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NBFC and HFC Update

Earnings and growth revive in Q3 FY2022; Overall improvement expected in the next fiscal

MARCH 2022

SUMMARY

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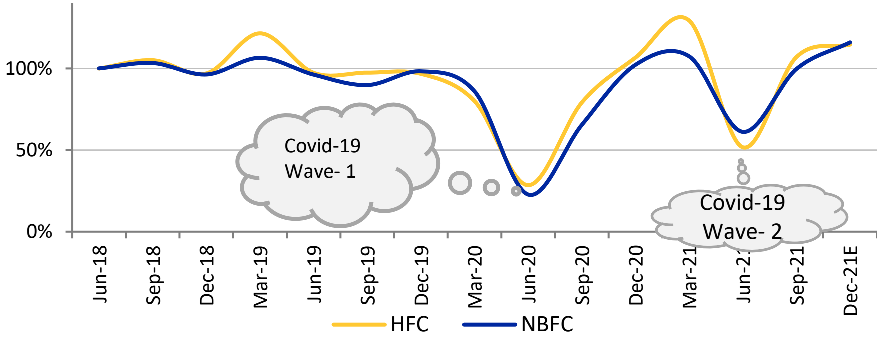
- Non-banking financial company (NBFC)-Retail (NBFC-Retail) assets under management (AUM) is estimated to grow by 5-7% in FY2022 and 8-10% in FY2023, while housing finance company (HFC) AUM would expand by 8-10% and 9-11%, respectively, during this period. NBFC-Wholesale AUM would continue to shrink in the current fiscal and stabilise in FY2023. The disbursement and AUM trend revived in Q2 and Q3 of FY2022 and the same is likely to continue in Q4 FY2022 as the impact of the third wave of the Covid-19 pandemic was limited; the setback witnessed in Q1, on account of Covid-related disruptions, is weighing on the overall growth in the current fiscal.
- The growth in the NBFC-Retail segment would be driven by personal credit, microfinance and gold loans as other traditional asset segments, i.e. vehicle finance and business credit, are still facing headwinds because of supply constraints, and asset quality concerns. For HFCs, the growth is expected to be driven by the housing loan (HL) book. Consequently, the share of non-housing loans (NHLs) is expected to moderate to 30% of the AUM by March 2023 from ~34% at present.
- Liquidity (on-balance sheet (B/S) and undrawn sanctions) for the sector has remained adequate with entities typically maintaining coverage for their next three months' repayments. Lower AUM growth in FY2022 warranted limited incremental funding requirement vis-à-vis previously envisaged. The sector, i.e. NBFCs and HFCs, would require Rs. 1.8-2.2 trillion of incremental fresh funding for meeting its growth requirement in FY2023, assuming the entities continue to maintain their liquidity buffer.
- Moderation in the credit cost would support the earnings performance in the current and next fiscal. ICRA expects the return on managed assets (RoMA) for NBFCs and HFCs to approach the pre-Covid levels of 2.7-2.9% and 1.8-2.0%, respectively, in FY2023. For FY2022, RoMA is estimated to be higher than FY2021 at 2.2-2.4% and 1.6-1.8%, respectively. Managing the operating efficiency, especially of NBFCs, and controlling incremental slippages, especially from the restructured book, would remain key monitorables.
- The reported asset quality, i.e. gross stage 3 (GS3), was impacted as some entities aligned their reporting in line with the Reserve Bank of India's (RBI) clarification on non-performing advances (NPAs) on November 12, 2021. While the RBI has provided an extension for its applicability, entities which have already aligned are not expected to revert to the old norms. The performance of the restructured book would remain a monitorable.
- The capital profile is adequate and sizeable capital infusion is not expected, considering the moderate portfolio growth expectation.

Disbursements and AUM growth revive in Q3; sustainability is key

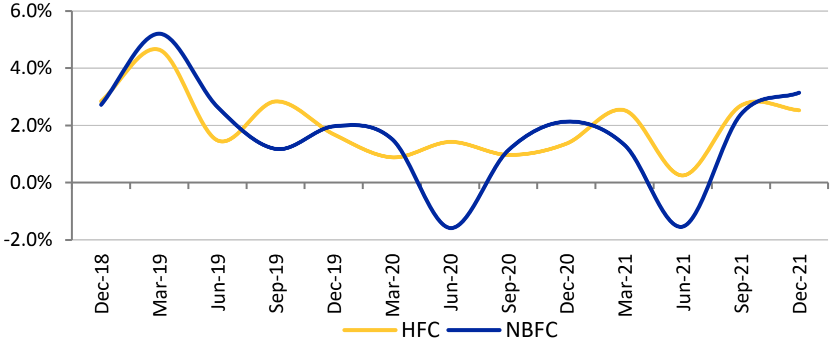
NBFC disbursements peaked in Q3 FY2022; HFC disbursements also improved but were lower than the peak of Q4 FY2021

EXHIBIT : Normalised quarterly disbursement trend - June 2018 (base quarter)



ICRA Research; data of 16 NBFCs and 11 HFCs; excluding PSUs and gold loan companies

EXHIBIT : QoQ AUM growth (sequential)

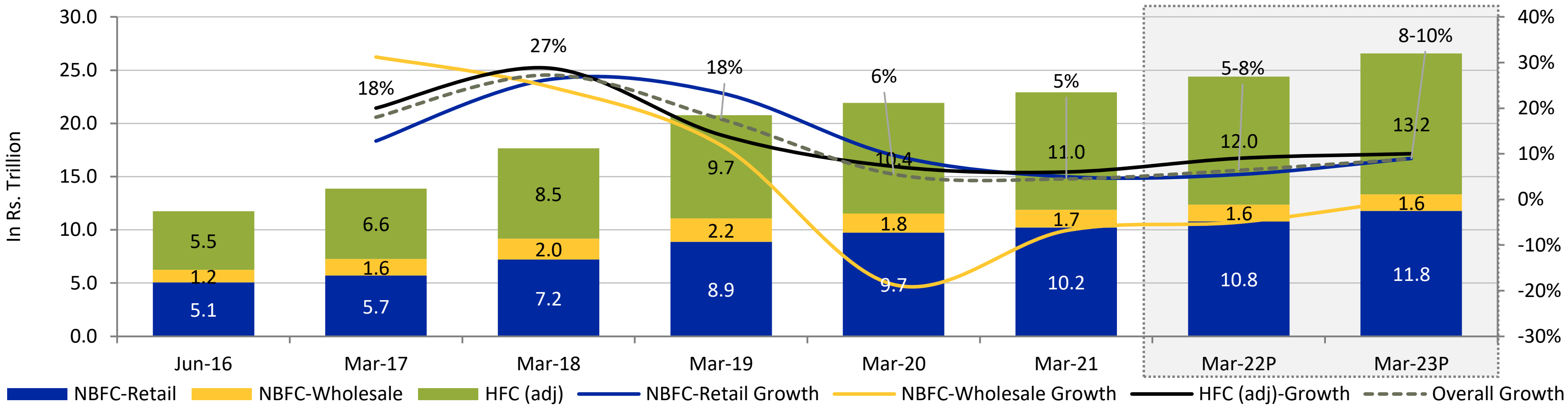


Source: ICRA Research; data of 24 NBFCs and 11 HFCs, excluding PSUs

- NBFC disbursements grew sequentially (quarter-on-quarter; QoQ) while HFC disbursements were flat and lower than the peak of Q4 FY2021. HFCs faced competition from other lenders, especially banks. Consequently, the sequential AUM growth for NBFCs was seen to be the highest in the last 11 quarters, while the HFC AUM growth rate dipped marginally.
- ICRA notes that the disbursement growth would have to remain healthier for a sustained AUM growth, considering the fact that the entities faced limited AUM rundown in the last fiscal, as a sizeable portion (~45%) of their book was under moratorium. Also, the AUM in 9M FY2022 was supported by portfolio restructuring (~3-4%), though at a much moderate level. Restructuring, in most cases, had a principal moratorium of 3-6 months.

