Finance companies liquidity profile amid the restructuring extension

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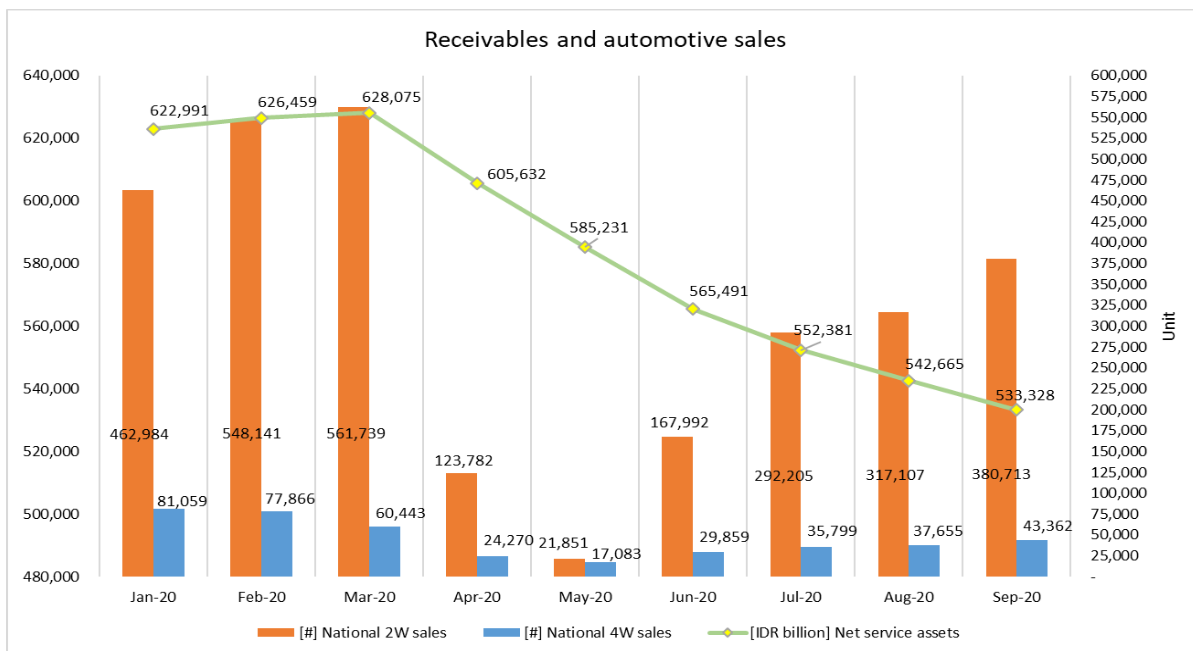
Pursuant to POJK regulation No. 14/2020, finance companies' debtors impacted by the pandemic are eligible for loan restructuring, including receiving longer terms, a lower amount of installment, or even payment holiday for a certain period of time. Initially, such a relaxation will terminate in April 2021, but in the recent release dated December 29, 2020, OJK has agreed to extend the relaxation up to April 2022. Under the situation, finance companies need to anticipate the possibilities of weakening cash flow. The pandemic has currently impacted finance companies mainly in the forms of declining new booking and a low installment collection. Accordingly, a higher amount of restructuring may heighten the liquidity risk of finance companies.

To mitigate this risk, finance companies need to maintain a strong relationship with banks being their main source of funding. Another source is shareholders' loans or capital injections that may be utilized to sustain the going concern of the finance companies, particularly for those already strained by financial obligations coming due. We also view that in the event this restructuring extension policy also involves banks' willingness to support the finance companies, this will ultimately help ease the finance companies' liquidity pressure. Although this will partly shift the liquidity risk to banks, banks typically have more room in managing their liquidity since the risk of substantial deposit withdrawals has been relatively low.

However, we observe that in our portfolio, there have been only a few finance companies requesting to restructure their borrowings to banks, partly to maintain trust and relationship with their partner banks. In our opinion, the pursuit of such a strategy is intended to keep the credit line with banks open so as to facilitate the finance companies to resume new loan disbursement once the pandemic abated.

Graph 1: The relationship between net service assets and automotive sales for the period of January 2020 – September 2020



Source: Finance companies' statistics – OJK, Gaikindo, AISI, processed by PEFINDO

Restructuring impact to finance companies' liquidity

With the extension of restructuring relaxation, finance companies' cash flow will significantly worsen. As of October 27, 2020, a total of 4.79 million contracts have been restructured with an outstanding amount of IDR177.7 trillion, or approximately 30% of the total industry's financing receivables. Accordingly, maintaining a good relationship with the partner banks is pivotal, given the finance companies' high reliance on funding, between 60% and 70%.

