ICRA

Non-Banks: Growth to revive in FY2022; key performance indicators however would remain under pressure

January 2021

Summary

FY2022 Outlook -Negative

AUM Growth ↓	Asset Quality ↓	Funding and Liquidity	Profitability ↓	Capital
7-9% Growth	**GNPA-130-200 bps**	**Rs. 1.9-2.2 Trillion**	**20-30% lower than Pre-covid level**	**Comfortable**
Growth to remain moderate in FY2022. Access to adequate funding would be critical as demand is expected to revive in the next fiscal	After the spike in FY2021; reported NPAs to remain stable but at elevated levels in FY2022 Estimate restructuring of about 4-6% of AUM on account of the pandemic.	additional funding required in FY2022 to support growth, apart from refinancing existing/maturing lines. Continuation of RBI/Govt initiatives would be critical	Profitability pressures to remain in the current and next fiscal because of higher credit cost and slower growth	No capital requirement considering the muted growth outlook

Growth to revive in FY2022; would remain elusive in FY2021

- Growth would remain elusive in current fiscal, affected by a) asset quality pressures b) limited new borrowers additions c) subdued demand. Expect AUM to remain flattish in March 2021, on YoY basis.
- Notwithstanding the expected demand improvement in FY2022, non-bank growth revival would remain contingent on funding availability , which may restrict AUM growth to 7-9% .
- As entities continue to par-down wholesale exposures, growth in this segment would take longer to register a positive uptrend

Exhibit : Retail NBFC Credit Growth Trends

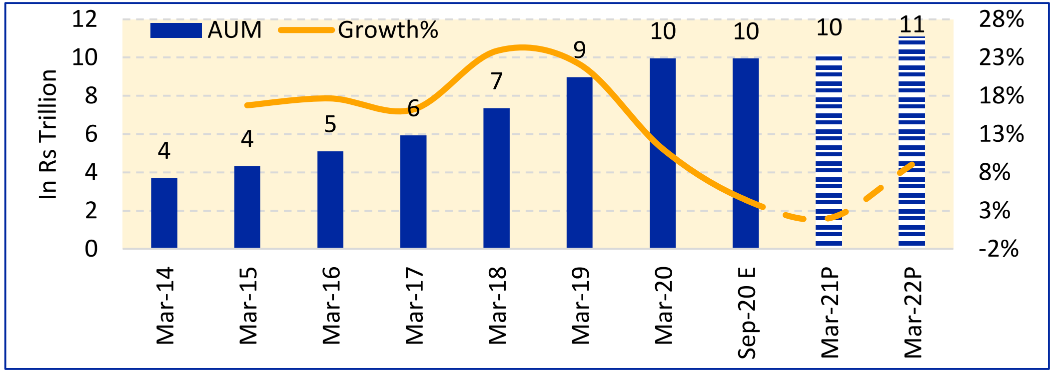


Exhibit: Wholesale NBFC (non-infra) Credit Growth Trends

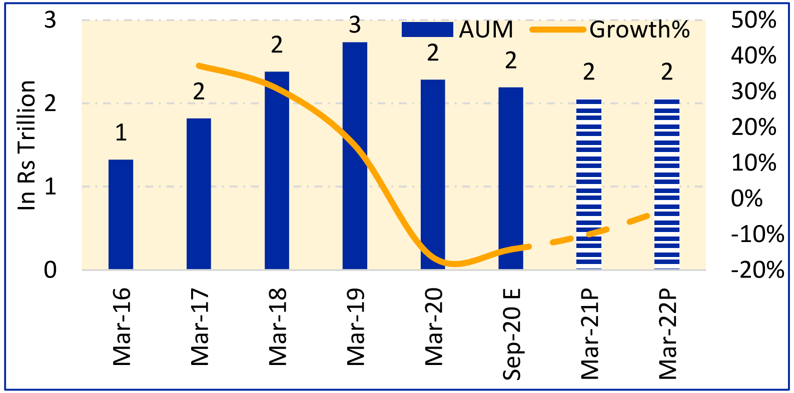
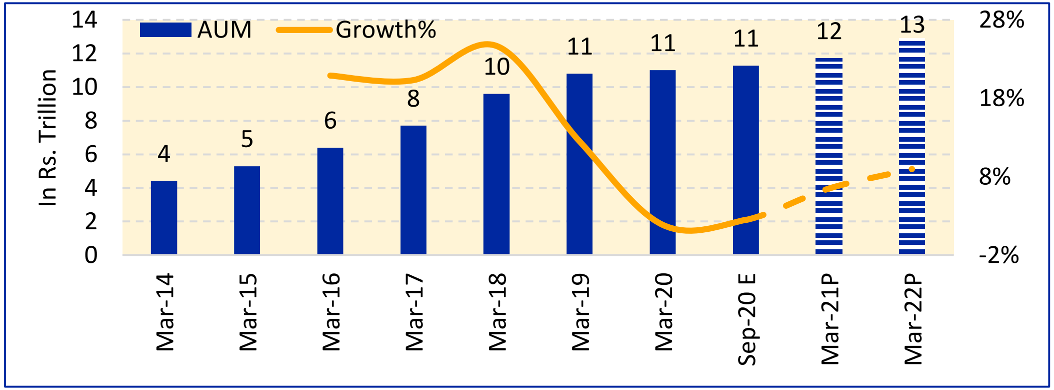


Exhibit: HFC Credit Growth Trends



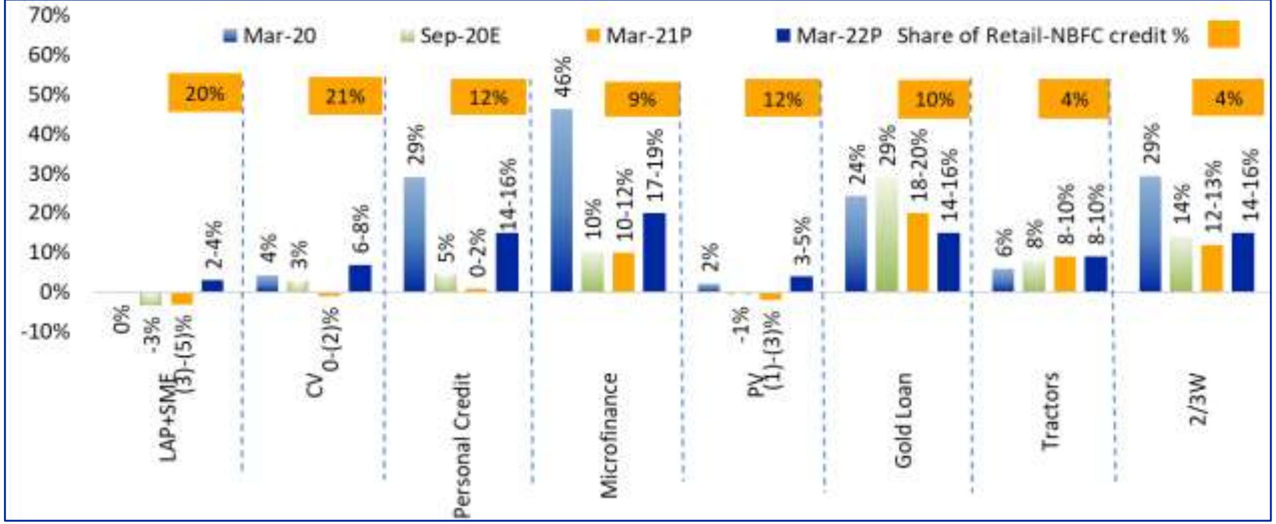
Source: *ICRA research ; Non-bank- NBFC +HFC (Excluding Infra NBFCs) Note: Data based on ICRA Sample of large entities excluding Infra NBFCs E-Estimated ; P-Projected*

