MOTILAL OSWAL

NBFC

NIM improvement over FY20-23E (bp)

CIFC	158
MMFS	70
PNBHOUSI	45
HDFC	1
LTFH	0
LICHF	-3
SHTF	-13
BAF	-25
MGFL	-85
MUTH	-91

FY22E PAT upgrade (%)

LICHF	9
BAF	6
CIFC	4
MMFS	2
MUTH	2
HDFC	2
SHTF	1
LTFH	1
MGFL	1
PNBHOUSI	0

Could cost of funds be the dark horse in the NBFC sector?

Sharp decline in incremental CoF to boost margins; Vehicle Financiers best placed

- **NBFCs have seen significant volatility in CY20 on the borrowings front from a sharp increase in CoF in 2Q to multi-year lows by the end of CY20. Given the abundant liquidity in the system and RBI's accommodative stance, incremental CoF across sources is likely to remain benign. NBFCs with a niche presence and strong pricing power are likely to witness margin expansion. Reduction in excess liquidity on the balance sheet and benefit of capital raise for a few players would also aid margins.**
- **NBFCs with healthy parentage and strong credit ratings have seen their CoF from market borrowings (NCDs and CPs) decline by ~200bp in the last six months. At the same time, cost of bank borrowings/public deposits has declined by ~80bp/130bp.**
- **Since the IL&FS crisis, all NBFCs in our coverage pruned their dependence on market borrowings. On an average, the share of market borrowings has fallen by 1,500bp over the past two years. Nevertheless, HDFC, LICHF, BAF and LTFH stand out in the NBFC pack, with over 40% of borrowings accruing from NCDs and CPs.**
- **Given their shorter borrowing profile, Vehicle Financiers are likely to benefit from savings on refinancing as 40-62% of their market borrowings are maturing in the next six quarters (1HFY20-FY22). Around 25-50% of market borrowings for HFCs are scheduled to mature over the next six quarters. Hence, the refinance benefit would play out slower for HFCs as compared to Vehicle Financiers.**
- **Another trigger for margin expansion in FY22 would be the reduction in liquidity on the balance sheet. On an average, liquid assets as a percentage of total assets are up 300-400bp over the past year. With gradual redeployment of money from liquid assets to loans, margins should benefit meaningfully. For Housing Financiers, every 100bp of liquidity redeployed into loans would boost margins by 3-4bp, while that for Vehicle Financiers would be 10-12bp. Hence, a reduction in liquidity to pre-COVID levels could benefit NBFC margins by 10-40bp in FY22E.**
- **Margins can also benefit from a reduction in overall leverage ratios across players. HDFC/MMFS/SHTF raised INR150b/INR31b/INR15b in FY21. Based on growth-RoE matrix and dividend payout ratio, leverage is likely to remain stable in the near term.**
- **We expect NIM to be largely stable for HFCs as a highly competitive environment would compel them to pass on the CoF benefit to their customers and as the share of high-yielding non-retail loans and LAP is likely to come down. Vehicle Financiers, with a niche customer segment and some pricing power, may not pass on the full benefit to their customers. Players like CIFC and MMFS are likely to witness 70-160bp improvement in NIM over FY20-23E. We increase our FY22E EPS estimates by low-to-mid single digits on average, with the highest upgrade of 9% for LICHF (aided by margin and credit cost) off a low base.**

~200bp decline in the cost of incremental market borrowings

Over the past nine months, there has been a sharp decline in the incremental cost of market borrowings for NBFCs, especially those with strong parentage. **For example, BAF raised two-year funds at 4.7% in Dec'20 compared to over 7% for three-year borrowings in Feb'20**. For HDFC, cost of long-term funds (five years) fell nearly 200bp to sub-6% over the same period. **Within Vehicle Financiers, MMFS has been the biggest beneficiary, with the cost of three-year borrowings declining by ~250bp to 5.25% in the past nine months.** Among larger NBFCs, while the cost of borrowing fell for Shriram Group entities, it still remains around 8%.

