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STRUCTURED FINANCE

Bounce back in collections of NBFCs in Q2 remains important to arrest the spike in delinquencies seen in retail loan pools in Q1 FY2022

JULY 2021

Highlights

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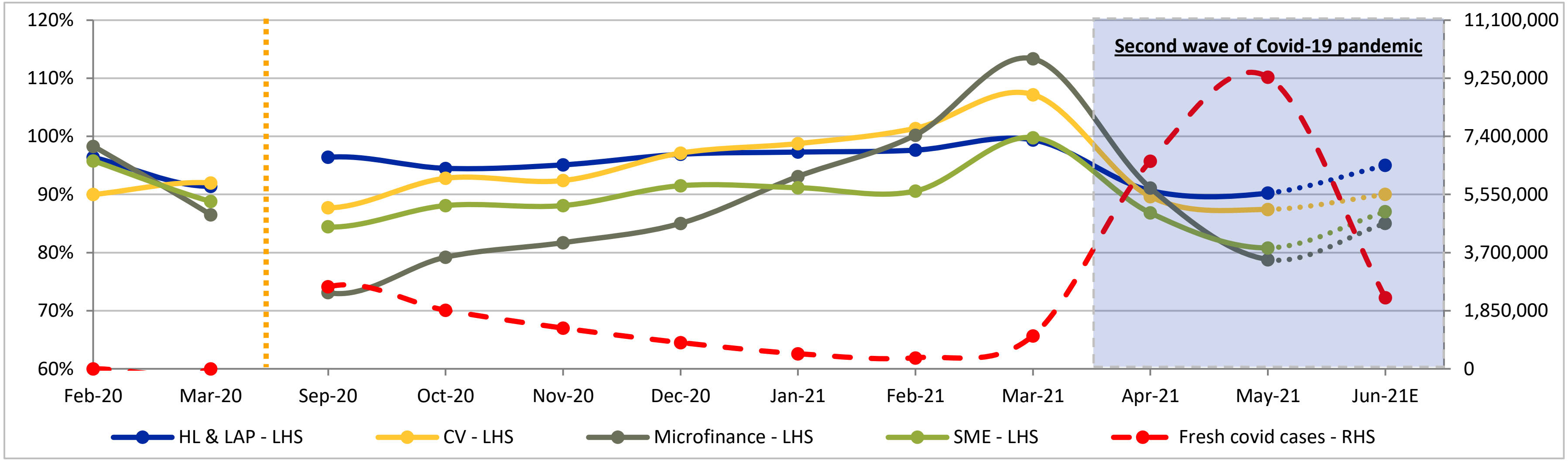
The average monthly collection efficiency and the asset quality of ICRA-rated retail loan pools have been further impacted in May 2021 as the disruption due to lockdown prevailed for an entire May 2021 month.

ICRA expects the collection efficiencies in ICRA-rated retail loan pools to recover in June 2021 and Q2 FY2022 on the back of easing of restrictions / lockdowns due to low fresh Covid-19 cases and elevated collection efforts of lenders.

- Post rebounding to the pre-pandemic level in Q4 FY2021, the average monthly collection efficiency of the ICRA-rated securitised retail loan pools originated by NBFCs and HFCs dropped by around 10-35% in May 2021 compared with March 2021 due to second wave-induced lockdowns.
- In May 2021, ICRA-rated microfinance pools witnessed the sharpest drop of 35% in their average monthly collection efficiency from the peak achieved in March 2021, followed by the SME loan pools and commercial vehicle loan pools, witnessing a decline of 20% each.
- The monthly collection efficiency in housing loans (HL) and loans against property (LAP) pools have remained robust and least impacted compared with other asset classes, given the prevailing online collection practices and the priority given by the borrowers to repay such loans.
- Nonetheless, gradual recovery in the collections has been witnessed in June 2021 with the easing of lockdowns in several geographies. Most of the lenders have slowed down their disbursements and elevated their collection efforts mirroring the trend seen last fiscal during the first wave.
- The incremental slippages in the softer buckets and harder bucket in ICRA-rated pools have increased in May 2021 compared to March 2021. The rise in 90+ delinquency has been highest in the unsecured SME loan pools and microfinance loan pools at 4% and 3.1%, respectively.
- The 90+ delinquency is expected to be at peak levels in May 2021 and would witness some reduction in June 2021 on the back of resumption in the collection activities of the lenders, assuming there are no extensive lockdowns in Q2 in major states.
- ICRA believes that lenders would utilise the restructuring scheme announced by the regulator for the borrowers facing temporary stress to contain the asset quality deterioration. Further, the improvement in asset quality should be gradual and in-line with last year’s trend.

