Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Mahindra & Mahindra Financial Services Ltd

Strong Performance, succession plan in place well in advance

NBFC	Sharekhan code: M&MFIN
Reco/View: Buy ↔	CMP: **Rs. 243**	Price Target: **Rs. 290** ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

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	19.57

Updated Dec 08, 2022

Low Risk

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

Source: Morningstar

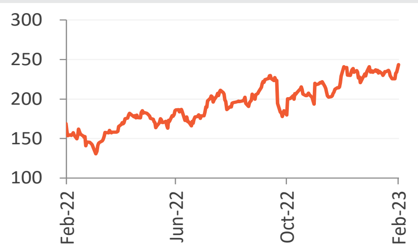
Company details

Market cap:	Rs. 30,023 cr
52-week high/low:	Rs. 248/128
NSE volume: (No of shares)	52.8 lakh
BSE code:	532720
NSE code:	M&MFIN
Free float: (No of shares)	58.1 cr

Shareholding (%)

Promoters	52.2
FII	16.1
DII	23.8
Others	8.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.8	10.5	27.9	51.9
Relative to Sensex	4.6	10.4	23.6	48.4

Sharekhan Research, Bloomberg

Summary

- M&M Finance reported strong performance in Q3FY2023 with PPoP significantly above consensus and our estimates reported at Rs. 998 crore (down 6% y-o-y/up 16% q-o-q). NIM (calculated as a percentage of average Loan assets) was stable q-o-q at 8.2%. Opex growth moderated with opex-to-average loan assets at ~3.4% vs. ~3.8% q-o-q.
- PAT was also ahead of expectation reported at Rs. 629 crore (down 30% y-o-y/up 40% q-o-q), led by strong PPoP and lower credit cost. Total credit cost was at 82 bps vs. 112 bps q-o-q. Gross stage-3 and net stage-3 assets declined by ~77 bps/39 bps q-o-q to 5.93%/2.52%. PCR on Stage-3 assets improved to 59% vs. 58% q-o-q. Gross Stage-2 assets also declined by 130 bps q-o-q to 8.4%.
- Loan assets grew by 21% y-o-y/5% q-o-q to Rs. 77,344 crore, aided by strong disbursement growth of 80% y-o-y/22% q-o-q. The company is benefitting from strong sectoral tailwinds and, its parent, Mahindra & Mahindra's (M&M) strong recovery in auto volumes. This is reflected in strong disbursement growth, and we expect this momentum to sustain.
- At the CMP, the stock trades at 1.8x/ 1.6x/ 1.3x its FY2023E/FY2024E/FY2025E BV estimates, respectively. We maintain Buy with a revised PT of Rs. 290.

M&M Finance reported robust business momentum during Q3FY2023, driven by strong tailwinds in the sector. Net interest income (NII) grew by 1% y-o-y/7% q-o-q. Margins were stable q-o-q at 8.2%, which was a positive surprise as the company managed to pass on incremental rates on the floating rate book, while, at the same time, increase the disbursements yield on vehicle book despite cost of funds rising steeply. Total operating expenses were up by 23% y-o-y and down 4% q-o-q. Opex growth moderated, and the company expects further reduction in opex in the near to medium term. Operating profit fell by ~6% y-o-y but was higher by 16% q-o-q. Total credit costs stood at 82 bps vs. 112 bps q-o-q. Write-offs were lower at Rs. 498 crore vs. Rs. 543 crore q-o-q. PAT stood at Rs. 629 crore (down 30% y-o-y/up 40% q-o-q). Gross Stage-3 and Net Stage-3 assets declined by ~77 bps/39 bps q-o-q to 5.93%/2.52%. PCR on Stage-3 assets improved to 59% vs. 58% q-o-q. Gross Stage-2 assets also declined by 130 bps q-o-q to 8.4%. GNPA as per the Reserve Bank of India's (RBI) IRAC norms was higher by Rs. 1,277 crore when compared to IND-AS Gross Stage-3 assets. However, the company does not foresee any impairment charge on account of the IRAC migration in FY2023.

Key positives

- Strong disbursement growth
- Margins were stable sequentially
- Improvement in Gross Stage-2 and Stage-3 assets sequentially

Key negatives

- Higher volatility in credit cost. There was no repossession of assets during the quarter, thus credit cost was lower due to lower write-offs.

