12 December 2018

Sector: NBFC

Ground Reality

On-the-ground demand strong

Average ticket sizes may see downward pressure

We recently visited several regional offices and branches of major vehicle financiers in and around Mumbai. Key takeaways:

- **The recent liquidity crunch has had a varying degree of impact on vehicle financiers' disbursements. One of the large financiers has partly curtailed disbursements, especially in the new-vehicle segment, while others have witnessed business-as-usual disbursements.**
- **The HCV segment is witnessing more of bulk purchases. As a result, loan demand is migrating to banks rather than to NBFCs. In addition, lending rates in this segment are sub-10%, making it difficult for NBFCs to compete.**
- **While it's early days, the impact of axle-loading norms seems to manifest in CV demand. Incrementally, demand is migrating to lower-tonnage vehicles, resulting in lower average ticket size on disbursements.**
- **Early stage delinquencies are stable for all players due to high levels of truck utilization coupled with moderation in fuel prices over the past 1-2 months. Freight rates have been largely stable on most routes.**

Varying degree of impact due to liquidity crunch

The recent liquidity crunch had a different degree of impact for different players. One of the large financiers has partly curtailed disbursements, especially in the new-vehicle segment, while others have witnessed business-as-usual disbursements. However, the demand environment remains robust. CV demand was strong in October but tapered in November. However, December and 4Q are likely to be strong quarters for CV demand, in M&HCV and LCV, according to consensus opinion. Further, **companies we met have set a FY19 disbursement target ranging from 20-30% for their vehicle finance businesses.**

HCV segment getting more competitive; yields higher in other segments

The HCV segment is witnessing intensifying competition by banks, which are lending at sub-10% rates. In addition, the market is moving towards bulk purchases, thus making banks a preferred choice for truck buyers. As a result, NBFCs are focusing less on this segment and migrating towards other segments like LCVs, used-CVs and cars. Generally, used-CVs and tractors give the highest yields at 17-20% while that for LCVs and cars is 12%+.

25-50bp hike in yields; to partially mitigate rise in cost of funds

All vehicle financiers that we met have hiked interest rates across products by 25-50bp. Note that since vehicle loans are fixed-rate loans, these hikes would be applicable on incremental loans only. On the other hand, incremental cost of funds have increased by 50-100bp since the IL&FS crisis. Hence, there would be some spread pressure on incremental lending over the near-term.

Axle load impact - moving towards lower-tonnage vehicle purchases

Some of the companies we met pointed to incremental migration towards lower tonnage vehicles in the M&HCV segment. This can be attributed to (a) impact of new axle-load norms (that allow overloading of 10-15% depending on the tonnage), and (b) stronger demand for tippers, which are usually mid-tonnage vehicles (used largely in infra and mining activities).

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Freight and construction/infra demand robust; Asset quality stable

On the demand side, both freight and infra-led demand continues to be robust. While infra-led demand is a bit tepid in the western regions of India, it is strong in the South and East-India. This, along with moderating fuel prices, has ensured adequate cash flows for the truck operator. As a result, delinquencies have been modest across segments. **In addition, CIFC has a model wherein the sales, credit and the collections teams are responsible for collection in the first 18 months. This intensive focus on collections is one of the reasons for superior asset quality performance v/s peers.**

Valuation and view

Over the past two months, vehicle financiers under our coverage have corrected by up to 30% given challenges on the liquidity front. While we acknowledge that there would be temporary issues, we do not expect any major setbacks over the near-to-medium term. This would impact growth by a few percentage points, in our view. **The key risk to our thesis would be in continued migration towards lower tonnage vehicles resulting in lower ticket size of disbursements, and thus lower-than-expected growth.** While we are positive on all the vehicle financiers we track (STF, MMFS and CIFC), our top pick is STF. The pain on account of transition to 90dpd is over and the transition to Ind-AS has been positive. Also, among the vehicle financiers under our coverage, **STF has the lowest dependence on CPs and the highest share of public deposits. We expect its balance sheet growth to remain in mid-to-high teens and reduction in credit costs to result in 17%+ RoE over the medium term.** The stock currently trades at 1.4x FY20E BVPS, which is close to the lowest in the past decade. The biggest risk to earnings (and multiples) for the sector as a whole would be continued increase in fuel prices.

