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Mahindra Finance

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Asset quality continues to improve; demand momentum positive

CMP	Target Price
Rs 259 as of (April 28, 2023)	Rs 270 (■) 12 months
Rating	**Upside**
HOLD (■)	4.2 %

- Mahindra Finance (MMFS) reported Q4FY23 PAT of ~Rs6.84bn (+8.8% QoQ/+13.9% YoY), a ~51% beat on consensus estimates primarily driven by significantly-lower provisions at Rs3.8mn vs. Rs1,551mn in Q3FY23. Operating profit declined by ~5.4% QoQ on account of margin compression and higher operating expenses. FY23 PAT stood at Rs19.84bn, doubling over FY22.
- Disbursements were marginally weaker sequentially, off the high base in Q3 (festive season) at Rs137.78mn (-4.8% QoQ/+49.7% YoY). Sequential weakness was witnessed in auto and tractor disbursements. Business assets, however, displayed healthy growth at 7.5% QoQ/27.4% YoY to ~Rs827.7bn, on account of lower repayments. Disbursements in FY23 were the highest ever, at ~Rs495.4bn (+79.6% YoY).
- Calc. margins were slightly compressed, by 8bps in Q4, owing to rising cost of funds and increased focus of MMFS on the lower-yielding affluent segment. Calc. CoF rose by 13bps QoQ. Operating expenses were sequentially higher by 19.5% QoQ, as MMFS continues to invest in technology. Opex-to-AUM stood at 3.9% (Q3: 3.5%).
- Asset quality continued to witness significant improvement, with GS3 and NS3 declining 144bps and 65bps QoQ to 4.49% and 1.87%, respectively. GS3 and NS3 have substantially improved over FY23, from 7.7% and 3.4%, as of Q4FY22. PCR on stage 3 assets stood at 59.5% (Q3: 59%). Stage 2 assets improved 240bps QoQ to 6%. Restructured assets of Rs5.39bn have been cured and are now classified under stage 1. The overall restructured book now stands at Rs16.35bn (2% of the business assets) vs. Rs26.4bn, as of Q3 (3.4% of business assets). Credit cost was negligible in Q4, as resumption of repossessions led to reversal of provisions of ~Rs6bn, entirely offsetting the write-offs. Overall ECL declined by ~100bps QoQ to ~4%.
- We assume coverage on the stock with a HOLD rating and a Mar-24E TP of Rs270/share, using the excess return on equity (ERE) method for Mar-25E P/BVPS of 1.7x, for FY25E RoA of ~2.3% and RoE of ~15.6%. **Key risks to our assumptions:** Macroeconomic slowdowns negatively impacting rural cash flows and weighing down on growth and asset quality.

- **What we liked:** 1) Positive guidance on asset quality in terms of low volatility going ahead augurs well for MMFS. 2) Lower credit costs leading to improved profitability sequentially. **What we did not like:** Sequential margin compression and higher operating expenses.
- **Management guidance:** i) Aim to list the housing subsidiary after 3 years. ii) Comfortable at a leverage levels of 5.5-6x . iii) RoE guidance of 15%. iv) There should be less volatility in GS3, going ahead. v) MMFS will continue investing in technology and expanding its network.

Financial Snapshot (Standalone)

(Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Net income	57,986	64,794	81,755	1,03,479	1,28,747
Net profit	9,888	19,843	21,979	30,295	36,963
EPS (Rs)	8.0	16.1	17.8	24.5	29.9
ABV (Rs)	126.5	138.3	149.4	164.8	186.0
RoA (%)	1.3	2.3	2.1	2.3	2.3
RoE (%)	6.5	12.1	12.4	15.6	17.0
P/E (x)	32.4	16.1	14.6	10.6	8.7
P/ABV (x)	2.0	1.9	1.7	1.6	1.4

Source: Company, Emkay Research

Change in Estimates	
EPS Chg FY24E/FY25E (%)	-/
Target Price change (%)	NA
Target Period (Months)	12
Previous Reco	HOLD

Emkay vs Consensus

EPS Estimates	FY24E	FY25E
Emkay	17.8	24.5
Consensus	18.8	22.9
Mean Consensus TP (12M)		Rs 277