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25bp NIM impact on FY22E PAT

LICHF	14
PNBHOUSI	12
MMFS	11
HDFC	9
LTFH	9
SHTF	7
CIFC	6
BAF	4
MGFL	3
MUTH	2

Increasing share of bank borrowings since the IL&FS crisis

While the cost of market borrowings has declined sharply, NBFCs have a lower share of market borrowings now as compared to two years ago. This is because, post the IL&FS crisis, companies meaningfully cut down their NCD & CP exposure. These players focused on bank borrowings and alternative sources like sell-downs and ECBs to raise incremental money. **In our coverage universe, only four players – HDFC, LICHF, BAF and LTFH – still have over 40% share of market borrowings.** These players are likely to benefit more than others ceteris paribus. **Nevertheless, players with a higher share of bank borrowings would also benefit, albeit to a lesser extent, as banks have cut their MCLR by 80-90bp since Feb'20 and some companies have moved to repo-linked borrowings from banks.**

HDFC, PNBHOUSI and MMFS to benefit from lower deposit cost

In addition to market borrowings, even deposits (both public and corporate) have witnessed a sharp decline in cost. HDFC's cost of incremental deposits is down 150-180bp to 5.5-6% since the start of the pandemic. For other deposit-accepting players, the decline has been slightly lower (100-150bp). **It is important to note that deposits constitute over 20% for only three players: HDFC (35%), PNBHOUSI (25%) and MMFS (22%).**

Liquidity on balance sheet to come down, to help margin expansion

In the past two years, NBFCs increased liquidity on their balance sheet to over 10% at present from an average of 3-4%. There are several players (BAF, MMFS, MUTH, etc.) who have nearly 20% liquidity on their balance sheet. **As concerns on availability of liquidity and collection efficiency have now abated, we believe most NBFCs would trim liquidity by 300-400bp in FY22E.** With a gradual redeployment of funds from liquid assets to loans, margins should benefit meaningfully. **For Housing Financiers, every 100bp of liquidity (yielding 4-5%) redeployed into loans (yielding 8-9%) would benefit margins by 3-4bp. For Vehicle Financiers, the benefit from redeployment of liquidity would be higher (10-12bp) since yields are ~15%. With a 300-400bp reduction in liquidity, NBFC margins could rise by 10-40bp in FY22E.**

Expect meaningful margin improvement over FY20-23E

Given the factors mentioned above, different NBFCs would have varying degrees of margin impact over the next 2-3 years. In the case of HFCs, we do not foresee any meaningful margin expansion as the benefit from lower CoF is passed on to borrowers. NBFCs with a higher share of fixed rate loans and shorter duration of liabilities are most likely to benefit. **Within our coverage universe, two players stand out in terms of margin improvement: CIFC (a 160bp improvement over FY20-23E) and MMFS (70bp).** The impact of NIM improvement on PAT varies across players – lower the RoA, higher the impact of NIM movement on PAT. As HFCs typically have the lowest RoA among NBFCs, followed by Vehicle and Gold Financiers, the EPS impact from an improvement in margins would be the highest for HFCs and the lowest for Vehicle Financiers, in our opinion. **We upgrade our FY22E EPS estimates by low-to-mid single digits across players to factor in margin benefit as discussed above.**

