

M&M Financial | BUY

Look beyond the rates; significant improvement in profitability ahead

Key takeaways from our meeting with Mahindra Finance (MMFS) management: i) Disbursement growth remains strong for July/August at c.30%. Management expects 20%+ AUM growth in FY19 (vs. 18% in FY18) which could accelerate to 25% in FY20 ii) Asset quality is significantly improving and company has witnessed 5% improvement in collection efficiency during July/August; Management expects GNPL to reduce to 7% by FY19 (vs. 9.4% in Q1) iii) MMFS expects 15bps increase in average outstanding cost of funds (incremental cost of funds up 75bps) which will be passed on via higher lending rate; iv) NPLs in the housing subsidiary have peaked and significant improvement is expected during 2HFY19 v) Management expects RoA/RoE to improve to 3%/18-20% by FY20 (vs. 1.8%/11% in FY18); We believe, with acceleration in growth and significant improvement in profitability, MMFS is well-placed to report top quartile return ratios over the next 2 years. We maintain BUY with a Mar'19 TP of INR 650.

- **Strong disbursement trends continue:** Disbursement growth has remained strong at 25-30% during July, August and management expects 20%+ AUM growth in FY19 which could accelerate to 25% by FY20. Management believe that there is further upside potential to this growth. This growth is driven by i) buoyancy across several states driven by good monsoons ii) increase in average ticket size iii) an increase in government spending; iv) acceleration of growth in the pre-owned vehicle segment and v) Continuous investment in distribution network – management expects to add 100 branches every year. Management believes rural sentiments are the best they have seen over the past 6-7 years. We expect AUM CAGR of 22% over FY18-FY20E.
- **Average borrowing cost to go up by 15-20bps:** MMFS funding cost stood at 8.3% during Q1 and it is incrementally borrowing at 8.75%. Management expects 15bps increase in average funding costs for FY19. Management expects margins to remain broadly stable as this increase in funding cost would be passed on to its customers. During the year, company has raised lending rates by 25bps in 1HFY19; it expects to increase lending rates further by 25-50bps near term. Further, company intends to maintain liquidity buffer of c.2% in FY19 which would increase to 3-5% in FY20.
- **Collection efficiency trends remain very strong:** Company has witnessed 5% improvement in collection efficiency during July/August. Management expects collection efficiency to remain strong and expects GNPL to reduce to 7% in FY19 (from 9.4% in Q1). There has been all round improvement across states; even worst performing states like TN has seen improvement in collection efficiency. Looking at overall buoyancy; management believes loan growth and improving asset quality trends are sustainable at least over the next 2 years. Based on its previous experience during elections, Management would be cautious and would avoid lending to segments which generate temporary demand during elections.
- **Maintain BUY with TP of INR 650:** We expect earnings CAGR of 53% over FY18-20E with RoA/RoE expanding to 2.9%/19% by FY20E. We value MMFS standalone at 3.0x Mar'20 BV implying value of INR 593 per share. We value MRHF at INR 41 per share and MIBL at INR 16 per share, implying a Mar'19 TP of INR 650.



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Recommendation and Price Target

Current Reco.	BUY
Previous Reco.	BUY
Current Price Target (12M)	650
Upside/(Downside)	43.8%
Previous Price Target	625
Change	4.0%

Key Data – MMFS IN

Current Market Price	INR452
Market cap (bn)	INR279.3/US\$3.9
Free Float	48%
Shares in issue (mn)	564.1
Diluted share (mn)	
3-mon avg daily val (mn)	INR720.7/US\$10.0
52-week range	538/386
Sensex/Nifty	38,018/11,477
INR/US\$	71.8