Moderate revival in growth expected in the next fiscal

Exhibit: YoY AUM growth trends and expectation

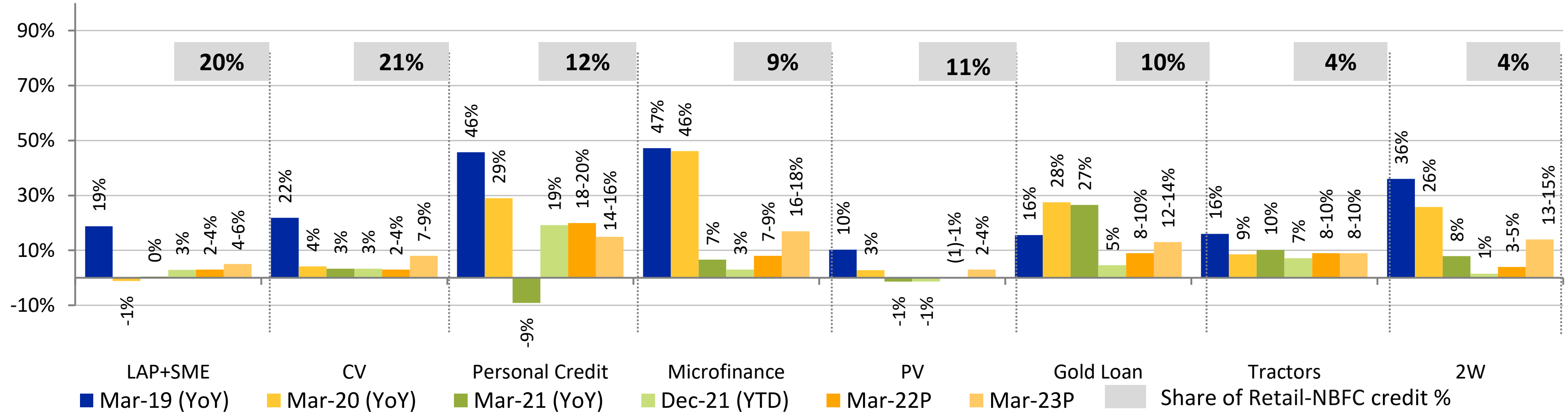


- The lacklustre performance in H1 FY2022, along with headwinds (vehicle supply, prepayments in the housing segment, etc), would affect the overall growth in FY2022. NBFC-Retail credit and HFC credit are estimated to grow at 5-7% and 8-10%, respectively, in FY2022, while the growth would improve to 8-10% and 9-11%, respectively, in FY2023.
- The wholesale credit of NBFCs, which declined in FY2020 and FY2021, is expected to contract further by ~5% in FY2022 and is estimated to consolidate and stabilise in FY2023. Overall NBFC+HFC is estimated to grow at 5-8% in FY2022 and ~8-10% in FY2023.

Source: ICRA Research; Adj - Excluding DHFL and Gruh till Mar-21; Piramal is included in HFCs, vis-à-vis NBFC-Wholesale in the past; the Sep-21 data includes the acquired DHFL book

Vehicle and LAP segment growth to lag other segment growth

Exhibit: Asset class-wise growth trends (Retail-NBFC)



- Some of the key segments, which bolstered growth in 9M FY2022, include gold loans, personal credit and rural finance.
- Growth in the vehicle finance segment (commercial vehicle (CV), passenger vehicle (PV), etc), business loans, including loan against property (LAP), and other commercial lending segments, which are closely linked to the overall economic performance, are expected to be better than FY2021. However, it is expected to take longer to register a reasonable revival.

Source: ICRA Research, company/company investor presentations, MFIN

HLs to drive HFC growth

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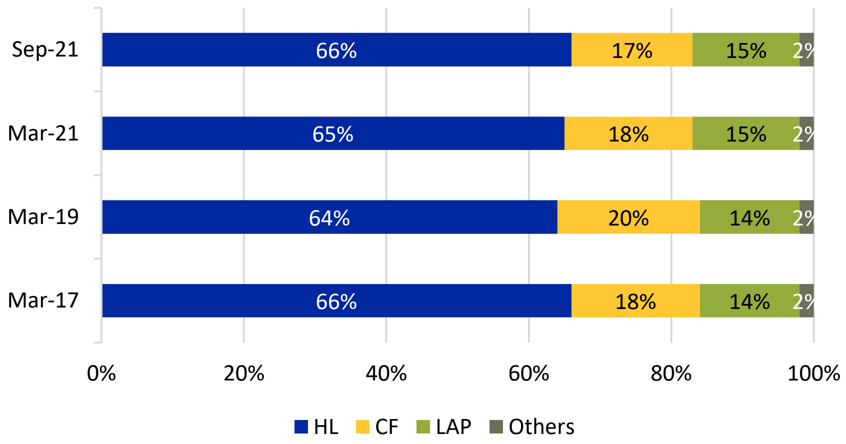
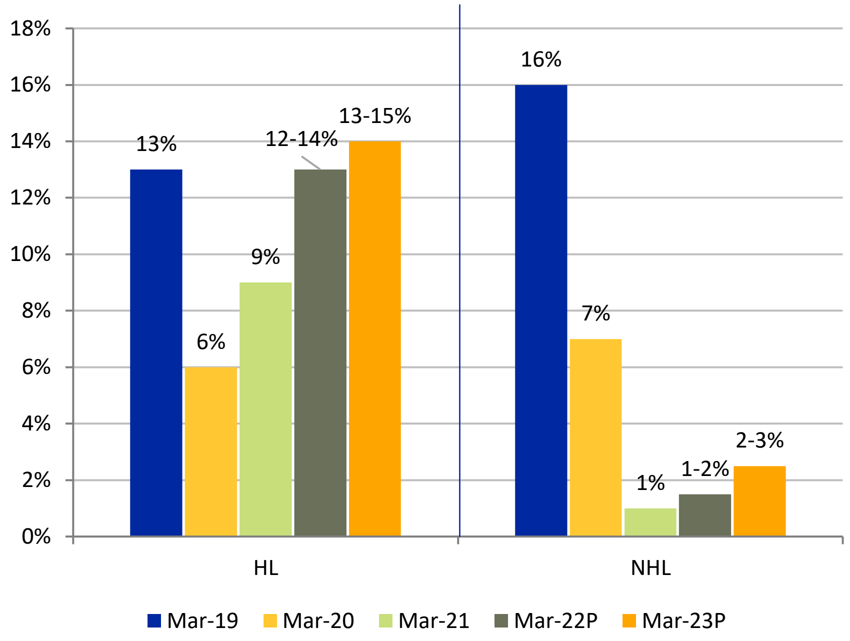
- HLs would be the key growth driver for HFCs over the near term.
- The share of NHL, which is currently ~34%, would moderate to 30% by March 2023.
- Construction finance accounts for ~50% of NHLs, which would shrink going forward. The rest is contributed by business and other loans against mortgage.