Sequential decline in collection efficiency across asset classes continued in May-21

Exhibit: ICRA-rated pools' monthly collection efficiency and trend in fresh Covid cases



- Post rebounding to the pre-pandemic level in Q4 FY2021, the monthly collection efficiency of the ICRA-rated retail loan pools originated by NBFCs and HFCs dropped by around 10-35% across asset classes in May 2021 compared with March 2021.
- The collection efficiency in ICRA-rated securitisation transactions began to decline from April 2021 onwards due to the disruption in the collection activities of the NBFCs and HFCs owing to the second wave induced lockdowns / restrictions imposed by several state governments.
- Further, with the absence of relief measures such as the moratorium provided in the previous year, the cash flows of businesses and income-generation ability of borrowers has been impacted significantly during second wave of the pandemic, thereby affecting their repayment capability, across asset classes.

Source: ICRA Research, Jun-21E represents estimated collection numbers, CEIC, Monthly collection efficiency = (current collections + overdue collections)/current billings

Collection efficiencies and delinquencies | HL & LAP pool performance

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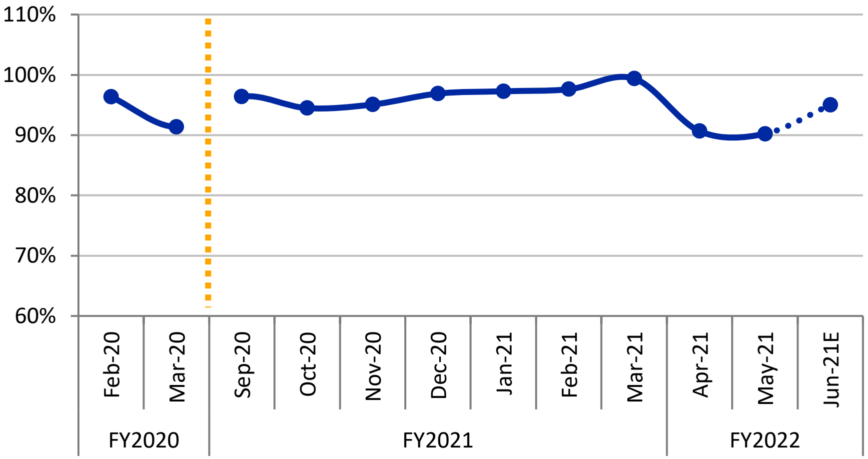
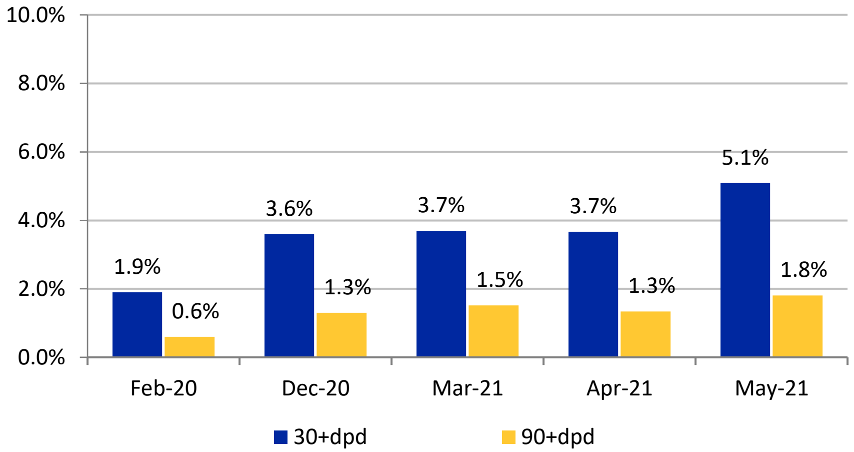
Exhibit: Monthly collection efficiency trend in ICRA-rated HL & LAP pools



Source: ICRA Research, Jun-21E represents estimated numbers,
Monthly collection efficiency = (current collections + overdue collections)/current billings

- Housing loans (HL) and loans against property (LAP) pools have demonstrated robust performance and remained the least impacted compared with other asset classes, given the prevailing online collection practices, association of the borrower with the underlying collateral and the priority given by the borrowers to repay such loans.

