



TM

Mahindra and Mahindra Financial Services

27 July 2021

Disbursement run-rate and collections bouncing back

RESULT UPDATE

Sector: NBFCs Rating: BUY
CMP: Rs 148 Target Price: Rs 185

Stock Info

Sensex/Nifty	52,579/ 15,747
Bloomberg	MMFS IN
Equity shares	1,236mn
52-wk High/Low	Rs 224/113
Face value	Rs 2
M-Cap	Rs 183bn/ USD 2.5bn
3-m Avg volume	USD 20mn

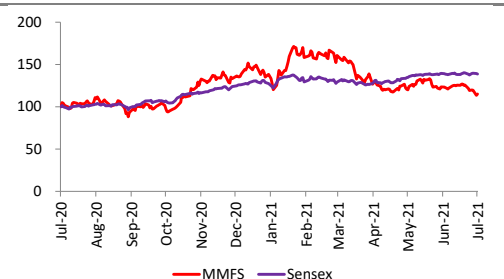
Financial Snapshot (Rs bn)

Y/E March	FY21	FY22E	FY23E
NII	50.5	51.5	56.6
PPP	41.5	38.7	41.5
PAT	3.4	12.2	14.7
EPS (Rs)	2.7	9.8	11.9
EPS Gr. (%)	-63.0	262.7	20.6
BV/Sh.(Rs)	119	126	134
Ratios			
NIM (%)	9.1	8.9	8.7
C/I ratio (%)	28.2	32.5	33.5
RoA (%)	0.4	1.5	1.7
RoE (%)	2.6	8.0	9.2
Payout (%)	40.3	35.1	35.1
Valuations			
P/E (x)	54.6	15.0	12.5
P/BV (x)	1.2	1.2	1.1
Div. Yield (%)	0.5	2.0	2.4

Shareholding pattern (%)

	Jun'21	Mar'21	Dec'20
Promoter	52.2	52.2	52.2
-Pledged	-	-	-
FII	17.9	20.2	21.4
DII	16.5	10.9	15.5
Others	13.4	16.7	11.0

Stock Performance (1-year)



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Mahindra and Mahindra Financial Services (MMFS) reported a loss of Rs 15.3bn in 1QFY22 due to higher provisions. The management has guided for an 80-90% write-back of provisions in 2HFY22E. The company has been prudent in recognizing the credit cost upfront and provided well with its stage-3 provision cover at 53.7%. The management overlay is now at ~4.5% of AUM. Despite lower working days and reduced freight movement, its disbursement run-rate and collections are bouncing back to pre-COVID levels. We remain sanguine about provision write-backs and expect a disbursement run-rate of Rs 65-85bn in FY22E. We reiterate our BUY rating on MMFS with a target price of Rs 185.

Disbursement run-rate at pre-COVID levels despite lower working days

The second wave had a severe impact on the rural and semi-urban markets where the company performs its major business operations. It largely works with the earn-and-pay segment that was impacted by subdued economic activity and customers' inability to utilize their assets and earn from them. With ~40% of working days available and 40%+ branches closed at peak, the company posted a decline of ~2% QoQ in AUM to Rs 636bn while disbursements stood at Rs 38bn. The average disbursement run-rate for 1QFY16-4QFY20 was Rs 92bn; the current run-rate, which is ~42% of the pre-COVID levels, seems reasonable given the restricted working days and movement of goods. With freight movement improving, we expect its disbursement run-rate at Rs 65-85bn during FY22E.

Expect write-backs with improving collection efficiency

The company posted a loss of Rs 15.3bn in 1QFY22 as provisions of Rs 28.2bn weighed on profits. The increased provisioning includes Rs 1.6bn of stage-2 provisions for restructured assets, Rs 3.9bn of management overlay and Rs 3bn of write-offs. The total management overlay now stands at Rs 27.1bn (~4.5% of AUM). The stage-3 coverage ratio is at 53.7% even as the loss-given defaults are in the mid-30s. The company remains well-capitalized at tier-1 ratio of 20.1%. The management has indicated that ~58% of stage-3 and ~83% of stage-2 contracts are solvable and it expects a roll-back in provisions to the tune of 80-90% in 2HFY22E. We believe MMFS has been prudent in recognizing the credit costs upfront and providing well for them. With improving mobility and movement of goods, customer cash flows should increase, implying higher collection efficiency in the ensuing months.

