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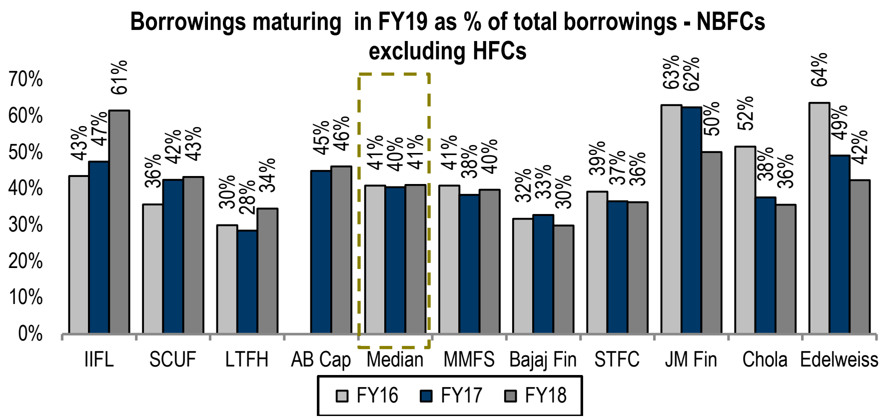
SECTOR REVIEW

Bracing for tighter liquidity

Figure 1: Share of short tenure borrowings has increased for IIFL, SCUF and LTFH. It remains 50%+ for JM Fin

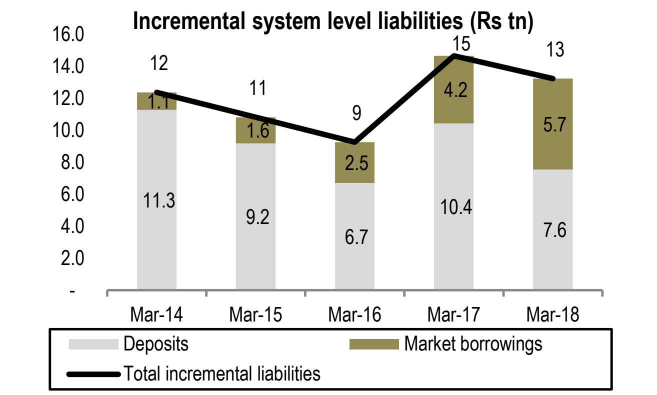


Source: Company data, Credit Suisse estimates

- **Liquidity needs rising.** Non Banking Financial Companies (NBFCs) have had a good run in recent years with strong loan demand, largely stable asset quality, and easy liquidity environment. At least the last factor could come under some question – given the recent macro trends (Aug GST, July 18 trade deficit). The liquidity needs are rising particularly for NBFCs who have been moving toward the shorter end of the liability curve (IIFL, SCUF, LICHF, LTFH in above chart).
- **Our framework to measure interest rates risk** takes into account the liabilities mix and duration, as well as expected growth rates for the NBFCs. JM, IIFL and Chola appear to have the highest risk of seeing sharp funding cost increases. On the other hand, these companies (and LICHF) also are present in loan segments with reasonably low pricing power – and hence most at risk of suffering a margin squeeze.
- **Downgrade IIFL to UNDERPERFORM, Chola to NEUTRAL.** We factor in lower margins going forward for IIFL, Chola, L&T finance and LICHF, leading to 2-22% EPS cuts. IIFL stock has largely missed the sharp correction in peer group, and our new target price shows a 15% downside. Downgrading to UNDERPERFORM from Outperform. Chola stock has corrected recently capping the downside (downgrade to NEUTRAL). After this, OUTPERFORM-rated stocks in our coverage are MMFS, Edelweiss, AB Cap (recent credit rating upgrade) and Indiabulls.

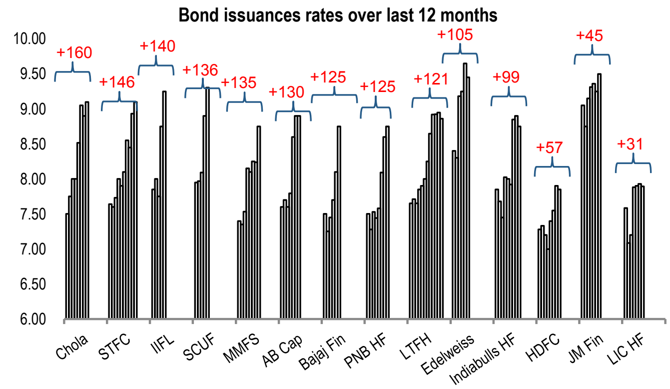
Focus charts

Figure 2: Market borrowing increasingly funding financial sector growth; could dry up under tight liquidity



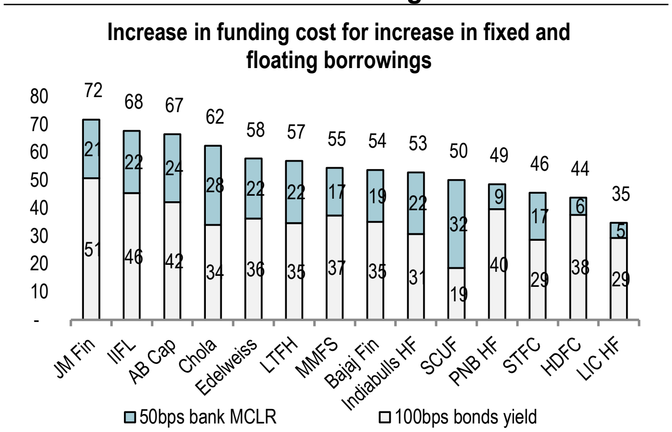
Source: RBI, NHB, Company data, Credit Suisse estimates

Figure 3: Tight liquidity situation already showing up as sharp rise in bond yields for NBFCs



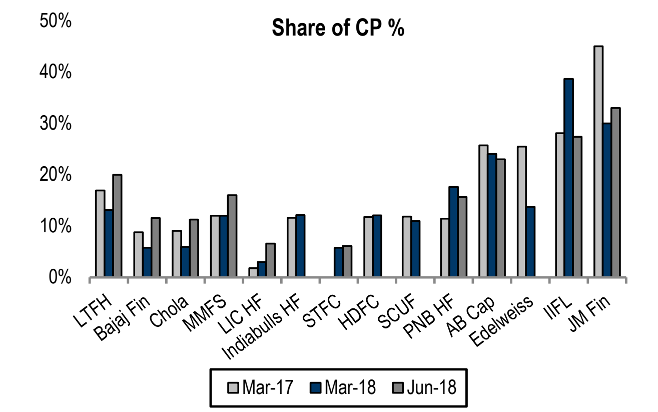
Source: Source: the BLOOMBERG PROFESSIONAL™ service

Figure 4: JM/IIFL/AB Cap should see sharper increase in funding costs, due to factors including reliance on short-term borrowings



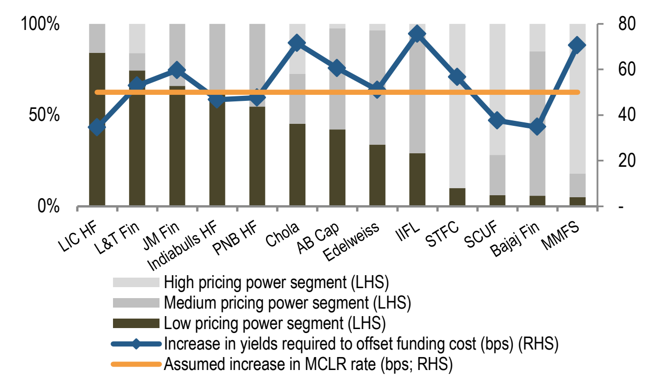
Source: Company data, Credit Suisse estimates

Figure 5: Share of CP funding has been increasing for some NBFCs



Source: Company data, Credit Suisse estimates

Figure 6: Ability to pass on the lending rate increase depends on pricing power. We are concerned on IIFL, Chola, JM Fin, LTFH and LICHF.



Source: Company data, Credit Suisse estimates

Figure 7: Changes to coverage stocks

Company	Rating		TP		Changes to EPS		
	Old	New	Old	New	FY19E	FY20E	FY21E
IIFL	O	U	830	610	-8%	-22%	-22%
Chola	O	N	1,750	1,470	-3%	-8%	-8%
LIC HF	N	N	600	560	-2%	-6%	-7%
L&T Finance	N	N	200	175	-2%	-5%	-4%

Source: Company data, Credit Suisse estimates

Bracing for tighter liquidity

Heavy dependence on market borrowings raises liquidity risk

The last few years have seen strong growth performance by NBFCs – fueled by a number of factors: slackness in PSU banks growth appetite, strong loan demand, largely stable retail asset quality and a benign liquidity environment. While most of these factors continue to be supportive, we believe there is reason to expect a turn in the liquidity environment driven by concerns of rising inflation and twin deficits (CAD and fiscal deficit). This is already reflected in rising bond yields recently, and we worry this can undermine the strong NII growth expectations of some of the NBFCs.

In particular, some companies have been building up some repricing/duration risks by moving shorter term on liabilities (including a sharp rise in share of CPs in Jun-18 quarter): IIFL, LTFH and Chola stand out.

Impact on funding cost – a framework

Tightening liquidity may lead to a faster rise in bond yields vs bank MCLR rates (which impact bank borrowing costs for NBFCs). On the other hand, bank borrowings are usually floating rate structures, thus the interest rate increases could flow through to entire back book, vs only incremental impact for bonds. Separately, shorter tenure borrowings run the risk of repricing faster. In addition, a faster growing company will see repricing of blended liabilities faster than slower growing companies.

Our framework captures the impact of all these factors in measuring the rise in blended funding costs from a 100 bp rise in bond yields, accompanied by a 50 bp rise in bank MCLR rates.

We conclude that JM, IIFL, AB Cap and Chola should see the highest rise in blended funding costs, given the funding mix and growth rates.

Pricing power not uniform across segments

NBFCs can increase lending rates to mitigate the impact of rising cost of funds and protect their margins. However, the extent to which these companies need to raise lending rates to neutralise the funding cost impact depends on a few characteristics of their loan book: fixed vs floating, maturity and general growth rates.

While we can arrive at the lending rate increase that companies need to take to pass on funding cost increase through this way, we cannot assume that all companies have equal ease of taking such rate increases. Pricing power varies across firms depending upon the segments they are present in. We have a framework to evaluate the pricing power across segments – taking into consideration the loan characteristics and level of competition (first presented in Nov-2017 report).

Our overall conclusion is that companies like IIFL, Chola, JM, LTFH and LICHF should find it tougher to pass on their funding costs – and hence at risk of margin compression. We downgrade IIFL to UNDERPERFORM from Outperform and Chola to NEUTRAL. We cut our earnings estimates for LICHF and LTFH on lower margins assumptions.

Valuation summary

Figure 8: NBFC valuation summary

Company	Current Price	Rating	Target	+/-	Mkt Cap (In $ bn)	P/BVPS (x)			ROE			PE (x)			EPS Growth (yoy %)			
7-Sep-18	Rs		Rs	(%)		FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18
Coverage Universe																		
M&M Finance	460	O	615	34%	4.0	2.8	2.4	2.1	12.3	17.6	21.2	26.2	15.1	10.9	95.4	73.3	39.1	1.9
Edelweiss	262	O	345	32%	3.4	3.5	2.9	2.1	15.9	17.3	18.3	26.7	18.6	13.4	35.1	43.3	38.8	1.6
Aditya Birla Capital	137	O	175	28%	4.2	3.5	2.6	2.3	10.8	10.3	12.5	32.4	28.6	19.3	(33.7)	13.3	48.1	1.0
Indiabull Finance	1,209	O	1,650	36%	7.2	3.4	2.3	2.0	25.9	24.6	24.9	14.4	11.1	8.7	33.9	30.0	26.7	3.2
Cholamandalam	1,437	N	1,470	2%	3.1	4.4	3.3	2.8	20.7	18.9	18.7	23.0	19.9	16.2	35.5	15.4	23.2	2.5
Shriram Transport	1,214	N	1,500	24%	3.8	2.2	1.8	1.3	13.0	19.7	20.2	17.7	9.9	7.8	23.0	78.7	27.3	1.9
SCUF	2,027	N	2,100	4%	1.9	2.3	2.1	1.8	12.6	15.3	17.6	19.4	14.3	10.9	19.2	35.9	31.0	2.5
L&T Finance	168	N	175	4%	4.7	2.9	2.6	2.1	13.9	17.6	15.5	22.7	15.7	14.9	42.0	44.4	5.4	1.7
LIC Housing Finance	501	N	560	12%	3.5	1.8	1.7	1.5	16.0	16.6	17.0	12.6	10.6	9.4	3.7	18.0	13.0	1.3
JM Financial	115	N	150	30%	1.3	2.2	1.9	1.7	16.3	15.8	17.2	14.8	13.0	10.6	31.6	13.3	22.7	3.3
Bajaj Finance	2,740	U	1,500	-45%	22.0	9.6	8.1	6.8	20.3	18.2	19.7	59.8	48.3	37.4	37.1	23.8	29.1	3.8
IIFL Holdings	693	U	610	-12%	3.1	4.4	3.5	2.7	19.2	20.4	18.1	24.4	19.1	17.4	31.3	27.9	9.6	2.6
HDFC	1,925	O	2,350	22%	45.3	5.3	4.5	4.2	24.1	16.0	15.5	25.8	30.5	28.0	58.6	(15.4)	9.1	3.3
Core valuations																		
HDFC Core	669	O			15.9	2.7	2.2	2.0	18.2	17.6	17.7	17.1	14.0	11.7	3.8%	21.8%	19.2%	
Edelweiss ex-insurance	236	O			3.0	3.5	2.8	2.0	19.6	20.5	20.6	21.2	15.1	11.2	30%	41%	34%	
AB Cap ex-insurance	99	O			3.0							29.4	22.6	14.8	-22%	30%	53%	

Note: O = Outperform; N = Neutral; U = Underperform

Source: Company data, Credit Suisse estimates

Heavy dependence on market borrowings raises liquidity risk

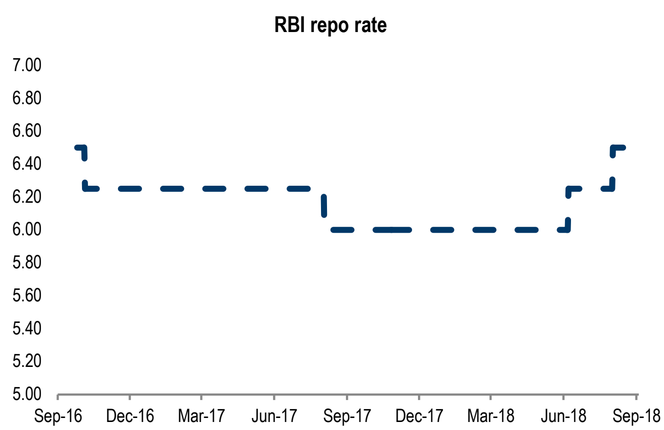
The last few years have seen strong growth performance by NBFCs – fueled by a number of factors: slackness in PSU banks growth appetite, strong loan demand, largely stable retail asset quality and a benign liquidity environment. While most of these factors continue to be supportive, we believe there is reason to expect a turn in the liquidity environment due to rising inflation and twin deficits (CAD and fiscal deficit). This is already reflected in rising bond yields recently, and we are concerned this can undermine the strong NII growth expectations of some of the NBFCs.

