2024 Outlook – time to turn selective

We expect growth moderation for lenders in FY25ii, after RWA increase and rising delinquencies in the pockets of unsecured loans (STPL, CC, MFI). However, large, diversified NBFCs under our coverage are set to deliver 20-25% AUM Cagr, led by product and distribution expansion. These growth rates will still be 5-10% points higher than their historical average, and 1.5x-2x of the banking system credit growth of ~13-14% in FY25ii. NIMs are unlikely to materially expand even for fixed rate lenders in FY25 (~10bps for CIFC/SHFL), as COF will remain elevated even after accounting for 50bps rate cut in 2HFY25. For banks and mortgage lenders, NIMs may come under pressure with interest rate cuts in FY25. For NBFCs, credit cost is likely to inch up by 20-40bps over FY25-26ii from FY23 levels; reflecting changing book mix and rising stress in unsecured loans. Expect large, diversified NBFCs to deliver 10-30% earnings growth vs 0-20% for banks in FY25ii (except HDFACB). Given the growth and asset quality headwinds for select smaller NBFCs, we retain our preference for BAF (top pick) and CIFC that are trading at reasonable valuations, adjusted for growth and profitability.

Growth to moderate but large, diversified NBFCs to grow at 1.5-2x of the banking system

We expect growth for NBFCs to moderate in FY25ii, after RWA increase and rising delinquencies in the unsecured segments (STPL, credit cards, MFI, etc.). Unsecured consumer loans contributed 3%-50% of incremental retail credit growth for large, diversified NBFCs under our coverage in 1HFY24 vs 45% for the NBFC sector. We expect a relatively lower AUM growth moderation of 300-600bps to 20-25% Cagr for NBFCs under coverage, given their growth led by product and distribution expansion. These growth rates will still be 5-10% points higher than their historical average and 1.5x-2x of the banking system credit growth of ~13-14% in FY25ii.

Need to hold the horses on margin tailwinds from lower COF

COF tailwinds from rate cuts in FY25 are unlikely to be material, because COF is set to rise 10-25bps further in 2HFY24 (bond repricing at 70-170bps higher rates, RWA increased linked ~25-30bps increase in bank borrowing cost and MCLR repricing); and is unlikely to decline much in FY25ii, even after building in 50bps of rate cuts in Sep'24. This is because: 1) Bond repricing would still happen at 75-170bps higher rates (except for LTFH and SHFL). 2) Cost of MCLR-linked bank borrowings likely to further increase in 1HFY25. Consequently, we expect marginal NIM expansion of ~5-10bps in FY25ii for even fixed rate lending NBFCs under our coverage, given the divergent COF and yield trajectories (competition, yields on new businesses, asset mix change). Forecast flat-to-30bps NIM compression for MMFS/ Fusion/ BAF, ~10bps expansion for CIFC/SHFL and 120bps expansion for LTFH (100% retail). This would be in contrast to 5-20bps of NIM compression for large Pvt/PSU banks (except HDFCB).

Credit costs to increase by 20-40bps with rising delinquencies in STPL, credit cards and MFI

While the AQ stress in small-ticket PL (STPL) is well known, we are seeing the signs of rising delinquencies in other unsecured loans such as credit cards and MFI. Credit card delinquencies have increased 10-100bps QoQ in 2QFY24 (RBL, SBI cards). Whereas the MFI state level delinquencies have inched up by 10-90 bps QoQ in MP/RJ/PB/UK/HR (14.6% of industry AUM) in 1QFY24. NBFCs under our coverage have minimal exposure to STPL, but MFI constitutes 28% of AUM for LTFH. We expect credit costs to increase by 20-40bps over FY24-26ii from FY23 levels for NBFCs under our coverage, reflecting changing book mix and rising stress in unsecured loans.

Large NBFCs at attractive valuations for superior earnings growth profile

Notwithstanding the growth moderation in FY25ii, we expect large NBFCs under our coverage to deliver earnings growth of 10-30% in FY25ii vs 0-20% for large Pvt and PSU banks (except HDFC). This is even as these NBFCs are trading near their LTA multiples. We have revised our estimates (4-5% earnings cut) and TPs for NBFCs: **BAF (Rs9,300), CIFC (Rs1,450), SHFL (Rs2,450), LTFH (Rs170), MMFS (Rs240) and Fusion (750).** Our preferred picks BAF and CIFC may appear expensive on an absolute basis, but are reasonably valued adjusted for superior profitability and growth (0.7x-1.1x PEG).

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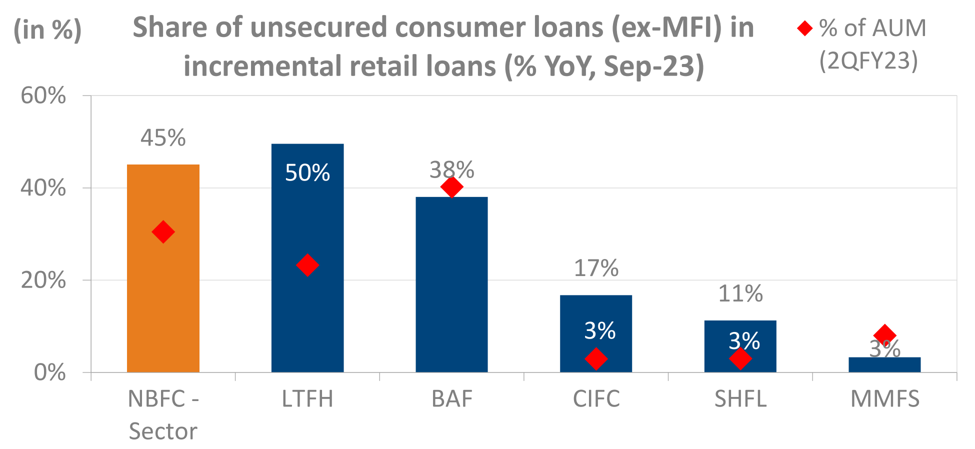
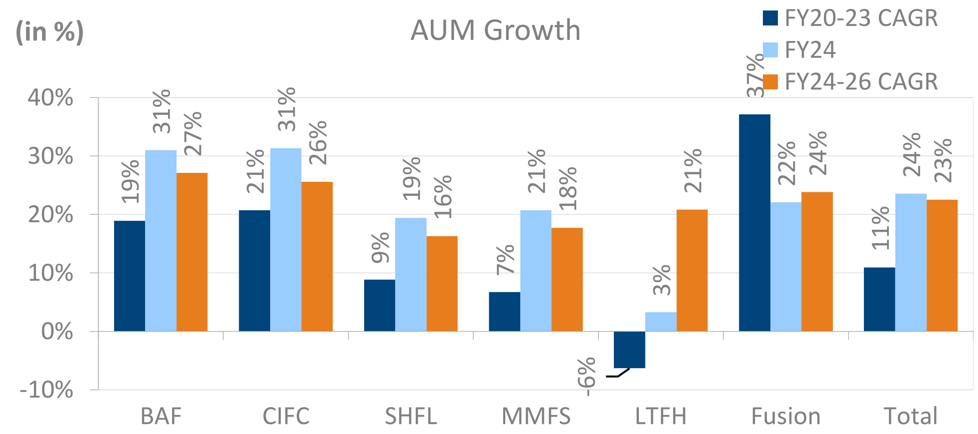
Focus Charts

Figure 1: Unsecured consumer loans (ex MFI) constituted 45% of incremental credit growth for NBFCs and 3-50% for NBFCs under our coverage



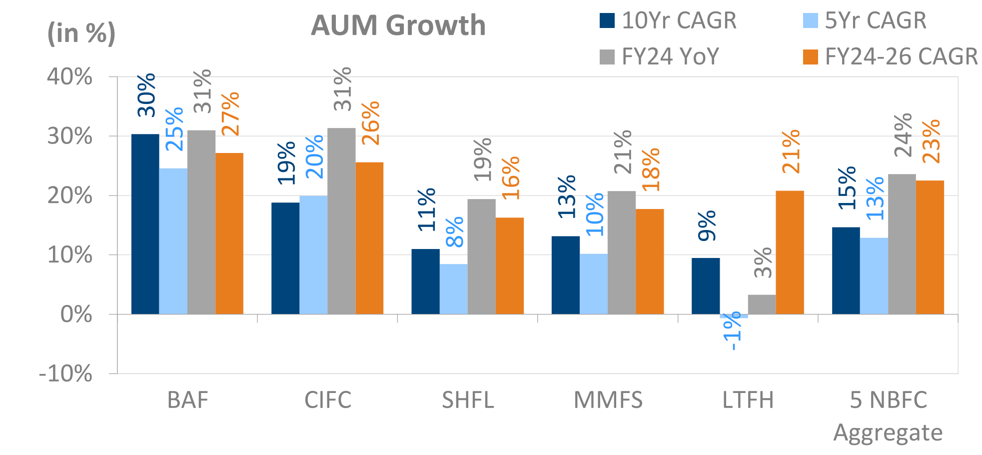
Note - Products considered for unsecured loans: LTFH – JLG (as not classified as MFI) & Consumer; BAF - Sales finance, B2C; CIFC – CSEL, SHFL: Personal; MMFS: Others; Source: Company, IIFL Research

Figure 2: Loan growth for NBFCs under coverage to moderate by 300-600bps, off a high base in FY24ii



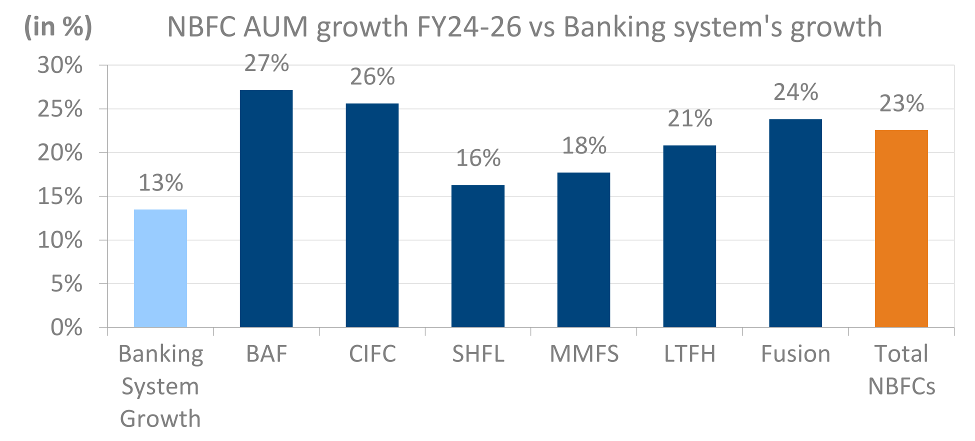
Source: Company, IIFL Research

Figure 3: Growth for NBFCs to moderate a bit from FY24ii levels. But, this will be 5-10% pts higher than the historical avg…



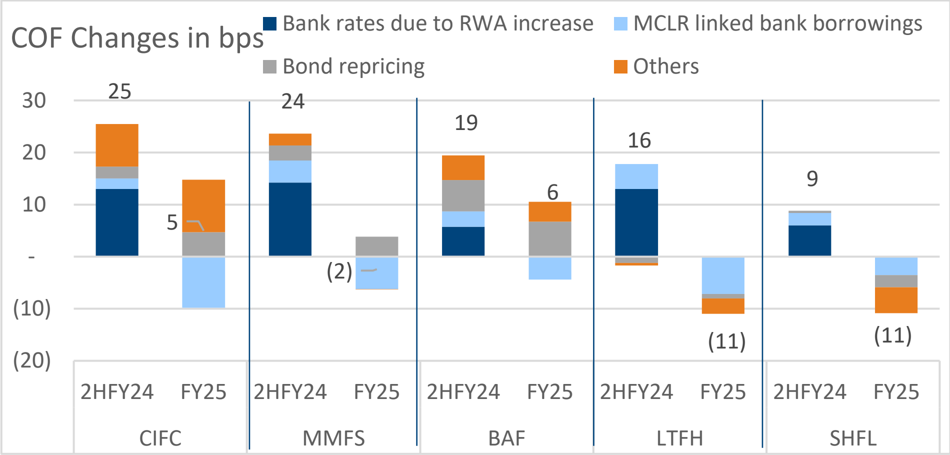
Source: Company, IIFL Research

Figure 4: …and 1.5x-2x the ~13-14% banking system credit growth in FY25ii



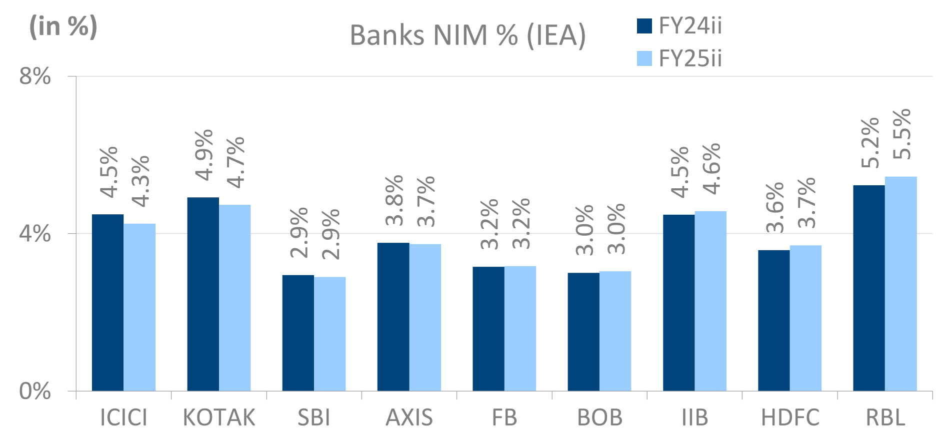
Source: Company, IIFL Research

Figure 5: NBFC's COF to increase by 10-25bps in 2HFY24, and unlikely to moderate materially in FY25ii even after factoring 50bps rate cut in Sep'24



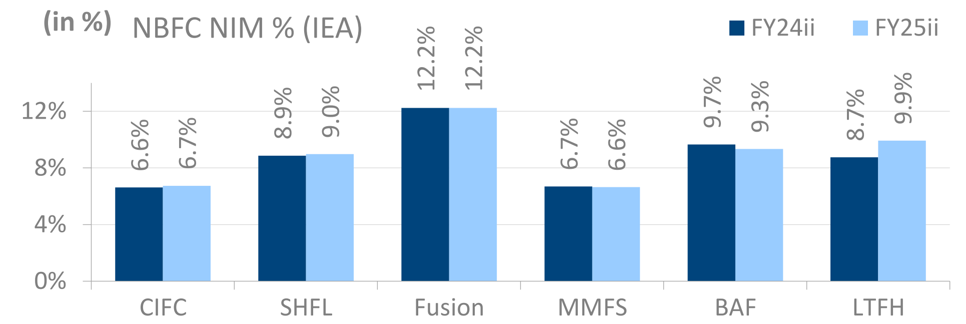
Source: Company, IIFL Research

Figure 6: NIMs for large PSU/Pvt banks to compress by 5-20bps in FY25ii…



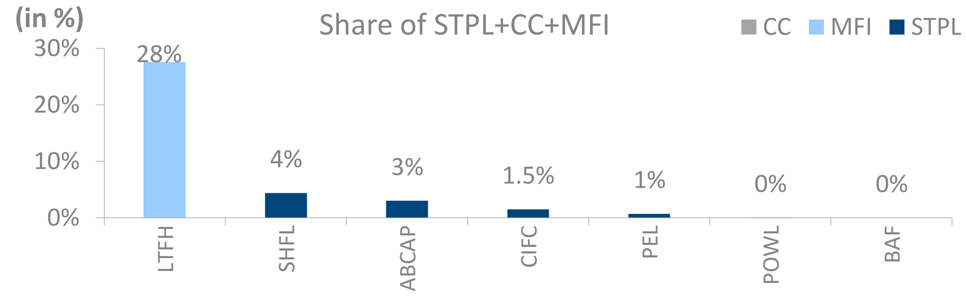
Source: Company, IIFL Research

Figure 7: …and would be in contrast to 5-10bps expansion for NBFCs with fixed rate book



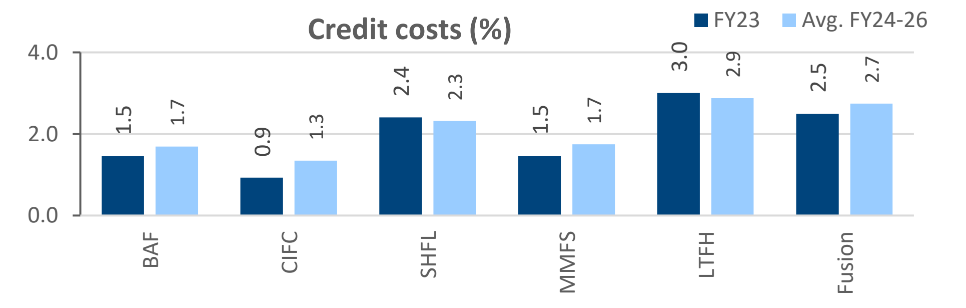
Source: Company, IIFL Research

Figure 8: NBFCs under our coverage have negligible exposure to STPL and 0-28% to MFI



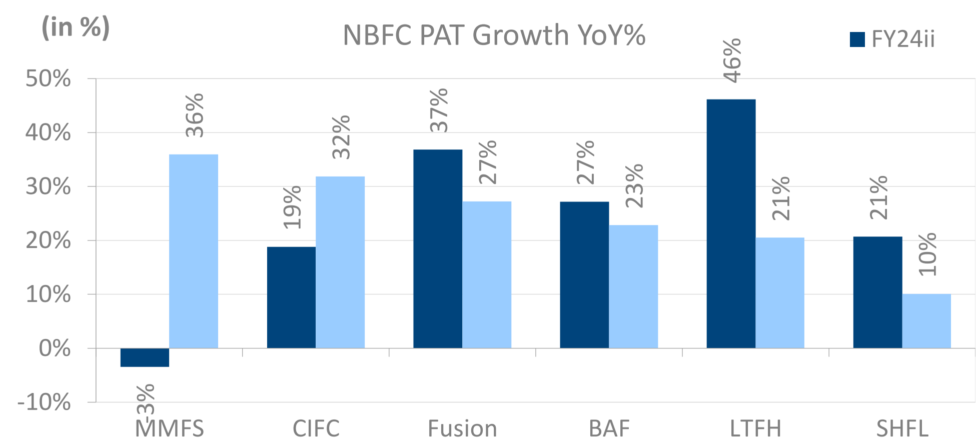
Source: Company, IIFL Research

Figure 9: We expect avg credit costs for NBFCs under over coverage to increase 20-40 bps from FY23 levels



