AXIS CAPITAL

Mahindra & Mahindra Financial Services

Near term soft, structural drivers intact

Financials | Company Update | September 19, 2024

BUY (NO CHANGE)

Current Price (Rs)	: 324
Target Price (Rs)	: 380 (350)
Potential Upside	: 17%

Market Data

No. of shares	: 1,234 mn
Free Float	: 47.8%
Market Cap (USD)	: 4,777 mn
52-week High/ Low (Rs)	: 337/ 237
Avg. Daily Volume (6M)	: 3.71 mn
Avg. Daily Value (6M;USD)	: 12.92 mn
Bloomberg Code	: MMFS IB
Promoters Holding	: 52.2%
FII / DII	: 10% / 21%

Price Performance

(%)	1M	3M	12M
Absolute	9.2	5.6	7.4
Relative	6.1	(1.7)	(15.3)

Source: Bloomberg

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We expect the growth softness to continue in the near term for MMFS (loan growth to remain weak in Q2), though structural drivers remain intact. As the festive season kicks in, we expect disbursements to pick up in H2. Though margin declined in Q1, it has levers in place to address this. With focus on asset quality, we do not expect any major challenges. Medium-term triggers include likelihood of provision reversal benefitting the earnings, recent approval to enter mortgage business to emerge as a balance sheet driver and room for operating leverage. Tier I at 16.4% is adequate for now, it will look to raise capital in FY26. We raise estimates by 3-6% on better operating leverage and roll-forward to Sept'26E. Raise TP to Rs 380 (2.2x H1FY27E P/ABV) from Rs 350. BUY.

Growth to remain back-ended

We expect softness in growth to persist in the near term for MMFS given the slowdown in auto volumes especially PVs and tractors where MMFS is a dominant player. However, we expect the growth to revive in H2, as festive season kick starts in. AUM growth in Q1FY25 was steady at 23% YoY/ 4% QoQ, and we expect AUM/ disbursements to grow at ~20%/ 18% YoY in FY25. The company is increasing its share in the used vehicle business (13% of AUM, 17% of disbursements in Q1FY25). Apart, it has decided to foray into mortgage business which will include housing loans/ LAP/ LRD etc. While the team is gradually getting in place, this will drive growth with lumpy and longer duration assets.

Margin levers in place, borrowing mix well diversified

MMFS has initiated adequate measures to address NIM concerns. It has increased the lending rates, which should benefit the company. Borrowing mix is well diversified which keeps the cost of funds under check (only 10 bps QoQ rise in H1). Given a fixed rate book, the company is also better placed to manage NIM in the event of a rate cut. With C/I ratio at ~41%, it has room for operating leverage as and when growth picks up, which should benefit return ratios. It has received corporate agency license from IRDAI to distribute insurance products and has onboarded six partners. This should eventually boost the fees.

Focus on maintaining asset quality

The company envisages to keep GS3 at <3.4% in FY25 (~3.6% in Q1FY25). PCR declined by ~3.5% QoQ to 59.8% in Q1FY25 which is guided by the ECL model. The management expects some more moderation in PCR from current levels towards the end of the year, which may result in some provision release, benefiting the earnings in turn. Consequently, credit costs at ~1.5% in Q1FY25 could come down in H2. Collection efficiency at 94% was in line with the historical trend and should improve from the current levels.

Financial summary (Standalone)

Y/E March	FY23	FY24	FY25E	FY26E	FY27E
Net Income (Rs mn)	64,794	71,355	82,493	94,591	1,08,024
PAT (Rs mn)	19,843	17,596	23,043	27,154	33,996
EPS (Rs)	15.1	13.6	18.7	22.0	27.5
EPS chg (%)	112.2	(10.1)	37.4	17.8	25.2
Previous EPS (Rs)	-	-	17.6	21.4	26.3
Adj BV (Rs)	118.8	133.2	149.5	161.0	176.3
PE (x)	22	24	18	15	12
P/BV (x)	2.6	2.3	2.1	1.9	1.7
RoE (%)	12.5	10.0	12.2	13.3	15.3
RoA (%)	2.4	1.7	1.9	1.9	2.1
Net NPA (%)	1.9	1.3	1.3	1.3	1.3

Source: Company, Axis Capital

MMFS vs CIFC (vehicle finance)

A comparison with Cholamandalam Investment & Finance Company's (CIFC) vehicle finance on key metrics (Q1FY25) indicates that MMFS's business potential remains intact and would converge to better return ratios as growth picks up. While MMFS has lower yields than CIFC currently, this should improve with share of used CV picking up (~13% of AUM). It has also increased the rates over the last two quarters, which should benefit in H2FY25. With C/I ratio at 41% (vs 39% for CIFC), MMFS has room for operating leverage which should be visible in H2. With H2 much better than H1 for vehicle financiers, we expect MMFS to report ~1.9% RoA for FY25.

