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ICRA Survey of Non-banking Financial Companies

Issuer optimism for FY2025 could be dented by the recent regulatory developments

MARCH 2024

List of abbreviations

AUM: Assets under management

CAGR: Compound annual growth rate

GNPA: Gross non-performing assets

GS3: Gross stage 3

HFC: Housing finance company

LAP: Loan against property

MFI: Microfinance institution

NBFC: Non-banking financial company

NBFC-IFCs: Non-banking finance company – Infrastructure finance company

NBFC-IDFs: Non-banking finance company – Infrastructure debt fund

RoMA: Return on managed assets

SME: Small and medium enterprise

YoY: Year-on-year

Highlights

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Lenders continue to be optimistic on growth; 54% of the issuers (by AUM) project higher-than-20% AUM growth in FY2025.

Lenders unanimously expect improvement in asset quality indicators.

Despite expected uptick in cost of funds, issuers expect profitability to remain largely stable in FY2025.

- ICRA conducted a survey across NBFCs in Feb 2024 to gauge their outlook and expectations for FY2025. Our survey revealed that issuers had not moderated their growth plans and expected the robust pace to continue into FY2025. However, recent regulatory actions may dampen growth aspirations in FY2025 and reorient them to augment their internal controls and compliances.
- Issuers are not expecting the share of unsecured loans to increase further from current levels. Consequently, any further boost in profitability due to such high yielding segments is expected to be limited.
- While Issuers expect further improvement in the asset quality indicators, ICRA expects some increase in delinquencies as the portfolio built over the last couple of years starts to season.
- While changes in the regulatory landscape would result in increase in cost of borrowings; the entities expect stable return indicators (return on managed assets), on the back of business growth and lower credit costs.
- Most lenders (by AUM) do not expect to raise capital in the near term. However, company-specific capital raise could be used to fund the high envisaged growth. Lenders plan to maintain the liquidity at current levels.
- Larger entities looking to diversify the funding mix and are likely to include higher incremental share of capital market borrowings, external commercial borrowings and securitisation. Share of co-lending expected to remain range-bound at less than 10% of AUM.
- ICRA estimates AUM growth to moderate in FY2025 on the back of high expansion witnessed in FY2023 and FY2024 along with tightening regulations and liquidity. The regulatory interventions could continue, in ICRA's view, if the sector's breakneck growth does not moderate.

Survey sample forms about two-thirds of the retail-NBFC industry AUM

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Exhibit: Break-up of sample entities by sector (number)

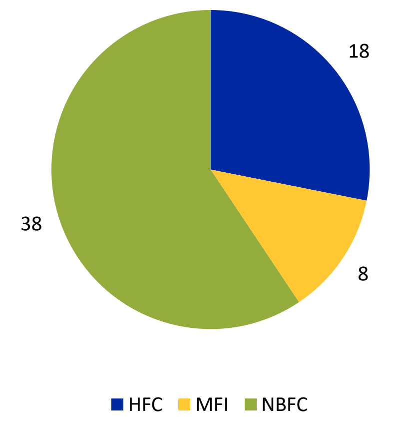
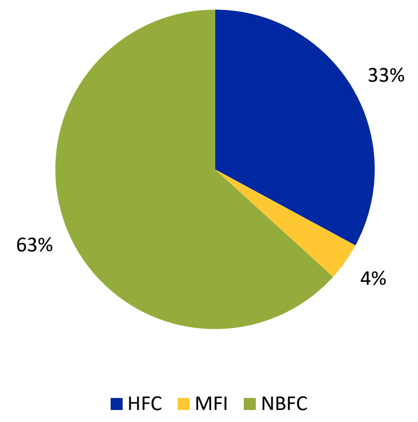
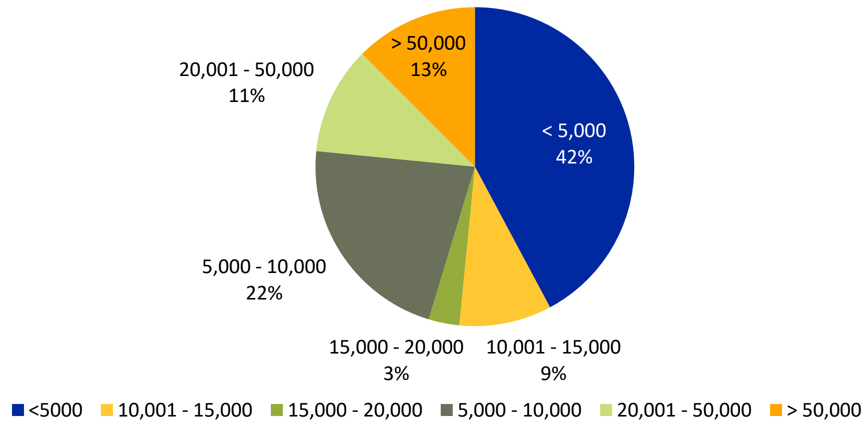


