

M&M Financial Services

Rs405
OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs39.1bn; US\$879m

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Result: Q4FY10

Comment: Strong NIM performance

Revision: Earnings estimates upgraded by 8.8% for FY11 and 5.8% for FY12

Key valuation metrics

Year to March 31 (Rs m)	NII	yoy chg (%)	Net profit	yoy chg (%)	EPS (Rs)	Adj. Bk Val	P/ Adj.Bk	PER	RoE
					(Rs)	(Rs/ share)	(x)	(x)	(%)
FY07	5,050	33.1	1,329.2	21.8	15.6	85.7	4.7	26.0	18.1
FY08	7,497	48.5	1,770.1	33.2	18.3	132.0	3.1	22.1	16.9
FY09	8,550	14.0	2,145.2	21.2	22.1	152.8	2.7	18.3	15.4
FY10	10,291	20.4	3,276.5	52.7	33.7	188.2	2.2	12.0	20.5
FY11E	12,390	20.4	3,884.2	18.5	39.9	225.6	1.8	10.1	20.6
FY12E	14,670	18.4	4,661.1	20.0	47.9	278.9	1.5	8.5	20.8

Highlights of Q4FY10 results

Mahindra & Mahindra Finance ('MMFIN') reported PAT of ~Rs1.4bn, ~30% yoy growth – ahead of our estimates of Rs1.2bn. The outperformance was led by a strong NII expansion (~30% yoy).

- **Strong NII growth led by expansion in margins:** MMFIN reported NII of ~Rs3.4bn – a strong 30% yoy growth, buoyed by expansion in margins. Margins expanded by a strong 135bp yoy (~310bp qoq) due to higher loan yields (288bp expansion yoy) as well as a 170bp yoy (125bp qoq) decline in cost of funds. Yield expansion was led by strong disbursements in the high yielding segments of CVs and UVs. Net of securitization gains, NII growth is at ~28% yoy. (Exhibit 1)
- **Gross NPAs decline, provision coverage improves:** Gross NPAs declined sharply 230bp qoq (and even higher 340bp yoy) to 6.4% as of Q4FY10. Net NPAs, too, came off by 140bp qoq to 0.9% during the quarter. The management has attributed the improvement in asset quality to significantly better collections in rural areas, in turn a function of improved cashflows for MMFIN's customer segments. The management believes that a buoyant semi-urban/rural economy is driving the improvement in asset quality. Coverage ratio improved from 74.9% in Q3FY10 to 86.4% in Q4FY10. (Exhibit 5)
- **Sharp decline in provisions; a key positive:** In line with improving asset quality, provisions were sharply below estimates at Rs339m. Collection efficiency improved to 100%+ in Q4FY10 (as against ~95% in 9MFY10), driving down the provisions (as % of average assets) from 2.4% in Q3FY10 to 1.5% in Q4FY10.

- **Strong momentum in disbursements:** Momentum in disbursements continued with a strong 90% yoy and 15% qoq growth to Rs27bn. Increasingly, MMFIN is looking at lucrative segments of used vehicles, construction equipment (currently 8% of total) and commercial vehicles (7% of total) to drive growth in the future. (Exhibit 2)
- **Loan book composition broadly stable:** Product mix (as a % of AUM) saw some changes on a yoy basis. UVs financed as a % of total AUM stood at 33%, lower than ~38% in Q3FY09. Led by strong growth in cars segment, share increased from 24% to 30% in Q4FY10. Total advances grew by 22.5% yoy in Q4FY10. (Exhibit 4)
- **Banks dominate funding mix:** During Q4FY10, sources of borrowing witnessed change on a yoy basis, as MMFIN resorted to more long-term sources of funding replacing borrowings from mutual funds by NCDs (27% of total borrowings). Consequently, proportion of bank loans have increased in overall borrowings to 44% in Q4FY10 (34% in Q4FY09). As a part of its strategy to fortify its liabilities, term loans have been raised from banks at significantly low rates (of ~6-7%) for tenure of 3-4 years (Exhibit 3).

Valuations & View

In Q4FY10, MMFIN reported strong NII growth, ahead of our estimates, buoyed by continued expansion in margins as cost of funds declined. With improving economic environment and better collection efficiency, MMFIN has reported a steady decline in Gross NPAs over past three quarters. As economic environment improves further, MMFIN's asset quality woes are likely behind it. While interest costs would inch up over FY11, we expect strong disbursement momentum to drive a healthy NII growth ahead. We are upgrading our estimates for FY11 by 8.8% and FY12 by 5.8% to factor in revival in business volumes and improved asset quality. Stock is currently trading at 1.5x FY12E adjusted book. Reiterate Outperformer with an 18-month price target of Rs530 (~1.9x FY12 adjusted book).