Exhibit 1: MMFS vs CIFC – Q1FY25 comparison on key metrics

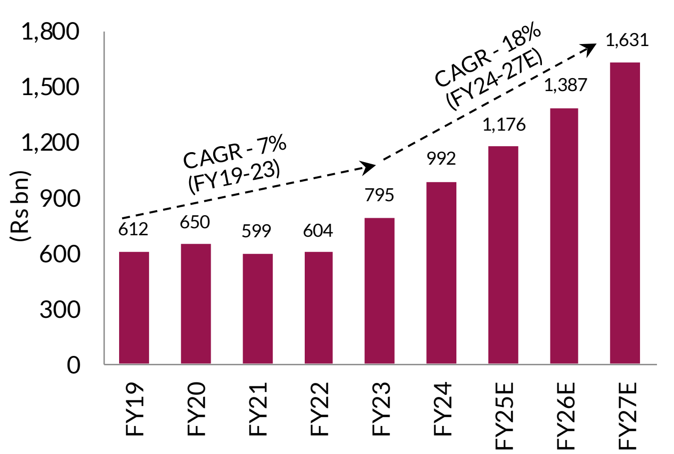
(%)	CIFC (vehicle finance)	MMFS
Yield	15.1	14.3
COF	7.2	7.8
Spreads	7.9	6.5
Credit costs	1.9	1.8
C/I	39.6	41.3
RoA - PBT	2.9	2.4

Source: Company, Axis Capital

AUM to see ~18% CAGR

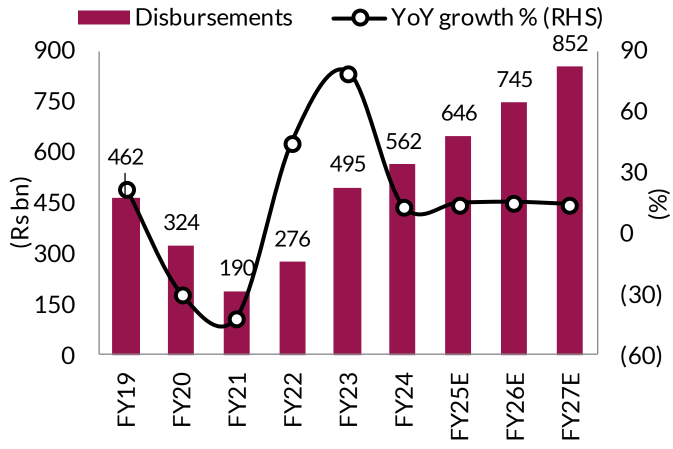
We expect AUM to see a steady CAGR of 18% (FY24-27E). We are currently not factoring in any increase that could arise out of the housing business. SME business will remain a key growth driver. Incrementally, the company is also focusing on pre-owned vehicles (~17% of overall disbursement at Rs 21.17 bn in Q1FY25). Insurance license will aid in accrual of fee income.

