BWR Web-Conference Series

NBFC BUSINESS OUTLOOK AND IMPACT OF COVID-19

April 25, 2020

Contact

investordesk@brickworkratings.com

Investor and Media Relations
+9184339 94686
liena.t@brickworkratings.com

Access the recording of web- conference using the link given below

Introduction

The outbreak of corona virus disease (COVID-19) has created dramatic changes in economic activities globally, as well as in India. The Indian Government imposing a nationwide lockdown since 24 March 2020 as a precautionary measure to contain the spread of the disease has created huge disruptions in economic activities, with every sector facing labour crisis and supply chain issues. On the corporate front, the increased liquidity pressure is impacting their credit profiles. Although the impact of the corona virus pandemic on the Indian economy was limited initially, the extension of the lockdown following the sharp escalation in the number of positive corona virus cases created significant uncertainty about the economic outlook and recovery. Hence, there is a need to closely monitor the unfolding domestic situation and impact on various sectors.
NBFCs, which have already seen a challenging last 18 months in terms of the liquidity situation, will see amplified pressure, especially on raising funds from the market. Following are some of our observations:

Banking

- Borrowers' ability to service loans post the moratorium will be an important monitorable, going forward.
- Asset quality is expected to witness a spike, especially in the MSME and retail sector.
- Provisioning on loan moratorium will impact the profitability of banks.

NBFCs

- Liquidity is severely impacted as banks resist giving moratoriums.
- Funding has nearly dried up as securitisation also sees no takers.
- Loan exposure to low-income borrowers will be the most impacted.

Housing Finance Companies

- These are relatively better placed as exposure is largely concentrated towards the salaried class.
- The asset quality of LAP and builder loans will be a major concern.
- Funding challenges remain, and co-lending with banks will see a rise.

Microfinance

- Collections take a hit as most borrowers seek a moratorium.
- Portfolio risk is limited as the impact on rural economy is limited.
- Funding from banks / NBFCs is critical as the liquidity buffer is limited.

Given the prevailing uncertainty, the spate and pace at which critical government measures or stimulus are undertaken assume significant importance to minimise long-term damage to the economy. Stimulus measures announced by the Finance Minister and Reserve Bank of India since the lockdown provide some cushion; however, uncertainty pertaining to how long the lockdown situation may continue prevails, and hence, more suitable measures are required to address the current crisis.
In this context, Brickwork Ratings organised a series of Web conferences with eminent experts to understand the impact of the lockdown on the NBFC sector and the way forward. The idea of having this panel and getting everyone together, with eminent panellists from around the country, was that many participants were interested in knowing how the current situation is panning out and measures being taken by the government and regulators and what more needs to be done and how. Hope you enjoy reading the transcriptions of the experts' views.

Contents

Summary of Key Takeaways

Mr Umesh Revankar
CEO, Shriram Transport Finance

HCV & construction equipment segments impacted the most

Mr Umesh Revankar, *CEO, Shriram Transport Finance*

- A large part of the segment is involved in the "essential services" logistics, and mostly smaller vehicles (LCVs and MHCVs) are relatively unaffected as they form an integral part of the supply chain.
- HCVs and construction equipment segments have been impacted the most due to the lack of activity in the cement, mining, steel and building materials sectors.
- Passenger vehicle pain is not expected to ease until a revival in the travel and tourism sector.
- New vehicle sales will suffer due to price hikes (BS-VI transition). Prices for used vehicles are also expected to see a rise.
- Instead of co-origination, banks would be suggested to provide some funds via term loans or through securitisation to NBFCs after evaluating their financials.
- To boost quicker disposal from banks' lending to NBFCs, measures similar to PCG (partial credit guarantee) measures announced earlier are expected.

Mr V P Nandakumar
MD & CEO, Manappuram Finance

Rural economy performing much better than urban economy

Mr V P Nandakumar, *MD & CEO, Manappuram Finance*

- The rural economy is faring better than the urban economy due to agriculture and allied activities.
- Gold prices have risen and are seeing increased redemptions by customers to either borrow more or sell gold in the market for liquidity needs.
- Gold loan companies are positioned reasonably better to raise funds from banks and external sources.
- Do not expect to see a significant increase in business in FY21 and sharp rise in gold prices.
- The regulator should come forward to provide some credit guarantee to the NBFC; only then will the lender be willing to take the risk.

Mr Gaurav Kumar
Founder & MD, Vivriti Capital

MFIs to emerge stronger from the crisis

Mr Gaurav Kumar, *Founder & MD, Vivriti Capital*

- The MFI sector has undergone considerable stress in the past decade and has emerged even stronger post crises (for example, the AP crisis and demonetisation). Past trends indicate a good repayment behaviour following such events.
- SROs, especially the MFIN, have been very proactive and have helped establish trust with all participants.
- Vivriti Capital is closely working with MFIN on pooled bond issuance
- The de-mon crisis helped pivot the industry towards cashless disbursements, and the COVID crisis will help pivot cashless collections in the long run.
- Some suggestions to the regulator can include setting-up a guarantee programme for MFIs, wherein DFIs such as NABARD and SIDBI can offer guarantees.
- Make a trade-off between MRR and MHP; relax the MHP and look at MRR.

