ICRA

NBFC Performance
Q1 FY2022 Update

Performance impacted by spike in overdues; trends expected to improve in subsequent quarters

SEPTEMBER 2021

Highlights

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NPAs increased by about 150 bps in Q1 FY2022; sharpest increase in the recent past but expected to moderate as collection efficiencies demonstrate an encouraging trend

Sizeable increase in provisions; currently 1.7x pre-Covid levels

Consequently, earnings plunged to multi-quarter low in Q1 FY2022; expect earnings performance to improve going forward and end FY2022 at levels similar to FY2021

- After the uptick seen in Q3 FY2021 and Q4 FY2021, disbursements plunged again in Q1 FY2022, as expected, though the decline was lower compared to Q1 FY2021. While pent-up demand supported July 2021 disbursements for many players, the sustainability of the same remains to be seen. The low base on the back of two consecutive years of YoY contraction in disbursements would lead to growth in the current fiscal.

- Subdued disbursements and portfolio rundown in the absence of any moratorium like in Q1 FY2021 led to shrinkage in the assets under management (AUM) for the non-banking financial company (NBFC) segment in Q1 FY2022,-somewhat higher than what was witnessed last year, while housing finance company (HFC) AUM remained flat.

- The asset quality was impacted by the spike in overdues, as the collection process was hindered by the second wave of the Covid-19 pandemic. It also impacted the fragile recovery in the cash flows of borrowers who were affected by the lockdown in the last fiscal. Marginal borrowers, therefore, slipped into the non-performing advances (NPA)/overdue category in Q1 FY2022.

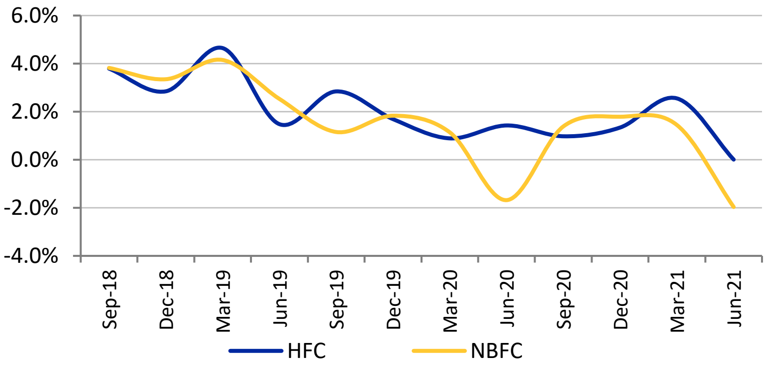
- Higher overall provisions {~1.7x the pre-Covid levels (December 2019)} provide these entities with adequate leeway to technically write off and cleanse their financials.

- Increase in credit costs led to further moderation in the net profits, which plunged during the quarter to the lowest level in the past few quarters. ICRA expects the earnings performance to improve in subsequent quarters as the asset quality improves and business picks up and expects profitability in FY2022 to remain similar to FY2021 levels.

- The on-balance sheet (on-B/s) liquidity and unavailed bank lines maintained by NBFCs and HFCs remain comfortable in relation to near-term maturities. Liquidity would be supported by the improvement in the collection trends, though some unwinding from the current level is expected with the upward trend in disbursements in Q2 FY2022. The capital profile continued to improve with a modest movement in the AUM compared with internal generation.

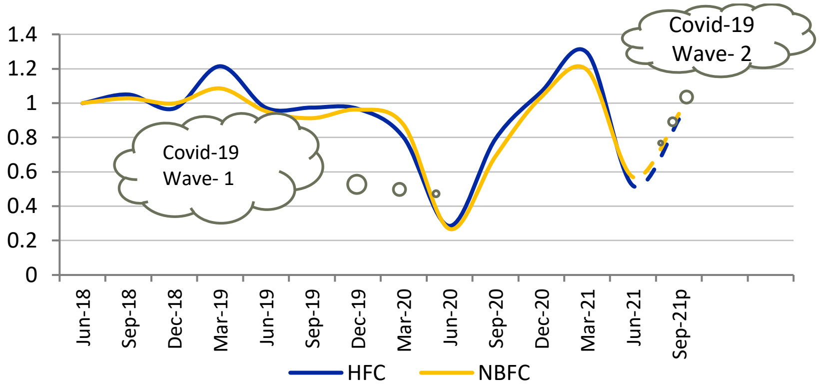
Second wave to temporarily push back revival