Exhibit 2: AUM to see ~18% CAGR



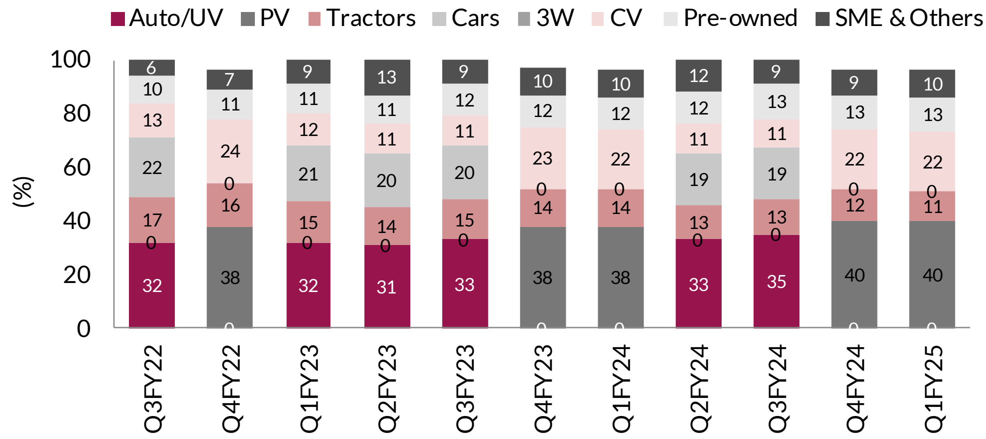
Source: Company, Axis Capital

Exhibit 3: Steady disbursement growth



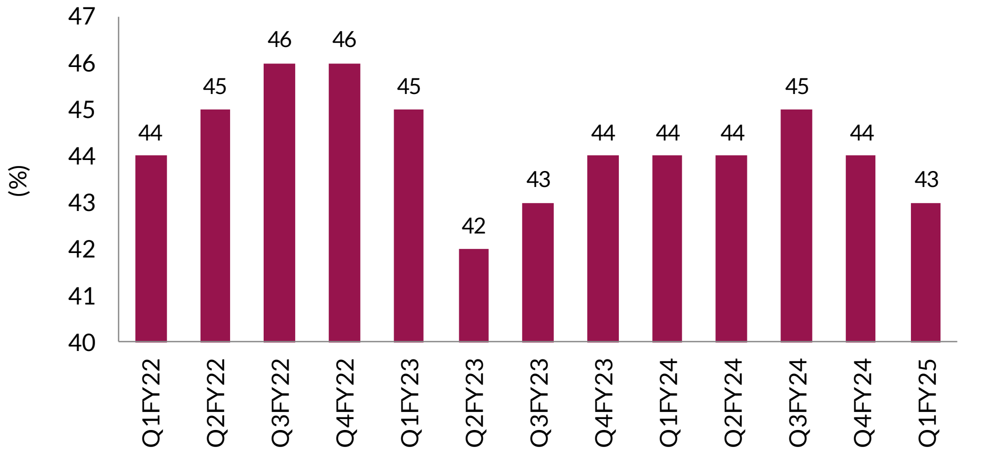
Source: Company, Axis Capital

Exhibit 4: AUM mix



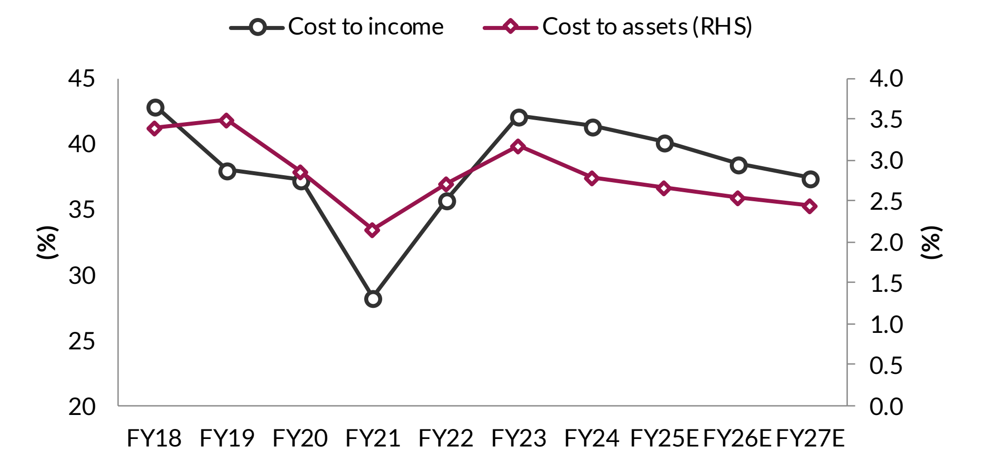
Source: Company, Axis Capital

Exhibit 5: M&M's contribution to total assets declining



Source: Company, Axis Capital

Exhibit 6: Operating leverage to kick in gradually

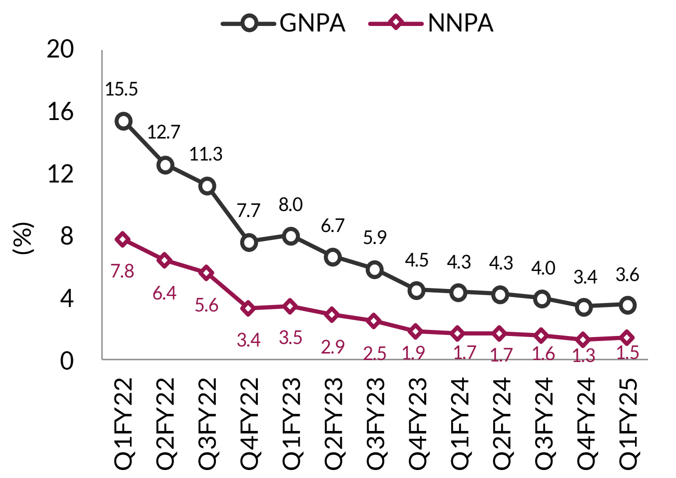


Source: Company, Axis Capital

Asset quality to remain intact

