Stock Idea

Sector: NBFC

March 19, 2021

Mahindra & Mahindra Financial Services Limited

Turning the wheels of fortune

Sharekhan
by BNP PARIBAS

Powered by Sharekhan's 3R Research Philosophy

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Mahindra & Mahindra Financial Services Limited

Turning the wheels of fortune

NBFC	Sharekhan code: M&MFIN	Initiating Coverage

Stock Idea

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

Reco/View

Reco:	**Buy**
CMP:	**Rs. 202**
Price Target:	**Rs. 260**

Company details

Market cap:	Rs. 25,501 cr
52-week high/low:	Rs. 224 / 77
NSE volume: (No of shares)	97.8 lakh
BSE code:	532720
NSE code:	M&MFIN
Free float: (No of shares)	59.1 cr

Shareholding (%)

Promoters	52.2
Public	47.5
Others	0.3

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-0.8	15.5	64.1	46.4
Relative to Sensex	-1.1	12.4	34.8	-20.6

Sharekhan Research, Bloomberg

Summary

- M&M Financial Services (MMFS) has evolved into a multi-product auto finance NBFC operating pan-India, having deep penetration and rural-centric strong network from being a vehicle financing arm for M&M earlier.
- Normalisation of credit costs and pick-up in AUMs in FY22E and FY23E would drive earnings and RoE.
- Stock trades at 1.8x / 1.7x FY2022E / FY2023E on standalone ABVPS; strong parent backing, strong and stable credit rating profile and high capital levels make business attractive.
- We initiate coverage with a Buy and Price Target (PT) of Rs. 260.

Mahindra & Mahindra Financial Services (MMFS) has grown and transformed from being primarily a financing entity for vehicle purchases (from parent M&M) to a leading multi-product auto finance non-banking financing company (NBFC) with a pan-India presence, deep penetration and a strong, rural-focused network. Going ahead, we believe that normalisation of credit costs (MMFS has taken significant upfront provision till Q3FY2021; credit costs would normalise in FY22E), pick-up in AUMs in FY22E and FY23E (aided by rise in auto sales), GDP growth and an improved capex cycle leading to disbursement growth) will drive up MMFS' earnings and RoE. Hence, while the past few quarters have been challenging (due to COVID-19 and the economic slowdown) for growth and asset quality, we expect MMFS to bounce back in FY2022E and FY2023E, which we believe would be key re-rating triggers. The rural segment has been resilient and rising government spends, increased sowing and ample reservoir levels augur well for rural-focused players such as MMFS. Growth is expected to be higher in Q4FY21 led by better cash flows from rural and semi-urban areas. Segments such as tractors should see better volumes in Q4FY21, while cars and other auto segment may take another six months to see complete revival. Asset-quality wise, the improvement in Collections is positive, and we expect the trend to continue, as Q4 is seasonally the best quarter in terms of collections on strong farm cash flows. Going forward, the management has guided to keep net NPAs at sub-4% levels and maintain provisioning coverage ratio (PCR) at 35-36%. The company has restructured only 1% of AUMs, which is also a positive cushion. We believe that as the company brings down its liquidity in next couple of months, margins should improve as the drag on profitability goes down. Backed by the Mahindra Group's strength, a strong and stable credit rating profile (which allows best-in-class borrowing rates) and augmented capital base (capital raise done in mid-FY21; Tier 1 at 21.9%) the business is attractive over the long term and set to stage a comeback as the economic scenario normalises. We initiate with a Buy rating with a Price Target (PT) of Rs. 260.

Our Call

At CMP, the stock is available at 1.8x / 1.7x FY2022E / FY2023E on the standalone ABVPS, which we find attractive, given the improving growth outlook (resumption of economic activity, support from a resilient rural segment etc). We expect disbursements to grow in H2 FY22E and expect an AUM growth of ~10% / 15% for FY2022E & FY2023E. The asset quality outlook is improving, with collection efficiency surging to 96% in December (from 82% in October); the November number too saw the m-o-m improvement continuing. The management has indicated that <1% of portfolio can be potentially restructured, which is manageable; and improving cost of funds will be positive for NIMs. We expect operating expenses to AUM ratio to be 2.5-2.7% range and RoE improving to 8% and 10%, respectively for FY2022E and FY2023E. We believe that the buoyancy in rural markets augurs well for commercial vehicle (CV) financiers, and coupled with business benefits from a strong parentage, a well-capitalised balance sheet and rigorous risk management practices (provides long-term visibility) offer scope for improving operating leverage and Return ratios, which provides additional comfort. We initiate with a Buy rating on the stock with price target of Rs. 260.

Key risk

Delayed recovery in economic activity will affect growth and profitability, further, it has exposure to the SME segments which may be vulnerable if economic recovery is delayed.

Valuation Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
NII	4,756.9	5,210.0	5,825.5	6,068.2	6,444.5
PPOP	3,017.7	3,398.2	4,191.6	4,363.6	4,630.1
PAT	1,557.1	906.4	839.1	1,263.3	1,802.5
EPS	25.3	14.7	6.8	10.2	14.6
ABVPS	124.1	120.2	104.5	113.9	121.8
P/E	8.0	13.7	29.7	19.8	13.8
P/ABVPS	1.6	1.7	1.9	1.8	1.7
ROE	14.3%	8.0%	5.5%	7.8%	10.3%
ROA	2.3%	1.2%	1.1%	1.5%	1.8%

Source: Company; Sharekhan estimates

Executive Summary

3R Research Positioning Summary

- **Right Sector:** Encouraging demand recovery, lower funding costs, and improving asset quality trends (rising collection efficiency and low restructuring pipeline).
- **Right Quality:** MMFS has progressed well as a pan-India, rural-focused, diversified vehicle financier (M&M Group's contribution is ~45%); with high and stable credit ratings and strong operating metrics, which underline its high pedigree.
- **Right Valuation:** Stock is available at reasonable valuations of 1.8x / 1.7x FY2022E / FY2023E on standalone ABVPS; supported by improving growth outlook and resumption of economic activity.

Valuation and return potential

- We expect the operating expenses to AUM ratio to be at 2.7-2.5% and see RoE improving to 7.8% and 10.3%, respectively for FY2022E and FY2023E.
- We initiate coverage with a Buy rating and a price target of Rs 260.

Catalysts

Medium Term Triggers

- Q4 is seasonally a strong quarter (due to better cash flows from rural and semi urban areas) and hence MMFS may see improved disbursement growth
- Segments like tractors may see better volumes in Q4FY21, while the cars and auto segment may take couple of quarters to normalise.
- NBFCs' one-year spreads have dropped significantly over the last few months, which helps reduce marginal Cost of Funds.

Medium Term Triggers

- Fall in credit costs to normal run-rate levels is to drive RoE recovery
- Drop in Cost of Funds and leverage to help support margins
- Strong rural recovery to support pick-up in AUMs in FY2022E and FY2023E

Earnings and Balance sheet highlights

- Backed by the Mahindra Group's strength, with a strong and stable credit rating profile (which allows best in class borrowing rates) MMFS has structural strengths
- Has augmented capital base (Rights issue done; takes Tier-1 ratio to 21.9%); well placed to capture growth opportunity
- Asset quality outlook is improving, with December collection efficiency at 96% (from 82% in October); m-o-m improvement is likely to continue.

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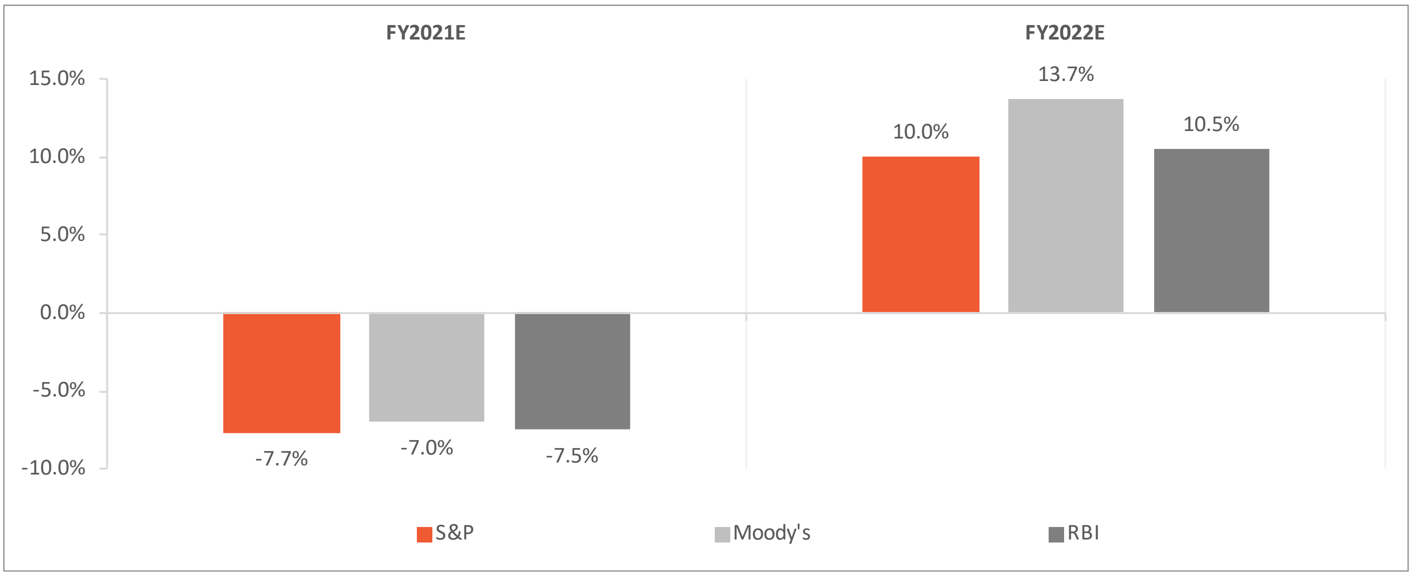
Why we like the NBFC sector

India's GDP growth expected to pick up in FY2022E, and as a result the automobile sector and thereby vehicle financiers expected to see better growth. An encouraging demand recovery, lower funding costs and improving asset quality (rising collection efficiency and low restructuring pipeline) augur well for NBFCs.

India – A Favourable Economic Outlook for FY22

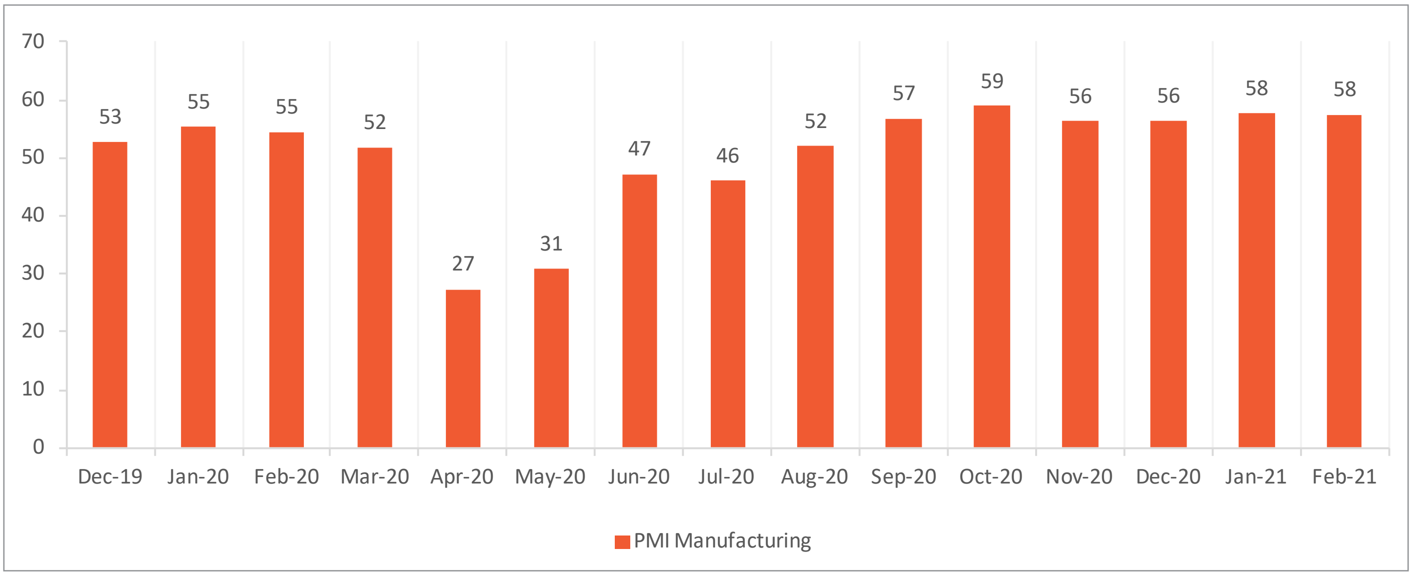
There has been a sharp improvement in economic activity in the past six months (as the effect of COVID-19 recedes) and many sectors were now reaching near normalcy in terms of activity levels. Macro-economic indicators are showing strong signs of improvement.

