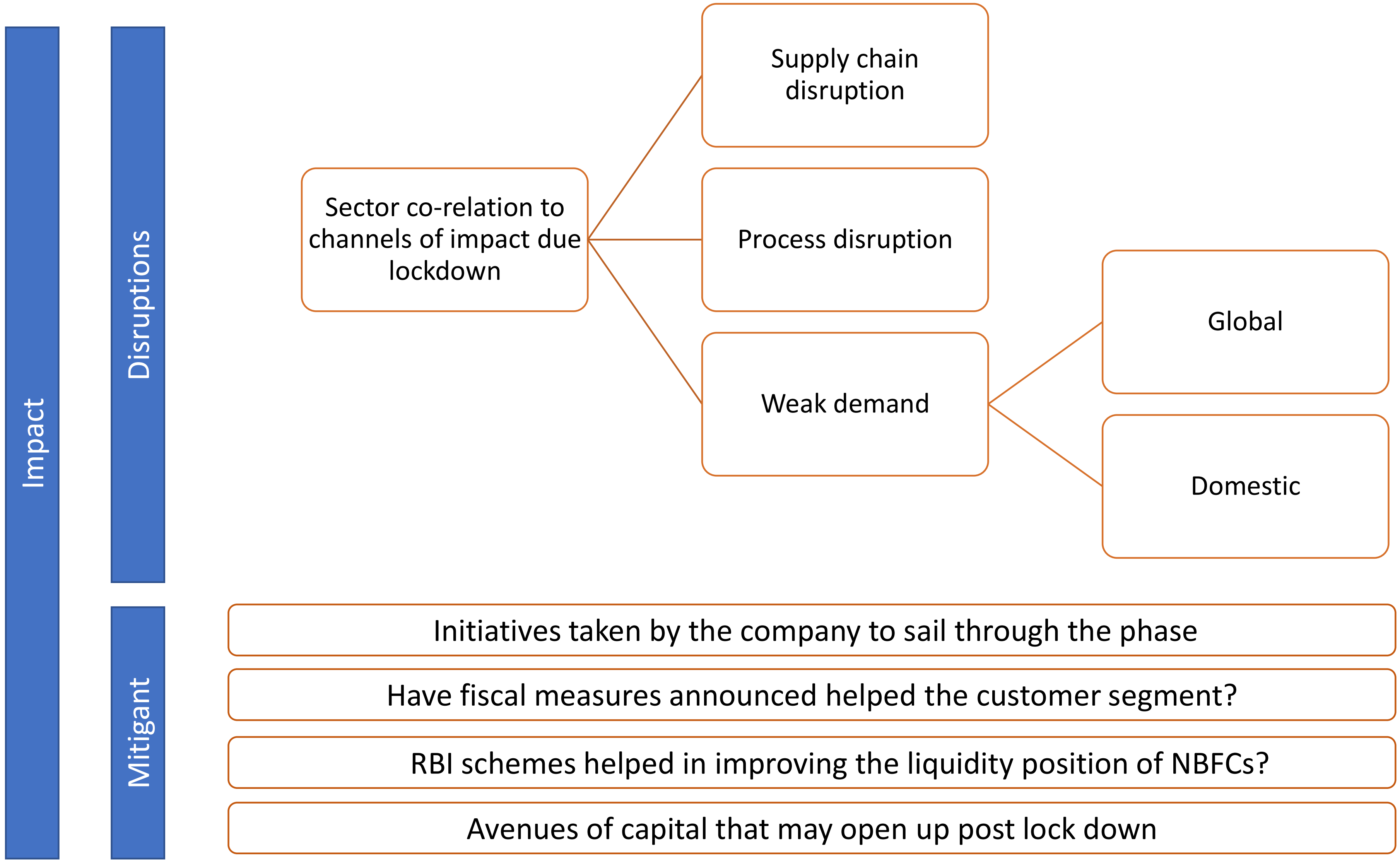
Impact of COVID19 on MFIs: Another test of resilience