Valuation & Recommendation

We see a recovery in customer cash flows and forecast a normalizing credit cost from FY22E onwards despite a potential blip in 1HFY22 due to the impact of the second wave of COVID. With improving cash flows, collection efficiency will improve and we could expect write-backs of provisions. While we remain positive on the company, the stock currently trades at 1.1x FY23E BVPS. We value the business at 1.4x FY23E P/BV (at par with its 10-year average) as we believe that a recovery in the end market is taking root and return ratios will bounce back by FY23E. We maintain our FY22E/23E estimates and target price of Rs 185 (upside of 25%) and reiterate **BUY**.

Exhibit 1: Quarterly performance

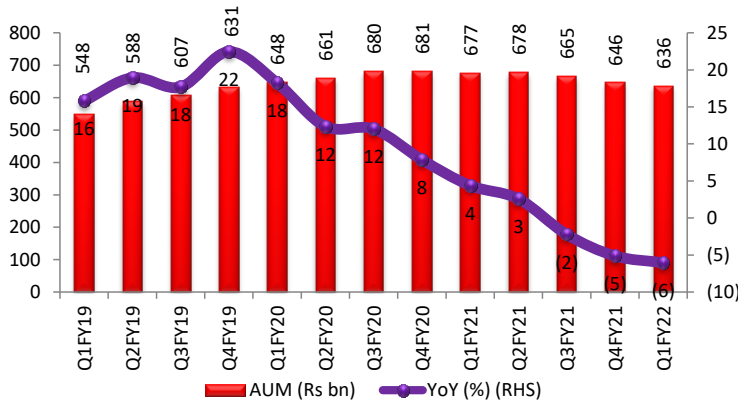
	FY20				FY21				FY22	Variation (%)	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	QoQ	YoY
Profit and Loss (Rs mn)											
Total Income	24,125	25,409	26,160	26,758	26,549	26,495	25,749	26,375	21,871	-17.1	-17.6
Operating Income	23,940	24,864	25,806	26,369	26,405	26,129	25,418	26,000	21,760	-16.3	-17.6
Other Income	185	545	354	389	144	366	331	375	111	-70.4	-23.3
Interest Expenses	11,282	12,022	12,089	12,895	12,646	12,216	11,583	10,887	10,179	-6.5	-19.5
Net Income	12,843	13,387	14,072	13,863	13,903	14,279	14,165	15,488	11,691	-24.5	-15.9
Operating Expenses	5,600	5,196	5,189	4,197	3,457	3,968	3,985	4,915	4,203	-14.5	21.6
Employee	3,521	2,940	2,889	2,134	2,245	2,614	2,473	2,820	2,698	-4.3	20.2
Others	2,079	2,256	2,300	2,062	1,211	1,354	1,512	2,095	1,505	-28.2	24.3
Operating Profits	7,243	8,190	8,883	9,666	10,447	10,311	10,180	10,573	7,488	-29.2	-28.3
Provisions	6,196	3,606	4,001	6,741	8,427	6,194	13,867	8,860	28,186	218.1	234.5
PBT	1,047	4,584	4,882	2,925	2,020	4,117	-3,687	1,713	-20,698	-1,308.1	-1,124.7
Taxes	363	2,066	1,229	716	523	1,082	-946	214	-5,411	-2,633.0	-1,134.6
PAT (before EO)	684	2,518	3,653	2,209	1,497	3,035	-2,741	1,500	-15,288	-1,119.4	-1,121.3
Asset Quality											
Gross Stage 3 (Rs bn)	53.0	52.0	57.7	57.5	62.2	47.7	66.4	57.9	98.3	69.9	58.1
Net Stage 3 (Rs bn)	39.8	41.9	44.5	39.7	37.3	16.7	42.1	24.3	45.5	87.0	22.1
Gross Stage 3 (%)	7.4	7.2	7.6	8.4	9.2	7.0	10.0	9.0	15.5	650bps	627bps
Net Stage 3 (%)	5.7	5.8	6.0	6.0	5.7	4.7	6.6	4.0	7.8	384bps	209bps
PCR (Calc., %)	24.9	19.5	22.9	31.0	40.1	64.9	36.6	57.9	53.7	-422bps	1,363bps
Ratios (%)											
Cost to Income	43.6	38.8	36.9	30.3	24.9	27.8	28.1	31.7	36.0	422bps	1,109bps
Tax Rate	34.6	45.1	25.2	24.5	25.9	26.3	25.6	12.5	26.1	1,367bps	25bps
CAR	19.4	19.7	19.6	19.6	19.6	20.8	21.9	22.2	23.8	160bps	420bps
<i>Tier I</i>	14.9	15.2	15.4	15.4	15.3	16.5	17.4	18.4	20.1	170bps	480bps
RoA - calculated	0.4	1.4	2.0	1.2	0.8	1.6	-1.4	0.8	-8.2	-899bps	-904bps
RoE - calculated	2.5	9.3	13.4	7.9	5.4	9.2	-7.4	4.1	-43.8	-4,789bps	-4,925bps
Key Details (Rs bn)											
AUM	714	727	759	772	814	819	818	817	790	-3.3	-3.0
Borrowings	550	567	590	595	634	604	592	587	556	-5.2	-12.2
Value of assets fin mix. (%)											
Auto/Utility vehicles	27	27	27	28	23	32	35	34	36	200bps	1,300bps
Tractors	17	16	17	17	34	26	20	18	25	700bps	-900bps
Cars	20	19	19	19	15	21	21	21	20	-100bps	500bps
Commercial Vehicles	18	17	16	15	6	5	5	5	4	-100bps	-200bps
Refinance & others	18	21	21	21	22	16	19	22	15	-700bps	-700bps
Total Borrowing Mix (%)											
Bank Term loans	28	27	25	30	28	26	26	25	23	-177bps	-498bps
Bonds/NCDs	41	39	37	35	35	36	35	33	35	184bps	-38bps
Securitization	9	12	15	15	13	14	14	18	17	-97bps	329bps
Deposits	15	17	19	20	21	22	23	23	24	100bps	342bps
Commercial Papers	7	4	5	0	3	2	3	2	2	-10bps	-136bps
Other Details											
Branches (Nos.)	1,334	1,337	1,326	1,322	1,324	1,256	1,246	1,388	1,391	3	67
Employees (Nos.)	22,005	22,304	21,850	21,862	21,431	21,135	20,544	19,952	19,571	-381	-1,860