Price Performance

%	1M	6M	12M
Absolute	-10.5	3.5	3.1
Relative*	-11.6	-8.1	-13.7

* To the BSE Sensex

Financial Summary

Y/E March	FY16A	FY17A	FY18A	FY19E	FY20E
Net Profit	6,726	4,002	8,918	15,652	20,970
Net Profit (YoY) (%)	-19.1%	-40.5%	122.8%	75.5%	34.0%
Assets (YoY) (%)	12.8%	16.2%	18.2%	20.8%	21.4%
ROA (%)	1.8%	0.9%	1.8%	2.6%	2.9%
ROE (%)	11.5%	6.4%	11.2%	15.7%	18.6%
EPS	11.9	7.1	14.5	25.5	34.1
EPS (YoY) (%)	-19.2%	-40.5%	104.9%	75.5%	34.0%
PE (x)	37.9	63.8	31.1	17.7	13.2
BV	107	114	153	172	196
BV (YoY) (%)	7.2%	6.3%	34.2%	12.0%	14.3%
P/BV (x)	4.21	3.96	2.95	2.63	2.30

Source: Company data, JM Financial. Note: Valuations as of 05/Sep/2018

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

- **Mahindra Rural Housing Finance (MRHF) – expect NPLs to improve during 2HFY19:**
Management believes NPLs in rural housing have peaked and expects significant improvement in 2HFY19. MRHF has high exposure in Maharashtra where it has seen spike in NPL. With 24 out of 26 districts in Maharashtra witnessing good rainfall, collection efficiency in Maharashtra has improved. Going forward, Management expects significant improvement in asset quality trends in 2HFY19. MMFS has increased its stake in rural housing finance subsidiary to 89% (vs. 87.5% YoY). This stake would increase further as MMFS would infuse fresh capital of INR 1.5-2bn while NHB would not be putting any capital.

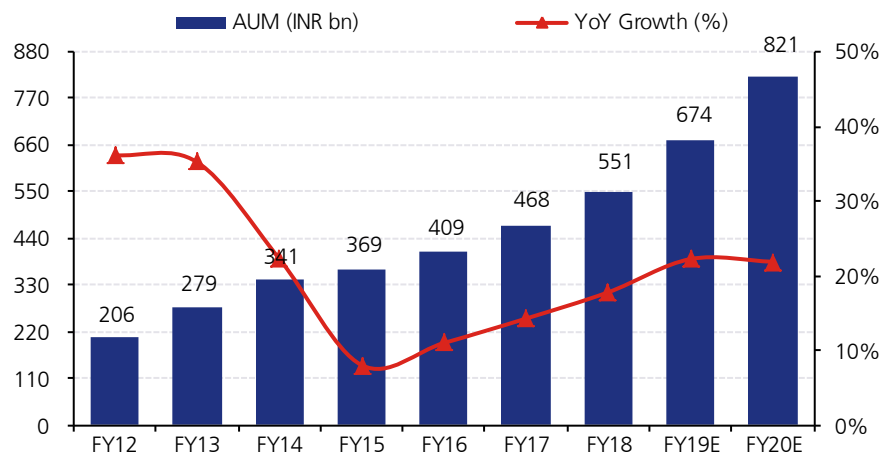
Exhibit 1. MMFS SOTP Valuation

MMFS SOTP	Holding	Valuation Methodology	Value Per Share	Contribution to TP (%)
MMFS - Standalone	100.0%	3x FY20E BV	593	91%
Mahindra Rural Housing	89.0%	2x FY20E BV	41	6%
Mahindra Brokers Limited	80.0%	15x FY20E earnings	16	3%
Total			650	100%

Source: Company, JM Financial

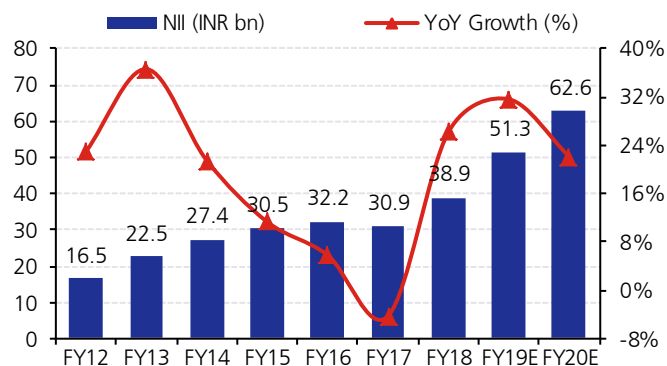
MMFS – Annual Trends

Exhibit 2. MMFS: Trend in AUM (INR bn)



