Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

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

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 18.25
Updated Feb 08, 2022

Low Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

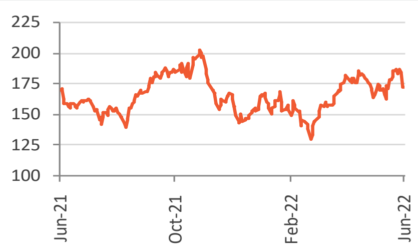
Company details

Market cap:	Rs. 21,319 cr
52-week high/low:	Rs. 206/128
NSE volume: (No of shares)	52.3 lakh
BSE code:	532720
NSE code:	M&MFIN
Free float: (No of shares)	59.1 cr

Shareholding (%)

Promoters	52.2
FII	17.9
DII	16.2
Others	13.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1.9	16.4	1.6	10.3
Relative to Sensex	2.5	22.1	1.4	10.1

Sharekhan Research, Bloomberg

Mahindra & Mahindra Financial Services

Growth scale through new businesses

NBFC	Sharekhan code: M&MFIN
Reco/View: **Buy** ↔	CMP: **Rs. 173**	Price Target: **Rs. 220** ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- We believe strong disbursements volumes reported by the company in May 2022 is indicative of healthy demand for M&M Financial Services and other vehicle financiers as well. Further, management has recently unveiled its Vision 2025, which is expected to give it a fillip to deliver on earnings performance going ahead.
- M&M Financial Services reported strong disbursements growth in May 2022 with disbursements of Rs. 2,973 crore, an increase of 272% y-o-y, on a lower base, which was impacted by the second Covid wave.Month-on-month disbursements grew by 8%. In FY2023 till date, disbursements stood at Rs. Rs. 5,686 crore,up 169% y-o-y. Collection efficiency was at 95% in May 2022 versus 67% in May 2021.
- The company has demonstrated stable asset quality through cycles. With collection efficiency at pre Covid levels in May 2022, it expects lower volatility in stage 3 assets in Q1FY2023. It continues to hold adequate liquidity buffer of Rs. 8,775 crore as of May 2022, which covers approximately three months of liquidity.
- The stock price has corrected by 17% from the highs of Rs. 206 and is available at 1.2x/1.1x its FY2023E/FY2024E BVPS. We re-iterate our Buy rating with an unchanged PT of Rs. 220.

Auto financiers are expected to witness improvement in loan book growth and easing asset-quality pressures with the normalisation of business activities. After weathering multiple challenges in the past three fiscals, overall assets under management (AUM) of NBFCs is likely to grow by 8-10% in FY2023E (industry estimates), driven by better economic activities, sufficient capital buffers, sizeable on-balance sheet provisioning along with adequate system liquidity,which is likely to aid funding. Improving economic activity, pick up in auto sales, and revival of used commercial segment are likely to drive loan book growth of auto financiers under our coverage. We expectAUM of auto financiers to post a CAGR of ~13% over FY2022E through FY2024E for our coverage. However, near-term challenges remain for auto financiers due to supply disruptions. M&M Financial Services (MMFS) is better placed in terms of loan book growth with strong vehicle financing franchise. Further, management is unveiling its Vision 2025, whichis expected to give the company afillip to deliver on earnings performance going ahead. With collection efficiency at pre Covid levels, MMFS expects lower volatility in stage 3 assets in Q1FY2023.

- **Improving loan growth and cyclical recovery:** With normalisation of economic activities, pick up in auto sales, and revival in the used commercial segment, we expect auto financiers to gain momentum in terms of loan book growth along with easing asset-quality pressures. We believe MMFS is set to benefit from the expected upcycle (FY2022E-FY2025E). Its vehicle AUM grew at a CAGR of ~6% over FY2018 to FY2022 and reached Rs. 650 billion. Under Vision 2025, management foresees AUM growth of 2x through leveraging its leadership in vehicle financing and scaling up new growth engines such as SME lending, LAP, leasing, and Digi Finco. Additionally, the company expects its new businesses (digi lending, SME financing, micro LAP) to contribute 15% to AUM mix. Hence, we believe MMFS is witnessing a turnaround with management's medium-term growth targets coupled with structural/cyclical tailwinds.
- **Asset quality to improve:** The company has successfully managed in navigating through the different credit cycles as compared to its peers. Given its strong parentage and strong liability franchise, the company has navigated the stress emanating from the COVID-19 pandemic reasonably well and is now poised to deliver on the articulated aspirational goals. Under the Vision 2025, MMFS aspires to contain gross stage 3 assets below 6% through credit cycles. Further, with the collection efficiency at pre Covid levels in May 2022, it expects lower volatility in stage 3 assets in Q1FY2023.
- **Strong capital position:** It is well capitalised with a CRAR of 27.8% (Tier-I capital of 24.3%). As of May 2022, it continues to hold adequate liquidity buffer of Rs. 8,775 crore,which covers approximately three months of liquidity.

