CV financing NBFCs AUM growth expected to be in double digit in FY23

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Summary

Indian commercial vehicle (CV) financing industry is dominated by NBFCs. While banks and captive financiers (CF) dominate the new CV funding, non-banking financial companies (NBFC) continue to have a stronghold in old CV funding, and NBFCs assets under management (AUM) are expected to grow in single digit in FY22. In FY23, however, the AUM growth is likely to be double digits on account of a revival in economic activity, aided by increased spending in infrastructure by the government.

NBFCs dominate the CV financing industry

The CV financing industry's[1] AUM stood at nearly Rs 3.4 trillion as of March 31, 2021 (CareEdge estimates) with banks, NBFCs, and CFs of original equipment manufacturers accounting for 38%, 40%, and 22% of the market, respectively. New CV financing comprises about two-thirds of the total CV financing industry, while used CV financing constitutes the rest. Banks and CFs hold 55% and 30% AUM share in the new CV segment, respectively, while NBFCs have a lion's share of the used CV financing pie at 91%.

Figure 1: AUM trend in CV financing

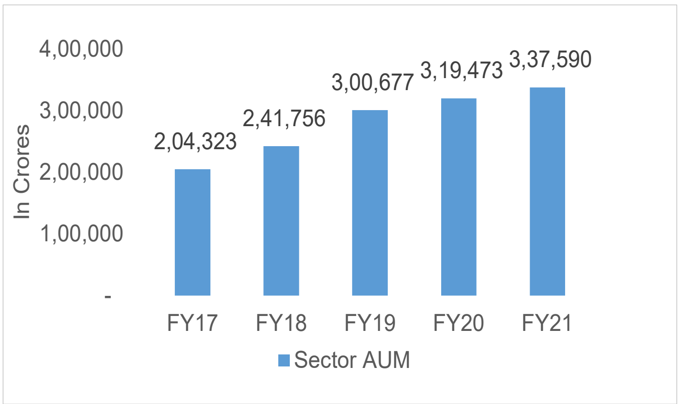
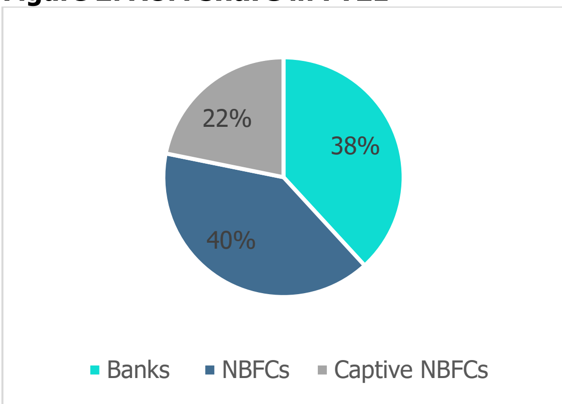


Figure 2: AUM share in FY21



Source: Company, CareEdge Ratings

Even before the Covid-19 pandemic, domestic CV sales were adversely impacted due to various factors. During FY20 (April 1 to March 31) medium and heavy commercial vehicle (MHCV) sales volume witnessed a y-o-y decline of 42% due to excess freight capacity on account of improved turnaround time post-GST, implementation of revised axle load norms, the overall slowdown in the economy, and planned transition from BSIV to BSVI. In FY21, MHCV sales further declined as the shift to BSVI from BSIV led to a 10-15% increase in CV prices, in turn causing deferral of new vehicle purchases. The impact of these factors was compounded even more by the Covid-19-led lockdown as low freight availability suppressed freight rates and affected the profitability of fleet operators, resulting in further deferral of new vehicles purchases. Consequently, the AUM growth rate of the CV financing industry, which had fallen to 6.3% in FY20 (as seen in figure 3) from its high levels of 24% in FY19 continued to fall further to 5.7% in FY21.

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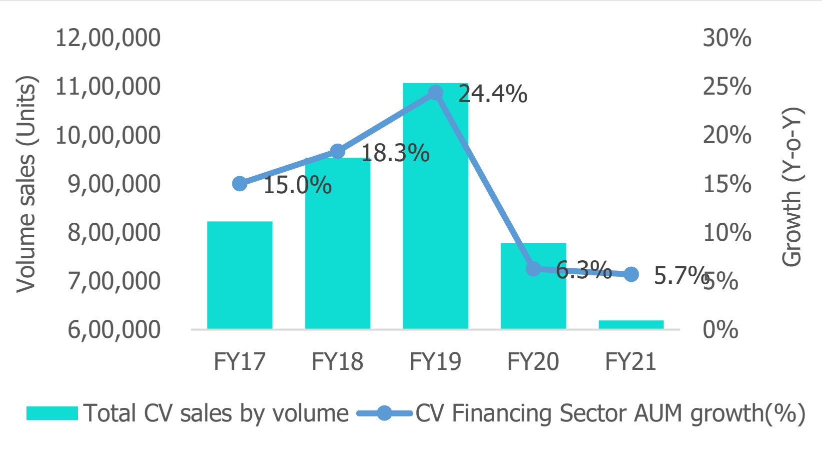
[1] CV financing industry for analysis comprises (i) Banks – HDFC Bank, ICICI Bank, Indusind Bank, Kotak Mahindra Bank, AU SFB (ii) NBFCs – CIFC, STFC, SUF and (iii) Captive finance companies of OEMs -HLF, TMFL, TMFSL

