ICRA

Non-banking Financial Companies

Funding constraints to pose key challenge for growth in FY2025

JULY 2024

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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AUM growth in FY2025 to moderate to 17-19% in the base case and to 14-16% in the stress case

Incremental funding requirement for the NBFC-Retail sector is estimated at Rs. 3.0 trillion in FY2025

Shoring up alternative sources of funding, as bank funding decelerates, is critical to achieve the projected sectoral growth

Profitability of NBFCs would moderate by 25-45 bps on a YoY basis.

- **The Retail AUM of NBFCs** (NBFC-Retail; *excluding HFCs)* continued its growth momentum for the second successive year in FY2024, with the sector estimated to have grown by 29% in FY2024, despite a series of tightening regulatory actions by the regulator in H2 FY2024. The full impact of these actions is expected to be felt in FY2025, with the growth likely to moderate in FY2025 to 17-19% in ICRA's base case.
- **Downside risks for AUM growth in FY2025** could emerge for the sector in case of further tightening regulatory actions or in case liquidity conditions tighten beyond ICRA's current expectations. The NBFC-Retail sector would be the most affected; though some impact is seen for the HFC sector too. In a stress case scenario, AUM growth in the NBFC-Retail segment could reduce to 14-16% in FY2025.
- **Incremental funding requirement** (over and above the refinancing of maturing debt) is estimated at Rs. 3.0 trillion in FY2025 for Retail-NBFCs. The share of bank credit to the NBFCs has been coming down in recent months after reaching close to 10% last year. As banks continue to tighten credit to NBFCs, entities would have to increase funding from other sources, including via market issuances, securitisation, and external borrowings. Inability to shore up such funding could result in a lower growth as envisaged in the stress case scenario.
- **Tightening funding and liquidity conditions** would push up the weighted average cost of funds (CoF) by 20-40 bps in FY2025. As the space for further increase in lending rates becomes more restricted, given the competitive scenario, entities would face margin pressure. Further, as growth in the high-yielding unsecured segment moderates, ability to calibrate the asset mix to support the margins would be diminished.
- **Asset quality is expected to weaken** incrementally as the portfolio seasoning catches up with the robust growth seen over the last two years. Consequently, delinquencies are expected to rise by 30-50 bps in FY2025, resulting in increased credit costs. Segments such as tractor financing, MFI, PL/CL, UBL, etc, are likely to be more impacted than other secured segments. This would impact the net profitability by 25-45 bps in FY2025.
- **The current sectoral capitalisation profile** is adequate for meeting growth targets in the near term. Some entities with tighter capital positions would, however, be required to raise capital. This could also be partly driven by the new regulatory requirements (such as risk weight on consumer credit, leverage guidelines)

Note: NBFCs: Non-banking financial companies; HFCs: Housing finance companies (excluding HDFC); AUM: Assets under management; VEF: Vehicle finance; GL: Gold loans; SBL: Secured business loans; UBL: Unsecured business loans; PL: Personal Loans; CL: Consumer loans; SME: Small enterprise loans; MFI: Microfinance; Sector: NBFC-Retail/Wholesale, HFC-Retail/Wholesale, NBFC-Infra*

ICRA Analytical Contact Details

Name	Designation	Email	Contact Number
Karthik Srinivasan	Senior Vice President	karthiks@icraindia.com	+91-22-61143444
A M Karthik	Vice President	a.karthik@icraindia.com	+91-44-4596308
Manushree Saggar	Vice President	manushrees@icraindia.com	+91-124-4545316
R Srinivasan	Vice President	r.srinivasan@icraindia.com	+91-44-4596315
Prateek Mittal	Assistant Vice President	prateek.mittal@icraindia.com	+91-33-71501100
Shaik Saleem	Senior Analyst	shaik.Saleem@icraindia.com	+91-40-45474829

Business Development/Media Contact Details

Name	Designation	Email	Contact Number
L Shivakumar	Chief Business Officer	shivakumar@icraindia.com	022-61693304
Neha Agarwal	Head – Research Sales	neha.agarwal@icraindia.com	022-61693338
Rohit Gupta	Head Business Development – Infrastructure Sector	rohitg@icraindia.com	0124-4545340
Vivek Bhalla	Head Business Development – Financial Sector	vivek.bhalla@icraindia.com	022-61693372
Vinita Baid	Head Business Development – Corporate Sector - West & East	vinita.baid@icraindia.com	033-71501131
Shivam Bhatia	Head Business Development – Corporate Sector - North & South	shivam.bhatia@icraindia.com	0124-4545803
Naznin Prodhani	Head – Group Corporate Communications & Media Relations	communications@icraindia.com	0124-4545860

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Thank You!