Our Call

Valuation: We maintain Buy on MMFS with an unchanged PT of Rs. 220: MMFS continued to report healthy disbursement volumes in May, representing strong demand. Disbursements also picked up significantly with better collection efficiency signaling recovery in vehicle finance, which is encouraging. Additionally, it plans to increase its non-vehicle share in mix SME, LAP, and digital finance. Further, management has unveiled its Vision 2025, which is expected to give it a fillip to deliver on earnings performance going ahead. Hence, given its strong liability franchise, leadership in rural financing along with strong parentage, the company is well on track to deliver on its aspirational goals. At the CMP, MMFS trades at 1.2x and 1.1x its FY2023E and FY2024E P/BV, respectively. Hence, we maintain our Buy recommendation on the stock with an unchanged PT of Rs. 220.

Key Risks

Likely deterioration in asset quality and its exposure to the SME segment are vulnerable and may take longer time to recover

Valuation Rs cr

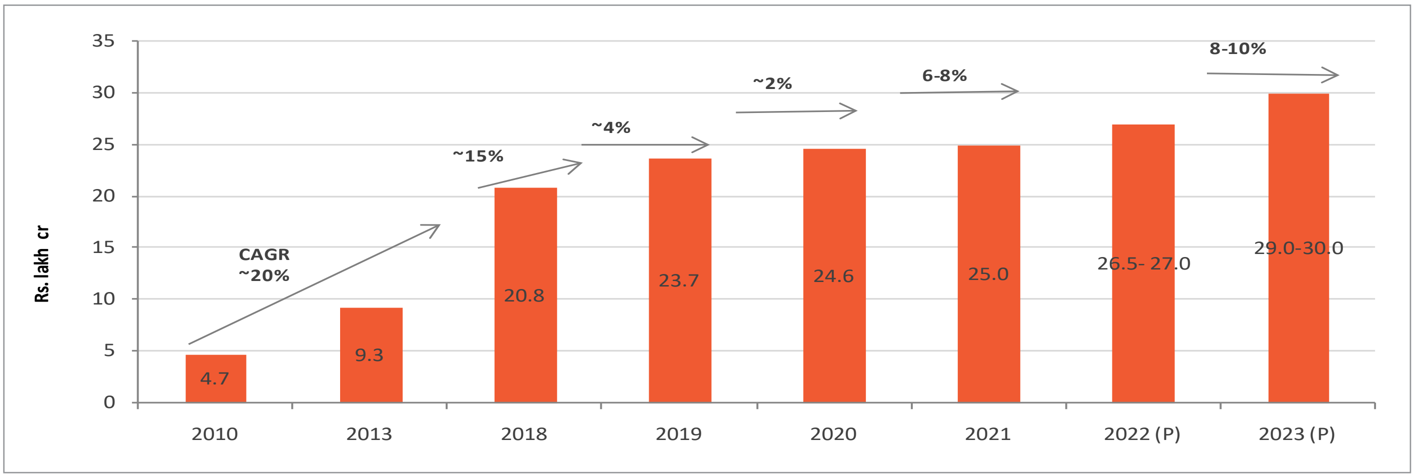
Particulars	FY21	FY22	FY23E	FY24E
NII	5,534	5,555	6,327	7,225
PAT	329	989	1,902	2,221
EPS (Rs)	2.7	8.0	15.4	18.0
BVPS (Rs)	119.4	126.5	144.5	158.5
P/E (x)	63.2	21.5	11.7	10.0
P/BVPS (x)	1.4	1.4	1.2	1.1
ROE (%)	2.5	6.5	11.4	11.9
ROA (%)	0.4	1.3	2.3	2.4

