Life after IL&FS: Is it game over for NBFCs?

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Post a Comment

The chief executives of top non-banking finance companies have never had it so bad telling the world, they are well-managed and solvent. A good part of their day is spent calming the nerves of corporate treasury heads and debt fund managers, assuring them that their money would be repaid on time.

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When core sector lender IL&FS first defaulted on payments to SIDBI in August-end, the NBFC/HFC (housing finance companies) industry – with an asset book of Rs 28.4 lakh crore (CARE Ratings data) – did not expect themselves to be at the wrong end of the cannon. Somewhere down the road, NBFCs and HFCs started getting compared with IL&FS, and their financials were put under deep scanners. A few debt fund managers started jettisoning NBFC papers in panic. And rumours started flying thick and fast – of this HFC going belly-up or that NBFC facing default prospects.

“It’s not right to compare IL&FS with NBFCs… IL&FS was more into project funding and core-sector financing. NBFCs, on the other hand, have significant retail operations. They keep well-diversified books,” says Umesh Revankar, MD-CEO of Shriram Transport Finance Company.

"Every 5 years, NBFCs phase through some sort of growth pangs... This happens when NBFCs take an aggressive growth path. NBFCs slow down during times of stress; and when a sense of normalcy return, they start doing brisk business. The current stress is just a minor blip; there are huge opportunities (for NBFCs) for at least 15 - 20 more years," Revankar adds.

While one cannot deny the role of gossip vines that trussed NBFCs, there appear fault lines that could be detrimental to the whole industry. Asset liability mismatches (ALM) and unbridled borrowing and lending to fuel super-growth and funnel out super-normal profits have not gone well with investors. Perhaps that explains the 40 – 50% correction in NBFC shares over the past few weeks. Unfortunately for non-banks, these anomalies are getting disinterred at a time when system liquidity is low and interest rates are moving up.

THE WINTER IS COMING

After nearly three years of rip-roaring business, NBFCs are bracing up for harsh winters ahead. Almost all have decided to conserve capital, arrest growth, slacken-off fresh disbursals and take eyes off the "non-cores."

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Many NBFCs may not have fresh money to lend now. Therefore, banks stepping into buy portfolios would help infuse liquidity within the NBFC eco-system. Troubled NBFCs may use this route to set their ALM mismatches right. The stronger ones could use this route to disburse fresh loans.

A few NBFCs managed to raise money in the nick of time. Take, for instance, Tata Capital Financial Services, which raised Rs 3373 crore via an NCD issuance - at varying coupon rates between 8.7 and 9.1.

"We had a good mix of investors, but a large chunk of them were individual applicants," says Kusal Roy, MD of the firm.

"We're well-capitalised" he adds.

But others may not be as fortunate. The best may now be able to raise fresh funds at 9.5 to 10.25%. That's almost 250 basis points higher than what NBFCs paid a year ago. A higher cost of funding would hit the profit margins of NBFCs – if they decide not to pass on the 'rate burden' to borrowers.

Larger NBFCs may overcome the current stress pretty much unscathed. Some may give up business to create adequate "liquidity buffers." They may adopt a more focused approach – in terms of the products they offer and the geography they serve. To raise capital, many NBFCs would try selling portions of their loan book (assets) to banks that are willing to buy.

"We're happy to look at it, provided it makes business sense... It has to be of good quality and at right price," says an HDFC spokesperson.

Well-managed NBFCs, with triple-A credit rating and adequate capital reserves, may find takers for their issuances too. Interestingly, there are hardly 20 NBFCs with triple-A credit rating.

Lower-rated mid- and small-sized NBFCs may find it difficult to raise fresh funds in the coming months. According to Mitul Budhbhatti, associate director, Care Ratings, most rated NBFCs comply with RBI-mandated 15% capital adequacy ratios. A few non-banks – with seasoned loan books – even keep upwards of 20% CAR.

"Such players are relatively well-placed," says Budhbhatti.

"But considering the current market dynamics, raising fresh funds will be a problem for many non-banks. If rollovers (of short-term instruments such as CPs) are not happening, these NBFCs will have to rely on banks or equity markets," Budhbhatti adds.