In particular, some companies have been building up some repricing/duration risks by moving shorter term on liabilities (including a sharp rise in share of CPs in Jun-18 quarter): IIFL, LTFH and Chola stand out.

Market interest rates rising faster than RBI's policy rate hikes…

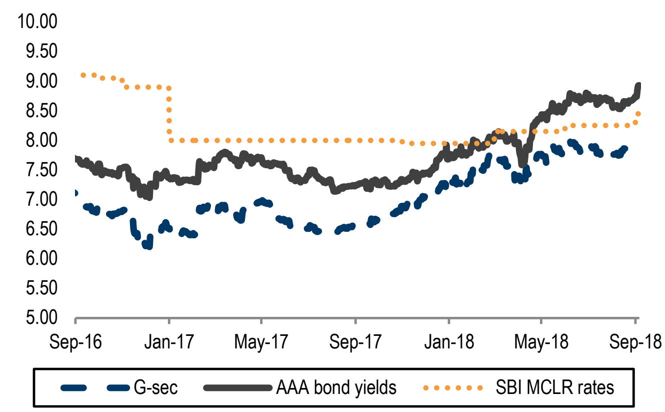
After a long hiatus, the RBI started increasing the policy rate since June 2018 driven by concerns of rising inflation and twin deficits (CAD and fiscal deficit). While RBI's cumulative repo rate increase has been to the tune of 50 bp, bond markets have witnessed yields hardening by ~100 bp since the start of the financial year – tracking the increase in government's benchmark yields which have increased by 65 bp.

Figure 9: RBI has raised policy rates by 50 bp since Jun-2018



Source: the BLOOMBERG PROFESSIONAL™ service

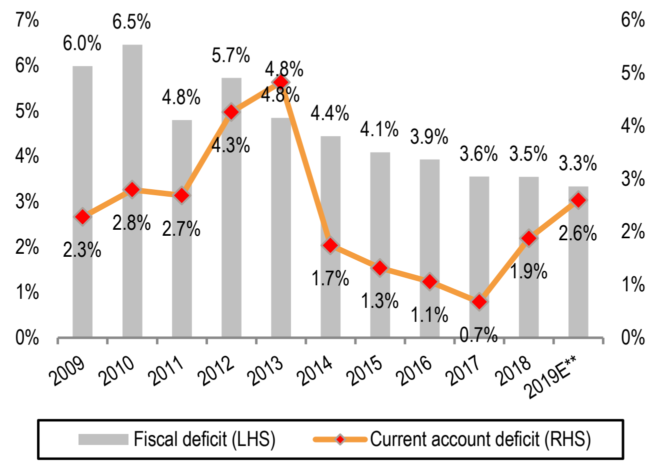
Figure 10: However, underlying rates (G-sec and bonds) have increased by 65-100 bp



Source: the BLOOMBERG PROFESSIONAL™ service

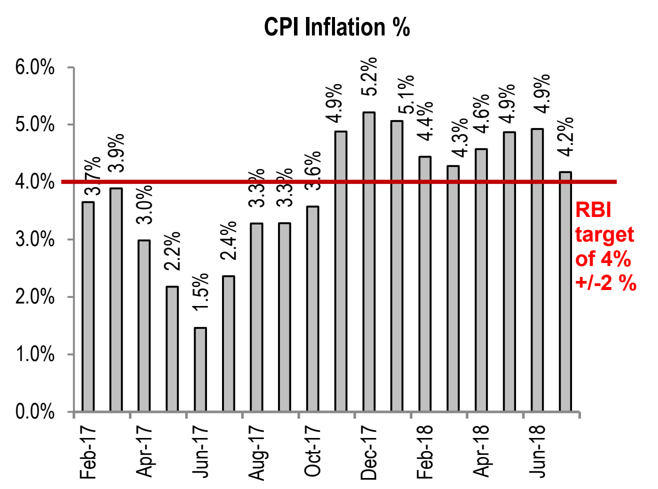
Benchmark government bond yields have crossed 8% due to concerns about government's ability to meet fiscal target and fund current account of deficit (links to our India strategist's notes 1, 2) along with rising inflation.

Figure 11: Current account deficit has been rising



**Note: Government budgeted fiscal deficit and CS estimate of FY19 current account deficit
Source: Company data, Credit Suisse estimates

Figure 12: CPI inflation

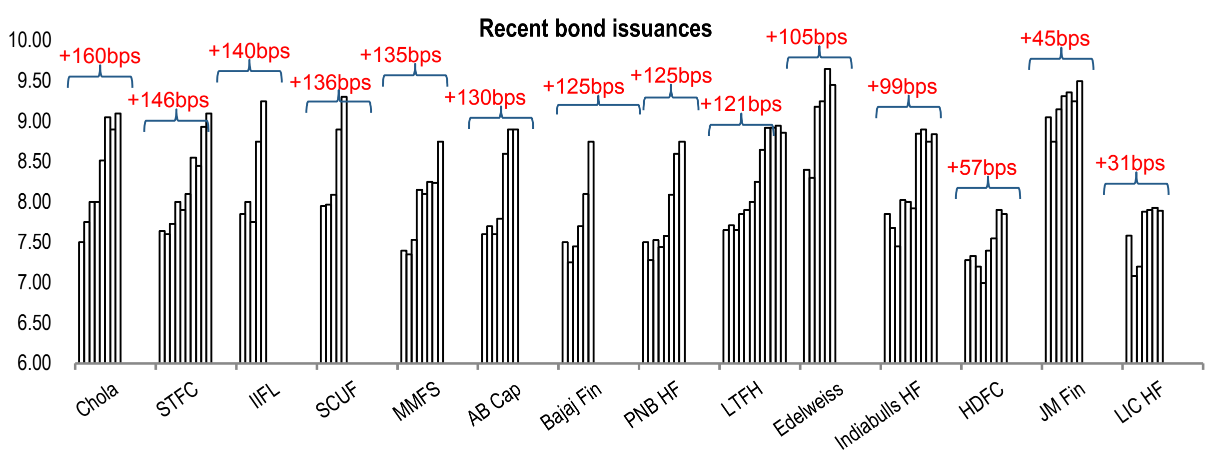


Source: Company data, Credit Suisse estimates

…increasing cost of bond funding for NBFCs

Tracking the rise in bond yields, cost of bond funding has increased across NBFCs. However, the quantum of increase differs for each NBFC. Chola, STFC, IIFL, SCUF, MMFS and AB Cap have seen bond coupons increase by 130-160 bp over the last 12 months, whereas HFCs like LIC HF and HDFC have seen increase to the tune of 30-60 bp. Indiabulls HF, aided by rating upgrade in FY18, witnessed its coupon rate increasing by 90 bp over the similar time frame.

Figure 13: Bond issuance costs have increased for NBFCs by 30-160 bp



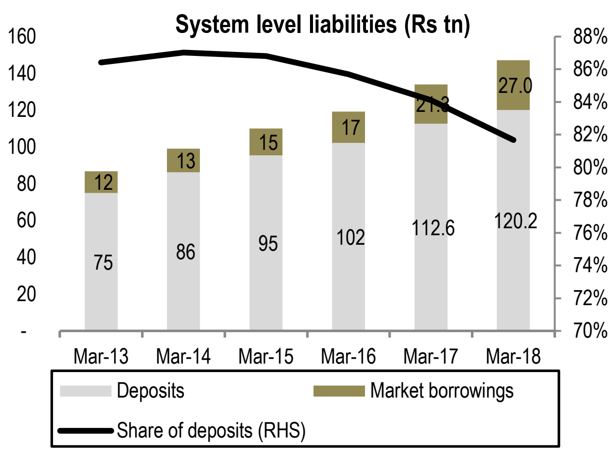
Source: Bloomberg

Heavy reliance on market borrowings in recent years

While public deposits remain the primary source of liabilities for the banking system in India (82% of total system liabilities), their share has been falling (from ~87% three years ago) with growing share of market borrowings (bonds, CPs, etc.). On an incremental basis, given the slower growth in banks, and faster growth in bond funded NBFCs, FY18 saw for the first time market borrowings contribute an all-time high of 45% of incremental borrowings for the financial system.

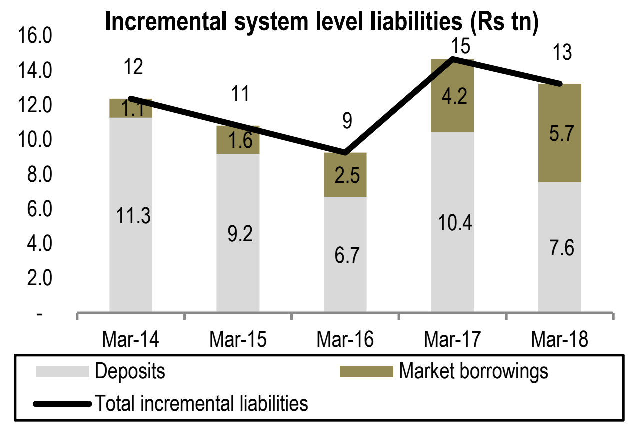
To support system credit growth of 15%, we estimate ~Rs15 tn of incremental funding requirement for the sector. This is at a time when the share of market borrowings by the financial sector in overall market borrowings has been increasing.

Figure 14: Share of market borrowings for banks and NBFCs has been increasing …



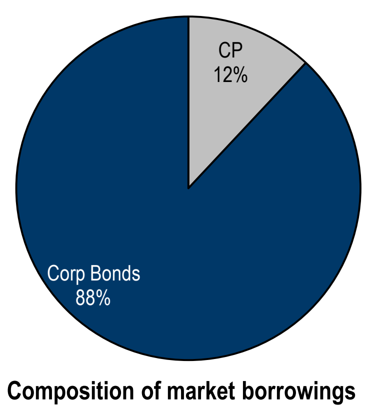
Source: RBI, NHB, Company data, Credit Suisse estimates
Note: Excluded bank borrowings by NBFCs and HFCs

Figure 15: …accounting for more than half of incremental liabilities in FY18. To sustain a 15% system growth, Rs15 tn of fresh funds needs to be sourced



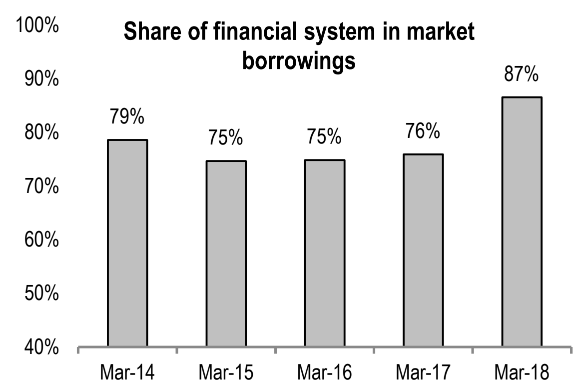
Source: RBI, NHB, Company data, Credit Suisse estimates
Note: have excluded bank borrowings by NBFCs and HFCs

Figure 16: 88% of market borrowings are via bonds



Source: SEBI, RBI, Company data, Credit Suisse estimates

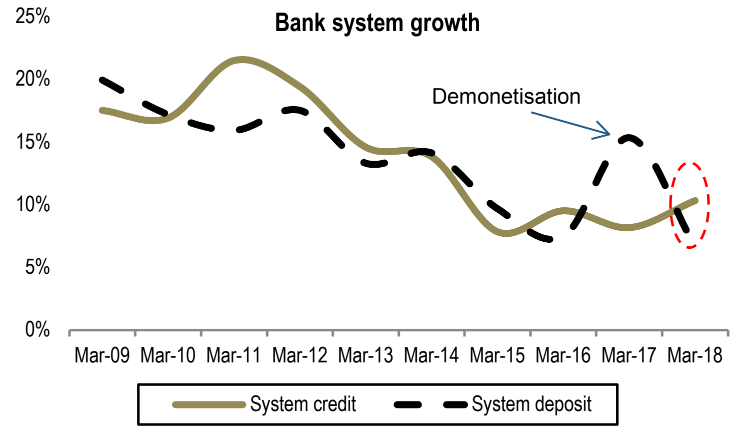
Figure 17: Share of financial system in market borrowings is rising



Source: SEBI, RBI, Company data, Credit Suisse estimates

In the event of tightness in market liquidity, it is unlikely that deposits alone could satisfy this entire demand especially when the deposit growth for banks is already lagging credit growth.

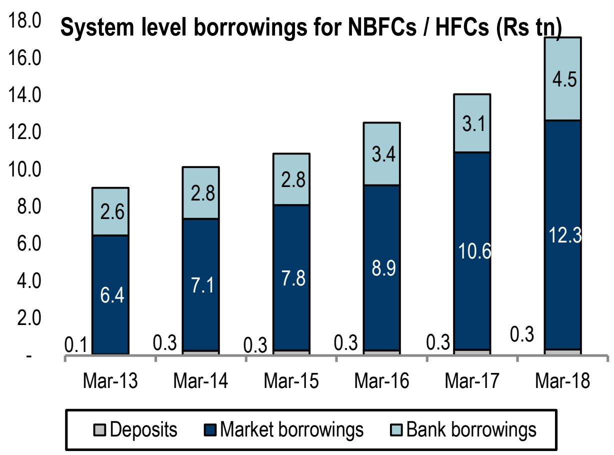
Figure 18: Deposit growth already lagging credit growth for banks



Source: RBI

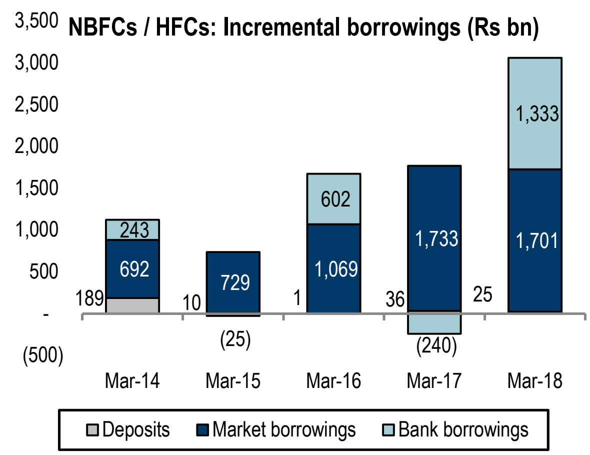
The issue is even more acute for NBFCs, who have come to largely rely on market borrowings for funding besides the rapid growth in loan growth for these NBFCs.