Indian GDP FY2022 - healthy growth expected



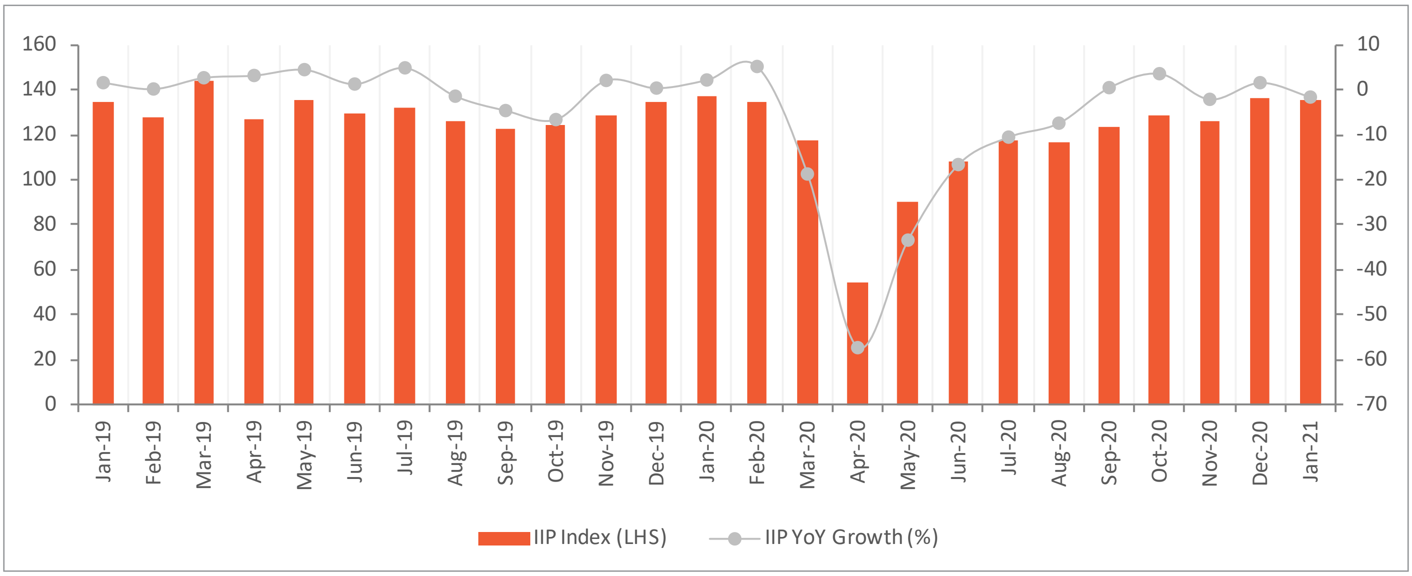
Source: Media report, Sharekhan Research

PMI Manufacturing stays steady above 50 mark



Source: IHS Markit, Sharekhan Research

IIP recovering gradually



Source: MOSPI

The revival has also been reflected in the monthly collections for lenders (Banks and NBFCs) who have seen off the moratorium and are seeing increasingly normalizing trends in collections.

E-way bill growth points to improving picture

a. Inter State (in per cent)

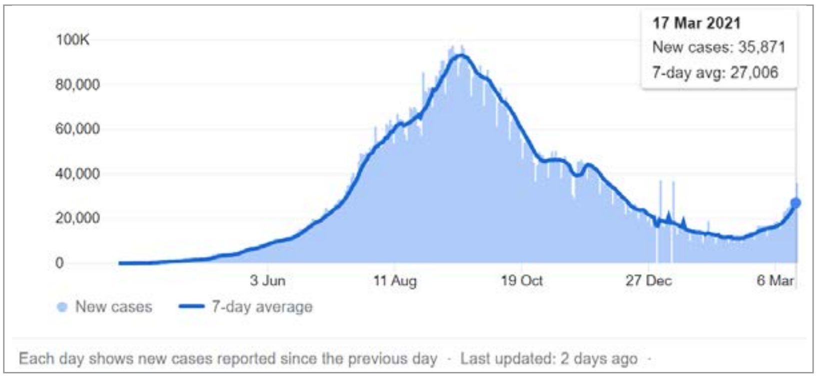
	Apr-20	May-20	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20
Telangana	-87	-59	-5	0	-5	16	27	18	32
West Bengal	-92	-74	-22	-20	-27	2	14	7	30
Tamil Nadu	-92	-66	-35	-23	-13	-2	32	10	23
Andhra	-83	-57	-9	-7	0	15	28	9	23
Gujarat	-89	-66	-28	-16	-11	13	28	1	15
Maharashtra	-90	-68	-33	-24	-16	-4	11	7	14
Karnataka	-91	-62	-17	-18	-7	0	14	3	13
Punjab	-88	-52	-5	8	3	4	21	13	13
M.P	-91	-62	-15	-3	0	12	27	12	11
Rajasthan	-93	-68	-19	0	4	6	19	6	10
Haryana	90	63	18	-5	-4	7	21	9	10
U.P	-91	-69	-10	-1	-4	0	18	10	8
Delhi	90	74	37	21	21	-12	4	-2	6

b. Intra State (in per cent)

	Apr-20	May-20	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20
Telangana	-53	-15	27	27	23	47	41	39	33
M.P	-82	-34	19	30	33	47	37	20	27
West Bengal	-76	-52	6	8	6	18	35	18	27
Tamil Nadu	-88	-54	-26	-16	-7	11	21	5	24
Andhra	-65	-30	8	6	6	21	19	16	22
Karnataka	-77	-35	1	-8	2	19	25	16	17
Punjab	-82	-32	13	22	23	22	23	11	16
U.P	-78	-46	-3	2	-4	10	17	3	14
Gujarat	-81	-50	-12	-2	1	18	36	7	14
Delhi	-82	-62	-25	-13	-11	0	8	0	14
Maharashtra	85	60	-23	-19	-7	7	17	6	12
Haryana	-91	-66	-20	-5	6	15	29	7	11
Rajasthan	81	40	2	12	7	12	16	3	8

Source: CEIC

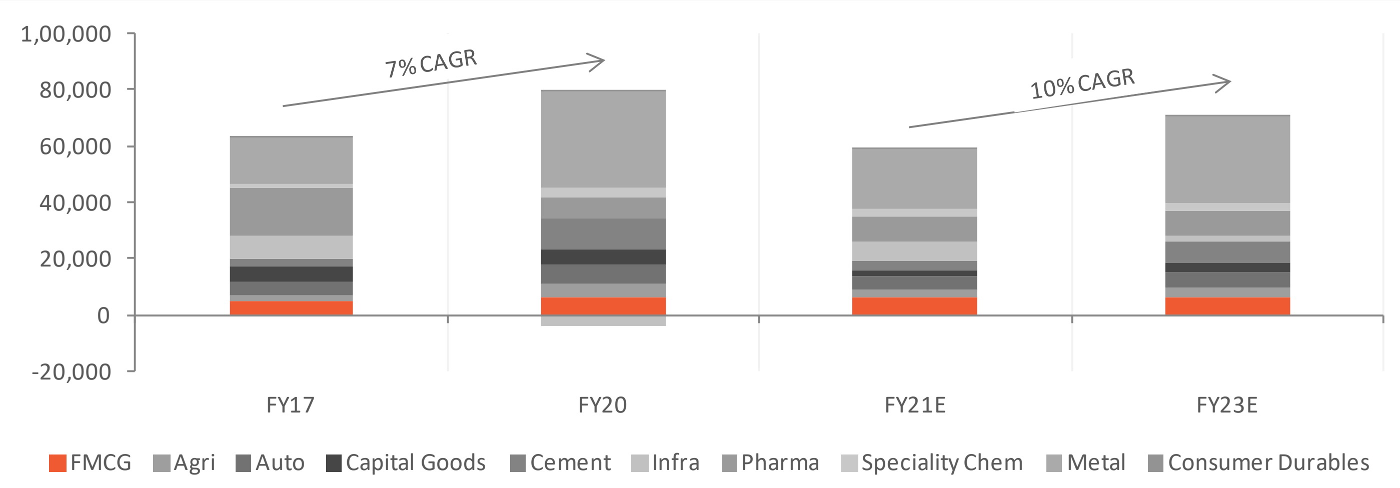
While the battle with COVID 19 is still on (and the picture is still evolving), the decline in the new cases (seen in India) over last few months, the development and deployment of vaccine are healthy trends which indicate the probability of sustained business activity levels and economic recovery are increased and likely to sustain.



Source: JHU CSSE COVID-19 Data

The revival in private-sector capex along with a V-shaped recovery, will be positive and with expectations of GDP growth crossing 10%+ in FY22 (as estimated by several agencies), we believe that it will augur well for a pick-up in the automobile sector as well.

Revival of Private Capex



Source: RBI, Media report, Sharekhan Research

Due to the fact that Vehicle financing NBFCs cater to informal borrower segments which are vulnerable and impacted by a weaker economic profile of the economy. Hence, an improving economic outlook, will be positive for their collection efficiency and disbursements.

Liquidity and interest rate environment to stay steady; augurs well for NBFC margins

The RBI, for the near foreseeable future, has stated that its stance of liquidity management remains accommodative and completely in consonance with its monetary policy stance. The RBI stands committed to ensure the availability of ample liquidity in the system and thereby foster easy financial conditions for the recovery to gain traction. Hence, supportive government and RBI policies in terms of keeping liquidity conditions benign and other measures (such as the TLTRO scheme) have significantly helped NBFCs segment in tiding over through the challenging past year. The accommodative monetary policy stance, with the real call rate in negative territory, tracking near eight-year lows has been beneficial for wholesale funded entities, such as NBFCs.

Corporate Bond yeild and spread

Products	Yeilds				Spreads		
	Rating	Dec-20	Jan-21	Variation	Dec-20	Jan-21	Variation
		Percent		(BPS)	(BPS)		
PSU Banks & Fis	AAA	4.89	4.96	7	43	26	-17
	AA	5.56	5.62	6	114	92	-22
	BBB-	8.76	8.75	-1	430	405	-25
Corporate	AAA	4.76	4.85	9	30	16	-14
	AA	5.62	5.74	12	116	105	-11
	BBB-	9.57	9.69	12	512	500	-12
NBFCs	AAA	4.94	4.96	2	48	27	-21
	AA	6.28	6.34	6	182	164	-22
	BBB-	10.56	10.62	6	611	592	-19

Source: FIMMDA

Corporate bond yields remained stable and spreads narrowed across the rating spectrum and issuer categories, reflecting that easing of risk premia and a congenial policy environment. Average spread of 3-year AAA rated corporate bonds over the G-sec yields of corresponding maturity issued by (i) public sector undertakings (PSUs), banks and financial institutions (FIs), (ii) corporates and (iii) NBFCs declined by 17 bps, 14 bps and 21 bps, respectively, in January. Even spreads on three-year BBB- rated bonds - the lowest rated investment grade bonds - issued by these entities narrowed by 25 bps, 12 bps and 19 bps, respectively, reflecting reduced risk aversion and benefitting from a system flush with liquidity.

We believe that while interest rates are likely to hold for the medium term, but on the incremental basis, they still remain below portfolio funding costs, and hence, as liabilities come up for re-pricing, the overall cost of borrowing for NBFCs should continue to decline.

Further, due to the nature of the industry, loan yields at a portfolio level are unlikely to move much lower, given that the back book is usually fixed rate (lesser proportion will re-price), and also lesser competitive intensity and not much pricing pressure (especially given the absence / or minimal presence of banks) in new loans in the segments.

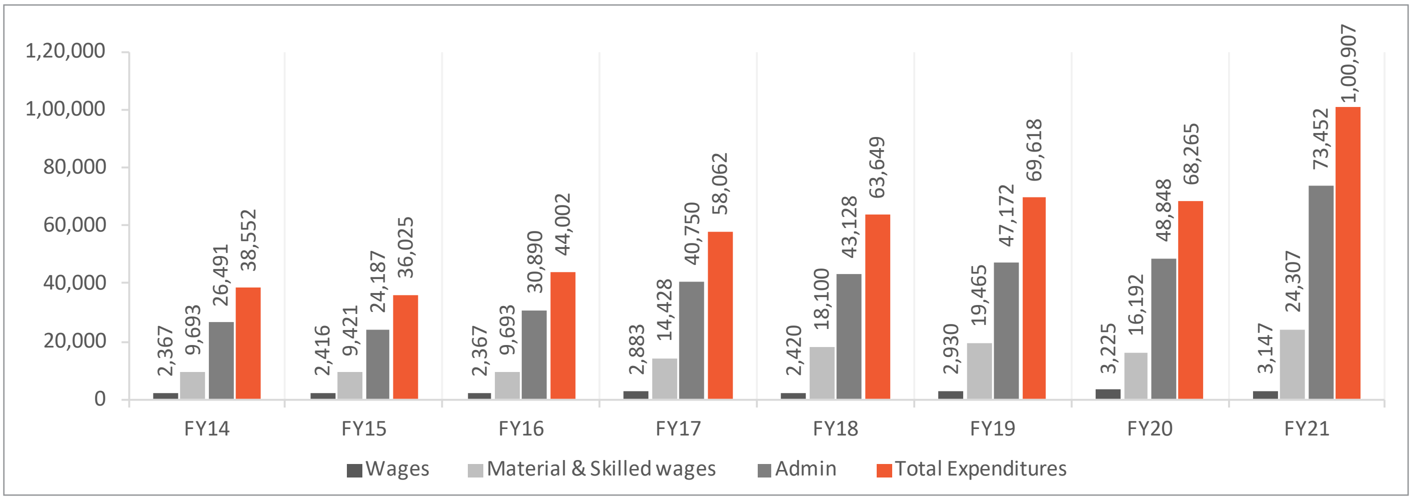
Further, as economic and funding scenario improves and sustains, we believe that NBFCs would also be winding down excess liquidity they are carrying, which should support their net interest margins.

Rural economy well–placed to see strong growth pick-up

The Rural economy and the agriculture sector are likely to see strong a growth pick-up, helped by factors such as a good monsoon, high reservoir levels, increase in crop sowing, etc. Moreover, the non-farm sector is expected to be helped by increased government spending, road construction, etc. which are likely to aid growth.

