



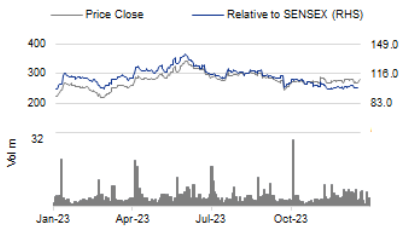
India

ADD (previously )

Consensus ratings*: Buy 21 Hold 11 Sell 8	
Current price:	Rs280
Target price:	Rs370
Previous target:	Rs370
Up/downside:	32.1%
InCred Research / Consensus:	22.1%
Reuters:	MMFS.BO
Bloomberg:	MMFS IN
Market cap:	US\$4,156m
	Rs345,392m
Average daily turnover:	US\$14.6m
	Rs1210.2m
Current shares o/s:	1,232.3m
Free float:	46.4%
*Source: Bloomberg	

Key changes in this note

Our channel check indicates a consistent improvement in the underwriting practices of the company, with a focus on better quality customers.



Source: Bloomberg

<b>Price performance</b>	1M	3M	12M
Absolute (%)	1.0	13.9	20.1
Relative (%)	2.6	2.3	0.5

<b>Major shareholders</b>	% held
Mahindra & Mahindra	52.0
LIC	6.3
HDFC Life	2.6

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# Mahindra & Mahindra Finance

## Healthy performance across parameters

- MMFS posted 3Q PAT of Rs5.1bn aided by ~30bp sequential improvement in margins & a lower provision amid consistency in improving the asset quality.
- We expect its margins to improve in 4QFY24F on repricing of loans & portfolio rejig and a likely lower provision amid stringent underwriting practices.
- MMFS is one of our high-conviction stock ideas due to its attractive risk-reward & improving return ratios. Retain ADD rating on it with a target price of Rs370.

### Healthy growth & improvement in margins despite tight liquidity

Mahindra & Mahindra Financial Services or MMFS posted healthy 3QFY24 loan disbursement growth at Rs154.4bn (+6.7% yoy), resulting in +25.5% assets under management or AUM growth to Rs970.5bn as of Dec 2023-end. MMFS witnessed a ~30bp qoq improvement in margins to ~6.8%, despite a consistent surge in the cost of funds, as rate hikes undertaken last quarter along with a favourable asset mix supported yields. We expect a gradual improvement in margins backed by repricing of loans and a rejig of the portfolio towards better-yield assets, but the elevated cost of borrowing may continue to disappoint.

### Granularity in asset quality visible; maintains prudent provisioning

MMFS has managed to maintain healthy asset quality even in 3QFY24. Gross stage-3 assets improved to ~4% vs. ~4.3% last quarter. The overall collection efficiency stayed healthy at ~95% whereas the provision coverage for stage-3 assets rose further to ~62.7% vs. ~61.5% last quarter. MMFS witnessed relatively lower provision reversal of Rs1.2bn against Rs3.4bn. Similarly, the provision towards ECL on financial assets for the quarter was lower by Rs860m due to improved asset quality. Our channel check indicates a consistent improvement in the underwriting practices of MMFS, with a focus on better-quality customers, which is reflected in the quarterly earnings.

### Perception issue to stay; moving towards sustainable RoA of +2%

MMFS has a perception issue amid its long-term track record of posting a disappointing performance despite superior corporate parentage (M&M Group) as well as a pan-India presence and strong brand recognition. Though 3QFY24's profitability had been weaker than expected, we expect MMFS to post sustainable RoA of +2% in the coming years backed by steady margins (~7.2%-7.3%), balanced operating leverage (cost-to-average assets ratio of ~2.6-2.8%) and improved credit costs range of ~1.5-1.7%. With improved customer sourcing, a rising mix of low-risk products and an efficient collection mechanism, profitability, in our view, may see an improvement.