Gold, housing, unsecured consumer and rural credit to drive growth

NBFC

- Growth drivers in the FY2020- microfinance, personal/consumer credit etc were impacted in the current year.
- Gold loan growth, however remained strong on the back of buoyant gold prices. Rural credit –tractor /two wheeler also are likely to perform relatively better than other asset segments in FY2021
- All key segments to witness revival in FY2022, it would however remain moderate than past trends

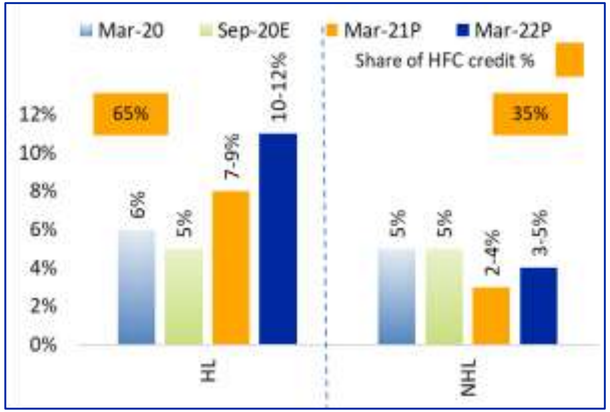
Exhibit: Retail NBFC Segmental YoY Growth Trends and Expectations



HFC

- Attractive interest rates and Govt initiatives to push housing credit growth. NHL loans growth to remain muted because of lender' risk aversion

Exhibit: HFC Segmental Trends and Expectations

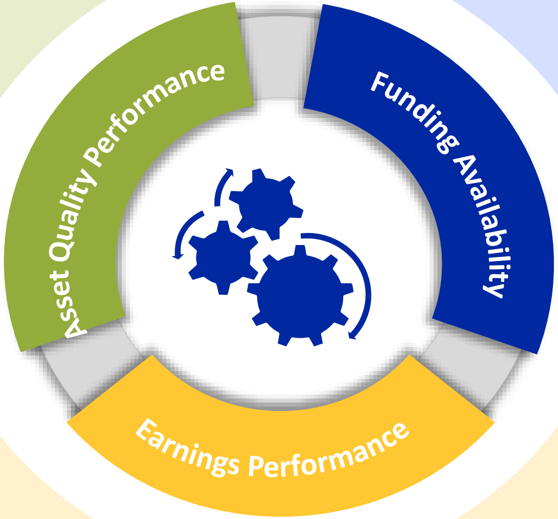


HL-Housing Loans ; NHL- Non Housing loans (LAP, CRE etc)

Source: *ICRA research ; E-Estimated ; P-Projected*

Navigating post covid challenges to be the key differentiator

- Some segments faced asset quality pressures even before the pandemic – vehicle, real estate, MSME etc
- Few segments were impacted specifically because of the pandemic- like microfinance, and consumer credit
- Improving collections, tightening controls and underwriting process along with expansion in borrower base would be key for meaningful growth to return



- Accessing diversified funding sources- bank funding near threshold levels
- Critical for Govt or RBI initiated funding support (TLTRO/PCG) to continue for the sector, at least over the near-term
- Access to credit lines which are tenor matched with assets and at competitive funding rates

- Slowing growth and expected credit losses, to act as a drag on near-term earnings performance
- Cost reduction initiatives however could bolster earnings performance

Asset quality related headwinds to remain in the near-term

Collections

Collection efficiency improving but still about 5-15% lower than pre-covid levels

Asset Quality Pressures

Increase witnessed in Softer bucket delinquencies by up to 15%

Restructuring

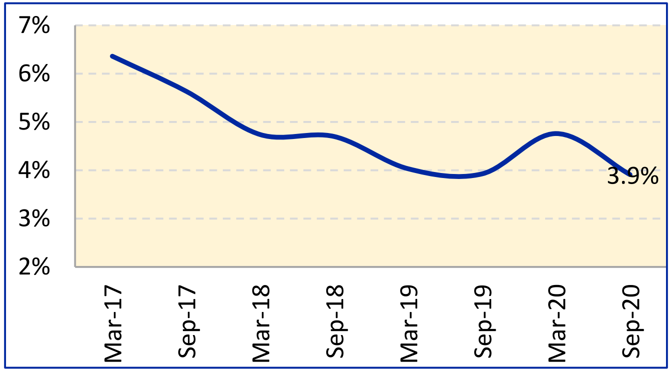
Expect restructuring of about 4-6% of the AUM

Losses and NPA

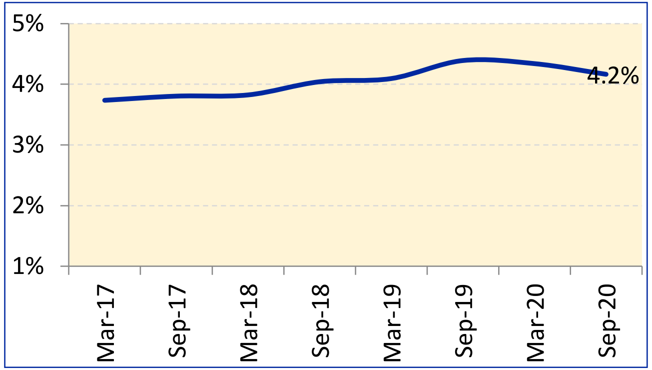
NPAs to go up by about 200 bps by March 2021. Slippages from restructured book and incremental stress to keep NPAs elevated in FY2022

