Market Intelligence
& Analytics

CRISIL
An S&P Global Company

Analysis of NBFC sector and select asset classes

Northern Arc Capital Limited

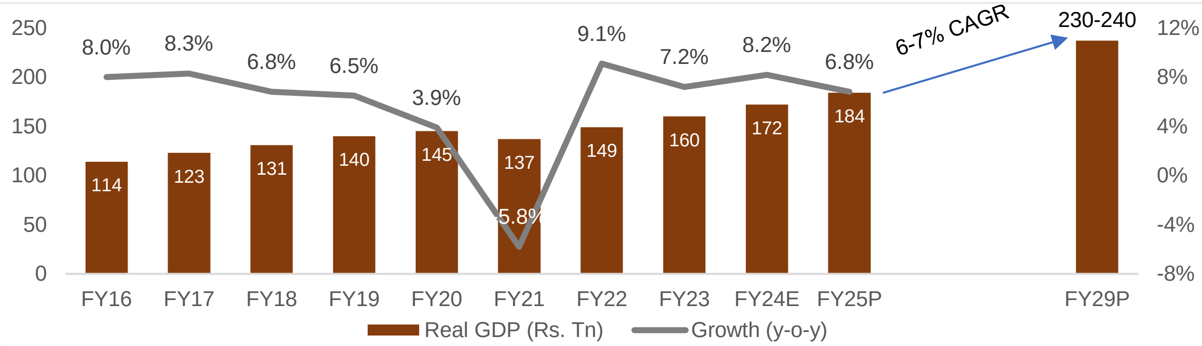
June 2024

Table of contents

Macroeconomic scenario

Key updates on the Indian economy

India's economy to grow at 6.8% in Fiscal 2025



Note: E = Estimated, P = Projected; GDP growth till fiscal 2023 is actuals. GDP Estimates for fiscals 2023- 2024 is based on NSO Estimates and 2024-2025 is projected based on CRISIL MI&A estimates and that for fiscals 2025-2029 based on IMF estimates; Source: NSO, CRISIL MI&A, IMF (World Economic Outlook – April 2024 update)

Over the past three Fiscals (FY22-FY24), the Indian economy has outperformed its global counterparts by witnessing a faster growth. Going forward as well, IMF projects that Indian economy will remain strong and would continue to be one of the fastest growing economies.

India is among the fastest-growing major economies (GDP growth, % year-on-year)

GDP Growth (% YoY)	2017	2018	2019	2020	2021	2022	2023	2024E	2025P	2026P	2027P	2028P
	BRICS Nations											
India	6.8	6.5	3.9	(5.8)	9.7	7.0	7.8	6.8	6.5	6.5	6.5	6.5
China	6.9	6.8	6.0	2.2	8.5	3.0	5.2	4.6	4.1	3.8	3.6	3.4
Russia	1.8	2.8	2.2	(2.7)	6.0	(1.2)	3.6	3.2	1.8	1.3	1.3	1.3
Brazil	1.3	1.8	1.2	(3.3)	4.8	3.0	2.9	2.2	2.1	2.1	2.0	2.0
South Africa	1.2	1.5	0.3	(6.0)	4.7	1.9	0.6	0.9	1.2	1.4	1.4	1.4
	Major Economies (outside BRICS)											
United States	2.2	2.9	2.5	(2.2)	5.8	1.9	2.5	2.7	1.9	2.0	2.1	2.1
Japan	1.7	0.6	(0.4)	(4.1)	2.6	1.0	1.9	0.9	1.0	0.8	0.6	0.6
Germany	2.7	1.0	1.1	(3.8)	3.2	1.8	(0.3)	0.2	1.3	1.5	1.1	0.8
France	2.5	1.8	1.8	(7.5)	6.3	2.5	0.9	0.7	1.4	1.6	1.5	1.4
UK	2.4	1.7	1.6	(10.4)	8.7	4.3	0.1	0.5	1.5	1.7	1.7	1.6

Note: All forecasts refer to IMF forecasts. GDP growth is based on constant prices, Growth numbers for India till 2022 are for financial year, 2023 is as per IMF estimates for FY23. Post FY24, all estimates for India are as per calendar year. Data represented for other countries is for calendar years, E: Estimated, P: Projected; Source: IMF (World Economic Outlook – April 2024), CRISIL MI&A

Financial conditions stabilise, broader economy to face elevated rates

The RBI's Monetary Policy Committee ("**MPC**") is expected to be on an extended pause for the next few meetings, as it evaluates the inflation trajectory and growth momentum. While CPI inflation has fallen in the past four months coming down to 4.3% in May 2023, down from 4.7% in April 2023, progress of monsoon and impact of El Nino will be monitored. The impact of past rate hikes on growth will be the most prominent in the current Fiscal. As growth slows, CRISIL MI&A expects RBI to initiate rate cuts in the last quarter of Fiscal 2024. While the pause on rate hikes has augured well for financial markets, elevated bank lending rates could tighten financial conditions for some segments of the economy which could ease down subsequently basis the direction of the economy.

US Fed pauses rate hikes, Eurozone inflation softens, while India remains resilient

On the global front, Given the resilient economic activity, a low unemployment rate and elevated inflation, the US Federal Reserve kept interest rates at 5.25-5.50% in its April meeting, maintaining a data-dependent approach in assessing the need for rate cuts. The US Fed is likely to wait longer for a rate cut until December, according to S&P Global. According to flash estimates released by Eurostat, Inflation in the euro area stayed steady at 2.4% in April, according to a flash estimate from the Eurostat. While inflation picked up in the food-related category (2.8% vs 2.6%), energy prices continued to decline, though the extent of deflation eased (-0.6% vs -1.8%). Core inflation eased further to 2.7% from 2.9%. driven by decreases in inflation in both non-energy industrial goods (0.9% vs 1.1%) and services. (3.7% vs 4.0%). Given that inflation continues to remain above its 2% target, the European Central Bank kept its policy interest rate unchanged at 4.5% in its April meeting.

While the risk of tight and volatile global financial conditions persists, India's vulnerability to these shocks is likely to be lower in Fiscal 2025. India's key external liability – current account deficit – will likely be pared this Fiscal on the back of lower crude oil prices. This, coupled with the RBI's adequate forex reserves and the country's good growth prospects, should cushion the impact of a global spill over on Indian macroeconomic conditions.

MPC maintains status quo on monetary policy

Amid strong economic growth, the RBI has been wary of monetary easing, remaining focussed on inflation risks. Like the Fed, the RBI's Monetary Policy Committee (MPC) kept policy rates and stance unchanged in June. GDP growth continues to surprise both the RBI and Fed, giving them time to ensure a durable reduction in inflation to their target levels before cutting rates. While inflation in the US has been above the Fed's 2% target, the headline inflation in India is now within the MPC's 2-6% target range, but not at 4% mid-point. CRISIL MI&A do not expect the MPC to cut rates before October. Assuming normal monsoon and gradual slowing in GDP growth, CRISIL MI&A expect two rate cuts in the second half of this fiscal.

Macroeconomic outlook for Fiscal 2025

Macro variables	Fiscal 2024E	Fiscal 2025P	Rationale for outlook
GDP (y-o-y)	8.2%	6.8%	Slowing global growth is likely to weaken India's exports, while peak impact of past rate hikes and lower fiscal impulse could temper domestic demand. Despite the lower forecast, India continuous to grow at the highest rate among major economies propelled by budgetary support to capital expenditure and strong rural demand to support growth.
Consumer price index (CPI) inflation (y-o-y)	5.5%	4.5%	Lower commodity prices, base effect, and cooling off domestic demand is likely to help in moderating inflation in Fiscal 2025.
10-year Government security yield (Fiscal-end)	7.0%	6.8%	A moderate reduction in gross market borrowings to lower pressures on yields in FY25. This, coupled with lower inflation, is likely to moderate yields in FY25. India's inclusion in the JP Morgan Emerging Market Bond Index is favorable for capital flows into government debt.
CAD (Current account balance)/GDP (%)	-1.0%	-1.0%	Softer crude oil prices and moderation in domestic growth will keep the trade deficit in check despite tepid exports of goods. Robust services trade surplus and healthy remittances will keep the current account deficit (CAD) in check.
₹/$ (March average)	83.0	83.5	Narrower CAD and healthy foreign portfolio flows into debt amid a favorable domestic macro environment will support the rupee

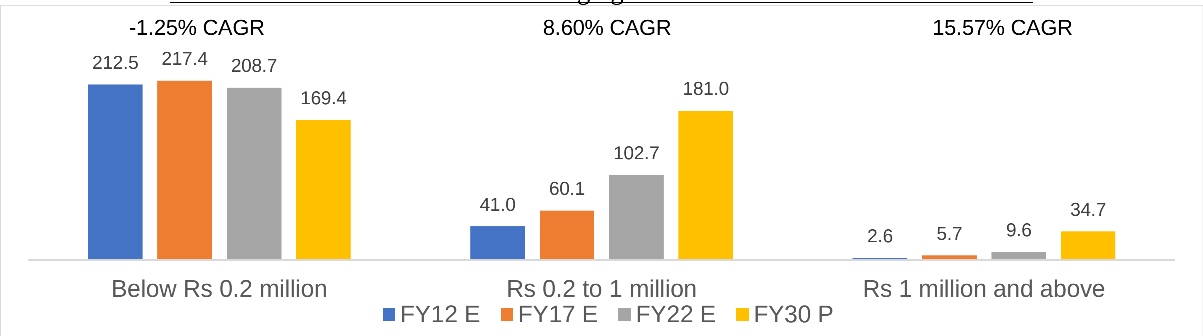
Note: P – Projected; Source: Reserve Bank of India (RBI), National Statistics Office (NSO), CRISIL MI&A

Rising Middle India population to help sustain growth

Proportion of Middle India (defined as households with annual income of between ₹0.2 to ₹1 million) has been on a rise over the last decade and is expected to grow further with continuous increase in GDP and household incomes. To illustrate, CRISIL MI&A estimates that there were 41 million households in India in this category as at the end of Fiscal 2012, and by the end of Fiscal 2030, CRISIL MI&A projects this figure will increase to 181 million households translating into a compound annual growth rate ("**CAGR**") of 9% over this time period. This growth in the number of middle-income households is expected to lead to enhanced opportunities for retail and MSME financiers as well as consumer goods marketers. A large number of these households, which have entered the middle-income bracket in the last few years, are likely to be from semi-urban and rural areas. The rise in incomes in these areas is also evident when one observes the trend in share of deposits coming into banks.

CRISIL MI&A believes that the improvement in the literacy levels, increasing access to information and awareness, increases in the availability of necessities, such as electricity, cooking gas, and toilets, and the improvement in road infrastructure has led to an increase in aspirations of Middle India, which is likely to translate into increased opportunities for financial service providers. In fact, some of these trends are already visible. Smart phone ownership, internet users and the proportion of users accessing social media is increasing rapidly. Smaller cities and towns (with population less than 1 million) account for a significant portion of sales of e-retailers.

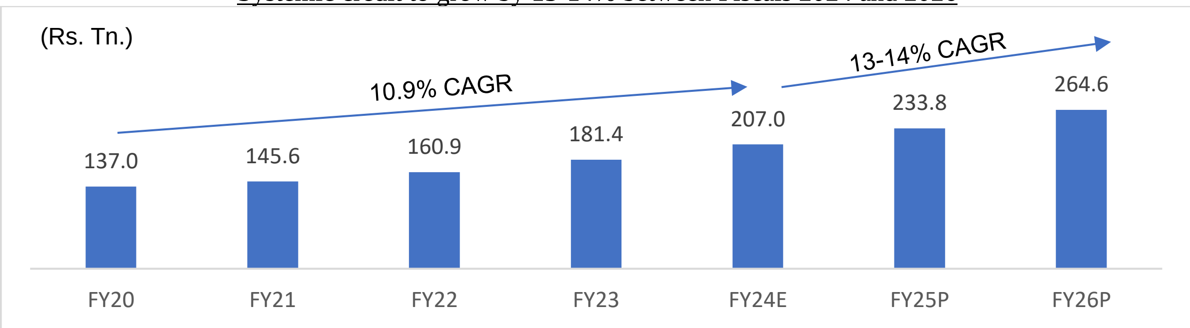
Middle India households to witness high growth from Fiscal 2012 to Fiscal 2030



Note: E - Estimated, P – Projected; Source: CRISIL MI&A

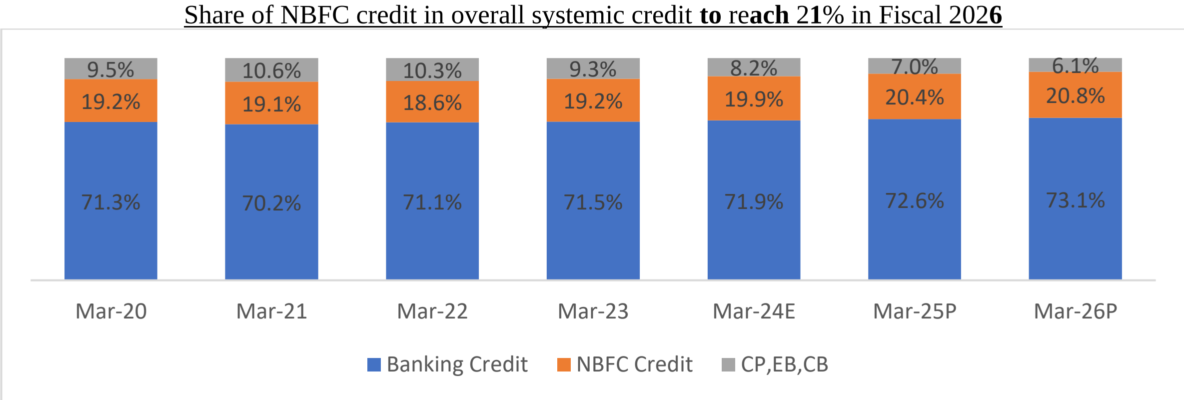
Credit penetration in India

Systemic credit to grow by 13-14% between Fiscals 2024 and 2026



Note: P – Projected; Systemic credit includes domestic banking credit (after deduction of bank lending to NBFC), NBFC credit, commercial papers, external borrowings, corporate bonds excluding those issued by Banks and NBFC; Source: RBI, Company Reports, CRISIL MI&A

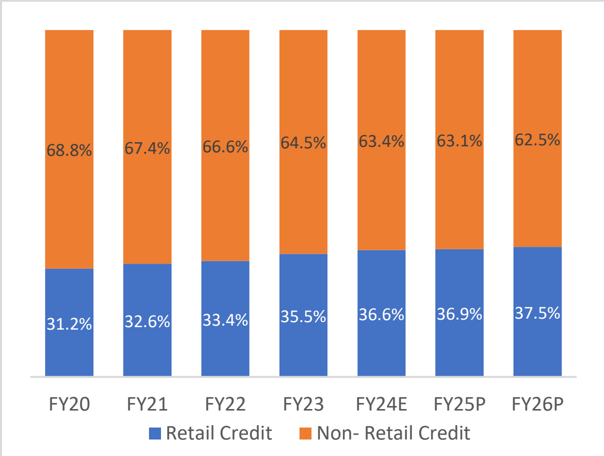
Share of NBFC credit in overall systemic credit **to** re**ach** 21% in Fiscal 202**6**



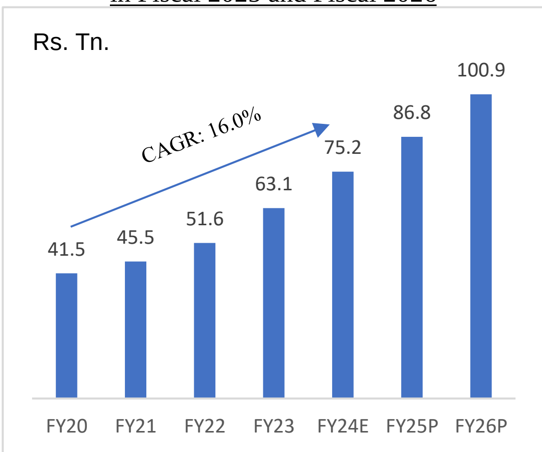
Note: P – Projected;9 Systemic credit includes domestic banking credit, NBFC credit, commercial papers, external borrowings, corporate bonds excluding those issued by Banks and NBFC; Source: RBI, Company Reports, CRISIL MI&A

The retail credit (includes Housing finance, Vehicle Financing, Gold Loans, Education Loans, Consumer Durables, Personal loans, Credit cards and Microfinance) in India stood at Rs. 75.2 trillion, as of FY24 and has rapidly grown at a CAGR of 16.0% during Fiscals 2020 and 2024. Retail credit growth in FY20 was around approximately 12.1% which came down to approximately 9.6% in FY21. However, post-pandemic, retail credit growth revived back to reach approximately 13.5% in FY22. In FY23, retail credit has grown at ~22.3% year on year basis. The Indian retail credit market has grown at a strong pace over the last few years and is expected to further grow at CAGR of 17-18% between FY24 and FY26 to reach Rs. 100.9 trillion by FY26. The moderation of growth of retail credit is on account of normalisation in unsecured segment which had witnessed exuberant growth in the past and impact of RBI's risk weight circular. *Moreover, the increasing demand and positive sentiments in the Indian retail credit market, presents an opportunity for both banks and NBFCs to broaden their investor base.*

Retail segment to account for 37.5% of overall systemic credit by Fiscal 2026

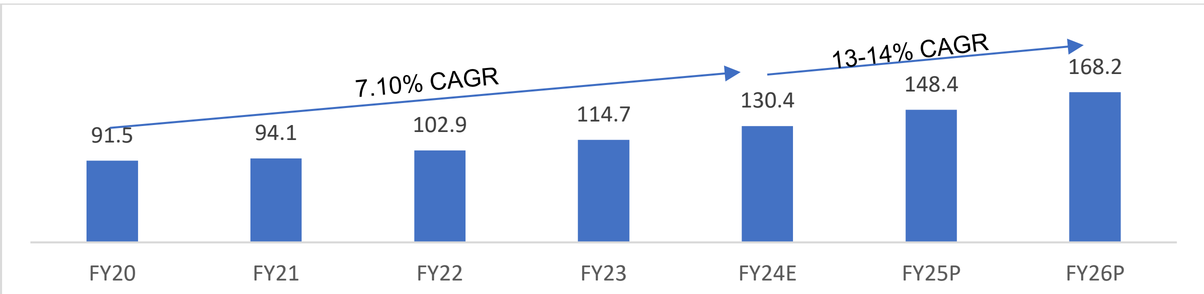


Retail credit growth to continue a strong footing in Fiscal 2025 and Fiscal 2026



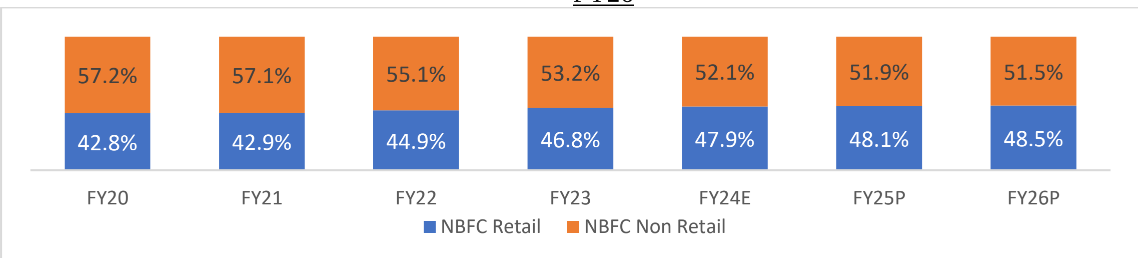
Note: E- Estimates, P – Projected; Source: RBI, CRISIL MI&A

Systemic nonretail credit to grow with lower growth



Note: E- Estimates, P – Projected; Source: RBI, CRISIL MI&A

Share of retail credit in total NBFC credit to grow to 48% by end of FY25 and expected to reach 48.5% in FY26



Note: E- Estimates, P- Projected; Retail credit includes housing finance, vehicle finance, microfinance, gold loans, construction equipment finance, consumer durable finance, MSME loans and education loans; Source: Company reports, CRISIL MI&A

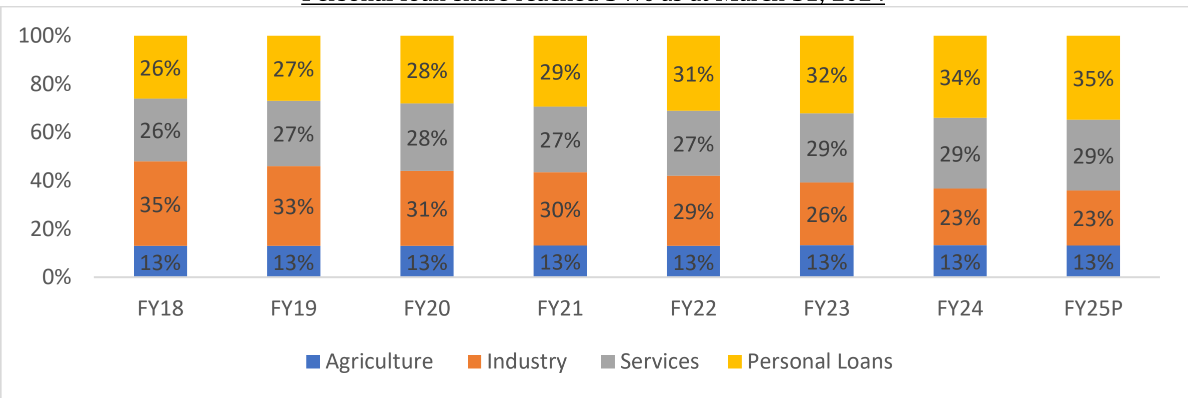
Personal Loan and Service segment to drive credit growth in Fiscal 2025

Industrial credit accounted for nearly a third of the overall banking credit mix in Fiscal 2019.

CRISIL MI&A estimates that agricultural credit grew in Fiscal 2024 due to higher priority sector lending ("**PSL**") targets, expected higher food-grain production, increase in commodity prices and increase in agriculture credit target. Industrial credit grew in Fiscal 2024 supported by healthy growth in segments like basic metal and metal products, chemical and chem products and government's continued focus on production linked incentive scheme. Services segment grew in Fiscal 2024 on back of healthy credit demand from Non-Banking Financial Companies ("**NBFCs**"). Personal Loans segment grew in Fiscal 2024 driven by sharp rise in demand in unsecured loans, demand in housing segment and pent-up demand in vehicle loans segment.

Going forward, CRISIL MI&A expects personal loans and services segment to drive credit growth in Fiscal 2025. Personal Loans segment is expected to show strong growth in Fiscal 2025 on back of credit demand from consumer durables, gold and other personal loan segment.

Personal loan share reached 34% as at March 31, 2024

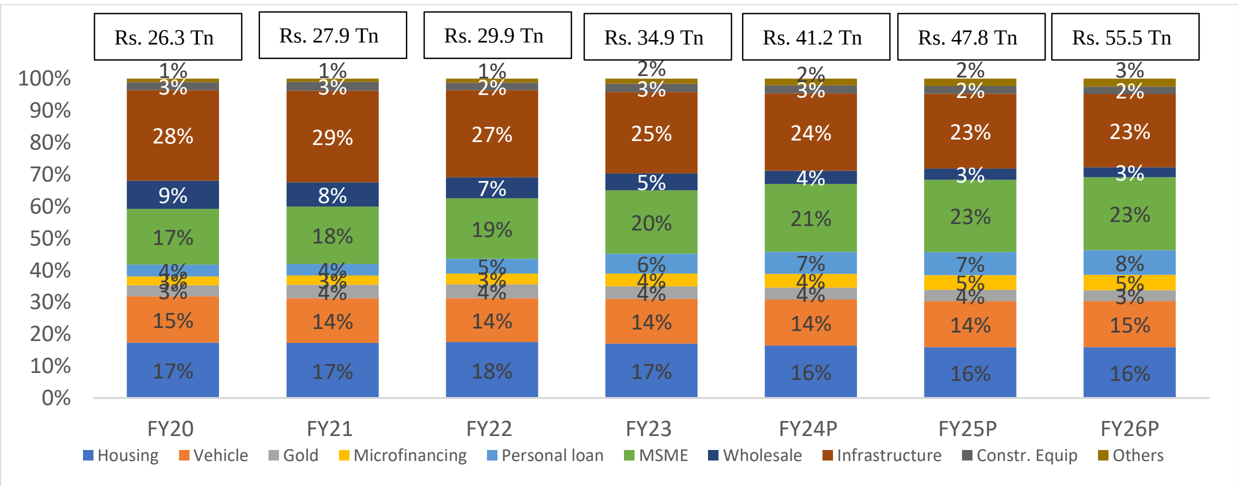


Note: As at the end of each Fiscal; P – Projected
Source: RBI; CRISIL MI&A

Housing finance accounts for third highest share in overall NBFC credit as of FY24

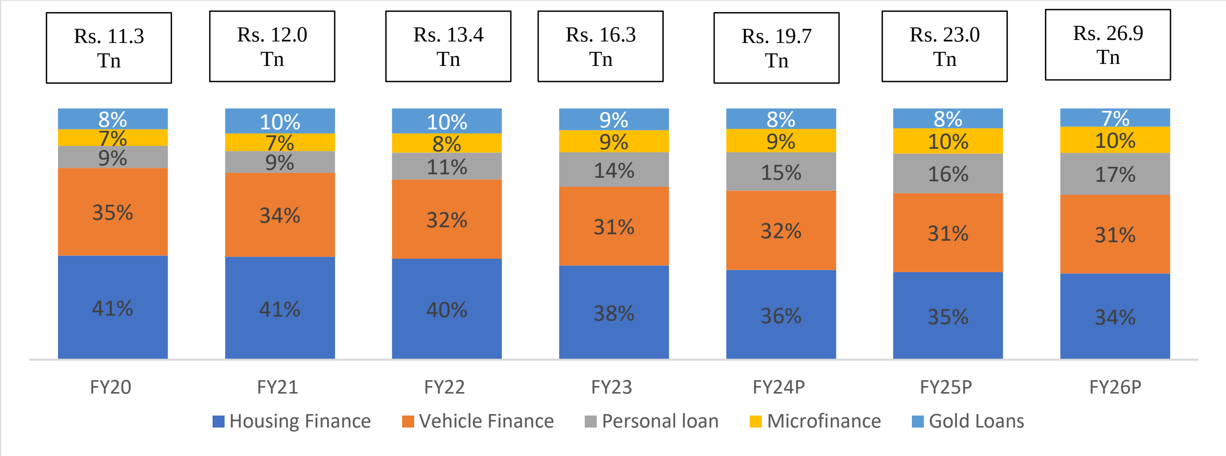
As of FY24 infrastructure financing accounts for the highest share in NBFC credit (24%), which was followed by MSME loans which account for 21% share of overall NBFC credit. Housing finance accounted for third highest share in overall NBFC credit outstanding with 16% share in overall NBFC credit.

Distribution of NBFC Credit across asset classes



Note: Others include education loan and consumer durable loans, Infrastructure includes PFC & REC
Source: Company reports, CRISIL MI&A

Housing finance accounted for the highest share in NBFC retail credit



Source: Company reports, CRISIL MI&A

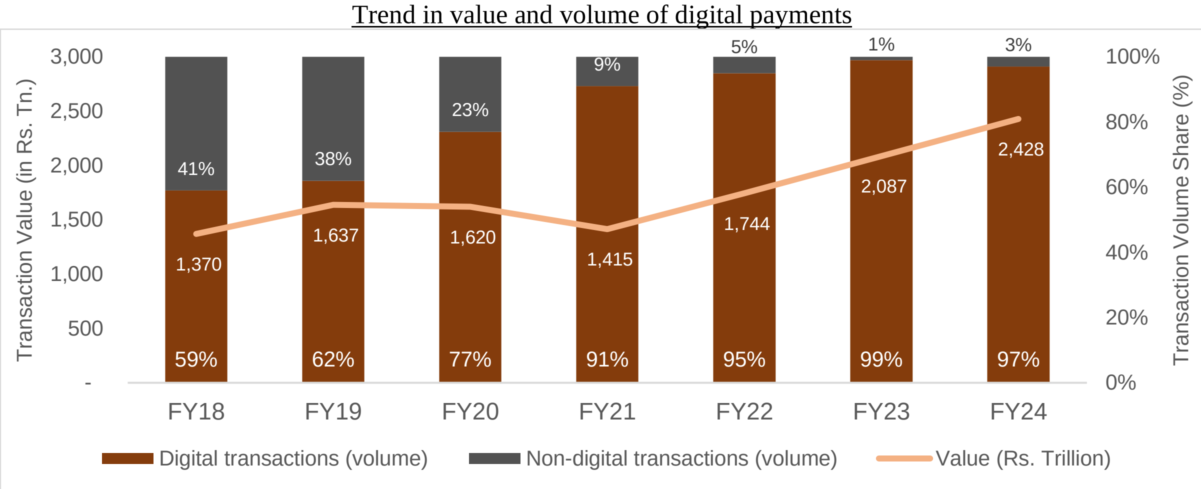
Housing finance accounted for the highest share in NBFC retail credit across fiscals accounting for 36% as of FY24, witnessing a fall in share from 41% in FY20. This was followed by vehicle financing and personal loans with 32% and 15% share in FY24 respectively. Top 3 asset classes accounted for ~83% of total NBFC retail credit. During the fiscals, personal loans witnessed the highest increase in credit share during FY20-24, growing from ~9% in FY20 to 15% in FY24.

Digital payments have witnessed substantial growth

The share of different channels in domestic money transfer has changed significantly over the past five years. Banks, for example, are witnessing a change in customer behaviour with fewer customers visiting bank branches for transactions. This change in behaviour was led by demonetisation when cash transactions slowed down, many new accounts were opened, and digital banking witnessed a surge in use and continued its growth trajectory. Post-COVID-19, with consumers preferring to transact digitally rather than engage in physical exchange of any paper or face-to-face contact, digital transactions have received another shot in the arm.

Between Fiscal 2018 and 2024, the volume of digital payments transactions has increased from ₹14.6 billion to ₹164.4 billion, causing its share in overall payment transactions to increase from 59% in Fiscal 2018 to 97% in Fiscal 2024. During the same period, value of digital transactions has increased from ₹1,371 trillion in Fiscal 2018 to ₹2,428 trillion in Fiscal 2024.

Trend in value and volume of digital payments

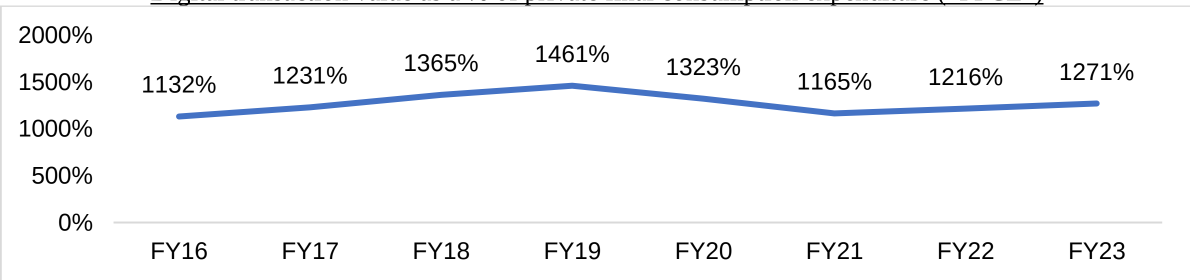


Note: Digital Payments includes RTGS payments, Credit transfers (AePS, APBS, ECS Cr, IMPS, NACH, NEFT, UPI), Debit Transfers (BHIM, ECS Dr, NACH Dr, NETC), Card Payments (Debit and Credit Cards) and Prepaid Payments Instruments
Source: RBI, CRISIL MI&A

Consumers are increasingly finding transacting through mobile convenient. CRISIL MI&A expects the share of mobile banking and prepaid payment instruments to increase dramatically over the coming years. In addition, CRISIL MI&A expects improved data connectivity, low digital payment penetration and proactive government measures to drive digitalisation in the country, transforming it into a cashless economy.

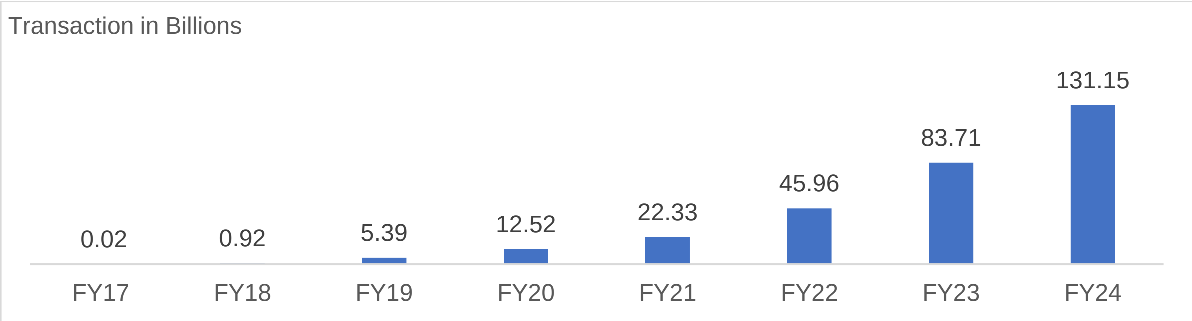
The value of digital transactions as a proportion of private consumption expenditure in between Fiscal 2016 and Fiscal 2023 also rose from 1,132% to 1,271%, which shows that the usage of digital transactions for consumption has been on the rise over the past few years.

Digital transaction value as a % of private final consumption expenditure ("PFCE")



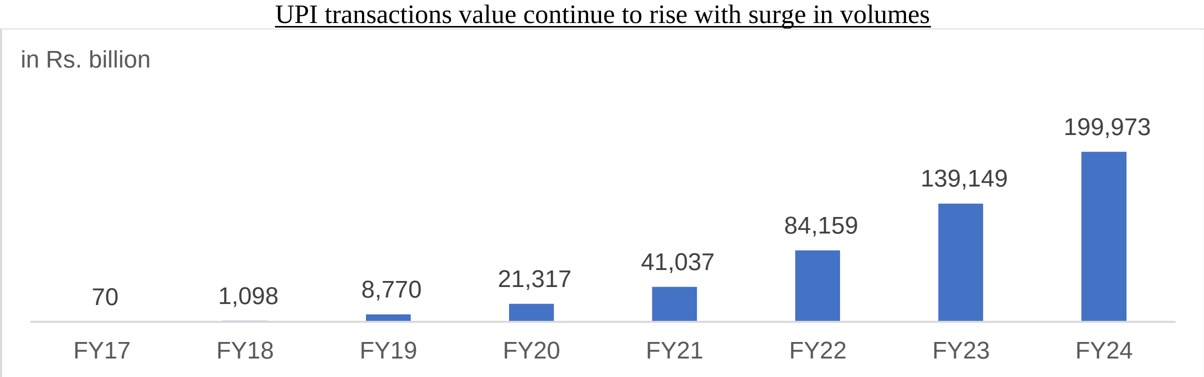
Note: PFCE is based on current prices; Source: Second advance income estimates Mops, RBI, CRISIL MI&A

UPI transactions volumes have zoomed between Fiscals 2017 and 2024



Source: RBI, CRISIL MI&A

UPI transactions value continue to rise with surge in volumes

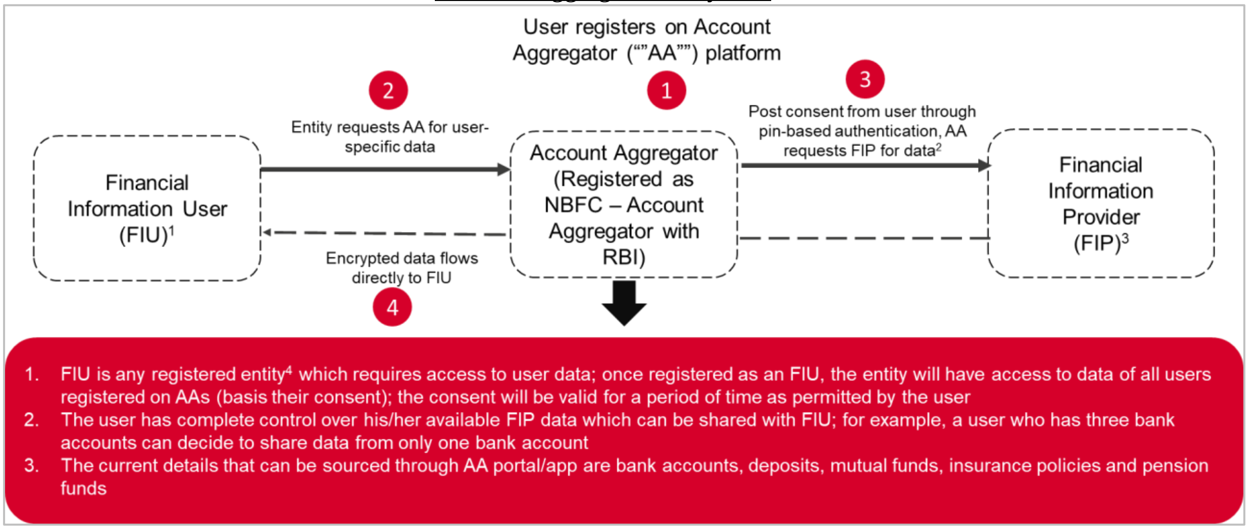


Source: RBI, NPCI, CRISIL MI&A

Account aggregators

The RBI launched the account aggregator ("**AA**") system on September 2, 2021. This has the potential to transform the financial landscape once there is widespread adoption amongst the stakeholders. AAs are essentially non-banking financial companies, licensed by RBI, that act as an intermediary to collect and consolidate data from all financial information providers ("**FIPs**"), such as banks, that hold users' personal financial data and share that with financial information users ("**FIUs**"), such as lending agencies or wealth management companies that provide financial services. These AAs would provide granular insights to lenders into customers' financial assets and their borrowing history centrally, based on customer consent. Availability of this data is expected to support faster onboarding of customers and could allow wealth advisors to utilize asset side data and advice switching between asset classes to yield better overall returns as per the risk appetite of the individual. For the AA platform providers, it is believed that entities having a first mover advantage, strong technological capability and deep engagement with FIUs and FIPs are slated to gain most out of the evolving landscape.