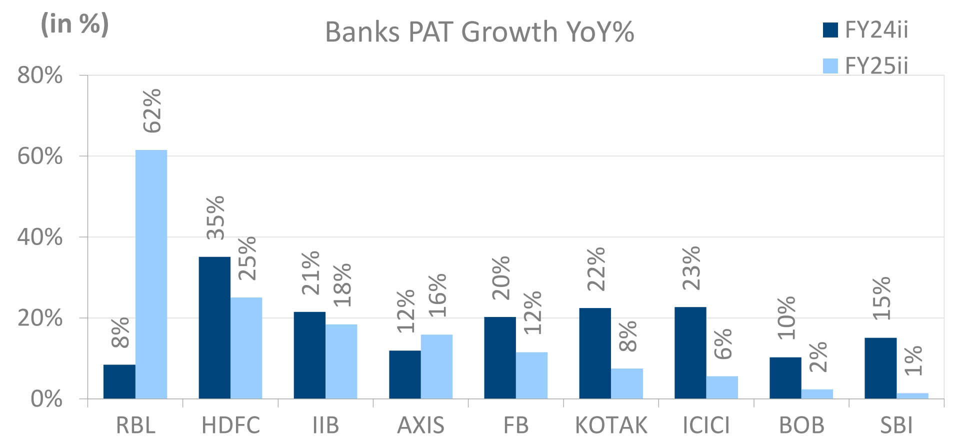
Source: Company, IIFL Research

Figure 10: Earnings growth for large NBFCs is likely to be 10-30% YoY in FY25ii…



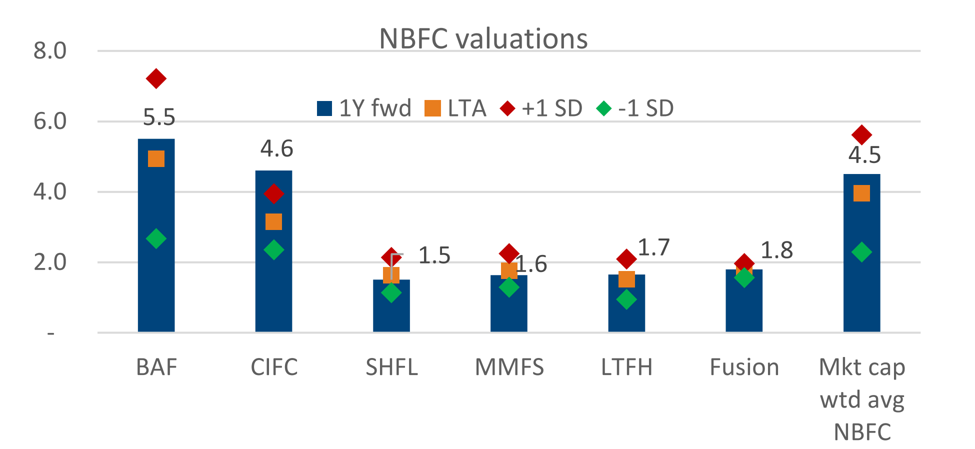
Source: Company, IIFL Research

Figure 11: …compared to 0-20% for large Pvt and PSU banks except HDFC bank



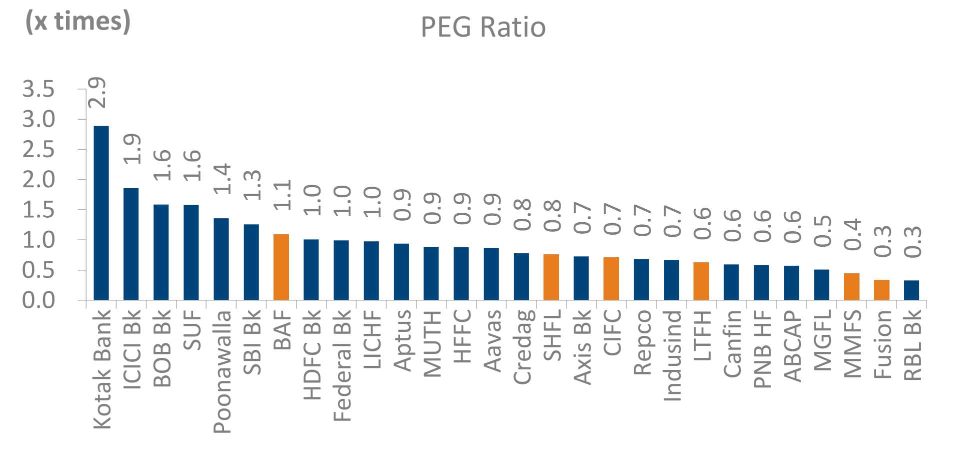
Source: Company, IIFL Research

Figure 12: NBFCs are broadly trading in-line with their LTA for 5-10% pts higher AUM growth



Source: Company, IIFL Research

Figure 13: BAF/CIFC: Valuations adj. for growth and profitability appear reasonable



Note: FY25PE/ Earnings growth CAGR over FY24-FY26

Source: Bloomberg consensus for non-covered banks/NBFCs;, IIFL Research

Figure 14: India NBFCs valuation table

Company	Market Cap (Rs bn)	CMP (Rs)	Reco	Target	Upside/ Downside	P/B			P/E			ROA (%)			ROE (%)		
						FY24	FY25	FY26	FY24	FY25	FY26	FY24	FY25	FY26	FY24	FY25	FY26
IIFL Covered																	
BAF IN	4,781	7,736	BUY	9,300	20%	6.3	5.3	4.3	32	27	21	4.6	4.4	4.4	22.5	21.6	22.5
CIFC IN	1,034	1,231	BUY	1,450	18%	5.4	4.4	3.4	32	25	18	2.4	2.4	2.7	18.8	19.6	21.5
SHFL IN	825	2,196	BUY	2,450	12%	1.7	1.5	1.3	11	10	9	3.3	3.1	3.2	15.6	15.2	15.8
MMFS IN	341	276	SELL	240	-13%	1.7	1.6	1.4	17	12	10	1.8	2.1	2.1	10.4	13.0	14.2
LTFH IN	419	168	ADD	170	1%	1.8	1.7	1.5	18	15	12	2.3	2.7	2.9	10.6	11.8	13.7
FUSION IN	61	604	BUY	750	24%	2.1	1.7	1.4	11	9	7	5.0	5.1	5.0	20.5	21.1	21.2
Consensus																	
LICHF IN	309	562				1.0	0.9	0.8	7	7	6	1.5	1.4	1.4	15.2	14.0	13.5
PNBHOUSI IN	205	789				1.4	1.2	1.1	14	12	10	2.0	2.0		10.8	10.8	11.8
CANF IN	103	771				2.4	2.0	1.7	14	12	10	2.0	2.1	2.1	18.1	18.4	18.3
APTUS IN	163	328				4.3	3.7	3.3	27	22	18	7.4	7.1	7.0	17.0	18.3	19.9
AAVAS IN	123	1,552				3.3	2.8	2.4	25	20	16	3.3	3.4	3.4	14.0	15.0	15.8
HOMEFIRS IN	83	936				4.0	3.4	2.9	28	22	18	3.8	3.6	3.5	15.0	16.2	17.5
MGFL IN	152	180				1.4	1.2	1.1	8	7	6	4.9	4.7	3.5	19.0	18.4	17.6
MUTH IN	598	1,489				2.5	2.2	1.9	14	12	11	5.1	5.2	5.3	17.7	18.3	17.8
ABCAP IN	456	175				1.7	1.5	1.4	16	13	11	1.8	1.8	1.8	11.9	12.6	13.6
CREDAG IN	276	1,731				4.3	3.4	2.7	20	16	14	5.5	5.4	5.3	24.0	23.0	22.0
POONAWALLA IN	353	459				4.3	3.5	3.3	30	26	21	4.4	4.8	4.4	13.0	12.9	16.7
SUF IN	413	3,719				4.9	4.3	3.6	32	26	23	2.8	2.9	2.8	15.7	17.0	16.6
IREDA IN	279	104				3.4	2.9	2.5	25	20	17	2.0	2.1	2.0	18.5	19.9	22.0
RECL IN	1,145	435				1.7	1.5	1.3	9	8	7	2.7	2.6	2.6	21.3	20.2	19.8
PIEL IN	208	926				0.7	0.7	0.7	16	15	11	0.7	1.4	1.7	1.8	4.6	6.2

Source: Bloomberg consensus for non-covered, Company, IIFL Research

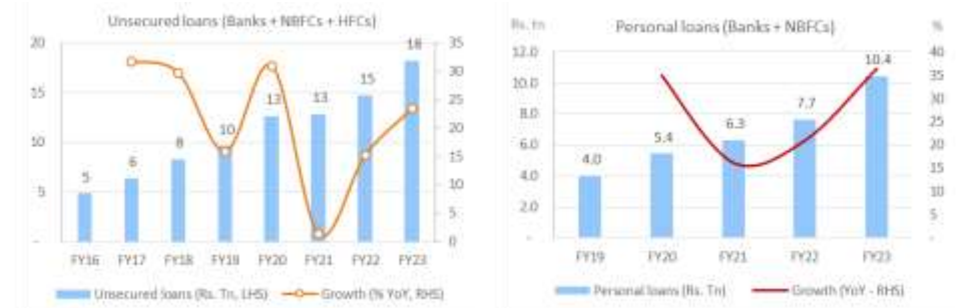
Growth to moderate but large, diversified NBFCs to grow at 1.5-2x of the system

We expect growth for NBFCs to moderate in FY25ii after RWA increase and rising delinquencies in the unsecured segments (STPL, credit cards, MFI, etc.). Unsecured consumer loans contributed 3-50% of incremental retail credit growth for large, diversified NBFCs under our coverage in 1HFY24 compared to 45% for the NBFC sector. We expect a relatively lower growth moderation of 300-600bps for large, diversified NBFCs under coverage given their product and distribution expansion led growth. These growth rates will still be 5-10% points higher than their historical average and 1.5x-2x of the banking system credit growth of ~13-14% in FY25ii.

Unsecured retail loan growth to moderate…

System-wide unsecured loans have been growing at 20% CAGR since FY16 and grew at ~25% YoY in FY23. Even within the unsecured loans, personal loans have been growing at a faster clip – where the NBFCs and FinTechs are rapidly gaining market share by disbursing smaller-ticket loans to Tier2 onward cities and to younger age customers.

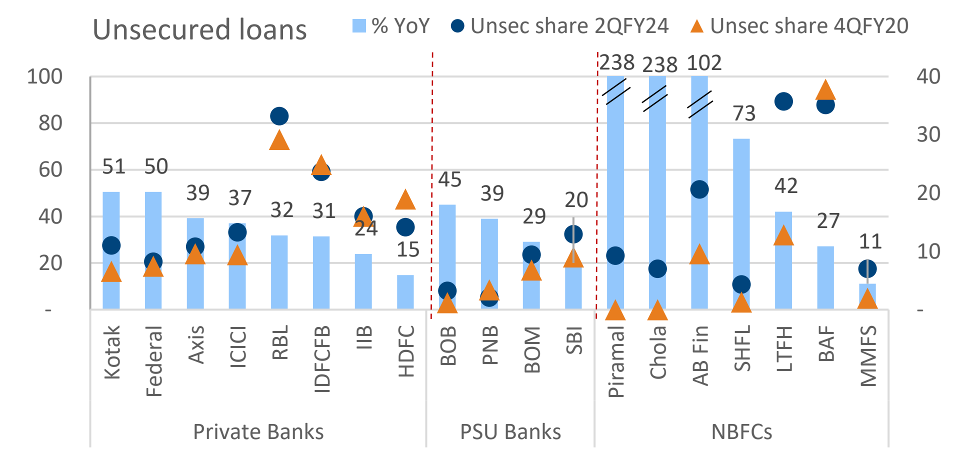
Figure 15:System-wide unsecured loans grew at 20% CAGR since FY16



Source: RBI, NHB, IIFL Research. Note: Incl consumer durable, credit card, education, PL and MFI.

For individual lenders, unsecured loans (including MFI) have grew 15-50% for banks, and 25-240% for select NBFCs (from lower base). Growth has been the strongest for BOB, Kotak, PNB, Axis and ICICI; whereas it has been relatively slower for IIB and HDFC Bank. NBFCs such as ala Chola, Piramal, AB Finance have seen their unsecured loans growing by 2-4x in FY23. For most private banks, SBI and BAF, these are existing segments where they predominantly lend to existing customers (60-85%). This is also evident in the movement in share of unsecured loans in their total loans, which has been flat to +4 pp since FY20, and now constitute 10-33% of their loan book. On the other hand, for most NBFCs (barring Bajaj Finance) this is largely a new segment, which has been scaled up post-pandemic. The share of unsecured loans has increased by 1-20 pp in the last three years to 5-35%. LTFH, Poonawalla, Piramal and AB Finance in particular, have seen a very strong growth in a short span of time; given that they have pivoted their business models in this direction.

Figure 16: Share of unsecured loans in banks' loan mix has been flat to up 4 pp to 10-25%, since FY20. However, the increase is much higher for NBFCs at 1-20 pp to 5 -35%; the highest increase is for LTFH, Poonawalla, Piramal and AB Cap



Source: Company, RBI, IIFL Research. Note: (1) Unsecured loans include consumer durable, personal loans, education, credit card, embedded finance and microfinance as of 2QFY24, (2) For NBFCs – it does not include unsecured business loans.

...with increase in risk weights and rising delinquencies

To temper the recent runaway growth in unsecured consumer loans and limit the rising delinquencies (discussed later in the report), the RBI has increased risk weights on unsecured consumer loans (primarily PL and CC) by 25% points from current 100%/125% to 125%/150% for banks and NBFCs. The higher risk weights are applicable on the entire stock of o/s loans and not just on incremental loans.

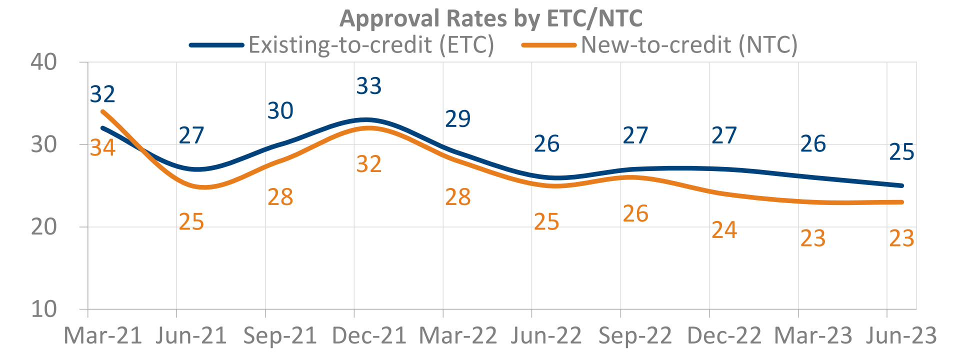
Figure 17:RBI has increased risk weights on consumer unsecured loans by 25%

NBFCs lending	Current	New	Remarks
Personal loans	100%	125%	25% pts increase
Credit cards	100%	125%	25% pts increase
MFI	100%	100%	No change

Source: RBI, IIFL Research

We expect unsecured loan growth to slow down from here as: (a) Higher risk-weights on personal loans and credit card impact the RoRWA on these products, and (b) rising delinquencies in small-ticket personal loans, credit card and microfinance loans make the lenders risk-averse. In fact early signs are already visible of the lenders scaling back in these segments. Lenders have started tightening underwriting standards for both existing-to-credit (ETC) and new-to credit (NTC) customers. Lenders having higher reliance on sourcing from FinTechs and small ticket PL should see their greater degree of growth and profitability slowdown.

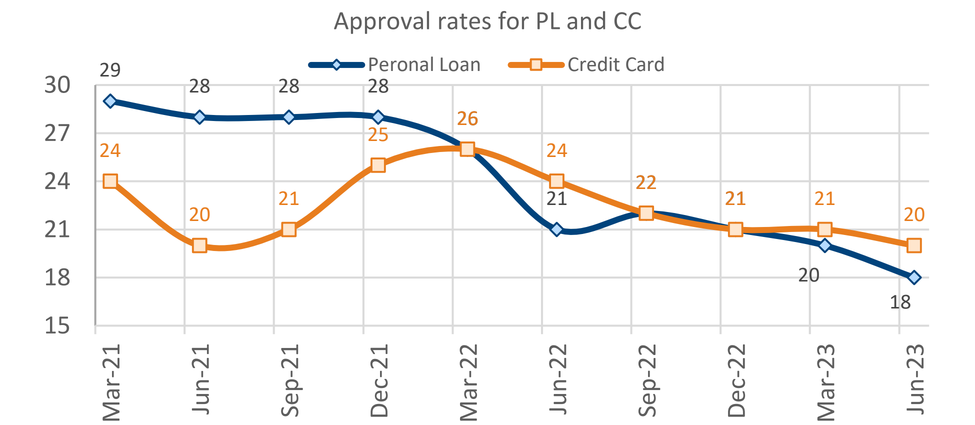
Figure 18:Lenders have tightened underwriting for both ETC and NTC customers



Source: TransUnion CIBIL, Company, IIFL Research

The approval rates for both personal loans and credit cards has been steadily declining in the last few quarters.

