INDIA

SELL

M&M Financial Services

Financials

Result Update **30 July 2018**

Lofty valuations; retain SELL

We retain Sell on MMFS with TP revised upwards to Rs390 (vs. Rs380 earlier). Q1'19 results were inline with our estimates on revenue end / higher on earnings front following lower provisions. AuM / Value of assets financed (VoAf) grew 21.1% YoY / 35.3% YoY, highest in the past several quarters. Commentaries on growth, asset quality remain encouraging and we have factored the same into our estimates. We continue to believe that valuations at 3.3x FY20E ABV for an exit RoE of 16% remain expensive. Retain SELL. Prefer Sundaram Finance in the asset financing space.

- **Q1'19 results – Inline results:** Q1'19 NII at Rs10.8bn (+45% YoY) was in-line with our estimates and led by strong 21.1% YoY growth in AuM's. VoAf grew 35.3% YoY driven by robust growth in CV (+109%YoY) and refinance (+35.3% YoY) portfolio. Adjusted for the same, VoAf would have grown 24.4% YoY. Operating profit came in at Rs7.1bn. MMFS reported Q1'19 nos under Ind-AS standards. GNPA / provisioning nos for Q1'18 thus have been restated. Q1'19 GNPA came in at Rs55.3bn (+9.8% QoQ). The sequential rise in GNPA follows the seasonality nature of business (as also validated from our channel checks). Provisions for the quarter came in at Rs2.9bn; NNPA stood in at Rs35.9bn (+8% QoQ). After accounting for taxes, profit came in at Rs2.7bn (vs. our estimates of Rs2.1bn).
- **Refinance & Others segment drive AuM growth higher; guidance lowered to 15-20% YoY:** Q1'19 AuM growth at 21.1% YoY, was highest in the past several quarter. While an improved AuM growth is positive, further breakdown highlights that a large part of incremental growth was in form of refinancing & others portfolio. These segments grew 42.5% (combined); also, adjusted for strong surge in CV portfolio (+30% YoY), Q1'19 AuM growth would have been at 14.2% YoY. Some of the factors that have attributed for strong growth in these segments could reverse / unlikely to sustain in ensuring quarters. This in addition to increased competitive intensity, state-elections, existence of discount factor and slow pace of recovery in certain markets will impact AuM growth. Management has guided for 15-20% YoY growth in AuM (vs. its earlier guidance of 20%+ growth in FY19E laid out post Q4'18 results concall); we are factoring in 18% CAGR in AuM over FY19-20E.
- **Near term provisions to remain volatile; earnings outlook:** GNPA (Stage 3) has reduced from 14.5% in Q1'18 to 9.4% in Q1'19 and follows improved recovery in the rural markets. Management has guided for loss given default (LGD) at 27-28%. Given uncertainty around asset quality and also given the seasonality nature of the business, overall provisioning is expected to remain volatile. We have tweaked our estimates on NIM / credit cost front. We expect MMFS to report 18% / 17% / 45% CAGR in AuM / NII / PAT over FY18-20E. This will translate into an exit RoA / RoE of 2.4% / 16.1% by end-FY20E.
- **Valuation, view and key risks:** Q1'19 results surprised on upside with improved AuM /VoAf growth and lower than expected provisions. Even as we build in strong recovery in earnings over FY18-20E, we continue to believe that valuations at 3.3x FY20E ABV for exit RoE of 16% by end-FY20E remain expensive. Retail SELL with TP at Rs390 (valued at 2.5x FY20E ABV). Key risks: Higher than expected AuM growth / lower slippages and thus reduced credit cost.