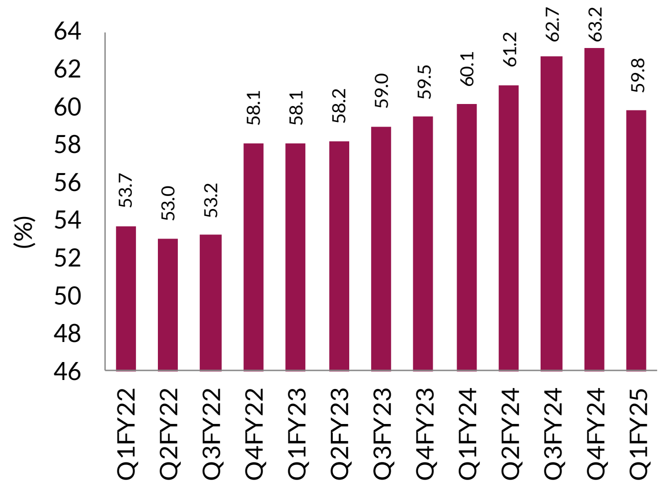
- Stability of asset quality is the utmost priority. The underwriting process has been strengthened with the use of data and analytics and improved review mechanisms aided by automated dashboards.
- It has reduced GNPA to 3.4% from a peak of 15.5% and will try to keep it below ~4% across the cycles. It has guided for a 3.6% GNPA in FY25. It will strive to keep GSII + GSIII at <10% (9.4% in Q1FY25).
- It has some leverage on provision reversals towards the end of the year when the ECL assumptions get revised.

