I C R A Limited
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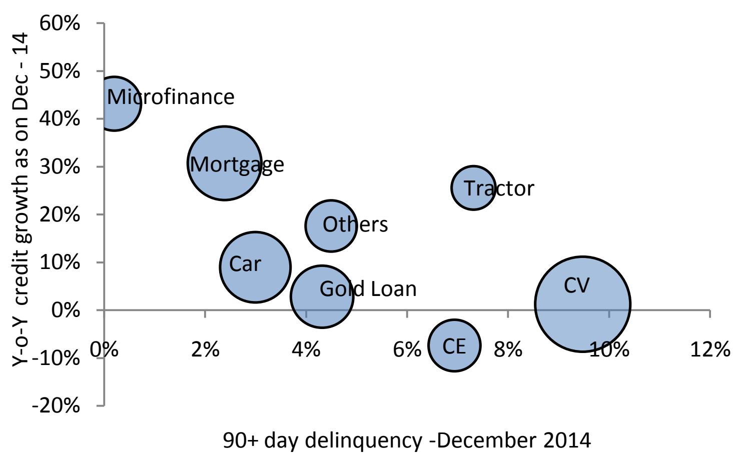
Growth and asset quality pressures persist although some signs of easing: ICRA

ICRA has published its quarterly review on Retail Non Banking Finance Companies for the period ended December 31, 2014. Key take away from the report are as follows:

- *Retail credit of NBFCs stood at Rs. 4.0 trillion and registered a y-o-y growth of 11.1% as December 31, 2014 against a y-o-y growth of 9.1% as on March 31, 2014. Higher growth follows a revival in the gold loan segment, which grew on a y-o-y basis by2.8% as on December 31, 2014 against a sharp y-o-y de-growth of16% as onMarch 31, 2014. Credit to the Mortgage and microfinance segmentsalso witness a pickup in growth, registering a y-o-y growth of 31% and 43% in December 2014 respectively.*

Figure 1: Size, growth and asset quality of NBFC retail segments



Source: ICRA Research estimates; Company information

- *Expected improvement in operating environment, particularly in the CV segment expected to support credit off-take. ICRA expects retail NBFC credit growth to improve to14-17% in FY16 from 11-13% in FY14 and 9% in FY13*

- *Competitive pressures have increasedwithbanks reporting higher level of y-o-y retail credit growth (excl. home loans) of 14.1% compared the11.1% growth reported by NBFCs as on December 31, 2014. Banks to maintain focus on retail segments given challenges in the corporate segment. ICRA however expects NBFCs' niche positioning, differentiated product offering, good market knowledge and good outreach to continue to enable them to tap opportunities.*

- *Asset quality pressure persists although appear to have peaked. While 90+ dpd are estimated to have increased to ~5.3% in December 2014 against ~4.7% in March 2014,ICRA notes early signs of improvement in the operating environment. CV fleet operator's cash flows have improved given favorable fuel prices and firm freight rates, which along with a pickup in economic activity could ease pressures. ICRA expects delinquency reversal to come with a lag towards the latter end of FY 16.*

- *NBFCs increase mobilization through debt capital markets given softening of interest rates and the reluctance of banks to bring down base rates. NBFC cost of borrowings softened in 9MFY15 by ~20-30 bp to ~10.5% against 10.8% in FY14 given favourable systemic rates and shift in borrowing mix. ICRA expects the proportion of funding through debt market instruments to increase further until banks lower base rates. In FY16 ICRA estimates NBFC fund requirement to be Rs. 2.2 trillion*

- *In 9MFY15 NBFCs reported a compression in return on net worth to 10.8% against 12.6% in FY14 on account of a rise in credit costs and reduction operating efficiencies given muted growth and expenses associated with recovery efforts. In FY16 while softening of borrowings costs and easing operating environment could ease pressures, ICRA expects profitability to be impacted by RBI regulations requiring NBFCs to migrate to a minimum NPA recognition norm of 150+ days from 180+ days, which would increase gross NPA and credit provisions. ICRA estimates the one-time hit on earnings owing to this transition to be 20-30 bps, which could lower ROEs to below 10% in FY 16.*

- *Net worth in relation to managed assets of NBFCs at~16.1% in December 2014. ICRA expects overall capitalization level for retail focused NBFCs to remain adequate at around 15-15.5%.*

Outlook

The economic environment, following a challenging period over the past couple of years has started to show signs of revival. Retail focused NBFCs, which have faced a challenging period of subdued growth and rising delinquencies could see some abatement of pressures. Factors such as a pickup in CV sale volumes, expected improvement in investment and industrial production provide an enabling credit off-take environment. While asset quality pressures of retail-focused NBFCs have persisted through 9M-FY15 delinquency buildup appears to have reached its peak. Improving cash flows and viability of transport operators, possible revival of the construction industry and strengthening of NBFC legal recourse with permission to provisions of the SARFEASI Act are favorable; a reversal of delinquencies however expected to come with a lag. At the same time profitability of retail focused NBFCs are expected to remain under pressure in FY-16, as ROEs could drop to under 10% (from 10.8% in 9M-FY15 and 12.6% in FY14) on account of the one-time impact as NBFCs adopt a tighter minimum NPA recognition policy. Over the medium term however expected revival in growth, a supportive operating environment and a stable/ soft interest rate regime are factors which could support NBFCs ability to improve profitability and shareholder returns

(Please visit our website www.icra.infor the detailed report)

Annexure:

Quarterly Financials of Retail focussed NBFCs up to December 31, 2014

	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14
Net Income from Operations/ Average Managed Assets	6.4%	6.2%	6.4%	6.2%	6.21%	6.2%	6.4%	6.6%	6.7%
Operating Expense / Average Managed Assets	2.6%	2.7%	2.7%	2.7%	2.8%	2.8%	2.9%	3.0%	3.1%
Operating Profit / Average Managed Assets	4.1%	3.8%	4.0%	4.0%	3.8%	3.8%	3.9%	3.9%	4.0%
Credit Provisions/ Average Managed Assets	0.9%	1.1%	1.1%	1.1%	1.2%	1.2%	1.5%	1.4%	1.6%
Profit After Tax/ Average Managed Assets	2.17%	2.0%	2.0%	1.9%	1.8%	1.9%	1.8%	1.7%	1.6%
Profit After Tax / Average Net worth	14.8%	13.5%	13.7%	12.9%	11.6%	12.1%	11.2%	10.7%	10.4%
Gross NPA%	2.2%	2.4%	2.7%	3.0%	3.6%	3.87%	4.5%	4.8%	5.0%
Net NPA%	1.1%	1.3%	1.5%	1.7%	2.1%	2.25%	2.6%	2.7%	2.7%
Net NPA/ Net worth	5.5%	6.1%	7.2%	8.1%	9.9%	10.5%	11.8%	12.5%	12.3%

Source: Quarterly financial results published by NBFCs and ICRA estimates