Rs mn	Q1FY19	Q1FY18	*YoY (%)*	Q4FY18	*QoQ (%)*	Q1FY19E	*Var (%)*
Net Interest Income	**10,771**	**7,427**	***45.0***	**13,050**	***(17.5)***	**10,771**	***(0.0)***
Operating Profit	7,061	4,260	*65.8*	8,261	*(14.5)*	6,060	*16.5*
Reported PAT	**2,691**	**2,014**	***33.6***	**4,245**	***(36.6)***	**2,074**	***29.8***
Gross NPAs	55,338	70,487	*(21.5)*	50,419	*9.8*	58,917	*(6.1)*
Net NPAs	35,923	42,509	*(15.5)*	33,258	*8.0*	28,359	*26.7*
PCR (%)* Stage 3	***35.1***	***39.7***	***(46bps)***	***34.0***	***105bps***	***51.9***	-

*Source: Company, Centrum Research *reported*

Target Price	Rs390
CMP*	Rs513
Downside	*25.0%*
Previous Target	Rs380
Previous Rating	SELL

Price Performance (%)*

	1M	6M	1Yr
MMFS IN	*9.3*	*8.6*	*27.8*
Nifty	*5.6*	*2.4*	*13.0*

Key Data	
Bloomberg Code	*MMFS IN*
Curr Shares O/S (mn)	617.8
Diluted Shares O/S(mn)	617.8
Mkt Cap (Rsbn/USDbn)	317.2/4.6
52 Wk H / L (Rs)	537.5/385.9
5 Year H / L (Rs)	537.5/173.1
Daily Vol. (3M NSE Avg.)	1522637.0

**as on 30 July 2018; Source: Bloomberg, Centrum Research*

Shareholding pattern *(%)**

	Jun-18	Mar-18	Dec-17	Sep-17
Promoter	*51.2*	*51.2*	*51.2*	*51.3*
FIIs	*28.1*	*29.4*	*35.7*	*32.0*
DIIs	*11.2*	*11.4*	*7.3*	*9.9*
Others	*9.5*	*8.0*	*5.9*	*6.8*

*Source: BSE, *as on 30 July 2018*

Earnings revision

Particulars (Rs mn)	FY19E			FY20E		
	New	Old	*Var (%)*	New	Old	*Var (%)*
NII + Oth. Inc	49,384	50,517	*(2.2)*	57,304	59,032	*(2.9)*
PPoP	30,201	32,532	*(7.2)*	35,422	38,578	*(8.2)*
PAT	13,374	13,884	*(3.7)*	17,451	17,746	*(1.7)*

Source: Centrum Research Estimates

Centrum vs. Bloomberg Consensus*

Particulars (Rs mn)	FY19E			FY20E		
	Centrum	BBG	*Var (%)*	Centrum	BBG	*Var (%)*
NII + Oth. Inc	49,384	51,079	*(3.3)*	57,304	61,016	*(6.1)*
PAT	13,374	13,942	*(4.1)*	17,451	17,655	*(1.2)*

Bloomberg Consensus				Centrum Target Price (Rs)	Variance (%)
BUY	SELL	HOLD	Target Price (Rs)		
22	5	6	525	390	*(25.7)*

**as on 30 July 2018; Source: Bloomberg, Centrum Research Estimates*

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Y/E Mar(Rs mn)	Net income#	PPOP	Reported PAT	*YoY (%)*	EPS (Rs)	P/E (x)	Adj BV (Rs)	P/Adj BV (x)	*RoA (%)*	*RoE (%)*
FY16	32,658	20,877	6,726	*(19.1)*	11.9	20.7	86.0	2.9	*1.6*	*11.4*
FY17	33,801	19,292	4,002	*(40.5)*	7.1	44.2	86.3	3.6	*0.9*	*6.4*
FY18	42,057	25,343	8,268	*106.6*	13.5	28.9	119.3	3.3	*1.7*	*10.5*
FY19E	49,384	30,201	13,374	*61.8*	21.8	22.4	135.6	3.6	*2.1*	*13.7*
FY20E	57,304	35,422	17,451	*30.5*	28.4	18.2	155.8	3.3	*2.4*	*16.0*

Source: Company, Centrum Research Estimates # Net income denotes NII + other income. FY16-FY19E have been valued on average market cap basis.

In the interest of timeliness, this document is not edited

Conference call highlights

AuM growth and outlook

- Infrastructure activities have gathered pace. This coupled with improved rural income bodes well from AuM growth perspective. MMFS has gained market share in the auto and tractor segments.
- Management has guided for 15-20% growth in AuM for FY19; growth rates are expected to be far more superior in H2FY19. However in its earlier concall (post Q4'18 results), management had guided for 20%+ YoY growth in AuM with over 22%+ YoY growth in AuM in H2FY19.
- Growth in CV and refinancing portfolio is shaping up well; exposure is towards all tonnage segments. In the refinance space, MMFS is present across all its business segments.
- Management expects growth in CV and the refinance book portfolio to outperform overall AuM growth owing to better outlook on the infrastructure and farming activities.
- ~80% of the utility vehicles book is sourced from Mahindra itself.
- 7.8% of the cars portfolio or 2-2.5% of the total portfolio is towards car aggregators.

