Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Mahindra & Mahindra Financial Services Ltd

Progressing well on guided lines

NBFC	Sharekhan code: M&MFIN

Reco/View: Buy	↔	CMP: **Rs. 259**	Price Target: **Rs. 315**	↑

↑ 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 March 08, 2023

Low Risk

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

Source: Morningstar

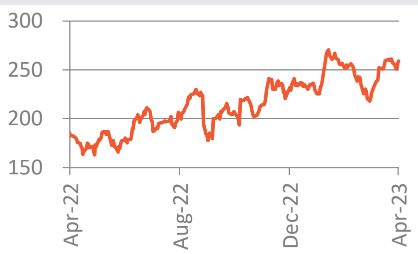
Company details

Market cap:	Rs. 31,994 cr
52-week high/low:	Rs. 272/ 161
NSE volume: (No of shares)	39.0 lakh
BSE code:	532720
NSE code:	M&MFIN
Free float: (No of shares)	59.3 cr

Shareholding (%)

Promoters	52.2
FII	14.9
DII	25.2
Others	7.8

Price chart



Price performance

()	1m	3m	6m	12m
Absolute	17.2	14.6	25.7	42.3
Relative to Sensex	11.1	11.6	23.8	36.1

Sharekhan Research, Bloomberg

Summary

- M&M Finance has been reporting strong asset-quality performance with GS3 and NS3 assets improving to 4.5%/1.9% vs. 5.9%/2.5% q-o-q, respectively. GS2 assets declined to 6.0% vs. 8.4% q-o-q. PCR on Stage-3 assets remained stable q-o-q at 59%.
- PAT beat was mainly due to the negligible credit cost reported for the quarter. On the operational front, numbers missed expectations due to NIM (calculated as a % of average loan assets) declining by 20bps q-o-q to 8% and higher opex growth with opex-to-average loan assets at ~3.9% vs. ~3.4% q-o-q.
- Loan assets grew by 27% y-o-y, aided by strong disbursement growth of 80% y-o-y in FY2023. Disbursement growth is expected to moderate going forward due to a higher base in the trailing 12 months; however, there are no demand concerns.
- Business momentum is progressing well on its guided vision 2025 and is expected to remain healthy, augmented by M&M's new product, increasing share of pre-owned vehicles, and the company diversifying into the semi-urban, rural affluent, and MSME segments. At the CMP, the stock trades at 1.7x/ 1.4x its FY2024E/FY2025E BV estimates, respectively. We maintain our Buy view with a revised PT of Rs. 315.

M&M Financial Services Limited (MMFSL) reported healthy business growth for Q4FY2023 and FY2023, driven by strong tailwinds in the sector. Net interest income (NII) grew by 10% y-o-y/3% q-o-q. Margins (calculated) declined 20 bps q-o-q to 8% due to rising cost of funds keeping spreads under pressure despite pick-up in yields. Total operating expenses increased by 23% y-o-y and 20% q-o-q. The company's focus is on strengthening tech capabilities and scaling up the business through building a strong digital stack, which should keep opex growth higher in the near term. Opex growth is likely to moderate over the medium term. Operating profit grew by ~5% y-o-y and fell by 5% q-o-q for the quarter. Total credit cost was negligible during the quarter vs. 82 bps q-o-q. PAT stood at Rs. 684 crore (up 14% y-o-y/9% q-o-q). Gross Stage-3 and Net Stage-3 assets declined by ~140 bps/60 bps q-o-q to 4.5%/1.9%. PCR on Stage-3 assets remained stable q-o-q at 59%. Gross Stage-2 assets also declined by 140 bps q-o-q to 6%. GNPA as per the Reserve Bank of India's (RBI) IRAC norms was higher by Rs. 1,184 crore when compared to IND-AS Gross Stage-3 assets. However, the company does not foresee any impairment charge on account of IRAC migration.

Key positives

- Asset-quality trends turning better than expectations.
- Credit cost was almost nil.

Key negatives

- Opex growth was higher, led by new business initiatives, higher collection-related spends, and rise in the training cost of employees.

Management Commentary

- Sentiments in rural markets across geographies remain positive, measured by rising volumes, strong collection efficiency, healthy cash flows, good monsoon outlook, and pick-up in infra activity.
- Management is confident of delivering healthy business growth, augmented by new vehicle volumes, increasing share of pre-owned vehicles (to support yield and gain market share), and diversifying into the semi-urban, rural-affluent, and MSME segments. New business now contributes 6% to overall loans.
- Going ahead, margins are expected to be lower due to change in the product mix and customer mix towards affluent customers. However, at the ROA level, the impact will be offset by lower credit cost and opex.

Our Call

Valuation – We maintain our Buy rating with a revised PT of Rs. 315: MMFSL continued to report healthy business momentum, exhibiting strong underlying demand. Asset-quality metrics are expected to remain stable in the near term. We believe the earnings trajectory is going to positively surprise going forward, led by healthy business growth and benign credit cost. Moreover, the company is embarking on high-performance culture along with strong risk culture embedded, which is a key positive. At the CMP, MMFSL trades at 1.7x and 1.4x its FY2024E and FY2025E ABV, respectively.

Key Risks

Economic slowdown can result in slower loan growth, lower-than-expected margins, and higher-than-anticipated credit cost.