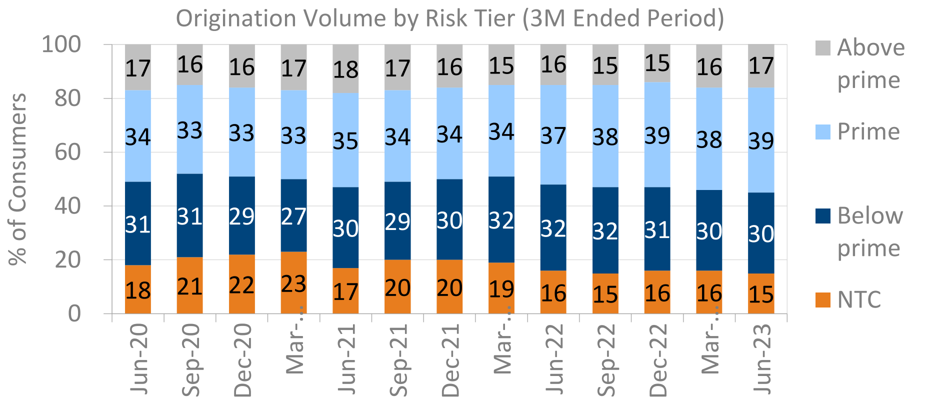
Figure 19: … reflected in the reducing approval rates for both PL and credit cards



Source: TransUnion CIBIL, Company, IIFL Research

Consequently, share of riskier NTC and below prime customers have reduced by 600bps in incremental originations in last few quarters.

Figure 20: As a result, share of NTC and below prime customers have reduced by ~600bps in last few quarters



Source: TransUnion CIBIL, Company, IIFL Research

Paytm, one of the largest Fintech originators, registered a first QoQ de-growth in PL disbursements (-3% QoQ) since commencing the business a few years back. Similarly, PEL's unsecured loan disbursements declined for second consecutive quarter (-5% QoQ). Whereas, LTFH's larger ATS (Rs170k) PL from FinTechs have also slowed with PL disbursements down 2% YoY.

Figure 21: Select NBFCs have started scaling back growth in personal loans

Source: Company, IIFL Research

It is interesting to note that many NBFC managements have indicated their intentions to slow down the growth in unsecured segments, but the banks have been relatively more sanguine about the future growth prospects. This in our view, is mainly the function of emanating stress in the underlying unsecured loan exposures. As discussed later in the report, stress has started to manifest mainly for the FinTechs and the NBFCs who rely on partnerships for sourcing the small ticket personal loans. The share of unsecured loans for select NBFCs has increased by 1-20 pp in the last three years vs. flat to only 4pp increase for the banks. Moreover, unsecured lending is a legacy segment for most banks and they continue to largely fund internal customers (existing-to-bank 70-85%). On the other hand, for most NBFCs (barring Bajaj Finance) this is largely a new segment, which has been scaled up post-pandemic. LTFH, Poonawalla, Piramal and AB Finance in particular have seen a very strong growth in a short span of time, as they have pivoted their business models in this direction.

Figure 22: NBFC management commentaries indicate conscious scaling back on personal loans and credit card growth

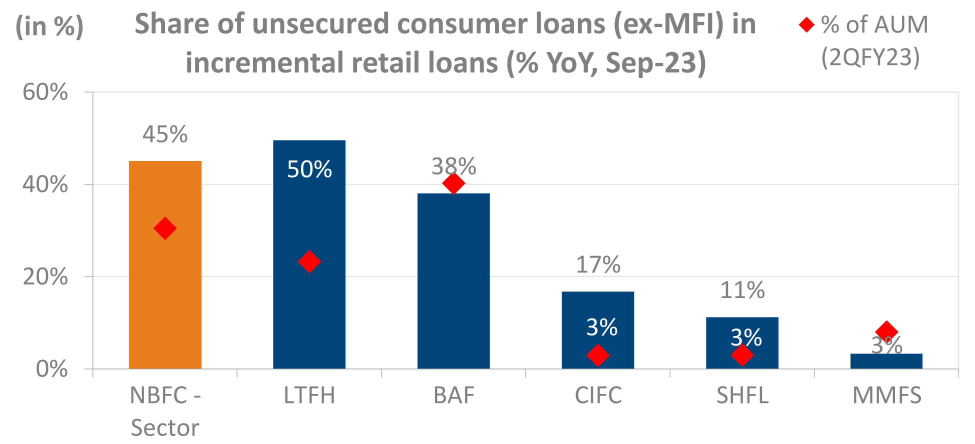
Company	Statements
Axis Bank	"... RBI has -- especially, RBI Governor has been calling out the growth in personal loans for quite some time. And obviously, you know, if the regulator is calling it out, we have to take full cognizance of what is being said."
IndusInd Bank	"We are not growing the asset book or the -- the card business or a PL business as a strategy of ours... overall, this is 5% of our books. We are not growing that fast."
Bajaj Finance	"...we have cut between 8% [in urban] and 14% [in rural] of the business as a preventive measure to those who have more smaller ticket loans, while they may be short term in nature, [they] represent imprudence…"
L&T Finance	"...we are moving from a single-access underwriting to a multi-access underwriting. This model will obviously take some time to mature. And so, we will grow this gradually. There is no hurry... you have noticed that we have sort of plateaued the acceleration rate of our personal loans business while we put these new tools in place and sort of slowly gain experience in these new tools."
Paytm	"...Personal loans for the future, let's say, at least for the next couple of quarters, will remain muted..."
SBI Cards	"While the growth has been strong, the industry also needs to sustain this with care. Credit card balances have gone up by 30% year-on-year to INR2.18 lakh crores as of August 2023. Amidst the strong growth, the regulator has been highlighting the need for prudent risk management..."
Shriram Finance	"...keeping this (Personal Loans) within the ambit of 5% cap on overall AUM…"
AB Capital	"...So very calibrated growth of business is what we are looking at in this (small ticket PL) segment.
Chola	"...We will be cautious on this (STPL) segment... Not adding any new partners in fintechs. Slowing down fintech partnerships and reducing the number going ahead..."

Source: Company, IIFL Research

Growth for NBFCs to moderate from peak in FY24ii…

At a sector level, NBFCs loan book grew by 26% YoY (Sep-23), led by retail and SME loan growth of 36% (Sep 23)/42% (Mar 23) YoY respectively. The retail loan growth was led by high growth in consumer unsecured retail loans which formed 45% of incremental retail loan growth (Sep-23). For NBFCs under our coverage, this number ranged between 3-50%.

Figure 23: Unsecured consumer loans (ex MFI) constituted 45% of incremental credit growth for NBFCs and 3-50% for NBFCs under our coverage



Note - Products considered for unsecured loans: LTFH – JLG (as not classified as MFI) & Consumer; BAF - Sales finance, B2C; CIFC – CSEL, SHFL: Personal; MMFS: Others; Source: Company, IIFL Research

For large diversified NBFCs under our coverage, which constitute of 35% of total NBFC credit (ex of PSU NBFCs) and 46% of retail loans, have grown at 25% Cagr over last two years (Sep21-23) and 30% YoY growth in 1HFY24. This has been led by: a) foray into new segments (product segment expansion) as they pivot to become multi-product, consumer based lenders and b) distribution expansion. NBFCs have evolved unique strategies to scale up new segments that leverage their existing strengths - physical distribution network, customer segment, geographical knowledge.

Figure 24: Large, diversified NBFCs are growing at 20-40% YoY off a low base

	FY21	FY22	FY23	H1FY24	H1FY22-H1FY24 CAGR
BAF	3.9%	25.6%	28.8%	32.9%	31.9%
CIFC	15.6%	9.9%	38.5%	41.7%	33.2%
SHFL	1.9%	9.1%	15.9%	19.7%	15.4%
MMFS	-5.1%	0.5%	27.4%	27.0%	21.4%
LTFH	-4.4%	-6.0%	-8.4%	-12.6%	-4.8%
FUSION	88.2%	73.5%	37.0%	24.6%	38.7%
Total	2.1%	10.6%	20.9%	23.5%	21.2%

Source: Company, IIFL Research

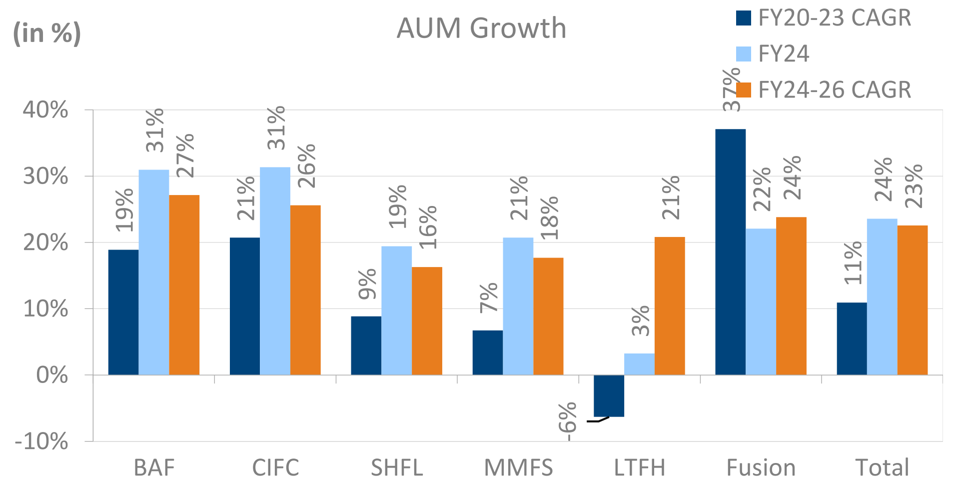
Figure 25: CIFC, SHFL, MMFS and LTFH are entering new retail / SME segments that aids growth, diversifies loan book and helps gain larger wallet share of customer. BAF also expanding into unexplored Retail loan segments having $450bn of market size

	Existing / traditional	New or Renewed focus Products	New Seg Mkt size
SHFL	VF	MSME, 2W, Personal Loans, Gold Loans	$ 190 bn
MMFS	VF	SME, Auto leasing, Micro LAP, Digital Personal loans	$340 bn
CIFC	VF, LAP/MSME	Affordable Housing, Secured Business, Unsec MSME, Large MSME, Personal loans & Prof loans	$480 bn
LTFH	MFI, 2W, Tractors, HL & LAP	Consumer Loans (PL), Secured small business loans (rural), SME/ Professional loans, Warehouse Receipt Financing	$340 bn
BAF	CD, Captive 2W, Personal loans, SME, LAS	Non-Captive 2W, New auto loans, Emerging corp. loans, MFI, Tractors, Secured MSME, Gold, Affordable Housing	$450 bn

Source: Company, IIFL Research

Notwithstanding the slowdown in pockets of retail lending, we expect a relatively slower growth moderation for large NBFCs under our coverage given their product and distribution expansion led growth. For NBFCs under our coverage, we expect growth over FY24-26ii to moderate by 300-600bps to 27%/26% Cagr for CIFC/BAF and to 16%-18% Cagr for SHFL/MMFS. For LTFH, we expect the retail loan growth to moderate to 24% Cagr from 29% in FY24ii.

Figure 26: Loan growth for NBFCs under coverage to moderate by 300-600bps off a high base in FY24ii

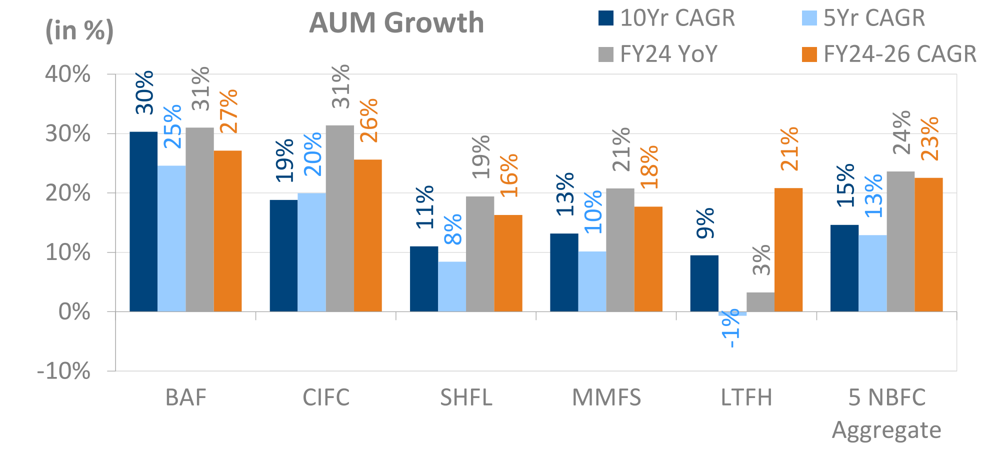


Source: Company, IIFL Research

…but will still be 5-10% points higher than historical average and 1.5x-2x the banking system credit growth

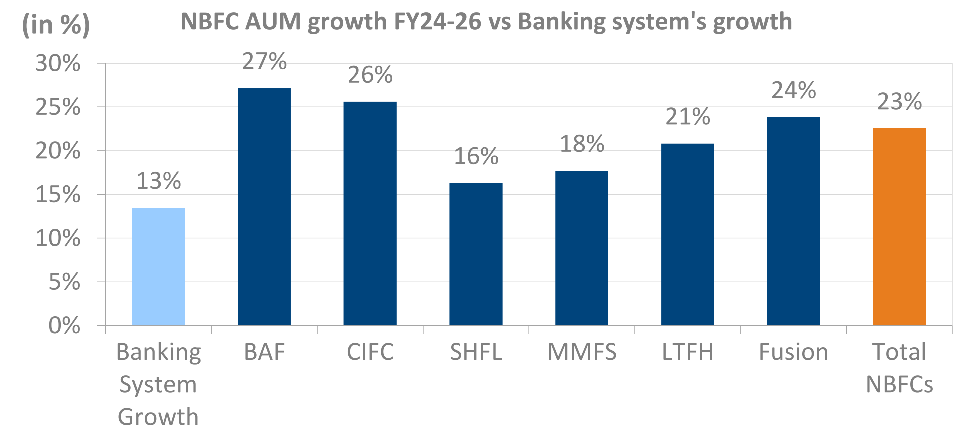
Even as growth for large NBFCs will moderate over FY24-26ii, we highlight that it will still be 5-10% points higher than their historical average. This will also be 1.5x-2x the banking system credit growth of ~13-14% in FY25ii.

Figure 27: Growth for NBFCs to moderate a bit from FY24ii levels. But, this will be 5-10% pts higher than historical avg…



Source: Company, IIFL Research

Figure 28: …and 1.5x-2x the ~13-14% banking system credit growth in FY25ii



Source: Company, IIFL Research

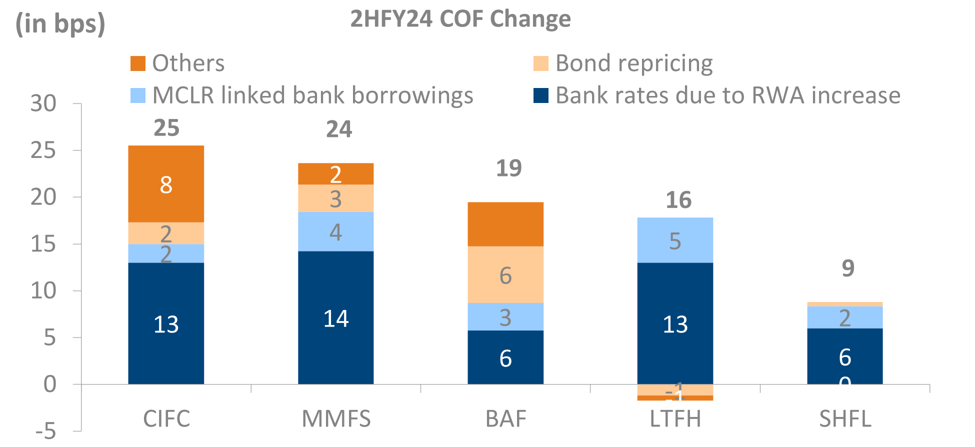
Need to hold the horses on margin tailwinds from lower COF

We believe the tailwinds from expected rate cuts in FY25 are unlikely to be material, since COF is set to rise 10-25bps further in 2HFY24 (bond repricing at 70-170bps higher rates, RWA increased linked ~25-30bps increase in bank borrowing cost and MCLR repricing) and is unlikely to decline much even in FY25ii, even after building in 50bps of rate cuts in Sep-24 as: 1) bond repricing would still happen at 75-170bps higher rates (except for LTFH and SHFL), and 2) cost of MCLR-linked bank borrowings are likely to further increase in 1HFY25 given the recent ~50- 100bps increase in bank deposit rates. Consequently, we expect marginal NIM expansion of ~5-10bps in FY25ii for even fixed rate lending NBFCs under our coverage, given the divergent COF and yield trajectories (competition, yields on new businesses, asset mix change). Forecast flat to 30bps NIM compression for MMFS/Fusion/BAF, ~10bps NIM expansion for CIFC/SHFL and 120bps NIM expansion for LTFH (100% retail). This would be in contrast to 5-20bps of NIM compression for large Pvt/PSU banks (except HDFCB).

COF set to rise 10-25bps in 2HFY24…

Based on our analysis of NBFCs' funding mix and maturity pattern, we expect COF for NBFCs to rise 10-25bps from 2QFY24 levels. This will be due to: 1) Likely ~25bps increase in bank funding cost, after the 25% points increase in risk weights for bank lending to NBFCs. 2) Incremental bond repricing happening at 70-170bps higher cost. 3) Pass-through of 10bps increase in MCLR rates over the last three months.

Figure 29: NBFC's COF to rise by 10-25bps in H2FY24



Source: Bloomberg professional, Company, IIFL Research

Banks expected to increase lending rates for NBFCs by ~25bps, due to increase in risk weights

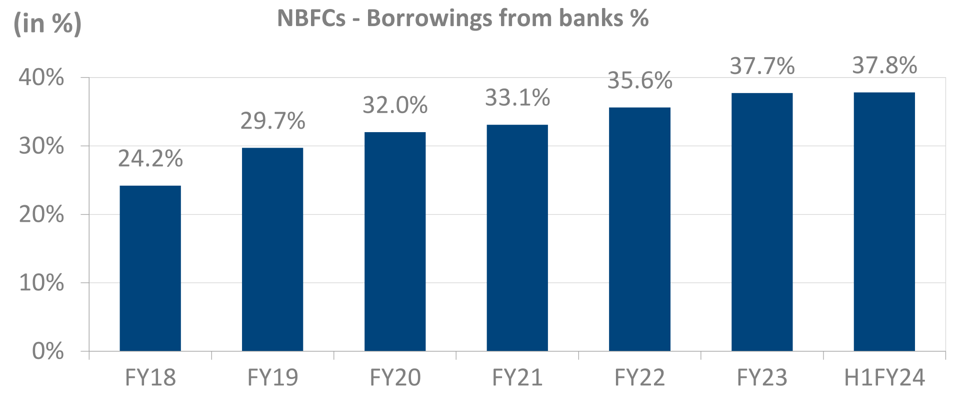
RBI has increased risk weights on bank lending to NBFCs by 25% pts (for A and above rated NBFCs), so as to reduce the interconnectedness between banks and NBFCs. Indeed, NBFC's reliance on bank funding post IL&FS, constituting 38% of their total borrowings (Sep'23) vs 24% in FY18. Our analysis and discussions with NBFCs indicate that while the discussions on revising lending rates are ongoing with the banks, one can expect ~20-30bps increase in bank lending rates (on entire stock) of bank funding, given the sharp increase in risk weights. This may reflect in 4QFY24 for NBFCs.