Mr Ashwini Hooda
Deputy MD, Indiabulls Housing Finance

SME & LAP portfolio worst hit for HFCs

Mr Ashwini Hooda, *Deputy MD, Indiabulls Housing Finance*

- The performance of the affordable housing segment is expected to be in line with the overall housing finance sector.
- HFCs are not sweating much due to a large part of lending being to the salaried class (~70%).
- April collections were at 95%, largely because due dates fall on the 5^{th} and are via standing instructions.
- Not many housing loan customers have opted for a moratorium; however, the repayment behaviour in the next 3 months will be a key monitorable.
- The SMEs and LAP portfolio is hit due to a lack of economic activity.
- Expect a large part of LAP, SME and developers to opt for the moratorium. Those who have paid April instalments will opt for refunds under the moratorium to support cash needs.

Partial credit guarantee scheme a way forward

Mr P K Gupta, *Former MD, State Bank of India*

Mr P K Gupta
Former MD, State Bank of India

- The collection efficiency of NBFCs came down from upwards of 95%.
- While collections will improve once the situation normalises, the bigger issue is sourcing funds for these NBFCs.
- NBFCs will have to look for newer business models and the co-origination one of these.
- In this situation, money lent to NBFCs may not result in fresh lending, but will be used to repair the balance sheet.
- A much longer moratorium will be required, and a lot of deep restructuring of loans is expected to take place.
- The partial credit guarantee scheme can be a way to move forward.
- In terms of securitisation, PSBs will look at a plain vanilla model rather than complicated ones.

Last 18 months have been difficult for the NBFCs

Mr Vydianathan Ramaswamy, *Director & Head Financial Sector Ratings, Brickwork Ratings*

Mr Vydianathan Ramaswamy
Director & Head Financial Sector Ratings, Brickwork Ratings

- Last 18 months have been difficult for NBFCs
- Credit ratio is near zero, hardly any upgrades have happened
- Continuously monitoring the situation and necessary actions will be taken at the right time
- Some of the large companies have availed moratorium but not all
- The companies that have not availed the moratorium but are managing clearly shows the strength of their balance sheet

Details of Panel discussion

Mr Umesh Revankar,

CEO, Shriram Transport Finance

- The CV industry in India is highly fragmented, and ownership is largely with small operators.
- The major products that are transported include day-to-day essentials. Most of these essentials move on LCGs or used vehicles because depending on the distance, India has 6 lakh villages, and all these villages are connected by this kind of transportation and it gets value by moving. Hence, these businesses are likely to remain strong.
- Construction-related activity involves moving cement, steel and building material. This part of the business has come to a standstill because construction activities have been stopped, and labourers have moved out; no activity related to construction is underway. It has now been a month, and it may take a while for activity to resume.
- Mining-related activity could witness some delay in starting. If this delay continues beyond July, there could be a longer vacuum. So if it starts by mid-May, some activity will happen by July, which will probably halt temporarily; but that is an annual event. That is one area which may be employing around 10% of the total vehicles that can get stopped for long.
- The remaining vehicles are in supply chains; this includes supplying raw material or taking out finished goods or interstate movement and moving various goods required to add value.
- So if one split it, the smaller vehicles and essential goods movement could constitute around 50-60% of all vehicles, including both new and used vehicles.
- Used vehicles are predominantly being operated for smaller-distance transportation, may be another 10% would be for construction, and the balance of nearly 30% may be for interstate transportation of goods, which may resume by May 15th.
- The least impacted area currently is that of essential goods transportation. Smaller vehicles and used vehicles are reasonably on the run and they are able to make their earnings. The most affected areas are construction equipment or construction-related activities and mining-related activities, which should be around 10-15%.
- The medium commercial vehicle segment, a part of the logistics system, should get reactivated by May 15th and probably will become a proper supply chain system in June. So, normalcy is expected by June for most activities; until then, it could be an 'earn and pay' kind of a situation. As far as goods transportation is concerned, there would be a V-shaped recovery very quickly because it forms a part of necessities.
- The only aspect that would suffer is new vehicle sales. In new vehicles, because of shifting from BS4 to BS6, prices have increased by 15% on

average. So, smaller vehicle prices have risen by 20%+ and the heavy vehicles by 10-12%.

- New vehicle sales will become a much bigger challenge, and new vehicle demand will not revive before December. Used vehicles will thus, play a major role in transportation and have some premium because new vehicles will not get added.
- The manufacturers of new vehicles would have to wait for the longest time to sell their vehicles in the transportation industry.
- As far as passenger vehicles are concerned, the stress will be there for at least 3 months, before the next tourism season starts.
- Tourism and travel activity will all get postponed. Probably by September, passenger activity will resume on a large scale; until then, urban transportation may get a quick revival.
- So local taxis and local transportation may get revived as soon as the lockdown ends, but the rest of the transportation may take a while, and when I say the rest of the transportation, that related to tourism and travel, will take a little longer.

Q. Do you think that the vehicle segment on the whole or two wheelers would pick up?

- There will be an increase in demand for two wheelers in the rural market due to better rural income compared with last year as kharif and rabi crops are good.
- Four-wheeler sales may not go up as prices are high, and disposable income is low.
- Passenger vehicles could do better. In China, passenger cars were allowed to run with a sheet between the passenger and driver sections and not more than two passengers and no private vehicles were allowed; this was done so that the cab drivers could have good income. If the government acts on these lines then even passenger transportation will definitely see a ray of hope.

Q. The CV financing industry is active in securitisation. Are you seeing any changes or expecting things to slow down? Or do you expect it to continue as in the past?