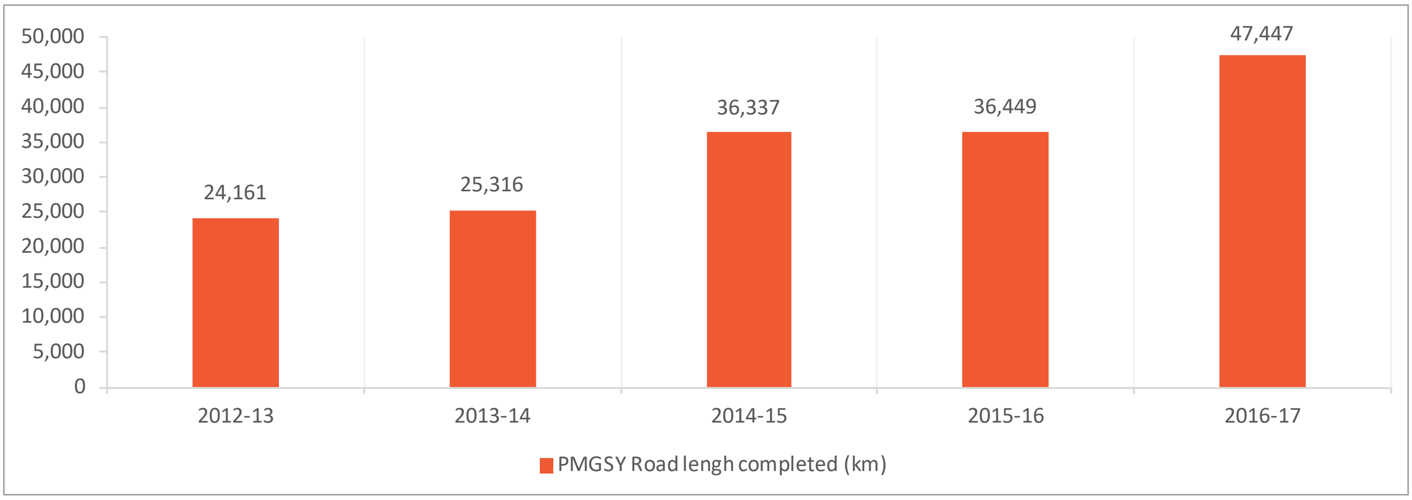
Even on a long-term basis, there is a structural case for the share of rural sales in overall auto sales to go up, given the under penetration, lack of requisite last-mile connectivity, rural road network expansion, etc. We believe that the above factors can help further accelerate, and provide a cyclical fillip for Vehicle financing NBFCs, which have a relatively higher share of their own business linked to the rural economy, and therefore stand to benefit.

Steady rise in Rural expenses (MGNREGA)



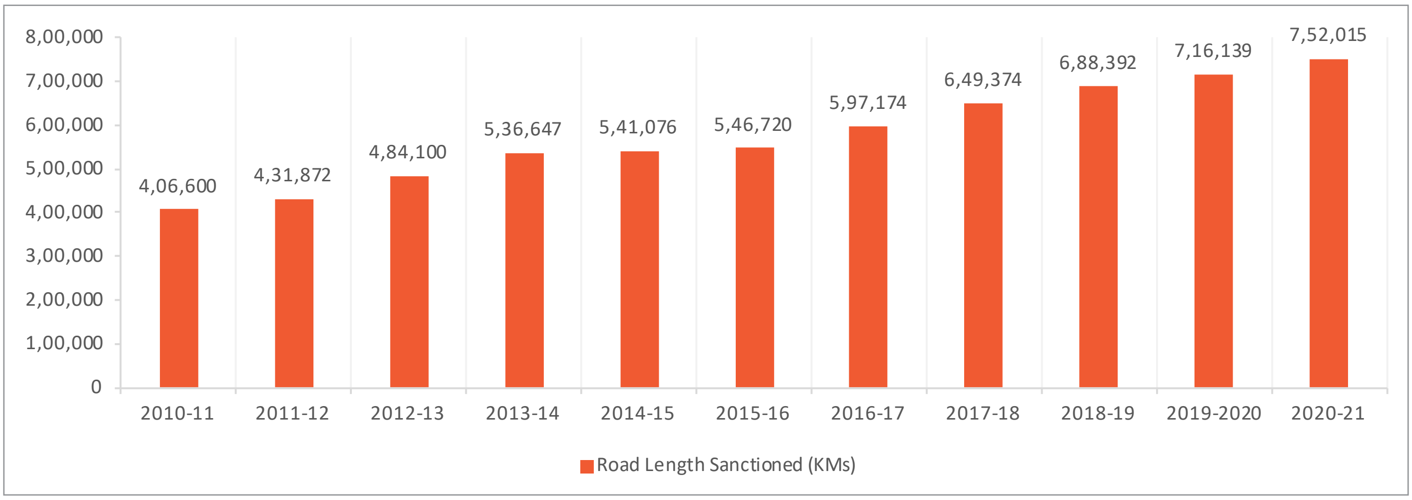
Source: Ministry of Rural Development

Steady rise in Rural road construction



Source: Ministry of Rural Development

Rural Road Length sanctioned



Source: PMGSY, Sharekhan Research

Better days ahead for auto financiers

The auto finance industry's outlook has improved as disbursement growth is recovering. The small car segment is expected to have higher growth over large vehicles. Loan-to-value (LTV) ratios are expected to reduce in near term by 0.5-1.0%, and thereafter increase post FY21.

Segment Wise growth in disbursements

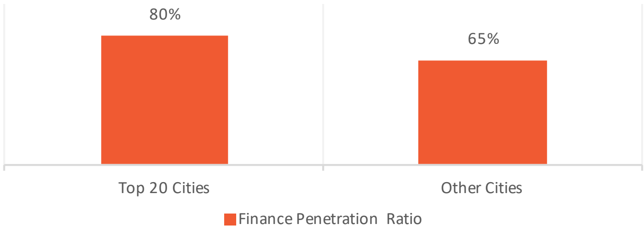
Particulars	FY14E	CAGR FY14-FY20	FY20E	FY21 (P)	FY22 (P)	FY23 (P)	CAGR FY20-FY23 (P)
	Rs bn	%	Rs bn	Rs bn	Rs bn	Rs bn	%
Passenger Vehicle	696	8%	1128	973	1170	1340	6%
Commercial Vehicle	319	9-10%	541	315	513	643	5-6%
Two Wheelers	140	14%	310	272	304	365	6%
Three Wheelers	64	9%	107	60	86	98	-3%

Source: Company, Sharekhan Research

Passenger vehicle penetration in India is still a long way to go as compared to other developed economies.

Car & UV Loan Portfolio	Top 20 Cities	Other Cities
Finance Penetration Ratio	80%	65%
Banks	17%	9%

Source: Company, Sharekhan Research



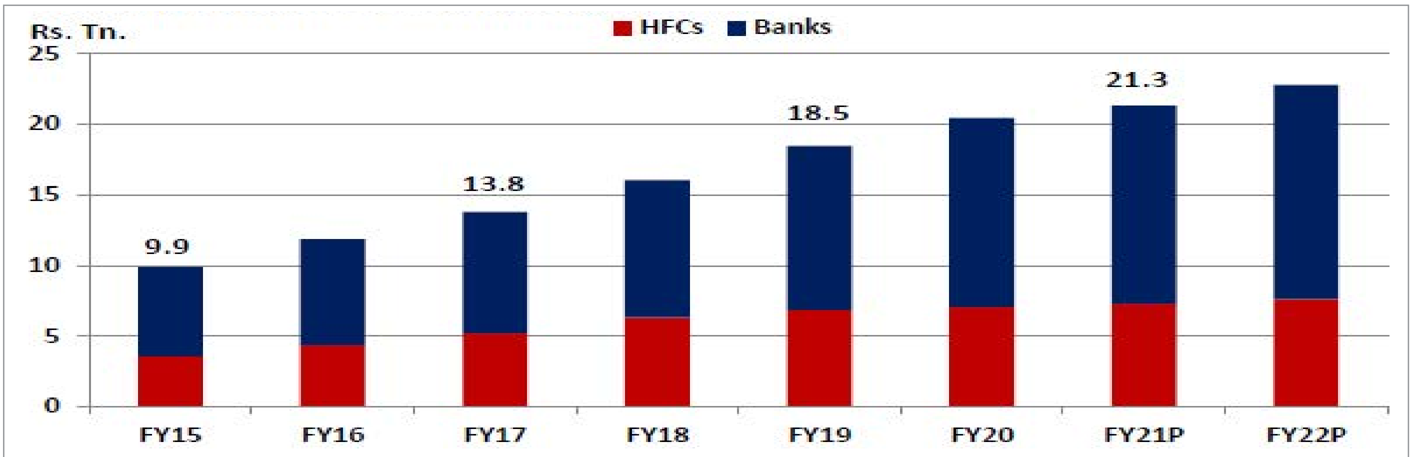
We believe a NBFC with a strong connect with dealerships and captive customer base is likely to maintain market share.

Housing Finance Growth

While growth in home financing has expectedly slowed down, it is likely to recover post COVID-19. Housing Credit outstanding is estimated to grow by 3-5% in FY21 and by 7-9% in FY22. The growth rate of banks is likely to be double that of HFCs in FY2021 due to lower interest rates and also a lower demand for bank credit.

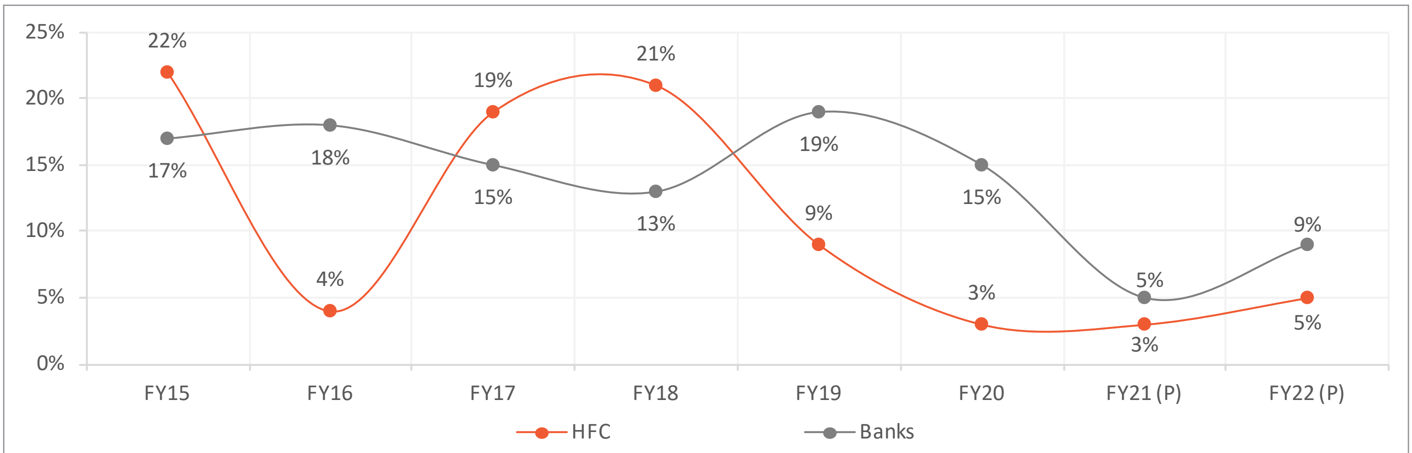
However, average home loan rates have reduced by 100 bps in the last one year. Even though delinquencies have risen in FY21 with growth slow growth and seasoning of portfolio, profitability has reduced. Positive actions taken by government like liquidity support and regulatory forbearance on asset quality have helped the sector.

Housing Portfolio size and market share



Source: Company, Sharekhan Research

Loan Book Outstanding Growth Rate



Source: Company, Sharekhan Research

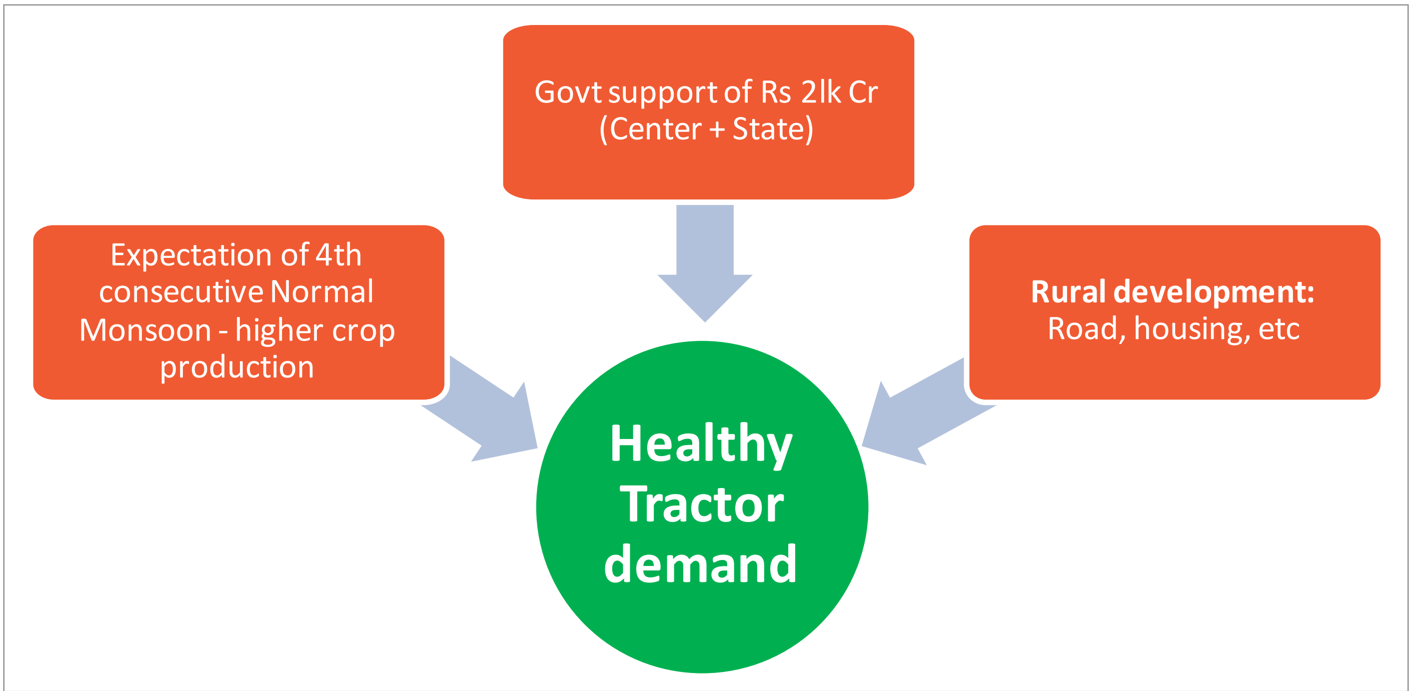
The rise in penetration of financing in Tier II/ smaller towns would fuel loan growth. Mortgage penetration in India is 9-11 years behind other regional emerging markets such as China and Thailand. Yet, higher disposable incomes, urbanisation and increased mortgage and finance penetration remain long-term growth drivers.