April 14, 2020

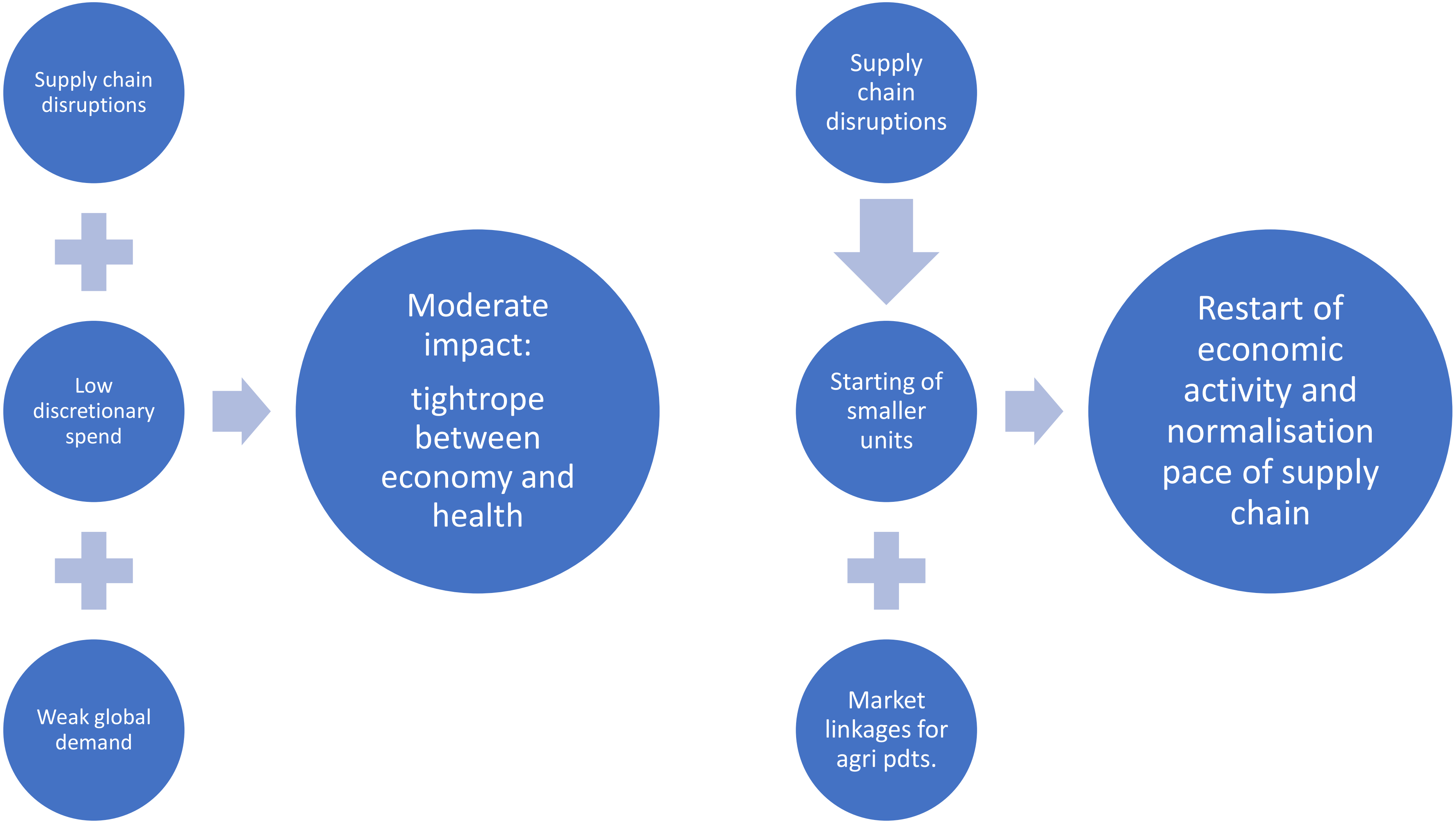
Next 45 minutes..