### Outlook & valuation

MMFS is one of our high-conviction stock ideas due to its attractive risk-reward & improving return ratios. We retain our high-conviction ADD rating on MMFS with a target price of Rs370, as we have valued the standalone entity at ~2.2x FY25F BV and added Rs20/share for its subsidiaries. Downside risks: Slowing growth, and deterioration in asset quality.

### Financial Summary

	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Net Interest Income (Rsm)	57,795	63,853	69,537	86,757	104,223
Total Non-Interest Income (Rsm)	191	941	1,277	1,434	1,607
Operating Revenue (Rsm)	57,986	64,794	70,814	88,190	105,830
Total Provision Charges (Rsm)	(23,683)	(9,992)	(17,490)	(16,790)	(20,348)
Net Profit (Rsm)	9,888	19,848	17,413	27,999	34,889
Core EPS (Rs)	8.02	16.07	14.10	22.67	28.25
Core EPS Growth	195%	100%	(12%)	61%	25%
FD Core P/E (x)	34.86	17.39	19.83	12.33	9.90
DPS (Rs)	3.60	6.00	5.00	9.00	11.00
Dividend Yield	1.29%	2.15%	1.79%	3.22%	3.93%
BVPS (Rs)	126.7	138.4	147.5	161.1	178.4
P/BV (x)	2.21	2.02	1.90	1.73	1.57
ROE	6.5%	12.1%	9.9%	14.7%	16.6%
% Change In Core EPS Estimates					
InCred Research/Consensus EPS (x)					

SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 1: Quarterly earnings summary**

Rs m	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	3QFY24	% yoy	% qoq
Operating Income	24,863	25,860	28,625	29,942	30,846	32,119	34,536	24.2%	4.1%
Interest Expenses	9,320	10,690	12,419	13,340	14,505	15,665	16,750	46.5%	8.0%
<b>Net Operating Income</b>	<b>15,543</b>	<b>15,170</b>	<b>16,206</b>	<b>16,602</b>	<b>16,341</b>	<b>16,455</b>	<b>17,787</b>	<b>8.5%</b>	<b>0.7%</b>
Other Income	122	230	291	625	409	286	368	24.1%	-30.1%
<b>Total Income</b>	<b>15,666</b>	<b>15,400</b>	<b>16,496</b>	<b>17,227</b>	<b>16,750</b>	<b>16,740</b>	<b>18,155</b>	<b>8.7%</b>	<b>-0.1%</b>
Operating Expenses	6,208	6,770	6,513	7,786	6,750	7,312	7,530	8.0%	8.3%
<b>Operating Profit</b>	<b>9,458</b>	<b>8,630</b>	<b>9,983</b>	<b>9,441</b>	<b>10,000</b>	<b>9,428</b>	<b>10,625</b>	<b>9.3%</b>	<b>-5.7%</b>
Provisions	6,453	1,980	1,551	4	5,264	6,266	3,469	216.4%	19.0%
CoR%	3.9%	1.1%	0.8%	0.0%	2.5%	2.8%	1.5%	148.1%	11.8%
<b>PBT</b>	<b>3,005</b>	<b>6,650</b>	<b>8,431</b>	<b>9,437</b>	<b>4,735</b>	<b>3,163</b>	<b>7,156</b>	<b>-52.4%</b>	<b>-33.2%</b>
Tax	776	1,620	2,142	2,596	1,209	811	2,034	-49.9%	-32.9%
Tax rate (%)	25.8%	24.4%	25.4%	27.5%	25.5%	25.6%	28.4%	5.3%	0.5%
<b>Reported PAT</b>	<b>2,229</b>	<b>4,480</b>	<b>6,290</b>	<b>6,841</b>	<b>3,527</b>	<b>2,352</b>	<b>5,122</b>	<b>-47.5%</b>	<b>-33.3%</b>
<b>AUM</b>	<b>6,76,930</b>	<b>7,38,170</b>	<b>7,73,440</b>	<b>8,27,700</b>	<b>8,67,320</b>	<b>9,37,230</b>	<b>9,70,480</b>	<b>27.0%</b>	<b>8.1%</b>
<b>Disbursements</b>	<b>94,720</b>	<b>1,18,240</b>	<b>1,44,670</b>	<b>1,37,780</b>	<b>1,21,650</b>	<b>1,33,150</b>	<b>1,54,360</b>	<b>12.6%</b>	<b>9.5%</b>

SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 2: Our revised earnings estimates**

Y/E Mar (Rs m)	FY24F			FY25F			FY26F		
	Earlier	Revised	% change	Earlier	Revised	% change	Earlier	Revised	% change
Net interest income	73,411	69,537	-5.3%	89,373	86,757	-2.9%	1,05,215	1,04,223	-0.9%
PPOP	44,400	40,863	-8.0%	56,063	54,372	-3.0%	67,055	67,179	0.2%
PAT	18,509	17,413	-5.9%	28,715	27,999	-2.5%	35,420	34,889	-1.5%
EPS (Rs)	14.9	14.1	-5.5%	23.3	22.7	-2.5%	28.7	28.2	-1.5%
AUM (Rs)	9,99,280	10,13,357	1.4%	11,90,673	12,25,330	2.9%	14,10,870	14,87,672	5.4%

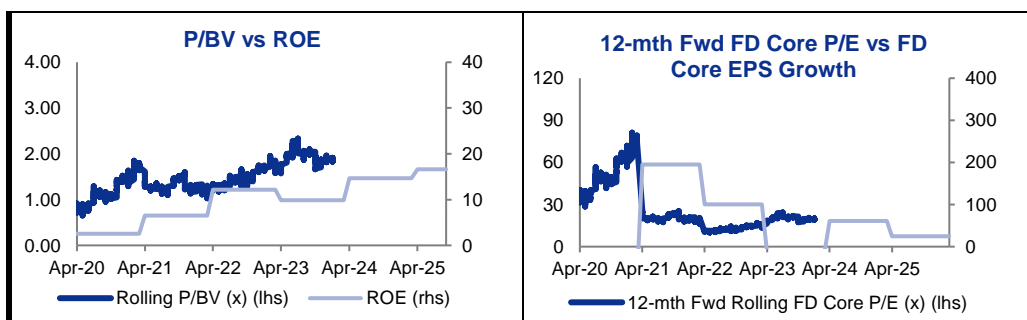
SOURCE: INCRED RESEARCH, COMPANY REPORTS

### 3QFY24 earnings conference-call highlights

- The full-year guidance on credit costs is in the range of 1.5% to 1.7%.
- The coverage ratio is expected to normalize at a lower level going ahead.
- The company expects the incremental cost of borrowing in 4QFY24F to remain at the same level as in 3Q. Operating expenses guidance is 2.5% by the end of FY25F. The RoA guidance stands at 2.5%.
- As regards the net interest margin or NIM, there is an aspiration target of 7.5% by FY25F, which has been recalibrated to 7%.
- The peak cost of funding is likely to remain at around the same levels as in 3Q unless there are changes on the repo rate side or the liquidity tightens further.
- The coverage ratio is currently model-driven. The ECL model determines the coverage ratio. It is higher as compared to peers. However, this is a function of loss-given default or LGD and probability of default or PD, and MMFS expects it to come down by 3Q of next year. But right now, it's mostly an ECL (expected credit loss) model, which dictates the kind of provision levels in the case of Stage-1, Stage-2, and Stage-3 assets.
- The inventory level at automobile dealers now stands at two months. MMFS expects a 10% growth in the commercial vehicle or CV segment, which will bring movement to its vehicle-financing business.
- The volume growth may be slightly lower, but the loan ticket sizes are going up due to premiumization and sports utility vehicles or SUVs account for a major portion of passenger vehicles. Even by keeping the same loan-to-value or LTV, the company stands to benefit in terms of overall growth.
- The launch of new models in passenger vehicles or PVs is leading to some demand upside. In the used vehicles segment, formalization has led to lending opportunities.
- Mahindra & Mahindra or M&M is in light commercial vehicles or LCVs, small commercial vehicles or SCVs and buses, The automobile industry will see a good growth in the CV segment and M&M aims to strengthen the growth momentum. In the tractor segment, the company expects the growth to decline next year. Prolonged stress is likely in the agri-segment, which will hit tractor demand. However, the overall demand in other segments is likely to lift rural demand.

