

Better than expected

In the light of recent developments in the NBFC space, we visited branches of NBFCs/HFCs in the outskirts of Pune to ascertain the (anecdotal) impact on key metrics.

Disbursals: As funding to NBFCs reduced considerably post the IL&FS and DHFL debacles, we expected disbursals to slow down across the board. We noticed a slowdown at CIFIC while MMFS and Repco reported healthy growth. Magma, too, displayed resilience but on a smaller base.

Interest Rates: Given the rise in CoFs for NBFCs, a pass through was certain. The impact on margins is contingent on the ability of the NBFCs to pass on the entire increase in the cost of funds to their customers. All the NBFCs/HFC branches we visited other than Manappuram have raised their interest rates in recent times. CIFIC has increased its rates by ~100bps since Apr-18, while Repco has raised its rates by a mere ~30bps since Oct-18.

Asset Quality: We do not foresee any major asset quality issues across the retail portfolios of NBFCs. Our stance was corroborated as neither of the NBFC/HFC branches we visited reported significant changes in asset quality.

View: Surprisingly, disbursals across the branches we visited were resilient. We believe low regional disbursals at CIFIC will be balanced by robust performance in other geographies, especially eastern India. Asset quality was stable, in line with expectations. Our constructive stance on CIFIC (TP

Rs 1,625, 3.25x Dec-20 ABV of Rs 500) and MMFS (TP Rs 500, 2.75x Dec-20 ABV of 175 + Rs 18 for MIBL) remains unchanged.

- **CIFIC:** Regional disbursals slowed down in Nov-18, led by the M&HCV segment (on a/c of poor demand coupled with higher interest rates). However, the focus on collections ensured superior asset quality.
- **MMFS:** Disbursal growth was robust at +30% YoY and ahead of internal targets. While the quantum of cash collections remains high, asset quality improved due to the increasing focus on collections.
- **Repco:** Disbursals increased gradually as competition from NBFC/HFCs in the area receded. Avg. monthly disbursals were ~Rs 55mn. Interest rates were increased by ~30bps since Oct-18. Asset quality was stable with branch GNPA's at ~1.6%; home loans constituted ~95% of the branch assets.
- **Magma Fincorp:** Regional disbursals in the year averaged ~Rs 65mn/month. In Oct & Nov-18, disbursals were higher at ~Rs 80mn & ~Rs 70mn (on a smaller base) but significantly lower than the target of ~Rs 100mn. The focus was on improving asset quality and productivity from the current levels (higher business/employee and branch).
- **Manappuram:** On an FYTD basis, regional AUM (36 branches) grew ~20% to ~Rs 3.6bn. Gold collateral grew ~2.6% to 1,674kg. Interest rates and discounts offered to customers remained unchanged over the past 3 months. Asset quality was largely stable with no major frauds in the region.

**Branch location: Shivaji
Nagar, Pune**

Cholamandalam Investment and Finance Company

Disbursals

- Regional Disbursals slowed down in Nov-18 to Rs 4bn vs. Oct-18 at ~Rs 5bn.
- A significant slowdown was witnessed in M&HCV disbursals.
- Tractor disbursals gained traction. This was attributed to govt. subsidies on large tractors and the increasing use of tractors for alternative purposes.
- LCV disbursals increased on a/c of strong demand by operators servicing e-commerce companies.

Asset Quality

- Overall asset quality improved across geographies. At the branch level, asset quality converged with overall levels.
- Overall early default stood at ~1.75%. Early default is a measure of asset quality that denotes the % of borrowers that have defaulted at least twice in the first 18 months.

Interest Rates

- In the face of rising CoF, CIFIC has increased its interest rates by ~100bps since Apr-18.
- As a result of increasing its rates, it is facing intense competition from banks in the area which are able to lend to the same customer profile at lower interest rates.

Key Challenges

- Competitors have resumed offering higher LTVs based on gross invoice values. This drastically reduced the borrower's contribution and creates scope for customer fraud. As CIFIC refrains from such practices, it is facing stiff competition. Further, it has stopped disbursals in areas that are prone to this issue.
- Delay in payments to contractors and transporters by the Govt of Maharashtra for infrastructure projects has resulted in lower demand for new MHCVs. Asset quality, too, has suffered marginally on this a/c. The situation has been accentuated by slowdown in bank funding to these parties.

New Initiatives

- CIFIC has tied up with RBL to launch co-sponsored cards under the brand name 'Vishesh'. These cards are issued to selected customers with limits based on past track records.
- Vehicle owners provide these cards to vehicle drivers to make payments for fuel and other expenses.