Relying on equity markets to raise funds may not be a great idea as NBFC valuations have almost halved on the bourses. D-Street bound NBFCs may have to dilute more to raise the necessary funds. Even then, many may not see significant investor appetite for their offering.

Atop all these concerns, several NBFCs are also grappling with 'asset-liability mismatches' on their books.

TIME LAPSES

Analysts at Nomura, a global investment bank, are especially worried about the funding mix of some NBFCs, which pose serious refinancing risk in the short- to medium-term. NBFCs such as CanFin Homes, PNB Housing and JM Financial have 15 to 30% of their liabilities through CP funding. CPs or commercial papers are short-term borrowing instruments with maturity periods ranging between 7 days and 1 year.

CPs played a critical role in the 18 – 20% year-on-year growth of NBFCs over the past three years. NBFCs started issuing cheaper and shorter-tenured commercial papers (CPs) and non-convertible debentures (NCDs) to meet their long-term funding needs. So they borrowed for one – three years and used the proceeds to disburse 15-year housing loans. This created grave asset liability mismatches (ALM) in the books of some NBFCs.

The likes of CanFin, HDFC, Repco and L&T Finance, among others, have seen an increase in the usage of CPs to meet their funding requirements. JM Financial, in fact, has reduced its reliance on CPs from 69% (of liabilities) in 2014 to 30%, as on last fiscal.

An NBFC has very limited options to raise funds: they most borrow bulk funds from banks and MFs. Banks fund upto 60% of NBFC fund requirements while debt mutual funds do about 35%. Over the last one year, banks have lowered their NBFC lending caps - mainly on account banks' own NPA troubles. This made MFs the lone financier of NBFCs.

The exposure of MFs to NBFC/HFC issuances has increased from Rs 1.46 lakh crore in August 2015 to Rs 2.56 lakh crore three years later. They face refinancing risk, on account of CPs and NCDs maturing before the end of current fiscal. NBFCs and HFCs have close to Rs 78,380 crore worth of papers (with MFs) coming up for redemption between now (October) and fiscal-end, as per data from Value Research, an MF tracker.

"The presence of short-term funding instruments has gone up significantly over last few quarters. This is bound to create mismatch in assets and liabilities," says Siddharth Purohit, a research analyst at SMC Institutional Equities.

But industry veterans like Banga of IndiaBulls and Rashesh Shah, CMD of Edelweiss Financial are not really worried about high incidence of CPs/NCDs in the funding mix. They are basing their premise on the fact that repayments (by borrowers of NBFCs) happen in tandem, ensuring steady cash inflows into NBFCs.

"Over 20% of a housing loan comes back into NBFCs in the first year; 33% of money lent to SMEs comes back in 12 months. Almost 100% of gold loans, consumer loans and MFI advances return in one year and 25% of auto loans come back within a year. So there is a lot of money coming into NBFCs for repaying to banks and MFs," says Edelweiss' Shah.

"Asset liability mismatch in NBFCs is not as grave as people are making it out to be… This industry survived with no funding for 20 days… There have been no known cases of defaults till date. This is just a stress test for NBFCs," he adds.

MUTUAL FUND DILEMMA

Mutual funds, the money-rollers of NBFCs, are fighting their own demons. In September, the MF industry logged liquid fund outflows worth Rs 2.11 lakh crore. The reason: IL&FS crisis and tight liquidity in the banking system.

But MF managers are confident about money coming back to their liquid fund portfolios soon. They are also open to rolling over matured CPs or subscribing to new offerings. MF veterans such as A Balasubramanian of Birla Sun Life Mutual Fund and Lakshmi Iyer of Kotak Mutual are putting up a brave front; they've brushed aside reports of a crisis within the NBFC space.

Non-banks may reduce fresh loan disbursals over the next few quarters. They may use incoming funds (NBFC borrower repayments) to pay off banks and MFs. This may erode (NBFC sector) growth by 5 – 7%, analysts opine.

NBFCs have touched lives in more ways than a bank. Pop into a neighbourhood electronic store, and you would know how. Regardless of the little sum of money in your wallet, you simply have to select your gizmo and let a non-bank pick up the tab. Your credit score could be any number between 600 and 900 - there's always an NBFC willing to fund you. Perhaps that was a wrong thing to do.

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