

24 July 2024

India | Equity Research | Q1FY25 results review

Mahindra & Mahindra Financial Services

Vehicle Finance

Strong earnings in a seasonally weak quarter; improving trajectory in RoA to continue

Mahindra & Mahindra Financial Services's (MMFSL) Q1FY25 financial performance continued to showcase seasonality as reflected in RoA falling to 1.8% vs 2.2% QoQ due to higher credit cost (led by seasonality). However, management's increased focus on building predictable and steady business model, with reduced volatility and seasonality, seems to be yielding gradual results as reflected in only 30bps QoQ increase in credit cost during Q1FY25 vs 250bps QoQ rise in Q1FY24 and 350bps QoQ rise during Q1FY23. Bulk of improvement in credit cost was driven by a steady decline in ECL provision to 3.3% in Q1FY25 vs 4% in Q1FY24 and 6.8% in Q1FY23.

Management attributes the decline in credit cost to shift in customer mix towards Prime and also change in ECL model during Q3FY24. As per revised ECL model, historical trends get updated on quarterly basis, which is gradually eliminating the adverse impact on ECL during covid. Total write-offs during Q1FY25 stood at 31bps and the same is lowest since covid. Total AUM growth stood at 4% QoQ, the same is lower-than-expectation due to lower business during Apr/May'24 due to election, heatwaves and floods in North east. However, management continues to maintain a positive stance and guided for >20% YoY growth during FY25. We maintain **ADD** rating with a revised TP of INR 330 (earlier INR 285), as we now assign 1.75x (earlier 1.5x) on Sep'25E BVPS given the improving business outlook and reducing volatility.

Management expects 50bps improvement in RoA to 2.2% by FY25

While RoA was 1.8% due to seasonally high credit cost at 1.7% vs 1.4% QoQ in Q1FY25, management sounded confident of delivering 2.2% RoA by FY25. RoA expansion of 40bps would be primarily driven by 25bps improvement in NIM + fees and rest 15bps is likely to driven by credit cost. In the long run, it aspires to achieve RoA of 2.5% with credit cost settling at 1.3-1.4%. During Q1FY25, corporate agency license from IRDAI for Insurance Distribution and it already onboarded six partners. The same is likely to drive fee income in coming quarters.

Financial Summary

Y/E March (INR mn)	FY23A	FY24A	FY25E	FY26E
Net Interest Income (NII)	57,691	66,494	80,427	94,522
PAT (INR mn)	19,843	17,596	23,142	30,038
EPS (INR)	16.1	14.3	18.7	24.3
% Chg YoY	100.6	(11.4)	31.5	29.8
P/E (x)	18.4	20.8	15.8	12.2
P/BV (x)	2.1	2.0	1.8	1.6
Gross Stage - 3 (%)	4.5	3.4	3.4	3.4
Dividend Yield (%)	-	-	-	-
RoA (%)	2.3	1.7	1.9	2.1
RoE (%)	12.1	10.0	12.1	14.1

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Market Data

Market Cap (INR)	366bn
Market Cap (USD)	4,367mn
Bloomberg Code	MMFS IN
Reuters Code	MMFS.BO
52-week Range (INR)	327 /237
Free Float (%)	48.0
ADTV-3M (mn) (USD)	14.8

Price Performance (%)	3m	6m	12m
Absolute	12.3	9.4	(5.3)
Relative to Sensex	3.4	(3.8)	(26.5)

Previous Reports

08-05-2024: [Q4FY24 results review](#)
30-04-2023: [Q4FY23 results review](#)

Q1FY25 financial performance; operating leverage partially offsets the impact of seasonally higher credit cost

PAT during Q1FY25 fell 17% QoQ to INR 5.1bn due to higher sequential credit cost. However, the sequential fall in PAT is lowest since FY21, reflecting the management's efforts on improving customer franchise (thus steady credit cost rather than volatile credit cost), focus on scaling high-yielding and non-seasonal business (unlike tractor, CV which are highly cyclical) are yielding positive outcomes.

Operating profit fell 3% QoQ to INR 11.3bn largely due to muted net revenue (fell 2% QoQ). Election, heatwaves and floods in North East impacted disbursement during Q1 (down 17% QoQ) and the same resulted in subdued AUM growth at 4% QoQ. While its focus on improving fee income resulted in 10bps QoQ increase in gross yields, 20bps QoQ increase in cost of funds led to 10bps decline in gross spread and the same impacted net revenue. Notably, steady improvement in cost ratios continued in Q1FY25 as well with opex to assets falling to 2.7% vs 2.8% QoQ and 3.2% a couple of years back. Increased fee-based operations (mutual fund distribution and insurance) further supported the earnings as other income went up 2x YoY. Credit costs increased to 1.7% vs 1.4% QoQ.