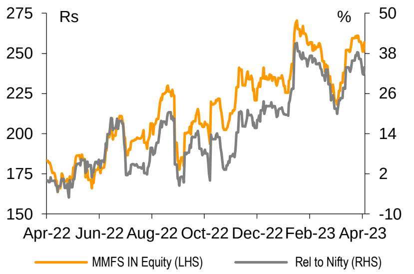
Stock Details	
Bloomberg Code	MMFS IN
Face Value (Rs)	2
Shares outstanding (mn)	1,236
52 Week H/L	272 / 161
M Cap (Rs bn/USD bn)	320 / 3.91
Daily Avg Volume (nos.)	36,80,104
Daily Avg Turnover (USD mn)	11.1

Shareholding Pattern Mar '23	
Promoters	52.2%
FIIs	14.9%
DIIs	25.2%
Public and Others	7.8%

Price Performance

(%)	1M	3M	6M	12M
Absolute	17	15	26	42
Rel. to Nifty	10	12	24	36

Relative price trend



Source: Bloomberg

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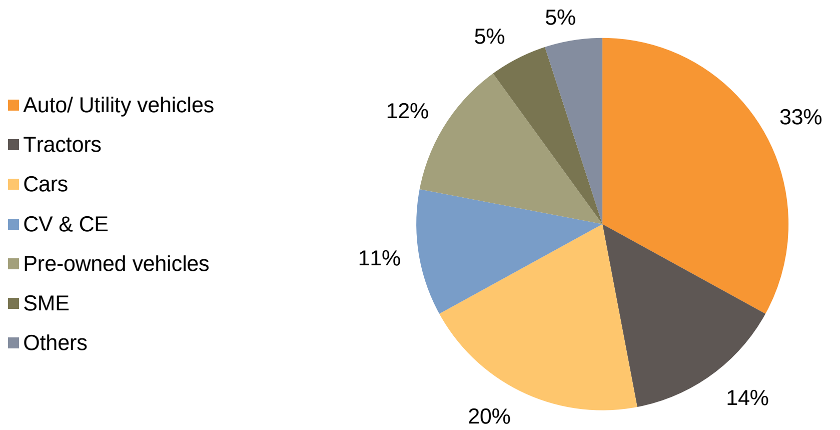
- **Our forecast:** Given the increased focus of MMFS on growing pre-owned cars, LAP and the leasing book, in addition to improvement in rural cash flows, we have built-in a disbursement CAGR of ~26% over FY23-26E, resulting in a similar growth in business assets over the same period. As new loans, especially in the fixed rate vehicle finance portfolio, are disbursed at the current higher rate, we expect margins to rise over the forecast period with average NIMs of ~7.8% over FY24-26E. As operating efficiencies kick-in for MMFS, we expect operating expense metrics to moderate over the forecast period, with opex-to-AUM declining from ~3.3% in FY23 to ~2.6% in FY26E. With decreasing volatility in GS3 expected by the Management and the significant improvement in asset quality seen over FY23, we expect average credit costs of ~2.3% over FY24-26E. While credit cost is higher vis-à-vis FY23, the FY23 credit cost was lower on account of reversal of provisions created during COVID-19. We have, thus, built-in FY26E RoA of ~2.3%, translating into RoE of ~17.4%.

Exhibit 1: Summary Financials

(Rs mn)	4QFY22	1QFY23	2QFY23	3QFY23	Q4FY23	YoY	QoQ	FY23	FY24E	YoY
Interest Income	23,917	24,372	25,163	27,947	29,344	22.7%	5.0%	1,06,826	1,40,128	31.2%
Interest Expenses	9,357	9,320	10,688	12,419	13,340	42.6%	7.4%	45,767	62,744	37.1%
Net Interest Income	**14,560**	**15,052**	**14,475**	**15,528**	**16,004**	**9.9%**	**3.1%**	**61,059**	**77,384**	**26.7%**
Other Income	747	614	930	969	1,223	63.8%	26.3%	3,735	4,374	17.1%
Total Income	15,306	15,666	15,405	16,496	17,227	12.5%	4.4%	64,794	81,758	26.2%
Operating Expenses	6,327	6,208	6,768	6,513	7,786	23.1%	19.5%	27,276	30,278	11.0%
Operating Profit	**8,979**	**9,458**	**8,637**	**9,983**	**9,441**	**5.1%**	**-5.4%**	**37,518**	**51,480**	**37.2%**
Provisions	639	6,453	1,985	1,551	4	-99.4%	-99.8%	9,992	21,804	118.2%
Credit cost share of avg. Business Assets	0.4%	3.9%	1.1%	0.8%	0.0%	-39bps	-82bps	1.4%	2.3%	98bps
PBT	8,341	3,005	6,652	8,431	9,437	13.1%	11.9%	27,526	29,676	7.8%
Tax	2,333	776	1,624	2,142	2,596	11.3%	21.2%	7,138	7,627	6.9%
Tax rate	28.0%	25.8%	24.4%	25.4%	27.5%		2bps	25.9%	25.7%	
PAT	**6,008**	**2,229**	**4,483**	**6,290**	**6,841**	**13.9%**	**8.8%**	**19,843**	**22,049**	**11.1%**
Business assets	**6,49,610**	**6,76,930**	**7,38,170**	**7,70,000**	**8,27,700**	**27.4%**	**7.5%**	**8,27,700**	**10,43,880**	**26.1%**
Disbursements	**92,020**	**94,720**	**1,18,240**	**1,44,670**	**1,37,780**	**49.7%**	**-4.8%**	**4,95,410**	**6,23,207**	**25.8%**
GS3 (%)	7.7	8.0	6.7	5.9	4.5	-321bps	-144bps	4.5	4.3	-14bps
NS3 (%)	3.4	3.5	2.9	2.5	1.9	-153bps	-65bps	1.9	1.8	-6bps
PCR (%)	58.1	58.1	58.2	59.0	59.5	136bps	46bps	59.5	59.5	0bps

