

Mahindra & Mahindra Financial Services

Pain inevitable, valuations attractive

MMFS' business and asset quality performance, and consequently earnings were hit by COVID-19, despite 4Q being a seasonally strong qtr. Operating performance is likely to be subdued in the near term. Elevated provisions are likely to persist, weighing down on earnings. A deep rural presence, capable collection infrastructure (as seen in the past) and relatively easy access to funds are positives. Inexpensive valuations underpin our BUY (TP of Rs 228, 1.4x FY22E ABV + Rs 18 for stake in MIBL)

- Asset quality:** 4QFY20 performance was a departure from usual trends-GNPAs (8.4%) were flat QoQ (+41.5% YoY) vs. the sharp improvement usually seen in 4Q. For perspective, between FY09 and FY20, GNPAs dipped ~19% QoQ in 4Q. This suggests that (1) the lockdown severely impacted collection efforts, and that (2) these efforts are highly concentrated to the end of the qtr (as suggested by our on-ground checks as well). GNPAs would've been ~150bp lower under normal circumstances, per the mgt. We expect asset quality to worsen as 75% of MMFS' book is under moratorium despite its rural focus. We expect GNPAs of ~10.4% by FY21E.
- Liquidity and borrowings:** Borrowings grew 15.3/1.1% to Rs 596bn and liquid assets were ~Rs 45bn (~6% of AUMs). MMFS is unlikely to face troubles on this front, as suggested by (1) historical trends (ability to raise ample funds post Sep-18 due to strong parentage), (2) recent fund-raising activities (~Rs 30bn raised in the last few months, ~Rs 6.8bn under TLTRO), (3) additional disclosures on the liquidity profile (however, underlying collection assumptions are unclear). MMFS did not avail moratorium on its bank borrowings, even as 75% of its own borrowers did. This was on a/c of the opportunity to substitute higher cost borrowings and maintain its repayment track record.
- COVID-19 related management commentary:** 75% of MMFS' borrowers (by number and value) opted for the moratorium but fewer farmers (amongst its borrowers) did so. 28-30% of borrowers (by value) are located in red zones. The co. saw collections improve in May (so far 2x of Apr-20 collections). 500 (~38% of overall) branches were open. The management was upbeat on farm cashflows and said that tractor demand was witnessing some revival. Split of customer profile- (1) taxi and cab operators (~11%), (2) farming (~25%), (3) self-employed incl. traders (~17%).

Financial Summary

(Rs mn)	4Q FY20	4Q FY19	YoY (%)	3Q FY20	QoQ (%)	FY19	FY20P	FY21E	FY22E
Net Interest Income	13,033	12,669	2.9	13,328	(2.2)	46,700	51,130	55,994	60,815
PPOP	9,666	7,803	23.9	8,883	8.8	30,177	33,982	38,462	42,250
PAT	2,338	5,925	(60.5)	3,650	(36.0)	15,571	9,064	9,645	13,904
EPS (Rs)	3.8	9.6	(60.6)	5.9	(35.9)	25.3	14.7	15.7	22.6
ROAE (%)						15.2	8.1	8.2	10.9
ROAA (%)						2.60	1.28	1.29	1.74
ABVPS (Rs)						123.9	120.2	115.1	150.9
P/ABV (x)#						1.21	1.25	1.31	1.00
P/E (x)#						5.9	10.2	9.6	6.7

Source: Company, HSIE Research; # Adjusted for subsidiaries value

BUY

CMP (as on 15 May 2020)	Rs 168
Target Price	Rs 228
NIFTY	9,137

KEY CHANGES	OLD	NEW
Rating	BUY	BUY
Price Target	Rs 240	Rs 228
EPS %	FY21E	FY22E
	-10.1%	-4.7%

KEY STOCK DATA

Bloomberg code	MMFS IN
No. of Shares (mn)	618
MCap (Rs bn) / (\$ mn)	104/1,375
6m avg traded value (Rs mn)	985
52 Week high / low	Rs 439/128

STOCK PERFORMANCE (%)

	3M	6M	12M
Absolute (%)	(56.3)	(48.1)	(54.8)
Relative (%)	(31.6)	(25.1)	(38.6)

SHAREHOLDING PATTERN (%)

	Dec-19	Mar-20
Promoters	51.2	51.2
FIs & Local MFs	17.5	15.2
FPIs	24.9	23.9
Public & Others	6.5	9.7

