# Retail-NBFC Credit Trends April 2019

**Growth slowed in Q3FY2019; pressures on asset quality and earnings expected to build-up if tight liquidity continues**


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# Executive Summary

The assets under management (AUM) of retail non-banking finance companies (Retail-NBFCs) witnessed a sharp slowdown in growth in Q3 FY2019 as entities facing tightened liquidity moderated their incremental disbursements. The AUM growth slowed to 3.3% QoQ in Q3 FY2019, the slowest in the last 10 quarters.

Retail-NBFC AUM stood at Rs. 8.4 trillion[1] as on December 31, 2018, registering a year-on-year (YoY) growth of 21.5%. All key segments of Retail-NBFC credit, which contributed to higher YoY growth of 24-25% in Q1/Q2 FY2019 namely, LAP+SME[2], commercial vehicle (CV), personal credit (unsecured including consumer durables) and microfinance, witnessed a deceleration in growth. While it was expected that the liquidity to NBFCs would improve and conditions would normalise by Q4 FY2019, it is taking longer as market liquidity remains tight and cost is high.

While the share of banks in NBFC funding has increased steadily from Q2 FY2019 onwards, the funding profile remains concentrated towards wholesale funders, namely banks and MFs. The applicability of rating-based risk weights for banking exposure to all NBFCs (excluding core investment companies; CICs) and the exit of some public sector banks (PSBs) from the prompt corrective action (PCA) are a positive for the near term, as this may provide some scope for incremental credit from the banking sector. However, the willingness of banks to take incremental credit exposure, considering the steep increase in their exposure post September 2018, their own internal sectoral thresholds and their ability to mobilise deposits/funding remain to be seen.

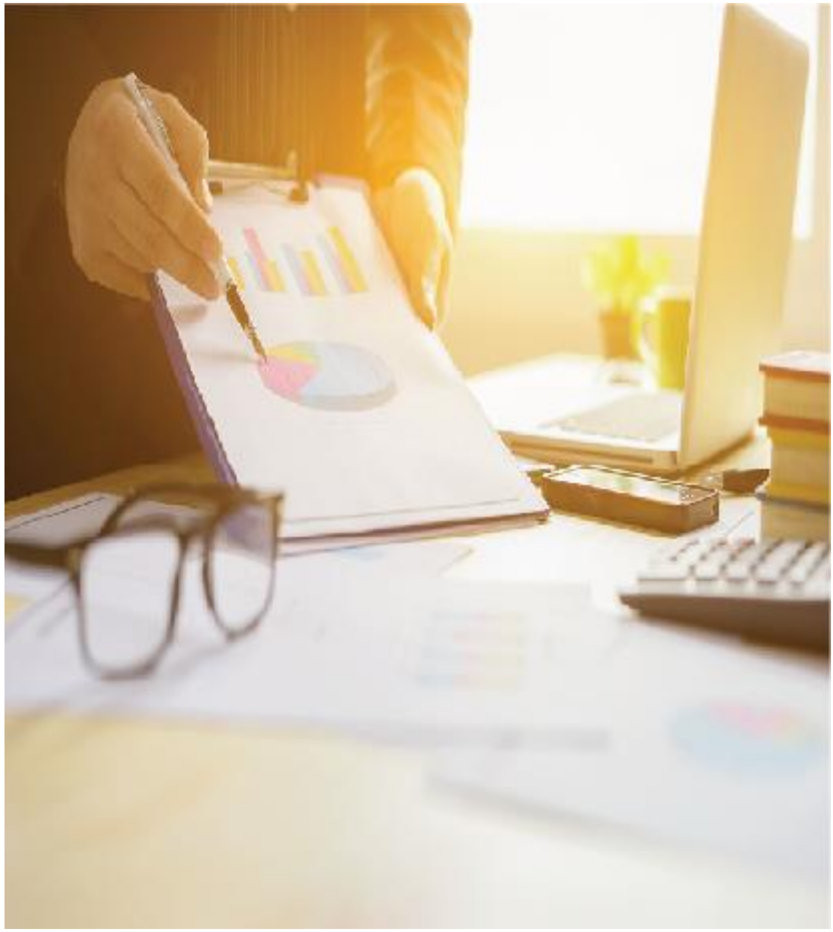
Meanwhile, NBFCs reduced their dependence on short-term (ST) funding (commercial papers) and witnessed a jump in loan sell-downs (portfolio securitisation [PTC] and direct assignment [DA]) as the total quantum of loan sell-downs by NBFCs in 9M FY2019 significantly exceeded FY2018 volumes. These loan sell-downs were also largely subscribed by banks. The share of DAs in NBFC loan sell-downs increased to 45% in 9M FY2019 from 31% in FY2018 though it remained lower than housing finance companies (HFCs), where the share was in the range of 94-95% in FY2018 as well as 9M FY2019.



*1Excluding Capital First Limited, which merged with IDFC Bank in December 2018*

*2 LAP+SME – Loan against property; micro, small and medium enterprises and business loans*

Retail debt issuance by NBFCs also increased quite sharply in the current financial year, though it is still modest in relation to the incremental requirement. Deposit mobilisation by deposit-taking NBFCs witnessed muted growth in FY2018 and H1 FY2019. The liquidity profile of retail-NBFCs, however, remained adequate with the augmentation of their on-book buffers and a slowdown in growth. Retail-NBFC asset-liability maturities (ALMs) are generally characterised by positive cumulative mismatches in the near-term bucket; this improved steadily in 9M FY2019 vis-à-vis the March 2018 levels.



The 90+ dpd (excluding MFIs) has remained stable at about 4.1- 4.2% over the last 2-3 quarters. However, asset quality pressure is expected to increase as credit flow to some key segments, namely SME+LAP, slows down. The share of unsecured personal credit (including microfinance) witnessed a steady increase in the recent past (currently 19% of total Retail-NBFC credit compared to 13% in December 2016). Moreover, entities are expected to focus on other riskier and high-yielding segments, including the used vehicle segment, personal credit and unsecured SME credit etc, to offset the impact of the increase in the cost of funds and competitive pressure from banks. The impact of the same on the credit quality would remain a monitorable over the next few quarters.

Profitability (Return on average managed asset; 12-month trailing) remained largely stable at 2.1%, supported by the ability of NBFCs to transfer the increase in the cost of funds on their incremental business, the upfront recognition of DA income and the reduction in credit costs as the asset quality remained relatively range-bound. The capital profile of Retail-NBFCs is adequate, considering the stable internal generation and moderation in growth. ICRA does not expect any significant capital requirement for the segment over the near term.

## Outlook

ICRA expects the credit growth to remain moderate till H1 FY2020 and revive only in H2 FY2020. Retail-NBFCs would register AUM growth of 16-18% in FY2019. While the growth would moderate further in H1 FY2020 because of the ongoing liquidity conditions and the general elections in Q1 FY2020, revival could be anticipated in H2 FY2020. ICRA expects the NBFC credit growth in FY2020 to be about 15-17% and NBFC-Retail credit is expected to cross Rs 10 trillion; growth rate could be higher if the fund flow to NBFCs improves.

The asset quality and earnings profile are expected to face headwinds with business growth slowing down and some key asset classes likely to witness increased credit related pressures. ICRA notes that operating profitability would contract, and credit cost could increase if the portfolio growth remains more moderate than in the past. Therefore, the return on managed assets (RoMA; excluding upfront gains, etc) is estimated at 1.7-1.9% for FY2020.

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