AGIC Takeaways – NBFC

BSE SENSEX	S&P CNX
38,365	11,317

Collection efficiency across segments

Segment	Collection Efficiency*
Housing	85-90
Vehicle	80-90
MFI	70-75

*Broad range taken from several companies in the business segment

RoE trend – MOFSL estimates

RoE %	FY20	FY21E	FY22E
ABCL	8.3	7.0	7.9
HDFC	13.1	13.0	12.9
INDOSTAR	-11.4	4.4	5.9
LTFH	15.6	6.7	12.0
MASFIN	19.8	16.0	16.9
MMFS	8.3	6.8	7.0
PIEL	-2.0	5.8	7.0
SHTF	14.9	9.2	12.9

Improving trends; upbeat commentary

Collection efficiency at 70–80% levels; disbursements picking up

We concluded our 16th Annual General Investor Conference, which saw participation from 15 NBFCs across various product segments.

- With improving macros across most business segments, there was increased optimism on collection efficiency (CE) as well as on growth across product segments. In retail lending, at least a 15–20% improvement was seen in collections over the last two months. Overall collection efficiency was at 70–75% for micro loans, at 80–90% for vehicle finance, and at 85–90% for affordable housing across financiers in Aug 2020. In terms of restructuring, most financiers await: a) trends in collections in September given the end of the moratorium and b) the Kamath committee recommendation.
- Vehicle finance – Tractors, 2Ws (two-wheelers), and SCVs (small commercial vehicles) have seen the fastest improvement. Tractors have benefited from a healthy crop harvest, and 2Ws have gained advantage owing to a growing preference for personal mobility due to the pandemic. SCVs have done well largely owing to last-mile connectivity. However, M&HCVs (medium and heavy commercial vehicles), especially linked to large fleet operators and the Commercial Passenger Vehicle segment, continue to face challenges.
- Housing finance – Given that no large-scale lay-offs or pay-cuts have been implemented by companies, the situation is manageable. In terms of real estate exposure restructuring, companies await final recommendations from the Kamath committee. Construction activity is back at normal levels in south India and 80%+ of pre-COVID levels in north India. Recovery in construction activity in Mumbai, India's largest market, has been at just 50–60% levels as the fear of the pandemic is high in migrant labor.
- Diversified financiers – Infra finance has been largely stable given the operational nature of the assets. The SME and MSME segments have also seen a healthy improvement in disbursements and collections as businesses are operating at 65–70% of earlier levels. Gold loan companies continue to be on a strong footing and have witnessed much stronger disbursements in 2Q v/s 1Q. In microfinance, while the overall collection efficiency is improving, geographic performances are mixed, with states such as Maharashtra (MH), Tamil Nadu (TN), West Bengal (WB), and Odisha (OD) seeing challenges. However, disbursements are yet to resume properly for most entities.
- All companies have ramped-up their collection infrastructure aggressively, and there are talks of the near-normalization of collection efficiency in most products by Diwali. While certain retail lending segments may require restructuring, this would be limited to less than 10% of the portfolio. In wholesale lending, certain real estate exposures, hospitality exposures, and toll road projects may require restructuring.

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- **Improving liquidity and a higher risk appetite on account of better collection performance have given companies the confidence to lift disbursements. Improvement in the Rural segment is a consensus view of most participants. Mass and affordable housing have been the key growth drivers for most housing financiers. While disbursements for vehicle financiers are likely to decline 40–50% YoY in FY21, AUM is likely to grow in the low single digits. Housing finance players are likely to witness normalization in disbursements by Nov–Dec'20, resulting in just 10–20% YoY decline in disbursements for the year.**
- **All the companies mentioned that the equity capital raise was only to reduce the overall leverage on the balance sheet. Otherwise, capital levels are comfortable for expected growth and any potential asset quality issues.**

Vehicle finance – Significant improvement in collection efficiency

Since most vehicle financiers operate in rural and semi-urban locations, buoyancy has led to faster-than-expected recovery. This is attributable to the focus on partial collections, even from customers under moratorium, especially 'SMA' customers. 2Ws and tractors are the key products to have shown strong traction, with CE reaching almost pre-COVID levels. SCVs (last-mile connectivity) have also shown improvement. As most operate in essential commodities, the impact on customer cash flow has been minimal. Importantly, the Small Road Transport Operators (SRTO) and Driver-cum-Operator segments have been less impacted. This is attributed to large fleet operators with driver shortage problems outsourcing their contracts to these segments. Passenger commercial vehicles such as cab aggregators, tourist vehicles, and school bus operators are facing higher issues and may need restructuring. The M&HCV segment is under some amount of pressure, weighed by limited freight availability and higher diesel cost. However, the migration to BS6 (prices are 12–18% higher v/s BS4) has helped maintain used vehicle prices at firm levels. Companies expect disbursements to decline 40–50% YoY in FY21. However, AUM would be largely flattish or grow in the low single digits due to interest capitalization and a lower repayment rate on account of moratorium.

Housing finance – Construction activity picking up; clarity on restructuring post finalization of Kamath committee recommendations

In south India, construction activity is almost back at pre-COVID levels, while in north India, it is at 80% of earlier levels. Mumbai is a laggard, with activities still at just 60–70% of earlier levels. Likewise, sales have picked up to 50% of pre-COVID levels v/s ~30% earlier. This is driven by Affordable and Mass Housing, while the Luxury segment remains a concern. The recent cut in stamp duty in Maharashtra would aid marginally. Other states could also follow suit. While disbursements are at 60–70% of YoY levels, they are expected to reach 85–100% of prior-year levels in 2HFY21. 15–25% of retail customers have availed moratorium; however, most of them have done so largely to conserve cash. The availment of moratorium on account of job loss or pay cuts is not meaningful. One company mentioned that the maximum stress from the retail moratorium book would be 10–15%. With regard to the restructuring of corporate loans, companies await final guidelines from the Kamath committee.