Figure 19: Market borrowings for NBFCs have been increasing…



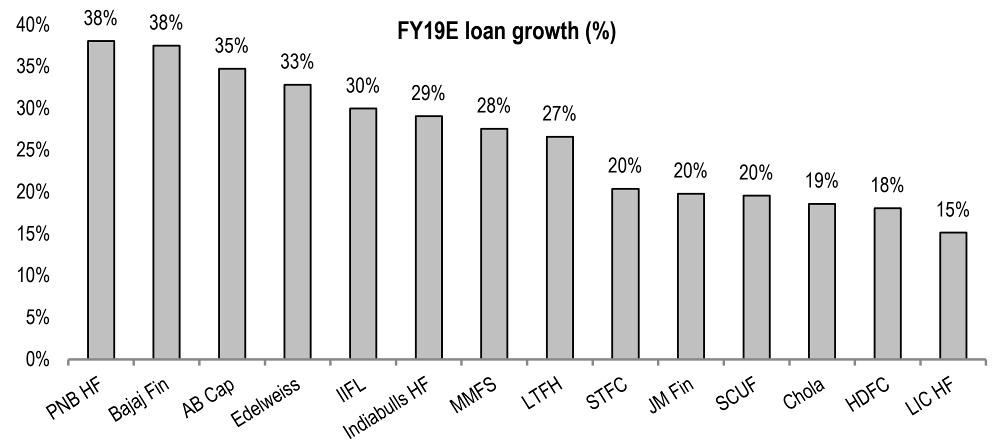
Source: RBI, Company data, Credit Suisse estimates

Figure 20: …with market borrowings contributing more than 50% of incremental borrowings in FY18



Source: RBI, Company data, Credit Suisse estimates

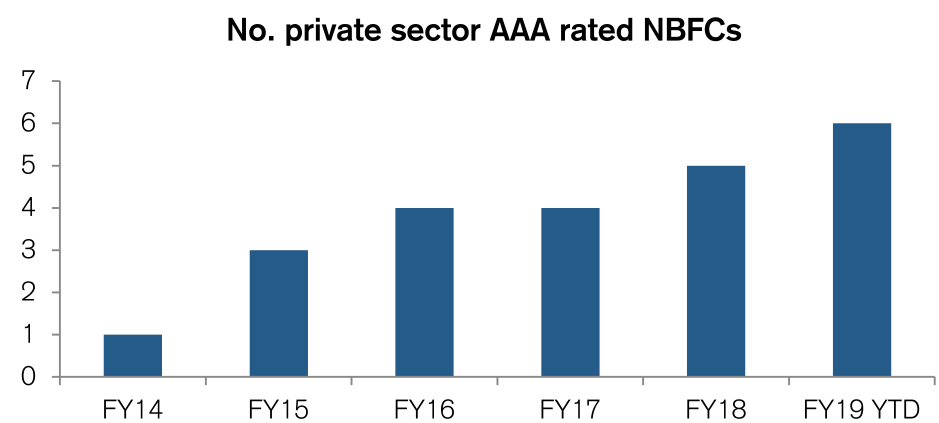
Figure 21: Loan growth expectation for NBFCs under coverage



Source: Company data, Credit Suisse estimates

In addition to benign liquidity conditions, the shift to market borrowings could have been helped by the rising trend of NBFC credit rating upgrades by rating agencies. We have seen the number of private NBFCs (non govt/PSU backed) going from only HDFC Ltd five years ago to at least seven now.

Figure 22: Fueled by many rating upgrades to AAA

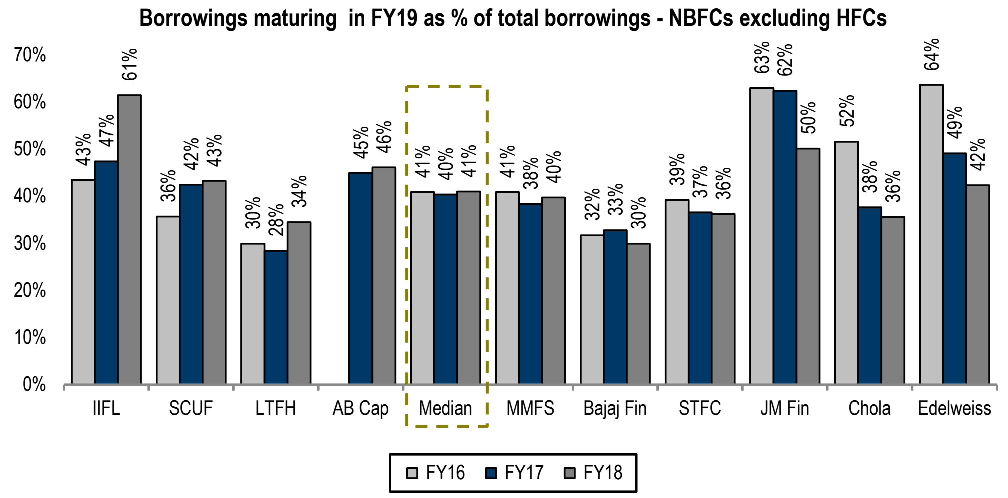


Source: Company data, Credit Suisse estimates

Some NBFCs have been moving towards shorter end of liabilities

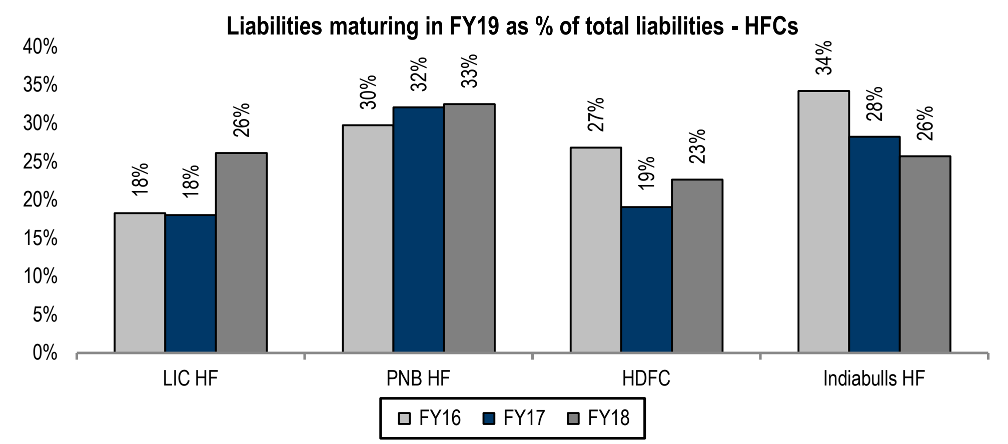
Some NBFCs like IIFL, SCUF, LICHF and LTFH have been moving towards the shorter end of the liabilities curve over the last few years – that could have obviously helped funding costs, but also allowed some repricing/duration risk to creep in.

Figure 23: Share of short tenure borrowings has increased for IIFL, SCUF and LTFH. It remains 50%+ for JM Fin



Note: We consider both short term borrowings and current portion of long term borrowings in this analysis.
Source: Company data, Credit Suisse estimates

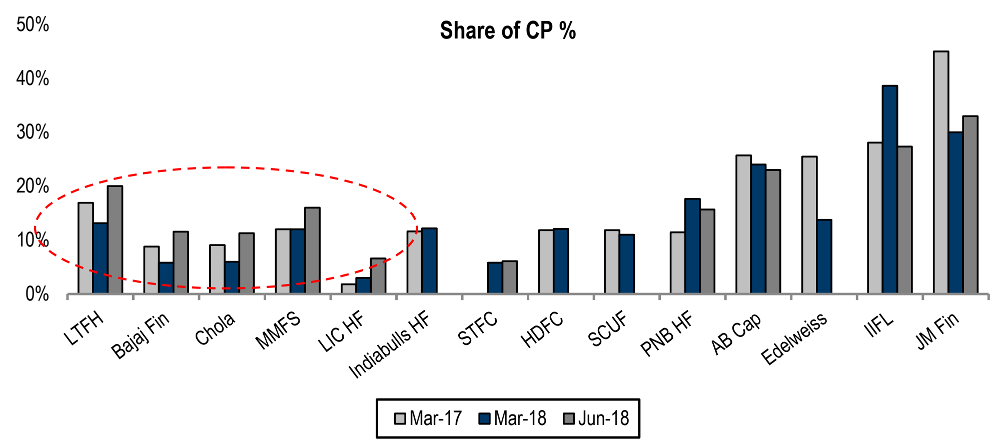
Figure 24: Share of shorter term liabilities has increased for LIC HF as well (based on ALM)



Source: Company data, Credit Suisse estimates

While the above charts are based on FY18 annual reports of the companies, the Jun-18 quarter results showed further rise in share of short-term commercial paper in the funding mix of some NBFCs.

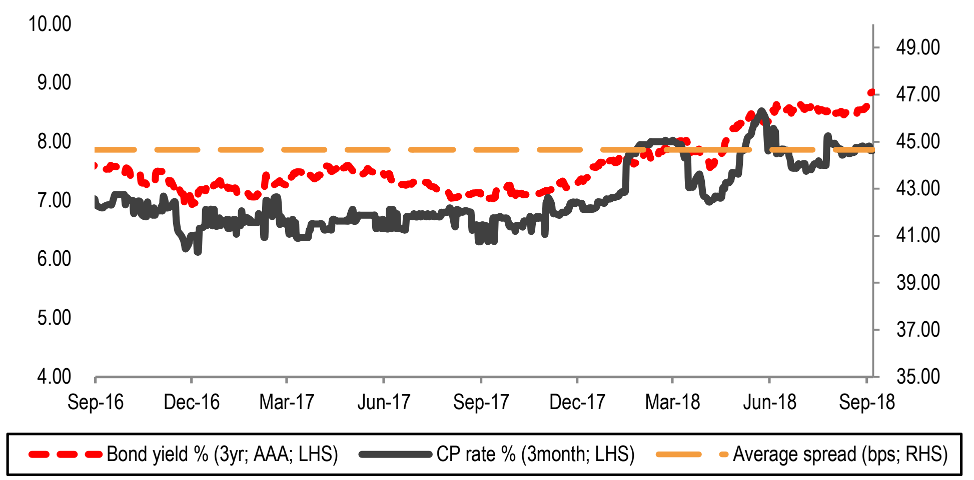
Figure 25: Share of CP funding has been increasing for some NBFCs



Source: Company data, Credit Suisse estimates

Being relatively cheaper than bonds by 45-50 bp, some companies increased the proportion of CPs recently. While this does help lower the funding cost in shorter term, it increases repricing/duration risk.

Figure 26: Cost of CPs vs bonds



Source: Company data, Credit Suisse estimates

Impact on funding cost – a framework

Tightening liquidity may lead to faster rise in bond yields vs bank MCLR rates (which impact bank borrowing costs for NBFCs). On the other hand, bank borrowings are usually floating rate structures, thus the interest rate increases could flow through to the entire back book, vs only incremental impact for bonds. Separately, shorter tenure borrowings run the risk of repricing faster. In addition, a faster growing company will see repricing of blended liabilities faster than slower growing companies.

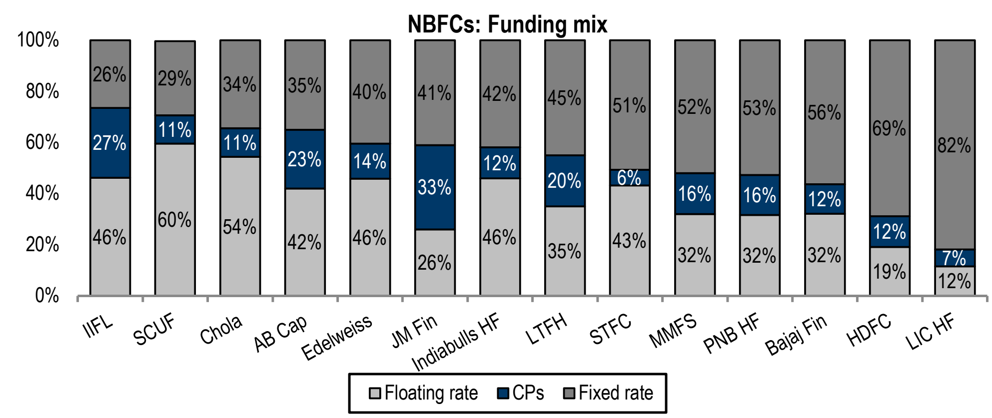
Our framework captures the impact of all these factors in measuring the rise in blended funding costs from a 100 bp rise in bond yields, accompanied by a 50 bp rise in bank MCLR rates.

We conclude that JM, IIFL, AB Cap and Chola should see highest rise in blended funding costs, given the funding mix and growth rates.

Factor #1: Liabilities mix – fixed vs floating

To the extent NBFCs are funded by floating rate liabilities (like bank borrowings benchmarked to MCLR), they risk seeing an upward repricing in their back book borrowings.

Figure 27: IIFL, SCUF and Chola have amongst the highest share of floating rate borrowings

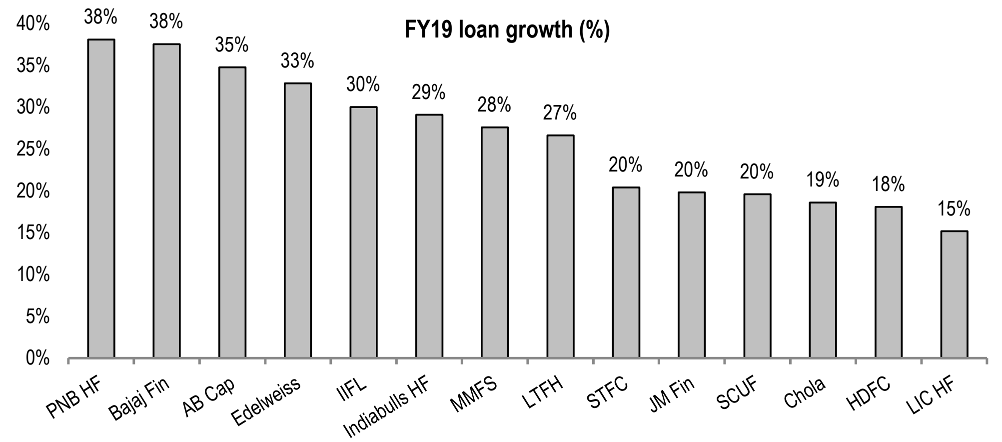


Source: Company data, Credit Suisse estimates

Factor #2: Higher growth rate = faster upward repricing of borrowings

Incremental borrowings would be at higher bond yields – thus faster growing companies could see a more rapid rise in their overall funding costs than slower growing ones.

Figure 28: Book growth a factor affecting how quickly bonds tightening can flow into the book

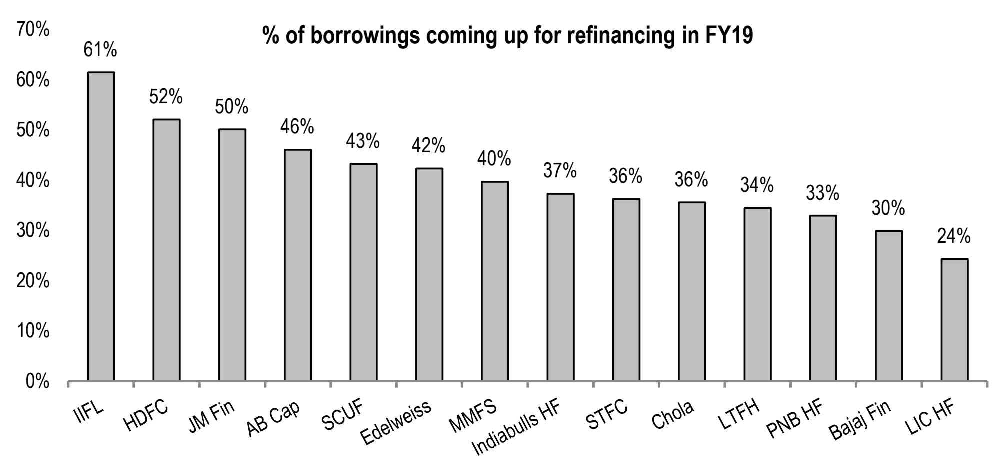


Source: Company data, Credit Suisse estimates

Factor #3: Maturity profile of borrowings

Fixed liabilities that are locked in for longer term protect the company against short-term spikes in rates. In the following analysis, we consider the share of borrowings/bonds maturing within a year as indicative of greater repricing risk.