Source: Company, Systematix Institutional Research

Earnings Call Highlights

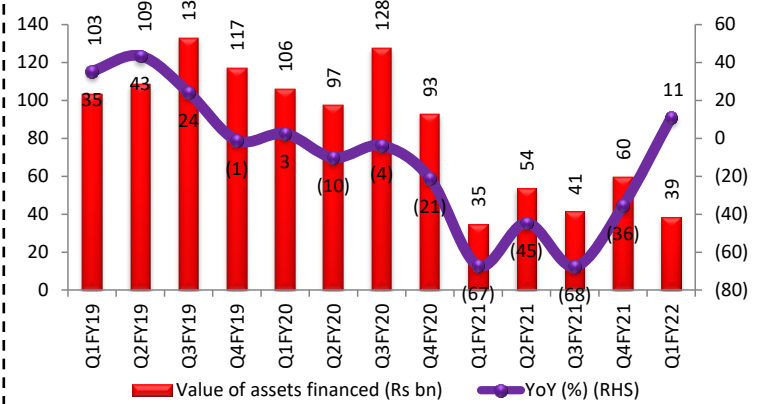
- The mandis were shut in May but reopened in June. The crop price was good; part cash flows that started in June and July are likely to be better.
- OEMs are bullish on the turnaround of volumes; Infrastructure activities have been expedited. Expect normalization from September onwards.
- The company did not resort to repossession of vehicles for most customers. It was difficult to reach out to customers due to the COVID situation, leading to limited telephonic conversations.
- Many customers were not willing to commit to long term restructuring given the higher interest outgo. They requested to make part payments (expected to bounce back in the ensuing months). Hence, the company recognized provisions early in 1Q.
- Restructuring of Rs 22bn was largely restricted to fleet operators, school bus operators, taxi aggregators. These customers indicated that they will need six months to bounce back. The management does not expect large restructuring in the coming quarters; indicated that it will be limited to ~30,000 more contracts.
- The vehicle utilization of customers is likely to bounce back to 60-70% in next 2-3 months. It will take ~6 month for utilisations to come up to 100% levels. Customers are likely to make part-payments; resolution likely in the ensuing months.
- The collections for April, May and June were 72%, 67% and 90% respectively. They are bouncing back in July and are at pre-COVID levels. July'21-Mar'22 is likely to see substantial reversals.
- Demand for vehicles has been picking up and supply is not an issue for OEMs. Demand for infrastructure tractors, entry level cars, construction equipment and pre-owned vehicles is increasing.
- The company expects to add 50 branches in FY22; has added 1,000 more people to collections.
- There was an interest reversal of Rs 2bn in 1QFY22.
- The management indicated that the stage-3 ratio at FY22E-end is likely to be 8-9%.