Steady growth across segments; AUM growth remained at 23% in Q1FY25; FY25 growth guidance of >20%

The company's overall portfolio growth of 23% YoY in Q1FY25, followed by the growth in its passenger and used-vehicle segments, which grew at 29% and 33% on YoY basis, led by a combination of strong credit demand and company's strategy to drive its portfolio mix towards used vehicles (unclear). Notably, the two segments together constituted 53% of overall portfolio. With respect to other segments, CV financing, which represented 22% of portfolio, grew at a calibrated pace of 23% YoY. Tractor financing (11% of portfolio), on the other hand, saw a decline of 4% YoY, which remained in line with the contraction in this segment at industry level.

Going forward, the company will continue to focus on growing its used-vehicle share in the overall portfolio mix. Additionally, it also plans to drive its growth through new businesses, i.e. SME, personal loans, consumer loans and leasing, which it plans to take to 15% of overall portfolio in the medium term vs 5% as of Jun'24. For FY25, the management has guided for >20% growth in its AUM.

Marginal increase in GS3 to 3.6% vs 3.4% QoQ; credit cost to moderate during rest of FY25

MMFSL's asset quality has been steadily improving since the last 12 quarters as reflected in GS3 falling to 3.4% in Q4FY24 from the peak of 15.5% during covid in Q1FY22. The improvement in asset quality was led by persistent collection efforts resulting in higher recoveries. However, momentum derailed marginally during Q1FY25 as reflected in GS-3 increasing to 3.6% vs 3.4% QoQ and collection efficiency moderating to 94% vs 98% QoQ. However, the collection was in line with historical trends as reflected in 94% collection during Q1FY24 and Q1FY23. Over the last 12 quarters, collection efficiency levels have remained range bound at 95-100% post the low of 80% in Q1FY22. Notably, even write-offs fell from 2.6% in Q4FY23 to 2.2% in Q4FY24 and 1.1% in Q1FY25.

Portfolio quality improvement also kept credit costs in check at 1.7% in Q1FY25 vs 2.5% in Q1FY24. The management remains confident of bringing down its losses in subsequent quarters and expects credit cost to come down further by 15bps in FY25.

NIM + fees likely to expand by 25bps in FY25

MMFSL has guided for 25bps NIM + fees expansion in FY25 as it believes its cost of funds has almost peaked and will now hover around ~8% in subsequent quarters. Spreads are also likely to be supported by yield hikes, following the change in portfolio mix towards the used-vehicle segment. In Q4FY24, the company had 20bps pricing hike and its likely impact will also be seen in portfolio yields in coming quarters. Further, corporate agency license from IRDAI for Insurance Distribution during Q1FY25 (already onboarded six partners) will boost fee income in coming quarters.

Notably, the company borrows most of its borrowings at a floating rate. This, coupled with fixed pricing in vehicle finance segment, may further benefit NIM as rate cycle reverses.

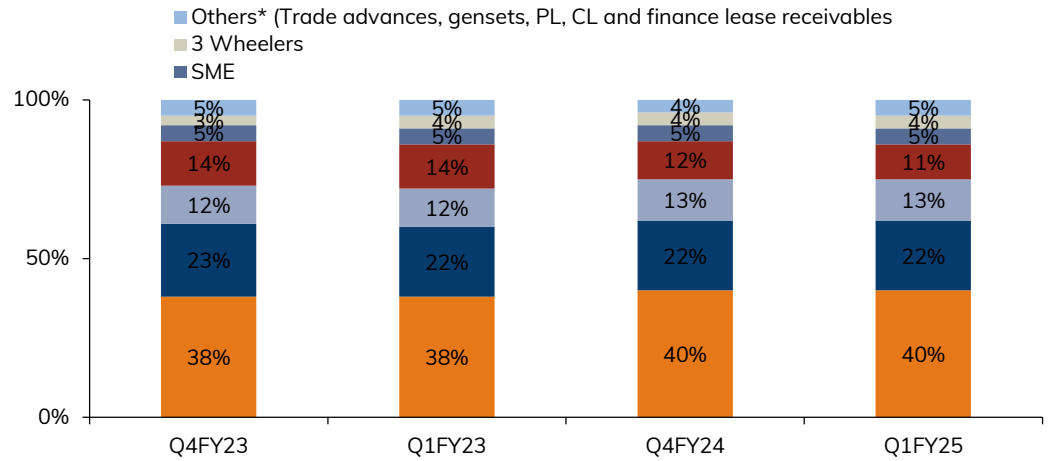
Key risks: 1) Cyclical nature of vehicle finance impacting growth; 2) stress unfolding higher than anticipated.