Quarterly results

P&L (Rs m)	Q4FY09	Q1FY10	Q2FY10	Q3FY10	Q4FY10	FY10	FY11E	FY12E	Comments
Interest income	3,893	3,202	3,530	3,939	4,636	15,308	18,752	22,973	
of which securitization income	426	164	165	340	585	1,254	1,201	1,381	
Net interest income	2,622	1,992	2,325	2,578	3,396	10,291	12,390	14,670	Ahead of estimates led by decline in cost of funds.
yoy growth (%)	10.7	8.1	18.3	21.6	29.5	20.4	20.4	18.4	
Other income	83	91	95	81	114	380	418	460	
Operating expenses	642	703	790	754	1,002	3,250	4,097	5,235	
yoy growth (%)	(4)	19	5	11	56	21.8	26.1	27.8	Operating expenses inch up due to higher collection expenses
Operating profit	2,063	1,380	1,630	1,905	2,507	7,421	8,711	9,895	
yoy growth (%)	17.1	6.3	31.0	29.2	21.5	22.1	17.4	13.6	
Provisions & write-offs	458	778	596	503	339	2,215	2,642	3,213	Sharp decline in provisions due to improving asset quality
Profit before tax	1,605	602	1,034	1,402	2,168	5,206	6,069	6,682	
yoy growth (%)	38.0	43.8	89.3	104.2	35.1	59.9	16.6	10.1	
Profit after tax	1,080	400	692	950	1,403	3,276	3,884	4,661	
yoy growth (%)	43.3	49.5	96.5	113.4	29.8	52.7	18.5	20.0	

Quarterly results

Ratios (%)*	Q4FY09	Q1FY10	Q2FY10	Q3FY10	Q4FY10	FY10	FY11E	FY12E	Comments
Gross spread (reported)	12.20	10.60	11.10	11.70	13.00				Up 130bp qoq
Spread on loans (calculated)	10.3	8.3	9.5	9.3	12.0	9.9	9.9	9.5	
NIMs	14.0	10.6	11.8	12.3	15.4	12.4	12.0	11.4	Decline in cost of funds as wholesale liabilities re-price at lower rates fuelled margins expansion
NIM (net of securitization)	11.8	9.8	10.9	10.6	12.7	10.9	10.8	10.3	
Other income / avg assets	0.4	0.5	0.5	0.4	0.5	0.5	0.4	0.4	
Total operating exp / avg assets	3.4	3.8	4.0	3.6	4.5	3.9	4.0	4.1	
Cost-Income ratio	23.7	33.8	32.7	28.3	28.6	30.5	32.0	34.6	
Provisions / avg assets	2.5	4.2	3.0	2.4	1.5	2.7	2.6	2.5	In line with decline in Gross NPAs, provision costs decline
PBT/Avg assets	8.6	3.2	5.2	6.7	9.8	6.3	5.9	5.2	
Tax/PBT	32.7	33.5	33.1	32.3	35.3	37.1	36.0	36.0	
PAT/avg assets	5.8	2.1	3.5	4.5	6.4	4.0	3.7	3.6	
CRAR (%)	19.5	18.8	17.7	19.4	18.5				
Tier-I CRAR (%)	17.4	17.2	16.2	16.8	16.1				
Balance Sheet (Rs m)									
Advances	68,384	69,630	77,206	78,855	83,788	83,788	107,803	130,691	Strong uptick in disbursals drives healthy loan growth
yoy growth (%)	2.9	2.0	3.3	11.3	22.5	22.5	28.7	21.2	
Total Assets	74,439	75,466	82,690	85,628	90,950	90,934	116,258	140,806	
yoy growth (%)	-0.8	1.4	9.6	3.6	6.2	22.2	27.8	21.1	
Borrowings (excl. securitization)	52,130	51,502	58,173	61,292	64,578	64,577	86,275	106,414	Bank loans dominate incremental funding mix.

