INDIAN MICROFINANCE SECTOR

Industry to witness healthy growth and further improvement in profitability in FY2024

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NBFC-MFIs' AUM expected to grow by 22-25% in FY2023, driven by buoyant demand and expected increase in average ticket size

With expected recovery in delinquencies, credit cost to decline in FY2023, though it would remain above the pre-Covid level

Adequate capital and liquidity support entity-level risk profiles

The growth rate of the assets under management (AUM) of non-banking financial companies - microfinance institutions (NBFC-MFIs) improved to around 20% (annualised) in H1 FY2023, after moderating in Q1 FY2023. Given the buoyant demand and the expected increase in the average ticket size, ICRA expects the growth to improve further in H2 FY2023 and accordingly retains its AUM growth estimate of 22-25% for NBFC-MFIs in FY2023. Moreover, ICRA expects a steady growth of 20-25% in FY2024. On the asset quality front, ICRA expects delinquencies to continue declining, aided by recoveries, write-offs, and sale to asset reconstruction companies (ARCs). This would result in a reduction in the credit costs, which, coupled with the expected improvement in the net interest margins (NIMs), given the increased lending rates, would help the industry register an improvement in the profitability metrics. ICRA expects NBFC-MFIs to report a return on managed assets (RoMA) of 1.9-2.1% in FY2023 and 2.6-2.8% in FY2024.

- **AUM growth to remain healthy:** The industry took time to adapt to the Reserve Bank of India's (RBI) revised regulatory framework, which led to a slowdown in disbursements in Q1 FY2023. However, disbursements picked up in Q2 FY2023 and the industry reported an increase in the growth rate in Q2 FY2023. ICRA expects the growth to remain healthy in H2 FY2023 and FY2024.
- **90+ dpd to continue improving:** With the waning of the Covid-19 pandemic-induced stress, the industry saw recoveries from overdue accounts. Despite higher slippages from the restructured book, aided by write-offs and the sale of delinquent portfolios to ARCs, the 90+ days past due (dpd) of the ICRA sample[1] declined to 4.5% as on September 30, 2022 from 5.8% as on March 31, 2022. For H2 FY2023, ICRA expects further reduction, however, the pace of reduction in Q3 FY2023 appears to be slower than anticipated and hence ICRA has revised its estimate for the 90+ dpd upwards to 3.0-3.3% by March 31, 2023 from earlier estimate of around 2%. Thereafter, it is expected to improve to 2.0-2.2% by the end of FY2024.
- **Adequate on-balance sheet liquidity and capitalisation profile:** On-book liquidity, as a percentage of the AUM, was ~13% as on September 30, 2022 (~18% as on March 31, 2022) for the ICRA sample. With the reduction in uncertainties and to meet the qualifying assets criteria (75% of total assets as microfinance loans), as per the revised regulatory framework, NBFC-MFIs reduced liquidity in H1 FY2023, though the same remains adequate. The capitalisation also remains adequate with a managed gearing {(on-book borrowings + off-book assets)/net worth} of 4.1 times as on September 30, 2022. Going forward, ICRA expects the leverage to remain adequate.
- **Stable outlook on NBFC-MFIs:** ICRA carries a Stable outlook for the microfinance industry, driven by the expected healthy growth in the AUM and the improvement in the profitability. The industry has raised the lending rates in the current fiscal post the removal of pricing caps under the revised regulations, which is expected to provide upside to the profitability going forward.