Figure 29: IIFL, HDFC and JM have higher proportion of borrowings coming up for refinancing over the next one year



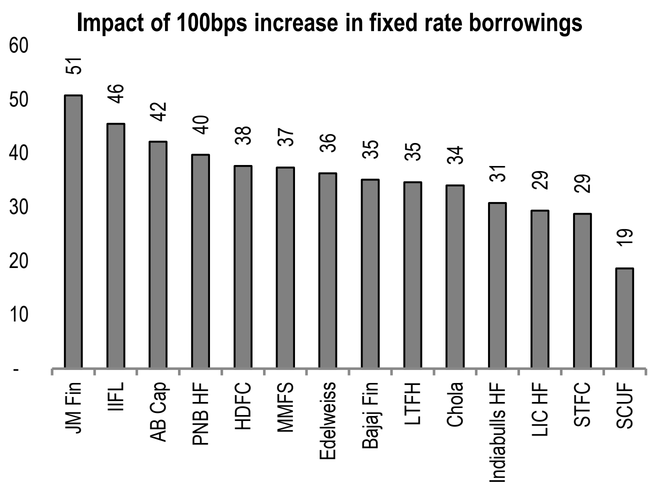
Source: Company data, Credit Suisse estimates

JM, IIFL, AB Cap, Chola could see higher impact on funding costs

Based on the above three parameters, we develop a framework to assess sensitivity of cost of funds for the NBFCs under our coverage for (1) a 100 bp increase in bond yields and (2) a 50 bp increase in bank rates. In order to assess this, we assume that the composition of incremental borrowings (over and above the refinancing of old ones) would reflect the same composition of back book.

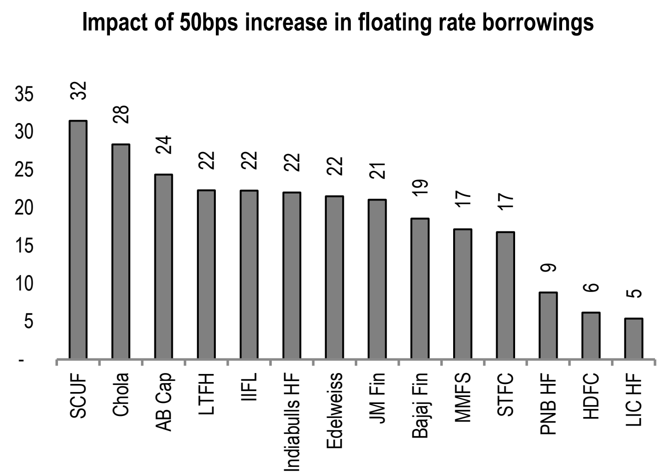
As per this analysis, JM, IIFL, AB Cap and Chola have the highest sensitivity to rising interest rates. Here, AB Cap's recent credit rating upgrade to AAA (link) should likely help it cushion the increase in funding costs.

Figure 30: Impact on blended funding cost for 100 bp increase in fixed rate borrowings…



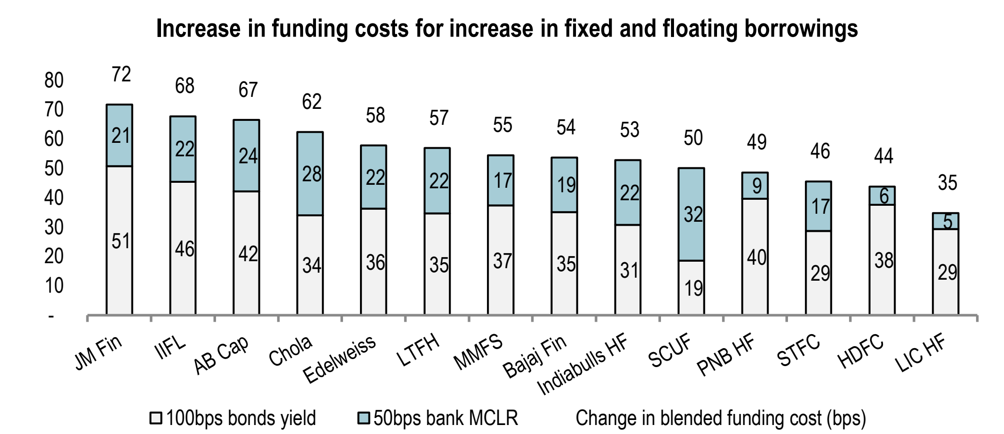
Source: Company data, Credit Suisse estimates

Figure 31: …and for 50 bp increase in floating rate borrowings



Source: Company data, Credit Suisse estimates

Figure 32: JM, IIFL, AB Cap and Chola could see highest cost increase (assuming 100 bp bond yield rise and 50 bp bank borrowings rise)



Source: Company data, Credit Suisse estimates

Pricing power not uniform across segments

NBFCs can increase lending rates to mitigate the impact of rising cost of funds and protect their margins. However, the extent to which these companies need to raise lending rates to neutralise the funding cost impact depends on a few characteristics of their loan book: fixed vs floating, maturity and general growth rates.

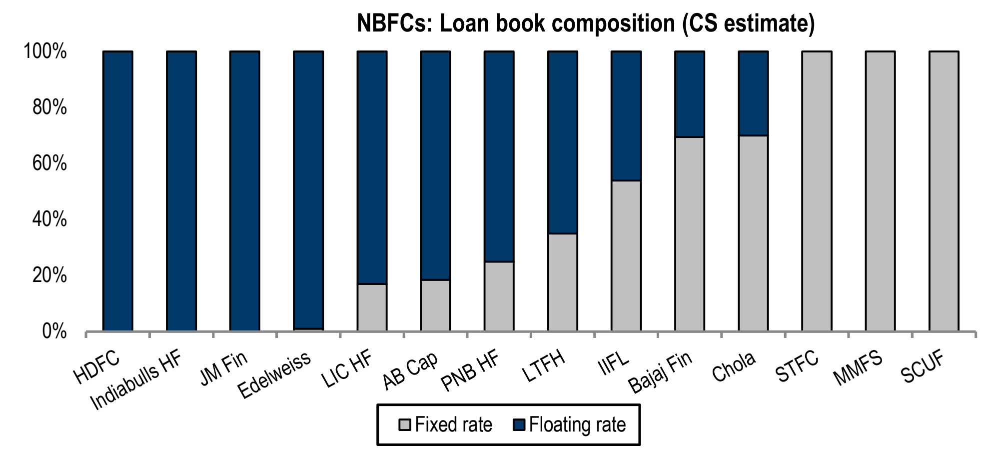
While this way we can arrive at the lending rate increase that companies need to take to pass on funding cost increase, we cannot assume that all companies have equal ease of taking such rate increases. Pricing power varies across firms depending upon the segments they are present in. We have a framework to evaluate pricing power across segments – taking into consideration the loan characteristics and level of competition (first presented in Nov-2017 report).

Overall conclusion is that companies like IIFL, Chola, JM, LTFH and LICHF should find it tougher to pass on their funding costs – and hence at risk of margin compression. We downgrade IIFL to UNDERPERFORM and Chola to NEUTRAL. We cut earnings for LICHF and LTFH on lower margins assumptions.

How much lending rate increase can offset the funding cost rise?

Based on our understanding and conversation with the companies, we believe that segments like home loans, LAP, LRD, corporate/wholesale loans are floating in nature where NBFCs can pass on the lending rate increase on existing book as well. On the other hand, commercial vehicle, auto, MFI, retail/small ticket SME loans which are fixed rate in nature – any lending rate increase would be only on prospective business.

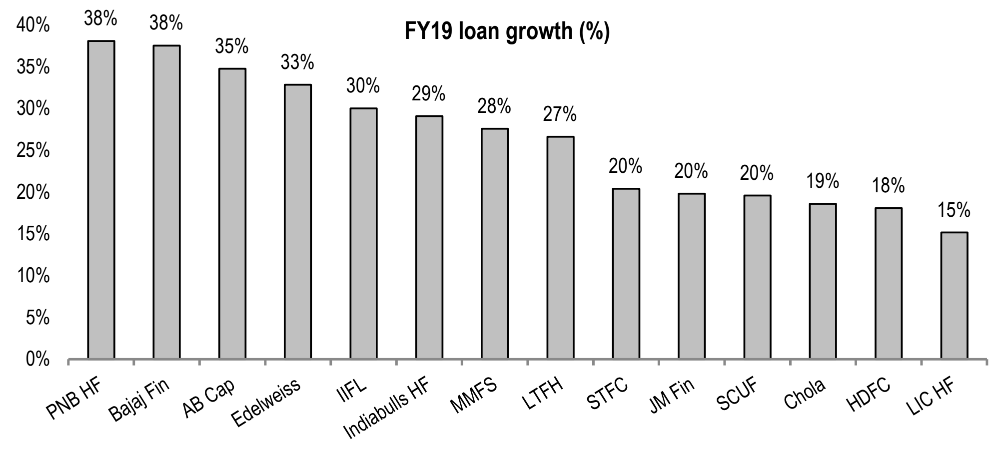
Figure 33: Floating vs fixed nature of loan book



Source: Company data, Credit Suisse estimates

The argument that faster growing companies will see the rising rates reflect into their liabilities faster also holds true for the assets side.

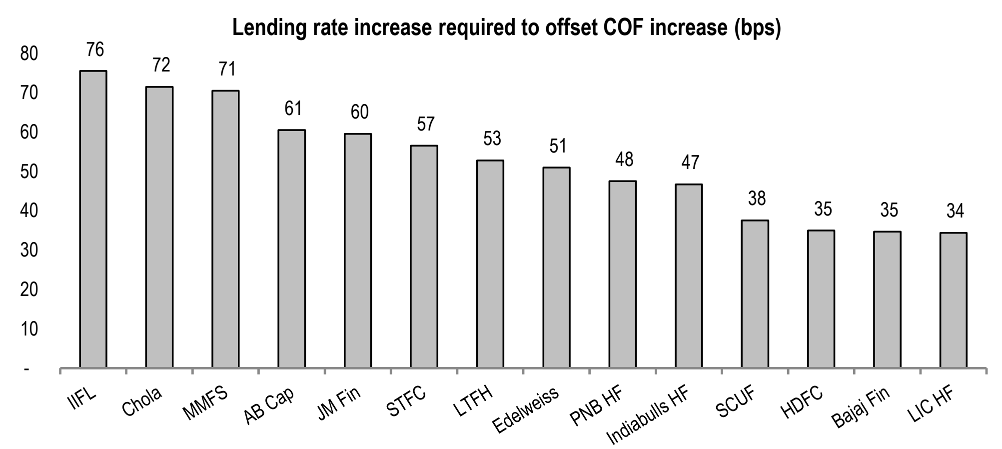
Figure 34: Loan book growth expectations



Source: Company data, Credit Suisse estimates

The chart below gives the indicative increase in yields that each NBFC would need to take to offset earlier calculated increase in cost of funds (for 100 bp increase in fixed and 50 bp increase in floating borrowings). The analysis has taken into account the proportion of floating rate loan book (where lending rates can be increased on existing book as well).

Figure 35: Increase in yields required to mitigate increase in funding costs (100 bp bond yields, 50 bp bank borrowings)



Source: Company data, Credit Suisse estimates

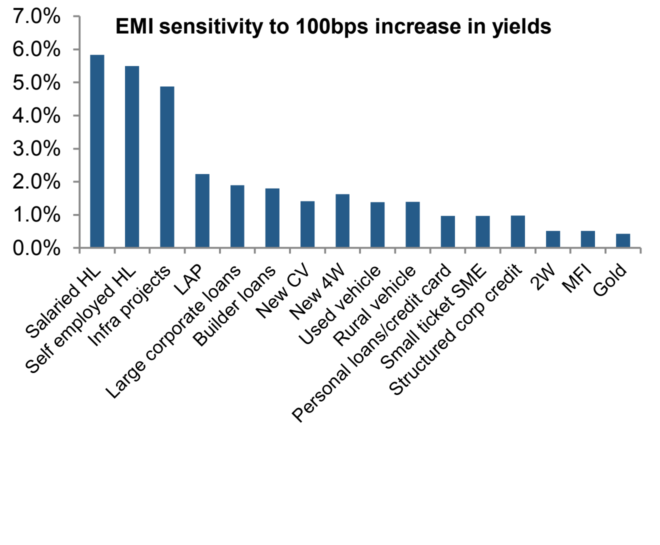
Pricing power to increase rates a determining factor

It is easier for lenders to raise interest rates in segments where pricing power is better. Here, we reproduce our analysis of relative pricing power in each segment from our Nov-2017 report (link).

To summarise, we measure pricing power in each loan segment as a combination of

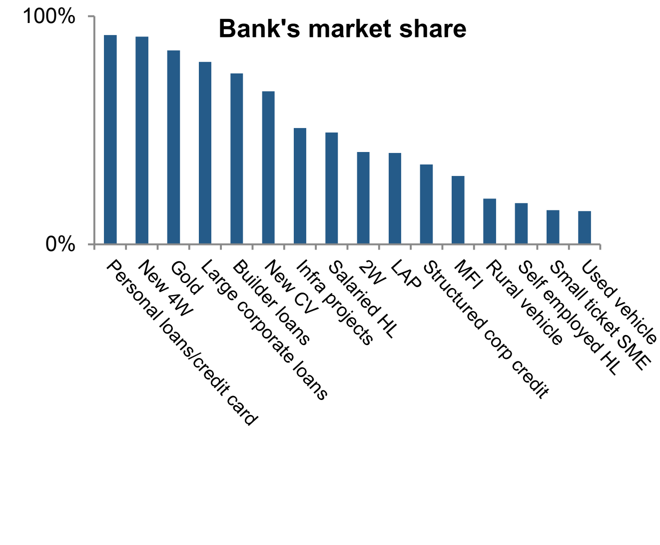
- EMI sensitivity to increase in lending rates (i.e., how big is lending rate a factor for borrowers in that segment), and
- Extent of competition (from banks) measured by bank's market share in each segment

Figure 36: Interest rate sensitivity high for home loans and infra projects [A]



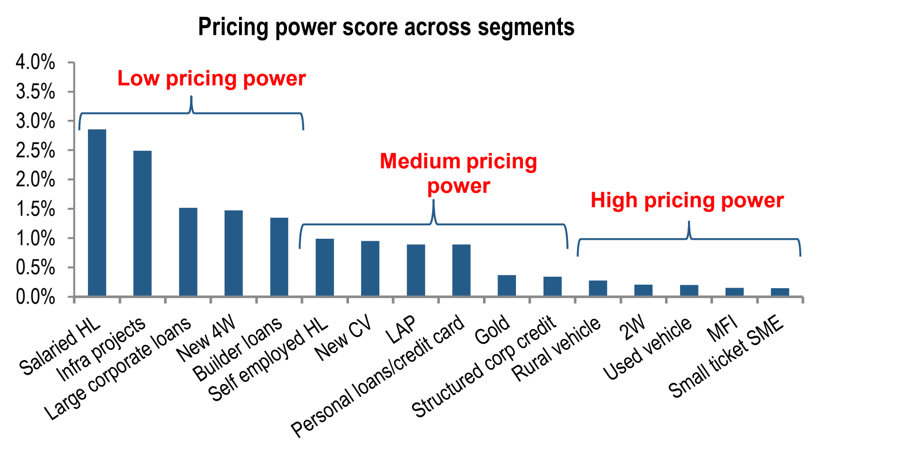
Source: Company data, Credit Suisse estimates

Figure 37: Extent of competition from banks [B]



Source: Company data, Credit Suisse estimates

Figure 38: Taking into account interest rate sensitivity and level of competition from banks, salaried home loans and large corp/infra-projects stand out as sectors with least pricing power = [A x B]

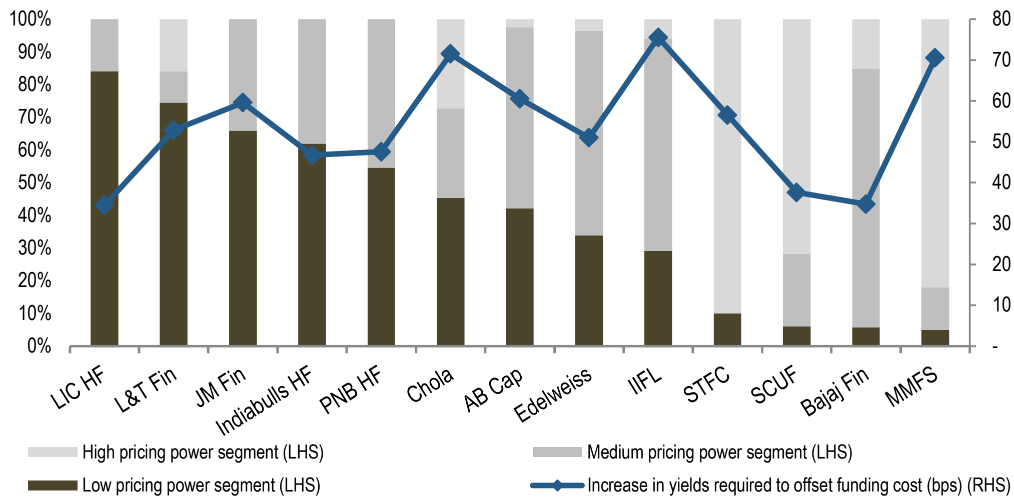


Source: Company data, Credit Suisse estimates

We then superimpose these pricing power scores onto the segments of operation of various NBFCs. The chart below shows the extent of lending rate increase that each NBFC has to take to offset the assumed funding cost increases, along with share of high, medium and low-pricing power sectors in the loan book. A company with large presence in low pricing power segments, and having a high threshold of lending rate increase required, should be at most risk of seeing a margin compression.

