

M&M Financial Services Ltd

BUY

CMP Rs230

Target Rs290

Upside 26.2%

HIGHLIGHTS

- ✓ In a weak macro environment, MMFS posted a commendable operating show with PPOP rising 8% qoq and 44% yoy. Key positive surprise was a substantial decline in opex, down 18% qoq and 38% yoy.
- ✓ Lower disbursements (VAF down 67% yoy) and collections (75% of customers under moratorium) directly suppressed large cost components like travelling, commissions and conveyance. Renegotiation of fixed costs (rentals, outsourced services, etc.) and reduction in discretionary costs (advertising, etc.) also pulled down the opex. On-roll manpower has been coming down as company is not replenishing attrition.
- ✓ Nil growth (8% yoy) continues to run behind AUM growth (14% yoy), largely reflecting built-up of liquidity on balance sheet and its consequent impact on the gross spreads. Cash/liquid inv. stood at Rs85bn+ (10% of total assets)
- ✓ MMFS made additional provisions of Rs4.8bn in stand-alone business and Rs1.9bn in housing finance subsidiary for covering contingencies that may arise from Covid. PCR on Stage-3 assets improved to 40% and even the cover on Stage 1 & 2 assets was marginally raised.
- ✓ The announced rights issue of Rs30.8bn will augment Tier-1 capital by ~500 bps. With a well-provisioned balance sheet, the capital raised will be largely utilized for growth and gaining market share when environment improves.

Our View

- ✓ Upgrade Reco to BUY from ADD. Raise FY21/22 profit estimates by significantly cutting the opex. Largely retained credit cost estimates despite management commentary suggesting upside risk.
- ✓ Characteristic of being a rural proxy and a pro-cyclical franchise to drive faster normalization of return ratios. Raise 12m TP to Rs290 (unadjusted for rights).

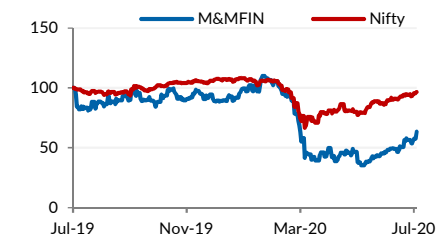
Risk to our call

- ✓ Spread of Covid impacting growth and prov. estimates

Stock data (as on Jul 20, 2020)

Nifty	11,022
52 Week h/l (Rs)	403 / 125
Market cap (Rs/USD mn)	141839 / 1893
Outstanding Shares (mn)	618
6m Avg t/o (Rs mn)	1,737
Div yield (%)	-
Bloomberg code:	MMFS IN
NSE code:	M&MFIN

Stock performance



	1M	3M	1Y
Absolute return	31.7%	38.3%	-36.5%

Shareholding pattern

Promoter	51.2%
FII+DII	39.5%
Others	8.9%

Exhibit 1: Financial Summary

Y/e 31 Mar (Rs mn)	FY19	FY20	FY21E	FY22E
Operating income	48,653	54,164	55,089	64,530
yoy growth (%)	35.0	11.3	1.7	17.1
PPOP	30,177	33,982	34,504	42,401
Net profit	15,571	9,064	10,399	21,291
yoy growth (%)	44.7	(41.8)	14.7	104.7
EPS (Rs)*	25.3	14.7	8.4	17.3
Adj.BVPS (Rs)*	123.9	120.2	85.2	110.1
P/E (x)*	9.1	15.6	16.6	8.1
P/adj.BV (x)*	1.9	1.9	1.6	1.3
ROE (%)	15.2	8.1	7.7	12.9
ROA (%)	2.6	1.3	1.4	2.5

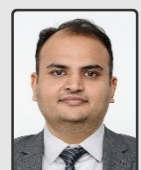
Source: Company, YES Sec – Research

Note: Per Share and Valuation ratios for FY21/22 adjusted for the rights issue

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CON-CALL HIGHLIGHTS

Rural Economy

- ✓ Rural buoyancy is clearly visible. MMFS's all branches are up and working and are witnessing good footfalls. Even the 300 branches at dealerships have seen strong recovery in customers footfalls
- ✓ Farm cash flows are strong was due to higher Rabi realization and Kharif sowing. Infra cash flows to improve with completion of various central and state government projects.
- ✓ Management expects FY21-24 to be a strong growth phase for the rural economy.
- ✓ Of MMFS's 2mn odd customers, barring the ~80000 taxi aggregators who work in peripheries of metros, rest all are engaged in rural transportation