Figure 30: RBI has increased risk weights on bank lending to NBFCs

Risk weights	Current	New	Remarks
Bank lending to NBFCs	Credit rating based	25% increase if <100% currently	Excluding PSL eligible lending
AAA rated	20%	45.00%	25% pts increase
AA rated	30%	55.00%	25% pts increase
A rated	50%	75.00%	25% pts increase
BBB & below	100% to 150%	100% to 150%	No change

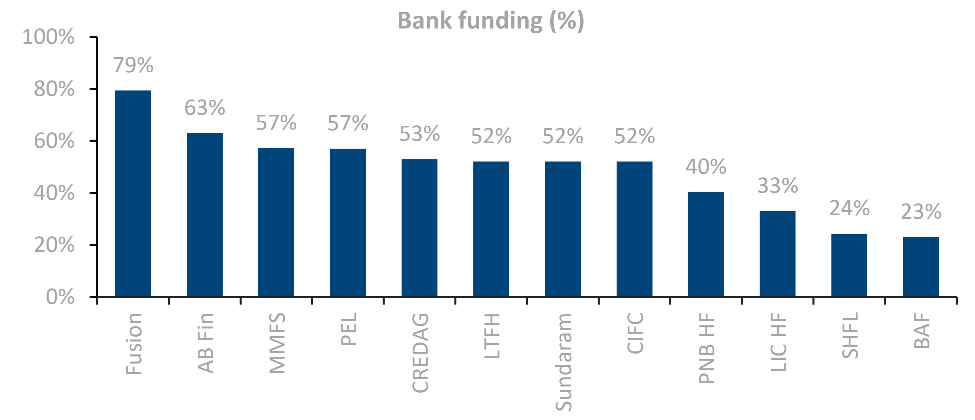
Source: RBI, IIFL Research

Figure 31: Banks percentage as share of borrowings has increased post IL&FS



Source: RBI, IIFL Research

Figure 32: 50-60% funding for mid-to-large NBFCs such as CIFC, LTFH, MMFS, AB Fin is from banks which is likely to experience increase in COF



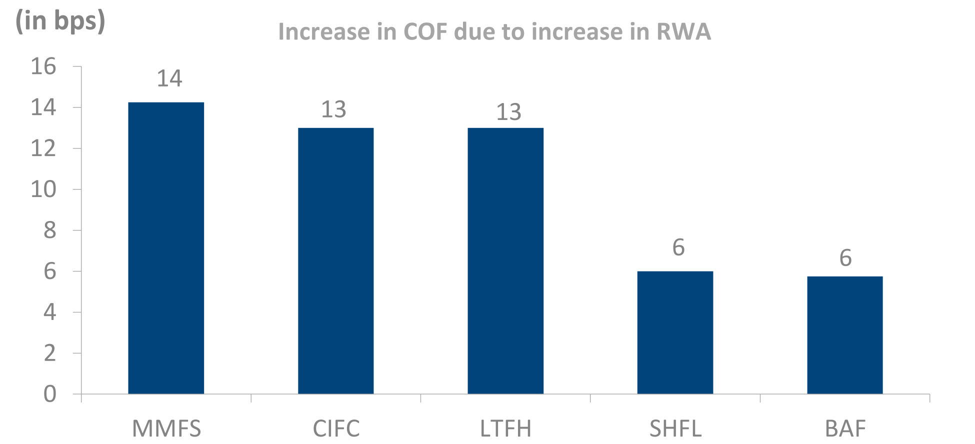
Source: Company, IIFL Research

Further, we also expect NBFCs to increasingly tap the market borrowings route, so as to reduce this reliance on bank funding. However, this can also lead to widening of credit spreads for borrowings by NBFCs in the absence of deepening of corporate bond market (regulatory measures being taken to deepen the market apart from the expectations of increased foreign flows in the market following India's inclusion in the JPM bond index, etc.).

Reliance on bank funding is higher (50-60%) for mid-to large NBFCs such as CIFC, LTFH, PEL, AB Fin but lower for BAF and SHFL (~25%). Out of our coverage, companies such as CIFC, LTFH will be able to increase share of market borrowings due to their parentage and good credit rating, MMFS should also be able to leverage its deposit license and be able to increase its non-bank borrowings. Whereas BAF (standalone) and SHFL have a diversified funding profile with low reliance on bank borrowings.

Our estimates show that if the banks were to raise lending rates by 25bps for NBFCs, it may result in 5-15bps increase in COF in 4QFY24 for NBFCs under our coverage.

Figure 33: Increase in COF for 25bps increase in bank lending rates to NBFCs

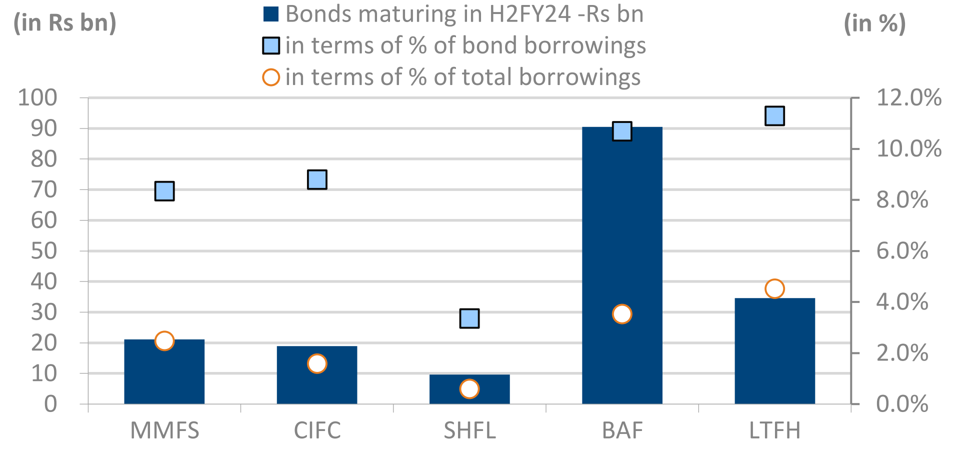


Source: Company, IIFL Research

Bond repricing to happen at 70-170bps higher rates in 2HFY24

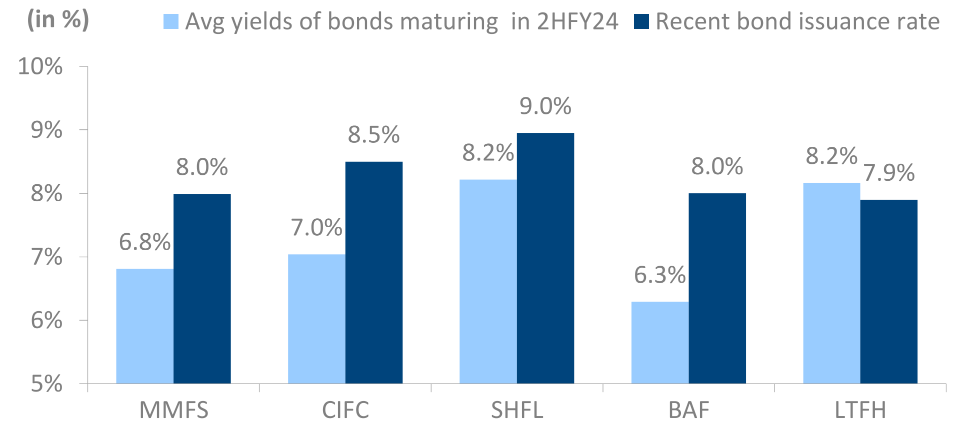
Our bond repricing analysis indicates that bonds coming up for maturity in 2HFY24 are likely to be repriced at 70-170bps higher for NBFCs under our coverage. This repricing hit will be the highest for BAF/CIFC/MMFS given at 170/150/120bps respectively for 8-11% of their bonds outstanding.

Figure 34: In H2FY24, 3-11% of bonds would come up for repricing…



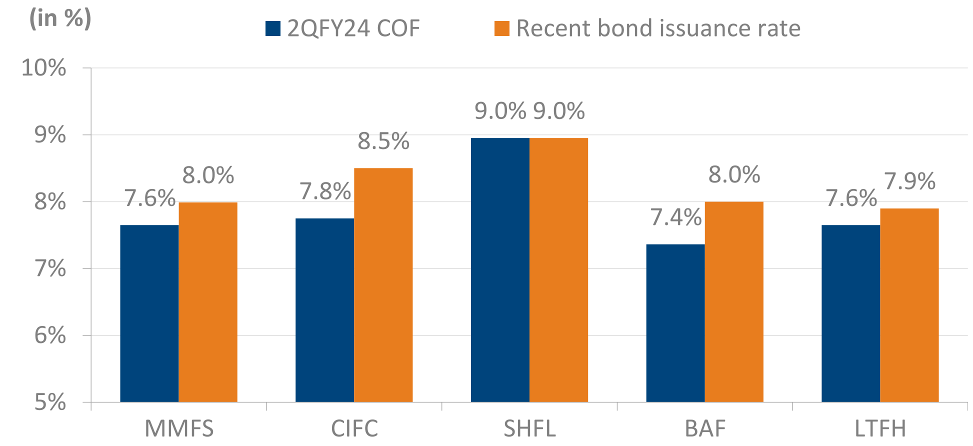
Source: Bloomberg Professional, Company, IIFL Research

Figure 35: …which will be repriced at 70-170bps higher rate (except LTFH)



Source: Bloomberg Professional, Company, IIFL Research

Figure 36: Recent bond issuances are being done at 0-75 bps higher than 2QFY24 COF

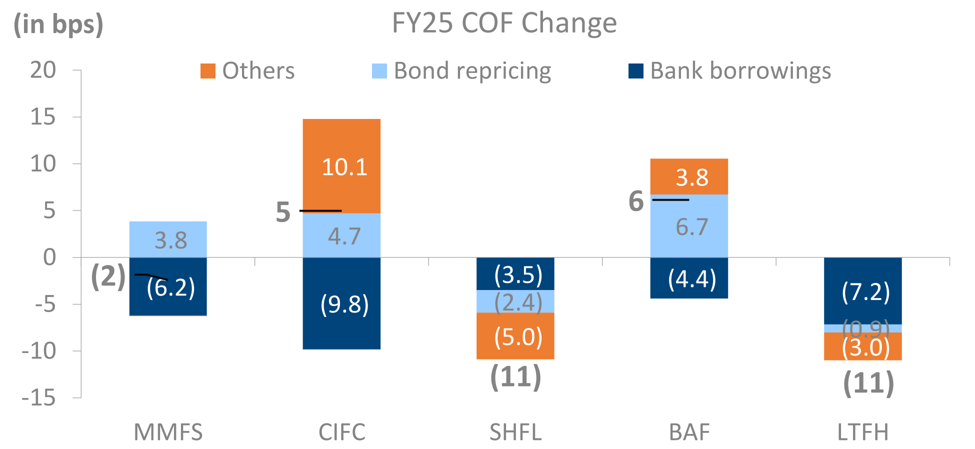


Source: Company, IIFL Research

…and unlikely to moderate meaningfully even after ~50bps of rate cuts in FY25

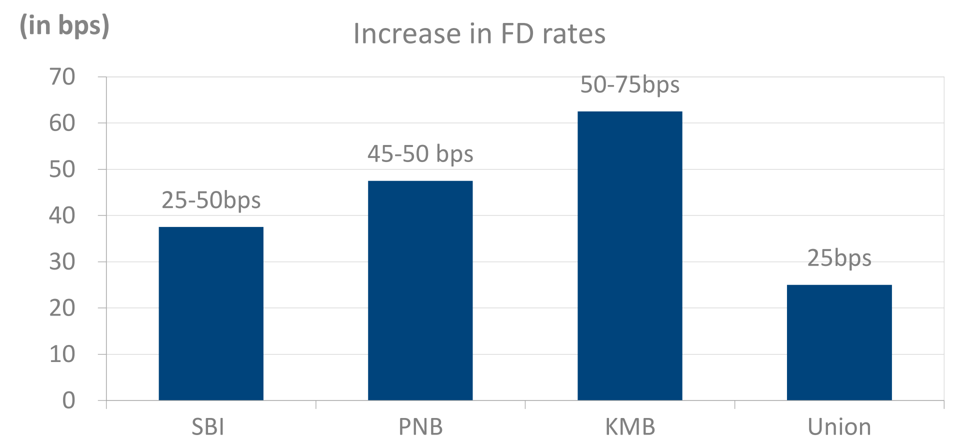
Notwithstanding the expectations of rate cuts in FY25, we highlight that COF for NBFCs are unlikely to moderate materially even if one were to assume a 50bps rate cut in 2HFY25 (equivalent to 25bps rate cut for the full year). This is because: 1) bond repricing would still happen at 75-170bps higher rates (except for LTFH and SHFL), and 2) cost of MCLR-linked bank borrowings are likely to further increase in 1HFY25 as MCLR rates are expected to further increase, considering the recent ~50-75bps increase in bank deposit rates.

Figure 37: COF unlikely to decline materially in FY25ii even after assuming 50bps rate cuts in Sep-24



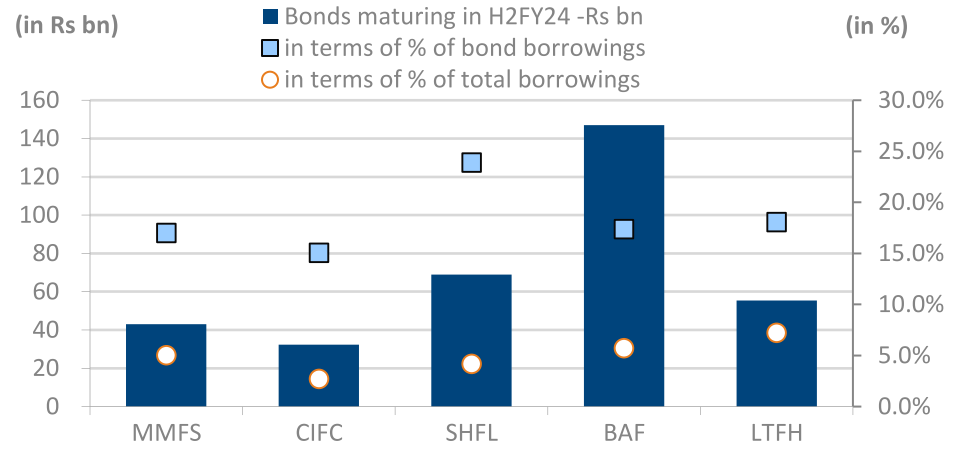
Source: Company, IIFL Research

Figure 38: Bank MCLR rates are likely to increase further with 50-75bps increase in deposit rates over last one month



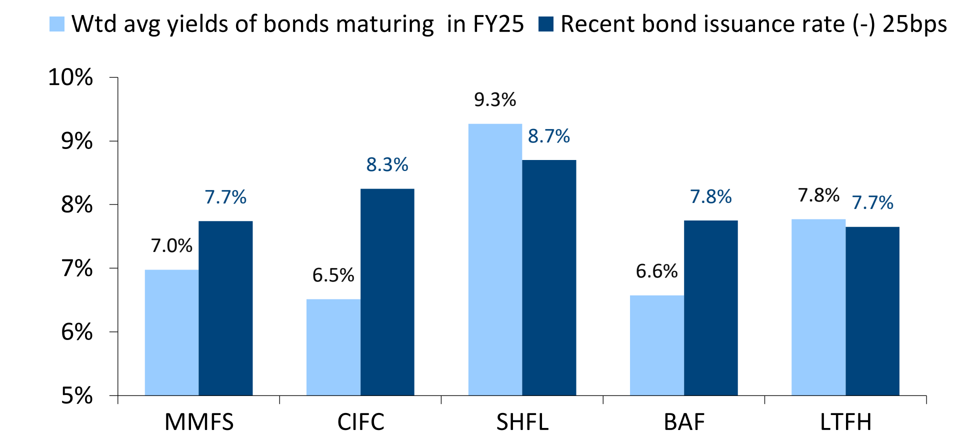
Source: Company, IIFL Research

Figure 39: In FY25, 15-25% of bonds of NBFCs would come up for repricing…



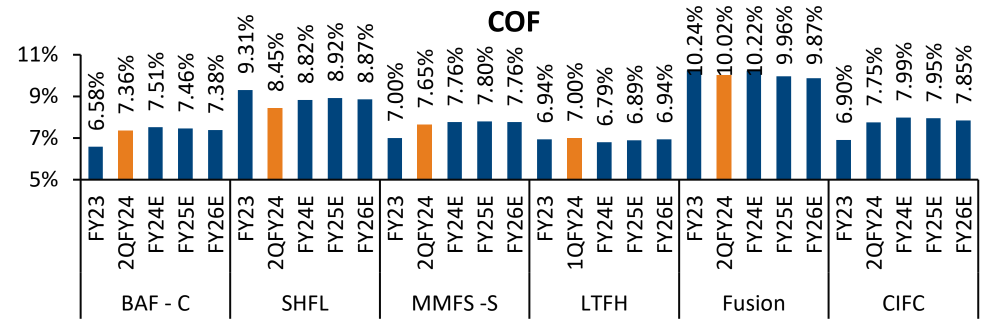
Source: Bloomberg Professional, Company, IIFL Research

Figure 40: …which would be repriced at 75-170bps higher rate even after assuming 50bps cut, save for SHFL and LTFH whose incremental bond issuances are likely to be at 10-60bps lower rates



Source: Company, IIFL Research

Figure 41: Expect COF to inch up in 2HFY24 and marginal ~5-10bps moderation in FY25ii