Exhibit 1: Q1FY25 result review (standalone)

Income statement (INR mn)	Q1FY25	Q1 FY24	% Change YoY	Q4FY24	% Change QoQ	FY24	FY23	% Change YoY
Net interest Income	17,836	15,844	12.6%	18,121	-1.6%	66,494	57,691	15.3%
Add: Other Income	1,480	905	63.5%	1,590	-6.9%	4,861	7,103	-31.6%
Total Net income	19,316	16,750	15.3%	19,710	-2.0%	71,355	64,794	10.1%
Less: Operating expenses	7,970	6,750	18.1%	7,980	-0.1%	29,572	27,276	8.4%
-Employee benefit expense	4,703	4,174	12.7%	4,243	10.8%	17,126	15,843	8.1%
-Depreciation & amortization	638	543	17.4%	604	5.5%	2,287	1,872	22.2%
-Other expense	2,629	2,033	29.3%	3,133	-16.1%	10,159	9,561	6.3%
Pre-provisioning profit	11,345	9,999	13.5%	11,730	-3.3%	41,783	37,518	11.4%
Less: Provisions & write-offs	4,482	5,264	-14.9%	3,415	31.2%	18,228	9,992	82.4%
PBT	6,864	4,735	44.9%	8,315	-17.5%	23,555	27,526	-14.4%
Less: Taxes	1,734	1,209	43.5%	2,126	-18.4%	5,959	7,138	-16.5%
PAT (excluding extra-ordinary items)	5,130	3,527	45.5%	6,190	-17.1%	17,596	20,388	-13.7%
Balance sheet key items (INR mn)								
AUM	10,63,390	8,67,320	22.6%	10,25,970	3.6%	10,25,970	8,27,700	24.0%
Loan assets on balance sheet	10,28,110	8,32,410	23.5%	9,91,950	3.6%	9,91,952	7,94,547	24.8%
Networth	1,86,860	1,74,600	7.0%	1,81,580	2.9%	1,81,575	1,70,889	6.3%
Borrowings	9,53,400	7,89,740	20.7%	9,22,260	3.4%	9,22,252	7,49,459	23.1%
Asset Quality								
Gross stage 3 (Rs mn)	37,900	37,700	0.5%	34,910	8.6%	37,900	37,700	0.5%
Gross stage 3	3.6%	4.4%	-79 bps	3.4%	16 bps	3.6%	4.4%	-79 bps
Net stage 3 (Rs mn)	15,240	15,030	1.4%	12,860	18.5%	15,240	15,030	1.4%
Net stage 3	1.5%	1.8%	-32 bps	1.3%	18 bps	1.5%	1.8%	-32 bps
Credit cost (annualised)	1.7%	2.5%	-77 bps	1.4%	34 bps	2.0%	1.4%	61 bps
Key ratios (annualised)								
Yield on AUM	13.8%	14.3%	-50 bps	14.2%	-39 bps	14.1%	14.0%	10 bps
Cost of funds	7.8%	7.5%	26 bps	7.8%	3 bps	7.7%	7.0%	68 bps
NIMs on AUM	6.8%	7.5%	-65 bps	7.3%	-44 bps	7.2%	7.8%	-64 bps
Other income on AUM	0.7%	0.6%	17 bps	0.8%	-11 bps	0.5%	1.0%	-44 bps
Cost to income	41.3%	40.3%	96 bps	40.5%	77 bps	41.4%	42.1%	-66 bps
Opex to AUM	3.1%	3.2%	-14 bps	3.2%	-15 bps	3.2%	3.7%	-51 bps
RoA	1.8%	1.4%	32 bps	2.2%	-46 bps	1.7%	2.3%	-65 bps
RoE	11.1%	8.2%	297 bps	13.9%	-275 bps	10.0%	12.1%	-215 bps
Debt to Equity (times)	5.1	4.5	12.8%	5.1	0.5%	5.1	4.4	15.8%
Tier 1	16.4%	18.9%	-250 bps	16.4%	0 bps	16.4%	18.9%	-250 bps
CAR	18.5%	21.2%	-270 bps	18.9%	-40 bps	18.5%	21.2%	-270 bps

