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Medium & Small Non-Banking Financial Companies

Capital fuels credit growth; loan quality and funding sustenance key for a smooth ride

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Highlights

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M&S NBFC AUM estimated to grow at 25-30% over the period FY2024-FY2025.

Past growth of M&S NBFCs was supported by regular and sizeable capital raises.

Barring entities in unsecured SME and personal loan segments, entities in other asset segments are adequately capitalised to meet projected growth till FY2025.

The non-banking financial company (NBFC) space is concentrated with large players accounting for the bulk of the assets under management (AUM), thus significantly influencing the industry-level key trends and performance metrices. This report assesses the performance of medium and small (M&S) entities in this space, which have been operating in the shadow of these large entities.

M&S NBFCs are defined as those with AUMs of less than Rs. 100 bn as in March 2023. The analysed sample of 105 M&S NBFCs in this note is largely constituted by entities rated AA- or lower.

Lower base and larger share of high growth segments - affordable housing, microfinance, secured business loans (LAP/SME), vehicle loans, unsecured loans – helped M&S NBFCs AUM grow at higher CAGR of ~25% between March 2019 and March 2023 vis-a-vis overall industry growth rate of ~9%.

M&S NBFCs constitute about 14% of the overall NBFC (excluding infrastructure financiers) AUM, up from about 8% in March 2019. In this note, their performance is being assessed in relation to other larger NBFCs (39 entities), which contributed to 81% of the industry.

AUMs of M&S NBFCs are expected to increase steadily with a potential CAGR of 25-30% in FY2024-FY2025. High growth shall keep portfolio seasoning low for M&S NBFCs. Unsecured loans, including microfinance and, LAP/SME loans shall continue to expand at a steeper pace.

M&S NBFC growth was supported by regular and sizeable capital raises in the recent past. Investors – both private equity (PE) participants and retail investors - viewed the segment favourably, with some entities witnessing majority stake purchase by PEs and some listing at the stock exchanges.

Entities in the unsecured SME and personal loan segments are expected to raise capital in the next 12-18 months, while other asset segments are adequately capitalised till FY2025 to meet their growth needs.

Highlights

Delinquencies on a lagged basis are elevated, indicating lower portfolio seasoning; performance of long-tail assets on steady state basis remains monitorable.

Improving operating efficiencies would be the key going forward as credit costs are likely to inch up and increase in leverage is expected to affect net interest margins.

M&S NBFCs reported lower gross stage 3(GS3) than their larger peers, partly attributed to the higher level of write-offs undertaken by these entities. Focus on unsecured loans and borrowers with average or moderate credit profile is resulting in higher loan losses.

Overall M&S NBFC GS3, on a 2-year lagged basis stood at about 4.2% in March 2023 vis-a-vis the reported GS3 of 2.5%. Delinquencies in some asset segments - SME/LAP and affordable housing loans, where the contractual tenors can go up to 10-15 years - would be visible only with a lag.

M&S NBFCs' overall provisions on loans are down sharply and they are carrying smaller provisions compared to larger players, with their reported stage 2 and 3 assets, especially in the last two fiscals, being lower. Stage-wise provisions are, however, similar to or higher than their larger peers.

Healthy business yields of M&S NBFCs are offset by a relatively elevated cost of funds and operating costs. Entities also hold higher liquidity, which exert pressure on their margins. This, along with elevated credit costs, impacted their earnings in the last few fiscals.

Upfront income on account of securitisation and co-lending bolster earnings for entities in this space. Improving operating efficiencies going forward, will remain the key for steady state earnings as credit costs are expected to inch up and, the increase in leverage is likely to affect margins.

M&S NBFCs carry higher liquidity vis-à-vis their larger peers; bank credit and securitisation are the key funding routes for these players. Co-lending volumes are expected to rise going forward.

Secured business loans and affordable housing entities have steadily registered improvement in performance and were also relatively less impacted during the pandemic. Unsecured loans (personal and SME) were most impacted and, their performance shall remain monitorable in the near term.

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Thank You!