India

Overweight *(no change)*

NBFC

3Q review: Opportunities amid obstacles

- Opportunities surrounding a spur in government spending with seasonality of 4Q might boost demand, although sustainability of the same is a challenge.
- The asset quality stress continues to loom around lower-ticket size unsecured products. We expect the trend in write-offs to remain elevated.
- Our preference is for superior quality NBFCs - Bajaj Finance and Shriram Finance – high conviction ADD-rated stocks. We remain cautious on CIFC.

Demand trend volatile; 4Q is expected to remain strong

We have witnessed volatility in disbursement growth across different businesses. Housing and gold lending has remained an outperformer amid elevated gold prices as well as improving momentum in rural India on the back of a healthy monsoon season. Used vehicle sales continue to outshine new vehicle sales which remained sluggish. Interestingly, the demand for tractors and medium and heavy commercial vehicles (M&HCV) was superior compared to light commercial vehicles (LCV). Microfinance continued to reel under the pangs of overleveraging. There is optimism surrounding a spur in government spending after the Union budget which is expected to boost demand. 4Q always remains a seasonally strong quarter, which, we believe, will continue in the current year as well; however, sustainability of the trend will be a key thing to watch out for.

Asset quality remains a challenge; write-offs to remain elevated

The asset quality stress continues to loom around lower-ticket size unsecured products like credit cards and personal loans. The heat surrounding overleveraging and misuse of funds still prevails; however, the tightening of underwriting norms by most lenders is checking new supply of the same. Microfinance institutions or MFIs continue to bleed, which is on the expected lines, and the same is expected to continue for another quarter or so. There are some initial signs of asset quality pain in small-ticket MSME loans, although not a major cause of concern yet. We expect the trend in write-offs to remain elevated in the near term.

Margin trajectory improving; cost of funds peaks out

Most NBFCs have reported flat-to-improvement in margins on a sequential basis as the cost of funds for most NBFCs has already peaked out. We believe the recent cut in the repo rate will ease the overall cost of funds further for most NBFCs as banks are bound to cut interest rates for loans which are linked to benchmarks. On the contrary, most NBFCs have the discretion to manage rates with an added advantage of a higher share of the fixed-rate loan book. This will ensure superior margin profile for most NBFCs under our coverage universe.

Outlook and valuation

We believe that lenders with a strong track record and robust asset quality management will continue to depict strong AUM growth. Bajaj Finance (BAF) continues to be an outlier, which has maintained a healthy growth momentum. We expect BAF (ADD; Rs9,750) to remain an outlier on growth and profitability fronts even during the current volatility. We also like Shriram Finance (ADD; Rs800) for its diversified growth and strong collection efficiency. We prefer to remain cautious on Cholamandalam Investment and Finance Company or CIFC (HOLD; Rs1,300) as we remain watchful of new businesses of this company which have been stagnating since the past few quarters, with a consistent surge in fresh slippage. We also have an ADD of MMFS (Rs330) among other vehicle financiers. Among housing finance companies, we like Home First Finance Company (ADD; Rs1,150) and Aavas Financiers (ADD; Rs2,100). We continue to maintain our recommendation on UGRO Capital (ADD; Rs320), Spandana Sphoorty Financial (HOLD; Rs 360) and SBI Cards (REDUCE; Rs550).

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Stock Ratings	Definition:
Add	The stock's total return is expected to exceed 10% over the next 12 months.
Hold	The stock's total return is expected to be between 0% and positive 10% over the next 12 months.
Reduce	The stock's total return is expected to fall below 0% or more over the next 12 months.

The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

Sector Ratings	Definition:
Overweight	An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
Neutral	A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
Underweight	An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

Country Ratings	Definition:
Overweight	An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
Neutral	A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
Underweight	An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.