On asset quality and the outlook on the same

- Our channel checks had pointed for increased incidences of repossession. Q1'19 saw repossession (from NPA accounts) of 12,597 vehicles vs. 11,596 vehicle in Q4'18.
- The quarter saw MMFS migrate to Ind-AS. Q1'18 GNPA nos have been restated. GNPA stood at Rs70.5bn (vs. Rs50.1bn under I-GAAP). The same has reduced to Rs55.3bn as at Q1'19.
- According to management, loss given default is at 27-28%; coverage ratio on stage-3 assets stood at 35.1%; including stage-1 and stage-2, the same was at 58.3% (vs. 50.1% YoY).

Subsidiaries' performance

- Rural housing finance subsidiary saw spurt in GNPA and follows challenges on collection front in key state of operations – Maharashtra. The state accounts for 45-50% of total exposure followed by Tamil Nadu, Andhra Pradesh and Gujarat etc.
- Q1'19 saw 30% YoY / 35% YoY growth in disbursement / loan portfolio. Of the loan portfolio of ~Rs71bn; exposure to affordable housing stood at ~Rs7bn or 10% of loans
- The insurance business reported PAT at Rs148mn (vs. Rs134mn YoY).

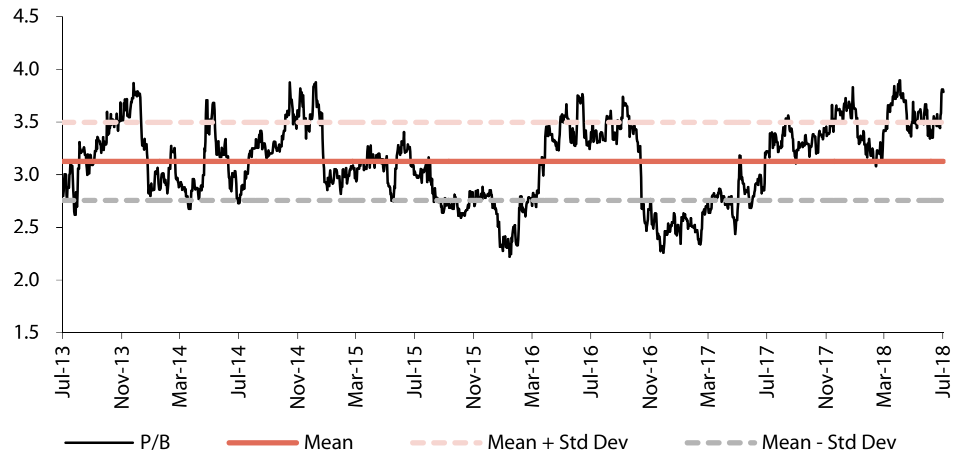
Sensitivity analysis and peer comparison

Exhibit 1: Sensitivity Analysis – impact of change in NIM and credit cost on FY19PBT

%		Credit cost				
		+ 10bps	+ 20bps	' Current levels	- 10bps	- 20bps
NIM	- 5bps	*(4.5)*	*(7.4)*	*(1.5)*	*1.4*	*4.3*
	- 10bps	*(6.0)*	*(8.9)*	*(3.1)*	*(0.1)*	*2.8*
	Current levels	*(2.9)*	*(5.9)*	-	*2.9*	*5.9*
	+ 5bps	*(1.4)*	*(4.3)*	*1.5*	*4.5*	*7.4*
	+ 10bps	*0.1*	*(2.8)*	*3.1*	*6.0*	*6.0*

