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Company update, TP &
earnings revision

Financials

Target price: Rs220

Earnings revision

(%)	FY21E	FY22E
PAT	↑ 9.0	↑ 3.3

Target price revision

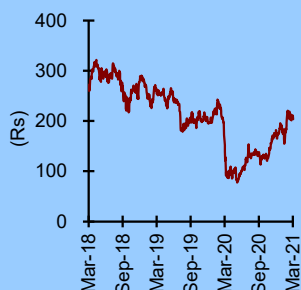
Rs220 from Rs175

Shareholding pattern

	Jun '20	Sep '20	Dec '20
Promoters	51.2	51.2	52.2
Institutional investors	36.6	33.9	36.7
MFs and others	9.4	9.1	10.8
FIs/Insurance	3.0	3.1	3.2
FPI	24.2	21.7	22.7
Others	12.2	13.8	11.1

Source: NSE

Price chart



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M&M Financial Services

ADD

Maintain

Rs203

Unwavering focus on collections; growth to lag

Based on our interactions with industry and market participants, we could gauge following trends for M&M Financial Services (MMFS): 1) Unwavering focus on collections with targeted weekly and monthly milestones and regular reviews; 2) improved collection efficiency across geographies (Q4 historically being a strong collection quarter); 3) no more refraining from repossession (in real stress cases); 4) actively pursuing upgrades from stage 1/2/3 bucket rather than forward flows (downgrades) to the next bucket. These suggest cumulative stage 2 + stage 3 assets, that went unusually high to 24%, should retrace directionally towards normalisation. However, the extent depends on how many are able to clear overdues (total EMI than single EMI). Valuations at 1.7x FY23E ABV look reasonable considering asset quality concerns seem overdone and metrics are looking up hereon. Maintain ADD with a revised TP of Rs220 (assigning 1.9x FY23E ABV, earlier Rs175). Key risks – asset quality volatility and growth moderation.

► **Unwavering focus on collections; stress likely to descend:** There was a sharp spike in stress pool for MMFS with stage-3 assets rising to 10% (from 7% QoQ) and stage-2 assets at 14% (from 7.7% QoQ). In terms of accounts, 315k accounts constituted stage-2, of which 90k accounts were regularly servicing (though would not have paid in full) and 15-20k accounts were in tractor segment, where money would have started flowing. Market feedback suggests intense collection efforts are being made towards targeted 20-25% of flow back (upgrades) to stage-1. All measures are taken to contain flow forward to stage-3 (which averages around 7-8% of stage-2).

Historically, Q4 witnesses an improvement in asset quality with stage-3 assets upgrading on a net basis by ~20%. On higher base and given the technical nature of slippages in Q3FY21, efforts are channelised to bring down stage-3 by 20-25% from Q3FY21 level. This is contrary to our earlier expectations of further buildup in stage-3 assets (with seasoning of stage-1/2 pool), thereby making us revise our estimates. Milestones are set for weekly and monthly collection targets and regular reviews are conducted for monitoring the progress and course correction measure (if needed).