Exhibit 2: AUM growth appears to have bottomed out...



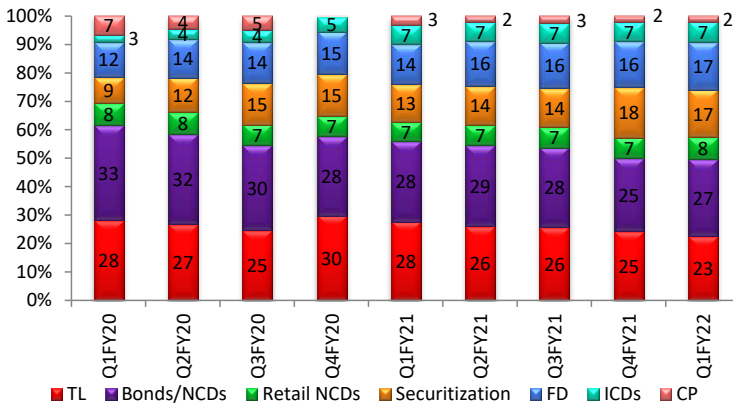
Source: Company, Systematix Institutional Research

Exhibit 3: ...Value of assets financed bouncing back despite lower working days in 1QFY22



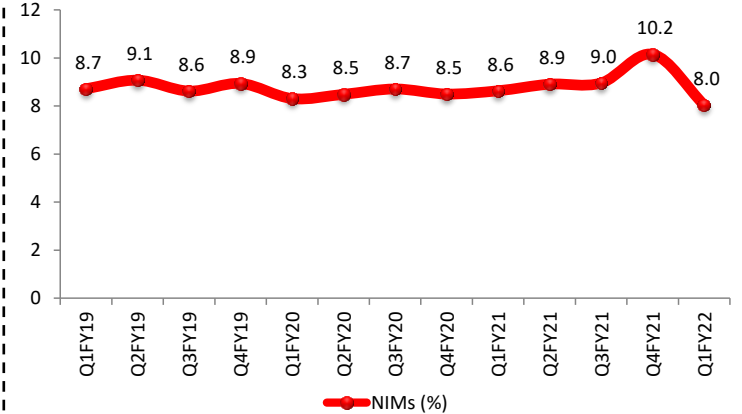
Source: Company, Systematix Institutional Research

Exhibit 4: Diversified borrowing mix...



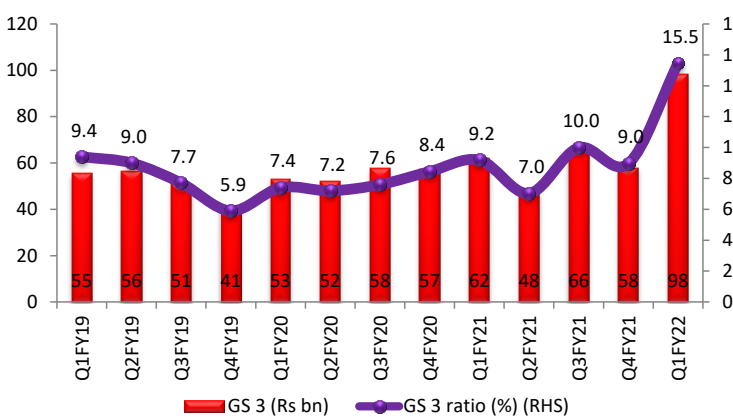
Source: Company, Systematix Institutional Research

