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SYSTEMATIX INSTITUTIONAL EQUITIES

Systematix

Institutional Equities

## Mahindra and Mahindra Financial Services

04 February 2023

## Results strong on growth and asset quality; Margins stable

## RESULT UPDATE

Sector: NBFCs

Rating: BUY

CMP: Rs 243

Target Price: Rs 320

## Stock Info

Sensex/Nifty	60,482/17,854
Bloomberg	MMFS IN
Equity shares	1,236mn
52-wk High/Low	Rs 248/128
Face value	Rs 2
M-Cap	Rs 301 bn/ USD 3.7 bn
3-m Avg volume	USD 9.6mn

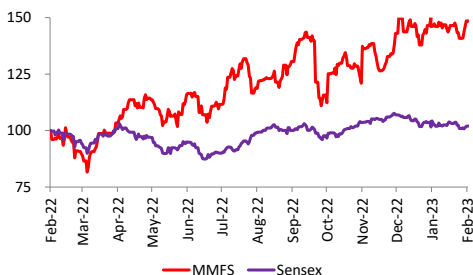
## Financial Snapshot (Rs mn)

Y/E March	FY23E	FY24E	FY25E
NII	61,780	79,563	99,804
PPP	38,881	52,366	67,897
PAT	18,565	22,718	27,927
EPS (Rs)	15.1	18.4	22.6
EPS Gr. (%)	87.8	22.4	22.9
BV/Sh (Rs)	136	148	162
<b>Ratios</b>			
NIM (%)	8.3	8.3	8.1
C/I ratio (%)	40.3	37.8	35.6
RoA (%)	2.1	2.1	2.1
RoE (%)	11.4	13.0	14.6
Payout (%)	36.8	36.8	36.8
<b>Valuations</b>			
P/E (x)	15.4	12.6	10.2
P/BV (x)	1.7	1.6	1.4
Div. Yield (%)	2.4	2.9	3.6

## Shareholding pattern (%)

	Dec'22	Sep'22	Jun'22
Promoter	52.2	52.2	52.2
—Pledged	-	-	-
FII	16.1	16.9	17.6
DII	23.7	22.1	18.0
Others	7.8	8.8	12.1

## Stock Performance (1-year)



Mahindra and Mahindra Financial Services (MMFS) reported healthy operating performance for 3QFY23 (marginally ahead of estimates) on the back of continued traction in AUM growth (21% YoY) and stable NIMs at 8.2%. Disbursement growth was strong at 22% QoQ, with growth across all vehicle categories viz Auto/ UV, Cars, Tractors, CVs, Pre owned vehicles. Asset quality continue to improve as stressed asset pool further declined by 211bps to 14.3% on the back of strong collection efficiency and higher write offs (Rs 5bn). We remain positive on 1) continued growth momentum across all vehicles categories, 2) scaling up of new business segments, 3) Stable NIMs, and 4) improving asset quality. We have revised our earnings estimates upwards by 29%/ 10% for FY23/24 as we factor into higher spreads and lower credit cost. As a result, the RoE profile improves to 13%/15% for FY24/25. Hence, we have changed our rating to BUY from HOLD, with a revised target price of Rs 320 (earlier Rs 250), based on 2x FY25E BV.

## Result key highlights

- MMFS NII was inline with estimates at Rs15.5bn, as AUM grew by 21% YoY (5% QoQ), even as NIMs remain stable at 8.2%. However, with lower than expected opex at Rs6.5bn (vs. est. of Rs7bn), operating profit was marginally ahead of estimates. Aided by sharply lower provisioning at Rs1.6bn (vs. est. of Rs4.5bn), PAT came in at Rs6.3bn, significantly ahead of estimates.
- Strong 22% QoQ disbursement growth was led by all product categories viz. Auto/ UV, Cars, Tractors, CVs, Pre owned vehicle, except SME/ Others which declined 21% QoQ on account of higher repayment in trade advances. As a result, AUM grew by 21% YoY (5% QoQ) vs. 16% YoY (9% QoQ) in 2QFY23.
- Opex came in 7% below estimates at Rs6.5bn, as the company didn't do any repossession activity during the quarter, hence not incurred any related costs.
- Gross Stage 3 (GS 3) further improved to 5.9% from 6.7% in 2Q, aided by strong client cashflows and elevated write offs (2.6% annualized). Stage 2 also improved by 135bps during the quarter to 8.4%. Stage 3 provision cover remained stable at 59% QoQ.