Based on this, we highlight IIFL, Chola, AB Cap and JM Fin as seeing risk. Among these, AB Cap's recent credit rating upgrade should be a mitigating factor.

Figure 39: Chola, IIFL, JM, LTFH may find it difficult to pass on required rate increases due to presence in segments with low pricing power

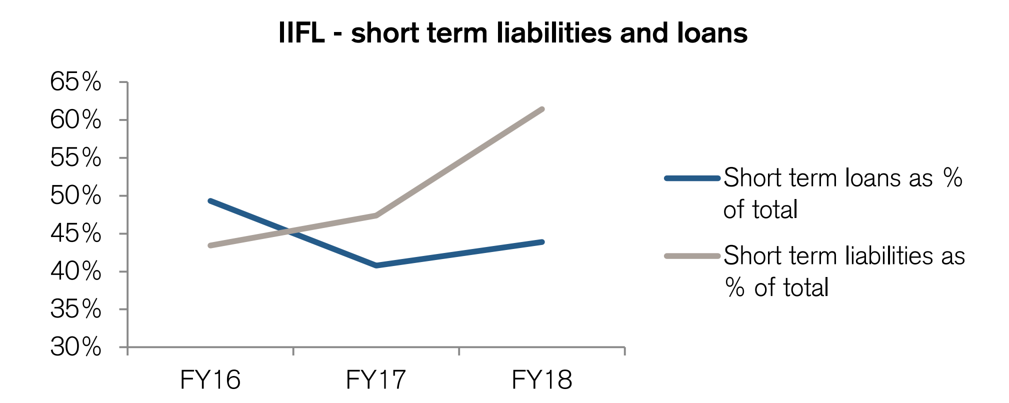


Source: Company data, Credit Suisse estimates

Downgrade IIFL to UNDERPERFORM

While we like IIFL's overall loan growth story, and leadership position in wealth management, we believe near-term risks from tighter liquidity and rising bond yields are becoming material. This is especially true in light of movement towards short-term funding by it in recent years (while the duration on loan book appears to be extending). While there is no risk of the company getting refinancing, this could come at an additional cost that IIFL may not be able to mitigate via higher yields given its presence in segments having limited pricing power.

Figure 40: IIFL's ALM gap in short term appears to be widening



Source: Company data, Credit Suisse estimates

IIFL stock has been one of the better performing stocks recently, having largely escaped the sharp correction in the NBFC peer group. We factor in drop in margins in the lending book, along with a slight slowdown in growth rates (still a healthy 30% YoY for FY19) - leading to up to a 22% drop in EPS for next three years. Our target price goes down to Rs610. We downgrade our rating to UNDERPERFORM from Outperform.

Figure 41: IIFL estimate changes

	New			Old			% change		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
NBFC AUM (Rs mn)	404,737	518,063	663,121	435,870	575,349	736,447	-7%	-10%	-10%
NBFC NII (Rs mn)	21,199	25,444	32,779	23,188	31,944	41,220	-9%	-20%	-20%
NBFC NIM (%)	5.9%	5.5%	5.6%	6.2%	6.3%	6.3%	-29 bps	-80 bps	-73 bps
Consol PAT (Rs mn)	11,507	13,405	17,657	12,472	17,127	22,702	-8%	-22%	-22%

Source: Company data, Credit Suisse estimates

Downgrade Cholamandalam to NEUTRAL

While Chola has been largely disciplined in ALM, we are concerned about the company's presence in segments of lower pricing power – namely LAP and new vehicle financing (together 78% of loan book). We thus expect some margin compression for the company – leading to ~8% EPS cuts. This brings down our P/E-based target price to Rs1,470 – leaving negligible upside from current levels. We downgrade stock to NEUTRAL.

Figure 42: Chola estimate changes

	New			Old			% change		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
AUM (Rs mn)	508,596	628,530	794,367	508,596	628,530	794,367	0%	0%	0%
NII (Rs mn)	32,526	38,815	49,187	33,075	40,750	51,743	-2%	-5%	-5%
NIM (%)	6.9%	6.8%	6.9%	7.1%	7.2%	7.3%	-12 bps	-34 bps	-36 bps
EPS (Rs/share)	72	89	116	74	97	126	-3%	-8%	-8%

Source: Company data, Credit Suisse estimates

Reduce estimates for LICHF

While LICHF works in the segment with probably the least pricing power (salaried home loans), we are concerned by the growing trend of shorter term liabilities. This exposes the company to repricing /duration risk. We reduce margin estimates leading to up to 7% EPS cuts, and our new target price is Rs560. The stock fall in recent weeks leaves low downside. We retain our NEUTRAL rating on the stock.

Figure 43: LIC HF estimate changes

	New			Old			% change		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
AUM (Rs mn)	1,915,714	2,235,859	2,624,737	1,915,714	2,235,859	2,624,737	0%	0%	0%
NII (Rs mn)	40,119	44,452	51,369	40,830	46,865	54,793	-2%	-5%	-6%
NIM (%)	2.2%	2.1%	2.1%	2.3%	2.3%	2.3%	-4 bps	-12 bps	-14 bps
EPS (Rs/share)	47	53	62	48	57	67	-2%	-6%	-7%

Source: Company data, Credit Suisse estimates

Reduce estimates for L&T Finance

L&T Finance is primarily a wholesale lender (70% of loan book), with reasonably low pricing power in most of its wholesale segments, in our view. In addition, the company has been moving towards shorter end of liabilities. This exposes it to repricing /duration risk. We reduce margin estimates leading to up to 5% EPS cuts, and our new TP is Rs175. The stock fall in recent weeks leaves low downside. We retain our Neutral rating on the stock.

Figure 44: L&T Finance estimate changes

	New			Old			% change		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
AUM (Rs mn)	1,059,205	1,297,930	1,553,369	1,059,205	1,297,930	1,553,369	0%	0%	0%
NII (Rs mn)	47,084	60,978	75,060	47,563	62,593	77,013	-1%	-3%	-3%
NIM (%)	5.0%	5.2%	5.3%	5.0%	5.3%	5.4%	-5 bps	-14 bps	-14 bps
EPS (Rs/share)	11	11	14	11	12	15	-2%	-5%	-4%

Source: Company data, Credit Suisse estimates

Asia Pacific/India
Diversified Financial Services

IIFL Holdings Limited (IIFL.BO)

Rating (from OUTPERFORM)	UNDERPERFORM
Price (07-Sep-18, Rs)	692.55
Target price (Rs)	(from 830.00) 610.00
Upside/downside (%)	-11.9
Mkt cap (Rs/US$ mn)	220,959 / 3,074
Enterprise value (Rs mn)	188,518
Number of shares (mn)	319.05
Free float (%)	35.3
52-wk price range (Rs)	850-576
ADTO-6M (US$ mn)	2.2

Target price is for 12 months.

Research Analysts

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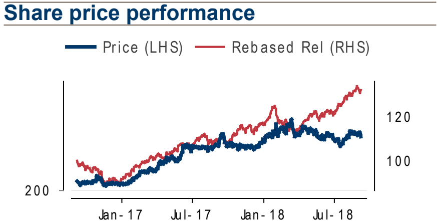
Funding costs could rise

- **Liquidity risk looming.** Due to the concerns of rising inflation and twin deficits (current account deficit and fiscal deficit), we believe we are entering a period of tight liquidity in India. This is important since easy liquidity was one of the factors fueling sharp profitable growth for Indian Non Banking Financial Services (NBFCs). Over the last two years, 75% of incremental funding for NBFCs came from market sources.
- **Expect some pressure on margins.** We build a framework in this report to analyse the rise in funding costs for NBFC – taking into account factors like liability characteristics (fixed vs floating, duration, etc.) as well as growth rates of companies. We then see how easy it would be for companies to pass on these costs to their borrowers.
- **IIFL runs risk of rising funding costs.** A rising share of shorter term borrowings, coupled with presence in segments of lower pricing power, imply that IIFL could see some margin pressure. In our models we factor in a 30 bp fall over the next one year. We also temper down growth expectations (FY19 down from 40% to 30%). This leads to up to 22% EPS cuts over the next two years.
- **Downgrade to UNDERPERFORM from Outperform.** IIFL remains one of the faster growing NBFCs under our coverage, and is a market leader in wealth management. While we like these parts of the business, concerns rise on the company's ability to maintain margins in the lending business. We downgrade our rating to UNDERPERFORM from Outperform with a new target price of Rs610 (from Rs830).

Share price performance



The price relative chart measures performance against the S&P BSE SENSEX IDX which closed at 38,389.82 on 07/09/18. On 07/09/18 the spot exchange rate was Rs71.89/US$1

Performance	1M	3M	12M
Absolute (%)	(2.3)	(0.1)	11.3
Relative (%)	(3.7)	(8.4)	(10.0)

Financial and valuation metrics

Year	3/18A	3/19E	3/20E	3/21E
Pre-provision Op profit (Rs mn)	18,887.9	22,004.3	27,099.4	36,109.5
Pre-tax profit (Rs mn)	16,635.7	21,552.8	25,245.8	33,781.1
Net attributable profit (Rs mn)	9,072.7	11,507.3	13,405.1	17,657.1
EPS (CS adj.) (Rs)	28.42	36.35	39.83	52.46
Chg. from prev. EPS (%)	n.a.	(7.7)	(21.7)	(22.2)
Consensus EPS (Rs)	n.a.	38.50	47.74	59.58
EPS growth (%)	31.3	27.9	9.6	31.7
P/E (x)	24.4	19.1	17.4	13.2
Dividend yield (%)	0.7	0.7	0.7	0.7
BVPS (CS adj.) (Rs)	158.82	197.42	255.61	302.49
P/B (x)	4.36	3.51	2.71	2.29
ROE (%)	19.2	20.4	18.1	18.8
ROA (%)	2.6	2.6	2.4	2.4
Tier 1 Ratio (%)	14.8	14.6	16.0	14.3

Source: Company data, Thomson Reuters, Credit Suisse estimates

IIFL Holdings Limited (IIFL.BO /)

Price (07 Sep 2018): **Rs692.55**; Rating: **(from OUTPERFORM) UNDERPERFORM**; Target Price: **(from Rs830.00) Rs610.00**; Analyst: **Sunil Tirumalai**

Income Statement (Rs mn)	**03/18A**	**03/19E**	**03/20E**	**03/21E**
Interest income	64,033	78,400	99,571	126,544
Interest expense	25,954	34,481	46,032	59,206
Net interest income	**38,079**	**43,919**	**53,539**	**67,338**
Fee and commission income	0	0	0	0
Trading income	0	0	0	0
Insurance income (& premiums)	0	0	0	0
Other income	-	-	-	-
Total non-interest income	**0**	**0**	**0**	**0**
Total income	**38,079**	**43,919**	**53,539**	**67,338**
Personal expense	0	0	0	0
Other expenses	19,191	21,915	26,439	31,228
Total expenses	**19,191**	**21,915**	**26,439**	**31,228**
Pre-provision profit	**18,888**	**22,004**	**27,099**	**36,109**
Loan loss provisions	3,277	2,131	3,974	5,006
Operating profit	**15,611**	**19,873**	**23,125**	**31,104**
Associates/JV	0	0	0	0
Other non-operating inc./(exp.)	1,025	1,680	2,121	2,677
Pre-tax profit	**16,636**	**21,553**	**25,246**	**33,781**
Taxes	5,055	7,000	8,304	11,390
Net profit before minorities	**11,581**	**14,553**	**16,941**	**22,391**
Minority interests	2,508	3,045	3,536	4,734
Preferred dividends	0	0	0	0
Exceptionals/extraordinaries	0	0	0	0
Reported net profit	**9,073**	**11,507**	**13,405**	**17,657**
Analyst adjustments	0	0	0	0
Net profit (Credit Suisse)	**9,073**	**11,507**	**13,405**	**17,657**

Balance Sheet (Rs mn)	**03/18A**	**03/19E**	**03/20E**	**03/21E**
Assets				
Gross customer loans	343,167	427,741	549,626	720,108
Risk provisions	2,541	3,909	4,691	5,604
Net customer loans	**340,606**	**422,381**	**543,077**	**712,127**
Interbank loans	-	-	-	-
Investment & securities	0	0	0	0
Cash & cash equivalents	24,376	42,774	38,474	50,408
Fixed assets	0	0	0	0
Intangibles	0	0	0	0
Other assets	30,416	31,942	45,596	48,922
Total assets	**395,398**	**497,097**	**627,147**	**811,457**
Liabilities				
Interbank deposits	0	0	0	0
Customer deposits	0	0	0	0
Total deposits	**0**	**0**	**0**	**0**
Other liabilities	329,734	416,699	519,723	683,557
Total liabilities	**329,734**	**416,699**	**519,723**	**683,557**
Shareholders' equity	**50,661**	**62,350**	**85,839**	**101,581**
Minority interests	15,003	18,048	21,585	26,319
Preferred stock	0	0	0	0
Total liabilities & equity	**395,398**	**497,097**	**627,147**	**811,457**

Per share	**03/18A**	**03/19E**	**03/20E**	**03/21E**
Shares (wtd avg.) (mn)	319	317	337	337
EPS (Credit Suisse) (Rs)	**28.42**	**36.35**	**39.83**	**52.46**
BVPS (Rs)	158.82	197.42	255.61	302.49
Tangible BVPS (Rs)	158.82	197.42	255.61	302.49
DPS (Rs)	4.99	5.04	4.74	4.74

Earnings	**03/18A**	**03/19E**	**03/20E**	**03/21E**
Growth (%)				
Revenue	35.0	15.3	21.9	25.8
Operating expense	33.9	14.2	20.6	18.1
Pre-provision profit	36.1	16.5	23.2	33.2
Net profit	32.2	26.8	16.5	31.7
Deposit	-	-	-	-

Valuation	**03/18A**	**03/19E**	**03/20E**	**03/21E**
EPS growth (%)	31.3	27.9	9.6	31.7
P/E (x)	24.4	19.1	17.4	13.2
P/B (x)	4.36	3.51	2.71	2.29
P/TB (x)	4.4	3.5	2.7	2.3
Dividend yield	0.7	0.7	0.7	0.7

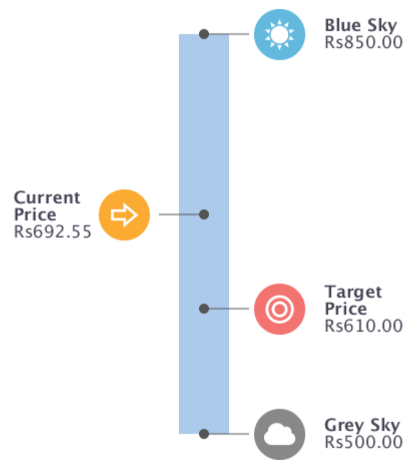
Profitability & margins (%)	**03/18A**	**03/19E**	**03/20E**	**03/21E**
ROE stated	19.2	20.4	18.1	18.8
ROE - CS adj.	19.2	20.4	18.1	18.8
ROA - CS adj.	2.6	2.6	2.4	2.4
Gearing (x)	7.4	8.0	7.7	7.8

Source: Company data, Thomson Reuters, Credit Suisse estimates

Company Background

IIFL is one of India's diversified non-banking financial services company operating diverse businesses across credit business, Wealth and Asset management, Financial advisory, Broking and other advisory services.