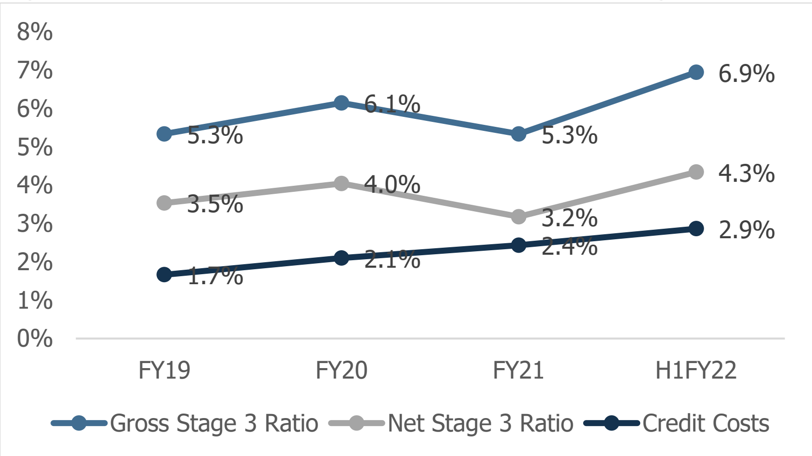
Figure 3: CV sales and CV financing industry AUM growth



Asset quality parameters of CV financing NBFCs

Asset quality of CV financing NBFCs witnessed a moderation in FY20 primarily due to the impact on collections. The Covid-19 induced nationwide lockdown led to them seeing an increase in Gross Stage 3 (GS3) assets from 5.3% as at the end of FY19 to 6.1% at the end of FY20. However, consequent to the various relief measures offered to the borrowers, including the extension of the moratorium from March 2020 to August 2020, emergency credit lines for MSMEs, and the one-time restructuring scheme of RBI, these NBFCs witnessed improvement in asset quality during FY21 with GS3 assets of 5.3%. The business of CV operators was again impacted in H1FY22 as the second wave of the Covid-19 pandemic emerged. Rural borrowers form a major part of the total borrowers of CV financing NBFCs. These borrowers were affected more by the second wave of Covid-19 due to increased infections in rural areas. The infection spread in rural and semi-urban areas during April-May 2021 was as extensive as in large cities, unlike in 2020 when rural infections were low. This led to the exhaustion of savings for medical purposes. Also, renewed lockdowns have subjected rural cash flows to a prolonged period of restricted economic activity which has affected their repayment capacity. Health and income concerns in the second wave were more pronounced in the rural and semi-urban areas. This, along with persistent stress in urban markets, led to higher non-performing loans and impairment costs (credit costs) in H1FY22.

Figure 4: Asset quality parameters of CV financing NBFCs



As seen in figure 4, GS3 assets stood at 6.9% as of the end of September 2021. But for restructuring of loans and ECLGS, GS3 assets would have been much higher. It is to be noted that many of the new CV financing NBFCs reported restructured assets of 4.5% and above as of September 30, 2021. During H1FY22, the credit cost also rose sharply to 2.9% on an annual basis; such an increase was partly due to provision towards restructured assets.

Tighter NPA upgradation norms to further increase reported GNPA

On November 12, 2021, the Reserve Bank of India (RBI) issued a clarification on "Upgradation of accounts classified as NPAs". Resultantly, most of the players in the sector reported a sharp increase in NPA. However, RBI has issued clarification vide its press release dated February 15, 2022, wherein it has given an extension of time until September 30, 2022, for NBFCs to put in place the necessary systems to implement this provision. The majority of NBFCs have assessed/reported the impact of the same on their asset quality. CV financing NBFCs have seen a relatively high increase in GNPA with many of them reporting an increase of around 250 bps on account of the November 2021 RBI circular. Aggregate data of CV financing NBFCs covered in the analysis showed GNPA of 9.59% as of December 31, 2021, after November 2021 RBI circular as against 7.10% before the circular. Few of the large NBFCs in this sector have always adhered to stricter norms by not upgrading the overdue account to a standard account unless the full overdue amount is received. Hence, the rise in GS3 ratios on account of the aforementioned factor was relatively lower for some of the CV financing NBFCs.

Outlook for CV financing NBFCs

Aggregate AUM of CV financing NBFCs witnessed low growth in FY20 and FY21 following three successive years of high growth rate during FY17-FY19. Such moderation in AUM growth was due to a combination of a slowdown in new CV sales volume which in turn impacted by various factors including cyclicality associated with the CV sector, changes in emission norms, and COVID-19 induced economic slowdown. With the continuation of impact of the second and subsequent wave of COVID-19, Aggregate AUM growth of CV financing NBFCs is likely to be muted with more than 5% y-o-y growth in FY22. With the expected revival in economic activity supported by increased spending in infrastructure by the government, aggregate AUM growth of CV financing NBFCs is expected to be in double digits in FY23.