## Key takeaways from the concall:

- Mr. Rebello will assume the position of MD & CEO of the Company (subject to necessary approvals from NRC, Board of Directors and Shareholders), after the retirement of Mr. Ramesh Iyer on 29th April, 2024.
- Management is quite optimistic about demand across all their segments. Pre-owned vehicle will be a growth engine, along with growth in the affordable housing segment and leasing business, SME lending as well as digital lending (a noticeable portfolio by FY24). Their market share has improved in almost all their product segments.
- RBI has released the ban on repossession. They will start repossessing on delinquent accounts which will lead to release of provision. They are comfortable with Stage 3 assets in the range of 3-4%.

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**Valuation & Recommendation**

MMFS continue to show strong disbursement growth along with marked improvement in stage2/3 assets, while maintaining the NIMs in a rising rate environment, which is very encouraging. With strong guidance on the business front and asset quality, we expect profitability to continue to improve over FY24E/25E, with RoA/ RoE of ~2.1%/ 15% from 1.3%/ 6.5% in FY22, respectively. At CMP, the stock trades at 1.4x FY25E BV. We remain positive on 1) continued growth momentum across all vehicles categories, 2) scaling up of new business segments, and 3) improving asset quality. We have revised our earnings estimates upwards by 29%/ 10% for FY23/24 as we factor into higher spreads and lower credit cost. As a result the RoE profile improves to 13%/15% for FY24/25. Hence, we have changed our rating to BUY from HOLD, with a revised target price of Rs 320 (earlier Rs 250), based on 2x FY25E BV.

## Exhibit 1: Quarterly performance

(Rs mn)	3QFY22	4QFY22	1QFY23	2QFY23	3QFY23	YoY (%)	QoQ (%)
Net Interest Income	15,353	14,560	15,052	14,475	15,528	1.1	7.3
Other Income	563	747	614	930	969	72.1	4.1
<b>Net Income</b>	<b>15,916</b>	<b>15,306</b>	<b>15,666</b>	<b>15,405</b>	<b>16,496</b>	<b>3.6</b>	<b>7.1</b>
Total Operating Expenses	5,294	6,327	6,208	6,768	6,513	23.0	-3.8
<i>As % Of Net Income</i>	33.3	41.3	39.6	43.9	39.5		
Employee Expenses	3,027	3,200	3,532	3,762	3,997	32.0	6.2
<i>As % Of Net Income</i>	19.0	20.9	22.5	24.4	24.2		
Other Expenses	2,266	3,127	2,676	3,007	2,517	11.1	-16.3
<i>As % Of Net Income</i>	14.2	20.4	17.1	19.5	15.3		
<b>Operating Profit</b>	<b>10,622</b>	<b>8,979</b>	<b>9,458</b>	<b>8,637</b>	<b>9,983</b>	<b>-6.0</b>	<b>15.6</b>
<i>As % Of Net Income</i>	66.7	58.7	60.4	56.1	60.5		
Provisions	-1,474	639	6,453	1,985	1,551	-205.3	-21.8
PBT	12,096	8,341	3,005	6,107	8,431	-30.3	38.1
Total Tax	3,158	2,333	776	1,624	2,142	-32.2	31.9
<b>Reported PAT</b>	<b>8,938</b>	<b>6,008</b>	<b>2,229</b>	<b>4,483</b>	<b>6,290</b>	<b>-29.6</b>	<b>40.3</b>
Extra Ordinary Items	0	0	0	-545	0		
Adjusted PAT	8,938	6,008	2,229	5,028	6,290	-29.6	25.1
Adjusted EPS	7.2	4.9	1.8	4.1	5.1	-29.6	25.1
<b>Yield Analysis (%)</b>	<b>3QFY22</b>	<b>4QFY22</b>	<b>1QFY23</b>	<b>2QFY23</b>	<b>3QFY23</b>	<b>YoY (bps)</b>	<b>QoQ (bps)</b>
Yield on AUM	15.6	14.8	14.7	14.2	14.8	-80	57
Cost of funds (AUM)	6.0	5.8	5.6	6.0	6.6	61	53
NIMs on AUM	9.6	9.0	9.1	8.2	8.2	-141	3
<b>Asset quality (Rs mn)</b>	<b>3QFY22</b>	<b>4QFY22</b>	<b>1QFY23</b>	<b>2QFY23</b>	<b>3QFY23</b>	<b>YoY (%)</b>	<b>QoQ (%)</b>
Gross NPAs	72,227	49,760	54,360	49,420	45,890	-36.5	-7.1
Net NPAs	33,807	20,860	22,790	20,660	18,820	-44.3	-8.9
Gross NPAs (%)	11.3	7.7	8.0	6.7	5.9		
Net NPAs (%)	5.6	3.4	3.5	2.9	2.5		
Provision cover (%)	53.2	58.1	58.1	58.2	59.0		