Exhibit 7: Asset quality has been improving



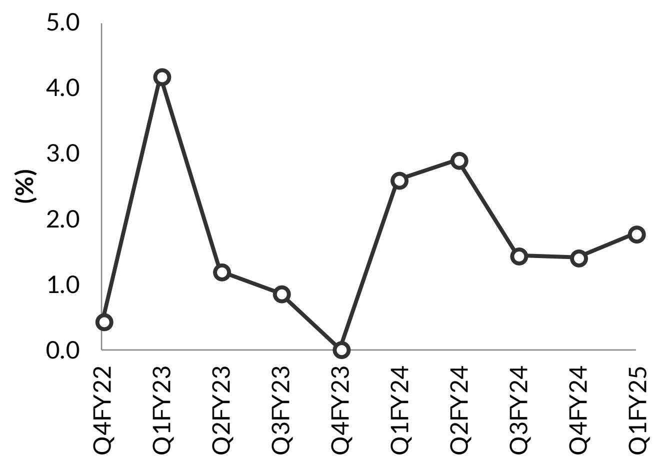
Source: Company, Axis Capital

Exhibit 8: PCR declines in Q1FY25



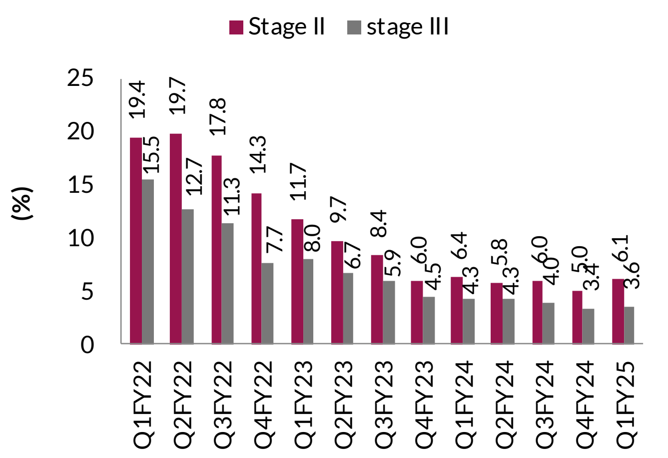
Source: Company, Axis Capital

Exhibit 9: Calculated credit costs a tad higher at 1.8%



Source: Company, Axis Capital

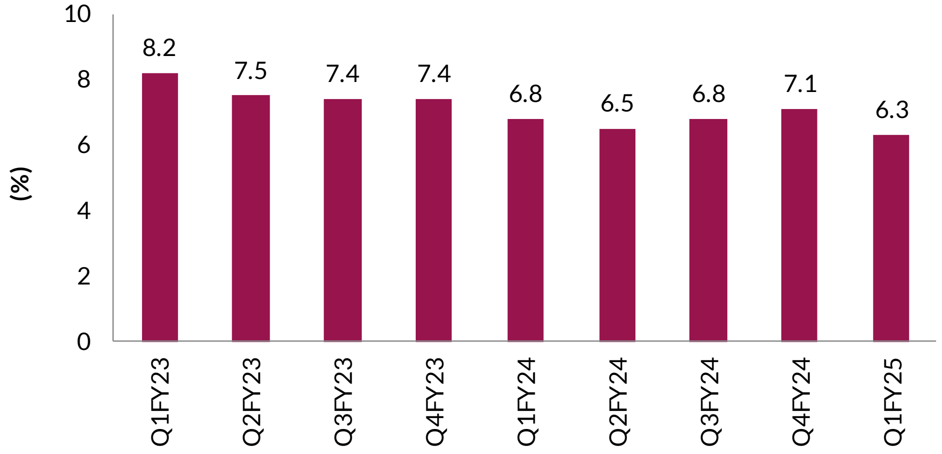
Exhibit 10: Stage 2+3 loans at ~9.7%



Source: Company, Axis Capital

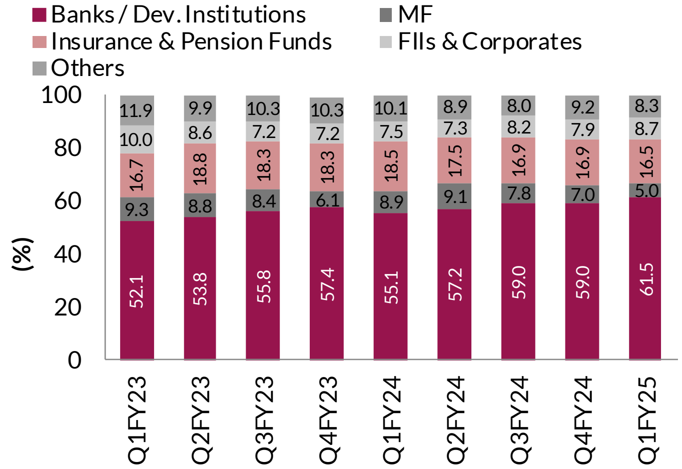
NIM to benefit from recalibration of customer segment. Limits on prime segment reached