Account Aggregator ecosystem



Note: 4 Registered with any one of the regulators – SEBI, RBI, IRDAI, PFRDA
Source: CRISIL MI&A

Other digital trends in India

Digital trend	Implications
Trade Receivables e-Discounting System (TReDS)	TReDS is an electronic platform for facilitating the financing / discounting of trade receivables of Micro, Small and Medium Enterprises (MSMEs) through multiple financiers. These receivables can be due from corporates and other buyers, including Government Departments and Public Sector Undertakings (PSUs). The Receivables Exchange of India Limited, one of the three RBI-licensed TReDS platforms, reported significant rise in TReDS business throughout, reaching ₹25,086 business in Fiscal 2023 from ₹13,500 in Fiscal 2022, witnessing 86% surge. The rise in TReDS business was owing to increased awareness among the corporates of its benefits and government’s efforts to onboard more corporates.
Central KYC (CKYC)	The Indian government launched Central KYC (CKYC) to help financial service providers and investors with the Know Your Customer (KYC) procedure. Customers can use a centralised KYC repository to submit their required documents only once and then access services from different financial institutions without having to go through the KYC procedure again. CKYC enables streamlining of the process of KYC by having a single form to follow, hence avoiding duplication of documents, accessing information quickly and securely through a central database, consolidation of KYC records across multiple entities, diminishing customer inconvenience.
E-KYC and Aadhaar based authentication	In India, Unique Identification Authority of India (UIDAI) facilities the authentication through online using demographic and biometric data. The unique identification number (UIN) or Aadhaar which is assigned on an individual level helps in establishing the identity of individual to public or private enterprises. The implementation of the Aadhaar has led to a revolution in authentication and consequently in monitoring and security, credit ecosystems, payment systems, and direct benefit transfers (DBT).

Digital trend	Implications
Open Network for Digital Commerce (ONDC)	E-commerce industry is still under growth phase and certain concerns which exist in the current scenario such as malpractices followed by players, barriers in launching new products, and limited reach to audience need to be addressed. Open Network for Digital Commerce (ONDC) is one such solution government is planning to implement to make the overall e-commerce market more efficient and inclusive. ONDC aims to provide equal opportunities to all traders by providing an easy and fair access to e-commerce. It will facilitate small businesses with opportunities to adopt and accept the online market as an additional business avenue for them. The consumers will also be equally benefitted by getting the option to choose a better product, coupled with reasonable price and with efficient and responsible delivery system. Apart from putting a control on malpractices, ONDC can improve the agility of market players by letting them implement more lightweight, agile digital commerce solutions to improve the customer experience and lower total cost of ownership.
DigiLocker service	In Union Budget 2023-24, the finance minister announced Simplification of the know-your-customer process through an expanded DigiLocker service and National Financial Information Registry. Support in technological advancement would promote financial inclusion, ensure better availability of customer data, enable faster and secure sharing of documents with financial institution and increase rural penetration.

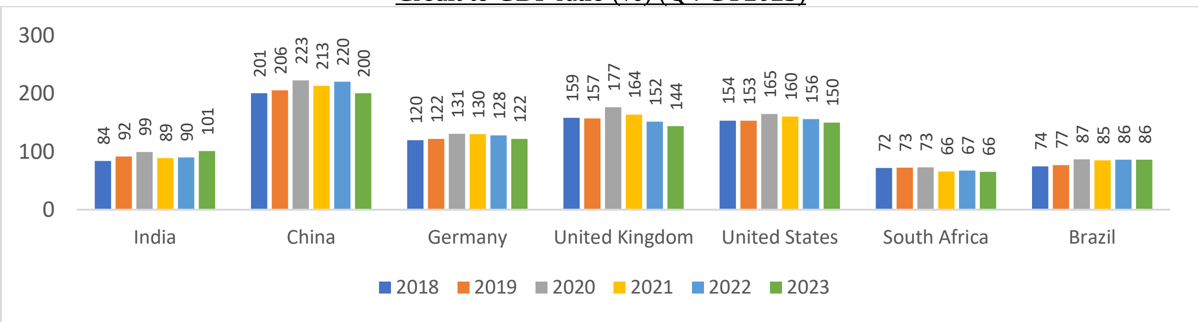
Source: CRISIL MI&A

Financial inclusion

Current scenario and key developments

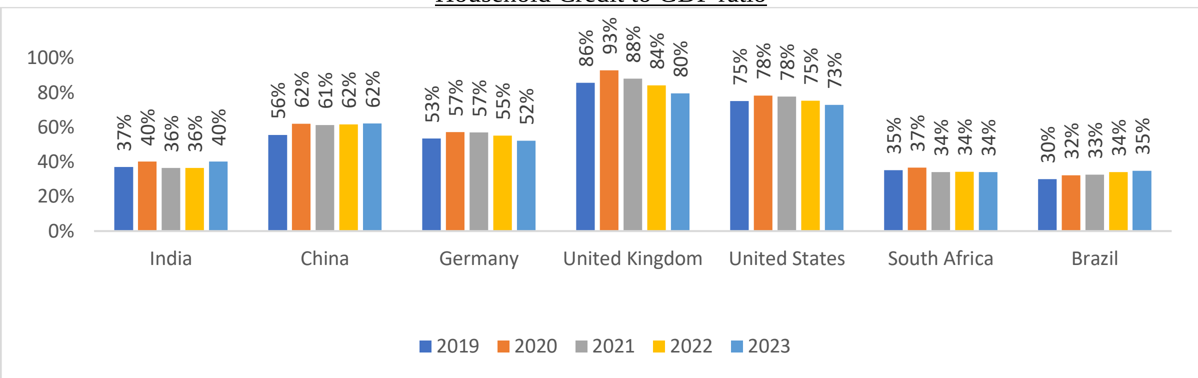
The significance of financial inclusion has deepened, particularly in the post-pandemic era, as vulnerable households and businesses strive to navigate the crises and achieve recovery. In terms of the credit to GDP ratio, India has a low credit penetration compared with other developing countries, such as, China, indicating a significant untapped potential. Similarly, in terms of credit to households as a proportion of GDP as well, India lags other markets, with retail credit hovering at around 40% of GDP as of 2023.

Credit to GDP ratio (%) (Q4 CY2023)



Note: Data is represented for calendar years for all countries except India; For India, numbers are for Fiscal year.
Source: Bank of International Settlements, CRISIL MI&A

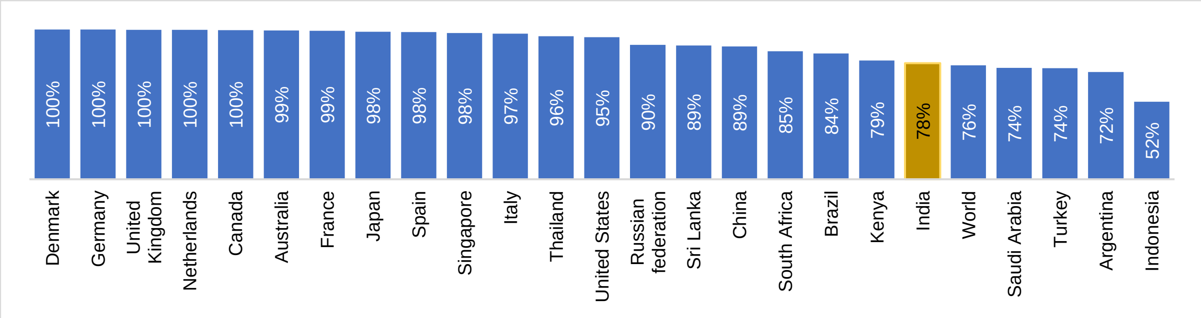
Household Credit to GDP ratio



Note: Data is for calendar year. Source: Bank of International Settlements, CRISIL MI&A

India's focus on financial inclusion is increasing; however, a large section of the population is still unbanked

Adult population with a bank account (%): India vis-à-vis other countries



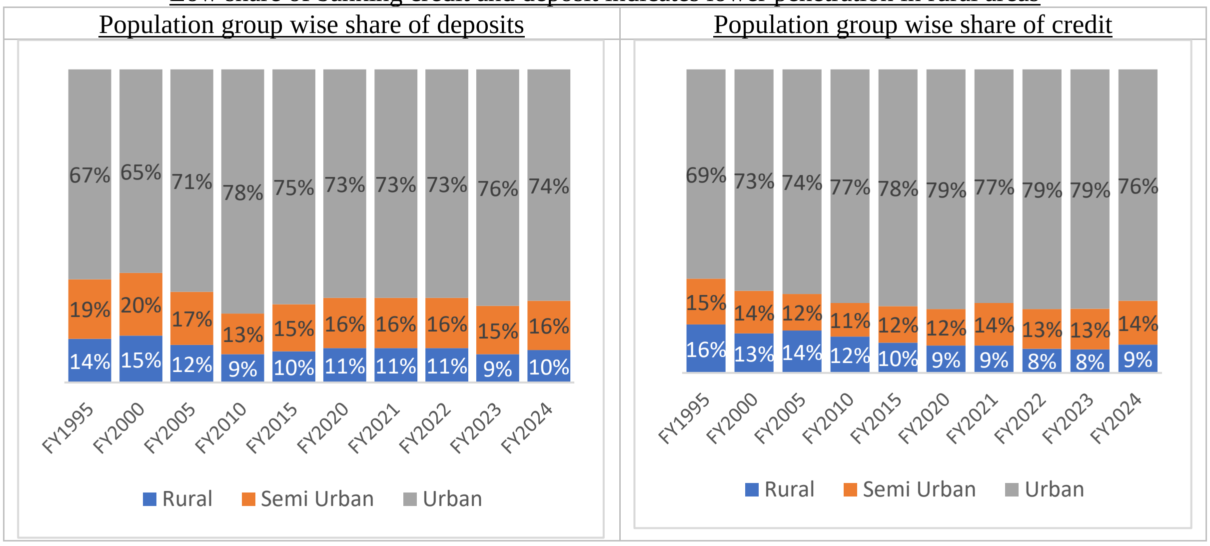
Note: Global Findex data for India excludes northeast states, remote islands and selected districts. Account penetration is for the population within the age group of 15+; Source: World Bank - The Global Findex Database 2021, CRISIL MI&A

Further, according to the World Bank's Global Findex Database 2021, 230 million unbanked adults live in India.

Rural India accounts for about half of GDP, but only about 9% of total credit and 10% of total deposits

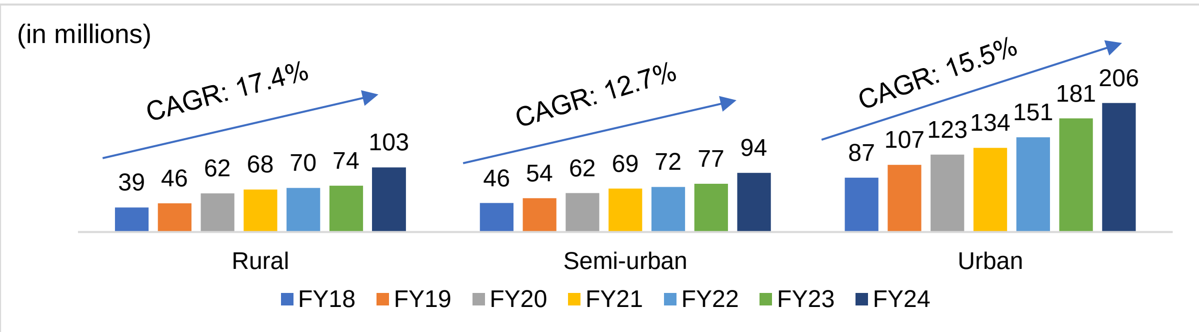
The chart below shows the percentage of GDP contribution and credit outstanding in rural and urban areas:

Low share of banking credit and deposit indicates lower penetration in rural areas



Note: Urban includes data for Urban and Metropolitan areas
Source: RBI, CRISIL MI&A

Bank credit accounts in rural, semi-urban and urban areas



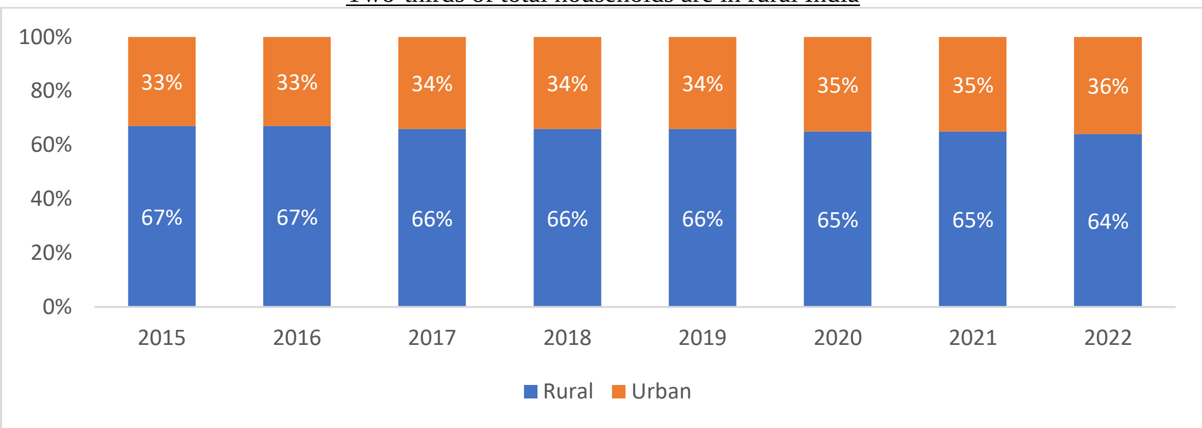
Note: Urban includes data for Urban and Metropolitan areas Data represents only bank credit accounts Source: RBI; CRISIL MI&A

Rural India – Under penetration and untapped market presents a huge opportunity for growth

Credit to metropolitan areas has decreased over the past few years with its share decreasing from 66% as at March 31, 2018 to 57% as of March 2024. Between the same period, credit share has witnessed a marginal rise in rural and urban areas. For semi-urban areas, credit share has gone up from 12% as of March 31, 2018, to 14% as of March 31, 2024.

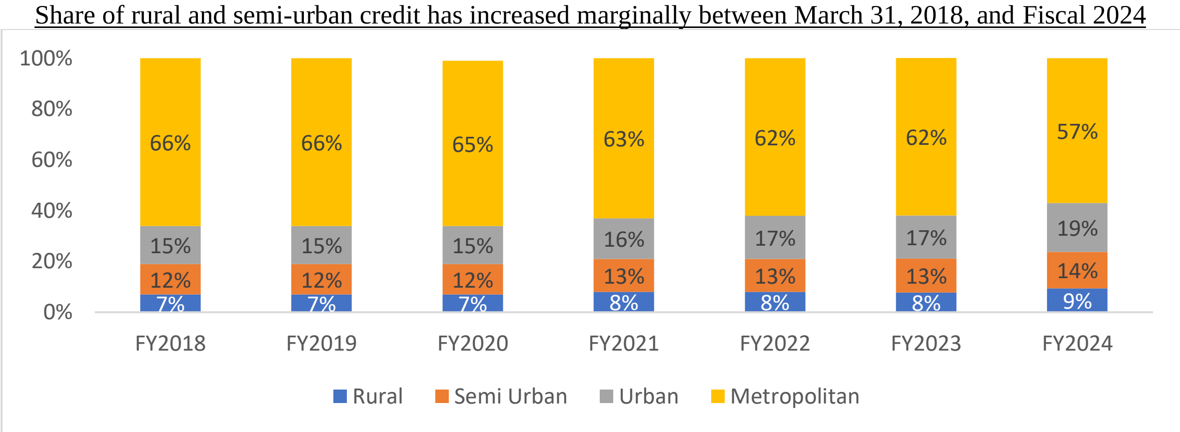
Rural areas, which accounted for around 47% of GDP, received only 9% of the overall banking credit, as at March 31, 2024, which also shows the vast market opportunity for banks and NBFCs to lend in these areas. With increasing focus of government towards financial inclusion, rising financial awareness, increasing smartphone and internet penetration, CRISIL MI&A expects delivery of credit services in rural area to increase. Further, usage of alternative data to underwrite customers will also help the financiers to assess customers and cater to the informal sections of the society in these regions.

Two-thirds of total households are in rural India



Source: World Bank; Census; CRISIL MI&A

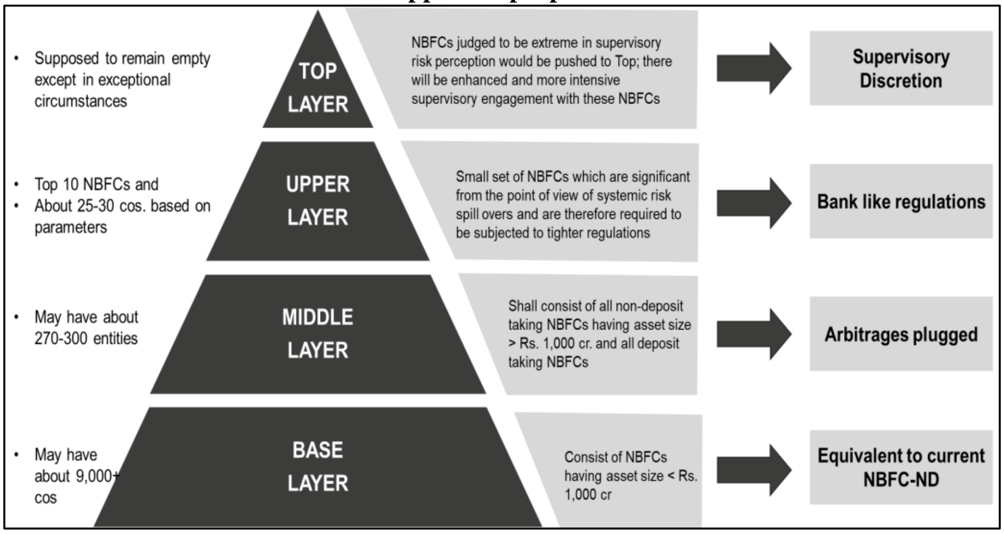
Share of rural and semi-urban credit has increased marginally between March 31, 2018, and Fiscal 2024



Note: As at the end of each Fiscal
Source: RBI, MOSPI, CRISIL MI&A

NBFC overview

Scale based approach proposed for NBFCs



Source: RBI, CRISIL MI&A

Regulatory distinction between banks and NBFCs

	NBFC – ND –SI	NBFC – D	Banks (Basel-III)
Minimum net owned funds	₹20 million	₹20 million	N.A.
Capital adequacy	15.0%	15.0%	11.5%
Tier I capital	10.0%	10.0%	9.5%
Stage III assets	90 days#	90 days#	90 days
Cash reserve ratio (CRR)	N.A.	N.A.	3.0%
Statutory liquidity ratio (SLR)	N.A.	15.0%$	18.00%
Priority sector	N.A.	N.A.	40% of advances
SARFAESI eligibility	Yes*	Yes*	Yes
Exposure norms (% of NOF)	Single borrower: 15% (+10% for IFC)	Single borrower: 15%	Single borrower: 15% (+5% for infrastructure projects)
	Group of borrowers: 25% (+15% for IFC)	Group of borrowers: 25%	Group of borrowers: 30% (+10% for infrastructure projects)

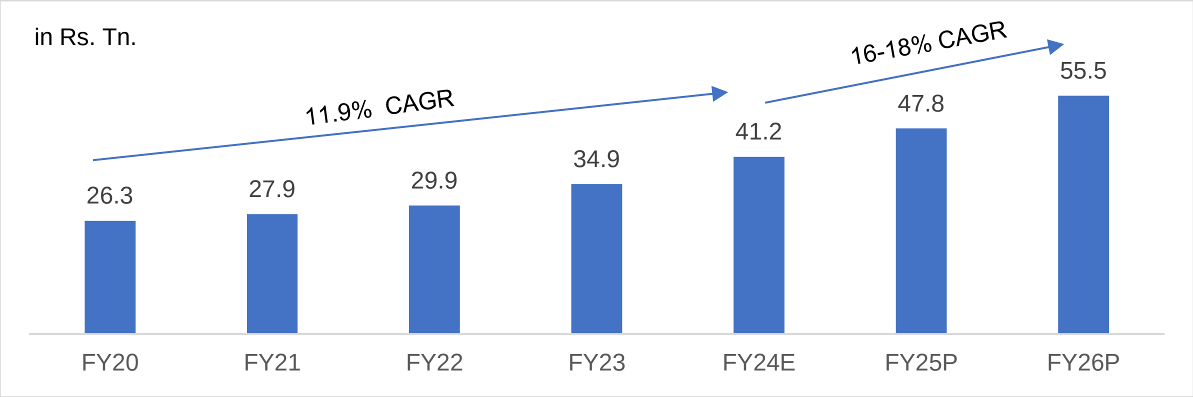
Note: NA - Not applicable
**The Ministry of Finance, in its union budget for 2021, proposed that the SARFAESI threshold be reduced from ₹5 million to ₹2 million*
$ as per RBI regulations, NBFC-D, shall invest in India in unencumbered approved securities valued at the price not exceeding the current market price of such securities an amount which shall, at the close of business or any day, not be less than 15% of the "public deposit".
 # Discretion with the audit committee of NBFCs to defer stage 3 classification beyond 90+dpd
Source: CRISIL MI&A

The RBI has taken a balanced view, and instead of going for a one-size-fits-all approach, it has opted for differential regulations based on the size and systemic importance of an NBFC. Furthermore, the importance of NBFCs in providing credit to underserved customers has been recognised. The RBI has not proposed imposition of CRR and SLR on NBFCs, which would come as a relief to NBFCs.

NBFC credit to grow faster than systemic credit between Fiscals 2024 and 2026

CRISIL MI&A projects NBFC credit to grow at 16%-18% between Fiscal 2024 and Fiscal 2026. The credit growth will be driven by the retail vertical, including housing, auto, and microfinance segments. Rapid revival in the economy is expected to drive consumer demand in Fiscal 2025, leading to healthy growth NBFCs. Moreover, organic consolidation is underway with larger NBFCs gaining share with some of the merger and acquisition in the NBFC space such as Ambit Finvest's acquisition of SME Corner and merger of Incred and KKR India. Further growth of the NBFC industry will be driven mainly by large and medium size players with strong parentage who have funding advantage and capability to invest and expand into newer geographies.

NBFC credit to grow at CAGR 16-18% between Fiscals 2024 and 2026



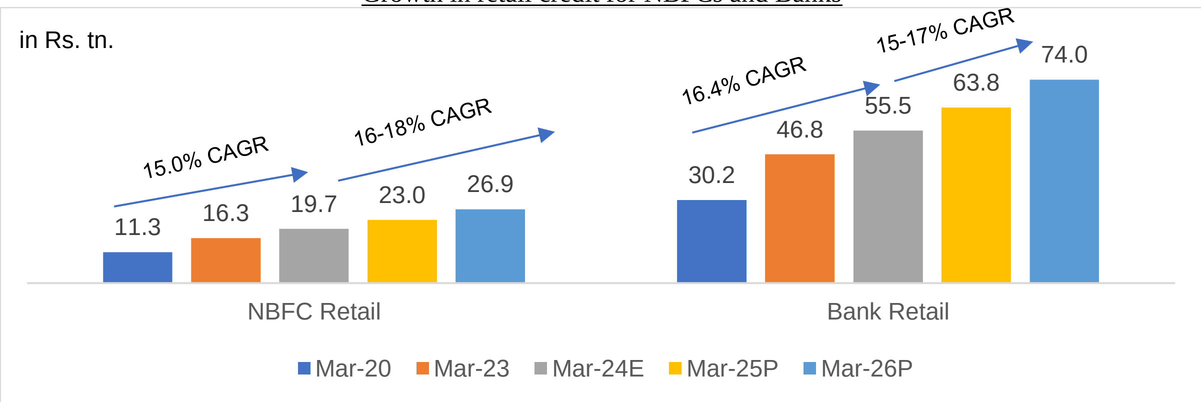
Note: P = Projected
Source: RBI, Company reports, CRISIL MI&A

Retail segment to support NBFCs overall credit growth

The NBFC sector has, over the years, evolved considerably in terms of size, operations, technological sophistication, and entry into newer areas of financial services and products. The number of NBFCs as well as the size of the sector have grown significantly, with a number of players with heterogeneous business models starting operations. The increasing penetration of neo-banking, digital authentication, and mobile phone usage as well as mobile internet has resulted in the modularization of financial services, particularly credit. Overall NBFC credit during FY20 to FY24, witnessed a CAGR of ~12% which was majorly led by retail segment which accounts for ~48% of overall NBFC credit and witnessed a CAGR of ~15%, while NBFC non-retail credit witnessed a growth of ~9% during the fiscals.

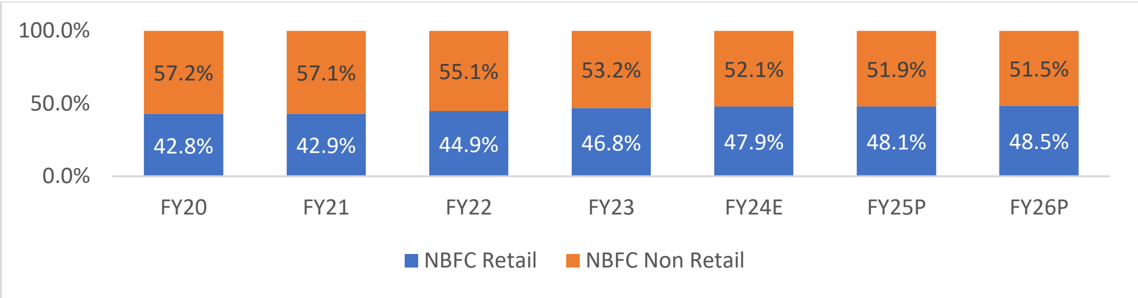
Going forward, growth in the NBFC retail segment is expected at 16-18% CAGR between FY24-FY26 which will support overall NBFC credit growth, with continued focus on the retail segment and multiple players announcing plans to reduce wholesale exposure, the retail segment's market share is expected to rise further to 48% by end of FY25 and remain around 48.5% in FY26.

Growth in retail credit for NBFCs and Banks



Note: P - Projected
Retail credit above includes housing finance, auto finance, microfinance, gold loans, construction equipment finance, consumer durable finance, MSME loans and education loans
Source: Company reports, RBI, CRISIL MI&A

Share of retail credit in total NBFC credit to grow to 48% by end of FY25 and expected to reach 48.5% in FY26



Note: E- Estimates, P - Projected
Retail credit includes housing finance, auto finance, microfinance, gold loans, construction equipment finance, consumer durable finance, MSME loans and education loans
Source: Company reports, CRISIL MI&A

Set forth are details of the NBFCs loan outstanding size in terms of assets under management ("**AUM**") and growth along with key growth drivers of each of the focused sectors:

Parameter	Sub-Parameter	AUM ₹Billions (Fiscal 2024)	Loan outstanding (CAGR Fiscal 2024-Fiscal 2026)	Key Growth Drivers
Overall NBFCs growth	Loan outstanding growth	41,200	16-18%	
Selected asset class wise NBFCs loan outstanding growth	MSME loans^	6,135	13-15%	Low credit penetration for MSMEs, increased data availability and transparency, and Government initiatives including credit guarantee fund scheme, emergency credit line guarantee scheme
	Micro finance loans$	1,709	23-25%	Government's continued focus on strengthening rural financial ecosystem, strong credit demand and increasing ticket sizes of loans
	Consumer finance#	4,592	17-20%	Strong macro tailwinds, increased consumer spending and digitization driving consumer durables demand
	Vehicle loans*	2,676	12-14%	Improving rural productivity, Government income support, improving industrial activity, Government's focus on infrastructure development and return to office
	Affordable housing loan	4,295	14-16%	Higher data availability, increasing affordability, urbanization, and supportive government policies
	Agri loans	35	9-10%	Increasing demand for high-value commodities, shift to tech-intensive supply chain solutions and increase in finance penetration across agriculture value chain

Note: Note: (^) MSME loans include small business loans and mid-corporate loans
(#) Consumer finance include personal loans, gold loans and consumer durable loans
(*) Vehicle loans include two-wheeler disbursement and new commercial vehicle loans
($) MFI loans data is for NBFC-MFIs. Source: Company reports, RBI, CRISIL MI&A estimates

Parameter	Sub-Parameter	Loan outstanding (CAGR Fiscal 2020-Fiscal 2024	Loan outstanding (CAGR Fiscal 2024-Fiscal 2026)
Size-wise loan outstanding growth	Small NBFCs	1%	12-14%
	Medium NBFCs	21%	16-19%
	Large NBFCs	13%	14-15%

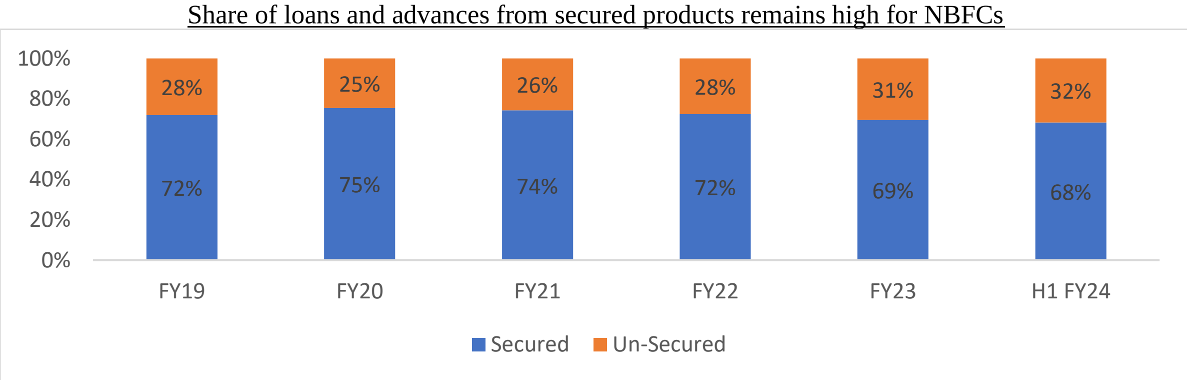
Note - Classification of players into large, medium and small is done basis below criteria : -
For MFIs - Large players have GLP> ₹20,000 million, Medium players have GLP between ₹5,000 and ₹20,000 million, Small players have GLP upto ₹5,000 million.
For other players - Large players have AUM> ₹50 billion, Medium players have AUM> ₹10 billion, Small players have AUM upto ₹10 billion
Source: CRISIL MI&A estimates

Set out below are certain details of the MSME, MFI and consumer finance sectors in India:

Particulars	As of and for the period ended March 31, 2024
MSME	
NBFC MSME industry AUM (₹ billion)**	6,135
NBFC MSME industry GNPA (%)	**4.8%-5.2%***
MFI	
NBFC MFI industry AUM (₹ billion)##	1,584
NBFC MFI industry GNPA (%)	**1.0%#**
Consumer Finance	
NBFC Consumer finance industry AUM (₹ billion)^^	4,592
NBFC Consumer finance industry GNPA (%)	**6.8%-7.4%^**

Note: (*) Simple average of GNPA ratio in small business loans and mid-corporate loans
(^) Simple average of GNPA ratio in personal loans, gold loans and consumer durable loans
(#) PAR (Portfolio at Risk) 91 to 180 Bucket ratio for NBFC-MFIs
(**) MSME loans include small business loans and mid-corporate loans
(^^) Consumer finance includes personal loans, gold loans and consumer durable loans
(##) MFI loans data is for NBFC-MFIs
Source: Company reports, RBI, CRISIL MI&A estimates

Share of loans and advances from secured products remains high for NBFCs



Source: RBI, CRISIL MI&A; Source: CRISIL MI&A

NBFCs have a reasonable market share across segments

Under-served households and businesses represent a significant proportion of India's population that faces challenges in obtaining credit due to reasons such as a lack of credit history and the inability to provide collateral. Government initiatives such as Pradhan Mantri Jan-Dhan Yojana (PMJDY), Aadhaar, and widespread digitization (referred collectively as the 'JAM Trinity') have expanded the formal financial inclusion for underserved Indian population. Additionally, the widespread availability of affordable data and digital disruption has transformed the financing landscape in India. NBFCs have generally been able to address this opportunity on account of their strong origination skills, extensive reach, better customer service, faster processing, streamlined documentation requirements, digitization of customer on-boarding process, customized product offerings, local knowledge, and differentiated credit appraisal methodology. The rapid evolution of fintechs over the last few years has added another dimension to the market served by NBFCs and has fuelled rapid growth across the landscape.

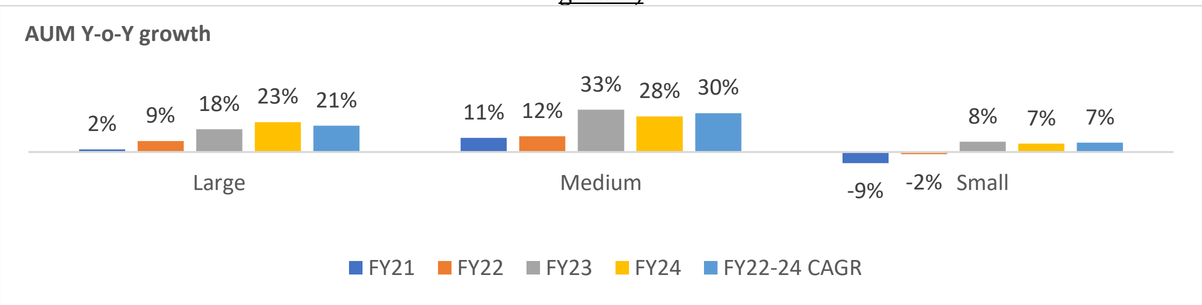
NBFCs have consistently gained or maintained market share across most asset classes over the last few years. Though, in certain segments such as housing finance to prime customers, they have lost market share to banks due to the decline in market interest rates. In the gold loans market, NBFCs slightly lost market share in Fiscal 2022 due to increasing focus of banks (both public and private) towards gold loans as well as RBI permitting banks to offer gold loans at a higher loan-to-value amidst the COVID-19 pandemic. Nevertheless, NBFCs continue to have a healthy market share across other segments.

Impact of digitization on retail credit

Digital lending products such as instant loans or online personal loans have completely revolutionised retail credit due to great convenience that it offers to the customers. The underwriting process, while essential for assessing borrowers, can sometimes be time-consuming and reliant on subjective elements. Thus, there is room for improvement in leveraging all available data efficiently. Organizations may find opportunities to streamline the process, making it more agile and resource-effective. Lenders are increasingly using their web platforms and creating apps to register, score, approve and disburse loans to their customers. For lenders, digitization has enabled them to make informed decision making through business insight generation and data visualization. Moreover, it has improved lead generation for lenders with faster onboarding of customers, comprehensive loan servicing, and fraud detection. For customers, it has become easier to gather information about different lenders with the help of digitization and compare them. Further, online loan application has made it convenient for borrowers to fill loan applications from remote locations, calculate EMIs, check for eligibility of loan amount and provide all documents digitally which enhances customer experience throughout the process and help them make an informed decision.

Furthermore, the India Stack, a set of APIs and tools that enable the building of digital platforms for various services, has been a game-changer in the retail credit sector. The India Stack includes Aadhaar (for identity verification), e-KYC (for paperless Know Your Customer processes), eSign (for digitally signing documents), and the Unified Payments Interface (UPI) for seamless and instant fund transfers. All of these components have been seamlessly integrated into the digital lending ecosystem, making it easier for lenders to streamline their operations and offer a seamless experience to borrowers. Looking ahead, the digitization of retail credit in India is expected to continue evolving.

Higher growth in medium NBFC as compared to large and smaller ones in Fiscal 2024 (AUM year-on-year growth)

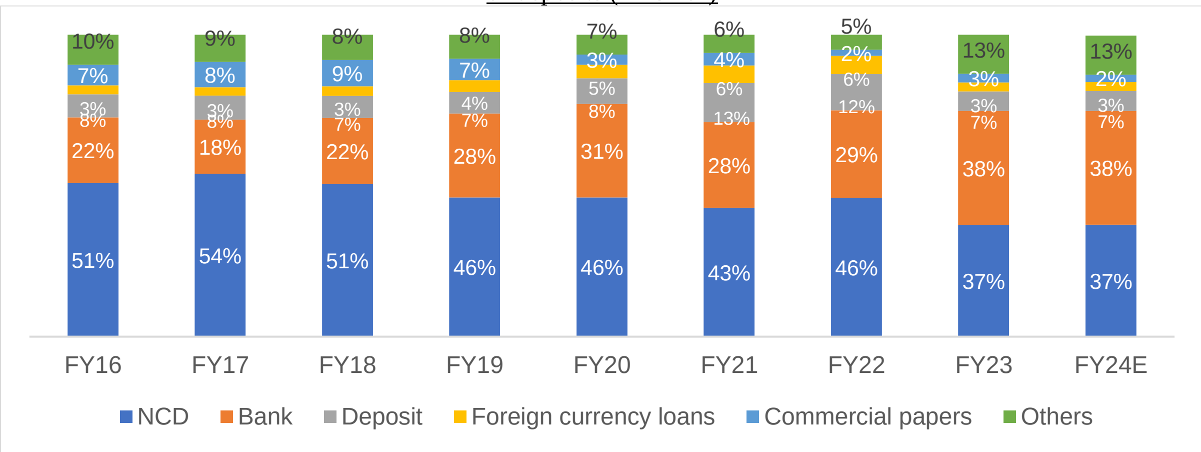


Note: Data includes data for retail and MSME focused NBFCs
Above data includes approximately 73% of total NBFCs credit as of March, 2024
Classification of players into large, medium and small is done basis below criteria:
For MFIs - Large players have GLP> ₹20,000 million, Medium players have GLP between ₹5,000 and ₹20,000 million, Small players have GLP upto R₹5,000 million
For other players - Large players have AUM> ₹50 billion, Medium players have AUM> ₹10 billion, Small players have AUM upto ₹10 billion
Source: Company Reports, CRISIL MI&A

Banks continue to gain share in borrowing mix of NBFCs

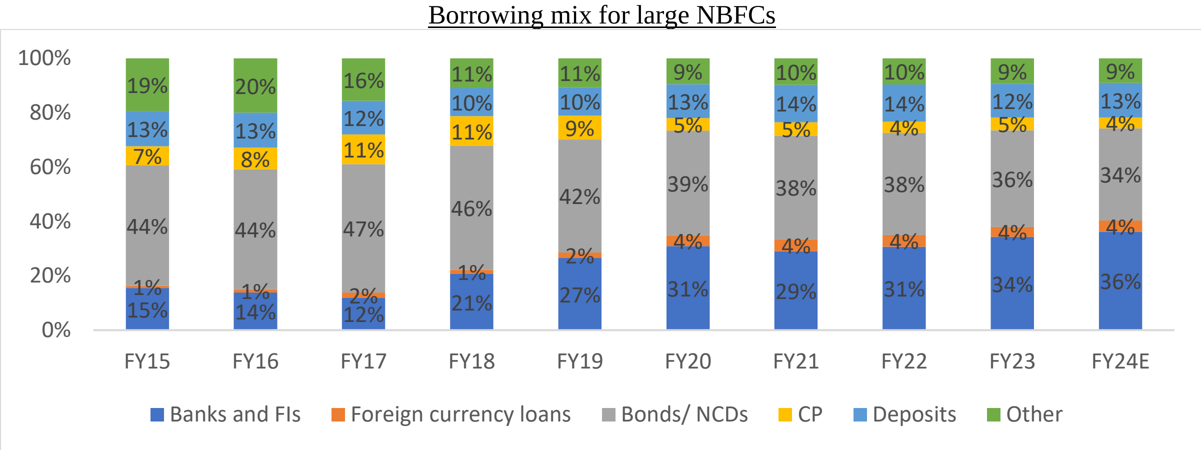
In Fiscal 2024, NBFCs' borrowings from banks witnessed high growth resulting in an increase in share to 38% of total funding up from 29% at the end of Fiscal 2022. Share of bank's lending to NBFCs have almost doubled during last 10 years. Going forward, CRISIL MI&A believes that funding access would gradually improve for NBFCs who are able to demonstrate strong performance and strong parentage. However, reliance on bank funding and funding from other NBFCs and small finance banks is expected to remain high in Fiscal 2025.