Source: Company, Systematix Institutional Research

## Exhibit 2: AUM

(Rs bn)	3QFY22	4QFY22	1QFY23	2QFY23	3QFY23	YoY (%)	QoQ (%)	% of total
Auto/ Utility vehicles	205	208	217	229	255	24.7	11.5	33.0
Cars	141	104	102	103	116	-17.5	12.3	15.0
Tractors	109	143	142	148	155	42.3	4.8	20.0
Commercial Vehicles	83	78	81	81	85	2.3	4.8	11.0
Refinance & Others	64	71	74	81	93	45.1	14.3	12.0
SME & Others	38	45	61	96	70	81.4	-27.5	9.0
<b>Total</b>	<b>639</b>	<b>650</b>	<b>677</b>	<b>738</b>	<b>773</b>	<b>21.0</b>	<b>4.8</b>	<b>100.0</b>

Source: Company, Systematix Institutional Research

**Exhibit 3: Disbursements**

(Rs bn)	3QFY22	4QFY22	1QFY23	2QFY23	3QFY23	YoY (%)	QoQ (%)	% of total
Auto/ Utility vehicles	28	29	31.3	41	49	75.0	19.5	34.0
Cars	15	9	12.3	12	20	30.6	69.6	13.8
Tractors	15	16	17.0	20	25	63.7	26.5	17.3
Commercial Vehicles	4	13	11.4	13	16	285.8	27.7	11.4
Pre owned vehicles	14	18	15.2	19	23	66.4	22.4	16.0
SME & Others	3	6	7.6	14	11	213.7	-20.6	7.5
<b>Total</b>	<b>80</b>	<b>92</b>	<b>95</b>	<b>118</b>	<b>145</b>	<b>80.1</b>	<b>22.4</b>	<b>100.0</b>

Source: Company, Systematix Institutional Research

**Exhibit 4: Source of Borrowing**

(Rs bn)	3QFY22	4QFY22	1QFY23	2QFY23	3QFY23	YoY (%)	QoQ (%)	% of total
NCDs	203	206	189	221	225	10.8	1.7	31.6
Bank Loans	131	154	184	246	274	108.3	11.2	38.5
Offshore Borrowings	40	26	26	20	14	-64.7	-27.2	2.0
Fixed Deposits	91	85	77	67	60	-34.4	-11.3	8.4
CP, ICD, TREPS	23	8	39	44	58	153.6	32.4	8.2
Securitisation/Assignment	83	81	78	79	81	-2.7	3.0	11.4
<b>Total</b>	<b>572</b>	<b>560</b>	<b>593</b>	<b>677</b>	<b>711</b>	<b>24.3</b>	<b>5.0</b>	<b>100.0</b>

