

Ind-Ra Affirms Mahindra Rural Housing Finance's Debt at 'IND AA+'/Stable; Limits Enhanced

Ind-Ra-Mumbai-23 June 2015: India Ratings and Research (Ind-Ra) has affirmed Mahindra Rural Housing Finance Limited's (MRHFL) debt instruments as follows:

- INR26bn bank loan (increased from INR18.5bn): affirmed at 'IND AA+'; Outlook Stable
- INR3.5bn commercial paper programme (increased from INR2.5bn): affirmed at 'IND A1+'
- INR2bn non-convertible debentures: affirmed at 'IND AA+'/Stable
- INR1bn subordinated debt: affirmed at 'IND AA+'/Stable

KEY RATING DRIVERS

MRHFL's ratings are driven by Ind-Ra's expectation of timely financial support from its parent, Mahindra & Mahindra Financial Services Limited (MMFSL; 'IND AAA'/Stable), supervised by the ultimate parent Mahindra & Mahindra Limited (M&M; 'IND AAA'/Stable). MRHFL is 87.5% owned by MMFSL (51% subsidiary of M&M), and operates in the same geographical locations as its parent. The two companies share strong operational and strategic linkages and MRHFL leverages the infrastructure as well as the local knowledge and expertise of its parent for customer acquisition.

Over and above the operational linkages with MMFSL, MRHFL benefits from access to group resources. The group companies including MRHFL and MMFSL have their HR and finance functions working closely with M&M. Moreover, two of MRHFL's directors are representatives from MMFSL and two others have been appointed by M&M, ensuring active coordination. Ind-Ra considers MRHFL important to MMFSL's strategy which is focused on rural customers and therefore believes that management integration and strategic oversight by MMFSL are likely to continue in the foreseeable future.

Gross NPL ratio rose to 5.8% in FY15 (FY14: 4.6%), as the portfolio seasoned and the impact of weak industrial and agricultural activity in 2014 was reflected. High NPLs are a characteristic of the borrower profile in rural geographies whose cash flows largely depend on monsoons and industrial activity. Asset quality is therefore likely to remain volatile over the medium term, though the high credit costs are compensated by the high yields in this segment.

Return on assets improved marginally to 2.5% in FY15 (FY14: 2.4%), despite a fall in net interest margin to 9.0% (9.3%), driven by a reduction in operating costs to 6.0% of assets (6.9%). The increase in the share of semi-urban business over the longer term could bring down costs further. However, Ind-Ra expects the operating costs to remain above peers', given the cost intensive nature of the rural business which will continue to contribute to more than half of the business over the medium term.

Capitalisation is modest and total capital adequacy ratio was 15.3% at FYE15 (Tier 1: 14.3%). An aggressive loan growth projection (FY15-FY18 CAGR of 62%) will necessitate regular equity injections by MMFSL over the medium term as internal accruals (FY15: 29.5%) are strong but may be insufficient. However, Ind-Ra understands that MMFSL is committed to infusing equity, when required.

Banks are likely to remain the predominant source of funding for MRHFL (77.5% of borrowings in March15), though this is well-spread across several banks which reduces the concentration risk. MRHFL benefits from the strong banking relationships of MMFSL and its expertise in raising funds from the market. The parent also provides funding support to MRHFL through inter-corporate deposits and subordinate debt. MRHFL's asset/liability maturity profile is largely matched with adequate sanctioned term loans and undrawn working capital lines; this is supported by the short tenor of loans of five-six years.

RATING SENSITIVITIES

MRHFL's ratings will continue to reflect the parent's credit strength and its linkages with MMFSL. A positive rating action, which Ind-Ra believes is unlikely over the medium term, will depend on a material improvement in MMFSL's credit profile and strengthening of group linkages. A substantial dilution of MRHFL's operational linkages with the parent or a weakening of MMFSL's credit profile could lead to a negative rating action.

COMPANY PROFILE

MRHFL is a housing finance company, established in April 2007 as a subsidiary of MMFSL. The company primarily operates in rural and semi-urban geographies and its borrowers are mostly involved in agriculture and allied activities. MRHFL is present in over 265 locations across nine states, with Maharashtra and Tamil Nadu contributing more than 59% to the loan book.

Contacts:

Primary Analyst

Priya Sunder

Associate Director

+91 22 4000 1710

India Ratings and Research Pvt Ltd

Wockhardt Tower, West Wing, 4th Floor

Bandra Kurla Complex, Bandra (E)

Mumbai 400051

Secondary Analyst

Prakash Agarwal

Associate Director

+91 22 4000 1753

Committee Chairperson

Ananda Bhoumik

Senior Director

+91 22 4000 1720

Media Relations: Mihir Mukherjee, Mumbai, Tel: +91 22 4035 6121, Email:

mihir.mukherjee@indiaratings.co.in.

Additional information is available at www.indiaratings.co.in. The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings has been compensated for the provision of the ratings.

Ratings are not a recommendation or suggestion, directly or indirectly, to you or any other person, to buy, sell, make or hold any investment, loan or security or to undertake any investment strategy with respect to any investment, loan or security or any issuer.

Applicable criteria, 'Financial Institutions Rating Criteria' and 'Rating of Bank Legacy Hybrids and Sub-debt Criteria', both dated 12 September 2012, are available on www.indiaratings.co.in

ALL CREDIT RATINGS ASSIGNED BY INDIA RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK:

[HTTP://WWW.INDIARATINGS.CO.IN/UNDERSTANDINGCREDITRATINGS.JSP](http://www.indiaratings.co.in/UNDERSTANDINGCREDITRATINGS.JSP). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEBSITE [WWW.INDIARATINGS.CO.IN](http://www.indiaratings.co.in). PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. INDIA RATINGS CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE.

India Ratings & Research (India Ratings) has six rating offices located at Mumbai, Delhi, Chennai, Kolkata, Bangalore and Hyderabad. India Ratings is recognised by Reserve Bank of India, Securities Exchange Board of India (SEBI) and National Housing Bank.