Tractor Industry – improving prospects

Easy credit availability, fund access, and high usage of tractors in farming operations have led India to be one of the largest markets for tractors, globally. To retain its status as a global leader in the agricultural tractor industry, the Indian government is actively involved in the credit and subsidy process.

Domestic sales declined by ~10% in 2019-20 after three years of robust growth where the industry grew by 22%, 22% and 8% in 2016-17, 2017-18 and 2018-19 respectively owing to poor commercial demand. According to CRISIL Research, domestic tractor demand is expected to be resilient in 2020-21 and will pick up in 2021-22.

Factors mentioned below are expected to aid the tractor sales growth & demand



Source: Company, Sharekhan Research

Already reeling under subdued consumer sentiment, domestic sales were further hit by supply chain disruptions due to the COVID-19 outbreak which hit production at manufacturing facilities in India during mid period of CY2020. However, since the last few months, substantial progress has been made in developing alternate sources for procuring components. The business was hugely impacted by the lockdown just before the start of festive days in large parts of the country. In compliance with regulations, the anticipated retail surge and billing totally stopped in all states.

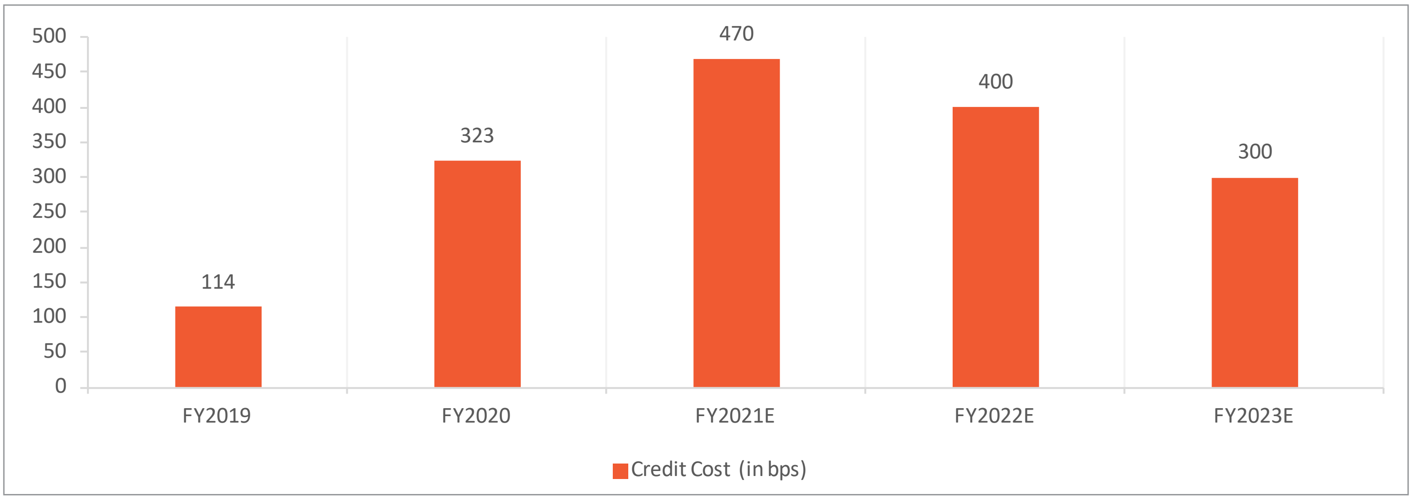
Why we like Mahindra Finance

Mahindra & Mahindra Financial Services (MMFS) has progressed well as a pan-India, rural-focused multi-segment diversified Auto financier (M&M group contribution ~45%); with high and stable credit ratings and strong operating metrics, which underline its high pedigree.

MMFS should benefit from improvement in RoE and earnings growth

We expect RoE and earnings growth to improve for FY2022E and FY2023E, as credit costs normalise and growth outlook improves.

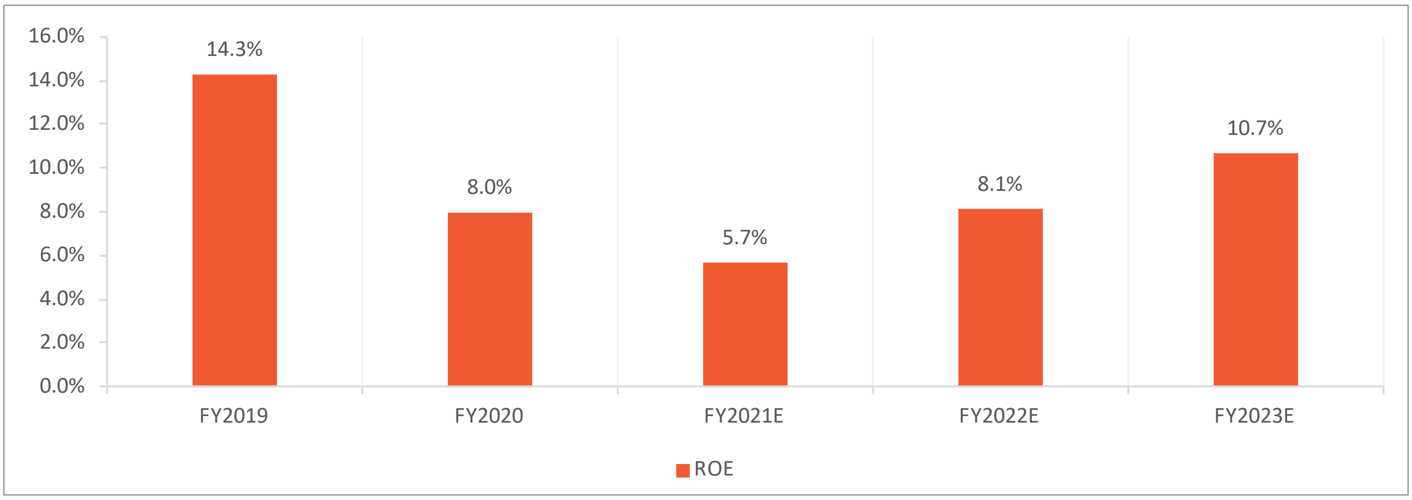
Credit cost (in BPS) on the path to normalcy



Source: Company, Sharekhan Research

MMFS has taken significant upfront provisioning and going forward, we expect its credit costs to move largely toward normalcy in F2022E and improve further in FY2023E, provided the economic strength is sustained. We expect economic recovery to also reflect positively on its credit costs, albeit with a lag.

Expected revival in ROE going forward

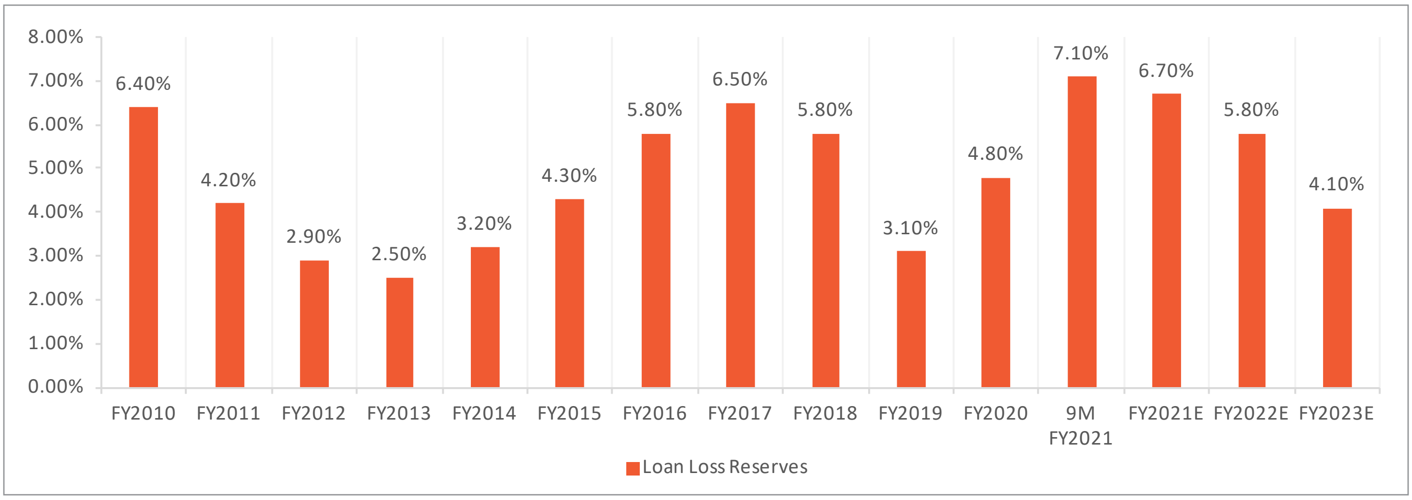


Source: Company, Sharekhan Research

Scope for multi-year re-ratings as credit costs set to decline

We expect a gradual re-rating over the course of next few quarters, as investors gain confidence in the improving credit cycle of MMFS. We believe that the firms' execution capabilities would be critical as it claws back on its recovery cycle. We believe a strong growth cycle and robust execution may drive faster re-rating for the NBFC.

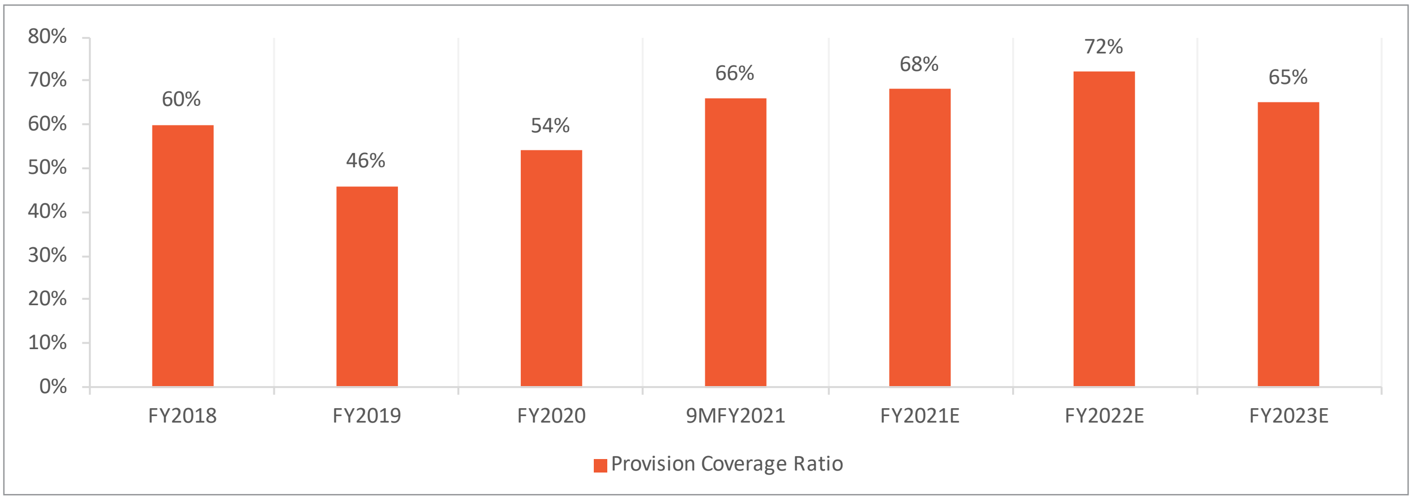
Loan Loss Reserves



Source: Company, Sharekhan Research

MMFS has been seeing a rise in its loan loss reserves over 9MFY2021 period. We believe that the same which are at multi-year high levels augur well and indicate lessening credit cost stress going forward for next 2-3 years.