Microfinance – 70%+ CE; higher stress in MH, TN, and east India

Based on MFIN's directives, there were no collections from customers in the first phase of moratorium. However, by the end of the second phase, collection efficiency had reached 70–75%. Disbursements are still muted as companies are considering parameters such as a minimum of two EMI payments, zero dpd before moratorium, etc., before resuming disbursements. Geographic performances are mixed – TN, WB, OD, and MH have witnessed lower collections due to either prolonged lockdowns or political interference. On the other hand, Bihar, Uttar Pradesh (UP), and Karnataka (KTK) have posted strong collection performances.

Diversified financiers – Comfortable liquidity; growth to improve gradually; rural remains key growth driver

Most SMEs opted for moratorium to conserve cash. With the economy getting back on track, SMEs have witnessed two-thirds of the business returning. Additionally, they are benefiting from the recent GOI schemes. Infrastructure finance has been the least affected. With the Renewable Power sector being a key focus area, it had a 'must-run' status during the lockdown. Hence, exposures in this segment remain comfortable. Toll road projects are seeing healthy vehicle movement, with traffic back at 90% of pre-COVID levels v/s 30% in April. Annuity project payments by NHAI have been timely. Gold finance continues to see good traction with higher gold prices and increased volume demand. The recent regulations granting a 90% LTV cap for banks is unlikely to impact NBFCs meaningfully given that: a) banks cater to a different customer segment and b) NBFCs still have various other advantages, such as TAT, repayment convenience, etc.

Most companies well-placed on capital; cost-cutting under focus

The sector has witnessed a meaningful number of equity capital raises in the past two months. Most companies have raised money largely in order to reduce leverage rather than as 'repair capital'. It is unlikely that companies would need further capital in the near-to-medium term as: a) asset quality performance has been better than initially expected and b) balance sheet growth is not likely to revert to pre-COVID levels before 2HFY22. On the opex front, views were divergent. Most companies expect opex to revert to normal as the business picks up. However, some companies such as MMFS, MGFL, etc., have taken this opportunity to permanently reduce certain expense lines.

Valuation and view

Overall, management commentary was upbeat given the gradual unlocking of the economy, MoM improvement in collection efficiency, and buoyant rural demand. Furthermore, adequate liquidity and improving collections have led to higher confidence on growth. The festive season remains crucial for the growth momentum to continue. With a sharp fall in incremental cost of funds, players are likely to deliver stable to improving margins over the next four quarters. While CE is positive across the board, the tail risk-coupled restructuring associated with the same would be the key monitorable in the ensuing quarters. However, we do not foresee any meaningful rise in NPA immediately as most companies are focused on collections from SMA 1 and 2 accounts. We believe players with a strong parentage, a healthy balance sheet, and low asset quality risk are likely to outperform. HDFC is our top pick in the space.

Coverage companies

Financials & Valuations (INR b)

Y/E March	2020	2021E	2022E
PBT Break-up			
NBFC	10.7	8.2	10.2
Housing	1.4	1.5	1.8
AMC	6.6	5.8	6.6
Life Insurance	1.4	1.4	1.5
Consol PBT	**16.9**	**16.2**	**19.8**
Consol PAT Post MI	**9.2**	**9.1**	**11.2**
Growth (%)	5.8	-0.7	22.5
RoE (%)	**8.3**	**7.0**	**7.9**

ADITYA BIRLA CAPITAL

Business mix

- It actively looks to granulize the portfolio, extensively seeks partnerships in tier 2/3 cities to increase physical outreach, and would focus on improving digital reach. The company plans to scale up its presence to 150 locations from 65.
- Retail and SME would continue to increase, while the Wholesale mix would decline in the coming years. The overall loan book mix target is to have 65% Retail and SME.
- It has strengthened its collection infrastructure over the last 6–8M. Bounce rates pre-COVID were at 8–13% across segments. Collection efficiencies are almost back at normal levels.
- The share of internal sourcing would be ~20%; it aspires to scale this up to 40–50%.
- **Insurance business:** The embedded value of the Life Insurance business is around INR55b; the Health Care business is expanding faster and would achieve breakeven by FY22. The capital requirement in the Health Insurance business stands at INR2–2.5b. In Life Insurance, it seeks to improve the distribution mix both in the Banca and Agency channels.
- There is a significant focus on cross-sell opportunities, and it is starting to sell health and life insurance policies jointly.
- **AMC business:** This comprises 7.2m retail folios; there is a continued focus on smaller towns / SIPs / equities.
- The Housing Finance business has adequate capital levels.
- **LAP portfolio**: Gross NPA is 1.2% in this segment; assess cash flow while taking a credit decision. Avg. LTV is 50% on the portfolio; 70% of the collateral is residential.
- Loans to developers stand at 5% of the total Real Estate portfolio; they are given to high-quality, selective developers and thus yield is lower v/s other peers.

