

Oct 28, 2023

RESULT REPORT Q2 FY24 | Sector: Financials

M&M Financial Services

A disappointing show

Multiple disappointments in sharp NIM decline, elevated opex and much higher credit cost

Bereft of any one-offs, MMFS delivered 5%/11%/55% miss on NII/PPOP/PAT in Q2 FY24. While the headline growth and asset quality trends were known, the substantial miss on earnings was driven by steeper-than-expected 30 bps margin contraction (led by decline in portfolio yield), high opex (required strategic investments) and significantly large credit cost (caused by meaningful slippages, material write-offs and high LGD). Management alluded to some weakness in collections during later part of September leading to significant flows from Stage-2 into Stage-3 (particularly in tractor finance portfolio). Loan write-offs remain significant in the context of the opening book and GNPLs.

Management expects 20%+ growth, margin recovery and much lower provisions in H2 FY24

Encouraging festive sales, strong rural cash flows, stable market share and diversified product portfolio underpins management's expectation of delivering 20%+ growth in the year. Unlike the first half, the portfolio mix is expected to shift towards higher yielding products of pre-owned vehicles (eased availability of vehicles) and tractor financing. NIM has been guided to recover from current 6.5% to 6.8% by Q4 FY24 aided by 1) planned lending rate hikes, 2) growth pick-up in higher yielding products and 3) conversion of interest-free trade advances (worth ~Rs50bn) into retail loans. Co. would be contemplating raising lending rates for select products and models after Diwali. Management expects credit cost for the year to be 1.5-1.7% (2.6% in H1) with significant reduction expected in Stage-3 assets through collections. The level of write-offs is expected to moderate in coming quarters.

Earnings undergo material cut; valuation to be impacted too - downgrade to NEUTRAL

We cut earnings estimates for FY24/25 by 17%/3% adjusting our margin and credit cost expectations. We haven't tweaked our growth assumptions but would like to see acceleration in disbursement growth in coming quarters. Margins are assumed to recover by a reasonable extent (adj. for product mix impact) in the next year when rates would likely soften. Credit cost needs to be too low in H2 FY24 for the annual guidance of 1.5-1.7% to be met. While roll backs and recoveries are usually stronger in H2 of a year, the reduction in GNPLs through collections will have to be significant and write-offs needs to be lower for achievement of management's credit cost guidance. It is plausible that better behaviour of the portfolio (better underwriting and customer selection since Mar'22) and resetting of ECL model to a lower LGD could drive moderate credit cost next year. However, in the near term we see valuation taking a knock as RoE improvement trajectory has been stalled. We downgrade the stock to NEUTRAL with a lowered 12m PT of Rs300.

Exhibit 1: Result table

Result table (Rs mn)	Q2 FY24	Q1 FY24	% qoq	Q2 FY23	% yoy
Total Operating Income	32,119	30,846	4.1	25,858	24.2
Interest expended	(15,665)	(14,505)	8.0	(10,688)	46.6
Net Interest Income	16,455	16,341	0.7	15,170	8.5
Other Income	286	409	(30.1)	235	21.6
Total Income	16,740	16,750	(0.1)	15,405	8.7
Operating expenses	(7,312)	(6,750)	8.3	(6,768)	8.0
PPOP	9,428	10,000	(5.7)	8,637	9.2
Provisions	(6,266)	(5,264)	19.0	(1,985)	215.7
PBT	3,163	4,735	(33.2)	6,107	(48.2)
Tax	(811)	(1,209)	(32.9)	(1,624)	(50.1)
PAT	2,352	3,527	(33.3)	4,483	(47.5)

Source: Company, YES Sec

Reco	: NEUTRAL
CMP	: Rs 277
Target Price	: Rs 300
Potential Return	: 8.3%

Stock data (as on Oct 27, 2023)

Nifty	19,047
52 Week h/l (Rs)	347 / 191
Market cap (Rs/USD mn)	332886 / 3998
Outstanding Shares (mn)	1,234
6m Avg t/o (Rs mn):	1,185
Div. yield (%):	2.2
Bloomberg code:	MMFS IN
NSE code:	M&MFIN

Stock performance



	1M	3M	1Y
Absolute return	-5.0%	-7.4%	34.7%

Shareholding pattern

Promoter	52.2%
FII+DII	39.9%
Others	7.8%

Δ in stance

(1-Yr)	New	Old
Rating	NEUTRAL	BUY
Target Price	300	350

Δ in earnings estimates

	FY24e	FY25e	FY26e
EPS (New)	14.7	21.3	27.0
EPS (Old)	17.7	22.0	-
% Change	-16.9%	-3.1%	-

