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 19.28
Updated Jul 08, 2022

Low Risk

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

Source: Morningstar

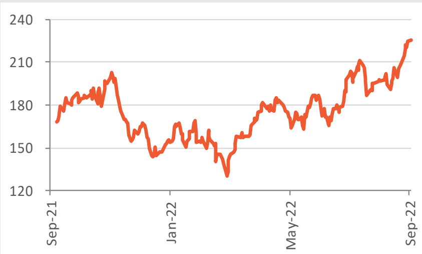
Company details

Market cap:	Rs. 27,892 cr
52-week high/low:	Rs. 232 / 128
NSE volume: (No of shares)	44.4 lakh
BSE code:	532720
NSE code:	M&MFIN
Free float: (No of shares)	59.2 cr

Shareholding (%)

Promoters	52.2
FII	17.6
DII	18.0
Others	12.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	14.7	30.6	53.7	33.7
Relative to Sensex	12.9	16.0	46.5	29.6

Sharekhan Research, Bloomberg

Mahindra & Mahindra Financial Services Ltd

In a sweet spot, growth momentum to sustain

NBFC		Sharekhan code: M&MFIN		
Reco/View: **Buy**	⇔	CMP: **Rs. 226**	Price Target: **Rs. 275**	↑

↑ Upgrade ⇔ Maintain ↓ Downgrade

Summary

- Mahindra & Mahindra Financial Services Ltd.'s (MMFSL's) credit costs is expected to moderate (from 3.9% in Q1FY23 to ~2%) in H2FY23 driven by a fall in repossession losses and write-offs. We believe the pandemic-led stress has mostly been factored into credit costs through accelerated write-offs.
- Effect of change in NPA recognition norms may be lower as reflected in sharp reduction in stage-2 loans (from 19.4% peak to 11.7% currently) and sustained ECL buffers (6.8%).
- Business momentum continues to remain robust as reflected in strong disbursements (up 104% y-o-y YTD). Branch expansion, incremental volumes from new product offerings (SME, LAP and Digital) and market share gains in auto/ UV segment would help to sustain healthy momentum.
- We expect MMFSL to deliver RoA/ RoE of 2.3%/ 12.7% by FY24E recovering from 1.3%/ 6.5% in FY22. At the CMP, the stock trades at 1.9x and 1.7x its FY2023E/FY2024E ABV. We reiterate a Buy on the stock with a revised PT of Rs. 275.

We believe that given the strong underlying demand trends, its positioning in rural/ semi urban customer segment along with improving its credit filters after pandemic-induced stress; strong business growth is here to sustain. Earnings trajectory is also expected to be healthy as credit costs is expected to moderate in 2HFY23 driven by lower repossession loss and lower write-offs. Majority of the clean-up has been done through accelerated write-offs in the past. The effect of the change in NPA recognition norms from October 2022 may be much lower as reflected in sharp reduction in gross stage-2 loans and company has adequate on ECL buffers.

- **Credit costs expected to moderate:** We believe pandemic-led stress has mostly been factored into credit costs through accelerated write offs in the past. Credit costs are expected to moderate in H2FY23 driven by lower repossession loss, lower write-offs and further improvement in stage-2 and -3 assets. Impact of change in NPL recognition norms from October 2022 may be lower as reflected in sharp fall in stage-2 loans (from 19.4% peak to 11.7% currently) and sustained ECL buffers (6.8%). Even after adopting the RBI's NPA circular, the company plans to maintain the current stage-3 PCR of ~58%. Currently, gross stage-3 assets are at 8% and restructured assets at 4.3% of AUM.
- **Strong business growth likely to sustain:** We expect disbursements to pick up further driven by strong business expansion (MMFSL plans to add 150 branches in FY2023E), incremental volumes from new product lines (SME, LAP and Digital Finance) and market share gains in car/UV segment. The company has maintained its leadership position in the Tractor and UV financing segments, which has always been its strength. Strong liability franchise and deep moats in rural/semi-urban customer segment positions MMFSL well. Considering these product portfolio diversifications and a healthy momentum in the existing business, we estimate AUM to clock a 14% CAGR over FY22-24E.