Asset quality: Clarity on restructuring over next few months

- Moratorium was the highest in the SME segment. Of the 28% of the portfolio under moratorium, ~86% has never been in the 30dpd bucket pre-COVID. Customers have opted for moratorium largely to conserve cash.
- It would look at restructuring loans only after the first repayments come through this month. Believe only businesses with large exposure to Hospitality / Tourism would need any sort of restructuring.
- There is no non-funded/guarantee exposure to Vodafone India Ltd.
- The SME book is performing quite well; cash flow impact is seen on SMEs due to lockdown, but GoI measures have aided to a great extent. It has been able to reduce SMA 2 in the last five months; 60–70% of the SME businesses are back at normal levels.

Product mix to drive RoE improvement

- Pre-COVID ROE was at 14%; retail asset growth would help improve ROE to 16% levels.

Valuation and view

Over the past quarter, the moratorium rate has declined from 33% to 28%, which is modest. However, the key thing to watch out for is how this portfolio behaves once it is out of moratorium in September. In addition, the quantum of portfolio requiring restructuring is unknown at the moment. Provisions could rise meaningfully in 2HFY21 once the moratorium is over. **The Asset Management business is likely to have a muted year as the industry combats redemption pressure in equities, along with slowing SIPs. Reduction in operating expenses would be the key to maintaining profitability.** The Life Insurance segment is on a robust trajectory. **The business continues to witness improved performance on persistency as well on VNB margins.**

HDFC

Business mix

- The transmission of interest rates has been much better this time v/s prior cycles.
- It would revert to prior-year disbursement levels by Nov/Dec. There is good traction in Mass Housing.
- The general sentiment is better than it was 3–4 months ago.
- It is considering the possibility of portfolio buyouts.
- HDFC received INR9b in dividends from subsidiaries and associates last year. Although, it may not receive any dividends this year.
- A 5–7% price correction is seen in real estate prices.
- It has seen the resolution of a few IBC cases (Jet Airways + two other smaller cases).
- No major construction finance loans in NCR; however, HDFC has retail loans in stuck projects in NCR.
- Over the past two years, inward balance transfers (BT-in) was equal to outward transfers (BT-out). This year, there may be more BT-in.

Asset quality

- 39% moratorium was reported in wholesale lending as of June, of which developer loans comprised 69%.
- Do not expect much LGD impact on real estate lending projects. Issues pertain more to liquidity than solvency.
- It would wait for the K V Kamath committee's guidelines before taking a call on wholesale restructuring.
- Do not expect more than 10–15% of the retail moratorium book to be stressed.

Liquidity/Funding

- Deposit traction remains strong. It cut rates by 115bp in 1HFY21.
- It raised NCDs at 5.4% recently.
- It has brought down liquidity marginally from 1Q levels of INR320b.

Financials & Valuations (INR b)

Y/E March	2020	2021E	2022E
Core PPoP	135.0	149.7	167.5
Adj. PAT	96.2	115.2	127.5
Adj. EPS (INR)	49.2	55.0	60.5
EPS Gr. (%)	10.8	11.8	10.0
BV/Sh. (INR)	537.9	583.3	631.8
ABV/Sh. (INR)	399.0	444.3	492.8
Core RoA (%)	1.8	1.8	1.8
Core RoE (%)	13.1	13.0	12.9
Payout (%)	23.7	43.5	43.5
Valuation			
AP/E (x)	17.4	13.4	9.3
P/BV (x)	3.3	3.1	2.8
AP/ABV (x)	2.1	1.7	1.1
Div. Yield (%)	1.2	1.5	1.6

Others

- 5–6% of the book comprises LAP. Lenders are going slow in LAP across the industry.
- It is seeing large builders such as Prestige and Raheja monetizing commercial real estate either through the REIT structure or otherwise. RMZ has sold its office assets to Brookfield.

Valuation and view

Improvement in the retail moratorium rate from 23% to 16% is encouraging and among the lowest in the industry. With the recent capital raise of INR100b, the company is well-capitalized with an estimated Tier-1 ratio of 18%+. This should help HDFC face any contingency, fund its own growth requirement, and further capture any inorganic opportunities at the parent (portfolio buyouts) and subsidiary levels (M&A opportunities). While near-term retail growth would be challenging, the medium-to-long term outlook remains strong, especially given the much lower competitive intensity within housing finance companies (HFCs). Sharp decline in incremental cost of funds over the past three months would help maintain stable spreads at 2.1–2.3%.

INDOSTAR CAPITAL FINANCE

Financials & Valuations (INR b)

Y/E March	2020	2021E	2022E
NII	6.0	5.6	6.2
PPP	3.8	3.6	4.1
PAT	-3.2	1.2	1.7
EPS (INR)	-35.1	13.2	18.6
EPS Gr. (%)	-235	-138	41
BV (INR)	290	305	324
Ratios			
NIM (%)	6.6	6.9	7.0
C/I ratio (%)	47.8	46.7	45.2
RoA (%)	-3.0	1.2	1.6
RoE (%)	-11.4	4.4	5.9
Payout (%)	0.0	0.0	0.0
Valuations			
P/E (x)	-7.2	19.3	13.6
P/BV (x)	0.9	0.8	0.8
Div. Yield (%)	0.0	0.0	0.0

Industry-level

- **Large fleet operators are dealing with multiple challenges**, such as a slowing GDP, low industrial production, insufficient freight (return load is not there) on the road, labor availability challenges, and higher diesel cost. This segment is primarily catered to by the large banks.
- Among the other segments, LCV, SCV, and MCV are doing well as they are largely into essential commodities, more rural-focused, and used for last-mile connectivity. NBFCs are the key players in this segment.
- Passenger commercial vehicles are dealing with migrant labor issues and lower demand in key metros. SFBs and some NBFCs finance this segment.

