

Credit cost to normalize in H2; reiterate BUY

BFSI - NBFCs ▶ Result Update ▶ October 23, 2024

TARGET PRICE (Rs): 360

Driven by the surge in credit cost (Q2: Rs7.0bn vs our estimate of Rs5.0bn and Q1: Rs4.5bn), MMFS reported weaker profitability in Q2FY25, with PAT at Rs3.7bn logging significantly below our estimate of Rs5.0bn. The rise in credit cost reflects the inherent seasonality in MMFS's business owing to the agrarian and rural self-employed customer segment. Notwithstanding the credit-cost surge in Q2, management appears confident about asset quality and credit-cost normalization in H2 led by recoveries and ECL Model refresh-driven reversal of provisions. Overall, we continue to believe that the strategic path chosen by MMFS is the right one, but execution will be crucial and performance improvement gradual (Read our earlier note: [Upgrade to BUY](#)). In addition to the gradual RoA expansion to 2.2%, the beginning of the rate-cut cycle, the rebound in tractor sales, the seasonal improvement in asset quality, the absence of MFI and unsecured PL exposure, and the palatable valuation in the near term make MMFS attractive; reiterate BUY with Sep-25E TP of Rs360.

Mahindra Finance: Financial Snapshot (Standalone)

Y/E Mar (Rs mn)	FY23	FY24	FY25E	FY26E	FY27E
Net profits	19,843	17,596	22,125	31,210	39,673
AUM growths (%)	27.4	24.0	19.9	19.5	18.8
NII growths (%)	9.9	9.4	15.0	22.6	18.6
NIMs (%)	7.6	6.8	6.6	7.0	7.1
PPOP growth (%)	0.7	11.4	17.5	31.0	22.4
Adj. EPS (Rs)	16.1	14.3	17.9	25.3	32.1
Adj. EPS growth (%)	100.6	(11.4)	25.7	41.1	27.1
Adj. BV (INR)	138.5	147.1	159.6	178.6	204.3
Adj. BVPS growth (%)	9.3	6.2	8.5	11.9	14.4
RoA (%)	2.3	1.7	1.8	2.1	2.3
RoE (%)	12.1	10.0	11.7	14.9	16.8
P/E (x)	17.5	19.8	15.7	11.1	8.8
P/ABV (x)	2.0	1.9	1.8	1.6	1.4

Source: Company, Emkay Research

Seasonal spike in credit cost hurts once again

MMFS reported a material miss on Q2FY25 earnings estimates, with PAT at Rs3.69bn coming materially below consensus/our estimates of Rs4.75bn/Rs5.0bn, respectively. The earnings miss was largely owing to a spike in credit cost for Q2 at Rs 7.0bn (Emkay: Rs5.0bn; Q1: Rs4.48bn) on account of seasonal factors (delayed monsoons, etc) affecting borrower's cash-flow leading to defaults. As the company had released its Q2FY25 business updates earlier, there were no surprises on the disbursements or AUM fronts. Additionally, the NII and PPOP also came broadly in line with our estimates.

Credit cost normalization in H2FY25; long-term strategy

Management appeared confident about credit-cost normalization in H2, driven by recoveries and upgrades in addition to a likely reversal of provision on account of ECL model refresh. The delayed and erratic monsoons led to increased stress in the tractor portfolio in agrarian states. With monsoons ending significantly above the long-term average across a large part of the country, better Rabi crop production in the upcoming season, along with good Kharif produce in the current season, is expected. On the back of the credit-cost normalization, the management has guided to FY25 RoA of ~1.8-2.0%. Having taken all the required steps in recent quarters and given the company's strategic direction, RoA of ~2.2% looks realistically achievable in the next 4-8 quarters, with ~40-50bps revenue yield improvement on account of increased fee income (cross-selling, loan related, and co-lending), 8-10bps improvement in cost of funds driven by active treasury management and gradual improvement in opex (likely to be sticky in the near term), and credit costs. While this strategy puts the company on the right track for the long term, we see a number of tailwinds in the near term including rate cut, revival in rural/agri demand, and tractor sales.

We reiterate BUY, with unchanged estimates and Sep-25E TP of Rs360

With expectation of credit-cost normalization in H2 on the back of recoveries, upgrades, and ECL model refresh-led lowering of PCR, we expect MMFS to deliver 1.8% RoA in FY25E. Against such a backdrop, we keep our recently updated (Read our earlier note: [Upgrade to BUY](#)) estimates unchanged. We reiterate our BUY rating on the stock and our Sep-25E TP of Rs360 (implying FY26 P/B: 2.0x).