Asset Quality (90+dpd) Trends in Key Segments-I

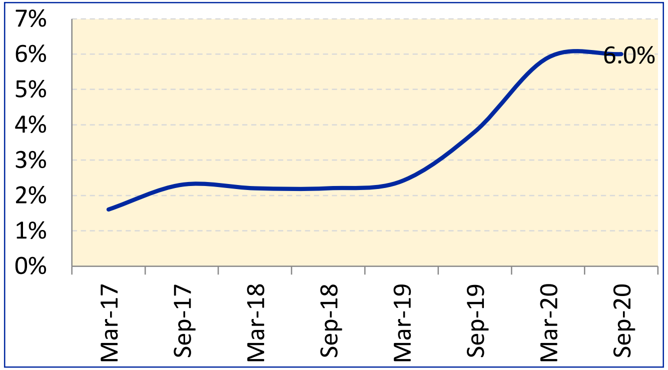
Prolonged moratorium limited forward flows into hard delinquencies buckets ; vulnerability however remain high for segments closely linked to economic activities



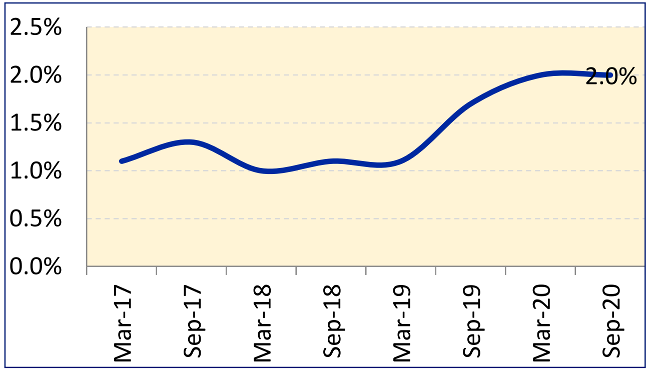
Commercial Vehicle



LAP+SME (NBFC)



CRE (HFC)

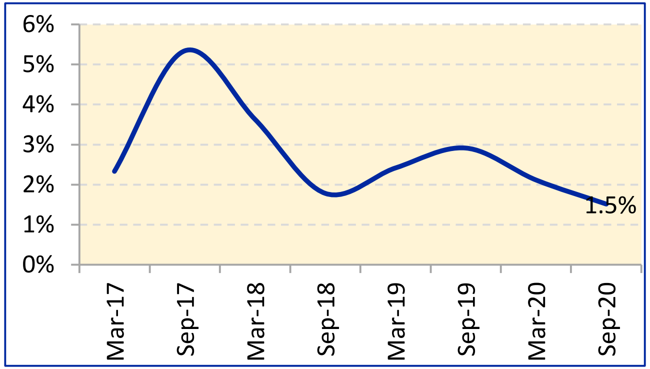


LAP (HFC)

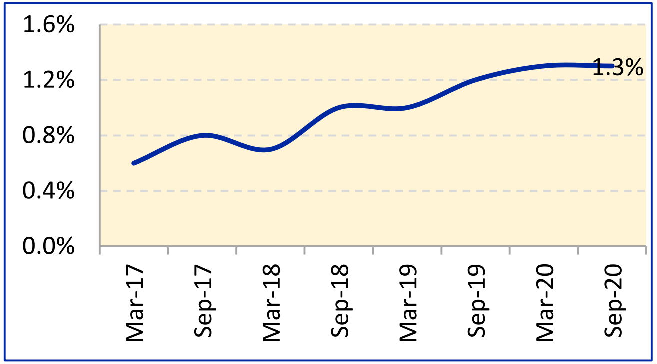
Source: *ICRA research; data based on ICRA Sample of entities ; best estimates are used were data was not available*

Asset Quality (90+dpd) Trends in Key Segments-II

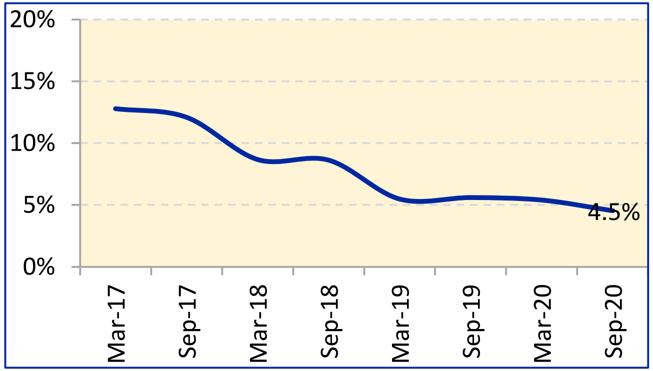
Housing and rural segments to perform relatively better; unsecured and consumption loan are likely to be more susceptible



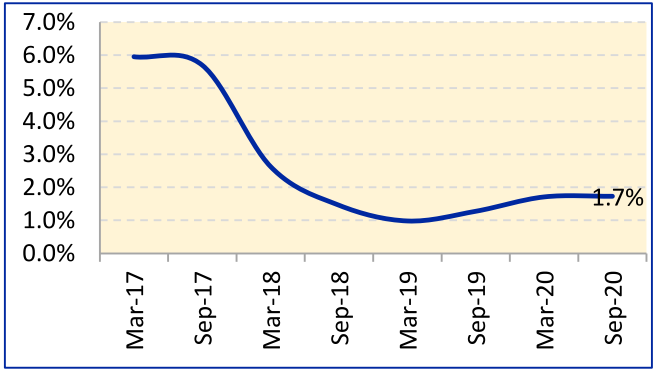
Gold Loans



Home Loans



Tractor

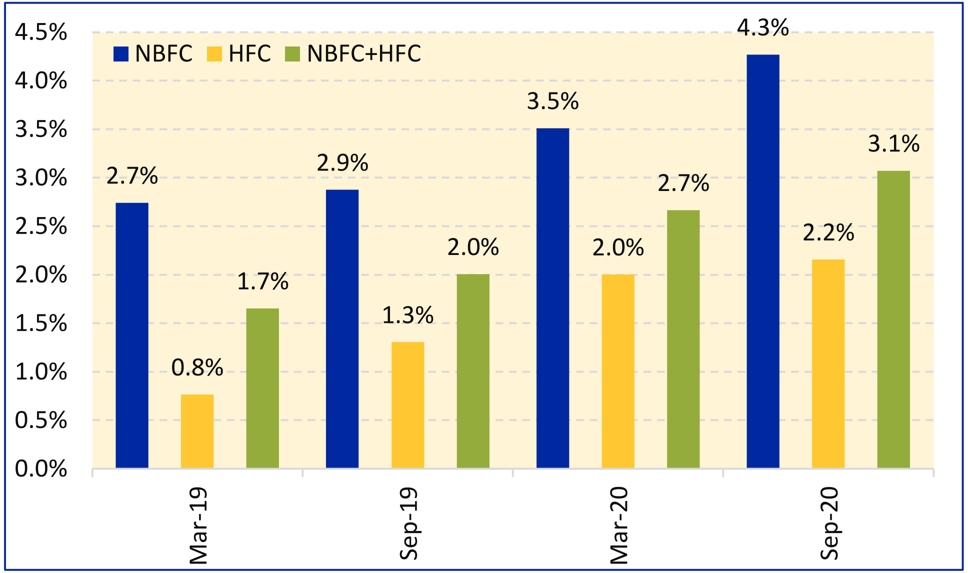


Microfinance

Source: *ICRA research; data based on ICRA Sample of entities ; best estimates are used were data was not available*