Opportunity size

- There are 8m vehicles on the road which are of 5-12 years' vintage. However, only 40% of these are financed by organized financiers.
- The scrappage policy (for the 0.8m vehicles that are 20+-yr-old) could lead to an opportunity size of INR1–1.25t. Note that scrappage of such vehicles would have a 2-3x multiplier effect on used vehicle transactions in the industry.

Growth and asset quality

- The near-term focus is on preserving asset quality. Two-thirds of vehicle finance customers have started paying. In a few segments, the rescheduling of EMIs would be required.
- The RE book worth INR25b has exposure to 9–10 developers, mostly in the outskirts of Mumbai. Most have taken morat and may go for restructuring.
- It is hiring people and focusing on expansion for the next growth cycle.
- Vehicle finance, SME, and affordable housing remain key focus areas.
- It aims to increase the branch count to 800. Incremental branches are likely to be smart branches with low infra cost and smaller sizes.

- Smart branches would take 50% lesser time to achieve breakeven, i.e., 9 months v/s 18 months in a normal branch.
- The focus on digitalization would improve processes and productivity.
- Provisions made in 4Q were taken after considering 1Q credit costs as well. They were sufficiently provided for.
- It has 75% collection efficiency in the Retail portfolio; 10–15% could seek the restructuring of loans. Commercial / Fleet operators are facing some challenges; they may seek the restructuring of loans. A large portion of the wholesale book is under moratorium.

Brookfield deal advantage

- Stringent due diligence was carried out for six months before it invested in INDOSTAR.
- It invested INR12.25b via equity and CCPS; the transaction was completed in July 2020. It is now designated co-promoter with a stake of ~57%.
- The deal provides easy access to bank funding. Also, it accelerates growth plans among promoters with deeper pockets.
- Two representatives on the board are from Brookfield.

Others

- Assignment and securitization markets are opening up.
- It has strong liquidity of INR21b+ on the balance sheet.
- Incremental cost of funds stands below 9%; avg. cost of funds would come down by 30–40bp with the reset clause coming into play in 2HFY21.
- It targets 3% ROA and 5x leverage on-BS and another 1x off-BS over the medium term.
- It is in talks with the relevant stakeholders to reduce promoter stake.
- Industry-wide, 40–50% of fleet owners (migrant laborers) have taken their vehicles to their hometowns.

Valuation and view

INDOSTAR's plan for loan book diversification has faced headwinds in a tough liquidity environment. The moratorium rate remains high across segments. The key concern remains on asset quality trends post the lifting of the moratorium. However, on the positive side, the company is very well-capitalized with a strong new parent. Also, a potential scrappage policy could aid near- to medium-term growth. The company's RoE trajectory is a key monitorable.

L&T FINANCIAL HOLDINGS

Improvement in collection efficiency (CE) across the Rural segment

- Micro Loans (ML) CE, which was 48% in June, has now reached 65–70%.
- The Farm segment CE has reached 90% v/s May at 77% and June at 87%.
- 2W CE has improved 70% earlier to 82–83% now. However, it is still lower than pre-Covid levels of 90% due to intermittent lockdowns in some states and complete lockdown in the containment zones.
- Infra is the least impacted sector as it is accorded priority status. 80% of the portfolio was operational even pre-COVID. Overall, infra morat is at 20–25%, mainly toward toll road and under-construction power projects.

Financials & Valuations (INR b)			
Y/E March	2020	2021E	2022E
Total Income	70.3	63.9	68.9
PPP	50.6	43.1	47.6
Adj. PAT	21.7	9.9	19.1
EPS (INR)	10.9	4.9	9.5
EPS Gr. (%)	-2.7	-54.6	93.1
BV/Sh. (INR)	72	75	84
Ratios			
NIM (%)	5.8	5.2	5.3
C/I ratio (%)	28.1	32.5	30.9
RoAA (%)	2.0	0.9	1.7
RoE (%)	15.6	6.7	12.0
Payout (%)	17.8	13.9	13.9
Valuation			
P/E (x)	5.9	13.0	6.7
P/BV (x)	0.9	0.8	0.8
Div. Yield (%)	2.0	0.9	1.8

- **Collection agencies are also a bit understaffed currently. They are at 80% capacity v/s 60% earlier. The company has appointed two more agencies and ramped-up the call center workforce to expedite collection efforts.**

Remains comfortable on Infra exposure

- Renewable energy production went up during the lockdown period and had a must-run status. Toll projects are doing well. Vehicle traffic was at 80% of pre-COVID levels in June (30% in April) and has now reached 85–90%. NHAI has honored all dues for annuity projects. In addition, toll-based projects are performing in-line with expectations. The company is only facing issues with road projects running to airports or temples. GOI has increased the concession period and the loan already factors contingencies. Moratorium has been extended wherever needed.
- In the case of power projects, LTFH lent only to projects with power purchase agreements (PPAs) and no offtake risk. The project cost already factors contingency cost, which is sufficient to take care of interest cost for the elongated period. In fact, one of the projects received a Commercial Operations Date (COD) during this pandemic period.
- Andhra Pradesh made the payment up to March at the rate of INR2.44/unit. The weakest cash flow, even in DSRA, is covered at least up to March 2021.
- In the wholesale book, restructuring may not be massive.

Real Estate – South India seeing strong improvement in construction activity; now at pre-COVID levels

- The southern markets' activity levels are at 100–120% of pre-COVID levels. Mumbai is at 60–70% and the northern markets at 80%.
- 85% of under-construction projects are under moratorium. The clear focus has been on getting the project started. The RERA extension of six months has also helped.
- Escrow collections were at 33% in June and further increased to 50%. Average sales currently are at 30–50% of pre-COVID levels.
- 88–92% of RE projects would not require a DCCO extension.

