Retail-NBFC Credit Trends October 2019

Retail-NBFC credit growth moderates; reduction in corporate tax rates a positive for earnings as asset quality and growth concerns rise

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Executive Summary

The assets under management (AUM) in the Retail-NBFC segment stood at Rs. 9.2 trillion[1] as on June 30, 2019, registering a year-on-year (YoY) growth of 18.5% vis-à-vis ~22% in March 2019 and ~24% in March 2018. All the key segments of Retail-NBFC credit, barring microfinance and personal credit (personal loans, consumer durable loans, etc), registered a slower quarter-on-quarter (QoQ) growth in Q1 FY2020. Retail-NBFC credit growth, excluding the microfinance segment, was about 17% (YoY) in June 2019 vis-à-vis 20% in March 2019 and about 22% in March 2018. While Retail-NBFCs are better placed from a liquidity perspective vis-à-vis their wholesale counterparts, weak demand from some key segments, namely vehicle (~50% of Retail-NBFC AUM) and loan against property + small and medium enterprises (LAP+SME; ~22%), along with competitive pressure from banks in the prime products like new vehicle finance and, customer categories like salaried, and larger SMEs hampered growth.

Banking credit flow to NBFCs is key for their near to medium term growth, as funding from other sources, including mutual funds (MFs), is expected to remain relatively moderate. The Government of India (GoI) and the Reserve Bank of India (RBI) have taken various initiatives since September 2018 to support the NBFC sector as credit flow to the sector fell short of the required level. The RBI and the GoI continued to take more initiatives in H1 FY2020 like systemic liquidity infusions and giving a priority sector tag to bank credit to NBFCs that on-lend to the agriculture, micro, small and medium enterprises (MSMEs) and affordable housing segments. Other initiatives include partial credit enhancement guarantees for public sector banks (PSBs) purchasing assets from NBFCs and the increase and harmonisation of single borrower NBFC exposure (of banks) with other corporates. These steps augur well for bolstering credit flow from the banking sector to NBFCs. However, some of these steps are relatively recent and their translation into an improvement in funding to NBFCs remains to be seen.

Anecdotal evidence suggests that much of the incremental bank credit in the recent past has gone to the better rated entities (AA category and above) and entities with good parentage or group support. The lower rated entities (less than AA rating) are still largely dependent on bank funding. Therefore, the banking sector's willingness to take incremental credit exposure, considering the steep increase in its exposure level to NBFCs post September 2018, the internal sectoral thresholds of banks and their ability to mobilise deposits/funds, remains to be seen.

1 Excluding Capital First Limited, which merged with IDFC Bank and Bharat Financial Inclusion Limited, which merged with IndusInd Bank; ICRA, from its report in July 2019, has enhanced its coverage and has included new entities and entities that achieved scale and are classified as systemically important – therefore, certain growth numbers and trends may not be comparable with past reports. ICRA would continue to add new entities for its estimation of the market size and for monitoring their performance for this report, as and when the entities achieve a reasonable scale

The tightening of MF regulations, including reduction in sectoral caps, and requiring higher exposures of liquid MFs to liquid assets, etc, are likely to impact incremental funding from MFs. NBFCs reduced their dependence on short-term (ST) funding (commercial papers; CPs) and increased proportion of loan sell-downs (portfolio securitisation [pass-through certificates; PTCs] and direct assignment [DA]) and funding via other sources including external commercial borrowings (ECBs) and retail debt issuances. The run rate of the loan sell-downs, which was observed in Q4 FY2019, sustained in Q1 FY2020, while ECB volumes picked up following the relaxation of norms in February 2019.

The 90+ dpd (excluding microfinance institutions; MFIs) inched up marginally to 4.0% in June 2019 from 3.9% in March 2019. The asset quality pressure is likely to increase as the credit flow to some key segments, namely small and medium businesses, the key target borrowers for NBFCs, slowed down while borrowers in other segments, including vehicle finance face a weaker operating environment, thereby impacting their cash flow and viability. ICRA continues to expect further weakening in the asset quality of NBFCs in the current fiscal.

The net profitability of Retail-NBFCs was impacted in Q1 FY2020 as growth remained muted, cost of funds was high, and entities faced higher credit costs. The PAT/AMA dipped to 2.1-2.2% in Q1 FY2020 from 2.5% in Q4FY2019. The provision and credit costs went up sharply in Q1 FY2020, largely due to a few players, because of write-offs and incremental provisions on NPAs/overdues and an overall uptick in early bucket delinquencies. ICRA notes that the operating profit would contract, and the credit cost would increase if the portfolio growth remains more moderate than in the past. However, the reduction in the tax rate would keep the return on managed assets (RoMA) at higher levels and is estimated to be 2.2-2.4% for FY2020.

Outlook

ICRA expects the credit growth to remain moderate in FY2020 vis-à-vis the previous two fiscals as demand remains modest and debt funding, especially to mid & small-sized NBFCs, remains subdued. Retail-NBFCs are expected to register AUM growth of 15-17% in FY2020 with the AUM expected to cross Rs. 10 trillion during the year. The growth rate could be higher if the fund flow to NBFCs improves. The asset quality is expected to face headwinds with business growth slowing down and with some key asset classes (vehicle and SME segments) likely to witness higher credit quality-related pressure. Reduction in the corporate tax rate, however, would bolster the RoMA of Retail-NBFCs (excluding MFIs) by 25-35bps. The RoMA for FY2020 is estimated to be 2.2-2.4%, notwithstanding the contraction witnessed in Q1 FY2020.

ABOUT ICRA

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