Financial Summary

(Rs mn)	FY24E	FY25E	FY26E
Op. income	70,365	89,367	107,036
PPOP	40,908	55,196	68,423
Net profit	18,144	26,292	33,328
Growth (%)	(8.6)	44.9	26.8
EPS (Rs)	14.7	21.3	27.0
ABVPS (Rs)	131.7	144.9	163.7
P/E (x)	18.8	13.0	10.3
P/ABV (x)	2.1	1.9	1.7
ROE (%)	10.3	13.9	15.8
ROA (%)	1.7	2.2	2.3

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KEY CON-CALL HIGHLIGHTS

- Monsoon has ended well and infra cash flows and asset deployment remain strong - festive sales have been good so far.
- Confident of 20%+ AUM growth in FY24 and about achieving the Mar'25 AUM target (implying 23-24% CAGR between FY22-25).
- Capital raise looks unlikely in the coming 12-15 months.
- NIM decline in Q2 FY24 driven by 1) increase in CoF, 2) higher share of better-quality customers and 3) stronger growth in relatively lower-yielding products like M&M UVs and PVs for personal use.
- NIM is expected to move up to 6.8% by March on the back of 1) planned lending rate hikes, 2) growth pick-up in higher yielding products like tractors and used vehicle financing (latter due to better availability of vehicles) and 3) conversion of interest-free trade advances (worth ~Rs50bn) into retail loans.
- Co. contemplating to raising lending rates for some products and models.
- Opex/Asset ratio would remain around 2.7-2.8% till FY25.
- Higher provision charge in Q2 FY24 due to deterioration in collection metric during Sept in some of the large markets - bulk of the GS3 increase was driven by the tractor portfolio.
- Management expects credit cost for the year to be 1.5-1.7% with significant improvement expected in next two quarters.
- GS3 is expected to decline meaningfully on account of strong collections in H2 - co. expects write-off level to further come down in coming quarters.
- While it would take 9-10 months before LGD starts to come down (running of 42-month ECL model), the PDs have been consistently improving.

Exhibit 2: Business Data

(Rs mn)	Q2 FY24	Q1 FY24	% qoq	Q2 FY23	% yoy
AUM	937,230	867,320	8.1	738,170	27.0
Auto/UV	309,286	286,216	8.1	228,833	35.2
Tractors	121,840	112,752	8.1	103,344	17.9
Cars	178,074	182,137	(2.2)	147,634	20.6
CV & CE	103,095	95,405	8.1	81,199	27.0
Pre-owned veh. & Others	224,935	190,810	17.9	177,161	27.0
Value of assets financed	133,150	121,650	9.5	118,240	12.6
Auto/UV	50,597	41,969	20.6	41,384	22.3
Tractors	13,315	15,206	(12.4)	11,824	12.6
Cars	25,299	24,330	4.0	20,101	25.9
CV & CE	14,647	13,382	9.5	11,824	23.9
Pre-owned veh. & Others	29,293	26,763	9.5	33,107	(11.5)

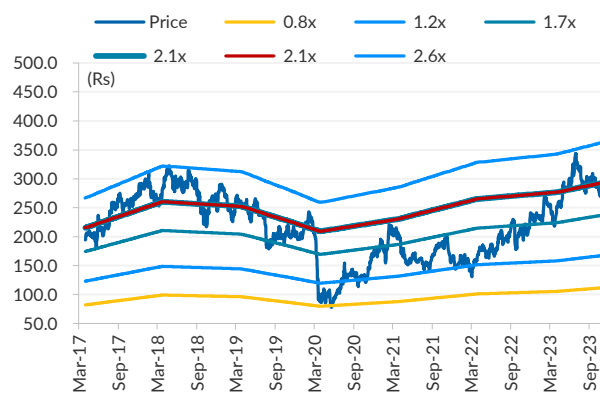
Source: Company, YES Sec

Exhibit 3: Key Ratios

(%)	Q2 FY24	Q1 FY24	chg qoq	Q2 FY23	chg yoy
Income Yield (%)	13.1	13.3	(0.2)	13.4	(0.3)
Cost of Funds (%)	6.1	5.9	0.2	5.2	0.9
Gross Spread (%)	6.5	6.8	(0.3)	7.5	(1.0)
Net Spread (%)	1.2	1.9	(0.7)	3.2	(2.0)
Cost to Income (%) *	43.7	40.3	3.4	43.9	(0.3)
Gross NPA (%)	4.3	4.3	-	6.7	(2.4)
Net NPA (%)	1.7	1.8	(0.1)	2.9	(1.2)
CAR (%)	18.7	21.2	(2.5)	23.8	(5.1)

