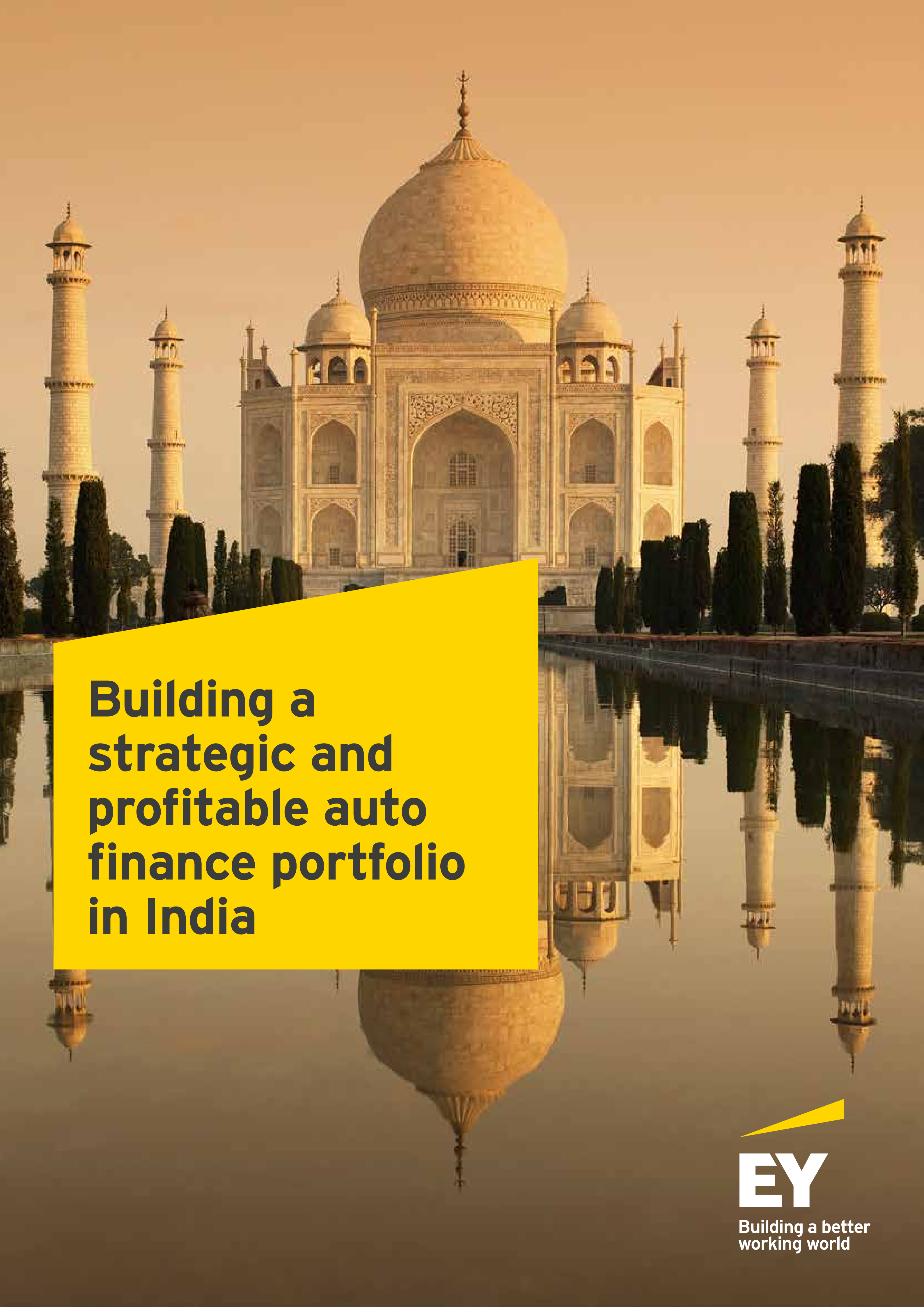
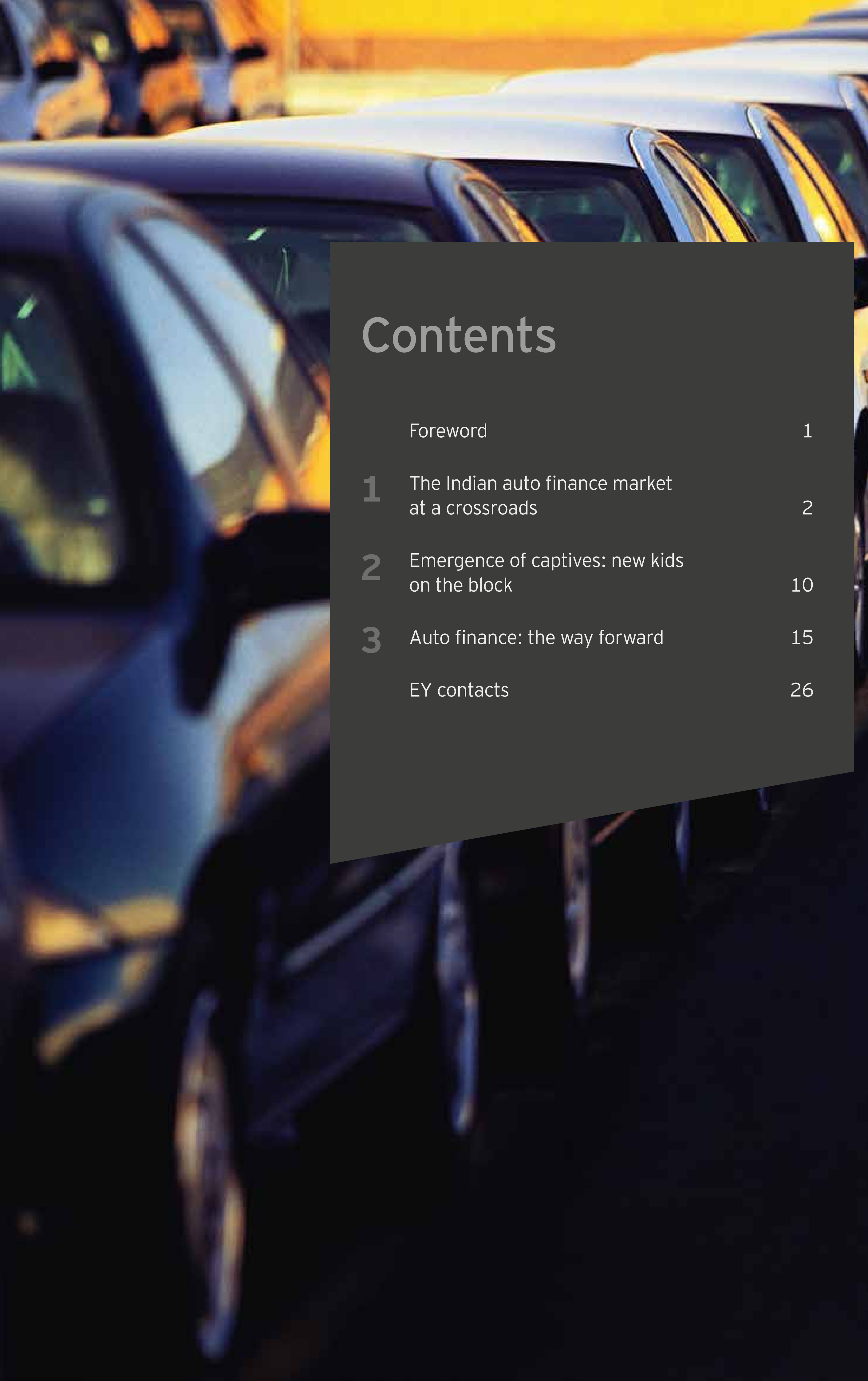


Building a strategic and profitable auto finance portfolio in India

EY

Building a better working world



Contents

Foreword

The Indian auto finance market is one of the most matured in the world, with penetration levels of approximately 75% and the experience of multiple cycles. With significant innovation in areas of digital underwriting, collections, customer life cycle management being driven in the market by leading OEM captives, it has the potential to become a benchmark in auto financing.

Jens Diehlmann
EY Global Automotive Finance Leader

The Indian auto finance market has seen a significant transformation. Key value drivers for the business have increasingly changed to building a more holistic relationship with both car buyers and dealers, requiring car financiers to relook at their auto business strategy.

