Dewan Housing, IL&FS crises expose NBFCs financial troubles; retail lenders still better placed

By: Eram Tafsir | Published: February 6, 2019 4:45 PM

India Ratings and Research said this week that the retail NBFCs are better placed than wholesale NBFCs. India Ratings has accorded a stable outlook on the retail NBFCs sector, but a negative outlook for wholesale NBFCs -- especially lenders to real estate players.

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The recent financial crises Dewan Housing Finance Corp Ltd (DHFL) and Infrastructure Leasing & Financial Services (IL&FS) have brought to the fore problems faced by non-banking financial companies (NBFCs).

The NBFCs sector has grown considerably in the last few years with an average growth of 22 per cent every year from 2006-2013. In India, NBFCs are regulated by different regulators such as RBI, IRDA, SEBI, National Housing Bank and Department of Company Affairs. The cooperation between these regulators is on an ad hoc basis and often post-event.

Considering this, BN Srikrishna committee recommended in 2013 that SEBI, IRDA, Pension Fund Regulatory and Development Authority and Forward

Markets Commission (since merged with SEBI) should be merged under one regulator to be called the Unified Financial Authority. In the wake of the recent events, such talks are once more gaining steam.

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NBFCs are expected to witness marginal pressures in FY20, India Ratings said in the report. The liquidity crisis has emerged because over the years, NBFCs have increased their reliance on short-term borrowings. This was done mainly to shore up profitability, which had been low due to the higher credit cost and failing yields. The situation may prompt NBFCs to overhaul their balance sheets, at least partially, by replacing short-term borrowings with long-terms funds.

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Further, the report highlights that retail NBFCs are better placed than wholesale NBFCs in terms of passing on the rising borrowing cost. Wholesale NBFCs, especially those financing real estate developers, could face heightened credit cost pressures due to a prolonged slowdown in the real estate sector and lower refinancing in the wake of weak system-wide liquidity.

The tepid growth of NBFCs is due to slower traction in sectors such as auto and real estate, noted the report. The performance of collateral backed MSME loans is expected to continue to deteriorate as the outlook for this segment was revised to negative from stable-to-negative as the lenders experience a moderation in real estate prices.

Lenders' over reliance on collateral rather than business cash flows of prospective buyers had been stretched during demonetisation, and formalisation of income post GST implementation is responsible for the current spate of continuing defaults, said the report. With regard to tractor loans, there is no scope of any improvement in delinquencies in the near term, as the borrowers continue to grapple with less-than-normal monsoons and falling prices of agricultural output.

Further, the report pointed out that the asset quality for Commercial Vehicle segment might not deteriorate in FY20 as well because of adequate fleet utilisation for lower tonnage vehicles. CV sales are expected to remain muted amid sufficient system capacity.

For micro finance NBFCs, loan collection and delinquency performance are expected to return to and remain at the pre-demonetisation levels. However, the NBFCs would exercise caution while foraying into new geographies, the report added.