

BUY

TP: Rs 280 | ▲ 22%

**MAHINDRA &
MAHINDRA FIN SVCS**

| NBFC

| 20 July 2020

Buoyant rural activity, fund raising brighten outlook – raise to BUY

Mahindra & Mahindra Financial Services (MMFS) reported strong 120% YoY growth in Q1FY21 PAT to Rs 1.5bn due to robust opex control and spread expansion. Buoyant farm incomes have been salutary both in terms of lowering moratorium loans and increasing collections. Strong liquidity buffers and fund raising (Rs 35bn in July) lend comfort as incremental credit costs can be well catered to. We raise FY21/FY22 earnings estimates by 135%/28% and upgrade the stock to BUY (from ADD) with a revised Jun'21 TP of Rs 280 (from Rs 170).

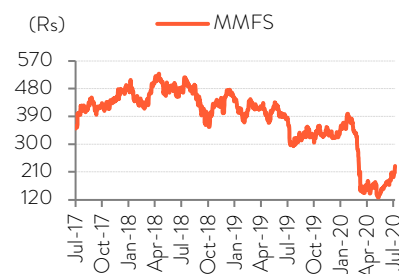
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Spread expansion, opex control aid operating profit: MMFS reported 14% YoY AUM growth to Rs 814bn, largely driven by low repayment as a large part of the book was under moratorium. We note spread expansion of 100bps YoY to ~8%, led by lower cost of funds and stable pricing power. The company has shown strong cost control in the form of lower discretionary opex in Q1, aiding 44% YoY growth in operating profit.

Ticker/Price	MMFS IN/Rs 230
Market cap	US\$ 1.9bn
Shares o/s	618mn
3M ADV	US\$ 39.0mn
52wk high/low	Rs 313/Rs 125
Promoter/FPI/DII	51%/24%/13%

Source: NSE

Lower moratorium share, better collections: The company reported ~40% of its book under moratorium as of June vs. 75% as of April. Management alluded to a strong rural pick-up due to better farm incomes. Also, mining activities and rural projects have picked up pace in pockets. Collections improved to Rs 22bn in June. Management expects collections to gather pace in coming quarters.

STOCK PERFORMANCE

Source: NSE

Fund raising, strong liquidity buffers to absorb incremental credit cost:

Management plans to raise funds of Rs 35bn in Jul'20. This will add to the present liquidity of Rs 85bn. MMFS also has Rs 20bn of working capital lines from several banks and has positive ALM in the less-than-one-year bucket. We expect incremental credit costs to be catered to by strong capital buffers post-fund raising.

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Net interest income	46,700	51,130	52,360	55,286	57,112
NII growth (%)	33.3	9.5	2.4	5.6	3.3
Adj. net profit (Rs mn)	15,571	9,064	2,425	11,571	17,863
EPS (Rs)	25.3	14.7	3.9	18.8	29.0
P/E (x)	9.1	15.6	58.3	12.2	7.9
P/BV (x)	1.4	1.2	1.2	1.1	1.0
ROA (%)	2.6	1.3	0.3	1.4	2.1
ROE (%)	15.8	8.3	2.1	9.6	13.5

Source: Company, BOBCAPS Research

BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda

Important disclosures, including any required research certifications, are provided at the end of this report.

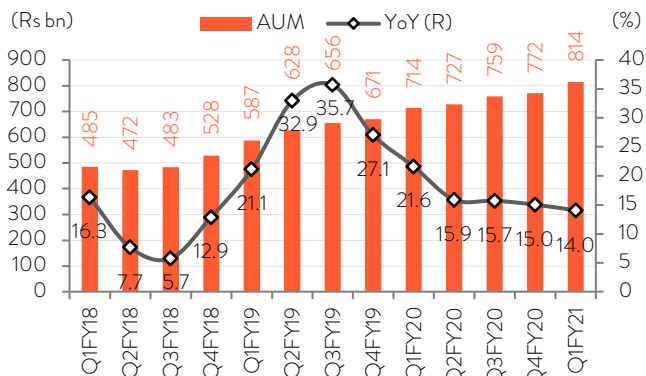


FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
Interest Income	26,405	23,940	10.3	26,369	0.1
Interest expenses	12,646	11,282	12.1	12,895	(1.9)
Net Interest Income	13,759	12,658	8.7	13,474	2.1
Other Operating Income	144	185	(21.9)	389	(62.9)
Total Income	13,903	12,843	8.3	13,863	0.3
Operating Expenses	3,457	5,600	(38.3)	4,197	(17.6)
Operating Profit	10,447	7,243	44.2	9,666	8.1
Provisions and Cont.	8,427	6,196	36.0	6,741	25.0
Profit before Tax	2,020	1,047	92.9	2,925	(30.9)
Tax Provisions	523	363	44.2	716	(26.9)
Net Profit	1,497	684	118.7	2,209	(32.2)