Our Call

Valuation – We maintain Buy on MMFSL with a revised PT of Rs. 275: MMFSL continued to report healthy disbursement numbers, exhibiting strong underlying demand and market share gains. Asset quality metrics is expected to improve further on the back of strong collection efficiency. Additionally, it plans to diversify its growth engines and increase its non-vehicle financing share in SME, LAP, and digital segment. We believe earnings trajectory is going to positively surprise going forward led by strong business growth and moderation in credit cost. At CMP, MMFSL trades at 1.9x and 1.7x of FY23E and FY24E ABV.

Key Risks

Economic slowdown led by slower AUM growth and higher-than-anticipated credit cost could affect earnings.

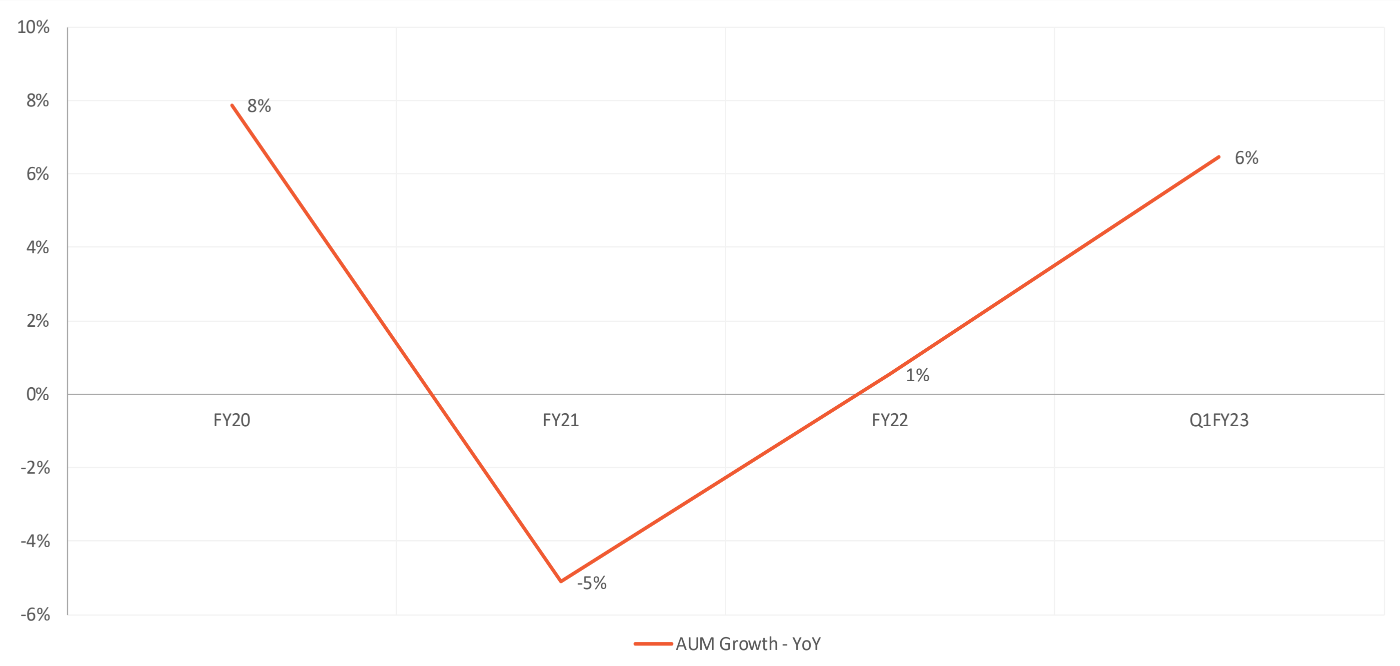
Valuation Rs cr

Particulars	FY21	FY22	FY23E	FY24E
NII	5,534	5,555	6,023	6,732
PAT	329	989	1,777	2,181
EPS (Rs)	2.7	8.0	14.4	17.7
RoA (%)	0.4	1.3	2.1	2.3
RoE (%)	2.6	6.5	11.2	12.7
P/E (x)	79.8	27.1	15.1	12.3
P/ABV (x)	2.1	2.0	1.9	1.7

