India

Overweight *(no change)*

Finance Companies

Gold lending in the spotlight

- Gold lending intensifying amid expensive personal loans; banks are increasing co-lending partnerships to improve penetration in rural and semi-urban areas.
- RBI has laid a level-playing field with a cash disbursal limit, but we see the regulator persisting with its intense scrutiny of the gold lending business.
- We prefer the gold finance business due to better growth trajectory & superior asset quality. The ban on IIFL will be beneficial for gold lenders like Muthoot.

Gold lending intensifies as unsecured loans become expensive

We believe that there is a gradual shift being from unsecured personal lending to gold lending amid the Reserve Bank of India or RBI's higher risk weights assigned to unsecured lending, which has translated into higher interest rates. In Nov 2023, the RBI had increased weights on unsecured personal loans to 125% from 100% while the risk weights on gold lending remained unchanged. This, along with rising gold prices, pushed the borrowers towards higher gold lending from unsecured personal lending.

RBI diktat increases level-playing field for gold lenders

The recent RBI diktat for cash disbursements (limited up to Rs 20,000) has brought in a level-playing field for non-banking finance companies or NBFCs. The disbursement norm will bring in discipline and will ensure that the overall business remains far more regulated. This cap on cash disbursements also brings in the fear of losing customers to money lenders, but we don't see it materializing in the near future.

Banks shoring up for co-lending partnerships

The gold lending space is broadly divided between banks and NBFCs, wherein banks cater to relatively higher ticket loans and are more focused towards the salaried segment while NBFCs cater to lower ticket loans, more towards the self-employed segment. However, to participate in the improving gold lending business, especially in the rural and semi-urban areas, banks are stretching their arms to grab more market share even in the lower ticket size loans through co-lending partnerships with gold NBFCs. Direct lending to lower ticket size is operationally unfavourable to banks, but the co-lending mechanism gives a good opportunity for banks to expand in this segment.

May see a shift from bullet to regular payments

Gold lending is broadly divided into two - bullet payments, where both the interest and principal are collected at the end of the tenure, and monthly payments, where the interest is collected on a monthly basis, but the principal is collected at the end of the tenure. In the case of bullet payments, the effective interest rate is higher due to compounding of unpaid interest. Thus, incrementally, banks and NBFCs are shifting to a monthly collection basis to reduce the overall burden on the borrowers. We believe the regulator will continue to closely monitor lending with a view to increasing transparency and protecting the interests of customers.

We like Shriram Finance (ADD, TP Rs3,000) & Muthoot Finance (NR)

There is a long tail of the gold financing business with a fast turnaround and very high churn. The barriers to entry are also high as it requires heavy investments in the initial stage (in the form of physical branches). Since it is short-tenure lending, large gold financers are diversifying their assets under management or AUM for more consistent growth. We prefer the gold finance business due to improved growth trajectory and superior asset quality. The gold finance business has historically witnessed lower credit costs with stable asset quality, resulting in lower income volatility. From our coverage universe, we prefer Shriram Finance (ADD; TP Rs3,000) which has a sizeable gold loan portfolio (~2.8% of AUM), with improving prospects of a further rollout of the gold finance business to the existing branches. Among the NBFCs not in our coverage universe, we like Muthoot Finance for its wider reach, superior brand recognition and relatively fair business practices.

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