Exhibit 11: NIM decline on lower yields, should recoup some bit



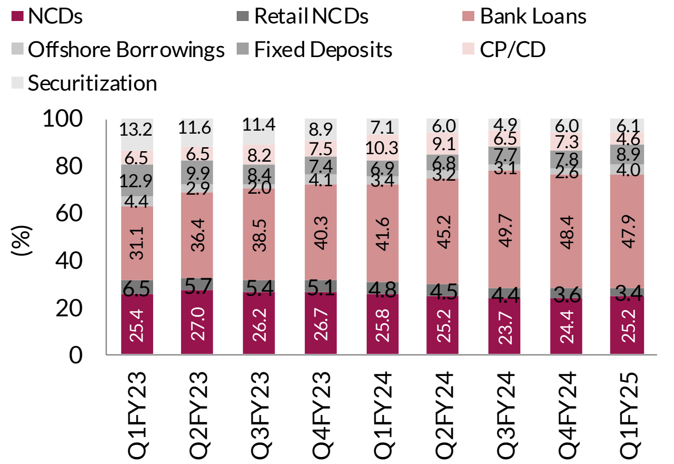
Source: Company, Axis Capital

Exhibit 12: Borrowing mix as per investor



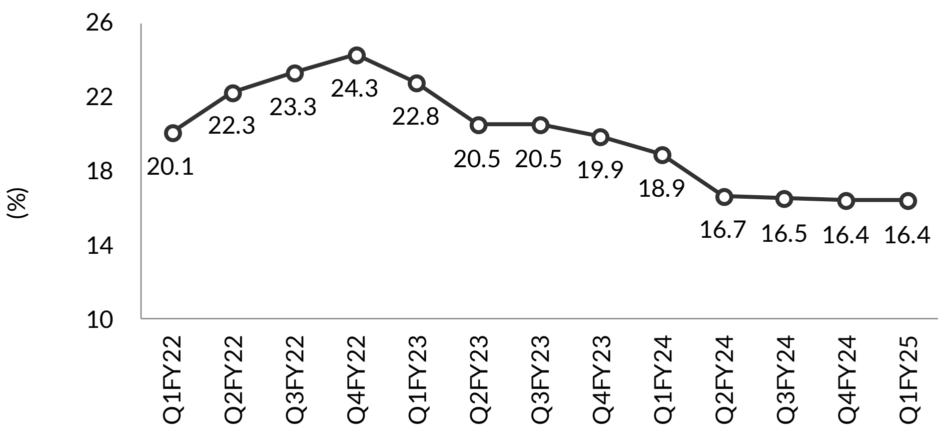
Source: Company, Axis Capital

Exhibit 13: Borrowing mix as per instruments



Source: Company, Axis Capital

Exhibit 14: Tier I at 16.4% comfortable, will look to raise capital in FY26



Source: Company, Axis Capital

Exhibit 15: Spread analysis

Spread analysis	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Q3FY24	Q4FY24	Q1FY25
Total Loan Income / Average Business Assets	13.70%	13.40%	13.70%	13.60%	13.30%	13.10%	13.40%	13.40%	13.10%
Total Income / Average Assets	13.00%	12.70%	13.00%	13.10%	12.70%	12.60%	13.10%	13.30%	12.90%
Interest cost / Average Assets	4.80%	5.20%	5.60%	5.70%	5.90%	6.10%	6.30%	6.20%	6.30%
Gross Spread	8.20%	7.50%	7.40%	7.40%	6.80%	6.50%	6.80%	7.10%	6.60%
Overheads / Average Assets	3.20%	3.30%	2.90%	3.30%	2.80%	2.80%	2.80%	2.90%	2.70%
Write offs & provisions / Average Assets	3.40%	1.00%	0.70%	0.00%	2.10%	2.40%	1.20%	1.20%	1.50%
Net Spread before Tax	1.60%	3.20%	3.80%	4.00%	1.90%	1.20%	2.70%	3.00%	2.40%
Net Spread after Tax	1.20%	2.40%	2.80%	2.90%	1.40%	0.90%	2.10%	2.20%	1.80%

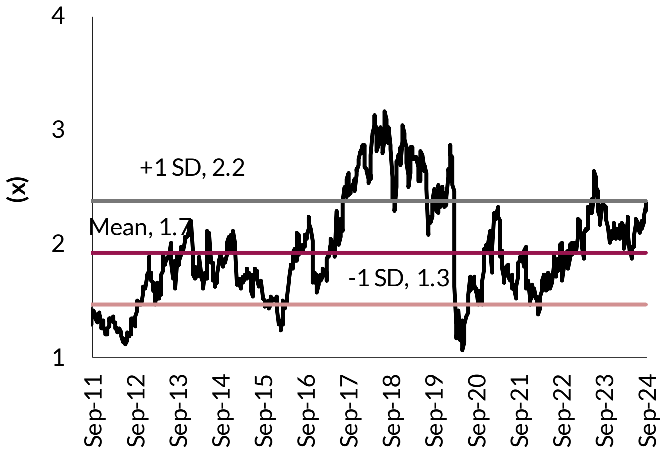
Source: Company, Axis Capital

Exhibit 16: Summary of estimate changes

	FY25E			FY26E			FY27E		
(Rs bn)	**Revised**	**Earlier**	**Chg (%)**	**Revised**	**Earlier**	**Chg (%)**	**Revised**	**Earlier**	**Chg (%)**
Net Interest Income	77.6	77.0	0.7	89.0	88.7	0.4	101.9	100.8	1.1
Operating Profit	49.4	47.6	3.8	58.2	57.2	1.7	67.6	65.5	3.2
PAT	23.0	21.7	6.2	27.2	26.4	2.7	34.0	32.5	4.8
EPS (Rs)	18.7	17.6	6.2	22.0	21.4	2.7	27.5	26.3	4.8
ABVPS	149.5	148.9	0.4	161.0	160.0	0.6	176.3	174.6	1.0
Key assumptions/ratios									
Credit Cost (%)	1.7	1.7		1.7	1.7		1.4	1.4	
NIM (%)	6.5	6.4		6.4	6.4		6.3	6.3	
RoA (%)	1.9	1.8		1.9	1.8		2.1	2.0	
RoE (%)	12.2	11.5		13.3	13.1		15.3	14.7	