Steady build-up in provisions

Exhibit: Provision carried by NBFC and HFCs

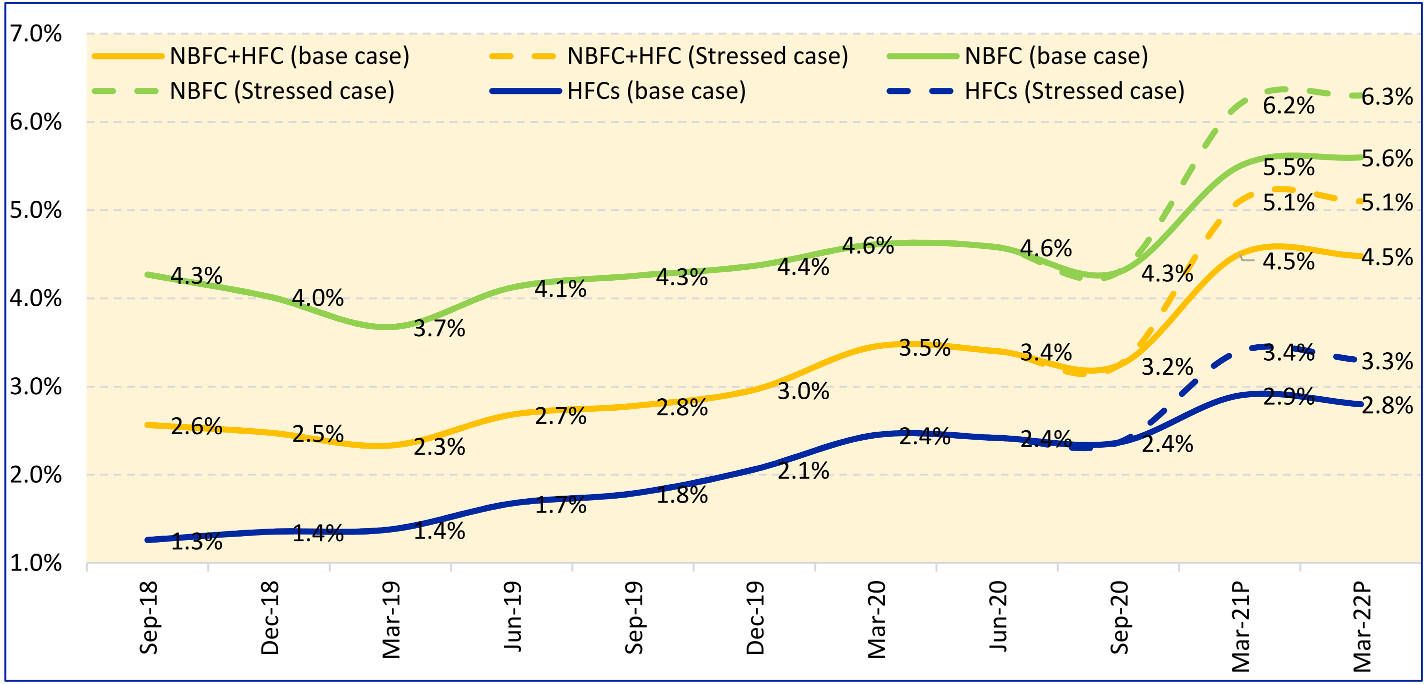


Source: *ICRA research; Data based on the 20 NBFCs and 11 HFCs;*
Estimates used where data was not available

- Non-banks currently are carrying about 50% higher provision than a year ago at about 3.1% of the look book as of September 2020 vis a vis 2.0% in September 2019.
- Higher provisions put them at a better position to absorb future uncertainties and the consequent impact on credit quality.
- Healthy pre-provision profits ~ 4% provides adequate room for further increase in provisions.

Reported NPA to remain elevated in FY2022

Exhibit: NPA/Gross stage 3- Trends and Expectations



Source: *ICRA research; Data based on the 20 NBFCs and 11 HFCs;*
Estimates used where data was not available

Entities are expected to offset credit losses partially with the provisions already created. However, incremental slippages, including from restructured book, would keep NPAs elevated even in FY2022.

Asset quality performance would also be closely linked to the trends in the operating environment and economic recovery

NCD Issuances remain rangebound; support from Govt/RBI initiatives

Exhibit: NCD Issuances –Monthly- ALL NBFC/HFCs

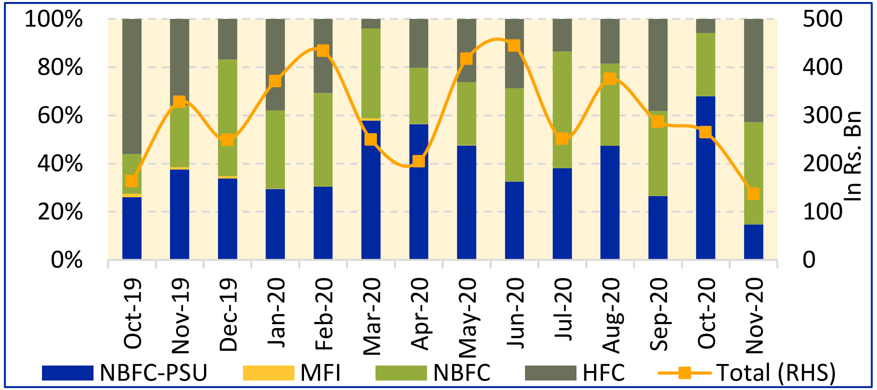


Exhibit: Monthly NCD Issuance (Excl NBFC-PSU)