Fali J Hodiwalla
Partner, Financial Advisory Services
Ernst and Young LLP

1

The Indian auto finance market at a crossroads

Auto finance market in India has gone through peaks and troughs, ...

The auto finance market is at the cusp of a high-growth period fuelled by economic growth, innovative products, improved credit collection processes and effective use of online channels. However, over the years, it has gone through several cycles of low-growth to high-intensity competition, to shrinkage, to stabilization and now at the cusp of rapid growth again.

1900s

- Auto finance market takes shape in late 1990s, as liquidity in economy and strong growth in auto sales drove NBFCs to aggressively capture market share.
- Banks participate only through on-lending to NBFCs.

2000s

- Opportunity in the auto sector and improvement in risk management techniques (introduction of credit bureaus) led to the emergence of banks as the leading market players (approximately 65% share) in the early 2000s.
- Organized players begin focusing on used vehicle and refinance.
- Financiers resort to aggressive selling through subventions and interest rates cuts.

2007-08

- The recession of 2007 led to a period of economic slowdown and NPAs shot up. This created a period of low growth and reduced competition. This was a phase of high rates, low LTVs and strict customer profiling.
- Liquidity crunch and rising defaults force players to reduce auto loan exposure. Several leading banks and NBFCs left the market and sold off portfolios.

2011-14

- Post 2011, even as the economy recovered, banks were still shy to lend aggressively.
- This opportunity was seized by OEMs to set up their own captives. Captive financiers start offering customized product offerings in loan and lease segments.

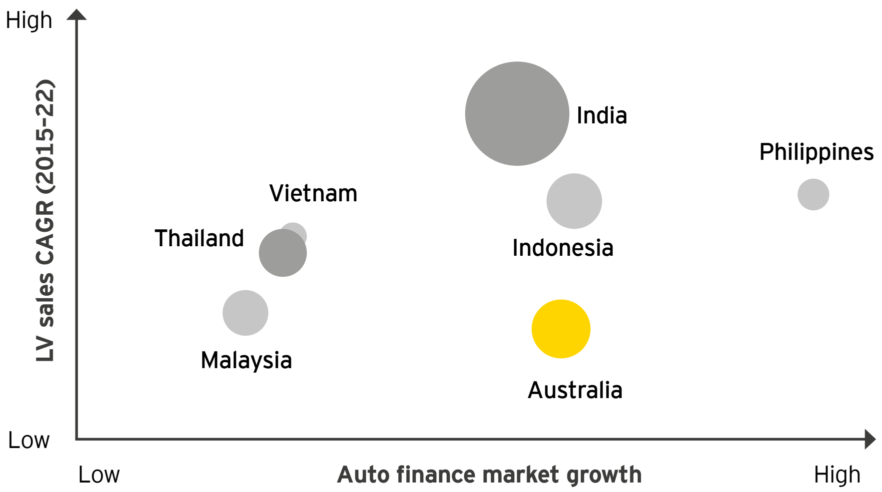
Present

After a period of slow growth till 2014–15, the auto finance industry has started to grow rapidly.

Increased presence of fleet taxis is opening up new segments.

These ups and downs of the auto and auto financing market have helped the market mature. It is currently a well-developed financing market with 74% finance penetration, and sub-1% NPAs. This puts it in a prime position to leverage the next cycle of consumerism and lending growth in the country.

... yet matured over time, making it one of the most developed auto finance markets in the Asian region.



Size of bubble indicates LV sales in 2015 and color denotes market maturity.

72%

India has a healthy portfolio LTV, at par with developed countries.

Auto finance market maturity description

1 High

These markets are characterized by strong presence of captives, operating through advanced financing and leasing products.

2 Moderate

While strong finance penetration and considerable market share of captives characterize these markets, high potential to increase adoption of advanced financing and leasing products exists.

3 Low

These markets have limited finance penetration, with automotive finance landscape primarily governed by local banks and NBFCs through standard product offerings.

The Asian market offers a good opportunity for lenders and captives to penetrate further and build high-growth portfolios.

Challenges

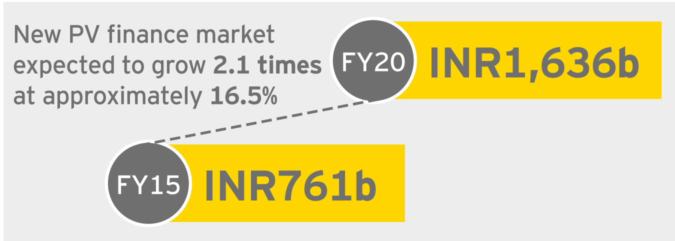
- Lack of credit history of first-time buyers
- Debt burdens relative to individual income are 30% higher as compared with the US
- Higher rate of loan defaults in some markets

Opportunities

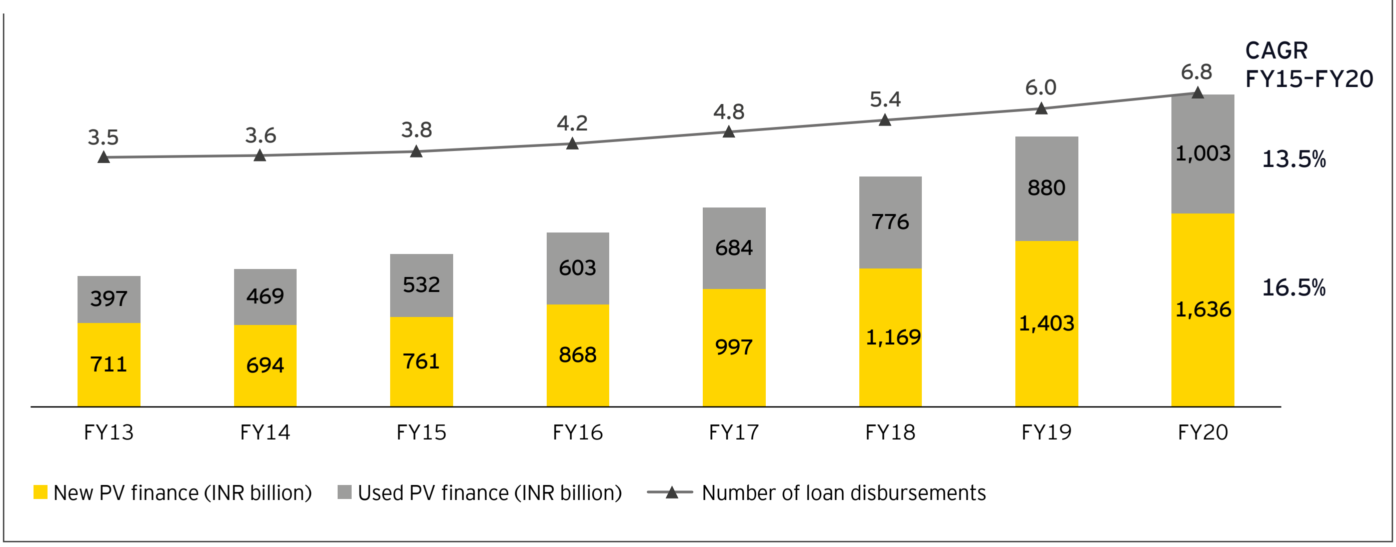
- Addition of 100 million people into middle class every year – a potential to add over a million additional new entry-level cars each year
- Current low auto finance penetration rates
- Regulations to avoid auto finance bubble – minimum down payment rule

The Indian auto finance market is poised for a breakout again and provides an addressable opportunity of over INR2,600b by FY20.

The period from 2010 to 2015 has been one of mixed recovery. The period witnessed increased participation from NBFCs and captives, resulting in intensified competition and product innovation. While in 2007-09, OEMs were primarily focused on developing and leveraging relationships with financiers to penetrate rural markets, during 2010-15, focus moved to leveraging finance for strengthening market position while improving dealer control and profitability.



Strengthening of PV finance market is expected to be driven by growth in both – loan disbursement volume and average loan value.