Source: Company; Sharekhan estimates

Given the strong underlying demand trend and strategic transformation undertaken, the company has been targeting 'Vision 2025' with following deliverables a) gross stage-3 at sub-6%; b) AUMs are expected to double by FY2025, supported by new product segments (contributing 15%); c) maintaining NIM of ~7.5%; d) RoA at ~ 2.5%. We believe consistent execution is critical here to improve the business metrics although structural drivers are in place.

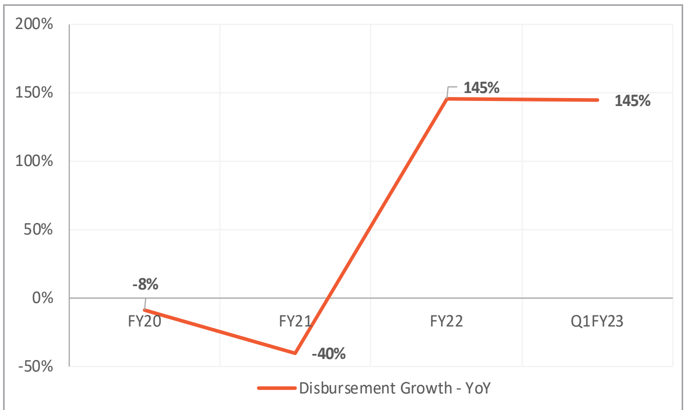
Trend in AUM growth



Source: Company, Sharekhan Research

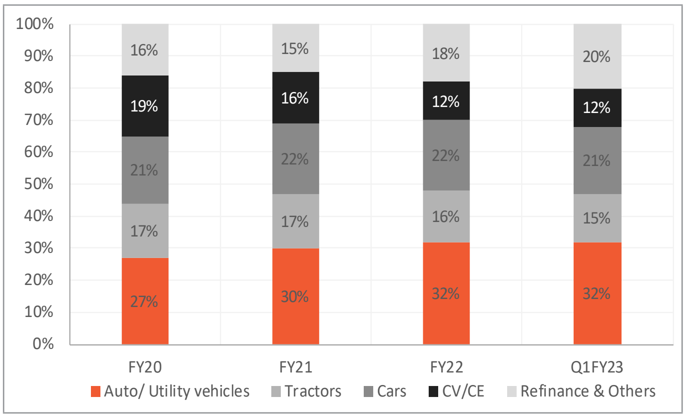
Disbursements are growing at a healthy pace, driven by cars/ Auto/ UV. SME financing (recently launched) is also shaping up well and started contributing to overall disbursements. It comprises short-term loans for agri processing/ engineering/ auto products, bill discounting, LAP, and lending to small well rated NBFCs. Strong disbursements should support healthy AUM growth going forward. Company believes overall sentiments are positive and cash flow is improving which should propel disbursement and AUM growth in FY23.