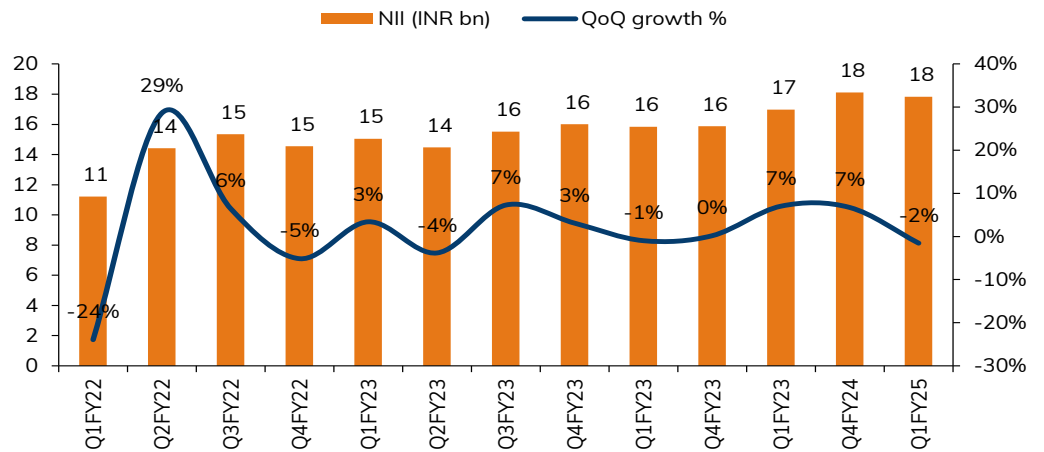
Source: Company data, I-Sec research

Exhibit 2: Declining share of cyclical sectors like CV & Tractor



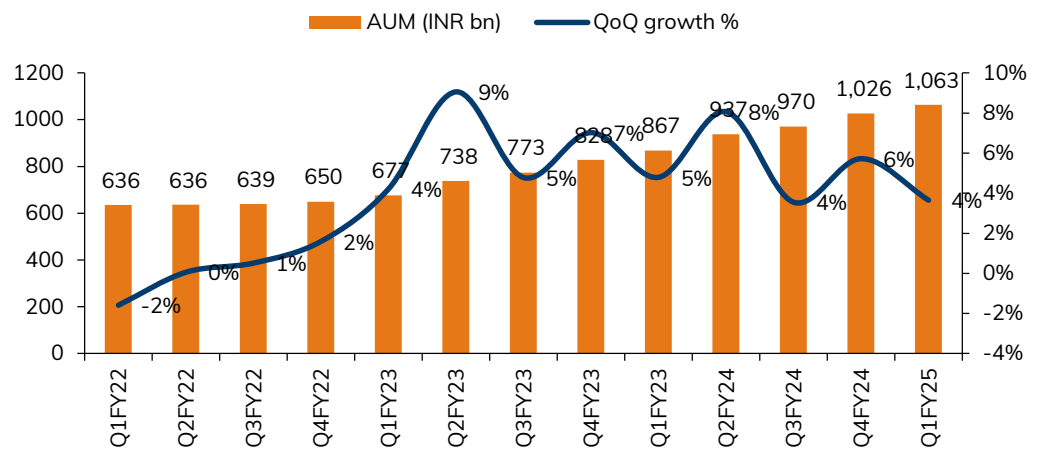
Source: Company data, I-Sec research

Exhibit 3: NII was lower 2% QoQ...