Source: Company; Sharekhan estimates

Growth drivers with better asset quality

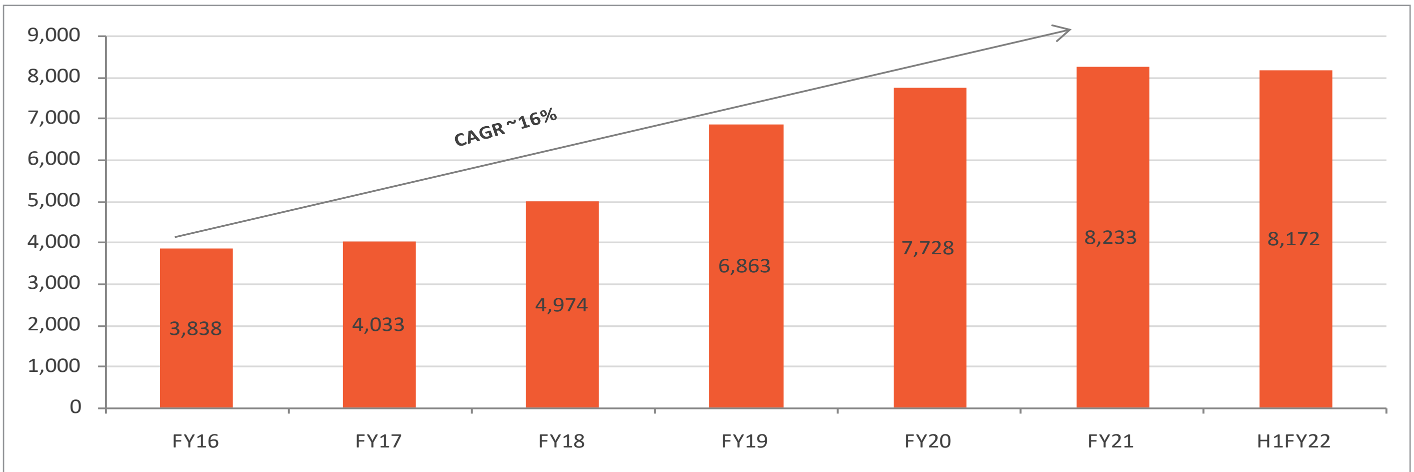
Auto financiers are expected to witness improvement in loan book growth and easing of asset-quality pressures with normalisation of business activities. After weathering multiple challenges in the past three fiscals, overall AUM of NBFCs is likely to grow by 8-10% in FY2023E (industry estimates), driven by better economic activities, sufficient capital buffers, sizeable on-balance sheet provisioning along with adequate system liquidity, which are likely to aid funding. Growth in the vehicle finance segment would also depend on the availability of vehicles, which are currently undergoing component shortage issues. However, segments such as two-wheelers, passenger vehicles, and heavy commercial vehicles may still be vulnerable. Apart from this, NBFCs are witnessing increasing demand from used vehicle financing. This is primarily driven by the preference of owning used cars, upgrades of two wheelers, and lower cost of used vehicles. Credit cost for auto financiers is expected to normalise as there is sizeable on-balance sheet provisioning. As per industry estimates,stage 3 assets of NBFCs are expected to remain elevated at ~6% in FY2023E, primarily on account of slippages in restructured book and emergency credit line guarantee scheme (ESLGS) portfolio. This was also on account of adherence to the revised norms of NPA recognition by the Reserve Bank of India (RBI). However, with the postponement of the timeline for adhering to upgraded non-performing assets norms and tailwinds for the sector such as improved economic activity, gross NPA ratio may decline by 150-200 bps. The vehicle finance segment also saw significant impact of ~500 bps decline in gross NPAs. Within the vehicle segment, two-wheelers, three-wheelers, and commercial passenger vehicles saw more slippages due to greater volatility in cash flows of borrowers. However, credit cost is expected to moderate as NBFCs have adequate provisioning buffers. We believe FY2023E may see normalcy in disbursements with segments such as loan against property (LAP), home loans, and vehicle finance witnessing higher demand. Additionally, the tractor finance segment is likely to remain stable given the agriculture sector's growth and government spending in rural areas.

AUM growth trajectory of NBFCs



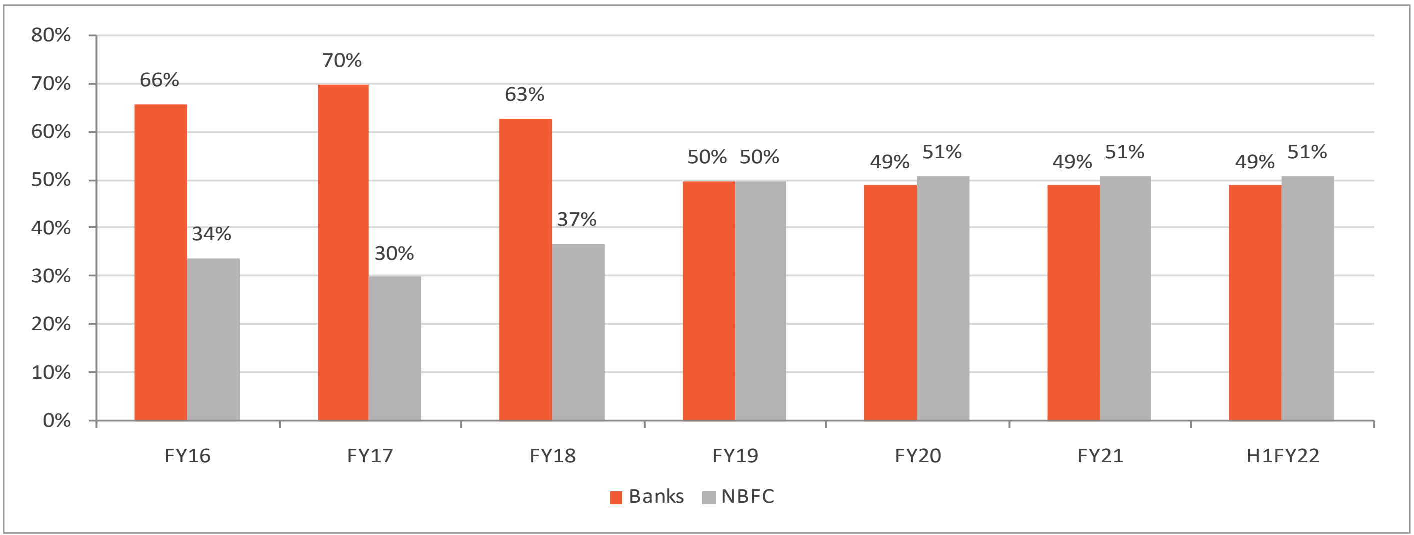
Source: Industry; Sharekhan Research

Vehicle Finance Industry AUM (Rs. billion)



