FINANCIAL Chronicle
Copyright©2022 Financial Chronicle
Fri, 24 Mar-17; Financial Chronicle - Delhi; Size : 2647 sq.cm.; Circulation:-; Page : 6

NBFCs

BALANCING STRONG GROWTH WITH RISING RISKS

Non-banking financial companies (NBFCs) are increasingly meeting the economy's huge latent retail credit needs not covered by traditional banks. This is against the backdrop of solvency challenges which have limited the risk appetite of the public-sector banks, says a report by **Moody's Investors Service**. Digital trends offer opportunities for innovation and partnerships. The deepening of the wholesale market provides easier access to funds.

However, delinquencies among NBFCs will likely rise over the next one-to-two quarters, as demonetisation adversely affects collections across asset classes, says the report.

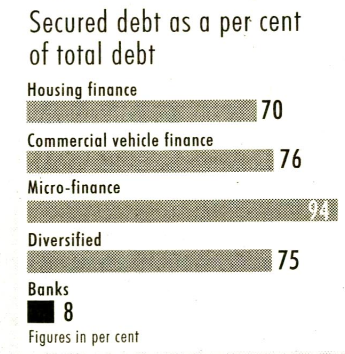
MICRO-FINANCE: RAPID GROWTH CAN EXPOSE PLAYERS TO DOWNSIDE RISKS

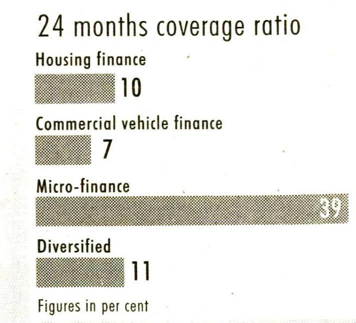
Credit demand in the micro-finance segment will likely stay buoyant. Nevertheless, rapid growth could expose the players to downside risks.

In this context, managing operational risk – employee training, retention, IT systems, and managing collection processes – will remain critical to differentiating the performance of the companies. Some companies are converting to small-finance banks to gain better access to funding.

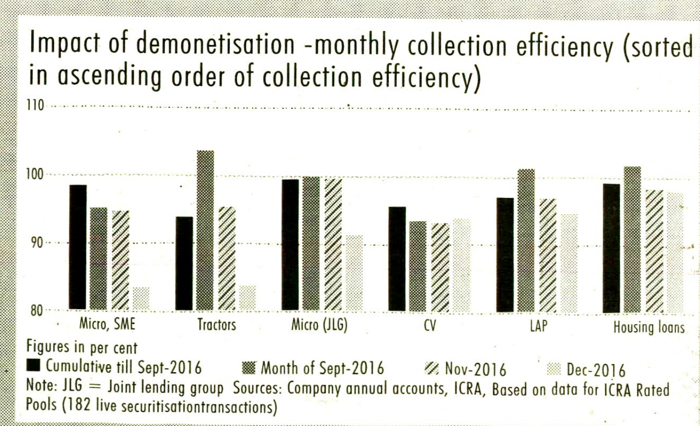
Funding and liquidity pose key downside risk

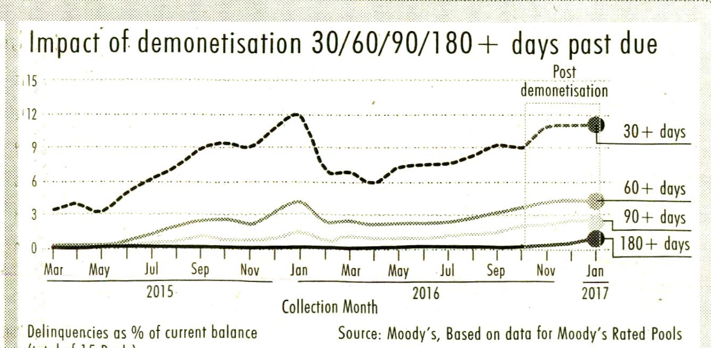
- NBFCs rely on confidence-sensitive funding, a structural weakness that is generally shared by their global peers and financial companies.
- In addition, in the Indian context, the greater dependence on secured debt creates structural subordination for unsecured lenders, particularly in the international market where most of the bonds are unsecured in nature.
- Their funding profile is expected to remain broadly stable, and their funding costs to moderate gradually given the reduction in policy rates.