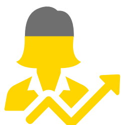


Promising future for the auto finance industry

The growth will be driven on the back of:

3%-5%

increase per annum in ticket size of cars



75%

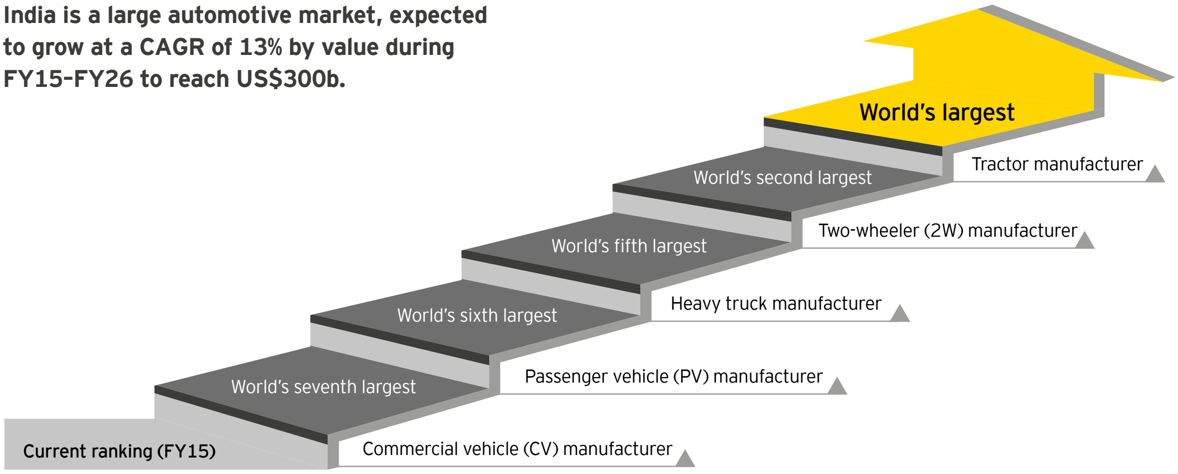
LTV growth of 2%-3% from **72%** to **75%**

80%

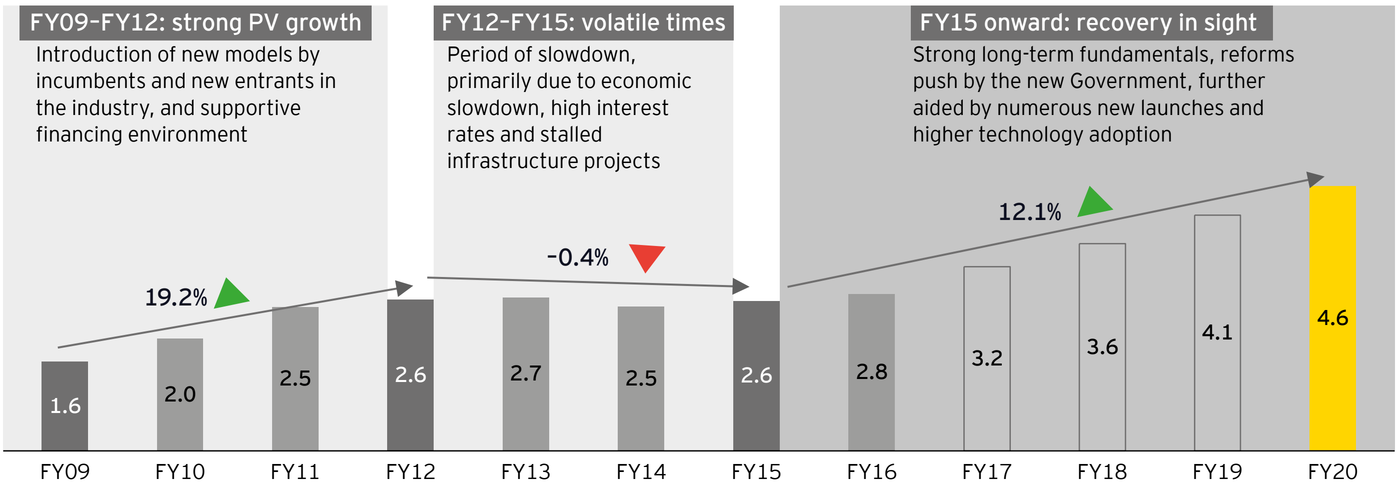
Finance penetration growth from 74% to 80%

The growth is expected to be driven by the revival of the underlying automotive market, ...

India is a large automotive market, expected to grow at a CAGR of 13% by value during FY15-FY26 to reach US$300b.



After facing stagnation in FY12–FY15, the country is witnessing signs of sustained recovery.

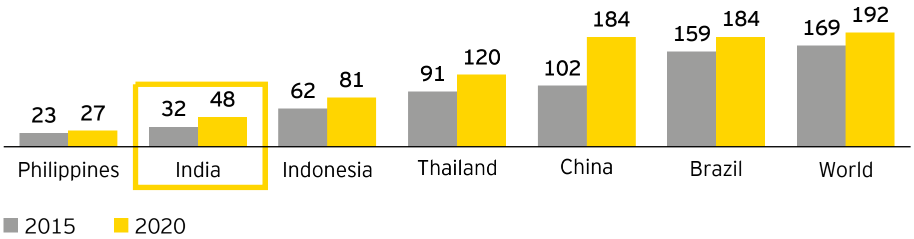


Total PV domestic sales, million units, FY09–FY20

The country's growth potential is helped by the existence of large driving population, which is expected to aid growth in vehicle penetration.

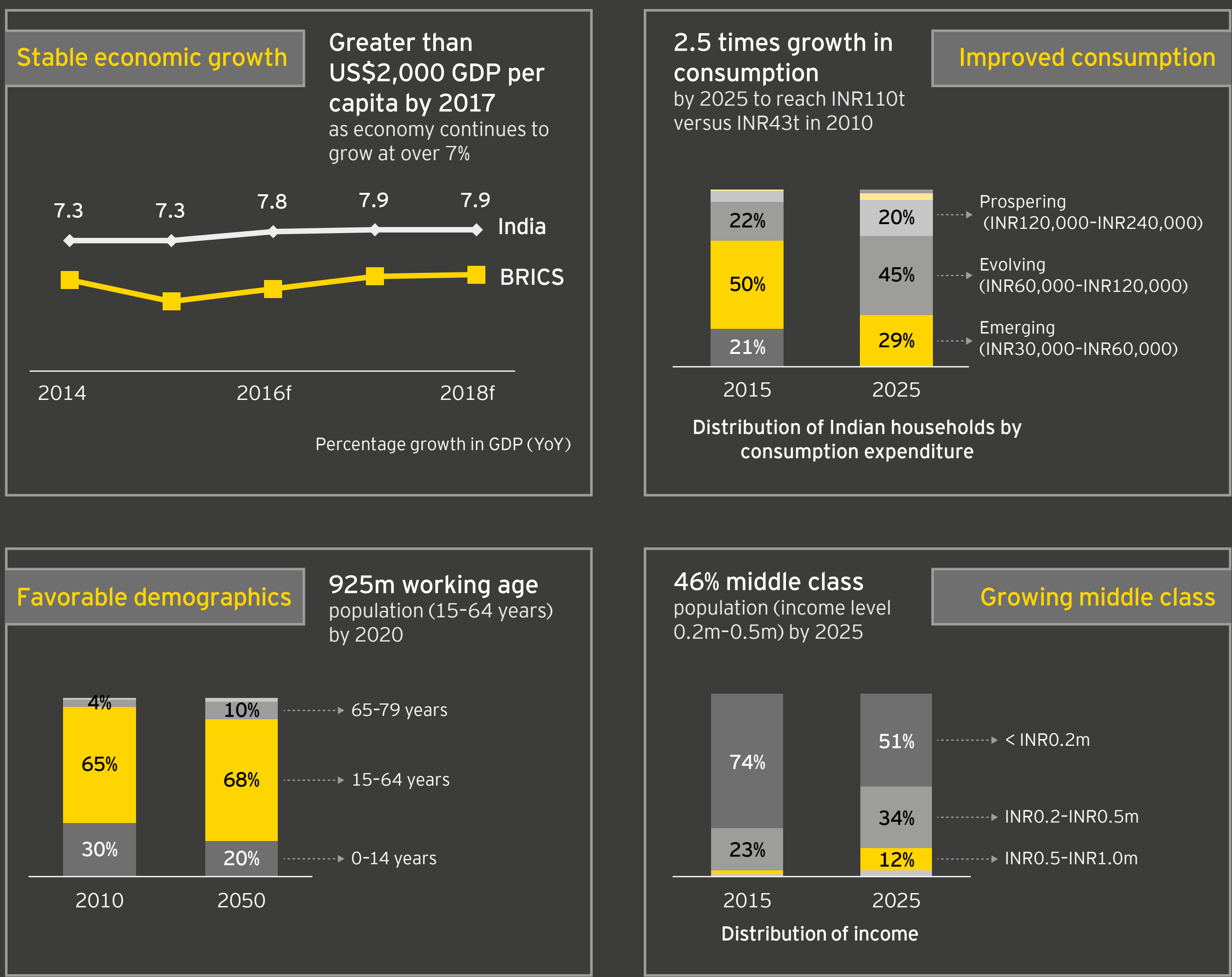
By 2020, the country's vehicle penetration is expected to increase by 50% albeit against low base. With a population size expected to hit 1.4 billion in 2020, and large majority of the population belonging to the driving age, the country provides for one of the world's most attractive auto markets.