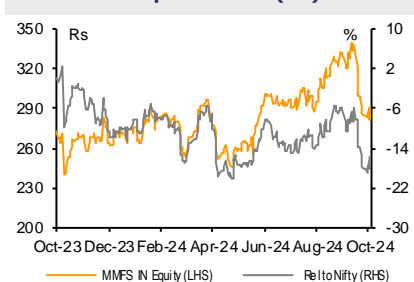
Target Price – 12M	Sep-25
Change in TP (%)	-
Current Reco.	BUY
Previous Reco.	BUY
Upside/(Downside) (%)	27.8
CMP (22-Oct-24) (Rs)	281.7

Stock Data	Ticker
52-week High (Rs)	343
52-week Low (Rs)	237
Shares outstanding (mn)	1,235.5
Market-cap (Rs bn)	348
Market-cap (USD mn)	4,139
Net-debt, FY25E (Rs mn)	16,236
ADTV-3M (mn shares)	4
ADTV-3M (Rs mn)	1,125.0
ADTV-3M (USD mn)	13.4
Free float (%)	-
Nifty-50	24,472
INR/USD	84.1
Shareholding, Jun-24	
Promoters (%)	52.2
FPIs/MFs (%)	10.1/30.7

Price Performance

(%)	1M	3M	12M
Absolute	(12.2)	(3.7)	1.4
Rel. to Nifty	(7.5)	(3.5)	(19.1)

1-Year share price trend (Rs)



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Exhibit 1: Actual vs estimates

MMFS – Earnings snapshot								Emkay estimates	
Q2FY25 (Rs mn)	Q2FY24	Q3FY24	Q4FY24	Q1FY25	Q2FY25	Chg QoQ	Chg YoY	Q2FY25	Variation
	Actual	Actual	Actual	Actual	Actual			Estimate	vs Estimate
Business Assets	937,230	970,480	1,025,970	1,063,390	1,124,340	3.6%	22.6%	1,126,000	-0.1%
Disbursement	133,150	154,360	152,920	127,410	131,620	-16.7%	4.7%	131,600	0.0%
NII	15,865	16,983	18,121	17,836	18,106	-1.6%	12.6%	18,737	-3.4%
Income	16,740	18,155	19,710	19,316	19,908	-2.0%	15.3%	20,389	-2.4%
PPoP	9,428	10,625	11,730	11,345	11,961	-3.3%	13.5%	11,788	1.5%
Provisions	6,266	3,283	3,415	4,482	7,035	31.2%	-14.9%	5,056	39.1%
PBT	3,163	7,341	8,315	6,864	4,927	-17.5%	44.9%	6,733	-26.8%
PAT	2,352	5,528	6,190	5,130	3,695	-17.1%	45.5%	5,032	-26.6%
Credit cost	2.78%	1.38%	1.37%	1.72%	2.57%	35bps	-77bps	1.85%	73bps
GS3	4.29%	3.97%	3.40%	3.60%	3.83%	20bps	-75bps	3.80%	3bps
NS3	1.71%	1.52%	1.28%	1.50%	1.59%	22bps	-28bps	1.57%	2bps

Source: Company, Emkay Research

Exhibit 2: Valuation matrix

				P/BV (x)			P/E (x)			RoA (%)			RoE (%)			Book Value (Rs)			EPS (Rs)		
	CMP/TP (Rs)	Upside	Mkt Cap (Rs bn)	FY25E	FY26E	FY27E	FY25E	FY26E	FY27E	FY25E	FY26E	FY27E	FY25E	FY26E	FY27E	FY25E	FY26E	FY27E	FY25E	FY26E	FY27E
At current market price	282	28%	398.1	1.8	1.6	1.4	15.7	11.1	8.8	1.8	2.1	2.3	11.7	14.9	16.8	160	179	204	17.9	25.3	32.1
At target price	360		398.1	2.3	2.0	1.8	20.1	14.2	11.2	1.8	2.1	2.3	11.7	14.9	16.8	160	179	204	17.9	25.3	32.1

Source: Company, Emkay Research

Exhibit 3: Quarterly Earnings Summary

(Rs mn)	Q2FY24	Q3FY24	Q4FY24	Q1FY25	Q2FY25	YoY chg	QoQ chg
Interest Income	31,530	33,733	35,471	36,122	37,448	18.8%	3.7%
Interest Expenses	15,665	16,750	17,351	18,286	19,343	23.5%	5.8%
Net Interest Income	15,865	16,983	18,121	17,836	18,106	14.1%	1.5%
Other Income	875	1,172	1,590	1,480	1,802	106.0%	21.8%
Income	16,740	18,155	19,710	19,316	19,908	18.9%	3.1%
Operating Expenses	7,312	7,530	7,980	7,970	7,947	8.7%	-0.3%
Operating Profit	9,428	10,625	11,730	11,345	11,961	26.9%	5.4%
Provisions	6,266	3,283	3,415	4,482	7,035	12.3%	57%
Credit cost (on avg Business Assets)	2.8%	1.4%	1.4%	1.7%	2.6%	-21bps	86bps
PBT	3,163	7,341	8,315	6,864	4,927	55.8%	-28.2%
Tax	811	1,813	2,126	1,734	1,232	51.9%	-29.0%
Tax rate	25.6%	24.7%	25.6%	25.3%	25.0%		
Reported PAT	2,352	5,528	6,190	5,130	3,695	57.1%	-28.0%
Networth	169,560	175,230	181,575	186,860	182,828	7.8%	-2.2%
Business assets	937,230	970,480	1,025,970	1,063,390	1,124,340	20.0%	5.7%
Disbursements	133,150	154,360	152,920	127,410	131,620	-1.1%	3.3%
GS3 (%)	4.29	3.97	3.40	3.60	3.83	-46bps	23bps
NS3 (%)	1.71	1.52	1.28	1.50	1.59	-12bps	9bps
PCR (%)	61.18	62.72	63.16	59.79	59.48	-170bps	-31bps
ROA – calculated (%)	0.92	2.07	2.22	1.76	1.21	30bps	-55bps
ROE – calculated (%)	5.47	12.83	13.88	11.14	8.00	253bps	-314bps