Source: Centrum Research Estimates

Exhibit 2: Rolling forward P/ABV chart



Source: Bloomberg, Company, Centrum Research Estimates

Exhibit 3: Comparative Valuations

Company	Mkt Cap (Rs mn)	*CAGR (FY18-FY20E) %*			PE (x)			*ROA (%)*			*RoE (%)*			P/BVPS (x)		
		NII + Oth inc	*PPOP*	*PAT*	FY18	FY19E	FY20E	*FY18*	*FY19E*	*FY20E*	*FY18*	*FY19E*	*FY20E*	FY18	FY19E	FY20E
MMFS*	**3,17,191**	***16.7***	***18.2***	***39.9***	**28.9**	**22.4**	**18.2**	***1.7***	***2.1***	***2.4***	***10.5***	***13.7***	***16.0***	**2.6**	**2.9**	**2.7**
SUF*	1,66,584	*18.4*	*21.1*	*22.0*	32.6	29.5	21.1	*2.5*	*2.5*	*2.7*	*13.8*	*14.9*	*16.1*	4.4	4.1	3.2
Chola	2,25,060	*22.6*	*25.5*	*26.0*	19.5	19.8	14.7	*2.7*	*2.8*	*2.8*	*20.0*	*21.7*	*22.0*	3.6	3.9	2.9
Shriram Transport	3,21,266	*17.3*	*21.4*	*31.0*	15.5	13.5	10.8	*2.2*	*2.5*	*2.6*	*14.7*	*17.5*	*18.4*	2.1	2.2	1.8
Magma Fin.	41,914	*13.7*	*15.4*	*34.3*	16.5	13.8	10.4	*1.6*	*2.1*	*2.3*	*10.2*	*12.1*	*12.7*	1.6	1.5	1.3

*Source: Bloomberg consensus, *Centrum Research Estimates. FY18-19E YTD have been valued on average market cap basis.*

Quarterly financials

Exhibit 4: Quarterly Financials

(Rs mn)	Q2FY17	Q3FY17	Q4FY17	Q1FY18 Ind-AS	Q2FY18	Q3FY18	Q4FY18	Q1FY19 Ind-AS
Income statement								
Interest earned	14,916	14,904	18,255	14,980	16,608	18,340	20,600	19,259
Interest expended	7,086	7,441	7,137	7,553	7,498	7,629	7,550	8,488
Net interest income	**7,830**	**7,463**	**11,117**	**7,427**	**9,110**	**10,711**	**13,050**	**10,771**
Non-interest income	241	130	173	107	221	124	138	138
Total income	**8,071**	**7,593**	**11,290**	**7,534**	**9,331**	**10,835**	**13,188**	**10,909**
Operating expenses	3,460	3,534	3,902	3,164	3,588	4,175	4,810	3,716
PPOP	**4,504**	**3,949**	**7,252**	**4,260**	**5,636**	**6,553**	**8,261**	**7,061**
Provisions	3,042	4,190	3,614	1,269	4,446	1,989	1,572	2,938
PBT	**1,462**	**(241)**	**3,638**	**2,991**	**1,190**	**5,213**	**6,688**	**4,122**
Tax	514	(85)	1,298	977	410	1,793	2,443	1,432
PAT	**948**	**(156)**	**2,341**	**2,014**	**780**	**3,420**	**4,245**	**2,691**
Ratios								
Growth YoY (%)								
NII	*2.3*	*2.1*	*11.1*	*27.3*	*16.3*	*43.5*	*17.4*	*45.0*
Opex	*27.8*	*24.3*	*18.7*	*17.3*	*3.7*	*18.1*	*23.3*	*17.4*
PPOP	*(10.5)*	*(11.2)*	*6.7*	*36.5*	*25.1*	*65.9*	*13.9*	*65.8*
PAT	*(35.1)*	*(123.3)*	*(36.8)*	*(45.5)*	*(17.8)*	*NA*	*81.4*	*33.6*
AuM	*14.1*	*13.5*	*14.3*	*16.3*	*13.8*	*13.3*	*17.8*	*21.1*
Margins (%)*								
Yield on AuM	*14.0*	*13.3*	*15.8*	*12.6*	*13.5*	*14.4*	*15.4*	*13.5*
Cost of AuM	*6.7*	*6.6*	*6.0*	*6.3*	*6.1*	*6.0*	*5.6*	*6.0*
NIM	*7.3*	*6.7*	*9.7*	*6.3*	*7.4*	*8.4*	*9.8*	*7.5*
Key drivers (%)*								
Cost-income	*42.9*	*46.5*	*34.6*	*42.0*	*38.4*	*38.5*	*36.5*	*34.1*
GNPA	*11.0*	*11.1*	*9.0*	*14.5*	*12.5*	*10.6*	*9.0*	*9.4*
NNPA	*5.6*	*5.2*	*3.6*	*9.3*	*6.5*	*5.6*	*6.2*	*6.3*
Provision coverage	*49.1*	*53.0*	*60.0*	*35.9*	*47.8*	*47.3*	*31.1*	*33.0*
RoA	*0.9*	*(0.1)*	*2.1*	*1.7*	*0.6*	*2.4*	*3.2*	*1.9*
RoE	*6.1*	*(1.0)*	*14.6*	*12.0*	*4.7*	*15.7*	*18.2*	*10.8*