Vehicle penetration, per 1,000 driving population



... the country's strong demographic, socioeconomic fundamentals ...

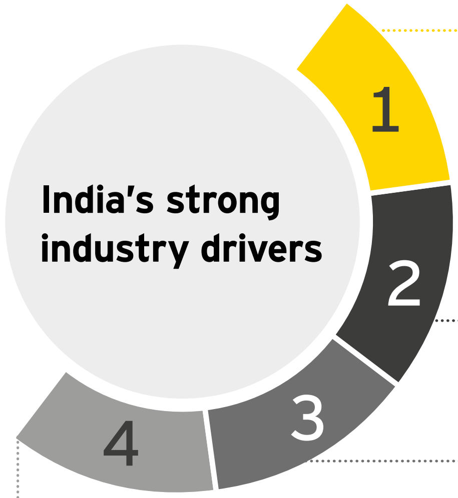
The long-term fundamentals for the market remain strong as the country evolves into the fastest-growing global economy. The country offers a strong growth potential to the industry, owing to its strong consumption, large youth population, and rise of the middle class and working population. Furthermore, favorable factors of production and a strong push by Government to improve manufacturing in the country are key enablers for OEMs looking to leverage local production to serve the country's and nearby markets.



Source: Kotak Institutional Equities Research; United Nations; Department of Economic and Social Affairs, World Bank

... as well as well-developed industry fundamentals, such as credit infrastructure.

The country's strong fundamentals provide significant foundation to a market that is poised to more than double its current market size by FY20.



Strong credit infrastructure

- India's credit infrastructure is well-developed due to increased use of credit bureaus, internal scoring models and strong collections processes leading to low NPAs in this sector.
- Gross NPA levels in the industry have significantly improved to sub-1% levels for most of the leading players, from 3%–5% seen during the 2009 crisis.

Product variants and new segments

- PV retail financing in India is predominantly through vanilla loan products. However, captives have started to offer innovative products and subvention schemes, including product bundling.
- These products are relatively complex to sell due to limited sales capability at the point of sale and low customer awareness. However, the related multifaceted benefits are expected to drive the sale of such products.

Used car financing

- Used PV disbursements of INR532b, is 41% of total and expected to grow 1.9 times at a CAGR of approximately 13.5% during FY15–FY20 to reach INR1,003b.
- Organized finance is expected to comprise approximately 20% of this market in FY20, up from approximately 15% in FY15.

Regulations favoring NBFCs and captives

- Regulations related to flexible lending norms such as subvention schemes and lending below base rates are stricter for banks, providing significant expansion opportunities for NBFCs and captives.
- Captives-driven subvention schemes are highly effective in Indian market.

However, the challenge faced by auto financiers – portfolio profitability – still remains.

Historically, auto financing has been a low-profitability business, due to intense competition, restricted pricing power and high opex costs. While the cost of funds, especially for NBFCs has been going down, the ROAs continue to operate in the 1%-1.6% ranges.

Percentage of average advances	Banks		NBFCs
Internal rate of return (IRR)	11.0%	NBFCs have higher lending rates on account of riskier profiles they lend to.	14.5%
Processing fees and other income	0.2%	NBFCs charge higher processing fees, particularly in the used segment.	0.65%
Interest expense	6.0%	NBFCs rely on expensive market instruments, driving up cost of funds.	9.0%
Net interest margin	5.2%		6.15%
Operating cost	1.75%	NBFCs have higher opex, mainly on account of door-step collections and salesforce payouts.	2.3%
Dealer payout	0.95%		0.8%
Credit loss	0.5%	Riskier target segment of NBFCs lead to higher credit losses.	0.5%
Profit before tax	2.0%		2.25%
Tax	0.6%		0.65%
ROA	1.4%	Control on credit loss is very critical for a reasonable ROA of a NBFC.	1.6%

The low ROAs on the auto finance portfolio have led to the withdrawal of several leading retail focused banks from the market, creating the opportunity for new players to come in.

2

Emergence of captives

New kids on the block

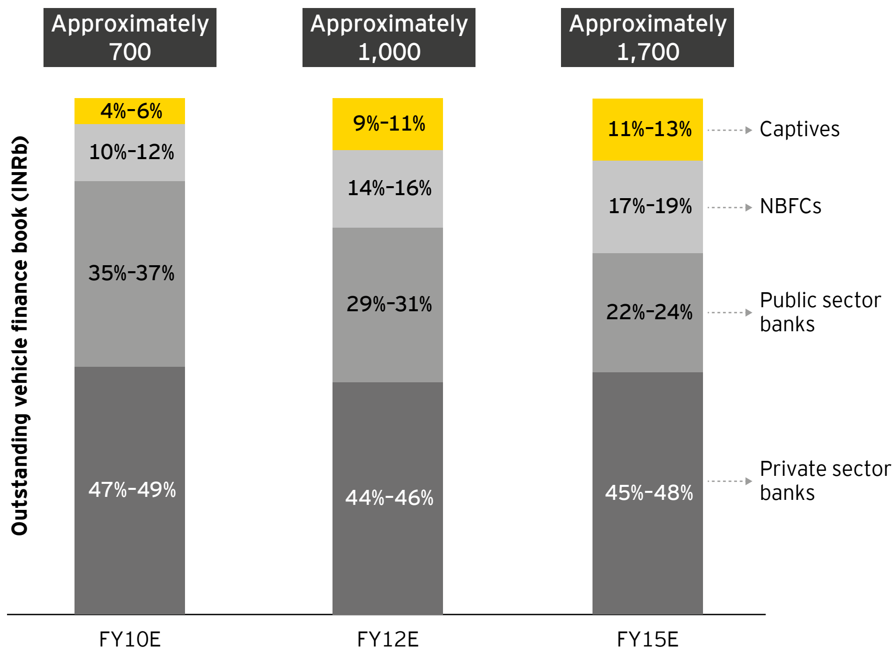
Captives have emerged as key contenders in the Indian automotive finance landscape

75%–80%

Finance penetration of foreign OEMs with captives has been higher than that of market, primarily driven by innovative campaigns.

While multiple financiers exist in the market, the top 10 players account for approximately 80% of the new PV financing market.

Changing competition landscape in new PV finance



1

The top three **private sector banks** dominate the market due to their wide **customer base, competitive rates, customer service and cross-selling** supported by aggressive marketing and wholesale financing tie-ups with dealers.