EXHIBIT 1: QoQ AUM growth (sequential)



Source: ICRA Research; data of 24 NBFCs and 11 HFCs, excluding PSUs ; June 21 is Estimated

EXHIBIT 2 : Normalised quarterly disbursement trend - June 2018 (base quarter)



Source: ICRA research; data of 17 NBFCs and 10 HFCs; excluding PSUs and gold loan companies ; June 21 is Estimated

- After witnessing an uptick in Q3 FY2021 and Q4 FY2021, disbursements plunged again in Q1 FY2022, as expected, and were down by about 55% on a QoQ basis. Anecdotal evidence suggests that disbursements revived quite sharply in July 2021 on the back of pent-up demand. However, the sustainability of the same would depend on the broader macro-economic indicators. As a base case, ICRA expects overall disbursements for FY2022 to be higher by about 6-8% on a YoY basis, on the back of the two consecutive years of YoY contraction.

- The AUM shrunk for the NBFC segment in Q1 FY2022, somewhat higher than what was witnessed in last fiscal, while the HFC AUM remained flat. This was on account of subdued disbursements as well as portfolio rundown in the absence of any moratorium like in Q1 FY2021. Also, competition from banks in the housing segment has led to increased BT.

Sharp rise in overdues in Q1 FY2022; rollbacks expected in subsequent quarters

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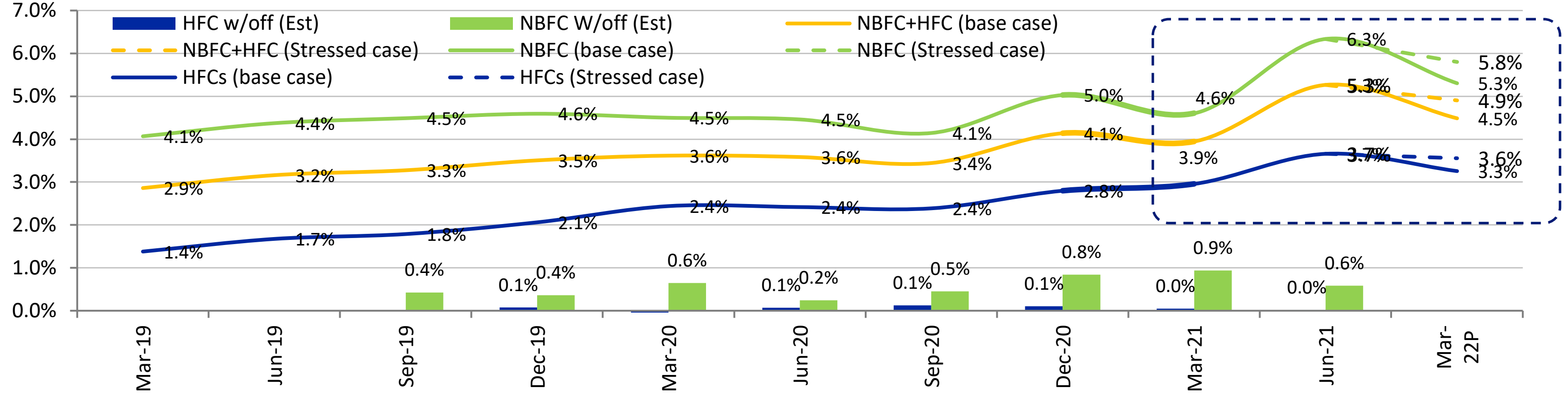
Exhibit 3: Asset quality trends and expectations -90+dpd