Exhibit : HFC Segment Wise Exposure



Source: ICRA Research ; CF- Construction Finance, LAP –Loan Against Property

Exhibit : Asset class-wise YoY growth trends (HFC)



Source: ICRA Research

Funding and Capital Profile

Liquidity has remained quite adequate

- *Entities have maintained commensurate on-B/S liquidity and unavailed credit lines; the coverage maintained by the NBFCs and HFCs has remained largely rangebound over the last 9 months*
- *Sector would require about Rs.1.8-2.2 trillion of additional funding in FY2023 for meeting the envisaged growth*

EXHIBIT: Coverage – Overall Liquidity/3-month Principal Repayment as of December 2021

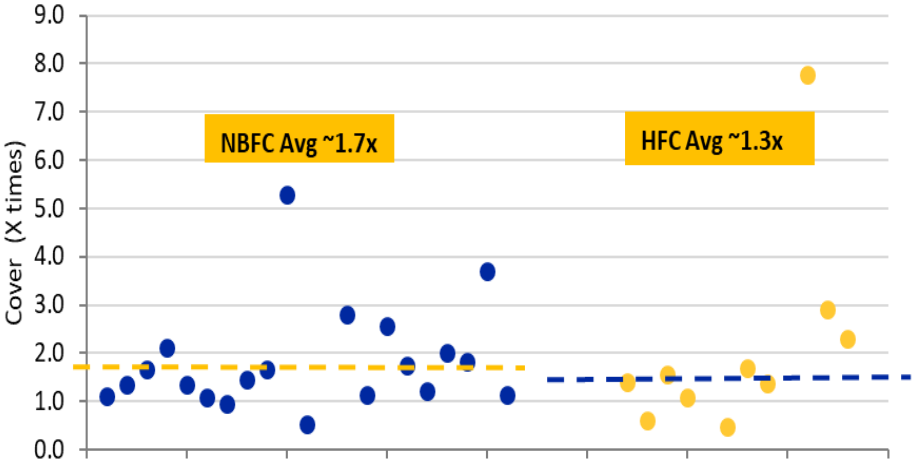
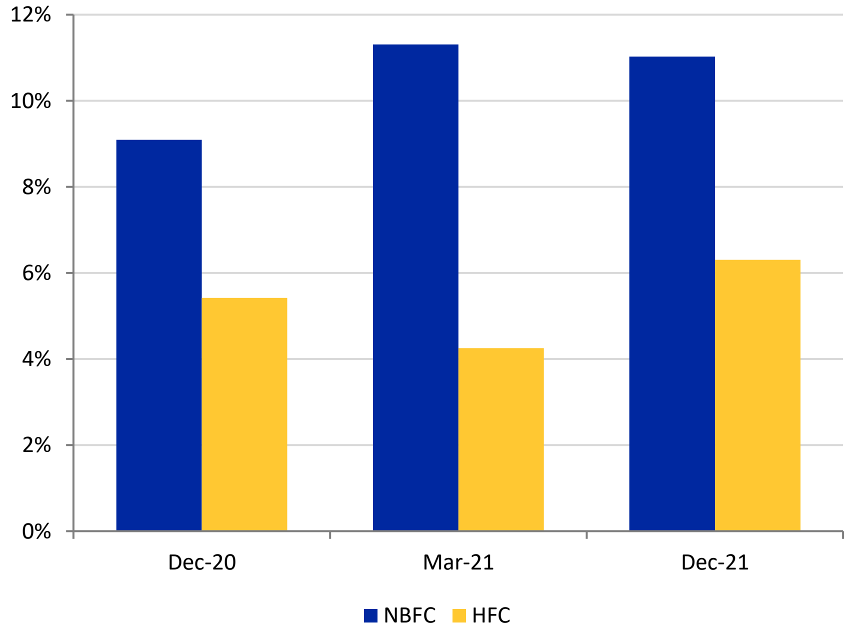


Exhibit: Cash and liquid investments/AUM (Estimated)



Source: ICRA Research, data of ICRA sample of 20 NBFCs and 10 HFCs); Overall liquidity - On B/s liquidity + sanctioned credit lines; estimates and nearest data used where Dec 21 data was not available

** Sep-21 data for HFCs*

Funding profile

Increase in the share of fixed deposits and other sources {including external commercial borrowings (ECBs)} indicates diversification push by entities, even if it was at a higher cost; banks continue to be the mainstay for overall funding, especially for non-deposit taking NBFCs

Exhibit: NBFC funding profile

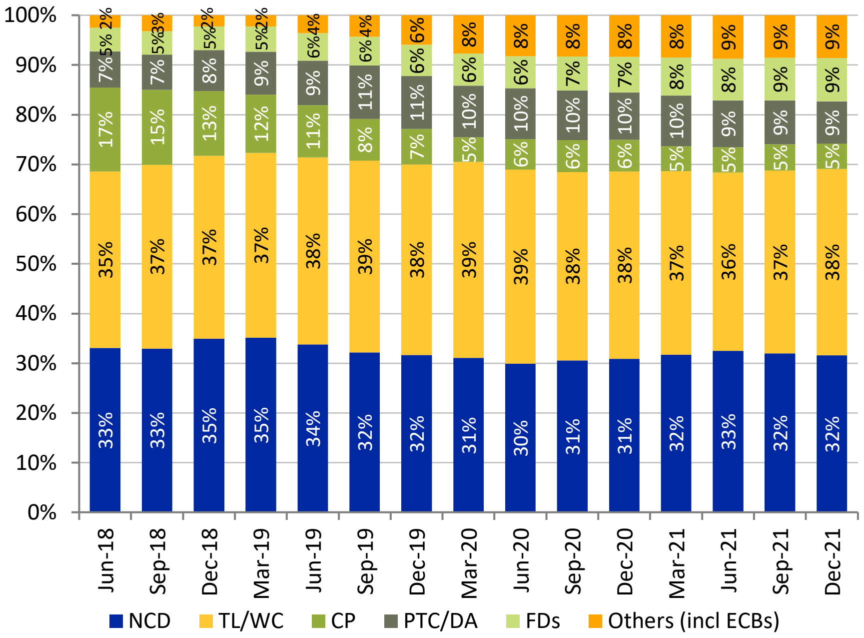
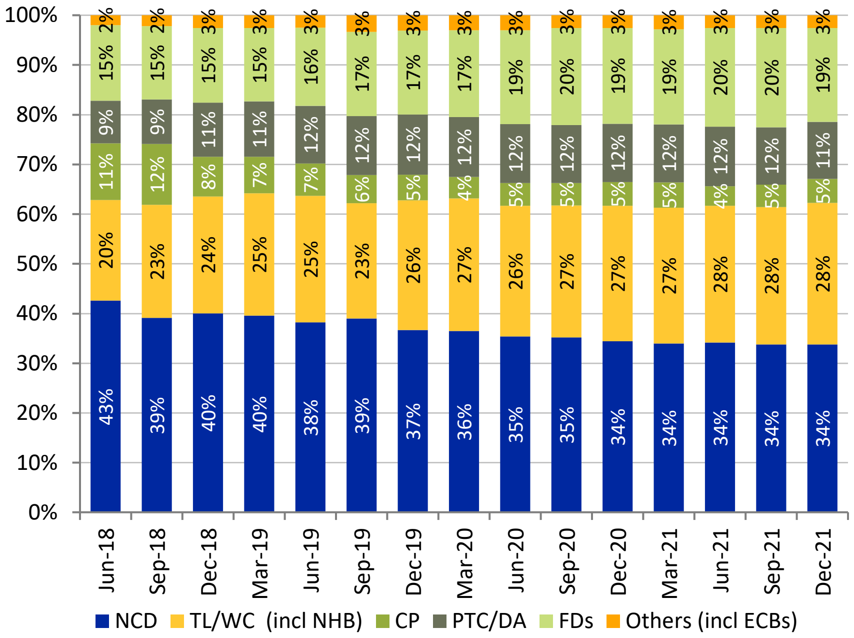


Exhibit: HFC funding profile



Source: ICRA Research, based on ICRA sample of entities

Banking and MF exposure

Bank credit and Debt-MF exposures to the sector have remained range-bound

Exhibit: Bank credit to NBFCs (excluding public finance institutions)