- Securitisation happens in two ways, one includes priority sector targets and some portion by pool, i.e., agri pool or transportation industry.
- Securitisation is of a shorter tenure because of the seasoned pool, so securitisation transactions should not go down.
- Large banks may not find comfort in direct lending, and PSBs are growing due to the merger. As you grow, you find it difficult to do small-ticket-size transactions on a large scale, so I think such transactions will go up.

Q. I want to ask about co lending, but we haven't seen the key financing industry talking much on those lines as other panellists have been saying it may become imperative going forward in the current situation wherein liabilities become a challenge. Do do you think the CV industry will look at co origination as one of the hot models?

- There are challenges in co lending; most banks have gone into a centralised model wherein all credit decisions are taken by a centralised system, so you are building a credit screen that will be uniform across geographies and industries; customised lending is virtually out.
- Imagine fitting an NBFC customer in a bank screen; why does a customer go to NBFCs? Because he does not fit into the bank screen. How can you bring in customers through NBFCs? That means you are making some adjustments.
- NBFCs having to train the team and customer to fit into the banking screen is not an ideal situation.
- I feel a very small NBFC can locally build some kind of a scale and remain there.
- The important step will be partnership with the bank so the best way for the bank is to look at the business model and financials of NBFCs and their past track record and give them a term loan by the securitisation pool. That is the best way to grow fast as transmission will be faster, and the lending decision will be faster.

Q. How do you think redemption pressure in the mutual funds industry will impact getting funds from the capital market and also parallely, what is happening with TLTROs?

- The mutual funds industry is not facing redemption pressure for the first time; in this kind of a pressure scenario, the RBI should have given a refinancing window to the industry to get through the liquidity challenge, and make it available through the bank. Since the banking sector is not taking any decision today, I think a giving a refinancing window is the best option as done in the past.
- As bank are not showing interest in the TLTRO since most PSBs are government-owned, unless the government gives some kind of support to CEOs and MDs, the banking sector will be shy. I think the government will come out with some kind of comfort given in the past like PCG; also, banks have high liquidity parked with the RBI, and they are awaiting some kind of comfort from the government.

Mr V P Nandakumar,

MD & CEO, Manappuram Finance

- A major part of our portfolio is gold loans. Gold loans are mostly in the rural economy.
- The rural economy is faring better than the urban economy in this scenario.
- Gold prices are increasing because of currency depreciation.
- Redemptions/releases are high maybe because many customers are releasing their jewellery because they want to sell jewellery, and they are selling it in the scrap market.
- In gold loans, things are appearing to be better than in other sectors.
- The MFIN has asked its members to give a moratorium, and we have also given a moratorium, but many customers are willingly coming forward to pay; we have provided them with an online payment solution.
- Collections may be to the extent of some 10-15% now in the vehicle finance sector. They are voluntarily paying the EMI. We do not have a very big portfolio of commercial vehicles.
- As said by Mr. Umesh, light commercial vehicles are being used for moving essential commodities and related items; even from these, collections have started coming in. The collections are at around 30% now.
- Once the block and chain is re-established the collections may come.
- Affordable housing we give up to Rs. 10 lakhs; there, better collections are seen. The collections are at over 40%.
- We have seen that given the various digital payment options, collections are coming in particularly from the rural economy. From the urban economy and urban markets, collections are not as encouraging as from rural markets.
- Gold loan companies have some privilege of getting reasonable liquidity from the banking system, even through the CP market now.

Q. As you said, the gold finance product is fine, and there is no problem in that product. In the way the gold prices are increasing now and are expected to continue to increase, can we expect to see at least this product in the NBFC space that will continue to grow in the current fiscal also?

- Usually, customers borrow based on their need only.
- They pledge their family jewellery and are very keen to redeem it at the earliest, and there is family pressure also for the middle class and lower middle class.

- I don't think that with a sharp increase in gold prices, there will be an unusual increase in business.

Q. You are also diversified into other products. Your funding requirement has gone up. How are you seeing things panning out on the liability side, given the challenge the mutual fund sector is facing and given that banks are also becoming risk averse? How much has that impacted you?

- We have not faced any liquidity challenge so far in the last one year.
- CPs used to be rolled over; even after the lockdown, we have bought around Rs 750 crores of CPs, which are rolled over, and some new CPs are floated.
- Investors are comfortable in the product of gold loans.

Q. On securitisation, you haven't done many transactions in the past, but in the current scenario do you think the gold finance industry will start doing more?

- The challenge is that repayment obligations are not structured, and the average life of the loan is 50 days; thus, we are not in a position to securitise, and some lenders are offering this as a medium-term loan, and this repayment is made through instalments. Thus, securitisation is not possible for our product.

Q. Any suggestions and recommendations to regulators and the government to ease constraints faced by the NBFC sector?

- A major concern for the lender is the credit concern; as long as it is there, they will be hesitant to lend. The government must come forward to provide a guarantee and some comfort to lenders since the option of TLTRO is not successful; so that challenge remains.