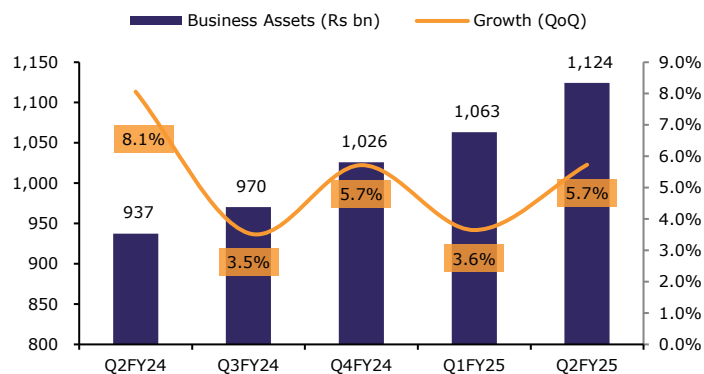
Source: Company, Emkay Research

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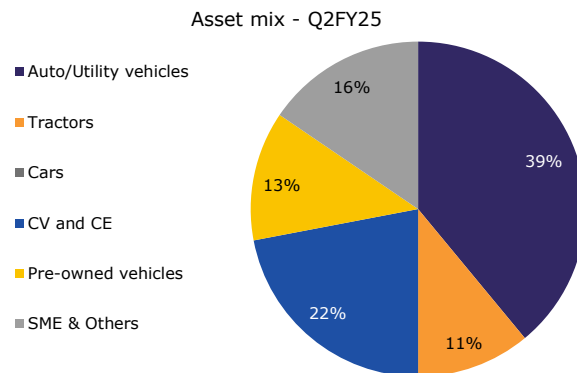
Result in charts

Exhibit 4: Business assets grew 5.7% QoQ during Q2FY25



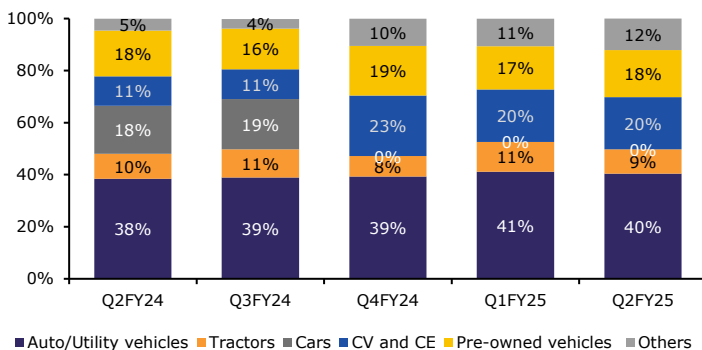
Source: Company, Emkay Research

Exhibit 5: Business asset mix – Auto segment dominates the overall mix



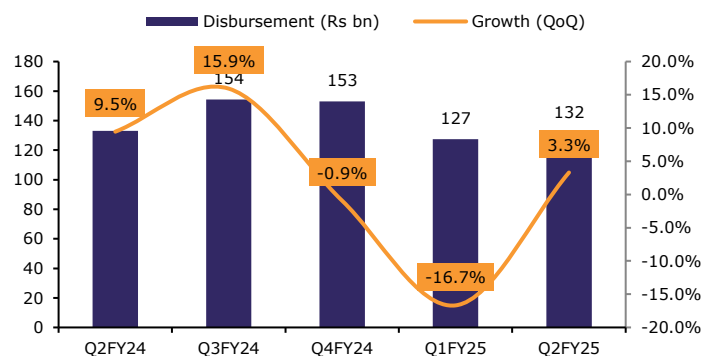
Source: Company, Emkay Research

Exhibit 6: Management aspires to increase the disbursement share of pre-owned vehicles to 20%



