Retail-NBFC Credit Trends January 2020

Retail-NBFC credit growth slowed quite sharply in Q2FY2020; asset quality weakening steadily

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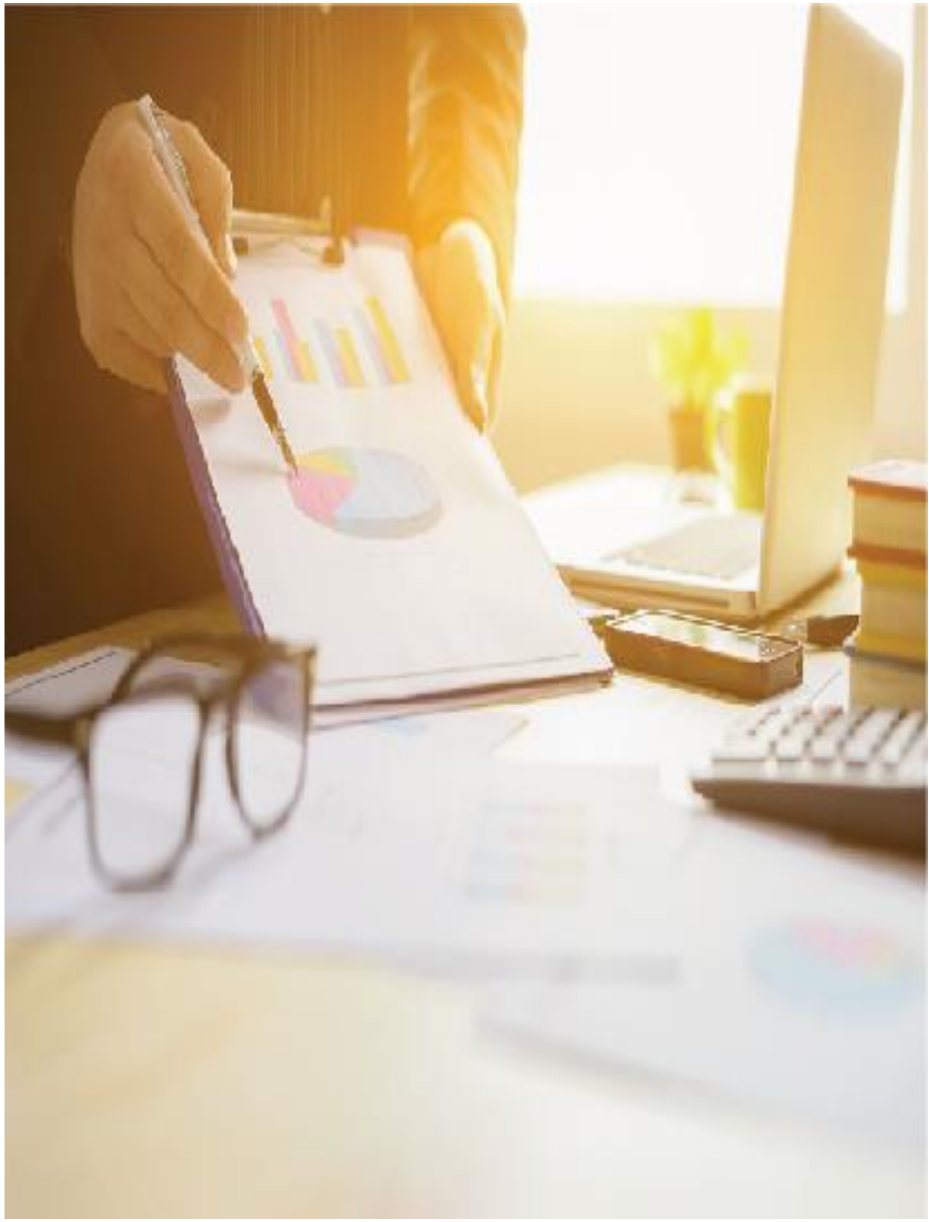
Executive Summary