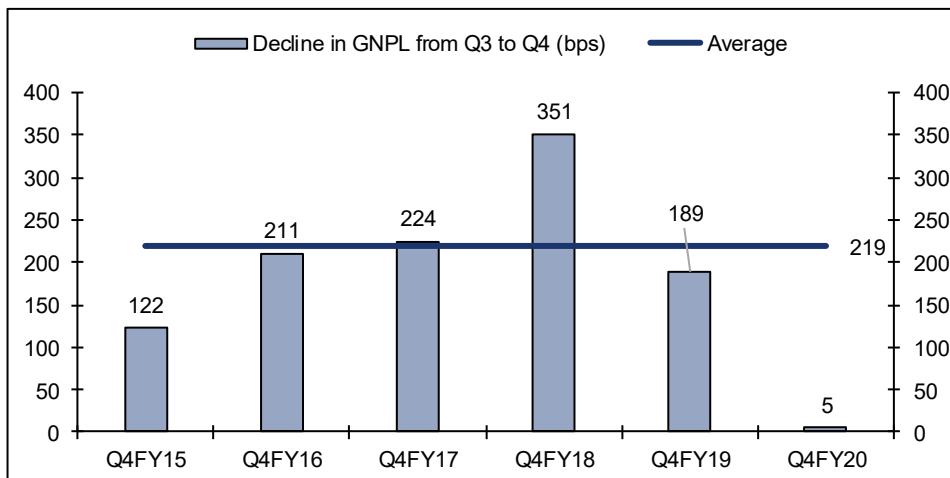
► **Collection efficiency consistently rebounding but coming at the cost of higher opex:** There was consistent rebound in collection efficiency - 96%/88%/82% for Dec/Q3FY21/Oct, respectively. With revival in activity levels and focused efforts, we believe trends are looking up further for Q4. One should not be surprised if it crosses beyond 105% mark as historically it's a strong collection quarter. Encouraging trend seems to be rising proportion of customers starting to make payment (of either single or multiple EMIs). Also, sustained repayment track record with gradual settlement of overdue installments may support upgrades into previous buckets and also cap further downgrades. However, intensive collection efforts are coming at the cost of higher opex (frequent visits/interactions with customers), but higher collection cost is the trend across industry.

Market Cap	Rs251bn/US\$3.4bn	Year to March	FY20	FY21E	FY22E	FY23E
Reuters/Bloomberg	MMFS.BO/MMFS IN	NII (Rs mn)	51,130	54,284	59,056	67,887
Shares Outstanding (mn)	1,235.5	Net Income (Rs mn)	9,064	5,658	16,395	18,727
52-week Range (Rs)	224/76	EPS (Rs)	7.4	4.6	13.3	15.2
Free Float (%)	48.8	% Chg YoY	-70.9	-39.3	197.4	14.2
FII (%)	22.7	P/E (x)	27.6	44.2	15.3	13.4
Daily Volume (US\$/'000)	25,521	P/BV (x)	2.2	1.7	1.6	1.4
Absolute Return 3m (%)	14.9	P/ABV (x)	3.0	2.0	1.9	1.7
Absolute Return 12m (%)	34.1	Dividend Yield (%)	0.0	0.5	1.5	1.7
Sensex Return 3m (%)	6.4	RoA (%)	1.3	0.7	2.0	2.0
Sensex Return 12m (%)	64.9	RoE (%)	8.1	4.3	10.6	11.2