Source: Company, Systematix Institutional Research

**Exhibit 5: Mahindra Insurance Brokers Limited**

(Rs mn)	3QFY22	4QFY22	1QFY23	2QFY23	3QFY23	YoY (%)	QoQ (%)
Total income	970	1,140	890	940	1,230	26.8	30.9
PBT	240	280	30	80	180	-25.0	125.0
PAT	180	210	20	60	130	-27.8	116.7
No. of employees (nos.)	1,047	1,027	955	857	777	-25.8	-9.3

Source: Company, Systematix Institutional Research

**Exhibit 6: Mahindra Rural Housing Finance**

(Rs mn)	3QFY22	4QFY22	1QFY23	2QFY23	3QFY23	YoY (%)	QoQ (%)
Loans disbursed	4,880	6,510	3,950	4,250	4,440	-9.0	4.5
No. of Customer Contracts (Nos)	23,806	29,915	16,162	12,719	12,229	-48.6	-3.9
Outstanding loan book	70,300	70,290	69,740	69,270	68,350	-2.8	-1.3
Total income	3,530	3,300	3,290	3,280	3,380	-4.2	3.0
PAT	670	-10	20	310	140	-79.1	-54.8
GNPA (%)	16%	11%	14%	15%	16%		
NNPA (%)	12%	8%	10%	11%	12%		

Source: Company, Systematix Institutional Research

**Exhibit 7: Change in estimates.**

(Rs bn)	Old Estimates		New Estimates		% Change	
	FY23	FY24	FY23	FY24	FY23	FY24
NII	57.3	74.1	61.8	79.6	7.8	7.4
Operating Profit	34.6	47.3	38.9	52.4	12.4	10.6
PAT	14.4	20.7	18.6	22.7	29.1	9.9
BV	134	145	136	148	1.6	2.2
EPS	11.7	16.8	15.1	18.4	29.1	9.9

Source: Company, Systematix Institutional Research

## Earnings call highlights:

### Management succession:

- Mr. Rebello will assume the position of MD & CEO of the Company (subject to necessary approvals from NRC, Board of Directors and Shareholders), when Mr. Ramesh Iyer, the current Vice Chairman & Managing Director of the Company, superannuates on 29th April 2024.

### Business:

- The business environment is favorable on the back of good farm cash flow rainfall and support price. The demand and supply position for CV has improved and the management is optimistic about demand in the market.
- They witnessed an improved market share in most of the products they work with.
- The leasing business (B2B, lending under the employee lease program)- 200-250 clients. Yields – 12%. They compete with other players in the market. They evaluate every deal and price it accordingly.
- For housing segment, in rural housing they see a correction in the asset quality and expect better results. They have put a legal team in place for the same. They are now expanding in the affordable housing segment and expect the share of this segment to go upto 40-50% of the total book in 3-4 years. So, correction of the past book along with growth in the new book will go hand in hand and improve the results of the housing segment. The ticket size will be upto 8 lakh, 12 lakh and 15 lakh.
- They expect digital lending book to have a noticeable portfolio and start reporting it. This product is being offered to existing customers with a good track record. Currently, the book has a O/S of Rs 400mn and is being offered to 4,000-5,000 customers.
- Earlier, ~90% of the collections were in cash form, they are now reduced to 40%.