Disbursements – Collections-led disbursement growth strategy

- **Farm** – With steady improvement in collections, disbursements have picked up sharply. Over Jun–Aug'20, LTFH was the top financier in the country.
- **2W** – Collections were initially lower due to lockdown; however, things improved sharply thereafter. While MS was 4% in May, it increased once again to 10% in June. Expect improvement in finance penetration to drive growth at the industry level.
- **Micro Loans** – Based on MFIN's directives, there were no collections in morat 1. Hence, hardly any disbursements were reported up to June 2020. It is carefully analyzing the situation before resuming disbursements. Even for top-up loans, LTFH has stringent criteria, such as a minimum of two EMI payments, zero dpd before moratorium, and a max INR10–15k top-up loan.
- In Infrastructure and Real Estate, the company is disbursing only sanctioned loans.
- **Expect FY21 to have the best ever festive season for rural-focused products. In FY22, rural is expected to be bumper as well. Overall growth would be led by**

rural (+20% YoY); however, caution on corporate loans would keep overall growth muted.

Asset quality – Adequately provided for

- Over the last six months, the entire focus was on collections. It aggressively targeted zero+ dpd collections. **1QFY21 debtors reduced INR13b and GS3 was down INR1b. Most of these accounts may have turned zero dpd.**
- The company utilized the gains on sale of the Wealth Management business to make provisions for one 'de-focused' account NPL.
- Break-up of the INR12.5b contingency provision buffer is: INR7.5b for Rural (3% of loans), INR4.5b for Housing (2%) and ~INR400m for Infra (only regulatory provisions as merely INR3.4b was overdue).
- With a strong operating profitability, even in the worst case, do not see any impact on the networth.
- Any COVID-related issues would be provided for this year. FY22 would commence without any baggage.

Liquidity sufficient – Would gradually reduce the drag

- It is maintaining very high liquidity – INR90–110b (~10% of AUM). This has led to additional negative carry of INR840m.
- It normally keeps 3–4% of AUM as liquidity in normal cases and would gradually reduce it to this level depending on the economic scenario.

Others

- Seeing some issues in CE (high-risk segment) in WB, MH, and TN (lockdown). Bihar and UP are doing well v/s the overall average in the ML segment.
- **Leverage on the balance sheet is adequate. Do not need growth or repair capital as of now. Leverage levels at the system level are reducing; hence, it may raise capital in FY21 (L&T parent is on board).**
- **No specific course of action has been decided for the MF business as yet.**
- The geographical mix of the ML portfolio is as follows: South/East/North/Central and West – 40%/25%/15%/20%.
- **It operates out of 82 locations in 2W, of which the company is in the top position in 40+ locations.**
- Yield in road projects is at 9–11%.

Valuation and view

The key retail businesses of LTFH have witnessed an improving trend month-on-month in terms of both disbursements and collections/moratorium. In the Farm segment, the company is witnessing healthy momentum given strong rural buoyancy. Likewise, trends in 2W financing have been positive. The two potential areas of asset quality stress could be microfinance and real estate finance. However, we believe the company's strategy of shoring up its provision buffer (**standard asset provisions at 1.8% of standard loans) is a prudent strategy.** We expect the company to continue to make contingency provisions over the next 2–3 quarters. The company is able to raise debt at attractive prices given its parentage. The AMC business has done well over the past three years and contributed 10%+ to consolidated PAT in FY20. We believe this business would continue to grow faster than the lending segments in the medium term.

MAS Financial Holdings

Financials & Valuations (INR b)			
Y/E March	2020	2021E	2022E
Total income	4.3	4.2	5.0
PPP	3.3	3.4	4.0
PAT	1.8	1.7	2.0
EPS (INR)	33.2	30.8	36.9
EPS Gr. (%)	19.2	-7.0	19.5
BVPS (INR)	182	205	232
Ratios			
NIM (%)	9.2	8.5	8.8
C/I ratio (%)	23.2	20.2	20.4
RoA on AUM (%)	3.2	2.7	2.8
RoE (%)	19.8	16.0	16.9
Payout (%)	24.1	26.0	24.4
Valuations			
P/E (x)	25.0	26.9	22.5
P/BV (x)	4.6	4.1	3.6
Div. yield (%)	1.0	1.0	1.1

Key updates

- It is on track to do INR3–5b worth of assignments in 2Q (better than 1Q).
- Collections from NBFC partners are good (93% efficiency) and it is not witnessing any stress.
- 43% of loans are directly sourced. This number would keep increasing over the medium-to-long term as the NBFCs that MASFIN lends to would not be able to grow.
- The company has 110 branches in 3500 locations (within a 40km radius). Expansion is currently on hold.
- RoA in direct lending is marginally higher than that in partnership lending.
- The CV portfolio would take longer to recoup.
- It has INR13b liquidity on the balance sheet, in addition to INR7b sanctions.

Asset quality / Collections

- Collection efficiency for August should be at 87–90% (v/s 87% for July and a run-rate of ~90%).

Others

- It works with 45–50 MFIs.
- It aims to reach a book size of INR140–150b over the next decade.
- The ticket size for incremental affordable home loans is INR350–400k (35–40% LTV). It has lean branches (4–5 employees per branch).