Trend in Disbursements



Source: Company, Sharekhan Research

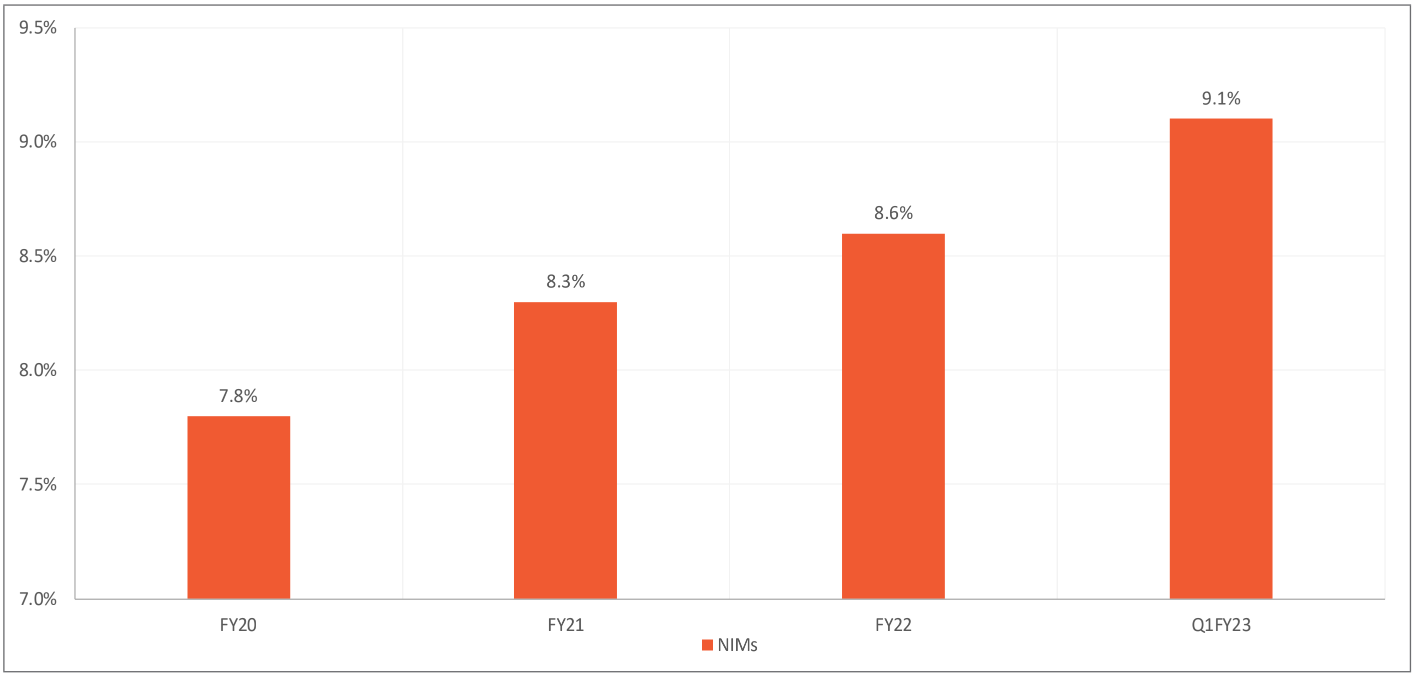
AUM Composition mix



Source: Company, Sharekhan Research

Margins could be affected going ahead as – a) MMFSL plans to cater affluent rural customer (relatively lower yields) and b) increase in COF although company could pass on the increased rates with a lag.