*Source: Company, Centrum Research; *denotes calculated nos*

Financials (standalone)

Exhibit 5: Income Statement

Y/E March (Rs mn)	FY16 I-GAAP	FY17 I-GAAP	FY18 I-GAAP	FY19E Ind-AS	FY20E Ind-AS
Net Interest Income	**31,668**	**32,630**	**40,895**	**48,018**	**55,601**
Non-Interest Income	990	1,171	1,162	1,367	1,702
Total Net Income	**32,658**	**33,801**	**42,057**	**49,384**	**57,304**
Total Operating Expenses	**11,781**	**14,509**	**16,714**	**19,183**	**21,882**
Employee Expenses	5,588	6,809	8,518	9,798	11,134
Other Operating Expenses	6,193	7,700	8,196	9,385	10,748
Pre-provision Profit	**20,877**	**19,292**	**25,343**	**30,201**	**35,422**
Provisions & Contingencies	10,495	13,092	12,266	9,626	8,573
Profit Before Tax	**10,381**	**6,200**	**13,727**	**20,576**	**26,848**
Taxes	3,656	2,198	4,809	7,202	9,397
Profit after tax	**6,726**	**4,002**	**8,918**	**13,374**	**17,451**

Source: Company, Centrum Research Estimates

Exhibit 6: Balance Sheet

Y/E March (Rs mn)	FY16	FY17	FY18	FY19E	FY20E
Current assets	7,358	7,288	5,767	6,178	7,419
Loans & Advances	3,66,616	4,25,234	5,10,043	6,07,698	7,24,132
Investments	14,833	18,895	18,732	19,122	19,531
Total Int Earning Assets	**3,88,807**	**4,51,416**	**5,34,542**	**6,32,998**	**7,51,083**
Other asses	1,135	1,120	1,197	1,333	1,536
Total Assets	**3,89,942**	**4,52,536**	**5,35,739**	**6,34,331**	**7,52,619**
Borrowings	3,06,248	3,62,521	4,11,695	4,99,044	6,02,568
Interest Bearing Liabilities	**3,06,248**	**3,62,521**	**4,11,695**	**4,99,044**	**6,02,568**
Other non int bearing Liabilities	22,813	25,243	31,013	32,465	34,076
Total Liabilities	**3,29,061**	**3,87,763**	**4,42,708**	**5,31,508**	**6,36,644**
Equity	60,881	64,772	93,031	1,02,823	1,15,975
Total Liabilities	**3,89,942**	**4,52,536**	**5,35,739**	**6,34,331**	**7,52,619**

Source: Company, Centrum Research Estimates

Exhibit 7: DuPont analysis

(% AuM)	FY16	FY17	FY18	FY19E	FY20E
Yield on assets	*14.7*	*13.7*	*13.7*	*13.8*	*14.0*
Cost of funds	*7.4*	*7.1*	*6.3*	*6.4*	*6.7*
Spreads	***6.7***	***6.1***	***6.7***	***6.5***	***6.4***
NIM	***7.7***	***7.0***	***7.6***	***7.6***	***7.5***
Other income	*0.2*	*0.3*	*0.2*	*0.2*	*0.2*
Total income	***8.0***	***7.3***	***7.8***	***7.9***	***7.8***
Operating expenses	*2.8*	*3.0*	*3.0*	*3.0*	*2.9*
Provisions	*2.6*	*2.8*	*2.3*	*1.5*	*1.2*
PBT	***2.5***	***1.3***	***2.6***	***3.3***	***3.6***
Tax	*0.9*	*0.5*	*0.9*	*1.1*	*1.3*
RoA	***1.6***	***0.9***	***1.7***	***2.1***	***2.4***
Leverage	*6.4*	*7.0*	*5.8*	*6.2*	*6.5*
RoE	***11.4***	***6.4***	***10.5***	***13.7***	***16.0***