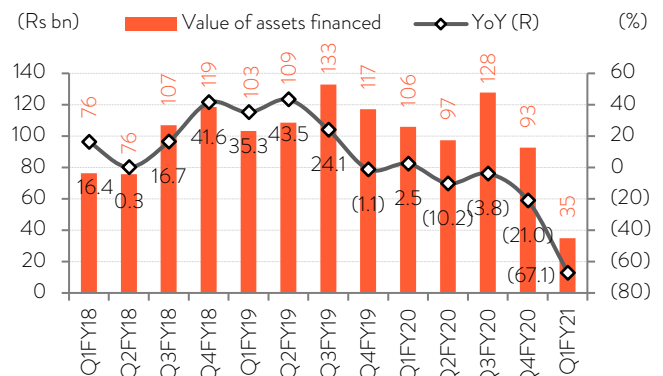
Source: Company, BOBCAPS Research

FIG 2 – AUM GROWTH WAS STEADY AT 14% YOY...



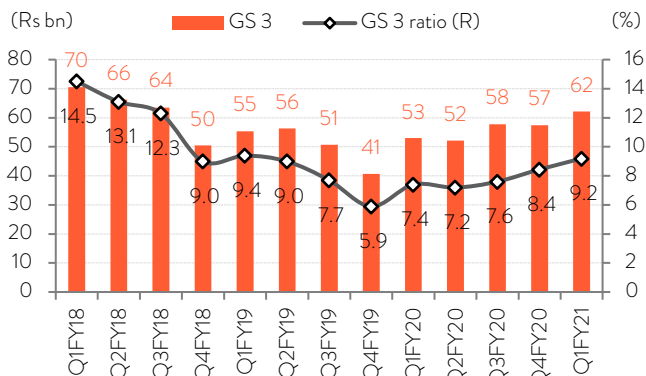
Source: Company, BOBCAPS Research

FIG 3 – ...DESPITE FALL IN VALUE OF ASSETS FINANCED DUE TO MORATORIUM



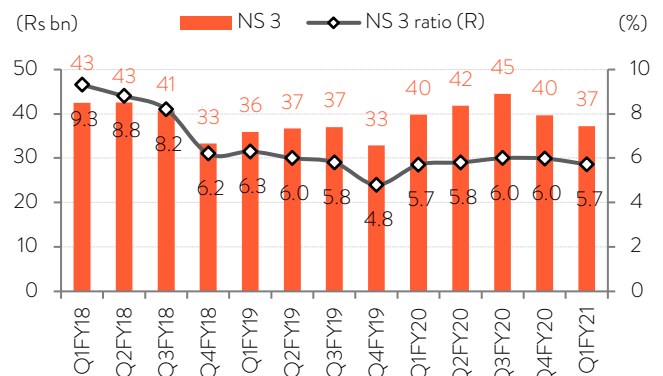
Source: Company, BOBCAPS Research

FIG 4 – GROSS STAGE-3 ASSETS INCREASED...