Meanwhile, access to the capital market through debt instruments has been more limited due to investors' more conservative stance. Growth opportunities are also limited as reflected in the subdued national automotive sales, both two and four-wheelers, despite early signs of a rebound. Therefore, banks are hesitant to lend support to the financing industry. Instead, they prioritize lending to their groups or alternatively to finance companies backed up by stronger parents. The table below shows that the bank loans to the finance companies have declined in general.

Table 1: off balance receivables and funding from domestic banks

In IDR billion	2016	2017	2018	2019	Sep-20
Off book receivables*	141,768.0	151,532.8	167,611.3	168,198.3	142,976.2
Funding from domestic banks	157,404.9	172,890.7	174,212.5	172,182.3	138,976.6

*) joint financing and channeling

Source: Finance companies' statistics – OJK, processed by PEFINDO

Further impact to finance companies' profitability performance

The pandemic has led to a significant deterioration in the finance companies' profitability. As signs of abatement has not appeared, an extension of restructuring is inevitable which call for strong support from the shareholders and partner banks. The pandemic has undermined profitability in several ways, namely lower revenue prompted by a decrease in automotive sales volume, loan restructuring, and high operating costs due to increased credit costs. We observed lower interest income to IDR66.4 trillion in 9M2020 from IDR69.9 trillion in 9M2019. The declining new booking has translated into lower financing receivables (on and off book) of IDR533.3 trillion as of 9M2020 or down by 14.1% YoY compared to financing receivables of IDR624.9 trillion in 9M2019.

Conversely, the higher credit cost (in spite of restructuring) has led to the need to increase provision expense. All these factors combined have resulted in a trend of finance companies' de-leveraging, as reflected in a lower gearing ratio, deterioration of asset quality, and higher provisioning expense, resulting in a rise of NPF and BOPO ratios. Ultimately, finance companies report much lower returns in 2020, as the ROAA stood at 2.0% in 9M2020, well below that in FY2019 of 4.8%.

In terms of cost funds, it showed a declining trend with an interest expense reported at IDR18.1 trillion as of 9M2020 or down by 13.2% YoY compared to IDR20.9 trillion as of 9M2019. The decline in the interest expense, in our view, resulted from two factors. The first is a cut in the BI seven-day reverse repo rate (BI7DRR) by 125 bps this year from 5.00% in January 2020 to 3.75% in November 2020. The second, in our view, is the low growth in recent years amid the pandemic. Since the pandemic starting in March 2020, finance companies have adopted a more conservative approach, reduced their business expansion, and focused on maintaining liquidity. This condition has prompted finance companies to seek a new loan facility with a lower interest since they also find it challenging to obtain good quality debtors that match their credit risks assessment.

Table 2: finance companies' financial ratios

Financial ratios	2016	2017	2018	2019	Sep-20
[x] Gearing ratio	3.0	3.0	3.0	2.6	2.4
[%] NPF	3.3	3.0	2.7	2.4	4.9
[%] ROAA	3.9	4.0	4.3	4.8	2.0
[%] BOPO	82.8	81.5	80.7	78.9	91.9

Source: Finance companies' statistics – OJK, processed by PEFINDO

Conclusion

In coping with the impact of restructuring extension, finance companies will need to ensure the adequate liquidity position. For finance companies affiliated with banks, big conglomerate groups, or major automotive principal, we view the impact should be neutral as finance companies under these categories derive benefit from stronger financial flexibility attributable to strong parents' support. This stronger financial flexibility will make it easier for finance companies to adjust to the restructuring extension without aggravating the pressure on their liquidity profiles. On the other hand, independent finance companies will likely be very selective in offering restructuring extensions to their debtors, as they also have to cope with their own liquidity pressure. Independent finance companies have to undergo the pandemic impact through lower collection rates, declining new booking, high restructuring amount, and lower funding facilities from banks. An ill-prepared restructuring extension may exacerbate the deterioration of their financial performance, particularly liquidity and profitability performance. In our opinion, independent finance companies will be more likely to execute or repossess the financing objects or collaterals to get cash upfront so as to enable them to settle their own financial obligations. The refinancing risk may escalate if finance companies are facing the maturing short-term financial liabilities, particularly from its debt issuance. Investors in public debt are considered to have less flexibilities in providing relaxation to the debt issuers, compared to the banking sector which has been allowed through POJK No.48/POJK.03/2020. There may be downward rating pressure with the debt maturity date is getting nearer without any concrete plan from the issuer in resolving this issue.

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