ICRA

Non-banking Financial Companies – Microfinance Institutions

Asset quality weighs heavily on growth and profitability

DECEMBER 2024

Agenda

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2 Microfinance Sector Growth

3 Profitability, Capitalisation and Liquidity

4 NBFC-MFI Sector Outlook

5 ICRA's Ratings Across NBFC-MFI Sector

Highlights

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ICRA expects NBFC-MFIs' AUM growth to decline sharply to a muted 0-5% in FY2025 from 29% in FY2024 amid mounting asset quality concerns

ICRA anticipates compression in margins and rise in credit costs to affect profitability; RoMA expected to moderate to 0.4-0.8% in FY2025 from 3.6% in FY2024

ICRA has a Negative outlook on the sector given the significant near-term headwinds on growth, asset quality and profitability.

- Asset quality of NBFC-MFIs[1] has been deteriorating with 0+dpd and 90+dpd increasing by ~390 bps and ~110 bps to ~7.9% and ~3.3%, respectively, in H1 FY2025. The industry is facing challenges stemming from borrower overleveraging, socio-political disruptions, and operational challenges.
- The sharp increase in the overall overdue book in H1 FY2025 poses significant downside risks to the near-term loan quality of the sector. Delinquencies are expected to further increase in the near term amid an expected rise in rejection rates, resulting in lower incremental credit and liquidity available with borrowers.
- Around 22% of the NBFC-MFIs' borrowers had loans from more than three lenders as of September 2024. Also, around 5% of the borrowers have total microfinance exposure above Rs. 2 lakh as of September 2024. With the revised guardrails and inclusion of unsecured retail loans in cap of total indebtedness, more borrowers will be ineligible for incremental funding.
- The overall attrition rate for the 12 months ended September 30, 2024 remained high with field level attrition exceeding 70% during the period. In H1 FY2025, NBFC-MFIs are gradually reducing the number of clients and assets under management (AUM) per field officer in an attempt to reduce workload, control attrition and focus on collections.
- The AUM of NBFC-MFIs declined by 4% in H1 FY2025 (growth of 29% in FY2024) amid operational challenges and asset quality concerns. Further, expected increase in borrower rejection rates is likely to result in subdued disbursements and a sharp moderation in AUM growth to 0-5% in FY2025.
- Increasing cost of funds and downward revisions in lending rates are likely to compress the interest margins of NBFC-MFIs in FY2025. Along with asset quality pressure leading to higher credit costs, this is expected to impact earnings in FY2025. NBFC-MFIs are likely to report a subdued return on average managed assets (RoMA) of 0.4-0.8% in FY2025, significantly lower than the record high of 3.6% in FY2024.
- Nonetheless, given the growth outlook, ICRA expects the industry to maintain adequate leverage amid the moderate capital requirement. Further, given the relatively shorter tenure of loans, NBFC-MFIs are well placed from an asset-liability management (ALM) perspective with no mismatches up to at least a year.

[1]*Non-banking Financial Companies – Microfinance Institutions*

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Thank You!