[1]ICRA sample in the note comprises a set of 25 NBFC-MFIs (minor variation in number at some places and for different dates), accounting for around 90% of the industry AUM as on September 30, 2022

Outlook

AUM Growth		**22-25% in FY2023** **20-25% in FY2024**	Given the buoyant demand and the expected increase in the average ticket size, the growth in the industry's AUM in the remaining quarters of FY2023 is expected to improve further. ICRA estimates full year growth of 22-25% in FY2023 and 20-25% in FY2024.
Credit Costs		**To gradually reduce in FY2023 and FY2024**	Higher slippages from the restructured book led to an increase in credit costs in H1 FY2023 vis-à-vis FY2022. ICRA estimates that a large part of the credit cost has been absorbed by the entities. Hence, some reduction is expected in H2 FY2023 and FY2024.
Funding and Liquidity		**Debt** **-Rs. 13,000-14,000 crore in FY2023** **-Rs. 17,500-18,500 crore in FY2024**	Liquidity is expected to remain comfortable for most entities. The funding requirement to support growth, apart from refinancing existing/maturing lines, stands at Rs. 13,000-14,000 crore for FY2023 and Rs. 17,500-18,500 crore for FY2024.
Profitability (RoMA) MFIs		**1.9-2.1% in FY2023** **2.6-2.8% in FY2024**	With the improvement in margins and the reduction in credit costs, the profitability is expected to improve in FY2023 and further in FY2024.
Capital		**Comfortable**	Moderate capital requirement is expected to meet the envisaged growth over FY2023-2025. Equity capital requirement is estimated at Rs. 4,000-4,500 crore for NBFC-MFIs during FY2023-2025 considering the industry's on-book portfolio growth (compound annual growth rate – CAGR) estimate of 20-25% p.a. for FY2023-FY2025, while maintaining the managed gearing below 5.0 times.

EXECUTIVE SUMMARY

- As the NBFC-MFIs streamlined their systems and processes and trained its staff as per the revised regulatory framework, disbursements started picking up in Q2 FY2023. This led to an improvement in the growth rate to 20% (annualised) in Q2 FY2023 from 8% (annualised) in Q1 FY2023. The AUM of NBFC-MFIs crossed Rs. 1.0 lakh crore as on March 31, 2022 and was reported at more than Rs. 1.1 lakh crore as on September 30, 2022.
- Given the buoyant demand and the expected increase in the average ticket size, the growth in the industry's AUM is expected to improve further in H2 FY2023 and remain buoyant in FY2024 as well. While demand remains firm at present, uncertain global macroeconomic conditions and the increase in interest rates could pose some downside risks.
- The 90+ dpd of NBFC-MFIs (ICRA sample) remained elevated at 5.8% of AUM as on March 31, 2022. However, with recoveries and write-offs and after factoring in incremental slippages from the restructured book, it declined to 4.5% as on September 30, 2022. ICRA expects the delinquencies to reduce further in H2 FY2023 and FY2024.
- NBFC-MFIs (ICRA sample) reported a standard restructured book of 3.7% of AUM as on September 30, 2022 (7.7% as on March 31, 2022). ICRA expects a further reduction in the standard restructured book by March 2023, driven by recoveries and slippages to non-performing assets (NPAs).
- On the liquidity front, NBFC-MFIs continue to maintain an adequate liquidity profile, though the same declined in H1 FY2023. This was on account of reduced uncertainties and for NBFC-MFIs to keep their non-qualifying assets (including liquidity) below 25% of the total assets. The on-book liquidity, as a percentage of the AUM, stood at around 13% as on September 30, 2022 for the ICRA sample compared to around 18% as on March 31, 2022.
- The profitability of NBFC-MFIs is expected to improve in FY2023. The impact of rising interest rates on funding costs is likely to be visible in H2 FY2023. However, the NIMs are expected to improve in FY2023 as the entities have increased their lending rates under the new regulatory regime. Higher NIMs, along with the moderation in credit costs, will support the improvement in the profitability indicators of NBFC-MFIs. ICRA expects NBFC-MFIs to report RoMA of 1.9-2.1% in FY2023 with the same improving further to 2.6-2.8% in FY2024.
- Given the industry's on-book portfolio growth (CAGR) estimate of 20-25% p.a. for FY2023-2025 and the intention of maintaining the managed gearing below 5.0 times, the entities would need external capital of Rs. 4,000-4,500 crore (19-21% of closing net worth as on March 31, 2022) during this period, in ICRA's opinion.

ABOUT ICRA

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