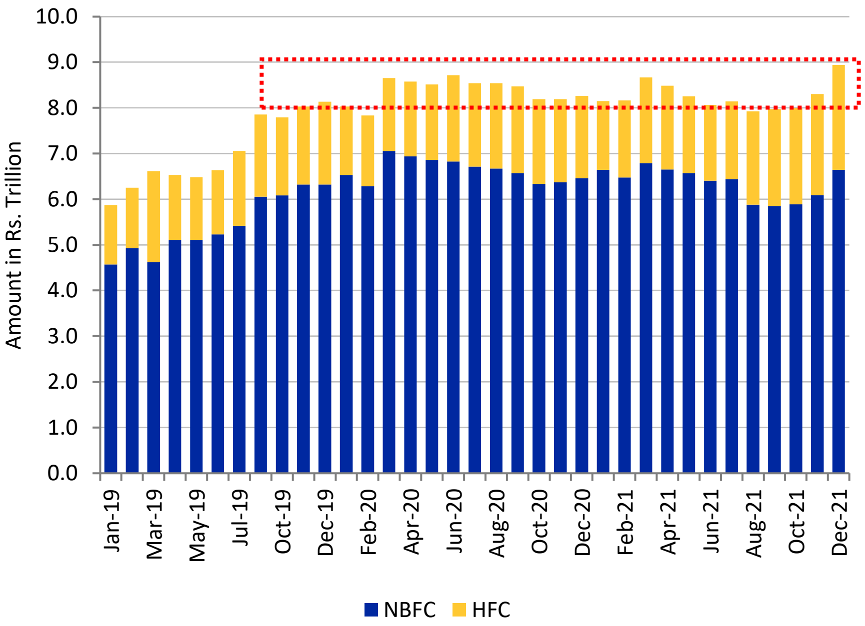
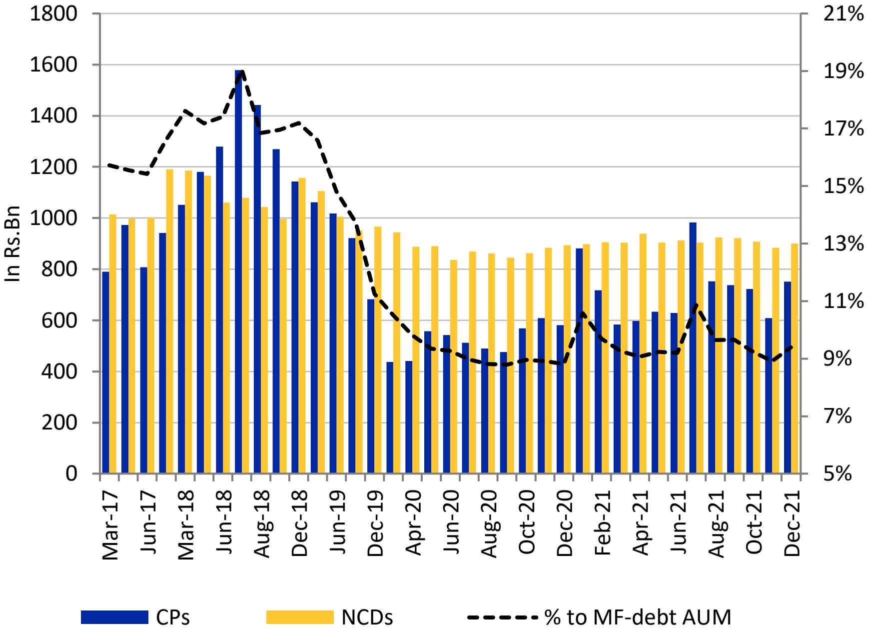


Exhibit: Debt MF investments in NBFC papers



Source: RBI, SEBI, ICRA Research

Issuance of market instruments

NCD issuances by non-PSU NBFCs/HFCs in 11M FY2022 was stable on a YoY basis

Exhibit: NCD issuances by private NBFCs/HFCs

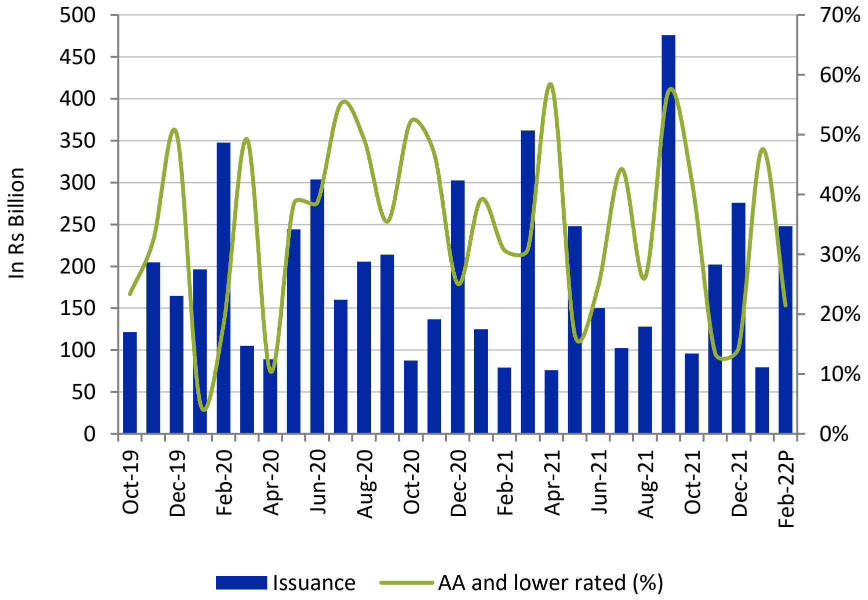
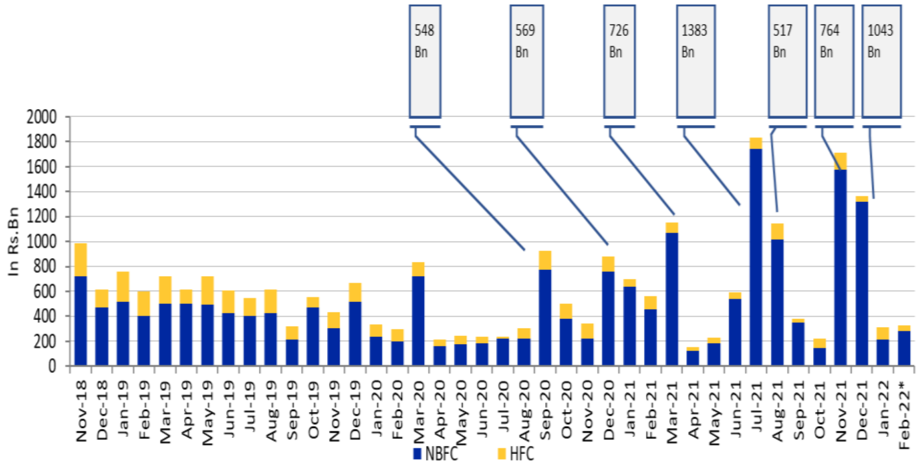


Exhibit: CP issuances



*Source: AIMIN, Ftrac , ICRA Research; P- Provisional ; The numbers in the boxes are estimated IPO financing (CP tenor of 7 days or less) * till Feb 25, 2022*