Pledged Shares

Source : BSE

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- Overall AUMs grew 12/2% to Rs 772bn, with growth slowing expectedly. Disbursals too, expectedly registered a sharp 21/28% dip. CV/CE AUMs (15% of overall AUMs) grew the fastest at 18.1/7.3%, even as related disbursals dipped 37.6/32.1%. Other segments registered AUM trends in line with overall trends. COVID-19 related disruptions will severely restrict business growth. We expect an AUMs CAGR of ~6% over FY21-22E.
- The upward trend in non-tax provisions persisted, as they grew 68.5% QoQ to Rs 6.74bn (3.5% ann. of closing AUMs). Of the total provisions, ~Rs 4.74bn were towards Stage III assets. Consequently, stage III coverage increased 1177/809bps to 31.0%. MMFS made provisions based on the underlying economic activity in which customers were engaged (for e.g. higher provisions for loans to taxi operators) and their geographical location (red/orange/green). Stage 1 & 2 provisions were 1.9% of total assets (+30/10bps). MMFS is expected to make higher provisions to insulate the b/s from the impact of COVID-19. We expect LLPs of 3.1% over FY21-22E.
- Operating costs registered a dramatic 24.4/19.1% fall, led by a 32.0/26.1% fall in staff costs. The management explicitly stated that this was on a/c of actual cost reductions, and not because of cost deferrals. When reconciled with performance on certain business parameters (disbursals and collection) this can be explained by the fact that a significant proportion of employee costs are variable. The management is pursuing the following cost control measures- renegotiation of branch rent contracts (20-25% potential savings), outsourcing of more functions etc. We find the management's target of a 40-50bps reduction aggressive as we do not see significant drivers and we model a C-AA ratio of ~2.7% over FY21-22E (vs. ~3.0% over FY18-20P).

Change In Estimates

Rs mn	FY21E			FY22E		
	Old	New	Change	Old	New	Change
NII	59,112	55,994	-5.3%	63,051	60,815	-3.5%
PPOP	36,134	38,462	6.4%	38,214	42,250	10.6%
PAT	10,732	9,645	-10.1%	14,584	13,904	-4.7%
ABV (Rs)	132	115	-13.1%	166	151	-8.9%

Source: Bank, HSIE Research

NII was muted led by slower AUM growth

The sharp dip in operating expenses was led by a 32.0/26.1% dip in staff costs

PPOP growth was boosted by the sharp fall in op-costs

Provisions on stage III assets were ~Rs 4.74bn

MMFS saw relatively faster growth in its CV/ CE book

Reliance on bank borrowings increased YoY/QoQ

Asset quality performance was in sharp departure from usual 4Q trends

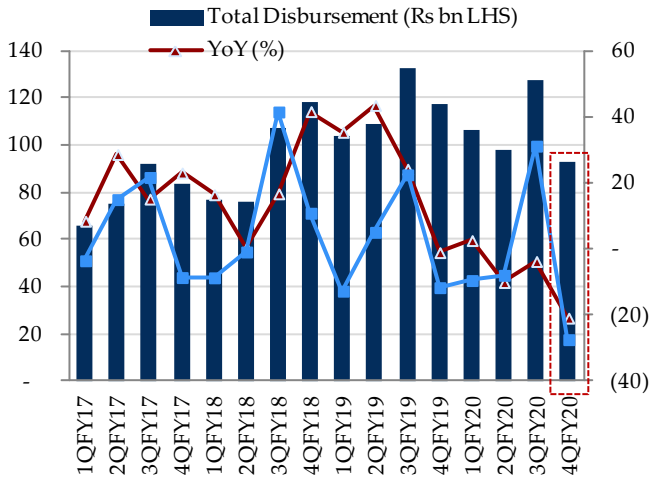
Sharp rise in coverage, we expect a further rise