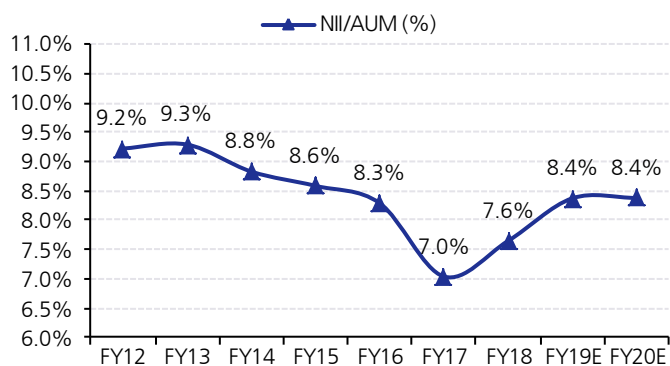
Source: Company, JM Financial

Exhibit 3. MMFS: Trend in NII (INR bn)



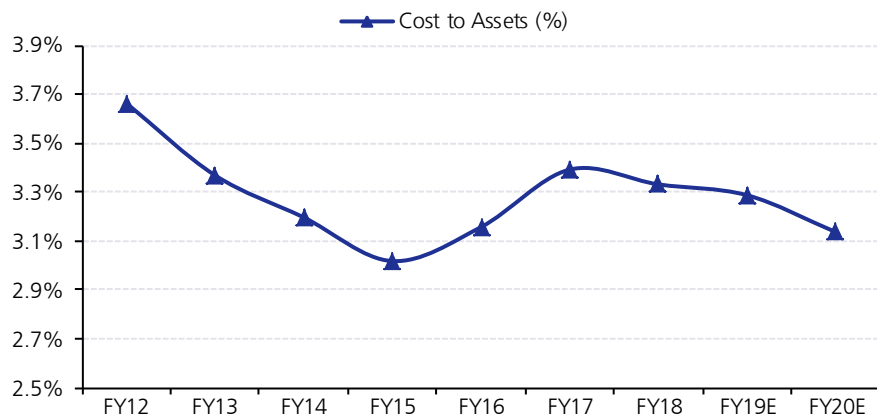
Source: Company, JM Financial

Exhibit 4. MMFS: Trend in NII/AUM (%)