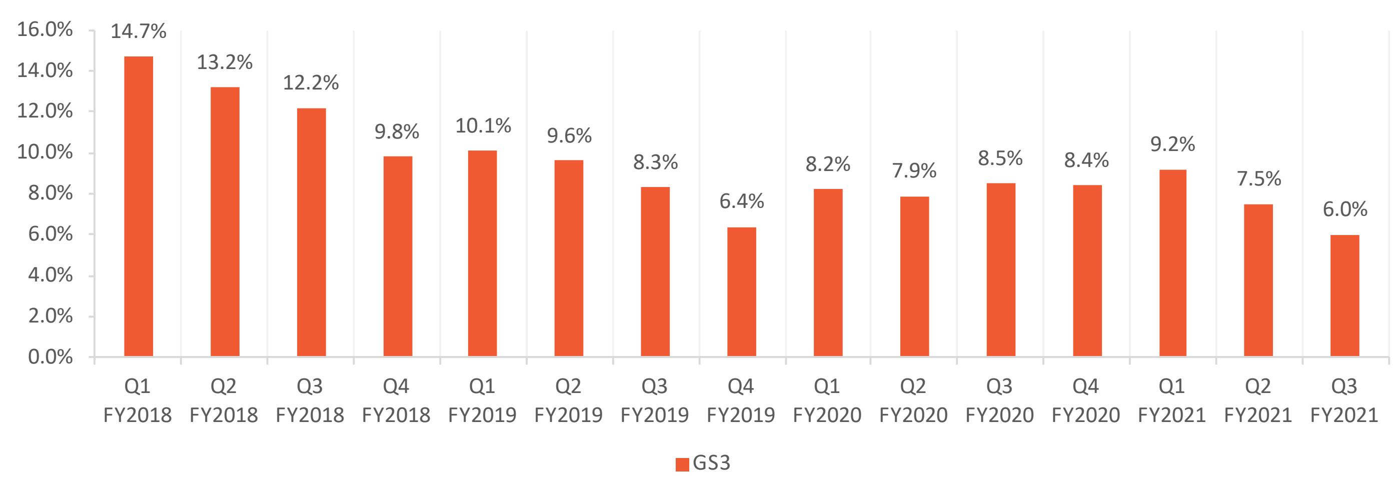
Provision Coverage Ratio



Source: Company, Sharekhan Research

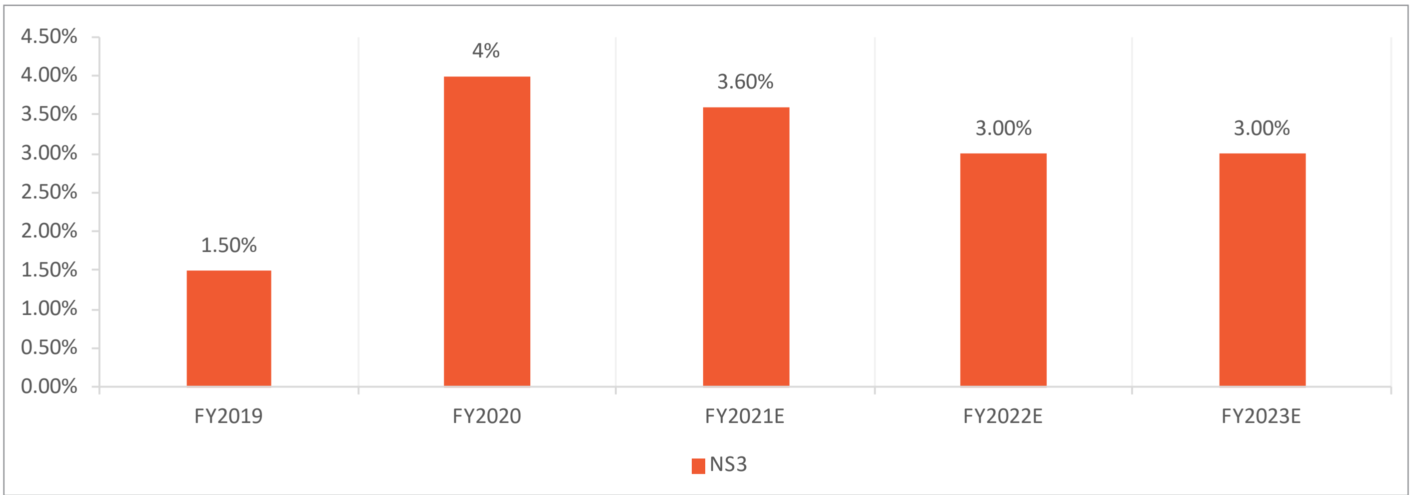
MMFS's Stage-2 ratio of 14% is higher than historical levels of ~10% (mainly due to the pandemic).

GS3 assets trending down



Source: Company, Sharekhan Research

NS3 assets expected to decline



Source: Company, Sharekhan Research

Helped by a high provision cover and improving economic scenario, we believe that credit costs forecasts for FY21-23 to be much lower than recent past for MMFS. This can help RoE recover, which would be a trigger for further re-rating of the stock.

Collection Efficiency, Moratorium and Restructuring

Collection Efficiency	October	November	Decemeber	Q3
FY2021	82%	84%	96%	88%
FY2020	88%	95%	95%	93%

Computed as (Current month demand collected + overdue collected) / (Curr Month demand due for the month)

Moratorium Availed contracts	Total No of Contracts	Nil collection in Q3 FY2021 - % of Nos
With amount due in Q3 FY2021	14,97,184	6%
Which had not made any payment till end Sep'20	2,74,061	16%

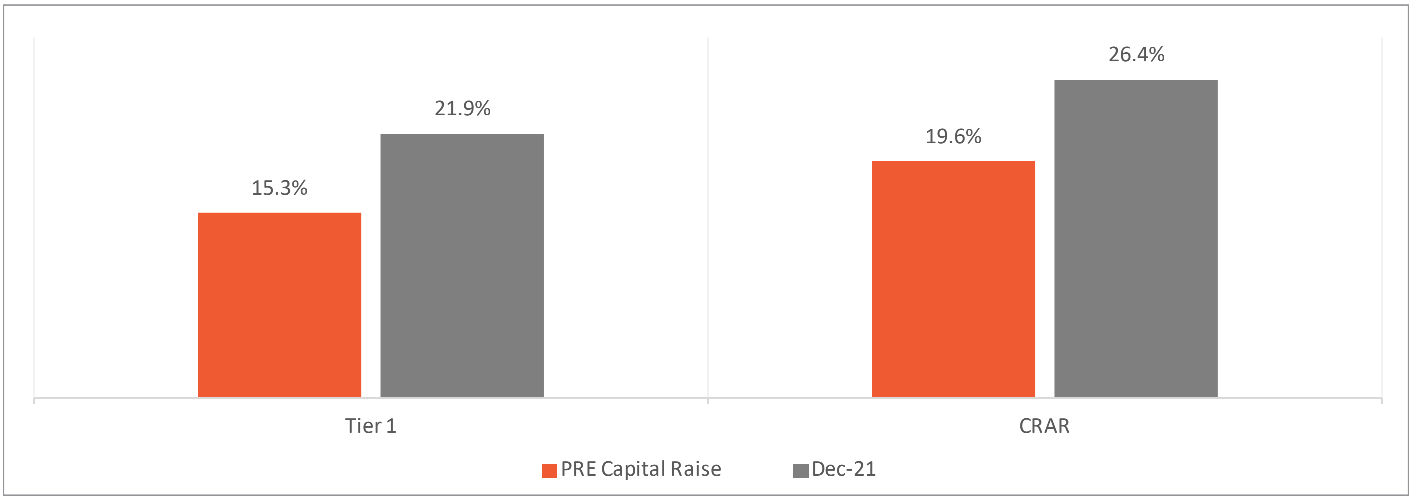
Source: Company, Sharekhan Research

Hence, while FY2022E will be the recovery year, the same is also likely to flow into FY2023E as well. We believe that the company is likely to see twin benefits of lower new bad loan formation, as well as also see improved loan recoveries and hence write-backs of provisions made in F2021E.

Rights issue augments Capital base, well placed to capture growth

MMFS augmented its capital base via a rights issue which not only saw its Tier-1 ratio rise, but also added to its net worth. The fund-raising has taken the Tier 1 ratio to 21.9% (added 680 bps to CRAR) and makes the company well-placed to capture growth opportunities.

Rights issue / Capital raise bolsters CRAR by 680 BPS

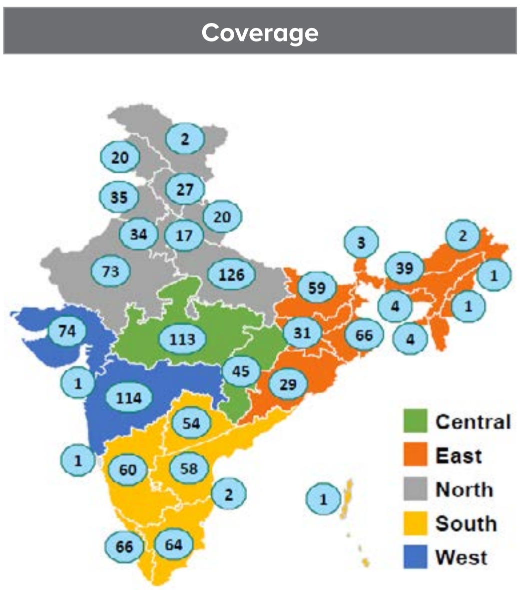


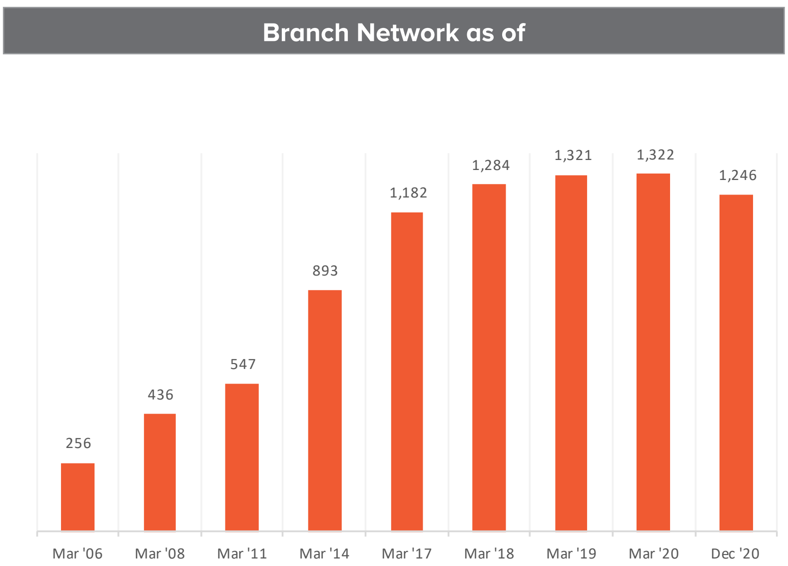
Source: Company, Sharekhan Research

Strong Distribution network, to capture uptick with diversification

Essentially, MMFS has a strong and large network with on-ground presence. This not only enables wide reach and geographic diversification but is also a growth trigger, which the company can take advantage of as the cycle turns.

Extensive Branch Network





Source: Company, Sharekhan Research

Controlling operating expenses can boost ROE

MMFS has been hinting at operational and structural tweaks which along with structural technology-led cost control initiatives can result in lower core operating expenses, which can add to its RoE. While for 9M FY2021, the company saw a fall in opex and an opex ratio of 2%, we believe that for the medium term as business and costs normalize, there is likely to be a rise in opex. However, with a pick-up in disbursements and a rise in AUM and therefore better branch utilisation, we expect the Opex to AUM ratio to decline.

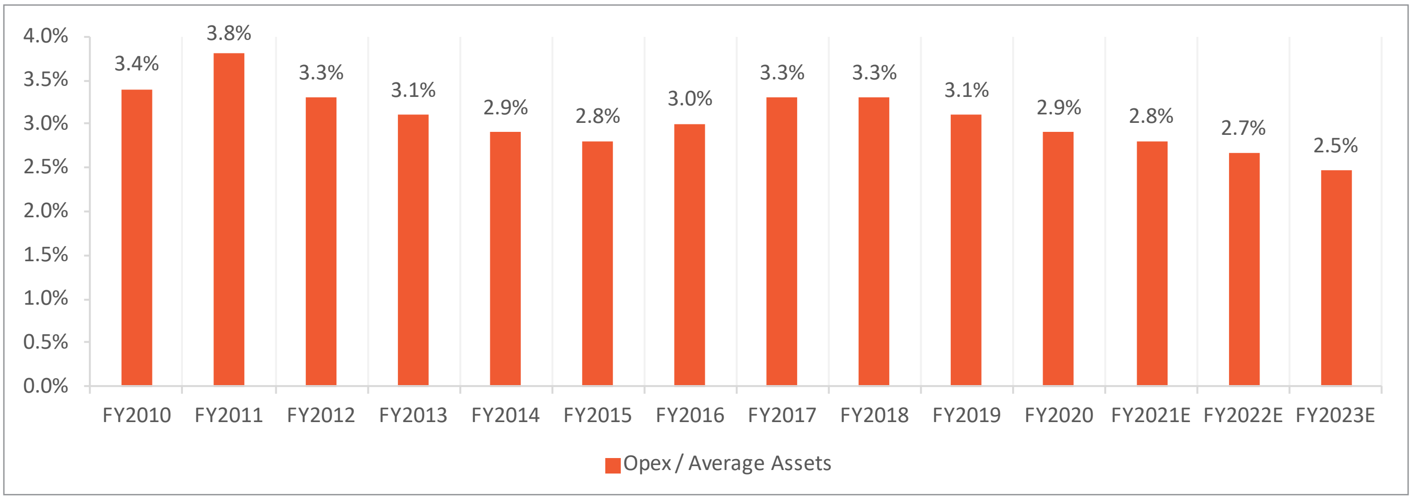
ROAA COMPONENTS

ROAA breakup	FY19	FY20	FY21E	FY22E	FY23E
NII as % of AVG. ASS	7.9%	7.4%	7.6%	7.3%	7.0%
NON INT. as % AVG. ASS	0.1%	0.2%	0.2%	0.2%	0.2%
Less: Op COST as % of AVG ASS	3.0%	2.8%	2.4%	2.3%	2.2%
Less: Impairments as % of AVG ASS	1.1%	2.9%	4.0%	3.2%	2.4%
Less: TAX as % of AVG ASS	1.4%	0.6%	0.4%	0.5%	0.7%
ROAA	2.6%	1.3%	1.1%	1.5%	1.9%

Source: Company, Sharekhan Research

Intuitively, if MMFS is able to cut opex by 50 bps, it can potentially result in structurally adding at ~280 bps to its RoE at normalized leverage, which will be significant. We believe that this is an additional positive for its valuation and would depend on successful execution.

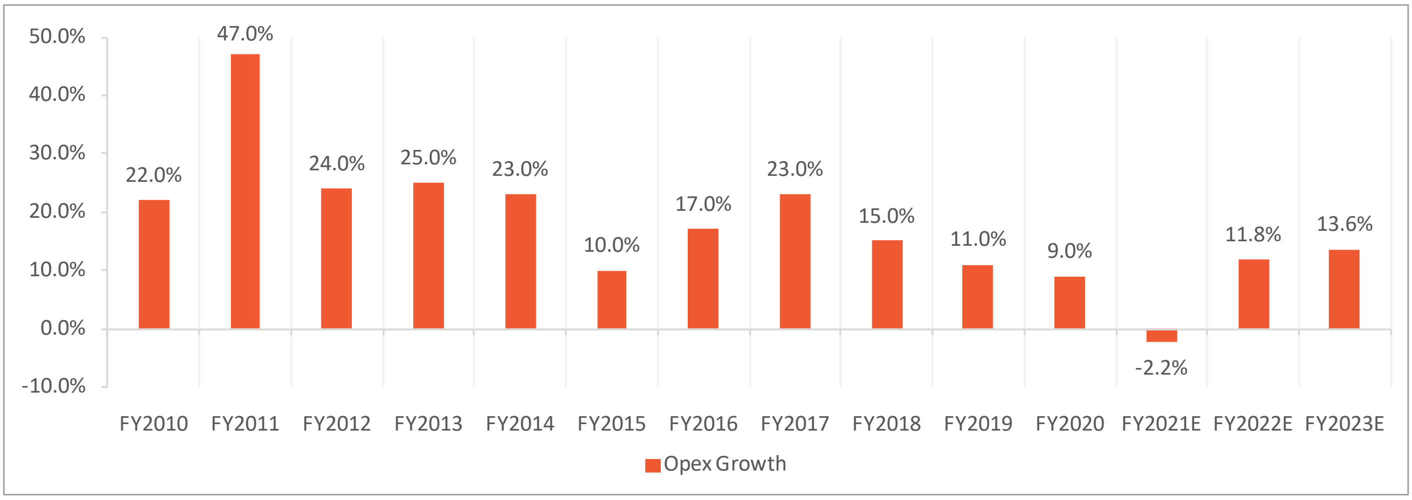
Opex as proportion of Average Assets expected to trend down



Source: Company, Sharekhan Research

Even as the opex to AUM ratio has fallen in FY21E, we expect normalisation and some pickup in FY22E and FY23E as MMFS steps up growth efforts.