Five quarters at a glance

Rs mn	4QFY19	1QFY20	2QFY20	3QFY20	4QFY20	YoY Growth	QoQ Growth
Net Interest income (NII)	12,669	12,383	12,385	13,328	13,033	2.9%	-2.2%
Non-interest income	683	460	1,001	743	829	21.5%	11.6%
Total income	13,352	12,843	13,387	14,072	13,863	3.8%	-1.5%
Total operating expenses	5,549	5,600	5,196	5,189	4,197	-24.4%	-19.1%
PPoP	7,803	7,243	8,190	8,883	9,666	23.9%	8.8%
Non-tax provisions	(1,145)	6,196	3,606	4,001	6,741	NA	68.5%
PBT	8,947	1,047	4,584	4,882	2,925	-67.3%	-40.1%
Tax expense	3,068	363	2,066	1,229	716	-76.7%	-41.8%
PAT	5,880	684	2,518	3,653	2,209	-62.4%	-39.5%
OCI	46	(120)	(33)	(3)	129	182.1%	-5102.3%
PAT + OCI	5,925	564	2,485	3,650	2,338	-60.5%	-36.0%
Other details							
Disbursements (Rs bn)	117.3	106.0	97.5	127.8	92.6	-21.0%	-27.5%
Auto/UV (%)	25.0	27.0	27.0	27.0	28.0	300 bps	100 bps
Tractors (%)	18.0	17.0	16.0	17.0	17.0	-100 bps	0 bps
Cars, non-M&M Uvs (%)	20.0	20.0	19.0	19.0	19.0	-100 bps	0 bps
CV/CE (%)	19.0	18.0	17.0	16.0	15.0	-400 bps	-100 bps
Pre-owned and others (%)	18.0	18.0	21.0	21.0	21.0	300 bps	0 bps
AUM (Rs bn)	689.5	714.1	727.3	758.8	771.6	11.9%	1.7%
Auto/UV (%)	26.0	26.0	26.0	27.0	27.0	100 bps	0 bps
Tractors (%)	17.0	17.0	17.0	17.0	17.0	0 bps	0 bps
Cars, non-M&M Uvs (%)	21.0	21.0	20.0	21.0	21.0	0 bps	0 bps
CV/CE (%)	18.0	19.0	19.0	18.0	19.0	100 bps	100 bps
Pre-owned and others (%)	18.0	17.0	18.0	17.0	16.0	-200 bps	-100 bps
Borrowings (Rs bn)	517.2	550.0	567.1	589.5	596.1	15.3%	1.1%
CRAR (%)	20.3	19.4	19.7	19.6	19.6	-70 bps	0 bps
Tier I (%)	15.5	14.9	15.2	15.4	15.4	-10 bps	0 bps
Profitability ratios (%)							
YoAUM (ca.lc.)	14.34	13.49	13.55	13.68	13.55	-79 bps	-13 bps
CoF (calc.)	8.87	8.35	8.61	8.36	8.70	-17 bps	34 bps
Spreads	5.47	5.14	4.94	5.32	4.85	-61 bps	-47 bps
NIM (calc.)	7.53	7.06	6.87	7.17	6.81	-72 bps	-36 bps
C-I ratio	41.6	43.6	38.8	36.9	30.3	-1129 bps	-660 bps
Tax rate	34.3	34.6	45.1	25.2	24.5	-982 bps	-71 bps
Asset quality							
Gross NPA (Rs mn)	40,602	52,952	52,038	57,733	57,467	41.5%	-0.5%
Net NPA (Rs mn)	32,803	39,789	41,867	44,519	39,665	20.9%	-10.9%
Gross NPAs (%)	6.40	8.20	7.90	8.50	8.44	204 bps	-6 bps
Net NPAs (%)	5.30	6.30	6.40	6.70	5.98	68 bps	-72 bps
Coverage ratio (%)	19.2	24.9	19.5	22.9	31.0	1177 bps	809 bps
Coverage ratio Incl. Stage I and Stage II (%)	46.1	45.8	43.6	43.8	53.8	770 bps	1000 bps