Blue/Grey Sky Scenario



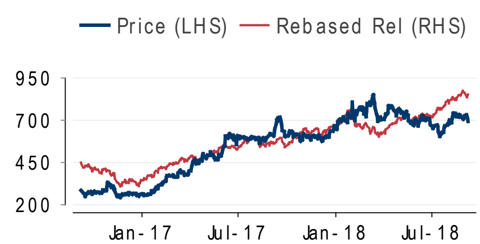
Our Blue Sky Scenario (Rs)	**(from 960.00) 850.00**

Our blue sky scenario of assumes faster-than-expected growth in the NBFC segment, better yield on wealth management AUA and a higher multiple.

Our Grey Sky Scenario (Rs)	**(from 600.00) 500.00**

Our grey sky scenario assumes lower-than-expected growth in the NBFC segment, higher-than-expected asset quality stress and a lower multiple.

Share price performance



The price relative chart measures performance against the S&P BSE SENSEX IDX which closed at 38,389.82 on 07-Sep-2018

On 07-Sep-2018 the spot exchange rate was Rs71.89/US$1

Asia Pacific/India
Diversified Financial Services

Cholamandalam Finance (CHLA.BO)

Rating	(from OUTPERFORM) NEUTRAL
Price (07-Sep-18, Rs)	1,437
Target price (Rs)	(from 1,750) 1,470
Upside/downside (%)	2.3
Mkt cap (Rs/US$ mn)	224,690/ 3,126
Number of shares (mn)	156.34
Free float (%)	46.9
52-wk price range	1,740-1,059
ADTO-6M (US$ mn)	6.7

Target price is for 12 months.

Research Analysts

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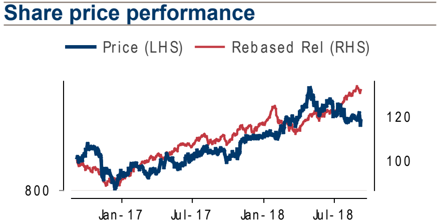
Softer margin performance going forward

- **Liquidity risk looming.** Due to the concerns of rising inflation and twin deficits (current account deficit and fiscal deficit), we believe we are entering a period of tight liquidity in India. This is important since easy liquidity was one of the factors fueling sharp profitable growth for Indian Non Banking Financial Services (NBFCs). Over the last two years, 75% of incremental funding for NBFCs came from market sources.
- **Expect some pressure on margins.** We build a framework in this report to analyse the rise in funding costs for NBFC – taking into account factors like liability characteristics (fixed vs floating, duration, etc.) as well as growth rates of companies. We then see how easy it would be for companies to pass on these costs to their borrowers.
- **Margin pressure already showing up?** We believe Chola's presence in segments of reasonably low pricing power could be a hindrance to pass on rising funding costs, in our view. Early signs of this were seen in 1Q19 results, where the company saw a 50 bp YoY margin drop (partly due to lending rate cuts).
- **Downgrade to NEUTRAL.** Chola is undergoing management change, with new management taking over after multiple years of strong performance under ex-CEO. While growth opportunity remains benign, our lower margins assumptions lead to 3-8% EPS cuts. We downgrade the stock to NEUTRAL with a new target price of Rs1,470 (from Rs1,750 earlier).

Share price performance



The price relative chart measures performance against the S&P BSE SENSEX IDX which closed at 38,389.82 on 07/09/18. On 07/09/18 the spot exchange rate was Rs71.89/US$1

Performance	1M	3M	12M
Absolute (%)	(1.3)	(8.4)	23.7
Relative (%)	(2.6)	(16.7)	2.5

Financial and valuation metrics

Year	3/18A	3/19E	3/20E	3/21E
Pre-provision Op profit (Rs mn)	18,335.2	21,862.4	27,272.3	35,891.7
Pre-tax profit (Rs mn)	14,837.6	17,363.0	21,646.6	28,667.6
Net attributable profit (Rs mn)	9,754.2	11,442.2	14,321.0	18,969.3
EPS (CS adj.) (Rs)	62.42	72.04	88.77	115.79
Chg. from prev. EPS (%)	n.a.	(3.1)	(8.2)	(8.2)
Consensus EPS (Rs)	n.a.	78.83	97.98	114.26
EPS growth (%)	35.5	15.4	23.2	30.4
P/E (x)	23.0	19.9	16.2	12.4
Dividend yield (%)	0.5	0.5	0.6	0.8
BVPS (CS adj.) (Rs)	325.00	441.68	512.47	657.80
P/B (x)	4.42	3.25	2.80	2.18
ROE (%)	20.7	18.9	18.7	19.9
ROA (%)	2.8	2.4	2.3	2.5
Tier 1 Ratio (%)	13.2	15.2	14.4	14.9

Source: Company data, Thomson Reuters, Credit Suisse estimates

Cholamandalam Finance (CHLA.BO /)

Price (07 Sep 2018): **Rs1,437**; Rating: **(from OUTPERFORM) NEUTRAL**; Target Price: **(from Rs1,750) Rs1,470**; Analyst: **Sunil Tirumalai**

Earnings Drivers	03/18A	03/19E	03/20E	03/21E
	-	-	-	-
	-	-	-	-
	-	-	-	-
	-	-	-	-
	-	-	-	-

Income Statement (Rs mn)	03/18A	03/19E	03/20E	03/21E
Interest income	54,258	67,444	81,859	102,447
Interest expense	23,078	34,918	43,044	53,260
Net interest income	**31,180**	**32,526**	**38,815**	**49,187**
Fee and commission income	0	0	0	0
Trading income	0	0	0	0
Total non-interest income	**781**	**1,230**	**1,830**	**2,733**
Total income	**31,961**	**33,756**	**40,645**	**51,920**
Personal expense	7,885	5,823	6,303	6,856
Other expenses	5,740	6,071	7,070	9,172
Total expenses	**13,625**	**11,893**	**13,373**	**16,028**
Pre-provision profit	**18,335**	**21,862**	**27,272**	**35,892**
Loan loss provisions	3,498	4,499	5,626	7,224
Operating profit	**14,838**	**17,363**	**21,647**	**28,668**
Other non-operating inc./(exp.)	0	0	0	0
Pre-tax profit	**14,838**	**17,363**	**21,647**	**28,668**
Taxes	5,100	5,942	7,347	9,720
Net profit before minorities	**9,738**	**11,421**	**14,299**	**18,948**
Reported net profit	**9,754**	**11,442**	**14,321**	**18,969**
Net profit (Credit Suisse)	**9,754**	**11,442**	**14,321**	**18,969**

Balance Sheet (Rs mn)	03/18A	03/19E	03/20E	03/21E
Gross customer loans	371,919	504,244	623,152	787,571
Risk provisions	4,397	5,391	5,280	5,978
Net customer loans	**366,098**	**496,873**	**615,419**	**778,484**
Interbank loans	-	-	-	-
Investment & securities	0	0	0	0
Cash & cash equivalents	4,482	31,390	33,398	34,801
Fixed assets	0	0	0	0
Other assets	19,283	22,872	28,265	35,723
Total assets	**389,863**	**551,134**	**677,082**	**849,008**
Total deposits	**0**	**0**	**0**	**0**
Other liabilities	339,073	480,982	594,404	741,239
Total liabilities	**339,073**	**480,982**	**594,404**	**741,239**
Shareholders' equity	**50,790**	**70,153**	**82,678**	**107,769**
Total liabilities & equity	**389,863**	**551,134**	**677,082**	**849,008**

Asset quality & Capital	03/18A	03/19E	03/20E	03/21E
Asset Quality (%)				
NPL/ gross loans	2.9	2.7	2.4	2.2
B/S loan loss coverage	41.4	40.0	35.0	35.0
Loan/ deposit ratio	-	-	-	-
Capital ratios (%)				
Capital adequacy ratio	18.4	21.3	20.6	21.0
Tier 1 ratio	13.2	15.2	14.4	14.9
Equity Tier 1 ratio	13.2	15.2	14.4	14.9

Per share	03/18A	03/19E	03/20E	03/21E
Shares (wtd avg.) (mn)	156	159	161	164
EPS (Credit Suisse) (Rs)	**62.42**	**72.04**	**88.77**	**115.79**
BVPS (Rs)	325.00	441.68	512.47	657.80
Tangible BVPS (Rs)	325.00	441.68	512.47	657.80
DPS (Rs)	6.50	7.50	9.25	12.06

Earnings	03/18A	03/19E	03/20E	03/21E
Growth (%)				
Revenue	29.5	5.6	20.4	27.7
Operating expense	30.3	(12.7)	12.4	19.9
Pre-provision profit	28.8	19.2	24.7	31.6
Net profit	35.6	17.3	25.2	32.5
Deposit	-	-	-	-

Valuation	03/18A	03/19E	03/20E	03/21E
EPS growth (%)	35.5	15.4	23.2	30.4
P/E (x)	23.0	19.9	16.2	12.4
P/B (x)	4.42	3.25	2.80	2.18
P/TB (x)	4.4	3.3	2.8	2.2
Dividend yield (%)	0.5	0.5	0.6	0.8

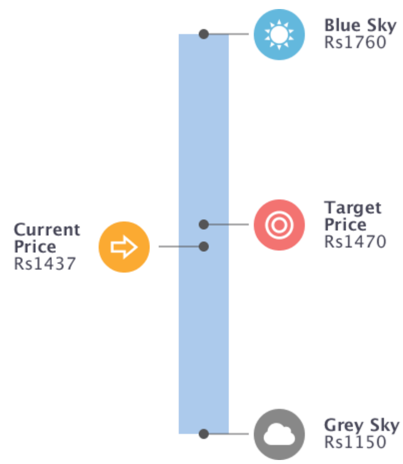
Profitability & margins (%)	03/18A	03/19E	03/20E	03/21E
ROE stated	20.7	18.9	18.7	19.9
ROE - CS adj.	20.7	18.9	18.7	19.9
ROA - CS adj.	2.8	2.4	2.3	2.5
Gearing (x)	7.5	7.9	8.1	8.1

Source: Company data, Thomson Reuters, Credit Suisse estimates

Company Background

Cholamandalam is a diversified financial services company that provides vehicle finance, equipment finance, home loans, home equity loans, SME loans, investment advisory services, stock broking and other financial services

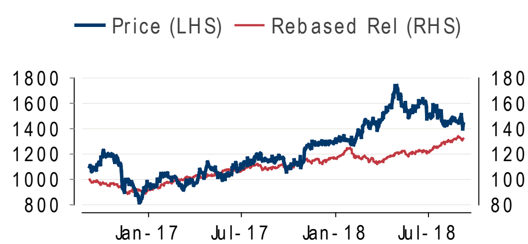
Blue/Grey Sky Scenario



Our Blue Sky Scenario (Rs)	(from 1,925) 1,760
Our blue sky scenario assumes the build of a higher NIM expansion over the next two years, lower credit costs with an uptick in overall economy along with valuing the company at a higher multiple	

Our Grey Sky Scenario (Rs)	1,150
For our grey sky scenario we build flat NIM over the next two years and higher credit costs due to asset quality stress along with valuing the company at a lower multiple	

Share price performance



The price relative chart measures performance against the S&P BSE SENSEX IDX which closed at 38,389.82 on 07-Sep-2018

On 07-Sep-2018 the spot exchange rate was Rs71.89/US$1

LIC Housing Finance Ltd (LICH.BO)

Rating	**NEUTRAL**
Price (07-Sep-18, Rs)	501.05
Target price (Rs)	(from 600.00) 560.00
Upside/downside (%)	11.8
Mkt cap (Rs/US$ mn)	252,861/ 3,517
Number of shares (mn)	504.66
Free float (%)	59.7
52-wk price range	669.55-463.05
ADTO-6M (US$ mn)	14.0

Target price is for 12 months.

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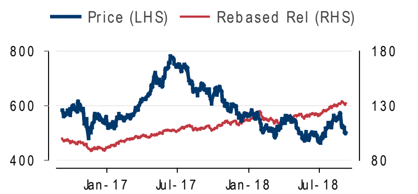
Most rate sensitive NBFC

- **Liquidity risk looming.** Due to the concerns of rising inflation and twin deficits (current account deficit and fiscal deficit), we believe we are entering a period of tight liquidity in India. This is important since easy liquidity was one of the factors fueling sharp profitable growth for Indian Non Banking Financial Services (NBFCs). Over the last two years, 75% of incremental funding for NBFCs came from market sources.
- **Expect some pressure on margins.** We build a framework in this report to analyse the rise in funding costs for NBFC – taking into account factors like liability characteristics (fixed vs floating, duration, etc.) as well as growth rates of companies. We then see how easy it would be for companies to pass on these costs to their borrowers.
- **Margins could fall further.** While LICHF works in the segment with probably the least pricing power (salaried home loans), we are concerned by its growing trend of shorter term liabilities. This exposes the company to repricing /duration risk. We reduce margin estimates thus leading to up to 7% EPS cuts.
- **Lacklustre growth.** LICHF is the slowest growing among the large HFCs, and is growing slower than market leader HDFC (2.5x loan book). Coupled with this, weak margins should lead to LICHF's earnings growth staying weak in coming quarters. Post earnings cuts, we arrive at our new target price of Rs560 (from Rs600). The stock fall in recent weeks leaves low downside. We retain our NEUTRAL rating on the stock.