Exhibit: Delinquencies in ICRA-rated HL & LAP pools

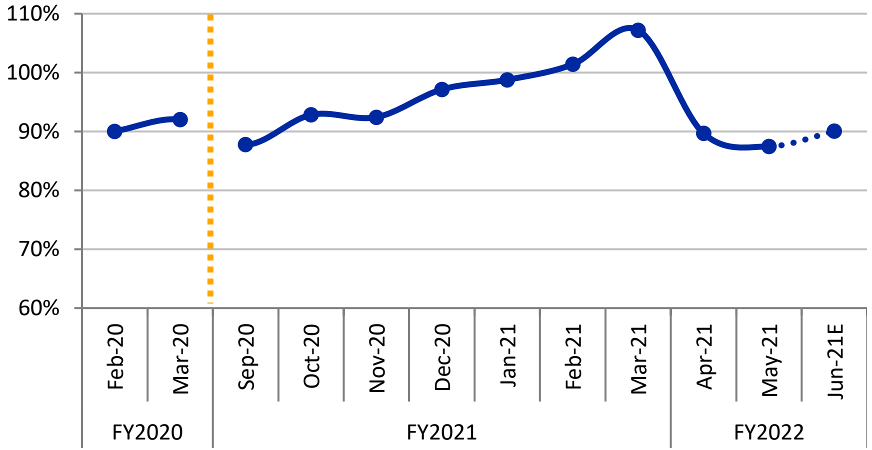


Source: ICRA Research, dpd – days past due

- While the mortgage segment has shown relatively stable collections when compared with other asset classes, the incremental slippages remained elevated in May 2021 mainly due to weaker performance of affordable housing loans and LAP in the pools.
- Nonetheless, based on the previous trends, ICRA believes that HL & LAP pools are expected to demonstrate the swiftest recovery (i.e. to March 2021 levels) in Q2 FY2022 given the presence of better borrower profile.

Collection efficiencies and delinquencies | CV loan pool performance

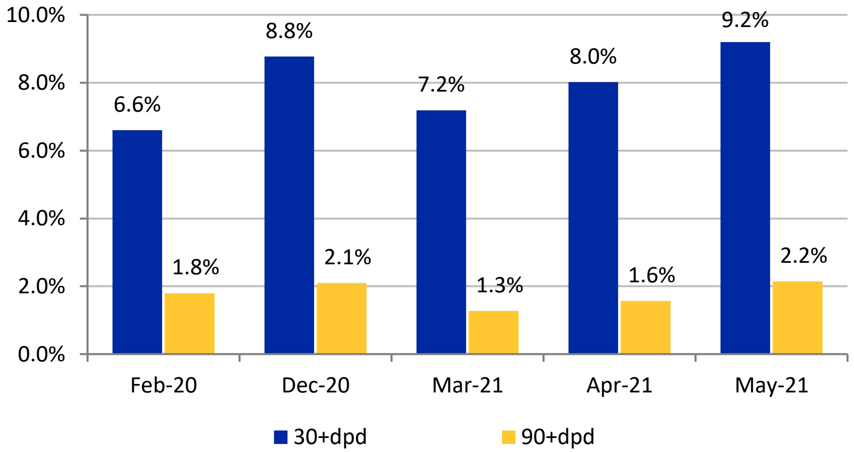
Exhibit: Monthly collection efficiency trend in ICRA-rated CV loan pools



Source: ICRA research, Jun-21E represents estimated numbers,
Monthly collection efficiency = (current collections + overdue collections)/current billings

- The collection efficiency in ICRA-rated commercial vehicle (CV) pools (includes tractor and construction equipment sub-pools), after recovering to pre-pandemic levels in March 2021, fell to around 87% in May 2021 due to the lockdown/restrictions prevailing for an entire month in May 2021 affecting the inter/intra-state movements amid muted business activities impacting the demand and fleet utilisation for the operators.
- Financed vehicles being used as school bus and transportation for staff pick-up/drop facility have seen their earnings shrink considerably during lockdown.