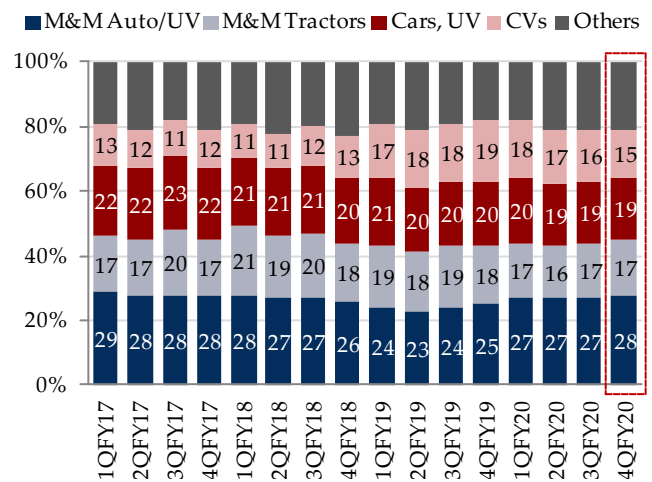
Source: Company, HSIE Research

Disburseals dip 21% YoY



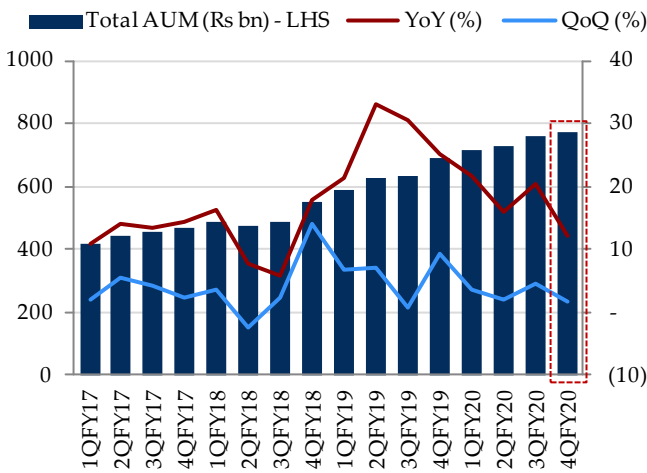
Source: Company, HSIE Research

Product-wise disbursal split



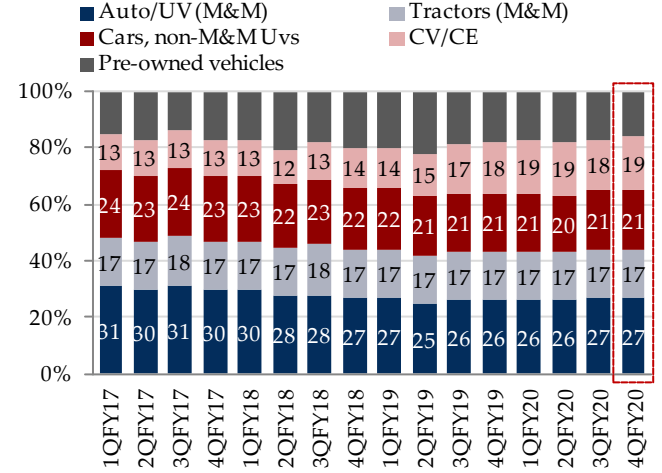
Source: Company, HSIE Research

AUM growth slows too 11.9% YoY



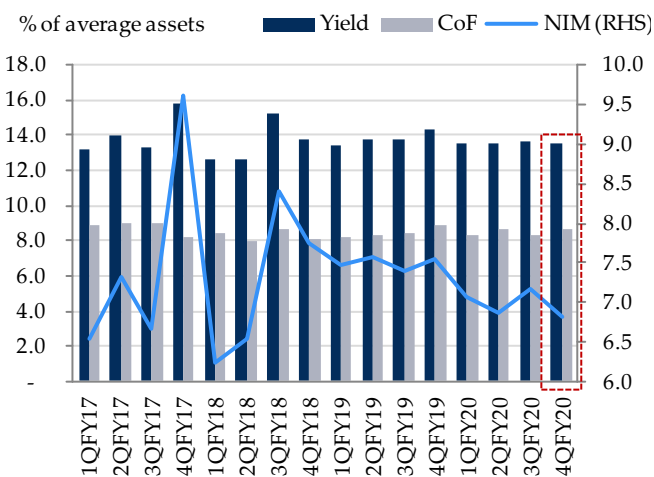
Source: Company, HSIE Research

AUM split: share of CV/CE on the rise



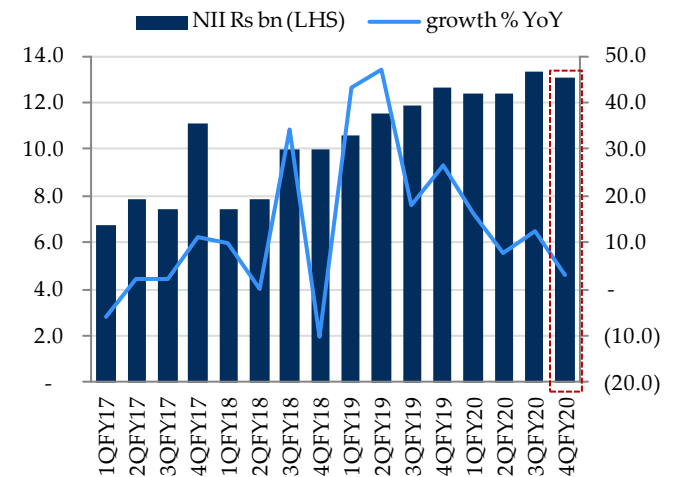
Source: Company, HSIE Research

Calc. NIM sees a QoQ fall



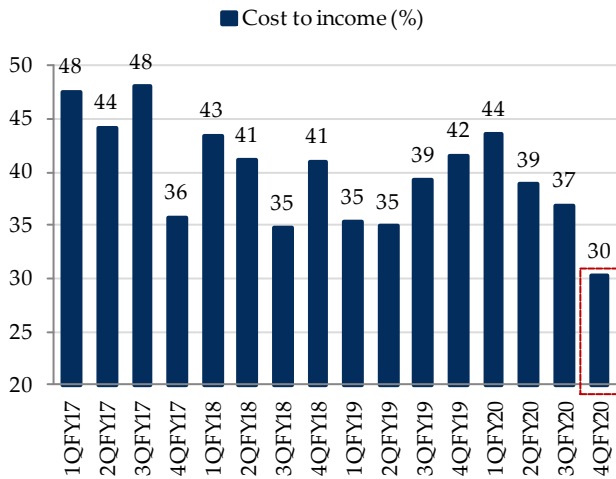
Source : Company, HSIE Research

NII growth slows to just 2.9% YoY



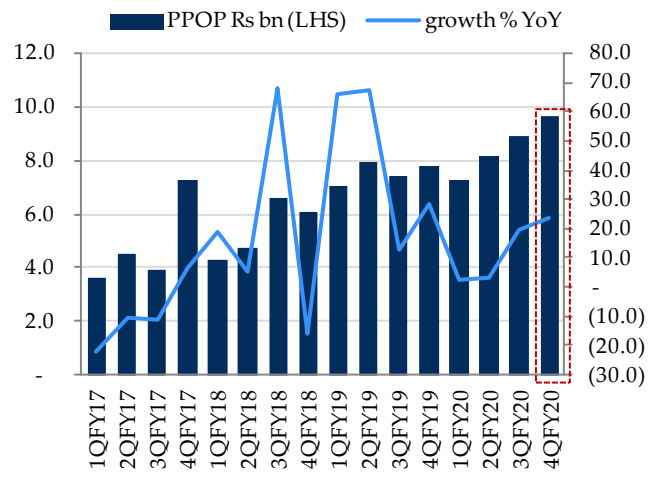
Source : Company, HSIE Research