### NIM/ Borrowing

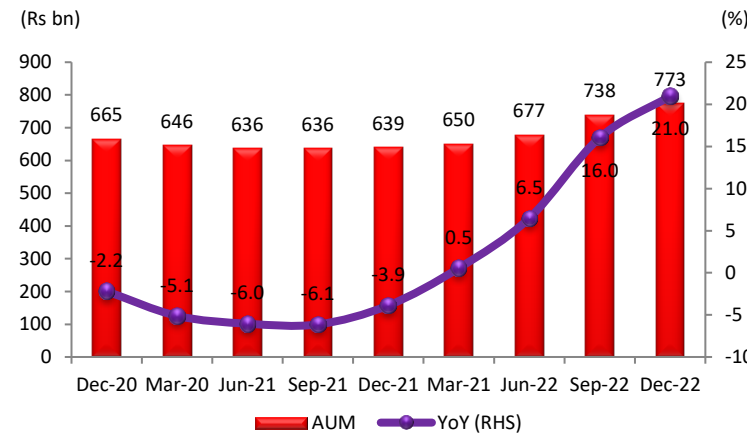
- The management has passed on 80Bps to the customers. The increased yields are applicable only on the new book from November onwards and hence the impact will be seen in the coming quarters.
- In terms of cost of funds, there will be an increase of 15-20Bps over the next 3-4 quarters. Rating change to AAA, will also provide better costs.
- Though the management expects the margins to remain stable, there might be a change on account of change in the product mix as well as rising interest rate environment.

### Opex:

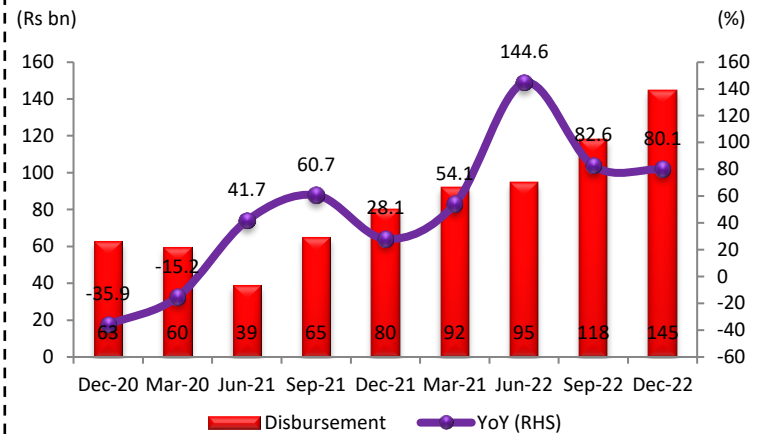
- Opex is elevated on account of their investment for the future. The management expects further investments in FY24. The benefit of these investments will be seen in terms of AUM growth and productivity.
- Additionally, they have taken some employees on rolls which were earlier outsourced and hence the employee benefit expenses have increased. This increase was partially offset as third party related repossession costs were not incurred during the quarter.

### Asset quality:

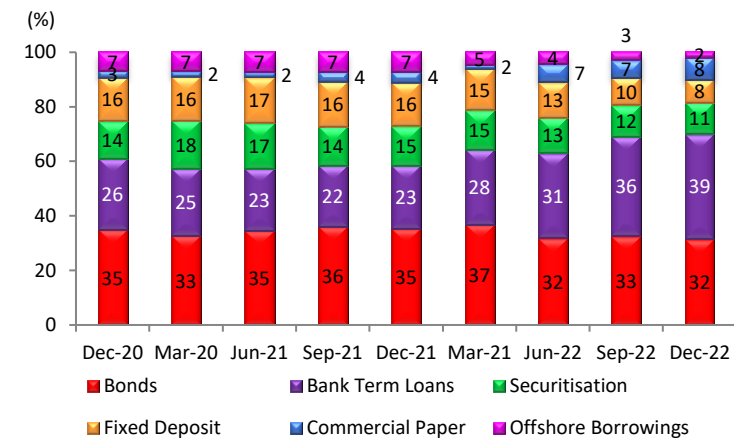
- Management will be comfortable with stage 3 in 3-4% range.
- RBI has released the ban on repossession. They will start with repossessing the delinquent account which will eventually lead to release of the provision.
- The management overlay now stands at Nil. The provisioning now is as per the ECL model (it is based on the historical trend of the customers).