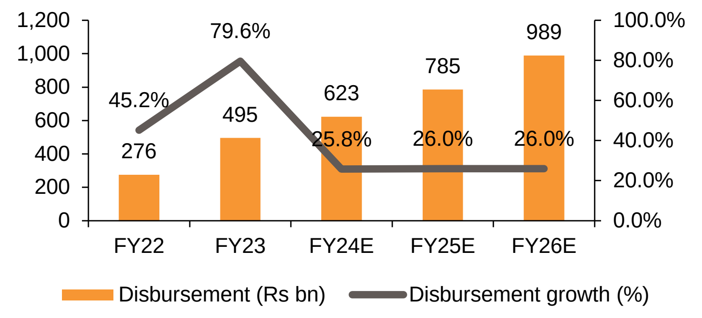
Source: Company, Emkay Research

Exhibit 2: Business asset mix dominated by vehicle finance, with increasing focus on growing SME, pre-owned cars and leasing, going ahead



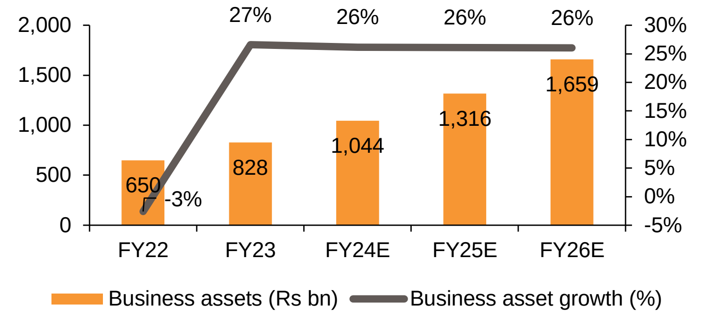
Source: Company, Emkay Research

Exhibit 3: Disbursement growth of 26% over FY23-26E, on the back of improved demand and increased focus on new products…



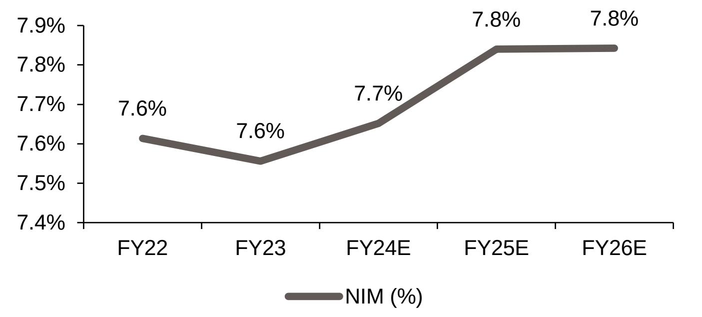
Source: Company, Emkay Research

Exhibit 4: …resulting in business asset growth of 26% over the same period



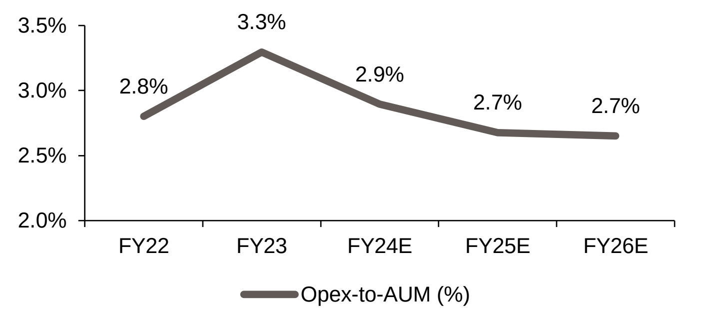
Source: Company, Emkay Research

Exhibit 5: We expect NIMs to improve, as new loans are issued at the higher marginal rate