Exhibit: Delinquencies in ICRA-rated CV loan pools

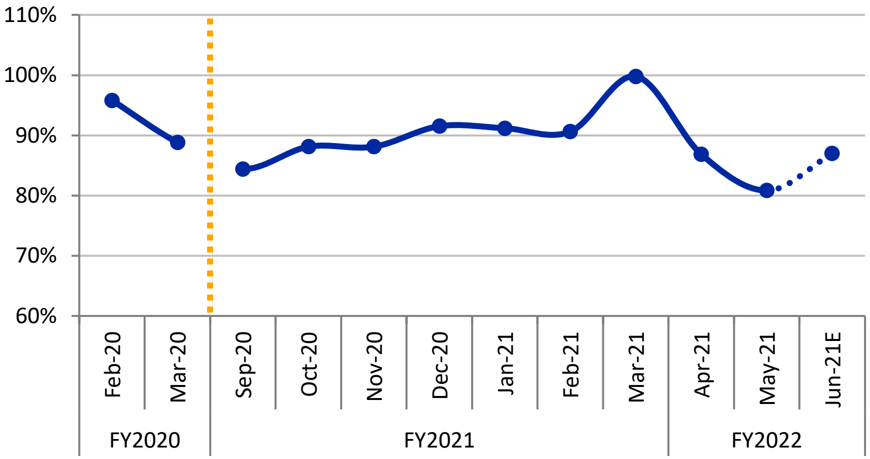


Source: ICRA research, dpd – days past due

- The slippages in softer and harder buckets have increased considerably in May 2021 due to the second wave induced lockdowns/restrictions impacting the transport operators' earning via 1) muted consumer demand, 2) material supply and productions remaining subdued, 3) inter/intra-state movements restrictions, and 4) elevated fuel prices.
- Recovery from the delinquent borrowers in CV loans can still be expected due to the presence of collateral with eventual losses being comparatively lower.

Collection efficiencies and delinquencies | SME loan pool performance

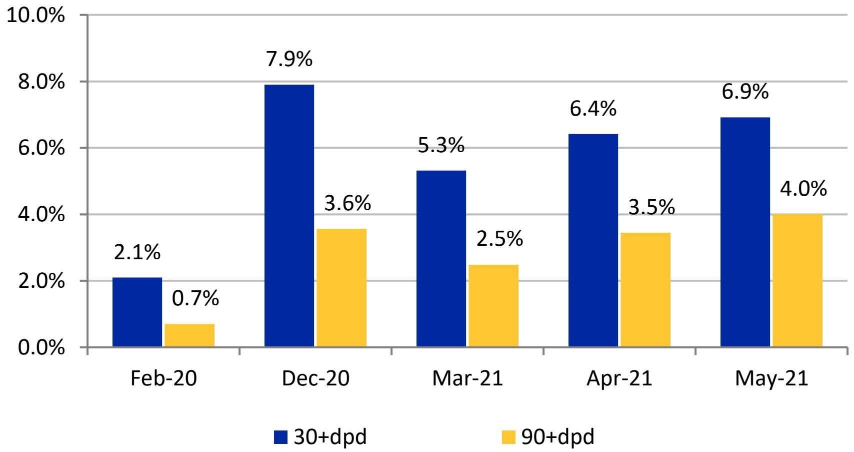
Exhibit: Monthly collection efficiency trend in ICRA-rated SME loan pools



Source: ICRA research, Jun-21E represents estimated numbers,
Monthly collection efficiency = (current collections + overdue collections)/current billings

- The SME loan pools were impacted materially in May 2021 as the average monthly collection efficiency dropped to around 80% from the highest levels seen in March 2021.
- This was due to restrictions imposed by several state governments on the opening of local establishments. Further, the weaker consumer demand and business activities have worsened the cash flows and loan repayment ability of the SME borrowers belonging to sectors such as hospitality, tourism, textile, gems & jewellery, food & entertainment etc.

