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Non-banking Financial Companies – Microfinance Institutions

Growth and profitability derailed by mounting asset quality stress

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List of abbreviations

ARCs	Asset reconstruction companies
AUM	Assets under management
bps	Basis points
BC	Business correspondent
CoF	Cost of funds
CP	Commercial paper
DA	Direct assignment
dpd	Days past due
FI	Financial institution
MCE	Monthly collection efficiency
MFIs	Microfinance institutions

NBFCs	Non-banking financial companies
NBFC-MFIs	Non-banking financial companies – microfinance institutions
NCDs	Non-convertible debentures
NIM	Net interest margin
p.a.	Per annum
PTCs	Pass-through certificates
RBI	Reserve Bank of India
RoMA	Return on average managed assets
SFB	Small finance bank
SHG	SHG Bank Linkage Programme
YoY	Year-on-year

Agenda

1 **NBFC-MFI Sector Outlook**

2 **Asset Quality Trends**

3 **Microfinance Sector Growth**

4 **Profitability and Capitalisation**

5 **Funding and Liquidity**

6 **ICRA's Ratings across the NBFC-MFI Sector**

Highlights

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ICRA expects NBFC-MFIs' AUM to decline by up to 5% in FY2025 amid mounting asset quality concern, followed by some improvement in FY2026.

ICRA anticipates compression in margins and rise in credit costs to affect profitability; RoMA expected to moderate to 0.0-0.4% 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 ~590 bps and ~230 bps to ~9.9% and ~4.5%, respectively, in 9M FY2025. The industry is facing challenges stemming from borrower overleveraging, sociopolitical disruptions, and operational challenges.
- The sharp increase in the overall overdue book in 9M FY2025 poses significant downside risks to the near-term loan quality of the sector. Delinquencies are expected to remain elevated in the near term amid rising 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.
- 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.
- The AUM of NBFC-MFIs declined by 11% in 9M FY2025 (growth of 29% in FY2024) amid operational challenges and asset quality concerns. Further, the increase in borrower rejection rates has resulted in subdued disbursements and the AUM is expected to decline by up to 5% in FY2025, followed by some improvement in FY2026.
- Increasing cost of funds and downward revisions in lending rates are likely to compress the interest margins of NBFC-MFIs in FY2025. This, along with higher credit costs due to asset quality pressure, is expected to impact earnings in FY2025. NBFC-MFIs are likely to report a subdued return on average managed assets (RoMA) of 0.0-0.4% in FY2025, significantly lower than the record high of 3.6% in FY2024.
- With muted AUM growth, funding need was lower in 9M FY2025. Lenders remain cautious in lending to the sector, given the persisting asset quality concerns and regulatory actions for two entities. Nonetheless, funding is likely to remain adequate amid the muted growth expectations in the near term.

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

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Thank You!