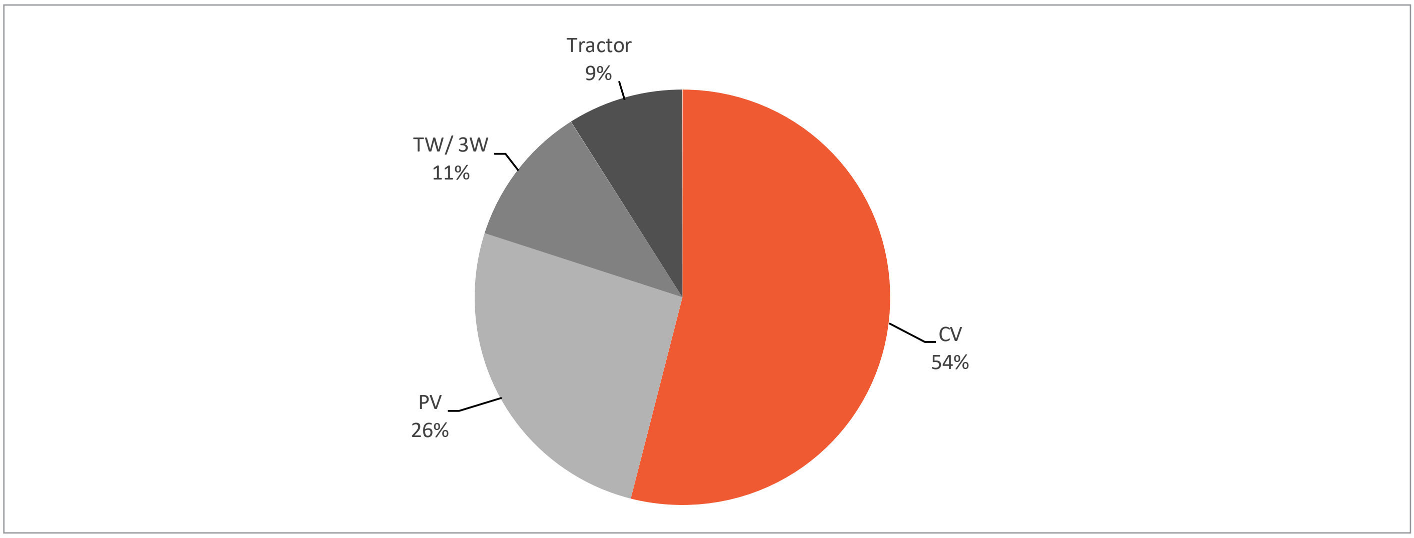
Source: Industry; Sharekhan Research

Banks and NBFCs share in vehicle financing



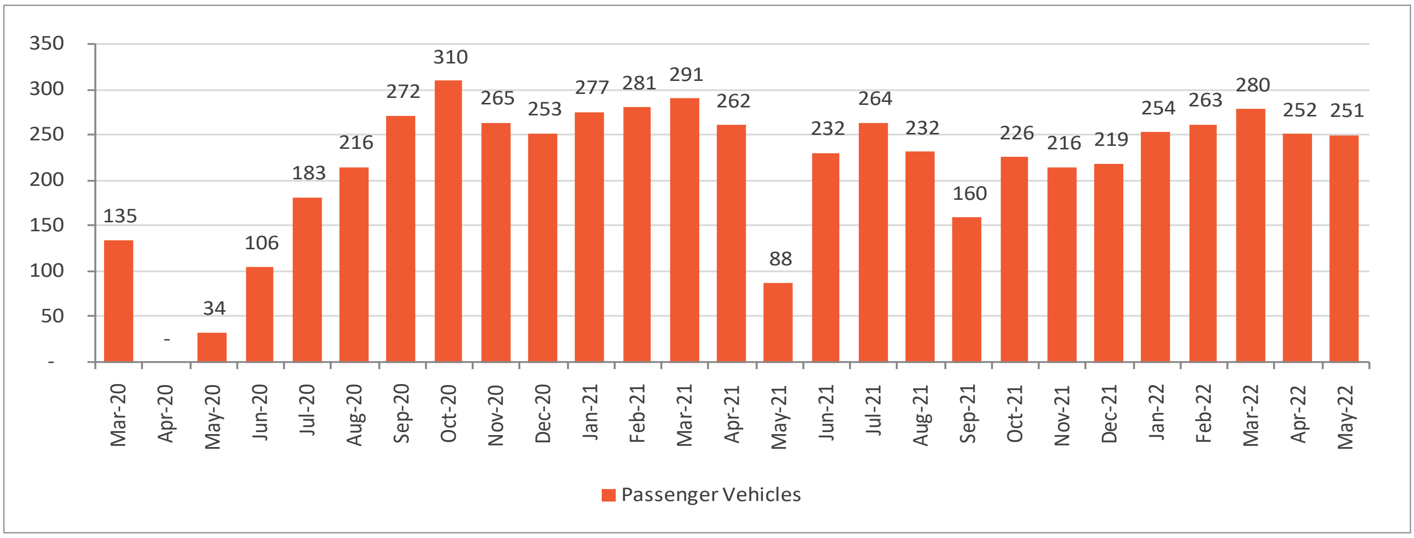
Source: RBI; Sharekhan Research

Vehicle Finance AUM Mix - FY21



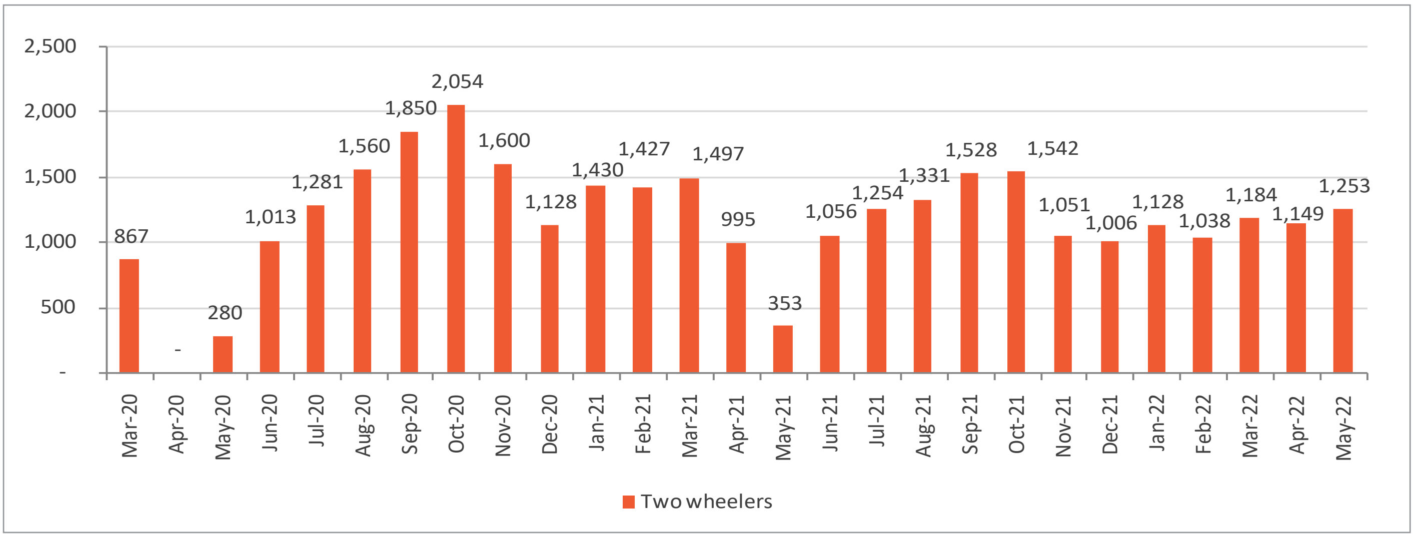
Source: Industry; RBI ; Sharekhan Research

Passenger Vehicles sales (in 000)