Bank borrowings is expected to remain primary source of funds for the NBFCs, apart from negotiable certificate of deposits ("NCDs")



Note: E- Estimates, Based on sample set of NBFCs accounting for more than 80% of overall borrowings of NBFCs as of March 2024
For Fiscal 2024, NCD includes Debt Securities and NCDs
Bank includes Banks and National Housing Bank, and Others include Related Parties, Foreign Institutions, External Commercial Borrowings, and other sources
Source: Company reports, CRISIL MI&A

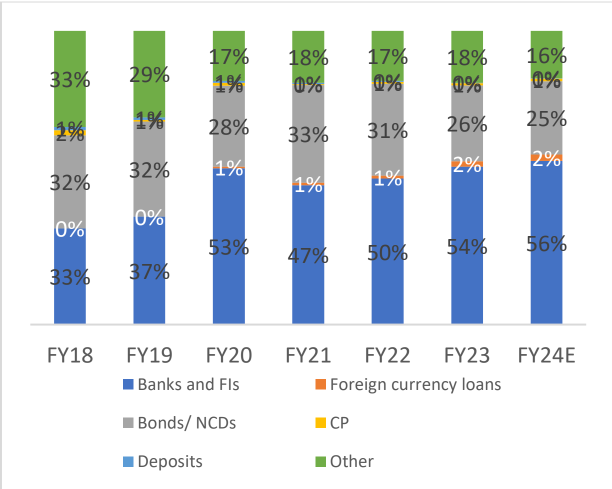
Borrowing mix for large NBFCs

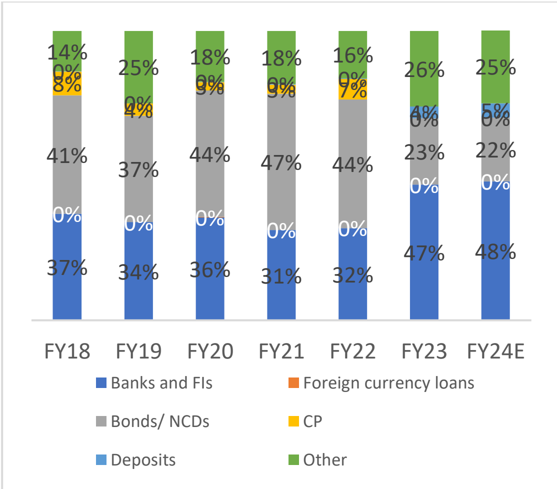


Note: E- Estimates, MFIs having GLP ₹20,000 million and other non-MFIs players having AUM> ₹50,000 million are classified under large category
Source: Company reports, CRISIL MI&A

Borrowing mix for medium NBFCs

Borrowing mix for small NBFCs

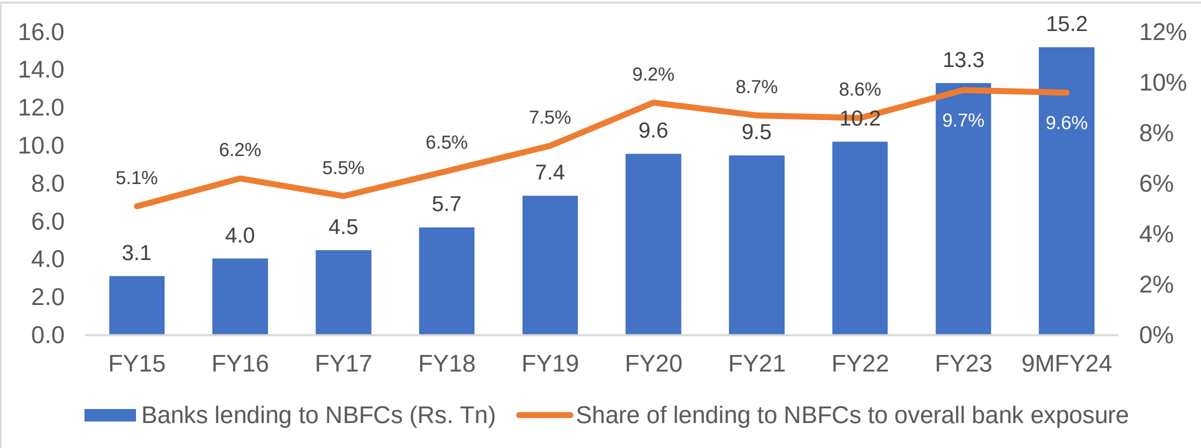




Note: E- Estimates, MFIs having GLP between ₹5,000 million and ₹20,000 million and other non-MFIs players having AUM> ₹10,000 million are classified under medium category, MFIs having GLP upto ₹5,000 million and other non-MFIs players having AUM upto ₹10,000 million are classified under small category
Source: Company reports, CRISIL MI&A

Going forward, bank funding to NBFCs is expected to continue to remain healthy, given the higher liquidity with banks. This will result in banks gaining further share in the borrowing mix across all NBFCs.

Bank funding to NBFCs continues to clock healthy growth



Source: RBI, Company reports, CRISIL MI&A

Growth in the banks' credit exposure to NBFCs grew at 14.28% from March 2023 to December 2023. The share of NBFCs in the overall credit exposure is at 9.6% as of December 2023.

Asset quality improved on account of efficiency in collection process and improvement in economic activity in Fiscal 2023

Asset quality for NBFCs is influenced by various factors such as economic cycle, target customer segment, geographical exposure, and local events. Within the NBFC universe itself, it is observed that various asset classes tend to exhibit heterogeneous behaviour. For example, the asset quality in small business loans and personal loans tends to be highly correlated with the macroeconomic environment. On the other hand, microfinance loans have shown lower historic correlation with macroeconomic cycles. This is because asset quality is more influenced by local factors, events that have wide ranging repercussions such as demonetisation and COVID-19 and relative leverage levels amongst borrowers.

Prior to Fiscal 2018, smaller NBFCs were aggressively expanding in terms of both market penetration and lending across asset classes, which led to rising asset quality concerns. The proportion of standard assets declined, as slippages to sub-standard category increased. After the NBFC crisis in Fiscal 2019, smaller NBFCs slowed down their lending activity and focused on improving their asset quality and shifting to retail segments that are less risky. In Fiscal 2020, doubtful assets for NBFCs registered a marginal uptick due to funding challenges and slower credit growth. However, efforts were made by NBFCs to clean up their balance sheets, as reflected in their write off and recovery ratios, which caused the NNPA to remain stable, and the PCR to improve.

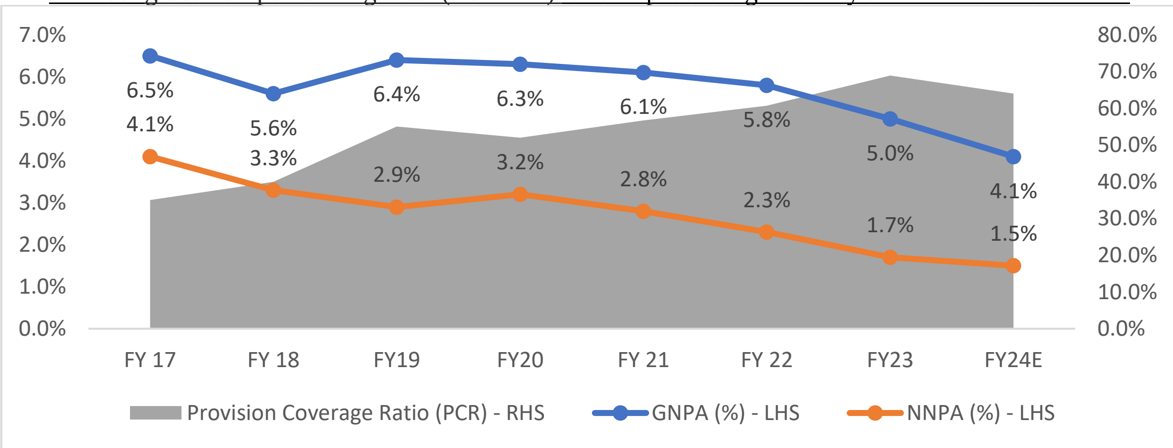
In Fiscal 2021, the proportion of doubtful and loss assets increased, largely driven by infrastructure and wholesale finance. In addition to funding challenges faced by the sector along with slower credit growth, COVID-19 escalated asset quality deterioration further owing to restricted movement, which affected collections. Moratorium and restructuring schemes announced by the Government came as an interim relief for the sector and delayed the asset quality concerns for some time. However, with the NPA standstill provision lifted in August 2020, gross NPAs ("GNPAs") in segments such as auto, microfinance and MSME spiked as of March 2021.

Further, the second wave of COVID-19 adversely affected the fragile recovery witnessed in the fourth quarter of Fiscal 2021 and affected collection efficiencies across asset classes in the first quarter of Fiscal 2022. However, the impact was not as severe as in the first wave, and players across segments reported improvement in GNPAs from the second quarter.

In November 2021, the RBI gave a clarification to the 'Prudential norms on Income Recognition, Asset classification and Provisioning pertaining to Advances', which requires the NBFCs to recognise NPAs on a daily due basis as part of their day-end process which is expected to lead to higher GNPA. Typically, the NBFCs ramp up their collection activity between due-date and month-end, leading to lower dues by the end of month. This flexibility will no longer be available to the NBFCs which could cause some proportion of loans in the 60–90-day period category to slip into >90 days period category. In addition to the end of the day recognition, the RBI has also clarified that upgradation of an account from NPA to standard category can only be done after all over-dues are cleared (principal along with interest), resulting in a borrower slipping into the NPA category to remain in the same category for longer time compared to the past. Hence, NBFC GNPAs increased in third quarter of Fiscal 2022 due to adherence to the said RBI clarifications. But with NBFCs bolstering their collection efforts and processes, and improvement in economic activity, as of Fiscal 2023, asset quality of NBFCs further improved on account of strong economic activity and improved collection efficiency and in fiscal 2024, Collection efficiency is expected to have hold up well, resulting in further easing of gross non-performing assets (GNPAs). CRISIL MI&A estimates GNPAs for NBFCs to have reduced significantly at the end of Fiscal 2024.

As of fiscal 2024, Northern Arc Capital has one of the lowest gross non-performing assets ("GNPA") of 0.45% and net non-performing assets ("NPA") of 0.08%.

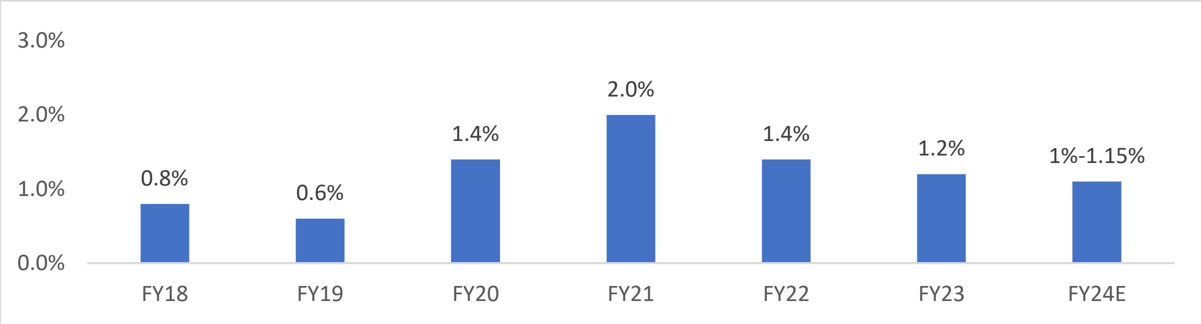
NBFCs' gross non-performing asset ("GNPA") ratio improved significantly at the end of Fiscal 2024



Note: E – Estimated; GNPA - Gross Non-Performing Assets as per cent of Gross Advances; NNPA – Net Non-Performing Assets as per cent of Net Advances; Provisioning Coverage Ratio (PCR) is the ratio of provisioning to gross non-performing assets
Source: RBI, CRISIL MI&A

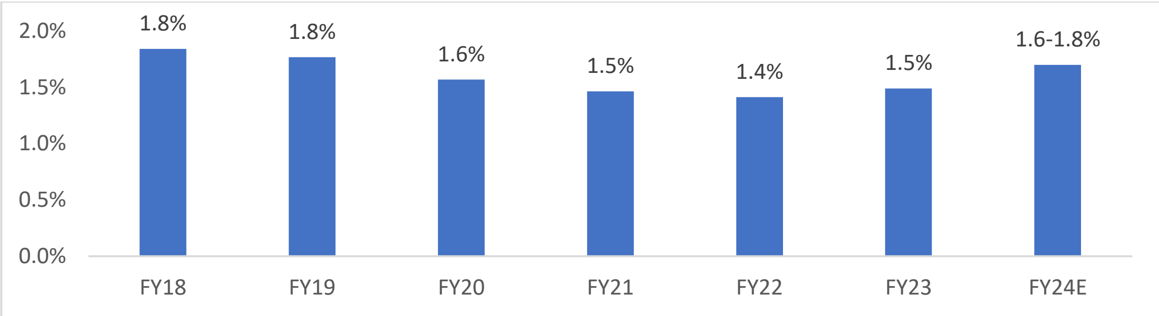
Profitability ratios of NBFCs

Reduction in credit costs for NBFCs in Fiscal 2023 and Fiscal 2024



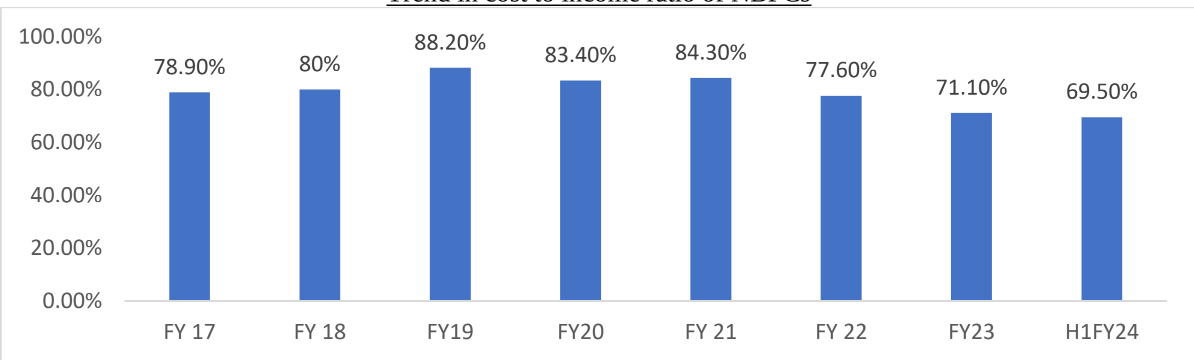
Note: E – Estimated
Source: RBI, CRISIL MI&A

Profitability (RoA) rebounded in Fiscal 2023 and Fiscal 2024 after continuous decline till Fiscal 2022 on account of decline in credit costs



Note: E – Estimated; P – Projected
Source: CRISIL MI&A

Trend in cost to income ratio of NBFCs



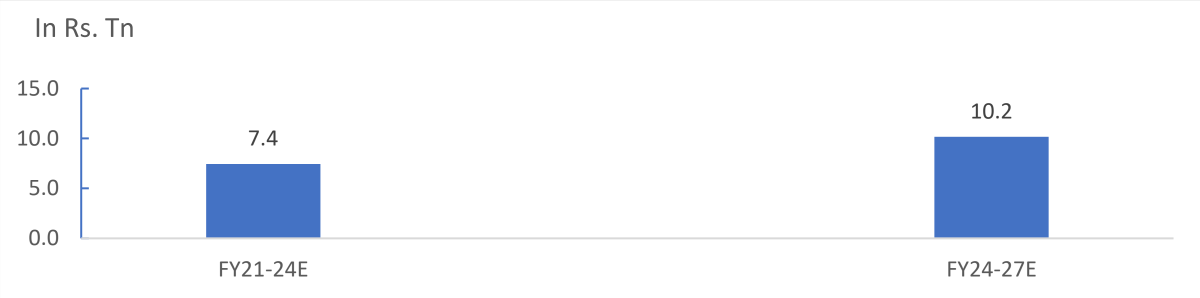
Source: RBI, CRISIL MI&A

NBFCs will need incremental funding of over Rs 7.47 trillion for future growth

During Fiscal 2021 to Fiscal 2024, NBFCs have increased their loan portfolio in key segments like low- and middle-income housing loans, MFI, commercial vehicle loans, two-wheeler loans, small business loans and personal loans and have raised ₹7.4 trillion to achieve the strong growth.

Based on the projected growth in loans, their profitability and leverage levels, CRISIL estimate that NBFCs will require funds to the tune of around ₹10.2 trillion during Fiscal 2025 to Fiscal 2027, which will get financed through a mix of equity, debt, and securitization. While the sector has witnessed increase in credit cost on account of COVID-19 in the last couple of years, however, segments have stabilised as economic activity resumed and therefore, CRISIL expect investor interest to continue to stay strong for NBFCs who are able to demonstrate strong performance and have in place the requisite systems, processes, and governance mechanisms as also management bandwidth and quality.

Funding requirement of NBFCs across select segments*



Note: E- Estimates, (*) Select segments includes – low- and middle-income housing loans (ticket size lesser than ₹7.5 million in metro regions and ₹5.0 million in non-metro regions), MFI, commercial vehicle loans, two-wheeler loans, small business loans (less than ₹10 million ticket size) and personal loans
Source: CRISIL MI&A estimates

Securitisation asset pool getting wider with emergence of newer asset classes

Mortgages share has reduced over the course on account of non- participation of few large mortgage loan originators who were active participants previously. Covered bonds, a structured finance product, involving primary recourse to the issuer with additional recourse to a pool of assets segregated from the issuer's balance sheet, drew investor attention in Fiscal 2021. Some of these issuances were in the form of market-linked debentures, an innovation that provided flexibility to link instrument yield to an external benchmark. Many of these issuances were invested in by HNIs and family wealth offices. Relatively newer asset classes, such as car-lease and supply-chain receivables, were also seen getting securitised last fiscal.

While traditional asset classes like mortgage loans, commercial vehicle loans, construction equipment loans and micro finance loans continue to dominate the structured finance space, the market has also seen noticeable innovation over the past few years with new structures being introduced that has helped expand the market. Some of the innovations include Multi Originator Securitisations, pooled loan issuance and partial credit enhanced bond. These products provide benefits to both investors and originators by meeting the market requirements in terms of yield, tenure or risk.

Some of the innovations that have taken place in the market over the last few years are detailed in the table below:

Period	Transaction name	Remark
March 2009	IFMR Trust Pioneer I	Northern Arc enabled first microfinance securitisation in India
Jan 2010	IFMR Capital MOSEC I	Northern Arc launched India's first pooled multi-originator securitization transactions (MOSEC)
April 2014	Pooled NCD programme of eleven Issuers[1] by corporate guarantors[2]	India's first pooled bond issuance product was launched
June 2017	IFMR Capital PLI June 2017	Northern Arc launched India's first pooled loan issuance product
Sept 2017	Solstice Trust Series I 2017	Northern Arc executed India's first Collateralised Loan Obligation (CLO) transaction
Dec 2017	IFMR Capital CEB I	Northern Arc executed India's first single issuer partial credit enhanced bond
Dec 2018	Northern Arc 2018 CV PERSEC Aurora	Northern Arc executed India's first vehicle loan backed securitisation transaction with replenishing structure (persistent securitisation)
Jan 2019	Kogta Financial India Limited*	Northern Arc executed India's first issuance of dual-recourse debentures

[1] Name of 11 issuers - Annapurna Microfinance Private Ltd. (AMPL), Asirvad Microfinance Private Ltd. (Asirvad), Arohan Financial Services Private Ltd. (Arohan), Disha Microfin Private Ltd. (Disha), Future Financial Servicess Ltd. (FFSL), India School Finance Company Private Ltd. (ISFC), Intrepid Finance and Leasing Private Ltd. (Fino), Pahal Financial Services Private Ltd. (Pahal), Suryoday Micro Finance Private Ltd. (Suryoday), SV Credit Line Private Ltd. (SVCL) and Svasti Microfinance Private Ltd. (Svasti)

[2] Corporate Guarantors - Reliance Capital Limited (RCL) and IFMR Capital Finance Private Limited (IFMR)

Period	Transaction name	Remark
April 2020	Northern Arc SDI Falcon 2019 (CredAble)	Northern Arc executed India's first securitisation transaction involving trade receivables
March 2021	NA	Northern Arc executed the first offshore pool bond issuance with an international DFI under their COVID-19 response program
Dec 2022	Nimbus 2022 TR Eagle	Northern Arc executed a trade receivable securitisation transaction
Oct 2023	Navi Finserv Limited*	Northern Arc co-invested with a foreign bank in a AAA securitisation paper, where it achieved the highest rating on the underlying pool belonging to the unsecured personal loan category for the digital lender. Northern Arc was also a back-up servicer in this transaction.

Note: (*) Issuer name
Source: CRISIL MI&A

Opportunities in partnership-based lending

Partnership based lending ("**PBL**") or Co-lending model ("**CLM**") refers to an arrangement between two parties wherein one of the parties agrees to take over a larger proportion of the loan (usually 80% in PBL and 100% in case of loans originated by business correspondents) originated by another party on its books, with the originator taking on the remaining (usually 20% in PBL) on its books. The collections and all the other activities pertaining to the loan are generally done by the originator. Mid and large sized NBFCs and a few banks as well have been undertaking lending through PBL for the last 3-4 years now by leveraging on the distribution, customer segment understanding and/or digital sourcing capabilities of smaller NBFCs and fintechs. The focus in the case of banks is largely to meet their PSL target, while mid and large sized NBFCs aim at earning higher risk-adjusted yields through PBL. This model allows smaller NBFCs and fintechs to cater to a larger customer base with lesser capital by leveraging the larger balance sheet of their partners. Backed by a strong understanding of retail lending processes and the performance of retail loans, Northern Arc Capital initiated partnership-based retail lending in Fiscal 2015 and they were also one of the first NBFCs to implement such a model in India.

<u>PBL model to enhance business opportunities for NBFCs</u>

Some of the key highlights of co-lending norms are:

- The co-lending banks are expected to take their share of the individual loans on a back-to-back basis in their books. However, NBFCs shall be required to retain a minimum of 20% share of the individual loans on their books.
- The banks and NBFCs shall formulate Board approved policies for entering into CLM and place the approved policies on their websites.
- The master agreement may provide for the banks to either mandatorily take their share of the individual loans originated by the NBFCs in their books as per the terms of the agreement, or to retain the discretion to reject certain loans after their due diligence prior to taking in their books.
- The CLM shall not be applicable to foreign banks with less than 20 branches.

<u>Various models available with banks to engage with NBFCs to meet the PSL targets</u>

Priority Sector Lending Certificates (PSLC)	Securitisation	Business Correspondent (BC)	Co-Lending
No operational and underwriting risks are involved, as the underlying asset, along with the risks and rewards, is held by the issuer	It requires an understanding of the market and the instrument, as there is a transfer of underlying receivables, including risks and rewards	It enables banks to take exposure across multiple regions and explore newer geographies	It enables banks to take exposure with partner NBFCs
No mark-to-market ("**MTM**") and capital requirement	MTM and capital requirement	No MTM, but requires capital	No MTM, but requires capital

Priority Sector Lending Certificates (PSLC)	Securitisation	Business Correspondent (BC)	Co-Lending
No impact on the banks' book sizes	Helps banks increase their book sizes	Helps banks increase their book sizes	Helps banks increase their book sizes
Has a life cycle only for a particular financial year	It involves large ticket size and have a longer life cycle of around 3-4 years	Involves tie ups with BCs like NBFCs to manage business for longer run	Involves partnership with NBFCs for Co-lending for PSL and non-PSL loans
Involves no credit risk	Credit enhancement is available in case of Pass-through certificates ("**PTCs**")	Involves a hurdle rate or initial loss-sharing	Involves an agreement in which a partner must maintain minimum 20% of the loan on their book
Yields are not relevant	Yields are relatively lower, as originators bargain with various banks for better pricing	Yields are comparatively higher	Yields are comparatively higher
A clear classification of assets for buyers	Risk of RBI questioning the classification of assets	Risk of RBI questioning the classification of assets	Policy to be guided by the RBI guidelines
Availability of certificates can be an issue	Application of GST (18%) could be a dampener, as it increases the cost, thus impacting volume	Difficult for both parties to exit, as it can impact the overall portfolio	Difficult for both parties to exit, as a master agreement shall be formed with the partner

Source: CRISIL MI&A

Future partnership-based lending model market opportunity

Currently, the PBL or co-origination model is largely being used for small ticket size products like MSME loans, consumer finance, gold loans and vehicle loans in the industry. However, with RBI putting in place a framework for co-lending and several NBFCs facing challenges in accessing capital, players are now also focusing on longer tenure and relatively higher ticket size loans like housing finance and loan against property.
Co-lending assets under management (AUM) of non-banking financial companies*1* (NBFCs) is nearing ~Rs 1 lakh crore in fiscal 2024 after more than 5 years since the model came into being. Over the medium term, growth momentum is seen healthy at 35-40% annually, amidst rising interests of partners - NBFCs as well as banks.

Some of the key growth drivers for co-lending market are:

- **Operational leverage –** CLM is operationally convenient for both partners as it enables partners to offer multiple products to customers which are not otherwise present in their current portfolio, thus providing diversification to the portfolio without having a separate operational setup for each product. Co-lending thus enhances operating leverage for financiers as it enables them to increase lending with existing infrastructure and resources.
- **Capital optimisation** – Entering into CLM allows smaller NBFCs to cater to a larger customer base with lesser capital by leveraging the larger balance sheet of their partners. Such NBFCs can leverage their origination skills and expertise in assessing specific customer segments while at the same time conserving their capital

Key Challenges in the NBFC sector in India:

- Access to low-cost funds: NBFCs often find it challenging to access low-cost funds compared to banks, which can impact their profitability and ability to lend at competitive rates.
- Asset-Liability Mismatches: NBFCs need to carefully manage their asset-liability mismatches, as they have a higher reliance on short-term borrowings to fund long-term assets, making them vulnerable to liquidity crunches.
- Regulatory oversight: NBFCs are subject to increasing regulatory oversight and compliance requirements, which can add operational complexity and costs.
- Competition from banks: NBFCs face stiff competition from banks, which have larger balance sheets, access to low-cost deposits, and the ability to offer a wider range of financial services.
- Risk management challenges: NBFCs need to have robust risk management frameworks to manage credit, market, and operational risks, which can be a challenge, especially for smaller NBFCs.
- Technological adoption: Keeping up with the rapid technological advancements in the financial sector, such as digitalization and fintech innovations, can be a challenge for some NBFCs.

- Reputation risk: Any adverse events or regulatory actions against NBFCs can lead to a loss of consumer confidence, which can negatively impact their business and growth.

Peer Analysis

In this section, CRISIL MI&A has compared the financial and operating performances of MSME, MFI and Diversified NBFCs on standalone financials along with consolidated financials for Northern Arc Capital based on the latest available data for Fiscals 2022, 2023 and Fiscal 2024. Five Star Business, SBFC Finance, Credit Access Grameen, Fusion Microfinance, Bajaj Finance, Cholamandalam, Poonawalla Fincorp and MAS Financial Services are the players considered for peer analysis basis their comparability with Northern Arc Capital in terms of operation and presence in various segments.

AUM of MSME players among the peer have witnessed strongest CAGR between Fiscal 2022 to Fiscal 2024

Northern Arc Capital is one of the leading players amongst India's diversified NBFCs in terms of AUM as of March 31, 2024, with a business model diversified across offerings, sectors, products, geographies, and borrower segments. Among the peer group considered for peer analysis, MSME players on average grew at a CAGR of 41.18% between Fiscal 2022 to Fiscal 2024 as compared to 36.86% of MFI players and 31.39% of diversified players among the peer group during the same period in terms of AUM. Northern Arc Capital has grown with CAGR of 28.35% between Fiscal 2022 to Fiscal 2024 in terms of AUM.

Player-wise AUM trend and growth

Players	Asset Under Management (AUM) (₹ Billion)			CAGR (Fiscal 2022-2024)
	Fiscal 2022	Fiscal 2023	Fiscal 2024	
MSME				
Five Star Business Finance Limited	50.7	69.1	96.4	37.90%
SBFC Finance Private Limited	31.9	49.4	68.2	46.24%
MFI				
Credit Access Grameen Limited	137.3	210.3	267.1	39.49%
Fusion Microfinance Private Limited	66.5	93.0	114.8	31.37%
Diversified				
Bajaj Finance Limited	1,467.4	1,810.0	2,448.3	29.17%
Cholamandalam Investment and Finance Company Limited	769.1	1,065.0	1,455.7	37.58%
Poonawala Fincorp Limited	165.8	161.4	250.0	22.80%
MAS Financial Services Limited	62.5	80.9	101.3	27.29%
Summary				
Total of MSME Lenders	82.6	118.6	164.6	41.18%
Total of MFI Lenders	203.9	303.3	381.9	36.86%
Total of Diversified Lenders	2,464.8	3,117.3	4,255.3	31.39%
Total of all the above lenders	2,751.2	3,539.2	4,801.8	32.11%
Northern Arc Capital	**71.1**	**90.1**	**117.1**	**28.35%**

Note: NA: Not Available, NM: Not Meaningful, Financials for peers are on standalone basis. Data for Northern Arc Capital is on consolidated basis
Source: Company reports, CRISIL MI&A

Northern Arc Capital has one of the lowest GNPA and NNPA in Fiscal 2024 amongst the compared peers

As of Fiscal 2024, Northern Arc Capital has the lowest GNPA at 0.45% followed by Bajaj Finance (1.05%) among peers. As of Fiscal 2024, Northern Arc has the lowest NNPA among peer at 0.08% followed by Credit Access Grameen (0.35%). In terms of credit cost, Poonawala Fincorp has lowest credit cost as of Fiscal 2024 among the peer for which data is available at 0.35% followed by Five Star Business (0.55%). Northern Arc Capital has credit cost of 0.47% as of fiscal 2023 and credit cost of 1.18% as of fiscal 2024. Further, Northern Arc Capital has one of the lowest Industry-wide credit costs amongst diversified NBFCs in India, as of March 31, 2024.

Asset quality trend

	GNPA (%)			NNPA (%)			Credit cost (%)*		
	Fiscal 2022	Fiscal 2023	Fiscal 2024	Fiscal 2022	Fiscal 2023	Fiscal 2024	Fiscal 2022	Fiscal 2023	Fiscal 2024
MSME									
Five Star Business Finance Limited	1.05%	1.36%	1.38%	0.68%	0.69%	0.63%	NA	0.28%	0.55%
SBFC Finance Limited	2.74%	2.43%	2.43%	1.63%	1.41%	1.36%	NA	NA	0.73%
MFI									
Credit Access Grameen Limited	3.12%	1.21%	1.18%	0.94%	0.35%	0.35%	3.45%	2.45%	1.84%
Fusion Microfinance Private Limited	5.70%	3.46%	2.89%	1.60%	0.87%	0.60%	NA	2.41%	3.47%
Diversified									
Bajaj Finance Limited	2.02%	1.19%	1.05%	0.85%	0.43%	0.46%	NA	NA	NA
Cholamandalam Investment and Finance Company Limited	6.80%	4.60%	3.54%	4.70%	3.10%	2.32%	1.15%	0.88%	0.98%
Poonawala Fincorp Limited	3.29%	1.44%	1.16%	1.30%	0.78%	0.59%	NA	-0.97%	0.35%
MAS Financial Services Limited	2.28%	2.15%	2.25%	1.70%	1.52%	1.51%	0.62%	0.75%	1.07%
Summary									
Average of MSME lenders	1.90%	1.90%	1.91%	1.16%	1.05%	1.00%	NA	NA	0.64%
Average of MFI lenders	4.41%	2.34%	2.04%	1.27%	0.61%	0.48%	NA	2.43%	2.66%
Average of Diversified lenders	3.60%	2.35%	2.00%	2.14%	1.46%	1.22%	NA	0.22% #	0.80% #
Average of all the above lenders	3.38%	2.23%	1.99%	1.68%	1.14%	0.98%	NA	NA	NA
Northern Arc Capital	**0.50%**	**0.77%**	**0.45%**	**0.21%**	**0.40%**	**0.08%**	**0.55%**	**0.47%**	**1.18%**

Note: NA = Not available; Financials for peers are on standalone basis. Data for Northern Arc Capital is on consolidated basis
(*) Credit cost = Provisioning / Average quarterly total assets; Average total assets is calculated based on quarterly average i.e. 5 point average for Fiscal 2022, Fiscal 2023 and Fiscal 2024.
(#) Average excluding Bajaj Finance
Source: Company reports, CRISIL MI&A

Poonawala Fincorp has the highest Return on Assets ("RoA") in fiscal 2024 amongst peers for which data is available

Poonawala Fincorp has the highest RoA (%) of 10.02% as of fiscal 2024 followed by Five Star Business (8.37%). Northern Arc Capital has RoA (%) of 2.73% as of fiscal 2023 and RoA (%) of 2.97% as of fiscal 2024.

Profitability trend

Players	Return on Asset (%)*		
	Fiscal 2022	Fiscal 2023	Fiscal 2024
Five Star Business Finance Limited	NA	8.48%	8.37%
SBFC Finance Limited	NA	NA	3.68%
Credit Access Grameen Limited	2.93%	5.06%	5.88%
Fusion Microfinance Private Limited	NA	4.66%	4.81%
Bajaj Finance Limited	NA	NA	NA
Cholamandalam Investment and Finance Company Limited	2.80%	2.77%	2.53%
Poonawala Fincorp Limited	NA	3.92%	10.02%
MAS Financial Services Limited	2.85%	2.84%	2.95%
Northern Arc Capital#	2.60%	2.73%	2.97%

Note: NA = Not available; Financials for peers are on standalone basis. Data for Northern Arc Capital is on consolidated basis
(*) Return on Assets = PAT / Average quarterly total assets; Average total assets is calculated based on quarterly average i.e. 5 point average for Fiscal 2022, Fiscal 2023 and Fiscal 2024.
(#) Profit after tax/ period attributable to Equity holders of the parent is considered as a proportion of average quarterly total assets
Source: Company reports, CRISIL MI&A

List of formulae and definition

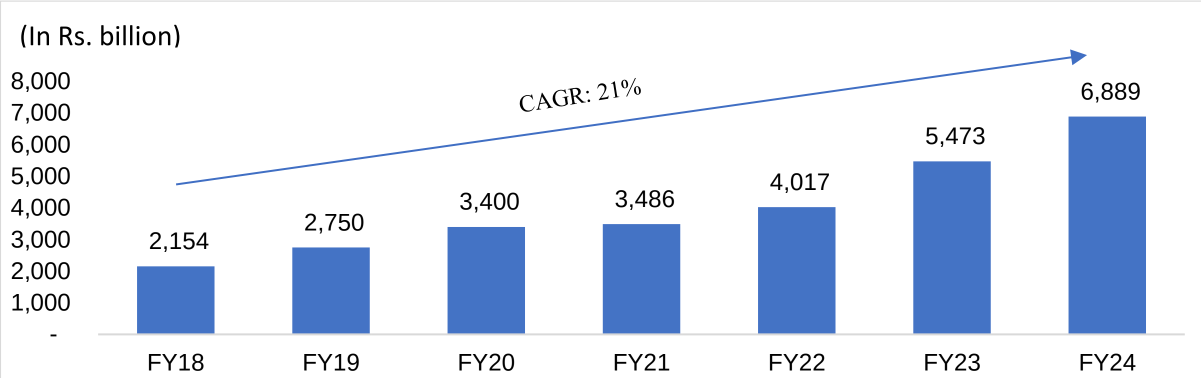
Parameter	Formulae
AUM	Asset Under Management as reported in the company disclosures
GNPA	Gross Stage 3 assets / Gross loans and investments (%) as reported in the company disclosures
NNPA	Net NPAs to net advances (%) as reported in the company disclosures
Credit cost	Provisioning / Average quarterly total assets
RoA	PAT / Average quarterly total assets

Microfinance Industry

Industry GLP has surged at 21% CAGR between Fiscal 2018 and Fiscal 2024

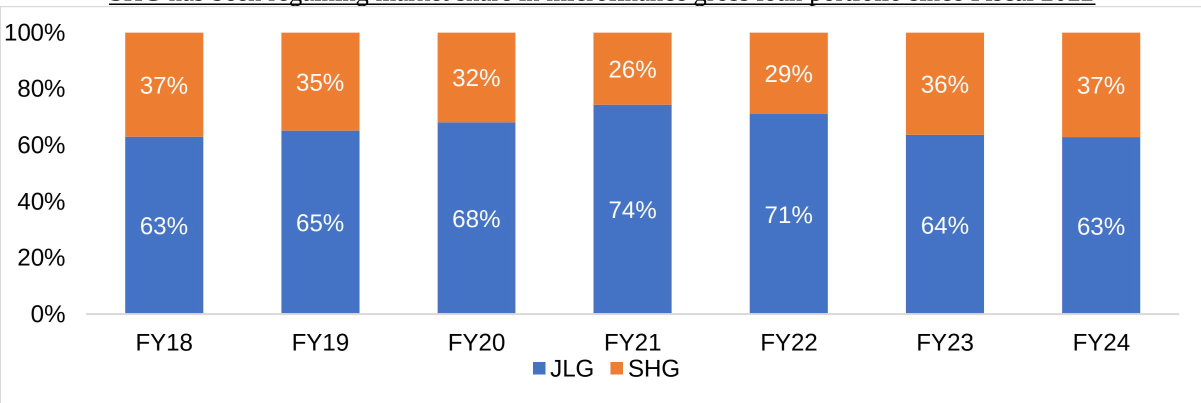
In Fiscal 2024, the overall microfinance industry portfolio outstanding grew 26% on-year to ₹6,889 billion. Going forward, the overall microfinance industry is expected to see strong growth on back of the government's continued focus on strengthening the rural financial ecosystem, strong credit demand, and higher ticket sized loans disbursed by microfinance lenders.