Share price performance



The price relative chart measures performance against the S&P BSE SENSEX IDX which closed at 38,389.82 on 07/09/18. On 07/09/18 the spot exchange rate was Rs71.89/US$1

Performance	1M	3M	12M
Absolute (%)	(10.3)	1.1	-25.7
Relative (%)	(11.7)	(7.2)	(46.9)

Financial and valuation metrics

Year	3/18A	3/19E	3/20E	3/21E
Pre-provision Op profit (Rs mn)	33,330.1	37,142.4	40,674.5	47,131.9
Pre-tax profit (Rs mn)	30,941.4	33,189.0	36,488.6	42,655.1
Net attributable profit (Rs mn)	20,139.1	23,771.9	26,858.7	31,422.0
EPS (CS adj.) (Rs)	39.91	47.10	53.22	62.26
Chg. from prev. EPS (%)	n.a.	(2.1)	(6.2)	(7.5)
Consensus EPS (Rs)	n.a.	46.25	53.85	63.76
EPS growth (%)	3.7	18.0	13.0	17.0
P/E (x)	12.6	10.6	9.4	8.0
Dividend yield (%)	1.4	1.6	1.8	2.1
BVPS (CS adj.) (Rs)	276.29	290.98	333.33	382.87
P/B (x)	1.81	1.72	1.50	1.31
ROE (%)	16.0	16.6	17.0	17.4
ROA (%)	1.2	1.3	1.3	1.3
Tier 1 Ratio (%)	13.4	12.3	12.1	11.9

Source: Company data, Thomson Reuters, Credit Suisse estimates

LIC Housing Finance Ltd (LICH.BO /)

Price (07 Sep 2018): **Rs501.05**; Rating: **NEUTRAL**; Target Price: **(from Rs600.00) Rs560.00**; Analyst: **Sunil Tirumalai**

Earnings Drivers	03/18A	03/19E	03/20E	03/21E
Loan growth	15.10	15.15	16.71	17.39
NIM (%)	2.38	2.24	2.14	2.11
Credit costs (before reversal of	0.00	0.00	0.00	0.00
Credit costs (after reversal of provisions)	0.00	0.00	0.00	0.00
Asset yields	9.54	9.41	9.45	9.50

Income Statement (Rs mn)	03/18A	03/19E	03/20E	03/21E
Interest income	148,260	168,360	196,223	230,777
Interest expense	111,246	128,241	151,771	179,408
Net interest income	**37,014**	**40,119**	**44,452**	**51,369**
Fee and commission income	1,337	1,071	1,418	1,659
Trading income	0	0	0	0
Total non-interest income	**1,337**	**1,071**	**1,418**	**1,659**
Total income	**38,351**	**41,189**	**45,871**	**53,029**
Personal expense	2,175	1,975	2,288	2,677
Other expenses	4,301	3,769	4,822	5,404
Total expenses	**6,477**	**5,743**	**7,110**	**8,081**
Pre-provision profit	**33,330**	**37,142**	**40,675**	**47,132**
Loan loss provisions	2,389	3,953	4,186	4,477
Operating profit	**30,941**	**33,189**	**36,489**	**42,655**
Other non-operating inc./(exp.)	-	-	-	-
Pre-tax profit	**30,941**	**33,189**	**36,489**	**42,655**
Taxes	10,823	9,438	9,651	11,254
Net profit before minorities	**20,118**	**23,751**	**26,838**	**31,401**
Reported net profit	**20,139**	**23,772**	**26,859**	**31,422**
Net profit (Credit Suisse)	**20,139**	**23,772**	**26,859**	**31,422**

Balance Sheet (Rs mn)	03/18A	03/19E	03/20E	03/21E
Gross customer loans	1,676,120	1,926,159	2,248,870	2,640,328
Risk provisions	12,490	10,445	13,010	15,591
Net customer loans	**1,663,630**	**1,915,714**	**2,235,859**	**2,624,737**
Interbank loans	-	-	-	-
Investment & securities	9,675	11,137	12,995	15,251
Cash & cash equivalents	30,554	16,367	15,305	12,543
Fixed assets	1,320	1,596	1,918	2,298
Other assets	14,537	16,264	18,478	21,159
Total assets	**1,719,716**	**1,961,077**	**2,284,554**	**2,675,987**
Total deposits	**0**	**0**	**0**	**0**
Other liabilities	1,580,239	1,814,206	2,116,312	2,482,744
Total liabilities	**1,580,239**	**1,814,206**	**2,116,312**	**2,482,744**
Shareholders' equity	**139,431**	**146,847**	**168,218**	**193,219**
Total liabilities & equity	**1,719,690**	**1,961,077**	**2,284,557**	**2,675,993**

Asset quality & Capital	03/18A	03/19E	03/20E	03/21E
Asset Quality (%)				
NPL/ gross loans	0.8	1.2	1.2	1.2
B/S loan loss coverage	95.8	45.1	48.1	49.1
Loan/ deposit ratio	-	-	-	-
Capital ratios (%)				
Capital adequacy ratio	16.0	15.0	14.8	14.6
Tier 1 ratio	13.4	12.3	12.1	11.9
Equity Tier 1 ratio	13.4	12.3	12.1	11.9

Per share	03/18A	03/19E	03/20E	03/21E
Shares (wtd avg.) (mn)	505	505	505	505
EPS (Credit Suisse) (Rs)	**39.91**	**47.10**	**53.22**	**62.26**
BVPS (Rs)	276.29	290.98	333.33	382.87
Tangible BVPS (Rs)	276.29	290.98	333.33	382.87
DPS (Rs)	6.80	8.03	9.07	10.61

Earnings	03/18A	03/19E	03/20E	03/21E
Growth (%)				
Revenue	2.9	7.7	11.4	15.5
Operating expense	5.3	(11.3)	23.8	13.7
Pre-provision profit	2.4	11.4	9.5	15.9
Net profit	3.7	18.0	13.0	17.0
Deposit	-	-	-	-

Valuation	03/18A	03/19E	03/20E	03/21E
EPS growth (%)	3.7	18.0	13.0	17.0
P/E (x)	12.6	10.6	9.4	8.0
P/B (x)	1.81	1.72	1.50	1.31
P/TB (x)	1.8	1.7	1.5	1.3
Dividend yield (%)	1.4	1.6	1.8	2.1

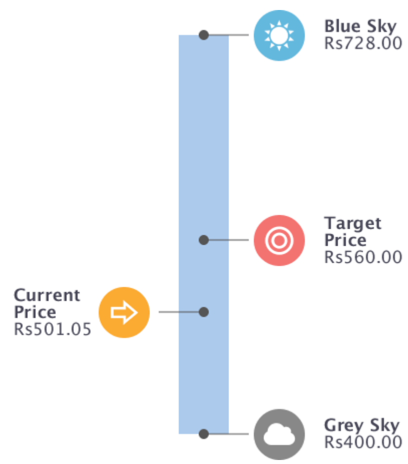
Profitability & margins (%)	03/18A	03/19E	03/20E	03/21E
ROE stated	16.0	16.6	17.0	17.4
ROE - CS adj.	16.0	16.6	17.0	17.4
ROA - CS adj.	1.2	1.3	1.3	1.3
Gearing (x)	12.9	12.9	13.5	13.7

Source: Company data, Thomson Reuters, Credit Suisse estimates

Company Background

LIC Housing Finance Limited provides loans for purchase, construction, repairs and renovation of houses to individuals, corporate bodies, builders and co-operative housing societies and has its operations within India.

Blue/Grey Sky Scenario



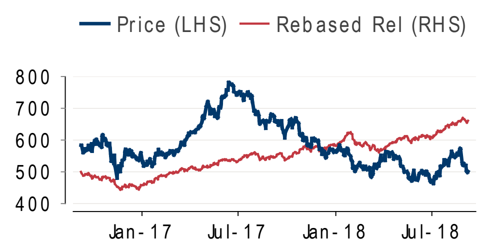
Our Blue Sky Scenario (Rs)	(from 720.00) 728.00

Our blue sky scenario assumes net interest margins to expand by 80 bp over the next two years and gross non-performing assets to fall to 20 bp, giving a higher multiple to the stock.

Our Grey Sky Scenario (Rs)	400.00

Our grey sky scenario assumes that net interest margins fall by 50 bp over the next two years driven by sharper-than-expected lending rate cuts by competition and gross non-performing assets increase to 100 bp, leading to multiple compression.

Share price performance



The price relative chart measures performance against the S&P BSE SENSEX IDX which closed at 38,389.82 on 07-Sep-2018

On 07-Sep-2018 the spot exchange rate was Rs71.89/US$1

Asia Pacific/India
Diversified Financial Services

L&T Finance Holdings Limited

(LTFH.BO / LTFH IN)

Rating	**NEUTRAL**
Price (07-Sep-18, Rs)	167.95
Target price (Rs)	(from 200.00) 175.00
Upside/downside (%)	4.2
Mkt cap (Rs/US$ mn)	335,405/ 4,666
Number of shares (mn)	1,997
Free float (%)	35.8
52-wk price range	211.10-141.60
ADTO-6M (US$ mn)	12.1

Target price is for 12 months.

Research Analysts

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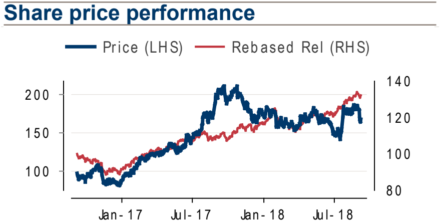
Wholesale lender should see margins pressure

- **Liquidity risk looming.** Due to the concerns of rising inflation and twin deficits (current account deficit and fiscal deficit), we believe we are entering a period of tight liquidity in India. This is important since easy liquidity was one of the factors fueling sharp profitable growth for Indian Non Banking Financial Services (NBFCs). Over the last two years, 75% of incremental funding for NBFCs came from market sources.
- **Expect some pressure on margins.** We build a framework in this report to analyse the rise in funding costs for NBFC – taking into account factors like liability characteristics (fixed vs floating, duration, etc.) as well as growth rates of companies. We then see how easy it would be for companies to pass on these costs to their borrowers.
- **Wholesale segments should see margin squeeze.** L&T Finance is primarily a wholesale lender (70% of loan book), with reasonably low pricing power in most of its wholesale segments, in our view. In addition, the company has been moving towards the shorter end of liabilities. This exposes the company to repricing /duration risk. We reduce margin estimates, which leads to up to 5% EPS cuts.
- **Fairly valued.** While L&T Finance shows promising growth in retail segments, the book still remains largely wholesale. In times of tighter liquidity, we are not confident of the company's sell-down strategy working well. Post earnings cuts, we arrive at a new target price of Rs175 (from Rs200). The stock fall in recent weeks leaves low downside. We retain our NEUTRAL rating on the stock.

Share price performance



The price relative chart measures performance against the S&P BSE SENSEX IDX which closed at 38,389.82 on 07/09/18. On 07/09/18 the spot exchange rate was Rs71.89/US$1

Performance	1M	3M	12M
Absolute (%)	(3.9)	(0.2)	-18.6
Relative (%)	(5.2)	(8.5)	(39.9)

Financial and valuation metrics

Year	3/18A	3/19E	3/20E	3/21E
Pre-provision Op profit (Rs mn)	36,365.7	45,315.3	60,791.8	76,540.3
Pre-tax profit (Rs mn)	17,406.6	28,613.2	32,219.2	42,314.6
Net attributable profit (Rs mn)	13,316.7	21,318.2	23,183.1	30,064.7
EPS (CS adj.) (Rs)	7.40	10.68	11.26	14.18
Chg. from prev. EPS (%)	n.a.	(1.6)	(4.7)	(4.4)
Consensus EPS (Rs)	n.a.	11.42	14.25	17.12
EPS growth (%)	42.0	44.4	5.4	25.9
P/E (x)	22.7	15.7	14.9	11.8
Dividend yield (%)	0.6	0.6	0.7	0.7
BVPS (CS adj.) (Rs)	57.19	64.85	80.83	91.62
P/B (x)	2.94	2.59	2.08	1.83
ROE (%)	13.9	17.5	15.4	16.4
ROA (%)	1.6	2.1	1.8	2.0
Tier 1 Ratio (%)	16.0	14.1	15.0	14.1

Source: Company data, Thomson Reuters, Credit Suisse estimates

L&T Finance Holdings Limited (LTFH.BO / LTFH IN)

Price (07 Sep 2018): **Rs167.95**; Rating: **NEUTRAL**; Target Price: **(from Rs200.00) Rs175.00**; Analyst: **Sunil Tirumalai**

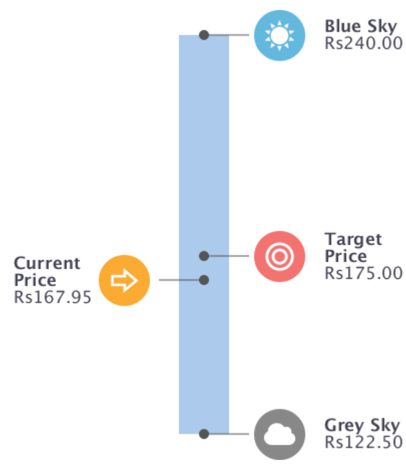
Earnings Drivers	03/18A	03/19E	03/20E	03/21E
Loan Growth	25.51	26.62	22.54	19.68
Net Interest Margin	5.03	4.97	5.17	5.26
AMC - AAUM growth (%)	67.77	45.00	35.00	30.00
AMC - Cost / Income (%)	83.84	78.84	75.34	71.84
Wealth Management - AAUM growth	34.68	20.00	20.00	20.00
Income Statement (Rs mn)	**03/18A**	**03/19E**	**03/20E**	**03/21E**
Interest income	100,210	127,956	163,502	199,059
Interest expense	53,261	67,335	85,144	102,908
Net interest income	**46,949**	**60,622**	**78,358**	**96,151**
Fee and commission income	0	0	0	0
Trading income	0	0	0	0
Total non-interest income	**4,789**	**7,060**	**9,005**	**10,926**
Total income	**51,738**	**67,681**	**87,362**	**107,077**
Personal expense	0	0	0	0
Other expenses	15,373	22,366	26,571	30,537
Total expenses	**15,373**	**22,366**	**26,571**	**30,537**
Pre-provision profit	**36,366**	**45,315**	**60,792**	**76,540**
Loan loss provisions	18,968	16,702	28,573	34,226
Operating profit	**17,398**	**28,613**	**32,219**	**42,315**
Other non-operating inc./(exp.)	0	0	0	0
Pre-tax profit	**17,407**	**28,613**	**32,219**	**42,315**
Taxes	2,748	7,237	8,978	12,192
Net profit before minorities	**14,658**	**21,376**	**23,241**	**30,123**
Reported net profit	**13,317**	**21,318**	**23,183**	**30,065**
Net profit (Credit Suisse)	**13,317**	**21,318**	**23,183**	**30,065**
Balance Sheet (Rs mn)	**03/18A**	**03/19E**	**03/20E**	**03/21E**
Gross customer loans	829,874	1,055,194	1,287,813	1,535,708
Risk provisions	18,200	28,444	30,784	32,311
Net customer loans	**782,992**	**987,824**	**1,215,763**	**1,460,603**
Interbank loans	-	-	-	-
Investment & securities	0	0	0	0
Cash & cash equivalents	33,438	52,391	68,546	63,071
Fixed assets	0	0	0	0
Other assets	75,875	96,071	117,724	140,892
Total assets	**892,306**	**1,136,286**	**1,402,033**	**1,664,566**
Total deposits	**0**	**0**	**0**	**0**
Other liabilities	764,810	993,445	1,217,142	1,456,729
Total liabilities	**764,810**	**993,445**	**1,217,142**	**1,456,729**
Shareholders' equity	**114,130**	**129,418**	**171,409**	**194,298**
Total liabilities & equity	**892,306**	**1,136,286**	**1,402,033**	**1,664,566**
Asset quality & Capital	**03/18A**	**03/19E**	**03/20E**	**03/21E**
Asset Quality (%)				
NPL/ gross loans	4.0	6.6	6.5	6.3
B/S loan loss coverage	55.2	40.7	37.0	33.3
Loan/ deposit ratio	-	-	-	-
Capital ratios (%)				
Capital adequacy ratio	21.5	19.8	20.7	19.8
Tier 1 ratio	16.0	14.1	15.0	14.1
Equity Tier 1 ratio	16.0	14.1	15.0	14.1
Per share	**03/18A**	**03/19E**	**03/20E**	**03/21E**
Shares (wtd avg.) (mn)	1,800	1,996	2,058	2,121
EPS (Credit Suisse) (Rs)	**7.40**	**10.68**	**11.26**	**14.18**
BVPS (Rs)	57.19	64.85	80.83	91.62
Tangible BVPS (Rs)	57.19	64.85	80.83	91.62
DPS (Rs)	1.00	1.00	1.20	1.20
Earnings	**03/18A**	**03/19E**	**03/20E**	**03/21E**
Growth (%)				
Revenue	31.1	30.8	29.1	22.6
Operating expense	20.4	45.5	18.8	14.9
Pre-provision profit	36.3	24.6	34.2	25.9
Net profit	45.6	60.1	8.7	29.7
Deposit	-	-	-	-
Valuation	**03/18A**	**03/19E**	**03/20E**	**03/21E**
EPS growth (%)	42.0	44.4	5.4	25.9
P/E (x)	22.7	15.7	14.9	11.8
P/B (x)	2.94	2.59	2.08	1.83
P/TB (x)	2.9	2.6	2.1	1.8
Dividend yield (%)	0.6	0.6	0.7	0.7
Profitability & margins (%)	**03/18A**	**03/19E**	**03/20E**	**03/21E**
ROE stated	13.9	17.5	15.4	16.4
ROE - CS adj.	13.9	17.5	15.4	16.4
ROA - CS adj.	1.6	2.1	1.8	2.0
Gearing (x)	8.4	8.3	8.4	8.4