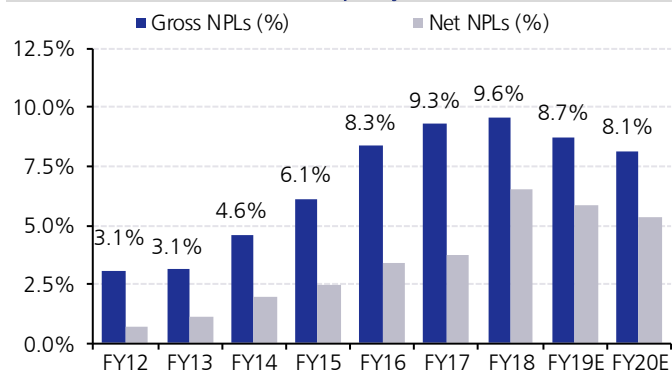
Source: Company, JM Financial

Exhibit 5. MMFS: Trend in cost-to-assets



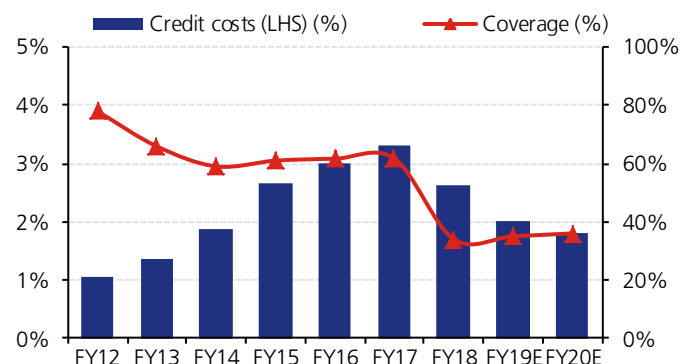
Source: Company, JM Financial

Exhibit 6. MMFS: Trend in asset quality



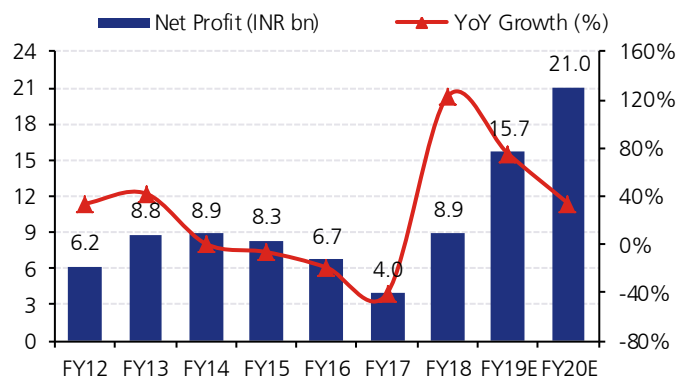
Source: Company, JM Financial

Exhibit 7. MMFS: Trend in credit costs



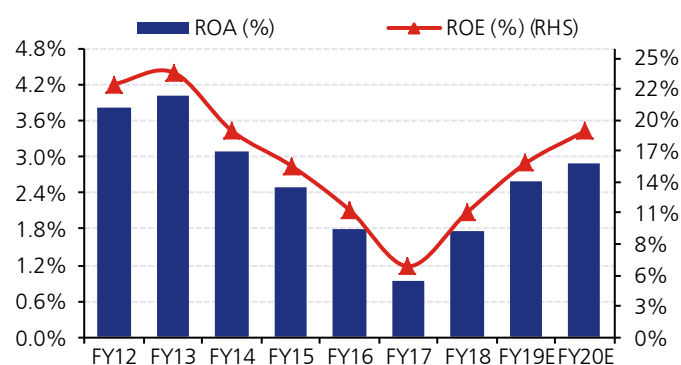
Source: Company, JM Financial

Exhibit 8. MMFS: Trend in earnings growth



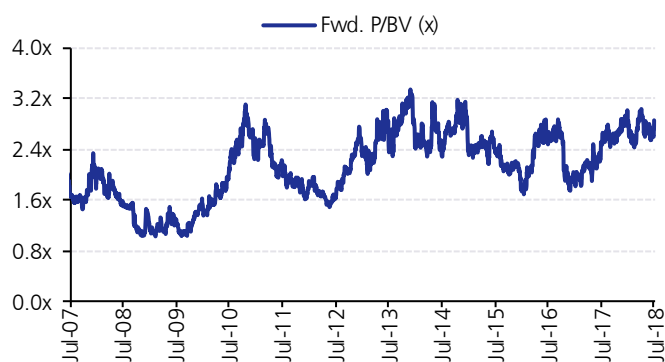
Source: Company, JM Financial

Exhibit 9. Trend in return ratios



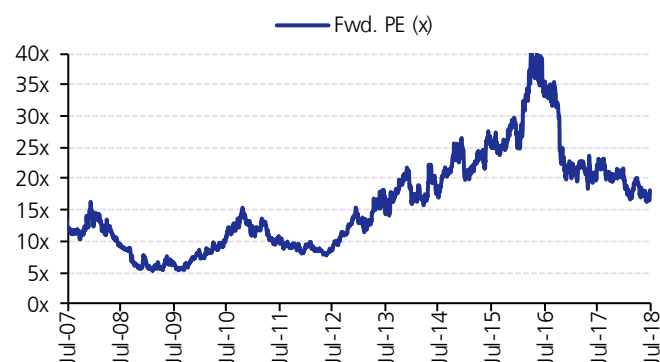
Source: Company, JM Financial

Exhibit 10. MMFS: One-year forward P/BV (x)



Source: Company, JM Financial

Exhibit 11. MMFS: One-year forward P/E (x)



Source: Company, JM Financial

Financial Tables (Standalone)