Exhibit: Break-up of sample entities by sector (AUM shares)



Source: ICRA Research

Exhibit: Break-up of sample entities based on AUM (in Rs. crore)



Source: ICRA Research

- The analysis presented in the following slides is based on the aggregate results of ICRA's survey of various NBFCs/HFCs/MFIs conducted in February 2024; these entities constitute about two-thirds of the Retail-NBFC industry AUM (excluding NBFC-IFCs and NBFC-IDFs).

Growth plans remain intact despite recent regulatory developments

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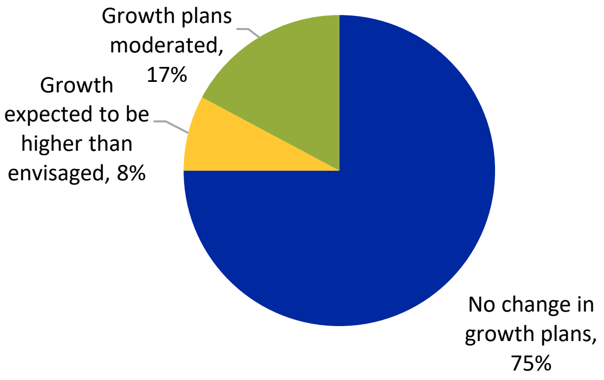
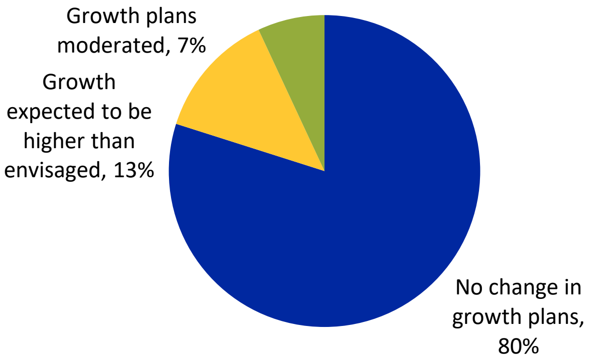
Exhibit: Break-up of entities by number