**Exhibit 8: Healthy AUM growth on the back of ....**

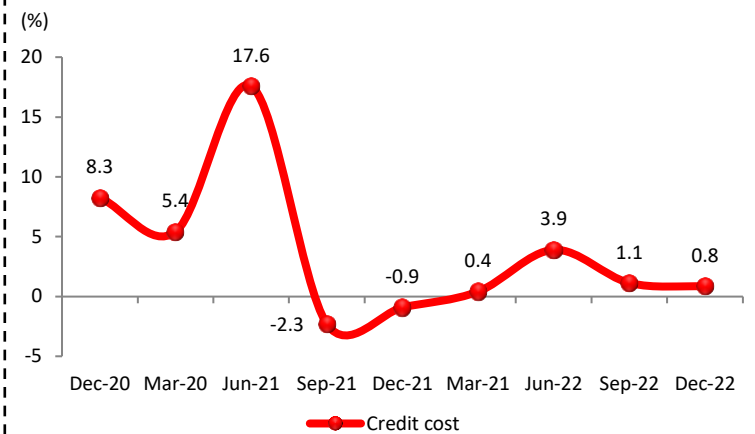
Source: Company, Systematic Institutional Research

**Exhibit 9: Strong disbursement growth...**

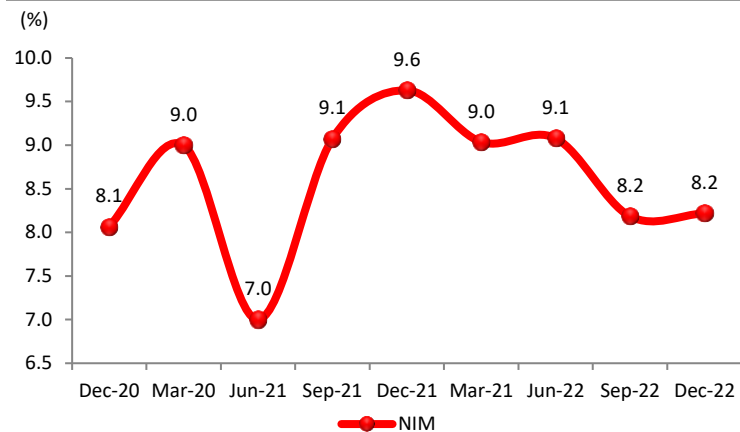
Source: Company, Systematic Institutional Research

**Exhibit 10: Diversified borrowing mix...**

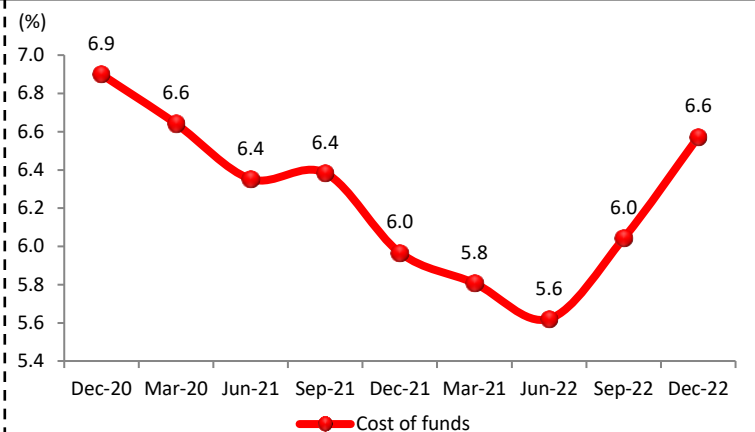
Source: Company, Systematic Institutional Research