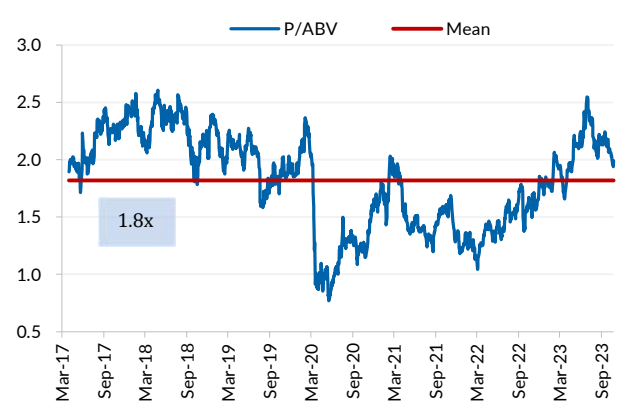
Source: Company, YES Sec; *Calculated.

Exhibit 4: 1-yr rolling P/ABV band



Source: Company, YES Sec

Exhibit 5: 1-year rolling P/ABV vis-a-vis the mean



Source: Company, YES Sec

FINANCIALS

Exhibit 6: Balance Sheet

Y/e 31 Mar (Rs m)	FY22	FY23	FY24E	FY25E	FY26E
Equity and Liabilities					
Equity Share Capital	2,466	2,467	2,467	2,467	2,467
Other Equity	153,815	168,422	177,928	195,583	220,273
Shareholders' fund	156,281	170,889	180,396	198,050	222,741
Non-Financial Liabilities					
Current Tax Liabilities (Net)	139	657	657	657	657
Provisions	2,214	2,607	2,607	2,607	2,607
Other Non-Financial Liabilities	1,078	1,241	1,365	1,501	1,652
Total Current Liabilities	593,176	786,772	926,858	1,113,936	1,312,906
Derivative financial instruments	1,822	1,807	1,807	1,807	1,807
Trade & Other Payables	10,053	11,663	12,246	12,859	13,501
Debt Securities	182,527	247,451	287,043	335,840	392,933
Borrowings (Excl. debt sec.)	260,052	412,341	490,685	598,636	709,384
Deposits	84,262	55,246	65,743	80,206	95,044
Subordinated Liabilities	31,299	34,421	40,961	49,973	59,218
Other financial liabilities	23,162	23,843	28,373	34,615	41,019
Total Liabilities & Equity	752,887	962,166	1,111,883	1,316,751	1,540,562
Assets					
Financial Assets					
Cash and cash equivalents	3,279	2,498	7,758	9,497	13,752
Bank balance	38,228	25,823	0	0	0
Derivative financial instruments	266	0	0	0	0
Trade receivables	91	218	218	218	218
Loans	604,446	794,547	953,457	1,144,148	1,350,095
Investments	84,403	99,886	109,875	120,862	132,949
Other Financial Assets	2,231	15,893	16,687	17,522	18,398
Non-Financial Assets	19,943	23,300	23,887	24,504	25,151
Current tax assets (Net)	5,629	5,044	5,044	5,044	5,044
Deferred tax Assets (Net)	8,364	6,372	6,372	6,372	6,372
Property, Plant and equipment	3,831	6,812	7,153	7,510	7,886
Other Intangible assets	98	144	144	144	144
Other non-financial assets	2,021	4,929	5,175	5,434	5,706
Total Assets	752,887	962,166	1,111,883	1,316,751	1,540,562

Source: Company, YES Sec

Exhibit 7: Income statement

Y/e 31 Mar (Rs m)	FY22	FY23	FY24E	FY25E	FY26E
Income from Operations	96,580	109,288	132,280	159,945	190,069
Interest expense	(39,202)	(45,767)	(63,315)	(72,118)	(84,727)
Net interest income	57,378	63,521	68,965	87,827	105,341
Non-interest income	608	1,273	1,400	1,540	1,694
Total op income	57,986	64,794	70,365	89,367	107,036
Total op expenses	(20,734)	(27,276)	(29,458)	(34,171)	(38,613)
PPoP	37,252	37,518	40,908	55,196	68,423
Provisions	(23,683)	(9,992)	(16,388)	(19,666)	(23,385)
Exceptional	0	(545)	0	0	0
Profit before tax	13,569	26,981	24,519	35,530	45,038
Taxes	(3,682)	(7,138)	(6,375)	(9,238)	(11,710)
Net profit	9,888	19,843	18,144	26,292	33,328