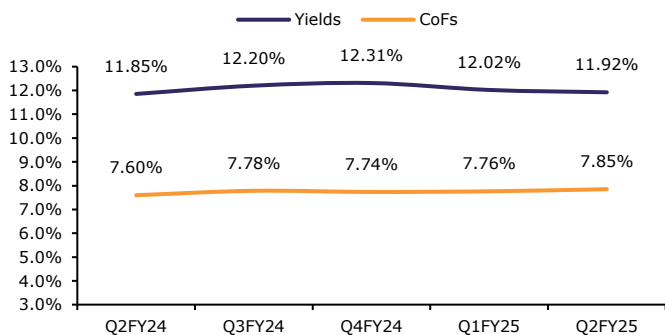
Source: Company, Emkay Research

Exhibit 7: Disbursement grew 3.3% QoQ during the quarter



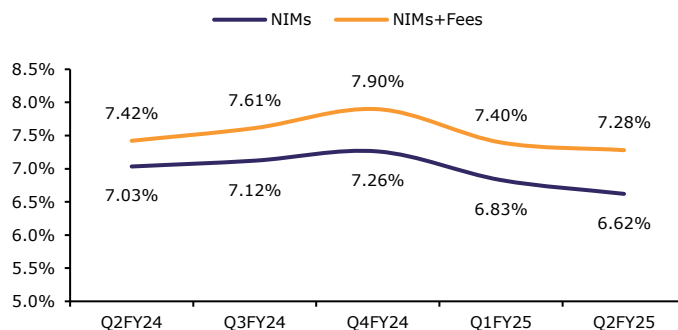
Source: Company, Emkay Research

Exhibit 8: CoFs inch up marginally on sequential basis

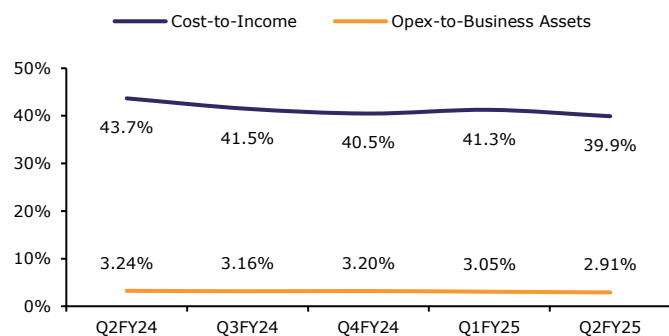


Source: Company, Emkay Research

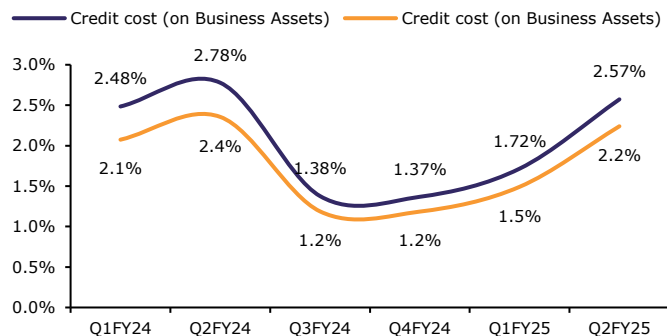
Exhibit 9: Margins witness slight moderation sequentially