Exhibit 5: ...leading to stable NIMs; dip in 1Q due to interest reversal



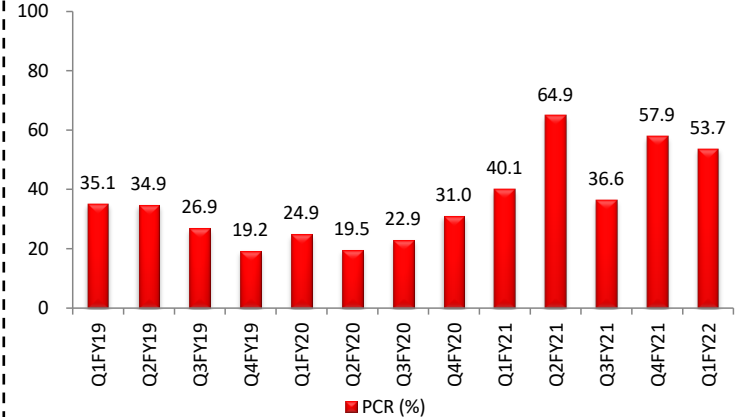
Source: Company, Systematix Institutional Research

Exhibit 6: Gross stage-3 spike due to recognition of loans in stage 3, we think it's better than restructuring...



Source: Company, Systematix Institutional Research

Exhibit 7: ...as stage 3 is well provided for and LGD still in the mid-30s



Source: Company, Systematix Institutional Research

Exhibit 8: Largely maintain FY22E and FY23E estimates

(Rs bn)	Old Est		New Est		% Change	
	FY22	FY23	FY22	FY23	FY22	FY23
NII (incl. Sec. Inc)	56.0	60.8	56.0	60.8	0	0
Other Income	1.4	1.5	1.4	1.5	0	0
Total Income	57.4	62.4	57.4	62.4	0	0
Operating Expenses	18.6	20.9	18.7	20.9	0	0
Operating Profits	38.8	41.5	38.7	41.5	0	0
Provisions	22.2	21.9	22.5	21.9	1	0
PBT	16.6	19.6	16.3	19.6	-2	0
Tax	4.2	4.9	4.1	4.9	-2	0
PAT	12.4	14.6	12.2	14.7	-2	0
Loans	662	728	665	731	0	0
Borrowings	635	699	638	702	0	0
Margins	8.9	8.8	8.9	8.7	-3bps	-4bps
Credit Cost	3.5	3.1	3.6	3.1	3bps	-2bps
RoE	8.2	9.2	8.0	9.2	-16bps	2bps
EPS	10	12	10	12	-2	0
BVPS	126	134	126	134	0	0

Source: Company, Systematix Institutional Research

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Profit & Loss Statement

YE: Mar (Rs mn)	FY19	FY20	FY21	FY22E	FY23E
Interest Income	86,146	97,120	97,841	98,620	108,909
Interest Expended	39,446	48,287	47,332	47,126	52,276
Net Interest Income	46,700	48,832	50,509	51,494	56,633
Change (%)	33.3	4.6	3.4	2.0	10.0
Other Operating Income	1,084	3,859	6,112	4,500	4,200
Other Income	869	1,473	1,216	1,405	1,545
Net Income	48,653	54,164	57,836	57,399	62,378
Change (%)	35.0	11.3	6.8	-0.8	8.7
Operating Expenses	18,476	20,182	16,325	18,659	20,924
Operating Profits	30,177	33,982	41,512	38,739	41,453
Change (%)	39.1	12.6	22.2	-6.7	7.0
Provisions	6,352	20,545	37,348	22,486	21,852
PBT	23,824	13,438	4,163	16,253	19,601
Tax	8,254	4,374	873	4,096	4,940
Tax Rate (%)	34.6	32.5	21.0	25.2	25.2
PAT	15,571	9,064	3,352	12,158	14,662
Change (%)	44.7	-41.8	-63.0	262.7	20.6
Proposed Dividend (Incl Tax)	4,779	0	1,153	4,249	5,124