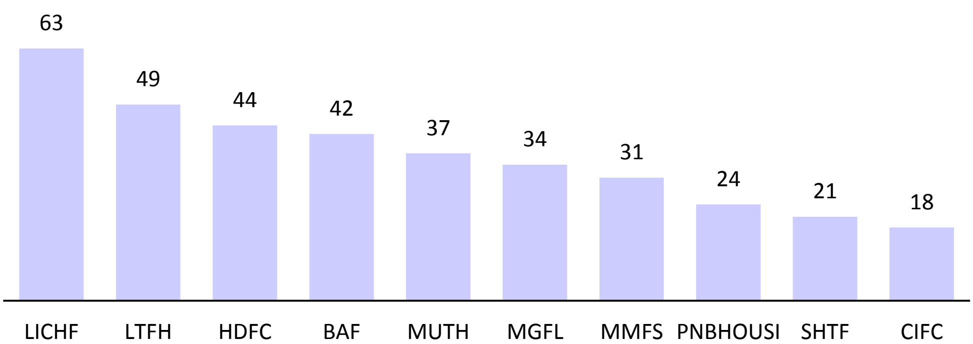
Story in charts

Players with strong parentage are now raising three-year money ~5% compared to over 7% prior to the COVID-19 outbreak

Sharp decline in incremental cost of market borrowings

- **HDFC, LICHF, BAF, and MMFS have witnessed the sharpest decline in incremental cost of NCD borrowings over the past 6-9 months. The incremental cost across tenures is down by ~200bp since Feb'20.**
- While the share of market borrowings has declined meaningfully over the past few years, there are still four players for whom the share stands above 40%: LICHF, LTFH, HDFC, and BAF. Consequently, these players are most likely to benefit from a decline in the cost of NCDs.

Exhibit 1: Share of market borrowings (%)



Source: MOFSL, Company

Exhibit 2: NCD issuance - HDFC

Interest Rate (%)	Date of Issue	Tenure (yr)
7.35	10-Feb-20	5.0
6.99	13-Feb-20	3.0
7.40	28-Feb-20	10.0
7.20	13-Apr-20	3.0
6.95	27-Apr-20	3.0
7.06	13-May-20	1.6
7.00	19-May-20	2.0
7.25	17-Jun-20	10.0
5.40	11-Aug-20	3.0
4.95	09-Sep-20	2.0
6.43	29-Sep-20	5.0
5.78	25-Nov-20	5.0

Source: NSE

Exhibit 3: NCD issuance - LICHF

Interest Rate (%)	Date of Issue	Tenure
7.45	10-Jan-20	3.1
7.97	28-Jan-20	10.0
7.33	12-Feb-20	5.0
6.57	12-Feb-20	1.4
5.45	26-Aug-20	3.0
6.19	25-Sep-20	4.2
5.53	01-Dec-20	4.1

Source: NSE

Exhibit 4: NCD issuance - BAF

Interest Rate (%)	Date of Issue	Tenure
7.10	12-Feb-20	3.0
7.60	28-Feb-20	10.0
7.65	28-Jan-20	5.0
7.90	28-Jan-20	10.9
7.66	14-Dec-19	5.0
7.35	14-Nov-19	3.0
7.06	29-Apr-20	3.1
6.75	01-Jun-20	3.0
5.70	19-Aug-20	3.0
5.20	19-Aug-20	2.0
7.25	27-Aug-20	10.0
6.00	27-Aug-20	4.0
4.66	03-Dec-20	2.0

Source: NSE

Exhibit 5: NCD issuance – MMFS

Interest Rate (%)	Date of Issue	Tenure
7.60	03-Feb-20	3.0
7.45	05-Mar-20	4.8
7.75	05-Mar-20	10.0
7.50	29-Apr-20	3.0
7.63	13-May-20	2.1
6.95	16-Jun-20	3.0
7.25	16-Jun-20	2.0
6.55	29-Jun-20	2.3
5.72	16-Oct-20	3.0
4.80	04-Dec-20	2.0
5.25	04-Dec-20	3.0

Source: NSE

Exhibit 6: NCD issuance - CIFC

Interest Rate (%)	Date of Issue	Tenure
7.41	12-Feb-20	3.0
6.90	27-Apr-20	1.0
6.74	17-Jun-20	1.2
6.93	17-Jun-20	1.5
7.20	17-Jun-20	2.0
7.92	08-Jul-20	5.0
5.85	21-Oct-20	2.4
6.80	26-Oct-20	4.0
9.30	03-Nov-20	Perpetual
5.70	06-Nov-20	2.3
5.45	25-Nov-20	2.0