Mr Gaurav Kumar,

Founder & MD, Vivriti Capital

- First let's briefly talk about the microfinance sector because this has been in the news for the last two weeks, given that the lockdown has impacted the sector more than other sectors.
- Our own experience of being in the sector is now more than a decade old. The sector has gone through multiple points of stress. And this sector, out of the eight sectors that Vivriti is into in financial services, has always emerged out of a crisis far stronger.
- There is much learning from the past that microfinance companies are kind of taking forward during this crisis.
- The sector has the strongest SRO, (self-regulatory organisation) in the form of the MFIN. The MFIN has been extremely proactive through and through, especially during this crisis, guiding how partners need to operate.
- This sector has also given an operating model that enjoys a fairly high degree of trust with the borrowers.
- Even during the peak crisis and demonetisation, the sector saw 90-day numbers at around 2.5-2.75%, and the peak 90-day number in the past has reached 13%.
- As Mr. Nandakumar also mentioned, although the MFIN has also encouraged and microfinance companies on their own have come out and given a moratorium to their customers, on contacting customers, almost 60% customers have responded in affirmative that they have cash, and that as and when the microfinance company becomes functional, they will be able to pay.
- This is overwhelmingly coming from the rural markets. Additionally, given the underlying customer profile, borrowers are largely drawing their income from either agriculture or agri allied. They are also involved in micro enterprises, which earn their own revenues on a daily basis.
- So at this stage, collection efficiencies have been low at around 10-15%, but our own experience in the past has been that you start seeing collection efficiencies bouncing at around 60-70% within the first three months and around almost 95% and above over a six-month period.
- Some of the key points of engagement and what the sector will have to watch out for post-lockdown are that this COVID situation is not going to go away in a hurry. There may be phases of multiple measures that the government may have to take depending on how the classification between the red and green zones works.
- This is one sector that still largely operates in cash. Microfinance companies will have to focus and find a protocol in terms of engaging with customers, some measures in terms of innovations around centre meetings and moving customers gradually towards digital channel needs to be taken.

- If we look at just 3.5-4 years back during demonetisation, this sector was the worst impacted, but that was also an inflection point where the model pivoted. Before demonetisation, the microfinance sector was largely cash-based in terms of disbursement, and the sector moved 100% towards bank transfers and cashless disbursements. Given the resilience and how entrenched this sector is in the rural economy; our own view is that we will see a much quicker bounce back.

- The preparedness of microfinance companies in collaboration with the MFIN has been cutting across sectors, one of the highest. Also, given the nature of underlying borrowers and rural pockets, we will see far better recovery in the next 60-90 days.

Q. You have a lot of clients in your portfolio that are in the BBB category, some in A category and some are below investment grade. How do you think the banking sector will now get confidence to start lending to these borrowers, and whether any form of structures that you are thinking can be of use to them?

- The challenge has been credit risk, rather than liquidity, and from the TLTRO proceeds, we know how much has been bid by each of these banks.

- Banks are now taking a trip around this strategy. It is extremely difficult to onboard a new issuer. So, it is difficult to evaluate the issuer and then get them into the system. So considerable focus will have to be on issuers who have been in the system and have already taken some exposure on.

- That leaves the question of what happens to companies below AA. Some allocation is being made at the sectoral level, and that will channelize capital into microfinance.

- In microfinance, we will see two legs. One is just given that 10% of the total proceeds should go to microfinance, and the larger ones should see the allocation. The larger ones, which are in the AA- to A category, should see bank participation, given that it helps banks achieving the priority sector lending target, and some of the MFIs have already benefitted from them.

- Second, we are looking at a pooled bond issuances structure, which at least takes the rating category up by 2-3 notches; whenever banks don't have comfort, we are thinking on the funded pooled bond structure where even they don't have to rely on the unfunded guarantee which might come in.

- We have in fact also made a recommendation to them and hopefully, the need of the hour is for the government sovereigns to step in. It would be truly remarkable if entities such as NABARD and SIBDI, which have seen the sector very closely and understand the sectoral issues very well, come in as guarantors. With them coming in, you will see a 2-3 notch upgrade.

- Given the nature of the TLTRO, we have been working on a pooled bond issuance very closely with the MFIN, as well as their partners.

- On the NBFC side, the challenge is much larger. In the BBB rated NBFCs, again pooled bond issuances can be put together. Just given the lack of allocation and their allocation already being made to the A- rated entities below 500cr, it would be a challenge for smaller NBFCs to get liquidity.

Q. Mr Gupta says public sector banks will not be interested in investing these structures as he calls them exotic structures and would want to stick to plain vanilla lending. Where do you think the appetite for investors would be here? Who do you think will be potential investors for such products?

- Mr Gupta is right if one looks at the historical experience.

- If we look at pooled loan issuances and the partial guarantee loan products that came out around 7-8 years back and now, we have seen pooled loan issuances being done Rs 3000 crores cumulatively.

- The main takers of these products have been private sector banks and NBFCs, the larger ones.

- Our own reading is that private sector banks have taken exposure through these products. They have had a very good experience, and none of the guarantees during the stressful periods of demonetisation plus post-IL&FS were called upon.

- Private sector banks should definitely accept this product, given that they have already done more than Rs 3000 crores.

- On the public sector side, as Mr Gupta said, once you have Developmental Financial Institutions (DFIs) in the form of NABARD and SIDBI coming in as guarantors, we will see larger acceptance coming in even from public sector banks.

- SBI has already done such structures and are not new to public sector banks. However, they have done these structures largely in the A and AA categories, wherein the guarantor was a sovereign. These two combinations will play an important role for public sector banks to get comfortable with these structures.

Q. How are you seeing things from the FPIs? Are we still seeing interest from FPIs in investing in India, especially now, when India in terms of the pandemic is not performing as badly as some other markets? Do you expect more funding to get allocated to companies in India and to NBFCs?

