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Retail-NBFC Credit Trends

Recovery visible from the lows of Q1 FY2022; sustenance remains key

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RETAIL-NBFC OUTLOOK – NEGATIVE

Swifter recovery in collection trends to uphold asset quality performance

AUM growth outlook maintained at 8-10%; Sustained supply-side constraints, especially in the vehicle segment, could be a growth impediment and would be monitorable in the near term.

Earnings to remain subdued in the current fiscal and revival is expected in FY2023

Liquidity and capital remain adequate

The asset quality pressures faced by retail non-banking financial companies (Retail-NBFCs) in Q1 FY2022 are expected to recede gradually in subsequent quarters as the recovery in collections is relatively swifter. Though collections are likely to reach the pre-Covid level by Q3 FY2022, sustenance of the same remains critical. The restructured book of NBFCs witnessed an increase in Q1 FY2022 and is expected to have increased further in Q2 FY2022 as the second wave of the Covid-19 pandemic prolonged the recovery of some asset segments – commercial vehicles (CVs), business loans, microfinance, etc. The sector witnessed a contraction in the assets under management (AUM) in Q1 FY2022 as business under all key segments were impacted. However, ICRA maintains the growth outlook at 8-10% for the sector, given the revival in demand, as macro-economic indicators turned benign, and considering the low base of the last fiscal. Sustained supply-side constraints, especially in the vehicle segment, could be a growth impediment and would be monitorable in the near term.

Higher provision and credit costs affected earnings in Q1 FY2022. While it would improve in subsequent quarters, the overall FY2022 earnings would remain similar to the last fiscal and below the pre-Covid level. Liquidity and capitalisation remain the silver linings for the sector; some level of unwinding of liquidity is expected as uncertainties around the operating environment moderate. Capitalisation is expected to remain adequate in view of the moderate near-term growth expectations for the sector.

- **ICRA continues to have a Negative credit outlook on the Retail-NBFC Sector; Outlook would be reviewed basis the Q2 FY2022 performance**
- **AUM contraction in Q1 FY2022:** Retail-NBFC AUM contracted again in Q1 FY2022 at a sharper rate of 1.7% (sequentially) vis-à-vis 1.3% in Q1 FY2021. This was due to the fall in disbursements as the second wave led to lockdowns in various states, which impacted operations. Collections, however, were relatively less impacted vis-à-vis the last fiscal when borrowers also had the option of availing a moratorium. Thus, muted disbursements and rundown in the existing portfolio due to repayments led to a relatively sharper fall in the AUM in Q1 FY2022. All key asset segments in the Retail-NBFC space faced either a contraction or a sharp deceleration in the growth rate.
- **Recovery in collection trend and healthy provisions provide comfort:** The 90+ days past due (dpd) increased significantly by about 150 bps during the quarter ended June 2021, the sharpest in the recent past; weakening was witnessed across asset segments in Q1 FY2022 with the collection process taking a hit and borrower-level cashflows impacted by the second wave. ICRA expects the 90+dpd to improve in the next few quarters supported by the improvement witnessed in collections and the restructuring undertaken by the companies. ICRA takes note of the increase in the overall provisions in the recent past, which are currently 1.8x the pre-Covid levels (December 2019) for Retail-NBFCs. This would give the entities adequate leeway to technically write off and clean up their balance sheets. Adjusting for write off and expected recoveries, the 90+dpd is expected come by about 50-100bps by March 2022 from the June 2021 levels.

- **Earnings performance similar to last fiscal:** Retail-NBFCs were able to maintain their pre-provision operating profitability (PPOP) at healthy levels of (5.5-6.0%) in the recent past (FY2019-FY2021). The credit cost was the key reason for the fall in profitability in FY2021 and Q1 FY2022. Earnings likely to remain subdued in FY2022 as well, as ICRA expects the overall credit cost to remain similar to the last fiscal. Thus, the return on managed assets (RoMA) is expected to remain stable at 2.0-2.1% in FY2022. Reduction of the same in the subsequent fiscal, provided there are no significant surges in Covid-19 infections, could result in the Retail-NBFC profitability reaching the pre-Covid level by FY2023.

- **Adequate liquidity and capital profile:** Entities were maintaining liquidity to cover more than 3 months of debt repayments (without factoring any collections) for a major part of the last fiscal. ICRA expects the liquidity profile to be maintained with adequate buffer to give comfort to various stakeholders in the near term with some unwinding of the same expected in H2 FY2022. Capitalisation is expected to remain adequate, considering the moderate growth expectations, although internal generation is muted. The capital structure of the sector, which has seen a steady improvement in the recent past, would be driven by access to funding and the consequent growth visibility.

ABOUT ICRA

ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

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