C-I ratio sees a sharp fall



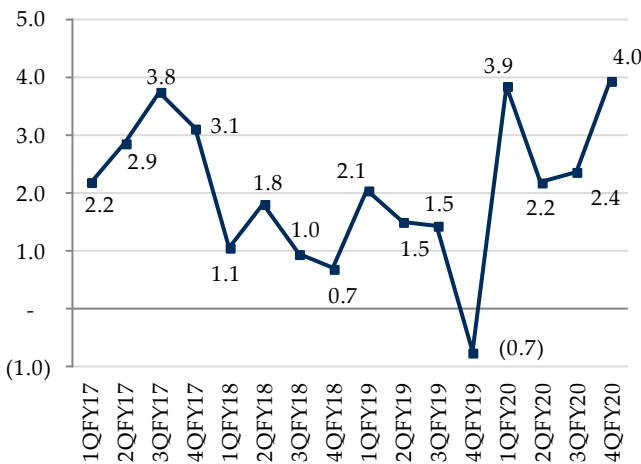
Source : Company, HSIE Research

Sharp PPOP growth boosted by fall in staff costs



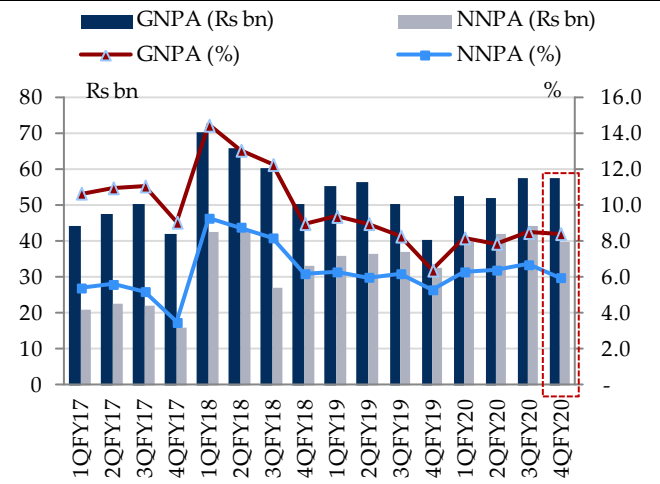
Source : Company, HSIE Research

Provisions see a sharp rise



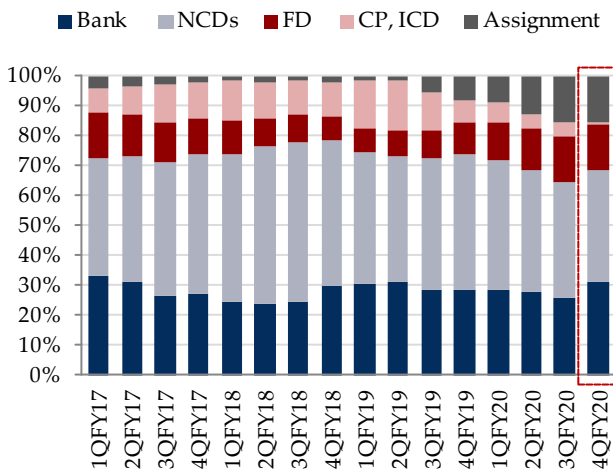
Source : Company, HSIE Research

GNPAs stable QoQ in departure from usual trends



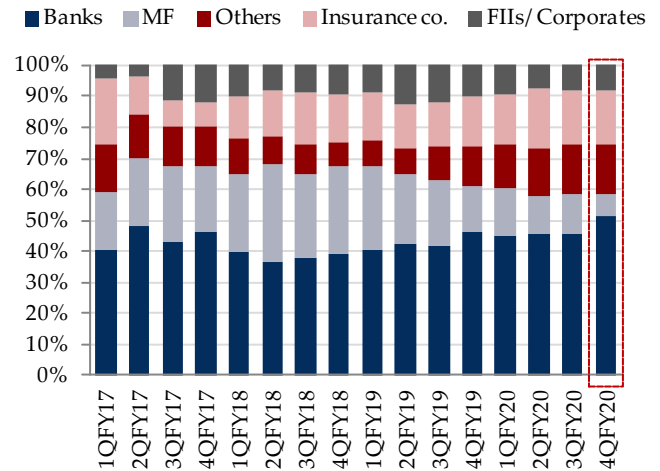
Source : Company, HSIE Research; 1QFY18 onwards as per IND-AS Re-stated 3QFY19 onwards\$

Instrument-wise funding mix split



Source : Company, HSIE Research, Note * - Incl. securitization

Instrument-wise funding mix split



Source : Company, HSIE Research

Peer set comparison

	M Cap (Rs bn)	CMP (Rs)	Rating	TP (Rs)	ABV (Rs)			P/E (x)			P/ABV (x)			ROAE (%)			ROAA (%)		
					FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
CIFC	122	149	BUY	251	91	98	115	8.8	8.9	7.7	1.65	1.52	1.30	18.8	14.8	15.0	2.26	2.01	2.16
MMFS	104	168	BUY	228	120	115	151	10.2	9.6	6.7	1.25	1.31	1.00	8.1	8.2	10.9	1.28	1.29	1.74
SHTF	146	642	ADD	891	527	603	814	4.8	5.6	4.9	1.22	1.06	0.79	17.7	13.3	13.4	2.70	2.08	2.14
INDOSTAR	37	277	REDUCE	253	276	277	291	24.6	19.9	17.4	1.01	1.00	0.95	3.9	4.9	4.8	1.14	1.44	1.70
LICHF	26	254	REDUCE	288	284	281	346	5.0	5.8	5.1	0.89	0.90	0.73	14.8	11.5	11.8	1.21	0.96	0.99
REPCO	7	112	ADD	215	246	258	303	2.4	2.8	2.8	0.46	0.43	0.37	17.7	13.1	11.5	2.55	2.05	1.96