- Two points I would broadly like to share from my own discussion over the last couple of days with foreign investors.
- First on equity capital because that's very important; this is the first situation we are facing, wherein both sides of the balance sheet have been impacted, and equity investors are going to wait for some time.
- Their current focus is to look at the existing portfolio, and many measures have been taken to increase the runway where companies are largely loss making, and more capital is going to be allocated, but only once they are very clear on the overall revenue model and cost optimisation.

- One interesting development we are seeing, and in fact we are working with some PE, is that their LPs are very supportive to their current portfolio, and they are looking at putting in debt into these companies.
- Equity investors are thinking very clearly that this is not a 3- or 6-month issue, but at least a 12-month issue.
- We don't see equity capital flowing in over the next 3-6 months, and a lot of numbers and assumptions need to be looked at again.
- On the offshore side, it has been very encouraging as some of them have taken exposure even in April; so the investors have been very sectoral focus
- Their focus areas have been largely the MFIs, affordable housing finance, clean energy and so on; so some of them are definitely trying to come in and support some of the sectors through bond issuance or an ECB product or by extending SPLC via an offshore bank, which is helping the domestic bank to take exposure.

Q. What will you expect from the government or regulators, especially for the MFIs segment, which has been hit the most, and also the affordable housing segment?

- Our request and submission to the government and regulator will be to set-up a fairly large guarantee programme for the MFI sector.
- Rolling out a fairly large guarantee fund will be extremely useful in getting some of the sovereign DFIs to offer guarantee to the sector, that will help some of the liquidity flow to come in
- Another suggestion to regulators is direct assignment securitisation; if the regulator is able to make a trade-off between the MRR and MHP at this stage, it will be prudent for some of these companies to quickly sell newly originated loans because older loans may have some challenges, but to address the skin in the game, we can actually look at increasing the MRR, which will also incentivise the seller
- There are two approaches MHP+MRR combination, and our request would be that at least in the short term, we should relax the MHP and look more at the MRR.

Mr Ashwini Hooda,

Deputy Managing Director, Indiabulls Housing Finance

- Clearly, housing finance companies are not sweating right now because of the nature of the product. 70% of the loans are to the salaried segment, and 30% are to the self-employed segment.
- We are in the affordable segment, but our affordable ticket size starts from a loan of Rs. 1.5-2 million, and we are not in the low ticket clearly. Our experience so far has been good; we have received almost 95% of collections in April.
- Our banking typically happens on 5th April, so it was early in the moratorium period. My sense is that all the banking is through standing instructions, and home loan products should behave well, especially for the salaried. The collection in that segment should remain high. There is a certain proportion of borrowers who come back to us. There is misconception wherein people think there is a waiver of EMIs and not a moratorium on the EMIs. In light of this, people have been asking for refunds for EMIs that have been paid.
- Apart from operational issues, after counselling, most people do not take a moratorium. So, for the home loan segment, a moratorium would not be asked for.
- The second segment that we are present in is the SME segment, i.e., the loan against property or what we call loan against homes. SMEs, of course, are directly hit by the whole lockdown wherein most businesses have stopped generating cash flows. In that background, a certain percentage of these borrowers would want a moratorium despite having paid the April EMI; they would want a refund because the impact is never immediate. It is more about what happens a few months down the line, and in anticipation or to preserve liquidity, many SMEs are requesting that although the amount has been debited automatically and they have paid because they are still liquid, they would want to avail the facility of a moratorium.
- One key difference between a home loan and loan against property is the LTVs. Typically, in home loans, the average LTV is 70% on book and the maximum it goes to is 80%. However, in the loan against property, the maximum is 60% and on book is around 45%. There is a risk of property prices lowering by around 10-20% in different micro markets. On average, our expectation is15%.
- We don't expect this to be a permanent diminution in the value of properties because India is one of the few large markets globally in which property prices have not increased in the last 10 years because of a high real interest rate.
- In other economies across the globe, we have seen property prices surge in the last 10 years. There is no scope for a significant deterioration, but since property purchases will be limited, and sellers will have to sell at a lower price, we believe 15% is par, if one has to sell property in the next

12-18 months. So, home loans to that extent always have a lower LTV cushion, but most borrowers are salaried, and it has a historic trend of the last 40 years, which we believe should hold up.

- In loan against property, because equity is trapped, and it is the primary house behind this loan. We believe even that segment should hold up. However, how does the liquidity would pan out for SMEs, what kind of hand holding we give and what kind of forbearance can come from the RBI in case this sector actually needs restructuring if the COVID-19 situation persists beyond May.

Q: What is happening on the affordable housing piece? How much impact is there currently, and if the lockdown continues further or if further moratorium extensions are given, how will this portfolio get impacted?

- Our affordable housing segment has, let's say, a ticket size of around Rs 1.5 million to 3 million for us. That is the segment wherein entry-level white-collar workers take loans 2-3 years after getting into the job. Those jobs are apparently doing fine currently. They do not sense a significant slashing of jobs in that sector, unless the pandemic persists; of course, for a few quarters then, the existence of these jobs also comes into question.
- We do not cater to blue collar workers or small businesses, in which, in my sense, the pain would be more, small businesses especially.
- Within home loans, we have always catered to higher segments and not below 1.5 million. The performance of this affordable housing segment in my sense is in line with the rest of the book, presently collections are at around 98%. In the worst case, they will dip to around 95-96%, and this is being worn out of a few cycles that we have seen on the quality of this portfolio, whether it is a global financial crisis or it was the mid-1990s. Across banks and housing finance companies, the prime portfolio has not seen a collection dip below 95%.
- Yes, RBI forbearance is there, and customers, to conserve liquidity at their end, may choose for a moratorium. But you know, institutions like ours may rather offer them some relief, waivers at the end of the term, some EMI waivers and make them pay rather than seek moratorium. These make up some of the strategies some players may be using to ensure collections remain good during this period.