- The important data that should be continuously monitored is stage-2 assets and if they are not growing, it's a clear indication that stage-3 assets are not likely to grow further and also as there is a settlement of those accounts.
- Out of the company's total borrowing, 46% has a floating interest rate, including MCLR-linked, and 56% are fixed-rate loans. Liquidity is continuously recalibrated. There is extra liquidity buffer to ensure that there is flow of funds in the pipeline.
- The coverage ratio of 60% does not mean 60% of LGD. LGD is calculated based on past loss. There is a reduction in credit loss, which will result in lower LGD, and the stage-3 assets number should be monitored to see whether it's declining over the years.
- The overall cost of funds is about 7.8%. Therefore, the incremental cost of funds is in the ballpark range at about 8% due to the freeze in lending, and the cost of funds may rise further.
- As regards collection efficiency, there is fall by 100bp but the overall efficiency is at the same level as last year.
- Gross non-performing assets or GNPA's, as per the Reserve Bank of India's norm, stand at 5.5%.

**BY THE NUMBERS**



**Profit & Loss**

(Rsm)	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Net Interest Income	57,795	63,853	69,537	86,757	104,223
<b>Total Non-Interest Income</b>	<b>191</b>	<b>941</b>	<b>1,277</b>	<b>1,434</b>	<b>1,607</b>
Operating Revenue	57,986	64,794	70,814	88,190	105,830
<b>Total Non-Interest Expenses</b>	<b>(19,466)</b>	<b>(25,402)</b>	<b>(27,740)</b>	<b>(31,254)</b>	<b>(35,676)</b>
Pre-provision Operating Profit	37,252	37,519	40,863	54,372	67,179
<b>Total Provision Charges</b>	<b>(23,683)</b>	<b>(9,992)</b>	<b>(17,490)</b>	<b>(16,790)</b>	<b>(20,348)</b>
Operating Profit After Provisions	13,569	27,526	23,373	37,582	46,831
<b>Pretax Income/(Loss) from Assoc.</b>					
Operating EBIT (incl Associates)	13,569	27,526	23,373	37,582	46,831
<b>Non-Operating Income/(Expense)</b>					
Profit Before Tax (pre-EI)	20,872	36,285	32,569	47,514	57,756
<b>Exceptional Items</b>					
Pre-tax Profit	13,569	27,526	23,373	37,582	46,831
Taxation	(3,682)	(7,134)	(5,960)	(9,583)	(11,942)
Consolidation Adjustments & Others					
<b>Exceptional Income - post-tax</b>		<b>(545)</b>			
Profit After Tax	9,888	19,848	17,413	27,999	34,889
Minority Interests					
Pref. & Special Div					
<b>FX And Other Adj.</b>					
Net Profit	9,888	19,848	17,413	27,999	34,889
Recurring Net Profit					

**Balance Sheet Employment**

(Rsm)	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Gross Loans/Cust Deposits					
Avg Loans/Avg Deposits					
Avg Liquid Assets/Avg Assets	84.6%	85.9%	87.0%	89.0%	90.0%
<b>Avg Liquid Assets/Avg IEAs</b>	<b>106.1%</b>	<b>105.0%</b>	<b>103.1%</b>	<b>103.0%</b>	<b>101.8%</b>
Net Cust Loans/Assets					
<b>Net Cust Loans/Broad Deposits</b>					
Equity & Provns/Gross Cust Loans					
Asset Risk Weighting					
<b>Provision Charge/Avg Cust Loans</b>					
<b>Provision Charge/Avg Assets</b>					
Total Write Offs/Average Assets					