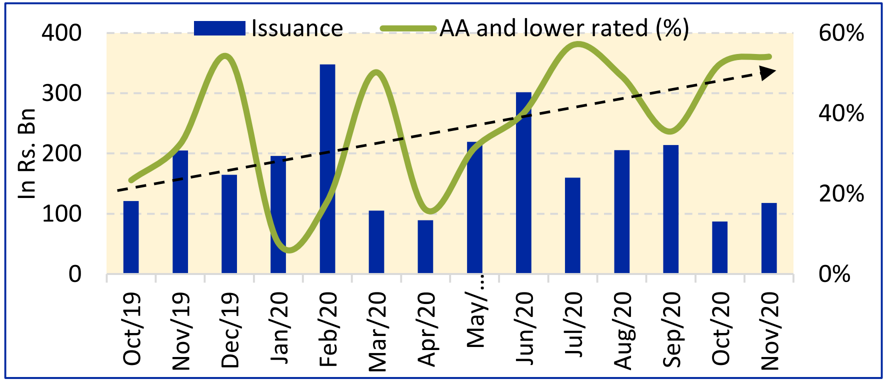
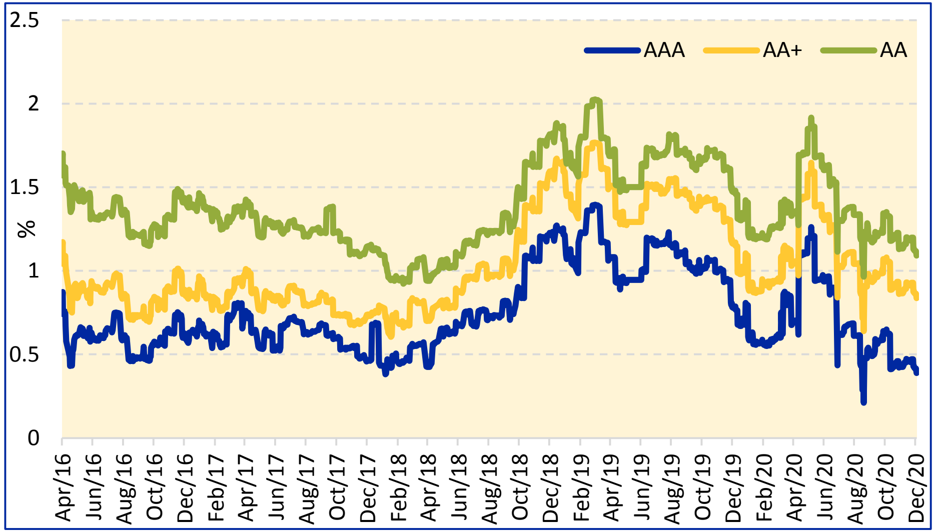


Exhibit: Rating wise Spreads -5Year



- LTRO/PCG drove NCD issuances; AA and below rated NCDs accounted for ~40% of the total NBFC+HFC issuances [excluding NBFC PSU] during May-Nov 2020
- Spreads have improved and are at multi-year low; but muted portfolio growth has impacted fresh NCD issuance

Source: AIMIN, Bloomberg, ICRA research

CP issuances witnessing some uptick; Short term rates remain attractive

Exhibit: NBFC-HFC Monthly CP Issuances

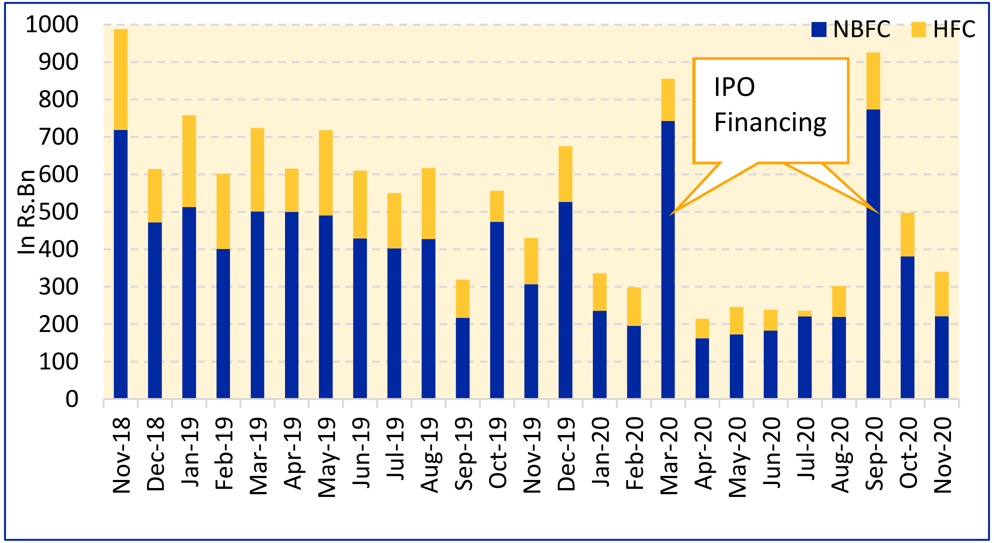
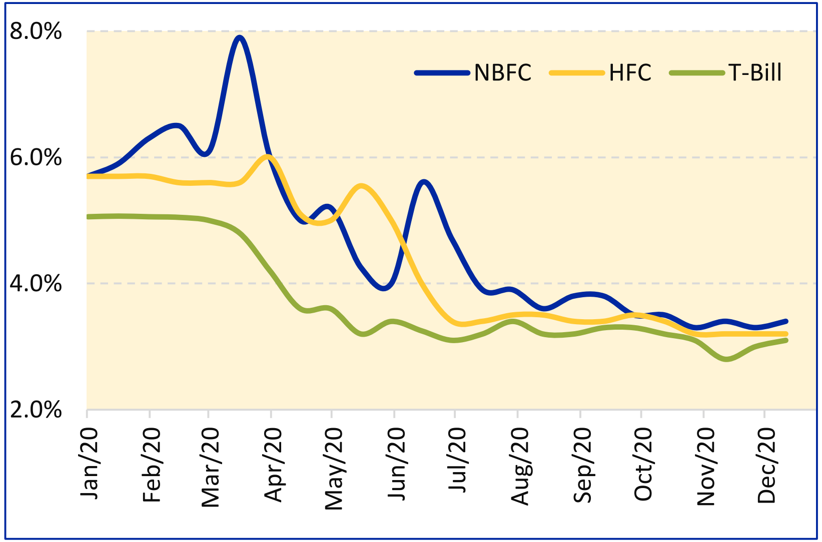


Exhibit: 90-day Short-Term Rate Trend



- After witnessing a steady decline in fresh issuance since September 2018, some uptick was witnessed since August 2020;Revival is on the back of a very attractive ST rates; issuances however still are around 60% of the levels seen in Q4FY2019.
- Increase in the share of short term instruments , would be a near-term rating monitorable

Source: AIMIN, F-trac, ICRA research

Bank credit driven by TLTRO+PCG; MFs renew interest

Exhibit: Bank loans to NBFC stagnant; incremental funding driven via TLTRO and PCG