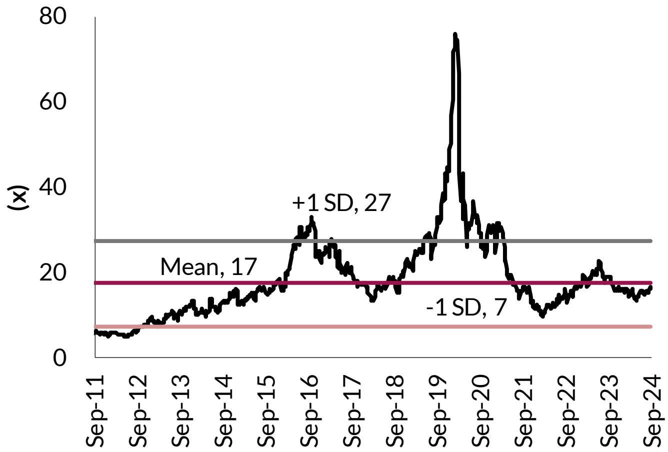
Source: Axis Capital

Exhibit 17: 1-year-forward P/ABV



Source: Bloomberg, Axis Capital

Exhibit 18: 1-year-forward P/E



Source: Bloomberg, Axis Capital

Financial summary (Standalone)

Profit & Loss (Rs mn)

Y/E March	FY23	FY24	FY25E	FY26E	FY27E
Interest earned	1,06,826	1,31,088	1,57,216	1,81,821	2,10,005
Interest expended	(45,767)	(64,269)	(79,645)	(92,791)	(1,08,100)
Net interest income	61,059	66,818	77,571	89,029	1,01,906
Non interest income	3,735	4,537	4,922	5,562	6,118
Net income	64,794	71,355	82,493	94,591	1,08,024
Operating expenses	(27,276)	(29,572)	(33,090)	(36,402)	(40,423)
Staff expenses	(15,843)	(17,126)	(20,209)	(22,836)	(25,348)
Other operating expenses	(9,561)	(10,159)	(11,886)	(13,550)	(14,905)
Operating profit	37,518	41,783	49,403	58,190	67,601
Provisions & contingencies	(9,992)	(18,228)	(18,052)	(21,245)	(21,348)
Pre-tax profit	27,526	23,555	31,351	36,945	46,253
Tax expense	(7,138)	(5,959)	(8,308)	(9,790)	(12,257)
Profit after tax	20,388	17,596	23,043	27,154	33,996
Extraordinary item	(545)	-	-	-	-
Minority interest/Associates	-	-	-	-	-
Adj. PAT	19,843	17,596	23,043	27,154	33,996

Balance Sheet (Rs mn)

Y/E March	FY23	FY24	FY25E	FY26E	FY27E
Total assets	**9,62,166**	**11,51,592**	**13,24,300**	**15,33,663**	**17,61,626**
Cash & Balances with RBI	28,321	26,891	23,521	27,742	16,306
Investments	99,886	96,508	86,857	78,172	71,918
Advances	7,94,547	9,91,952	11,76,080	13,87,131	16,30,697
Fixed assets	6,956	9,308	9,729	11,271	12,066
Other assets	32,456	26,933	28,113	29,348	30,638
Total liabilities	**9,62,166**	**11,51,592**	**13,24,300**	**15,33,663**	**17,61,626**
Equity capital	2,467	2,469	2,469	2,469	2,469
Preference capital	-	-	-	-	-
Reserves & surplus	1,68,189	1,78,984	1,92,810	2,09,102	2,29,500
Networth	1,70,889	1,81,575	1,95,279	2,11,571	2,31,968
Borrowings	7,49,459	9,22,252	10,78,456	12,70,394	14,76,822
Deposits	-	-	-	-	-
Other liabilities & prov.	41,818	47,766	50,566	51,698	52,835