2

PSU banks have been losing market share, primarily due to relatively **passive strategies in the face of increasing competition** from NBFCs and captives, and tight credit environment. These banks predominantly compete on **competitive pricing and low service costs.**

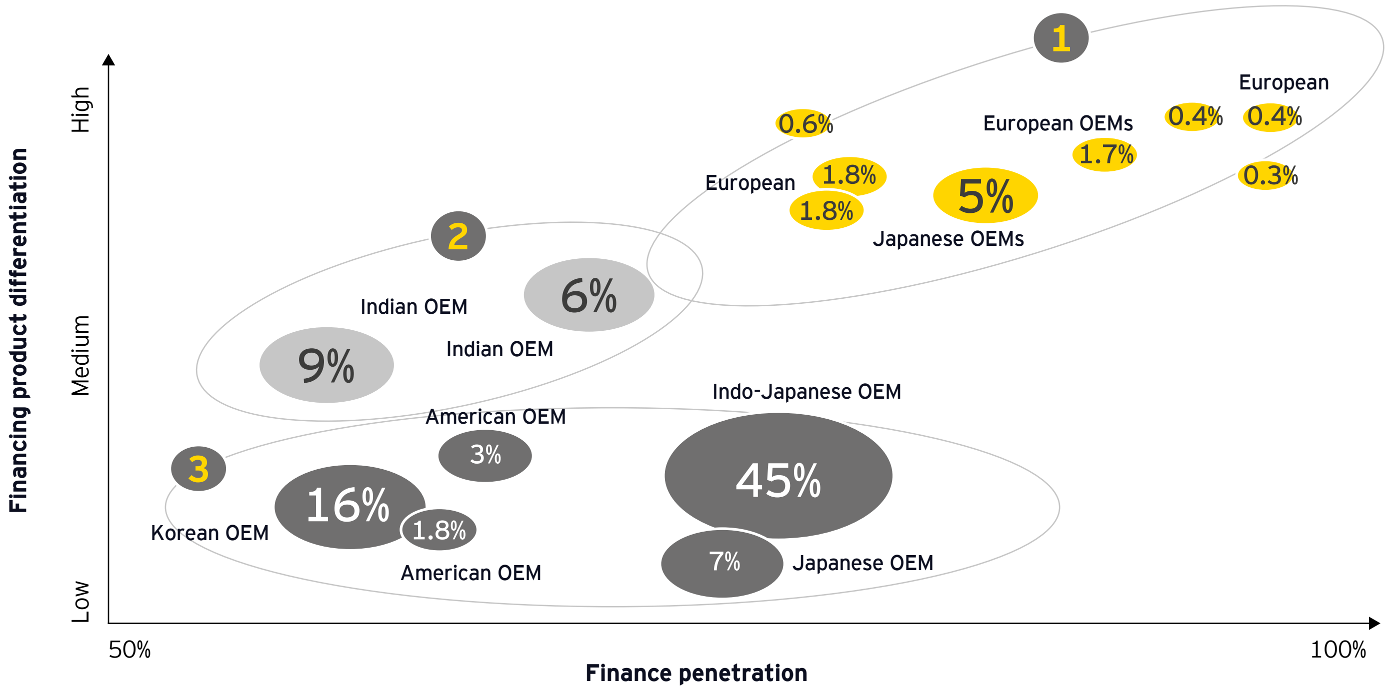
3

NBFCs and captives have primarily **leveraged non-metro and rural customer base** to increase market share. While NBFCs have focused on high-risk customers, captives have looked to offer subvention-linked innovative products.

Source: Company annual reports, India Ratings and Research reports, EY analysis

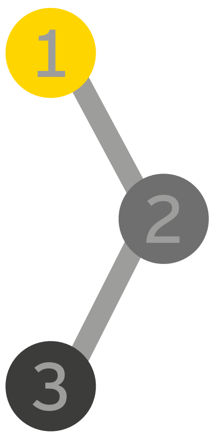
Most foreign OEMs have adopted the captive route to improve finance penetration.

The financing approach of OEMs in India exhibits three major strategic approaches as depicted in the chart below.



Foreign OEMs with captive financing setups

These companies have leveraged captives to promote sales through differentiated financing products. Further, they have actively supported dealer funding requirements and enhanced dealer relationships.



Indian OEMs with captive financing setups

While these companies offer a combination of standard and customized products, they have a low finance penetration due to higher focus in rural segments.

Financing through tie-ups: banks and NBFCs

These companies offer standardized product offerings and primarily rely on cash discounts to increase sales momentum.

Source: Company annual reports, India Ratings and Research reports, EY analysis

Captives have been successful as they added value to the entire ecosystem – OEM, dealers and customers, ...

Captives are playing a pivotal role across the customer and vehicle life cycle with an overarching objective to drive profitability based on higher sales and brand enhancement. Over the year, captive finance units have been able to drive multiple agendas for OEMs, such as enabling growth in dealer profitability, improving customer engagement and reducing the dependence on other financing channels.

Captives' success in the retail market has been primarily driven by their potential to offer differentiated and innovative financing schemes with effective customization. Furthermore, captives provide lucrative dealer financing schemes with interest-free periods and subventions to aid inventory funding and drive dealer profitability.

OEM | **Goal**: Incremental sales ← **Improved group profitability** → Brand enhancement

Objective of captive	Potential to offer **differentiated finance schemes with subventions** to increase sales in urban areas	Offer product, customer segment and geography-specific schemes	Potential to **enhance residual and resale value** and increase used car sales
Key stakeholders: Dealer profitability and control (↑)	Potential to **improve dealer relationship** and control by providing inventory and other fund requirement	Improved profitability due to incremental sales and **increased in-house finance penetration**	Potential to improve aftersales revenue by offering **bundled products**
Key stakeholders: Customer engagement (↑)	Ability to develop a **customer database**, use **analytics** and leverage for resell and cross-sell	Potential to improve customer relationship by offering **"one stop solution"** through bundled products	Opportunity to improve **customer loyalty**
Key stakeholders: Dependency on existing financing channels (↓)	Ability to independently conduct **creative marketing campaigns**	Ability to **bridge existing credit gaps** and increase sales	

Pre-sales → Sale → Post-sale → Repurchase

Car life cycle

Source: EY analysis

… particularly leveraging on subvention schemes, differentiated products and dealer engagement.

Differentiated products and subvention-based schemes have provided a strong opportunity for captives to garner market share, as they enhance the overall value proposition for the customer.

Approximately

80%

of customers would consider buying a car higher than their budget, if attractive financing schemes are available.

58%

of dealers believe differentiated finance products can lead to more than 10% increase in sales.

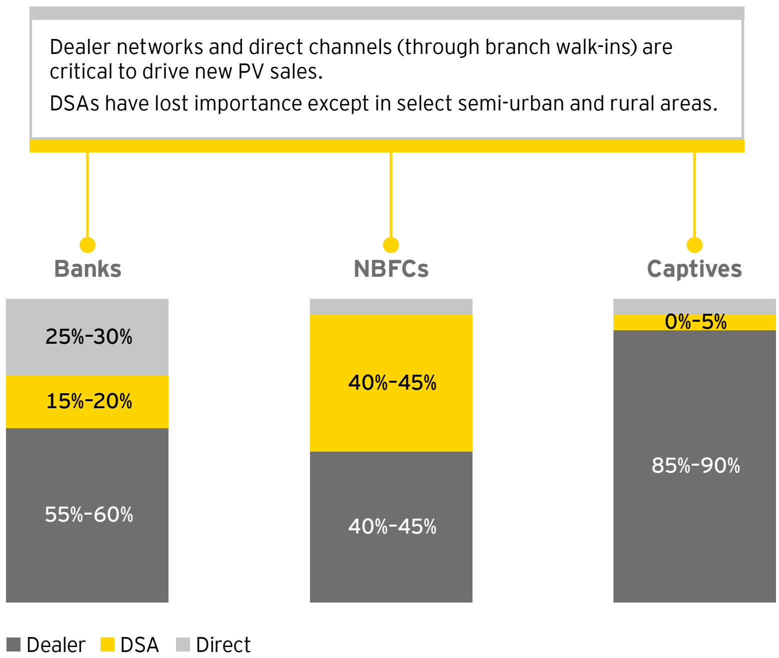
However, the market is witnessing a growing trend where OEMs with captives are able to provide alternative financing products including leasing, step-up or step-down, and bullet or balloon payments. These products have enabled captives to attract the premium customer segments and enhance overall customer value proposition.

Meanwhile, banks are offering high LTVs and longer loan repayment tenures to customers, leveraging their large customer bases while also waiving processing or foreclosure fee in order to stay competitive in a market where regulations limit their ability to customize financing products.

Vanilla loans continue to dominate the Indian market landscape with approximately 95% market share, as their ease of availability and simple structure attracts majority of customers, while alternative financing products have had low popularity due to multiple challenges:

1. Complexity to sell due to sales capability at the point of sale
2. Customers' fear of being duped
3. Low customer awareness

Captives have also leveraged the dealer channel well to drive their growth



3

Auto finance
The way forward

While it's a high-growth market, the restricted profitability on the book, even during good credit cycles, is not driving enough banking and NBFC focus on this segment. In this section, we look at a few key drivers to the auto financing strategy, which can significantly enhance the portfolio profitability, even making it the most lucrative product on a retail financier's book.