GLP clocked 21% CAGR between March 2018 and March 2024



Note: Data includes data for Banks lending through SHG and joint liability group (JLG), SFBs, NBFC-MFIs, other NBFCs and non-profit MFIs
Source: MFIN, CRISIL MI&A

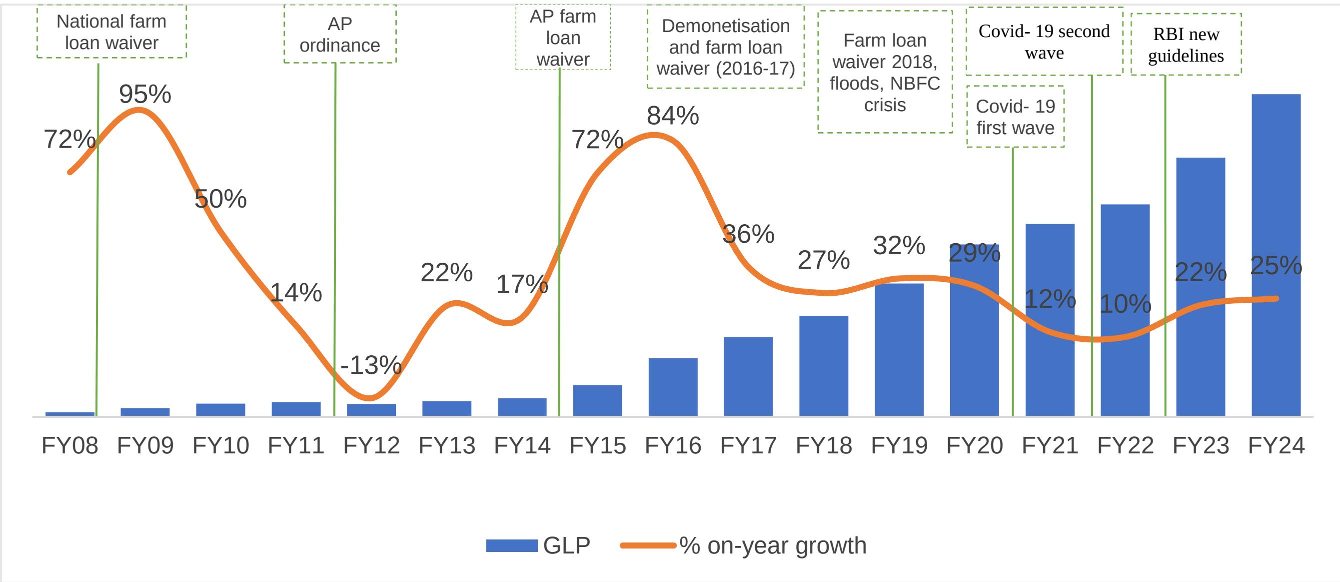
SHG has been regaining market share in microfinance gross loan portfolio since Fiscal 2022



Note: SHG data includes data for Banks lending through SHG and MFI data includes data for Banks lending through joint liability group (JLG), SFBs, NBFC-MFIs, other NBFCs and non-profit MFIs
Source: MFIN, CRISIL MI&A

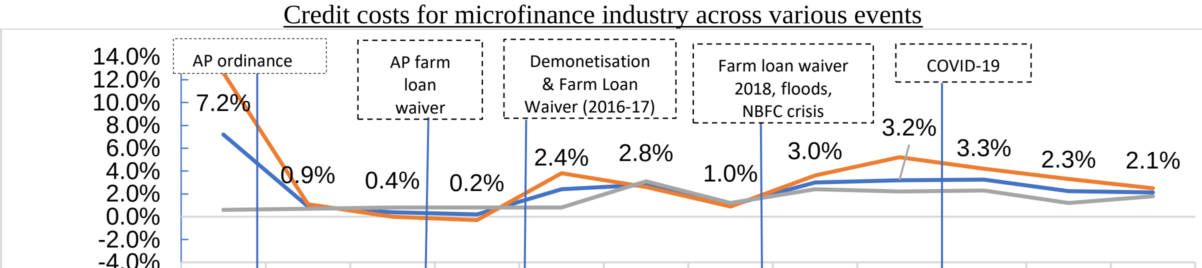
MFI Industry has witnessed robust growth despite challenges and changing landscape

MFI industry has shown resilience over the past decade



Note: Data includes data for Banks lending through joint liability group (JLG), SFBs, NBFC-MFIs, other NBFCs and non-profit MFIs. It excludes data for Banks lending through SHG
The amounts are as at the end of Fiscal year
Source: MFIN, CRISIL MI&A

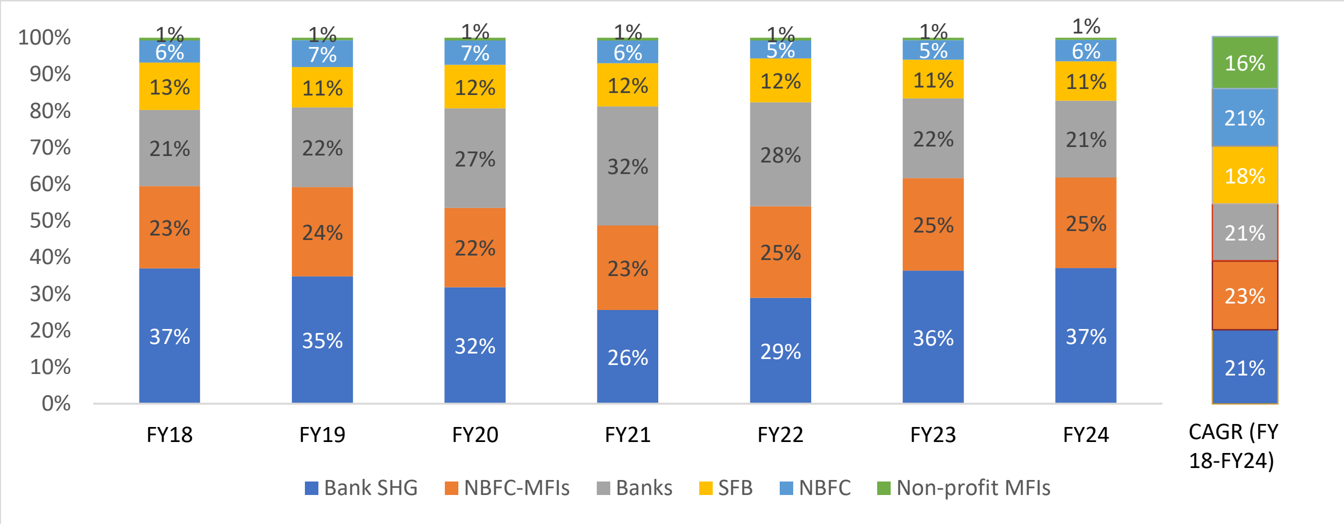
Credit costs for microfinance industry across various events



	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24
Overall	7.2%	0.9%	0.4%	0.2%	2.4%	2.8%	1.0%	3.0%	3.2%	3.3%	2.3%	2.1%
MFIs	12.6%	1.1%	0.0%	-0.3%	3.8%	2.6%	0.9%	3.6%	5.2%	4.2%	3.3%	2.5%
SFBs	0.6%	0.7%	0.8%	0.8%	0.8%	3.1%	1.2%	2.4%	2.2%	2.3%	1.2%	1.8%

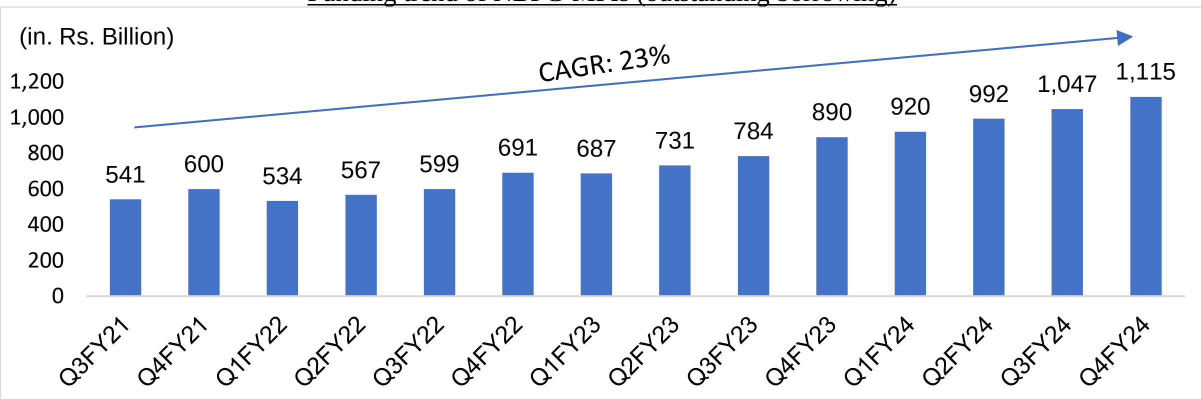
Note: Data includes data for 12 MFIs (includes NBFC MFIs) and eight SFBs which constitute more than 80% of Industry
Jana SFB, North East SFB and Shivalik SFB has been excluded from analysis
Source: Company Reports, CRISIL MI&A

NBFC MFIs account for 25% of the total gross loan portfolio as of March 2024



Note: Data includes data for banks SHG, bank JLG, SFBs, NBFC-MFIs, other NBFCs and non-profit MFIs.
Source: CRISIL MI&A, Industry

Funding trend of NBFC-MFIs (outstanding borrowing)

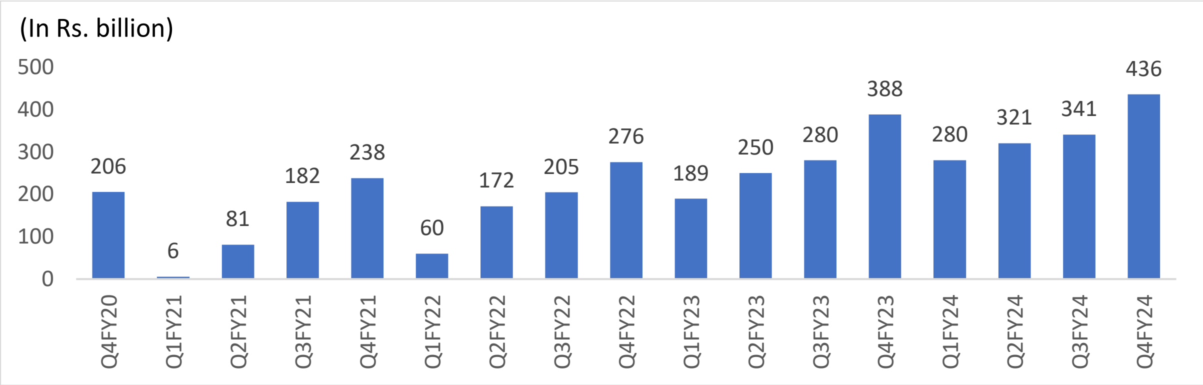


Note: Data includes only NBFC-MFIs
Source: MFIN, CRISIL MI&A

NBFC-MFIs' disbursements grew 24% in Fiscal 2024 as Q4FY24 witnessed highest disbursements since Fiscal 2020

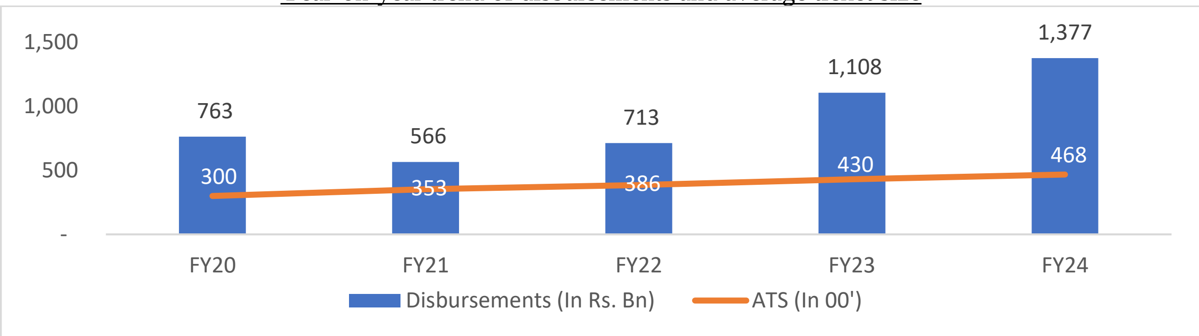
Fiscal 2024 continued witnessing strong growth in the disbursements of NBFC-MFIs at 24% to reach ₹1,377 billion. The growth was supported by increase in the number of clients by 19.4% on-year in Fiscal 2024 as well as increase in branch network. Moreover, growth was further supported by rise in rural economic activities, improved collection efficiency, implementation of the RBI's new regulatory framework, increased penetration and bigger average ticket size of disbursement.

NBFC-MFIs reported highest disbursements in Q4FY24 at Rs. 436 billion since Fiscal 2020



Note: Data includes NBFC MFI players
Source: MFIN, CRISIL MI&A

Year-on-year trend of disbursements and average ticket size

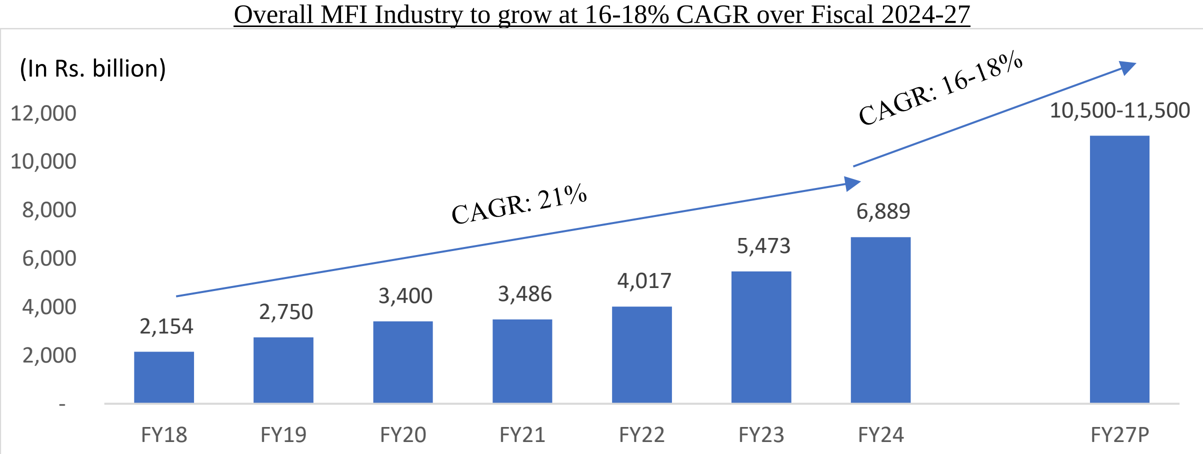


Note: Data of 49 NBFC-MFIs has been considered who are members of MFIN as of 31st March , 2024
Source: MFIN, CRISIL MI&A

Rising penetration to support continued growth of the industry

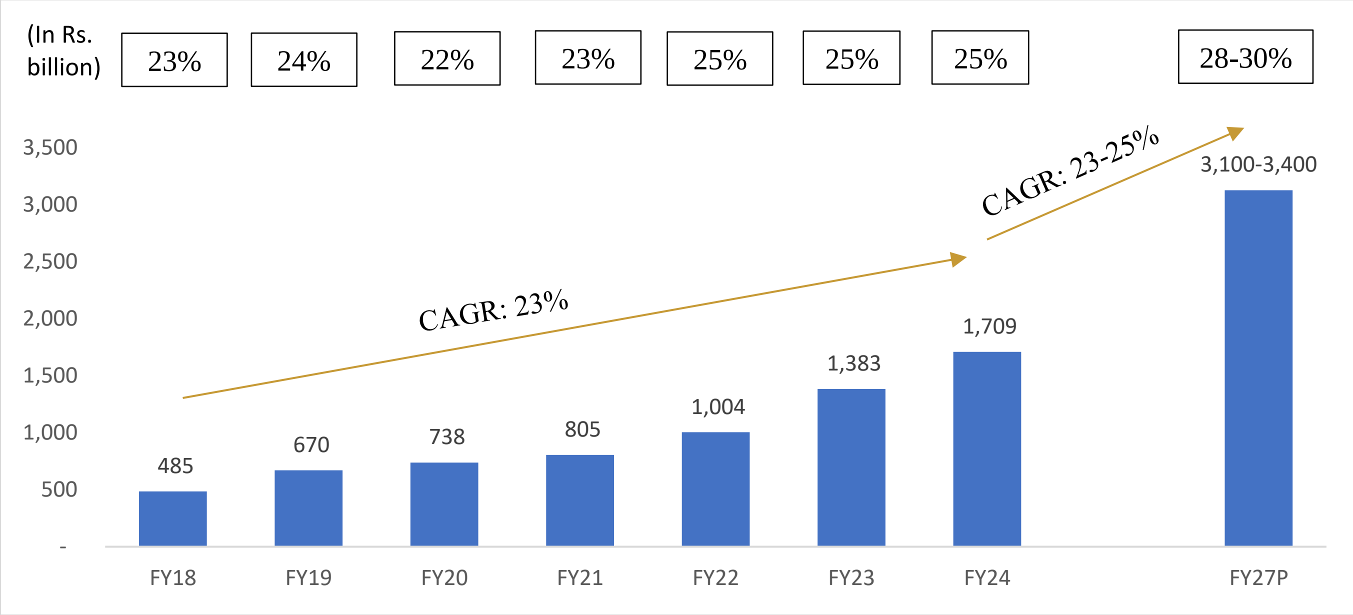
With economic revival and unmet demand in rural regions, CRISIL MI&A expects the overall MFI portfolio size to grow at CAGR of 16-18% between Fiscals 2024 and 2027. CRISIL MI&A expects NBFC-MFI industry to log 23-25% CAGR between Fiscals 2024 and 2027. Key drivers for the superior growth outlook include increasing penetration into the hinterland and expansion into newer states, faster growth in the rural segment, increase in average ticket size and higher usage of support systems such as credit bureaus. The presence of self-regulatory organisations, such as MFIN and Sa-Dhan, is also expected to support the sustainable growth of the industry going forward. Moreover, household credit is a huge untapped market for the MFI players. The country has seen household credit penetration via MFI loans rising, but it is still on the lower side.

Overall MFI Industry to grow at 16-18% CAGR over Fiscal 2024-27



Note: P - Projected
Graph includes data for bank lending through joint liability group, bank lending through self-help groups, SFBs, NBFC-MFIs, other NBFCs and non-profit MFIs
Source: MFIN, Company reports, CRISIL MI&A

NBFC MFI Industry to grow at a faster rate than overall MFI Industry



Note: P - Projected
Data includes NBFC MFI players
Figures in boxes represent market share of NBFC MFI in overall MFI AUM
Source: MFIN, Company reports, CRISIL MI&A

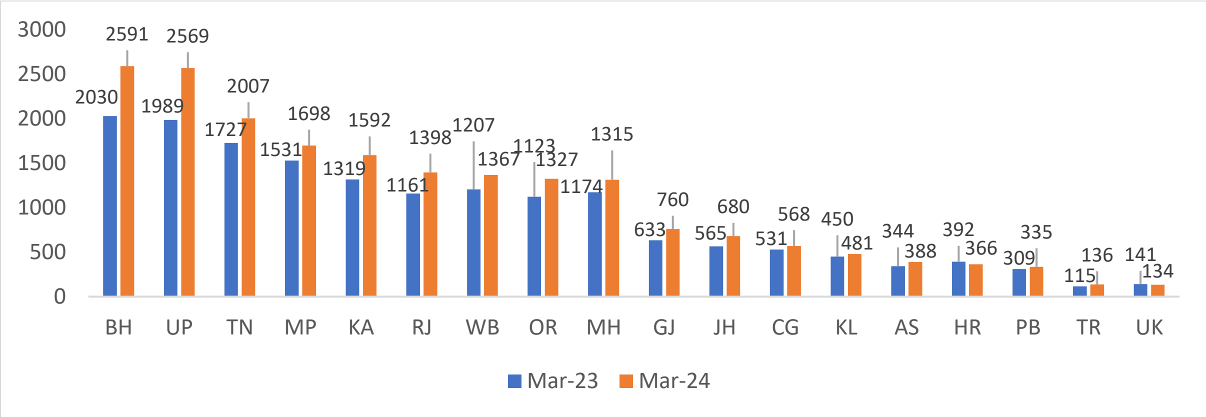
The portfolio outstanding of the NBFC-MFIs grew at a healthy CAGR of 23% between Fiscals 2018 and 2024 to Rs 1,709 billion. NBFCs, SFBs and NBFC-MFIs registered highest growth at 37%, 28% and 24% respectively in Fiscal 2024. Going ahead, CRISIL MI&A expects the NBFC-MFIs to continue to outplace other MFI lenders amid improving asset quality and continued traction in economic activity. Complementing the tailwinds will be rising profitability supported by higher net interest margins. The confluence of these factors augurs well for the credit profiles of NBFC MFI, allowing them to grow faster. The NBFC-MFIs are expected to gain market share in the medium term with a healthy double-digit CAGR of 23-25% between Fiscals 2024 and 2027.

Key trends in MFI industry

Players tapping newer states and districts to widen client base

CRISIL MI&A finds a significant jump in the number of MFIs operating in Uttar Pradesh, Bihar and Karnataka in recent years. The total number of branches in these states has significantly increased as of March 2024 compared to March 2023, leading to a jump in their portfolio outstanding. The availability of borrower credit related data from credit information companies has also ensured that MFIs have access to more data on borrowers, helping them make informed lending decisions.

<u>Total branches of MFIs in each state/UT</u>



Note: Data includes only NBFC-MFI players and those states where ten or more MFIs are operating
Source: MFIN, CRISIL MI&A

CRISIL MI&A expects penetration to deepen going forward, which will further drive growth. Madhya Pradesh, Bihar and Tamil Nadu are states with large unserved populations and hence, provide an opportunity for existing players to improve their penetration and market share.

Rural segment continues to drive MFI business

With fewer branches and outlets of banks and NBFCs in rural and semi-urban areas as compared with urban areas, the rural market (comprising of rural and semi-urban) in India for lending is still under-penetrated, thereby opening up a huge opportunity for savings and loan products. CRISIL MI&A believes that establishing a good rapport with rural customers leads to longer and more loyal customer relationship, which can be further leveraged to cross-sell other products.

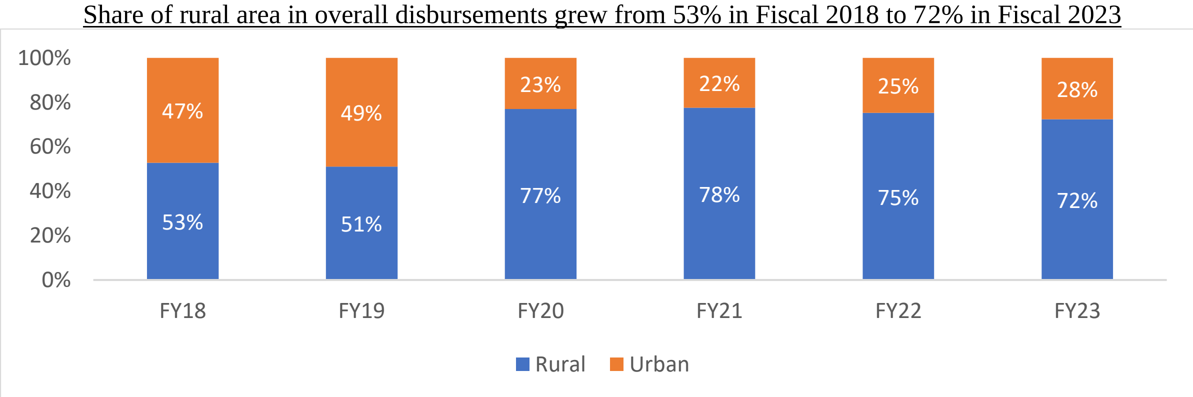
With the government's focus on financial inclusion and increasing number of financial institutions opening up branches in the unbanked areas, CRISIL MI&A has seen that demand for loan is higher in rural areas.

Disbursement and number of borrowers in rural areas (as of Fiscal 2023)

(₹billion)	Disbursement (Fiscal 2023)	Share of disbursement	Portfolio outstanding	Share of Gross Loan Portfolio (GLP)	Share of borrowers
Rural	1,273	72%	1,331	74%	74%
Urban	486	28%	468	26%	26%

Note: Values taken as per Bharat Microfinance Report 2023
Source: Sa-Dhan, CRISIL MI&A

Share of rural area in overall disbursements grew from 53% in Fiscal 2018 to 72% in Fiscal 2023



Note: Values taken as per Bharat Microfinance Reports
Source: Sa-Dhan, CRISIL MI&A

Growth drivers

Furthering financial inclusion provides huge potential for growth for MFIs

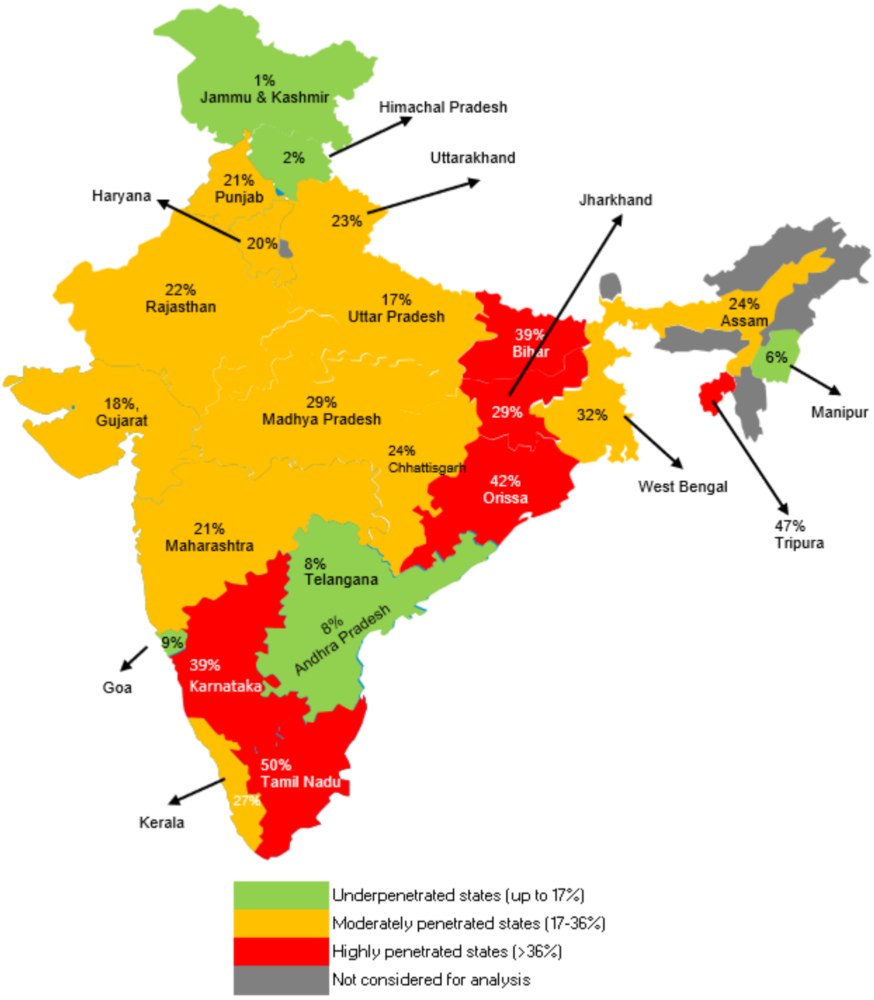
Within the large suite of products and services under financial inclusion, MFIs have a major role to play in the provision of credit. The sheer size of the market (in terms of financially excluded households) and the ability of MFIs to provide credit to this segment at affordable rates would create heathy growth opportunities for MFIs in future.

Product diversification through Microfinance Plus products

By introducing Microfinance Plus or Credit Plus products, several microfinance players have expanded into diversifying their products/services by helping the target customers gain access to other necessities such as education, healthcare, power, better infrastructure, insurance, etc. that help in their standard of living and overall economic development.

Underpenetrated states to drive growth for MFI in the coming years

CRISIL MI&A expects growth in the MFI portfolio to come from states that have a relatively lower penetration. Thus, CRISIL MI&A expects underpenetrated states like Uttar Pradesh, Andhra Pradesh and Telangana to drive future growth along with some of the moderately penetrated states, such as Rajasthan, Maharashtra, Madhya Pradesh and Gujarat.



Note: Data includes data for banks' lending through JLG, SFBs, NBFC-MFIs, other NBFCs and non-profit MFIs. It excludes data for banks' lending through SHG. The amounts are as of the end of the financial year.
Note: Penetration has been computed by dividing no. of MFI clients by estimated number of households in March 2024

Note: Pan-India penetration has been determined based on the analysis of 20 states
Source: MFIN, CRISIL MI&A

Key success factors

Ability to attract funds/raise capital and maintain healthy capital position

The microfinance industry has seen rapid growth over the past few years owing to small ticket sizes and doorstep disbursement. Despite this, a large portion of the market remains underpenetrated, making it necessary for MFIs to raise funds at regular intervals to sustain growth.

Geographically diversified portfolio helps MFIs mitigate risks

A large, well-diversified portfolio in different geographies enables players to mitigate risks associated with a concentrated portfolio. Apart from this, a wider scale of operation helps them reduce operating expenses as a percentage of outstanding loans. Rural areas are still under-penetrated in India; hence, players operating in/focused on these areas are likely to see faster growth in their portfolios.

Ability to control asset quality and ageing of NPAs

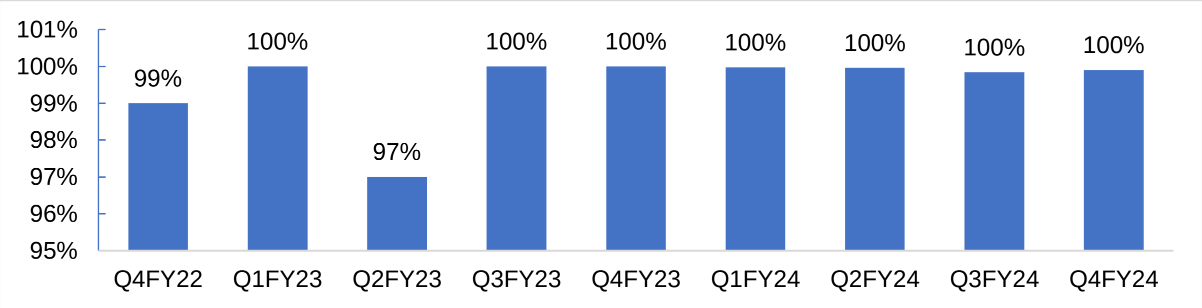
The vulnerability of MFI portfolios to local issues and events that impact the repayment ability of borrower households makes it critical for them to have a strong hold on asset quality and regularly engage with borrowers to control the ageing of NPAs. MFIs, thus, need to put in place methods and use analytics to understand and predict the quality of the portfolio, and minimize the frequency and size of asset quality-related risks.

Digitalisation to bring down costs, improve collection efficiency and profitability for MFIs

The use of technology has helped MFIs grow at a fast pace, improve efficiency, reduce cash usage and turnaround time, develop new products, provide better services to customers, and use analytics for portfolio monitoring and credit appraisal. CRISIL MI&A expects that the lower cost of servicing customers, better productivity, and lower credit costs through the use of technology will help MFIs improve their profitability.

Adoption of technology in Microfinance Industry

Trend in cashless disbursements for NBFC-MFIs



Note: Data includes NBFC MFI players
Source: MFIN, CRISIL MI&A

Reduction in credit cost to boost profitability of MFIs in the medium term

CRISIL MI&A predicts a gradual decrease in credit costs throughout Fiscal 2024 to support the overall profitability of the microfinance industry. In this context, the new framework introduced by the RBI is favourable for MFIs. This framework includes higher income eligibility thresholds for borrowers and provides greater flexibility in loan pricing for MFIs.

Profitability (return on assets) of MFIs to improve in Fiscal 2024

RoA tree	Fiscal 2019	Fiscal 2020	Fiscal 2021	Fiscal 2022	Fiscal 2023	Fiscal 2024
Interest income	18.2%	17.2%	15.7%	15.9%	17.3%	20.1%
Interest expense	8.5%	7.7%	7.4%	7.1%	7.3%	8.1%
Net interest income	**9.7%**	**9.6%**	**8.3%**	**8.8%**	**10.0%**	**12.1%**
Other income	2.1%	2.0%	1.2%	1.3%	2.3%	2.6%
Operating costs	5.5%	5.1%	4.4%	4.9%	5.4%	6.1%
Credit cost	0.7%	1.5%	4.6%	3.5%	3.3%	2.5%
Tax	1.6%	1.5%	0.3%	0.6%	1.0%	1.9%
RoA	**4.0%**	**3.5%**	**0.2%**	**1.1%**	**2.6%**	**4.2%**

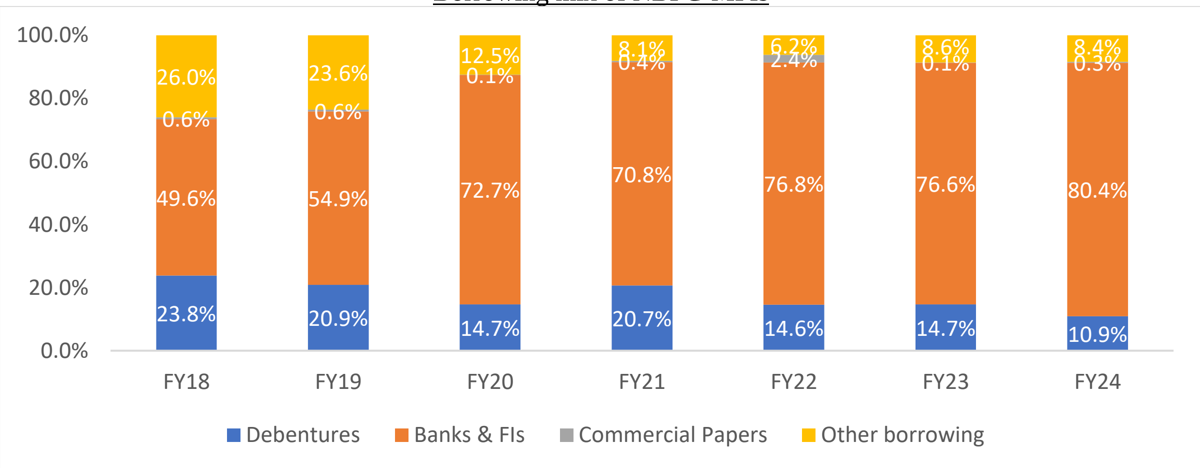
Note: Interest income = Interest income on average yearly assets; Interest expense = Finance cost on average yearly assets; Net interest income = (Interest income less interest expense) on average yearly assets; Other income = Other income on average yearly assets; Operating costs = Operating expenses on average yearly assets; Credit cost = Impairment on financial instruments on average yearly assets; Tax = Tax expenses on average yearly assets; RoA = Profit after tax on average yearly assets
Data of Spandan Sphoorty, CreditAccess Grameen, Asirvad Microfinance, Muthoot Microfin, Satin Creditcare Network, Annapurna Finance, Fusion Microfinance, IIFL Samasta Finance, Svatantra Microfin, Belstar Microfinance and Arohan Financial Services has been considered for RoA Tree
Data for fiscal 2019 to fiscal 2024 is taken from public disclosures of mentioned companies.
Source: CRISIL MI&A

Borrowing mix

Banks have traditionally been the key lenders to NBFC-MFIs. Smaller players would resort to portfolio sell-outs to channel growth.

The share of term loans is expected to increase with a decline in NCD borrowings on account of hardening of interest rates due to a 250 basis points hike in repo rates in Fiscal 2023.

Borrowing mix of NBFC-MFIs



Note: Data is based on sample set of NBFC MFIs accounting for 95% of the GLP as of Q3 Fiscal 2024, Other borrowing include sub-debt and external borrowings
Source: MFIN, CRISIL MI&A

Challenges in microfinance industry in India:

- Financial literacy - People in rural areas often lack financial knowledge and therefore having transaction with them and making them understand terms and conditions of loan products become challenging.
- Over-indebtedness – Due to lack of adequate financial literacy, the industry is susceptible to borrowers failing to manage their debt properly which leads to over-indebtedness and adversely impacts repayment capabilities particularly in geographical areas that are highly penetrated.

- Higher NPAs – Since micro loans are unsecured, risk of credit loss increases. Moreover, NPAs are higher in microfinance sector as compared to housing, vehicle, etc. owing to customer profile.
- Prone to external shocks – Historically, Micro borrowers have been prone to socio-economic and environmental disturbances which significantly impact their repayment capabilities.
- Cost of outreach - Reaching rural areas and servicing small loan amounts involve high cost of operations. Setting-up branches and/or having partnership with agents, high disbursement and collection cost involved (employees need to visit remote villages for sourcing and collection of small loan amounts which increase the transportation cost) increase the overall cost of MFIs focusing in rural areas.
- Technological challenges - People in rural areas are not so tech savvy to understand and carry out banking transactions and therefore requirement of manual involvement is more which is time consuming and also increases the cost.
- Dominance of Cash Transactions: Cash transactions continue to be the dominant mode of loan repayments in the microfinance sector. The reliance on cash-based repayments can be prone to errors and increase the risk of frauds, posing challenges for microfinance lenders in maintaining accurate records and reducing operational complexities.