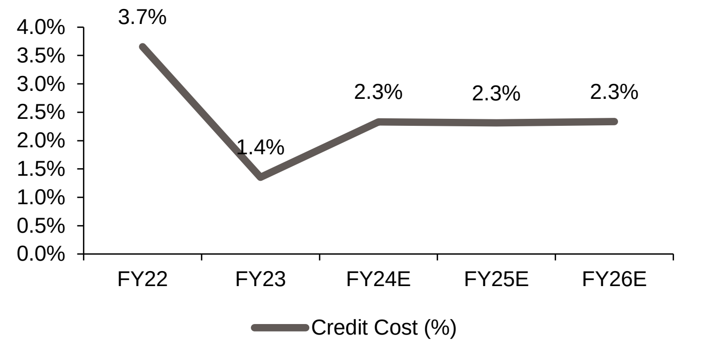
Source: Company, Emkay Research

Exhibit 6: Operating leverages are expected to kick-in, resulting in improvement in opex-to-AUM over FY23-26E



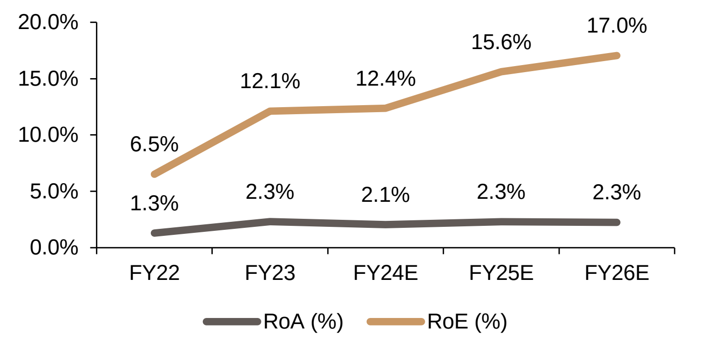
Source: Company, Emkay Research

Exhibit 7: Lower GS3 volatility and improved cash flows are expected to result in average credit costs of ~2.3% over FY23-26E…



Source: Company, Emkay Research

Exhibit 8: …resulting in FY26E RoA of ~2.2% and RoE of ~17%



Source: Company, Emkay Research

Concall Highlights

- MMFS is positive on the rural demand momentum, and rural cash flow is holding up, measured by demand for vehicle loans and margin money brought in by customers and collection efficiency.
- 15-20% of MMFS's business is self-generated.
- Brought rigor to cost by taking a clear decision on processes that are not required and focusing more on using technology infrastructure and right partnerships.
- As a part of its growth strategy, Company is changing its customer mix by focusing on affluent rural and semi urban customers than customer segments that were a pain point during the stressful period. Apart from its vehicle financing business, MMFS will be focusing more on MSME LAP, leasing book (working with more than 250 corporates now), consumer loan and PL for the existing customer base.
- Company has gained market share in most categories, while maintaining its leadership position in the pre-owned car segment and new tractor financing.
- MMFS has no plan to enter the metro market. Its focus is on continual growth and gaining market share in rural and semi-urban markets.
- Primary focus is on improving asset quality and choosing the right customer while letting go of the vulnerable customer segment, to mitigate the credit risk. This has been volatile in the past and may see stability here on because of low NNPA and the right customer mix. PCR will be maintained at 60% levels.
- MMFS should not be seen as a captive finance company; only 1/3rd of the customers are M&M customers, and MMFS is the sole decision maker with respect to financing decisions.
- In its housing subsidiary, MMFS applying its learnings from past experience for creating efficient strategies for business growth; it is expected to see improvement over a 3-year period. MMFS might even look to launching an IPO with respect to this business, after 3 years.
- Sustainable growth to come from product mix, with higher growth from vehicle loans (leadership position), new tractor finance (leadership position), LAP yielding more with less opex and low credit cost, and keeping the pricing protected. Most of the portfolio qualifies for PSL.
- In the unsecured business, lending is undertaken in a measured way and company is not expanding aggressively. Asset quality and customer experience is more important.
- At the current level, MMFS will be able to absorb an additional 25bps hike, but any further hike would be passed-on, similar to other players in the market.
- Comfortable leverage levels at 5.5x-6x.
- The company will continue investing in technology and data, and hence opex ratio is expected to peak out and then gradually lower down.
- Cash collection has come down to 35% from 55-60% levels; no new employees were added to the collection team, whereas some employees have been reallocated to the debt collection and business team.
- Currently, the company is operating from 1,400 branches and expects to open another 200 branches.