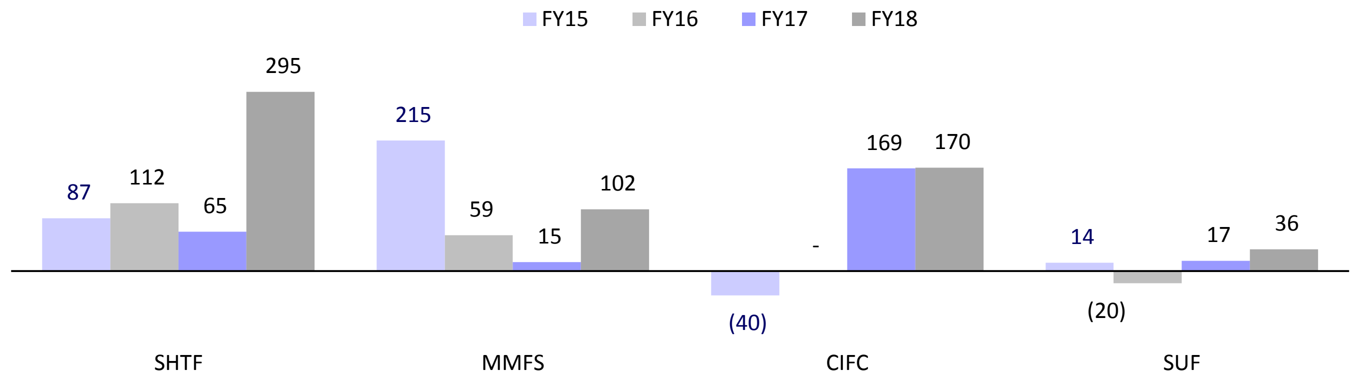
Appendix

Vehicle financiers have expanded their branch networks

Vehicle financiers have been investing for growth

- While vehicle financiers were cautious on new branch openings over FY15-17, they turned positive in FY18.
- All players under our coverage have significantly added to their branch count over the past year.
- This would help is delivering strong growth over the next 1-2 years.

Exhibit 1: Vehicle financiers were bullish on branch openings



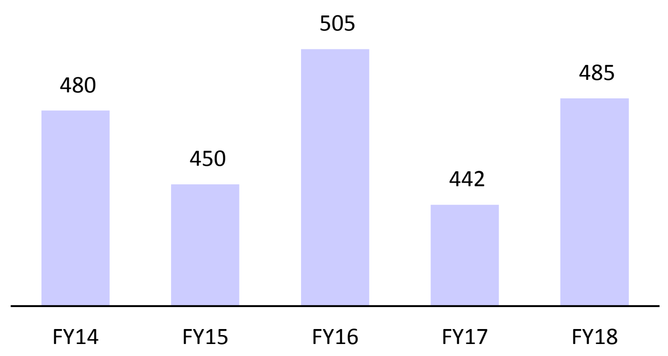
Source: MOSL, Company

Only Sundaram Finance has consistently increased its per-branch disbursements over the years

Improving branch productivity to aid along with branch network expansion

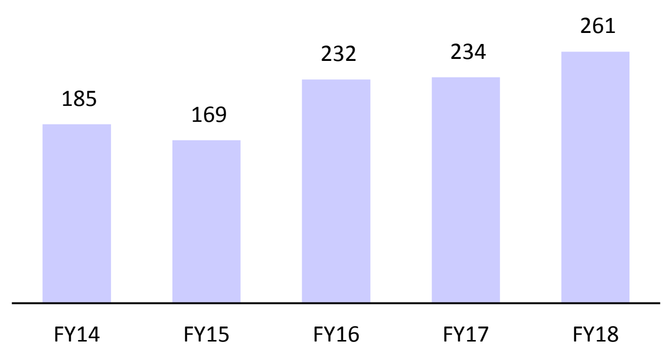
SHTF and MMFS have room to go before they reach historical highs in terms of per-branch disbursements. SUF has delivered continuously improving performance. **In addition, branch productivity (disbursement/branch) for SHTF is ~2x that of other players.**

Exhibit 2: SHTF's disbursement/branch still at FY14 levels



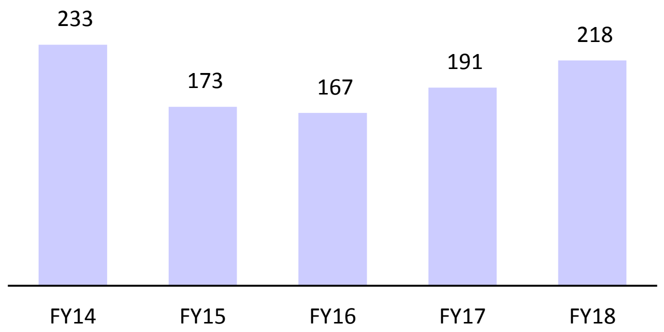
Source: MOSL, Company; Note: FY16 disb. adjusted for CEF subsidiary