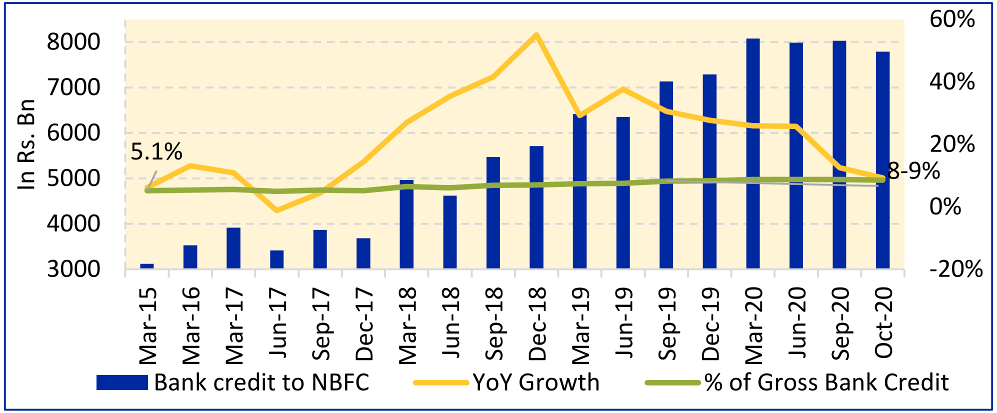


Exhibit: Asset quality concerns impact securitisation volumes in FY2021; Jump in volumes expected in FY2022

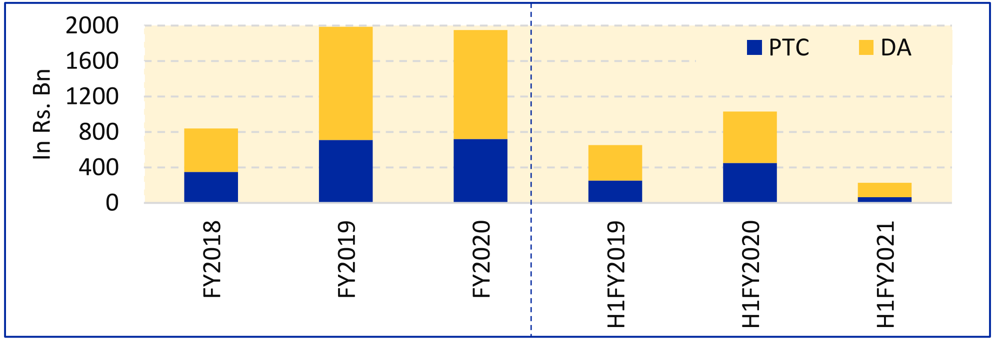
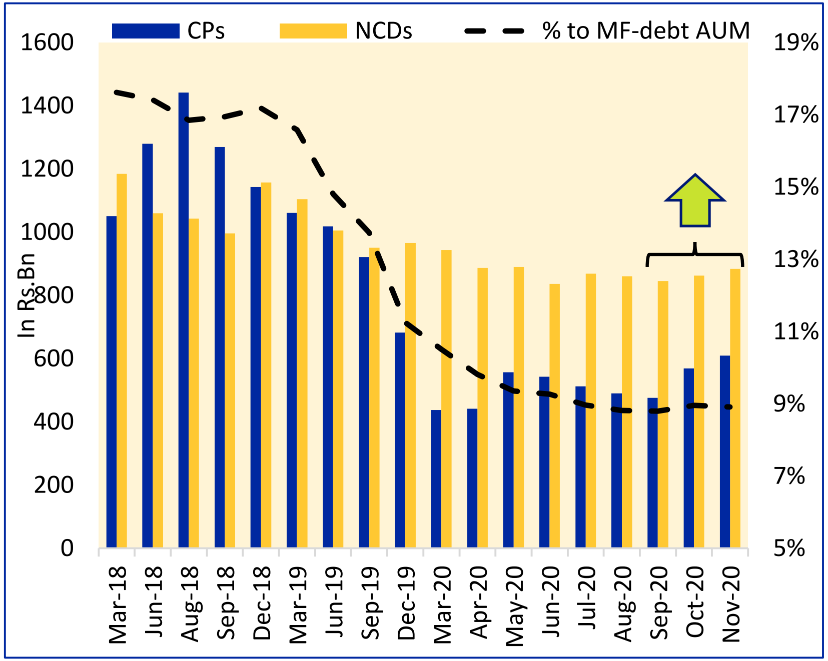


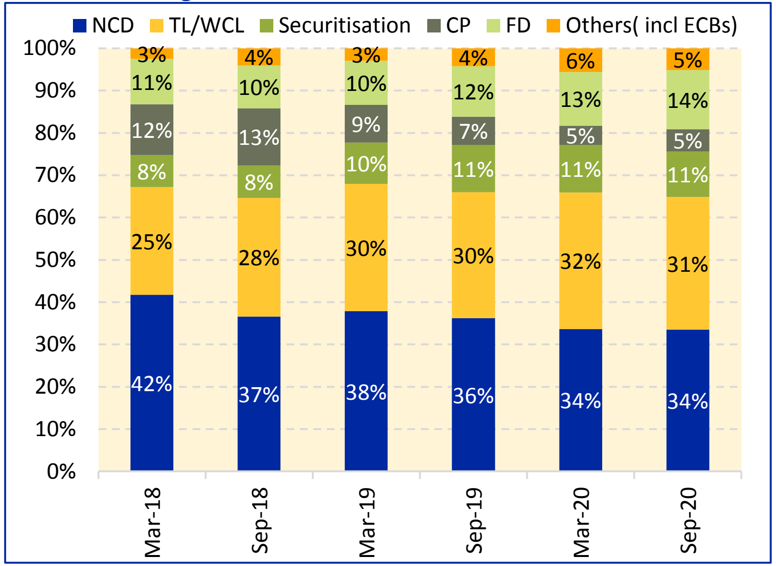
Exhibit: MF investments in NBFC papers witnessed some revival; share however continues to remain low



Source: RBI, SEBI, ICRA research

Funding profile and outlook

Exhibit: Funding Profile of NBFC+HFC



Source: *ICRA research; Data based on the 20 NBFCs and 11 HFCs; Estimates used where data was not available*

- Additional funding requirement during FY2022 - Rs. 1.9-2.2 trillion- to support growth, apart from the refinance of existing and maturing loan facilities

Exhibit: Expectations and Outlook

NCDs

- MFs renewed interest towards the sector is a positive
- Expect issuances to steadily increase if asset quality trends does not weaken beyond expected levels. Exposure level however would remain sizeably lower than levels of 2018-19.

Term Loans

- Bank can extend targeted credit (TLTRO)even a loans going forward.
- Bank' NBFC sectoral exposure at all time high. This could hinder incremental flow to the sector

PTC/DA

- Securitisation volumes in H2 FY2021 expected to be more than double the volumes seen in H1FY2021. Volumes to jump to Rs. 1.2-1.5 trillion in FY2022 from 0.6-0.8 trillion in FY2021
- Improvement in collection efficiencies would be crucial for future issuances

CPs

- Attractive ST rates could push CP issuances
- Share in overall borrowing could register an increase but likely to remain lower than FY2019 levels

FDs

- Better yields to depositors and retail focus by entities supported deposit mobilisation growth so far.
- Dependence on deposit mobilisation going forward in a scenario where market borrowing rate are low and growth is subdued, remains to be seen.