- ❑ Impact assessment framework
- ❑ Liquidity Impact
- ❑ Historical default rates: Peek into the data
- ❑ Key Risks
- ❑ Outlook
- ❑ From the practitioner’s lens

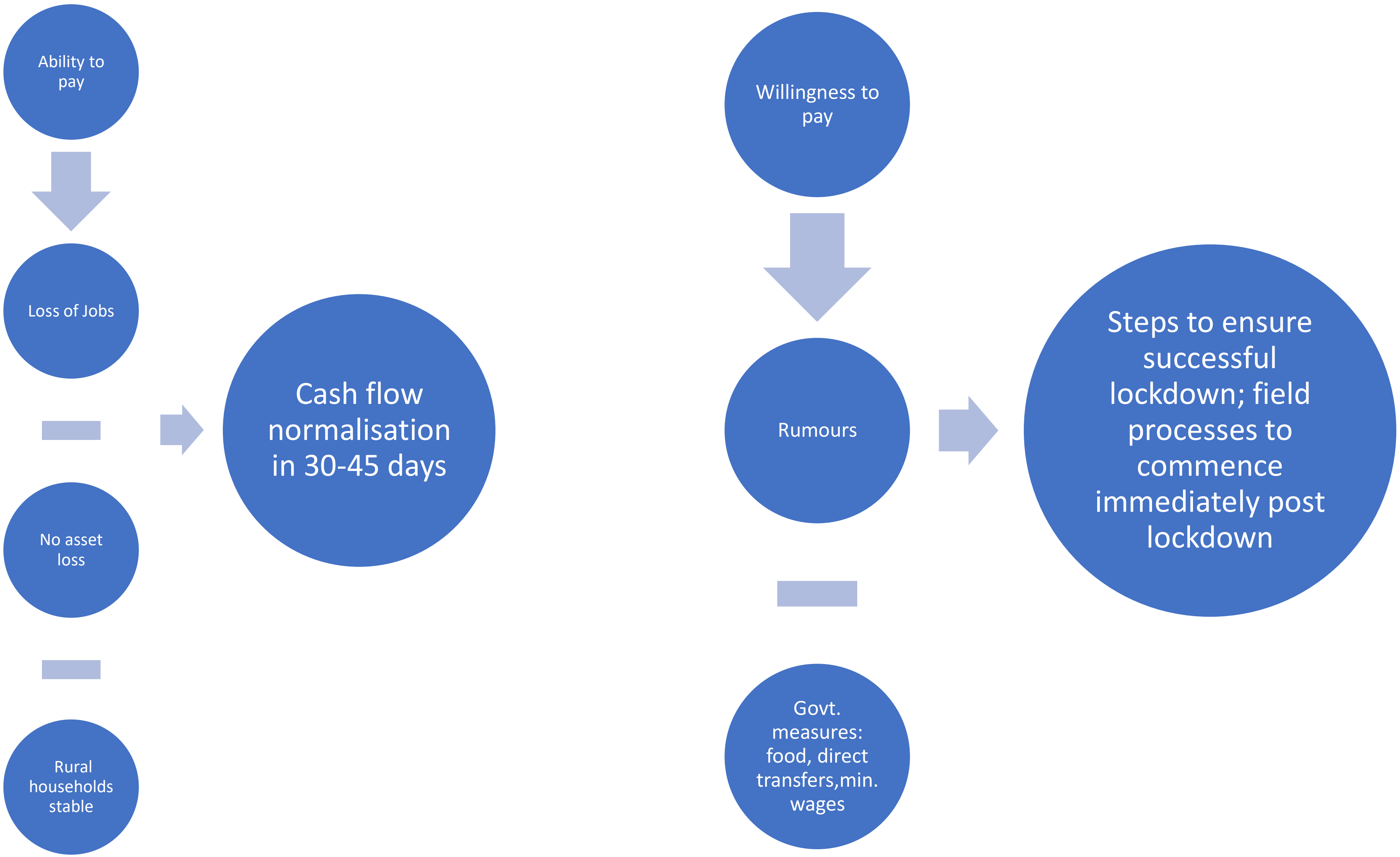
Assessment framework



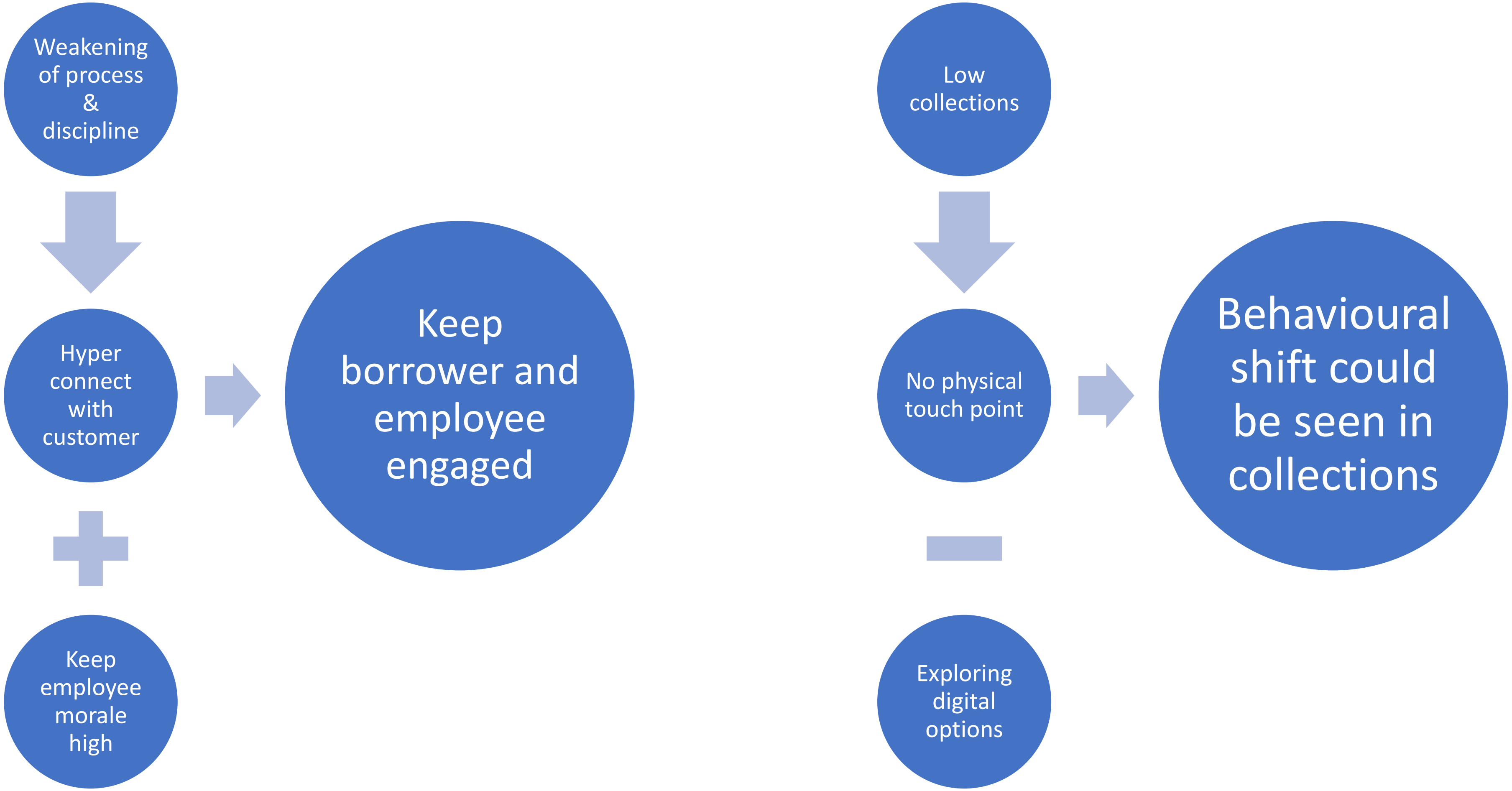
Impact Assessment framework – MFI :: Pillar 1: *Sector co-relation to channels of impact*