Source: Company, Axis Capital

Key Ratios

Y/E March	FY23	FY24	FY25E	FY26E	FY27E
PER SHARE DATA					
FDEPS (Rs)	14.7	13.6	18.7	22.0	27.5
BV (Rs)	126.6	140.1	158.2	171.4	187.9
Adj. BV (Rs)	118.8	133.2	149.5	161.0	176.3
DPS (Rs)	3.3	5.7	7.5	8.8	11.0
Dividend payout (%)	21.8	42.1	40.0	40.0	40.0
YIELDS & MARGINS (%)					
Yield on advances	14.1	13.7	13.8	13.6	13.4
Cost of fund	7.0	7.7	8.0	7.9	7.9
Net interest margin	7.4	6.6	6.5	6.4	6.3
ASSET QUALITY (%)					
Gross NPAs	4.6	3.4	3.4	3.5	3.3
Net NPAs	1.9	1.3	1.3	1.3	1.3
Credit cost	1.4	2.0	1.7	1.7	1.4
Provisioning coverage	59.5	63.2	63.0	63.0	63.0
CAPITAL (%)					
Tier-I	19.9	16.4	15.9	15.3	14.6
CAR	22.5	18.9	17.9	17.1	16.2
EFFICIENCY (%)					
ROA	2.38	1.66	1.86	1.90	2.06
ROE	12.5	10.0	12.2	13.3	15.3
Cost to income	42.1	41.4	40.1	38.5	37.4
CASA	-	-	-	-	-
Effective tax rate	25.9	25.3	26.5	26.5	26.5
GROWTH (%)					
Net interest income	9.9	9.4	16.1	14.8	14.5
Fee income	-	-	-	-	-
Operating expenses	31.6	8.4	11.9	10.0	11.0
Profit after tax	106.2	(13.7)	31.0	17.8	25.2
Advances	31.5	24.8	18.6	17.9	17.6
Deposits	-	-	-	-	-
Total assets	27.8	19.7	15.0	15.8	14.9

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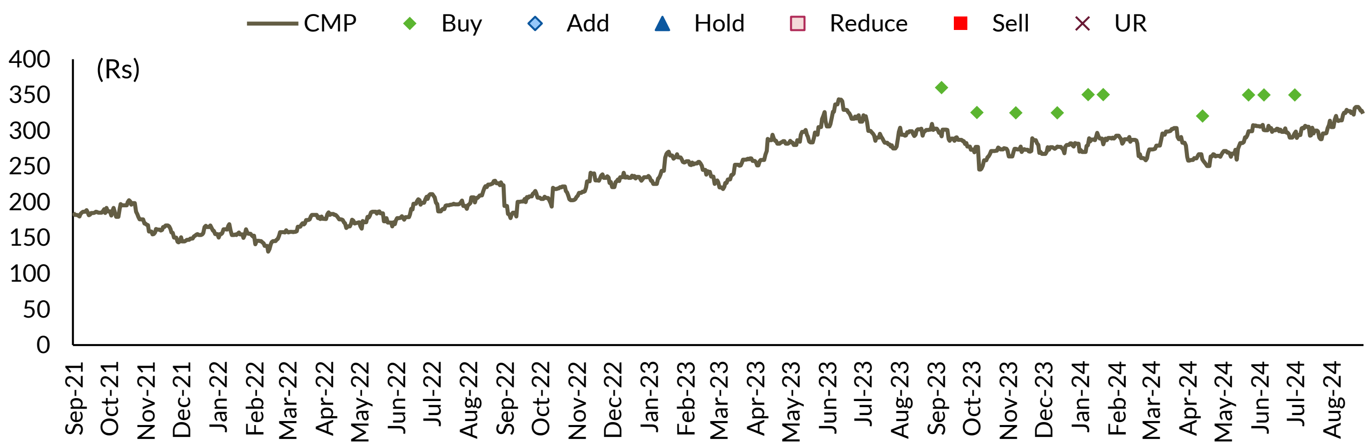
DEFINITION OF RATINGS

Ratings	Expected absolute returns over 12 months
BUY	More than 15%
ADD	Between 5% to 15%
REDUCE	Between 5% to -10 %
SELL	More than -10%

Mahindra & Mahindra Financial Services (MMFS.NS, MMFS IB) Price and Recommendation History



Date	Target Price	Reco	Date	Target Price	Reco	Date	Target Price	Reco	Date	Target Price	Reco
28-Sep-23	360	Buy									
28-Oct-23	325	Buy									
30-Nov-23	325	Buy									
04-Jan-24	325	Buy									
30-Jan-24	350	Buy									
12-Feb-24	350	Buy									
06-May-24	320	Buy									
14-Jun-24	350	Buy									
27-Jun-24	350	Buy									
23-Jul-24	350	Buy									

Source: Axis Capital