Source: Company data, Thomson Reuters, Credit Suisse estimates

Company Background

L&T Finance Holdings Limited is engaged in lending via its subsidiaries for mortgages, MFIs, Infrastructure and other segments. It also offers different financial products and services through its Wealth Management and Asset Management units

Blue/Grey Sky Scenario



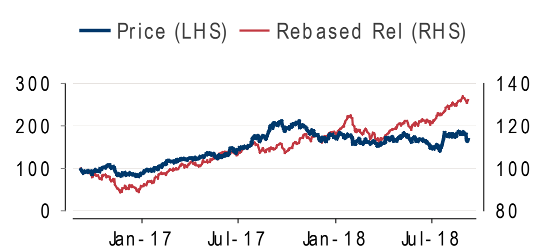
Our Blue Sky Scenario (Rs) **(from 260.00) 240.00**

Our blue sky scenario assumes continued strong growth in its rural and housing segments of lending and lower-than-expected haircut on wholesale book. Competition from PSU banks post recapitalisation remains benign. Robust growth in the AMC and Wealth management businesses leads to improving cost / income as businesses gain scale.

Our Grey Sky Scenario (Rs) **(from 140.00) 122.50**

Our grey sky scenario assumes lower-than-expected growth in its rural and housing segments of lending and higher-than-expected haircut on wholesale book. Aggressive competition from PSU banks post recapitalisation leading to margin compression and lower growth. The AMC and Wealth management businesses failing to gain scale leading to below optional returns

Share price performance



The price relative chart measures performance against the S&P BSE SENSEX IDX which closed at 38,389.82 on 07-Sep-2018

On 07-Sep-2018 the spot exchange rate was Rs71.89/US$1

Companies Mentioned *(Price as of 07-Sep-2018)*
Aditya Birla Capital Ltd (ADTB.BO, Rs136.85)
Bajaj Finance Ltd (BJFN.BO, Rs2740.05)
Cholamandalam Finance (CHLA.BO, Rs1437.15, NEUTRAL, TP Rs1470.0)
Edelweiss Financial Services Ltd (EDEL.BO, Rs261.6)
Housing Development Finance Corp (HDFC.BO, Rs1924.9)
IIFL Holdings Limited (IIFL.BO, Rs692.55, UNDERPERFORM, TP Rs610.0)
Indiabulls Housing Finance Ltd (INBF.BO, Rs1209.45)
JM Financial Ltd (JMSH.BO, Rs115.4)
L&T Finance Holdings Limited (LTFH.BO, Rs167.95, NEUTRAL, TP Rs175.0)
LIC Housing Finance Ltd (LICH.BO, Rs501.05, NEUTRAL, TP Rs560.0)
Mahindra and Mahindra Financial Services Ltd (MMFS.BO, Rs460.35)
Shriram City Union Finance Ltd (SHCU.BO, Rs2026.85)
Shriram Transport Finance Co Ltd (SRTR.BO, Rs1214.2)

Disclosure Appendix

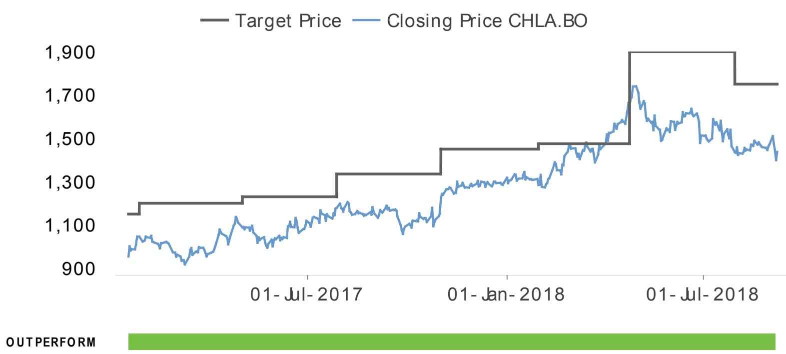
Analyst Certification

I, Sunil Tirumalai, certify that (1) the views expressed in this report accurately reflect my personal views about all of the subject companies and securities and (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

3-Year Price and Rating History for Cholamandalam Finance (CHLA.BO)

CHLA.BO Date	Closing Price (Rs)	Target Price (Rs)	Rating
17-Jan-17	954.15	1150.00	O *
27-Jan-17	1045.35	1200.00	
02-May-17	1088.45	1230.00	
28-Jul-17	1178.95	1335.00	
01-Nov-17	1221.95	1450.00	
30-Jan-18	1284.25	1475.00	
24-Apr-18	1649.60	1900.00	
30-Jul-18	1435.95	1750.00	

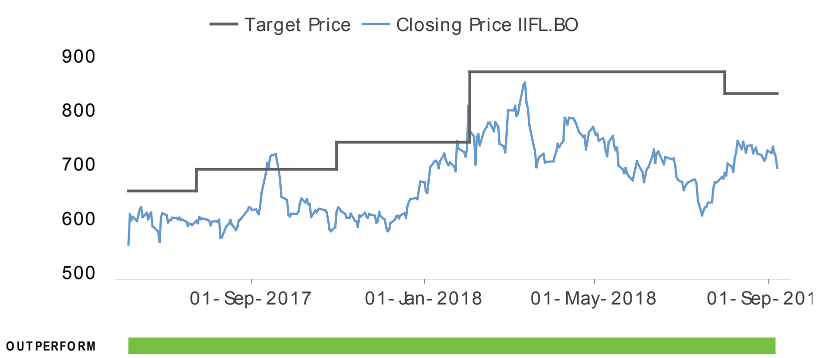
** Asterisk signifies initiation or assumption of coverage.*



3-Year Price and Rating History for IIFL Holdings Limited (IIFL.BO)

IIFL.BO Date	Closing Price (Rs)	Target Price (Rs)	Rating
06-Jun-17	550.60	650.00	O *
24-Jul-17	594.95	690.00	
31-Oct-17	611.25	740.00	
02-Feb-18	760.60	870.00	
01-Aug-18	683.30	830.00	

** Asterisk signifies initiation or assumption of coverage.*



3-Year Price and Rating History for L&T Finance Holdings Limited (LTFH.BO)

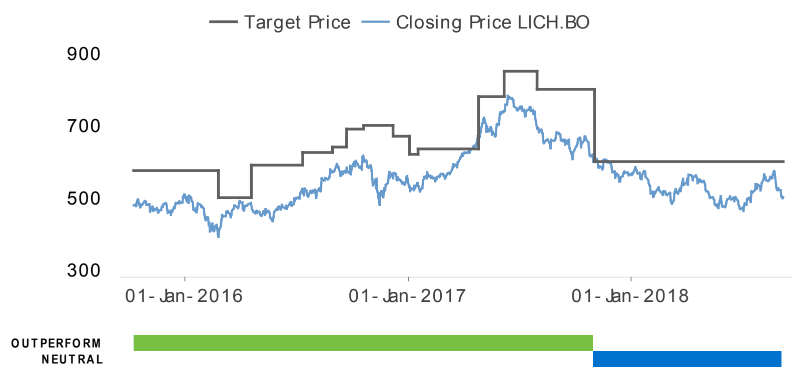
LTFH.BO	Closing Price	Target Price	
Date	(Rs)	(Rs)	Rating
27-Nov-15	66.20		NR
02-Nov-17	198.80	210.00	N *
29-Jan-18	177.65	205.00	
08-May-18	180.80	200.00	

** Asterisk signifies initiation or assumption of coverage.*

3-Year Price and Rating History for LIC Housing Finance Ltd (LICH.BO)

LICH.BO	Closing Price	Target Price	
Date	(Rs)	(Rs)	Rating
09-Oct-15	478.55	575.00	O
25-Feb-16	391.75	500.00	
19-Apr-16	485.20	590.00	
12-Jul-16	520.85	625.00	
30-Aug-16	572.80	640.00	
22-Sep-16	583.10	690.00	
20-Oct-16	609.05	700.00	
07-Dec-16	553.75	670.00	
03-Jan-17	530.75	620.00	
17-Jan-17	532.20	635.00	
26-Apr-17	675.80	780.00	
07-Jun-17	739.65	850.00	
31-Jul-17	691.50	800.00	
02-Nov-17	605.35	600.00	N

** Asterisk signifies initiation or assumption of coverage.*



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Neutral (N) : The stock's total return is expected to be in line with the relevant benchmark* over the next 12 months.
Underperform (U) : The stock's total return is expected to underperform the relevant benchmark* over the next 12 months.

**Relevant benchmark by region: As of 10th December 2012, Japanese ratings are based on a stock's total return relative to the analyst's coverage universe which consists of all companies covered by the analyst within the relevant sector, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities. As of 2nd October 2012, U.S. and Canadian as well as European ratings are based on a stock's total return relative to the analyst's coverage universe which consists of all companies covered by the analyst within the relevant sector, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities. For Latin American and Asia stocks (excluding Japan and Australia), ratings are based on a stock's total return relative to the average total return of the relevant country or regional benchmark (India - S&P BSE Sensex Index); prior to 2nd October 2012 U.S. and Canadian ratings were based on (1) a stock's absolute total return potential to its current share price and (2) the relative attractiveness of a stock's total return potential within an analyst's coverage universe. For Australian and New Zealand stocks, the expected total return (ETR) calculation includes 12-month rolling dividend yield. An Outperform rating is assigned where an ETR is greater than or equal to 7.5%; Underperform where an ETR less than or equal to 5%. A Neutral may be assigned where the ETR is between -5% and 15%. The overlapping rating range allows analysts to assign a rating that puts ETR in the context of associated risks. Prior to 18 May 2015, ETR ranges for Outperform and Underperform ratings did not overlap with Neutral thresholds between 15% and 7.5%, which was in operation from 7 July 2011.*

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Neutral/Hold*	38%	(58% banking clients)
Underperform/Sell*	12%	(54% banking clients)
Restricted	2%	

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Target Price and Rating
Valuation Methodology and Risks: (12 months) for Cholamandalam Finance (CHLA.BO)

Method: We value Cholamandalam's stock price at a 15x P/E (price-to-earnings) on two-year forward EPS of Rs98, to arrive at a target price of Rs1,470 per share. Our 15x 24M forward EPS (earning sper share) multiple is at a premium to valuations at peer group. We believe the premium is justified given the growth outlook and recent portfolio track record. We rate Cholamandalam stock NEUTRAL we believe near term risks from tighter liquidity and rising bond yields are becoming material which could impact NIMs

Risk: Risks to our NEUTRAL rating and target price of Rs1,470 for Cholamandalam are: Key upside risks include: (1) Lower than expected NIM compression, (2) reduction in asset quality stres enabling the company to experience opex benefits from reduction in recovery expenses. Key downside risks: (1) greater than expected increase in funding costs, (2) high recovery expenses (3) Management change with new management taking over after multiple years of strong performance under ex-CEO

Target Price and Rating
Valuation Methodology and Risks: (12 months) for IIFL Holdings Limited (IIFL.BO)

Method: We value IIFL Holding Ltd at a target price of Rs610 using sum-of-the-parts valuation assigning: 1) 13x multiple to 24-month forward earnings of NBFC busiensss, 2) 19x multiple to 24-month forward earnings of wealth business and 3) 10x multiple to 24-month forward to capital market and other businesses. We believe this is a fair multiple given the established diversified retail lending franchise cpupled with expectation of NIM compression due to rise in cost of funds for the lending business. We rate the stock UNDERPERFORM as we believe near term risks from tighter liquidity and rising bond yields are becoming material.

Risk: Risks to our UNDERPERFORM rating and target price of Rs610 for IIFL Holdings Limited include: 1) Lower than expected NIM compression in lending segment; 2) faster than expected market share gains in new growth areas of CV (commercial vehicle) and SME (small-medium enterprise) lending which have established incumbents; 3) Yield expansion in the wealth management business.

Target Price and Rating
Valuation Methodology and Risks: (12 months) for L&T Finance Holdings Limited (LTFH.BO)

Method: We value L&T Financial Holdings (LTFH) at Rs175 using sum-of-the-parts for its various businesses: (1) lending business at 13.5x 24-month forward EPS of Rs11/share of LTFH; (2) investment management business at 20x 24-month forward EPS of Rs1; and (3) wealth management business at 18x 24-month forward EPS of Rs0.16/share of LTFH. We have a NEUTRAL rating on the stock since we believe that at current valuations the stock is already pricing in initial few years of 'turnaround' along with concerns on margins on account of increase in funding costs

Risk: Key upside risks to our NEUTRAL rating and TP of Rs175 for L&T Financial Holdings (LTFH) are: (1) Lower than expected NIM compression; and (2) lower-than-expected haircut on its stressed whole sale book. Downside risks include: (1) higher-than-expected loan losses in the pre-2012 infra loan book; and (2) slower ramp-up in new focus segments in retail lending.

Target Price and Rating
Valuation Methodology and Risks: (12 months) for LIC Housing Finance Ltd (LICH.BO)

Method: Our target price of Rs560 for LIC Housing Finance Ltd is based on a P/E (price-to-earnings) multiple of 10x on our 24M forward EPS (earnings per share) of Rs56. We assign a multiple of 10x in line with its historical long-term average. We have a NEUTRAL rating on LIC Housing as we see risks to margins with increase in funding costs.

Risk: Upside risks to our target price of Rs560 and NEUTRAL rating for LIC Housing Finance Ltd include: (1) benign competition, and (2) bond market interest rates softening. Key downside risks include: (1) greater-than-expected margin compression; (2) spike in interest rates and (3) frequent management changes.

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