Opex growth to rationalise going forward

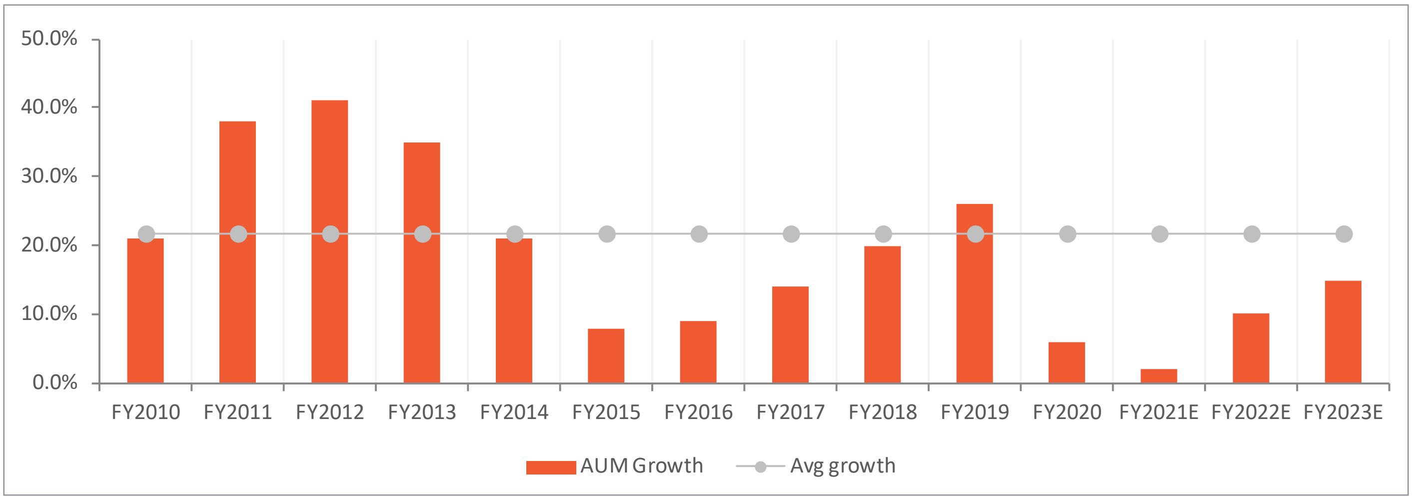


Source: Company, Sharekhan Research

Auto sales growth to drive up AUMs

India's GDP is expected to make a strong comeback in FY22E after a pandemic-hit FY21. Auto sector being closely linked with the fortunes of the economic activity is also expected to benefit. Hence, as vehicle sales pick up in FY22E, we expect a logical conclusion to be vehicle financier's disbursements to also rise as well. Further while we have not factored in ticket size increase, the same will also be a factor in to aid growth for players like MMFS.

AUM growth expected to pickup in FY2022E and FY2023E



Source: Company, Sharekhan Research

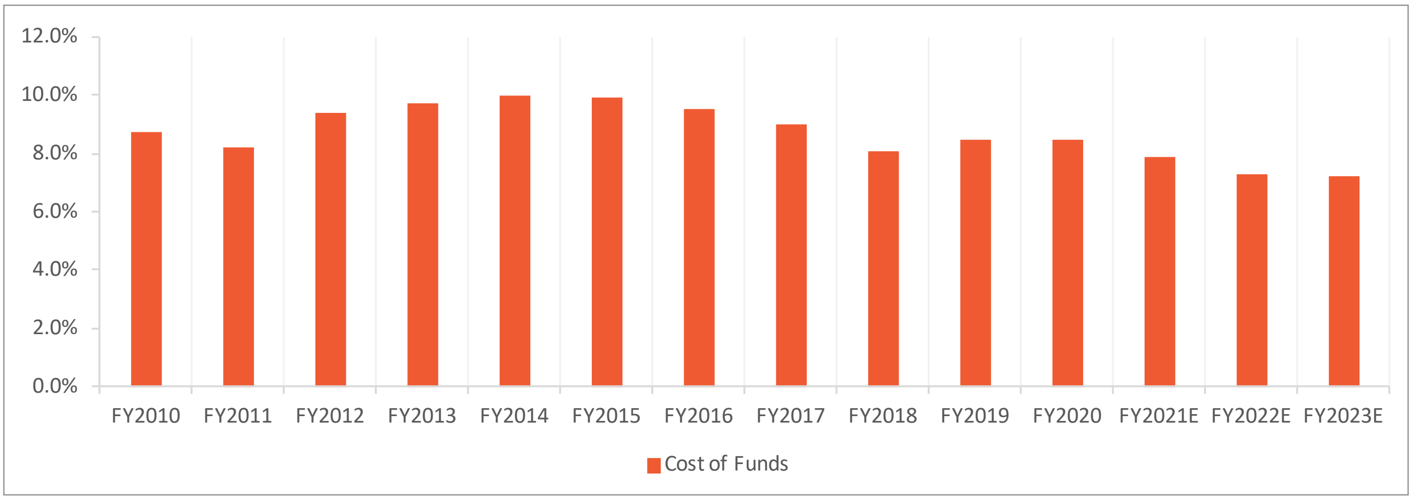
MMFS' management too has indicated that while they expect Q4FY21 volumes to be closer to pre-COVID19 levels, they expect growth to revert to normal from H2FY22 onwards. Segments driving the same are expected to be CVs (aided by infrastructure push, pick-up in mining activities and overall economic pickup), used tractors (MMFS has a strong leadership position in the tractor market, and can aggressively target the used tractors segment both within existing customer and new customers base) and revival/normalisation in demand from pandemic-hit segments (e.g. taxi operators, tour operators, etc).

Falling Cost of funds – provides cushion for NIMs

MMFS has been able to maintain its NIMs well, helped by its consistent high credit ratings and improving yields. We expect NIMs to be on a positive trajectory due to lower cost of funds.

However, higher liquidity on the balance sheet, which the company has been maintaining on a prudent basis, has been a drag on the margins, due to lower yields on liquid assets.

Falling cost of Funds, to continue benefiting MMFS as re-pricing happens



Source: Company, Sharekhan Research

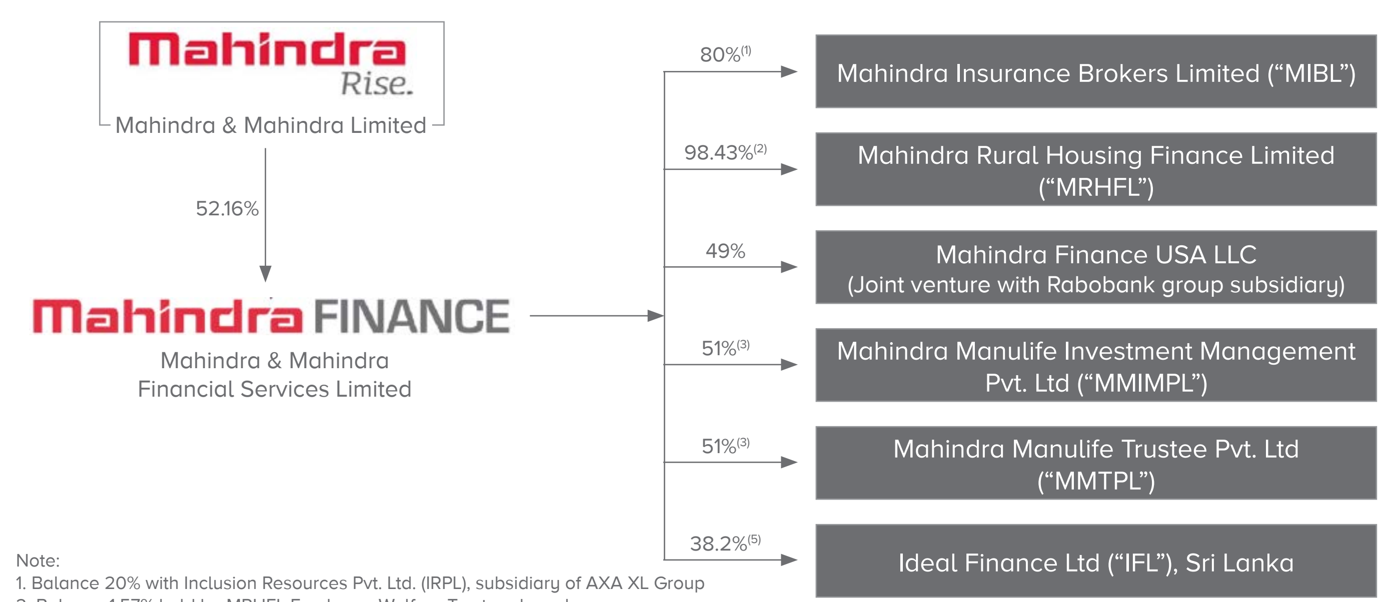
Company Background

Mahindra & Mahindra Financial Services has decades of rich experience in the financial sector and the expertise of the management provide the company a deep insight into customer requirements.

The company provides a wide range of financial products and services through a nationwide distribution network. It has presence in multiple businesses and with its 'AAA' credit rating is well placed in the rural India.

MMFS is the Preferred partner of prominent original equipment manufacturers (OEMs) and associated with nearly 9,000 dealers providing assured business and cross-sell opportunities.

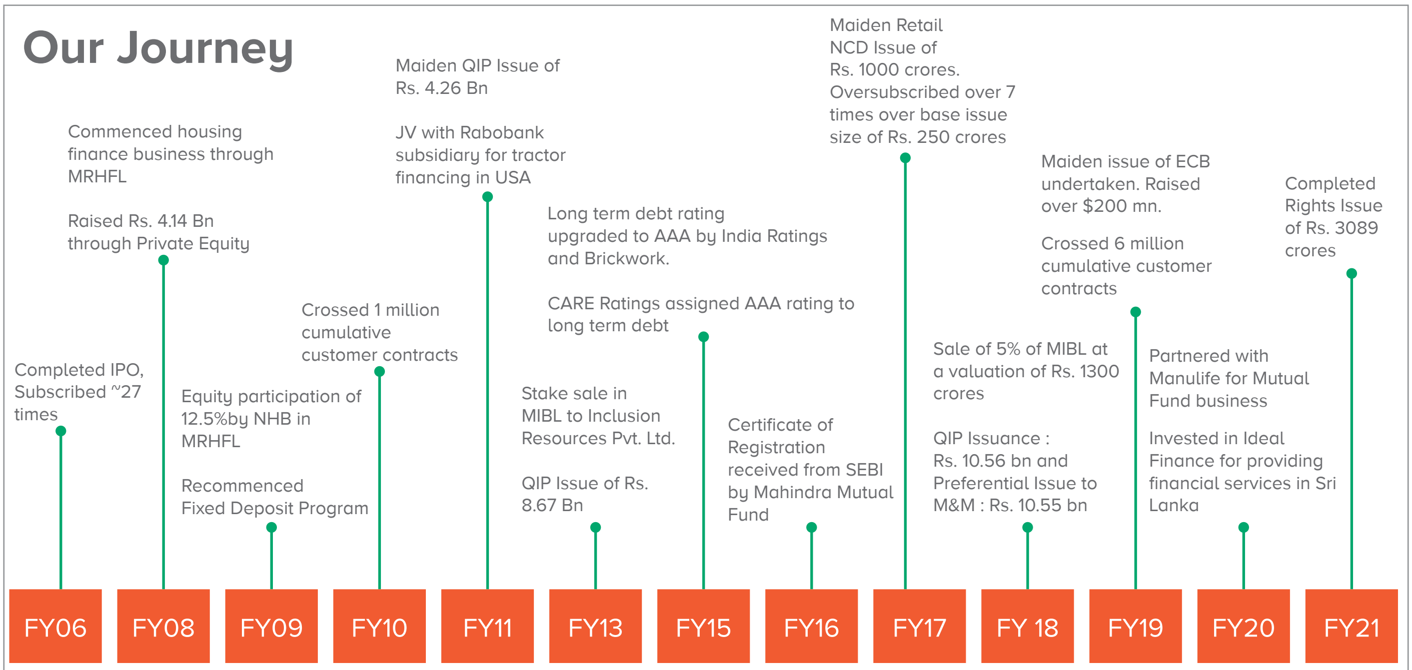
MMFSL Group structure



Note:
1. Balance 20% with Inclusion Resources Pvt. Ltd. (IRPL), subsidiary of AXA XL Group
2. Balance 1.57% held by MRHFL Employee Welfare Trust and employees
3. Manulife Investment Management (Singapore) Pte. Ltd. holds 49% of the shareholding of MMIMPL and MMTPL.
4. Mahindra Finance CSR Foundation is a wholly owned subsidiary to undertake all CSR initiatives under one umbrella
5. The Company has entered into a subscription agreement to acquire 58.26% of IFL and has remitted an amount of Rs.440 million towards acquiring 38.2% of its equity share capital