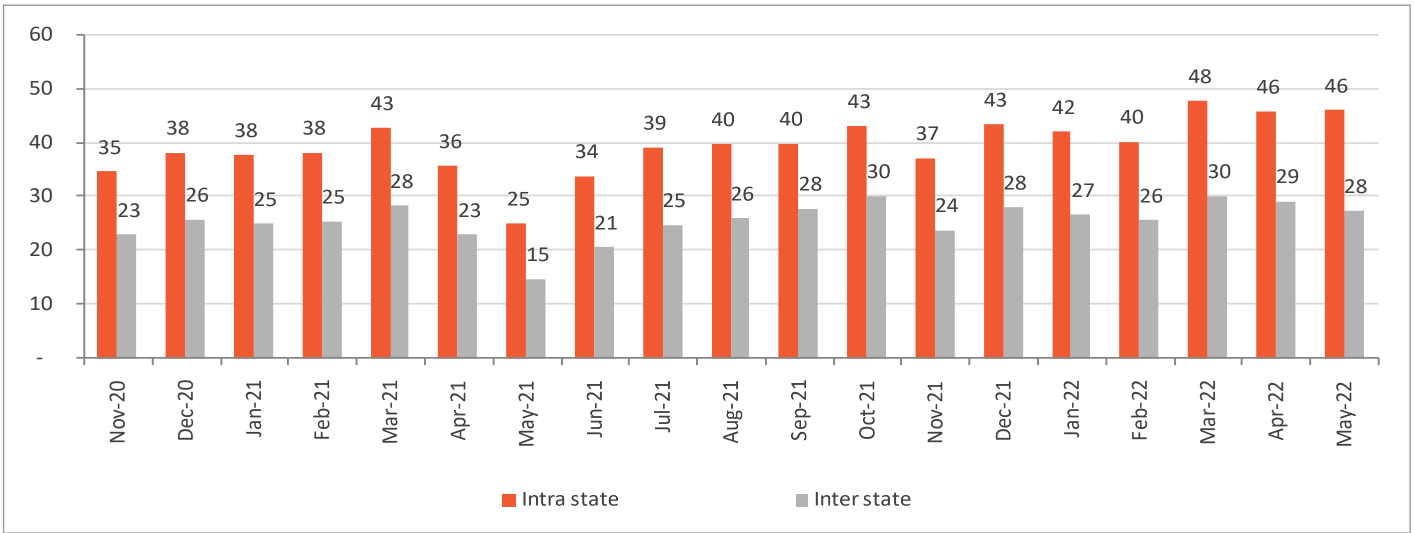
Source: SIAM ; Sharekhan Research

Two wheelers sales (in 000)