Management Commentary

- Management has guided there would be some margin compression going forward due to change in the product mix (lower yield product) and customer mix. However, at the ROA level, the impact will be offset by lower credit cost and opex. The SME segment and leasing are expected to be the growth engines going forward.
- The company has put up a succession plan for Mr. Ramesh Iyer (Vice Chairman and MD), who would retire in April 2024. Mr. Raul Rebello (currently COO) will be appointed as MD and CEO to ensure a smooth transition.

Our Call

Valuation – We maintain our Buy rating with a revised PT of Rs. 290: Mahindra Finance continued to report healthy performance in terms of disbursement numbers, exhibiting strong underlying demand and market share gains. Asset-quality metrics are expected to remain stable. Additionally, the company is diversifying its growth engines and increasing its non-vehicle financing share in SME, LAP, and digital segments. We believe the earnings trajectory is going to positively surprise going forward, led by strong business growth and lower opex adding to operating leverage along with contained credit cost. At the CMP, the stock trades at 1.8x/1.6x/1.3x its FY2023E/FY2024E/FY2025E BV estimates.

Key Risks

Economic slowdown due to which slower loan growth and higher-than-anticipated credit cost.

Valuation (Standalone) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
NII	5,555	6,479	7,661	8,427
PAT	989	1,843	2,570	2,827
EPS (Rs.)	8.0	14.9	20.8	22.9
ROA	1.3	2.1	2.3	2.3
ROE	6.5	11.2	12.7	12.7
P/E (x)	27.5	14.7	10.6	8.5
P/BV (x)	1.9	1.8	1.6	1.3

Source: Company; Sharekhan estimates

Key result highlights

Margin profile surprised positively: NII grew by 1% y-o-y/7% q-o-q. Margins were stable q-o-q at 8.2%, which was a positive surprise as the company managed to pass on incremental rates on the floating rate book while, at the same time, increase the disbursements yield on vehicle book despite cost of funds rising steeply. Management has guided there would be some margin compression going forward due to change in the product mix (lower yield product) and customer mix, among others. However, at the ROA level, the impact will be offset by lower credit cost and opex. Lending rates have increased by ~80 bps, and the company further plans to selectively increase the rates in various segments.

Operating expenses moderated: Total operating expenses were up 23% y-o-y and down 4% q-o-q. Opex growth moderated and the company expects further reduction in opex in the near to medium term, which should add to operating leverage.

Asset-quality matrix trends better: Gross Stage-3 and Net Stage-3 assets declined by ~77 bps/39 bps q-o-q to 5.93%/2.52%. PCR on Stage-3 assets improved to 59% vs. 58% q-o-q. Gross Stage-2 assets also declined by 130 bps q-o-q to 8.4%. Management has guided that GS3 could improve further by 100 bps over the medium term. GNPA as per the Reserve Bank of India's (RBI) IRAC norms was higher by Rs. 1,270 crore when compared to IND-AS gross stage-3 assets. However, the company does not foresee any impairment charge on account of the IRAC migration in FY2023. Total credit costs stood at 82 bps vs. 112 bps q-o-q. Write-offs were lower at Rs. 498 crore vs. Rs. 543 crore q-o-q. There were no repossession of assets during the quarter, thus credit cost was lower due to lower write-offs. Management also guided that underwriting has significantly improved and there are very less delinquencies in loans, which are written in the last 12-18 months.

Growth outlook: Strong sectoral tailwinds is driving robust disbursement growth. The company is likely to sustain the momentum going forward. The company's business assets grew by 21% y-o-y/5% q-o-q, aided by strong disbursement growth of 80% y-o-y/22% q-o-q. Farm income is good, infra-activity is also picking, cashflows in the rural market are improving, demand for tractor and other CV is holding up well, footfall is improving at OEM, supply chain, and availability of vehicles is also improving. This gives confidence that strong momentum is expected to sustain. SME lending is done towards sectors such as automobile, engineering, agriculture, and small NBFCs. The company also provides trade advance to auto dealers for inventory funding. SME lending and leasing would be the growth engines in the medium term. The company is well on track to achieve FY2025 guidance given earlier.

Succession plan in place: The company has put up a succession plan for Mr. Ramesh Iyer (Vice Chairman and MD) who would retire in April 2024. Mr. Raul Rebello (currently COO) will be appointed as MD and CEO to ensure a smooth transition.

