

## Is it time to book profit in NBFC stocks?

Even as Q2 earnings appear promising, experts believe high valuations post the recent rally limits the risk-reward for NBFC stocks

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*Representative image*

If you had bought shares of non-banking financial companies (NBFCs) at the start of 2016, they would have enriched your portfolio with at least 10 per cent gains; almost twice the year-to-date 5.6 per cent gains of the S&P BSE Sensex. In fact, in the case of select NBFC stocks such as Bajaj Finance, Cholamandalam Investment and Finance, Shriram Transport or Muthoot Finance, the returns are anywhere between 35-90 per cent.

At the beginning of 2016, there was a shift in preference from banks to NBFC stocks as the asset quality of banks and

growth prospects, especially public sector banks, were questionable. In contrast, NBFCs offered higher earnings visibility without compromising on profitability and asset quality. Moderation in interest rate on bonds helped them further reduce their cost of funds, thereby supporting their profitability. While some of these fundamentals haven't changed, particularly on loan growth or profitability, experts advice that investors exercise caution.

Macquarie cautions investors that NBFC stocks are probably like an expanding bubble. "NBFCs have rallied sharply on strong earnings growth delivered at a time when growth is hard to come by. But at current valuations, the margin of safety is too low," the brokerage wrote in its report. Others like analysts at Religare Capital Markets have a similar opinion. The brokerage, which recently concluded its road show on Indian financial institutions in the US, said in its note: "Most investors agreed with our view that NBFCs are trading at premium valuations compared to their underlying fundamentals." Adding to the concerns on valuations, Citi also pointed out that the best part of bond rate (decline) trades are probably done, suggesting that not much of incremental cost advantage may be available for NBFCs going forward.

For housing finance companies, there could be more troubles. Rating agency Ind-Ra pointed out that delinquency in loan against property (LAP) portfolio could increase in the next four quarters. "Signs of early stress are visible in LAP business, including a sharp rise in 90 days past due delinquencies for some of the large players," it said. Also, if banks (private and public), post strong Q2 results and maintain decent guidance on asset quality, investors may shift preference from NBFC to banks once again, as many of them are also trading at reasonable valuations.

Given the changed scenario, investors will have to be very stock specific with NBFC and banking stocks. R Sreeshankar, head of research, Prabhudas Lilladher, said that it would be unfair to broad-brush the NBFC stocks and book profit across the counter. "NBFCs are very dynamic now and ones like L&T Finance remain a good buy despite the stock run up as its business will become more focused in the next 24 – 36 months," he said.