Impact Assessment framework – MFI :: Pillar 2: *Customer Impact*



Impact Assessment framework – MFI :: Pillar 3: *Process impact*



Sector resilience has been proven during multiple events – seen many challenges since 2008

1st to be impacted but also bounce back would be swift witnessed in demon, floods and cyclones

Liquidity Impact

Liquidity issue irrespective of scale due to:

- Timing
  - Mismatch in timing due to inflow and outflow
  - Significant quantum of funds are generally raised in March across NBFCs
  - NBFCs disbursed aggressively expecting fund inflow, which dried up post Mar 20 (limited inflow against expectation)
- Growth expectation:
  - Led to disbursements (upfronted outflow)
  - Limited buffers for debt repayments due to expectation of inflows
  - Severe stress in the sector expected from April without moratorium
- PSL opportunities that come up in March in some of the sectors: another key funding source, which witnessed limited action

Private Equity support:

- PEs have infused capital to shore up balance sheets during stress
- New addition to portfolio practically on stand still
- Infusion in existing portfolio for most cos. could be seen post Sep20

Liquidity Impact

COVID Schemes

- Banks announced COVID schemes for emergency liquidity
- Absence of material working capital lines will see limited benefit trickle to the NBFC segment

Multilateral institutions

- Significant allocation by multilateral institutions, primarily for existing portfolio companies to start with
- Impact funds are in principle agreement to support the portfolio cos. to tide over the current liquidity situation

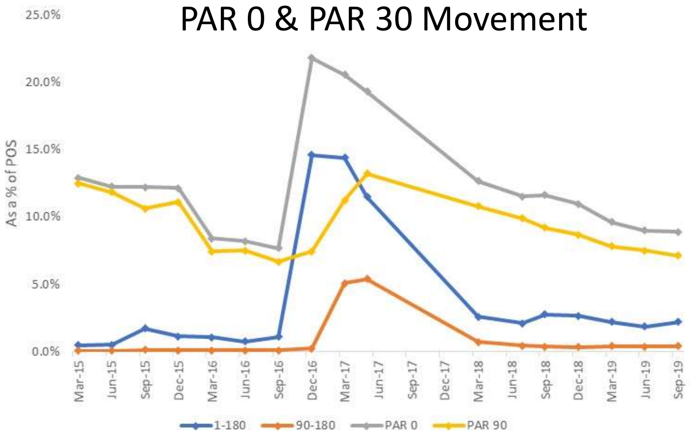
LTROs

- Rs. 1 lakh crore with 50% for primary issuances
- Risk aversion seeing limited investment by banks into papers rated lower than AA+
- Not a breather for majority of the NBFCs

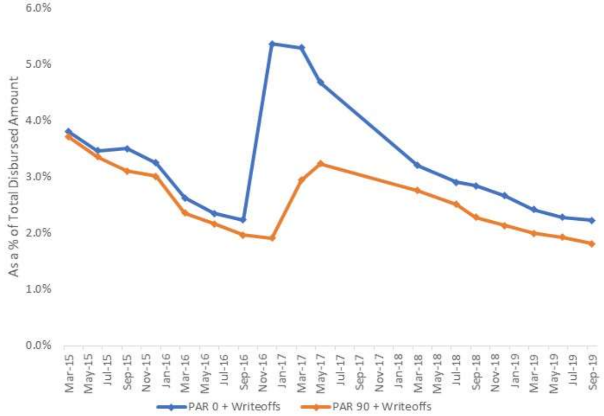
Historical default rates

- Quarterly 90+ dpd (including write-offs) indicate c. 2.5-2.75% credit cost for the industry over the period Mar15-Mar19
- This includes historical 90+ outstanding on each period end date
- As the events have been hitting with higher frequency, the intuitive expectation would be to witness increase in PAR/ weak assets, however the graphs below indicate an increase only due to demonetisation (PAN India event), and localised events (even if impacting multiple districts across 2-4 states not moving the needle)