Benchmark rates

Cost of funds trends upwards; however, pace is more moderate than expected

Exhibit: 3-year G-Secs vis-à-vis AAA NBFC and HFC trends

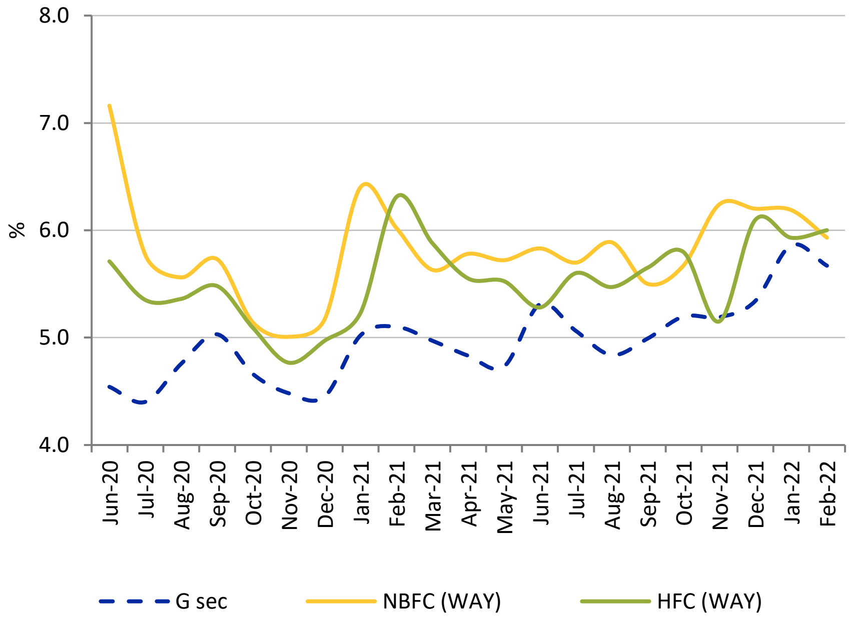
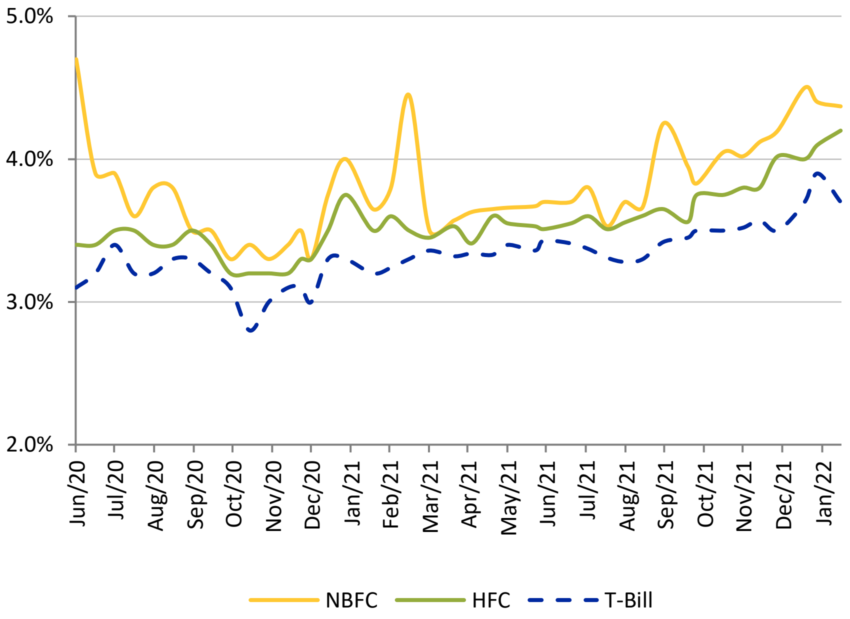


Exhibit: 90D T-bill vis-à-vis 90-day CP rates of NBFCs/HFCs



Source: AIMIN, ICRA Research

Securitisation and deposit trend

ICRA

Securitisation volumes up and estimated at Rs.1.1 trillion for FY2022; Deposit growth, while moderating, had remained healthier vis-à-vis portfolio growth

EXHIBIT: Securitisation volumes

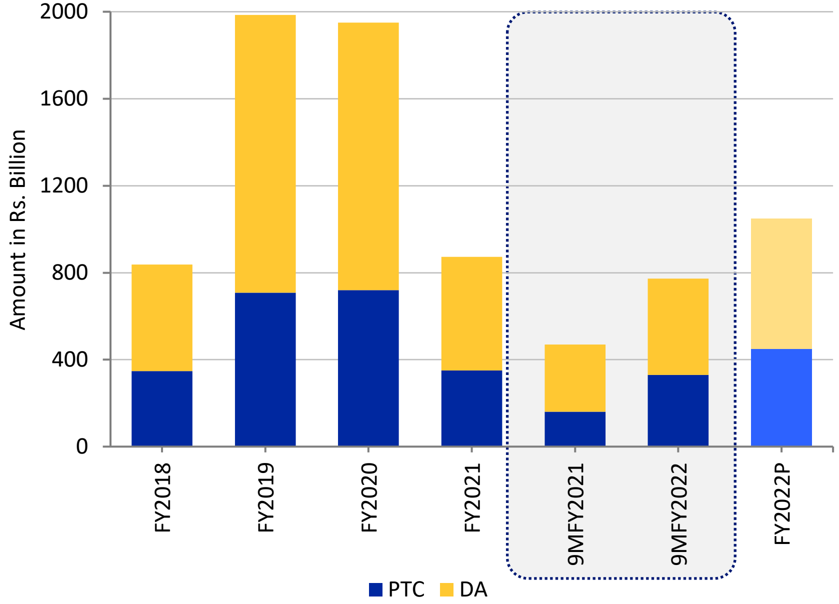


Exhibit: NBFC deposit trend

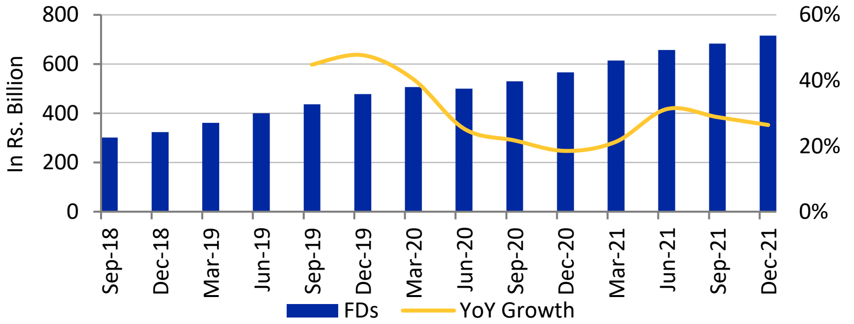
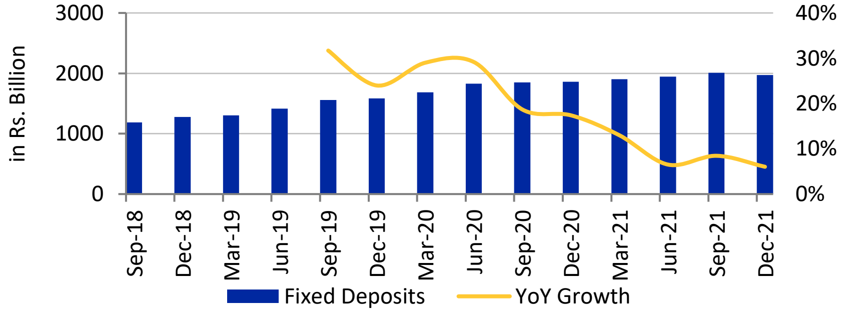


Exhibit: HFC deposit trend

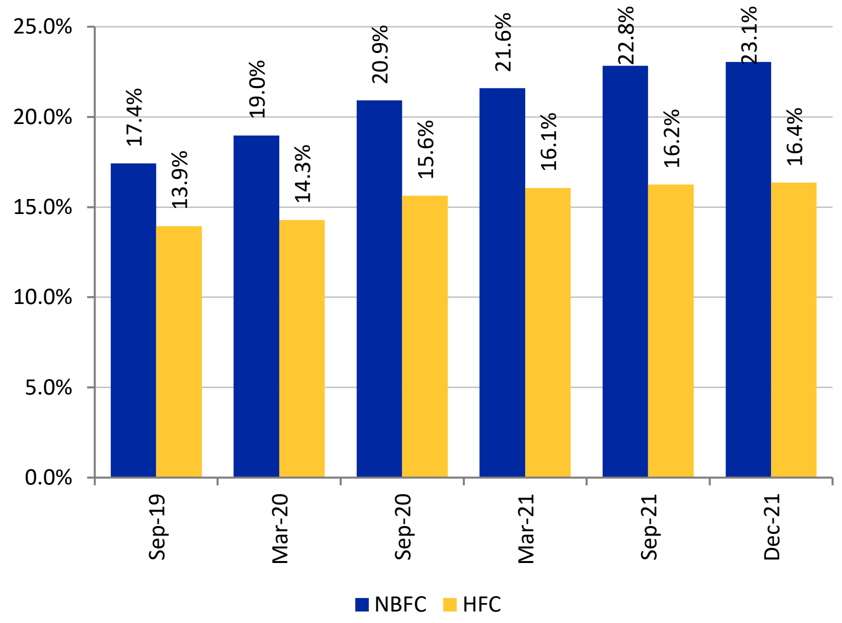


Source: ICRA Research, RBI
Deposit data based on ICRA sample of entities

Capitalisation profile

Capital profile has improved steadily on the back of subdued growth, while internal generation remained relatively higher

Exhibit: Net worth/ AUM



- Some entities have raised capital over the last 18 months in view of the uncertainties posed by the pandemic.
- In general, the sector would not require sizeable capital in the next fiscal, considering the moderate growth expectation. However, some entities may raise equity because of their higher leverage or growth expectations.