Key Financials (Standalone)

Income Statement

Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Net interest income	**55,554**	**61,059**	**77,381**	**98,070**	**1,22,150**
Other income	**2,432**	**3,735**	**4,374**	**5,409**	**6,596**
Net income	57,986	64,794	81,755	1,03,479	1,28,747
Operating expenses	**20,734**	**27,276**	**30,278**	**35,301**	**44,076**
Pre provision profit	37,252	37,518	51,477	68,178	84,671
PPP excl treasury	**37,252**	**37,518**	**51,477**	**68,178**	**84,671**
Provisions	**23,683**	**9,992**	**21,804**	**27,278**	**34,768**
Profit before tax	13,569	27,526	29,673	40,901	49,903
Tax	**3,682**	**7,138**	**7,694**	**10,606**	**12,940**
Tax rate	27	26	26	26	26
Profit after tax	9,888	19,843	21,979	30,295	36,963

Source: Company, Emkay Research

Balance Sheet

Y/E Year End (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Equity	2,466	2,467	2,467	2,467	2,467
Reserves	1,53,815	1,68,422	1,82,220	2,01,239	2,27,470
Net worth	**1,56,281**	**1,70,889**	**1,84,687**	**2,03,706**	**2,29,937**
Other Liabilities and Provisions	38,467	41,818	43,909	46,104	48.409
Borrowings	5,58,139	7,49,459	9,46,267	12,15,105	15,40,054
Total liabilities	**7,52,887**	**9,62,166**	**11,74,863**	**14,64,916**	**18,18,401**
Cash and bank	41,507	28,321	18,181	30,279	30,404
Investments	84,403	99,886	1,09,875	1,20,862	1,38,992
Loans	6,04,446	7,94,547	10,03,196	12,65,735	15,95,911
Others	18,603	32,456	35,612	39,241	43,415
Total assets	**7,52,887**	**9,62,166**	**11,74,863**	**14,64,916**	**18,18,401**

Source: Company, Emkay Research

Key Ratios (%)

Y/E Year End	FY22	FY23	FY24E	FY25E	FY26E
NIM	7.6	7.6	7.7	7.8	7.8
RoA	1.3	2.3	2.1	2.3	2.3
RoAE	6.5	12.1	12.4	15.6	17.0
GNPA (%)	7.7	4.5	4.3	4.2	4.1
NNPA (%)	3.5	1.9	1.8	1.8	1.7

Source: Company, Emkay Research

Per Share Data (Rs)	FY22	FY23	FY24E	FY25E	FY26E
EPS	8.0	16.1	17.8	24.5	29.9
BVPS	126.5	138.3	149.4	164.8	186.0
ABVPS	126.5	138.3	149.4	164.8	186.0
DPS	3.6	6.0	6.6	9.1	8.7

Source: Company, Emkay Research

Valuations (x)	FY22	FY23	FY24E	FY25E	FY26E
PER	32.4	16.1	14.6	10.6	8.7
P/BV	2.0	1.9	1.7	1.6	1.4
Dividend Yield (%)	1.4	2.3	2.6	3.5	3.4

Source: Company, Emkay Research

Growth (%)	FY22	FY23	FY24E	FY25E	FY26E
NII	0.4	9.9	26.7	26.7	24.6
PPOP	(10.3)	0.7	37.2	32.4	24.2
PAT	200.5	106.2	7.8	37.8	22.0
Loans	0.8	31.5	26.3	26.2	26.1

Source: Company, Emkay Research

Quarterly (Rs mn)	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23
NII	14,560	15,052	14,475	15,528	16,004
NIM (%)	8.1	8.2	7.5	7.4	7.4
PPOP	8,979	9,458	8,637	9,983	9,441
PAT	6,008	2,229	5,028	6,290	6,841
EPS (Rs)	2.20	2.03	2.03	1.95	1.87

Source: Company, Emkay Research

Shareholding Pattern (%)	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Promoters	52.2	52.2	52.2	52.2	52.2
FIIs	17.9	17.6	16.9	16.1	14.9
DIIs	16.2	18.0	22.1	23.8	25.2
Public and Others	13.8	12.3	8.8	8.0	7.8

Source: Capitaline

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