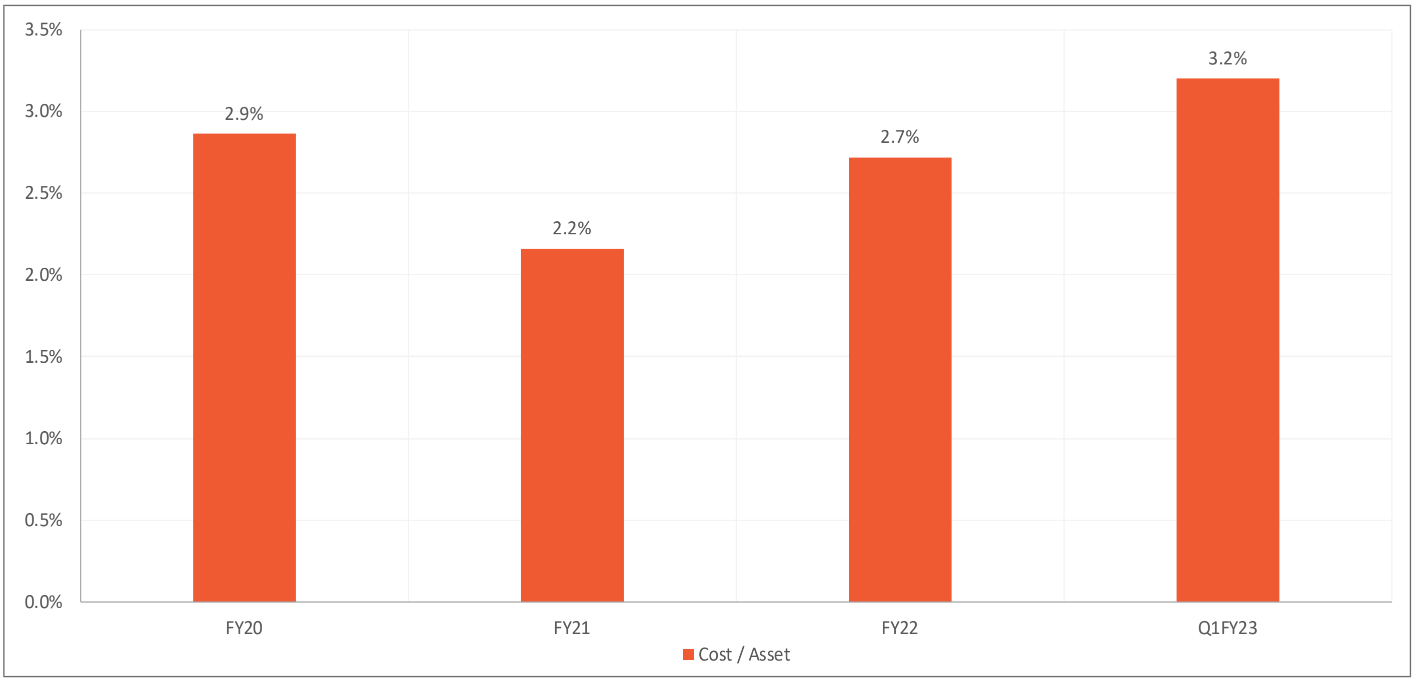
Trend in Margin Trajectory



Source: Company, Sharekhan Research

Opex growth in FY23E is likely to be higher led by investments in technology, required talent pool and investment in new product segment. Company believes substantial investments in technology and team have been made, hence cost-to-assets ratio is expected to fall below 3% in near to medium term vs 3.2% reported in Q1FY23.