Source: ICRA Research; data of 22 NBFC and 11 HFCs (excluding PSUs);Note: NBFC+HFC data is computed based on the NBFC (excluding PSU) and HFC share in the overall sectoral AUM
June 21 is estimated

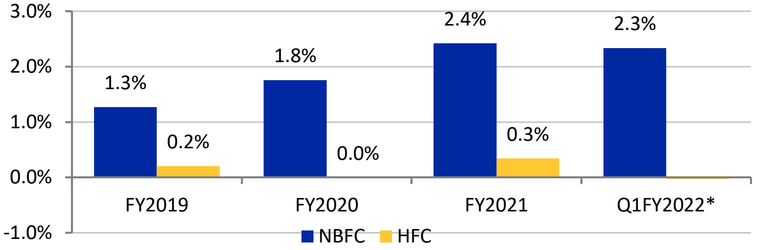
- The asset quality weakened quite sharply in Q1 FY2022 because of the localised lockdowns imposed by various states on account of the second wave of the pandemic, which impacted the collection process of the entities. It also impacted the fragile recovery in the cash flows of borrowers who were affected by the pandemic in the last fiscal. Therefore, the marginal borrowers slipped into the NPA/overdue category during this period.

- The jump in overdues was the sharpest in the recent past as borrower-level liquidity got stretched, given the absence of a loan moratorium like the one provided in the last fiscal; about 45% of the NBFC loans had availed a moratorium as of August 2020, largely from the individual and micro, small and medium enterprises (MSME) loan segments.

- ICRA expects the headline asset quality numbers to moderate as the collection efficiency (CE) trend remains encouraging. ICRA holds on to its expectation of a 50-100 bps increase (net of recoveries and W/offs) in the overdues in FY2022, assuming there are no further pandemic-induced lockdowns.

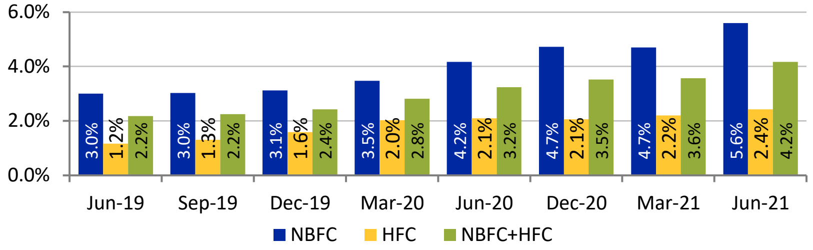
Provisions increased sharply; write-offs remain high

Exhibit 4: Write-offs remain high (% of AUM)



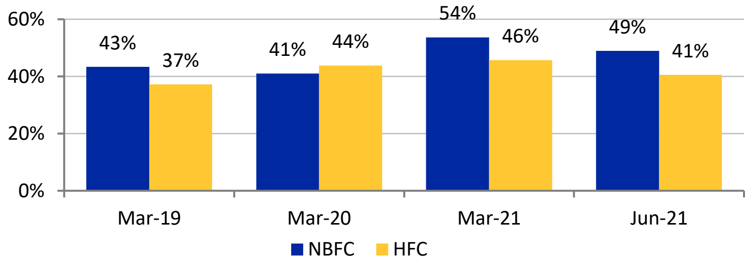
*Source: ICRA research; data of 22 NBFCs and 11 HFCs, excluding PSUs ; * Q1 FY2022 is Estimated and Annualised*

Exhibit 5: Provisions remain high; provide buffer for incremental risk



Source: ICRA research; data of 22 NBFCs and 11 HFCs, excluding PSUs ; June 21 is Estimated

Exhibit 6: Provision cover moderate with the increase in NPA/Stage 3



Source: ICRA research; data of 22 NBFCs and 11 HFCs, excluding PSUs ; June is Estimated