Please refer to important disclosures at the end of this report

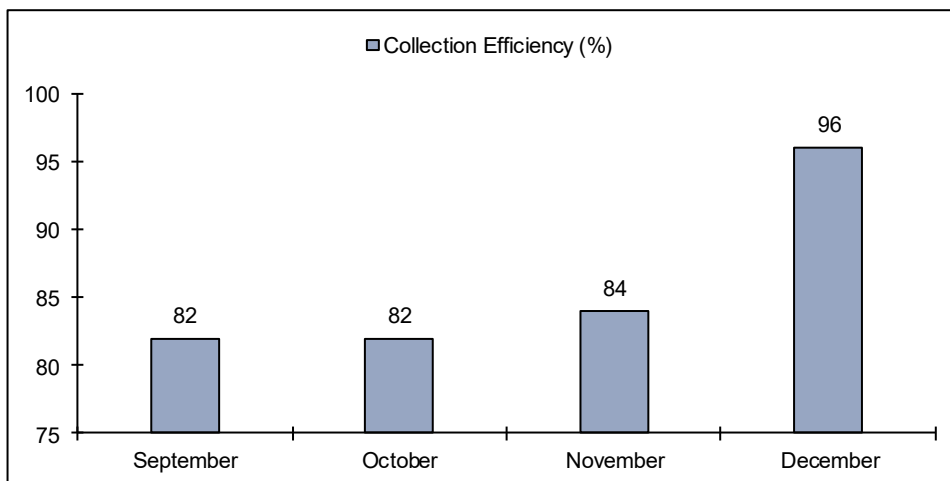
- ▶ **Actively pursuing repossession in real stress cases:** The company is no more refraining from repossession of assets to merely support customers in challenging times if it believes it's a real stress situation or account is gradually becoming unviable. In such cases, to further aggravate resolutions during year-end, the company is actively pursuing repossession. Repossessed assets' stock (out of NPA) as of Q3 was 10.8k vehicles, which we believe can almost jump 1.5-2.0x QoQ. Also, historically, ~40-45% of customers, whose assets are repossessed, tend to settle the overdues and release the assets and similar trend will be witnessed in this environment as well.
- ▶ **Collections taking precedence over growth in interim:** Sentiment in MMFS' target segment (rural/semi-urban) is turning positive and the company too had prepared itself for the upcoming opportunities through deep presence, partnership/co-lending and strong dealer relationships. It has made a shift in its policy whereby it has started focusing on prime customers' low-yielding personal segment, making a shift from the traditional high yielding earn & pay segment (cab aggregators, Ola, Uber), which is currently reeling under stress. Normalisation to pre-covid level is prolonged leading to flat AUM growth in FY21E; we build 13%/17% growth in AUM over FY22E/FY23E, respectively.