Source: ICRA Sample of entities

Earnings Performance

Earnings performance - I

HFC yields moderated in view of the competitive pressures while NBFC yields remained range-bound; cost of funds remained favourable

Exhibit: NBFC - Business yield

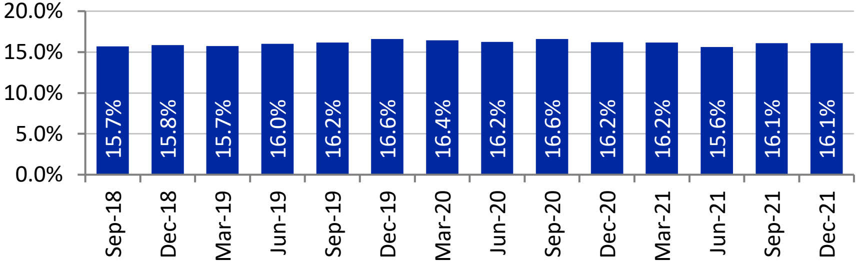


Exhibit: HFC - Business yield

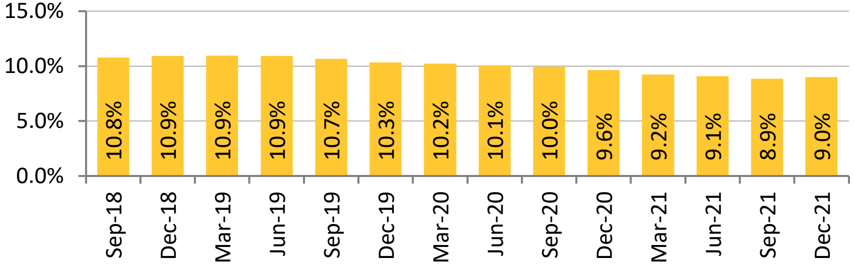


Exhibit: NBFC - Cost of funds

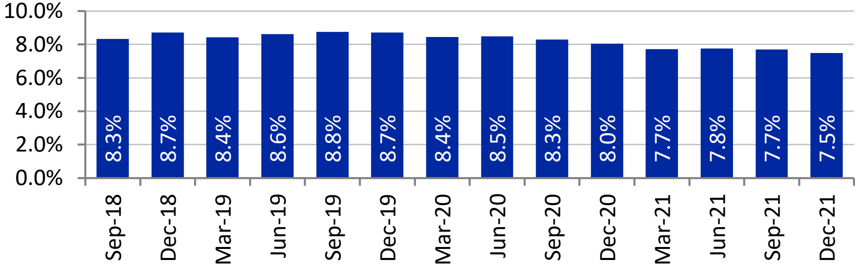
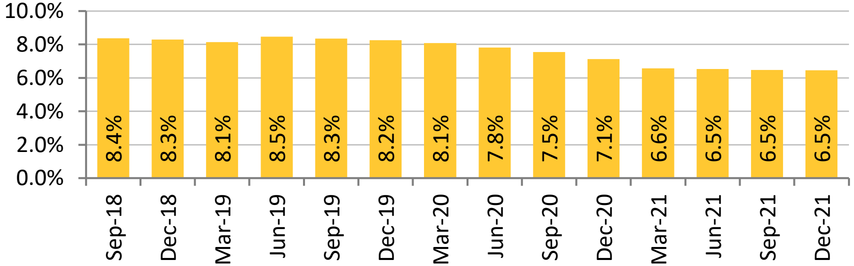


Exhibit: HFC - Cost of funds



Source: ICRA Research, based on ICRA sample of entities (21 NBFCs and 11 HFCs)

Earnings performance - II

Margins upheld by favourable cost of funds, even as entities held higher balance sheet liquidity

Exhibit: NBFC - Net interest margin

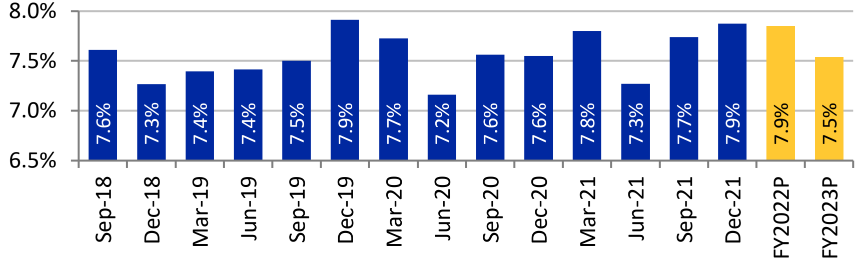


Exhibit: HFC - Net interest margin

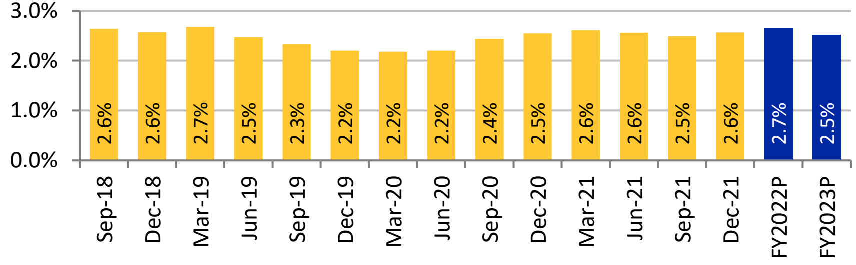


Exhibit: NBFC - Other income

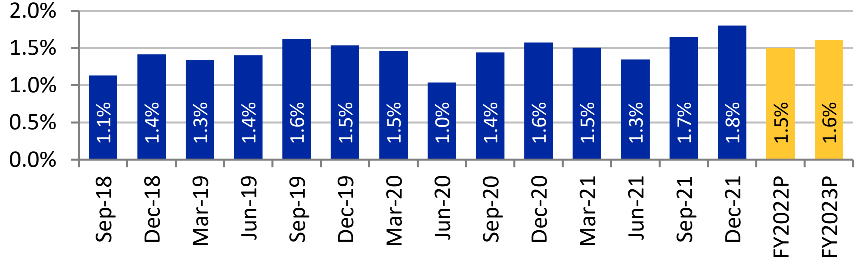
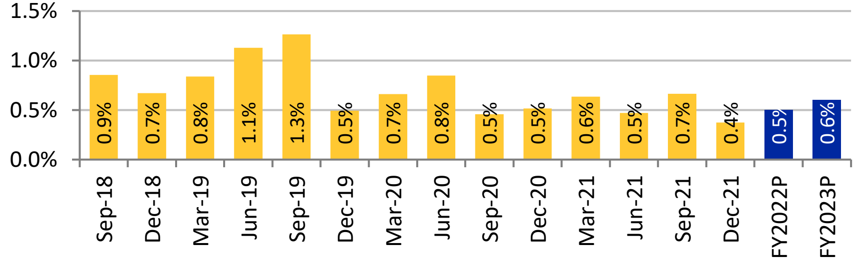


Exhibit: HFC - Other income



Source: ICRA Research, Past data based on ICRA sample of entities; ratios based on Average managed assets (AMA) AMA= total assets + off b/s exposure

Earnings performance - III

Operating expenses moved up with revival in business volumes and increased focus on collections and system augmentation; credit costs are past the peak witnessed during the pandemic