View: With regional disbursement growth slowing down in the near term, a challenge lies ahead for CIFIC to meet its regional growth targets. However, robust growth observed in other geographies will enable the co. to meet its overall targets. The focus on asset quality and collections observed at the branch level was impressive. Further, profitability consciousness at a product level is creditable.

**Branch location: Swargate,
Pune**

No of contracts: ~12000

No of LMV contracts: ~2000

Mahindra & Mahindra Financial Services

LMV Disbursals

- The branches in the region disburse ~Rs 100mn worth of LMV loans in a month. Disbursals to drivers partnered with cab aggregators amount to ~Rs 30mn.
- In sharp contrast to competitors, disbursals in this segment have been 10% higher than budgeted and have witnessed a ~30% YoY growth.
- The co as a whole disbursed a record 84000 loans in Nov-18.

Business Structure

- Unlike other asset financiers, MMFS follows a vertical structure instead of a branch/ functional structure- a recent change.
- In a vertical structure, employees are focused on a single product. In such a structure, the same employee is in charge of disbursals and collections for a limited time period. This structure creates accountability for disbursals made.

Interest Rates

- MMFS has increased interest rates over the past 2 months. Yields range between 9.5-17% with an average of 14.5%.
- LTVs are ~85% and the loans are extended net of discount.

Employee Morale

- High employee morale was evident from the persons we interacted with as a result of better compensation practices and top management engagement.
- The incentive structure has been revised- now offered on every 10 cases instead of 15.
- Attrition levels were low and the average employee association with the branch was 5.5 years.

View: We believe that the unflinching focus on disbursals has contributed to growth even while other players had to slow down resulting in an increase in regional mkt share.

Branch location: Narayan Peth, Pune

Branch AUM: Rs 1.85bn

**AUM Mix:
95%- Home Loans
5%- LAP**

**80%- Salaried Persons
20%- Non Salaried Persons**

RepcO HFC has 4 branches in Pune

Average Ticket Size - Rs 1.5-2mn

Largest Home Loan- Rs 20mn

Largest LAP Loan- Rs 10mn

**Branch Employee Strength:
3-Collection
5-Operations
1-Branch Manager**

No of Live Accounts- 1750

RepcO Home Finance Company

Disbursals

- FYTD Disbursals amounted to ~Rs 420mn vs. ~Rs 400mn in FY18.
- The branch handles 25-30 cases a month, implying an average ticket size of ~Rs 2mn.
- 80% of the loans are sourced through Direct Sales Agents (DSAs). The remainder is sought by means of reference from existing customers. The branch is focusing on reducing its reliance on DSAs by increasing the strength of its internal sales force.
- The branch's focus appears to be on the quantum of monthly disbursals and not the number of cases handled. This may result in higher average ticket sizes, contrary to the management's strategy.

Interest Rates

- The average yields on the branch's book were ~11%. The loans are priced as per the MLR which has a 6 month reset period.
- Given the rise in the CoF, Repco has raised interest rates by 30bps since Oct-18. In spite of this, we expect NIMs to come under pressure as the CoF has risen faster.

Asset Quality

- Branch GNPA's were ~Rs 300mn (~1.6%) of which 50% are considered critical. Critical NPA's are those wherein the borrower has not been making repayments. The largest NPA was ~Rs 5mn.
- Branch NPA's consisted almost entirely of home loans.

Repayments and Foreclosures

- Average monthly repayments were ~Rs 20mn (implied repayments at Rs 27mn). ~50% of monthly repayments were on account of prepayments and balance transfers (implied prepayment and balance transfer rate: 10% ann.).
- Most of the balance transfers were to Gruh, DHFL, LICHFC and the Bank of Maharashtra.

View: Contrary to expectations, disbursals remained resilient. We believe that NIM compression is on the cards as loan re-pricing has not been able to keep pace with the rise in the CoF. Stable asset quality and the continuation of lending activities, in the face of retreating competition are positives.

Branch Location: Shivaji Nagar, Pune

**No of Branches:
3- Pune**

**9- Western Maharashtra
25- Maharashtra**

**AUM (Western Maharashtra)
- ~Rs 1.25bn**

**AUM Mix:
Tractors- 20%,
CVs- 60% and
LMVs and Others-20%**

Magma Fincorp

AUM and Disbursals

- The regional AUM grew ~25% YTD. Average disbursals were ~Rs 65mn per month. Disbursals for Oct and Nov-18 were ~Rs 80mn and ~Rs 70mn. The AUM growth is optically high on account of a smaller base. The region had run into troubled waters due to changes in senior level staff. Disbursal growth remained below targets.
- The regional disbursal target for the year is ~Rs 1.25bn; FYTD disbursals were ~Rs 520mn. We believe that the pursuit of this target will be an uphill task.
- The monthly disbursal target for each branch is ~Rs 10mn (5 Field Officers/Branch x 5 Cases/Month x Avg Ticket Size-Rs 0.4mn).
- A separate field officer is responsible for collections in 60+dpd cases, this field officer has a jurisdictional radius of ~60km. Further, 30-35 cases are handled by each officer.