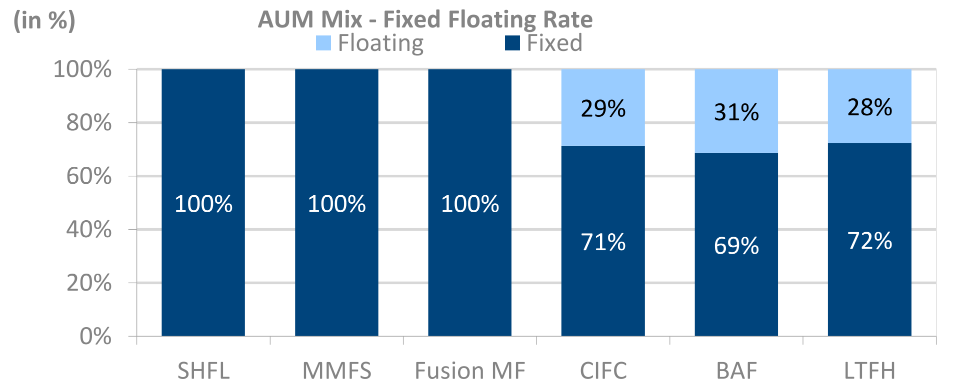


Source: Company, IIFL Research

Marginal NIM expansion of ~5-10bps for even fixed rate lenders in FY25ii

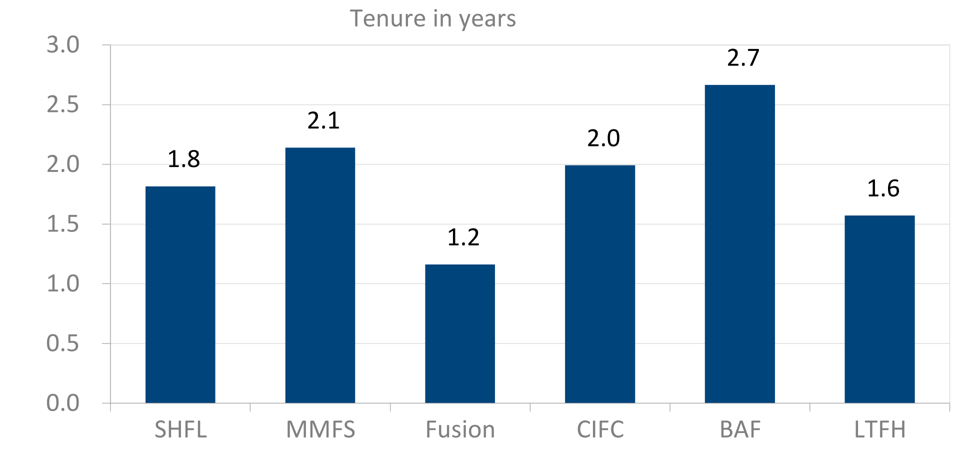
NBFC's yield trajectory would be a function of multiple factors: 1) share of floating loans, 2) loan tenure 3) share of new businesses in overall AUM, 4) market forces (competition) and 5) endowment benefit (equity raise). After accounting for change in asset yields, COF change and benefit of 50bps rate cuts in 2HFY25, we expect divergent NIM outcomes for even fixed rate NBFCs under our coverage in FY25ii. We forecast flat to 30bps compression for MMFS/Fusion/BAF, ~10bps expansion for CIFC/SHFL and 120bps expansion for LTFH (100% retail).

Figure 42: NBFCs: Fixed rate book is 70-100% of its AUM



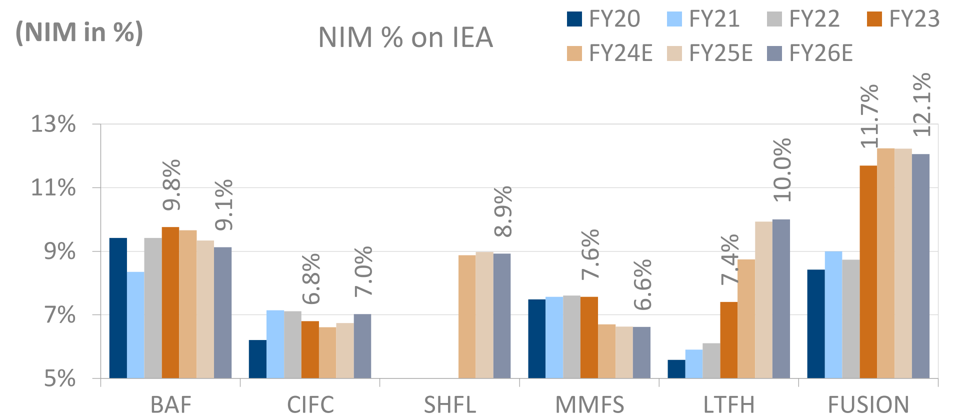
Source: Company, RBI, IIFL Research

Figure 43: NBFCs: Effective loan book tenure



Source: Company, IIFL Research

Figure 44: Expect marginal NIM expansion of 5-10bps in FY25 for fixed rate lenders even after baking in 50bps rate cuts in Sep'24

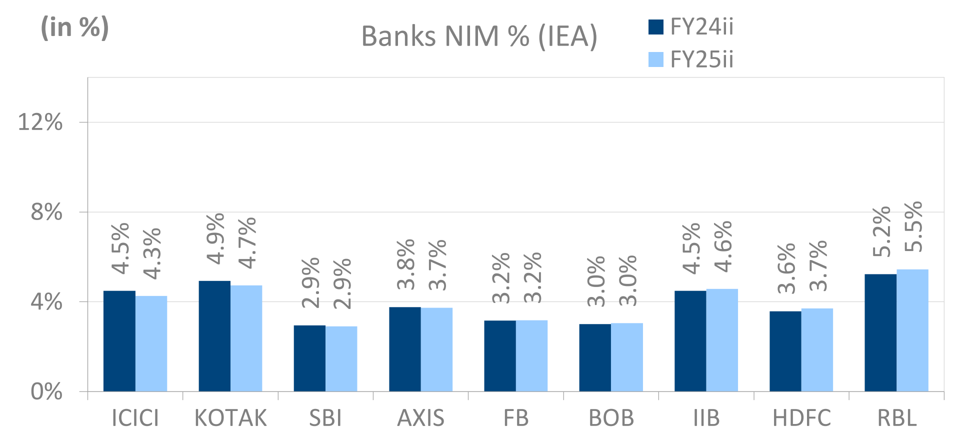


Source: Company, IIFL Research

NIMs: NBFCs to outperform banks in FY25

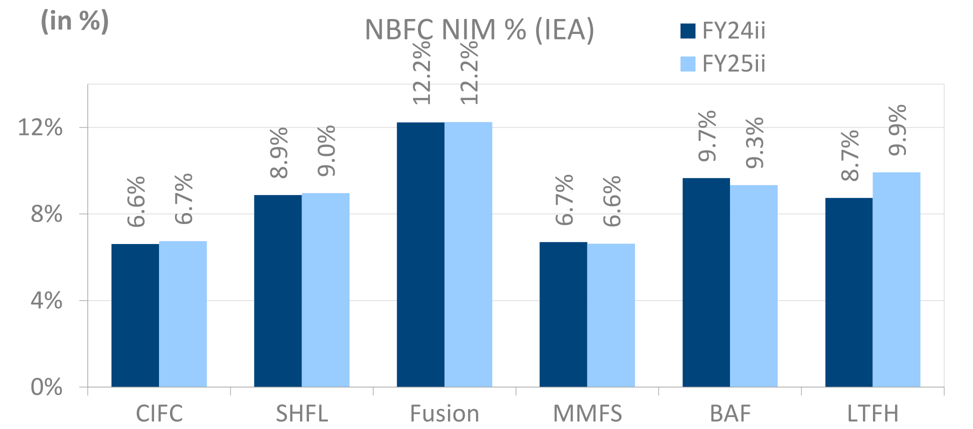
NIMs for fixed rate lenders are likely to witness only marginal expansion of 5-10bps in FY25ii. This would be in contrast to 5-20bps of NIM compression for large Pvt/PSU banks (except HDFC bank).

Figure 45: NIMs for large PSU/Pvt banks to compress by 5-20bps in FY25ii…



Source: Company, IIFL Research

Figure 46: …and would be in contrast to 5-10bps expansion for NBFCs with fixed rate book



Source: Company, IIFL Research

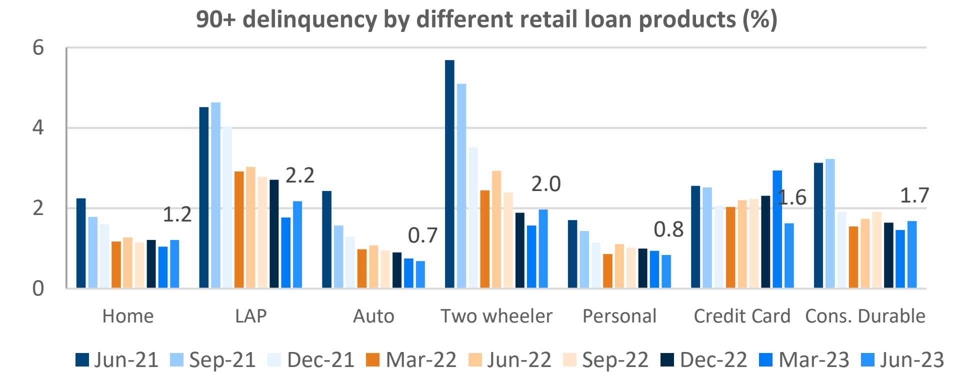
Credit costs to increase by 20-40bps with rising delinquencies in STPL, credit cards and MFI

While the AQ stress in small ticket PL (STPL) is well known, we are also seeing signs of rising delinquencies in other unsecured loans such as credit cards and MFI. The 30/90 DPD on STPL (<Rs25k ATS) is 5-8x higher than larger ticket PL at 16.6%/10.4%. With Fintechs originating a majority of these STPL loans, their NPAs are 2-4x that for traditional lenders. Lenders such as AB Cap, SHFL, PEL, CIFC and IDFCB have 0.3-4.5% exposure to these STPL/Fintech loans. Credit card delinquencies have increased 10-100bps QoQ in 2QFY24 (RBL, SBI cards). Whereas, MFI state level delinquencies have inched up by 10-90 bps QoQ in MP/RJ/PB/UK/HR (14.6% of industry AUM) in 1QFY24. Consequently, MFIs reported 50-60bps QoQ increase in slippages (ann.) in 2QFY24. NBFCs under our coverage have minimal exposure to STPL but MFI constitutes 28% of AUM for LTFH. We expect credit costs to increase by 20-40bps over FY24-26ii from FY23 levels for NBFCs under our coverage, reflecting changing book mix and rising stress in unsecured loans.

AQ stress in small ticket PL and rising delinquencies in credit cards and MFI

Unsurprisingly, the 90+ delinquency across retail products is showing an improving trend over the last two years, as collection efficiencies normalised post COVID, save for credit cards where 90+ delinquencies were rising until 4QFY24 before moderating in 1QFY24. However, we note that early delinquencies (30+ DPD) are increasing in credit cards for the industry and is also evident in segmental numbers disclosed by RBL and SBI Cards.

Figure 47: 90+ DPD improving across retail products, except for credit cards where 90+ was rising until 4QFY24 before moderating in 1QFY24



Source: Company, IIFL Research

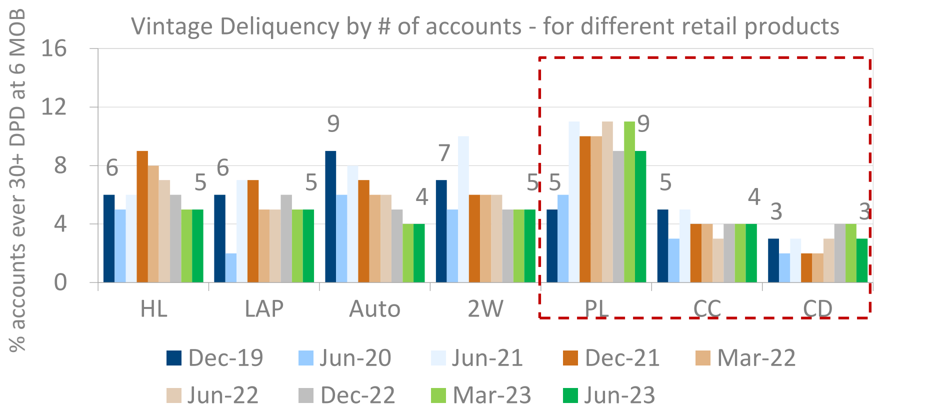
For credit cards, early delinquencies (30+DPD) increased 60bps QoQ in 1QFY24. Further, credit card segmental data for RBL and SBI cards indicate delinquencies inching up another 10-100bps QoQ in 2QFY24.

Figure 48: Credit card early delinquencies (30+ DPD) increased 60bps in 1QFY24 for the industry and trends from RBL and SBI Cards showing further 10-100bps increase in delinquencies in 2QFY24

Source: Company, IIFL Research

But more importantly, vintage delinquency analysis (by number of accounts) shows that early delinquency trends are still stable-to-rising for unsecured loans vis-à-vis improvement witnessed in other secured retail loan products. For PLs, 9% of accounts have crossed 30+ DPD after being six months-on-book (MOB) vs 5% pre-COVID and 4-5% of accounts for other retail loan products.

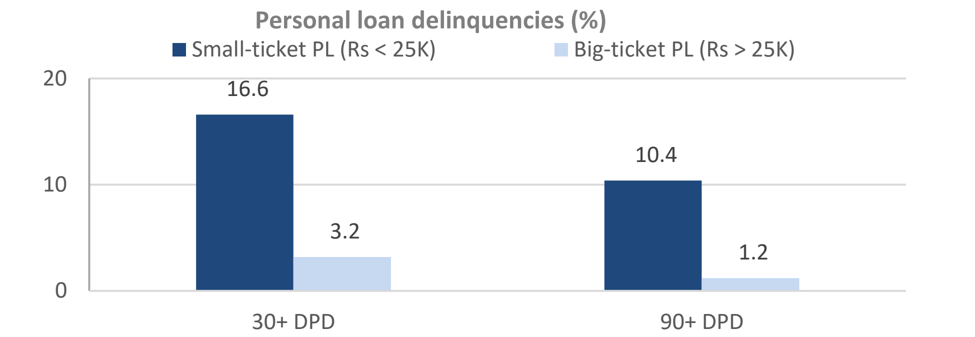
Figure 49: Vintage delinquency improving for all retail loan products, barring unsecured loans where it is stable-to-rising



Source: TransUnion CIBIL, Company, IIFL Research

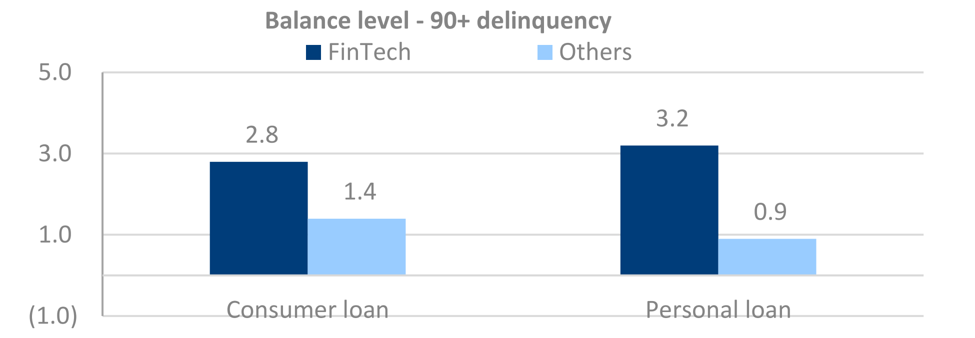
The higher overall delinquency in PL segment is a result of disproportionately higher delinquencies in the STPL segment. Data from credit bureaus demonstrate that 30+/90+ DPD for <Rs25k STPL loans are 5-8x higher than larger ticket PL at 16.6%/10.4% respectively. With Fintechs originating a majority of these STPL loans, their NPAs (90+ DPD) are 2-4x that for traditional lenders, according to data from credit bureaus. This higher delinquency on STPL loans that account for 85% of PL market by volume helps explain the contrast in delinquency trends on value and volume basis.

Figure 50:Small-ticket personal loans have 5-9x higher delinquencies vs big-ticket loans, and is rising



Source: TransUnion CIBIL, IIFL Research

Figure 51: Unsecured loan delinquencies for FinTech lenders are 2-3x vs other lenders

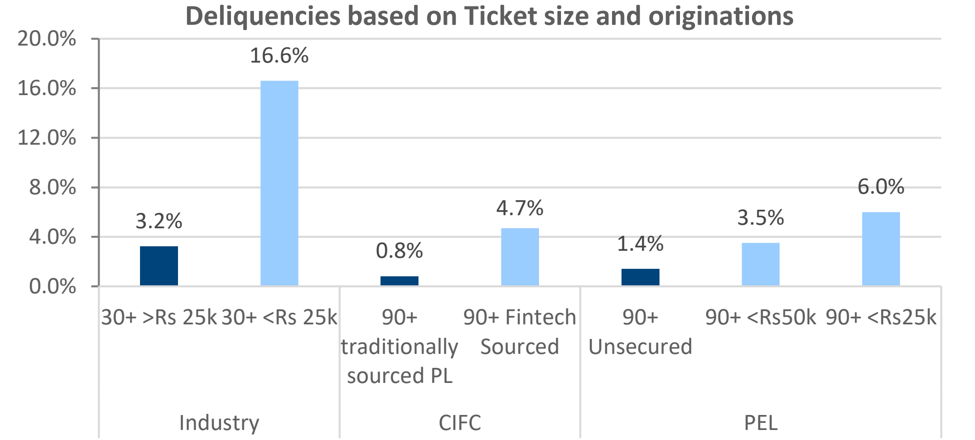


Source: TransUnion CIBIL, IIFL Research

Stress visible for lenders sourcing STPL through FinTechs…

Individual lenders have also called out disproportionately higher NPAs in the small ticket PL segments in their 2QFY24 results. These higher delinquencies have emanated across different lenders that lent such STPL loans in partnerships with FinTechs. Smaller the ATS for such STPL, higher the NPAs, per the management commentary. For instance, PEL's NPAs on <Rs50k/25k PL have been 3.5%/6% compared to 1.4% on its total unsecured loans (MFI, business loans, large ticket PL).