Source: NSE

Exhibit 7: NCD issuance - LTFH

Interest Rate (%)	Date of Issue	Tenure
9.00	04-Dec-19	5.0
8.25	24-Jan-20	3.0
7.68	04-Mar-20	3.0
7.80	28-Apr-20	3.0
7.50	11-May-20	1.3
GSec-linked	17-Aug-20	2.0
5.85	02-Dec-20	3.0

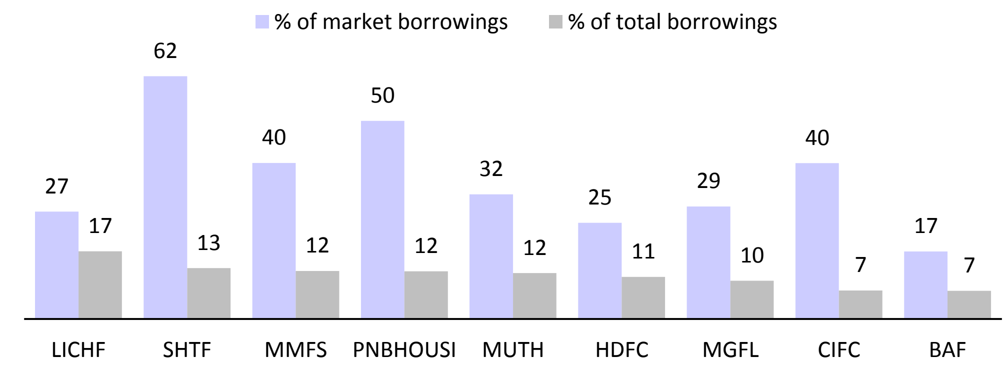
Source: NSE; Note: L&T Finance Ltd.

25-50% of market borrowings for HFCs are maturing in the next 18 months. For Vehicle Financiers, the share of such NCDs stands at 40-62%

Share of borrowings maturing by Mar'22 varies across players

- There are three factors that determine the decline in average CoF: a) fall in incremental CoF, b) proportion of borrowings that would get refinanced, and c) expected AUM growth.
- Players with longer-tenure borrowings tend to benefit less in such situations as a smaller proportion of borrowings mature and get refinanced at lower rates.
- We note that Vehicle Financiers would benefit more than HFCs as 40-62% of market borrowings are scheduled to mature over the next 18 months for the former v/s 25-50% for HFCs.
- **As a share of total borrowings, the quantum of NCDs maturing over the next 18 months stands at 10-13% for most players. LICHF stands out with 17% share.** BAF has only 7% share of total borrowings maturing in the next 18 months. This is primarily due to its long tenure of borrowings.

