Will NBFC stocks continue to rise?

Expected rebound in rural consumption and good asset quality have lifted NBFC stocks. Find out if they have steam left.

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Over the past few months, shares of non-banking financial companies have surged, even as PSU bank stocks have tanked. The former even trumped stocks of private banks, which had so far been among investor favourites. Some NBFC stocks have spiked by as much as 60-80%. Investors have latched on to them due to the higher growth trajectory and superior asset quality reported by the firms. But while these appear to be in a sweet spot, should you invest in NBFC stocks at current levels?

Small ticket loans get the nod

The March quarter earnings highlighted the wide gap in the quality of financials of the banking and non-banking sectors. On an aggregate level, profit after tax (PAT) for private sector banks increased by 23% while that for NBFCs jumped 32% over the corresponding period last year. PSU banks reported heavy losses owing to stricter NPA provisioning norms.

NBFCs managed to achieve this growth while maintaining healthy asset quality in their loan books. These players are making their presence felt in the credit space, eating into the market share of banks across different segments. With most banks focused on firefighting the NPA problem, NBFCs' healthier books have put them in a better position to expand their loan book aggressively. Housing finance in particular has seen NBFCs shine bright. According to Crisil, the share of NBCFs in the housing finance industry increased from 26% to 38%, shrinking the share of banks from 74% to 62%. NBFCs already dominate auto finance and consumer durable finance.

NBFCs are now considered the best placed to tap opportunities arising at the base of the pyramid. Several microfinance-focused NBFCs as well as home finance providers catering to low-ticket size borrowers are in the limelight for this reason. Most of these NBFCs offer a play on a bountiful monsoon which is expected to revive rural consumption. Higher disposable income in the hands of rural households will likely cause an expansion in the loan books of these companies. "The rural, semi-urban focus of these players has attracted the attention of investors," says Ambareesh Baliga, a Sebi registered independent market analyst. Microfinance institutions-turned small finance banks Equitas Holdings and Ujjivan Financial Services both enjoyed spectacular debuts on the bourses recently, riding on the same theme. These are currently trading 58% and 72% above offer price, respectively.

Lalit Nambiar, Fund Manager at UTI Mutual Fund, reckons some NBFCs have benefited owing to their pure-play exposure to niche segments like tractors or heavy commercial vehicles finance. Shriram Transport Finance and Sundaram Finance are leaders in this segment. Housing finance companies such as Can Fin Homes, Gruh Finance and Repco Home Finance are also beneficiaries of their presence in lower income segments. These are expected to benefit from a Budget provision that allows first-time home buyers additional deduction for interest payment of ₹50,000 per annum for loans of up to ₹35 lakh sanctioned during this financial year, provided the value of the house does not exceed ₹50 lakh.

What you should do

Now the question is, do these stocks provide good opportunity even at current levels? Valuations have surged. NBFCs like Bajaj Finance and Sundaram Finance are trading at 6.5 times and 4.2 times book value, respectively. To put this in perspective, housing finance major HDFC—the largest listed NBFC in the country—is trading at 3.8 times book value. Analysts say it is time to be cautious, given that the risk-reward equation is less favourable for these stocks. Kotak Securities in a report notes how the banking and financial services sector has seen an surprising change in perception in the past few weeks and cautions against over-optimism in NBFC stocks.

"The market had been quite prompt to award the rapid growth in assets of banks over the past few years, only to regret it later," the report says, adding, "We do not doubt the credit processes of NBFCs but highlight that the stocks have rallied sharply on hopes of rapid growth in their assets and NII and improvement in financial ratios on likely economic recovery." While an expected revival in rural consumption could be a big positive, timely progression of the monsoon will be critical for NBFC stocks to retain the gains made over the past few months, says Baliga. He feels niche housing finance players still appear more attractive than prominent lenders like HDFC and LIC Housing Finance. However, he advises investors not to make fresh investments in shares of Equitas and Ujjivan following the sharp run-up in their prices.

ANALYSTS URGE CAUTION

The risk-reward equation is not so favourable for these stocks.

	CMP (₹)	PBV	3-MONTH RETURN (%)	1-YEAR RETURN (%)
Cholamandalam Investment and Finance	964	4.1	44.2	64.9
GIC Housing Finance	275	2.0	30.8	33.1
Repco Home Finance	745	4.9	28.9	26.3
Shriram Transport Finance	1,160	2.6	25.4	41.3
Gruh Finance	279	12.2	19.3	27.5
Sundaram Finance	1,428	4.2	16.4	-2.6
Bajaj Finance	7,498	6.5	15.9	59.0
Canfin Homes	1,185	3.6	15.6	77.1
Dewan Housing Finance Corp	203	1.1	10.8	4.6
Housing Development Finance Corp.	1,207	3.8	8.4	-0.6
SREI Infrastructure Finance	59	0.8	7.5	81.1
LIC Housing Finance	471	2.6	3.7	19.0

Data as on 13 June 2016. Compiled by ETIG Database. CMP is current market price; PBV is price-to-book value.

With a sharp uptick in prices, several NBFC stocks appear expensive.

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