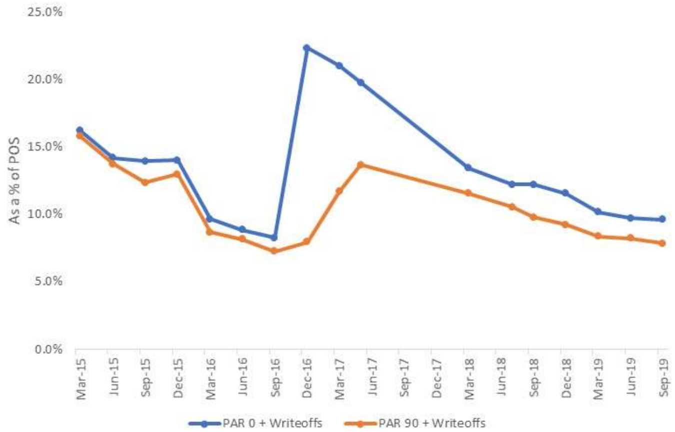
PAR 0 & PAR 30 Movement



Movement of PAR + Writeoffs as a % of Total Disbursement Amount



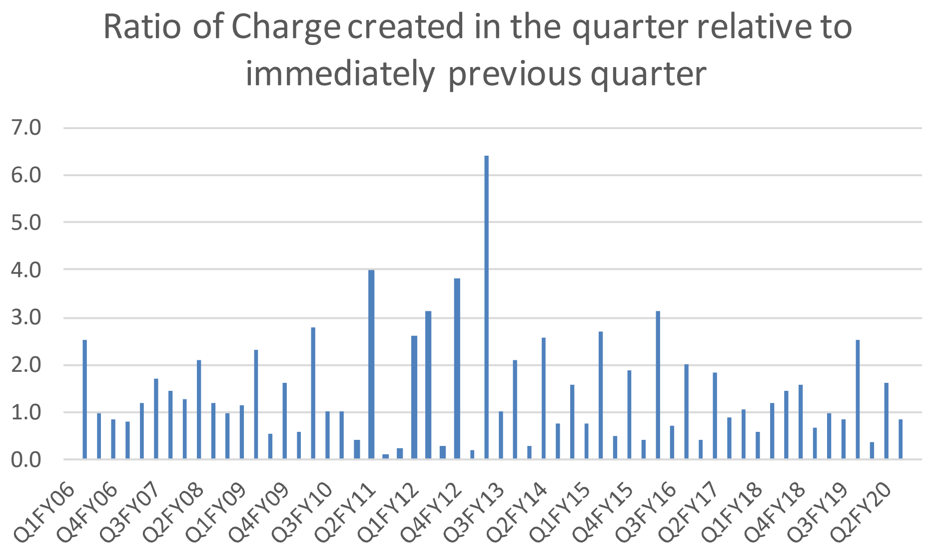
Movement of PAR + Write offs as a % of POS