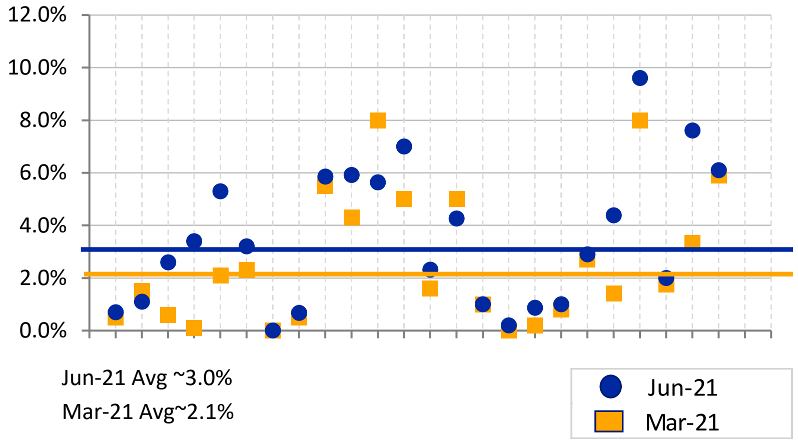
- Write-offs remained high in Q1 FY2022, but lower than the levels witnessed in Q3 and Q4 FY2021. Notwithstanding the improving CE, asset quality pressures persist as recovery from accounts affected by the disruptions in the last fiscal stands impacted and a sustained revival in demand and the operating environment is uncertain. We expect write-offs to remain high in FY2022 and similar to the last fiscal.

- ICRA takes note of the increase in the overall provisions, which are currently 1.7x (NBFC ~1.8x & HFC ~1.5x) of the pre-Covid levels (December 2019). This would give the entities adequate leeway to technically write off and clean up their balance sheets.

- The NPA/Stage 3 increased sharply, thereby affecting the coverage ratios. Nevertheless, coverage ratios remain higher than the pre-Covid levels.

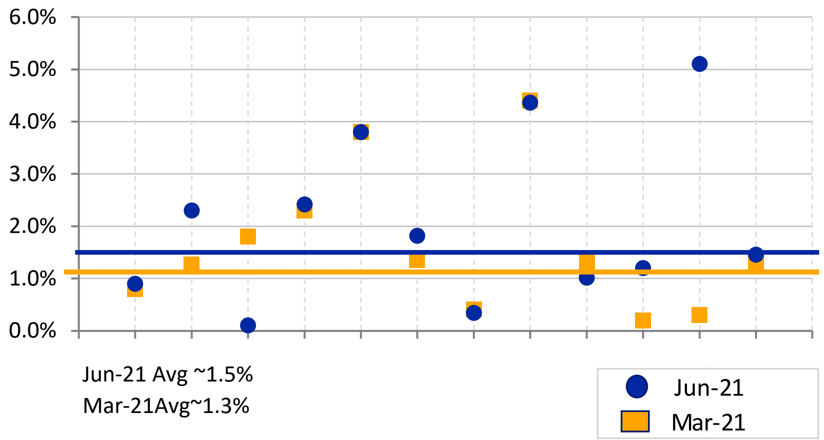
Restructured book increased

Exhibit 7: NBFC restructuring- O/s in Mar 2021 and June 2021



Source: ICRA research; data of 24 NBFC (excluding PSUs) ; excluding DCCO

EXHIBIT 8 : HFC restructuring O/s in Mar 2021 and June 2021



Source: ICRA research; data of 12 HFCs; excluding DCCO

- The restructured book increased for both NBFCs and HFCs in view of the stress faced by the borrowers on account of the second wave and the elongation in the recovery period for the borrowers affected in the last fiscal.
- The updated restructuring guidelines (May 2021/Jun 2021), covering individuals and small businesses, extension in the MSME restructuring guidelines and the relaxed eligibility, criteria augur well for the target borrower segments of NBFCs and HFCs.
- While the availability of the restructuring window is till September 2021, the steady improvement in the collection efficiencies (CE) bodes well for the segment. ICRA, however, notes that some of the NPAs/Stage 3 (loans that slipped in Q1 FY2022) could also be restructured.

