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# NBFCs and HFCs

## Managing funding in the tightened credit environment is key for near-term growth

JULY 2022

# SUMMARY

Non-convertible debenture (NCD) issuances by non-banking financial companies (NBFCs) and housing finance companies (HFCs) in Q1 FY2023 hit a multi-quarter low with the same being ~28% lower than Q1 FY2022 and 65% lower than Q1 FY2021. The issuances were lower by ~22-28% compared to Q1 FY2020 and Q1 FY2019 as well. The hike in the repo rates by the Reserve Bank of India (RBI) in May and June 2022, along with the elevated inflation prints, have affected investor appetite. While the overall issuances were affected by the sharp fall in the participation of public sector undertakings (PSUs) operating in this space, private entity issuances were also down in Q1 FY2023 on a YoY basis.

Commercial paper (CP) volumes, adjusted for initial public offering (IPO)-related issuances, remained range-bound for the sector (NBFCs + HFCs) over the last two fiscals. However, overall CP issuances saw some uptick in the last few months, driven by HFC issuances. The share of HFCs in the overall adjusted issuances increased sharply to 35-40% in the last two quarters (Q4 FY2022 and Q1 FY2023) compared to the average of ~20% in the prior quarters, driven mainly by one large issuer. Incrementally, in view of the increasing interest rate scenario and competitive pressures, entities may look to increase the share of short-term (ST) funding to support margins.

Bank credit to NBFCs/HFCs has moved up steadily over the last 5-6 months as the growth in the assets under management (AUM) resumed, post the setback in Q1 FY2022. Further, bank interest rates were favourable vis-à-vis capital market funding for PSUs and other large and high-rated entities, which led to them shifting from capital markets to banks. Mid-sized entities, targeting certain segments (agriculture, micro and small enterprises, etc), also benefited from the priority sector lending (PSL) tag for their bank loans and had access to funds at competitive rates from banks. Scope for further funding from banks would depend on the growth in overall banking credit as bank lending to the sector is high and stood at ~8-9%.

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Sell-downs {securitisation or direct assignment (DA)} may emerge as the key funding source for the sector as asset quality related concerns have reduced and, the revival in growth observed in the recent past would support sell-downs. The sell-down market has also expanded over the past few years with the improvement in the share of non-priority sector assets in the overall volumes and diversification in the investor base. Retail funding via deposits may also witness a revival with the increase in the interest rate for other funding sources and as entities try to leverage their franchise.

Yields for NCDs and CPs have reached the pre-Covid levels, though the spread over the risk-free rate remained quite low vis-à-vis the past. The same was driven by the favourable supply-demand environment on the back of limited PSU participation and access to bank funding at favourable rates. While these factors may change going forward, the expected merger of HDFC Limited into HDFC Bank would still result in a benign spreads scenario for the sector.

We have factored in a 100-basis points (bps) increase in the weighted average cost for the sector in the current fiscal. While this would impact margins, a favourable credit/provision cost position vis-à-vis the last fiscal would support the profitability of the players.

The AUM growth in FY2022 was somewhat better than our expectations, largely drive by the steep growth witnessed in Q4. NBFC+HFC (excluding infra) credit is estimated to have grown 9.5% in FY2022. While HFC grew ~10%, the NBFC-retail segment grew by 8.5% and the NBFC-wholesale segment grew by 12% in FY2022. The sharp growth in the NBFC-wholesale segment was attributable to the low base and the uptick in credit by large and parent-backed NBFCs, which increased their supply chain, capital market and other corporate exposures. We continue to maintain our growth estimate for FY2023 for NBFC+HFC (excluding infra) at 9-11%.

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# Thank You!