Figure 52: STPL loans and loans sourced through FinTechs have 2.5-6x NPAs vs larger ATS PL and that sourced through traditional channels (DSA + in-house)



Source: Company, IIFL Research

SHFL and AB Cap have the highest exposure to STPL loans (4% / 3% of total loan book) followed by CIFC/PEL/Ponnawala/IDFCB have 5-150bps exposure. Whereas, other lenders have disclosed 'negligible' or 'NIL' exposure to this segment. These STPL loans are source through Fintechs with LTFH/AB Cap/PEL also sourcing >Rs50k ATS PL from Fintechs. SHFL's <Rs50k PL is being sourced internally to its existing 2W customers.

Figure 53: AB Cap/CIFC/PEL/Poonawala/IDFCB have 5-400bps exposure to Fintech sourced, STPL loans. LTFH/AB Cap/PEL also source higher ATS STPL loans from Fintechs

Bank/ NBFC	Loan Book <₹50,000	FinTech Sourced (% of total)	FinTech Sourced (% of PL)	Remarks
AB Capital	3%	4.5%	22.0%	ATS of Rs 33k for entire PL/ CL book.
Chola	1.5%	1.5%	25.0%	ATS sourced though FinTechs: ~₹ 50K vs ATS sourced through traditional ~₹300k
L&T Finance	minimal	4%	42.0%	ATS of overall PL segment is at ~₹ 1.75L
Shriram Fin	4.40%	0%	0%	ATS ~₹40 -70k (Sourced in-house)
Poonawalla	0.02%			ATS of PL segment is >₹ 80K
Piramal	0.72%	5%	41%	ATS of digital loan portfolio is ~Rs50k
HDFC Bank	Negligible			
ICICI Bank	Negligible			
Axis	Negligible			
RBL	Negligible			
IDFCB	0.29%			
SBI	Negligible			
BOB	Negligible			

Source: Company, IIFL Research

2QFY24 management commentaries have called out STPL as a pocket of stress, either at the sector level or for respective exposures. Additionally, SBI cards and RBL bank have also called out rise in early delinquencies in the credit card segment. After 60bps QoQ increase in 30+ DPD in Jun-23, there has been further 10-100bps increase in credit card delinquencies for SBI Cards and RBL's credit card segment.

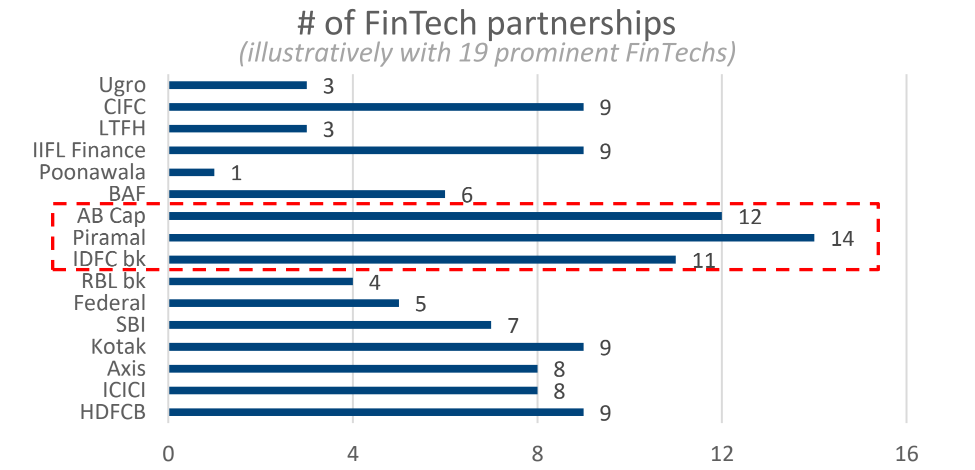
Figure 54: Companies have called out AQ stress in STPL and rising delinquencies in credit cards

Company	Statements
Axis Bank	"...So, 50,000 and below is where we believe there is stress. That portion for us is almost nil..."
ICICI Bank	"...As far as the industry outlook is concerned, I think we have also seen some of the research which has come out, which makes this distinction between the smaller ticket size loans and the larger ticket size loans..."
IndusInd Bank	"...Yes, in the STPL cases, where the ticket sizes are less than 50,000 or 70,000, you are seeing some stress, but not in the other -- other ticket size. On the credit card also, I think there is a 30-plus flow of about 20 basis points to 25 basis points..."
L&T Finance	"...the stress largely exists in the low-ticket personal loans segment which is less than INR50,000 sort of ticket size..."
Poonawalla Fincorp	"...Our loan book of below 50,000 is less than 4 crore... Our average ticket size here is above 80,000..."
SBI Cards	"...The industry data from Credit Bureau too suggests some deterioration and delinquency in credit cards and personal loans... generally there are customers who are under stress, are not able to pay in the -- during the period...
RBL Bank	"...We have seen the extremely lower end of limits ticket sizes being slightly higher stress than general..."
Chola	[NPA on Fintech sourced unsecured book (ATS of ~Rs50k) is 4.7% and that sourced through traditional channels (DSA+ in-house) is 0.82%]
Piramal	[NPA for <Rs50k unsecured loans is 3.5% vs overall unsecured loan NPAs of 1.4%. Whereas, NPAs for <Rs25k unsecured is ~6%]

Source: Company, IIFL Research

Lenders ala Piramal, AB Finance and IDFC FB have far more number of FinTech partnerships (illustratively out of 19 prominent FinTechs) for sourcing unsecured loans. Detailed list of partnership is appended in the Appendix.

Figure 55: Lenders ala Piramal, AB Finance and IDFC FB have higher number of partnerships with the FinTechs

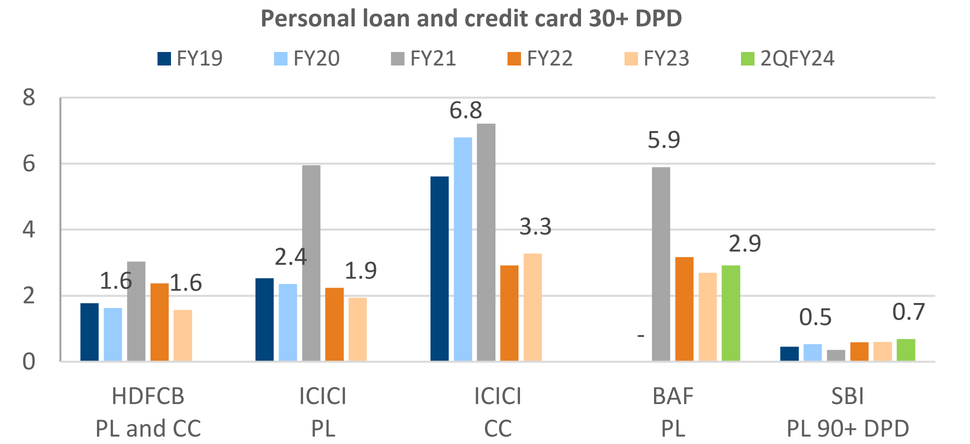


Source: Company, IIFL Research

...whereas lenders with historical track record of PL faring relatively better

We note that unsecured retail loans and more specifically, PL is a legacy segment for most banks (particularly Private and SBI) and BAF. These lenders have demonstrated a superior underwriting track record, which was tested during Covid. This is visible in 30+ PL and CC delinquencies of HDFCB, ICICI, BAF and 90+ DPD for SBI being lower than pre-Covid levels.

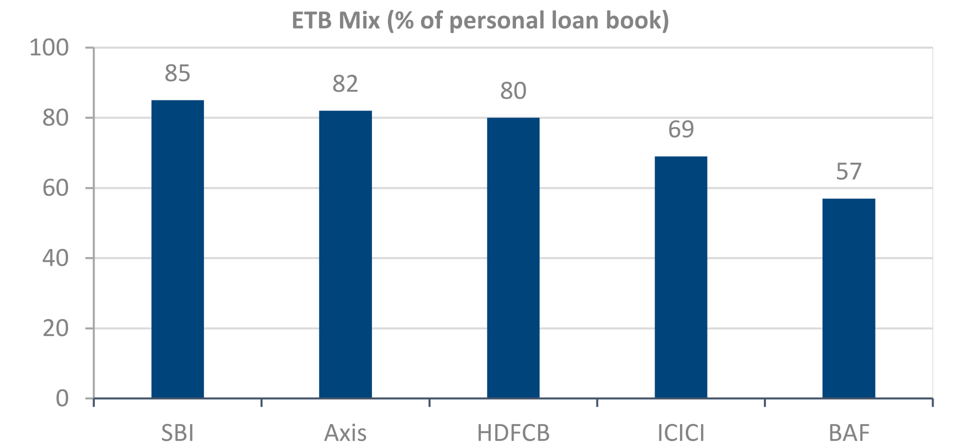
Figure 56: HDFCB, ICICI and BAF's 30+ DPD back to pre-Covid level …



Source: Company, IIFL Research. Note: SBI not directly comparable in the above chart as it is 90+ DPD vs. 30+ DPD for the others

This relatively better AQ outcome is a result of these lenders lending predominantly to existing customers (60-85%).

Figure 57: …mainly due to the focus on existing-to-bank (ETB) customers rather than relying on FinTech originations

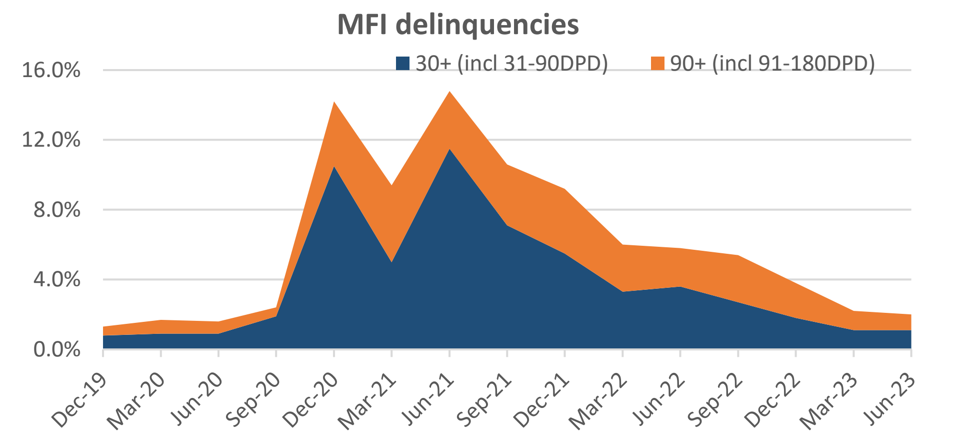


Source: Company, IIFL Research

Signs of rising MFI delinquencies in some states

At the industry level, MFI delinquencies seem to be improving with 30-180DPD delinquencies declining 20bps QoQ in Jun'23 to 2.0%, but are still higher than the pre-Covid range of ~1.5%. However, state-level numbers demonstrate early delinquencies (1-180 DPD) rising ~10bps QoQ in states such as MP and Rajasthan. Whereas, 90+ DPD have risen 10-90bps QoQ in Punjab/UK/HR.

Figure 58: At the industry level, MFI delinquencies improving QoQ



Source: CRIF, IIFL Research

Figure 59: Early delinquencies rising in MP and RJ…

1-180 DPD	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23
BR	9.9%	6.0%	5.3%	4.3%	2.9%	1.8%	1.7%
TN	19.9%	12.9%	9.3%	6.6%	4.5%	3.1%	2.4%
UP	8.4%	4.5%	4.7%	4.4%	3.9%	2.7%	2.7%
KA	11.8%	7.1%	5.6%	4.0%	2.7%	1.5%	1.2%
WB	21.3%	12.7%	14.6%	15.8%	11.0%	5.3%	4.4%
MH	10.8%	7.8%	7.1%	6.9%	4.7%	3.2%	3.1%
MP	13.6%	8.4%	7.9%	8.0%	5.6%	4.0%	4.1%
OR	11.2%	7.1%	6.1%	6.2%	4.9%	3.4%	3.0%
RJ	13.2%	8.4%	7.7%	7.4%	5.6%	4.4%	4.5%
KL	26.9%	15.6%	10.9%	9.7%	6.1%	3.3%	3.2%

Source: CRIF, IIFL Research

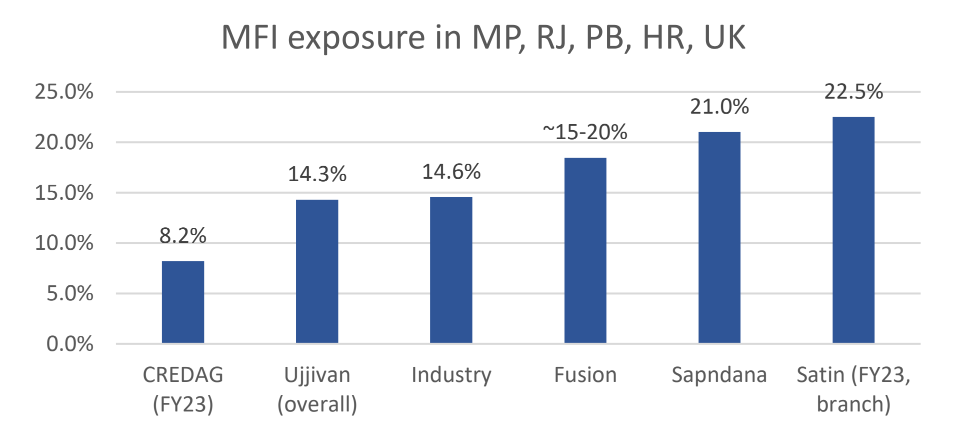
Figure 60: …and 90+ delinquencies increasing 10-90bps QoQ in PB/UK/HR/SK

Statewise 90+ DPD	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23
JK	0.5%	0.3%	0.5%	0.3%	0.5%	0.2%	0.1%
HP	0.7%	0.7%	0.5%	0.5%	0.4%	0.4%	0.4%
PB	6.1%	2.9%	2.3%	1.6%	2.3%	1.2%	2.1%
UK	2.9%	1.8%	1.9%	2.8%	2.2%	0.9%	1.1%
HR	3.4%	1.8%	1.8%	4.2%	2.4%	1.2%	1.3%
RJ	3.4%	2.7%	2.3%	2.6%	2.0%	1.4%	1.3%
UP	2.1%	1.3%	1.1%	1.3%	1.2%	0.6%	0.6%
BR	2.7%	1.7%	1.2%	1.4%	1.1%	0.6%	0.4%
WB	7.5%	4.2%	3.3%	5.4%	4.8%	1.9%	1.4%
SK	3.4%	2.5%	2.3%	5.7%	3.4%	1.2%	1.3%
GJ	2.3%	2.3%	2.0%	2.6%	1.7%	1.3%	1.3%
MP	3.3%	3.2%	2.5%	3.0%	2.3%	1.4%	1.4%
CG	2.9%	3.4%	2.3%	3.0%	2.3%	1.2%	1.1%
JH	3.0%	2.1%	1.7%	1.5%	1.3%	0.8%	0.6%
OD	3.0%	2.9%	2.1%	2.5%	2.0%	1.4%	1.1%
MH	3.1%	2.9%	2.2%	2.6%	1.8%	1.1%	1.0%
GOA	2.9%	2.3%	2.3%	3.2%	2.0%	1.0%	0.6%
KL	3.5%	4.4%	3.2%	3.0%	2.1%	1.0%	0.8%
KA	2.1%	5.0%	1.6%	1.3%	1.4%	0.9%	0.5%
TN	4.0%	2.8%	3.8%	4.0%	2.6%	1.2%	0.8%
AR	1.1%	0.7%	2.8%	1.7%	1.4%	0.7%	0.5%
NA	3.7%	3.2%	3.1%	10.6%	5.0%	0.8%	0.8%
MA	3.1%	1.3%	2.4%	2.4%	1.2%	0.4%	0.4%
MZ	5.9%	3.0%	2.5%	2.7%	1.9%	0.5%	0.4%

Source: CRIF, IIFL Research

MP and RJ are the larger amongst the 5 states (MP, RJ, PB, UK and HR) witnessing higher delinquencies in Jun-23 and account for 10.5% of MFI industry AUM. The aforementioned 5 states have an average 90+ delinquency rate of 1.4% vs 0.9% for the industry as on June'23. Due to unseasonal rains and floods in these states in Q2 collection efficiencies too would have declined and could lead to some additional stress in the near term.

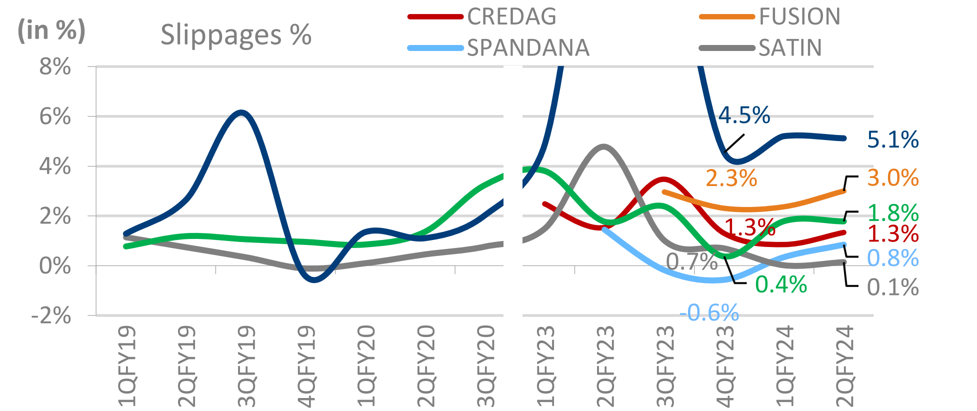
Figure 61: MFI players like Fusion, Spandana and Satin have higher exposure in rain-affected states and could witness higher impact



Source: MFIN, Company, IIFL Research

Further, we note that slippages for individual MFIs bottomed out in 4QFY23 and since then it has been inching up. Even in 2QFY24, slippages increased ~50-60bps (ann.) sequentially for CREDAG/Fusion/Spandana.

