ICRA

INDIAN MORTGAGE FINANCE MARKET

Industry performance on upward trajectory; growth and profitability expected to improve further in FY2023

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Table of Contents

Table of EXHIBIT

OUTLOOK: STABLE

HFCs reported on-book portfolio growth of 11% (adjusted: 9%) in FY2022, in line with ICRA's estimate of 8-10%. ICRA has revised its portfolio growth estimate to 10-12% for FY2023 from 9-11% earlier

Despite reduction in credit cost, profitability remained steady in FY2022 (similar to FY2021 level) because of higher operating costs. However, it is expected to improve, almost to the pre-Covid level, in FY2023

Healthy capital and liquidity support entity-level risk profiles

The on-book portfolio of the non-banking financial companies-housing finance companies (NBFC-HFC) sector grew 11% year-on-year (YoY; 9% adjusted)[1] in FY2022, driven by the steady growth in disbursements. The growth was slightly better than ICRA's growth estimate of 8-10% for FY2022 (as per ICRA's report of March 2022 and earlier). Given the buoyancy in disbursements, ICRA has revised its growth estimate to 10-12% for FY2023 (from 9-11% earlier). The challenges posed by the second wave of the Covid-19 pandemic led to a deterioration in the asset quality metrics in Q1 FY2022, though the industry saw a sharp recovery in Q2 FY2022. However, because of the tighter regulations on the recognition and upgradation of gross non-performing assets (GNPAs), as per the Reserve Bank of India's (RBI) notification - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances – Clarifications dated November 12, 2021, the industry reported an increase of 20 basis points (bps) in the GNPAs in Q3 FY2022. Nevertheless, the recovery continued in Q4 FY2022 and the GNPAs declined to 3.1% as on March 31, 2022 (compared to ICRA's estimate of 3.0-3.3%) from 3.3% as on December 31, 2021. ICRA expects further improvement in FY2023 and retains its estimate of 2.7-3.0% of GNPAs by March 31, 2023. Further, ICRA notes that the provision cover maintained by most HFCs would cushion the profitability, going forward.

- **GNPAs improved in Q4 FY2022 with further recovery expected in FY2023:** The asset quality of HFCs was affected by the pandemic, with additional strain due to the second wave in Q1 FY2022. The GNPAs increased significantly in Q1 FY2022 followed by a recovery in Q2 FY2022. However, tighter regulations led to an increase in the GNPAs to 3.3% in Q3 FY2022. With continued recovery, driven by healthy collections, the GNPAs improved in Q4 FY2022, in line with ICRA's estimates. Going forward, ICRA expects further recovery in FY2023 and retains its GNPA estimate of 2.7-3.0% as on March 31, 2023. The credit costs are also expected to decline in FY2023, which will help improve the profitability in FY2023.
- **Healthy provision cover and liquidity provide cushion:** The healthy provision cover maintained by most entities is expected to provide a cushion to absorb the losses on the identified asset quality stress. In addition, HFCs have been maintaining healthy on-balance sheet liquidity for the last few quarters, which is expected to continue in the near term, given the challenging environment. The minimum liquidity coverage ratio (LCR) requirements for non-deposit taking HFCs, as per their respective asset-size classification, are also being maintained.
- **Outlook remains Stable:** ICRA expects the asset quality indicators to witness some improvement, going forward, and also expects a steady growth in the industry portfolio and profitability as the healthy provision cover would protect the margins.