Second wave of infections impacted the budding recovery in collections of NBFCs

Exhibit 9: Vehicle NBFC and ICRA-Rated CV pools (Normalised Feb 2020)

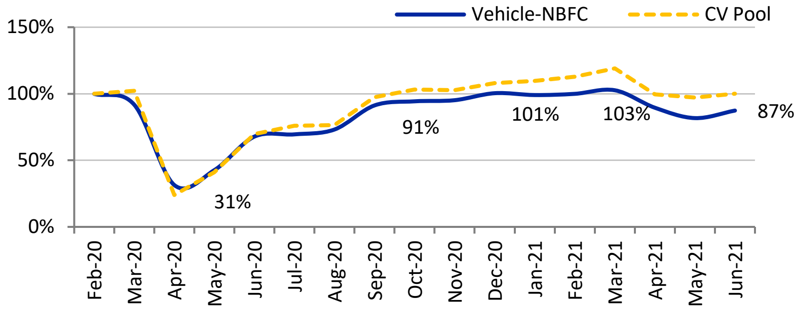


EXHIBIT 10 : LAP/SME NBFC and ICRA-Rated LAP and SME pools (Normalised Feb 2020)

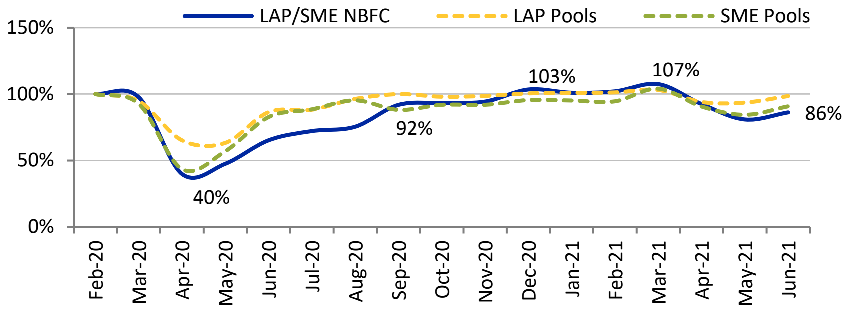
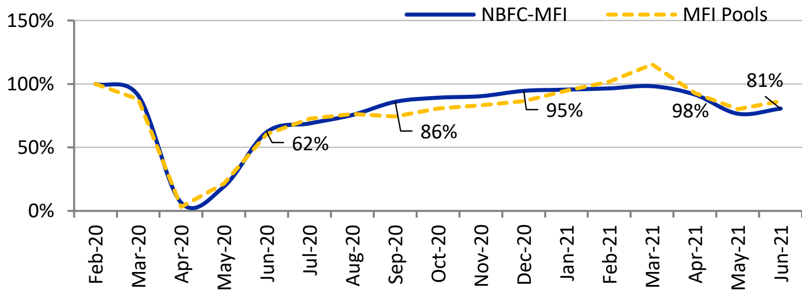


EXHIBIT 11: NBFC-MFI and ICRA-Rated MFI pools (Normalised Feb 2020)