Source: ICRA Research

Exhibit: Break-up of entities by AUM



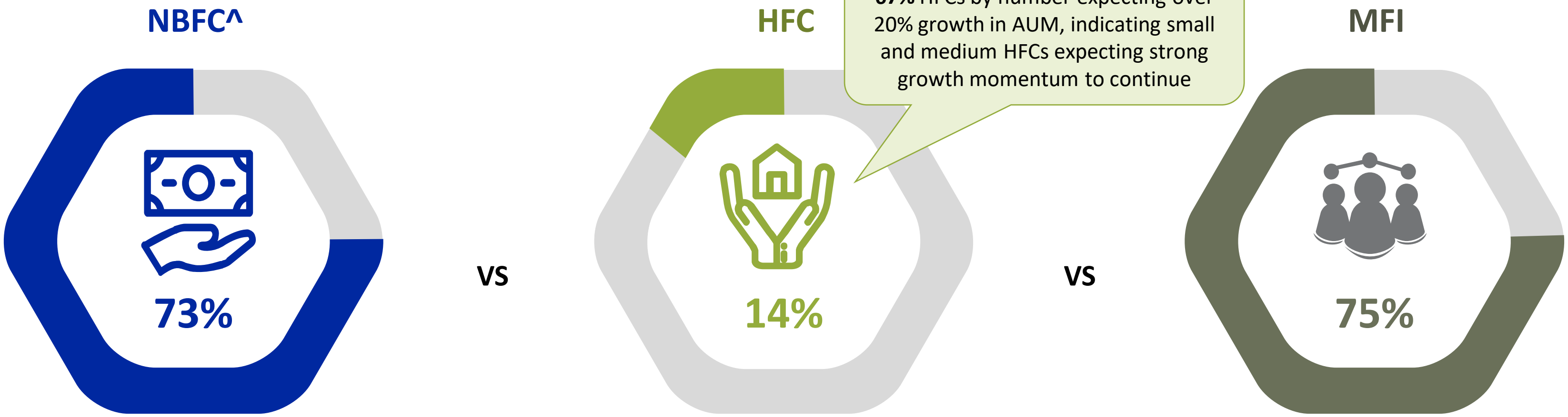
Source: ICRA Research

- When the survey was conducted in Feb 2024, issuers were optimistic on FY2025 growth. However, supervisory actions on some of the entities and regulatory tightening for the NBFC sector in general indicates the regulator's concern following the high credit growth in the space.
- The operational, governance and other credit assessment-related lapses in entities, which were observed during the RBI annual inspections and other audits, in view of the increased systemic importance of the sector, seem to be the key driver for the recent actions. Thus, entities might increase the focus on tightening internal controls and ensure adherence to all regulatory and prudential norm, in our view.
- Given the concerns highlighted, if the pace of growth does not moderate, ICRA anticipates that further regulatory tightening is possible in FY2025 as well.

More than half of issuers (by AUM) target higher than 20% growth in FY2025

Exhibit: Share of entities (by AUM) expecting an AUM growth of over 20% in FY2025

67% HFCs by number expecting over 20% growth in AUM, indicating small and medium HFCs expecting strong growth momentum to continue