Chart 1: Historically, stage-3 assets decline ~20-25 (on net basis) in Q4



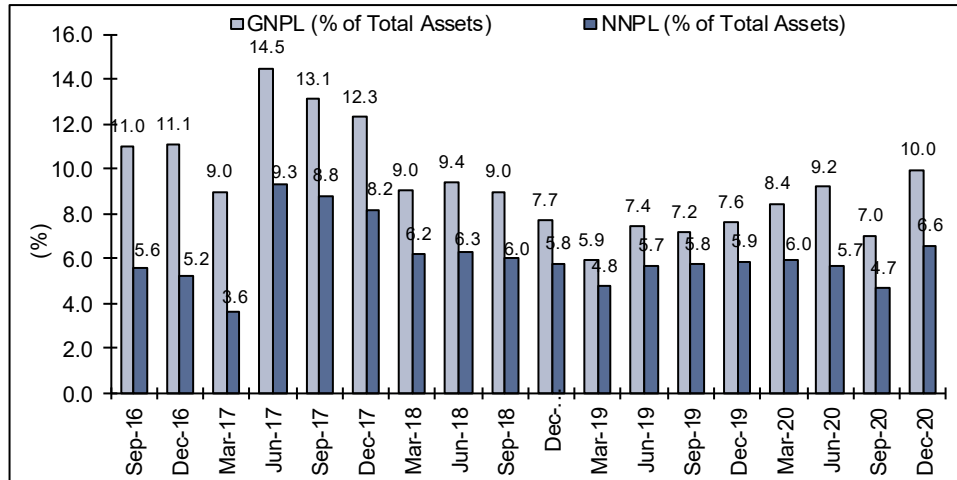
Source: Company data, I-Sec research

Chart 2: Collection efficiency on uptrend, pace likely to accelerate in Q4



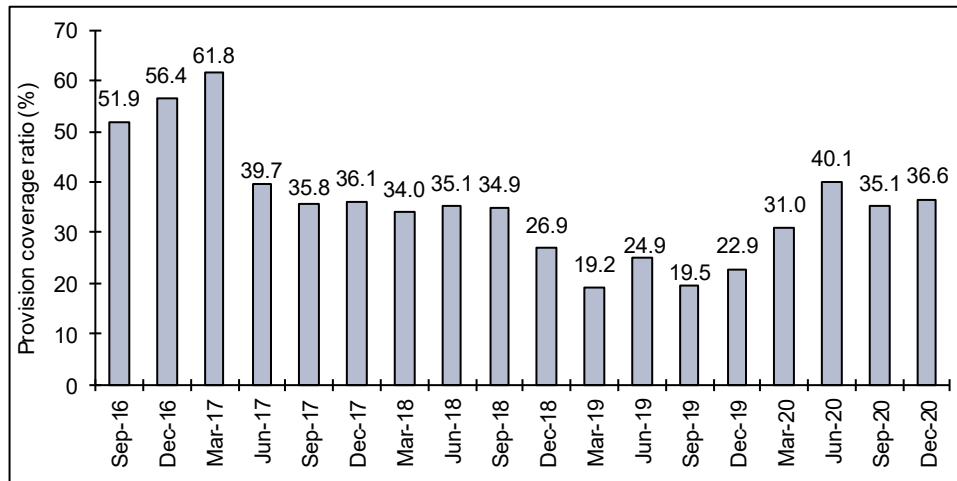
Source: Company data, I-Sec research

Chart 3: Focus on collections to contain further surge in stage-2/3 assets



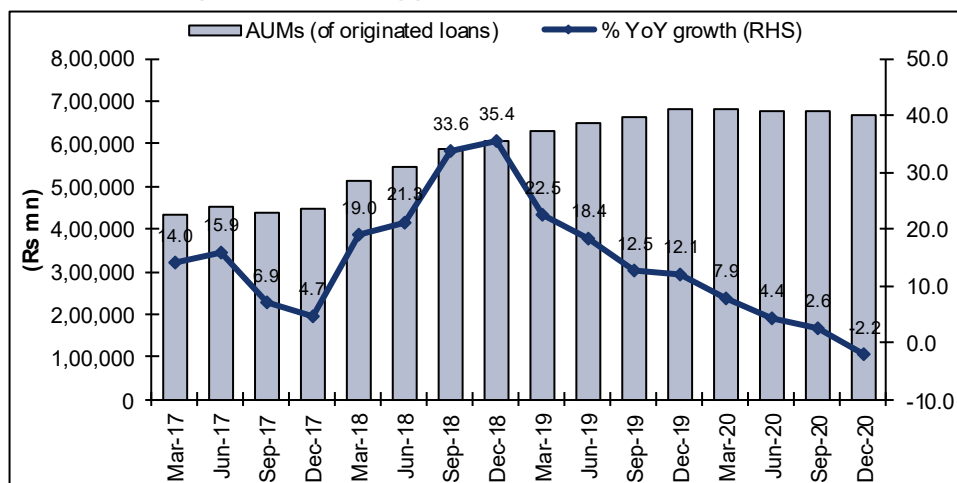
*Note: Numbers for FY18 and FY19 are as per Ind-AS
Source: Company data, I-Sec research