Q: Are you seeing or expecting many people coming for moratoriums, and also for your moratorium, are you applying for moratoriums or expecting moratoriums?

- The way it works is that the salaried class, by and large 90-95%, will not seek moratorium.
- For LAP and home loans to SMEs, we expect many people to come forward and seek moratoriums. Developers, my sense is, will ask for a moratorium. So, the way we see this is that around 30-40% of our book is in the segment in which many people will ask for moratoriums.

- Just because they ask for it does not mean that they need it. Everyone wants to conserve liquidity in this time because the horizon of the exit of the pandemic is unknown. So, while people can sustain for, let's say, 6-12 months, they may not be able to sustain for 18-24 months. So, in light of these considerations, there may be some requests, and we may incentivise these people rather than taking the moratorium.

- Having said that, back-to-back we would be ending up offering this moratorium to a certain percentage of our customers. We are seeking a moratorium from our banks, and our experience has been good so far. I mean, in April, we have not far paid any of the banks. It helps conserve my liquidity while I service the next 12 months' repayments.

- Being very conscious of the fact that there is no clear sign of when the pandemic will end. Also, the moratorium does not apply to my foreign currency offshore borrowing. Even the bond market is slightly undecided currently on how to end the moratorium. Keeping all these things in mind, at least banks are approached, and we will keep receiving these.

Q: There's another view in the market and given that there isa TLTRO facility that is available in the market wherein banks can lend to NBFCs also. Then, should NBFCs be given the moratorium?

- You can never go wrong if you are along the side of caution.

- Yes, if the question is whether you need a moratorium, I don't need one; in fact, I had prefunded all my March repayments to my lenders by 15 March itself because I could see lockdown getting imposed.

- I am on the side of caution, and to conserve liquidity is very prudent. In this case, yes TLTRO will be received. We already received two sanctions yesterday. We already launched a Rs 1500 crore bond programme, of which, Rs 300crore was subscribed yesterday itself.

Q: You have seen mutual funds restraining their lending to NBFCs in the past few months, and with the latest Franklin Templeton situation, do you see this challenge to be as exasperating for others and mutual funds to become even more wary of investment and lending to NBFCs, and how will that pan out?

- In my perception, these are definitely exceptional times.

- Clearly, since there is no visibility on how the environment will pan out, non-banks, which are already reeling under limited access to the market will suffer. The papers have become illiquid, and our secondary markets are not developed, unlike in the US or other developed markets.

- Apart from 2-3 names in the entire non-banks space, no paper generally also finds enough liquidity. So, it was bound to suffer in these extraordinary circumstances, and it's fair to accept these things happen only once in 5-7-10 years and can't be the rule of the game.

- My view is that once things stabilise and are back to normal, whether it happens in three or nine months, the acceptance of non-banks paper would be there.

- Mutual funds understand that NBFCs have been a quality investment over a decade with no accident, apart from the recent issues and returns that investors have earned, the supernormal returns that they have may get compensate for any risks that may occur.

- Of course, SEBI has done its bit; the disclosure norms for investment by these mutual funds are much better.

- Going forward, the NBFCs have learnt that the only way to have permanent access to liquidity is capital markets. The capital markets are ensuring 90% or more of your asset is actually a retail granular asset and not a wholesale asset until such time that you don't have a developed market. This is the course most non-banks would take, and as long as that is the case, there are disclosures now, wherein you need to disclose what kind of a retail and wholesale mix is there.

- I think NBFCs will get back to the marketplace as and when things normalise.

Q: So, a shift in business model is something that is imperative now. That will ensure NBFCs will continue to access funds. One other question that has come from the audience, and as Mr Gupta spoke earlier, is that the PCG scheme launched from the government didn't take off to the extent envisaged due to multiple problems. One of the problems he said was that a guarantee is only available up to a certain period of time, whereas the pool maturity will be much longer and didn't give much comfort to the banks. It didn't take off so much but we saw that you have done quite a bit under the PCG scheme and do you expect this to continue to work, going forward, or does something need to be changed in the scheme to make it more effective?

- The reason we were perhaps the largest issuers of mortgage loans under PCG schemes was that over the last 7-8 years, we have sold more than 50,000cr-portfolios in home loans and LAP to various banks, almost 20 banks.

- So, we had an established credit history with these banks; they had bought our tools and they had seen how the NPAs were 10-20 basis points across cycles.

- There was a lot of comfort in our portfolio, and even before our PCG, we could sell our portfolio in quantum.

- In FY19, we could sell down without PCG, Rs 20,000 crore of our book to raise cash and redeem our commercial papers. So clearly, while PCG is more suited to a shorter duration, it was not very helpful for mortgage players as our loans were for a longer tenure and the guarantee was only 2 years; as we saw people and banks were buying our pools any way, and the introduction of PCGs only delayed our securitisation programme and increased our costs by 50 basis points of the guarantee commission that we were supposed to pay to the government.

- Yes, PCG as a partial credit guarantee scheme would work in an environment where asset class has become an issue in which securitisation is concerned, and as a result, that guarantee would slide back into the securitisation programme.