Figure 62: Slippages rising after bottoming out in Mar-23; increased ~50-60bps QoQ in 2QFY24

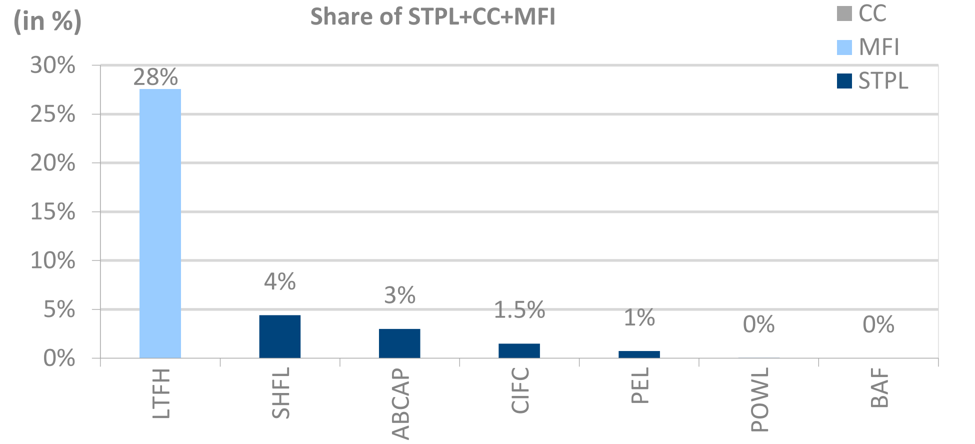


Source: Company, IIFL Research

Expect credit costs to increase 20-40bps from FY23 levels

NBFCs under our coverage have minimal exposure to STPL, where the AQ stress is acute. Whereas, MFI where delinquencies are rising, constitute 0-28% of loans (Fusion: 100% being an NBFC-MFI). As unsecured consumer lending growth slows down, we also expect some incremental AQ stress to come to the fore.

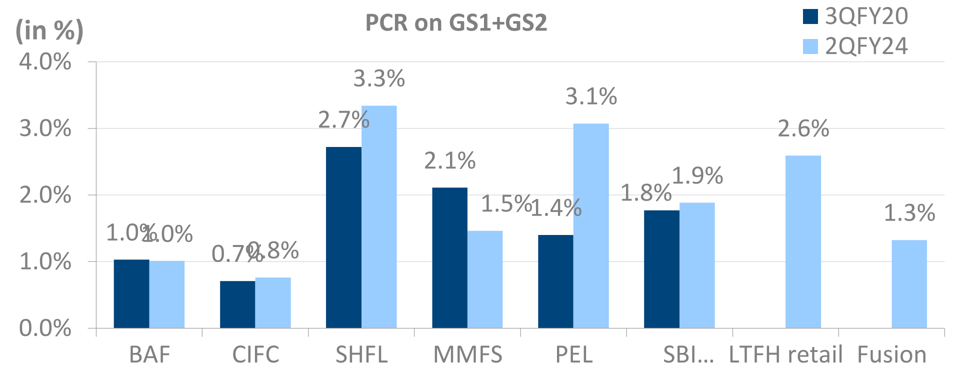
Figure 63: NBFCs under our coverage have negligible exposure to STPL and 0-28% to MFI



Source: Company, IIFL Research

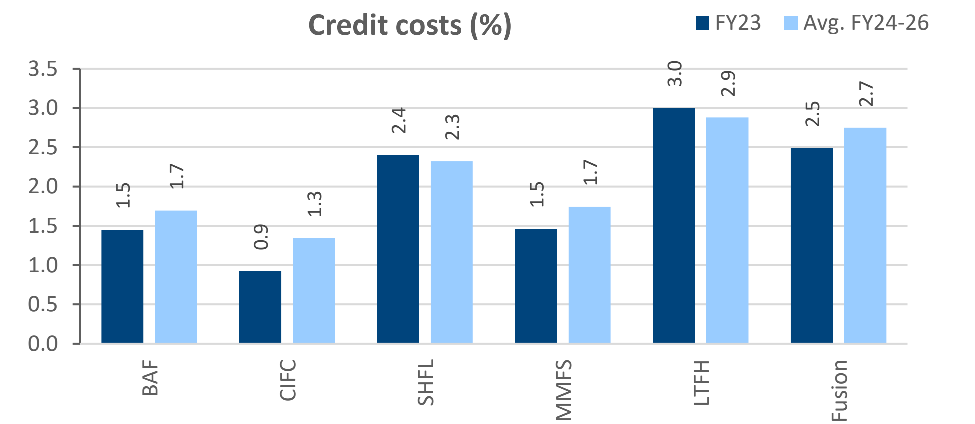
Consequently, we expect 20-40 bps increase in credit costs over FY24-26ii for NBFCs under our coverage from FY23 levels. This compares with 10-30bps moderation in credit costs for HDFC/ICICI/IIB and 5-30bps increase for SBI/BOB/Axis/Kotak from FY23 levels. We note that NBFCs also have 10-160bps higher stage 1 & 2 PCR (except MMFS who has reduced coverage by 60bps) vs pre-Covid levels, which should help them manage AQ stress in STPL and rising delinquencies in MFI.

Figure 64:...NBFCs have increase stage 1/2 PCR by 10-160bps from pre-Covid levels



Source: Company, IIFL Research

Figure 65: We expect average credit costs for lenders under over coverage to increase 10-40 bps from FY23 levels



Source: Company, IIFL Research

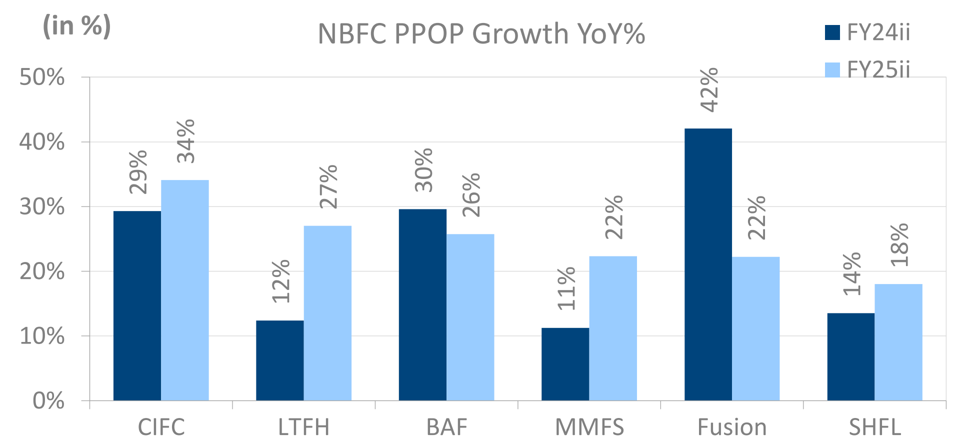
Large NBFCs at attractive valuations for superior earnings growth profile

Notwithstanding the growth moderation in FY25ii, we expect large NBFCs under our coverage to deliver earnings growth of 10-30% in FY25ii, compared to 0-20% for large Private and PSU banks (except HDFC). This is even as these NBFCs are trading near their LTA multiples. Our preferred picks BAF and CIFC may appear expensive on an absolute basis, but are reasonably valued adjusted for superior profitability and growth (0.7x-1.1x PEG).

Better earnings growth trajectory for large NBFCs under our coverage vs banks...

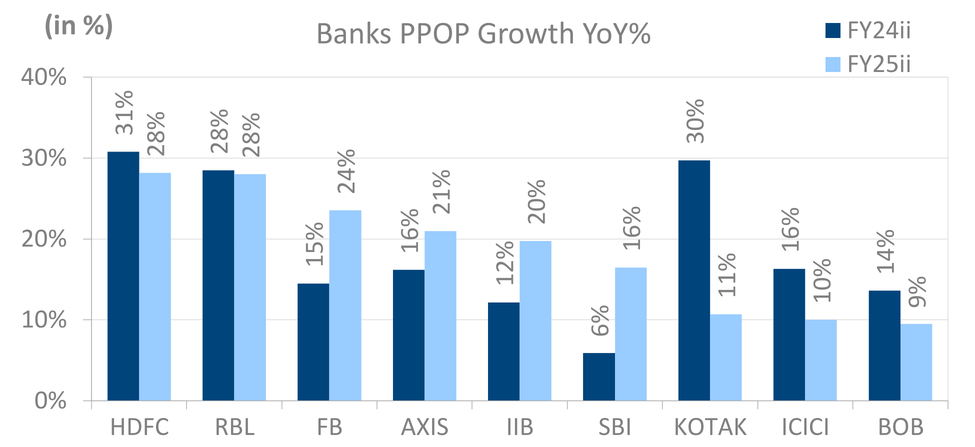
While we note the growth moderation for NBFCs in FY25ii, large NBFCs will still be growing their loan book at 1.5-2x the banking system credit growth. Thus, while banks are likely to report PPOP growth of 10-20% except HDFC bank, large NBFCs are likely to deliver 20-35% PPOP growth in FY25ii.

Figure 66: Large NBFCs are expected to deliver 20-35% YoY PPOP growth in FY25ii…



Source: Company, IIFL Research

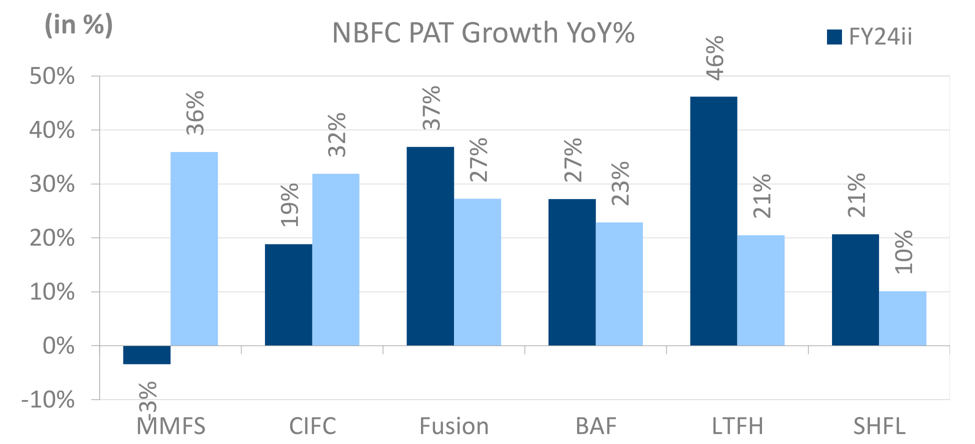
Figure 67: …compared to 10-20% YoY for large Private and PSU banks in FY25ii, save for HDFCB



Source: Company, IIFL Research

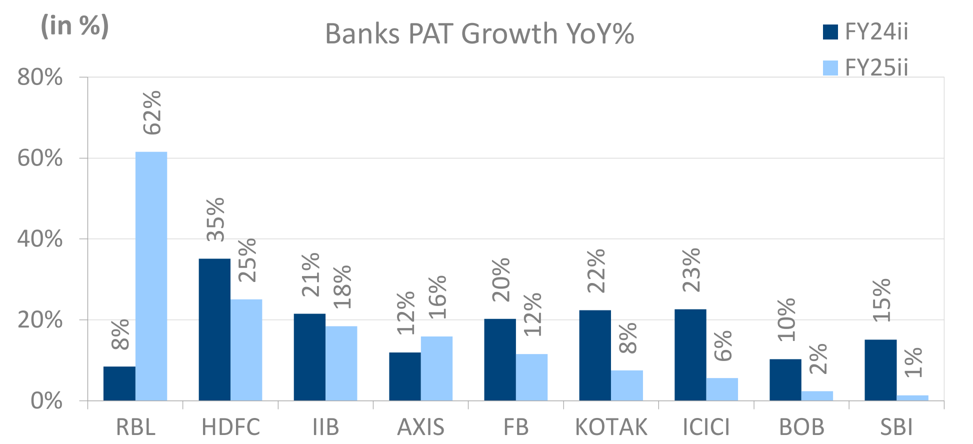
Similarly, large NBFCs are expected to deliver earnings growth of 10-30% YoY in FY25ii vs 0-20% for large Private and PSU banks, except HDFC bank.

Figure 68: Earnings growth for large NBFCs likely to be 10-30% YoY in FY25ii…



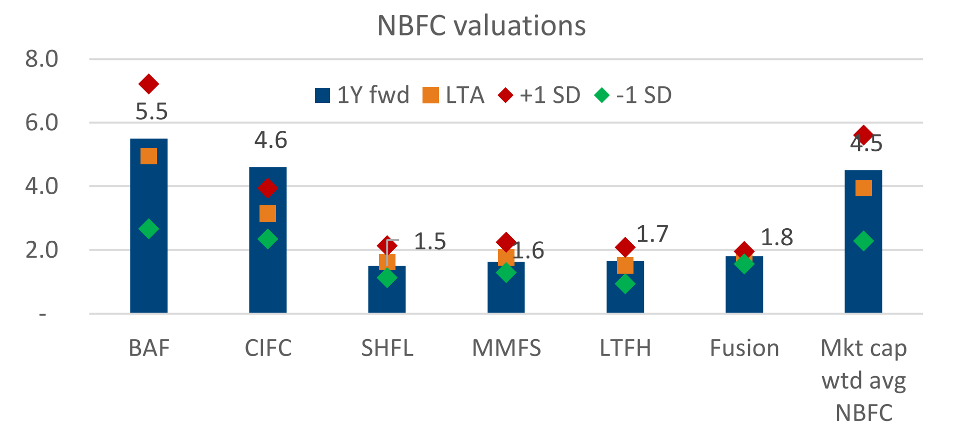
Source: Company, IIFL Research

Figure 69: **...compared to 0-20% for large Private and PSU banks, except HDFC bank**



Source: Company, IIFL Research

Figure 70: NBFCs broadly trading in line with their LTA for 5-10% pts higher AUM growth

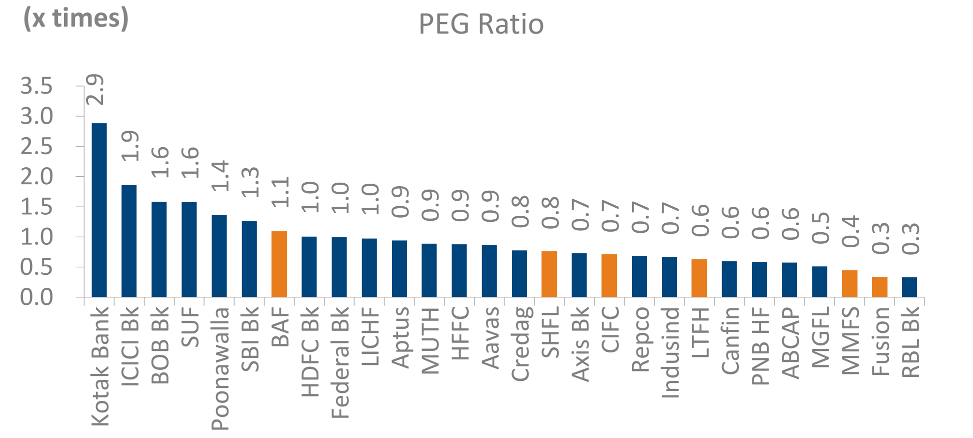


Source: Company, IIFL Research

...for valuations that are in line with LTA

We note that NBFCs are broadly trading near to their long-term average multiples (1YF P/B) for 5-10% points higher growth, compared to their LTA. While on an absolute basis (P/B or P/E), NBFCs such as BAF and CIFC may appear expensive, we believe that they are reasonably valued, adjusted for superior profitability and growth (PEG of 0.7x-1.1x). We prefer BAF, CIFC and SHFL amongst NBFCs and remain cautious on MMFS.

Figure 71: BAF/CIFC: Valuations adj. for growth and profitability appear reasonable

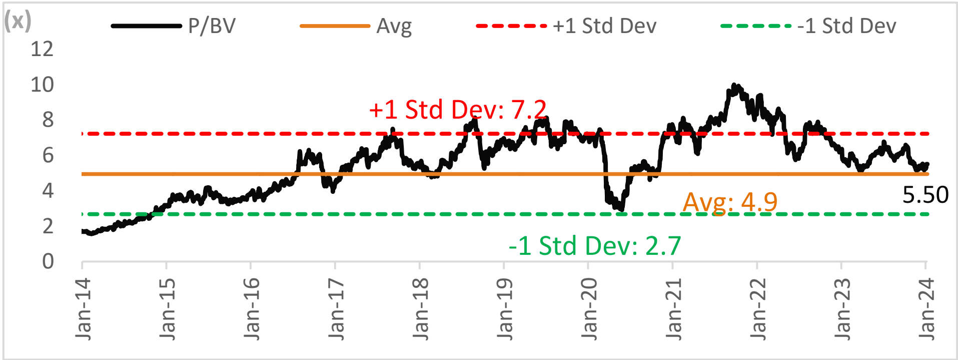


Source: FY25PE/ Earnings growth CAGR over FY24-FY26; Bloomberg Professional, IIFL Research

BAF: Top BUY idea for 2024

- We expect a bit of growth moderation for BAF after the RWA increase. But, it will still be able to grow at 2x the system credit growth (27% Cagr) led by: (1) Expansion into new segments ($450bn market). (2) Distribution expansion for the existing products as it increases geographic product penetration (currently 3% of BAF's locations offer >80% of its products). (3) Benefit from vintage maturity of locations (60% locations have <5Y vintage). (4) Higher ATS of the new segments. Recent regulatory actions are unlikely to have material near-term financial impact (two digital products: 8-10% of disbursements by volume and RBL co-branded card partnership: ~3% of PBT).
- BAF was one of the early adaptors of new tech, enabling it to grow at scale. Its high-profit pool, agility and ability to implement at scale makes it a partner of choice for global tech companies. It is now adopting Gen-AI at scale (developing all-AI call centres) and is also integrating GPT co-pilots into its operations for productivity gains, which would help BAF deliver non-linear growth and we expect C/I to moderate by 250bps to 31.5% by FY26.
- After the recent underperformance, BAF is trading near its LTA of 5.5X 1YF P/B. Management expects the EMI card embargo to be resolved over next few months, which will be a key catalyst. Recommend BUY with TP of Rs9,300 (5.2X FY26 P/B) for 22% ROEs and 24% earnings Cagr.