ICRA's growth expectation*: 17-19%

ICRA's growth expectation*: 12-14%

ICRA's growth expectation*: 23-25%

*Source: ICRA Research; Note: ^NBFC (Excluding HFC and NBFC-IFC) , * for FY2025*

Issuers not expecting the share of unsecured loans to go up in FY2025

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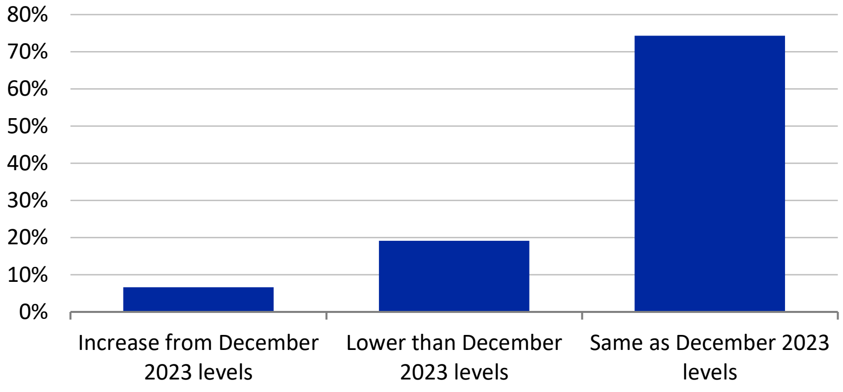
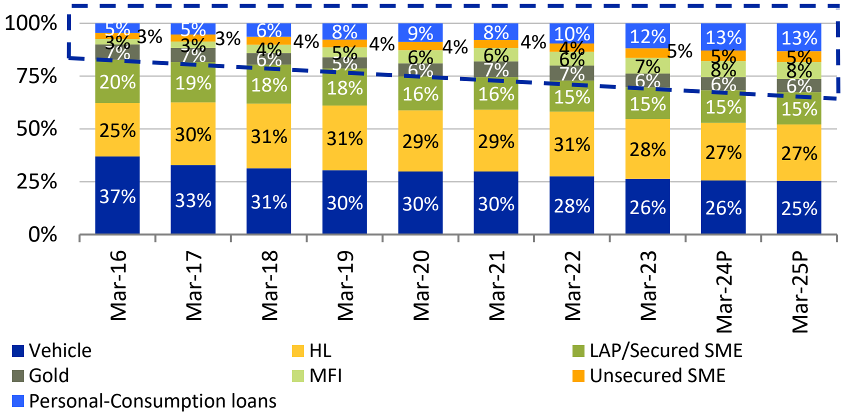
Exhibit: Share of unsecured loans in total AUM by March 2025



Source: ICRA Research

Exhibit: Trend in share of key retail asset segments for the sector – ICRA's outlook

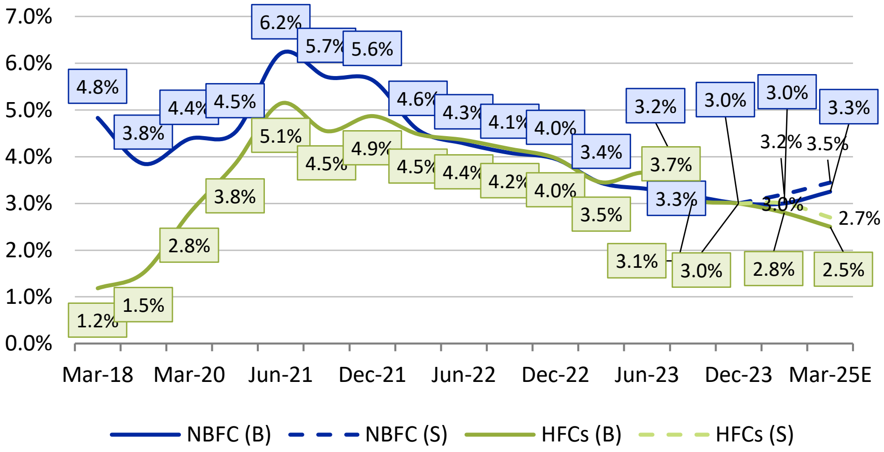


Source: ICRA Research

- Unsecured loans, i.e., microfinance, SME loans and personal consumption finance, have sustained their growth at a stronger pace vis-à-vis the overall NBFC retail assets growth.
- Unsecured loans grew at a CAGR of 27% during the five-year period ended March 2023 compared to 11% for secured loans.
- Within the unsecured loan book, ICRA expects some slowdown in growth of personal consumption loans as recent regulatory scrutiny and measures would impact the capital and funding availability for entities in this segment.

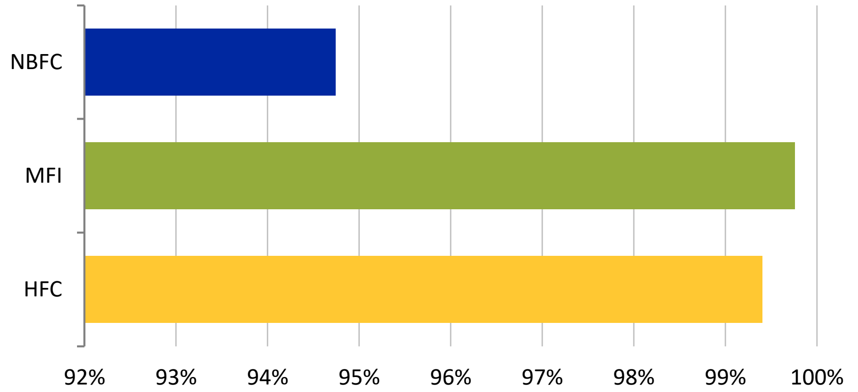
Issuers unanimously expect asset quality to improve in FY2025