Source: Company, HSIE Research, # Adjusted for subsidiaries value

Financials

Income statement

(Rs mn)	FY15	FY16	FY17	FY18	FY19	FY20P	FY21E	FY22E
Interest Earned	50,368	53,935	57,694	65,842	86,146	99,417	106,186	113,120
Interest Expended	24,967	26,393	28,575	30,816	39,446	48,287	50,191	52,305
Net Interest Income	25,401	27,542	29,120	35,025	46,700	51,130	55,994	60,815
Other Income	5,479	5,116	4,681	1,010	1,953	3,034	2,764	2,855
Total Income	30,880	32,658	33,801	36,036	48,653	54,164	58,758	63,670
Total Operating Exp	10,068	11,781	14,509	14,336	18,476	20,182	20,296	21,420
PPOP	20,811	20,877	19,291	21,700	30,177	33,982	38,462	42,250
Provisions & Contingencies	8,275	10,495	13,091	5,681	6,352	20,545	25,516	23,587
PBT	12,536	10,382	6,200	16,018	23,824	13,438	12,946	18,663
Provision For Tax	4,219	3,656	2,198	5,907	8,254	4,374	3,301	4,759
PAT	8,318	6,726	4,002	10,638	15,571	9,064	9,645	13,904
APAT	8,318	6,726	4,002	10,111	15,571	9,064	9,645	13,904

Source: Bank, HSIE Research

Statement of assets and liabilities

(Rs mn)	FY15	FY16	FY17	FY18	FY19	FY20P	FY21E	FY22E
SOURCES OF FUNDS								
Share capital	1,128	1,129	1,130	1,229	1,230	1,231	1,231	1,231
Reserves and surplus	55,566	59,752	63,642	94,990	107,850	112,408	120,606	132,425
Shareholders' Funds	56,694	60,881	64,772	96,219	109,080	113,639	121,837	133,656
Borrowings	201,360	221,574	279,814	411,485	538,606	600,981	608,374	668,452
Other Liabilities	92,687	113,340	115,266	20,223	23,094	26,093	29,795	34,185
Total Liabilities	350,741	395,795	459,852	527,927	670,780	740,713	760,006	836,292
APPLICATION OF FUNDS								
Advances	329,298	366,577	425,292	485,470	612,496	649,935	655,792	720,143
Investments	8,537	14,833	18,895	28,286	39,607	63,876	63,112	69,305
Fixed assets	1,101	1,135	1,120	1,197	1,631	3,635	3,999	4,398
Other Assets	11,807	13,249	14,546	12,974	17,046	23,266	37,104	42,446
Total assets	350,741	395,795	459,852	527,927	670,780	740,712	760,006	836,292