Exhibit: Delinquencies in ICRA-rated SME loan pools

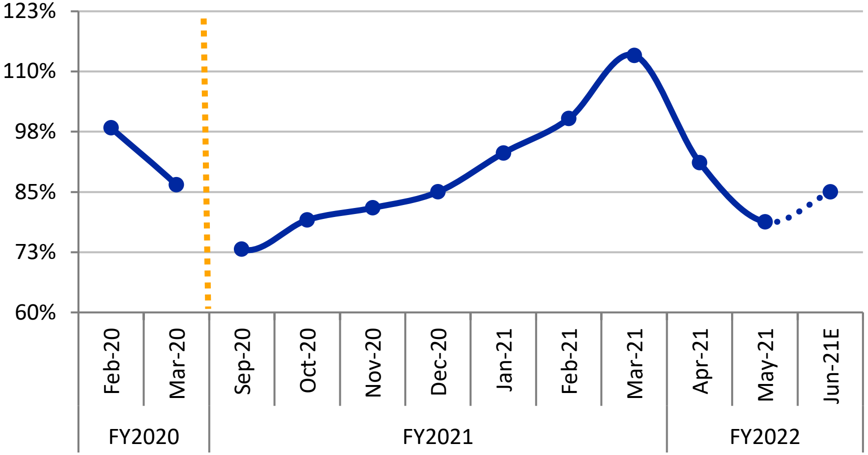


Source: ICRA research, dpd – days past due

- The slippages in softer and harder buckets have seen a rise in May 2021 compared with March 2021 due to the presence of self-employed borrower in the segment. These borrowers are highly vulnerable and are expected to be impacted significantly given their lean business operations during crisis and economic shocks.
- A material recovery may not be expected in the unsecured SME loan as recovery from harder buckets would be difficult, resulting in the losses being higher than seen in the past due to the absence of a collateral.

Collection efficiencies and delinquencies | Microfinance loan pool performance

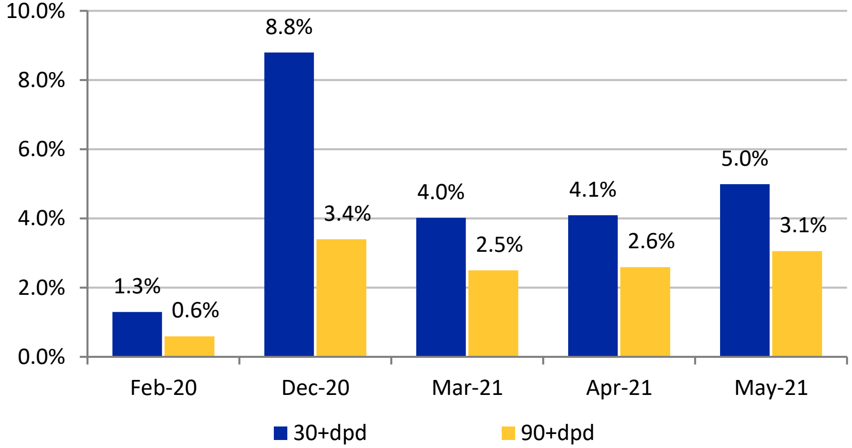
Exhibit: Monthly collection efficiency trend in ICRA-rated Microfinance loan pools



Source: ICRA research, Jun-21E represents estimated numbers,
Monthly collection efficiency = (current collections + overdue collections)/current billings

- The average monthly collection efficiency of ICRA-rated microfinance pools has been the sharpest for microfinance pools where monthly collection efficiency was lower by 35% in May 2021 compared to March 2021 levels. It almost touched the low level of September 2020 due to presence of financially weak borrower profile whose repayment ability was further impacted during the lockdown.
- Further, the spread of the second wave in semi-urban and rural areas has been prominent compared to the first wave which has became a hindrance in cash collections dominated segment. Also, the higher infections among the staff has affected the morale and collection ability of the lenders.