Exhibit 3: CIFC's disbursement /branch at 9% CAGR



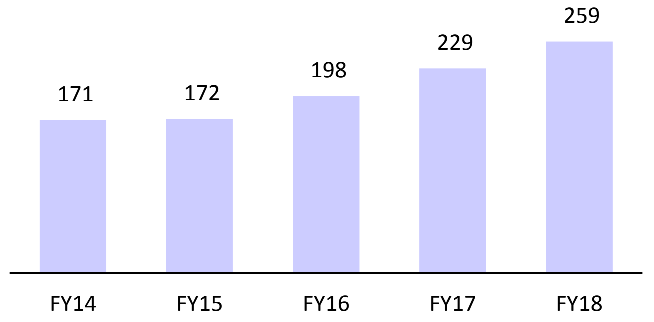
Source: MOSL, Company; Note: Includes only VF disbursements

Exhibit 4: MMFS' disbursement /branch below FY14 levels



Source: MOSL, Company

Exhibit 5: SUF the most consistent performer – 11% CAGR



Source: MOSL, Company

VF players have pricing power since EMI is not very sensitive to interest rates

Vehicle financiers have pricing power; EMI not very sensitive to change in interest rates

- Since vehicle financiers cater to a segment largely untouched by banks, they have higher pricing power, in our view.
- In addition, given the short duration of loans, EMI doesn't change much for a 100bp increase/decrease in interest rates. Hence, it would be easier for vehicle financiers to pass on the increase in cost of funds to the borrowers.

Exhibit 6: EMI sensitivity of INR0.5m, 3 year loan to change in interest rates – 3% increase in EMI for 100bp increase in interest rates

Interest rate	EMI
14%	17,089
15%	17,333
16%	17,579
17%	17,826
18%	18,076

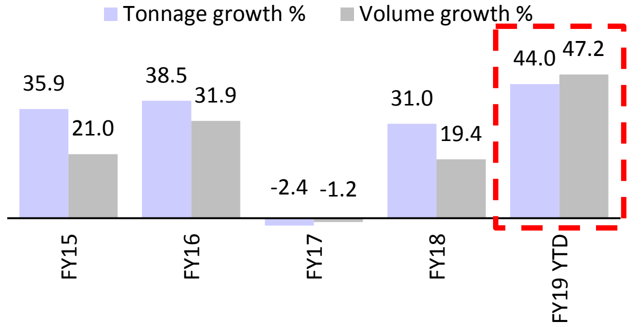
Source: MOSL

Early signs of migration towards lower tonnage vehicles in the M&HCV industry

Early signs of trend reversal in the M&HCV industry

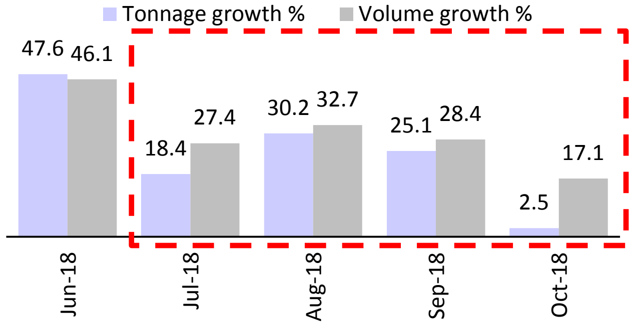
- Over the past five years, there was a clear migration towards higher tonnage vehicles in the M&HCV industry. This led to tonnage growth outpacing volume growth. As a result of higher weighted-average ticket size, disbursement growth for CV financiers outpaced volume growth for OEMs.
- However, this trend has witnessed a reversal in the past few months. In FY19 YTD, volume growth (47% YoY) outpaced tonnage growth (44% YoY). The difference was stark in Oct'18 with volume growth of 17% v/s tonnage growth of just 3%.