Collection, Moratorium & Asset Quality

- ✓ Collections in April at Rs5bn, May at Rs10bn and June was Rs22bn+ (on demand of Rs29bn, implying collection efficiency of 75%). July is tracking better than June
- ✓ 48% of loan portfolio under moratorium considering payments (full installments) received in June. Management expects moratorium % to come down in July-August with customers segments like tractors coming out. Many customers also have a support of farm income
- ✓ NNPL level could reach 4% by FY21 end; improvement will be through collection and settlement on repossession
- ✓ Co. may take additional provision in certain segments and products like MHCV and Taxi Aggregators. Such customers will remain in moratorium and would require a longer time to recuperate. Most likely from Oct or Nov they will start paying regularly.
- ✓ Management believes that current coverage on the Stage-3 assets is sufficient

Liquidity and Capital

- ✓ MMFS has cash/liquid investments of over Rs85bn, and in addition has undrawn sanctioned lines. Co. does not intend to raise liquidity on the Balance Sheet any further.
- ✓ ALM is matched in every bucket. Improving collection and capital raise will buffer liquidity position. Tied-up for liability repayments till March
- ✓ Being a silver jubilee year for the co., the Board wanted to reward existing shareholders by pricing the rights issue lower. The capital raising is for growth.

Cost Management

- ✓ While there was a sharp drop in travelling cost, conveyance expenses and dealer commissions in Q1 FY21, they will start reverting with normalization in collection and disbursements (directly variable cost)
- ✓ Nevertheless, management confident about 15-20% drop in overall cost during the year led by renegotiation of branch rentals, Security and BPO contracts, lower branding and advertising, reduction in legal cost, etc.
- ✓ The co. has also moved 5% fixed cost to variable. It will not be recruiting till operating environment completely normalizes. Even increments have been deferred for time being.
- ✓ Opex/Assets ratio from around 2.8-3% is expected to decline to 2.5-2.6% in the medium term, before reaching 2% eventually

Disbursements

- ✓ In June, MMFS financed 30000 vehicles. Average volume for the next nine months could be around 45000. The co. can execute around 60000 vehicles monthly in a buoyant scenario.
- ✓ Maruti and its dealerships are taking about very high enquiry levels. Even other OEMs are expecting material improvement in demand from H2
- ✓ In management's view, H2 FY21 would see a lot of buoyancy. The only caveat being a deeper spread of Covid.
- ✓ Tractor, Small cars, Small LCV/Pick-ups and Used Vehicles will be first products to recover.

Exhibit 2: Result Table

(Rs mn)	Q1 FY21	Q4 FY20	% qoq	Q1 FY20	% yoy
Total Operating Income	26,405	26,369	0.1	23,940	10.3
Interest Expenses	(12,646)	(12,895)	(1.9)	(11,282)	12.1
Net Interest Income	13,759	13,474	2.1	12,658	8.7
Other income	144	389	(62.9)	185	(21.9)
Total Income	13,903	13,863	0.3	12,843	8.3
Operating expenses	(3,457)	(4,197)	(17.6)	(5,600)	(38.3)
PPOP	10,447	9,666	8.1	7,243	44.2
Provisions	(8,427)	(6,741)	25.0	(6,196)	36.0
PBT	2,020	2,925	(30.9)	1,047	92.9
Tax	(523)	(716)	(26.9)	(363)	44.2
Adjusted PAT	1,497	2,209	(32.2)	684	118.7

Source: Company, YES Sec – Research

Exhibit 3: Key Ratios

(Rs mn)	Q1 FY21	Q4 FY20	% qoq	Q1 FY20	% yoy
Income Yield (%) ^	14.0	14.5	(0.5)	14.2	(0.2)
Cost of Funds (%) ^	6.7	6.8	(0.1)	6.6	0.1
Gross Spread (%) ^	7.3	7.7	(0.4)	7.6	(0.3)
Net Spread (%) ^	1.1	1.9	(0.8)	0.6	0.5
Cost to Income (%)*	24.9	30.3	(5.4)	43.6	(18.7)
Provisions/Avg. Assets (%)	4.4	2.9	1.5	3.6	0.8
RoE (Cumulative) (%)	5.3	8.1	(2.8)	2.5	2.8
RoA (Cumulative) (%)	0.8	1.3	(0.5)	0.4	0.4
Gross NPA (%)	9.2	8.4	0.8	8.2	1.0
Net NPA (%)	5.7	6.0	(0.3)	6.3	(0.6)
CAR (%)	19.6	19.6	-	19.4	0.2

Source: Company, YES Sec – Research, * Calculated

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