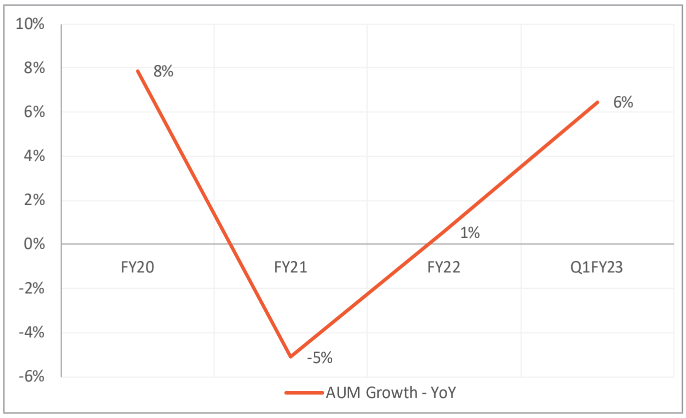
Trend in Cost to Asset ratio



Source: Company, Sharekhan Research

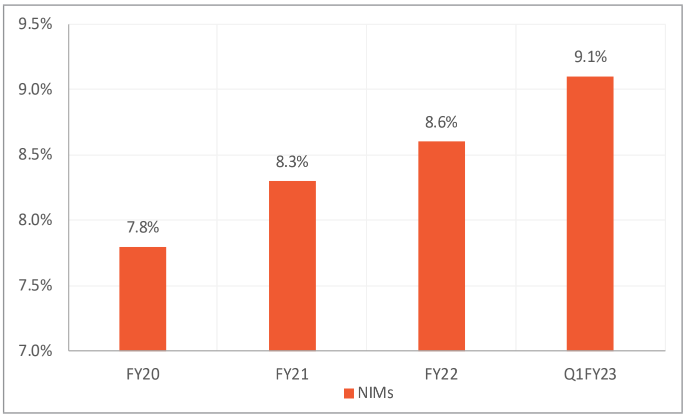
Financials in charts

Trend in AUM growth



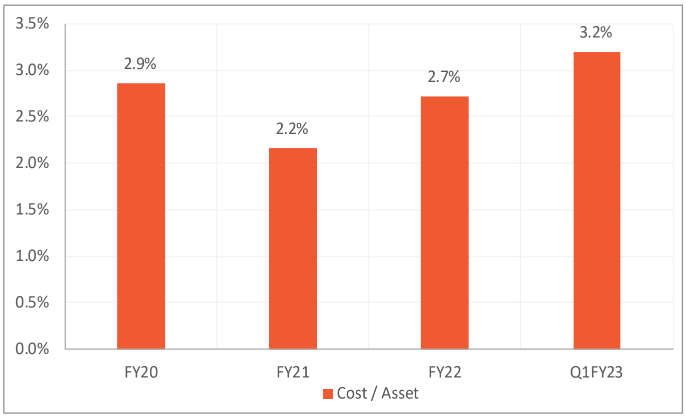
Source: Company, Sharekhan Research

Trend in Margins



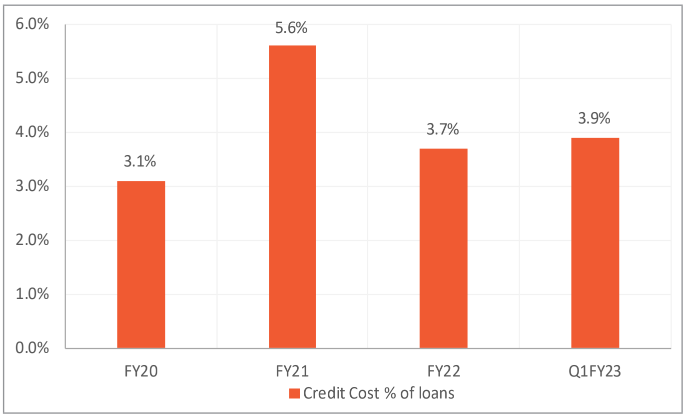
Source: Company, Sharekhan Research

Trend in Cost to Assets



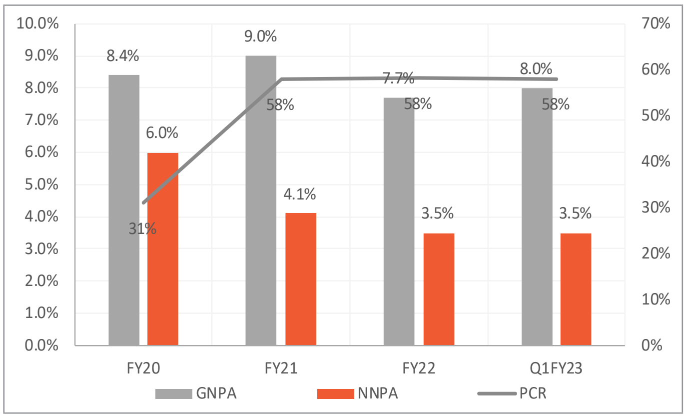
Source: Company, Sharekhan Research

Trend in Credit Cost



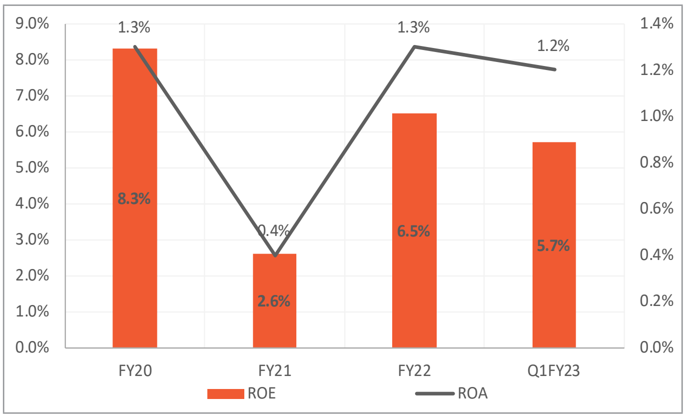
Source: Company, Sharekhan Research

Trend in Asset Quality



Source: Company, Sharekhan Research

Trend in Return Ratio



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Economic recovery is encouraging

The Indian economy has been witnessing sharp revival, which is expected to benefit the primary sectors including automobiles & infrastructure sectors. Recovery in the Auto sector over the past six months has been encouraging, but private capex is yet to pick up. Auto Financing is picking up and asset -quality trends are also improving. NBFCs with diverse product offering strategy, strong ALM management, strong liquidity buffers, strong risk management framework, healthy liability franchise, and well-capitalised have ample growth opportunities and are well placed.

■ Company Outlook – Earnings outlook positive

Business momentum continues to remain strong as reflected in disbursement volumes. We believe given the strong underlying demand trends, its positioning in rural/ semi urban customer segment along with improving its credit filters after pandemic induced stress; strong business growth is here to sustain. Earnings trajectory is also expected to be healthy as credit costs is expected to moderate in 2HFY23. Majority of the cleanup has been done through accelerated write offs in the past. Additionally, its subsidiaries also add to the company's overall value.

■ Valuation – We maintain Buy on MMFSL with a revised PT of Rs. 275