Exhibit: NBFC - Operating expenses ratio

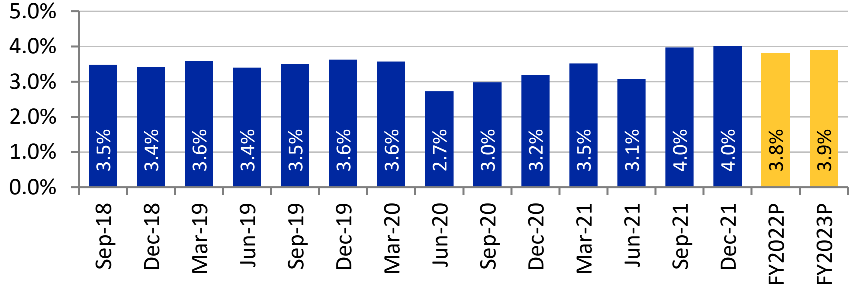


Exhibit: HFC - Operating expenses ratio

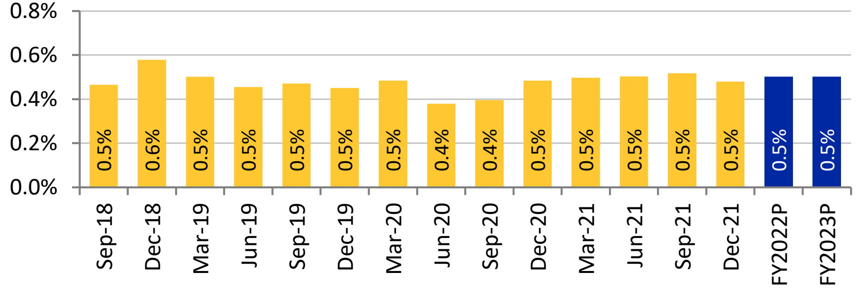


Exhibit: NBFC - Credit cost

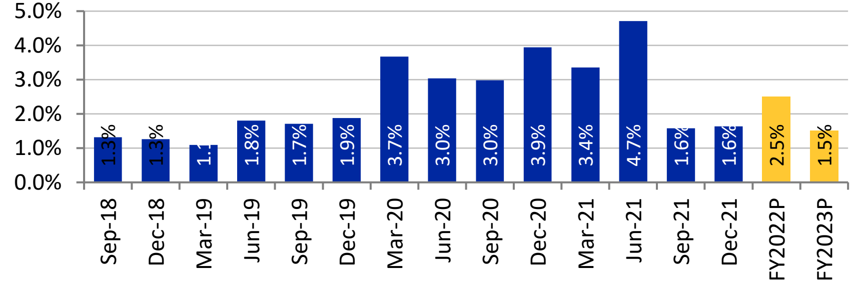
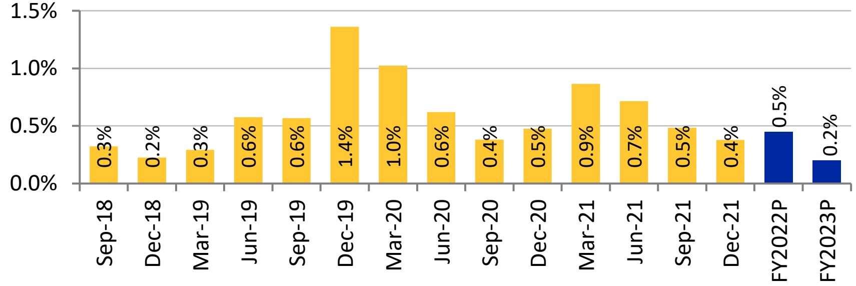


Exhibit: HFC - Credit cost



Source: ICRA Research, Past data based on ICRA sample of entities; ratios based on Average managed assets (AMA)   AMA= total assets + off b/s exposure

Earnings performance - IV

Net earnings for the current fiscal would remain moderate; to improve to near pre-Covid level in the next fiscal

Exhibit: NBFC - PBT

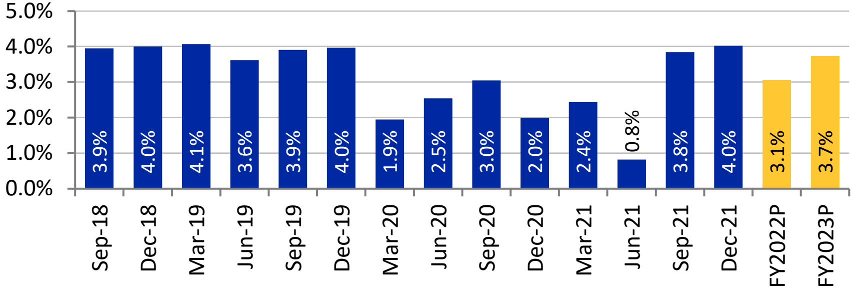


Exhibit: HFC - PBT

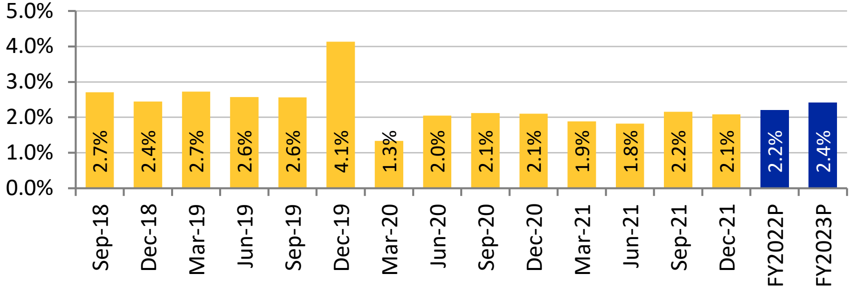


Exhibit: NBFC - PAT

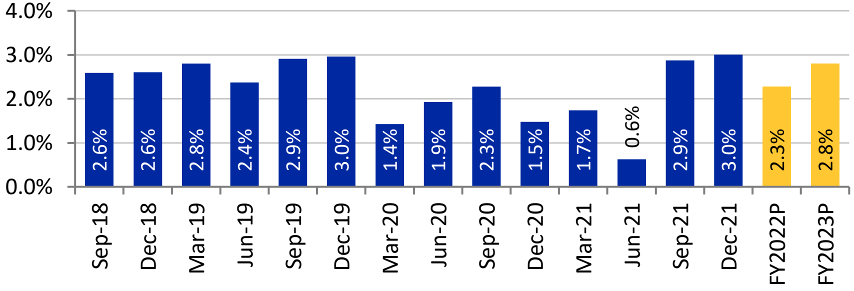
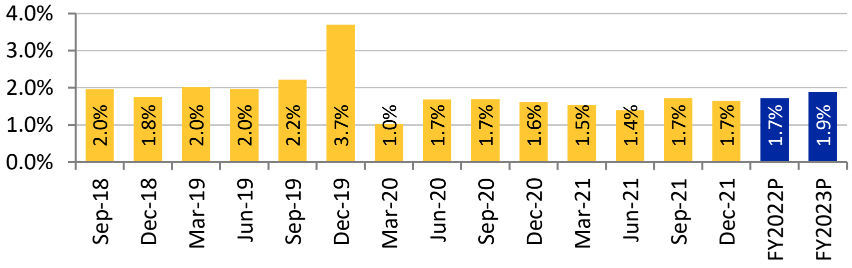


Exhibit: HFC - PAT



Source: ICRA Research, Past data based on ICRA sample of entities; ratios based on Average managed assets (AMA)   AMA= total assets + off b/s exposure