Exhibit: Delinquencies in ICRA-rated Microfinance loan pools

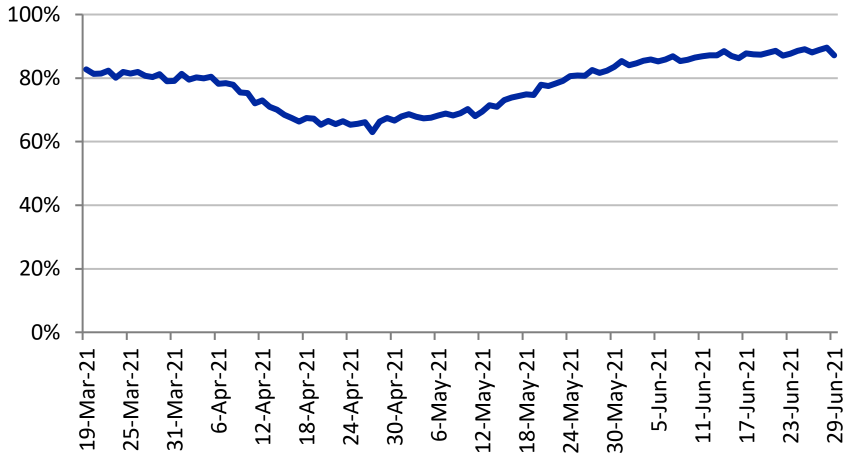


Source: ICRA research, dpd – days past due

- The incremental slippages in May 2021 increased in ICRA-rated microfinance pools due to the presence of marginal borrower profile. However, ICRA expects the asset quality to improve in June 2021 given the presence of better-quality contracts in pool who would withstand the impact of second wave of pandemic. Further, with the ease in restrictions since June 2021 and resumption in broader business activities, the asset quality is expected to improve in the segment.
- Like SME loans, a substantial recovery from a harder bucket (i.e. 90+dpd) would continue to remain a challenge.

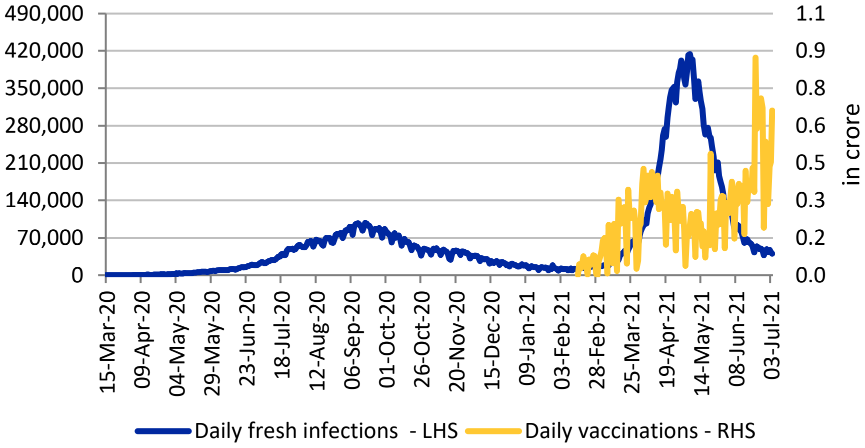
Easing restrictions/lockdown led by reduction in infections a respite for collections

Exhibit: Top 11 states account for most of the daily Covid-19 infections



Source: *CEIC*

Exhibit: Fresh infections and daily vaccination in India



Source: *CEIC*

- Eleven states (AP, Assam, Chattisgarh, Delhi, Karnataka, Kerala, Maharashtra, Odisha, Rajasthan, Tamil Nadu and West Bengal) account for ~80% of the total daily infections wherein ease in restrictions/lockdown have been observed in June 2021 except West Bengal and Kerala.
- Following the decline in the fresh infections in June 2021, most of the state governments in India have eased the lockdown or lockdown-like restrictions in a phased manner.

- Severe drop in collections have been witnessed in May 2021 across lenders. With the easing of restrictions and rising share of population (~33 crore) receiving vaccination as of June 2021, the concerns on asset quality of retail loans are likely to submerge with the expectations of higher recovery in collections in June 2021 being reported by several lenders.
- Further, successful continuation of the vaccination programme to cover a major portion of the Indian population would be critical in the near term.

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Thank You!