Valuation and view

93% collection efficiency from NBFC partners in this environment is a key positive. The company works with 120+ partners, which helps diversify the risk. Liquidity at 25%+ of borrowings is higher than what most other NBFCs maintain. The company is well-capitalized with Tier I of 32%. We like MASFIN's focus on profitability over growth. In this environment, growth is likely to remain muted.

MAHINDRA FINANCE

Mahindra FINANCE

Financials & Valuations (INR b)			
Y/E March	2020	2021E	2022E
NII	51.1	57.5	55.7
PPP	34.0	42.8	39.2
PAT	9.1	9.1	11.0
EPS (INR)	14.7	7.4	8.9
EPS Gr. (%)	-41.8	-49.9	21.3
BV/Sh.(INR)	185	125	132
Ratios			
NIM (%)	8.3	9.2	9.2
C/I ratio (%)	37.3	29.1	33.4
RoA (%)	1.3	1.2	1.5
RoE (%)	8.3	6.8	7.0
Payout (%)	0.0	23.4	23.4
Valuations			
P/E (x)	9.0	18.0	14.9
P/BV (x)	0.7	1.1	1.0
Div. Yield (%)	0.0	0.0	1.3

Business updates

- Disbursements are currently at 50–55% of pre-COVID levels. In passenger cars, the focus is on personal use. Other focus segments include LCV, UV (pickups), tractors, and used vehicles. It is not doing CV disbursements.
- Expect normalized disbursements in 2HFY21. However, FY21 disbursements would be 40–50% lower YoY.

Asset quality

- Collection efficiency is currently ~80% on total billings.
- Around 30% of customers have not paid for the past five months. A maximum of 15–20% of these customers could potentially be impacted and slip into NPL.
- Restructuring would be done on a case-by-case basis. It would finalize a policy in 15 days. 4–5% of the book may be restructured.
- ~80% of moratorium customers were 0dpd as of 29th Feb.

Funding

- 70–80bp drop has been seen in overall cost of funds and 150bp drop in bond market cost to 7% in the past six months. Incremental cost of bank loans is at 7–7.25% and CPs at 3.5%.
- It would probably reduce liquidity on the balance sheet by March.
- It has reduced deposit rates thrice over the past five months. It is currently raising deposits at 5.7–7.0%.
- It typically does securitization of INR5–10b per quarter. It has not done anything in 1Q and 2Q thus far. This would resume from Dec once there is some clarity on the outcome of the moratorium loans.

Others

- 3–4% of total AUM is toward cab aggregators. 7–8% of the total book is M&HCV.

Valuation and view

Month-on-month improvement in disbursements and collections is encouraging. Within the product mix, tractors, entry-level cars, and LCVs are likely to do well, while M&HCV and taxi aggregators are likely to witness slow recovery. However, the fact that 20% of standard customers have not paid a single installment to date is a bit concerning. We believe 5–10% of the loan book would have to be restructured. This would largely stem from the cab aggregator and M&HCV portfolios. The focus on cost-cutting is encouraging – however, we wait to see sustainability in the same.

Financials & Valuations (INR b)

Y/E March	2020	2021E	2022E
Revenues	130.7	129.1	141.3
EBITDA	17.9	21.6	27.5
PAT	-5.5	16.9	22.1
EPS (INR)	-24.5	74.8	93.4
EPS Gr. (%)	-135	-405	25
BV/Sh. (INR)	1,274	1,322	1,392
Payout (%)	-53	35	35
Valuations			
P/E (x)	NA	17.0	13.6
P/BV (x)	1.0	1.0	0.9
Div. Yield (%)	1.0	2.1	2.6

PIRAMAL ENTERPRISES

Financial Services business – Sustainable ROE of 15–17%

- It is transitioning from being a wholesale financier to retail financier. Even within wholesale, it is trying to reduce concentration risk.
- In retail finance, the initial focus would be on housing and secured business loans.
- Shriram is now just a financial investment on the books. It would monetize its stake in the business at the opportune time.
- **Sustainable ROE is likely to be 15–17% in the Financial Services business.**
- ~60–65% of the wholesale book and 25% of the retail book is under moratorium; restructuring is likely to be low with the uptick in economic activity.
- The Hospitality and Hotels sector exposure at INR15b may require restructuring.
- Provision was done with the expectation of no sales and recoveries in the current quarter, 30% repayment in 3Q, and 50% in 4Q. The real situation has turned out better than anticipated depending on provisions made. It would be in no hurry to decrease provisions.
- **Borrowing costs are largely in the range of 9–10%, with few deals at <9%. Borrowing costs continue to reduce. Exposure to Commercial Papers is now <INR10b.**

Retail finance – Higher reliance on digital

- The focusing is now on mass and affordable housing finance v/s affluent segments earlier.
- **PIEL is focusing on Tier II to IV cities with populations of 10k–4m**

- The company would use the Hub and Spoke model with its current presence in large cities (owing to its presence in the affluent housing segments) acting as hubs. Spokes would need to be added for smaller towns. The company does not see the need to add too many branches owing to the digital platform.
- McKinsey is helping to draw out a plan for the retail finance rollout.
- It is looking at multi-level partnerships. It would leverage on its partners' database/digital infrastructure. A potential partnership could be with a telecom company.
- The focus would be on cities with a low bank presence as it is not possible to compete with banks due to the higher borrowing rate.
- **Until the COVID-related disruption persists, the company would focus on secured lending.**
- It would also look at inorganic opportunities in the Retail Lending space. The target need not necessarily be integrated if it has some unique capabilities.