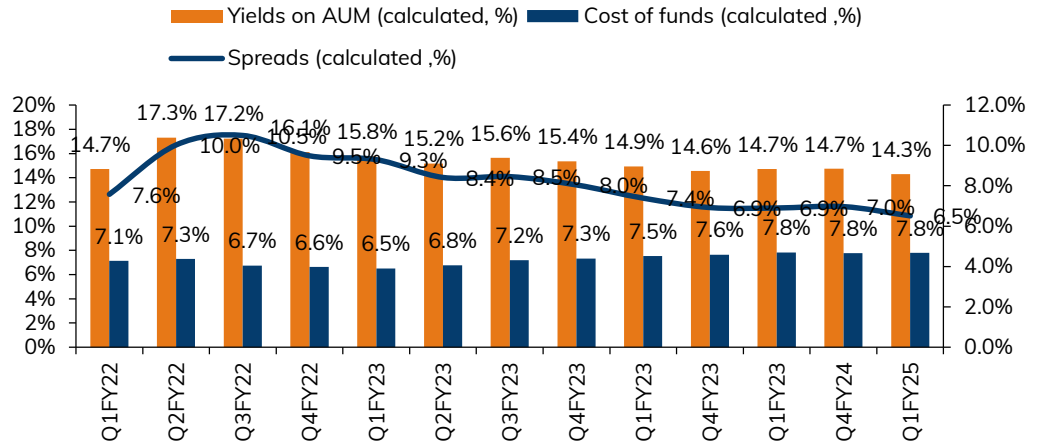
Source: Company data, I-Sec research

Exhibit 4: ...due to muted 4% QoQ AUM growth



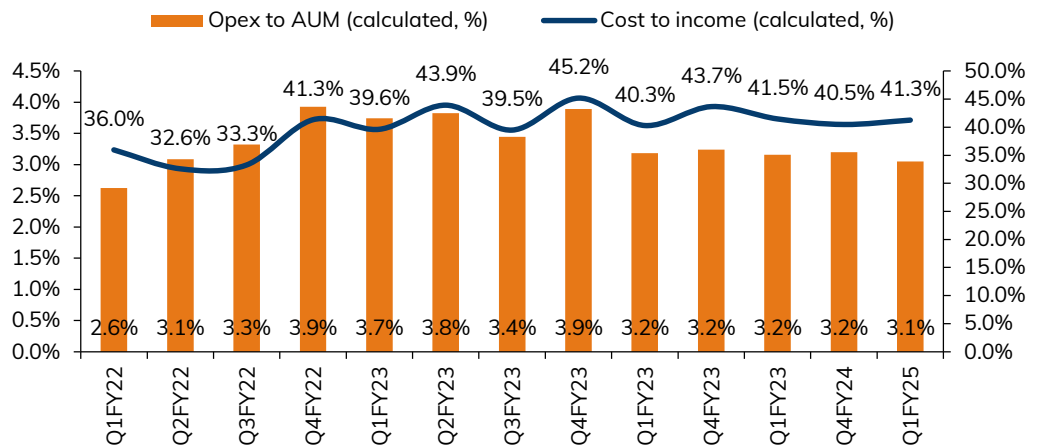
Source: Company data, I-Sec research

Exhibit 5: Spreads contracted due to sequential decline in AUM yield



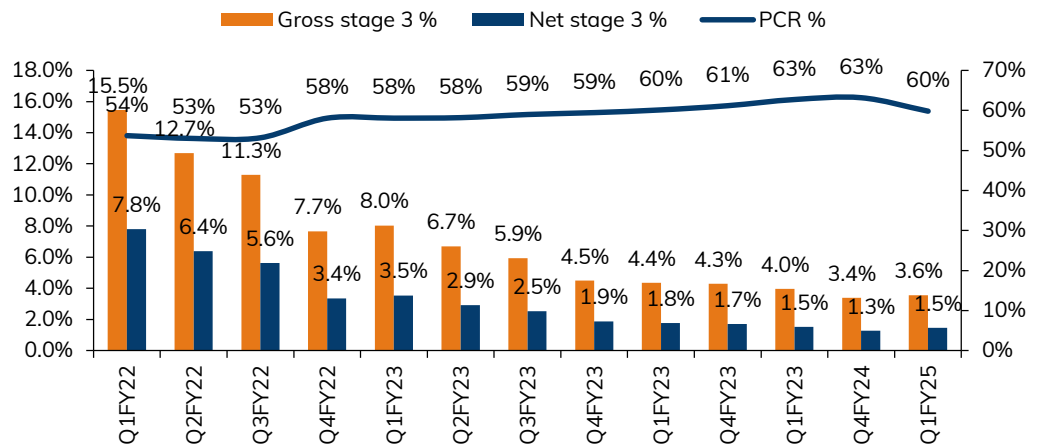
Source: Company data, I-Sec research

Exhibit 6: Steady decline in Opex to AUM



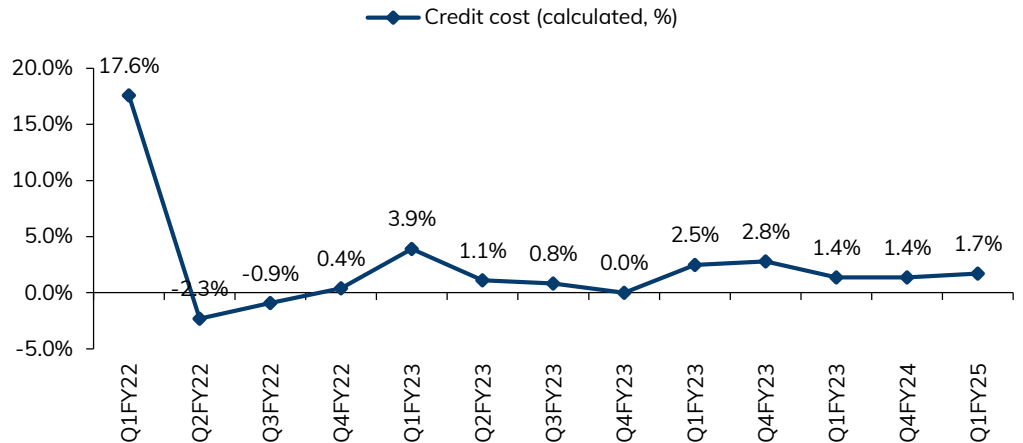
Source: Company data, I-Sec research

Exhibit 7: GS3 inches up, after consistent moderation since last 12 quarters



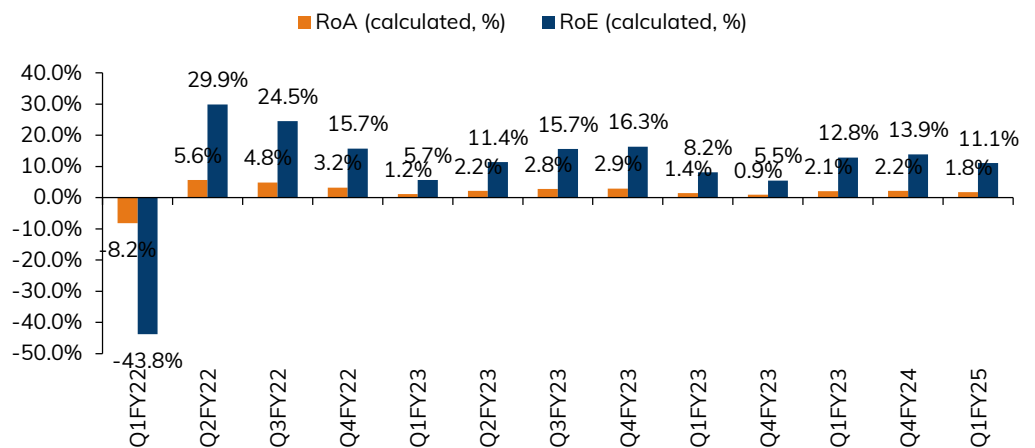