**Exhibit 11: Credit cost improved on improved asset quality**

Source: Company, Systematic Institutional Research

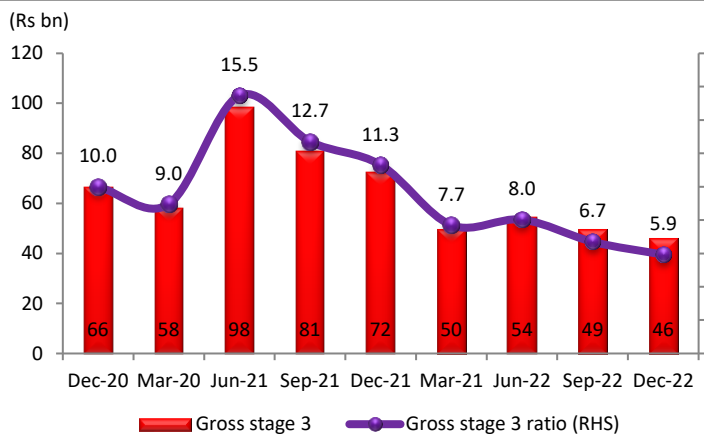
**Exhibit 12: NIM were stable ...**

Source: Company, Systematic Institutional Research

**Exhibit 13: ... even as cost of funds rise**

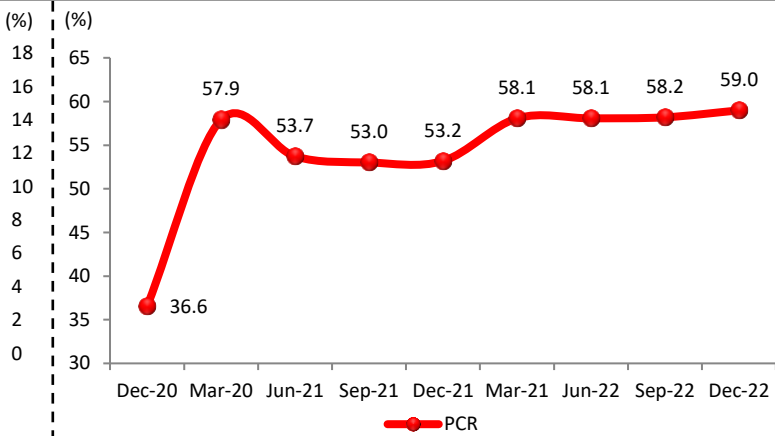
Source: Company, Systematic Institutional Research

Exhibit 14: Gross stage-3 improved significantly by 80bps



Source: Company, Systematix Institutional Research

Exhibit 15: Stage-3 provision cover maintained



Source: Company, Systematix Institutional Research

## FINANCIALS

## Profit &amp; Loss Statement

YE: Mar (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Net interest income	55,338	55,554	61,780	79,563	99,804
Other income	607	608	968	1,252	1,602
Net Income	57,836	57,986	65,179	84,146	1,05,473
Operating expenses	16,325	20,734	26,299	31,780	37,577
Preprovision profit	41,512	37,252	38,881	52,366	67,897
Provisions	37,348	23,683	13,403	21,188	29,571
Profit before tax	4,224	13,569	25,478	31,177	38,326
Tax	873	3,682	6,913	8,459	10,399
Tax rate	20.7	27.1	27.1	27.1	27.1
Reported Profit after tax	3,352	9,888	18,565	22,718	27,927

Source: Company, Systematix Institutional Research

## Balance Sheet

YE: Mar (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Equity	2,464	2,466	2,466	2,466	2,466
Reserves	1,44,651	1,53,815	1,65,545	1,79,900	1,97,546
Net worth	1,47,115	1,56,281	1,68,011	1,82,366	2,00,012
Borrowings	5,85,767	5,58,139	7,59,069	9,82,364	12,45,478
Others	37,483	38,467	50,634	57,135	48,531
<b>Total liabilities</b>	<b>7,70,365</b>	<b>7,52,887</b>	<b>9,77,715</b>	<b>12,21,865</b>	<b>14,94,021</b>
Cash	33,221	41,507	50,377	43,464	27,553
Investments	1,17,054	84,403	1,00,753	1,08,660	1,10,210
Loans	5,99,474	6,04,446	7,97,464	10,32,053	13,08,476
Others	17,212	18,603	24,044	31,116	39,451
<b>Total assets</b>	<b>7,70,365</b>	<b>7,52,887</b>	<b>9,77,715</b>	<b>12,21,865</b>	<b>14,94,021</b>