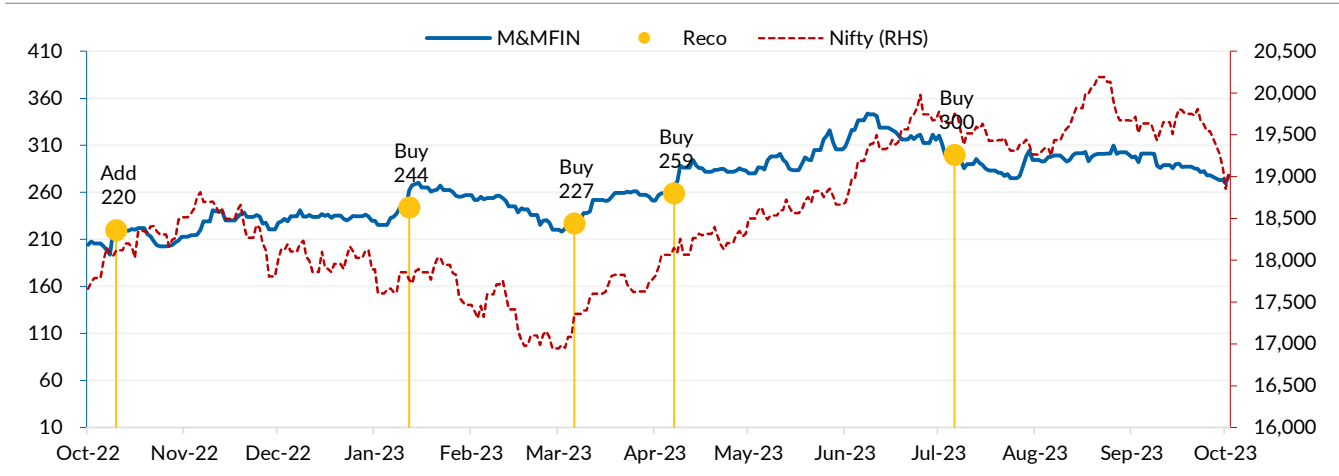
Source: Company, YES Sec

Exhibit 8: Growth and Ratio matrix

Y/e 31 Mar	FY22	FY23	FY24E	FY25E	FY26E
Growth matrix (%)					
Net interest income	0.3	10.7	8.6	27.3	19.9
Total op income	0.3	11.7	8.6	27.0	19.8
Op profit (pre-provision)	(10.3)	0.7	9.0	34.9	24.0
Net profit	195.0	100.7	(8.6)	44.9	26.8
Advances	0.8	31.5	20.0	20.0	18.0
Total Borrowings	(4.7)	34.3	18.0	20.4	18.0
Total assets	(2.3)	27.8	15.6	18.4	17.0
Profitability Ratios (%)					
NIM	8.9	8.6	7.6	8.0	8.1
Non-interest income /Total income	1.0	2.0	2.0	1.7	1.6
Return on Avg. Equity	6.5	12.1	10.3	13.9	15.8
Return on Avg. Assets	1.3	2.3	1.7	2.2	2.3
Per share ratios (Rs)					
EPS	8.0	16.1	14.7	21.3	27.0
Adj. BVPS	109.8	126.3	131.7	144.9	163.7
DPS	3.6	6.0	6.0	6.0	6.0
Other key ratios (%)					
Loans/Borrowings					
Cost/Income	108.3	106.0	107.8	107.5	107.4
CAR	35.8	42.1	41.9	38.2	36.1
Tier-I capital	27.8	27.8	25.5	23.6	22.5
Gross NPLs)	24.3	24.3	22.2	20.6	19.8
Credit Cost	7.7	4.5	4.0	3.6	3.3
Net NPLs	3.7	1.4	1.8	1.8	1.8
Tax rate	3.4	1.9	1.8	1.6	1.5
Dividend yield	27.1	26.5	25.2	25.2	25.2

Source: Company, YES Sec

Recommendation Tracker



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