Exhibit 8: NCDs scheduled to mature over 1HFY21-FY22



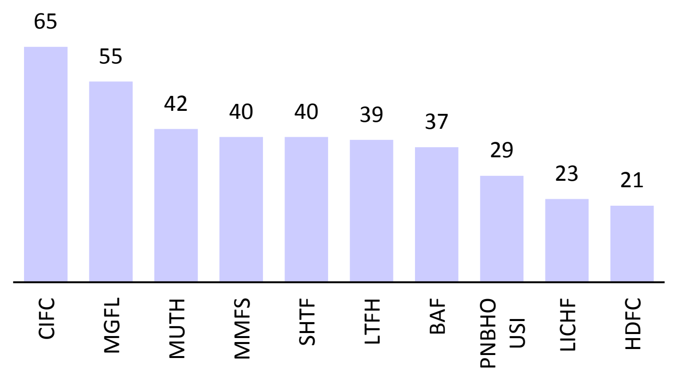
Source: MOFSL, Company

CIFC/MGFL have a high share of bank borrowings at 65%/55%

80-90bp reduction in MCLR by banks to benefit NBFCs immediately

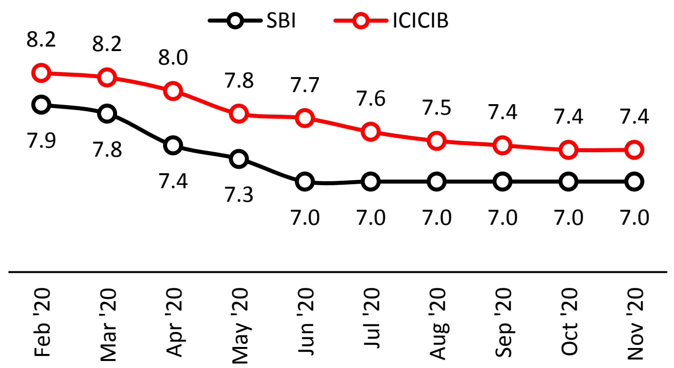
- After the 75bp repo rate cut by RBI in Mar'20, banks have cut their MCLR quite meaningfully. By and large, the one-year MCLR is down 80-90bp since Feb'20.
- HFCs typically have a lower share of bank borrowings, while Vehicle and Gold Financiers have a higher share of bank borrowings.
- **While the quantum of decline in the cost of bank borrowings is much lower than that of market borrowings, it is important to note that the re-pricing benefit happens much quicker (within one year). Also, a few companies have moved to repo-linked borrowings as well.**

Exhibit 9: Share of bank borrowings (%)



Source: MOFSL, Company

Exhibit 10: One-year MCLR reduces by 80-90bp since Feb'20



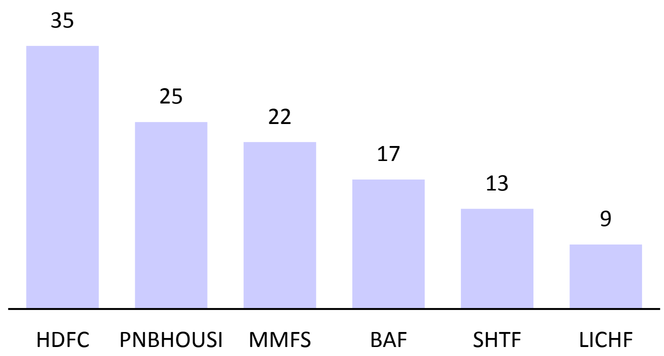
Source: MOFSL, Company

HDFC to benefit from lower cost of deposits as deposits comprise 35% of total borrowings

Cost of deposits down meaningfully; HDFC key beneficiary

- In addition to NCDs, the cost of deposits too has witnessed a meaningful decline over the past three quarters. On an average, it has declined 100-150bp across players. A notable exception here is SHTF for whom the decline in the cost of deposits has been modest.
- **Among NBFCs under our coverage, HDFC is best placed on this front as: a) it has the highest share of borrowings from deposits (35%), and b) its cost of deposits is lower than peers by a meaningful (60-70bp) margin.**

Exhibit 11: Share of deposits in total borrowings (%)



Source: MOFSL, Company

Exhibit 12: Interest rates on public deposits with a 2-3 year tenure

%	March	June	December
HDFC	7.30	6.68	5.65
PNBHOUSI	7.65	7.57	6.34
BAF	7.65	7.45	6.30
SHTF	7.7-8.3	8.1-8.8	7.7-8.2
MMFS	7.80	8.0-8.3	6.3-6.6