Source: Company data, I-Sec research

Exhibit 8: Credit costs uptick contained at 30bps QoQ as against much steeper hike in Q1FY24 and Q1FY23



Source: I-Sec research, Company data

Exhibit 9: RoAs settled at 1.8% as credit cost inches up QoQ



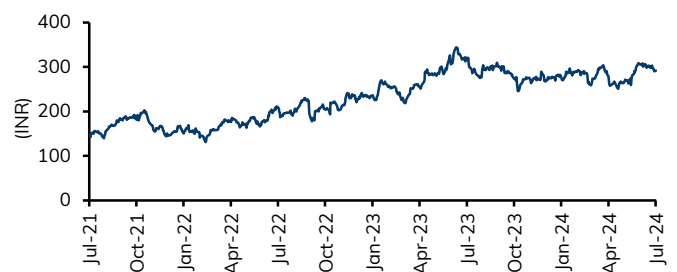
Source: Company data, I-Sec research

Exhibit 10: Shareholding pattern

%	Dec'23	Mar'24	Jun'24
Promoters	52.2	52.2	52.2
Institutional investors	39.6	40.7	40.7
MFs and others	15.7	15.0	16.9
FIs/Banks	0.1	0.0	0.0
Insurance	11.0	13.5	13.6
FIIIs	12.8	12.1	10.2
Others	8.2	7.1	7.1