Chart 4: Without using subjectivity, provided adequately on stress pool



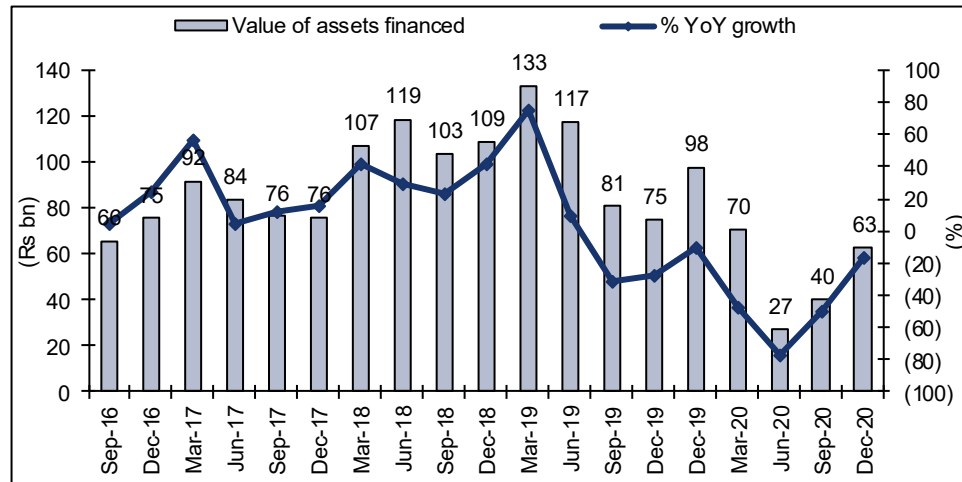
Source: Company data, I-Sec research

Chart 5: AUM growth to be lagged



Source: Company data, I-Sec research

Chart 6: Disbursements down 50% YoY in 9MFY21; to normalise in 2-3 quarters



Source: Company data, I-Sec research

Financial summary (standalone)

Table 1: Profit and loss statement

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E	FY23E
Interest earned	86,456	99,417	1,02,449	1,08,883	1,24,138
Interest expended	39,502	48,287	48,165	49,827	56,250
Net interest income	46,954	51,130	54,284	59,056	67,887
Other income	1,680	3,034	2,571	2,627	2,753
Operating expenses	6,954	7,514	4,812	7,374	9,212
Employee costs	10,901	11,484	9,752	10,235	10,967
Depreciation	602	1,183	1,263	1,266	1,318
Pre-provisioning op profit	30,177	33,982	41,028	42,809	49,143
Provisions & contingencies	6,352	20,545	33,431	20,900	24,117
Profit before tax and exceptional items	23,824	13,438	7,598	21,909	25,026
Exceptional items	0	0	0	0	0
Profit before tax (PBT)	23,824	13,438	7,598	21,909	25,026
Income taxes	8,254	4,374	1,939	5,515	6,299
Net profit	15,571	9,064	5,658	16,395	18,727

Source: Company data, I-Sec research

Table 2: Balance sheet

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E	FY23E
Share Capital	1,230	1,231	2,464	2,464	2,464
ESOPs	0	0	0	0	0
Reserves and surplus	1,07,850	1,12,408	1,46,403	1,58,362	1,71,914
Shareholder's equity	1,09,080	1,13,639	1,48,867	1,60,826	1,74,378
Borrowings	5,31,120	5,96,140	6,09,796	6,72,732	7,88,887
Current liabilities & provisions	30,580	30,933	34,027	39,131	45,000
Total liabilities & stockholders' equity	6,70,780	7,40,712	7,92,689	8,72,689	10,08,266
Fixed Assets	1,631	3,635	3,735	3,835	3,935
Loans & advances	6,12,496	6,49,935	6,40,307	7,22,439	8,45,630
Investments	37,917	59,110	97,828	1,05,892	1,14,621
Cash and Balance	9,585	6,768	34,310	25,512	27,615
Other assets	5,434	16,368	20,244	18,846	20,399
Deferred tax assets	3,717	4,896	3,917	3,133	2,507
Total assets	6,70,780	7,40,712	7,92,689	8,72,689	10,08,266