Source: Company, Systematix Institutional Research

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YE: Mar (%)	FY19	FY20	FY21	FY22E	FY23E
Interest Income	14.4	13.8	12.9	12.3	12.4
Interest Expended	6.6	6.8	6.3	5.9	6.0
Net Interest Income	7.8	6.9	6.7	6.4	6.5
Income from Securitisation	0.2	0.5	0.8	0.6	0.5
Net operating income	8.0	7.5	7.5	7.0	6.9
Other Income	0.1	0.2	0.2	0.2	0.2
Net Income	8.1	7.7	7.7	7.1	7.1
Operating Expenses	3.1	2.9	2.2	2.3	2.4
Operating Income	5.0	4.8	5.5	4.8	4.7
Provisions/write offs	1.1	2.9	4.9	2.8	2.5
PBT	4.0	1.9	0.6	2.0	2.2
Tax	1.4	0.6	0.1	0.5	0.6
PAT	2.6	1.3	0.4	1.5	1.7
Leverage	6.1	6.5	5.8	5.3	5.5
RoE	15.8	8.3	2.5	8.0	9.2

Source: Company, Systematix Institutional Research

Balance Sheet

YE: Mar (Rs mn)	FY19	FY20	FY21	FY22E	FY23E
Equity Share Capital	1,230	1,231	2,464	2,464	2,464
Reserves & Surplus (Ex OCI)	103,072	112,408	144,651	152,560	162,097
Net Worth	104,221	113,639	147,115	155,024	164,561
Other Comprehensive Income	81	0	0	0	0
Net Worth	104,302	113,639	147,115	155,024	164,561
Change (%)	11.8	9.0	29.5	5.4	6.2
Borrowings	528,469	594,623	585,767	638,293	702,123
Change (%)	31.8	12.5	-1.5	9.0	10.0
Other liabilities	38,009	32,451	37,483	44,979	48,353
Total Liabilities	670,780	740,712	770,365	838,296	915,036
Investments	37,917	59,110	116,073	113,171	114,868
Change (%)	38.7	55.9	96.4	-2.5	1.5
Loans and Advances	612,496	649,935	599,474	664,889	731,378
Change (%)	26.2	6.1	-7.8	10.9	10.0
Other assets	20,367	31,668	54,818	60,236	68,790
Total Assets	670,780	740,712	770,365	838,296	915,036

Source: Company, Systematix Institutional Research

Ratios

YE: Mar	FY19	FY20	FY21	FY22E	FY23E
Spreads Analysis (%)					
Yield on Portfolio	15.7	15.4	15.7	15.6	15.6
Cost of Borrowings	8.5	8.6	8.0	7.7	7.8
Interest Spread	7.2	6.8	7.6	7.9	7.8
Net Interest Margin	8.7	8.3	9.1	8.9	8.7
Profitability Ratios (%)					
Cost/Income	38.0	37.3	28.2	32.5	33.5
RoE	15.8	8.3	2.6	8.0	9.2
RoA	2.6	1.3	0.4	1.5	1.7
Asset Quality (%)					
GNPA	40,706	57,467	57,860	60,135	58,395
NNPA	32,907	39,665	24,340	36,081	35,037
GNPA %	6.4	8.8	9.0	9.0	8.0
NNPA %	5.4	6.4	4.0	5.6	4.9
PCR %	19.2	31.0	57.9	40.0	40.0
Capitalisation (%)					
CAR	20.3	19.6	22.2	23.1	22.1
Tier I	15.5	15.4	18.4	20.2	19.7
Tier II	4.8	4.2	3.8	2.9	2.4
Average Leverage on Assets (x)	6.1	6.5	5.8	5.3	5.5

Valuation	FY19	FY20	FY21	FY22E	FY23E
Book Value (Rs)	169.5	184.7	119.4	125.8	133.6
Price-BV (x)	0.9	0.8	1.2	1.2	1.1
EPS (Rs)	12.6	7.3	2.7	9.8	11.9
EPS Growth (%)	44.7	-41.8	-63.0	262.7	20.6
Price-Earnings (x)	11.7	20.2	54.6	15.0	12.5
Dividend (Rs)	6.5	0.0	0.8	3.0	3.6
Dividend Yield (%)	4.4	0.0	0.5	2.0	2.4

Source: Company, Systematix Institutional Research

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