Press Release

Covid-19 intensifies headwinds for NBFCs

Liquidity and ability to service debt are short term challenges;
Asset quality and profitability at serious risk in the longer run

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While the liquidity position of the NBFCs with a good track record and a solid business franchise were starting to return to comfortable levels in H2FY20, Covid-19 has triggered a fresh set of challenges. Acuité Ratings has undertaken a comprehensive analysis of 11 large retail NBFCs to understand the impact of Covid-19 on the immediate liquidity as well as on asset quality and profitability outlook for the sector in FY21. These 11 entities account for 43% of the advances of the retail NBFC sector.

Since RBI has provided a 3 month moratorium framework (March – May, 2020) for banks and NBFCs, almost all NBFCs are expected to provide and also avail such a moratorium, which is likely to provide only a temporary reprieve. We believe that the impact of Covid-19 on the overall NBFC sector will not only be limited to a tough liquidity position and weaker ability to manage debt servicing in the short term but there will also be a longer term impact of the shutdown on their asset quality, business and profitability levels.

In our opinion, the immediate implication for the retail NBFCs is the lack of clarity on their debt servicing ability in the near term i.e. Q1FY21. With collections coming to a standstill, the primary cash flows of the NBFCs have been completely disrupted. While we can presume that most banks will provide back to back loan moratorium, there is no indication that it will be applicable for debt market instruments. Acuité's analysis of the top 11 retail NBFCs in India highlights that almost 60% of their borrowings (excluding securitisation) are from non-bank sources and require continuity in debt servicing. With minimal collections, the NBFCs can only depend on their cash reserves and any backup credit lines from banks, if available for servicing such debt. **Says Suman Chowdhury, Chief Analytical Officer, Acuité Ratings & Research *"The aggregated debt repayment including interest for the top 11 retail NBFCs in the current quarter i.e. Q1FY21 is estimated to be between Rs. 40,000 Cr - Rs. 60,000 Cr while the cash reserves are estimated to be around Rs. 45,000 Cr. It is apparent that many of these NBFCs would find it difficult to manage their cash flows including their operating expenses during the next 3 months unless they get access to additional bank lines or refinance. We estimate the refinancing requirement for these NBFCs at around Rs. 10,000-20,000 Cr to avoid any challenges in their debt servicing and to sustain their operations."***

Beyond the immediate liquidity challenges, the key risk for these NBFCs is a sharp deterioration in the delinquency levels subsequent to the expiry of the 3 month moratorium. Acuité has worked out a profitability (RoAA) vulnerability matrix for the retail NBFC sector depending on the leverage levels and the expected delinquency (or Stage 3) levels. **Says Vinayak Nayak, Head – Financial Sector Ratings, Acuité Ratings *"Our vulnerability analysis indicates that NBFCs with leverage of 3x or more have a significant likelihood of incurring losses in FY21 if the stage 3 delinquencies or NPAs increase over 8%; in particular, those NBFCs with capital adequacy levels of 20% and lower are likely to be more impacted as the buffer to absorb any losses will be lower vis-à-vis regulatory threshold. Even if the deterioration in asset quality is not that sharp and it increases only up to the band 5%-8%, the impact on the profitability will be very significant given the low business volumes particularly in the first half of FY21 and the high operating costs of the larger players."*** Further, the utilisation of the cash collateral (CC) is a significant possibility in securitised pools over the next 6 months and can have an additional impact on the NBFCs' profitability. Acuité's analysis expects the disruption from complete or partial lockdown to subside completely by Q2 FY2021, which if prolonged, can have a more severe impact and raise concerns on the sustainability of a few players.

About Acuité Ratings & Research Limited:

Acuité Ratings & Research Limited *(Erstwhile SMERA Ratings Limited)* is a full-service Credit Rating Agency registered with the Securities and Exchange Board of India (SEBI). The company received RBI Accreditation as an External Credit Assessment Institution (ECAI), for Bank Loan Ratings under BASEL-II norms in the year 2012. Since then, it has assigned more than 8,000 credit ratings to various securities, debt instruments and bank facilities of entities spread across the country and across a wide cross section of industries. It has its Registered and Head Office in BKC, Mumbai.

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