MMFSL continued to report healthy disbursement numbers, exhibiting strong underlying demand and market share gains. Asset quality metrics is expected to improve further on the back of strong collection efficiency. Additionally, it plans to diversify its growth engines and increase its non-vehicle financing share in SME, LAP, and digital segment. We believe earnings trajectory is going to positively surprise going forward led by strong business growth and moderation in credit cost. At CMP, MMFSL trades at 1.9x and 1.7x of FY23E and FY24E ABV.

Peer Comparison

Particulars	CMP	MCAP	P/E(x)		P/BV(x)		RoA (%)		RoE (%)	
	Rs/Share	(Rs Cr)	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Mahindra & Mahindra Finance	226	27,892	15.1	12.3	1.9	1.7	2.1	2.3	11.2	12.7
Cholamandalam Investment and Finance Company	797	65,473	21.8	19.5	4.0	3.3	3.3	3.0	24.5	20.9

Source: Company, Sharekhan research

About company

Mahindra & Mahindra Financial Services Limited (MMFSL) is a subsidiary of Mahindra and Mahindra Limited. MMFSL is one of India's leading non-banking finance companies focused in the rural and semi-urban area. The company finances purchase of new and pre-owned auto and utility vehicles, tractors, cars, commercial vehicles, construction equipment and SME Financing. It has a strong network of 1322 branches spread across 25 states and 5 Union Territories in India.

Investment theme

Business momentum continues to remain strong as reflected in disbursement volumes. We believe given the strong underlying demand trends, its positioning in rural/ semi urban customer segment along with improving its credit filters after pandemic induced stress; strong business growth is here to sustain. Earnings trajectory is also expected to be healthy as credit costs is expected to moderate in 2HFY23. Majority of the cleanup has been done through accelerated write offs in the past. Additionally, its subsidiaries also add to the company's overall value.

Key Risks

Economic slowdown led by slower AUM growth and higher-than-anticipated credit cost could affect earnings.

Additional Data

Key management personnel

Mr. Ramesh Iyer	Vice Chairman & Management Director
Mr. Vivek Karve	Chief Financial Officer
Mr. Amit Raje	Chief Operating Officer, Digital Business
Mr. Raul Rebello	Chief Operating Officer, Core Business

Source: Company Website

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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