Earnings performance - V

Return indicators expected to improve in line with net profitability

Exhibit: NBFC - Return on average net worth

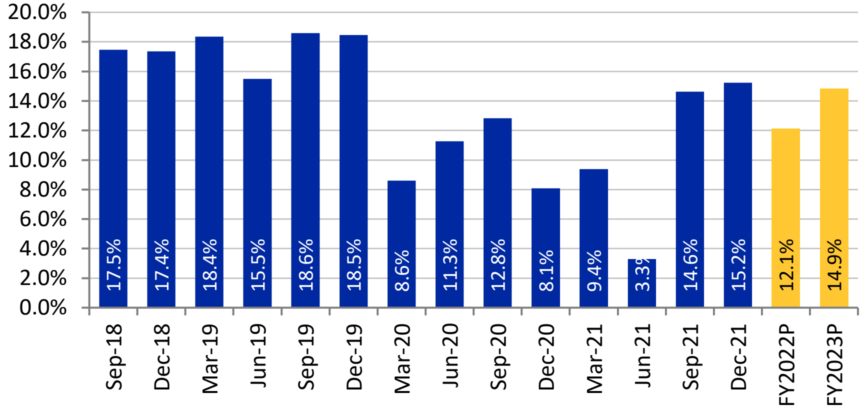
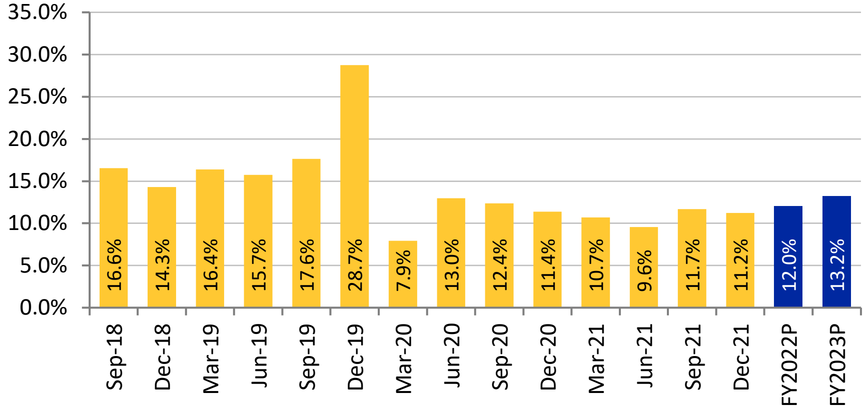


Exhibit: HFC - Return on average net worth



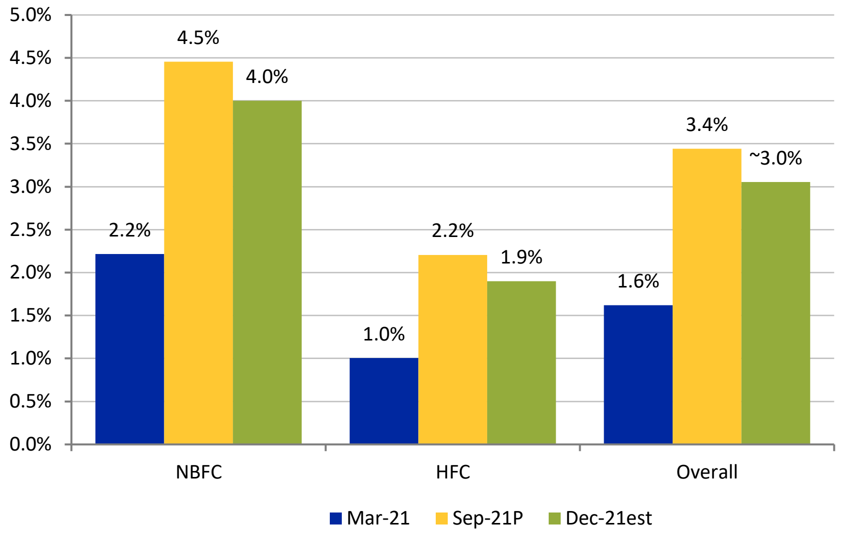
Source: ICRA Research, Past data based on ICRA sample of entities

Asset Quality Performance

Restructured book

Restructured book moderated from the peak in September 2021

Exhibit: Restructured book

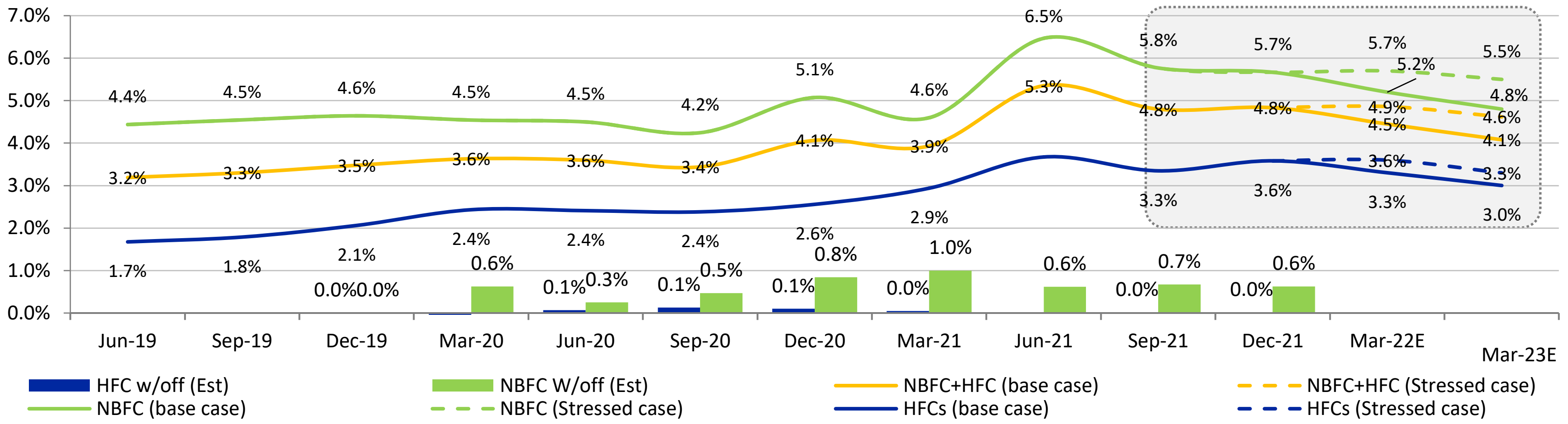


Source: ICRA Research

- Of the total restructured book of NBFCs, ~70% was done in H1 FY2022, while the same stood at 40% for HFCs.
- Restructuring in the current fiscal was largely done in Q2 FY2022, generally with a moratorium of 3-6 months. With the commencement of repayments from these accounts in Q3/Q4 FY2022, the performance of the same remains to be seen.
- Based on the performance of the book restructured in the last fiscal, slippage from the NBFC restructured book is expected to be higher at 20-25% vis-à-vis 5-10% for HFCs.

Reported asset quality impacted by tightened NPA norms

Exhibit: Gross stage 3 trend and outlook



- About 55% of the sample NBFCs and 75% of the HFCs (in AUM terms of the ICRA sample of entities) have aligned their GS3 reporting with the tightened NPA norms provided by the RBI via its clarification on November 12, 2021. While the RBI provided some relaxation in the applicability of the same (from October 2022), entities which have already aligned are less likely to revert to the older norms. Please refer to the ICRA Report on the above.
- Write-offs, especially for NBFCs, remain elevated. The performance of the restructured book would remain a monitorable in the near term as sizeable restructuring was undertaken in H1 FY2022 and typically had a moratorium of 3-6 months.

Source: ICRA Research; based on ICRA sample of entities (21 NBFCs and 11 HFCs)

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Analyst Contact Details

Karthik Srinivasan	**A M Karthik**	**Sachin Sachdeva**	**Manushree Saggar**
Senior Vice President	*Vice President*	*Vice President*	*Vice President*
karthiks@icraindia.com	a.karthik@icraindia.com	sachin.sachdeva@icraindia.com	manushrees@icraindia.com
+91-9967651530	+91-9791018775	+91-9811786698	+91-9810290745

www://

Business Development/Media Contact Details

L. Shivakumar	**Jayanta Chatterjee**	**Naznin Prodhani**
Executive Vice-President	*Executive Vice-President*	*Head Media & Communications*
shivakumar@icraindia.com	jayantac@icraindia.com	communications@icraindia.com
022- 6114 3406	080 – 4332 6401	0124 – 4545 860

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Thank You!