1 Choose the right segments and target them with the right customer value propositions.

The Indian market is witnessing new segments emerge with rise in level of income across tiers and strata. The rise of consumerism and the onset of the digital age have fuelled the aspirations and requirements of the millenials, which the auto financiers need to gear up to meet. Hence it is critical for any financier to identify and target their segments and geographies well, and thereon build customized value propositions. Financiers would need new operating models to reach out to customers, establish credit worthiness and make the most of the opportunity. It must be noted that the customers today will benchmark us to their best e-commerce app and not the best bank.

Rapid-growth segments	Segment characteristics	Segment's financing needs	A financier's value proposition
First-time buyers	Growth in youth population, favorable income and rising aspirations are fuelling rapid increase of first-time buyers.	Need for affordable financing options with high LTVs and a great customer experience	Engaging early in life cycle through affordable financing – subventions and high LTV schemes
Fleet and taxi segment	Fleet and taxi segment accounts for approximately 10% of the Indian PV sales. The emergence of high-growth taxi aggregator platforms is expected to further drive the segment's volume, as more drivers look to own cars to integrate with these platforms.	Need for affordable financing with high LTVs, longer tenures, flexible documentation and income surrogates	Repayment flexibility, bundled maintenance, high LTVs, long tenure schemes backed by risk-based pricing
Self-employed	A fast-growing segment which continues to be the key target for NBFCs, and generally facing the issue of unavailability of traditional income proofs, this segment is a driver of growth and profitability for NBFCs.	Fast turnarounds, need for financing options relying on surrogates for income and with ease of documentation	Bundled schemes backed by risk-based pricing and with used car, top-up or refinance options

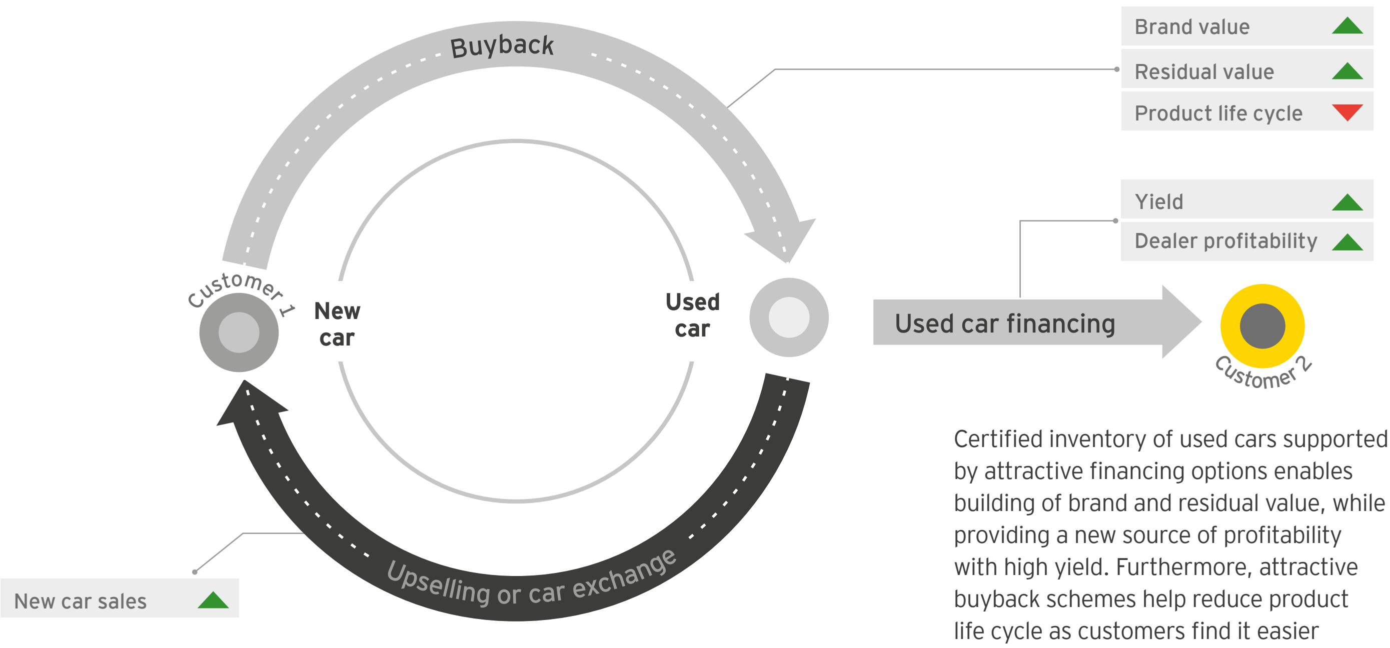
70% of the **compact car owners** are **under 35 years of age.**

Opportunity to benefit from the increased disposable income of the semi-urban, rural and aggregator taxi segment

36% of the **premium cars owners** have bought their cars **exchanging their old ones.**

2 Leverage used car financing – to reduce product life cycle, drive new car sales, enhance brand value and improve yields.

Used car financing has multifaceted benefits for OEMs and dealers



Certified inventory of used cars supported by attractive financing options enables building of brand and residual value, while providing a new source of profitability with high yield. Furthermore, attractive buyback schemes help reduce product life cycle as customers find it easier to graduate to better models, thereby further driving new car sales.

01 **New source of profit and high yield:** Used car sales, supported by attractive financing, acts as an additional source of profit for the dealer. Furthermore, its high yield helps drive the profitability for the financier.

02 **Product lifecycle:** Used car financing schemes can enable buyback options making it easier for customers to change vehicles frequently, driving down the average age of a product.

03 **Brand and residual value:** Easier buyback and existence of OEM's warranty, driven by the financing schemes, help drive growth in the residual value. This further helps establish strong brand identity.

04 **New car sales:** Buyback schemes and reduced product life cycle will drive new car sales at the dealership.

Approximately **40%** of customers change cars within four to six years, followed by approximately 30%, who do so in two to four years.

Approximately **40%** of the used car buyers are below 30 years of age.

Imperative ❯ Offer buyback guarantee before the end of the product life cycle to achieve higher residual value.

3 Refinance existing customers, cross-sell and bundle.

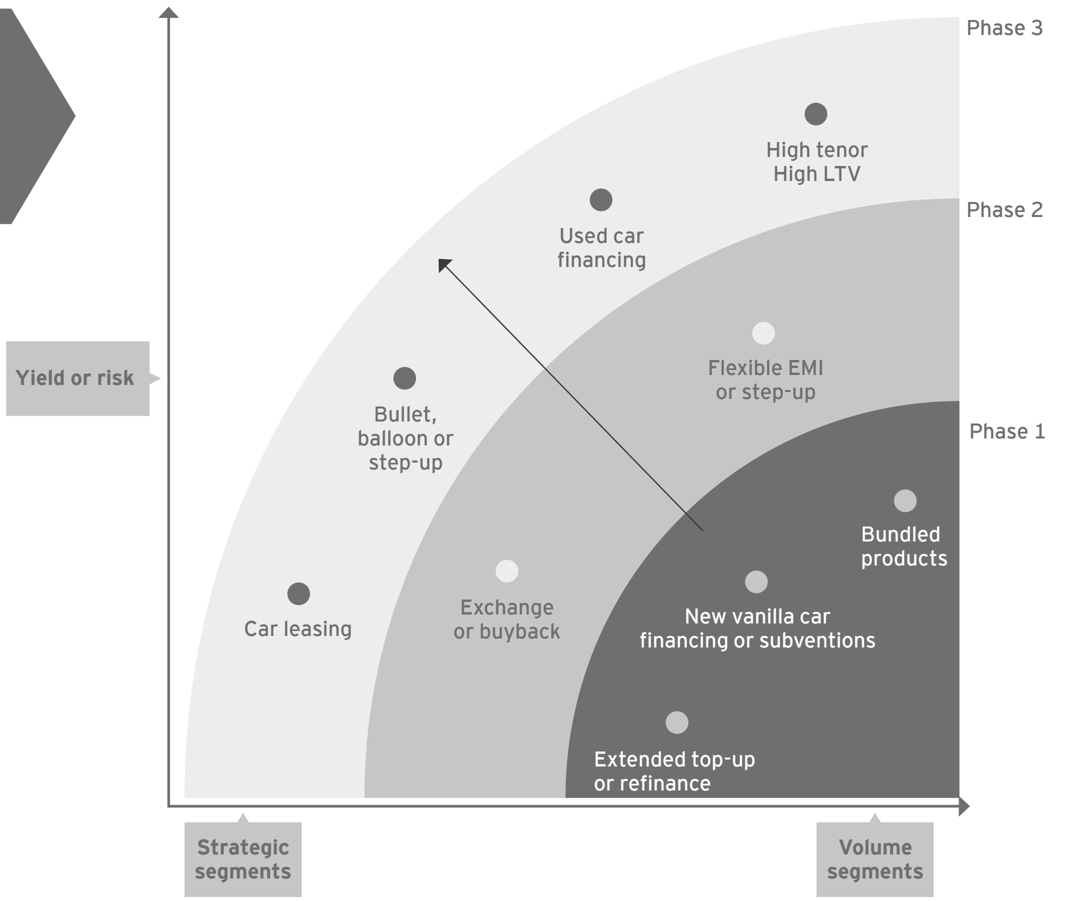
Auto finance can provide a base of asset-tested customers who can be cross-sold a multitude of financial products. The options include:

1. Refinancing of existing auto loans
2. Higher risk auto finance product variants such as high tenor, high LTV, balloon, interest only and step-up
3. Bundling of automotive accessories, services warranties and insurance
4. Unsecured loans based upon repayment performance on existing loan

2.5%

ROA of a leading NBFC, that started out as auto finance captive and was able to diversify into unsecured lending and other adjacent business lines, using the captive asset-tested customer base.