Overall Private Non-Bank Funding Avenues

- *Incremental funding to private non-banks (NBFCs & HFCs) from key funding avenues, namely banks loans, market instruments, securitisation and external commercial borrowings (ECBs; based on approvals), grew by about 21% YoY during the 12-months ended September 2019. Increase in securitisation and funding via the ECB route offset the reduction in the commercial paper (CP) share in the overall borrowing outstanding of non-banks.*
- *ICRA estimates that private non-banks were able to secure about Rs. 9.0 trillion of long-term (LT) funding between October 2018 and September 2019 via bank funding, bond issuances, and the securitisation and ECB route (approvals).*
- *Retail focused entities and entities with strong parentage were able to raise adequate funds.*
- *Bank credit to the sector improved with PSU banks taking the lead in taking direct exposures. The bank credit outstanding to the sector increased by about Rs. 1.7 trillion between October 2018 and September 2019.*
- *Good interest from banks for retail loan-sell downs boosted the securitisation/assignment volume substantially. Volumes jumped to Rs. 2.4 trillion between October 2018 and September 2019. Based on the ICRA rated transactions, close to 85% of the loan sell-downs were subscribed by banks.*
- *Large-sized and better rated entities with strong parentage were also able to secure funding via the debenture route with adequate interest for such papers from the insurance sector and asset management companies (AMCs). Bond issuances by housing finance companies (HFCs) went up by 40% YoY during October 2018-September 2019, largely driven by two players. NBFC (overall) bond issuances were down 20% YoY while NBFC (largely the retail focussed entities) were down by 27% as these entities were able to raise funds via the loan sell-down route and, as growth slowed.*
- *Entities took benefit of the relaxed norms for ECBs to diversify their borrowing profile and as domestic funding flow remained subdued. ECB approvals worth about $17 billion were secured by non-banks between October 2018 and September 2019 vis-à-vis $9 billion in the corresponding period in the previous year. Private NBFCs and HFCs secured approvals of about $9.5 billion during the above-mentioned period. The cost of ECBs was higher, ranging from 50 bps to up to 200 bps in some cases, over the domestic borrowing rate.*



Retail-NBFC Growth and Outlook:

- *The assets under management (AUM) of NBFCs retail segment (Retail-NBFC) grew by 15.5% YoY in Q2 FY2020 to Rs. 9.4 trillion. This was the slowest since Q4FY2015 as a demand slowdown in the vehicle segment, which contributes almost 50% to the overall Retail-NBFC AUM, impacted growth. Further, the weaker offtake in the small and medium enterprises (SME) segment (22% of AUM) led to slower growth with NBFCs also becoming more cautious towards SMEs/small businesses.*

- *The QoQ AUM growth was also the slowest in the last 4-5 years as all key segments, barring personal credit and microfinance, witnessed a significant slowdown compared to past averages. The microfinance and personal credit segment growth remained healthy and higher than most other asset classes, notwithstanding a dip in Q1FY2020 in the microfinance segment and Q2FY2020 in the personal credit.*