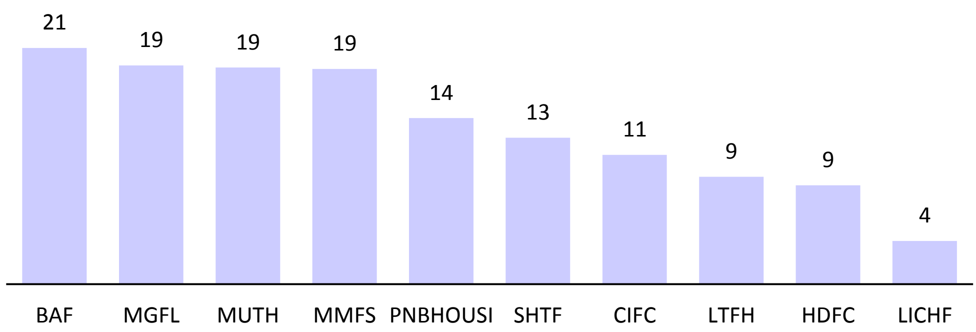
Source: MOFSL, Company

BAF, MMFS, MUTH and MMFS have ~20% liquidity on their balance sheet

Moderation in liquidity to lower NIM drag

- Over the past six months, NBFCs shored up liquidity on their balance sheet given uncertainties in the funding market as well as potential ALM mismatches due to the moratorium on payment of loan EMIs.
- Even some well-rated players like MMFS and BAF have ~20% of borrowings as liquidity on their balance sheet. These players would not need to carry so much liquidity and would redeploy some of it into loans.
- **For Housing Financiers, every 100bp of liquidity (fetching 4-5%) redeployed into loans (yielding 8-9%) would benefit margins by 3-4bp. For Vehicle Financiers, the benefit of redeployment of liquidity would be higher at 10-12bp since yields are typically ~15%.**
- **With a 300-400bp reduction in liquidity, NBFC margins could benefit by 10-40bp in FY22.**

Exhibit 13: Liquidity on the balance sheet (% of borrowings)

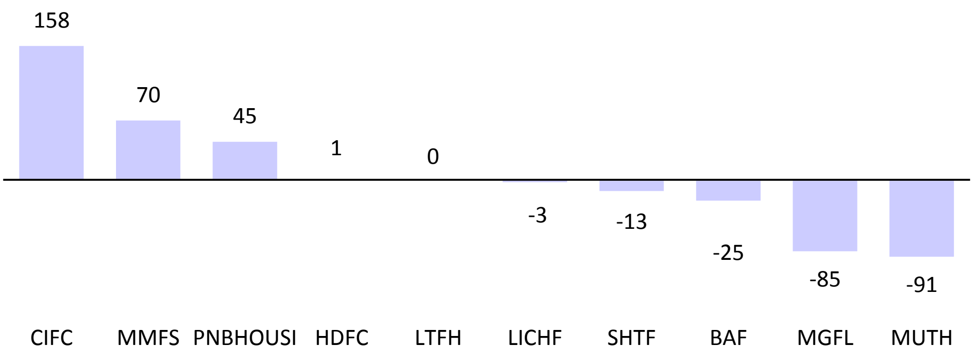


Source: MOFSL, Company

Margin improvement highest for Vehicle Financiers

- Within our coverage universe, Vehicle Financiers are most likely to benefit from margin expansion as they need to pass on the lower CoF benefit to their borrowers. Due to competitive pressures, HFCs would also have to pass on the CoF benefit to their customers, resulting in margins being largely stable.

Exhibit 14: Increase in NIM over FY20-23E (%)