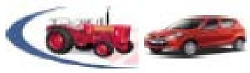
Source: Company, Sharekhan Research

Evolution and development



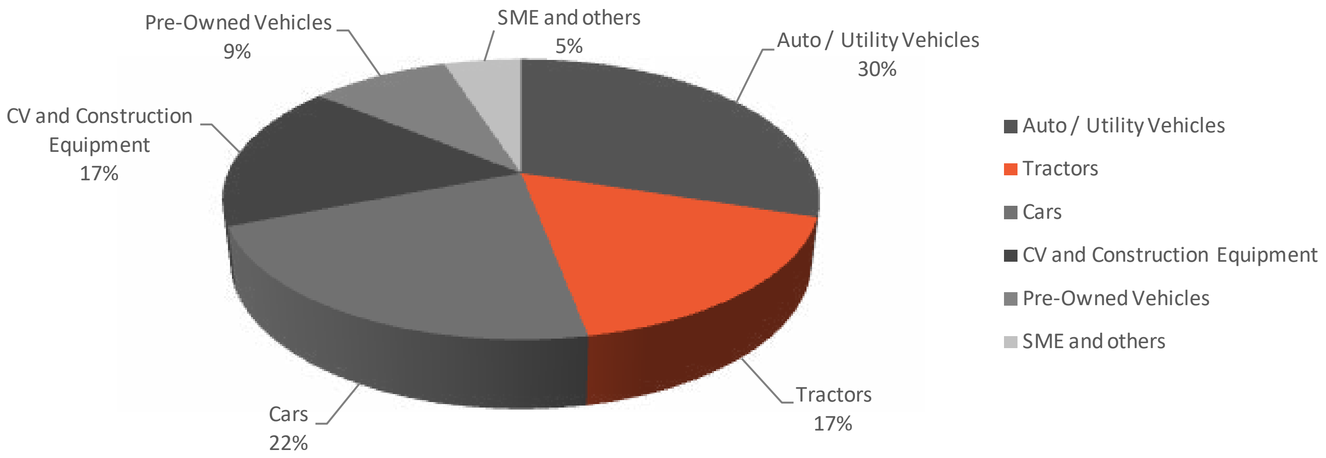
Source: Company, Sharekhan Research

A diversified Product Portfolio

Vehicle Financing	• Loans for auto and utility vehicles, tractors, cars, commercial vehicles and construction equipments	
Pre-Owned Vehicles	• Loans for pre-owned cars, multi-utility vehicles, tractors and commercial vehicles	
SME Financing	• Loans for varied purposes like project finance, equipment finance and working capital finance	
Personal Loans	• Offers personal loans typically for weddings, children’s education, medical treatment and working capital	
Mutual Fund Distribution	• Advises clients on investing money through AMFI certified professionals under the brand “MAHINDRA FINANCE FINSMART”	
Insurance Broking	• Insurance solutions to retail customers as well as corporations through our subsidiary MIBL	
Housing Finance	• Loans for buying, renovating, extending and improving homes in rural and semi-urban India through our subsidiary MRHFL	
Mutual Fund & AMC	• Asset Management Company/ Investment Manager to ‘Mahindra Mutual Fund’, which received certificate of registration from SEBI	

Source: Company, Sharekhan Research

AUM Break-up

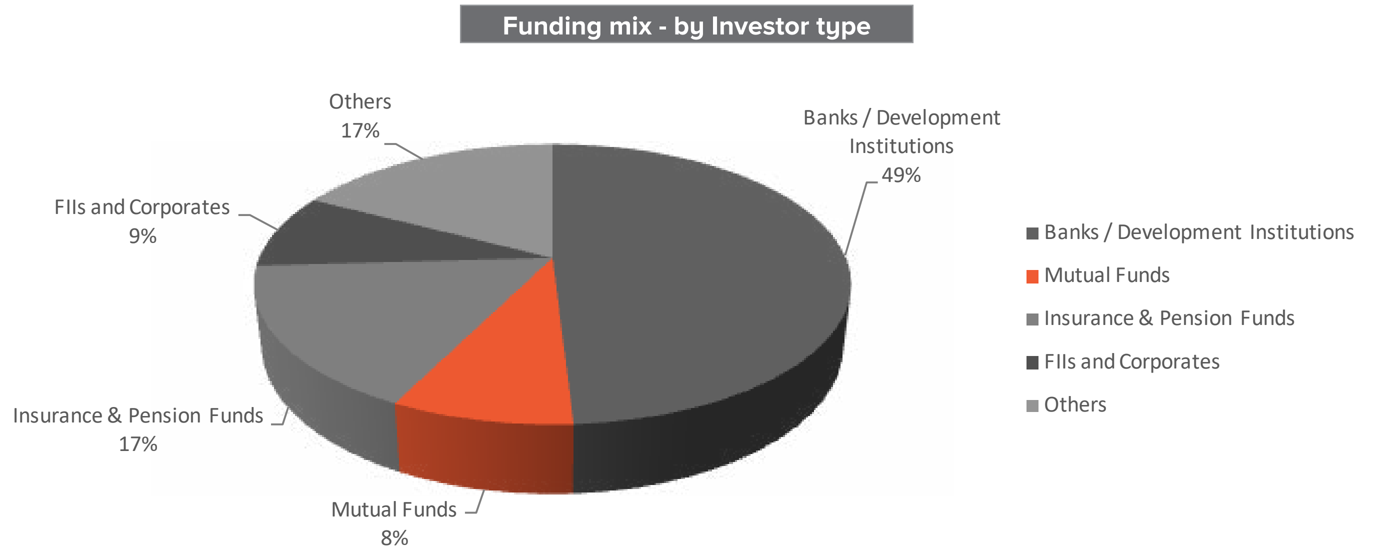


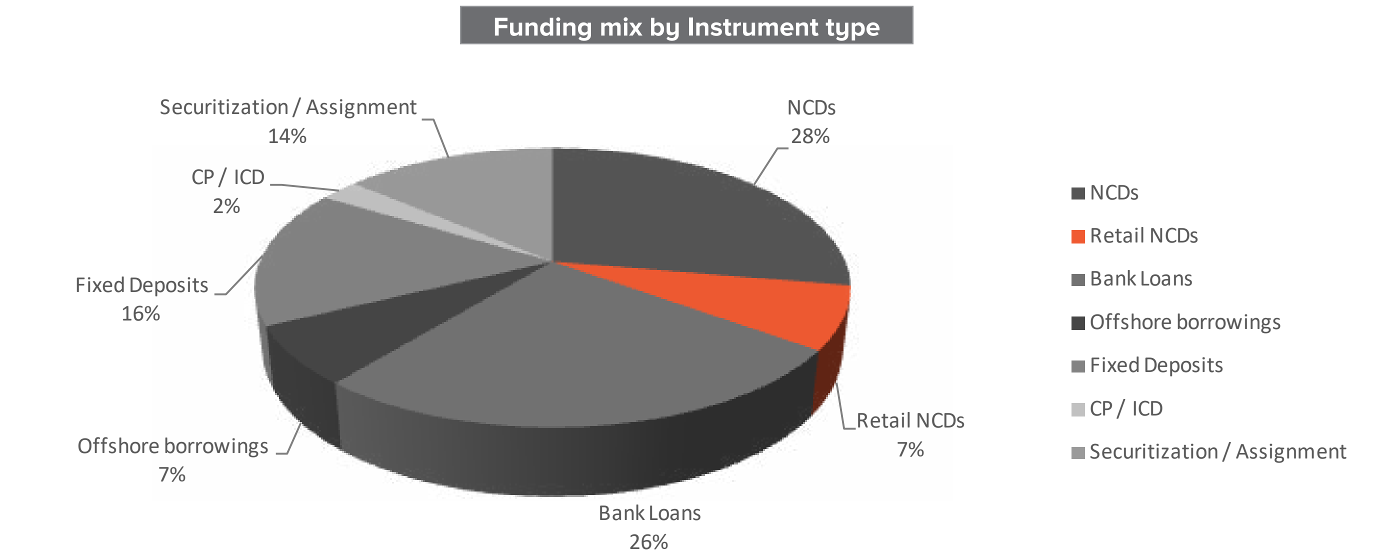
Source: Company, Sharekhan Research

Credit ratings

India Ratings has assigned AAA/Stable, CARE Ratings has assigned AAA/Stable, Brickwork has assigned AAA/Stable and CRISIL has assigned AA+/Stable rating to the MMFS’ long-term and subordinated debt.

Broad-based liability mix

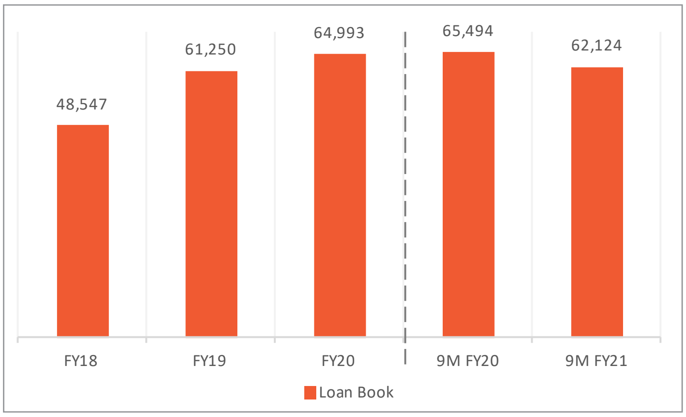




Source: Company, Sharekhan Research

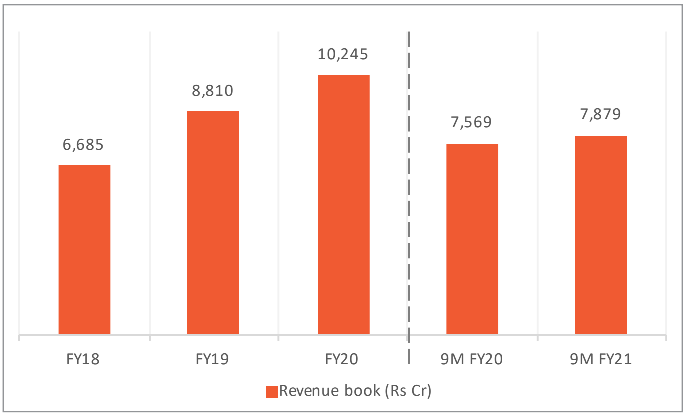
Financials in charts

Loan Book growth (Standalone; Rs crore)



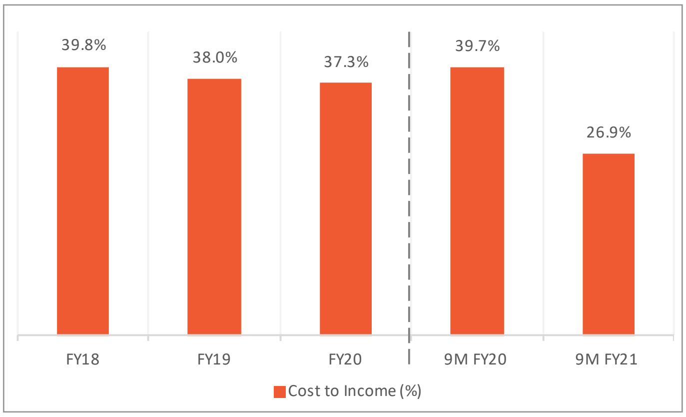
Source: Company, Sharekhan Research

Revenue growth (Standalone; Rs crore)



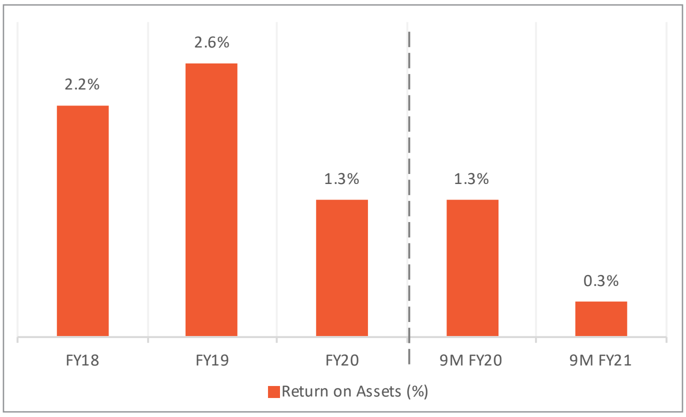
Source: Company, Sharekhan Research

Cost to Income (Standalone; %)



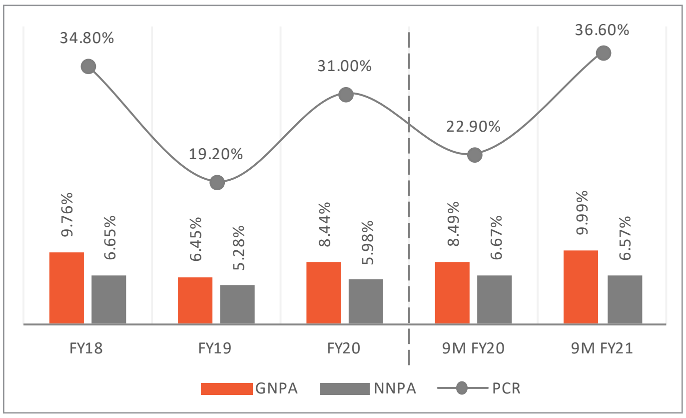
Source: Company, Sharekhan Research

Return on Assets Ratios (Standalone; %)



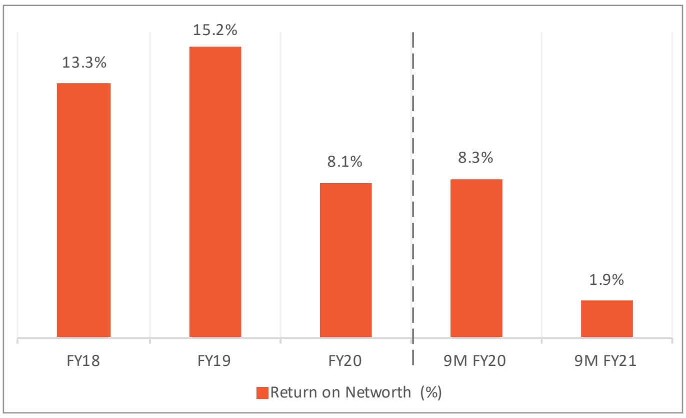
Source: Company, Sharekhan Research

Asset Quality (%)



Source: Company, Sharekhan Research

Return on Networth Ratios (Standalone; %)



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Green shoots in the economy encouraging; Rural segment a bright spot

Post the unlocking of the economy, financial services companies are reporting an incremental pick-up in credit demand. Leading indicators specify recovery in economic activity, which will be positive. Higher MSPs, increased Kharif sowing, good monsoons, and adequate water storage position are leading to increased tractor demand and overall resilience of the rural economy; therefore, the rural economy continues to be a bright spot at these times as well. A recovery in the vehicle finance (VF) sector over the past six months has been encouraging, with lower funding costs and improving traction (including sub-segments), among other factors. Asset-quality trends have also improved, driven by managements' assessment of a low restructuring pipeline. While the sector is not completely out of the woods, we expect a normalisation in H2CY2021. In this backdrop, aided by a strong parentage, highly rated and well-capitalised nimble NBFCs have ample growth opportunities as the market expands.