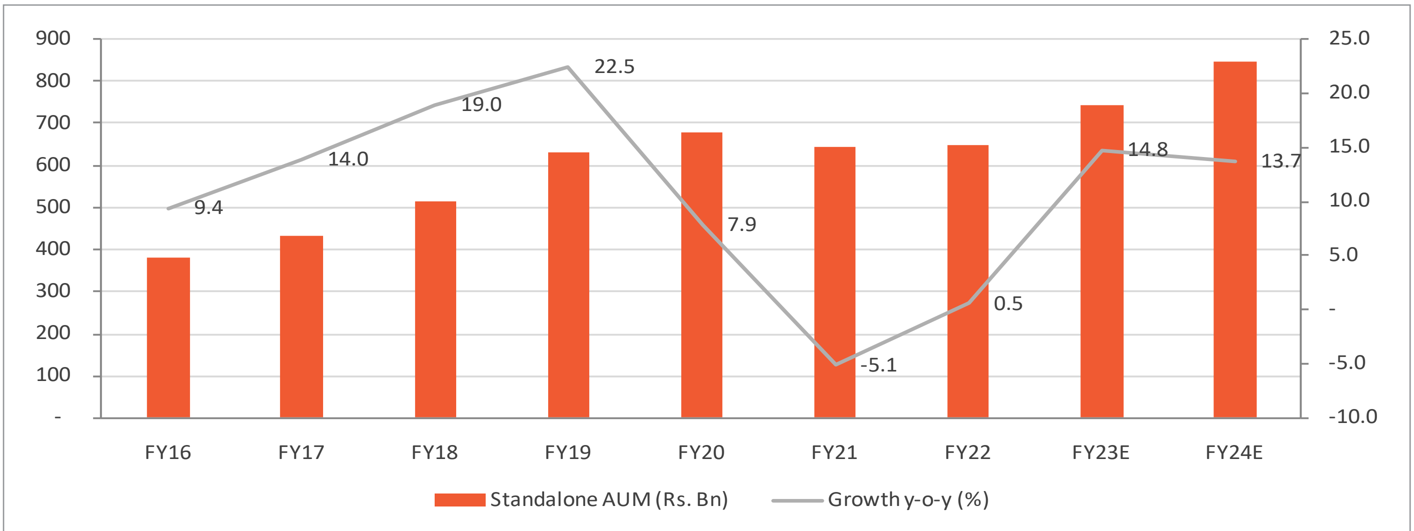
Source: SIAM ; Sharekhan Research

Number of e way bills issued witnessed consistent growth in May 2022



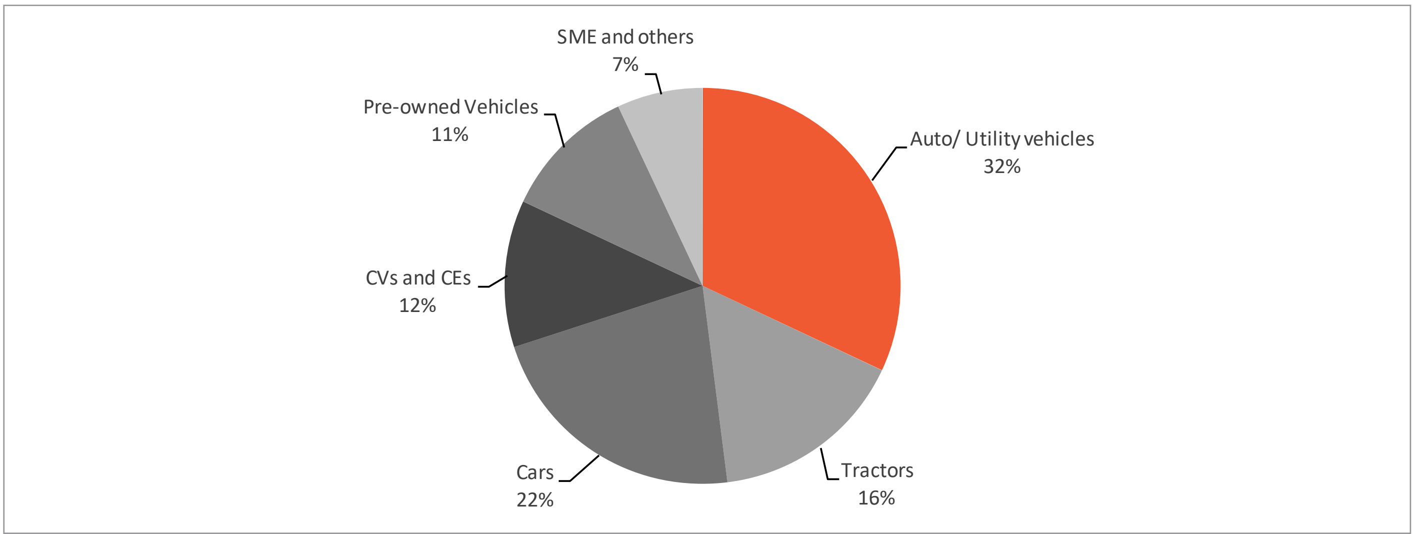
Source: GSTN; Sharekhan Research

MMFS AUM is expected to witness strong growth



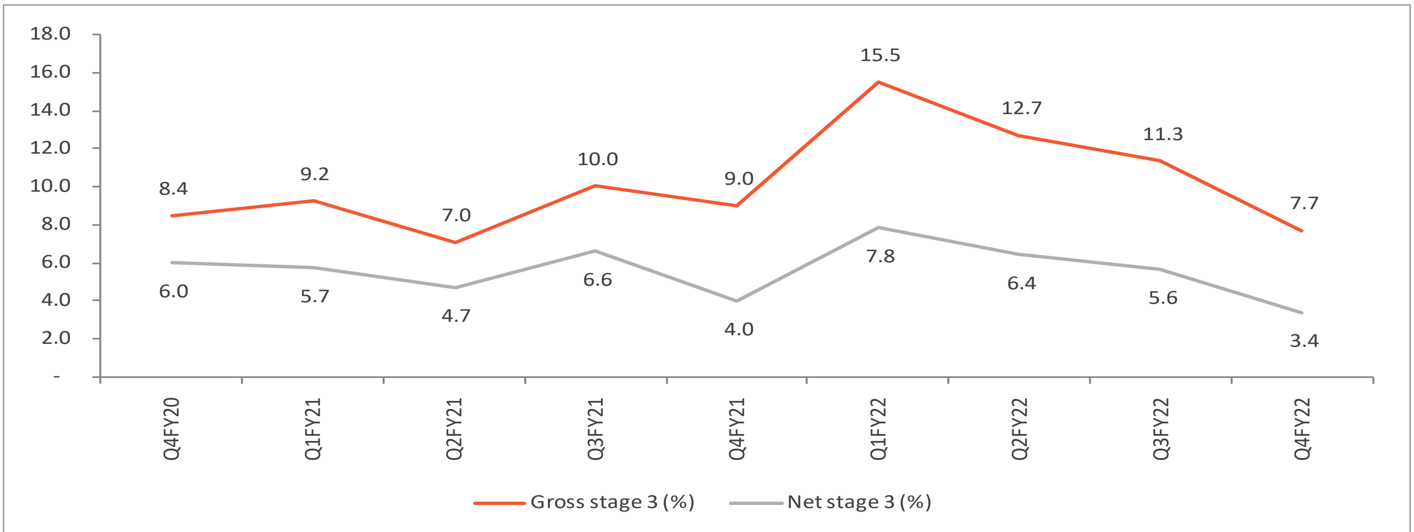
Source: Company; Sharekhan Research

AUM mix (%)- Q4FY22



Source: Company; Sharekhan Research

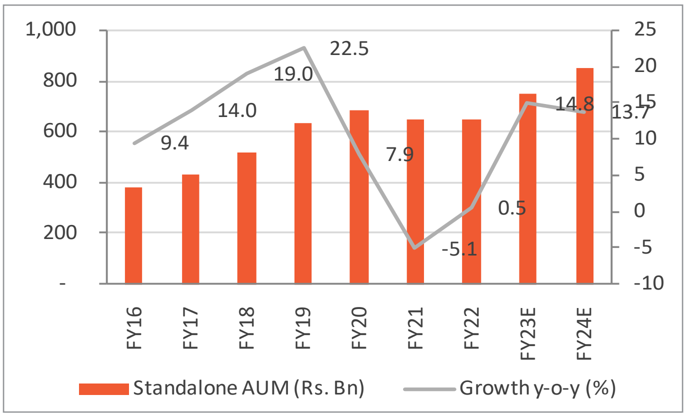
Asset quality



Source: Company; Sharekhan Research

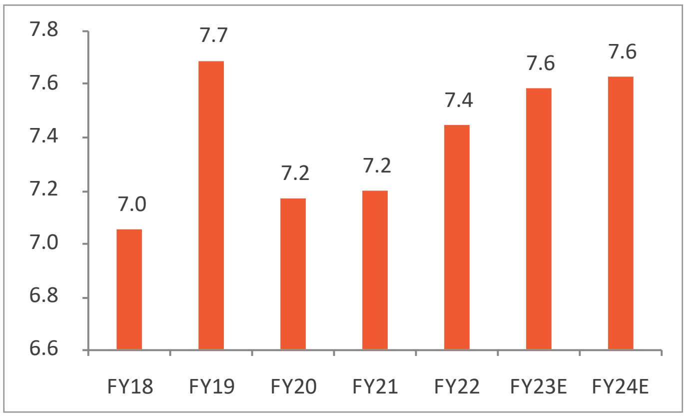
Financials in charts

AUM growth



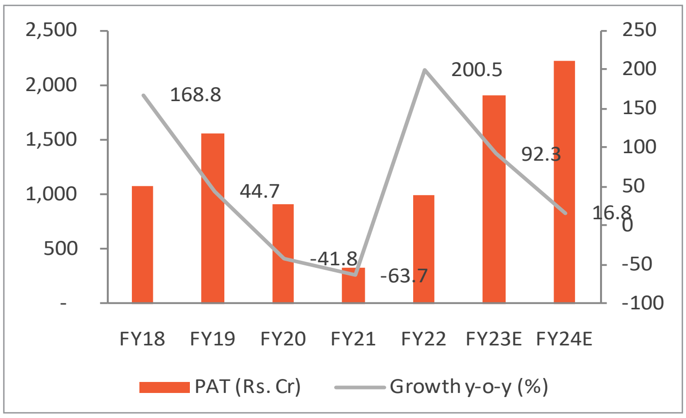
Source: Company, Sharekhan Research

NIM on assets (%)



Source: Company, Sharekhan Research

PAT trend



Source: Company, Sharekhan Research

Outlook and Valuation

Sector view - Notwithstanding near-term challenges, the rural segment is a bright spot

The economy has been witnessing improved macro-economic sentiments, which are expected to boost the primary sectors, including automobiles and infrastructure sectors. 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, and while the sector is not completely out of the woods (due to COVID-19 resurgence). In this backdrop, aided by a strong liability franchise, highly rated and well-capitalised nimble NBFCs have ample growth opportunities and are well placed to overcome challenges.

Company outlook - Strong fundamentals make MMFS attractive