Source: Company, BOBCAPS Research

FIG 5 – ...BUT 40% PCR KEPT NET STAGE-3 ASSETS MANAGEABLE



Source: Company, BOBCAPS Research

FIG 6 – DETAILED QUARTERLY PERFORMANCE

	FY19				FY20				FY21	Variation (%)	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	QoQ	YoY
Profit and Loss (Rs mn)											
Total Income	19,397	21,455	22,461	24,795	24,125	25,409	26,160	26,758	26,549	(0.8)	10.0
Operating Income	19,285	21,097	22,304	24,552	23,940	24,864	25,806	26,369	26,405	0.1	10.3
Other Income	111	357	157	243	185	545	354	389	144	(62.9)	(21.9)
Interest Expenses	8,488	9,310	10,205	11,443	11,282	12,022	12,089	12,895	12,646	(1.9)	12.1
Net Income	10,909	12,145	12,256	13,352	12,843	13,387	14,072	13,863	13,903	0.3	8.3
Operating Expenses	3,849	4,276	4,812	5,549	5,600	5,196	5,189	4,197	3,457	(17.6)	(38.3)
Employee	2,634	2,410	2,716	3,141	3,521	2,940	2,889	2,134	2,245	5.2	(36.2)
Others	1,214	1,866	2,096	2,408	2,079	2,256	2,300	2,062	1,211	(41.3)	(41.7)
Operating Profits	7,060	7,869	7,444	7,803	7,243	8,190	8,883	9,666	10,447	8.1	44.2
Provisions	2,938	2,311	2,247	-1,145	6,196	3,606	4,001	6,741	8,427	25.0	36.0
PBT	4,122	5,558	5,197	8,947	1,047	4,584	4,882	2,925	2,020	(30.9)	92.9
Taxes	1,432	1,744	2,010	3,068	363	2,066	1,229	716	523	(26.9)	44.2
PAT (before EO)	2,691	3,814	3,187	5,880	684	2,518	3,653	2,209	1,497	(32.2)	118.7
Asset Quality											
Gross Stage 3 (Rs bn)	55.3	56.4	50.6	40.6	53.0	52.0	57.7	57.5	62.2	8.2	17.4
Net Stage 3 (Rs bn)	35.9	36.7	37.0	32.8	39.8	41.9	44.5	39.7	37.3	(6.1)	(6.4)
Gross Stage 3 (%)	9.4	9.0	7.7	5.9	7.4	7.2	7.6	8.4	9.2	75bps	179bps
Net Stage 3 (%)	6.3	6.0	5.8	4.8	5.7	5.8	6.0	6.0	5.7	(26bps)	2bps
PCR (Calc., %)	35.1	34.9	26.9	19.2	24.9	19.5	22.9	31.0	40.1	910bps	1,522bps
Ratios (%)											
Cost to Income	35.3	35.2	39.3	41.6	43.6	38.8	36.9	30.3	24.9	(541bps)	(1,874bps)
Tax Rate	34.7	31.4	38.7	34.3	34.6	45.1	25.2	24.5	25.9	142bps	(875bps)
CAR	21.9	19.7	19.4	20.3	19.4	19.7	19.6	19.6	19.6	0bps	20bps
Tier I	16.6	14.5	14.7	15.5	14.9	15.2	15.4	15.4	15.3	(10bps)	40bps
RoA - calculated	2.0	2.7	2.1	3.6	0.4	1.4	2.0	1.2	0.8	(38bps)	42bps
RoE - calculated	11.0	15.4	12.6	22.2	2.5	9.3	13.4	7.9	5.4	(242bps)	294bps
Key Details (Rs bn)											
AUM	587	628	656	671	714	727	759	772	814	5.5	14.0
Borrowings	429	467	501	531	550	567	590	595	634	6.5	15.2
Value of assets fin mix. (%)											
Auto/Utility vehicles	24	23	24	25	27	27	27	28	23	(500bps)	(400bps)
Tractors	19	18	19	18	17	16	17	17	34	1,700bps	1,700bps
Cars	21	20	20	20	20	19	19	19	15	(400bps)	(500bps)
Commercial Vehicles	17	18	18	19	18	17	16	15	6	(900bps)	(1,200bps)
Refinance & others	14	14	14	14	16	18	18	18	3	(1,500bps)	(1,300bps)
Total Borrowing Mix (%)											
Bank Term loans	30	31	28	28	28	27	25	30	28	(209bps)	(56bps)
Bonds/NCDs	44	42	44	44	41	39	37	35	35	(4bps)	(620bps)
Securitization	1	2	6	8	9	12	15	15	13	(149bps)	427bps
Deposits	8	11	12	13	15	17	19	20	21	58bps	579bps
Commercial Papers	16	14	10	7	7	4	5	0	3	305bps	(331bps)
Other Details											
Branches (Nos.)	1,291	1,296	1,313	1,321	1,334	1,337	1,326	1,322	1,324	2	(10)
Employees (Nos.)	19,346	20,201	21,082	21,789	22,005	22,304	21,850	21,862	21,431	(431)	(574)

Source: Company, BOBCAPS Research

Earnings call highlights

Business

- Rural turnaround to be faster than urban recovery
- All branches open; ~300+ smart branches at dealer locations also open
- June the only active month in Q1FY21; loans disbursed for 30,000 vehicles with average ticket size of Rs 400,000-500,000
- Tractors most buoyant, followed by cars and pick-up vehicles
- HCV and taxi aggregator demand to take longer to recover
- Demand for pre-owned vehicles a bit subdued
- Opex drop in Q1 not expected to recur in subsequent quarters
- No incremental hiring underway
- Mining opening up and road projects getting on track in some pockets
- Taxi aggregators comprise 80,000 out of the 2mn customers – MMFS in contact with all of them