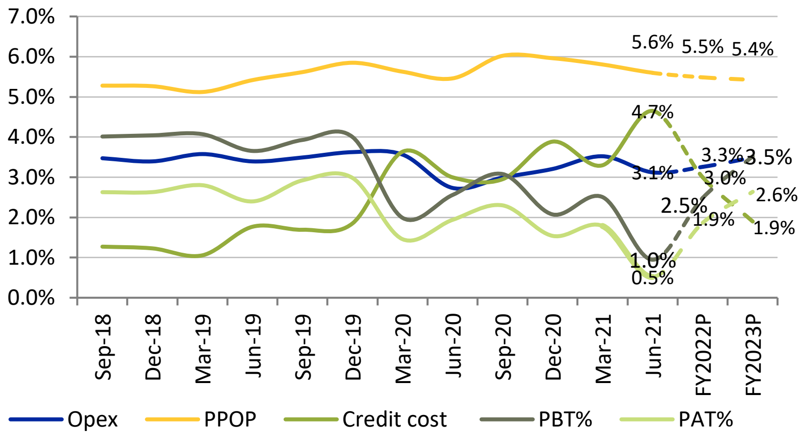


- The CE declined by about 20-25% during April-May 2021 vis-à-vis March 2021 levels. The decline was not as severe as the last fiscal when the nationwide lockdown was imposed.
- The CE improved marginally in June 2021, up 3-5% vis-à-vis May 2021, with relaxations in the lockdowns. A similar trend was witnessed in July 2021 and the CE is expected to improve further.

Note: NBFC CE (vehicle and LAP/SME) is based on entity level data and classification is based on the dominant asset class of the entity. Segmental data is used where available. Based on best information available/estimates
CE- Indexed to Feb 2020 levels

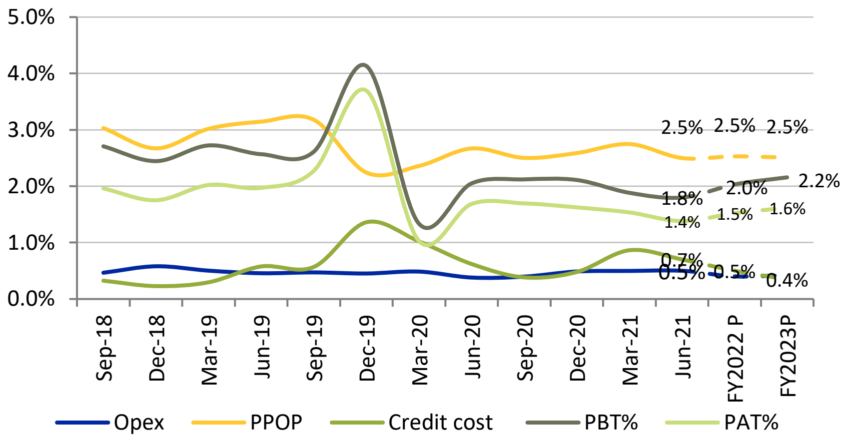
Earnings to remain under pressure

Exhibit 12: NBFC earnings profile (Quarterly Annualised)



Source: ICRA research; data of 22 NBFC ; P-Projected as % of AMA

Exhibit 13: HFC earnings profile (Quarterly Annualised)



Source: ICRA research; data of 11 HFCs ; P-Projected ; as % of AMA

- NBFC credit costs spiked sharply in Q1 FY2022 as write-offs remained elevated and provisions went up in view of the increase in the overdues. While HFC NPA/Stage 3 also increased during the period, credit costs moderated vis-à-vis Q4 FY2021 as provisions did not go up sharply like in the case of NBFCs and write-offs were negligible.

- Consequently, net profits plunged during the quarter to the lowest level in the recent past. Assuming there are no further lockdowns, ICRA expects the earnings performance to improve in subsequent quarters as the credit costs would moderate with the reduction in overdues from the June 2021 levels. ICRA estimates the pre-tax return on average managed assets (PBT%) for FY2022 to remain similar to the FY2021 levels (NBFC - 2.4-2.6% and HFC - 1.9-2.1%). Optimistically, if the CE trends remain healthy and slippages remain contained, the PBT% may also benefit from the reversals in provisions.