Source: Bloomberg

Exhibit 11: Price chart



Source: Bloomberg

Financial Summary

Exhibit 12: Profit & Loss

(INR mn, year ending March)

	FY23A	FY24A	FY25E	FY26E
Interest Income	1,03,458	1,30,764	1,58,905	1,86,017
Net Interest Income (NII)	57,691	66,494	80,427	94,522
Other Income	7,103	4,861	6,361	7,446
Total Income (net of interest expenses)	64,794	71,355	86,788	1,01,969
Employee benefit expenses	(15,843)	(17,126)	(20,993)	(23,474)
Depreciation and amortization	(1,872)	(2,287)	(2,229)	(2,609)
Fee and commission expenses	-	-	-	-
Other operating expenses	(9,561)	(10,159)	(12,322)	(13,626)
Total Operating Expense	(27,276)	(29,572)	(35,544)	(39,709)
Pre Provisioning Profits (PPoP)	37,518	41,783	51,244	62,259
Provisions and write offs	(9,992)	(18,228)	(20,265)	(21,667)
Profit before tax (PBT)	26,981	23,555	30,979	40,592
Total tax expenses	(7,138)	(5,959)	(7,837)	(10,554)
Profit after tax (PAT)	19,843	17,596	23,142	30,038

Source Company data, I-Sec research

Exhibit 13: Balance sheet

(INR mn, year ending March)

	FY23A	FY24A	FY25E	FY26E
Share capital	2,467	2,469	2,469	2,469
Reserves & surplus	1,68,422	1,79,106	1,98,165	2,22,833
Shareholders' funds	1,70,889	1,81,575	2,00,634	2,25,302
Borrowings	7,49,459	9,22,252	10,64,541	12,22,835
Provisions & Other Liabilities	41,818	47,766	52,542	54,118
Total Liabilities and Stakeholder's Equity	9,62,166	11,51,592	13,17,717	15,02,255
Cash and balance with RBI	28,321	26,891	17,884	8,434
Fixed assets	6,956	9,308	11,170	13,404
Loans	7,94,547	9,91,952	11,64,017	13,62,099
Investments	99,886	96,508	92,327	84,382
Other Assets	32,456	26,933	32,319	33,935
Total Assets	9,62,166	11,51,592	13,17,717	15,02,255

Source Company data, I-Sec research

Exhibit 14: Key Ratios

(Year ending March)

	FY23A	FY24A	FY25E	FY26E
AUM and Disbursements (INR mn)				
AUM	8,27,700	10,25,970	12,02,932	14,06,261
On-book Loans	8,27,700	10,25,970	12,02,932	14,06,261
Disbursements	4,95,410	5,62,080	6,43,573	7,36,555
Repayments	3,17,320	3,63,810	4,66,611	5,33,226
Growth (%):				
Total AUM (%)	27.4	24.0	17.2	16.9
Disbursements (%)	79.6	13.5	14.5	14.4
Repayments (%)	16.5	14.7	28.3	14.3
Loan book (on balance sheet) (%)	27.4	24.0	17.2	16.9
Total Assets (%)	27.8	19.7	14.4	14.0
Net Interest Income (NII) (%)	15.6	15.3	21.0	17.5
Non-interest income (%)	(12.2)	(31.6)	30.9	17.1
Total Income (net of interest expenses) (%)	11.7	10.1	21.6	17.5
Operating Expenses (%)	31.5	8.4	20.2	11.7
Employee Cost (%)	35.2	8.1	22.6	11.8
Non-Employee Cost (%)	23.3	6.3	21.3	10.6
Pre provisioning operating profits (PPoP) (%)	0.7	11.4	22.6	21.5
Provisions (%)	(57.8)	82.4	11.2	6.9
PBT (%)	98.8	(12.7)	31.5	31.0
PAT (%)	100.7	(11.3)	31.5	29.8
EPS (%)	100.6	(11.4)	31.5	29.8
Yields, interest costs and spreads (%)				
NIM on loan assets (%)	8.2	7.4	7.5	7.5
NIM on IEA (%)	7.5	7.0	7.1	7.2
NIM on AUM (%)	7.8	7.2	7.2	7.2
Yield on loan assets (%)	14.8	14.6	14.7	14.7
Yield on IEA (%)	13.4	13.7	14.0	14.1
Yield on AUM (%)	14.0	14.1	14.3	14.3
Cost of borrowings (%)	7.0	7.7	7.9	8.0
Interest Spreads (%)	7.8	7.0	6.8	6.7
Operating efficiencies				
Non interest income as % of total income	52.2	49.0	48.7	48.9
Cost to income ratio	42.1	41.4	41.0	38.9
Op.costs/avg assets (%)	3.2	2.8	2.9	2.8
Op.costs/avg AUM (%)	3.7	3.2	3.2	3.0
No of employees (estimate) (x)	26,329	26,662	28,419	28,889
No of branches (x)	1,386	1,402	1,417	1,492
Salaries as % of non-interest costs (%)	58.1	57.9	59.1	59.1
NII /employee (INR mn)	2.2	2.5	2.8	3.3
AUM/employee(INR mn)	31.4	38.5	42.3	48.7
AUM/ branch (INR mn)	597.2	731.8	848.9	942.3
Capital Structure				
Average gearing ratio (x)	4.4	5.1	5.3	5.4
Leverage (x)	5.6	6.3	6.6	6.7
CAR (%)	22.1	19.5	18.7	18.2
Tier 1 CAR (%)	19.4	17.3	16.7	16.5
Tier 2 CAR (%)	2.7	2.2	1.9	1.7
RWA (estimate) - INR mn	7,70,619	9,22,335	10,55,388	12,03,189
RWA as a % of loan assets	97.0	93.0	90.7	88.3