MSME Loans

Brief overview of MSMEs in India

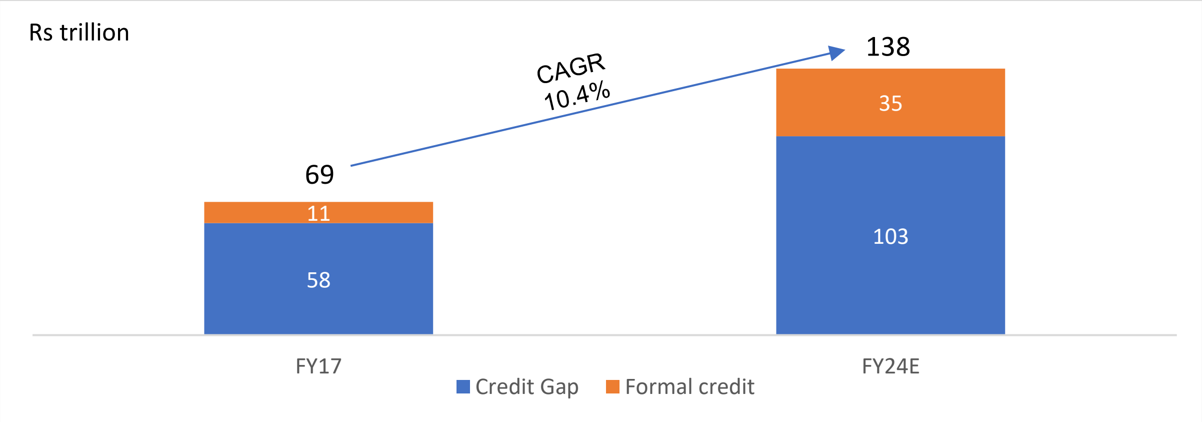
MSME segment account for 29% of India's GDP

₹ trillion	Total MSME GVA	Growth (%)	Total GVA	Share of MSME in GVA (%)	All India GDP	Share of MSME in All India GDP (in %)	Number of MSMEs (in millions)*
Fiscal 2016	41	11.0%	126	32.3%	138	29.5%	63.5
Fiscal 2017	45	10.9%	140	32.2%	154	29.3%	65.5
Fiscal 2018	51	13.0%	155	32.8%	171	29.7%	66.5
Fiscal 2019	57	12.9%	171	33.5%	190	30.3%	68.5
Fiscal 2020	61^	7.6%	184	33.4%	201	30.5%	NA
Fiscal 2021	54^	-12.0%	182	29.7%	198	27.2%	NA
Fiscal 2022	69^	27.1%	214	32.0%	235	29.2%	70.0

Note: (*) – Estimated, All India GDP as of current prices, (^) Calculated numbers
Source: MSME Ministry Annual report, CRISIL MI&A

MSME Credit gap estimated at ₹ 103 trillion as of Fiscal 2024

MSME credit demand largely met by informal sources



Source: IFC report on Financing India's MSMEs dated November 2018, CRISIL MI&A estimates

Even while the credit gap has increased, new MSME units continue to be set up across India. Between Fiscals 2016 and 2022, 18.3 million units were set up, according to the Government of India registration data of MSMEs. Thus, though a myriad of small businesses is set up every day in India, access to credit remains a challenge. However, the industry has witnessed an increase in access to formal credit to MSME, which could be attributed to the increase in the number of registered MSMEs to 26,607,728 as of June 2024 from 495,013 in March 2016.

Small Business Loans

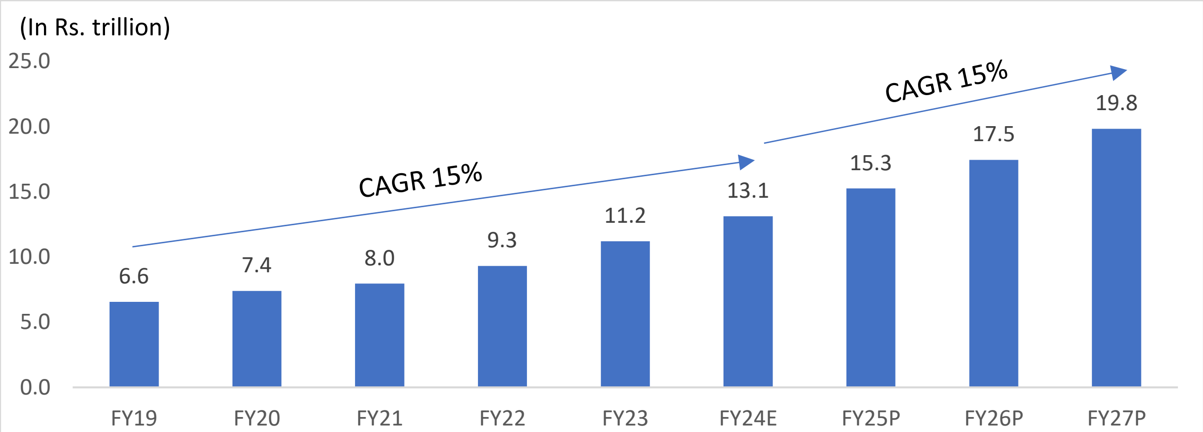
Small Business Loans witnessed a reasonable growth in the past

In this section, CRISIL have classified all loans with ticket size lower than ₹1 crore extended to MSMEs, irrespective of the turnover of the entity, as small business loans. CRISIL MI&A estimates outstanding small business loans given out by banks and NBFCs to be around ₹13.1 trillion as of March 2024.

Small business loans grew at a fast pace, registering a CAGR of 15% over Fiscal 2019 and 2024. Over the years, more data availability and government initiatives like GST has led to increasing focus of lenders, especially the NBFCs, on the underserved segment of MSME customers as lending to this segment has become easier compared to the past.

Growth in small business loans was supported by increase in disbursements in the non-loan against property ("**LAP**") (unsecured and secured) segment for NBFCs due to rapid industrialisation, driven by loans to the micro segment. With economic activity reviving and cash flows improving, NBFCs increased their funding in the unsecured segment while restricting lending in the LAP segment owing to the asset quality stress of the previous years. Growth was further led by improved underwriting, increasing funding to the unsecured portfolio.

Small Business Loans to grow at 15% CAGR over Fiscal 2024 and 2027



Note: E - Estimated, P - Projected
Source: CRISIL MI&A

Going forward, small business loans are expected to grow at 15% CAGR between Fiscals 2024 and 2027 led by both LAP and Non-LAP segments aided by increasing penetration, enhanced use of technology, newer players entering the segment, and continued government support.

Growth drivers

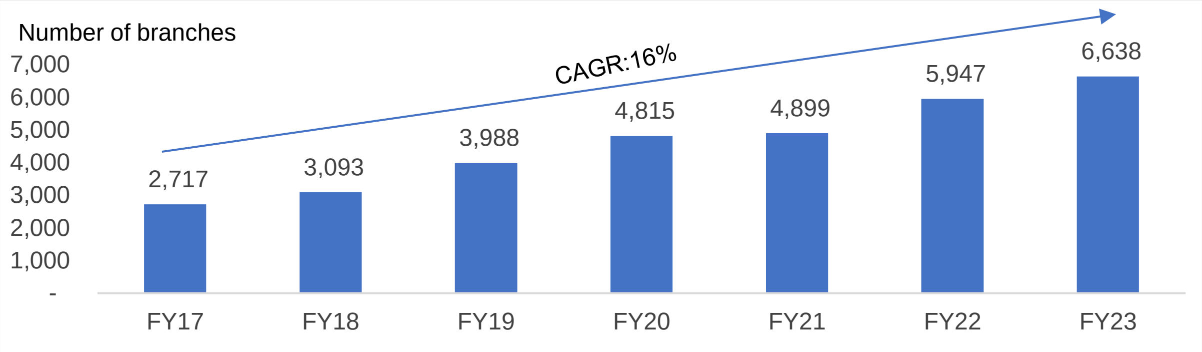
Low credit penetration for MSMEs

Less than 10% of the MSMEs have access to formal credit in any manner. There are around 70 million MSME's out of which less than 10% have access to formal credit. This untapped market offers huge growth potential for financial institutions. CRISIL MI&A estimates the credit gap to have increased to ₹ 103 trillion as of Fiscal 2024.

Growth in branch network of players in MSME segment

Over past few years, players offering MSME loans have expanded their branch network with the intent to serve a larger customer base. In the future also, CRISIL MI&A expects lenders with a strong focus on MSME lending and healthy competitive positioning to continue to invest in branch expansion. With increasing branch network, customer acquisition and credit penetration, share of MSME loans is also expected to increase.

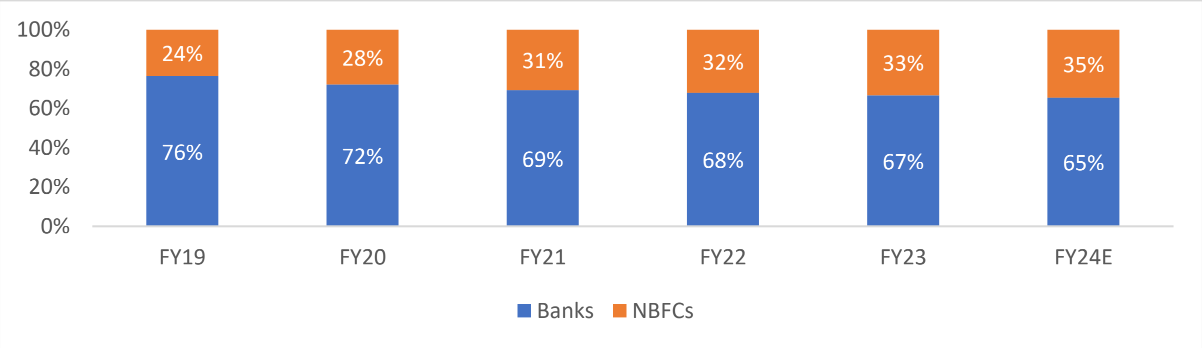
<u>Number of branches have grown at 16% CAGR over Fiscals 2017 and 2023</u>



Note: The above data includes branches for Fedbank Financial Services, Five Star Business Finance, Vistaar Finance, Veritas Finance, HDB Finance and IIFL Finance
Source: Company Reports, CRISIL MI&A

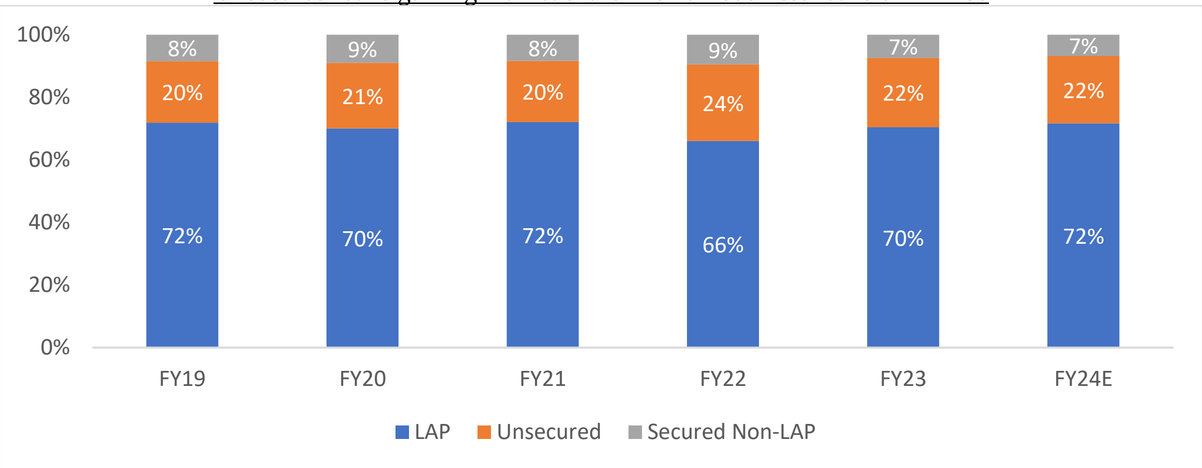
NBFCs increasing their presence in the small business loans segment

NBFCs continue to gain market share from banks in small business loans



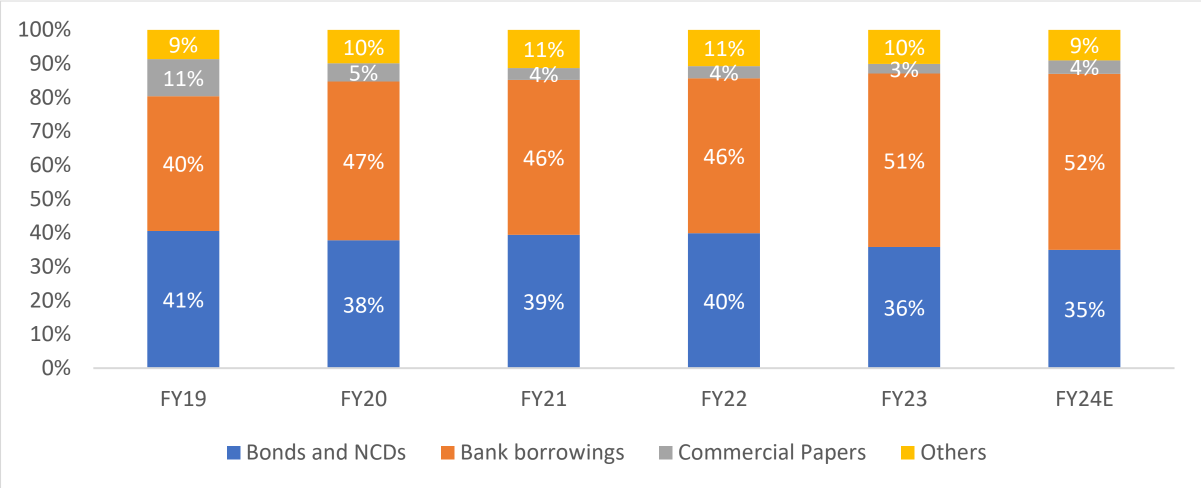
Note: E - Estimated
Overall industry has been considered for calculation of market share of banks and NBFCs in small business loans

Unsecured loans gaining market share in small business loans of NBFCs



Note: E- Estimate
Source: CRISIL MI&A

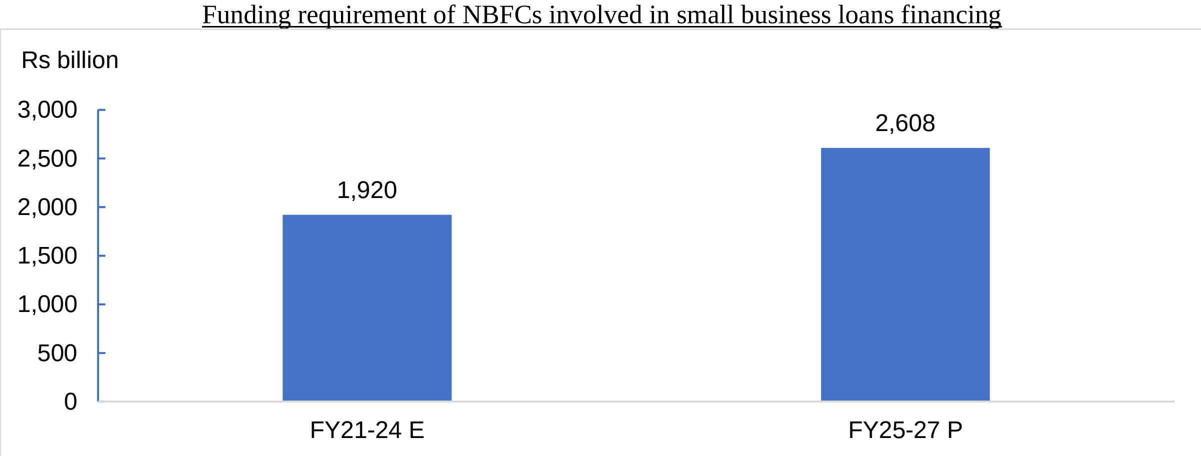
Bank borrowings continue to gain market share in the borrowing mix of NBFCs focused on small business loans



Note: E – Estimated, The above liability profile is based on data for 17 players accounting for 55-60% of portfolio in NBFC Small Business lending
Source: Company Reports, CRISIL MI&A

NBFCs require a capital of approximately ₹2.6 trillion over next three years for small business loans

Funding requirement of NBFCs involved in small business loans financing



Note: E – Estimated, P - Projected
Source: Company reports, CRISIL MI&A Estimates

NBFC profitability to remain stable on account of lower credit costs

Improved net interest margins ("**NIMs**") and decline in credit costs are the key reasons for improving or stable profitability in Fiscal 2024. The pent-up demand drove the AUM growth especially across higher yielding segments which impacted profitability positively. In addition, credit costs declined for all the players in Fiscal 2023 and remained stable in Fiscal 2024 due to overall improvement in collection efficiency. On an overall basis, the RoA is estimated to improve in Fiscal 2024 for all the NBFCs.

Furthermore, CRISIL MI&A expects profitability to remain stable in near term as asset quality is expected to remain range bound.

	Fiscal 2021E	Fiscal 2022E	Fiscal 2023E	Fiscal 2024E	Fiscal 2025P
Net Interest Margin (NIM)	6.2%	6.3%	6.6%	6.7%	6.6%
Operating Cost	2.4%	2.3%	2.3%	2.2%	2.2%

	Fiscal 2021E	Fiscal 2022E	Fiscal 2023E	Fiscal 2024E	Fiscal 2025P
Credit costs	2.3%	2.4%	2.2%	2.1%	2.1%
Return of Asset (RoA)	1.2%	1.4%	1.6%	1.8%	1.8%

Note: E - Estimated, P – Projected

Net interest income = (Interest income less interest expense) on average yearly assets; Operating costs = Operating expenses on average yearly assets; Credit cost = Impairment on financial instruments on average yearly assets; RoA = Profit after tax on average yearly assets

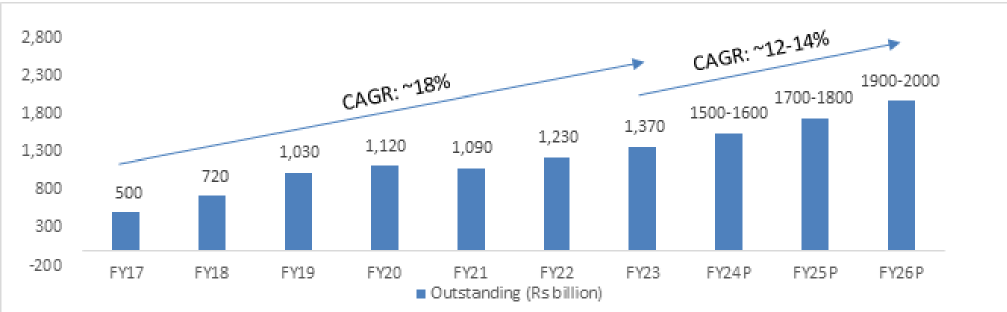
Source: Company reports, CRISIL MI&A

Mid corporate loans

NBFC's mid-corporate loan portfolio grew at CAGR of 18% between Fiscal 2017 to Fiscal 2023

We have defined mid-corporate loans as loans with a ticket size of between ₹5-30 crore. The aggregate value of such loans given out by NBFCs is estimated at around ₹1.37 trillion as of March 2023. Between Fiscals 2017 and 2023, NBFCs credit to the mid-corporate segment increased at a strong approximately 18% CAGR.

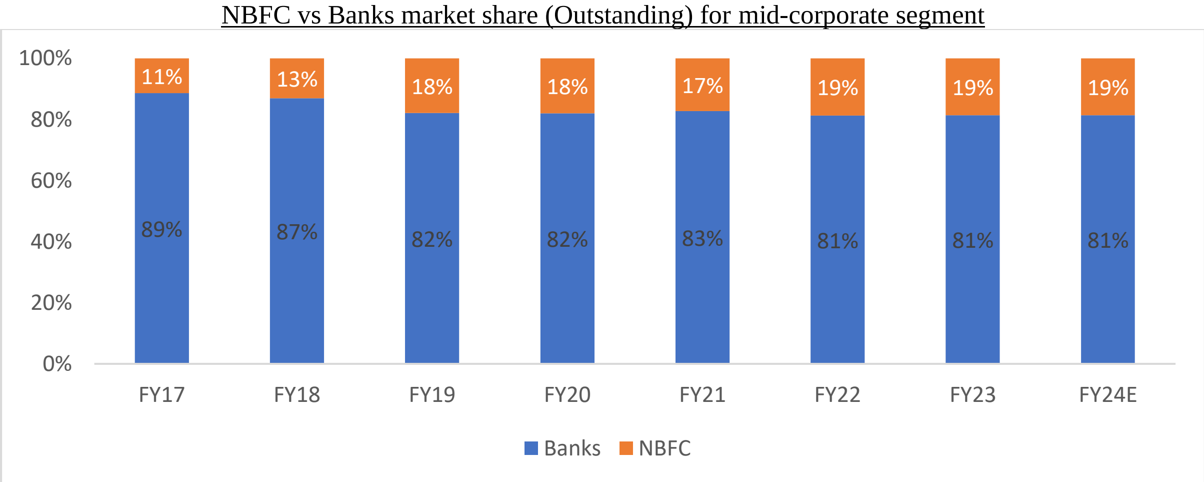
Credit outstanding by NBFC's in Mid-corporate segment expected to grow at 12-14% in the next three years.



Note: P - Projected
Source: CRISIL MI&A estimate

NBFCs have gained market share in mid-corporate segment

NBFC vs Banks market share (Outstanding) for mid-corporate segment



Note: E – Estimated; Banks include data for PSUs, Private banks and Foreign banks
Source: CRISIL MI&A estimate

Challenges in the MSME Finance Industry in India:

- Access to Finance: MSMEs, especially small and micro enterprises, often face limited access to formal credit. Lack of collateral and insufficient credit history can make it challenging for them to secure loans from financial institutions.

- Informality and Documentation: Informal nature of many MSMEs and the difficulty in obtaining the required formal documentation can pose significant challenges in assessing creditworthiness and underwriting these loans. Developing efficient processes to gather and validate the necessary information from MSME borrowers is crucial for lenders to overcome this barrier.
- Risk Perception: Addressing this risk perception through the development of robust risk assessment and mitigation strategies is a key challenge for lenders. Improving their ability to accurately evaluate the credit risk profile of MSME borrowers can help lenders overcome their hesitance in lending to this segment.
- Evolving Credit Needs: The financing requirements of corporates are constantly evolving, necessitating lenders to adapt their loan products and underwriting approaches to cater to these dynamic needs.
- Sector-Specific Risks: MSME and Mid-corporate borrowers are often susceptible to industry-specific challenges and volatility. Effective risk assessment and mitigation strategies are essential to address these sector-specific risks.

Consumer Finance loans

Consumer finance loans cater to the diverse needs and aspirations of the Indian population, facilitating access to credit for various purposes, primarily revolving around consumption.

Personal Loans

The growth in personal loans to normalise in near-to-medium term

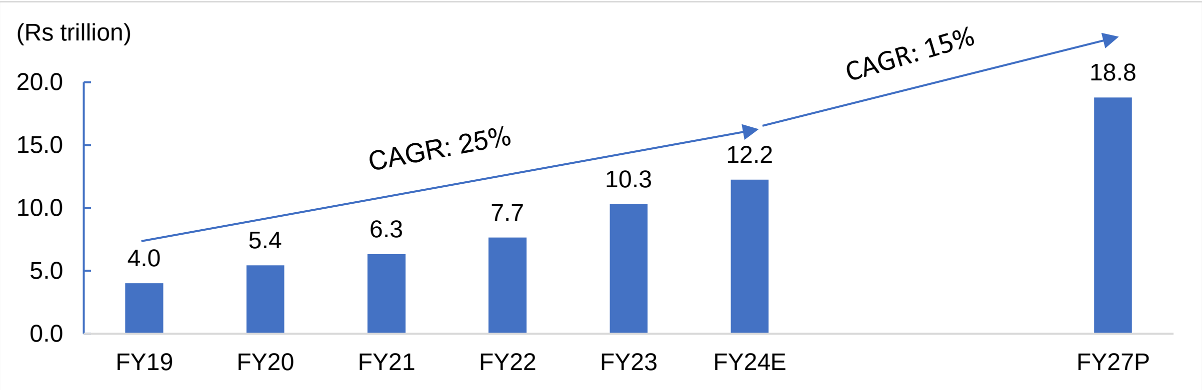
CRISIL MI&A estimates the segment to grow by 18-20% in Fiscal 2024 benefitting from a healthy credit demand. However, systemic hardening of interest rates, inflation and other macro factors could present challenges to growth in the near term. GNPA levels are estimated to normalize in Fiscal 2024 inching closer to pre-pandemic levels, led by a continued recovery in collection efficiency and high write-offs, driven by healthy capital buffers, along with healthy growth in the loan book. A marginal uptick is expected in fiscal 2025, as the loan book undergoes some seasoning after a period of supernormal loan-book growth in previous fiscals.

The outstanding credit for NBFCs stood at ₹2.6 trillion in Fiscal 2024 after posting strong growth of 48% in Fiscal 2023 and 21% in Fiscal 2024. It is further projected to grow to approximately ₹3.2 trillion in Fiscal 2025 with a growth rate of 19-20%.

The personal loans segment witnessed post-pandemic exuberance during fiscal 2023 and fiscal 2024

Personal loan outstanding stood at ₹12.2 trillion in Fiscal 2024 and is likely to cross approximately ₹18.5 trillion in Fiscal 2027. At work will be multiple factors, including the granularity of retail loan book against legacy asset-quality issues in the chunky wholesale segment, leveraging of technology to achieve scale, changing consumption patterns, and improvement in income-profile of the customers.

Personal loan outstanding to reach ₹18.8 trillion in Fiscal 2027



Note: E – Estimated, P - Projected
Source: CRISIL MI&A

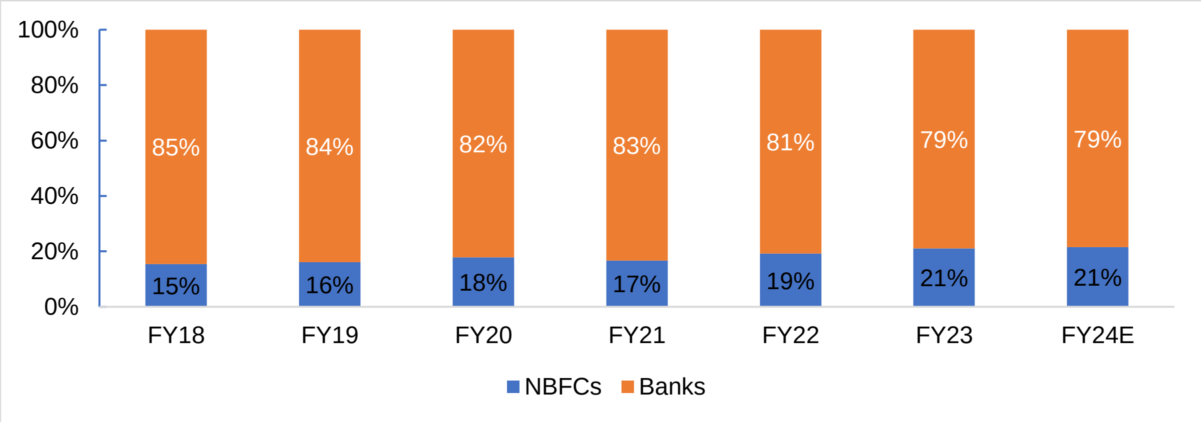
NBFCs market share expected to further increase

NBFCs have outpaced banks in terms of growth in outstanding, leveraging their segmental focus versus banks. In contrast, personal loans represent just a portion of the overall portfolio for banks. Also, NBFCs benefit from their extensive branch network, which is spread across remote areas too. These factors, along with high contribution from the digital platforms, drove a sharp 48% on-year growth in credit outstanding of NBFCs in Fiscal 2023 and is estimated to have grown 20-22% in Fiscal 2024.

Banks' credit growth is estimated to be healthy at 16-18% in Fiscal 2024, despite a high base, spurred by their aggressive focus on the retail loans segment in recent times. Additionally, because of salaried-customers base and a higher share of Tier 1 cities in the portfolio, banks' borrower segment faced lower cash-flow disruptions, thereby realising a better asset quality performance versus NBFCs.

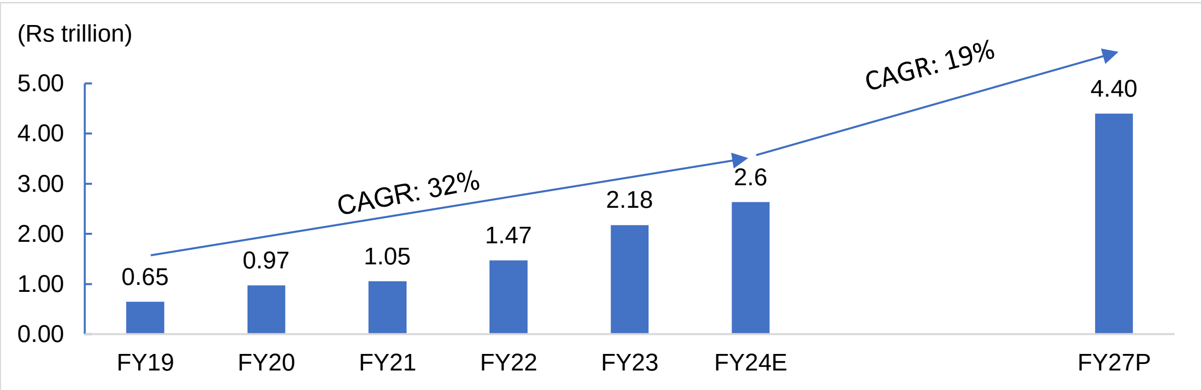
In the case of NBFCs, with a higher share of the self-employed segment, along with a greater share of 'Tier 2 and lower' cities in the portfolio, asset quality was weaker compared with banks. However, with NBFCs growing faster than banks, CRISIL MI&A Research expects the former's market share to increase in Fiscal 2025.

Share of NBFCs has increased in the past few years



Note: E - Estimated
Source: CRISIL MI&A

NBFC book to grow faster than that of banks



Note: E – Estimated, P – Projected
Source: CRISIL MI&A

RBI follows up with the circular on “Regulatory measures towards consumer credit and bank credit to NBFCs” after striking a cautious note

Noting the exuberant growth of unsecured lending against the backdrop of a rising interest rate environment, the RBI started cautioning the lenders since the end of fiscal 2023 regarding the potential risks associated with the rapid growth in unsecured lending by NBFCs.

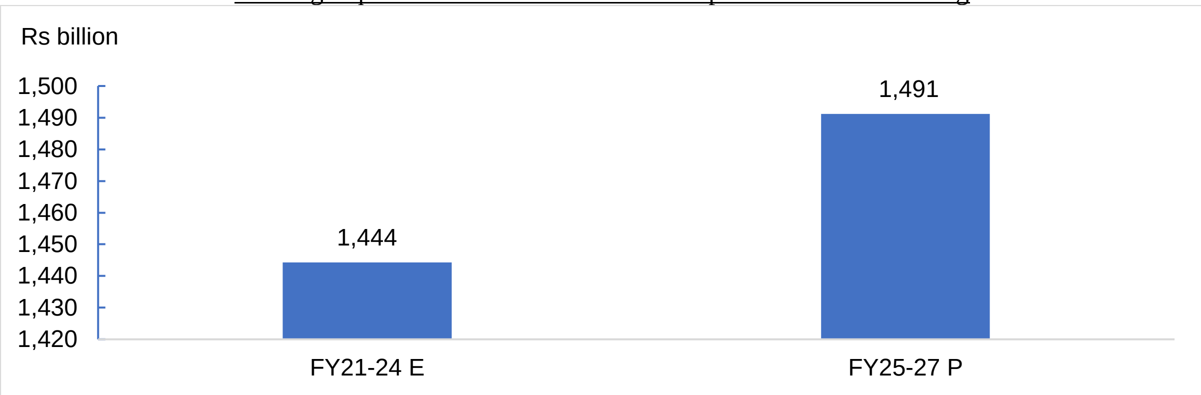
In November 2023, the RBI introduced the circular on “Regulatory measures towards consumer credit and bank credit to NBFCs” (“**Circular**”) as a deterrent to the growth of unsecured loans. As per the circular, the risk weights of all consumer credit exposure for both commercial banks and NBFCs (including credit card receivables of scheduled commercial banks) was increased by 25%, excluding housing, vehicle, education and gold loans. Additionally, the risk weight for exposure by banks to NBFCs, where the extant risk-weight of the NBFC is below 100%, was also increased by 25%.

Banks faced an ~85 bp impact on capital adequacy due to the circular, whereas the impact for key NBFCs operating in the consumer lending segment was as high as 200-400 bps. Larger NBFCs, rated A- and above and operating in these segments, will also face an additional impact on their borrowing costs from bank funding, as capital cost for the banks increases in such cases. These higher lending rates by banks to NBFCs could also spill over to corporate bonds in the form of higher yields through widening of credit spreads for NBFCs. Such an increase in the cost of funds for NBFCs could drive demand for securitisation and co-lending. This could accelerate capital raising by entities for managing loan-book growth while ensuring adequate capital buffers are maintained. Hence, this could lead to higher capital requirement by lenders and increased lending rates for borrowers.

NBFCs require funding of approximately ₹1.5 trillion over next three years for personal loans

Based on the projected growth in the personal loans portfolio, profitability and leverage levels, CRISIL estimate that NBFCs involved in financing personal loans will require funding to the tune of around ₹1,491 billion between Fiscal 2025 and Fiscal 2027, which will get financed through a mix of equity, debt, and securitization.

Funding requirement of NBFCs involved in personal loans financing



Source: Company Reports, CRISIL MI&A Estimates

NBFC profitability to remain stable in near term

In the personal loans segment, the spreads remain reasonably attractive at 8-9%. However, the impact of credit costs associated with unsecured lending continues to influence the overall profitability.

NBFCs are reducing their reliance on direct selling agents in favor of cross-selling strategies and digital sourcing modes. This transition aims to reduce costs and improve customer acquisition efficiency.

In Fiscal 2024, profitability is estimated to have improved further largely on account of improvement in credit cost. Nevertheless, a marginal uptick in credit cost is expected in fiscal 2025, as the loan book undergoes some seasoning after a period of supernormal loan-book growth in previous fiscals.

ROA improved in Fiscal 2023 and Fiscal 2024 and is expected to remain stable in near term

	Fiscal 2020E	Fiscal 2021E	Fiscal 2022E	Fiscal 2023E	Fiscal 2024E	Fiscal 2025P
Net Interest Margin (NIM)	9.78%	9.67%	9.88%	10.13%	10.30%	10.23%
Operating Cost	4.35%	4.60%	4.50%	4.40%	4.40%	4.30%
Credit costs	2.70%	4.20%	3.60%	3.20%	3.00%	3.10%
Return on Asset (RoA)	2.56%	1.32%	1.93%	2.43%	2.68%	2.63%

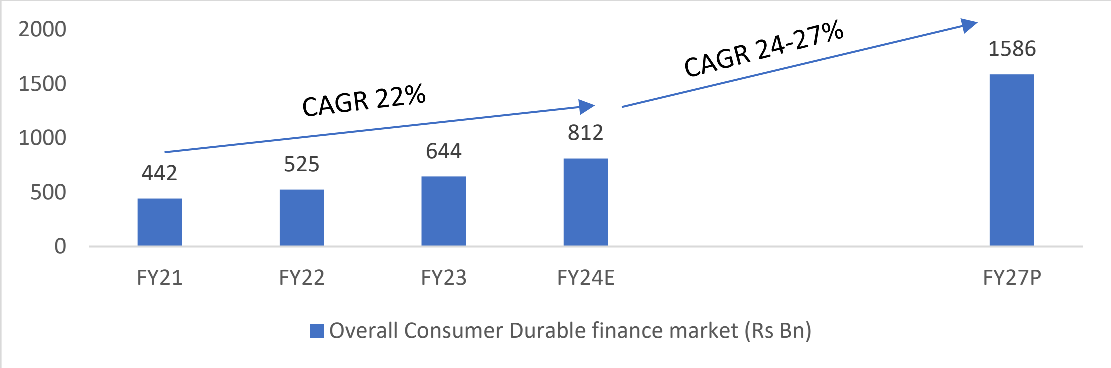
Note: E - Estimated, P – Projected
Net interest income = (Interest income less interest expense) on average yearly assets; Operating costs = Operating expenses on average yearly assets; Credit cost = Impairment on financial instruments on average yearly assets; RoA = Profit after tax on average yearly assets

Source: Company reports, CRISIL MI&A

Consumer durables finance

Consumer durables financing market continues the healthy momentum

Overall consumer durables finance market



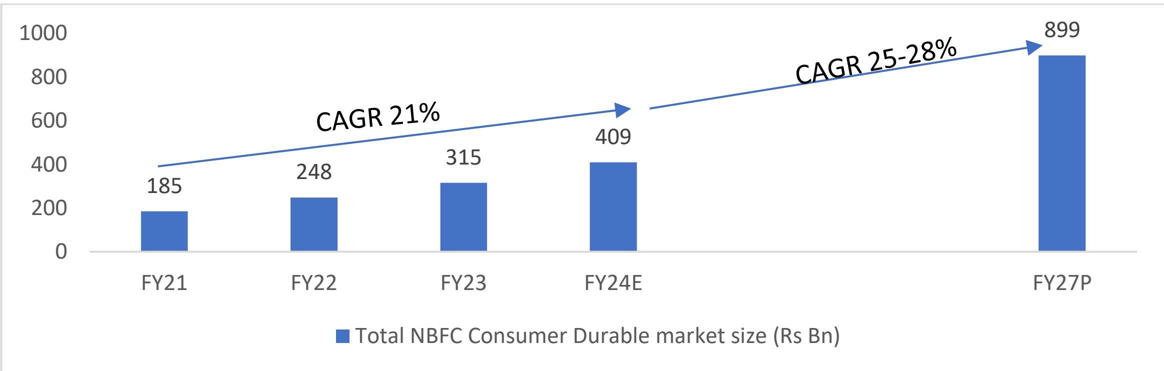
Note: E – Estimated; P - Projected
Source: RBI, CRISIL MI&A

CRISIL MI&A Research estimates the market size for consumer durables financing to reach Rs 812 billion in fiscal 2024, logging 26-27% growth over the previous fiscal. This growth momentum is expected to continue in fiscal 2025 with slight moderation due to impact of RBI's decision to increase risk weights on consumer loans which has led to lenders recalibrate their lending strategies.