Source: Company, Centrum Research Estimates

Exhibit 8: Key Ratios

Y/E March	FY16	FY17	FY18	FY19E	FY20E
Growth Ratios (%)					
Loans	*11.3*	*16.0*	*19.9*	*19.1*	*19.2*
AUM	*11.0*	*14.3*	*17.8*	*18.5*	*18.5*
Borrowings	*12.8*	*18.4*	*13.6*	*21.2*	*20.7*
NII	*5.5*	*3.0*	*25.3*	*17.4*	*15.8*
Opex	*17.0*	*23.2*	*15.2*	*14.8*	*14.1*
PPOP	*0.3*	*(7.6)*	*31.4*	*19.2*	*17.3*
Provisions	*26.8*	*24.7*	*(6.3)*	*(21.5)*	*(10.9)*
PAT	*(19.1)*	*(40.5)*	*122.8*	*50.0*	*30.5*
Operating Ratios (%)					
Yield on advances	*15.9*	*15.0*	*14.7*	*14.7*	*14.8*
Cost of borrowings	*8.0*	*7.6*	*7.0*	*7.3*	*7.6*
NIM	*7.7*	*7.0*	*7.6*	*7.6*	*7.5*
Non-int inc / Total income	*3.0*	*3.5*	*2.8*	*2.8*	*3.0*
Opex/ Avg assets	*3.2*	*3.4*	*3.4*	*3.3*	*3.2*
Provisioning cost (bps)	*2.6*	*2.8*	*2.3*	*1.5*	*1.2*
Effective tax rate	*35.2*	*35.5*	*35.0*	*35.0*	*35.0*
RoA	*1.6*	*0.9*	*1.7*	*2.1*	*2.4*
RoE	*11.4*	*6.4*	*10.5*	*13.7*	*16.0*
Credit Quality Ratios (%)					
Gross NPA	*8.0*	*9.0*	*9.2*	*7.7*	*6.8*
Net NPA	*3.2*	*3.6*	*3.9*	*3.2*	*2.8*
NPA coverage ratio	*61.7*	*61.8*	*58.1*	*58.4*	*58.7*
Per Share (Rs)					
BVPS	107.8	114.6	151.4	167.3	188.7
Adjusted BVPS	86.0	86.3	119.3	135.6	155.8
EPS - wt avg	11.9	7.1	13.5	21.8	28.4
Valuations Ratios					
Price/BV (x)	2.3	2.7	2.6	2.9	2.7
Price/Adj. BV (x)	2.9	3.6	3.3	3.6	3.3
P/E (x)	20.7	44.2	28.9	22.4	18.2
Dividend Yield (%)	*1.6*	*1.3*	*1.0*	*1.0*	*1.2*

Source: Company, Centrum Research Estimates. FY16-19E have been valued on average market cap basis. YoY nos for FY19 are not comparable given transition to Ind-AS.

Appendix A

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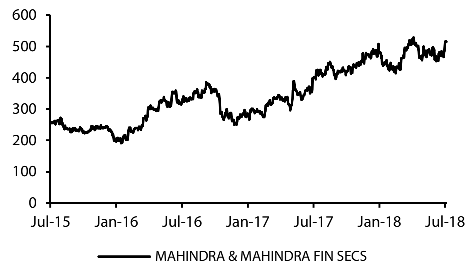
M&M Financial Services price chart



Source: Bloomberg, Centrum Research

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Rating	Market cap < Rs20bn	Market cap > Rs20bn but < 100bn	Market cap > Rs100bn
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Hold	Upside between -20% to +20%	Upside between -15% to +15%	Upside between -10% to +10%
Sell	Downside > 20%	Downside > 15%	Downside > 10%

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