Yield expansion by branching out the product portfolio



4 Innovate dealer financing to drive retail volumes by leveraging the wholesale-retail linkage.

Dealers are a key part of the auto finance value chain and one of the most important levers that drive growth by helping them overcome their financial challenges. Dealers' financial needs are focused around multiple aspects such as capex to expand business, working capital to sustain operations and inventory funding. Lenders need to play a significant role in ensuring support to dealers by providing flexibility in their offerings

50%
of dealer profitability comes from servicing and accessories, followed by insurance, new car sales and then finance commission.

Captives help drive dealer profitability

Revenue

Driving incremental sales ...

... through captives' customized products enables cross and up selling of the products. Attractive financing also helps with the sales of slow moving model inventory.

Furthermore, captives' product bundling can drive dealers to secure additional revenues through participation in aftermarket.

The lenders are well-positioned to develop and maintain an exhaustive customer database, enabling dealers in lead generation.

Driving down dealer costs, while providing business support

Captives' inventory funding schemes, backed by flexibilities such as credit-free periods, staggered payments and case-specific relaxation of penal interest charges help drive down dealer costs, especially against cyclical demand.

Furthermore, captives provide capex support through term loans, while also financing current assets including part purchases, receivables etc. through working capital limit.

Cost

Average cost borne by dealers per customer lead

Imperative 〉 Inventory funding is over **70%** of a typical dealer's funding requirement, making it the focal point of **captive-dealer relationship.**

5 Explore leasing; it offers a high potential market for captives.

While leasing companies have been present in India for a couple of decades, market has remained limited owing to both supply-side limitations and demand dynamics. The leasing market has been largely dominated by Indian subsidiaries of global leasing companies, with Indian leasing companies and captives gaining market share in recent years.

Captives can leverage the existing OEM-dealer relationships to offer a better value proposition, better service quality and, importantly, manage the residual value risk better thus leading to a gain in market share. Leasing is prevalent in car price segments of more than INR500,000 in mid-size, UV and luxury car segment. While the total cars under leasing are at approximately 70,000, the current leasing penetration of corporate sales is minimal at approximately 10%.

INR126b

Potential leasing opportunity from the corporate segment assuming leasing penetration reaches at par with international markets

Competitive positioning

High-end vehicles

Indian captives primarily cater to individual customers of luxury and premium vehicles. This segment is mostly ignored by other leasing companies owing to high risk perception of customers. Furthermore, there is a need for high sales and education efforts to drive the segment.

An attractive segment but will take time to realize benefits

Majority of leasing companies in India focus on the corporate segment, due to low-risk customers, existing product awareness and tax benefits to customers. While being the most attractive, high intensity of competition exists in the segment.

Can be an immediate focus segment – leverage existing corporate relationships

Individual customers — Corporates

Key drivers for auto leasing in India

1. Growing passenger vehicle market with widening product portfolio, increasing sales of luxury cars and geographic penetration
2. Increased disposable income and aspirations, leading to increased vehicle replacement trends
3. Corporates increasingly looking for better expense management, helped by tax leverage; impending arrival of GST regulations
4. Increasing awareness of tax benefits in corporate employees, opening up new customer segments owing to entry of cab aggregators into leasing business to grow fleet sales

INR1m

Average leasing ticket size as compared with average PV loan disbursement of INR380,000

10%–15%

Projected growth in PV leasing till FY20

10%–15%

Net benefit to customers of lease over loans and expected to increase post GST implementation

6 Deploy templatized and micro market model-based application scorecards to drive risk-based pricing.

There are multiple challenges in credit underwriting process, which if addressed well, can drive significant value creation for a captive's customers. Customers are faced with a need to undertake multiple dealer visits for provision of documents and experience delay in car purchase due to high turnaround time. There is a strong need to improve TATs through instant decisioning. The financiers also need to accommodate the lack of documented income especially for self-employed customer segments and monitor regional variations in credit behavior, building the same back into the profiling and pricing framework.

Templatized underwriting process and "expert judgment" scorecards

The captives should enable template-driven underwriting through expert judgment-based scorecards that classify customers into score bands, which can then define the loan amount multiples, LTVs, documentation and pricing.

Why is it needed?

1. Templatization enables better TATs and customer experience.
2. Bureau credit score in India is not as predictive as global scoring models.
3. There is of documented income especially in cass of self-employed customer segments.

Micro market attractiveness models

The lenders can try and develop a micro market attractiveness index using demographic, socioeconomic, catchment and portfolio performance data.

Why is it needed?

1. These models are critical to account for the regional variances in consumer credit behaviour in India.
2. They can help leverage portfolio performance and other MM data to underwrite risk appropriately.

Risk-based pricing

Interest rate – one of the most critical success criteria for a auto finance lender – can be easily determined through risk-based pricing, facilitating better overall portfolio profitability.

Why is it needed?

1. More good customers can be sourced by offering lower pricing.
2. Appropriate risk pricing can help retain the "not-so-good" customers.

7 Create a best-in-class customer experience by enabling instant approvals.

Auto finance is central to the car buying process and, with automakers' heightened focus on minimizing the time spend in the car buying process, the need for an efficient and hassle-free auto finance approval becomes pertinent. Since the approval and disbursal process is core to the auto finance value chain, getting it right can ensure that the customer is delighted and becomes a long-term customer.

Financiers need to focus on leveraging digital and analytical tools to reduce the complexity of loan approval and documentation. The market leaders today have attained that position by providing 30-minute approvals at the dealer shop.

57% of the surveyed dealers recommend financing on the basis of the customer profile and TAT of loan processing.

Application		Underwriting		Disbursement	
Awareness or knowledge	Select and apply	Loan processing (soft approval)	Loan sanction (hard approval)	Documentation	Disbursement
		24–72 hours		48–72 hours	
1.1 Customer is informed about auto finance product by the DSE*.	2.1 Customer provides basic information for pre-qualification.	3.1 Hygiene checks are performed at the bank processing unit.	4.1 Field investigation and telephone verification are triggered and as applicable.	5.1 List of pre-disbursement documents is shared with customer.	Original documents are verified.
Customer receives targeted marketing offers for auto loan products.	2.2 DSE suggests financing product or provider as per customer profile.	3.2 Basic eligibility criteria are verified (e.g., income, CIBIL, de-dupe, ITR checks) and sample RCU.	4.2 Credit assessment is conducted as per internal scoring models.	5.2 Customer drops off documents at the dealership or branch.	Loan agreement is executed at either of customer office or residence or a bank branch.
Customer visits the financier's branch, website or mobile banking app to obtain information.	2.3 Customer provides initial documentation to the DSE.	3.3 Soft approval communicated to dealers and customers.	4.3 Deviation is checked and approvals taken as per authority matrix.	5.3 FE visits customer to collect the documents form customer's residence or office.	Dealer submits down payment receipt.
Customer compares financier products through TPT websites.	2.4 FE* logins the customer application and uploads scanned copy.	3.4 Customer decides to proceed or refer alternative financiers for better offer.	4.4 Approval is communicated to customers and dealers.	5.4 Physical file is transferred from dealership to financier office.	Loan is disbursed to dealer.
	Customer receives pre-approved loan offer basis existing relationship with financier.	Dealer is given a portal access integrated with the financier's systems.	Customer tracks application status through net banking or phone banking.		