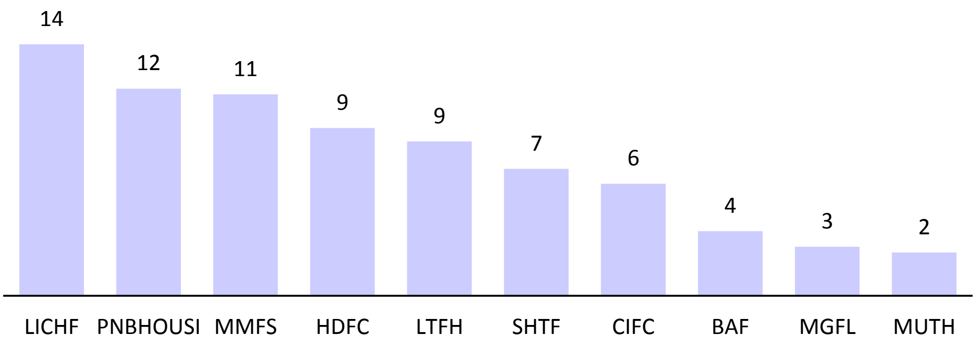
Source: MOFSL, Company

LICHF, MMFS and PNBHOUSI have the highest sensitivity of PAT to changes in NIM

PAT sensitivity highest for HFCs, lowest for Gold Financiers

- Lower the RoA, higher the impact of NIM movement on PAT. As HFCs have the lowest RoA among NBFCs, followed by Vehicle and Gold Financiers, the EPS impact from an improvement in margins would be the highest for HFCs and the lowest for Vehicle Financiers.

Exhibit 15: Impact on FY22E PAT due to a 25bp increase in NIM (%)



Source: MOFSL, Company

See up to 9% FY22E PAT upgrade across players

- Given the tailwinds on the margin front, we increase our FY22E PAT estimates by up to 9%. On average, the PAT upgrades are in low-to-mid single digits driven by benefit on the margin front.

Exhibit 16: Mid-to-high single digit PAT increase across most players for FY22E

FY22E (INR m)	Old estimate	New estimate	Change (%)
HDFC	1,22,450	1,24,868	2
LICHF	30,105	32,744	9
PNBHOUSI	11,205	11,199	0
BAF	79,200	84,049	6
LTFH	21,465	21,582	1
MMFS	11,169	11,448	2
CIFC	19,093	19,932	4
SHTF	29,152	29,350	1
MUTH	40,986	42,002	2
MGFL	20,109	20,218	1

Source: MOFSL, Company

Valuation matrix

	Rating	CMP	Mcap	P/E (x)		P/BV (x)		RoA (%)		RoE (%)	
		(INR)	(USDb)	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
HFCs											
HDFC*	Buy	2,454	56.2	25.6	20.0	2.8	2.3	1.8	1.8	12.3	11.9
LICHF	Buy	362	2.5	6.1	6.1	0.9	0.8	1.3	1.2	15.8	14.0
PNBHF	Neutral	355	0.8	6.2	5.3	0.7	0.6	1.2	1.4	11.4	12.2
REPCO	Buy	238	0.2	5.0	4.7	0.7	0.6	2.4	2.4	15.6	14.3
Vehicle Finance											
SHTF	Buy	997	3.0	10.0	8.7	1.1	1.0	2.1	2.4	12.7	12.6
MMFS	Buy	171	1.5	21.6	18.9	1.4	1.3	1.3	1.4	7.3	7.0
CIFC	Buy	376	4.2	18.8	16.1	3.2	2.7	2.4	2.5	18.4	18.1
Diversified											
BAF	Neutral	5,184	41.5	71.9	39.3	8.6	7.2	2.6	4.2	12.6	19.9
SCUF	Buy	1,043	0.9	8.0	7.1	0.9	0.8	2.9	3.2	11.3	11.5
LTFH	Buy	90	2.4	19.3	8.4	1.2	1.1	0.8	1.9	6.4	13.4
INDOSTAR	Neutral	324	0.5	96.5	26.5	1.0	1.0	0.4	1.4	1.3	3.8
MAS	Buy	923	0.7	32.2	26.8	4.5	4.0	3.5	4.1	14.9	15.9
Gold Finance											
MUTH	Buy	1,188	6.5	13.6	11.6	3.3	2.7	6.6	6.8	27.0	25.6
MGFL	Buy	164	1.9	8.4	6.9	1.9	1.6	5.4	5.8	25.6	25.1
Wholesale											
PIEL	Buy	1,407	4.1	12.8	11.0	1.0	1.0	0.0	0.0	8.4	9.4
ABCL	Buy	85	2.8	11.3	8.6	0.9	0.7	1.4	1.5	8.7	8.9

Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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