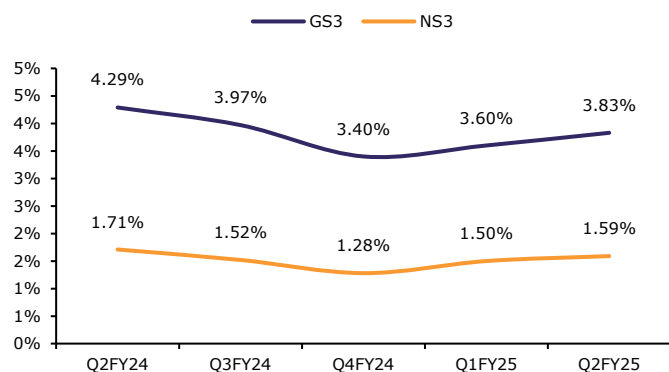
Source: Company, Emkay Research

Exhibit 10: Improved efficiency results in improvement in Opex

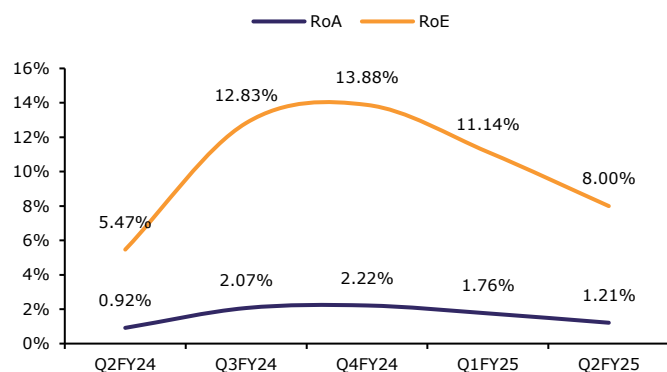
Source: Company, Emkay Research

Exhibit 11: Credit cost increases materially during the quarter

Source: Company, Emkay Research

Exhibit 12: Overall asset quality worsens during the quarter

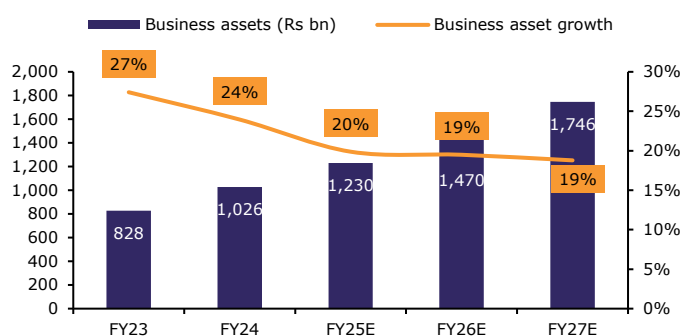
Source: Company, Emkay Research

Exhibit 13: RoA dips to 1.21% during Q2FY25

Source: Company, Emkay Research

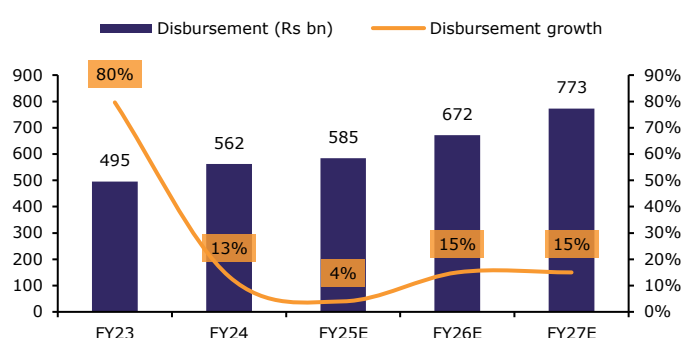
Story in charts

Exhibit 14: Strong asset growth driven by robust rural recovery and diversification