Exhibit 7: Tonnage growth outpaced volume growth in the past five years in the M&HCV goods segment…



Source: SIAM, MOSL

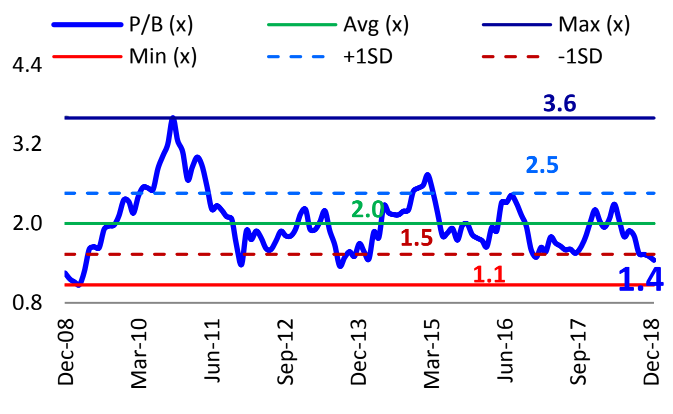
Exhibit 8: …however, the trend reversed in recent month with implementation of new axle norms



Source: SIAM, MOSL

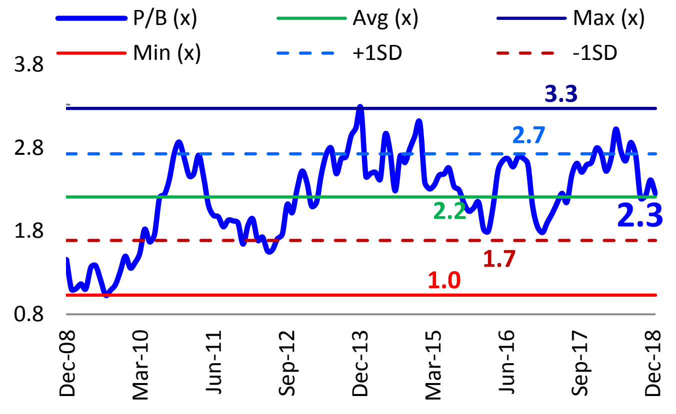
Valuation charts

Exhibit 9: STF – 1yr forward PB



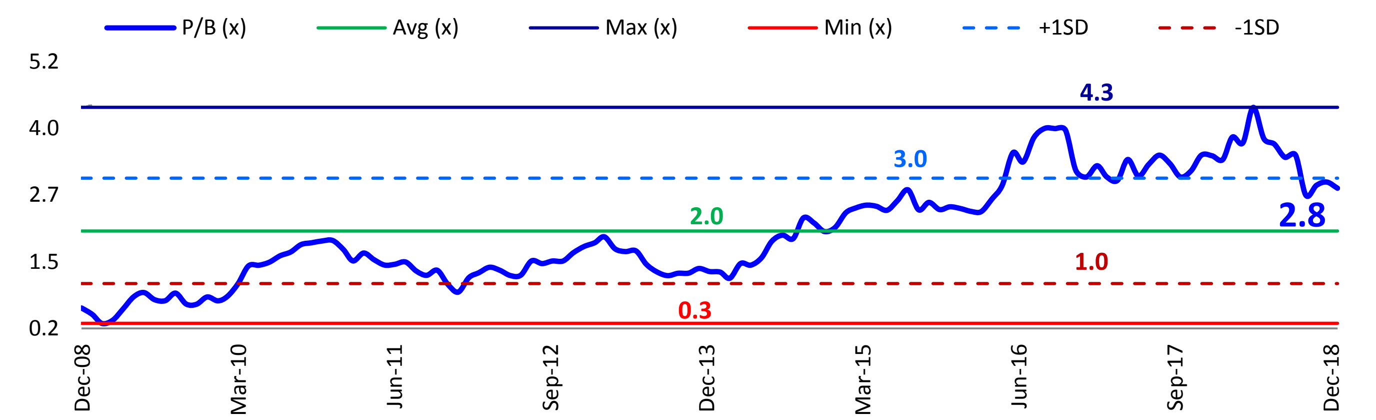
Source: MOSL, Company

Exhibit 10: MMFS – 1yr forward PB



Source: MOSL, Company

Exhibit 11: CIFC – 1yr forward PB



Source: MOSL, Company

Valuation Matrix

	Rating	CMP	Mcap	P/E (x)			P/BV (x)			RoA (%)			RoE (%)		
		(INR)	(USDb)	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E
ICICIBC*	Buy	350	30.7	23.7	31.1	12.5	1.6	1.5	1.4	0.8	0.5	1.2	6.8	4.9	11.5
HDFCB	Buy	2,085	77.8	30.8	26.1	21.8	5.1	3.8	3.4	1.8	1.8	1.8	17.9	16.7	16.5
AXSB	Buy	619	21.6	557.3	34.5	16.3	2.5	2.3	2.1	0.0	0.6	1.1	0.5	7.0	13.4
KMB*	Neutral	1,236	32.3	38.0	33.2	27.0	4.7	4.1	3.6	1.7	1.6	1.7	12.5	11.8	13.2
YES	Buy	187	5.7	10.1	9.3	7.6	1.7	1.5	1.3	1.6	1.3	1.3	17.7	16.7	17.9
IIB	Buy	1,583	13.0	26.3	23.5	16.0	4.0	3.6	2.9	1.8	1.7	2.1	16.5	16.2	20.0
FB	Buy	88	2.3	18.5	15.2	10.2	1.4	1.3	1.2	0.7	0.8	0.9	8.3	9.0	12.2
DCBB	Neutral	158	0.7	19.8	16.5	13.2	1.8	1.7	1.5	0.9	0.9	0.9	10.9	10.9	12.3
JKBK	Neutral	37	0.3	9.8	4.0	3.2	0.4	0.3	0.3	0.2	0.5	0.6	3.8	8.9	10.4
SIB	Buy	16	0.4	8.7	11.2	5.8	0.6	0.6	0.5	0.4	0.3	0.5	6.6	4.9	9.1
Equitas	Buy	116	0.5	125.3	20.4	14.7	1.7	1.6	1.5	0.3	1.3	1.4	1.4	8.2	10.4
RBL	Buy	574	3.3	37.9	27.9	20.0	3.6	3.3	2.9	1.1	1.2	1.3	11.6	12.3	15.2
Private Aggregate															
SBIN (cons)*	Buy	285	34.9	-47.4	49.8	8.9	1.0	1.0	1.0	-0.2	0.1	0.6	-3.5	1.1	11.4