Exhibit : Gross stage 3 (GS3) trend and outlook by ICRA



Source: ICRA Research

Exhibit : Share of issuers (by AUM) expecting 100 bps or more improvement in asset quality over December 2023 level



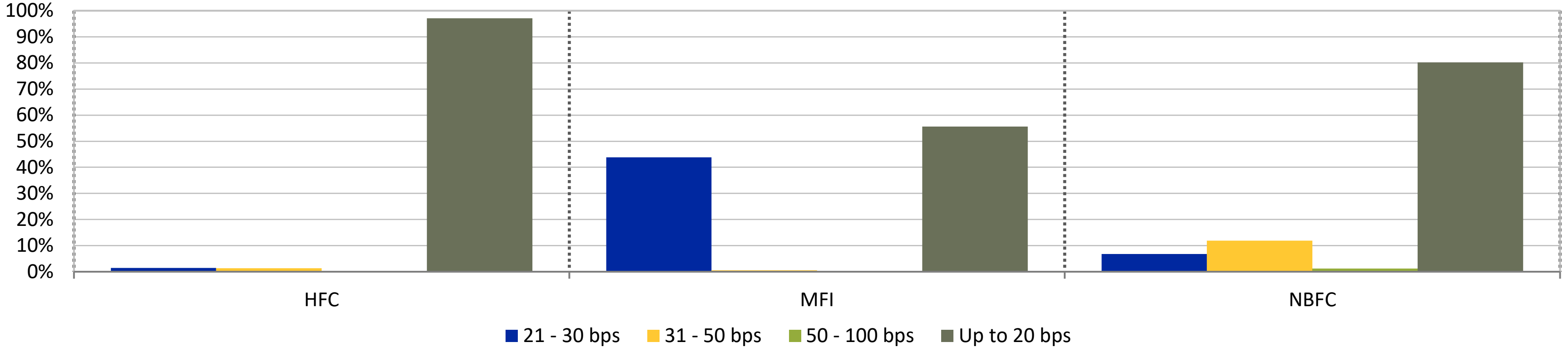
Source: ICRA Research

- Incrementally, ICRA expects the GS3 to start bottoming out over the next few quarters and start inching up as the sectoral growth moderates; however, issuers are more bullish on the asset quality and largely expect improvement in FY2025.

Expected increase in cost of borrowings in next 15 months

Over 85% of the issuers by AUM expect up to 20 bps increase in cost of borrowings

Exhibit : Expectation on increase in cost of borrowings (by AUM)



Source: ICRA Research

- ICRA expects regulatory developments and tighter liquidity to push up the weighted average cost of funds (CoF) by 30-50 basis points (bps) in H2 FY2024 and further 20-30 bps in FY2025