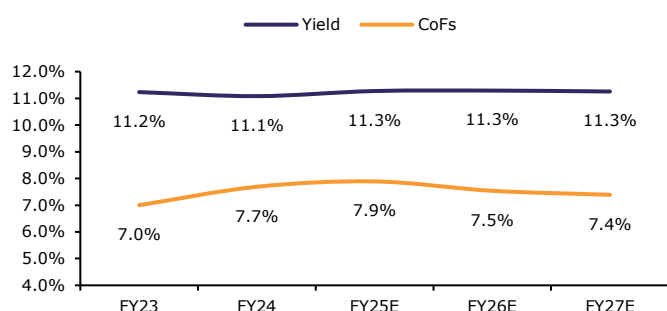
Source: Company, Emkay Research

Exhibit 15: We expect disbursement to grow ~15% over FY26-27E



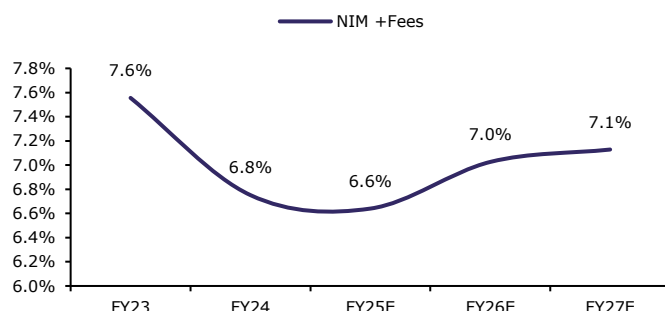
Source: Company, Emkay Research

Exhibit 16: CoF moderation led by active treasury management



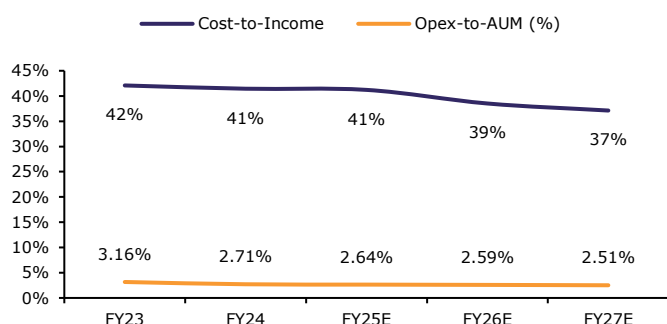
Source: Company, Emkay Research

Exhibit 17: NIM+Fees improvement led by higher fee income and CoF moderation



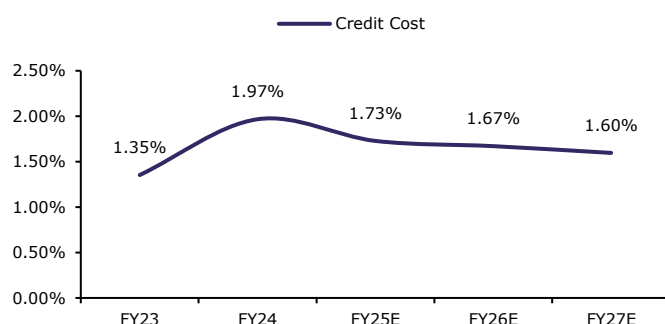
Source: Company, Emkay Research

Exhibit 18: Opex to remain sticky in the near term



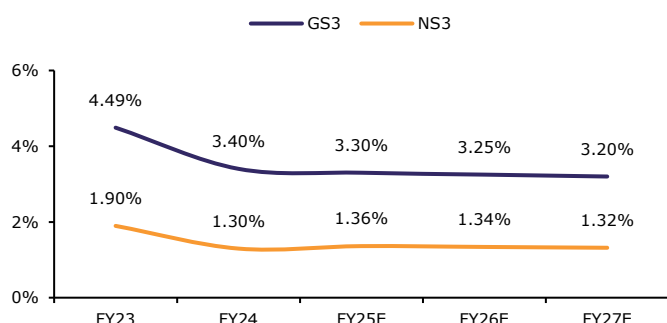
Source: Company, Emkay Research

Exhibit 19: Credit cost improvement led by business diversification



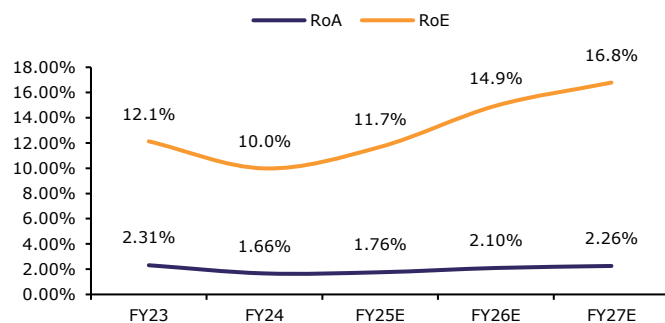
Source: Company, Emkay Research

Exhibit 20: Robust asset quality



Source: Company, Emkay Research

Exhibit 21: Margin expansion led by improved operational efficiency and active treasury investment



Source: Company, Emkay Research

Management call highlights

- The elevated interest cycle has had a bearing on the original NIM aspirations. Management expects NIMs at around 6.5% for FY25.
- Diversification is expected to further rise, but it has not been in sync with the original plan. The recent announcement on Mortgage and the Insurance License will be a good mode of diversification.
- GS3 at 3.8% has climbed up by 20bps from last quarter. 40% of the GS3 hike has come from the Tractor segment, wherein cashflows have been impacted. The CV segment has also seen some pain in Q2 which has hit collection efficiency. Such pain has been largely witnessed in agriculture states.
- Maharashtra, Gujarat, MP, and AP have seen some disruption in rainfall which has resulted in a delay in cashflows. However, management does not expect this delay to lead to default. Management does not see much challenge in non-agri states
- Tractor and CV volume growth has been flattish which has resulted in muted disbursements. Volume growth in PVs has been flat for half of the year and is now seen declining in the quarter. Overall, the outcome is more of a reflection of the slowdown in auto sales volumes. Management has seen marginal improvement in the tractor segment and other vehicles, in October. However, management is not building in too much excitement for H2, on the auto sales front.
- 3W, PV, and CV growth for the company is not too divergent from the industry's. There could be a minor overlap of micro finance customers in the 3W segment, but management is not seeing too much stress from micro finance customers, to which the company does not have much exposure.
- The company has tied up with 6 insurance partners, and there is a stated aspiration to grow income from such partnerships.
- Management said that growth for the full year will be somewhat conservative. While some green shoots are being seen in certain segments in the wheels category, the management is focusing on specific pockets.
- Management confidence on improvement in credit cost is on account of the real recovery that happens in H2 and as the overall GS3 stock typically moderates in H2. Additionally, management sees LGD coming down, basis the number modeled. Hence, management expects credit cost to remain in the 1.3-1.5% range.
- Management expects AUM CAGR at 15% over the next 3 years.
- Incremental passing on of IRRs on stocks and increase in Fee income will be further driven by improvement in NIMs. Also, growth in the tractor and the used car businesses will result in improvement in NIMs. Hence, management expects margins to improve by 10-15bps.
- Slippages for H1FY25 have been higher on YoY basis; this can be contributed to the tractor and LCV business segments. Management mentioned that slippages can be controlled through strong recoveries in H2FY25.
- Further, some delay has been seen in the semi-employed and self-employed customer segments. However, the company will increase collection efforts for driving improvement in recoveries. As most loans are secured, the management does not see any reason for customers defaulting; however, there might be some delay in repayment.
- Management expects coverage ratios to improve in H2.

