

Improving quarter but asset quality still remains hazy

Mahindra & Mahindra Financial Services (MMFS) reported a healthy set of Q2FY21 numbers wherein steady AUM led to a reasonable topline. However, outlook on asset quality looks difficult with uncertainty on substantial proportion of AUM.

Advances growth was broadly flattish at ~0.9% YoY to ₹ 64389 crore, led by decline in growth for commercial (down ~70% YoY) and pre-owned vehicles (down ~61% YoY). Disbursements declined 45% YoY, though sequential witnessed revival of 55% to ₹ 5400 crore. Maintaining excess liquidity was partially offset by a reduction of interest rates, which led gross spreads to decline ~20 bps YoY to 7.4% (7.3% in Q1FY21).

Credit costs continued to remain elevated at ₹ 619 crore (~76 bps of AUM), including Covid-19 provision of ₹ 433 crore. This took outstanding Covid provision to ₹ 910 crore (i.e ~111 bps of advances). Asset quality improved with GNPA ratio (with standstill asset norms) at 7.03% vs. 7.88% in Q2FY20 and 8.44% in Q1FY21. Excluding standstill asset classification, GNPA ratio came in at 7.53%, down ~91 bps QoQ. Collection efficiency for September 2020 improved to ~82%, though it was still below pre-Covid level.

The management remained focused on cost rationalisation announced earlier. Accordingly, opex fell sharply by 24% YoY, primarily led by ~11%/46% YoY decline in employee/ other expenses. Higher provisioning was offset by a lower opex, which led to PAT growth to ₹ 304 crore, up 21% YoY.

Within subsidiaries, advances in Mahindra Rural Housing Finance was down by 6.6% YoY to ₹ 7485 crore. Disbursements declined sharply by ~90% YoY to ₹ 106 crore. GNPA continue to remain elevated with NNPA at ~9.5%.

Gradual revival in business growth; H2FY21 remains crucial

MMFS reported improvement of ~91 bps QoQ in GNPA ratio (excluding standstill asset norms) at 7.53%. Collection efficiency saw improvement at ~82% in September 2020 vs. average collection level of ~87-88%. Given ~2.75 lakh of total ~16 lakh customers have not paid even a single EMI, repayment trend of these exposure is to be watched in Q3FY21E. Currently, no loan has been restructured though management expects ~1-1.5 lakh customers (exposure: ~₹ 6000 crore) to be restructured.

Valuation & Outlook

A gradual recovery in auto sales and rural economy bodes well for MMFS. The management expects a pick-up in AUM growth at ~8-10% in FY21E and ~15-20% in FY22E. However, our estimates remain a bit conservative. We expect continued focus on cost to aid earnings. A gradual revival is expected in business momentum but the asset quality trend remains uncertain and is keenly watched. Therefore, we maintain our **HOLD** rating on the stock with a revised target price of ₹ 140/share (earlier ₹ 160), valuing core auto business at ~1.1x FY22E ABV and ~₹ 12 as value for subsidiaries (post assuming 20% holding company discount).



Particulars

Particulars	Amount
Market Capitalisation	₹15524 crore
GNPA (Q2FY21)	4766.8
NNPA (Q2FY21)	3093.8
NIM (Q2FY21)	1.7%
52 week H/L	442/128
Face Value	₹2
Net worth	1,13,639
D II Holding (%)	12.45
F II Holding (%)	21.41

Key Highlights

- Total Covid provisions stood at ₹ 910 crore (~111 bps of advances)
- ~2.75 lakh of total 16 lakh customers have not paid a single EMI.
- Management expects ~₹ 6000 crore to be restructured, pertaining to ~1-1.5 lakh customers
- Maintain HOLD with a target price of ₹ 140

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Key Financial Summary

Key Financials	FY18	FY19	FY20	FY21E	FY22E	CAGR (FY19-22E)
NII	3534	4778	5269	5606	5996	8%
PPP	2170	3018	3398	4012	4189	12%
PAT	1076	1556	906	976	1370	-4%
ABV (₹)	102.5	124.1	120.2	96.2	118.5	
P/E	6.7	4.9	8.5	15.8	11.4	
P/ABV	1.2	1.0	1.0	1.3	1.1	
RoA	2.2	2.6	1.3	1.3	1.7	
RoE	13.4	15.2	8.1	7.3	8.2	