Most players expect profitability to remain stable

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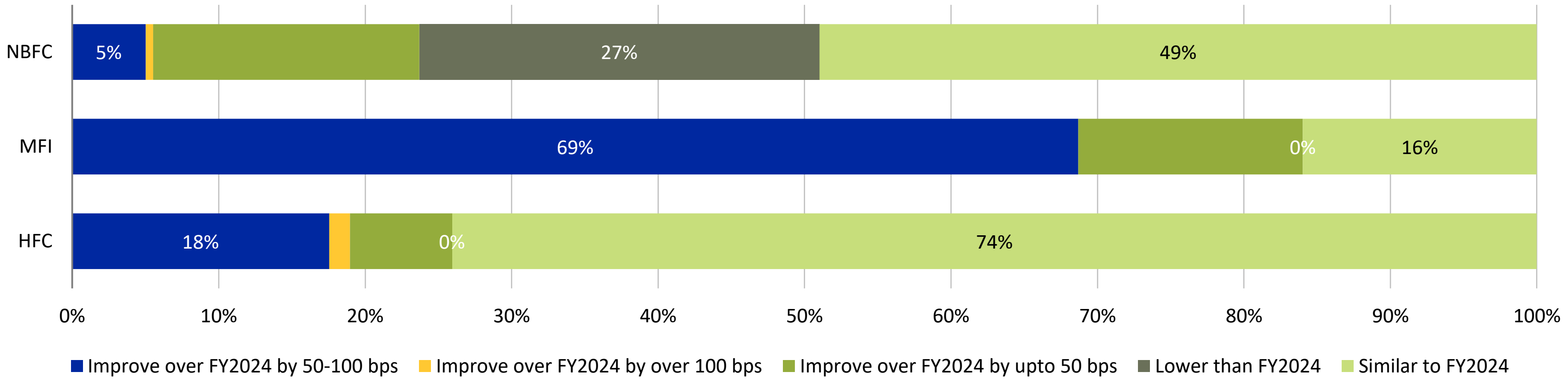
Exhibit: Expected return on managed assets in FY2025



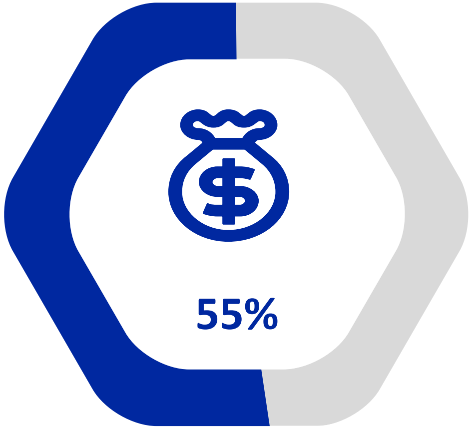
Source: ICRA Research

- HFCs expect a more stable performance to continue in FY2025, while MFIs expect improvement in return indicators.
- NBFCs have slightly divergent views with some issuers also expecting moderation in return indicators in FY2025. Overall, 76% of issuers expect stable or marginally lower profitability.
- ***ICRA expects profitability of NBFCs to moderate by 20- 40 bps on a YoY basis, while HFCs are expected to report stable profitability indicators in FY2025; MFI profitability is expected to marginally improve by 10-20 bps.***