Business Strategy and Structure

- Magma follows a branch/functional business structure and not a vertical structure. As a result, employees are required to focus on individual functions such as either sales or collections across product lines.
- Target customers include first time buyer up to customers with 5 CVs. In the retail/LMV segment, the focus is on potential customers that do not have any income proof.

Other Observations

- The increase in Govt subsidies on large tractors (70bh) has contributed to an increase in tractor disbursals; this view was shared by the CIFC branch.
- Banks are also focusing on tractor finance to meet priority sector lending requirements instead of crop loans.

Branch location: Kasba Peth, Pune

No of Branches in Pune- 36

AUM (Pune) - ~Rs 3.6bn (as at Nov-18)

Gold Collateral (Pune)- 1670kg (as at Nov-18)

Total no of customers- 45000

Duration of average customer relationship- 2-3 years.

Majority of the borrowers require funds for employment in their businesses

Average collateral ~30gm

Average LTV- ~65%

The average tenure of the loan is 90 days

Manappuram Gold Loans

AUM, Collateral and Disbursals

- The co has 36 branches in Pune, having a total AUM of ~Rs 3.6bn vs. Gold Collateral of 1,670kg. The average AUM/ branch is ~Rs 100mn.
- YTD Growth: AUM across branches grew ~20% while gold collateral grew ~2.6%. The implied increase in LTV was ~900bps (from ~58% to ~67%).
- The quantum of gold collateral fell by 30kg in Oct & Nov-18 due to the festive season.
- The co does not charge any processing fees on the disbursal of loans. The turnaround time for disbursals is ~15 minutes. The average footfall is ~55 per day of which 20 turn into actual customers.
- The co encourages customers to deposit their gold even after repayment of the loans so that customers can avail fresh loans at their convenience.

Interest Rates

- Neither has the company increased interest rates nor has it altered discounts to customers in the past 3 months.

- Interest rates are a function of the LTV amongst other parameters, ranging between 1-2% pm. The minimum LTV is ~33% while the maximum LTV is 75%. Interest is calculated on daily outstanding balances.

Gold Appraisal and Storage

- The gold collateral is appraised by two persons within the branch; the branch manager may function as the third level appraiser. There is a degree of discretion/ human element involved in appraising the collateral.
- If fraud is detected at the time of appraisal, the customer details are circulated across branches. Approximately 1-2 such cases are detected per month.
- The gold is stored in cellular safes (a large vault consisting of multiple individual safes, only one of which can be opened at a time) within a 'strong room'. Within the safe, gold is stored in packets that are fitted with GPS trackers.
- The branch has one day and one night security guard.

Peer Set Comparison

NBFC	MCap (Rs bn)	CMP (Rs)	Rating	TP (Rs)	ABV (Rs)			P/E (x)			P/ABV (x)			ROAE (%)			ROAA (%)		
					FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
SHTF	287	1,267	BUY	1,604	604	711	832	12.2	10.2	8.8	2.10	1.78	1.52	16.3	17.1	17.3	2.47	2.56	2.51
MMFS #	292	475	BUY	500	141	162	180	19.8	16.2	13.8	3.24	2.83	2.64	14.5	16.0	17.4	2.39	2.46	2.53
LICHF	247	489	BUY	534	273	318	369	10.3	9.3	8.1	1.79	1.54	1.32	17.5	16.9	16.9	1.30	1.26	1.24
CIFC	197	1,259	BUY	1,625	354	433	522	16.4	13.5	11.2	3.56	2.90	2.41	21.1	21.4	21.4	2.73	2.78	2.85
REPCO	24	383	BUY	583	223	260	302	9.9	8.9	7.8	1.71	1.47	1.27	16.8	16.1	15.9	2.27	2.21	2.18