Credit growth for NBFCs to come from prime and below prime customers and fintechs

The growth will continue to be driven by demand from prime and below prime consumers as against higher rated consumers in the near term. In fiscal 2024, growth in NBFC consumer durables' credit grew at a much faster pace and gained market share over banks due to their ability to provide flexible lending solutions and tailored services. Their outstanding book, which grew 27% on-year in fiscal 2023, and is estimated to have grown further by 29-30% on-year in fiscal 2024. Innovative financing models and low ticket-size based growth by fintech's will also be a major contributor for the consumer durable financing growth.

Consumer durables financing from NBFCs

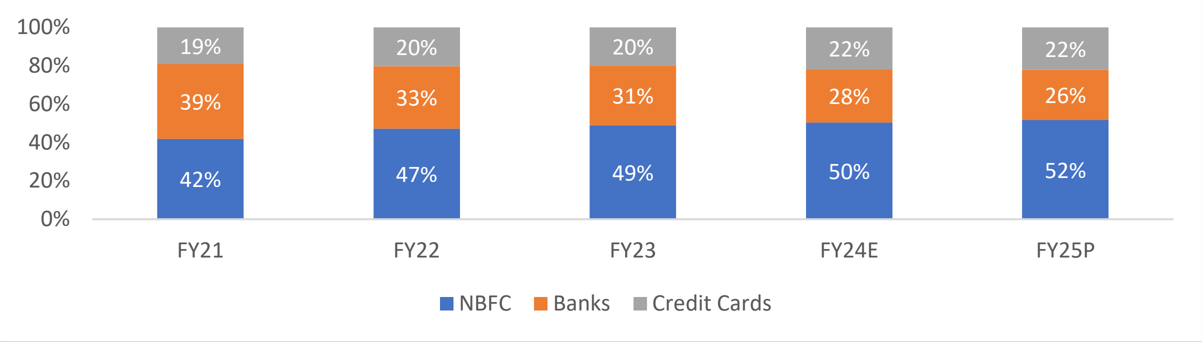


Note: E – Estimated; P - Projected
Source: RBI, CRISIL MI&A

NBFCs' share continue to increase as healthy growth continues

The consumer durable loan disbursements involve point-of-sale financing, i.e., these loans are normally processed at the retail outlet or at the showroom. A customer would prefer to avail equated monthly instalment ("**EMI**") schemes while purchasing an appliance rather than going to a bank for a loan. Hence, NBFCs have an advantage due to their tie-ups with such brick-and-mortar retailers. Share of NBFCs in the overall consumer durables market has increased post pandemic as compared to banks, driven by the surge in credit demand, along with penetration into newer markets. Share of credit cards segment has increased steadily due to issuance of new credit card, increased spending and disbursements through credit cards and pay-later options. However, banks have revised their credit card rules concerning reward points and spending requirements in beginning of fiscal 2025. Additionally, with alternative relatively-lower-cost financing options available, fintechs pose a challenge to the market share of credit cards.

Share of banks to reduce significantly due to aggressive expansion strategies of non-banks and fintech's



Note: E – Estimated; P - Projected
Source: Company reports, CRISIL MI&A

Gold loans

Gold loans AUM is expected to grow at 14-15% CAGR between Fiscal 2024 and 2027 to reach ₹11,307 billion by March 2027

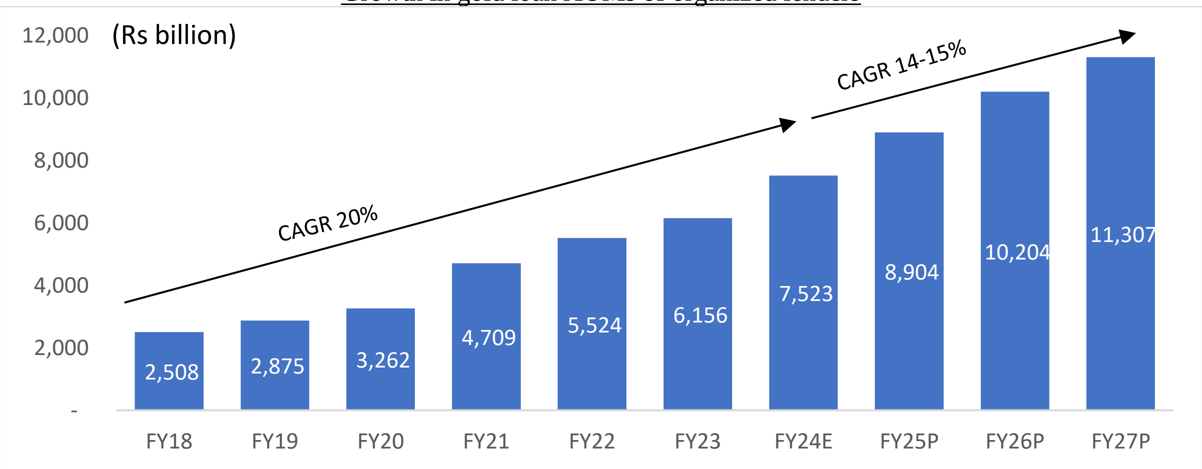
The gold loan sector is still largely catered by unorganized players with potential for new entrants to enter the market and create space. Gold loans are typically small ticket, short duration, convenient and instant credit, and are typical sourced and serviced through a physical branch infrastructure. Moreover, the gold loan product and customer segment are adjacent to the small ticket financing segment – for both consumers and small businesses alike.

Going forward, CRISIL MI&A believes the following factors to support industry growth:

- Scope to capture share from unorganised gold loan financiers.
- Initiatives to increase awareness and increasing comfort of customers with gold loans due to the convenience.
- Geographic diversification to markets beyond the Southern part of India.

Demand for gold loans from micro enterprises and individuals to fund working capital and personal requirements is expected to increase owing to pickup in economic activity. In addition, with demand reviving and market expansion through doorstep gold loans model, CRISIL MI&A expects AUM to touch close to ₹11,307 billion by March 2027, translating into a 14-15% CAGR between Fiscal 2024 and 2027.

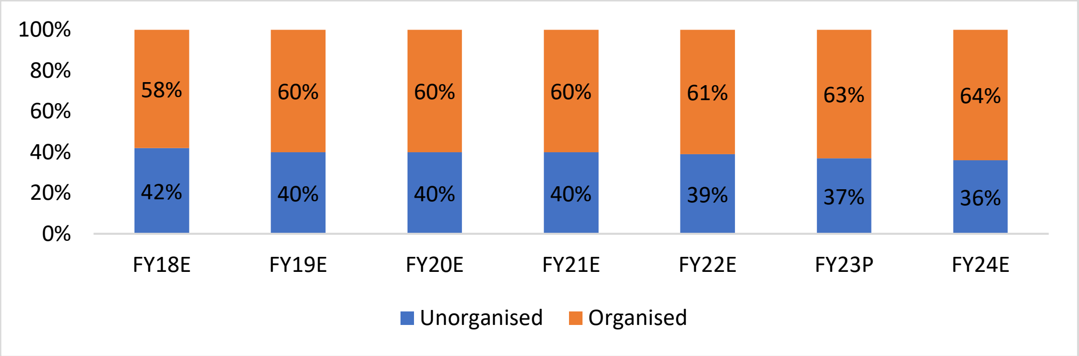
Growth in gold loan AUMs of organized lenders



Note: E – Estimated, P - Projected

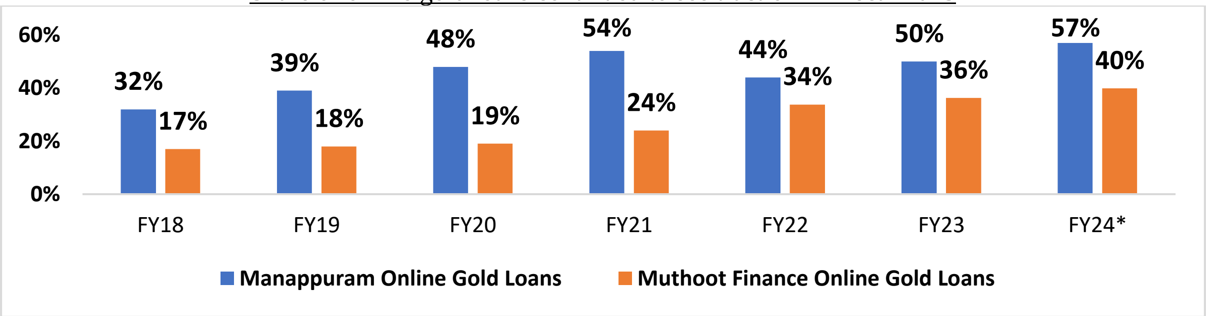
Source: CRISIL MI&A

Share of unorganized and organized lenders



Note: E - Estimated
Source: CRISIL MI&A

Share of online gold loans continued to see traction in Fiscal 2023



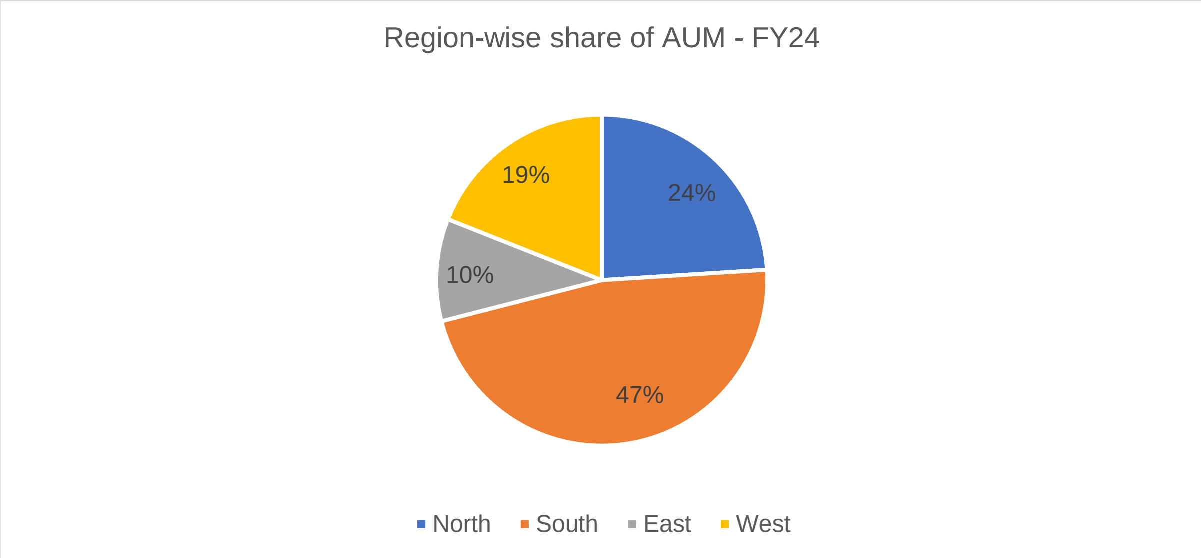
Note: (*) Data for Muthoot Finance is as of December 2023
Source: Company Reports, CRISIL MI&A

Demand for gold loans skewed towards southern states

Southern states accounted for the largest pie of the overall AUM over the past five years. This was because of:

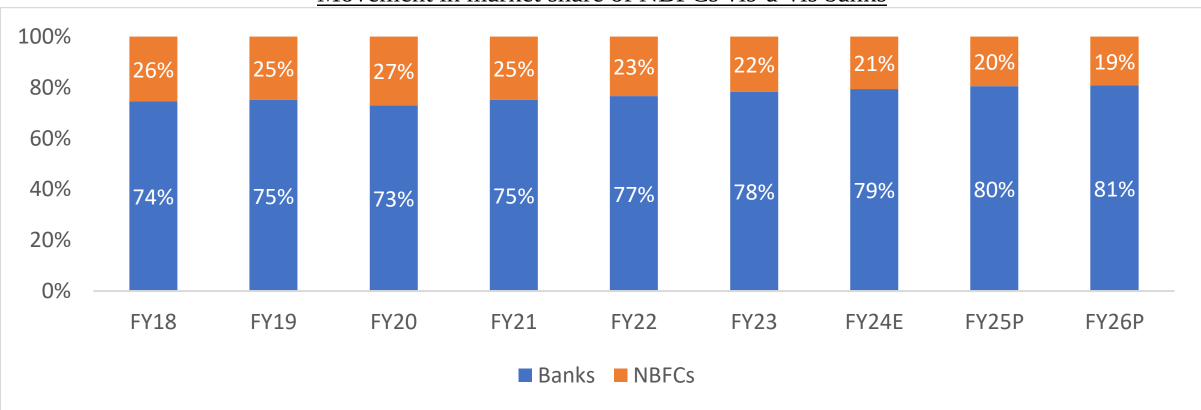
- Better awareness among gold owners in the South towards raising funds via pledging gold compared with other regions.
- Origination and established franchisees in the South, supported by simple procedures that ensure quick loan disbursement.

Though the South continues to dominate, players have been shifting focus to untapped markets in the eastern and western regions, which have fewer branches but provide incremental growth opportunity.



Note: Aggregate includes Muthoot Finance and Manappuram Finance
Source: Company reports, CRISIL MI&A

Movement in market share of NBFCs vis-a-vis banks



Note: E – Estimated, P - Projected
Source: CRISIL MI&A

Despite uptick in cost of funds, profitability to improve owing to credit growth pick-up

While a contraction in net interest margin (NIM) had impacted NBFC profitability in fiscal 2023, a recovery in it is estimated to have improved profitability in fiscal 2024.

Yields have been declining for various players amid acute competition from banks. In fact, competition continues to put pressure on NIMs of gold loan NBFCs. Typically, banks offer gold loans at a lower yield of 7-15% because of their low cost of funds, while NBFCs charge 18-24%. Banks felt the initial effect of competition when certain NBFCs introduced teaser rate loans, which adversely impacted yields in the segment. With majority of the teaser loans ending, the yields may have bottomed out. However, at a structural level, yields of gold loan NBFCs could continue to be lower than pre-pandemic levels in the near-to-medium term.

Hence, the NIM is estimated to have expanded in fiscal 2024, benefitting from a revival in portfolio growth and cooling off of competition from banks. NIM is forecast to expand further this fiscal driven by the softening cost of funds and steady portfolio expansion.

Also, operating cost as a percentage of total average assets is estimated to have increased further last fiscal in step with the portfolio growth. This is expected to tone down these fiscal as operating efficiencies set in with healthy portfolio growth.

A modest uptick was estimated in credit costs in fiscal 2024 as GNPA remained steadily above historical levels, only to be offset by auction and sale of NPAs to ARCs. However, with respect to sale to ARCs, the write-offs remained negligible owing to the value and liquidity of gold as collateral, thereby limiting credit costs. Additionally, higher gold prices will lower the LGD for ECL calculation, resulting in lower provision, leading to further buffering of credit costs, assuming stable LTV levels. Credit cost is expected to decline in fiscal 2025 in line with projected NPA levels.

Overall, return on assets (RoA) is estimated to have improved in fiscal 2024 and is expected to further improve this fiscal on account of better NIM and controlled credit cost.

Trend in ROA for gold loan NBFCs

	Fiscal 2018	Fiscal 2019	Fiscal 2020	Fiscal 2021	Fiscal 2022	Fiscal 2023	Fiscal 2024E	Fiscal 2025P
Net Interest Margin (NIM)	14.3%	13.6%	13.2%	12.1%	10.8%	9.6%	10.1%	10.3%
Credit costs	0.6%	0.05%	0.12%	0.18%	0.10%	0.09%	0.20%	0.20%
Return on Asset (RoA)	5.6%	5.5%	6.6%	6.6%	5.6%	4.7%	4.8%	5.1%

Note: E – Estimated, P – Projected
Aggregate includes Muthoot Finance and Manappuram Finance which represents ~60% of gold loan NBFC market
Net interest income = (Interest income less interest expense) on average yearly assets; Credit cost = Impairment on financial instruments on average yearly assets; RoA = Profit after tax on average yearly assets

Source: Company reports, CRISIL MI&A

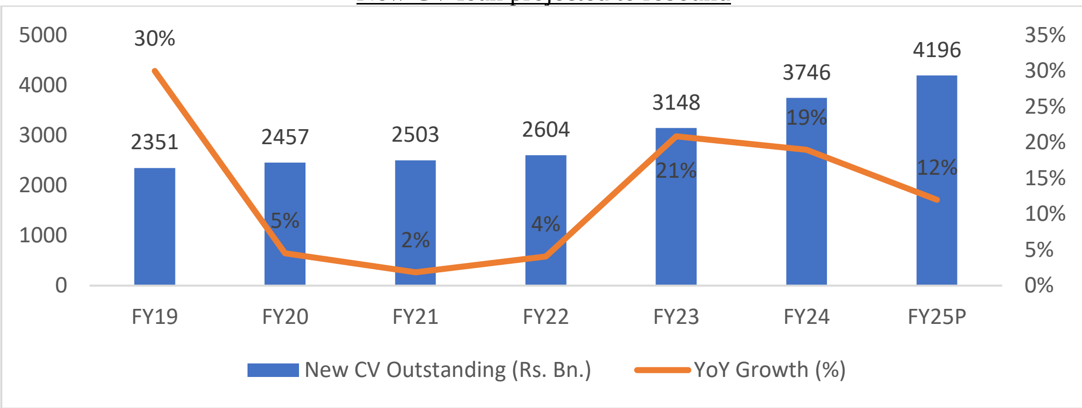
Challenges in the Consumer Finance Industry in India:

- High-Interest Rates: Consumer loans in India often carry relatively high-interest rates compared to other loan products. Achieving a balance between lender profitability and affordable interest rates for consumers remains a challenge.
- Regulatory Complexities: The consumer loans industry is subject to various regulatory guidelines and policies, which can sometimes be complex and evolving. Keeping up with changing regulations, such as those related to risk-weights, documentation requirements, and reporting, can be a challenge for lenders.
- Competition and Market Saturation: The consumer loans market in India has become increasingly competitive, with both traditional financial institutions and digital lending platforms vying for a share of the market.
- Loan Defaults and Delinquencies: Given the unsecured nature of products like personal loans and consumer durable loans, defaults and delinquencies can be a significant concern for lenders, particularly during times of economic uncertainty.

Vehicle Financing

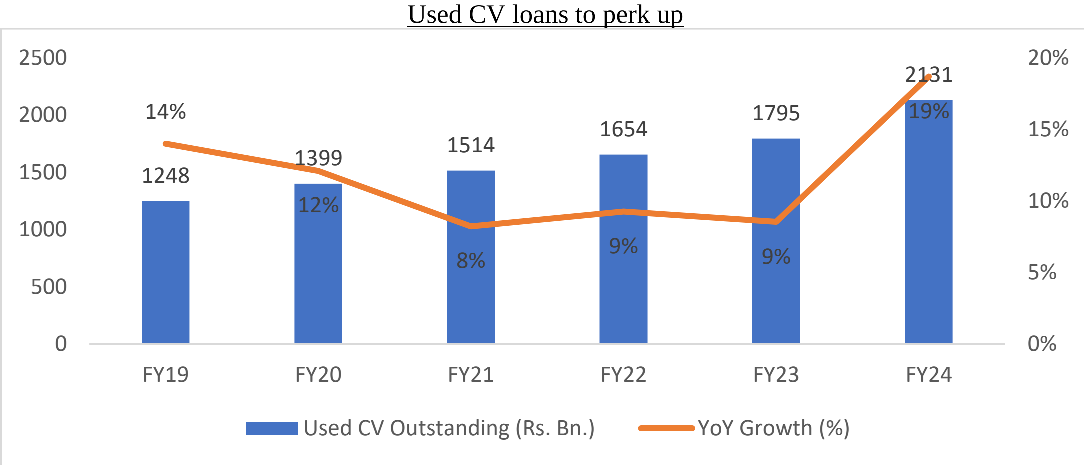
Strong bounce back in Fiscal 2023 and Fiscal 2024 in new commercial vehicle ("CV") financing

New CV loan projected to rebound



Note: P – Projected
Source: Company reports, CRISIL MI&A

Used CV loans to perk up



Source: Company reports, CRISIL MI&A

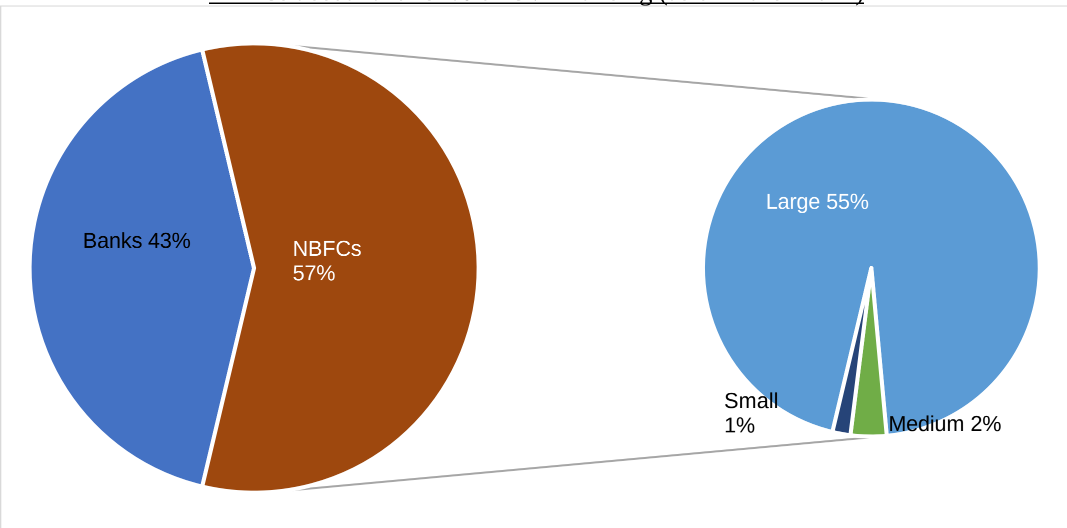
NBFC's share of CV financing stood at approximately 57% market share

NBFCs held lion's share (more than 60% share over past 6-7 years) in overall commercial vehicle financing on account of relatively superior customer connect in small fleet operators ("**SFOs**") and first time buyers customer segment, strong and deep understanding of local economy, Ease of loan processing, relatively higher loan-to-value ("**LTV**"), and higher risk-taking ability of NBFCs. Banks have sharper focus on financing LFOs based on their superior credit profiles. They also prefer big ticket financing, like that for MHCVs. While the sector has been under stress and delinquencies over past two years, the quality of the portfolio improved in Fiscal 2023 as economic activity picked up thus increasing repayment capabilities. This has enabled banks to capture market share in both LFOs and SFOs as they can offer better loan rates and higher ticket size than NBFCs.

However, as banks are more cautious in lending to riskier CV asset classes, NBFCs can maintain their strong hold and build better customer profiles. NBFCs can cater to LFOs that are more volatile and riskier than SFOs during adversities. As some NBFCs are mainly focused on CV financing, they have built a strong customer base that will support them going forward. As of March 2024, CRISIL MI&A estimates that NBFCs have a market share of approximately 57% in CV financing.

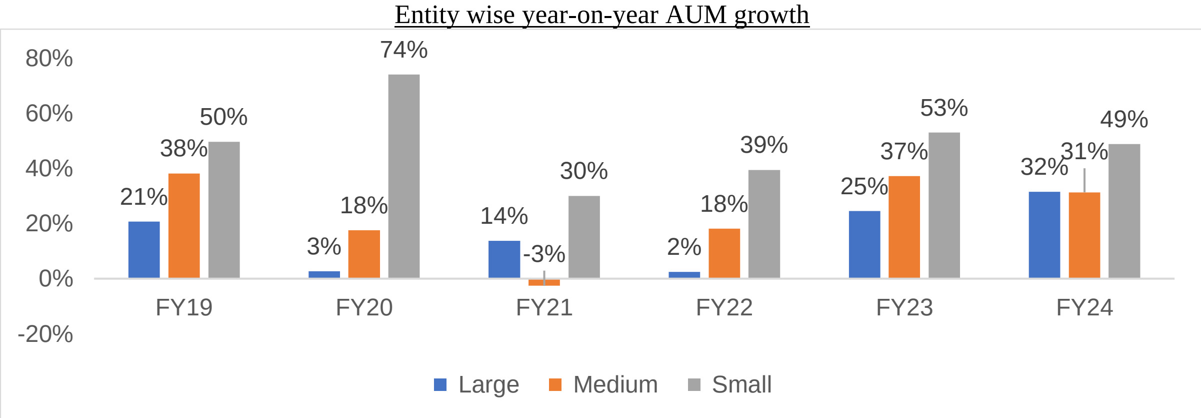
Out of the total proportion of NBFCs, few larger NBFCs such as Shriram Finance, Tata Motors Finance, Sundaram Finance, Cholamandalam Finance and Mahindra and Mahindra Finance holds majority share in overall NBFCs CV loan book (approximately 95% of NBFCs CV loan book).

NBFCs account for 57% of CV financing (as of March 2024)



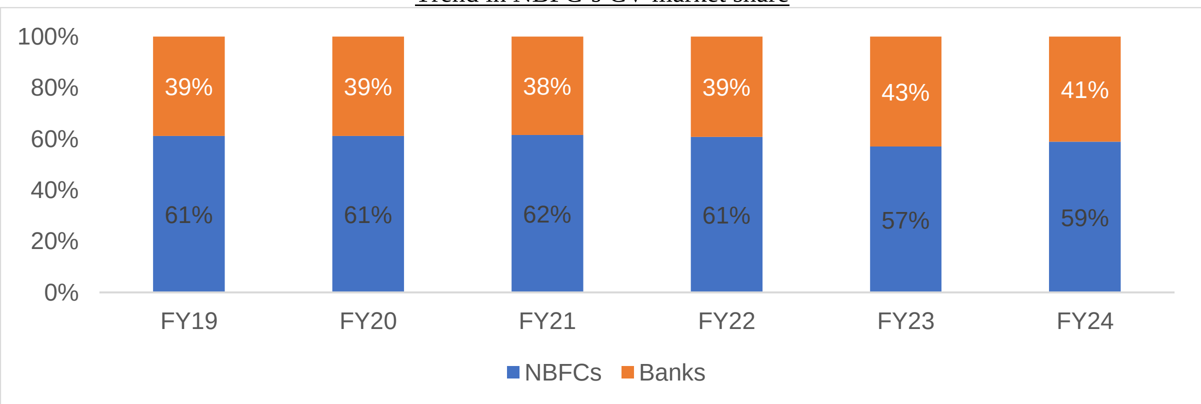
Source: Company reports, CRISIL MI&A

Entity wise year-on-year AUM growth



Note: Large NBFCs includes players having AUM more than ₹50 billion for CV finance
Mid-sized NBFCs includes players having AUM between ₹10 billion to ₹50 billion for CV finance
Small NBFCs includes players having AUM less than ₹10 billion for CV finance
Source: Company reports, CRISIL MI&A

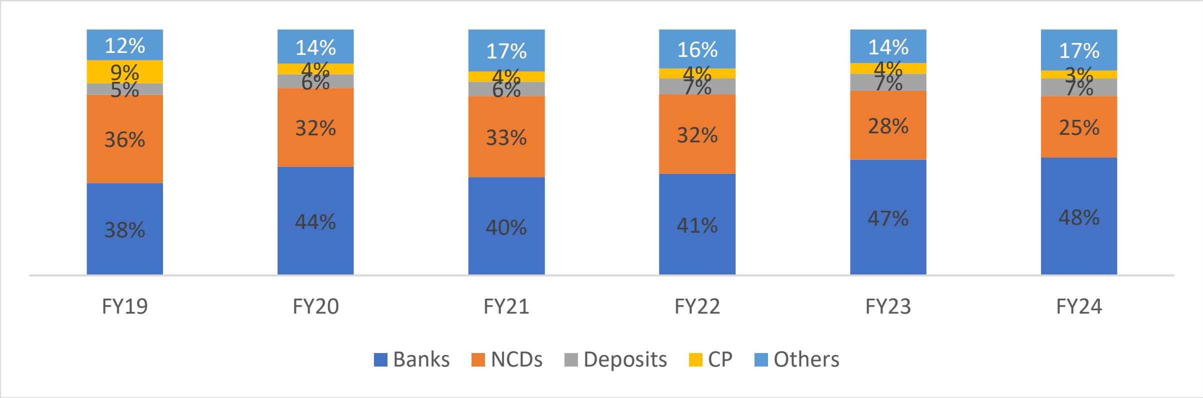
Trend in NBFC's CV market share



Source: Company reports, CRISIL MI&A

Players' dependence on bank borrowing continue to remain high

Liability profile of CV finance focused NBFC players

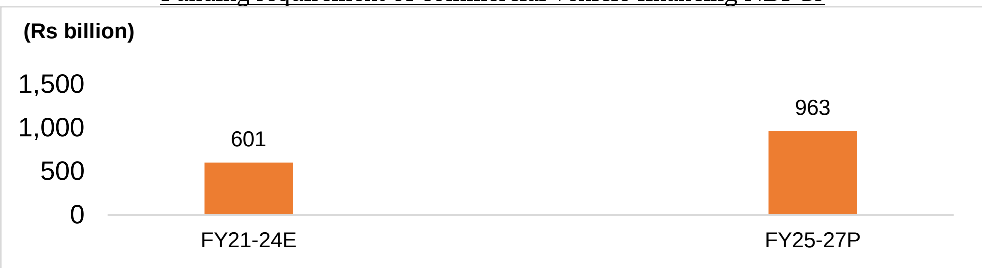


Note: For Borrowing Mix CRISIL have considered 18 players which cumulatively accounts for approximately 85% market share amongst the NBFC CV finance universe

NBFCs require capital of around approximately ₹963 billion for CV financing over next 3 years

Based on the projected growth in the CV finance portfolio, profitability, and leverage levels, CRISIL estimate that commercial vehicle financing NBFCs will require capital to the tune of around approximately ₹963 billion between Fiscal 2025 and Fiscal 2027, which will get financed through a mix of equity, debt, and securitization.

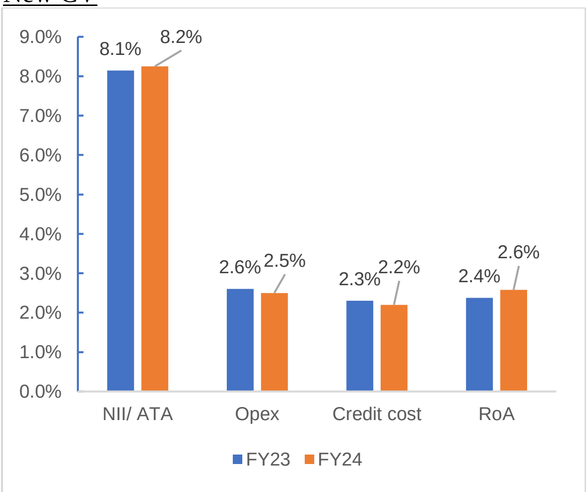
Funding requirement of commercial vehicle financing NBFCs



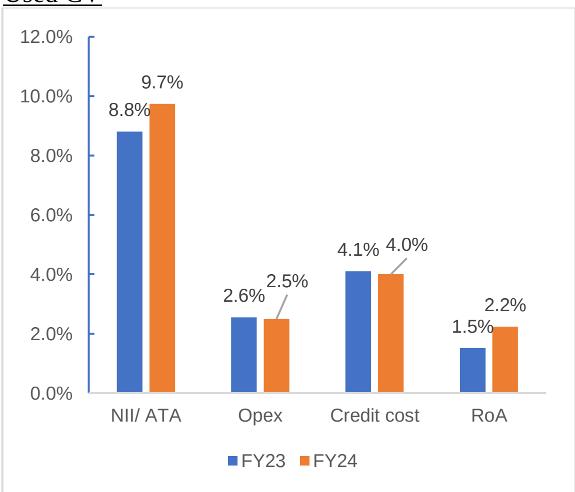
Note: E - Estimated; P - Projected
Source: CRISIL MI&A estimates

Key Profitability parameters

New CV



Used CV



Source: Industry, Company reports, CRISIL MI&A

Two-Wheeler Loans

Two-wheeler industry witnessed double-digit growth in Fiscal 2024

Two-wheeler sales witnessed substantial growth of 14% in Fiscal 2024 from Fiscal 2023 owing to increase in scooter sales as urban income sentiments improved and EV penetration increased. Under two-wheeler segment, scooters grew at a faster pace than motorcycles as urban sentiments recovered faster. Moreover, electric two-wheeler also witnessed record-high sales in Fiscal 2024. However, overall sales volume is still below the pre-pandemic levels due to significant price hikes witnessed by two-wheeler segment in last four Fiscals thereby affecting consumer sentiments.

Two-wheelers sales to improve in Fiscal 2025 due to:

- Rural demand recovery due to expected above-normal monsoon in 2024 as indicated by Indian Meteorological Department (IMD)
- Increase in consumer spending owing to rise in income levels
- Increased accessibility to financing options for two-wheelers
- Rising need for personal mobility
- Improved customer sentiments
- Increase in overall road infrastructure capex
- Expected robust festive season demand
- Multiple model launches in electric vehicles ("**EVs**") by leading original equipment manufacturers ("**OEMs**").
- Softening inflation
- Incomes catching up with price hikes and inflation

Headwinds in demand recovery could be:

- Monsoon below the expected levels
- Price hikes due to onboard diagnostic device (OBD)-II norms leading to 3-5% increase in of asset cost.

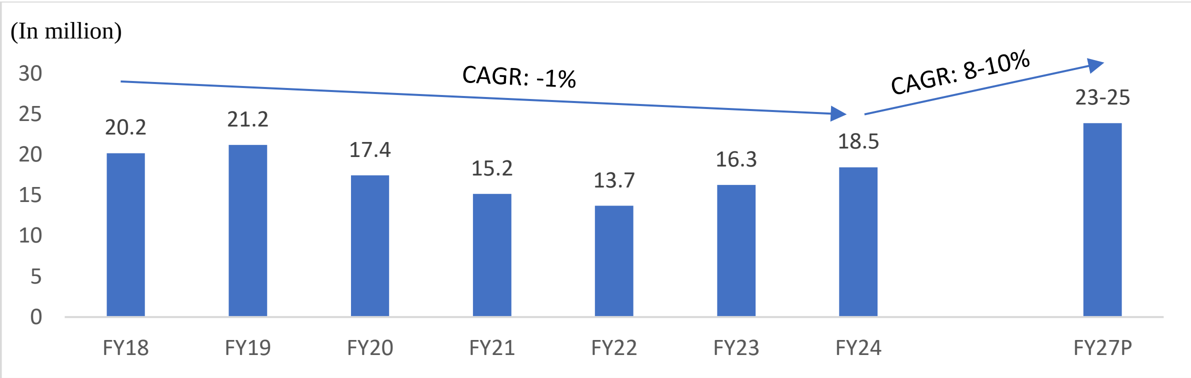
In the long-term, CRISIL MI&A expects domestic two-wheeler sales to record a CAGR of 8-10% between Fiscal 2024 to Fiscal 2027 post a robust recovery in Fiscal 2023 and Fiscal 2024. Improving rural productivity, diversification towards horticultural crops, government income support schemes and structural measures taken by the government such as PM-KISAN, eNAM, Pradhan Mantri Fasal Bima Yojna ("**PMFBY**") to name a few, will aid rural income in the long run. This is expected to drive sales of motorcycle segment, which will be a primary beneficiary of the rural growth.

Scooters are expected to witness higher penetration in the rural market (scooters have an urban market share of approximately 65-75%) which will drive growth. The consumer preference shifting towards higher 'cc' scooters (125cc) is also likely to aid demand. This is due to a ramp up seen in road construction over the last few years. However, EV penetration is going to eat up scooters market share in the long run.

Moreover, mopeds, which account for 3-5% of domestic two-wheeler sales, are expected to decline the long run. Shift in consumer preference towards other vehicle segments and EV penetration will act as key reasons impacting moped sales.

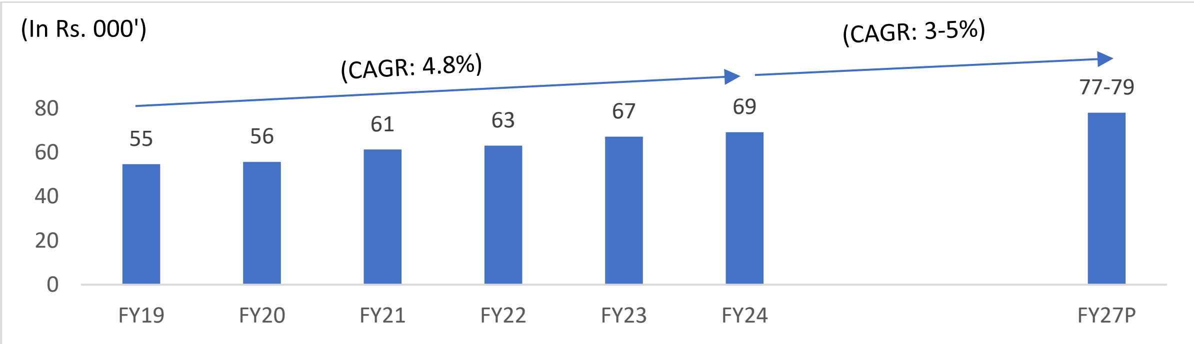
Furthermore, the EV industry and its financing are experiencing significant growth due to the escalating focus on climate change and sustainability.