Exhibit 1: Margins expand as cost of funds decline (%)

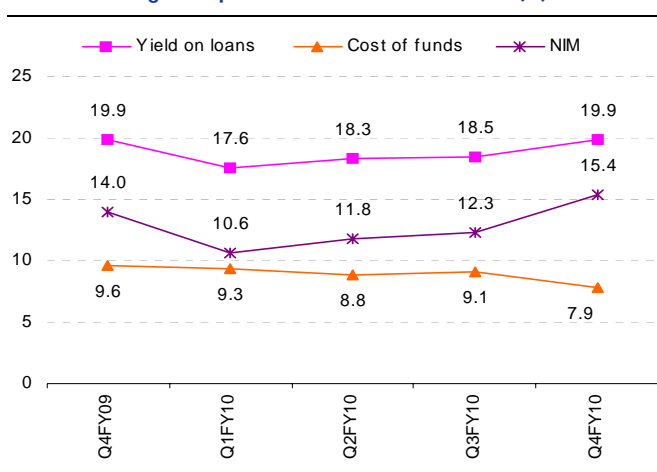
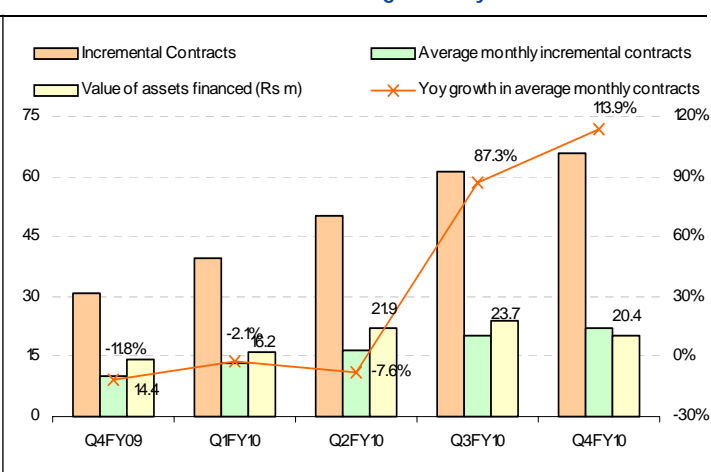


Exhibit 2: Disbursements show strong recovery



*NIMs gross of securitization, calculated ratios on average quarterly balances

Exhibit 3: Bank loans dominate incremental funding (Rsbn)

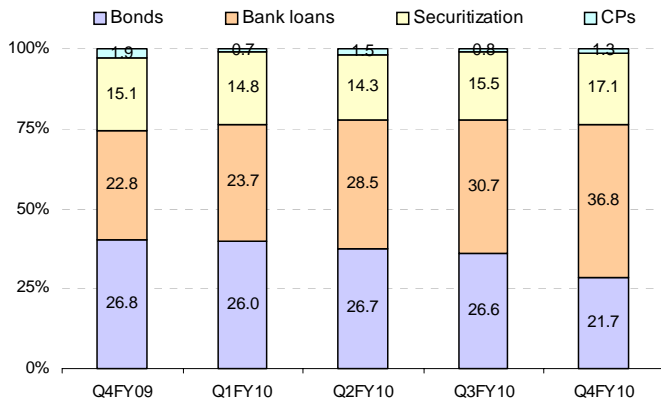


Exhibit 4: Composition of AUM broadly stable

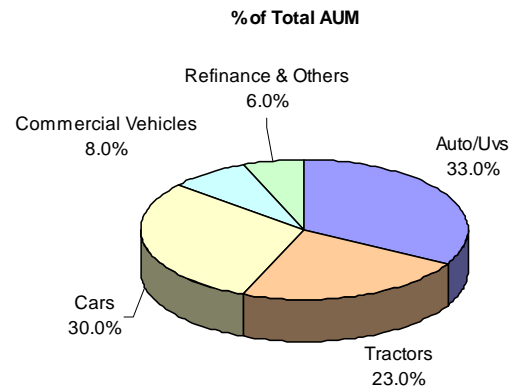


Exhibit 5: Gross NPAs decline; coverage improves

For the quarter ended (%)	Mar-09	Dec-09	Mar-10	yoy chg (% / bps)	qoq chg (% / bps)
Gross NPAs (Rs mn)	6909	7988	6112	-12%	-23%
Net NPAs (Rs mn)	1943	2001	829	-57%	-59%
Gross NPAs (%)	8.7%	8.7%	6.4%	(230)	(230)
Net NPAs (%)	2.6%	2.3%	0.9%	(170)	(140)
Provisioning coverage	71.9%	74.9%	86.4%	1,456	1,149
Provisions / average loans	2.6%	2.6%	1.7%	(97)	(91)

Exhibit 6: Performance of insurance subsidiary

Rs mn	Q4FY09	Q3FY10	Q4FY10	YoY growth (%)
Total Income	59	88	81	37
PBT	33	52	37	12
PAT	22	34	25	14

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