# Press Release

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# NBFCs structurally stronger, credit share seen rising 300 bps

*Demonetisation impact, competition key monitorables*

Non-banking finance companies (NBFCs) are back in the limelight by achieving significant scale and carving out a larger share of systemic credit for themselves.

CRISIL foresees their share of overall loans rising 300 basis points (bps) to 17.6% in the next three fiscals through 2019, even as the spoils contract for banks. That builds on a growth of 300 bps seen in the last five years. NBFCs (including housing finance companies) achieved high growth in the past by leveraging innovation, origination and customer connect, and by diversifying their funding profile. They could grow even faster as public sector banks, facing asset quality challenges, remain circumspect on lending.

**Says Gurpreet Chhatwal, Business Head, Large Corporates, CRISIL Ratings, *"Domestic NBFCs have leveraged their unique strengths and some of them have scaled up to become world-class institutions. NBFCs with assets of over Rs 40,000 crore more than trebled to 10 from 3 in the last four fiscals."***

Innovative product launches have resulted in robust diversification that, in turn, strengthened business profiles. Products that constituted just 16% of NBFC advances in fiscal 2012 will constitute 40% by fiscal 2019. Much of the growth has emanated from mortgages and MSME financing. We expect NBFCs to steadily grow their higher-yielding unsecured MSME financing book. Managing operational complexities and higher credit costs would be the key to scalability here.

As for other segments, housing finance remains an outperformer. However, large NBFCs in this space have ceded market share to medium-sized rivals. Yet, overall sector-wide portfolio growth is seen steady. Going forward, we also see vehicle loans growth picking up and gold loans growing moderately after a lull.

The real estate lending space has seen the entry of several new players. Growth, however, is expected to be lower going ahead given the emerging risks.

We also see risks building in the loan against property category (LAP) with the segment experiencing stronger headwinds than envisaged earlier, with competition from private banks leading to sharper and sooner-than-expected yield compression. And soft property prices could reduce the collateral cushion available in LAP portfolios, thus increasing risks if borrower cash flows are insufficient for loan servicing. As a result, growth in this segment is expected to be lower than estimated.

**Says Krishnan Sitaraman, Senior Director, CRISIL Ratings, *"NBFCs have strengthened their funding profile well over time, which has helped them scale up. They have attracted significant investor interest, too -- in terms of equity funding, and also debt funding through diversified sources."***

In the past five years, they have raised Rs 26,000 crore equity. A material pick-up in securitisation and new avenues such as masala bonds will further strengthen their resource profile. Further, for NBFCs, the borrowing cost differential with banks has narrowed by ~50 bps over the past four years.

But a key challenge for NBFCs will be to manage competition from private banks and simultaneously balance risk and profitability. It's here that proactive investments in technology and operational innovations would help, in terms of enhancing competitiveness.

As for demonetisation, CRISIL foresees the short-term impact to be manageable for the NBFCs it rates because of access to undrawn lines of credit from banks and liquid assets. The Reserve Bank of India's move to temporarily relax NPA recognition norms will also provide some near-term respite. The long-term implications are, however, evolving. If the disruption faced by NBFCs in cash-intensive businesses prolongs beyond two months, asset quality pressures could manifest *(Please refer to CRISIL Ratings' Credit Alert,* 'Non-bank, corporate credit profiles face liquidity test, *published on November 21, 2016)*.

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