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. The company's subsidiaries namely Mahindra Rural Housing Finance (MRHF) are expected to be strong franchises in the long term. Its insurance broking business, Mahindra Insurance Brokers Limited (MIBL) is an asset-light broking business and has a strong fee income engine in its favour. We believe strong subsidiaries also add to the company's overall value.

Valuation - We maintain Buy on MMFS with an unchanged PT of Rs. 220

MMFS continued to report healthy disbursement volumes in May, representing strong demand. Disbursements also pickedup significantly with better collection efficiency signaling recovery in vehicle finance, which is encouraging. Additionally, it plans to increase its non-vehicle share in mix SME, LAP, and digital finance. Further, management has unveiled its Vision 2025, which is expected to give it afillip to deliver on earnings performance going ahead. Hence, given its strong liability franchise, leadership in rural financing along with strong parentage, the company is well on track to deliver on its aspirational goals. At the CMP, MMFS trades at 1.2x and 1.1x its FY2023E and FY2024E P/BV, respectively. Hence, we maintain our Buy recommendation on the stock with an unchanged PT of Rs. 220.

Peer Comparison

Companies	CMP (Rs / Share)	M CAP (Rs cr)	P/BV(x)		P/E(x)		RoA (%)		RoE (%)	
			FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Mahindra Finance	172	21,313	1.2	1.1	11.7	10.0	2.3	2.4	11.4	11.9
Cholamandalam Investment	617	50,660	4.4	3.8	23.3	20.3	2.7	2.7	21.0	20.1