Growth in two-wheeler industry sales volume



Note: P - Projected
Source: CRISIL MI&A

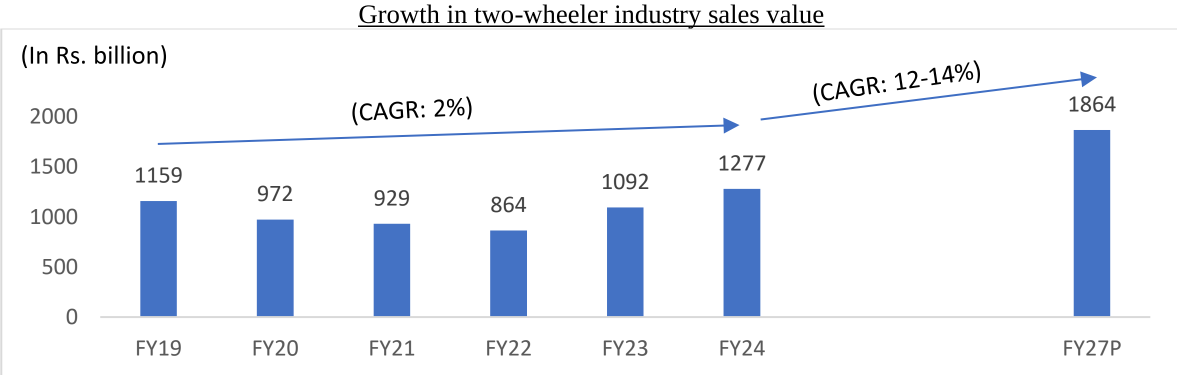
Trend in growth of average ticket size of two-wheelers



Note: P - Projected
Source: CRISIL MI&A estimates

In value terms, CRISIL MI&A project the industry sales value to grow at a CAGR of 12-14% between Fiscal 2024 to Fiscal 2027.

Growth in two-wheeler industry sales value



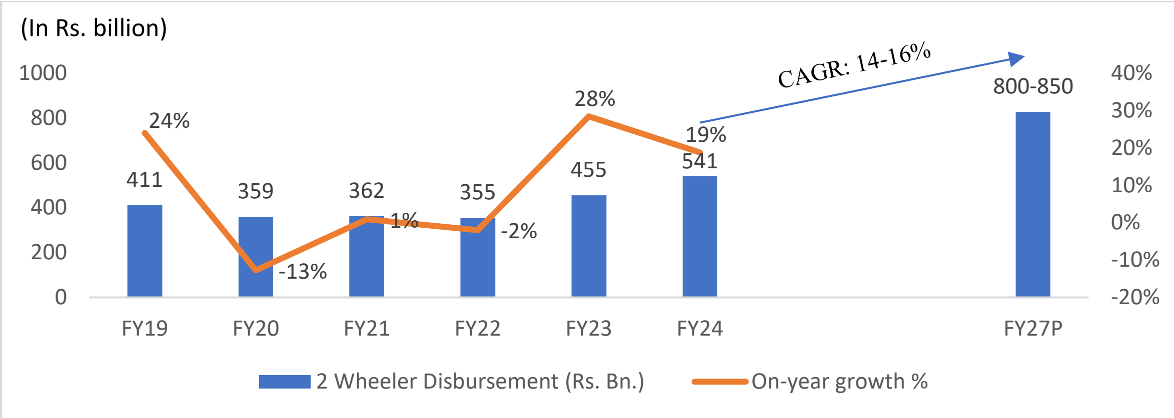
Note: P - Projected
Source: CRISIL MI&A

Two-wheeler loan disbursements expected to grow at a 13-15% CAGR from Fiscal 2023 and Fiscal 2026

Two-wheeler loan disbursements increased by 19% CAGR between Fiscals 2015 and 2020, led by an increase in average vehicle prices, considerable shift of consumer preference towards premium segments (mostly in urban areas), increasing LTV, and higher finance penetration.

Two-wheeler loan disbursement decreased by 2% in Fiscal 2022 owing to 9% fall in two-wheeler sales during the Fiscal due to increasing realisation. Two-wheeler sales increased 19% on year in Fiscal 2023 on account of recovery in scooter sales as urban income sentiments improved and rise in EV penetration. CRISIL MI&A expects two-wheeler disbursements to grow at 13-15% CAGR from Fiscal 2023 to 2026, driven by recovery in scooter sales with improvement in urban sentiments along with increase in two-wheeler EV penetration and improving rural infrastructure.

Growth in two wheeler loan disbursements



Note: P = Projected
Source: CRISIL MI&A

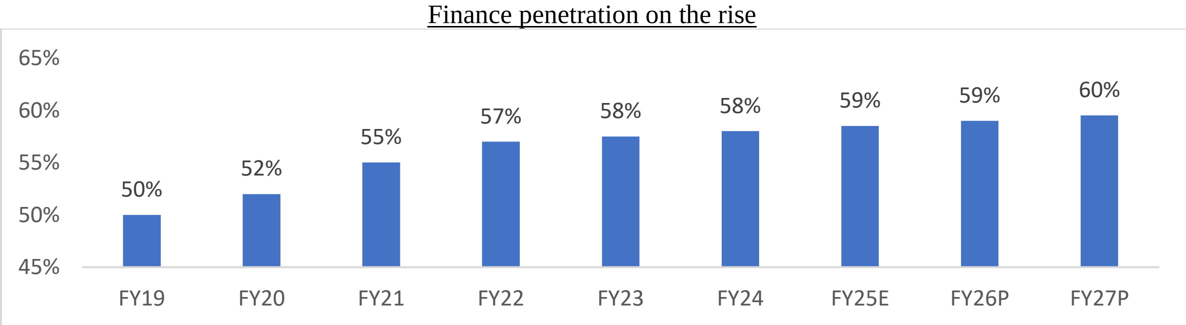
Key Industry Parameters

Finance penetration estimated at approximately 58% in Fiscal 2024

Cash transactions continue to dominate two wheelers sales, as compared with other automobile segments, given the industry's smaller ticket sizes, relatively lower-income profile of customers, high default rates, and difficulty in repossessing vehicles.

Finance penetration is estimated to have increased to around 58% in Fiscal 2024 from 50% from Fiscal 2019 due to increasing options available to customers. CRISIL MI&A project finance penetration to further increase, and cross 60% over the next three fiscal years.

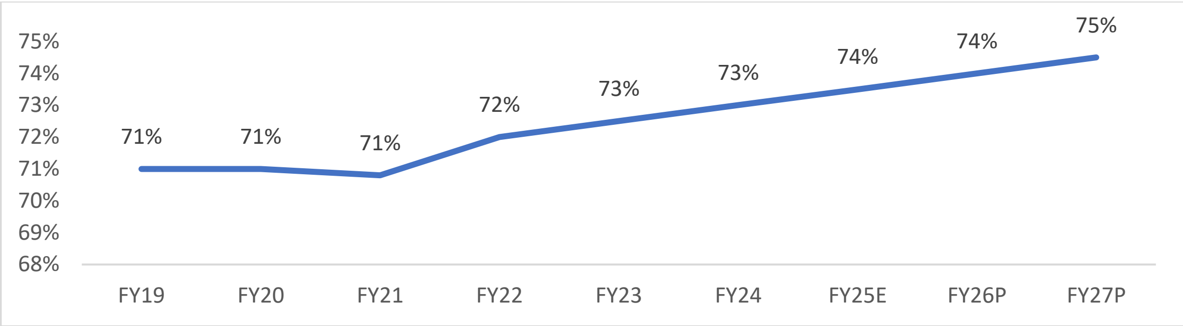
Finance penetration on the rise



Note: E – Estimated; P - Projected
Source: CRISIL MI&A

LTVs to improve in-line with demand recovery

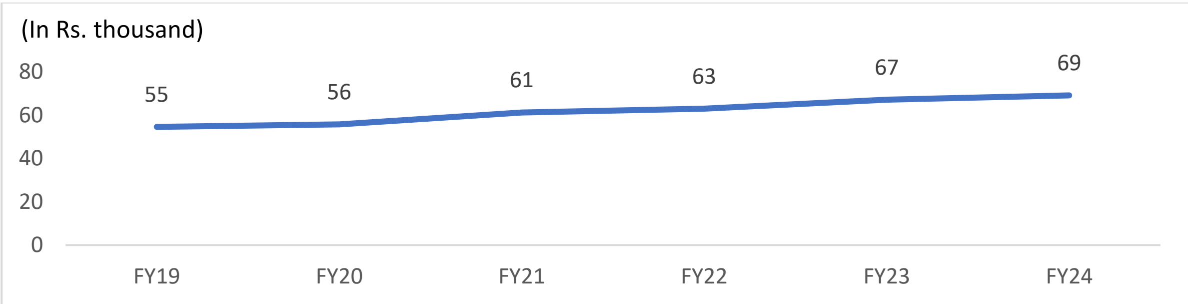
During the COVID-19 pandemic, financiers were being more apprehensive in providing two-wheeler loans. Lending was available more to customers with stable income and good track record. Post-pandemic, subdued demand owing to high-cost increase led to financiers offering a wide range of schemes and promotions like low down payment, attractive enterprise management incentive options, no charge on processing fees, etc., in order to attract more customers for small ticket size purchases. Additionally, OEMs started offering discounts across various models in order to push sales. In Fiscal 2024, retail sales of two-wheelers improved by 14% on-year after 25% jump in Fiscal 2023. This led to increase in LTV in Fiscal 2023 and marginal increase in Fiscal 2024. Going forward, LTVs are expected to increase further as demand sentiments improve.



Note: E – Estimated; P – Projected
Source: CRISIL MI&A

Increase in average ticket size on account of rising vehicle prices

CRISIL MI&A expects an increase in the average ticket size of loans, led by an increase in the average vehicle price, a considerable shift in consumer preference towards premium-segment vehicles, increasing proportion of urban people and rising LTV ratios. CRISIL MI&A estimate a further 3-5% rise in the average ticket size as two-wheeler prices increase.



Source: CRISIL MI&A

NBFCs poised to dominate two-wheeler financing on better rural penetration

The two-wheeler financing segment is increasingly becoming a stronghold of NBFCs due to their greater ability to tap rural markets by offering loans at rates much lower than those of unorganised peers. Limited presence of banks in rural markets also helps them. Major captive NBFCs in the segment are Bajaj Finance, Hero FinCorp, and TVS Credit Services, and major non-captive ones are Shriram Finance and Muthoot Capital, among others. Though weaker demand sentiments have delayed their expansion, NBFCs remain poised to dominate the two-wheeler financing segment this Fiscal as well as banks are likely to tread the space carefully.

Factors favouring banks and NBFCs:

(i) For Banks –

- Banks have a stronghold on two-wheeler financing in urban areas due to which their two-wheeler GNPAs are lower than that of NBFCs.
- Banks can offer variable interest rates based on customer credit history to attract more customers and gain share in the segment.
- As a result, pre-tax RoAs are set to remain rangebound between 4% and 5%.

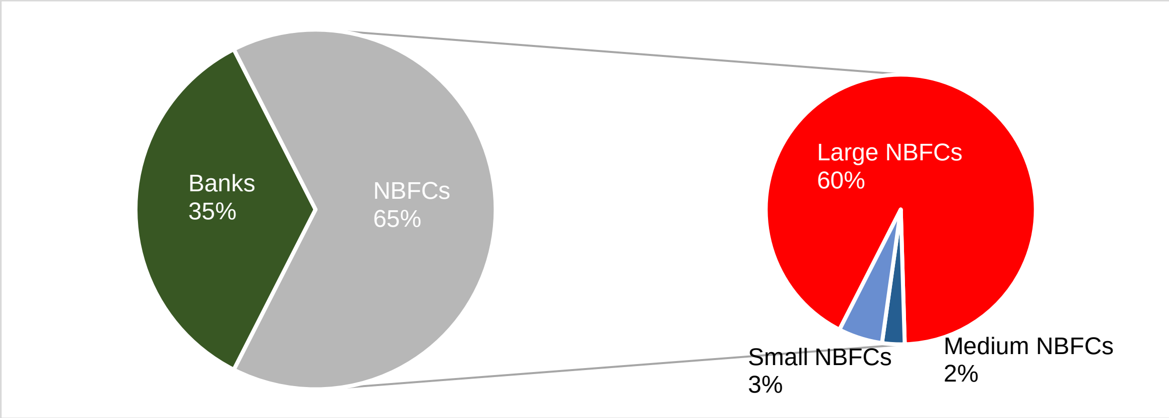
(ii) For NBFCs:

- Two-wheelers are more popular in the rural and semi-urban areas. Thus, captive players, who have a hold in these areas, can capitalise on it to increase their share.
- The under-penetrated rural market will be the key growth segment for NBFCs. Rising income will be further aided by better rural connectivity and rising participation of women in both, urban and rural areas.

NBFCs have been usurping market share from banks

CRISIL MI&A estimates NBFCs' share in two-wheeler financing to be 65% in Fiscal 2024. Financers have been offering a wide range of schemes and promotions (such as low-down payment, attractive EMI options, waiver of processing fees) to attract more customers for small ticket-sized purchases.

NBFCs account for 65% of two-wheeler financing (as of March 2024)

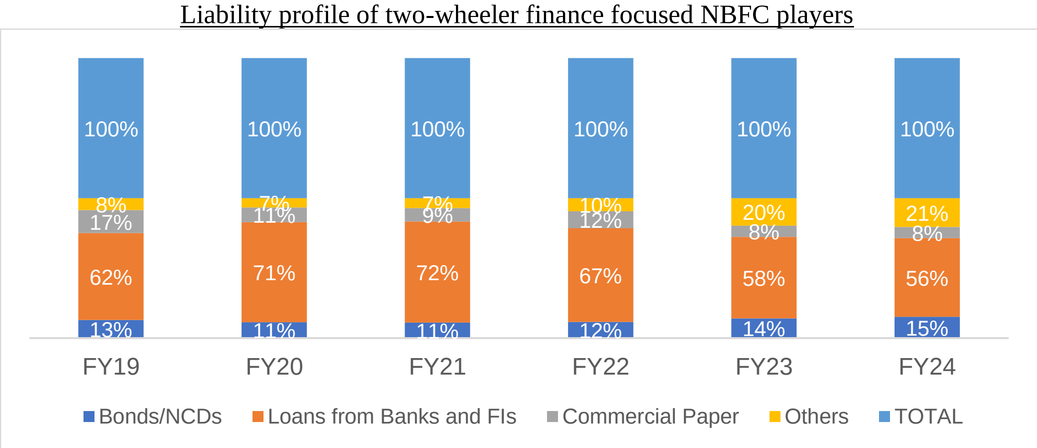


Note: Large NBFCs includes players having AUM more than ₹50 billion from two-wheeler finance
Mid-sized NBFCs includes players having AUM between ₹10 billion to ₹50 billion from two-wheeler finance
Small NBFCs includes players having AUM less than ₹10 billion from two-wheeler finance
Source: Company reports, CRISIL MI&A

Banks continue to be the support pillar for two-wheeler financing NBFCs

Going forward, bank funding to NBFCs is expected to continue to remain healthy, given the higher liquidity with banks. This will result in banks gaining further share in the borrowing mix across all NBFCs.

Liability profile of two-wheeler finance focused NBFC players

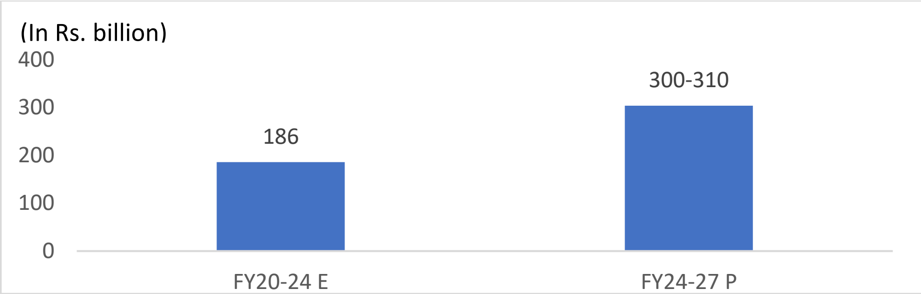


Note: For Borrowing mix CRISIL have considered 6 players which cumulatively accounts for 31% market share amongst the NBFC-Two wheeler universe
Source: Company Reports, CRISIL MI&A estimates

NBFCs require capital of around Rs 300 billion for two-wheeler financing over next 2 years

Based on the projected growth in the two-wheeler finance portfolio, profitability and leverage levels, CRISIL MI&A estimate that two-wheeler financing NBFCs will require capital to the tune of around Rs 300 billion between Fiscal 2025 and Fiscal 2027, which will get financed through a mix of equity, debt, and securitization.

Funding requirement of two-wheeler financing NBFCs



Note: E - Estimated; P - Projected
Source: CRISIL MI&A

Profitability of NBFC two-wheeler loans

Ratios	Fiscal 2020E	Fiscal 2021E	Fiscal 2022E	Fiscal 2023E	Fiscal 2024E	Fiscal 2025P
Net Interest Margin (NIM)	17.03%	16.65%	16.15%	16.81%	17.92%	18.31%
Operating Cost	6.00%	5.90%	6.05%	6.20%	6.10%	6.10%
Credit costs	4.70%	7.00%	6.50%	5.00%	4.70%	4.60%
Return on Asset (RoA)	4.24%	2.51%	2.41%	3.76%	4.77%	5.10%

Note: E - Estimated P - Projected
The above figures are estimates of overall industry
Net interest income = (Interest income less interest expense) on average yearly assets; Operating costs = Operating expenses on average yearly assets; Credit cost = Impairment on financial instruments on average yearly assets; RoA = Profit after tax on average yearly assets

Source: Company Reports, CRISIL MI&A

Challenges in the Vehicle Finance Industry in India:

- Evolving Mobility Landscape: The rapid changes in the automotive industry, such as the shift towards electric vehicles, shared mobility, and autonomous technologies, can impact the lending landscape. Lenders need to stay agile and adapt their underwriting criteria, product offerings, and risk management strategies to cater to the evolving preferences and financing needs of vehicle buyers.
- Asset Repossession and Disposal: In the event of loan defaults, lenders face the challenge of efficiently repossessing the financed vehicles and disposing of them in the secondary market. Navigating legal and regulatory frameworks, managing logistics, and ensuring a fair and transparent repossession and resale process can be complex and resource-intensive for lenders.
- Residual Value Risk: Accurately estimating the future residual value of vehicles at the end of the loan tenor is a significant challenge for vehicle finance lenders. Fluctuations in the used vehicle market, changes in consumer preferences, and technological advancements can impact the resale value, posing risks to the lender's asset valuation.

Housing finance focused on low- and middle-income housing segment

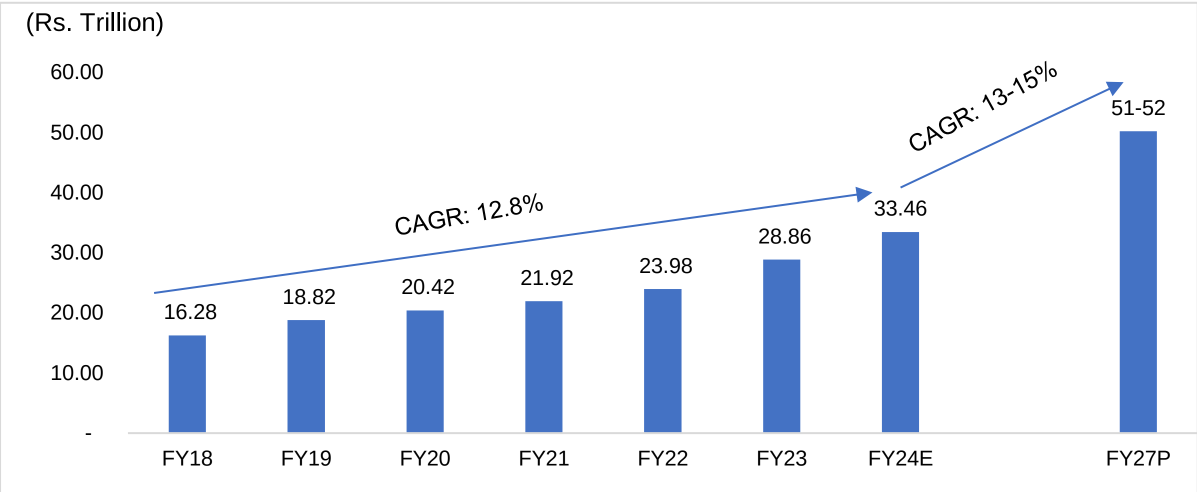
Affordable Housing finance market to double digit growth in Fiscal 2024; growth to accelerate in the next three years

In this section, housing loans with ticket size lesser than ₹7.5 million in metro regions and ₹5 million in non-metro regions have been included. Loans offered below these thresholds are referred to as housing loans focused on low- and middle-income housing segment.

The low- and middle-income segment focused housing finance market clocked a healthy approximately 13% CAGR (growth in loan outstanding) over Fiscals 2018-2024 on account of a rise in disposable income, healthy demand and a greater number of players entering the segment. As of March 2024,, outstanding loans to this segment approximated estimated at around ₹33.4 trillion.

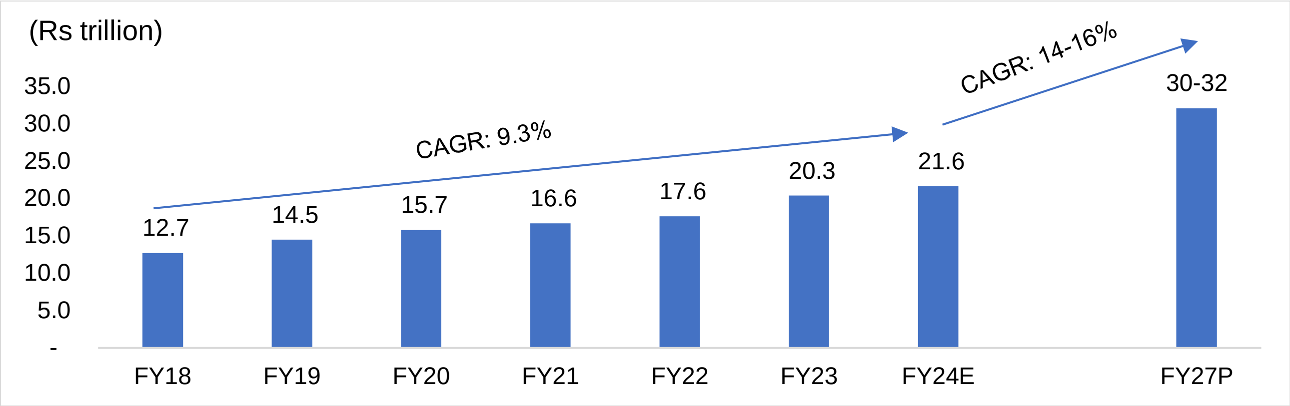
CRISIL MI&A estimates home loans outstanding (banks and non-banks) focused on low- and middle-income housing segment to grow with CAGR of 14-16% between Fiscal 2024 to Fiscal 2027. With investment demand being relatively low, demand will be largely propelled by buyers in the affordable and mid-income housing segment who are looking at a home purchase for own use.

Projected growth in outstanding loans for housing finance market



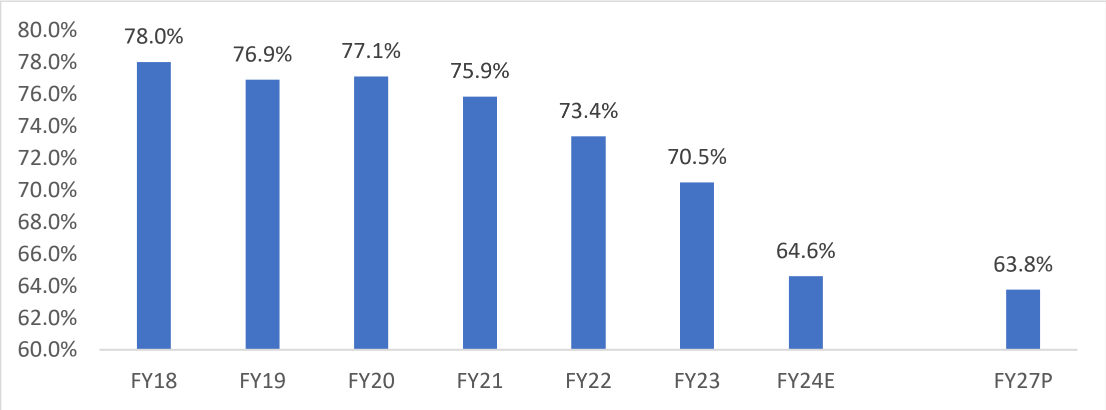
Note: E- Estimated, P- Projected
Source: Company reports, RBI, CRISIL MI&A

Projected growth in outstanding loans for housing finance market focused on low- and middle-income housing segment



Note: E- Estimated, P- Projected
Source: Company reports, RBI, CRISIL MI&A

<u>Share of outstanding loans for housing finance market focused on low- and middle-income housing segment in the overall housing finance market</u>

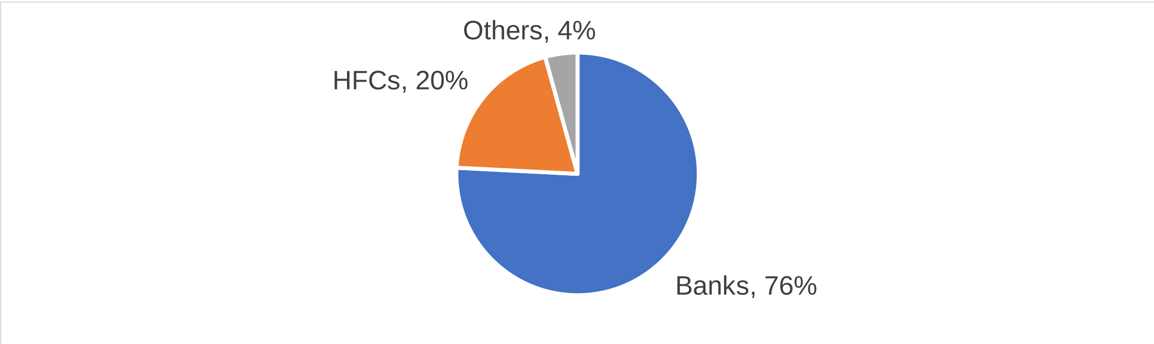


Note: E- Estimated, P- Projected
Source: Company reports, RBI, CRISIL MI&A

<u>Housing Financing Companies ("HFCs") have a market share of close to 20% in Fiscal year 2024</u>

CRISIL MI&A expects share of HFCs to decrease in Fiscal 2025 as banks will gain market share over HFCs/NBFCs, because of their competitive advantage of higher liquidity as compared to HFCs/NBFCs and their ability to offer low interest rates.

<u>Share of HFCs in low- and middle-income housing segment</u>

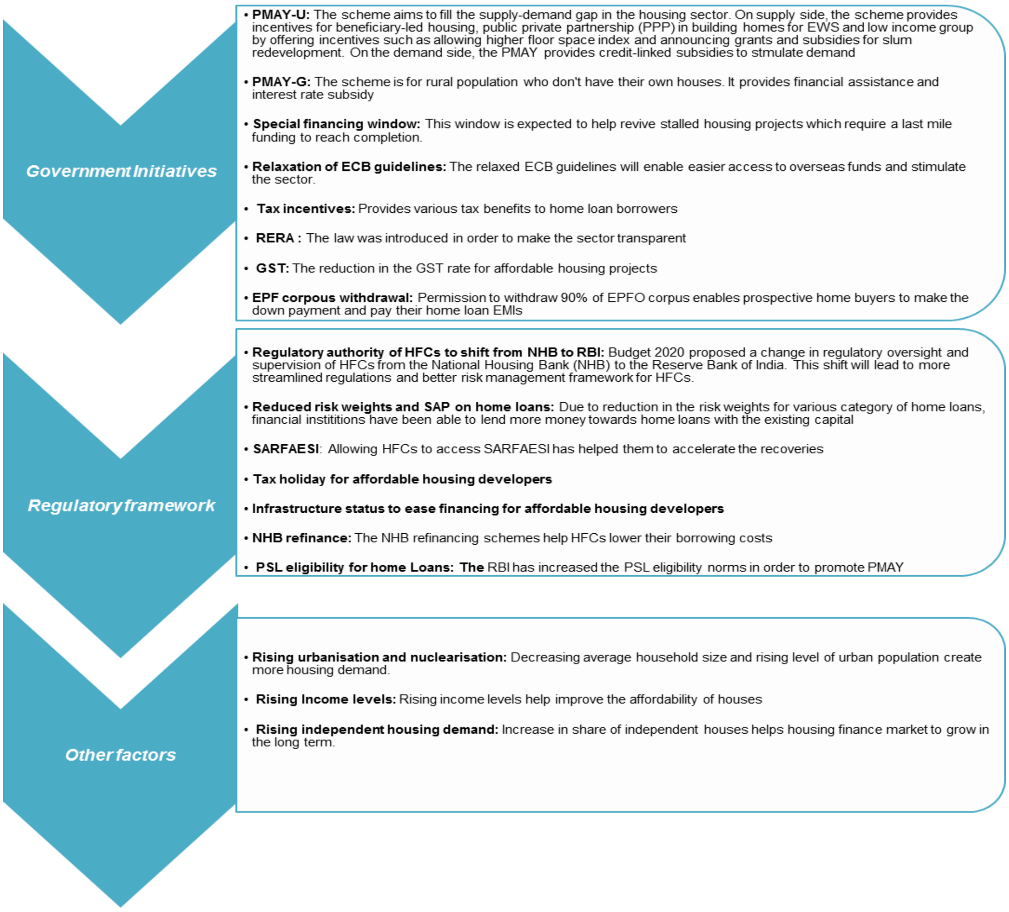


Note: E- Estimated,
Others include Small Finance Banks, NBFCs, Foreign Banks, Regional Rural Banks, and State Co-operative Banks

Source: Company reports, RBI, CRISIL MI&A

Growth drivers for housing finance

Higher transparency in the sector, increasing affordability and urbanisation, and government incentives will push up the housing finance market over the next five years.

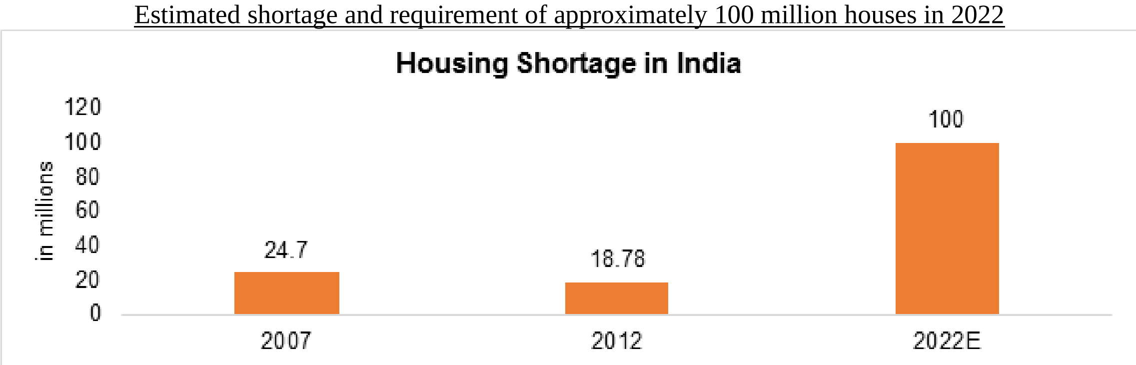


Source: CRISIL MI&A

Other factors

Housing shortage in India

Estimated shortage and requirement of approximately 100 million houses in 2022



Note: E: Estimated; Source: RBI, Planning Commission, CRISIL MI&A

Opportunity for financiers well established in Affordable Housing segment

As per the report of RBI-appointed Committee on the Development of housing finance securitisation market (September 2019), the total value of units to fulfil the entire shortage is estimated at ₹149 trillion, out of which ₹58 trillion is estimated to be the aggregate loan demand for housing.

Estimates for aggregate demand for Housing

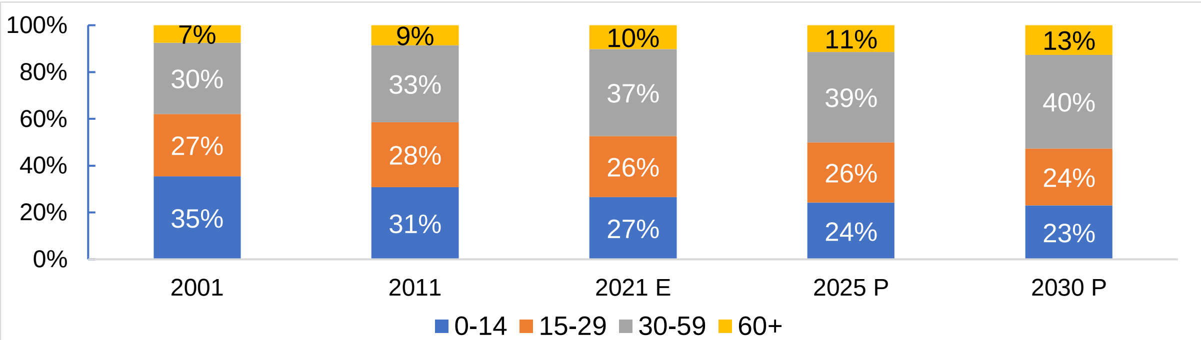
Income Segment	Housing Shortage (in million)	Avg. ticket size (₹million)	Value of Units (in ₹trillion)	LTV	Credit Penetration	Aggregate loans demand (in ₹trillion)
Economically Weaker Section (EWS)	45	0.75	34	40%	40%	5
Low Income Group (LIG)	50	1.5	75	50%	80%	30
Middle Income Group (MIG) and above	5	8	40	65%	85%	22
Total	**100**		**149**			**58**

Source: RBI Committee Discussion (Sept 2019), CRISIL MI&A

Healthy demand emanating from smaller markets: Faster growth in smaller districts and relatively muted demand for high ticket housing in metros have led to increased share of smaller districts (tier-II and below cities) in housing loans over the last couple of years.

Favourable demographic & declining age of home loan borrowers

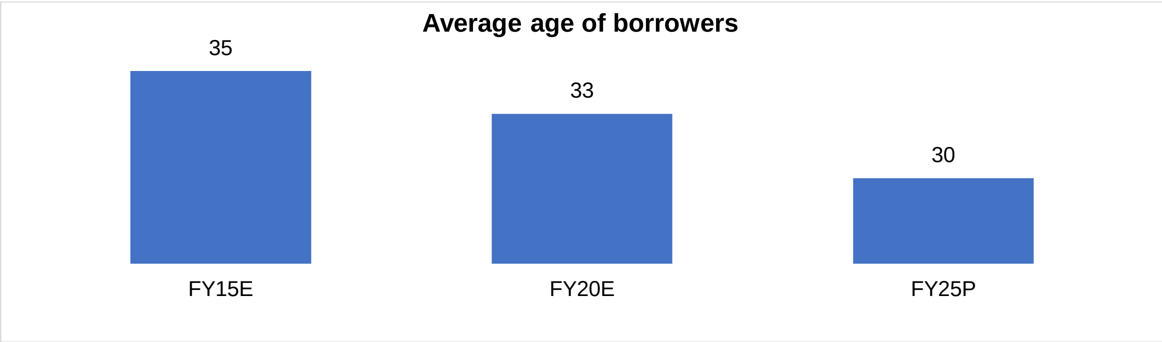
India's demographic dividend



Note: E - Estimated, P – Projected
Source: United Nations Department of Economic and Social affairs, CRISIL MI&A

Average age of borrowers has been declining over the years and was estimated at 33 years in Fiscal 2020. CRISIL expect this figure to decline further with growth in salaries and people's strengthening preference for accumulating assets, both for investment purpose and tax benefits. India's demographic profile is expected to favour the industry, leading to growth in the Housing Finance market.

Declining age of borrowers

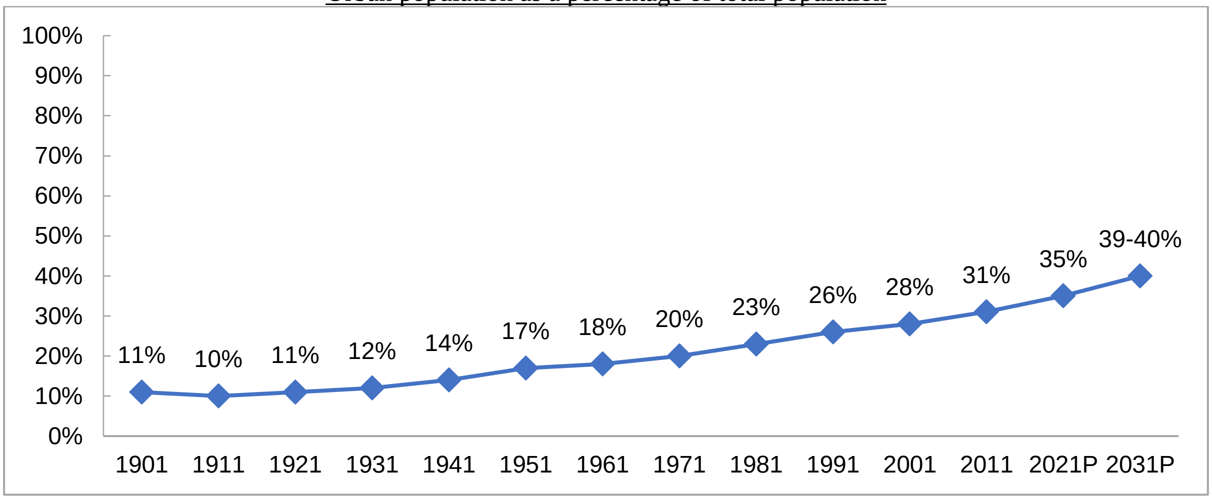


Note: E – Estimated, P – Projected
Source: CRISIL MI&A

Urbanisation crossed 35% in 2021

The share of urban population in relation to the total population has been consistently rising over the years. People from rural areas move to cities for better job opportunities, education, better life, etc. Entire families or only a few people (generally earning member or students) may migrate, while a part of the family continues to hold on to the native house.