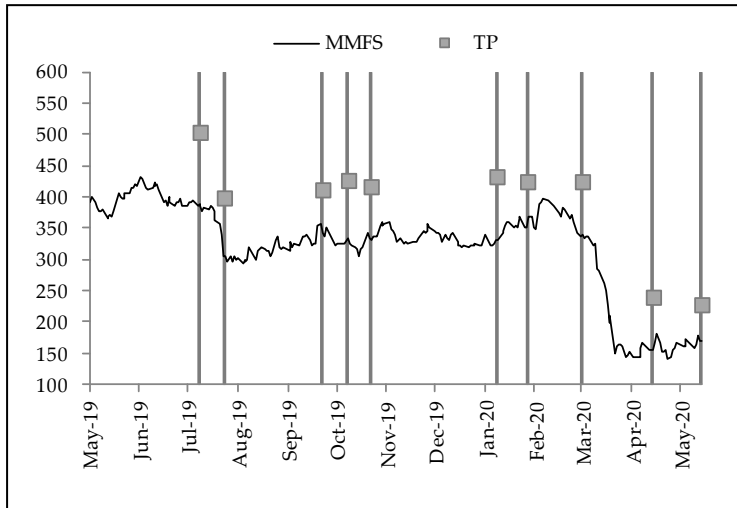
Source: Bank, HSIE Research

Key Ratios

	FY15	FY16	FY17	FY18	FY19	FY20P	FY21E	FY22E
VALUATION RATIOS								
EPS (Rs)	14.7	11.9	7.1	17.3	25.3	14.7	15.7	22.6
Earnings Growth (%)	(6.2)	(19.1)	(40.5)	152.7	54.0	(41.8)	6.4	44.2
BVPS (Rs)	100.5	107.8	114.6	156.6	177.4	184.6	197.9	217.1
Adj. BVPS (Rs)	86.0	86.0	86.3	102.5	123.9	120.2	115.1	150.9
DPS (Rs)	4.0	4.0	2.4	4.0	6.5	0.0	2.4	3.4
ROAA (%)	2.49	1.80	0.94	2.15	2.60	1.28	1.29	1.74
ROAE (%)	15.5	11.4	6.4	13.2	15.2	8.1	8.2	10.9
P/E (x)	10.2	12.6	21.2	8.7	5.9	10.2	9.6	6.7
P/ABV (x)	1.75	1.75	1.74	1.47	1.21	1.25	1.31	1.00
P/PPOP (x)	4.1	4.1	4.4	4.3	3.1	2.7	2.4	2.2
Dividend Yield (%)	2.4	2.4	1.4	2.4	3.9	-	1.4	2.0
PROFITABILITY								
Yield On Advances (%)	13.9	13.56	12.88	13.15	14.08	13.61	13.70	13.85
Cost Of Funds (%)	9.6	9.14	8.55	8.06	8.46	8.57	8.37	8.27
Core Spread (%)	4.3	4.43	4.34	5.09	5.62	5.03	5.33	5.58
NIM (%)	7.2	7.08	6.64	6.99	7.63	7.00	7.22	7.45
OPERATING EFFICIENCY								
Cost/Avg. Asset Ratio (%)	3.0	3.2	3.4	2.9	3.08	2.86	2.70	2.68
Cost-Income Ratio	32.6	36.1	42.9	39.8	38.0	37.3	34.5	33.6
BALANCE SHEET STRUCTURE RATIOS								
AUM Growth (%)	11.2	11.3	16.0	14.1	26.2	6.1	0.9	9.8
Borrowings Growth (%)	10.2	12.8	18.4	10.9	31.8	12.4	1.1	9.8
Equity/Assets (%)	16.2	15.4	14.1	18.2	16.3	15.3	16.0	16.0
Equity/Loans (%)	17.2	16.6	15.2	19.8	17.8	17.5	18.6	18.6
Total CRAR	18.3	17.3	17.6	22.7	20.3	19.6	19.2	19.4
Tier I	15.5	14.6	13.2	17.0	15.5	15.4	15.2	15.4
ASSET QUALITY								
Gross NPLs (Rs mn)	20,997	32,242	41,827	50,419	40,706	57,467	80,115	78,931
Net NPLs (Rs mn)	8,182	12,351	15,997	33,258	32,907	39,665	50,971	40,802
Gross NPLs (%) Total Assets	5.9	8.00	9.00	9.00	6.45	8.44	10.34	9.66
Net NPLs (%) Total Assets	2.4	3.17	3.60	6.20	5.28	5.98	6.58	5.00
Coverage Ratio (%)	61.0	61.7	61.8	34.0	19.2	31.0	36.4	48.3
Provision/Avg. Loans (%)	2.3	2.7	2.99	1.13	1.04	2.81	3.29	2.89
ROAA TREE								
Net Interest Income	7.61%	7.38%	6.81%	7.09%	7.79%	7.24%	7.46%	7.62%
Non-Interest Income	1.64%	1.37%	1.09%	0.20%	0.33%	0.43%	0.37%	0.36%
Operating Cost	3.02%	3.16%	3.39%	2.90%	3.08%	2.86%	2.70%	2.68%
Provisions	2.48%	2.81%	3.06%	1.15%	1.06%	2.91%	3.40%	2.96%
Tax	1.26%	0.98%	0.51%	1.20%	1.38%	0.62%	0.44%	0.60%
ROAA	2.49%	1.80%	0.94%	2.05%	2.60%	1.28%	1.29%	1.74%
Leverage (x)	6.2	6.3	6.8	6.1	5.8	6.3	6.4	6.2
ROAE	15.5%	11.4%	6.4%	12.6%	15.2%	8.1%	8.2%	10.9%

Source: Company, HSIE Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
9-Jul-19	389	BUY	504
24-Jul-19	304	BUY	399
22-Sep-19	354	BUY	412
9-Oct-19	334	BUY	427
24-Oct-19	333	BUY	417
9-Jan-20	325	BUY	433
29-Jan-20	352	BUY	425
2-Mar-20	345	BUY	425
15-Apr-20	156	BUY	240
17-May-20	168	BUY	228

From 2nd March 2020, we have moved to new rating system

Rating Criteria

- BUY: >+15% return potential
- ADD: +5% to +15% return potential
- REDUCE: -10% to +5% return potential
- SELL: > 10% Downside return potential

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