Exhibit 1: Variance Analysis

	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	Comments
NII	1,391	1,284	8.3	1,376	1.1	Stable AUM growth led to reasonable NII growth
NIM (%)	1.7	1.8	-10 bps	1.7	-3 bps	
Net Total Income	1,428	1,339	6.7	1,390	2.7	
Staff cost	261	294	-11.1	225	16.4	
Other Expenses	135	226	-40.0	121	11.8	
PPP	1,031.1	819.0	25.9	1,044.6	-1.3	Tight cost control and stable NII led to healthy PPP growth
Provision	619.4	360.6	71.8	842.7	-26.5	Covid-19 provisions during Q2FY21 was at ₹ 433 crore, which took total Covid provisions to ₹ 910 crore (~111 bps of advances)
PBT	411.7	458.4	-10.2	201.9	103.9	
Tax	108.2	206.6	-47.6	52.3	106.8	
PAT	303.5	251.8	20.6	155.7	94.9	Higher provisioning was offset by a lower opex, which led PAT to grow 21% YoY.

Key Metrics

GNPA	4,766.8	5,203.8	-8.4	6,218.4	-23.3	Asset quality improved with GNPA ratio without standstill asset norms at 7.53%, down 91 bps QoQ
NNPA	3,093.8	4,186.7	-26.1	3,726.2	-17.0	
Advances	64,389	63,793	0.9	63,840	0.9	Disbursements growth was muted to ₹ 5400 crore, down 45% YoY.
Borrowings	43,820	49,780	-12.0	51,864	-15.5	

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(₹C crore)	FY21E			FY22E		
	Old	New	% Change	Old	New	% Change
Net Interest Income	5,056.4	5,605.9	10.9	5,274.5	5,996.1	13.7
Pre Provision Profit	2,915.7	4,012.5	37.6	3,020.0	4,188.9	38.7
NIM calculated (%)	8.0	8.5	51 bps	8.2	8.5	31 bps
PAT	906.6	976.1	7.7	1,205.0	1,369.6	13.7
ABV (₹)	73.4	96.2	31.0	83.6	118.5	41.7

Source: Company, ICICI Direct Research

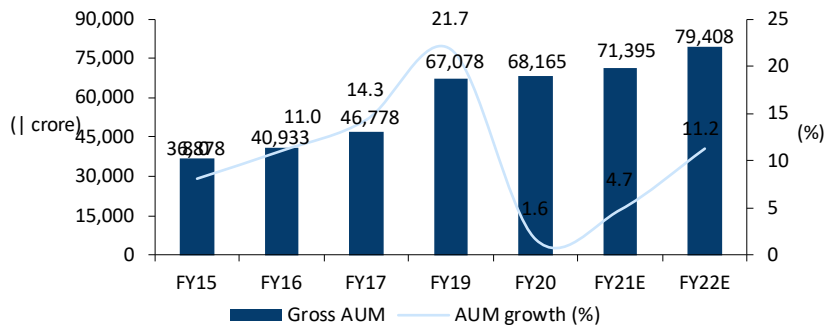
Exhibit 3: Assumption

	Current				Earlier	
	FY19	FY20	FY21E	FY22E	FY21E	FY22E
Credit growth (%)	26.2	6.1	3.3	10.0	-4.9	8.2
Borrowing Growth (%)	23.3	4.0	2.6	8.6	-5.5	6.8
NIM Calculated (%)	9.1	8.3	8.5	8.5	8.0	8.2
Cost to income ratio (%)	38.0	37.3	30.0	32.0	44.0	44.0
GNPA (₹crore)	4,060	5,747	5,495	5,812	7,382	8,528.4
NNPA (₹crore)	3,280	3,967	3,572	3,197	6,311	7,334.4

Source: Company, ICICI Direct Research

Story in Charts

Exhibit 4: AUM to grow at ~11% CAGR in FY21-22E



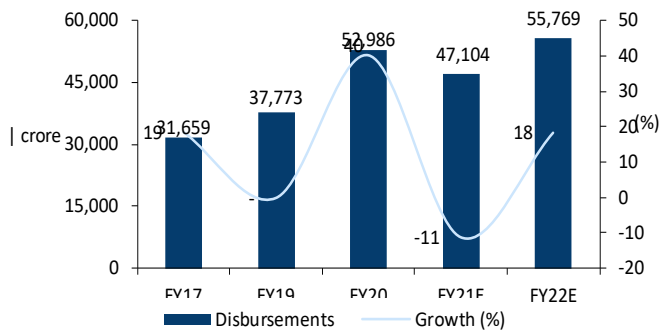
Source: Company, ICICI Direct Research

Exhibit 5: CV/CE segment to remain on slower track in near term

Breakup of Assets Financed	FY17	FY18	FY19	FY20	FY21E	FY22E
Auto/ Utility vehicles	28	26	25	28	23	21
Tractors	19	18	18	17	19	23
Cars	22	20	20	19	16	15
CV & C construction equipments	11	13	19	16	17	17
Used Vehicle	13	14	14	18	21	22
SME and others	7	9	4	3	3	2
Total advances (₹ crore)	46778	55101	67078	68165	71395	79408