Valuation (Standalone) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
NII	5,555	6,106	7,661	8,427
PAT	989	1,984	2,570	2,827
EPS (Rs.)	8.0	16.1	20.8	22.9
ROA	1.3	2.3	2.3	2.3
ROE	6.5	12.1	12.7	12.7
P/E (x)	27.5	15.7	10.8	9.7
P/BV (x)	2.0	1.9	1.7	1.4

Source: Company; Sharekhan estimates

Key result highlights

- **Margin outlook:** NII grew by 10% y-o-y/3% q-o-q. Margins (calculated) declined by 20bps q-o-q to 8% due to rising cost of funds, keeping spreads under pressure despite pick-up in yields. Management has guided that there could be some margin compression going forward due to a 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.
- **Opex growth elevated:** Total operating expenses increased by 23% y-o-y and 20% q-o-q. Opex growth was higher, led by new business initiatives, higher collection-related spends, tech spends, and rise in the training cost of employees. The company expects reduction in opex over the medium term, which should add to operating leverage.
- **Asset-quality matrix trends better:** Gross Stage-3 and Net Stage-3 assets declined by ~140 bps/60 bps q-o-q to 4.5%/1.9%. PCR on Stage-3 assets remained stable q-o-q at 59%. Gross Stage-2 assets also declined by 140 bps q-o-q to 6%. GNPA as per the RBI's IRAC norms was higher by Rs. 1,184 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. Reduction in credit cost was led by lower GS3 and GS2 assets. 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 are driving robust disbursement growth. Sentiments in the rural market across geographies remain positive, measured by rising volumes, strong collection efficiency, healthy cash flows, good monsoon outlook, and pick-up in infra-activity. SME lending is done towards sectors such as automobile, engineering, agriculture, and small NBFCs. The company also provides trade advances to auto dealers for inventory funding. Management is confident of delivering healthy business growth, augmented by new vehicle volumes, increasing share of pre-owned vehicles (to support yield and gain market share), and diversifying into the semi-urban, rural-affluent, and MSME segments. New business now contributes 6% to overall loans. The company is well on track to achieve FY2025 guidance given earlier.
- **Others:** The company intends to improve its distribution network by adding 200 more branches by FY2025 and adding new partnerships. The company is embarking on a high-performance culture along with strong risk culture embedded, which is a key positive.

Results (Standalone) **Rs cr**

Particulars	Q4FY23	Q4FY22	y-o-y	Q3FY23	q-o-q
Net Interest Income	1,600	1,456	10%	1,553	3%
Other income	122	75	64%	97	26%
Net Income	1722	1531	13%	1,650	4%
Opex	779	633	23%	651	20%
Operating Profit	944	898	5%	998	-5%
Provisions	0.4	64	-99%	155	-100%
PAT	684	601	14%	629	9%

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Economic recovery is encouraging; Rural demand expected to pick up

The Indian economy has experienced a fast recovery, which is anticipated to help important industries like transportation and infrastructure. Although the past six months of growth in the automotive industry have been encouraging, private capital expenditures have not yet increased. The auto finance market is expanding, and trends in asset quality are rising. There are some promising signs of a rise in rural demand. NBFCs with a diverse product offering strategy, strong asset liability management, robust liquidity buffers, strong risk management framework, and healthy liability franchise are well capitalised and have ample growth opportunities.

■ Company Outlook – Earnings outlook positive

Business momentum remains strong, as reflected in disbursement volumes. We believe business growth would slightly moderate due to a higher base, but it would remain healthy 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. The 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 monitorables would be margins going forward.

■ Valuation – We maintain our Buy rating with a revised PT of Rs. 315:

MMFSL continued to report healthy business momentum, exhibiting strong underlying demand. Asset-quality metrics are expected to remain stable in the near term. We believe the earnings trajectory is going to positively surprise going forward, led by healthy business growth and benign credit cost. Moreover, the company is embarking on high-performance culture along with strong risk culture embedded, which is a key positive. At the CMP, MMFSL trades at 1.7x and 1.4x its FY2024E and FY2025E ABV, respectively.

Peer Comparison

Companies	CMP (Rs/ Share)	MCAP (Rs Cr)	P/E (x)		P/B (x)		RoE (%)		RoA (%)	
			FY24E	FY25E	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
M&M Finance	259	31,994	10.8	9.7	1.7	1.4	12.7	12.7	2.3	2.3
Cholamandalam	871	71,623	23.6	19.9	3.9	3.5	19.4	20.2	3.0	2.7

Source: Company; Sharekhan Research

About the company

MMFSL is a subsidiary of Mahindra and Mahindra Limited. The company is one of India's leading non-banking finance companies focusing on rural and semi-urban areas. The company finances the 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 five 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. The earnings trajectory is also expected to be healthy, as credit costs are expected to remain benign. 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 can result in slower loan growth, lower-than-expected margins, and higher-than-anticipated credit cost.

Additional Data

Key management personnel

Ramesh Iyer	Vice Chairman and Management Director
Vivek Karve	Chief Financial Officer
Raul Rebello	Chief Operating Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Mahindra & Mahindra Ltd.	52.2
2	Life Insurance Corp of India	7.2
3	Wishbone Fund Pvt. Ltd.	2.7
4	HDFC Life Insurance Co. Ltd.	2.6
5	Wishbone Fund Ltd.	2.3
6	HDFC Asset Management Co. Ltd.	2.2
7	Axis Amc Ltd.	1.8
8	Vanguard Group Inc.	1.8
9	SBI Funds Management Ltd	1.7
10	Kotak Mahindra Asset Management Co Ltd	1.5

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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