Others

- Healthy ECB issuances in the last fiscal.
- While H1 issuance was modest ,expect some pick up in H2 and in the next Financial year, depending on the overall cost of such loans and AUM growth

Earnings so far supported by benign borrowing rates and lower operating costs

Exhibit: Cost of Funds (COF)

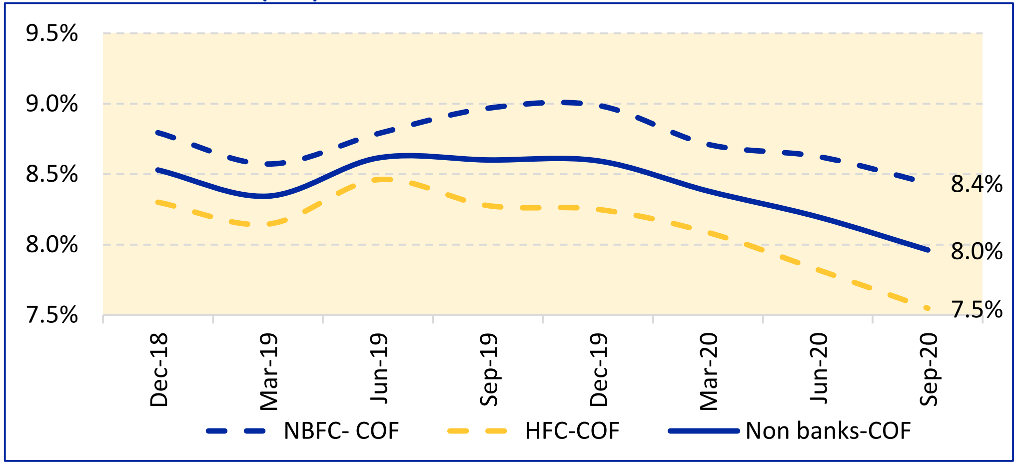


Exhibit: NBFC Earnings Trend

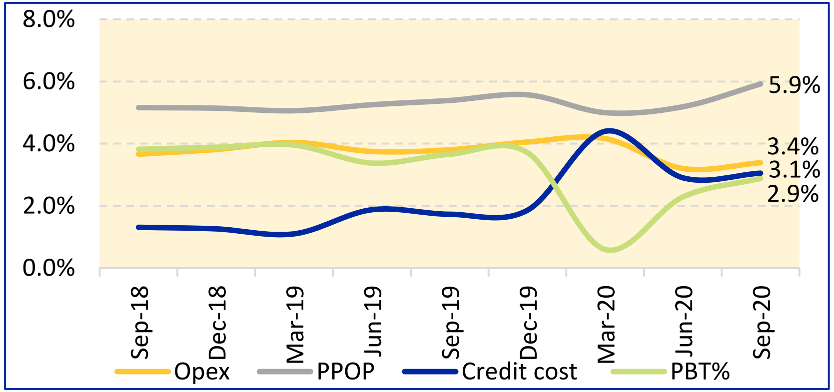
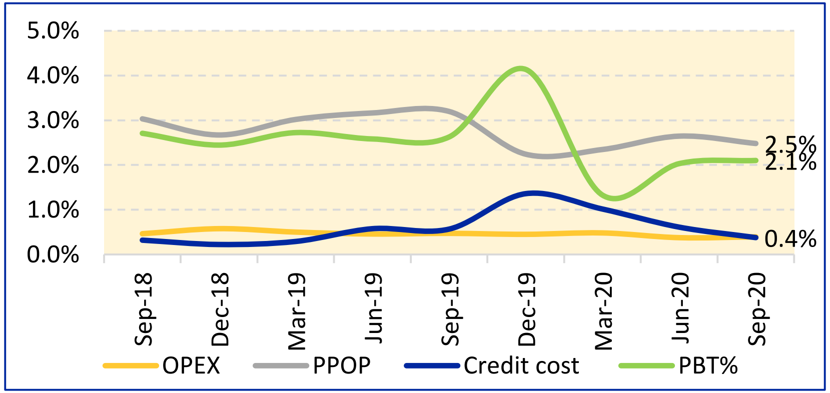


Exhibit: HFC Earnings Trend



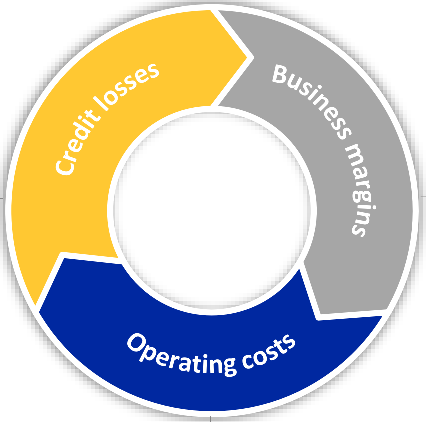
- Reduction in the cost of funds supported the NBFC/ HFC margins, even as players held higher liquidity and faced increased competitive pressures from the banking sector
- Reduction in the operating costs in H1FY2021 was due to lockdown and control measures; Some of these are expected to yield long-term benefits
- Lower-than-expected stress and healthy provision covers would support earnings if asset quality does not deteriorate beyond estimated levels. Higher credit cost however would continue to impact earnings over the next 12-15 months.

Source: *ICRA research; Data based on the 20 NBFCs and 11 HFCs; Estimates used where data was not available*

Earnings Outlook

Exhibit: Earnings drivers

- Entities would be faced with higher credit costs emerging from loan loss/ write-offs
- Expected credit loss estimates would require entities to hold higher provisions if the macroeconomic and operating environments remain unfavourable



- Competitive pressures may warrant exposure to high risk/ high cost borrower/asset segments
- Higher liquidity than in the past and increased regulatory requirements would act as a drag on margins