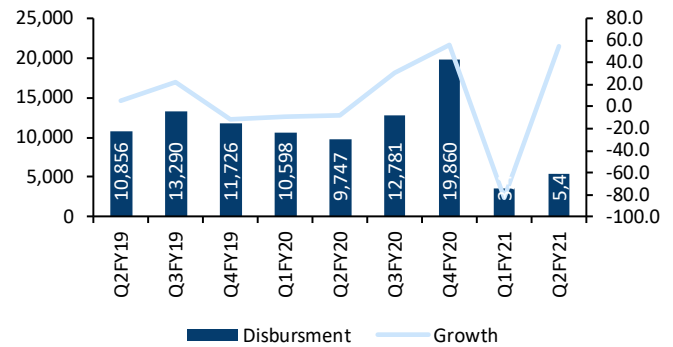
Source: Company, ICICI Direct Research

Exhibit 6: Gradual pick up in disbursement ahead



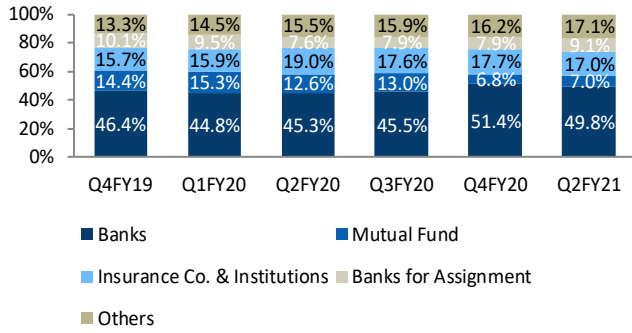
Source: Company, ICICI Direct Research

Exhibit 7: QoQ improvement in disbursements in Q2



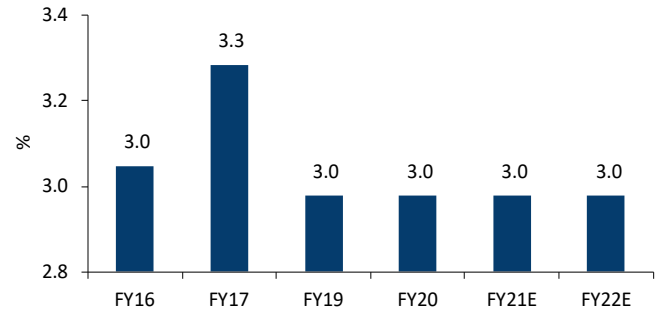
Source: Company, ICICI Direct Research

Exhibit 8: Borrowing mix



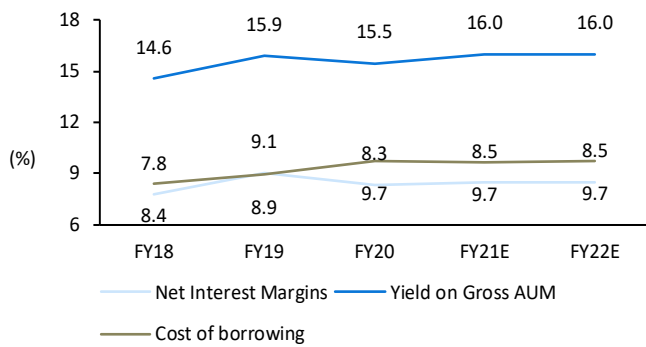
Source: Company, ICICI Direct Research

Exhibit 9: Opex to AUM to remain at ~3% in FY19-22E



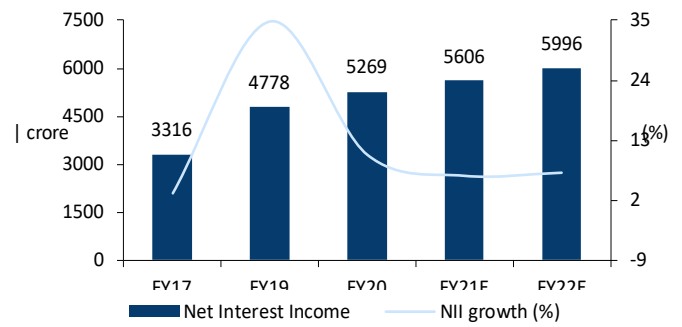
Source: Company, ICICI Direct Research

Exhibit 10: Margins seen to remain steady...