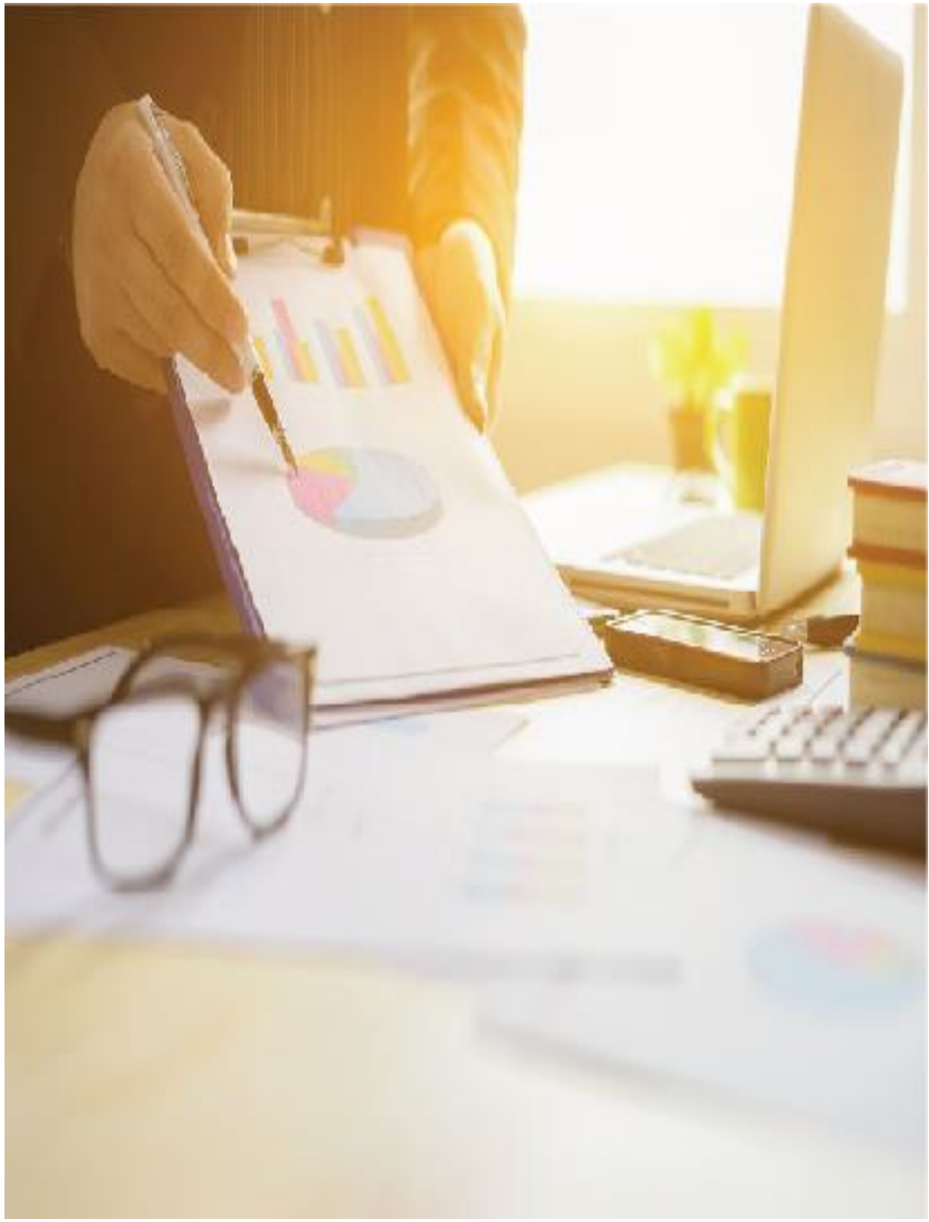
  In view of the subdued demand outlook, ICRA expects Retail-NBFCs to grow 12-14% in FY2020, with the expectation of some revival in H2 FY2021, depending on an improvement in demand and the availability of timely funding to the segment.

Asset Quality

- *The 90+ dpd (excluding MFIs) inched up steadily to 4.1% in September 2019 from 3.9% in March 2019. The asset quality pressure is expected to increase as the credit flow to some key segments, namely SME + loan against property (LAP), slowed down while borrowers in other segments, including vehicle finance, are facing a weaker operating environment, thereby impacting their cash flow and viability. ICRA continues to expect weakening in the asset quality of NBFCs in the current fiscal.*

Funding and Liquidity (excluding MFIs)

- *The share of bank funding in the overall borrowing mix of Retail-NBFCs increased to 41% in September 2019 from 38% in September 2018 while the share of loan sell-downs increased to 10% from 7%. The share of CP dipped to 8% from 14% during this period.*



- *The asset-liability maturity (ALM) profile of Retail-NBFCs is generally characterised by positive cumulative ALM mismatches in the near-term bucket. This improved compared to March 2018 as the entities maintained on-book liquidity while the credit growth slowed down.*
- *The cost of funds, however, continued to increase. The quarterly annualised average cost of funding increased by about 40 bps in H1 FY2020 to 8.9%.*

Profitability:

- *The net profitability (Profit after tax[PAT]/average managed assets [AMA]) of Retail-NBFCs stood at 2.7% in Q2 FY2020. This was supported by a lower tax rate. The average tax to PBT ratio of the ICRA sample dipped to 29% (somewhat higher than the effective rate of 25% because of the DTA impact for some players) vis-à-vis the average of 37% in the previous four quarters. The PBT/AMA was like the levels witnessed in Q4 FY2019 (but higher than Q1 FY2020) as the credit cost dipped with the dip in the provision coverage during the quarter. Moreover, some entities reported one-time gains (additional finance charges, dividend incomes, fair value change income, etc), which bolstered the overall profitability.*
- *ICRA, however, notes that the operating profitability would contract if the portfolio growth remains more moderate than in the past and the credit cost would increase because of the weaknesses in the operating/demand environment of the target borrower segments. ICRA expects the Retail-NBFC RoMA to be about 2.3-2.5% in FY2020.*

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