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Non-banking Financial Companies

Asset quality concerns elevated for unsecured segments

OCTOBER 2024

Agenda

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 by 30-50 bps for NBFC-Retail; however, unsecured segments to face a larger impact driven by factors such as borrower overleveraging.

Entities continue to maintain adequate on-b/s liquidity given the tightening funding scenario; cumulative asset-liability mismatches continue to remain largely positive.

Profitability of NBFCs would moderate by 30-50 bps on a YoY basis.

- **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, UnSME, etc. are likely to slow down significantly from the sustained robust growth witnessed over the past few years.
- **Asset quality for NBFC-Retail** overall 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. Within this, meaningful divergence in the performance of unsecured segments is anticipated, 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 after reaching close to 10% previously. As banks continue to tighten credit flows to NBFCs, entities would have to increase funding from other sources, including via market issuances, securitisation, and external borrowings. Incremental funding requirement (over and above the refinancing of maturing debt) is estimated at Rs. 3.0 trillion in FY2025 for Retail-NBFCs. Tight funding conditions would push up the weighted average CoF by 20-40 bps in FY2025.
- **Net profitability of NBFCs** would moderate by 30-50 bps in FY2025 and credit costs increase. Space for further increases in lending rates is restricted given the competitive scenario and regulatory scrutiny. 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.
- **Liquidity coverage** witnessed some moderation, though remaining 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.
- **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; LAP: Loans against properties; UnSME: Unsecured/Quasi Secured SME loans; 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!