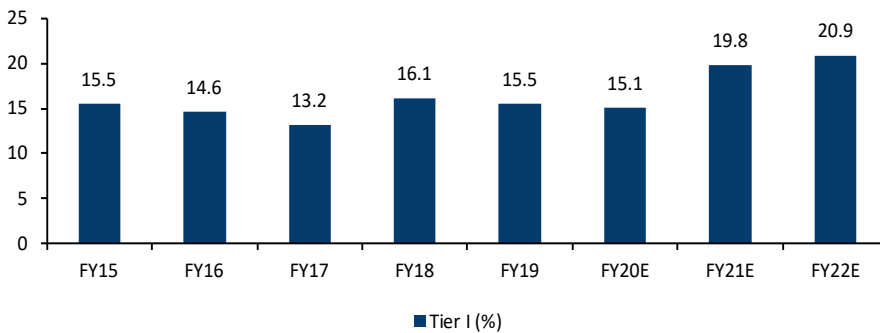
Source: Company, ICICI Direct Research

Exhibit 11: ...leading to healthy growth in NII



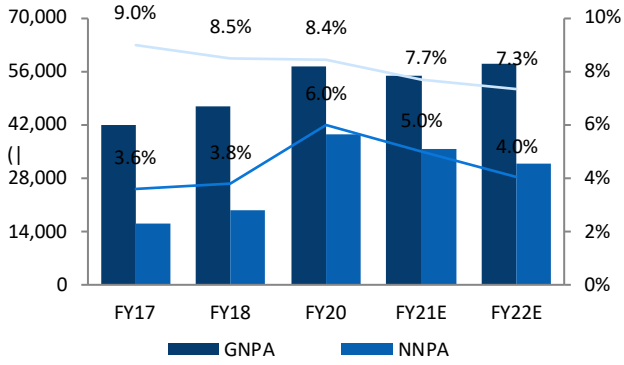
Source: Company, ICICI Direct Research

Exhibit 12: Capital adequacy remains comfortable



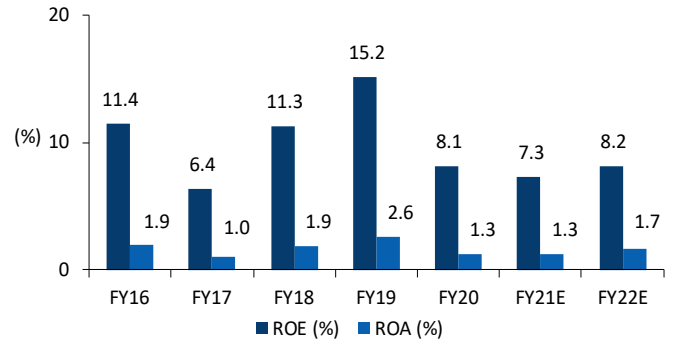
Source: Company, ICICI Direct Research

Exhibit 13: Asset quality trend



Source: Company, ICICI Direct Research

Exhibit 14: RoA to remain at ~1.7% by FY22E



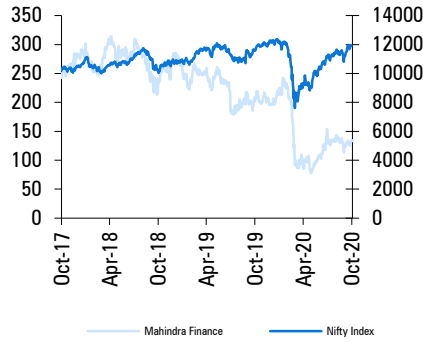
Source: Company, ICICI Direct Research

Exhibit 15: Shareholding pattern

(in %)	Sep 19	Dec 19	Mar 20	June 20	Sep 20
Promoter	51.2	51.2	51.2	51.2	52.2
FII	25.1	24.9	23.94	23.5	21.41
DII	15.3	15.4	15.55	13.1	12.45
Others	8.4	8.6	9.32	12.19	13.98

