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NBFCs and HFCs

Improvement in asset quality could partially offset the expected margin pressures, going forward

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SUMMARY

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Non-banking financial companies {NBFCs excluding housing finance companies (HFCs)} and HFCs registered an improvement in their asset quality in Q4 FY2022 as the impact of the Omicron variant of Covid-19 was minimal, slippage from the restructured book was lower and, entities augmented their collections in view of the tighter Income Recognition, Asset Classification and Provision (IRAC) norms, which are applicable from October 2022. NBFC write-offs remained elevated and marginally higher than the last fiscal, while HFC write-offs were modest.

The gross stage 3 (GS3) for NBFCs reduced substantially during the quarter, reaching almost to the pre-covid level, while the improvement was relatively moderate for HFCs. NBFC GS3 reduced to 4.4% in March 2022 from 5.7% in December 2021. HFCs GS3 moderated, in line with ICRA's expectation, and stood at 3.3% vis-à-vis 3.6% in December 2021. While the overall GS3 was expected to reduce steadily from the June 2021 level, the November 12, 2021 circular and the consequent alignment of GS3 reporting in-line with this circular by many entities led to a stable GS3 number between September 2021 and December 2021.

The Reserve Bank of India (RBI), vide its circular of February 15, 2022, provided some relaxation to the implementation of the tightened IRAC norms. However, as expected, most of the entities which had already aligned their GS3 reporting with the tighter IRAC norms *(entities can continue reporting GS3 as per IndAS, i.e.90 day past due basis and, non-performing advances (NPAs) as per IRAC, if they choose to)* continued to focus on collections and did not avail the deferment provided by the RBI. Higher focus on collecting from the 30-90 overdue bucket, vis-à-vis the 60-90/90+ bucket in the past, supported asset quality.

SUMMARY

Slippage from the restructured book , especially for NBFCs, was lower than expected, which also favourably contributed to the asset quality performance. The performance of this book would remain a monitorable, considering the weakening macroeconomic/operating environment and the balloon repayment schedule of some of these loans. The standard restructured books of NBFCs and HFCs stood at about 2.7-3.0% and 1.4-1.6%, respectively, as of March 2022, down from the peak of 4.5% and 2.2%, respectively, in September 2021.

The profitability of the players during the Covid-19 pandemic was supported by the favourable cost of funds, even when entities faced a growth slowdown, had higher on-balance sheet liquidity leading to negative carry, built up their provisions in view of the uncertainties around the pandemic and undertook sizeable write-offs without significantly impacting the earnings.

Although the GS3 has moderated, entities continue to carry higher provisions. This would provide them with some room to deal with pressure on the margin in the current fiscal as their borrowing rates are going up. As a base case, ICRA expects NBFC/HFC net profitability (return on average managed assets, ROMA) for FY2023 to remain at the same levels as the last fiscal.

Analyst Contact Details

	Karthik Srinivasan	A M Karthik	Sachin Sachdeva	Manushree Saggar
	Senior Vice President	*Vice President*	*Vice President*	*Vice President*
Email	karthiks@icraindia.com	a.karthik@icraindia.com	sachin.sachdeva@icraindia.com	manushrees@icraindia.com
Phone	+91-22-61143444	+91-44-45964308	+91-124-4545307	+91-124-4545316

Business Development/Media Contact Details

	L. Shivakumar	Jayanta Chatterjee	Naznin Prodhani
	Executive Vice-President	*Executive Vice-President*	*Head Media & Communications*
Email	shivakumar@icraindia.com	jayantac@icraindia.com	communications@icraindia.com
Phone	+91-22-6114 3406	+91-80-4332 6401	+91-124-4545 860

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Thank You!