Results (Standalone) Rs cr

Particulars	Q3FY23	Q3FY22	Y-o-Y %	Q2FY23	Q-o-Q %
Net Interest Income	1,553	1,535	1%	1,448	7%
Other income	97	56	72%	93	4%
Net Income	1,650	1592	4%	1,541	7%
Opex	651	529	23%	677	-4%
Operating Profit	998	1062	-6%	864	16%
Provisions	155	-147	NM	199	-22%
PAT	629	894	-30%	448	40%

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Economic recovery is encouraging; Rural demand expected to pick up

The Indian economy has been witnessing a sharp revival, which is expected to benefit primary sectors, including automobiles and infrastructure. Recovery in the automobile 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 improving. There are some green shoots in rural demand picking up, driven by higher income due to good monsoon and good kharif crop. NBFCs with a diverse product offering strategy, strong asset liability management, robust liquidity buffers, strong risk management framework, healthy liability franchise, and are well-capitalised have ample growth opportunities for growth

■ Company outlook - Earnings outlook positive

Business momentum remains strong as reflected in disbursement volumes. We believe strong business growth is here to sustain, given the robust underlying demand trends, the company's position in the rural/ semi-urban customer segment, and better credit filters after pandemic-induced stress. Earnings trajectory is also expected to be healthy. A majority of the clean-up has been done through accelerated write-offs in the past. Additionally, its subsidiaries add to the company's overall value. Key monitorable would be margins going forward.

■ Valuation - We maintain our Buy rating with a revised PT of Rs. 290

Mahindra Finance continued to report healthy performance in terms of disbursement numbers, exhibiting strong underlying demand and market share gains. Asset-quality metrics are expected to remain stable. Additionally, the company is diversifying its growth engines and increasing its non-vehicle financing share in SME, LAP, and digital segments. We believe the earnings trajectory is going to positively surprise going forward, led by strong business growth and lower opex adding to operating leverage along with contained credit cost. At the CMP, the stock trades at 1.8x/1.6x/1.3x its FY2023E/FY2024E/FY2025E BV estimates.

Peer Comparison

Companies	CMP (Rs/ Share)	MCAP (Rs Cr)	P/E (x)		P/B (x)		RoE (%)		RoA (%)	
			FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
M&M Finance	243	30,023	14.7	10.6	1.8	1.6	11.2	12.7	2.1	2.3
Cholamandalam	780	64,115	25.0	22.2	4.7	4.0	19.4	19.4	2.8	3.0

Source: Company; Sharekhan Research

About company

Mahindra Finance is a subsidiary of Mahindra and Mahindra Limited. The company 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. The company has a strong network of 1,386 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 strong business growth is here to sustain, given the robust underlying demand trends, the company's position in the rural/semi-urban customer segment, and better credit filters after pandemic-induced stress. Earnings trajectory is also expected to be healthy, as credit costs are expected to moderate. A majority of the cleanup has been done through accelerated write-offs in the past. Additionally, the company's subsidiaries add to its 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. Raul Rebello	Chief Operating Officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	MAHINDRA & MAHINDRA LTD	52.16
2	LIFE INSURANCE CORP OF INDIA	7.02
3	WISHBONE FUND PVT STD	2.74
4	HDFC LIFE INSURANCE CO LTD	2.58
5	HDFC ASSET MANAGEMENT CO LTD	2.10
6	SBI FUNDS MANAGEMENT LTD	1.85
7	BLACKROCK INC	1.64
8	VANGUARD GROUP INC	1.52
9	KOTAK MAHINDRA ASSET MANAGEMENT CO LTD	1.40
10	NIPPON LIFE INDIA ASSET MANAGEMENT LTD	1.29

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

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Disclaimer: This document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This Document is subject to changes without prior notice. This document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved) and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other reports that are inconsistent with and reach different conclusions from the information presented in this report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst has not dealt or traded directly or indirectly in securities of the company and that all of the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst and SHAREKHAN further certifies that neither he or his relatives or Sharekhan associates has any direct or indirect financial interest nor have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report nor have any material conflict of interest nor has served as officer, director or employee or engaged in market making activity of the company. Further, the analyst has also not been a part of the team which has managed or co-managed the public offerings of the company and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Limited or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either, SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

Compliance Officer: Ms. Binkle Oza; Tel: 022-61150000; email id: complianceofficer@sharekhan.com;

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

Registered Office: Sharekhan Limited, The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA, Tel: 022 - 67502000/ Fax: 022 - 24327343. 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.