Liquidity and capital remain adequate

Exhibit 14: Quarterly average cost of funds remain range-bound in Q1 FY2022

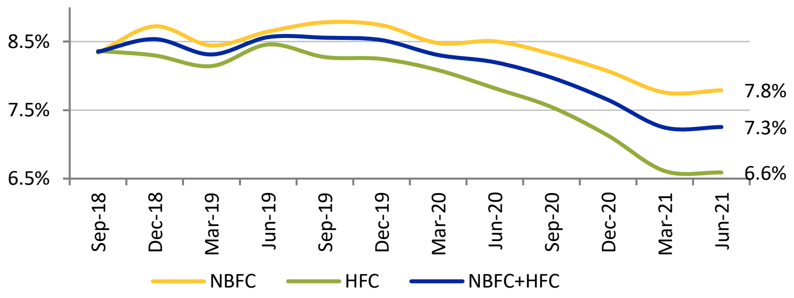


Exhibit 15: Capital profile remains adequate on the back of low AUM growth

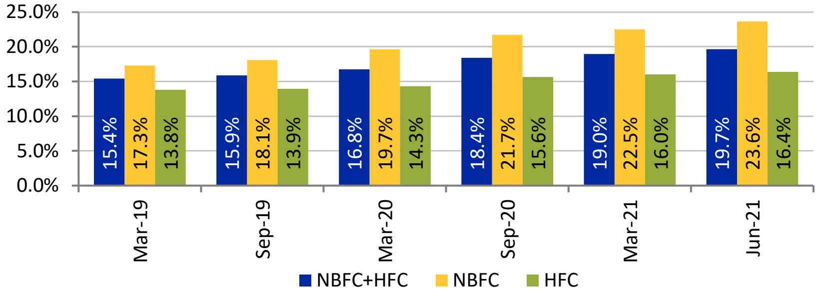
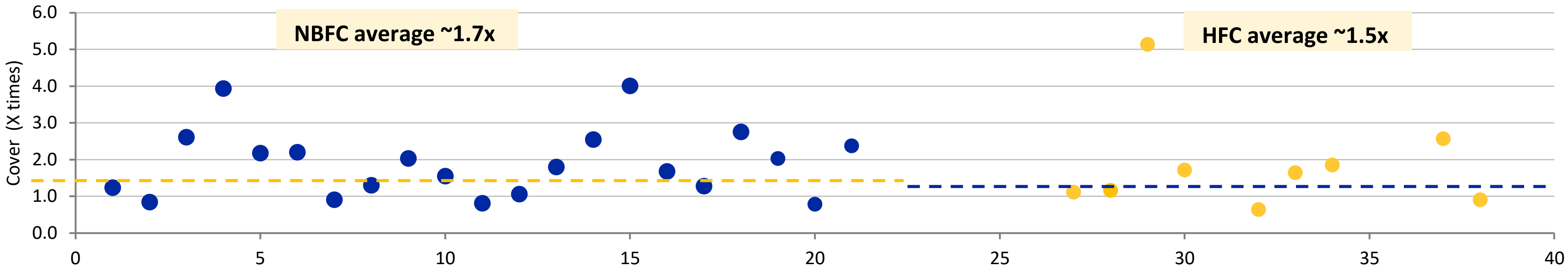


Exhibit 16: Coverage: Overall Liquidity/ 3-month principal repayment as of Jun 2021



Source: *ICRA Research; data of ICRA sample of entities; Overall liquidity - On B/s Liquidity + Sanctioned credit lines; estimates and nearest data used where Jun 21 data was not available*

Sector Outlook

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FY2022 Outlook -Negative

AUM Growth	Asset Quality	Funding and Liquidity	Profitability	Capital
7-9% growth	**50-100 bps increase in GNPAs**	**~ Rs. 2.0 trillion**	**Pre-tax RoMA 2.2-2.3% for FY2022**	**Adequate**
Growth to remain moderate in FY2022 vis-à-vis long-term average Access to adequate funding would be critical	Reported NPAs (net of write-offs) to increase by 50-100bps in FY2022 Restructured book o/s as of March 2022 to 3.1-3.3 vis-à-vis 1.6% in March 2021	Additional funding required in FY2022 to support growth, apart from refinancing existing/maturing lines.	Moderation in credit cost would push pre-tax RoMA to 2.7-2.9% in FY2023	No capital requirement, considering muted growth outlook

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