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Retail-NBFC Credit Trends

Business recovery to gain further traction in FY2023; sector outlook revised to Stable from Negative

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RETAIL-NBFC OUTLOOK – STABLE

AUM growth estimated at 5-7% for FY2022; expected to improve to 8-10% in FY2023

Earnings to remain moderate in FY2022 with revival expected in FY2023

Liquidity and capital remain adequate

Retail non-banking financial companies (Retail-NBFCs; excluding Housing finance companies) are expected to witness an improvement in the growth in the assets under management (AUM) in FY2023 to 8-10% vis-à-vis the growth of 5-7% estimated for FY2022. Growth was hampered in FY2022 by the decline in the AUM in Q1 while it improved in Q2 and Q3, resulting in overall growth of 4% in 9M FY2022. The asset quality is expected to improve from the December 2021 levels. ICRA expects the gross stage 3 (GS3) to moderate by up to 80 basis points (bps) over Q4 FY2022 and FY2023 from the current level. The overdues by the end of March 2023 are expected to be marginally above the pre-Covid-19 pandemic level. However, the performance of the restructured book remains a monitorable. The standard restructured book, as of December 2021, moderated by about 50 bps from the peak level in September 2021.

The earnings performance of the segment has improved since Q1 FY2022 and the sector reported strong profitability indicators in Q2 and Q3 FY2022 as the credit costs moderated. Credit cost was the key reason for the subdued earnings performance in FY2021. The return on managed assets (RoMA) is expected to be 2.2-2.4% in FY2022 and reach the pre-Covid level of 2.7-2.9% in FY2023. Entities continue to maintain adequate liquidity while capitalisation is expected to remain commensurate in relation to the growth expectations for FY2023. The outlook on the sector has been revised to Stable from Negative in view of the expected improvement in earnings, asset quality and AUM growth.

- **AUM growth stood at 4% in 9M FY2022:** Retail-NBFC AUM growth revived as disbursements picked up in Q2 and Q3 FY2022. However, the overall growth in 9M FY2022 was muted at ~4%, given the contraction in Q1. Muted disbursements and the rundown in the existing portfolio due to repayments led to the relatively sharper year-on-year (YoY) fall in the AUM in Q1 FY2022 with the second wave of the pandemic disrupting businesses. As disbursements picked up in Q2 and Q3, supported to an extent by pent-up demand, the AUM grew by 2.8% and 3.6%(sequentially QoQ), respectively, during the above-mentioned quarters. ICRA estimates the AUM growth for the sector at 5-7% for FY2022 with the same expected to improve to 8-10% in FY2023 on the back of two years of low growth, assuming there are no further disruptions that would impact businesses.

- **Asset quality indicators expected to improve in FY2023:** The GS3 moderated in Q2 FY2022 from the peak in Q1 FY2022; it had increased significantly by about 150 bps in Q1 FY2022, the sharpest in the recent past. As of September 2021, the GS3 was still about 100 bps over the March 2021 level and remained at a similar level in December 2021 as some asset segments had witnessed an increase in overdues. Moreover, some entities had aligned their GS3 reporting with the tightened non-performing advances (NPA) reporting, which was indicated by the Reserve Bank of India (RBI) via its clarification in November 2021. As the impact of the surge in infections witnessed in Q3/Q4 was modest on businesses, the asset quality is expected to improve vis-à-vis the December 2021 levels. ICRA expects the GS3 to reduce by up to 80 bps in FY2023 from the current level. Overdues are expected to be marginally above the pre-Covid level by the end of March 2023.

The performance of the restructured book, however, remains a monitorable; the standard restructured book, as of December 2021, moderated by about 50 bps from the peak level in September 2021. The provision levels remain high, notwithstanding the moderation from the June 2021 level, and stood at 1.6x of the pre-Covid level for NBFCs.

- **Earnings remain strong; expected to reach pre-Covid level in FY2023:** The earnings performance of Retail-NBFC remained strong in Q3 FY2022, supported by the moderation in the credit cost, which remained stable (1.6%; quarterly annualised) and substantially lower than the level witnessed since the start of the pandemic in Q4 FY2020. Interest margins remained range-bound during the pandemic on the back of the fall in the cost of funds (CoF) and stable business yields, even when the NBFCs carried high on-balance sheet liquidity and faced low credit growth. Going forward, considering the high provision buffers and the expected moderation in overdues, credit costs, which were the key reason for the earnings pressure during the pandemic, are expected to trend downwards. This would support the earnings performance. Inflationary risks would push up the CoF (weighted average CoF to increase by about 50 bps in FY2023) and entities would face higher operating costs vis-à-vis the pandemic period on account of improvement in business volume, higher collection efforts and other expenses towards the tightening of systems and information technology (IT) to meet various regulatory and business requirements. Nevertheless, the expected moderation in the credit cost is expected to offset the same and support earnings (net profitability – RoMA), which would be close to the pre-Covid level of 2.7-2.9% in FY2023. The performance is expected to remain moderate in FY2022 on account of the weak Q1 performance.

- **Adequate capital and liquidity profile:** The capital profile of Retail-NBFCs has improved consistently over the last 2+ years as growth slowed (around 5% in FY2021 and ~4% growth in 9M FY2022) but the return on capital was higher (10-11%). Further, some entities raised capital over the last two years in view of the uncertainties on account of the pandemic. The capital profile of this segment is currently adequate, considering the growth outlook, and ICRA does not expect significant capital requirement for the segment over the near term. Entities continue to maintain a liquidity buffer (on-balance sheet (on-B/s) + sanctioned credit lines) adequately covering the repayments for the next three months. As the operating environment stabilises, the entities may choose to reduce their on-B/s liquidity.

- **In view of the trend witnessed in the earnings and growth and the further expected improvement in the earnings, asset quality and growth in the FY2023 the credit outlook on the Retail-NBFC sector has been revised to Stable from Negative.**

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