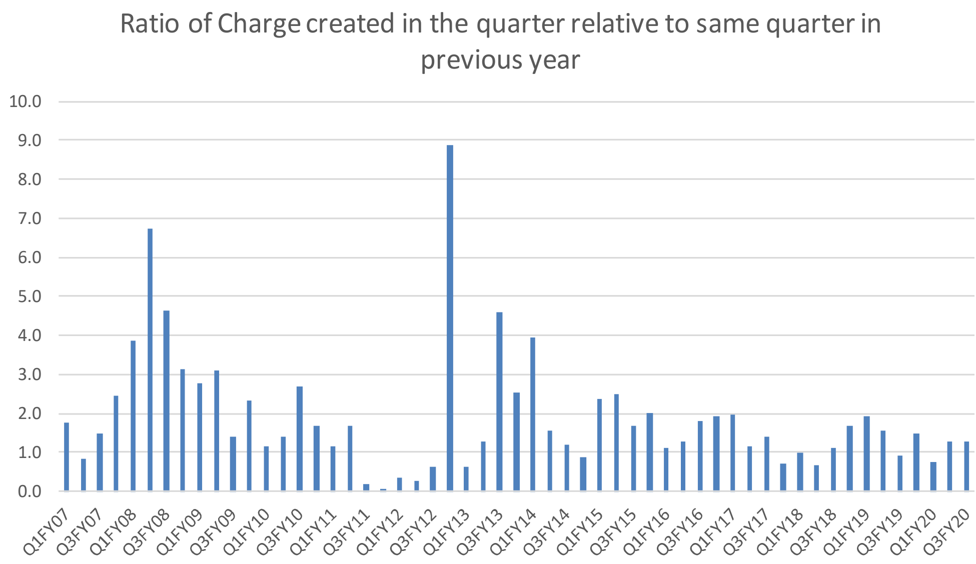


Source: Equifax, Vivriti Analysis

Lenders have been supportive

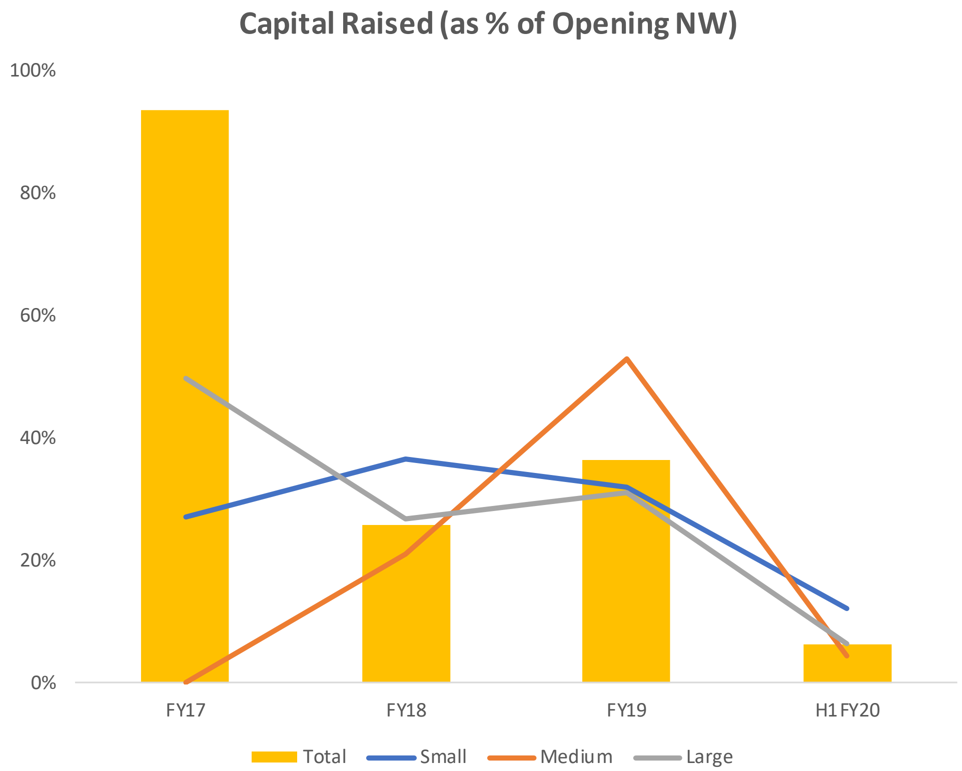
- The sector has witnessed regular and swift support from the lenders across cycles
- We have not seen complete shutdown of funding in the last 7 years, although the quantum could have varied
- The typical lag time has been 1-3 quarters, depending upon the intensity of event as sheen in the below graphs:





Source: MCA Charge creation

Equity interest and infusion has been regular



- The sector has been able to raise equity consistently
- Relative to respective sizes, cos. across the buckets have been able to raise largely similar and healthy quantum although the valuations and hence dilution levels have been different

Source: Financials of individual MFIs, VC's analysis

ALM position

- Considering 0% collection efficiency through Apr-Jun 2020
  - c. 50% would fall short of opex and debt repayments in Jun 2020
- If we combine lack of moratorium along with 0% collection efficiency:
  - c. 70% of the entities will face shortfall during the months of Apr-May20
- Measures which will support liquidity:
  - Moratorium would be critical across all lenders for smooth transmission and discipline maintained across the industry
  - Multilateral institutions continuing to evaluate new deals / cos. even now
  - With disbursements halted, current liquidity is expected to be retained, and any collections will further strengthen the liquidity position of the MFIs
  - PSL nature of assets, coupled with expectation of faster bounce back would continue to attract lenders

Key Risks

Stress	Sub-factors	Key Risks	Key Mitigant
Sectoral Interplay	Supply chain disruption	• Extension of lockdown further stressing cash flows and opex • Ultimate recovery from underlying and hence write backs of income accrued during moratorium period	• Regular touch with clients • Restart collection process immediately
		• Recurrence of infections amongst the customers/ employees/ geo region	• Mapping pincodes • Manage non hot-spot areas
Customer Impact	Ability to pay: Rural Stress	• Closure of mandis and limited market linkages to alternate mandis • Delay in procurement by state governments of rabi crop • Labour availability for harvesting ready crops • Strength of cold storage facilities would be tested	• Partial easing of economic activities • Positive statements from States on protecting farmer interests
Default		• Lack of timely mortarium would tag MFIs as defaulters • will require extension of maturity across pools to prevent GNPA on PTC exposure • DAs will experience volatility	• 100% transmission • Pools / ABS may start flowing from beginning Q2 only as ground situation becomes clearer
Process Impact	Invoking JLG	• Trying to invoke joint liability could result in door to door collection, impact efficiency and field discipline • Borrower backlash and local political interventions	• Collaborative approach • Top-up loans and support financing would be prevalent
	State level actions	• Restrictions on collections at state level • Impact MFIs planning collections after lockdown ease	

Outlook

Sector waterfall on time to recovery

- Key is to activate collections immediately in the field once the situation normalises
- Best practices that would differentiate NBFCs would be driven by:
  - **Employee Management**
    - Frontline warriors playing an important role in keeping the chord between lender and borrowers active
    - Keep the morale high and ensure hyper-communication with borrowers
  - **Borrowers and field management**
    - Regular calls to borrowers by field staff, operations team to avoid spreading of rumours
    - Educating on the difference between moratorium and waiver
    - Plans to restart meetings post lockdown, to get the field discipline and processes back on track
  - **Change in collections approach**
    - Preparation of pincode wise plan as some areas would continue to be under lock down
    - More of a collaborator in these times than enforcing collections
    - Top-up loans and support financing would be prevalent

Outlook

Asset quality deterioration

- Limited impact till May on reported nos., customers not paying without moratorium can also be classified under moratorium
- Sudden deterioration from Jun'20 quarter, before the recovery starts

Behavioral change

- Push towards digital collections
- Alternate documentation mechanism
- More focus on BS strength and leverage management

Liquidity will return

- Will see multilateral institution participating first
- Support from PSUs and other impact investors to follow
- Structured products would garner interest of the private investors
- Sector would continue to be attractive for equity investors

Conclusion

- Collections would be c. 5-8% in May, increasing to 55-60% in June 2020 (given that the lockdown ends on May 3)
- Overall credit cost could be c. 6-7%, however spread over 18-24 months, which the balance sheets can absorb

The sector continues to be structurally sound, and the current issue is that of liquidity and risk aversion; controlled asset quality slippage and PSL benefit would help in fund raise

Thank you

Panel Discussion

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