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Press Release

Sharper impact of Covid 2.0 on MFI and small NBFC sector

Gradual unlocking along with the measures by RBI and Govt may provide relief

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The impact of the second Covid wave has again raised concerns over the recovery of the microfinance (MFI) and the small NBFC sector, which was already battling the elevated credit stress and declining AUM in FY21. A study by Acuité Ratings shows that out of thirteen issuer downgrades by credit rating agencies during Q1FY22 in the financial sector, ten issuers are smaller MFI and NBFCs engaged in providing unsecured MSME loans, personal and vehicle loans. A further analysis undertaken for the MFIs and smaller NBFCs rated by Acuité indicates that the collection efficiencies which were seen recovering above 90% in Mar-21 have dropped to between 65%-85% levels during Q1FY22. While the gradual 'unlock' measures by the State Governments will help to normalise collections, the monetary and fiscal measures taken to improve access to funds through government guarantees along with enabling restructuring of underlying borrower loans should ensure that the credit quality for the sector doesn't deteriorate in a significant manner.

The sector has been staging a comeback with marked improvement in disbursals and collection efficiency levels since Q3 2021. However, with second wave of Covid forcing many states to impose strict lockdowns, the sectoral recovery has been interrupted and led to a perceptible deterioration in credit quality. Among the ten entities downgraded in the sector, six have been put in the non-investment category and out of that, three have witnessed a default. Similarly, the transition in securitisation transactions reveals that out of the thirteen pool transactions which have been downgraded or put on rating watch negative during Q1FY22, eight pool transactions have underlying exposure to microfinance and unsecured MSME loans.

The impact of second wave of Covid has been more pronounced on collections in the asset classes of microfinance and two-wheeler loans as compared to the first cycle. ***Says Suman Chowdhury, Chief Analytical Officer, Acuité Ratings & Research "Even as two-wheeler as an asset class fared better during the first wave of lockdowns, the impact has been greater during the second cycle on account of the spread of the pandemic in rural areas and the stress on the borrowers' cash flows due to loss of income as well as high medical expenses. Given the intermittent nature of economic activities in the wake of Covid spread in Q1FY22, the borrower income streams, particularly of those serviced by smaller NBFCs/MFIs have been severely impacted, thereby exacerbating the asset quality stress for these lenders. While there has been some improvement in collection efficiency levels during the month of Jun-21, delinquencies are set to rise during Q1FY21; for smaller MFIs, 90 dpd figures are expected to be in the range of 4.5%-5.0% as on Jun-21."*** The blanket moratoriums provided last year during the period of Mar-Aug 2020 had helped the lenders in bridging the liquidity gaps which softened the impact of the first wave to an extent. However, the absence of moratorium has made the borrower stress more visible in this cycle and along with lack of adequate funding, the deterioration in liquidity and therefore credit quality for smaller NBFCs and MFIs was almost inevitable.

Besides the lower collections, the debt raising ability of these smaller players has been impacted with estimated 50% of players (having loan portfolio of <500 Cr) having received adequate funds. Constraints in raising both equity & debt coupled with sharp drop in securitization volumes on account of increased delinquency concerns, have resulted in a liquidity squeeze for smaller players. Acuité has noted that some of the players were not able to raise any incremental borrowings during Q1FY22. Amidst the dip in the collection rate, the limited ability to raise debt or equity at this juncture has accentuated the stress in the liquidity position of these players, which already had a limited headroom to the absorb the impact.

However, the economic environment has clearly turned positive since the end of May with a steady reduction in daily case loads and mortalities along with the unlocking measures taken by almost all the states in June. The distinct improvement in the mobility indicators since Jun-21 augurs well for the resumption of collection activities. The government of India has also announced a few additional fiscal relief measures for the businesses and borrowers impacted severely by the second wave of the pandemic. The size of the ECLGS programme under sovereign guarantee which was launched in May-20 has been increased from Rs. 3.0 Lakh Cr to Rs 4.5 Lakh Cr. Acuité has noted that a substantial number of MSMEs in its rated portfolio has availed funding from ECLGS which is helping them to maintain an adequate liquidity position despite the challenging business environment. The other significant measure to provide upto 75% credit guarantee for bank loans to the MFI sector upto an aggregate amount of Rs 7,500 Cr is a timely step. Earlier, RBI in Apr-21, had earmarked an additional Rs 16,000 Cr funding limit for SIDBI for lending to MSMEs, directly or indirectly. In order to provide further relief to the businesses hit by Covid 2.0, the newly announced restructuring window has been extended for all entities with outstanding credit up to Rs 50 Cr. Given the ongoing stress in the NBFCs' portfolio, we expect a significant increase in the quantum of restructured loans in Q1/Q2 of FY22. In our opinion, all such measures will not only add up to support the continuity of credit flow to microfinance and MSME borrowers but also provide liquidity relief to the smaller lenders.

Adds Mr. Chowdhury "Acuité believes that the overall prospects for the MFI and small NBFC sector will improve with the gradual normalisation of the economy over the next few quarters. We expect to see a recovery in disbursement growth in H2FY22. However, some of the smaller players with low capital raising ability, higher leverage and low liquidity buffers may continue to face credit challenges in the near term."

About Acuité Ratings & Research Limited:

Acuité Ratings & Research Limited is a full-service Credit Rating Agency registered with the Securities and Exchange Board of India (SEBI). The company received RBI Accreditation as an External Credit Assessment Institution (ECAI), for Bank Loan Ratings under BASEL-II norms in the year 2012. Since then, it has assigned more than 8,700 credit ratings to various securities, debt instruments and bank facilities of entities spread across the country and across a wide cross section of industries. It has its Registered and Head Office in BKC, Mumbai.

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