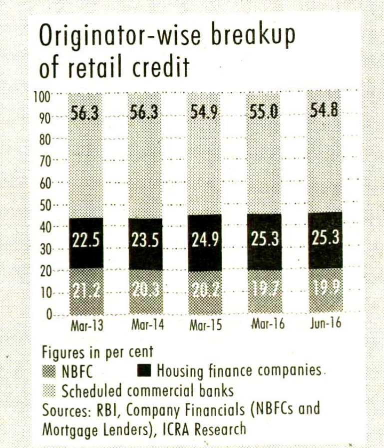




Graphs: Pinki Paul







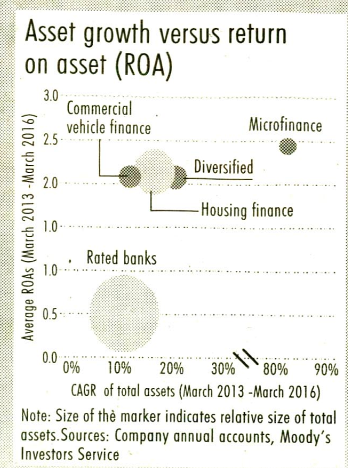
Impact of demonetisation varies

- Delinquencies are expected to rise in the near-term as demonetisation impacted collections across asset classes.
- Loans that have sizeable cash collections, such as microfinance, two-wheeler loans and tractor loans, saw a significant decline in collection efficiency in the months of November and December.

n On the other hand, segments that are more tied to the formal and urban economy, such as loan against property (LAP) and housing loans, witnessed limited disruption due to demonetisation.

NBFCs have gained market share in the origin of retail credit

- Competition from the bigger banks has intensified in recent years as banks are increasingly targeting retail lending to offset weakness in their corporate loans. Nevertheless, niche target segmentation will preserve growth opportunities for the NBFCs.
- Funding constraints and ability to scale the business beyond the niche segments will differentiate the credit profiles of the companies.



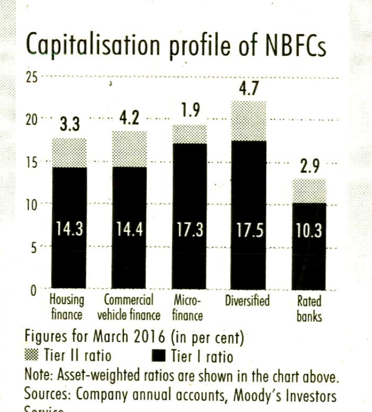
Note: Size of the marker indicates relative size of total assets. Sources: Company annual accounts, Moody's Investors Service

Capitalisation profile will broadly remain stable

- Overall, the capitalisation levels of NBFCs have remained at adequate levels, with average tier 1 ratios in excess of 14 per cent.
- Nevertheless, capital generation will lag credit growth. Accretion to external capital will, therefore, be key to sustaining their growth momentum.

Wide variance in profitability profiles, despite similar business models

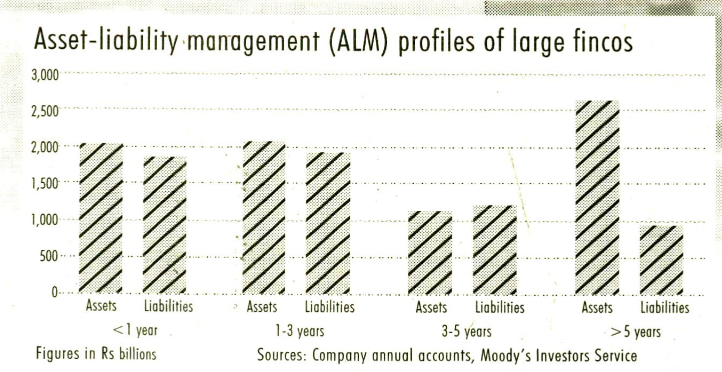
- NBFCs as a whole outperform banks in terms of growth and profitability, but there is wide variance across different NBFCs.
- In particular, performance of housing finance companies (HFCs) can vary widely, according to the nature of the portfolio and their ability to manage costs.

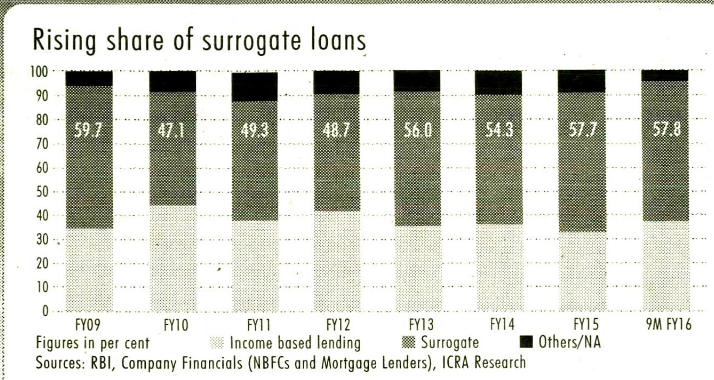


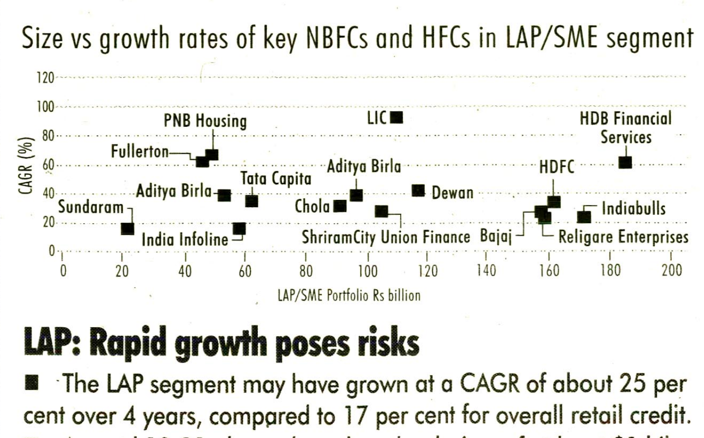
Note: Asset-weighted ratios are shown in the chart above. Sources: Company annual accounts, Moody's Investors Service