[1] *Figures from September 2021 include the book (including securitised) of erstwhile Dewan Housing Finance Limited (DHFL), which was acquired by Piramal Capital & Housing Finance Limited (PCHFL); hence, to calculate the adjusted growth, we have added the same book size in the corresponding quarters of the last fiscal*

Portfolio Growth	**FY2023 – 10-12% growth**	HFCs reported on-book portfolio growth of 11% (adjusted 9%) in FY2022, in line with ICRA's estimate of 8-10%. ICRA revises its portfolio growth estimate to 10-12% for FY2023 from 9-11% earlier; access to adequate funding would remain critical
Asset Quality (GNPAs)	**FY2023 – 2.7-3.0% by March 2023**	Industry witnessed a recovery in GNPAs in Q2 FY2022 after a significant spike in Q1 FY2022. Thereafter, GNPAs increased to 3.3% as on December 31, 2021 due to tightened norms, but declined to 3.1% by March 31, 2022. ICRA expects further recovery of 30-40 bps in FY2023
Funding and Liquidity	**Rs. 1.2 lakh crore for FY2023**	Liquidity remains comfortable; additional funding required in FY2023 to support growth, apart from refinancing existing/maturing lines, is estimated at around Rs. 1.2 lakh crore
Profitability (RoMA)	**FY2023 – Improvement from FY2022, to almost reach pre-Covid level**	Despite reduction in credit cost, profitability remained moderate in FY2022 because of increase in operating cost and relatively slower growth compared to pre-Covid times FY2023 to witness improvement and profitability to move close to the pre-Covid level
Capital	**Comfortable**	No major capital requirement to sustain expected growth outlook, given the relatively comfortable capitalisation profile

EXECUTIVE SUMMARY

- The overall HFC credit in India is estimated at Rs. 12.2 lakh crore as on March 31, 2022, with exposures across home loan (HL), loan against property (LAP), construction finance (CF), and lease rental discounting (LRD).
- The on-book portfolio of HFCs grew 11% YoY (9% adjusted) in FY2022, driven by the growth in disbursements in the last three quarters of the year. The second wave of the pandemic had impacted disbursements in Q1 FY2022, leading to nil sequential growth in the on-book portfolio. However, there was a sharp recovery thereafter, driven by the healthy demand in the industry and the increasing level of economic activity. With the momentum of disbursement growth expected to continue, ICRA has slightly revised its growth estimate for the HFCs' portfolio upwards to 10-12% for FY2023 from 9-11% earlier.
- The asset quality metrics remain volatile, given the vulnerable borrower profile, especially of self-employed borrowers, through HL and LAP as well as the affordable segment. Nevertheless, the industry witnessed a reduction in the GNPAs to 3.1% as on March 31, 2022 from the high of 3.6% as on June 30, 2021. The reduction was primarily driven by recoveries in the HL and LAP segments, whereas the CF segment continued to witness an increase in the GNPAs in Q4 FY2022. The recovery is expected to continue, going forward, across segments (including CF segment) and ICRA accordingly estimates a further reduction of 30-40 bps in the GNPAs in FY2023. Though a meaningful reduction in the GNPAs is expected to take some time, existing provisions are expected to protect profitability, going forward.
- The industry saw a reduction in the outstanding restructured book to 1.7% of the assets under management (AUM) as on March 31, 2022, slightly better than ICRA's estimate of 1.8-1.9%. The reduction, from the high of 2.3% as on September 30, 2021 (1.1% as on March 31, 2021), was driven by increased recoveries, given the improvement in borrower's cash flows. This, coupled with the increasing base, led to a decline in the standard restructured book (net of slippages).
- Capital and liquidity remain silver linings for the sector. Considering the relatively low, albeit improved, growth outlook, ICRA does not envisage any sizeable equity infusion requirement. However, the sector would require around Rs. 1.2 lakh crore of additional funding for the envisaged growth in FY2023.
- Though HFCs continue to face headwinds because of the currently evolving situation, their ability to maintain adequate liquidity and control the asset quality would be the key differentiator. ICRA analysed the liquidity position of 21 HFCs as on March 31, 2022 and observed that they have been maintaining liquidity (including unavailed sanctions) to cover around 3 months of debt repayments. ICRA expects the liquidity profile to be maintained with adequate buffer to give comfort to various stakeholders, though the same is expected to decline gradually from the currently high levels.

ICRA

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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