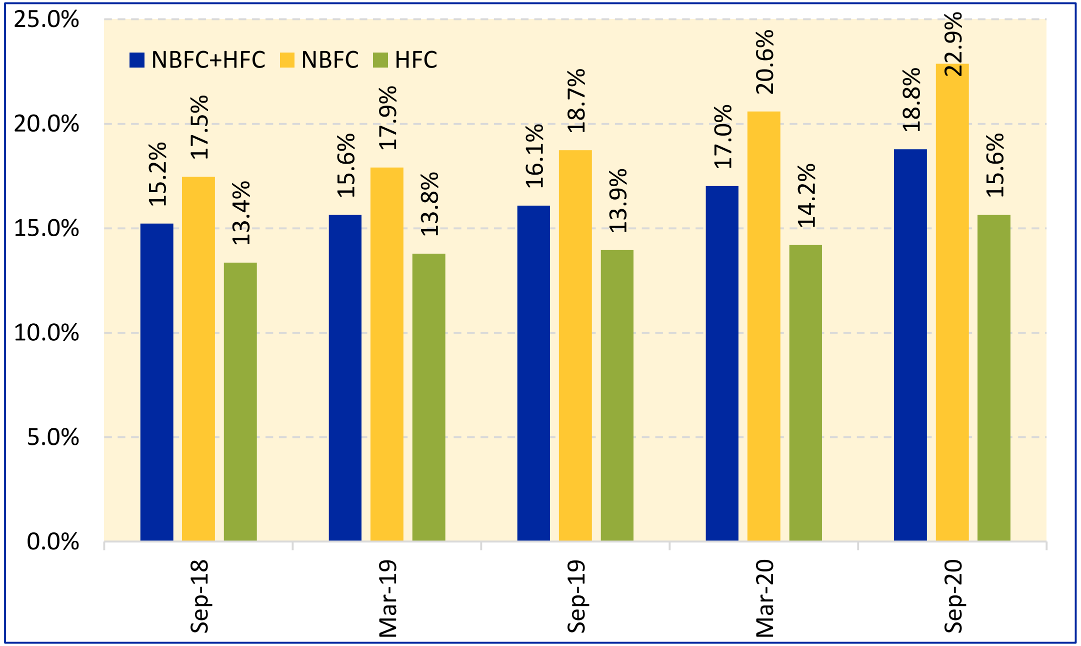
- Some increase in operating costs from the current levels may be observed due to the increased collection efforts and as disbursements improve

Expectation :

PBT % to remain 20-30% lower than pre-covid levels in FY2021 and FY2022

Comfortable Capital Profile

Exhibit: Networth/AUM Trend

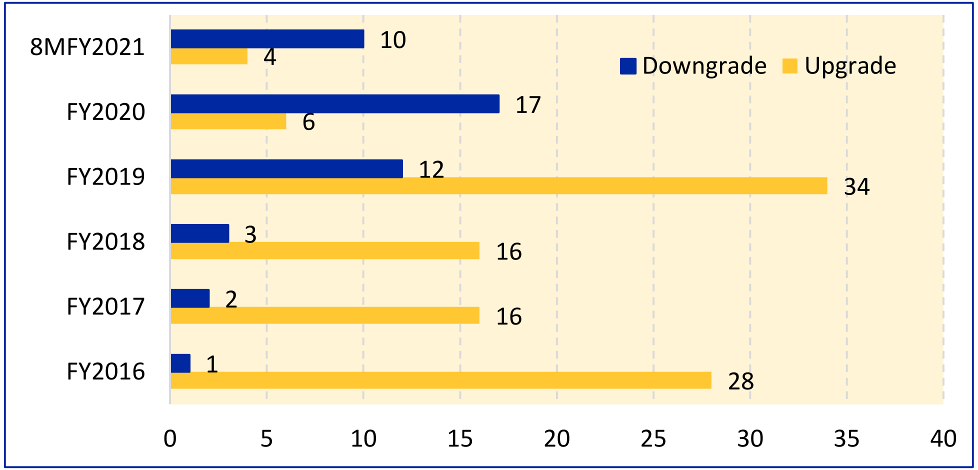


- Capital profile is quite comfortable on the back of slowing growth ; Some large entities also raised external capital
- During 9MFY2021, larger entities have about ~Rs. 170bn of fresh equity via rights issue and QIP placements.
- Most HFCs are expected to meet the enhanced capital requirement ,considering muted growth outlook.

Source: *ICRA research; Data based on the 20 NBFCs and 11 HFCs; Estimates used where data was not available*

Rating Changes for NBFC-HFCs

Exhibit: Trend in Rating Action



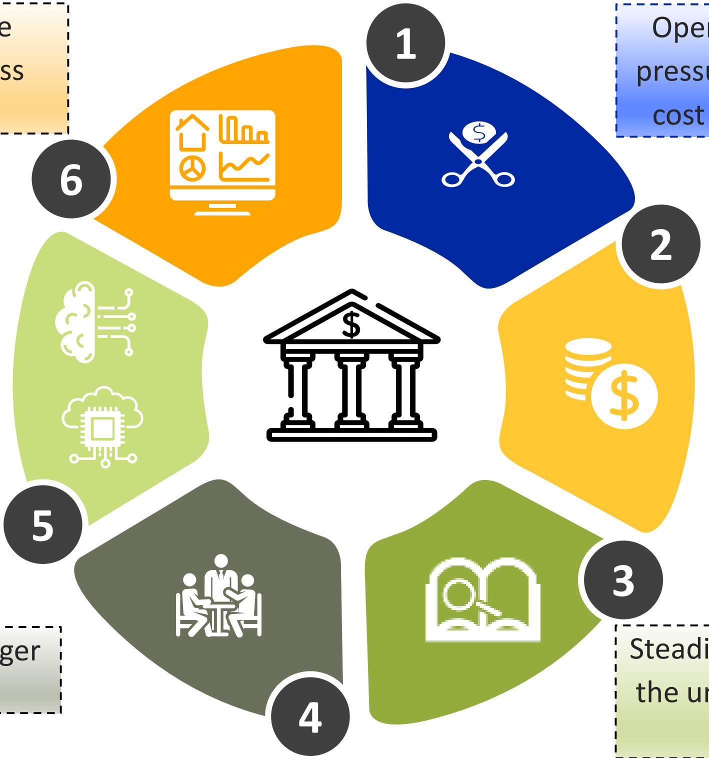
Source: *ICRA research; Entities part of the same group, where ICRA has taken consolidated rating view, are clubbed and treated as one in the above chart*

- Credit profile of non-banks are under pressure since H2 of FY2019, as the liquidity tightened and risk aversion towards the sector increased. Most upgrades witnessed during the year were in H1 FY2019.

- Reversing the trend seen till FY2019, the number of downgrades were higher than the number of upgrades in FY2020 and 8MFY2021.

- The key reasons for the downgrade include high share of wholesale exposures, weakening earnings/asset quality or subdued debt raising ability. In addition to the downgrades, the outlook on long-term ratings of eight entities were changed to 'Negative' in 8MFY2021, reflecting the heightened stress.

Way forward...



Operating cost control is crucial as margin pressures would re-emerge, with increase in cost of funds and competition from banks

Funding at attractive rates with tenor matched with assets and access to capital are key for growth.

Entities part of corporate groups and having strong parentage are better placed

Steadily augment internal controls and prune the underwriting process to key credit costs under control

Co-lending and Partnerships with larger lenders/ banks

Digital initiatives and technology to improve credit assessment and delivery

Product diversification to improve competencies and support business growth

ICRA

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THANK YOU!