Source Company data, I-Sec research

	FY23A	FY24A	FY25E	FY26E
Asset quality and provisioning				
GNPA (%)	4.5	3.4	3.4	3.4
NNPA (%)	1.8	1.3	1.4	1.5
GNPA (INR mn)	37,170	34,910	41,052	48,194
NNPA (INR mn)	15,070	12,860	17,242	21,687
Coverage ratio (%)	59.5	63.2	58.0	55.0
Credit Costs as a % of avg AUM (bps)	135	197	182	166
Credit Costs as a % of avg on book loans (bps)	135	197	182	166
Return ratios				
RoAA (%)	2.3	1.7	1.9	2.1
RoAE (%)	12.1	10.0	12.1	14.1
ROAAUM (%)	2.7	1.9	2.1	2.3
Dividend Payout ratio (%)	-	-	-	-
Valuation Ratios				
No of shares	1,234	1,234	1,234	1,234
No of shares (fully diluted)	1,234	1,234	1,234	1,234
EPS (INR)	16.1	14.3	18.7	24.3
EPS fully diluted (INR)	16.1	14.3	18.7	24.3
Price to Earnings (x)	18.4	20.8	15.8	12.2
Price to Earnings (fully diluted) (x)	18.4	20.8	15.8	12.2
Book Value (fully diluted)	139	147	163	183
Adjusted book value	129	139	152	169
Price to Book	2.1	2.0	1.8	1.6
Price to Adjusted Book	2.3	2.1	1.9	1.7

Source Company data, I-Sec research

Exhibit 15: Key Metrics

(Year ending March)

	FY23A	FY24A	FY25E	FY26E
DuPont Analysis				
Average Assets (INR mn)	8,57,526	10,56,879	12,34,655	14,09,986
Average Loans (INR mn)	6,99,497	8,93,250	10,77,984	12,63,058
Average Equity (INR mn)	1,63,585	1,76,232	1,91,104	2,12,968
Interest earned (%)	12.1	12.4	12.9	13.2
Interest expended (%)	5.3	6.1	6.4	6.5
Gross Interest Spread (%)	6.7	6.3	6.5	6.7
Credit cost (%)	1.2	1.7	1.6	1.5
Net Interest Spread (%)	5.6	4.6	4.9	5.2
Operating cost (%)	3.2	2.8	2.9	2.8
Lending spread (%)	2.4	1.8	2.0	2.4
Non interest income (%)	0.8	0.5	0.5	0.5
Operating Spread (%)	3.2	2.2	2.5	2.9
Tax rate (%)	26.5	25.3	25.3	26.0
ROAA (%)	2.3	1.7	1.9	2.1
Effective leverage (AA/ AE)	5.2	6.0	6.5	6.6
RoAE (%)	12.1	10.0	12.1	14.1

Source Company data, I-Sec research

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BUY: >15% return; ADD: 5% to 15% return; HOLD: Negative 5% to Positive 5% return; REDUCE: Negative 5% to Negative 15% return; SELL: < negative 15% return

ANALYST CERTIFICATION

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