Profit & Loss (INR mn)					
Y/E March	FY16A	FY17A	FY18A	FY19E	FY20E
Net Interest Income	32,246	30,866	38,942	51,254	62,601
Profit on Investments	11	10	10	50	70
Exchange Income	0	0	0	0	0
Fee & Other Income	402	2,925	3,104	3,817	4,607
Non-Interest Income	412	2,935	3,114	3,867	4,677
Total Income	32,658	33,801	42,056	55,121	67,279
Operating Expenses	11,781	14,509	16,714	19,730	22,808
Pre-provisioning Profits	20,877	19,292	25,343	35,391	44,470
Loan-Loss Provisions	10,495	13,091	12,266	11,422	12,356
Provisions on Investments	0	0	0	0	0
Others Provisions	0	0	0	0	0
Total Provisions	10,495	13,091	12,266	11,422	12,356
PBT	10,382	6,201	13,077	23,969	32,114
Tax	3,656	2,198	4,809	8,317	11,144
PAT (Pre-Extraordinaries)	6,726	4,002	8,268	15,652	20,970
Extra ordinaries (Net of Tax)	0	0	650	0	0
Reported Profits	6,726	4,002	8,918	15,652	20,970
Dividend paid	2,713	1,610	1,610	4,383	5,872
Retained Profits	4,013	2,392	7,308	11,269	15,099

Source: Company, JM Financial

Key Ratios					
Y/E March	FY16A	FY17A	FY18A	FY19E	FY20E
Growth (YoY) (%)	0	0	0	0	0
Deposits	0.0%	0.0%	0.0%	0.0%	0.0%
Advances	11.3%	16.0%	19.9%	21.5%	21.9%
Total Assets	12.8%	16.2%	18.2%	20.8%	21.4%
NII	5.8%	-4.3%	26.2%	31.6%	22.1%
Non-interest Income	2.5%	611.7%	6.1%	24.2%	21.0%
Operating Expenses	17.0%	23.2%	15.2%	18.0%	15.6%
Operating Profits	0.3%	-7.6%	31.4%	39.7%	25.7%
Core Operating profit	-13.3%	-39.9%	118.7%	73.0%	34.0%
Provisions	26.8%	24.7%	-6.3%	-6.9%	8.2%
Reported PAT	-19.1%	-40.5%	122.8%	75.5%	34.0%
Yields / Margins (%)	0	0	0	0	0
Interest Spread	6.54%	5.28%	5.93%	6.55%	6.65%
NIM	8.80%	7.37%	7.92%	8.71%	8.77%
Profitability (%)	0	0	0	0	0
Non-IR to Income	1.3%	8.7%	7.4%	7.0%	7.0%
Cost to Income	36.1%	42.9%	39.7%	35.8%	33.9%
ROA	1.80%	0.94%	1.78%	2.61%	2.88%
ROE	11.5%	6.4%	11.2%	15.7%	18.6%
Assets Quality (%)	0	0	0	0	0
Slippages	6.63%	6.81%	0.00%	2.20%	2.25%
Gross NPA	8.34%	9.27%	9.56%	8.74%	8.15%
Net NPAs	3.37%	3.76%	6.52%	5.86%	5.37%
Provision Coverage	61.7%	61.8%	34.0%	35.0%	36.0%
Specific LLP	3.50%	3.63%	0.41%	1.32%	1.29%
Net NPAs / Networth	20.4%	24.8%	35.3%	34.4%	33.7%
Capital Adequacy (%)	0	0	0	0	0
Tier I	14.59%	12.80%	16.35%	15.74%	14.85%
CAR	17.29%	15.20%	22.05%	21.36%	20.18%

Source: Company, JM Financial

Balance Sheet (INR mn)					
Y/E March	FY16A	FY17A	FY18A	FY19E	FY20E
Equity Capital	1,129	1,130	1,229	1,229	1,229
Reserves & Surplus	59,508	63,396	92,932	1,04,202	1,19,301
Deposits	0	0	0	0	0
Borrowings	2,94,523	3,46,704	3,94,166	4,84,627	5,96,091
Other Liabilities	40,391	48,376	55,129	66,609	80,892
Total Liabilities	3,95,795	4,59,852	5,43,678	6,56,893	7,97,743
Investments	14,833	18,895	18,732	19,830	21,902
Net Advances	3,66,578	4,25,234	5,10,043	6,19,687	7,55,227
Cash & Equivalents	6,221	5,781	4,111	4,957	5,664
Fixed Assets	1,135	1,120	1,197	1,433	1,724
Other Assets	0	0	0	0	0
Total Assets	3,95,795	4,59,852	5,43,678	6,56,893	7,97,743