Asset quality

- Collection at Rs 500mn in April, Rs 15bn in May and Rs 22bn in June
- About 40% of customers out of moratorium with dues fully paid. Not all customers are current; they will emerge from moratorium only in August
- Tractor customers at 30% of moratorium book
- GNPA and NNPA numbers to see downward trend in coming quarters

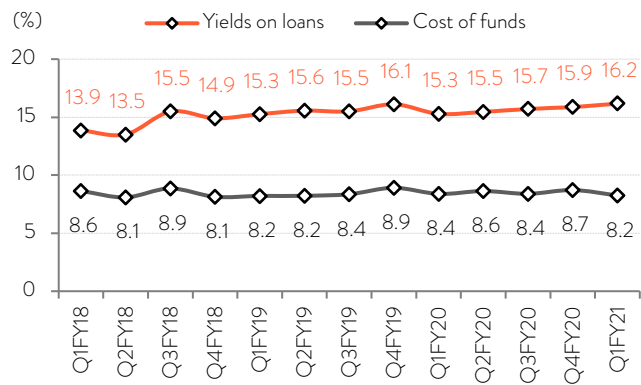
Liquidity

- Need to raise additional capital for any adverse asset quality situation
- Rights issue priced at Rs 50 due to silver jubilee year and to make it attractive for all shareholders
- Liquidity at Rs 85bn as of June; will suffice for next 3-4 months

Guidance

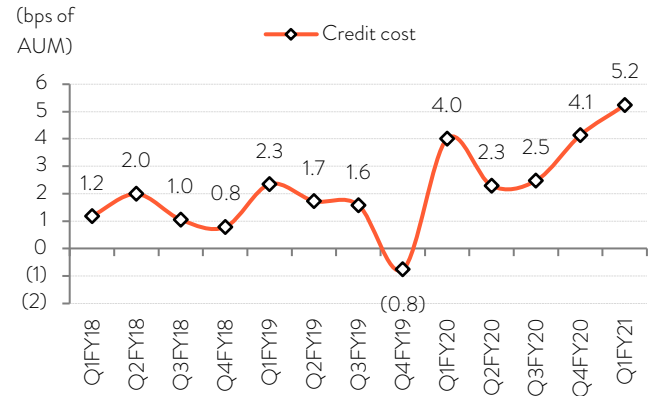
- Cost rationalisation of 10-15% in FY21 due to less travelling, rent renegotiation and technology usage
- Looking at Rs 20bn disbursement per month

FIG 7 – EXPANSION IN SPREADS DUE TO LOWER COST OF FUNDS



Source: Company, BOBCAPS Research

FIG 8 – CREDIT COSTS SHOT UP DUE TO ACCELERATED PROVISIONS FOR COVID-19



Source: Company, BOBCAPS Research

Valuation methodology

MMFS faces multiple challenges as asset health likely deteriorates sharply in the wake of Covid-19. We believe the demand environment will take two years to normalise, thereby affecting volume and value growth through to FY23. Tepid AUM growth and intensified collection efforts are expected to drive up the expense ratio to ~260bps.

However, the company has demonstrated strong opex control in Q1FY21, as guided in the previous quarter. This gives us comfort for discretionary opex reduction in FY21/FY22. Also, collections are picking up pace and rural activity looks buoyant. Loans under moratorium reduced to 40% in June vs. 75% as of April.

Given the healthy Q1FY21 performance, we raise our FY21/FY22 earnings estimates by 135%/28% and upgrade our rating to BUY (from ADD) on strong opex control, good liquidity buffers, fund raising in the near term and buoyant rural activity. Valuing the stock based on a residual income model, we have a revised Jun'21 target price of Rs 280 (earlier Rs 170). We also introduce FY23 estimates. Our assumptions (remains unchanged) include cost of equity of 14.8%, risk-free rate of 7.75%, risk premium of 5%, and a long-term growth rate of 5%.