- At a time when people were buying those mortgage pools without any support, I don't think this was not needed at that time. If you ask me, it would be more helpful today as there is a general averseness to asset classes where there is uncertainty and retail credit in India is very resilient. But still, people don't know how the pandemic will play out and in general, there is a conservative behaviour from banks, and PCG will help in this situation.

Mr PK Gupta,

Former Managing Director, State Bank of India

- In the last two years, we have seen most of the credit growth in the country happen because of NBFCs, which have been lending quite aggressively; however, after this crisis, the collection efficiency of NBFCs will have lowered.
- Hope that if the situation lasts long, NBFCs will be able to get back to the collection efficiencies of upwards of 95%, something comparable with what happened during demonetisation.
- The bigger issuer is on the funding of NBFCs actually, started in the last 1.5 years since IL&FS crisis and followed by DHFL fall, making it difficult for NBFCs to raise money from market.
- The sources of funds have completely dried up as far as the NBFCs are concerned, and reliance on bank financing seems to have become even more, while banks' balance sheets are stressed at the moment.
- Credit to the MFIs and NBFCs are facing stress, and the question is how much more exposure can banks take in?
- There is a case for liberalising the terms of the PCG that the government has been offering. If the guarantee is available for the duration of the loan portfolio, I think banks will be able to take on lending to NBFCs.
- The second important initiative that the RBI had taken was co-origination. However, for some reason, this has not taken off because some complications, including technology issues, are involved on how co-origination will be done.
- The time has now come for banks and NBFCs to cooperate more such that banks don't take direct exposure to NBFCs, but on the underlying assets, and make use of NBFCs in a more efficient manner to originate and collect loans.
- The other issue of course has been on the moratorium on whether the moratorium should be extended to the NBFCs. I think there are two sets of views.
- One of course is that underlying loans that the NBFCs have originated are getting the moratorium, so they should also get the moratorium.
- The larger issue for banks is that their balance sheets are stressed, and their capital adequacy ratios are undergoing a bit of an issue of whether they do more by handing more to NBFCs or they do origination themselves, which is the more preferred way of doing it.
- At some level, there is also a concern that any money lent to NBFCs now will not result in fresh lending, but get used to repair the balance sheets of NBFCs; this concern exists at some levels. Thus, the RBI and government have to do a bit more so the issue gets resolved satisfactorily.

Q: What do you think needs to change for banks to lend to smaller NBFCs, and if not the TLTRO route, then what route can mid- and small-sized NBFCs take to get liquidity?

- The concern is that how much risk the banks can take onto their balance sheets, particularly when you know most NBFCs and MFIs are facing issues on their collections, and we know their asset books are stressed.
- Some of the 50,000cr made available through SIDBI and NHB could be a better route
- Secondly, what are the other sources of funding for NBFCs. Could bank financing be the only source of finance for NBFCs? There is a question on how much funds can the NBFCs raise. Thus, I think until you have clarity on some of these issues, going forward, there would be some hesitation on banks' lending to NBFCs.
- The existing exposure of banks to NBFCs is quite large, and the question lies on how much they can add to their current balance sheets; I think this is where the issues lies, and the RBI, government and banks need to sit together and work out the solution.

Q: Even with this 10% provisioning requirement for the SMA accounts wherein a moratorium has been given, our estimate has been that an around Rs 35,000 crores hit would be taken by banks on their profitability. So, if the lockdown continues as there are already indications that it may not end on May 3, then how badly do you think banks can get hit? What do banks now have to do to ensure their balance sheets remain healthy?

- The moratorium announced is not going to help actually; a longer moratorium is going to be required.
- Most loans would require restructuring, and not just restructuring, quite a deep restructuring would be required.
- Fresh lending has to happen to existing units to restart their businesses also. Some of the interest too that has been applied and not been collected has to be converted into some kind of a fund-related trust. An example is the interest deferment regarding which the RBI announced that three months' interests can be deferred, but have to be paid in June. I am not sure how many people will be able to pay four months interest in June itself. That will need to be converted into some kind of a long-term liability, which is, say, 2-3 years.
- Similarly, for the finance of working capital also, some of it will have to be converted into term loans, so a lot of deep restructuring would be required. As of now, what the RBI has committed is that MSME loans of up to Rs 25,000 crores that were under stress as of 1st January can be restructured.
- So loans that were not under stress as of 1st January cannot be restructured and those more than Rs 25,000 crores cannot be restructured. A further relaxation of norms on what can be restructured

will be required. So I think NBFCs constitute one of the side issues the banks have, and there are bigger challenges for banks, going forward.

Q: So, as you said, the PCG scheme if modified appropriately is something banks will be willing to look at. So, does this mean you believe that if a guarantee is provided by the government of India, then such structures can take off?

- By the time the government announces changes in the scheme itself, demand from NBFCs will have lowered, and not many structures would get done.

- So, there was an issue around NBFCs not being in the SME category in the last one year; that was another reason many NBFCs could not take advantage of that. The second is the credit guarantee, as per the RBI scheme, wherein banks could offer credit enhancement actually, and then those structures would be done in the market.

- But for the capital requirements of the banks offering the credit enhancement was quite substantial. So, given the constraints on the capital, it probably didn't make much sense for banks to offer credit enhancement, and this is why it didn't take off. So, if liquidity is there in the market, and as a bank, if you need to really maintain the capital on the enhancement that you have provided, you could very well take the risks onto your books also. It didn't make sense for the banks to provide capital and not use the liquidity for funding the same asset.