PNB	Neutral	71	2.9	-1.4	-3.8	8.2	0.5	0.6	0.6	-1.7	-0.7	0.3	-29.5	-13.6	6.7
BOI	Neutral	86	1.9	-2.0	16.9	10.4	0.5	0.5	0.4	-1.0	0.1	0.2	-17.8	2.5	4.0
BOB	Buy	113	4.0	-11.5	11.9	7.1	0.7	0.7	0.6	-0.3	0.3	0.5	-5.8	5.7	8.9
CBK	Neutral	258	2.5	-4.1	13.4	5.8	0.6	0.6	0.5	-0.7	0.2	0.5	-12.2	3.9	8.5
UNBK	Neutral	77	1.2	-1.4	-17.9	21.7	0.4	0.3	0.3	-1.1	-0.1	0.1	-23.7	-2.1	1.6
Public Aggregate															
Banks Aggregate															
HDFC*	Buy	1,939	44.4	35.7	23.9	20.3	4.2	2.9	2.7	1.9	1.9	1.7	18.6	16.3	15.1
LICHF	Buy	448	3.1	13.3	9.9	8.2	1.6	1.4	1.2	1.1	1.3	1.5	13.3	14.9	15.8
IHFL	Buy	734	4.1	8.1	7.5	6.3	2.1	1.8	1.6	3.4	3.2	3.2	27.9	26.3	27.4
PNBHF	Buy	960	2.1	19.4	15.3	12.4	2.5	2.2	1.9	1.6	1.4	1.4	14.0	15.4	16.8
GRHF	Neutral	295	2.9	59.6	48.0	43.3	15.0	12.6	10.7	2.5	2.5	2.4	29.8	28.5	26.7
REPCO	Buy	330	0.3	10.0	8.3	7.5	1.6	1.4	1.2	2.2	2.3	2.3	16.9	17.6	16.7
Housing Finance															
SHTF	Buy	1,155	3.6	16.7	10.6	9.0	1.9	1.7	1.4	1.9	2.3	2.3	12.7	16.9	17.1
MMFS	Buy	438	3.5	25.1	19.2	16.6	2.8	2.5	2.3	2.3	2.5	2.4	12.5	13.9	14.5
BAF	Neutral	2,494	19.4	57.5	38.0	30.7	9.3	7.6	6.3	3.3	3.7	3.6	20.4	22.0	22.4
CIFC	Buy	1,241	2.6	19.9	15.9	14.1	3.8	3.2	2.6	2.7	2.4	2.2	20.9	21.8	20.3
SCUF	Buy	1,575	1.4	15.6	11.2	10.0	1.9	1.7	1.5	2.8	3.3	3.3	12.7	15.9	15.5
LTFH	Buy	144	3.8	21.3	12.5	10.7	2.6	2.2	1.8	1.7	2.3	2.3	14.2	18.8	18.7
MUTH	Neutral	478	2.6	11.1	9.6	8.4	2.5	2.1	1.8	5.5	5.8	5.8	24.1	23.6	22.9
MAS	Buy	569	0.4	29.7	22.5	18.4	4.3	3.8	3.3	4.1	4.2	4.1	20.7	17.8	18.9

NOTES

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Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	> - 10 % to 15%
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