs (Rs mn)	12,351	15,997	19,706	15,548	13,752
Gross NPLs (%) Total Assets	8.00	9.00	8.50	7.95	7.45
Net NPLs (%)Total Assets	3.17	3.60	3.80	2.51	1.86
Coverage Ratio (%)	61.7	61.8	58.1	68.4	75.1
Provision/Avg. Loans (%)	2.7	3.0	2.4	2.0	1.9

ROAA TREE	FY16	FY17	FY18	FY19E	FY20E
Net Interest Income	7.38%	6.81%	7.34%	8.21%	8.21%
Non-Interest Income	1.37%	1.09%	1.04%	0.83%	0.78%
Operating Cost	3.16%	3.39%	3.33%	3.33%	3.30%
Provisions	2.81%	3.06%	2.44%	2.09%	2.00%
Tax	0.98%	0.51%	0.96%	1.23%	1.26%
ROAA	1.80%	0.94%	1.65%	2.39%	2.44%
Leverage (x)	6.3	6.8	6.4	6.1	6.5
ROAE	11.4%	6.4%	10.5%	14.5%	15.8%

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
24-Jan-18	490	BUY	531
10-Apr-18	491	BUY	548
26-Apr-18	507	BUY	590
6-Jul-18	459	BUY	590
31-Jul-18	513	BUY	590

Rating Definitions

BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

Disclosure:

We, **Darpin Shah, MBA, Pranav Gupta, ACA & Kaushik Utpat, CA**, authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. HSL has no material adverse disciplinary history as on the date of publication of this report. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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Any holding in stock –No

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