Source: Company, HDFC sec Inst Research; # Adjusted for Subsidiary

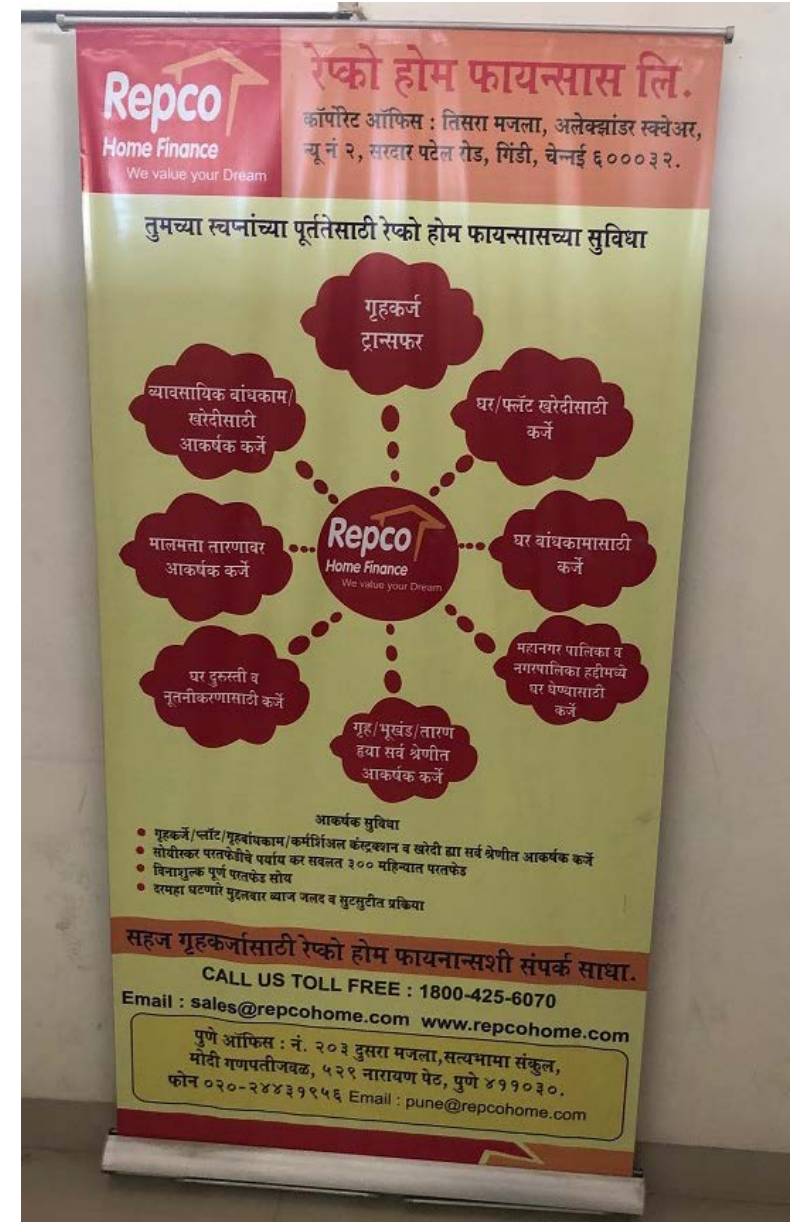
CIFC Branch: 'Vishesh' Credit Card Advertisement



Repco's Branch: Advertisement



Repco Branch



MMFS Branch: A busy Cash Counter on the EMI Due Date



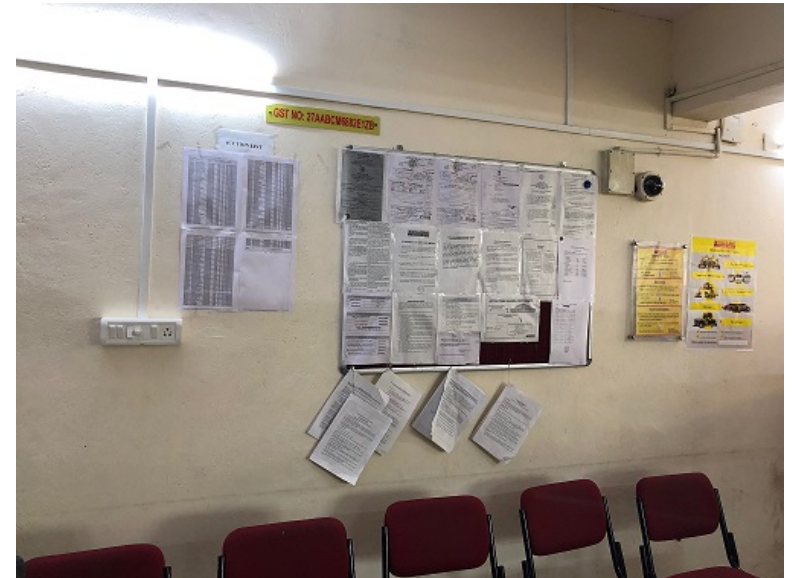
MMFS Branch: A busy Cash Counter on the EMI Due Date



Manappuram Branch: Customer Counter



Manappuram Branch: Notice Board



Magma Branch

Magma Branch: Token Dispensing Device



Magma Branch: Cash Counter



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