Source: Company, ICICI Direct Research

Exhibit 16: Price chart



Source: Company, ICICI Direct Research

Financial summary

Exhibit 17: Profit and loss statement ₹ crore

(₹Crore)	FY19	FY20	FY21E	FY22E
Interest Earned	8723	10098	10568	11277
Interest Expended	3945	4829	4963	5281
Net Interest Income	4778	5269	5606	5996
Non Interest Income	87	147	126	164
Net Income	4865	5416	5732	6160
Staff cost	1090	1148	1063	1147
Other Operating expense	757	870	657	825
Operating profit	3018	3398	4012	4189
Provisions	636	2054	2702	2351
PBT	2382	1344	1310	1838
Taxes	825	437	334	469
Net Profit	1556	906	976	1370
EPS (₹)	25.33	14.73	7.92	10.93

Source: Company, ICICI Direct Research

Exhibit 18: Key Ratios

(Year-end March)	FY19	FY20	FY21E	FY22E
Valuation				
No. of Equity Shares (Crore)	61.5	61.5	123.3	125.3
EPS (₹)	25.3	14.7	7.9	10.9
BV (₹)	177.5	184.7	125.1	144.0
ABV (₹)	124.1	120.2	96.2	118.5
P/E	4.9	8.5	15.8	11.4
P/BV	0.7	0.7	1.0	0.9
P/ABV	1.0	1.0	1.3	1.1
Yields & Margins (%)				
Net Interest Margins	9.1	8.3	8.5	8.5
Yield on Gross AUM	15.9	15.5	16.0	16.0
Cost of borrowing	8.9	9.7	9.7	9.7
Quality and Efficiency (%)				
GNPA	5.9	8.4	7.7	7.3
NNPA	4.8	6.0	5.0	4.0
ROE (%)	15.2	8.1	7.3	8.2
Return on Gross AUM	2.6	1.3	1.3	1.7

Source: Company, ICICI Direct Research

Exhibit 19: Balance sheet ₹ crore

(₹Crore)	FY19	FY20	FY21E	FY22E
Sources of Funds				
Capital	123	123	247	251
Reserves and Surplus	10785	11241	15182	17797
Networth	10908	11364	15429	18048
Borrowings	48765	50732	52050	56537
Current liabilities & Provisor	7405	11975	10067	8123
Total	67078	74071	77546	82708
Applications of Funds				
Fixed Assets	133	364	436	524
Investments	3792	5911	6711	5908
Advances	61250	64993	67112	73850
Other Assets	1403	1403	1312	1229
Cash with RBI & call money	502	1426	1975	1198
Total	67078	74097	77546	82708

Source: Company, ICICI Direct Research

Exhibit 20: Growth ratios (%)

	FY19	FY20	FY21E	FY22E
Credit Growth (%)	26.2	6.1	3.3	10.0
Borrowing growth (%)	23.3	4.0	2.6	8.6
NIM calculated (%)	9.1	8.3	8.5	8.5
Cost to income ratio (%)	38.0	37.3	30.0	32.0
GNPA (₹crore)	4060	5747	5495	5812
NNPA (₹crore)	3280	3967	3572	3197

Source: Company, ICICI Direct Research

Exhibit 21: ICICI Direct coverage universe (BFSI)

Sector/Company	CMP			M Cap (₹Cr)	EPS (₹)			P/E (x)			P/ABV (x)			RoA (%)			RoE (%)		
	(₹)	TP (₹)	Rating		FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
HDFC (HDFC)	1,947	1,770	Buy	3,49,323	103.1	42.5	57.5	18.9	45.8	33.9	3.9	3.3	3.2	3.6	1.4	1.7	21.7	8.0	9.7
Mahindra & Mahindra Financial	127	140	Hold	15,524	14.7	14.7	14.7	8.6	8.6	8.6	1.1	1.3	1.1	1.3	1.3	1.7	8.1	7.3	8.2
Bajaj Finserv (BAFINS)	5,983	7,000	Buy	93,801	269.7	249.3	300.4	22.2	24.0	19.9	3.0	2.6	2.3	1.9	1.4	1.3	15.3	11.6	12.4
Bajaj Finance (BAJFI)	3,233	3,850	Buy	1,94,831	89.5	68.7	95.4	36.1	41.1	33.9	6.1	5.7	5.1	2.8	1.8	2.2	20.2	12.1	14.8
LIC Housing Finance (LIC HF)	283	345	Buy	15,170	46.5	59.0	66.1	6.1	4.8	4.3	1.0	1.0	0.9	1.1	1.2	1.2	13.8	15.5	15.6

Source: Company, ICICI Direct Research

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Sell: <-15%



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