SOURCE: INCRED RESEARCH, COMPANY REPORTS

**BY THE NUMBERS...cont'd**

<b>Balance Sheet</b>					
<b>(Rsm)</b>	<b>Mar-22A</b>	<b>Mar-23A</b>	<b>Mar-24F</b>	<b>Mar-25F</b>	<b>Mar-26F</b>
<b>Total Gross Loans</b>	<b>609,055</b>	<b>794,550</b>	<b>1,022,897</b>	<b>1,254,130</b>	<b>1,543,855</b>
Liquid Assets & Invst. (Current)					
Other Int. Earning Assets					
Total Gross Int. Earning Assets	609,055	794,550	1,022,897	1,254,130	1,543,855
<b>Total Provisions/Loan Loss Reserve</b>					
Total Net Interest Earning Assets	609,055	794,550	1,022,897	1,254,130	1,543,855
Intangible Assets					
<b>Other Non-Interest Earning Assets</b>	<b>5,727</b>	<b>26,230</b>	<b>28,853</b>	<b>31,467</b>	<b>34,329</b>
<b>Total Non-Interest Earning Assets</b>	<b>17,925</b>	<b>39,410</b>	<b>44,711</b>	<b>48,074</b>	<b>51,760</b>
Cash And Marketable Securities	41,507	28,320	28,149	39,263	10,178
<b>Long-term Investments</b>	<b>84,403</b>	<b>99,890</b>	<b>94,896</b>	<b>102,487</b>	<b>112,736</b>
Total Assets	752,890	962,170	1,190,652	1,443,955	1,718,529
Customer Interest-Bearing Liabilities					
Bank Deposits					
Interest Bearing Liabilities: Others	558,138	715,040	894,948	1,075,518	1,245,203
Total Interest-Bearing Liabilities	558,138	715,040	894,948	1,075,518	1,245,203
Banks Liabilities Under Acceptances					
Total Non-Interest Bearing Liabilities	38,471	76,240	113,577	169,426	253,011
Total Liabilities	596,609	791,280	1,008,525	1,244,944	1,498,214
Shareholders Equity	156,281	170,890	182,128	199,011	220,315
<b>Minority Interests</b>					
Total Equity	156,281	170,890	182,128	199,011	220,315

<b>Key Ratios</b>					
	<b>Mar-22A</b>	<b>Mar-23A</b>	<b>Mar-24F</b>	<b>Mar-25F</b>	<b>Mar-26F</b>
Total Income Growth	0.1%	10.5%	8.9%	24.8%	20.1%
Operating Profit Growth	(9.9%)	2.3%	9.3%	32.2%	23.2%
Pretax Profit Growth	226%	103%	(15%)	61%	25%
Net Interest To Total Income	99.7%	98.5%	98.2%	98.4%	98.5%
Cost Of Funds	6.85%	7.19%	8.00%	7.10%	6.80%
Return On Interest Earning Assets	16.0%	15.6%	14.7%	13.8%	13.1%
Net Interest Spread	9.12%	8.43%	6.74%	6.66%	6.29%
Net Interest Margin (Avg Deposits)					
Net Interest Margin (Avg RWA)					
Provisions to Pre Prov. Operating Profit	64%	27%	43%	31%	30%
Interest Return On Average Assets	7.59%	7.45%	6.46%	6.59%	6.59%
Effective Tax Rate	27.1%	25.9%	25.5%	25.5%	25.5%
Net Dividend Payout Ratio					
Return On Average Assets	1.30%	2.31%	1.62%	2.13%	2.21%

SOURCE: INCRED RESEARCH, COMPANY REPORTS

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