NBFCs have good access to the capital markets

- Despite their weak funding profiles, Indian maintain well-matched asset liability management profiles, which protect against downside risks in the case of adverse interest rate movements.
- Nevertheless, NBFCs remain exposed to volatility in refinancing at times of adverse market conditions.





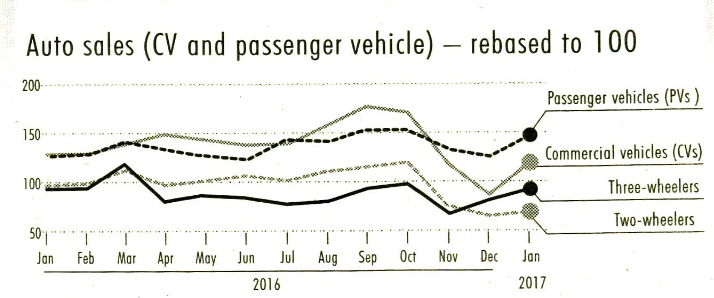


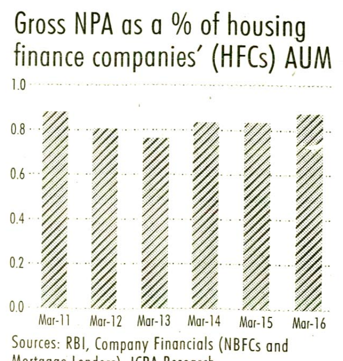
LAP: Rapid growth poses risks

- The LAP segment may have grown at a CAGR of about 25 per cent over 4 years, compared to 17 per cent for overall retail credit.
- Around 10-11 players have loan book sizes of at least \$1 billion versus 2-3 players four years ago.
- Favourable market conditions could have led to an under-appreciation of the risks involved

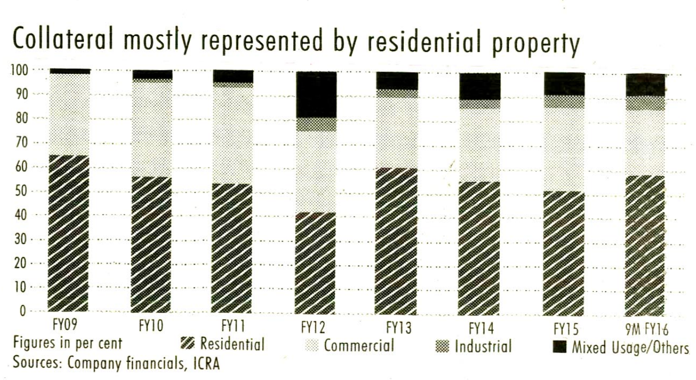
Commercial vehicle: Growth outlook subject to macro factors

- Pre-buying ahead of Bharat Stage-IV will help improve the growth prospects for commercial vehicle (CV) loans.
- Private investment remains muted; weak investment activity and uncertainty as to the implementation of the GST represent the key downside risks.
- Asset quality has begun to stabilise, after incorporating the impact of demonetisation.





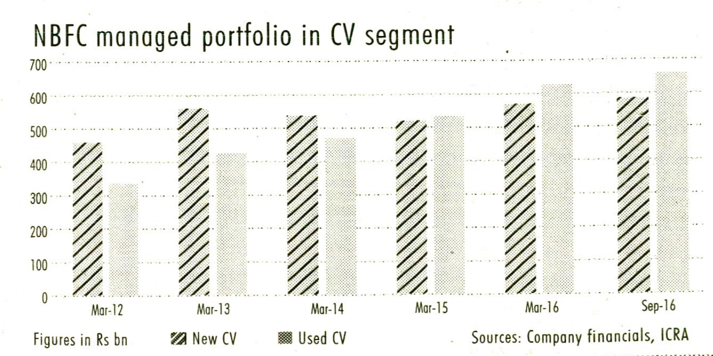
Sources: RBI, Company Financials (NBFCs and Mortgage Lenders), ICRA Research



Sources: Company financials, ICRA

Housing finance: Favourable demographics to support asset quality of mortgage loans

- Favourable demographics and economics, tax incentives for home loans and an increasingly affordable housing segment should support asset quality.
- The loss is expected, given default for both home loans and LAP loans will be limited given the underlying collateral.



Sources: Company financials, ICRA

Source: Moody's Investors Service