Figure 72: BAF 1YF P/B (update)

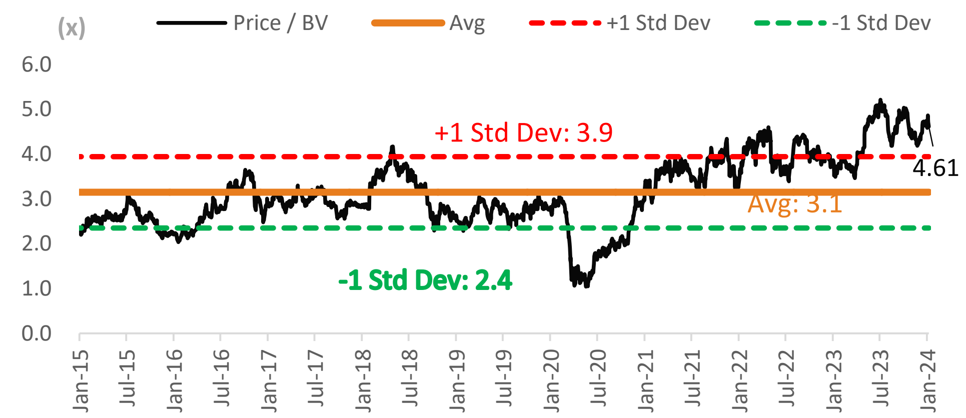


Source: Bloomberg Professional, IIFL Research

CIFC: Superior growth and profitability profile to sustain premium valuations

- CIFC is set to deliver higher growth (27%/30% AUM/earnings Cagr vs LTA of 19%/24%) led by renewed focus in HL and LAP (distribution expansion) and foray into new segments (MSME, PL); which are ROA accretive on steady state basis.
- Like for other NBFCs, CIFC's COF is unlikely to materially decline in FY25. But, we expect NIMs to bottom out in 4QFY24 and recover from there on as: share of higher rate VF book increases, 30bps rate hike of July starts reflecting and share of higher-yielding new businesses increase. Consequently, we expect the overall NIMs to expand ~10bps in FY25ii and another 30bps aided by equity conversion of Rs20bn CCDs.
- While the absolute valuations are rich at 4.7X 1YF P/B, those are reasonable at 0.7x PEG adj., for superior profitability and growth. Retain BUY with TP of Rs1,450 for 21% ROEs and 28% EPS Cagr.

Figure 73: CIFC valuations 1YF P/B

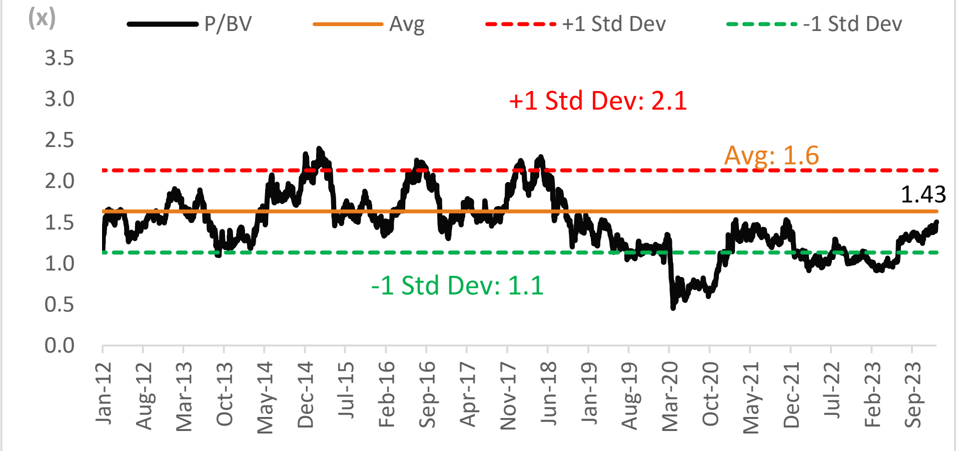


Source: Bloomberg Professional, IIFL Research

SHFL: Beneficiary of margin tailwinds at undemanding valuations

- STFC-SCUF merger has helped SHFL become a more diversified VF lender (non-VF 17% of AUM) and also accelerated its growth profile from ~11% to high teens. We expect SHFL to deliver 16% AUM Cagr led by distribution expansion for SCUF's consumer loans as it cross sells SCUF loans from SHFL branches (3x vs SCUF).
- SHFL should see margins expanding 10bps in FY25ii, led by moderating COF and rising share of higher yielding SCUF segments.
- SHFL is trading at undemanding valuations of 1.5x 1YF P/B for 15.5% ROEs and earnings growth of 14% Cagr.

Figure 74: SHFL valuations 1YF P/B

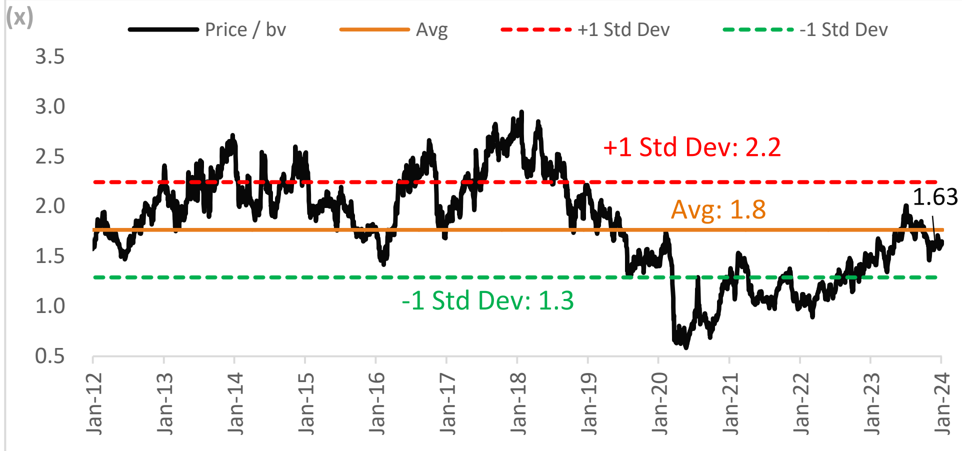


Source: Bloomberg Professional, IIFL Research

MMFS: Growth slowdown with subdued sustainable profitability

- Growth moderating. VF growth is moderating off a high base and is expected to remain subdued in FY25ii. Also, the planned scale up of its non-VF book is constrained (7% of book vs 15% target) due to the margin dilutive nature of the book. Consequently, AUM growth is expected to moderate to 17% in FY25ii from 25% currently.
- Margins unlikely to improve materially. Apart from the yield pressure from new businesses, MMFS's COF is set to rise by 25bps in 2HFY24 and unlikely to moderate in FY25ii despite building 50bps rate cuts given that repricing will happen at ~70bps higher rates.
- We reiterate our cautious stance on weaker sustainable profitability of 2.1% ROAs and 14% ROEs even by FY26ii.

Figure 75: MMFS valuations 1YF P/B

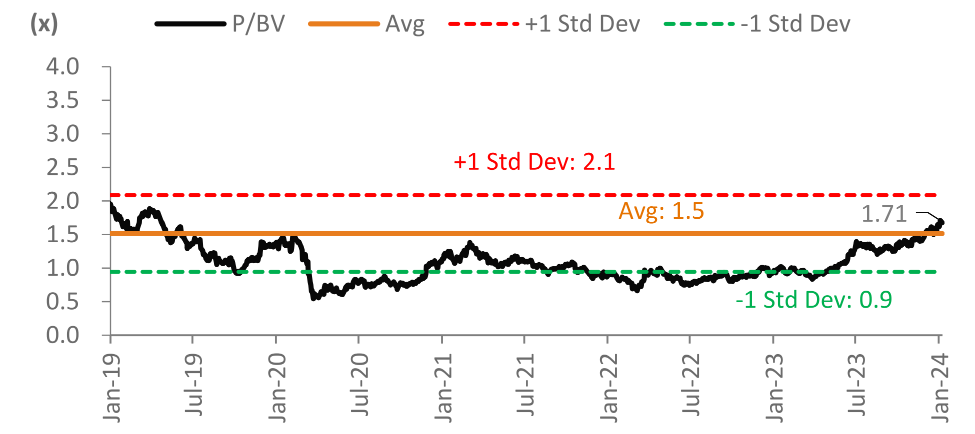


Source: Bloomberg Professional, IIFL Research

LTFH: Retailisation on track, rising share of unsecured loans a monitorable

- LTFH is fast executing on its retailisation strategy with the company likely to become a 100% retail lender by FY25. While retail loan book is scaling up, it is primarily being led by unsecured loans (MFI, 2W, PL) with the latter's share increasing 750bps over the last two years to 55% of retail loans.
- LTFH's profitability is improving in-tandem with retailisation, with the company expected to report ~3% ROAs (on total assets) by FY26. However, ROEs will remain constrained at ~14% by FY26, due to excess capitalisation even after 50% payout over the next two years (~3%+ dividend yield).
- After xx% stock returns over the last six months, LTFH is now trading at 1.7x P/B FY25 – ~10% premium to its LTA. Rising share of unsecured loans (MFI, 2W and PL) and declining collection efficiencies in 2W and PL YoY are a monitorable for us, since 40% of PL is being sourced through e-aggregators (ATS: Rs172k). Retain ADD with revised TP of Rs170, implying 1.7x FY25 P/B for ~14% ROEs and 24% earnings growth.

Figure 76: LTFH valuations 1YF P/B



Source: Bloomberg Professional, IIFL Research

Fusion: Improving profitability and reasonable growth at attractive valuations

- Fusion's recent underperformance can be attributed to higher credit costs and lower collection efficiency (CE) performance relative to its peers. We believe the former to be due to the change in Fusion's write off policy (270DPD from 360DPD earlier and similar to CREDAG's). Lower CE was due to the higher delinquencies in four states contributing ~15% of AUM (sector wide trend), but improving, per the management.
- After transitioning to 270DPD by the end of this fiscal, we expect credit costs and profitability for Fusion to improve in FY25ii with AUM growth/ROAs/ROEs of 24%/5.1%/21% respectively.
- At 1.7x FY25 P/B, Fusion is trading at 50% discount to CREDAG for 8% lower profitability and also 13% discount to Spandana, despite having 400bps higher ROEs. Retain BUY with TP of Rs750.

Figure 77: Fusion is trading at 50% discount to CREDAG for 8% lower profitability and 13% discount to Spandana, despite having 400bps higher ROEs

		MCap	P/B (x)		P/E (x)		ROA (%)		ROE (%)	
	CMP	(Rs bn)	FY24	FY25	FY24	FY25	FY24	FY25	FY24	FY25
FUSION	610	61.0	2.1	1.7	11.6	9.1	5.0	5.1	20.5	21.1
CREDAG	1,731	275.6	4.3	3.4	19.9	16.2	5.5	5.4	24.0	23.0
SPANDANA	1,212	86.3	2.4	2.0	16.2	12.3	4.7	4.7	15.4	17.0

Source: Bloomberg Professional, Company, IIFL Research

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A graph of daily closing prices of securities is available at http://www.nseindia.com/ChartApp/install/charts/mainpage.jsp, www.bseindia.com and http://economictimes.indiatimes.com/markets/stocks/stock-quotes. (Choose a company from the list on the browser and select the "three years" period in the price chart).

Name, Qualification and Certification of Research Analyst: Viral Shah (CA, CFA), Rikin Shah(CA, CFA), Jai Daxini(Chartered Accountant)

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Stock Broker SEBI Regn.: INZ000164132, PMS SEBI Regn. No. INP000002213, IA SEBI Regn. No. INA000000623, SEBI RA Regn.:- INH000000248

Key to our recommendation structure

BUY - Stock expected to give a return 10%+ more than average return on a debt instrument over a 1-year horizon.

SELL - Stock expected to give a return 10%+ below the average return on a debt instrument over a 1-year horizon.

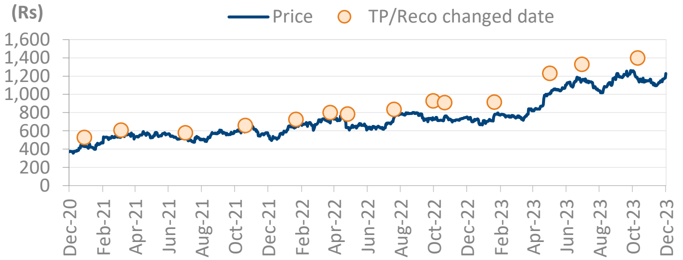
Add - Stock expected to give a return 0-10% over the average return on a debt instrument over a 1-year horizon.

Reduce - Stock expected to give a return 0-10% below the average return on a debt instrument over a 1-year horizon.

Distribution of Ratings: Out of 261 stocks rated in the IIFL coverage universe, 120 have BUY ratings, 5 have SELL ratings, 88 have ADD ratings, 4 have NR ratings and 44 have REDUCE ratings

Price Target: Unless otherwise stated in the text of this report, target prices in this report are based on either a discounted cash flow valuation or comparison of valuation ratios with companies seen by the analyst as comparable or a combination of the two methods. The result of this fundamental valuation is adjusted to reflect the analyst's views on the likely course of investor sentiment. Whichever valuation method is used there is a significant risk that the target price will not be achieved within the expected timeframe. Risk factors include unforeseen changes in competitive pressures or in the level of demand for the company's products. Such demand variations may result from changes in technology, in the overall level of economic activity or, in some cases, in fashion. Valuations may also be affected by changes in taxation, in exchange rates and, in certain industries, in regulations. Investment in overseas markets and instruments such as ADRs can result in increased risk from factors such as exchange rates, exchange controls, taxation, and political and social conditions. This discussion of valuation methods and risk factors is not comprehensive – further information is available upon request.

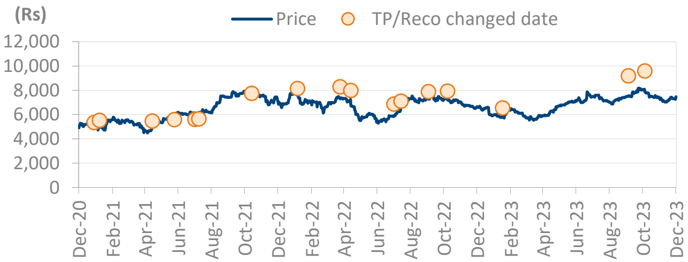
CIFC: 3 year price and rating history



Date	Close price (Rs)	Target price (Rs)	Rating
18 Oct 2023	8093	9600	BUY
18 Sep 2023	7494	9200	BUY
30 Jan 2023	5761	6550	ADD
21 Oct 2022	7432	7930	ADD
16 Sep 2022	7386	7900	ADD
28 Jul 2022	6396	7100	ADD
15 Jul 2022	5879	6860	ADD
27 Apr 2022	7241	8000	ADD
07 Apr 2022	7347	8300	ADD
19 Jan 2022	7744	8150	ADD
27 Oct 2021	7863	7760	ADD
22 Jul 2021	5938	5650	ADD

Date	Close price (Rs)	Target price (Rs)	Rating
15 Jul 2021	6134	5600	ADD
07 Jun 2021	5993	5580	ADD
28 Apr 2021	4873	5470	ADD
21 Jan 2021	4982	5530	ADD
11 Jan 2021	5082	5350	ADD

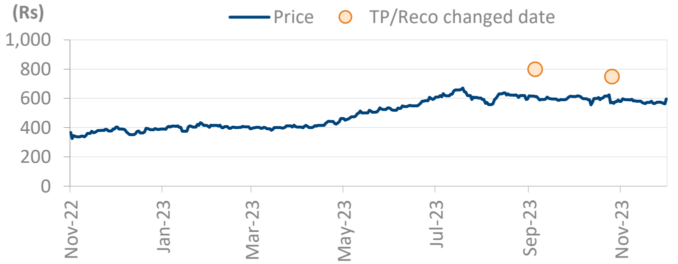
Bajaj Finance: 3 year price and rating history



Date	Close price (Rs)	Target price (Rs)	Rating
23 Oct 2023	1187	1400	BUY
13 Jul 2023	1149	1330	BUY
15 May 2023	1005	1230	BUY
02 Feb 2023	707	915	BUY
03 Nov 2022	710	910	BUY
13 Oct 2022	745	930	BUY
02 Aug 2022	701	835	BUY
09 May 2022	636	785	BUY
07 Apr 2022	703	800	BUY
03 Feb 2022	639	725	BUY
02 Nov 2021	589	660	BUY
15 Jul 2021	513	580	BUY

Date	Close price (Rs)	Target price (Rs)	Rating
19 Mar 2021	528	610	BUY
11 Jan 2021	432	530	BUY

Fusion: 3 year price and rating history

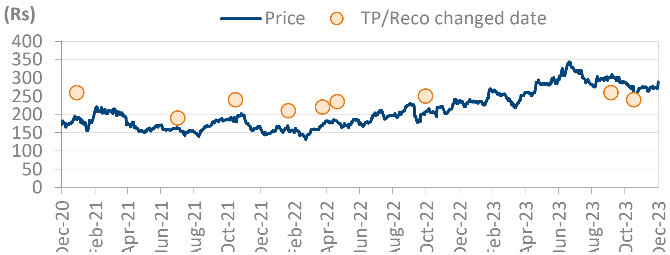


Date	Close price (Rs)	Target price (Rs)	Rating
08 Nov 2023	569	750	BUY
18 Sep 2023	618	800	BUY

L&T Finance: 3 year price and rating history

Date	Close price (Rs)	Target price (Rs)	Rating
25 Oct 2023	133	140	ADD
18 Sep 2023	130	135	ADD

M&M Fin Services: 3 year price and rating history



Date	Close price (Rs)	Target price (Rs)	Rating
30 Oct 2023	277	240	SELL
18 Sep 2023	300	260	SELL
13 Oct 2022	207	250	BUY
04 May 2022	182	235	BUY
07 Apr 2022	169	220	BUY
03 Feb 2022	169	210	BUY
29 Oct 2021	186	240	BUY
15 Jul 2021	163	190	BUY
11 Jan 2021	190	260	BUY

Shriram Transp Fin: 3 year price and rating history

Date	Close price (Rs)	Target price (Rs)	Rating
18 Sep 2023	1915	2250	BUY