Undervalued NBFCs in India: A Credit Consumption-Led Opportunity

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Abstract

This report analyzes the growing trend of credit consumption in India and identifies an emerging investment opportunity in undervalued Non-Banking Financial Companies (NBFCs). By evaluating macroeconomic indicators, consumer behavior, and market valuations, we argue that select NBFCs such as Bajaj Finance Ltd. present a strong investment case in the medium to long term.

1 Executive Summary

- Credit consumption in India is rising rapidly due to urbanization, digital lending, and changing consumer preferences.
- NBFCs are crucial enablers of credit growth, especially in underserved segments.
- Several NBFCs are trading below historical and sector-average valuation multiples.
- This report highlights the structural opportunity and suggests ways to capitalize on the current market mispricing.

2 Macroeconomic and Consumer Trends

- Credit card spending has grown significantly from Rs 1.2 lakh crores in FY13 to Rs 15.6 lakh crores by 9MFY25 at a CAGR of 27.7%, reflecting a strong growth in consumer expenditure fueled by rising incomes, increasing credit card adoptions, growing digitalisation and economic expansion.
- The total number of outstanding cards also increased significantly from 2 crores in FY13 to 10.8 crores by 9MFY25, at a CAGR of 23.6%,
- Increase in household debt-to-GDP from 47.58% in 2018 to 80% in 2024.
- Surge in credit card issuance and EMI-based purchases.
- Growing adoption of Buy Now, Pay Later (BNPL) models.

3 NBFC Sector Overview

3.1 Role in the Economy

NBFCs serve as the backbone of financial inclusion by lending to retail customers, MSMEs, and sectors underserved by traditional banks.

3.2 Market Segmentation

- Consumer loans
- Vehicle financing
- Gold loans
- MSME financing

3.3 Regulatory Landscape

The RBI mandates NBFCs to maintain a strict Liquidity Coverage Ratio (LCR), report detailed cash flows across maturity buckets, and adopt board-approved liquidity risk management policies. They must also comply with the RBI's 2021 Securitisation Guidelines.

4 Investment Thesis

- Credit growth translates directly to NBFC revenue growth.
- Companies offering BNPL schemes are the new credit card companies. Historically, credit card companies have shown great growth and this growth should transfer to BNPL companies.
- Digitally native NBFCs benefit from lower customer acquisition cost and better asset quality through data analytics.
- Increased credit spending in India provides a great opportunity.

5 Risks and Mitigation

- The increase in credit spending is not sustainable. If incomes do not increase at a higher rate, defaults increase, increasing the amount of NPAs.
- This could erode the lending company's profitability, potentially leading to a decline in stock price.
- NPAs, interest rates and regulatory laws need to be monitored in order to safely exit this trade without getting caught up in the bubble.

6 Case Study: Bajaj Finance Ltd.

6.1 About

BFL is India's largest lender for consumer electronics, digital products, and lifestyle goods. It has one of the lowest NPA% in India with its GNPA at 0.96% for Q1FY25. 10% of its AUM is in rural lending. Rural India is said to have the highest increase in credit spending.

6.2 Finances

- Its Revenue has increased 2.14x since Q1FY22.
- Its Net Profit however has increased 1.88x since Q1FY22.
- It has managed to keep its net NPA below 0.5% for the past two years.
- Promoter stake has recently increased.
- The stock is trading at a lower PE than its 5 year median PE of 38.
- It has one of the lowest debt to equity ratio among its competitors.

7 Conclusion

The current surge in credit consumption represents a secular trend. Select NBFCs stand to gain disproportionately due to their market position, digital agility, and pricing. Market mispricing offers investors a rare opportunity to enter at attractive valuations.

References

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