March 16, 2011
Mumbai

NBFC loans to match banks' non-mortgage retail lending: CRISIL

Regulations to tighten, competition to intensify

CRISIL believes that non-banking financial companies (NBFCs) are well-positioned to establish a stronger presence in the retail finance space, and match the non-mortgage retail lending portfolio of banks by end-March 2013. CRISIL estimates that the retail loan portfolio of the NBFC sector will grow to over Rs.4.0 trillion by March 31, 2013. The recent trends of strong growth and improving asset quality and profitability are likely to continue, strengthening the credit risk profiles of NBFCs over the medium term. Nevertheless, NBFCs may face challenges on other fronts. Given their increasing role in the financial sector, NBFCs will need to adapt to a more stringent regulatory environment over the medium term. Competition in the NBFC sector will also intensify, and players will need to diversify their resource profiles, maintain competitive borrowing costs, and ensure availability of skilled human resources to maintain growth.

Says Ms. Roopa Kudva, Managing Director and CEO, CRISIL, *"**NBFCs continue to play a critical role in making financial services accessible to a wider set of India's population, including semi-urban and rural areas, which account for majority of the NBFCs' business. With their keen understanding of customer needs, NBFCs remain focused on product innovation and customisation—factors that will help them gain an edge over banks while maintaining their niche positioning. NBFCs can, therefore, double their loan portfolio, and even match the market share of banks in the non-mortgage retail finance space by March 2013**."*

CRISIL believes that the asset quality of NBFCs will continue to improve over the medium term as it has in 2010-11 (refers to financial year, April 1 to March 31), after deteriorating significantly between 2007 and 2010. Their gross non-performing assets are expected to decline by around 125 basis points by end-March 2013, from a high of 3.5 per cent as on March 31, 2010. The improvement will be driven by a structural shift in asset composition towards secured asset classes, stronger underwriting norms and monitoring mechanisms, and a favourable business environment. However, the performance of new asset classes such as loans against property (LAP) and gold loans will continue to be keenly monitored.

CRISIL also expects improvement in the core profitability (as measured by net profitability margin; NPM) of retail NBFCs to continue. In 2011-12, the sector's NPM (pre-credit costs) is expected to reach 2.9 per cent, its highest in five years. Decline in credit costs and improving operating efficiencies could offset the impact of a contraction in interest spreads, arising from increasing borrowing costs. While intensifying competition from banks or new entrants may constrain the sector's profitability over the long term, entities with a strong competitive niche, comfortable resource profile, and prudent credit standards, will be well-positioned to withstand such challenges.

Adds Mr. Pawan Agrawal, Director, CRISIL Ratings, ***"In its transition to the next phase of growth, the NBFC sector will face the test of a tighter regulatory framework, which is consistent with its emerging systemic importance and larger size. CRISIL believes that enhanced regulations will reduce the sector's regulatory arbitrage vis-à-vis banks, moderate growth and profitability in certain product segments, and improve transparency."*** The competitive landscape in the retail finance sector could change, given the likelihood of some NBFCs converting to banks, and entry of new players, including captive finance entities. As players attain scale in operations and increase their geographical reach, their ability to manage challenges pertaining to growth will determine their future credit risk profiles.

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