Pharma business – RoCE in the low double digits; debt levels to reduce to INR25b

- All businesses are now consolidated into one entity with a simplified group structure.
- Debt levels are likely to reduce to INR25b, v/s INR45b currently, post the closure of the deal with Carlyle.
- The networth allocated to Pharma is INR50b.
- **It is seeing strong traction in CDMO (30+ orders related to COVID) and the domestic Consumer business; the Critical Care business would take time to return to normal.**
- RoCE is in the early double digits currently, and in the next three years, it would be in the 20s. It was 6–7% earlier.
- **Capacity utilization is at 70% as of now.**
- There is enough liquidity on the balance sheet to tap any opportunity in the business.
- The company has end-to-end capabilities in the CDMO business with its integrated business model. This aids with customer retention and gaining a larger share of the wallet.
- It is looking at inorganic opportunities, but does not want to be another generics company competing in India / other geographies. It is looking at niche segments with potential for higher margins.
- **The domestic Consumer Health business has achieved breakeven.**

Take on Real Estate exposure

- For the project financed by the company wherein ~24k laborers were employed, 60% of the labor is back on site.
- **90% of the exposure has started seeing an uptick in activity.**
- Residential sales have improved to 50–60% of pre-COVID levels.
- **Only one exposure is more than 15% of networth; 6–7 exposures are at 6–7% of networth each and 2–3 exposures at ~10%.**
- The Lodha exposure is ~INR30b currently, which the company is trying to reduce to INR25b by March. Security cover for Lodha is ~2x due to finished good inventory.

- **Of the loan book, ~35% is in Mumbai/MMR, <10% in NCR, and the rest in the cities of Hyderabad, Bangalore, Pune, and Chennai.**
- The loan mix is as follows: commercial – 20%, housing finance – 10%, corporate – 10%, residential – 60%.
- In the bulk of the RE portfolio, PIEL is the sole or largest lender.

Valuation and view

Over the past year, PIEL has curtailed disbursements in wholesale lending and reduced exposure to its Top-10 clients. It has also de-leveraged the balance sheet meaningfully. We believe FY21 would remain a year of caution for the FS business, with the company continuing to focus on strengthening the balance sheet. The Pharma business is witnessing increased traction, and the recent stake sale has set a benchmark for its valuation. Strong traction in the CDMO business is a key positive.

SHRIRAM TRANSPORT FINANCE

Financials & Valuations (INR b)

Y/E March	2020	2021E	2022E
Net Inc.	83.1	77.6	85.0
PPP	62.3	60.3	66.0
PAT	25.0	18.0	28.8
EPS (INR)	110	71	114
EPS Gr. (%)	-2.4	-35.5	60.0
BV/Sh (INR)	794	842	945
Ratios			
NIM (%)	8.0	7.1	7.2
C/I ratio (%)	25.0	22.3	22.3
RoA (%)	2.3	1.5	2.3
RoE (%)	14.9	9.2	12.9
Payout (%)	5.4	12.0	12.0
Valuations			
P/E (x)	6.2	9.7	6.0
P/BV (x)	0.9	0.8	0.7
Div. Yield (%)	0.7	1.0	1.7

Business updates

- In June/July, disruption was witnessed only in supply chain distribution as return loads were not as smooth (waiting period increased by 1–2 days).
- Rent was reduced by 15–25% across offices; the senior management has taken pay cuts (10–20% in 1Q). Cost reductions to continue for at least 2–3 quarters.
- Freight rates (up by ~20% across segments in the whole country) / the customer's earnings are not an issue. Operating days are down to ~18 days/month from 23 days/month.
- Due to the scarcity of drivers, large fleet operators outsourced goods movement to small truck owners in July/August. As a result, expect the Owner-cum-Driver segment / Used Vehicles segment to fare relatively better.
- Do not expect new vehicle sales to move up, largely due to price increase post BS6 (20–25% higher than BS3). >80–85% of operational vehicles (in SHTF's portfolio) are BS3 vehicles. Since there are no large benefits on cost savings in the transition to BS6, expect used vehicle prices to remain firm. Expect BS3 vehicle prices to rise (up 2–5% thus far).
- Reached 65–70% of run-rate at Shriram Auto mall auctions in July and August.
- Do not see much growth from the new vehicles segment until Dec'20. Expect higher-double-digit growth in the books in FY22 (largely driven by used vehicles).
- It would continue to conserve capital. Tier 1 would be maintained at 19.2–19.5%. It has resolution/approvals in place for an INR25b equity raise.
- It has 27–28% market share in used vehicles (up 800bp since 2007) and scope to gain 5–6% over the next decade. Do not see much competition beyond six years. Some new entrants in Used CV could just be doing re-financing.
- ~50% of the portfolio is in rural (vintage of 6–7 years / lower ATS).
- Do not foresee much change in repayment rates in FY22 (could move up by 200–300bp max).

Asset quality

- More than 73% of customers have made payments amounting to 53% by value of the total billings. Collection efficiency in August improved QoQ. Expect 80–85% collection efficiency in value terms in Sep and 90% in volume terms. Robust collections were reported in lower ATS in the CV segment. Contracts would be

considered 1st September onward for restructuring, if required (this is the non-March–August contracts).