Source: Company data, I-Sec research

Table 3: Key ratios*(Year ending March 31)*

	FY19	FY20	FY21E	FY22E	FY23E
Growth (%):					
Standalone total AUM	22.5	7.9	0.7	12.8	17.1
Net Interest Income	33.1	8.9	6.2	8.8	15.0
Total Non-Interest Expenses	28.8	9.3	-21.6	19.3	13.9
Pre provisioning operating profits	39.1	12.6	20.7	4.3	14.8
PAT	44.7	-41.8	-37.6	189.8	14.2
EPS	36.8	-70.9	-39.3	197.4	14.2
Yields, interest costs and spreads (%)					
Assets	6,70,780	7,40,712	7,92,689	8,72,689	10,08,266
NIM - on assets	7.7	7.2	7.0	7.1	7.1
Yield on loan assets	15.3	15.7	15.9	16.0	15.8
Average cost of funds	8.7	8.6	8.0	7.8	7.7
Interest Spreads	6.7	7.1	7.9	8.2	8.1
Operating efficiencies					
Non-interest income as % of total income	2.8	3.1	2.9	2.7	2.4
Cost to income ratio (%)	41.6	30.3	30.6	30.8	29.5
Op.costs/avg AUM (%)	3.2	3.1	2.3	2.6	2.6
No. of employees (estimate)	21,789	21,862	20,649	21,073	21,506
No. of branches	1,622	1,784	1,963	2,159	2,375
Average annual salary (Rs)	5,00,307	5,25,316	4,72,261	4,85,668	5,09,951
Annual inflation in average salary(%)	12.6	5.0	-10.1	2.8	5.0
Salaries as % of non-int.costs (%)	59.1	10.6	15.3	13.7	12.9
NII /employee (Rs mn)	2.2	2.3	2.6	2.8	3.2
AUM/employee(Rs mn)	29.0	31.1	33.2	36.7	42.1
AUM/ branch (Rs mn)	389.1	381.6	349.3	358.3	381.3
Capital Structure					
Debt-Equity ratio	4.9	5.2	4.1	4.2	4.5
Leverage (x)	6.1	6.5	5.3	5.4	5.8
CAR (%) –standalone	20.3	19.6	23.1	4.2	4.5
Tier 1 CAR (%) -standalone	15.5	15.4	19.3	5.4	5.8
Tier 2 CAR (%) - standalone	4.8	4.2	3.8	22.0	20.7
Asset quality and provisioning					
GNPL (standalone)	40,706	57,467	58,283	61,503	61,125
NNPL (standalone)	32,907	39,665	34,970	39,977	40,953
GNPL (% of standalone loans)	6.6	8.8	9.1	8.5	7.2
NNPL (% of standalone loans)	5.4	6.1	5.5	5.5	4.8
Coverage ratio (%)	19.2	31.0	40.0	35.0	33.0
Return ratios & capital management					
RoAA (%)	2.6	1.3	0.7	2.0	2.0
RoAE (%)	15.2	8.1	4.3	10.6	11.2
Payout ratio (%)	24.6	0.0	20.9	21.6	22.1
Valuation Ratios					
EPS (Rs)	12.7	7.4	4.6	13.3	15.2
Price to Earnings	16.0	27.6	44.2	15.3	13.4
BVPS (Rs)	88.7	92.3	120.8	130.5	141.5
Adj BVPS (Rs)	68.9	68.5	99.8	106.5	116.9
Price to Book	2.3	2.2	1.7	1.6	1.4
Price to Adj Book	2.9	3.0	2.0	1.9	1.7
Dividend yield (%)	3.2	0.0	0.5	1.5	1.7

Source: Company data, I-Sec research

Table 4: DuPont analysis (on average assets)*(% year ending March 31)*

	FY19	FY20	FY21E	FY22E	FY23E
Interest earned	14.2	14.1	13.4	13.1	13.7
Interest expended	6.5	6.8	6.3	6.0	6.2
Gross Interest Spread	7.7	7.2	7.1	7.1	7.5
Provisioning for NPAs	1.0	2.9	4.4	2.5	2.7
Net Interest Spread	6.7	4.3	2.7	4.6	4.8
Operating cost	3.0	2.9	2.1	2.3	2.4
Lending spread	3.6	1.5	0.7	2.3	2.5
Non-interest income	0.3	0.4	0.3	0.3	0.3
Operating spread	3.9	1.9	1.0	2.6	2.8
Tax	1.4	0.6	0.3	0.7	0.7
ROA	2.6	1.3	0.7	2.0	2.1
Effective leverage (AA/ AE)	5.9	6.3	5.8	5.4	5.6
RoAE	15.2	8.1	4.3	10.6	11.5

Source: Company data, I-Sec research

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