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Non-banking Financial Companies

Adequate capitalisation to support risk profile of NBFCs amidst asset quality issues

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Agenda

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1 NBFC-Retail Sector Outlook

2 Macroeconomic Trends and Underlying Growth Drivers

3 Overall Sectoral Performance Trends

4 NBFC-Retail Asset Class-wise Trends

5 ICRA Rating Action across NBFCs/HFCs/MFIs

Highlights

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Gross Stage 3 to weaken cumulatively by 40-70 bps for NBFC-Retail over FY2025 and FY2026; unsecured segments to face a larger impact driven by factors such as borrower overleveraging.

Profitability of the NBFCs would moderate by 30-50 bps on a YoY basis in FY2025 and would remain stable in FY2026.

Net worth / AUM for the NBFC sector remains adequate at 21% as of September 2024

- **Asset quality risks** have once again come to the forefront for the NBFCs as entities grapple with the impact of the fast-paced growth seen over the past two years. Delinquencies in the NBFC-Retail segment overall would continue to weaken in the near term as the portfolio seasoning catches up. Consequently, delinquencies are expected to rise by 30-50 bps in FY2025 and 10-20 bps in FY2026, resulting in increased credit costs. Within this, meaningful divergence is anticipated with weaker performance of unsecured segments driven by factors such as borrower overleveraging, weakening of borrower credit profiles, etc. while secured segments are expected to perform relatively better.

- **The share of bank credit to the NBFCs** has been coming down in recent months to 9% after having reached close to 10% previously. As banks' credit flows to NBFCs remain tight, funding from other sources, like market issuances and securitisation, will become critical. Incremental funding needs (over and above the refinancing of maturing debt) are estimated at Rs. 3.0 trillion in FY2025 for Retail-NBFCs. Tight funding conditions will push up the weighted average CoF by 20-40 bps in FY2025, though it is likely to stabilise in FY2026.

- **Consequently, the Retail AUM of NBFCs** (NBFC-Retail; *excluding HFCs)* is expected to grow at a moderated pace of 17-19% in FY2025, significantly lower than the 29% growth witnessed in FY2024. Certain asset segments (especially unsecured), such as MFI, PL/CL, etc. are likely to slow down disproportionately.

- **Net profitability of NBFCs** would moderate by 30-50 bps in FY2025 as interest margins moderate and credit costs increase. Further, as growth in the high-yielding unsecured segment moderates, ability to calibrate the asset mix to support the margins would be diminished. Credit costs would increase as entities build up provisions and undertake technical write-offs in line with the weakening asset quality performance.

- **The sectoral capitalisation profile** is adequate to absorb any asset quality shocks and support the projected AUM growth in the near term. Some entities with significant credit losses may, however, need to raise 'confidence capital' to boost lenders' and other stakeholders' confidence.

- **Liquidity coverage** remains at adequate levels overall, in line with the tightening funding scenario and increased COF. Reliance on short tenor borrowings such as commercial papers has been range-bound. As a result, ALMs of most NBFCs are well placed with positive cumulative mismatches for at least up to 12 months.

Note: NBFCs: Non-banking financial companies; HFCs: Housing finance companies (excluding HDFC); AUM: Assets under management; VEF: Vehicle finance; GL: Gold loans; LAP: Loans against properties; SME: Unsecured/Quasi Secured loans (machinery, stock, etc.) offered to enterprises and individuals for bysiness purposes; PL: Personal Loans; CL: Consumer loans; SME: Small enterprise loans; MFI: Microfinance; COF: Cost of funds; Sector: NBFC-Retail/Wholesale, HFC-Retail/Wholesale, NBFC-Infra*

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Thank You!