- Some customers have paid in one month and defaulted in the next. 20–21% would have not honored a single payment since Mar'20.
- The restructuring of loans would be on a case-by-case basis – no blanket restructuring. The worst case scenario is 10% of the portfolio would need restructuring. It would start restricting (if any) post 10th Sep'20. Do not see much restructuring in the Used Vehicles segment.
- PV (22% of portfolio): Cab aggregators financed (3–3.5% of the portfolio) in June were impacted severely in Mumbai and Chennai (Bangalore/Delhi relatively better). Currently, 60% of cab aggregators are on the road; expect this to reach ~80% post the monsoons. The school bus portfolio remains stressed.
- >85% of customers by value should be honoring their payments from the 1st week of Sep'20.
- LGD should be maintained. Expect FY21 credit cost to be lower than 2.7%. In the worst case scenario, it would be 3%. Some customers could ask for interest waivers; expect ~50% write-backs in Mar/Apr'21. Pre-COVID LGD was down by 100–150bp on a YoY basis.

Liquidity/Funding

- Incremental cost of borrowings from banks at 8.0–9.2%. Raised more than INR100b debt capital post-COVID. Been able to raise money from the banks (largely PSUs) and institutions, and through securitization. Confident about raising money from MFs soon.
- Cost of funds is coming off with a reduction in MCLR rates; it would take 2–3 quarters to reflect in the numbers.
- It has received sanctions from 8–9 banks.

Others

- It has not announced plans for the re-appointment of Puneet Bhatia.
- The merger with SCUF is on the back burner for now.
- More than 80% of loans have tenures of three years or more.
- The company has been in touch with each and every customer. It has virtually put offices in petrol pumps (HPCL/BPCL), discouraging a few sets of customers to visit its branches.
- At the junior/executive levels, ~40% of costs are variable in nature.
- Hedging contracts – rupee movement is not routed through P&L (shown in OCI); only some specific interest adjustments would be via the P&L.

Valuation and view

We believe SHTF is better placed than most vehicle financiers as it caters primarily to the FTU segment, which is better off in the current environment v/s large fleet operators. This reflects improving collection efficiency trends and bodes well for asset quality in the near term. In addition, the company has diversified into new borrowing sources such as retail NCDs and ECBs. The share of ECBs in the total borrowings has increased meaningfully from 10% to 18% YoY. SHTF has also increased liquidity to 11–12% of the balance sheet. This should address concerns related to liquidity and ALM. We believe AUM growth would be muted, although it would gradually improve over the next four quarters.

Non-coverage companies

AAVAS FINANCIERS

- Disbursement volumes reached 90% of prior-year levels in July and August. It would take one more quarter for the business to normalize.
- Expect 30–40bp annual improvement in the expense ratio.
- The moratorium rate further declined in July and August. Credit costs should be similar to those in prior quarters – do not expect a big surprise on this front.
- Top-ups are 7–8% of loans. It does not give top-ups to overdue customers.

CANFIN HOMES

- It is disbursing 65% of peak numbers currently. Expect to improve to 85–90% of run-rate levels by 4QFY21.
- New branch disbursements are as follows: INR100–120m in the 1st year, doubles in the 2nd year, and reached INR500–600m in the 3rd year.
- The company has blacklisted certain NBFCs for BT-in as they do not fit its risk parameters
- May increase non-home loan share in the next 3–4 years.
- Collection efficiency in August should be 80%+.

CREDITACCESS GRAMEEN

- High-single-digit/Low-double-digit AUM growth is expected this year. However, the company should grow at a 20–25% CAGR over the medium term.
- 60% of growth would come from higher loans outstanding to existing customers and 40% from new customers (broken up into 25–30% from new customers in existing locations and 10–15% from new customers in new locations).
- 17% of customers did not pay in July (Maharashtra was higher at 26%). Expect this to come down to single digits post-Sep/Oct.
- As per management's understanding, restructuring is not applicable to MFIs. MFIN has formally written to the RBI for a clarification on the same.

ESSKAY FINCORP

- Disbursements in August were at 50% of pre-COVID levels and are expected to rise to 70–80% of pre-COVID levels in September.
- Moratorium 1 stood at 53% (50% by number of customers), which declined to 19% (18% by number of customers). ~70% of borrowers continued to make payments during the moratorium period.

MANAPPURAM FINANCE

- Good traction is seen in gold loans. Disbursements in August have crossed pre-COVID levels. Expect 5–6% QoQ growth in 2QFY21. Although, tonnage may remain subdued.
- Expect 12–15% consol. AUM growth in FY21, with the share of gold loans increasing from 68% to ~75%.
- Collection efficiency in August: MFI – 75%, Vehicle Finance – ~80%, Affordable Housing Finance – 85–90%; cannot comment on credit costs, though.

MUTHOOT MICROFINANCE

- Aspire to be among the Top 3–4 MFIs in India by FY23. It targets INR150b AUM by FY25 v/s INR47b in FY20.
- Collection efficiency was as follows: June – 54%, July – 62%, August – 75%. Expect collection efficiency to improve to 90% in Oct and 98% by Dec.
- 45% of center meetings happen weekly, while 55% happen monthly. Interestingly, monthly center meetings are faring better in terms of collection efficiency.
- It has a 250-member internal audit team that audits all branches six times a year.

NORTHERN ARC

The following takeaways are with regard to its NBFC partners and end-customers:

- Most of the MFIs it works with availed 50–80% morat on their borrowings from lenders.
- Currently, there is an investor interest in securitized pools of secured assets such as home loans and LAP. Appetite for unsecured pools would take a while to return.
- Do not see a big liquidity concern with most of the small NBFCs, especially after the TLTRO and SIDBI money coming in. These NBFCs are well-capitalized to absorb ensuing asset quality shocks.
- Collection efficiency is at 70% in most segments, barring some, such as Education.
- Do not expect much of the restructuring needs to be fulfilled by the smaller NBFCs.

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SELL	< - 10%
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