Mahindra Finance: Standalone Financials and Valuations

Profit & Loss					
Y/E Mar (Rs mn)	FY23	FY24	FY25E	FY26E	FY27E
Interest Income	106,826	131,088	157,280	186,871	220,170
Interest Expense	45,767	64,269	80,454	92,651	108,403
Net interest income	61,059	66,818	76,826	94,220	111,767
NII growth (%)	9.9	9.4	15.0	22.6	18.6
Non interest income	3,735	4,537	6,713	10,406	13,510
Total income	64,794	71,355	83,539	104,626	125,277
Operating expenses	27,276	29,572	34,430	40,298	46,508
PPOP	37,518	41,783	49,109	64,328	78,769
PPOP growth (%)	0.7	11.4	17.5	31.0	22.4
Provisions & contingencies	9,992	18,228	19,492	22,550	25,661
PBT	27,526	23,555	29,617	41,779	53,108
Extraordinary items	(545)	0	0	0	0
Tax expense	7,138	5,959	7,492	10,568	13,434
Minority interest	0	0	0	0	0
Income from JV/Associates	0	0	0	0	0
Reported PAT	19,843	17,596	22,125	31,210	39,673
PAT growth (%)	100.7	(11.3)	25.7	41.1	27.1
Adjusted PAT	20,388	17,596	22,125	31,210	39,673
Diluted EPS (Rs)	16.1	14.3	17.9	25.3	32.1
Diluted EPS growth (%)	100.6	(11.4)	25.7	41.1	27.1
DPS (Rs)	6.0	6.3	5.4	6.3	6.4
Dividend payout (%)	37.3	44.2	30.0	25.0	20.0
Effective tax rate (%)	25.9	25.3	25.3	25.3	25.3
Net interest margins (%)	7.6	6.8	6.6	7.0	7.1
Cost-income ratio (%)	42.1	41.4	41.2	38.5	37.1
PAT/PPOP (%)	52.9	42.1	45.1	48.5	50.4
Shares outstanding (mn)	1,233.6	1,234.4	1,234.4	1,234.4	1,234.4

Source: Company, Emkay Research

Asset quality and other metrics					
Y/E Mar (Rs mn)	FY23	FY24	FY25E	FY26E	FY27E
Asset quality					
GNPL - Stage 3	37,170	34,910	40,589	47,768	55,869
NNPL - Stage 3	15,070	12,860	16,236	19,107	22,347
GNPL ratio - Stage 3 (%)	4.5	3.4	3.3	3.3	3.2
NNPL ratio - Stage 3 (%)	1.9	1.3	1.4	1.3	1.3
ECL coverage - Stage 3 (%)	59.5	63.2	60.0	60.0	60.0
ECL coverage - 1 & 2 (%)	1.4	1.2	1.2	1.1	1.0
Gross slippage - Stage 3	0	0	0	0	0
Gross slippage ratio (%)	0.0	0.0	0.0	0.0	0.0
Write-off ratio (%)	3.4	2.1	1.5	1.4	1.3
Total credit costs (%)	1.4	2.0	1.7	1.7	1.6
NNPA to networth (%)	8.8	7.1	8.2	8.7	8.9
Capital adequacy					
Total CAR (%)	22.5	18.9	18.3	17.5	17.2
Tier-1 (%)	19.9	16.4	15.9	15.1	14.8
Miscellaneous					
Total income growth (%)	11.7	10.1	17.1	25.2	19.7
Opex growth (%)	31.5	8.4	16.4	17.0	15.4
PPOP margin (%)	4.3	3.8	3.8	4.1	4.3
Credit costs-to-PPOP (%)	26.6	43.6	39.7	35.1	32.6
Loan-to-Assets (%)	82.6	86.1	87.3	88.4	89.2
Yield on loans (%)	14.5	14.1	13.9	13.8	13.7
Cost of funds (%)	7.0	7.7	7.9	7.5	7.4
Spread (%)	7.5	6.5	6.1	6.3	6.3

Source: Company, Emkay Research

Balance Sheet					
Y/E Mar (Rs mn)	FY23	FY24	FY25E	FY26E	FY27E
Share capital	2,467	2,469	2,469	2,469	2,469
Reserves & surplus	168,422	179,106	194,594	218,001	249,740
Net worth	170,889	181,575	197,063	220,470	252,209
Borrowings	749,459	922,252	1,117,375	1,340,521	1,593,637
Other liabilities & prov.	41,818	47,765	50,154	52,661	55,295
Total liabilities & equity	962,166	1,151,592	1,364,591	1,613,653	1,901,140
Net loans	794,547	991,952	1,191,866	1,426,086	1,695,358
Investments	99,886	96,508	106,159	116,775	128,452
Cash, other balances	28,321	26,891	26,840	27,058	28,987
Interest earning assets	922,754	1,115,351	1,324,865	1,569,919	1,852,798
Fixed assets	6,956	8,111	9,328	10,727	12,336
Other assets	32,456	28,130	30,398	33,007	36,006
Total assets	962,166	1,151,592	1,364,591	1,613,653	1,901,140
BVPS (Rs)	138.5	147.1	159.6	178.6	204.3
Adj. BVPS (INR)	138.5	147.1	159.6	178.6	204.3
Gross loans	827,700	1,025,970	1,229,979	1,469,774	1,745,894
Total AUM	995,650	1,185,602	1,420,413	1,694,945	2,010,395
On balance sheet	827,700	1,025,970	1,229,979	1,469,774	1,745,894
Off balance sheet	167,950	159,632	190,434	225,170	264,500
Disbursements	495,410	562,080	584,563	672,248	773,085
Disbursements growth (%)	79.6	13.5	4.0	15.0	15.0
Loan growth (%)	31.5	24.8	20.2	19.7	18.9
AUM growth (%)	27.4	24.0	19.9	19.5	18.8
Borrowings growth (%)	34.3	23.1	21.2	20.0	18.9
Book value growth (%)	9.3	6.2	8.5	11.9	14.4