Source: Company; Sharekhan Research

About company

MMFS is a subsidiary of Mahindra and Mahindra Limited. MMFS is one of India's leading non-banking finance companies focused in the rural and semiurban 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 rural and semi-urban areas of India. The company has 1,388 offices across 27 states and 7 union territories in India, with over 7.3 million vehicle finance customer contracts since inception.

Investment theme

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. MMFS is deeply penetrated in 27 states/7 UTs through a network of >1,246 branches.

Key Risks

Likely deterioration in asset quality and its exposure to the SME segment are vulnerable and may take longer time to recover.

Additional Data

Key management personnel

Mr. Ramesh Iyer	Vice Chairman & Management Director
Dr. Rebecca Nugent	Independent Director
Mr. Amit Raje	Whole-time Director
Mr. Vivek Karve	Chief Financial Officer
Ms. Arnavaz M Pardiwalla	Company Secretary & Compliance Officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	LIC of India	5.7
2	WISHBONE FUND LTD	2.7
3	HDFC Life Insurance Co Ltd	2.5
4	SBI Funds Management Ltd	2.2
5	ICICI Prudential Asset Management Co Ltd	1.9
6	BlackRock Inc	1.7
7	Vanguard Group Inc/The	1.5
8	HDFC Asset Management Co. Ltd	1.5
9	Nippon Life India Asset Management	1.2
10	Kotak Mahindra Asset Management Co. Ltd	1.2

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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