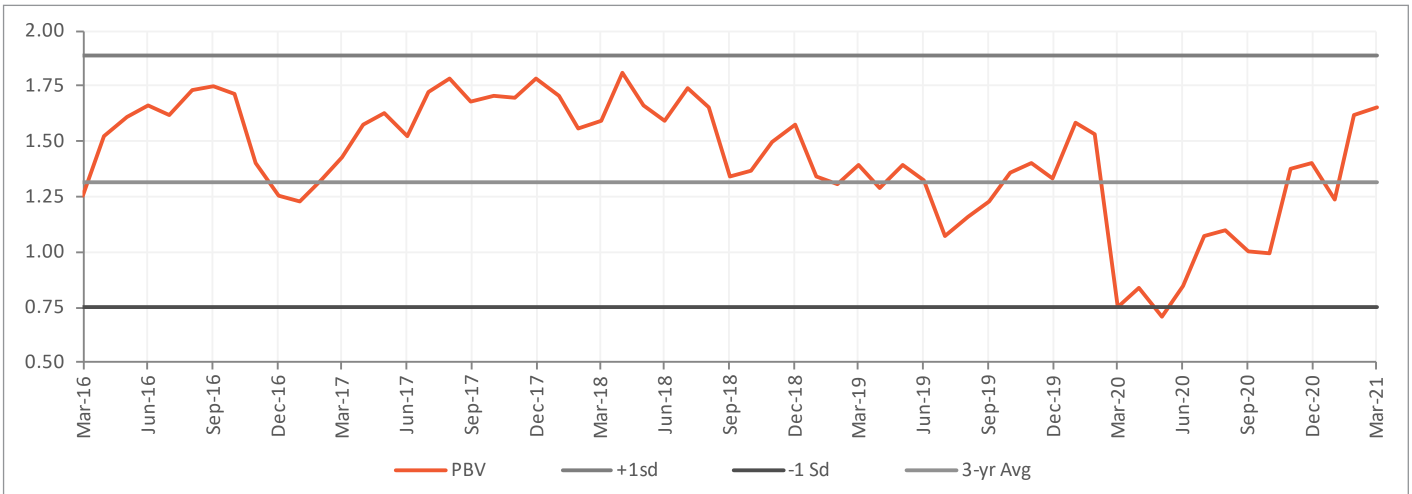
■ Company Outlook – Strong fundamentals make it attractive

Mahindra & Mahindra Financial Services (MMFS) has transformed in the past decade from primarily a financing entity for vehicle purchases (from parent M&M) to a leading multi-product NBFC in India with a pan India presence, deep penetration and strong network with a rural focus. Going ahead, we believe factors like normalization in credit costs (MMFS has took significant upfront provision till Q3 FY2021; FY2022E to see normalized credit costs) and pickup in AUMs in FY22E and FY23E (aided by Auto sales pickup, GDP growth and improved capex cycle leading to disbursement growth) will aid earnings growth and ROE expansion. Hence, while the past few quarters have been a challenge (due to pandemic, economic slowdown etc) for growth and asset quality, we expect a rebound in earnings and ROE for MMFS in FY2022E and FY2023E which we believe would be triggers for re-rating of the stock. Asset quality wise, the improvement in Collections is positive, and we expect the trend to continue, as Q4 is seasonally best quarter in terms of collections on strong farm cash flows. Going forward, management guides to keep Net NPAs at sub 4% levels and maintain PCR at 35-36%. Company has restructured only 1% of AUM which is also a positive cushion. Its subsidiaries, namely Mahindra Rural Housing Finance (MRHF) is expected to be strong franchise in the long term. Its Insurance broking business, Mahindra Insurance Brokers (MIBL) is an asset light broking business and has strong fee income engine in its favour. We believe that strong subsidiaries also add to the company's overall value.

■ Valuation – Initiate with a Buy, with a Price Target (PT) of Rs. 260

At CMP, the stock is available at 1.9x / 1.8x FY2022E / FY2023E on the standalone ABVPS, which we find attractive, given the improving growth outlook (resumption of economic activity, support from a resilient rural segment etc). We expect disbursements to grow in H2 FY22E and expect an AUM growth of ~10% / 15% for FY2022E & FY2023E. The asset quality outlook is improving, with collection efficiency surging to 96% in December (from 82% in October); the November number too saw the m-o-m improvement continuing. The management has indicated that <1% of portfolio can be potentially restructured, which is manageable; and improving cost of funds will be positive for NIMs. We expect operating expenses to AUM ratio to be 2.8-2.5% range and RoE improving to 8% and 10%, respectively for FY2022E and FY2023E. We believe that the buoyancy in rural markets augurs well for commercial vehicle (CV) financiers, and coupled with business benefits from a strong parentage, a well-capitalised balance sheet and rigorous risk management practices (provides long-term visibility) offer scope for improving operating leverage and Return ratios, which provides additional comfort. We initiate with a Buy rating on the stock with price target of Rs. 260.

One-year forward P/BV (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP	P/BVPS (x)		P/EPS (x)		RoE (%)		RoA (%)	
	Rs/Share	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
M&M Financial	202	1.5	1.4	19.8	13.8	7.8	10.3	1.5	1.8
Cholamandalam Investment	527	3.6	3.0	18.8	16.0	21.2	20.9	3.0	3.0
Shriram Transport Finance	1,327	1.4	1.2	10.9	9.1	13.2	14.1	2.4	2.6
Sundaram Finance	2,499	4.0	3.5	29.4	23.3	14.5	16.2	2.7	3.1

Source: Company, Sharekhan research

Financials

Statement of Profit and Loss Rs cr

Particulars	FY2019	FY2020	FY2021E	FY2022E	FY2023E
Total revenue from operations	**8,723**	**10,098**	**10,474**	**10,973**	**11,965**
Other income	87	147	155	162	171
Total income	8,810	10,245	10,628	11,135	12,136
Finance costs	3,945	4,829	4,579	4,830	5,439
Net Interest income	**4,757**	**5,210**	**5,825**	**6,068**	**6,445**
Expenses	-	-	-	-	-
Fees and commission expense	30	41	42	46	53
Employee benefits expenses	1,090	1,148	1,120	1,141	1,162
Depreciation, amortization and impairment	60	118	121	123	125
Others expenses	667	710	575	632	727
Pre-Provisions Operating Profit	3,018	3,398	4,192	4,364	4,630
Impairment on financial instruments	635	2,054	3,055	2,652	2,188
Exceptional items	-	-	-	-	-
Profit before tax	**2,382**	**1,344**	**1,137**	**1,712**	**2,442**

Source: Company; Sharekhan estimates

Key Ratios

Others Parameters	FY2019	FY2020	FY2021E	FY2022E	FY2023E
Tax / PBT	34.6%	32.5%	26.2%	26.2%	26.2%
Cost / Income	38.0%	37.3%	30.7%	30.8%	30.9%
Opex / AUM	3.0%	3.1%	2.8%	2.7%	2.5%
Total Income / Avg. Assets	14.7%	14.5%	13.9%	13.5%	13.1%
Intest Exp. / Avg. Assets	6.6%	6.8%	6.0%	5.8%	5.9%
Gross Spread	8.1%	7.7%	7.9%	7.6%	7.2%
Overheads / Avg. Assets	3.1%	2.9%	2.4%	2.3%	2.2%
W/o & NPA / Avg. Assets	1.1%	2.9%	4.0%	3.2%	2.4%
Net Spread	4.0%	1.9%	1.5%	2.1%	2.6%
NIMs	7.9%	7.4%	7.6%	7.3%	7.0%
RoE	14.3%	8.0%	5.5%	7.8%	10.3%
RoA	2.3%	1.2%	1.1%	1.5%	1.8%
Per Share Nos					
EPS	25.3	14.7	6.8	10.2	14.6
Adj. BVPS	124.1	120.2	104.5	113.9	121.8
Asset Quality					
GS-3%	5.9%	8.4%	9.2%	7.5%	6.0%
NS-3%	4.8%	6.0%	3.6%	3.0%	3.0%

Source: Company; Sharekhan estimates

Balance Sheet **Rs cr**

Particulars	FY2019	FY2020	FY2021E	FY2022E	FY2023E
Financial Assets					
Cash and cash equivalents	502	677	4,021	4,191	3,973
Bank balance other than (a) above	457	749	764	840	966
Derivative financial instruments	10	93	93	93	93
Receivables	5	9	9	10	11
Loans	61,250	64,993	66,293	72,922	83,860
Investments	3,792	5,911	6,029	6,632	7,627
Other financial assets	169	477	486	535	615
Total Financial Assets	66,184	72,908	77,695	85,223	97,145
Non-financial Assets					
Current tax assets (Net)	302	240	240	240	240
Deferred tax assets (Net)	372	490	490	490	490
Property, plant and equipment	133	338	344	351	357
Intangible assets	31	26	31	36	41
Other non-financial assets	57	70	80	90	100
Total Non Financial Assets	894	1,163	1,184	1,206	1,227
Total Assets	67,078	74,071	78,879	86,429	98,372
Financial Liabilities					
Derivative financial instruments	77	40	44	49	53
Trade payables	979	606	667	734	807
Other payables	34	29	32	35	39
Debt securities	22,319	17,745	18,100	19,910	22,896
Borrowings (Other than debt securities)	21,302	29,487	30,077	33,085	38,047
Deposits	5,667	8,812	8,988	9,887	11,370
Subordinated liabilities	3,559	3,418	3,486	3,835	4,410
Other financial liabilities	1,927	2,314	2,360	2,596	2,986
Total Financial Liabalities	55,864	62,452	63,011	69,312	79,709
Non-Financial Liabilities					
Current tax liabilities (net)	14	14	14	14	14
Provisions	207	143	449	714	933
Other non-financial liabilities	85	98	113	130	149
Total Non Financial Liabilities	306	255	575	857	1,096
EQUITY					
Equity share capital	123	123	247	247	247
Other equity	10,785	11,241	15,045	16,012	17,320
Total Networth	10,908	11,364	15,292	16,259	17,567
Total Liabilities and Equity	67,078	74,071	78,879	86,429	98,372

Source: Company; Sharekhan estimates

About company

Mahindra & Mahindra Financial Services Limited (MMFSL) is a subsidiary of Mahindra and Mahindra Limited (holds 52.16% stake in MMFS). MMFS is one of India's leading non-banking finance companies focused in the rural and semi-urban sector. The key Business Area is primarily of financing purchase of new and pre-owned auto and utility vehicles, tractors, cars, commercial vehicles, construction equipment and SME Financing. MMFS's vision is to be a leading provider of financial services in the rural and semi-urban areas of India. The company has 1,246 offices covering 27 states and 7 union territories in India, with over 7.14 million vehicle finance customer contracts since inception.

Investment theme

Mahindra & Mahindra Financial Services (MMFS) has grown and transformed as a business in the past decade from being primarily a financing entity for vehicle purchases (from its parent M&M) to a leading multi-product NBFC in India with a pan India presence, deep penetration and strong network with a rural focus. Going ahead, we believe factors like normalization in credit costs (MMFS has took significant upfront provision till Q3 FY2021; FY2022E to see normalized credit costs) and pickup in AUMs in FY22E and FY23E (aided by Auto sales pickup, GDP growth and improved capex cycle leading to disbursement growth) will aid earnings growth and ROE expansion. Hence, while the past few quarters have been a challenge (due to pandemic, economic slowdown etc) for growth and asset quality, we expect a rebound in earnings and ROE for MMFS in FY2022E and FY2023E which we believe would be triggers for re-rating of the stock. Asset quality wise, the improvement in Collections is positive, and we expect the trend to continue, as Q4 is seasonally best quarter in terms of collections on strong farm cash flows. Going forward, management guides to keep Net NPAs at sub 4% levels and maintain PCR at 35-36%. Company has restructured only 1% of AUM which is also a positive cushion. Its subsidiaries, namely Mahindra Rural Housing Finance (MRHF) is expected to be strong franchise in the long term. Its Insurance broking business, Mahindra Insurance Brokers (MIBL) is an asset light broking business and has strong fee income engine in its favour. We believe strong subsidiaries, also add value to the overall value of the company.

Key Risks

Delayed recovery in economic activity will affect growth and profitability, further, it has exposure to the SME segments which may be vulnerable if economic recovery is delayed.

Additional Data

Key management personnel

Mr. Ramesh Iyer	Executive Director-MD
Dr. Rebecca Nugent	Independent Director
Amit Raje	Non-Executive Non-Independent Director
Mr. Vivek Karve	Chief Financial Officer
Ms. Arnavaz M Pardiwalla	Company Secretary & Compliance Officer

Source: Company website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	BlackRock Inc	2.45
2	LIC of India	2.4
3	HDFC Life Insurance Co Ltd	2.13
4	Valiant Mauritius Partners Ltd	1.93
5	Government Pension Fund - Global	1.9
6	Norges Bank	1.89
7	WISHBONE FUND LTD	1.86
8	SBI Funds Management Pvt Ltd	1.75
9	Vanguard Group Inc/The	1.68
10	Invesco Asset Management India Pvt	1.25

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;