Larger players not expecting to raise capital

Smaller peers likely to raise capital

Break-up by numbers



Entities planning to raise capital in next 15 months

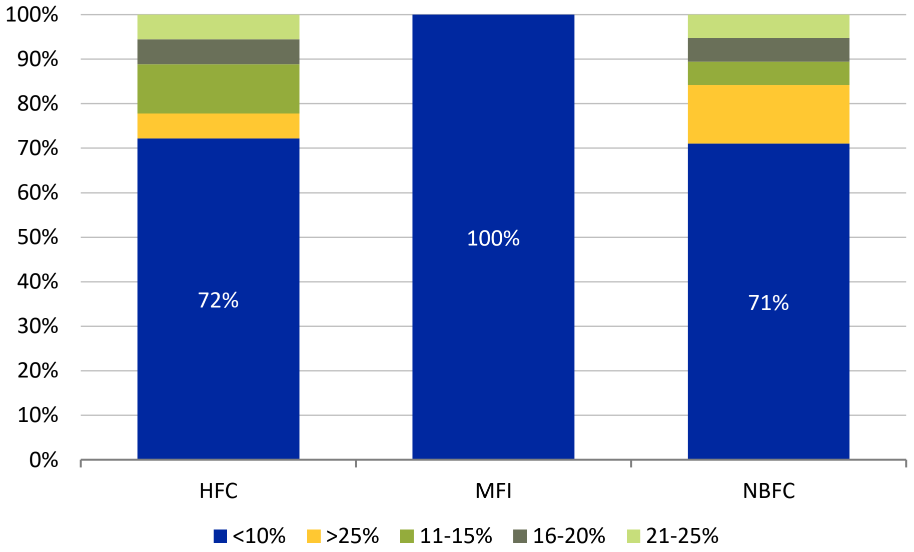
Break-up by AUM

Source: ICRA Research

Co-lending not expected to contribute significantly to AUM

~20% of the issuers (by number) expect co-lending/fintech partnership book to constitute over 15% of the overall AUM by March 2025

Exhibit: Share of co-lending/fintech partnerships in overall AUM by March 2025 (by number)



Source: ICRA Research

Expectations of lower share of co-lending/partnership-based business in the overall AUM, driven by asset quality concerns and tighter regulations on digital lending.

Other challenges with co-lending include issues in system integration, and upfront income booking related concerns.

Fund availability for growth will continue to be a key driver for co-lending. Thus, smaller entities with limited financial flexibility might look at this route more often.

Larger NBFCs/banks might continue to use co-lending for testing new products.

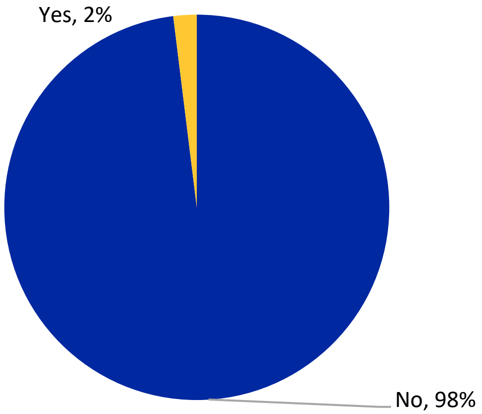
Will the share of banks in funding mix reduce in 15 months?

Larger entities are expecting the share of bank funding to reduce and the share of capital market borrowings to increase; smaller peers to rely more on securitisation and co-lending

Source: ICRA Research

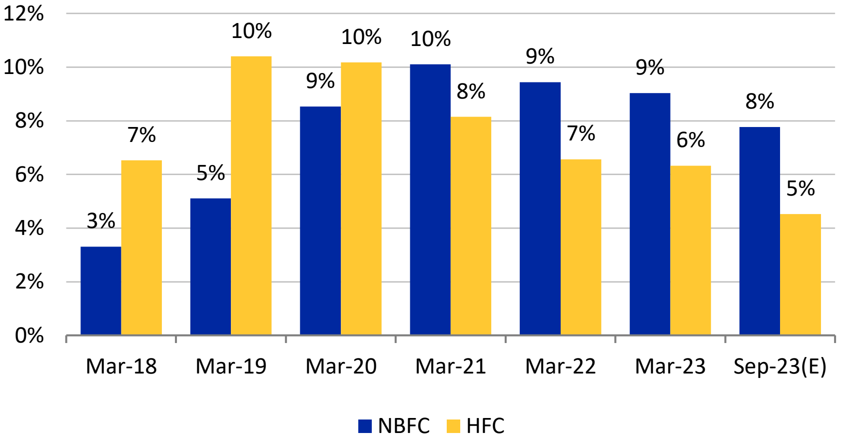
Liquidity expected to be maintained

Exhibit: Will the on-balance sheet liquidity reduce in the next 15 months from December 2023 level?



Source: ICRA Research

Exhibit: Cash and investment as % of total assets



Source: ICRA Research; E-estimated

- On-balance sheet liquidity of NBFCs and HFCs has continued to moderate over the historical levels; however, entities plan to maintain liquidity at similar levels, going forward.
- The requirement for maintaining high quality liquid assets (HQLA) is also contributing to this liquidity.

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Thank You!