Pain point | Standard point | Leading practice

Dealer sales executive | Call center executive | Digital | Finance executive | Field agents | Financier systems | Dealer-led | Bank-led | Third-party-led

8 Keep funding costs under control through a mix of short- and long-term funds, and parent guarantees.

While leveraging a right mix of short-term and long-term funds to drive down the costs of funding, the lenders also need to strategically leverage their parent's credit ratings and support to gain access to cheaper funds.

Sources of funds

Include CPs and NCDs by driving toward profitability in the first two years. Alternatively, depending on pricing and availability, ICLs and rupee-denominated bonds can also be considered.

Initial focus on dealer financing can help ensure that short-term borrowings and CPs are able to meet the requirements, keeping cost of funds low.

Parent support

Letter of comfort, corporate guarantee from global parent can improve credit rating and has a positive impact on borrowing costs.

Parent support compensates for lack of track records and can help save close to 50–100 bps.

Asset liability management (ALM)

Approximately 20%–50% of outstanding book is typically short-term in nature. Most entities have an ALM mismatch in the initial years; diverse funding sources available in the later years reduce the ALM mismatch.

Lenders need strong ALM to mitigate liquidity and interest rate risk in the initial years, especially through CPs.

Rating and security

Issuing NCDs requires a minimum credit rating of "A2" and issuing CPs requires a credit rating of "A3." Furthermore, all NCDs, including short-term NCDs, should be fully secured.

CPs and NCDs require captives to enter into credit rating exercise early in their life cycle to reduce the cost of borrowing. Audited financial statements are required for borrowing from these instruments.

Cost of funds

While the equity component varies, the cost of funds ranges between 8.5%–11% for majority of finance companies.

Base rate of foreign banks is lower than private sector banks by 0.5%-0.75%. CPs and NCDs are cheaper by close to 0.5%-0.75% than short-term and long-term bank borrowing respectively.

Auto financing ROA can touch close to 3% with some or all of these initiatives.

The historically low-ROA auto financing business can drive upto 2.9% ROA with the help of several peripheral revenue and cost drivers, making it a highly risk-free yet profitable and therefore attractive business line in a retail portfolio.

Percentage of average advances	NBFC conventional		NBFC transformed
IRR	14.5%	Increased share of used car, rural and taxi segment, refinance and top-up loans	15.4%
Processing fees and other income	0.65%	Through bundled product offerings	0.8%
Interest expense	9.0%	Optimal funding strategy	8.8%
Net interest margin	6.15%		7.4%
Operating cost	2.3%	Reduced sales support cost through digital, enhanced productivity through Trade advance, enhanced scale through refinance or top-up	2.0%
Dealer payout	0.8%	Increased direct sales through cross-sell and digital	0.6%
Credit loss	0.8%	Enhanced application scorecards, predictive analytics and larger share of cross-sell	0.65%
Profit before tax	2.25%		4.15%
Tax	0.68%		1.25%
ROA	1.6%	Fully leveraging the improvement initiatives can significantly enhance the ROA	2.9%

Therefore, it is imperative that NBFCs and banks look at auto financing as an anchor product on their portfolios and build scale, through the right OEM partnerships, than just a customer offering to tick the boxes.

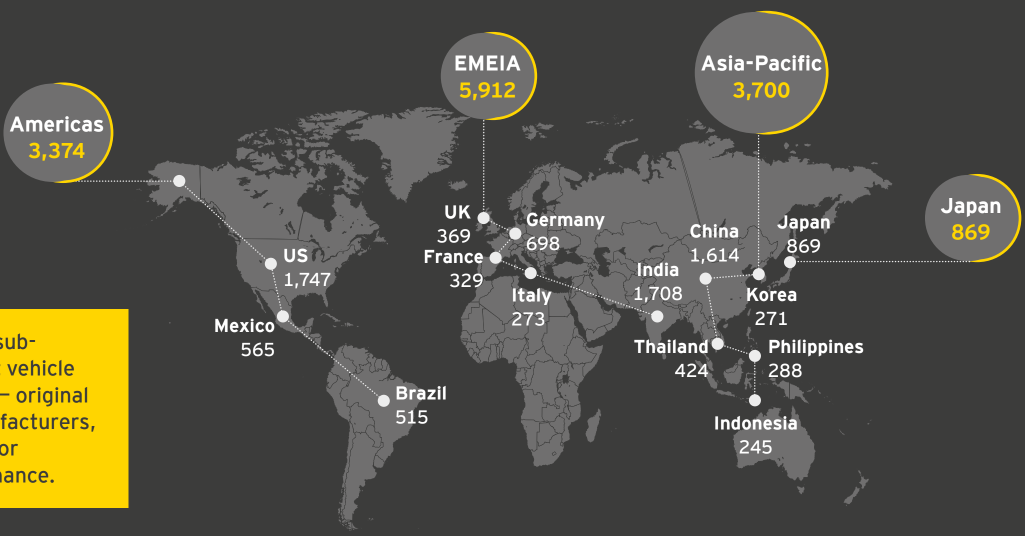
Glossary

ALM	Asset liability management
BRICS	Brazil, Russia, India, China and South Africa
CAGR	Compound annual growth rate
CIBIL	Credit Information Bureau (India) Limited
CP	Commercial paper
CV	Commercial vehicle
DSA	Direct sales agent
FPI	Foreign portfolio investment
GDP	Gross domestic product
GST	Goods and services tax
HNIs	High-net worth individual
ICL	Image cash letter
IVR	Interactive voice response
KPI	Key performance indicator
LTV	Loan-to-value
MIS	Management information system
MM	Micro market
NBFC	Nonbanking financial company
NCDs	Nonconvertible debenture
NPA	Nonperforming asset
OEM	Original equipment manufacturer
PSB	Public sector bank
PSU	Public sector unit
PV	Passenger vehicle
SIAM	Society of Indian Automobile Manufacturers
SMS	Short message service
SUV	Sports utility vehicle
TAT	Turnaround time
UV	Utility vehicle
YoY	Year-over-year

How EY can help

Our Global Automotive Center brings together **13,855 professionals** around the globe to help clients achieve their potential – a team with technical experience in providing **assurance, tax, transaction and advisory services.**

EY's areas of concentration touch all sub-sectors of the industry, including light vehicle manufacturers, component suppliers – original equipment and aftermarket, CV manufacturers, retailers and dealers, electric vehicle or advanced mobility, and automotive finance.



How EY can help you in automotive?

Strong global network	In-depth regional experience	Change management experience in diverse environments

What we deliver

Advisory

- Performance Improvement
- Risk
- Technology

Retail Advisory

- Dealer Operations
- Dealer Risk Management
- Dealer Performance
- Financial Advisory
- People and Organizational Change
- Dealer System, Process Integration
- Mobility Strategy

Tax

- Business Tax Services
- Global Compliance and Reporting
- Human Capital
- Indirect Tax
- International Tax Services
- Law
- Transaction tax

Transaction Advisory Services (TAS)

- Capital Transformation
- Transaction Support
- Transaction Tax

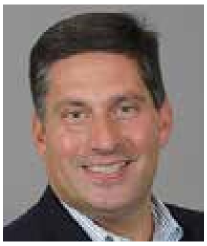
Assurance

- Accounting Compliance and Reporting
- Climate Change and Sustainability Services
- External Audit Services
- Financial Accounting Advisory Services
- Fraud Investigation and Dispute Services

What we deliver

Higher margin	Higher customer loyalty	Sustainable results

EY contacts



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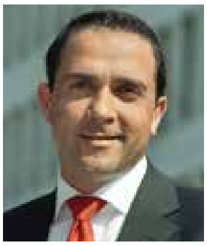

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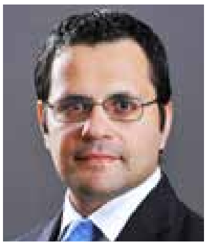

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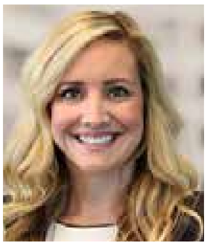

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Acknowledgements

Special thanks to Abhinav Chauhan, Abhishek Gupta and Vivek Sapre for the analysis and compilation of this study.