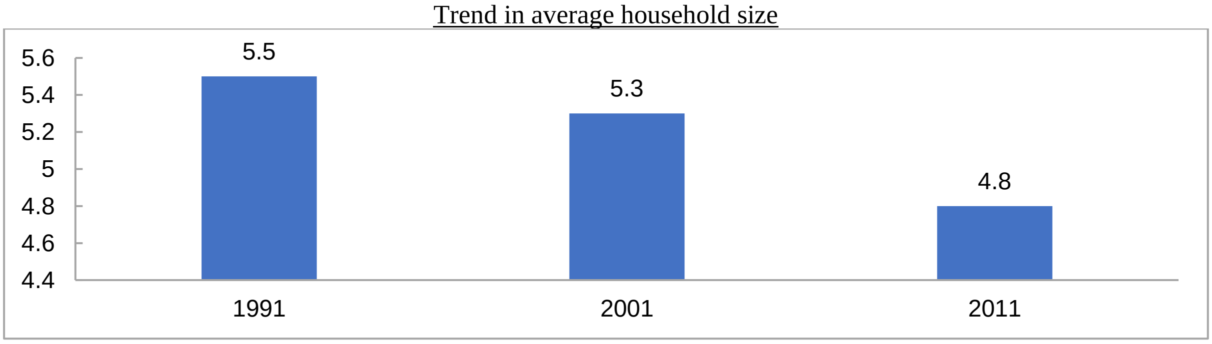
Urban population as a percentage of total population



Note: P - Projected
Source: Census 2011, World Urbanisation Prospects: The 2011 Revision (UN), CRISIL MI&A

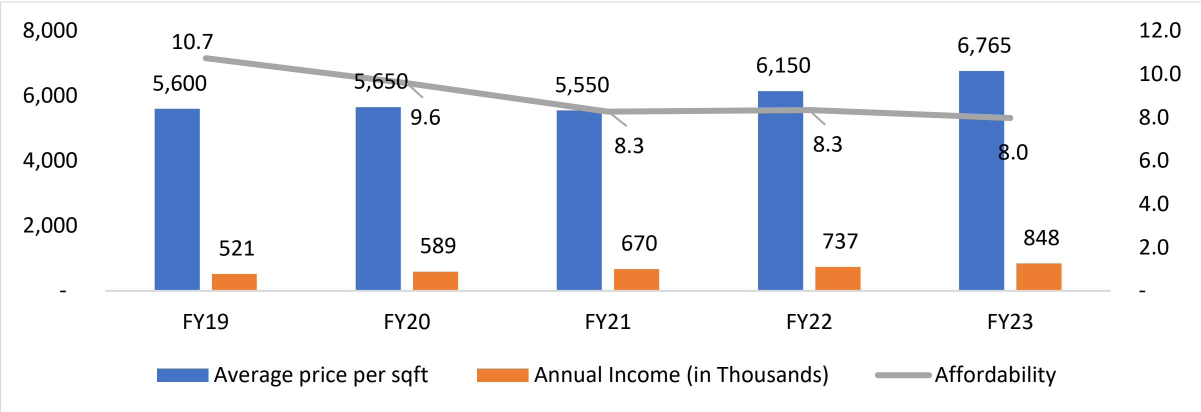
Rise in number of nuclear families leads to formation of new houses

Trend in average household size



Source: Census 2011, CRISIL MI&A

Real estate prices relatively higher though affordability has only improved historically

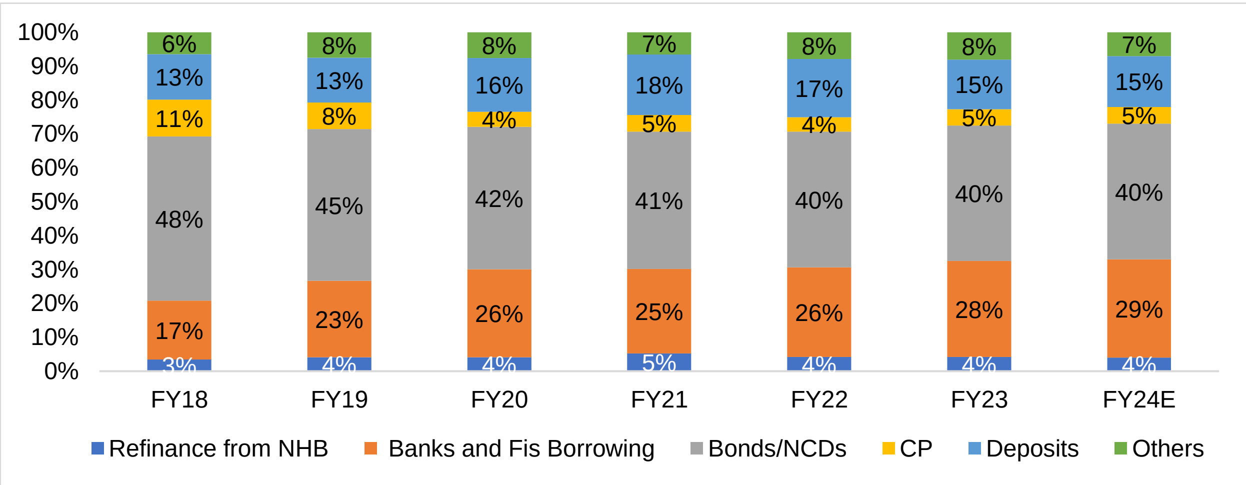


Note: The charts indicate the price per sqft based on top 10 markets - Delhi NCR, Mumbai, Pune, Ahmedabad, Chennai, Kolkata, Bangalore, Chandigarh, Hyderabad, and Kochi, at a Pan India level, the overall prices could be way lower than estimates, Affordability is computed as average price per sqft / annual income
Source: CRISIL MI&A

Banks borrowing to gain further share in the borrowing mix of HFCs

In Fiscal 2021, with the RBI aggressively cutting the repo rate, the benchmark commercial paper and NCD rates softened as well. However, despite the reversal in the interest rate cycle, risk perception stayed elevated for players with a larger non-retail portfolio and those without strong parent company support.

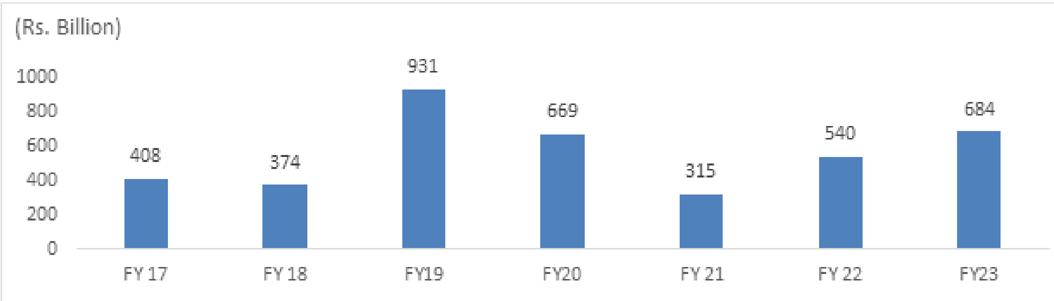
Resources mix of HFCs: Share of bank borrowings is rising as a reliable continued source of funding



Note: E- Estimated
Source: Company Reports, CRISIL MI&A

HFCs increased focus on securitization post the liquidity crisis in the middle of Fiscal 2019, as a mechanism to raise funds to meet their liquidity requirements. As a result, securitisation volumes rose to more than double the previous year in Fiscal 2019. In Fiscal 2020 too, securitization remained a preferred way for HFCs to raise funds. The volumes in Fiscal 2020 were close to ₹0.7 trillion. However, securitisation volumes tanked in the Fiscal 2021 due to increased uncertainty post the COVID-19 pandemic. Securitisation volumes recovered in Fiscal 2022 and Fiscal 2023 to ₹540 billion and ₹684 billion respectively but remains lower than the peak in Fiscal 2019.

<u>Mortgage-based securities securitization volumes spiked up post the liquidity crisis (₹ billion)</u>



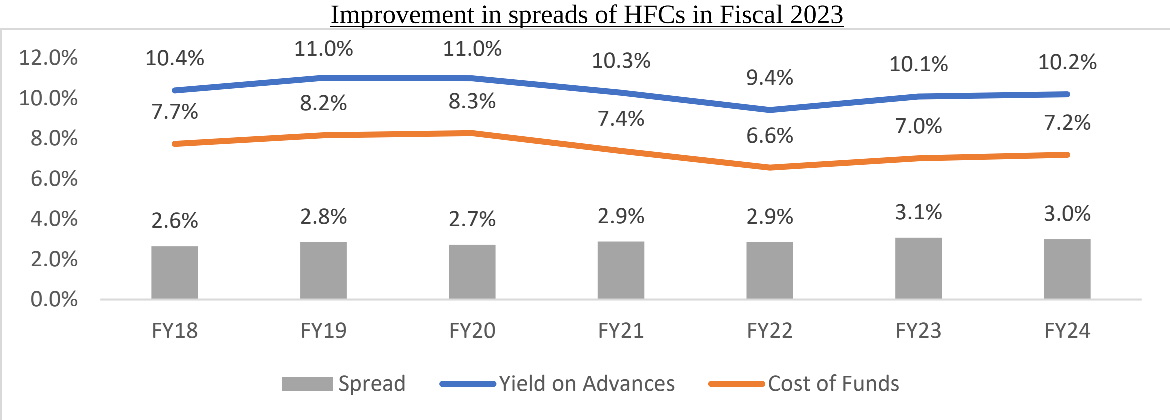
Source: CRISIL Ratings

Spread improved in Fiscal year 2023 with increase in yields and marginal rise in cost of borrowing

During the second half of Fiscal 2021, the housing market began to show green shoots owing to steps taken by the centre and state governments to boost economic activity. The yield on advances decreased 90 bps in Fiscal 2022 as well, with home loan rates at a historical low. Additionally, the RBI kept its accommodative stance and did not raise repo rates in Fiscal 2022. This helped support the 80 basis points decreases in borrowing costs. Further, this led to spreads of 2.9% in Fiscal 2022.

With the aggressive 250 basis points repo rate hike during Fiscal 2023, the yield on advances have increased approximately 70 bps and cost of funds approximately 40 basis points, leading to spread margins improving to 3.1%. As of Fiscal 2024, yield on advances is around 10.2% with marginal increase in cost of funds.

<u>Improvement in spreads of HFCs in Fiscal 2023</u>

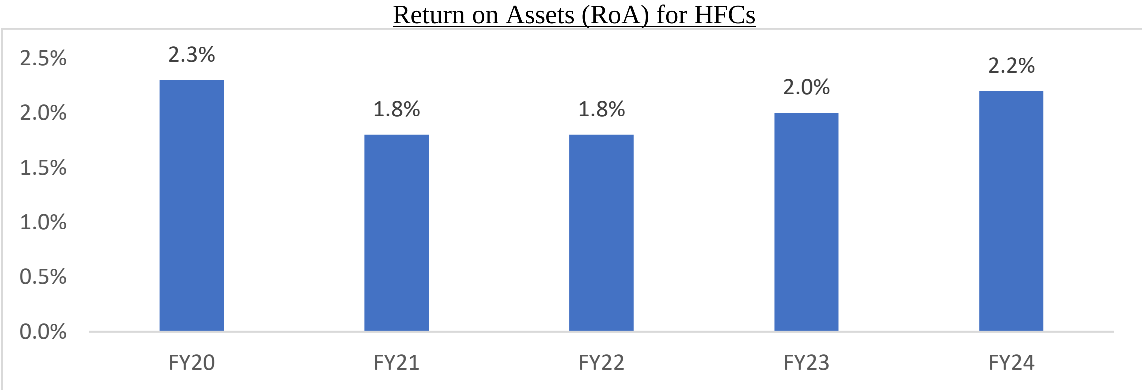


Source: NHB, Company reports, CRISIL MI&A

HFCs RoA improved marginally in Fiscal 2023; to further improve in the next Fiscal

The return on assets for HFCs have improved by approximately 20 basis points in Fiscal 2023 and Fiscal on account of increase in their spreads and lower credit costs. In Fiscal 2025 too, the profitability for HFCs is expected to improve to approximately 2.2-2.3% on account of marginal decrease in credit cost.

<u>Return on Assets (RoA) for HFCs</u>



Source: Company reports, CRISIL MI&A

HFCs may need incremental funding of over ₹3.6 trillion for future growth

In between Fiscal 2020 and Fiscal 2024, HFCs have increased their loan portfolio of housing loans catering to the low and middle income housing segment by approximately ₹1.9 trillion and have raised ₹2.3 trillion to achieve growth as well as cover credit cost during the period. There has also been a large growing investor interest in this sector, with most HFCs raising equity capital.

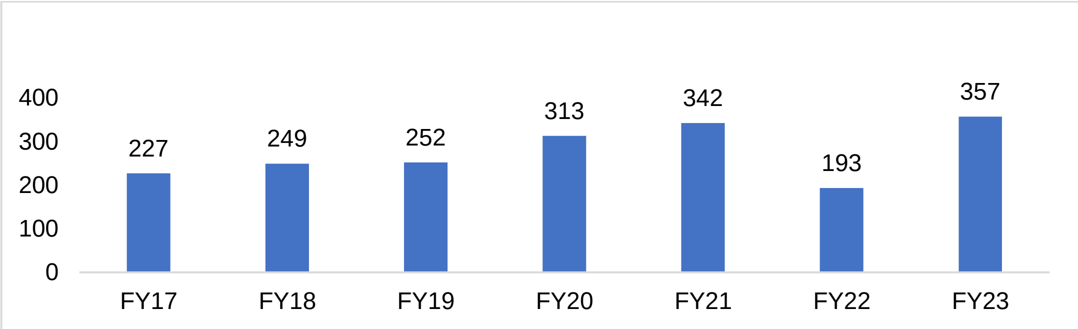
Furthermore, Housing Finance players are increasingly using digital field applications and credit scoring platforms to improve customer experience, reach out to newer customer segments and enhance operational efficiency. Financiers in recent times have partnered with various technology providers in order to gain efficiency in sourcing of loans by using customer level data analytics tools, which helps them in generation of leads.

Therefore, based on the projected growth in loans, their profitability and leverage levels, CRISIL estimate that HFCs will require capital to the tune of around ₹3.6 trillion between Fiscal 2024 and Fiscal 2027, which will get financed through a mix of equity, debt, and securitization.

Funding requirement for HFCs (₹ billion)

Note: E - CRISIL MI&A Estimates, P - Projected
Source: CRISIL MI&A

Refinance Disbursement by NHB across all entities (₹ billion)



Source: NHB, CRISIL MI&A

Key Risks in the Overall Housing Finance Industry

- Economic Scenario: Any trends or events that have a significant impact on India's economy, including a rise in interest rates, could impact the financial standing and growth plans of HFCs. A decline in the interest rate with strong growth in the economy will boost the purchasing power of people, thus boosting demand for houses and housing loans. When the government introduces rules and regulations such as the Benami Transactions Act, establishes bodies such as the Real Estate Regulatory Authority, or takes decisions such as demonetisation, all to control illegal activities and curb black money, demand for housing and housing loans takes a hit.
- Insufficiency of data for credit appraisal: Credit-score availability in India is still at a nascent stage despite the presence of credit bureaus. In several cases, borrowers lack a formal proof of income documents. This makes it difficult to judge the ability of the borrower to repay.

- Liquidity Risk: The apartment culture has still not developed in many of the semi-urban and rural areas, leading to financing of individual properties. This makes it harder to sell a property that is built according to the needs of the borrower. Also, in rural areas, it may become difficult to find a buyer for a repossessed property due to cultural issues. All this leads to liquidity risk.
- Collateral Fraud: The rising number of collateral frauds in the sector is becoming a serious issue. As a result, lending institutions are being forced to implement additional control measures, which increase their underwriting expenses.
- Delay in project approvals and construction: The cash flows of HFCs are largely dependent on the timely completion of projects in which their customers have bought housing. If the project gets delayed, the borrower may start defaulting on loans. Additionally, project delays also tend to impact growth in the loan book.
- Thin spreads in Housing Finance: HFCs face a risk of thin net interest margins due to lower interest rates in the segment as compared to other asset classes like MSME loans, vehicle financing etc. This is further aggravated due to intense competition in the segment among HFCs, banks and NBFCs.
- Asset Liability Mismatch: Housing finance faces significant ALM challenges, arising due to inherent mismatch between the long-term nature of housing loans and the shorter-term funding sources used by housing finance companies (HFCs). This creates a maturity mismatch, where assets have longer durations than liabilities

Agriculture value chain Finance

Agriculture value chain finance estimated to grew at 7% CAGR between Fiscals 2019 and 2024

CRISIL estimates agri-lending to have grown at a healthy pace (13%) due to 9-10% increment in agriculture target from ₹16.5 trillion in Fiscal 2022 to ₹18 trillion in Fiscal 2023 and estimated credit growth in agri-ancillary activities like food processing, setting up agri-clinics and agri-business centres. While growth remained moderate in Fiscal 2023, it is estimated to have grown year on year at 9% in Fiscal 2024. This can be attributed to agri-credit target for Fiscal 2024 which was set to ₹20 trillion with major focus on agri-allied sectors. The highest share of institutional credit (towards agriculture sector) goes towards pre-harvest activities, followed by infrastructure financing as of Fiscal 2024. Increase in agriculture production capacity, rising demand for food and processed goods, and entry of organized players in the market are expected to push credit demand for post-harvest financing as well.

NBFCs are mainly present in the farm mechanisation and infrastructure finance. Post-harvest financing, which includes warehouse receipt finance as well as loans for food and agro processing loans, is another space where NBFCs are increasing their presence continuously and has strong growth potential in the coming years.

CRISIL MI&A estimates that the commodities (with the exception of perishables like fruits and vegetables) are held by various participants of the agriculture value chain for an average period of 6-9 months in a year. However, due to the seasonality factor, the peak funding requirement arises during the harvest time (from September to February), which CRISIL MI&A estimates to be 1.5 times of the average funding requirement in a year availed by all participants in the agriculture value chain.

Pre harvest Finance

- Short term loans for production of crops
- Includes loans for seeds, fertilizer, labor, plantation and horticulture etc.
- Tenure is one crop season

Infrastructure Finance

- Short term or long term loans
- Include loans for farm mechanization, land development, warehouse development and development of water resources
- Tenure is one crop season to 18 months

Allied activities financing

- Short term loans
- Loans towards animal husbandry, poultry, sheep rearing, dairy etc.

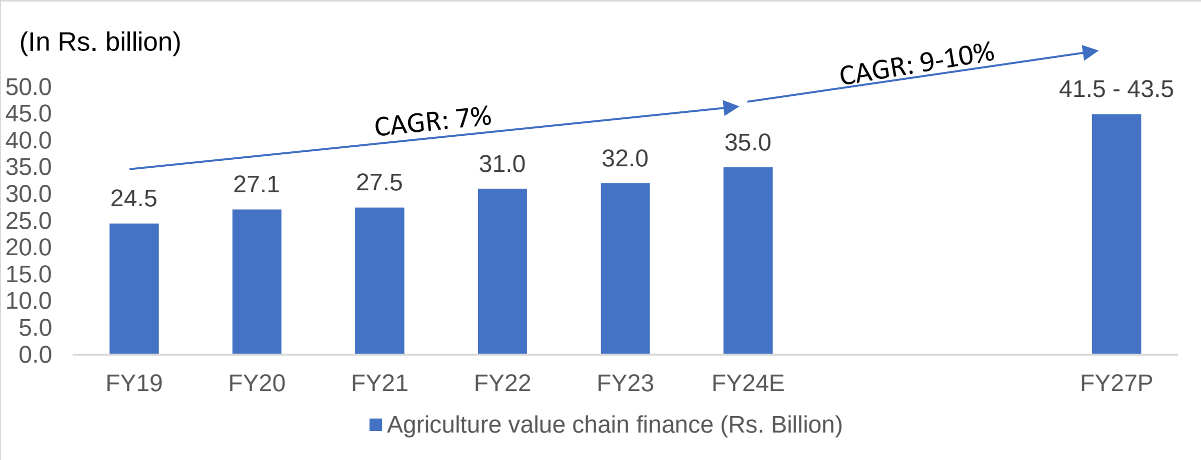
Post Harvest Finance

- Short term or long term loans
- Includes credit for warehouse receipt and food agro processing units
- Tenure is one crop season to 18 months

Agriculture supply chain finance provided by NBFCs to grow at 9-10% CAGR in next 3 years

Indian agriculture industry has been witnessing a shift towards technology-intensive supply chain solutions which involves usage of cutting-edge tech solutions based on artificial intelligence, internet of things, blockchain, etc. Adoption of such tech-based solutions in agriculture supply chain will further increase the need for credit going ahead.

We are also likely to witness increase in finance penetration in across agriculture value chain due to increase in organised players and technology use.



Note: E – Estimated, P - Projected
Source: Company reports, CRISIL MI&A

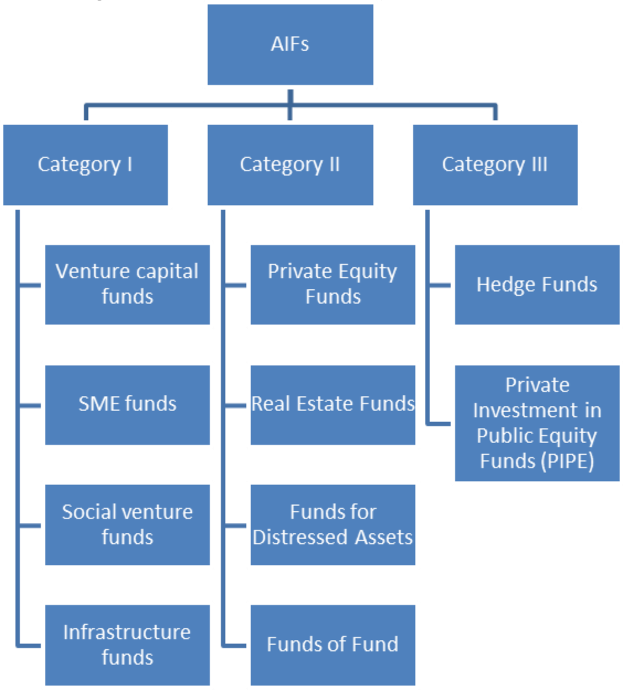
Challenges in Agriculture value chain Finance Industry in India

- Inconsistent or changing regulations across states can make it difficult for financial institutions to develop standardized products and services.
- The inherent risks in the agricultural sector, such as weather uncertainties, price volatility, and crop failures, make it challenging for lenders to accurately assess and mitigate these risks.
- The fragmented nature of agricultural value chains, with numerous intermediaries and limited direct linkages between farmers and end-consumers, makes it difficult to assess the creditworthiness and cash flows across the value chain.
- Capacity building programs for both farmers and financial institutions are crucial to bridge the knowledge gap and facilitate better decision-making.

Alternative Investment Funds ("AIFs")

Alternative assets include equity, private equity, private debt (dealing mainly in performing credit, distressed assets, real estate credit, and infrastructure funds), early-stage ventures, special opportunity funds, and art. However, it does not include traditional investments, such as mutual funds and life insurance. Equity AIFs cater to the ultra-high net worth individuals ("**UHNI**")/ high net worth individuals ("**HNI**") clients and compete with equity PMSs for the wallet share of such clients.

According to Securities and Exchange Board of India ("**SEBI**"), AIFs are classifies in three broad categories:



AIF has gained strong traction in recent years

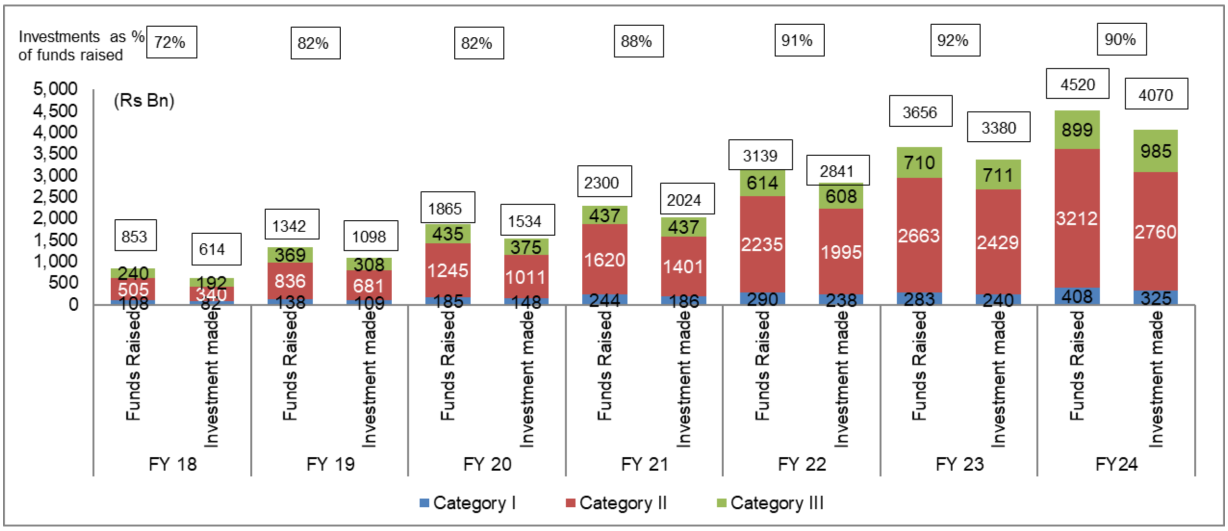
In recent years, AIFs have gained significant attraction due to its ability to generate higher returns for UHNIs/HNIs by investing in funds such as real estate funds, venture capital funds and start-up funding, as well as enabling investors to take exposure to specific themes such as private debt focused on entities focused on financial inclusion.

The growth in AIF industry could be attributed to the surge in investment activities and fund raising in India along with support from regulatory reforms brought by SEBI. As of March 31, 2024, there were approximately 1,300 AIFs overseeing over ₹11.35 trillion in investor commitments, as against approximately 300 AIFs with ₹0.84 trillion in commitments as of March 31, 2017, reflecting an impressive CAGR of approximately 45% during the period.

Despite such a strong growth in AIF, India's AIF market is still underdeveloped as compared to rest of world. For example, in 2019, the AIF industry size in the U.S. was USD10.3 trillion. The key factors for the underdeveloped AIF market in India are higher investment ticket size and higher returns from traditional investment options. The higher investment criteria keep a large number of potential investors away from AIF market, which in turn could bring in higher amount of funds.

Pension funds and insurance companies are expected to increase their allocation to private debt as AIF market matures and generates higher yields as compared to traditional asset class. Furthermore, offshore funds and UHNIs/HNIs are expected to continue to bring in additional funds for higher returns.

Investment made in AIFs have increased significantly



Source: SEBI Statistics, CRISIL MI&A

Around 71% of fund raised by AIFs as on March 2024 are under Category II funds, which includes real estate funds, private equity funds and debt funds. Category III funds were able to raise funds of around ₹899 billion which is 20% of overall fund raised by AIFs as of March 2024. Category III funds are permitted to invest in commodity derivatives until 10% of Investible funds and they are also allowed to leverage up to two times.

Player-wise total AUM and number of AIF Funds

Sr. No	Firm Name	Year of incorporation	Total AUM (INR Crores)	No. of Funds	Sectoral Focus
	Domestic fund managers				
1	Northern Arc Investments	2014	INR 3000+ Crores	10	Financial inclusion
2	Anicut Capital	2015	INR 2000+ Crores	5	Consumer Discretionary, Education/Training, BFSI, Healthcare, Retail
3	Vivriti Asset Management	2017	INR 1994 Crores	9	Financial inclusion
4	Centrum Alternatives	2017	NA	NA	Retail financial services, chemicals, metals, building materials, healthcare, packaging,
	Key offshore fund managers/ investors with Indian operations				
1	BlueOrchard Finance	2001	USD 11.0+ billion	Multiple funds with a global emerging markets coverage	Financial inclusion, climate, education
2	Triodos Investment Mgmt.	1980	EUR 5.7 billion	Multiple diversified regional funds	Climate and energy, microfinance, sustainable trade, organic food and agriculture, arts and culture, sustainable real estate
3	ResponsAbility Investments AG	2003	USD 4.0+ billion	Multiple diversified regional funds	Agribusiness, Energy and Utilities, Environmental Services, Financial Services, Food, Renewable Energy
4	Developing World Markets	1994	USD 2.7+ billion	Multiple funds with a global Emerging Markets coverage	Agribusiness, Education/Training, Energy and Utilities, Financial Services, Real Estate, Renewable Energy

Sr. No	Firm Name	Year of incorporation	Total AUM (INR Crores)	No. of Funds	Sectoral Focus
5	Triple Jump	2006	EUR 2.2 million	Multiple diversified regional funds	Diversified, Agribusiness, Energy and Utilities
6	Incofin Investment Mgmt.	2009	USD 1.2 Bn	Multiple funds covering 65+ countries	Financial inclusion, agribusiness
7	Caspian Impact Investments	2005	INR 2,000+Crores	Caspian Impact Investments	Agtech, Clean Tech, EdTech, Electric & Hybrid Vehicles, Financial Inclusion, FinTech, HealthTech, IoT (Internet of Things)

Note: AUM – Assets Under Management
Players are arranged as per AUM size
Source: Data sourced from company websites as of June 2024, Rating Rationale, CRISIL MI&A

Growth drivers of AIF Industry in India

<u>RBI allowance of foreign investment</u>

Category III AIF with foreign investment are permitted to make portfolio investments in only those securities or instruments in which an FPI can invest under the Foreign Exchange Management Act, rules or regulations made thereunder. In May 2021, SEBI, in consultation with RBI, doubled the overseas investment limit for AIFs from USD750 million to USD1500 million.

<u>Simplification of procedures</u>

AIFs set up in Gujarat International Finance Tec-City ("**GIFT City**") only require approval from International Financial Services Centre ("**IFSC**") and not the four regulators. IFSC has permitted higher leverage level for Category II funds with the consent of the fund's investors. Additionally, the IFSC has offered flexibility to fund the managers' and investors with regards to co-investment and diversification norms for fund portfolio.

<u>GIFT City</u>

GIFT City AIFs have several preferential rules concerning single window clearance, leverage, diversification restrictions, absence of SEBI approval for investments outside India as well as deal structuring and capital allocation.

Challenges in AIF Industry in India

<u>Regulatory Uncertainties</u>

Evolving regulatory framework and frequent changes in guidelines by the Securities and Exchange Board of India (SEBI) can create uncertainty for AIF industry and its investors. Clarity and consistency in the regulatory environment are essential for the growth and development of the AIF industry.

<u>Limited Investor Base</u>

The AIF industry in India has a relatively narrow investor base, primarily comprising institutional investors and high-net-worth individuals (HNIs).

<u>Fund Raising Challenges</u>

AIF managers often face challenges in raising capital, especially for niche or specialized investment strategies, due to the perceived higher risks and lack of track record.

Liquidity and Exit Challenges

The limited secondary market and exit options for AIF investments can pose challenges for investors, especially those seeking liquidity before the fund's maturity.

Climate financing

The climate financing industry in India has gained significant momentum over the years and the Indian government is actively supporting and investing in renewable energy which has led to significant growth in the renewable energy sector. As of March 2024, the two leading power financing companies in India boasted gross loan assets of ₹992 billion towards renewable energy sector, underscoring not just their current standing but also signalling the vast potential for expansion in other climate financing aspects. This robust foundation and continued governmental backing position the sector for further sustainable development and environmental impact.

An overview of the climate financing industry in India:

- Renewable energy investment: India has become a global leader in renewable energy investments, particularly in solar and wind power. India's installed non-fossil fuel capacity has increased more than 4 times in the last 10 years and stands at more than 191.679 Giga Watts (including large Hydro), about 43% of the country's total capacity (as of April 2024). The installed solar energy capacity has increased by more than 29 times in the last 10 years and stands at 82.64 GW as of April 2024. The installed Renewable energy capacity (including large hydro) has increased by around 128% since 2014.
- Sustainable agriculture: Agriculture remains a cornerstone of the Indian economy. Climate financing in the agricultural sector is directed towards promoting sustainable farming practices, improving irrigation techniques, and enhancing resilience to climate change impacts. Government programs like the National Mission for Sustainable Agriculture aim to support these initiatives.
- Emission reduction projects: India has been actively involved in emission reduction projects, including afforestation, reforestation, and energy-efficient technologies. Initiatives under the Clean Development Mechanism and programs like the Perform, Achieve, and Trade scheme have been crucial in reducing carbon emissions.
- Green bonds: Indian corporations and financial institutions have increasingly issued green bonds to fund climate projects. These bonds are designed to raise capital specifically for environmentally friendly projects. SEBI has issued guidelines for green bonds to promote transparency and accountability.
- International climate finance: India has also been a recipient of international climate finance, including funds from the Green Climate Fund and bilateral agreements with countries like Germany, Japan, and the United Kingdom. These funds are used to support various climate projects and enhance climate resilience in the country.

Challenges in the Climate Financing Industry in India:

- Policy uncertainties: Despite positive steps, policy uncertainties at both the state and national levels can deter investors. Clarity in regulatory frameworks and consistent policies are needed for sustained growth in climate finance.
- Access to finance: Small and medium-sized enterprises and rural projects often struggle to access climate finance. Ensuring inclusivity in funding mechanisms remains a challenge.
- Climate risks: India's susceptibility to climate change impacts, including floods, droughts, and extreme weather events, poses unique challenges. Assessing and mitigating these risks are vital for climate projects.
- Capacity building: Enhancing the capacity and knowledge of stakeholders in the climate financing ecosystem, from financial institutions to project developers, is essential.

Examples of Private Sector Climate Finance Tools

Commercial bank lending with climate considerations	Conventional commercial bank lending with climate considerations is growing, driven by both commercial banks' voluntary climate strategy and financial regulations.
Green bonds and green loans	Green bonds and loans are used to exclusively finance projects that have positive climate and environmental impacts.
Sustainability-linked bonds and	Sustainability-linked bonds and loans are used by corporates and sovereigns to raise capital often at lower costs, by committing to achieve predefined key performance parameters on sustainability.

sustainability-linked loans	
Sustainability bonds and social bonds	Sustainability and social bonds are financing tools where the proceeds are used to finance projects that achieve positive climate and social impacts.
Green asset-backed securities (ABSs)	Green securitization can transform illiquid climate-friendly assets into tradable financial securities.
Other financial instruments	Other financial instruments are used in private climate finance, including through certain environmental, social, and governance funds (with climate considerations), as well as private equity and venture capital investments in climate-related firms. Shareholder engagement is also used to encourage companies' green investment decisions.

Sources: World Bank, IMF, CRISIL MI&A

Debt investment platforms

The rapid proliferation of online bond platforms in India over the past two to three years can be attributed to a confluence of factors that have reshaped the landscape of bond trading and investment in the country. First and foremost, the ongoing digital transformation in India has played a pivotal role. Online bond platforms have removed traditional barriers, allowing retail investors to access and invest in bonds that were previously the domain of institutional investors. This has democratized investments, making them more inclusive.

There is also increased investor demand for fixed-income securities, including bonds. As investors seek to diversify their portfolios and balance risk, bonds have gained attention as a stable source of income. Online platforms provide a convenient and accessible way for investors to explore this asset class. Furthermore, educational initiatives offered by online bond platforms have demystified bond investments for retail investors. They provide valuable resources to help investors understand the bond market and make informed decisions.

Investment by retail investors in corporate bonds has increased in the last couple of years, however, their share in overall issuances remain significantly low. Alternative investment platforms have enabled retail investors to invest directly in corporate bond and other debt instruments with minimum investment of ₹10,000. While the share is significantly low, going forward it is expected to increase at a much faster pace with increasing awareness and regulatory support.

Advantages and Challenges of Debt Investment Platforms in India

Advantages of Debt Investment Platforms:

- Diversification: Debt investment platforms provide access to a wide range of debt instruments, allowing investors to diversify their portfolios. This diversification can help spread risk and reduce the impact of poor performance in a single instrument.
- Ease of access: These platforms make investing in debt instruments more accessible and convenient. Investors can explore and invest in various debt products online without the need for traditional brokerage services.
- Lower entry barriers: Many platforms allow investors to start with relatively small amounts, making debt investments accessible to a broader range of individuals, including those with limited capital.
- Professional management: Debt mutual funds and certain other debt instruments offered through these platforms are professionally managed. This means experienced fund managers make investment decisions on behalf of investors, saving them time and effort.
- Liquidity: Some debt investment platforms allow for secondary market transactions, providing liquidity to investors who wish to sell their investments before maturity.
- Risk mitigation: Debt platforms often provide information on credit ratings, maturity periods, and yield, helping investors make informed decisions and manage risk effectively.
- Regular income: Many debt investments, such as fixed deposits and certain bond funds, offer regular interest payments, providing investors with a predictable income stream.
- Customized portfolios: Some platforms offer tools and services to help investors build customized debt portfolios based on their risk tolerance, financial goals, and time horizon.

Challenges of Debt Investment Platforms:

- Interest rate risk: Debt investments are subject to interest rate risk. When interest rates rise, the value of existing bonds may decrease, potentially leading to capital losses.
- Credit risk: Some debt instruments, especially those with higher yields, may carry credit risk. This means there’s a risk that the issuer may default on interest or principal payments.
- Market volatility: Debt markets can experience periods of volatility, which can impact the performance of debt investments, especially those with longer maturities.
- Lack of liquidity: Not all debt instruments are highly liquid, and in some cases, investors may face difficulties in selling their investments before maturity.
- Tax implications: Taxation of debt investments can be complex, and the tax treatment may vary depending on the specific instrument and the investor’s financial situation.
- Regulatory changes: Debt investment platforms may be affected by changes in financial regulations and tax laws, which can impact the attractiveness of certain debt instruments.

- Market knowledge required: While platforms aim to simplify the investment process, investors still need to have some knowledge of debt instruments and the market to make informed decisions.

About CRISIL Market Intelligence & Analytics

CRISIL Market Intelligence & Analytics, a division of CRISIL, provides independent research, consulting, risk solutions, and data & analytics. Our informed insights and opinions on the economy, industry, capital markets and companies drive impactful decisions for clients across diverse sectors and geographies.

Our strong benchmarking capabilities, granular grasp of sectors, proprietary analytical frameworks and risk management solutions backed by deep understanding of technology integration, make us the partner of choice for public & private organisations, multi-lateral agencies, investors and governments for over three decades.

About CRISIL Limited

- CRISIL is a leading, agile and innovative global analytics company driven by its mission of making markets function better.
- It is India's foremost provider of ratings, data, research, analytics and solutions with a strong track record of growth, culture of innovation, and global footprint.
- It has delivered independent opinions, actionable insights, and efficient solutions to over 100,000 customers through businesses that operate from India, the US, the UK, Argentina, Poland, China, Hong Kong, UAE and Singapore.
- It is majority owned by S&P Global Inc, a leading provider of transparent and independent ratings, benchmarks, analytics and data to the capital and commodity markets worldwide.

for more information, visit www.crisil.com

Connect with us: LINKEDIN | TWITTER | YOUTUBE | FACEBOOK | INSTAGRAM

CRISIL Privacy Notice

CRISIL respects your privacy. We may use your personal information, such as your name, location, contact number and email id to fulfil your request, service your account and to provide you with additional information from CRISIL. for further information on CRISIL’s privacy policy please visit www.crisil.com/privacy.