Source: Company, Emkay Research

Valuations and key Ratios					
Y/E Mar	FY23	FY24	FY25E	FY26E	FY27E
P/E (x)	17.5	19.8	15.7	11.1	8.8
P/B (x)	2.0	1.9	1.8	1.6	1.4
P/ABV (x)	2.0	1.9	1.8	1.6	1.4
P/PPOP (x)	0.7	0.7	0.6	0.4	0.4
Dividend yield (%)	2.1	2.2	1.9	2.2	2.3
Dupont-RoE split (%)					
NII/avg AUM	7.1	6.1	5.9	6.0	6.0
Other income	0.4	0.4	0.5	0.7	0.7
Securitization income	0.0	0.0	0.0	0.0	0.0
Opex	1.3	1.1	1.1	1.0	1.0
Employee expense	1.8	1.6	1.6	1.6	1.5
PPOP	4.3	3.8	3.8	4.1	4.3
Provisions	1.2	1.7	1.5	1.4	1.4
Tax expense	0.8	0.5	0.6	0.7	0.7
RoAUM (%)	2.4	1.6	1.7	2.0	2.1
Leverage ratio (x)	5.3	6.2	6.9	7.5	7.8
RoE (%)	12.1	10.0	11.7	14.9	16.8
Quarterly data					
Rs mn, Y/E Mar	Q2FY24	Q3FY24	Q4FY24	Q1FY25	Q2FY25
NII	15,865	16,983	18,121	17,836	18,106
NIM(%)	6.5	6.8	7.1	6.6	6.5
PPOP	9,428	10,625	11,730	11,345	11,961
PAT	2,352	5,528	6,190	5,130	3,695
EPS (Rs)	1.90	4.48	5.01	4.15	2.99

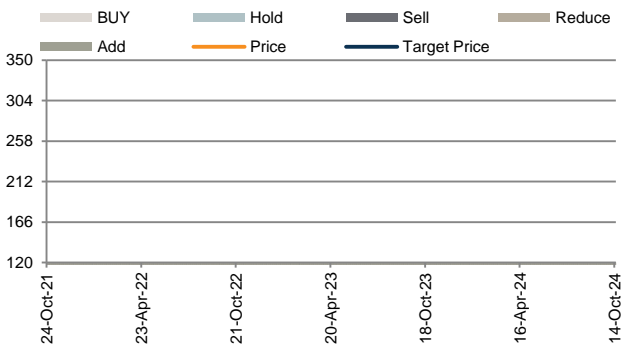
Source: Company, Emkay Research

RECOMMENDATION HISTORY - DETAILS

Date	Closing Price (INR)	TP (INR)	Rating	Analyst
18-Oct-24	291	360	Buy	Avinash Singh
04-Oct-24	300	280	Reduce	Avinash Singh
01-Oct-24	330	270	Reduce	Avinash Singh
02-Sep-24	322	270	Reduce	Avinash Singh
20-Aug-24	304	270	Reduce	Avinash Singh
24-Jul-24	299	270	Reduce	Avinash Singh
04-Jul-24	292	270	Reduce	Avinash Singh
05-Jun-24	269	260	Reduce	Avinash Singh
07-May-24	252	260	Reduce	Avinash Singh
24-Apr-24	253	260	Reduce	Avinash Singh
06-Apr-24	292	280	Reduce	Avinash Singh
31-Jan-24	283	280	Reduce	Avinash Singh
05-Jan-24	271	240	Reduce	Avinash Singh
30-Nov-23	269	235	Reduce	Avinash Singh
28-Oct-23	272	235	Sell	Avinash Singh
30-Jul-23	293	315	Hold	Avinash Singh
08-Jul-23	316	320	Hold	Avinash Singh
29-Apr-23	249	270	Hold	Avinash Singh

Source: Company, Emkay Research

RECOMMENDATION HISTORY - TREND



Source: Company, Bloomberg, Emkay Research

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ADD	5-15% upside
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