Source: Company, JM Financial

Dupont Analysis					
Y/E March	FY16A	FY17A	FY18A	FY19E	FY20E
NII / Assets	8.64%	7.21%	7.76%	8.54%	8.61%
Other Income / Assets	0.11%	0.69%	0.62%	0.64%	0.64%
Total Income / Assets	8.75%	7.90%	8.38%	9.18%	9.25%
Cost / Assets	3.16%	3.39%	3.33%	3.29%	3.14%
PBP / Assets	5.59%	4.51%	5.05%	5.90%	6.11%
Provisions / Assets	2.81%	3.06%	2.44%	1.90%	1.70%
PBT / Assets	2.78%	1.45%	2.61%	3.99%	4.42%
Tax rate	35.2%	35.5%	36.8%	34.7%	34.7%
ROA	1.80%	0.94%	1.78%	2.61%	2.88%
RoRWAs	1.79%	0.90%	1.70%	2.57%	2.88%
Leverage	6.5	7.1	5.8	6.2	6.6
ROE	11.5%	6.4%	11.2%	15.7%	18.6%

Source: Company, JM Financial

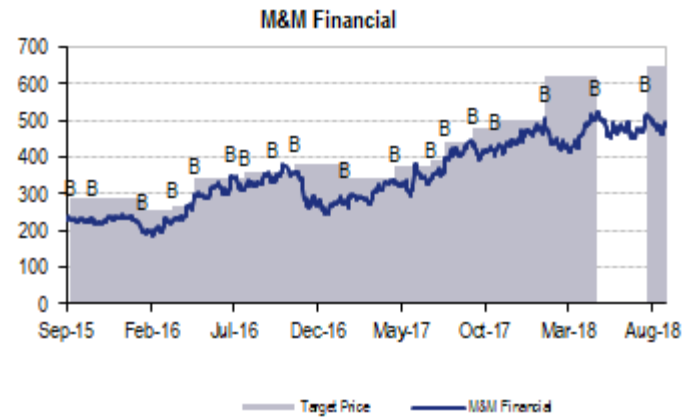
Valuations					
Y/E March	FY16A	FY17A	FY18A	FY19E	FY20E
Shares in Issue	564.6	565.0	614.5	614.5	614.5
EPS (INR)	11.9	7.1	14.5	25.5	34.1
EPS (YoY) (%)	-19.2%	-40.5%	104.9%	75.5%	34.0%
PER (x)	37.9	63.8	31.1	17.7	13.2
BV (INR)	107	114	153	172	196
BV (YoY) (%)	7.2%	6.3%	34.2%	12.0%	14.3%
ABV (INR)	156	156	130	172	196
ABV (YoY) (%)	8.7%	0.0%	-16.7%	31.9%	14.3%
P/BV (x)	4.21	3.96	2.95	2.63	2.30
P/ABV (x)	2.89	2.89	3.48	2.63	2.30
DPS (INR)	4.8	2.8	2.6	7.1	9.6
Div. yield (%)	1.1%	0.6%	0.6%	1.6%	2.1%

Source: Company, JM Financial

History of Earnings Estimate and Target Price

Date	Recommendation	Target Price	% Chg.
15-Sep-15	Buy	290	
23-Oct-15	Buy	290	0.0
22-Jan-16	Buy	255	-12.1
17-Mar-16	Buy	265	3.9
25-Apr-16	Buy	345	30.2
30-Jun-16	Buy	345	0.0
25-Jul-16	Buy	360	4.3
14-Sep-16	Buy	360	0.0
25-Oct-16	Buy	380	5.6
25-Jan-17	Buy	340	-10.5
26-Apr-17	Buy	375	10.3
29-Jun-17	Buy	390	4.0
25-Jul-17	Buy	440	12.8
15-Sep-17	Buy	480	9.1
26-Oct-17	Buy	500	4.2
24-Jan-18	Buy	620	24.0
25-Apr-18	Buy	UR	
27-Jul-18	Buy	650	

Recommendation History



APPENDIX I

JM Financial Institutional Securities Limited

(formerly known as JM Financial Securities Limited)

Corporate Identity Number: U67100MH2017PLC296081

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

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