Source: Company, Systematix Institutional Research

## Dupont (as % of Average Assets)

YE: Mar	FY21	FY22	FY23E	FY24E	FY25E
Interest Income	13.6	12.4	12.4	12.9	13.3
Interest Expense	6.3	5.1	5.3	5.6	6.0
Net Interest Income	7.3	7.3	7.1	7.2	7.3
Other income total	0.3	0.3	0.4	0.4	0.4
Net Income total	7.7	7.6	7.5	7.7	7.8
Operating expenses total	2.2	2.7	3.0	2.9	2.8
Preprovision profit	5.5	4.9	4.5	4.8	5.0
Provisions	4.9	3.1	1.5	1.9	2.2
Profit before tax and exce. items	0.6	1.8	2.9	2.8	2.8
Profit before tax	0.6	1.8	2.9	2.8	2.8
Tax total	0.1	0.5	0.8	0.8	0.8
Profit after tax	0.4	1.3	2.1	2.1	2.1

Source: Company, Systematix Institutional Research

## Key Ratios

YE: Mar	FY21	FY22	FY23E	FY24E	FY25E
Yield on portfolio	15.5	14.6	14.4	14.7	14.7
cost of borrowings	8.0	6.9	6.9	7.1	7.3
Spread	7.5	7.8	7.5	7.6	7.4
NIM (on AUM)	8.3	8.6	8.3	8.3	8.1
Cost/ Income (%)	28.2	35.8	40.3	37.8	35.6
Credit cost (%)	4.9	3.1	1.5	1.9	2.2
RoA(%)	0.4	1.3	2.1	2.1	2.1
RoE(%)	2.5	6.5	11.4	13.0	14.6
Leverage (x)	5.8	5.0	5.3	6.3	7.1
Tier I (%)	22.2	24.2	20.3	17.8	16.1
CAR (%)	26.0	27.8	23.0	19.9	17.9
Gross NPA (%)	9.0	7.7	6.0	6.0	6.0
Net NPA (%)	4.0	3.4	2.6	2.6	2.6
Provision coverage (%)	57.9	58.1	59.0	59.0	59.0

Source: Company, Systematix Institutional Research

## Growth

YE: Mar (%)	FY21	FY22	FY23E	FY24E	FY25E
Net interest income	8.2	0.4	11.2	28.8	25.4
Net Income total	6.8	0.3	12.4	29.1	25.3
Preprovision profit	22.2	-10.3	4.4	34.7	29.7
Profit before tax	-68.6	221.2	87.8	22.4	22.9
Profit after tax	-63.0	195.0	87.8	22.4	22.9
Loan	-7.8	0.8	31.9	29.4	26.8
Disbursement	-36.0	45.2	88.5	25.0	20.0
AUM	-5.1	0.5	29.2	29.4	26.8

Source: Company, Systematix Institutional Research

## Valuation ratios

YE: Mar	FY21	FY22	FY23E	FY24E	FY25E
FDEPS (Rs)	3	8	15	18	23
PER (x)	87	29	15	13	10
Book value (Rs)	119	127	136	148	162
P/BV (Rs)	1.9	1.8	1.7	1.6	1.4
Adj. book value (Rs)	100	110	120	126	135
P/ABV (Rs)	2.3	2.1	1.9	1.8	1.7
P/PPP (x)	6.9	7.7	7.4	5.5	4.2
Dividend yield (%)	0.3	1.3	2.4	2.9	3.6

Source: Company, Systematix Institutional Research



## Institutional Equities Team

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### Equity Research

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