FIG 9 – REVISED ESTIMATES

(Rs bn)	Old			New			Change (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
NII (incl. Sec. Inc)	53.6	55.2	59.6	54.2	57.4	59.6	1.0	3.9	0.0
Other Income	1.7	1.9	2.2	1.7	1.9	2.2	0.0	0.0	0.0
Total Income	55.3	57.1	61.8	55.8	59.3	61.8	1.0	3.8	0.0
Operating Expenses	21.4	23.7	24.3	20.1	22.4	24.3	(6.0)	(5.4)	0.0
Operating Profits	33.9	33.5	37.6	35.7	36.9	37.6	5.3	10.3	0.0
Provisions	32.5	21.4	13.7	32.5	21.5	13.7	(0.1)	0.3	0.0
PBT	1.4	12.1	23.8	3.2	15.4	23.8	134.9	28.0	0.0
Tax	0.3	3.0	6.0	0.8	3.9	6.0	134.9	28.0	0.0
PAT	1.0	9.0	17.9	2.4	11.6	17.9	134.9	28.0	0.0
Loans	644	658	788	707	716	788	10	9	0
Borrowings	579	586	725	636	638	725	10	9	0
Margins	8.3	8.5	7.9	8.0	8.1	7.9	-	-	-
Credit Cost	5.0	3.3	1.8	4.8	3.0	1.8	-	-	-
RoE	0.9	7.6	13.5	2.1	9.6	13.5	-	-	-
EPS	2	15	29	4	19	29	134.9	28.0	0.0
BVPS	186	198	226	189	203	226	1.2	2.8	0.0

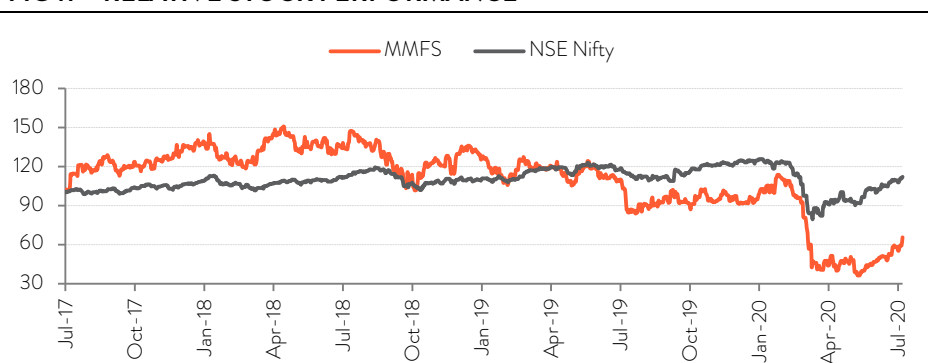
Source: BOBCAPS Research

FIG 10 – VALUATION ASSUMPTIONS

Parameter	(%)
Cost of Equity	14.8
Risk-free rate	7.75
Risk premium	5.0
Terminal growth rate	5.0

Source: BOBCAPS Research

FIG 11 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- Below-expected harvest yield in FY21
- Poor monsoon in FY21
- Lower water reservoir levels during FY21-FY22

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net interest income	46,700	51,130	52,360	55,286	57,112
NII growth (%)	33.3	9.5	2.4	5.6	3.3
Non-interest income	1,953	3,034	3,489	4,013	4,718
Total income	48,653	54,164	55,849	59,299	61,830
Operating expenses	18,476	20,182	20,139	22,392	24,270
Operating profit	30,177	33,982	35,710	36,907	37,559
Operating profit growth (%)	39.1	12.6	5.1	3.4	1.8
Provisions	6,352	20,545	32,477	21,479	13,742
PBT	23,824	13,438	3,233	15,428	23,817
Tax	8,254	4,374	808	3,857	5,954
Reported net profit	15,571	9,064	2,425	11,571	17,863
Adjustments	0	0	0	0	0
Adjusted net profit	15,571	9,064	2,425	11,571	17,863

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Equity capital	1,230	1,231	1,231	1,231	1,231
Reserves & surplus	103,072	112,408	114,832	123,977	138,094
Net worth	104,302	113,639	116,063	125,208	139,325
Deposits	0	0	0	0	0
Borrowings	528,469	594,623	636,492	637,677	724,991
Other liabilities & provisions	38,009	32,451	40,563	46,648	53,645
Total liabilities and equities	670,780	740,712	793,118	809,532	917,961
Cash & bank balance	9,585	14,258	9,003	14,125	36,129
Investments	37,917	59,110	59,405	60,890	73,068
Advances	612,496	649,935	707,214	716,491	788,034
Fixed & Other assets	10,782	17,410	17,497	18,026	20,730
Total assets	670,780	740,712	793,118	809,532	917,961
Deposit growth (%)	NA	NA	NA	NA	NA
Advances growth (%)	26.2	6.1	8.8	1.3	10.0

