Vehicle-finance companies in fast lane

Strong vehicle demand to support earnings growth of top lenders

SHREEPAD S AUTE

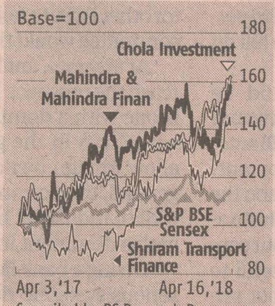
The share prices of vehicle-finance companies are up 7-17 per cent in the past one month. One reason being that the companies are expected to post a strong set of numbers for the January-March 2018 quarter (Q4), mainly because of hefty vehicle sales. Notably, the trend is likely to continue till FY19, and this should reflect favourably on the share price returns, despite their outperformance in the past one year.

"Considering the healthy demand for commercial and utility vehicles, we expect Shriram Transport Finance (STF) and Cholamandalam Investment and Finance Company (CIFC) to deliver stronger set of numbers. Mahindra and Mahindra Financial Services (MMFS) is expected to register strong demand trends, supported by higher tractor sales," observe analysts at Emkay Global in their recent report on Q4 result expectations.

During the March 2018 quarter, sales of commercial vehicles surged by over 29 per cent (YoY) and that of utility vehicles by 22 per cent. Even in the December 2017 quarter, vehicle sales witnessed a double-digit growth and tractor volumes were also healthy.

This buoyancy in the automobile sector is likely to have translated into a 15-20 per cent YoY growth in assets under management (AUM reflects size of the loan book) of the top vehicle-finance companies. This is because the vehicle sector, including tractors, accounts for around 70 per cent, 90 per cent and 100 per cent of CIFC, MMFS and STF's AUM, respectively. In fact, for CIFC and MMFS, it would be the highest AUM growth in the past several quarters.

The expected rise in AUM and low cost of funds would help these firms clock around 19 to 26 per cent YoY growth in net interest income (interest earned minus expensed). Analysts at Motilal Oswal Securities expect the lower cost of funds to result in a 30 to 40 basis point expansion (on a yearly basis) in net interest margin (NIM: NII as a per cent of AUM).



Compiled by BS Research Bureau

An upswing in the rural economy, good monsoon forecast and seasonally better quarter (Q4) are also expected to have augured well for these firms in terms of asset quality and credit cost, as recoveries are likely to have improved.

Analysts, however, point to the impact of STF as it shifts to a 90-day NPA or bad loans recognition norms (from 120 days earlier), which could weigh on its asset quality and earnings in Q4 to some extent. "We anticipate improvement in the underlying trend, transition to 90 dpd (days past due, delay in repayment) recognition norms will impact Q4 earnings (of STF)," analysts at Edelweiss Securities said in a recent report. Nevertheless, this would only be an accounting hiccup.

Analysts are bullish on these stocks, suggesting around 12-18 per cent upside over a one-year period. They believe a pick-up in economic growth and rural demand will help sustain a healthy growth in earnings, while aiding asset quality in the current fiscal. While earnings of CIFC is increasing by 17-20 per cent, STF and MMFS's are seen growing by 30-35 per cent in FY19.