Figure 5: CV financing NBFCs AUM growth rate

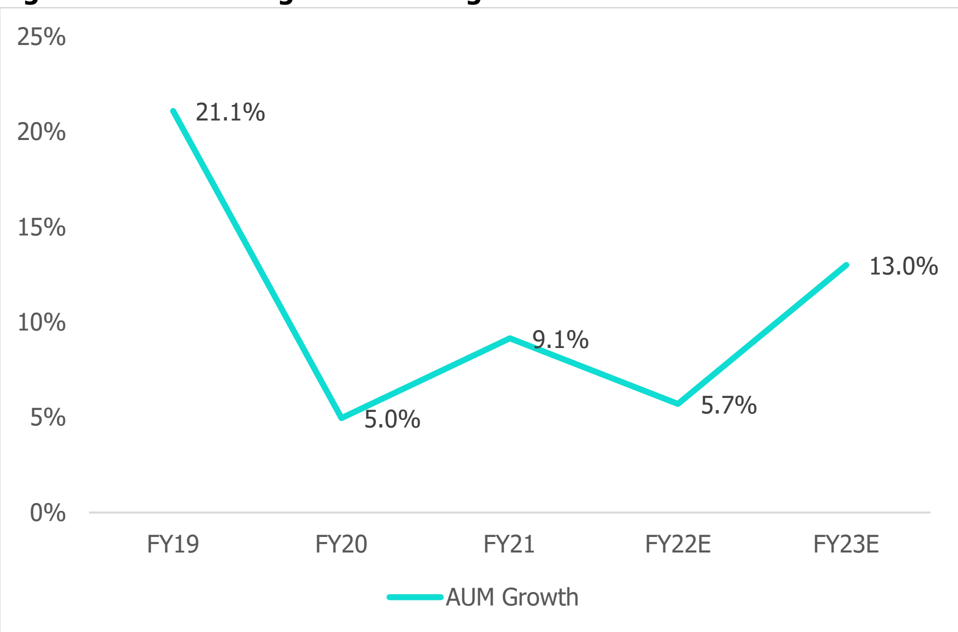
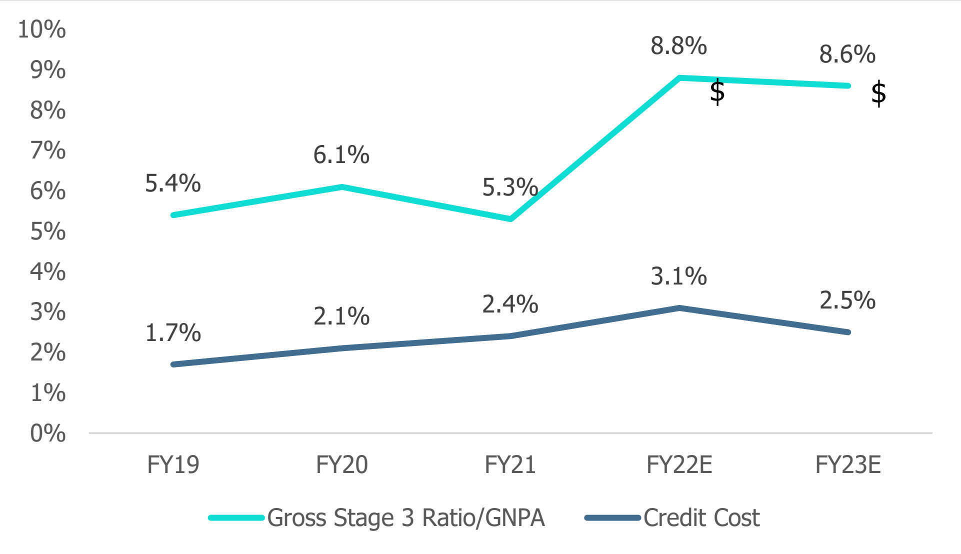


Figure 6: CV financing NBFCs GS3/GNPA & credit cost



$-past fiscal year figures correspond to Gross Stage (GS3) assets and estimated figures correspond to GNPA considering the impact of the November 2021 RBI circular

On the asset quality front, the CV financing NBFCs witnessed sharp deterioration in H1FY22 with the GS3 ratio going up from 5.3% on March 31, 2021, to 6.9% on September 30, 2021, and further to 7.10% (post RBI circular 9.59%) as on December 31, 2021. With the postponement of the November 2021 RBI circular, 250 bps impact on asset quality is deferred. However, CareEdge expects the asset quality overhang to remain in the near term. Further, with most of the CV financing NBFCs carrying a significant amount of restructured loans and likely slippages from this portfolio, asset quality for the sector is unlikely to improve significantly in FY23 unless the sector reports high AUM growth. Most CV financing entities have strengthened their balance sheet and have shored up capital and these provide comfort against adverse scenarios, however, concerns remain.

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