Mr Vydianathan Ramaswamy,

Director & Head Financial Sector Ratings, Brickwork Ratings

Q. What is the experience on the rating side? What is the credit ratio and outlook, going forward?

- In the last 18-24 months, the situation has been difficult, especially for NBFCs; from a rating perspective, we are monitoring the situation and taking rating actions wherever necessary.
- The credit ratio is close to 0 since there are hardly any upgrades, and most ratings are downwards; we continue to monitor the situation, and as and when needed, we would take appropriate action.
- We also understand that the lockdown situation has also brought uncertainty. Thus, post-lockdown, we will continue to engage with clients and take necessary actions.

Q. How are you treating the moratorium given by the clients? How is that accounted for in the rating process, and what do you expect would happen after the moratorium ends?

- With regard to banks where the moratoriums are given, we ask the client to provide us with the written confirmation, we will take necessary actions post the period if we believe repayments are not timely.
- However, in the case of NBFCs, we are seeing that there is still some uncertainty, so if there are applications for the same, we are confirming them.
- In the case of capital market instruments, if the moratorium request is sent to the investor before the due date, and if it is confirmed, we will consider it.

Q. Are large companies availing moratoriums, or is this limited to mid- and small-size companies?

- Not all companies have gone in for the moratorium, and we have a good number of our own rated companies that have not availed a moratorium as of now, so it's a mixed bag.
- Also, the benefit has been that the March cycle collection for the NBFC sector has been pretty good. Thus, from a liquidity perspective they are well-placed; however, it is also important to see when the lockdown is would be lifted.

Q. Are companies taking a moratorium treated any differently from those not taking it?

- Yes, it provides added comfort from liquidity perspective for those who have not gone in for the moratorium; this does not necessarily imply a rating change at this point in time, but from a comfort perspective and credit risk perspective, we believe they are better placed.

Q. You heard Gaurav talk about innovative products likely to enter the market, especially for mid-size NBFCs that are otherwise not able to access these funds. Do you think these structures with multi entities getting into a bond issuance or a pool loan issuance and partial guarantee provided by stronger NBFCs will help get these ratings up and get access to funds?

- Yes, we do believe these factors, which are secured in nature and are an alternate channel of funding for mid-size NBFCs, are important as going by what we have seen in the past, these structures have performed very well.
- Many NBFCs had availed this benefit, but at that point in time, what we saw involved better rated entities (AA and some from the A category), but it is important to see how it benefits the BB category NBFCs.

****

ABOUT BRICKWORK RATINGS

Brickwork Ratings is India's home-grown credit rating agency built with superior analytical prowess from industry's most experienced credit analysts, bankers and regulators Established in 2007, Brickwork Ratings aims to provide reliable credit ratings by creating new standards for assessing risk and by offering accurate and transparent ratings. Brickwork Ratings provides investors and lenders timely and in-depth research across the structured finance, public finance, financial institutions, project finance and corporate sectors. Brickwork Ratings has employed over 350 credit analysts and credit market professionals across 8 offices in India. Our experienced analysts have published over 12,000 ratings across asset classes. Brickwork Ratings is committed to provide the investment community with the products and services needed to make informed investment decisions. Brickwork Ratings is a registered credit rating agency by Securities and Exchange Board of India (SEBI) and a recognised External Credit Assessment Agency (ECAI) by Reserve Bank of India (RBI) to carry out credit ratings in India. Brickwork Ratings is promoted by Canara bank, India's leading public sector bank. More on Canara bank available at www.canarabank.co.in

BWR Rating criteria is available at https://www.brickworkratings.com/ratingscriteria.aspx

Brickwork Ratings (BWR), a SEBI registered Credit Rating Agency, has also been accredited by RBI and empanelled by NSIC, offers Bank Loan, NCD, Commercial Paper, MSME ratings and grading services. NABARD has empanelled Brickwork for MFI and NGO grading. BWR is accredited by IREDA & the Ministry of New and Renewable Energy (MNRE), Government of India. Brickwork Ratings has Canara Bank, a Nationalized Bank, as its promoter and strategic partner.

BWR has its corporate office in Bengaluru and a country-wide presence with its offices in Ahmedabad, Chandigarh, Chennai, Guwahati, Hyderabad, Kolkata, Mumbai and New Delhi along with representatives in 150+ locations. BWR has rated debt instruments/bonds/bank loans, securitized paper of over ₹ 10,00,000 Cr. In addition, BWR has rated over 6300 MSMEs. Also, Fixed Deposits and Commercial Papers etc. worth over ₹24,440 Cr have been rated.

DISCLAIMER

All opinions expressed by the Participants are solely their current opinions and do not reflect the opinions of Brickwork Ratings (BWR) and its associates and/or affiliates or the companies with which the Participants are affiliated, and may have been previously disseminated by them. The Participants' opinions are based upon information they consider reliable, but neither BWR nor its affiliates, nor the companies with which such participants are affiliated, warrant its completeness or accuracy, and it should not be relied upon as such. The Participants may be actively involved in securities trading discussed in the interview/content, on behalf of themselves, their companies and their clients. Also, the Participants and/or their companies engage in securities trading and may hold both long and short options and/or futures positions in the same security, as well as the underlying stock. The opinions expressed by the Participants may be short-term in nature and are subject to change. Any views expressed is NOT a recommendation to buy, sell or hold any security and/or investments. BWR has no responsibility for any liability arising out of the views expressed here to any parties.