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
EPS	25.3	14.7	3.9	18.8	29.0
Dividend per share	6.5	0.0	0.0	3.4	5.2
Book value per share	169.5	184.7	188.6	203.5	226.4

Source: Company, BOBCAPS Research

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
P/E	9.1	15.6	58.3	12.2	7.9
P/BV	1.4	1.2	1.2	1.1	1.0
Dividend yield (%)	2.8	0.0	0.0	1.5	2.3

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Net interest income	7.8	7.2	6.8	6.9	6.6
Non-interest income	0.3	0.4	0.5	0.5	0.5
Operating expenses	3.1	2.9	2.6	2.8	2.8
Pre-provisioning profit	5.0	4.8	4.7	4.6	4.3
Provisions	1.1	2.9	4.2	2.7	1.6
PBT	4.0	1.9	0.4	1.9	2.8
Tax	1.4	0.6	0.1	0.5	0.7
ROA	2.6	1.3	0.3	1.4	2.1
Leverage (x)	6.1	6.5	6.7	6.6	6.5
ROE	15.8	8.3	2.1	9.6	13.5

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Net interest income	33.3	9.5	2.4	5.6	3.3
Pre-provisioning profit	39.1	12.6	5.1	3.4	1.8
EPS	2532.3	1473.0	394.0	1880.4	2902.9
Profitability & Return ratios (%)					
Net interest margin	8.7	8.3	8.0	8.1	7.9
Fees / Avg. assets	0.3	0.4	0.4	0.5	0.5
Cost-Income	38.0	37.3	36.1	37.8	39.3
ROE	15.8	8.3	2.1	9.6	13.5
ROA	2.6	1.3	0.3	1.4	2.1
Asset quality (%)					
GNPA	6.4	8.8	13.6	16.5	15.2
NNPA	5.4	6.4	9.3	10.6	9.7
Provision coverage	19.2	31.0	35.0	40.0	40.0
Ratios (%)					
Credit-Deposit	0.0	0.0	0.0	0.0	0.0
Investment-Deposit	0.0	0.0	0.0	0.0	0.0
CAR	20.3	19.6	18.0	18.6	18.3
Tier-1	15.5	15.4	14.5	15.5	15.8

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

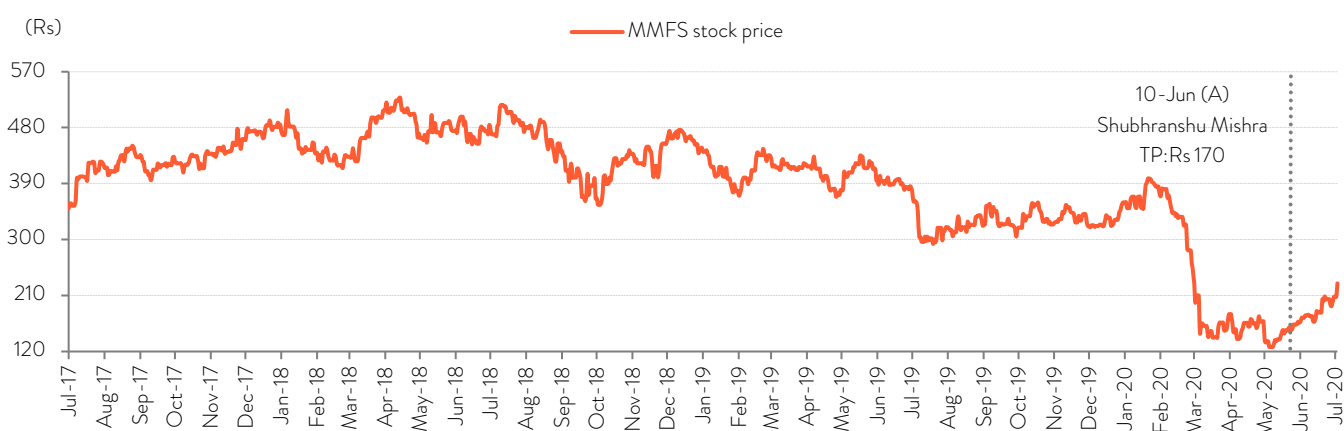
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): MAHINDRA & MAHINDRA FIN SVCS (MMFS IN)



B – Buy, A – Add, R – Reduce, S – Sell

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