INDIAN NBFC INDUSTRY ANALYSIS

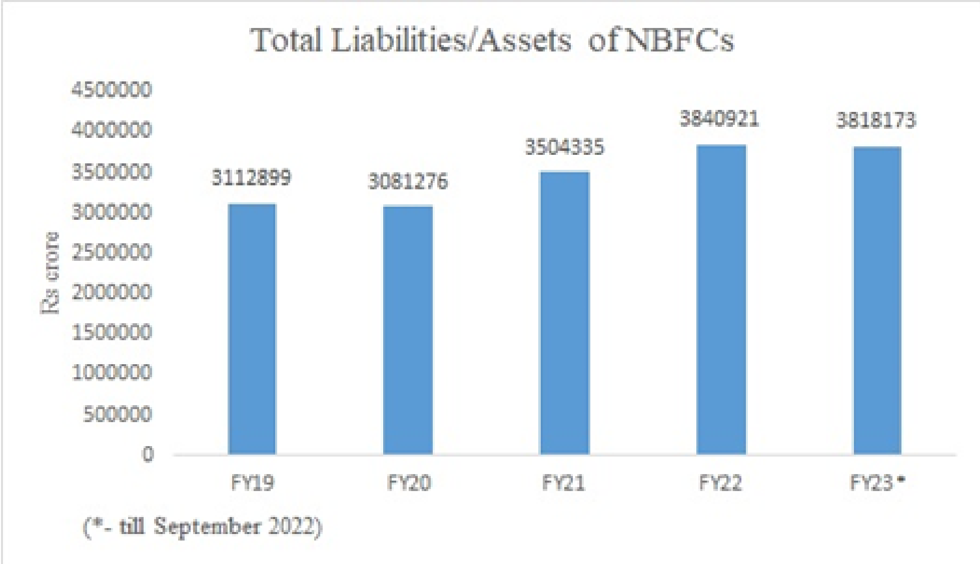
JUNE- 2023

sukhanidhi
INVESTMENT ADVISORS
Equity Research & Advisory Services

Over the past few years, Non-Banking Financial Companies (NBFCs) have played a prominent role in the Indian financial system. They provide financial inclusion to the underserved section of the society that does not have easy access to credit. NBFCs have revolutionized the Indian lending system and have efficiently leveraged digitization to drive efficiency and provide customers with a quick and convenient financing experience. The plethora of services include vehicle financing, MSME financing, home financing, microfinance and other retail segments. The Government has consistently worked on the governance measures to strengthen the systemic importance of the NBFCs. As of January 31, 2022 there were approximately 9,495 NBFCs registered with Reserve Bank of India (RBI), of which 49 deposit accepting NBFCs. The pandemic impacted the NBFCs operations, leading to decline in disbursements across the sectors. However, the support and focus of the Government through various liquidity measures such as repo rate cut, targeted long-term repo operations, special liquidity scheme and partial credit guarantee scheme, kept the sector afloat.

IN TERMS OF ASSEST / LIABILITY STRUCTURES :

In terms of asset/liability structures, NBFCs are subdivided into deposit-taking NBFCs (NBFCs-D) - which accept and hold public deposits - and non-deposit taking NBFCs (NBFCs-ND). Among non-deposit taking NBFCs, those with asset size of Rs 500 crore or more are classified as non-deposit taking systemically important NBFCs (NBFCs-ND-SI). After the regulatory overhaul in October 2022, NBFCs are segregated into four layers, namely, Base Layer (NBFC-BL), Middle Layer (NBFC-ML), Upper Layer (NBFC-UL) and Top Layer (NBFC-TL), based on their size, activity, and perceived level of riskiness. In terms of size, NBFC-BL comprises all NBFCs-ND with asset size below Rs 1,000 crore. NBFCs-ND with asset size above Rs 1,000 crore and NBFCs-D are put in NBFC-ML. NBFC-UL comprises those NBFCs (including NBFCs-D) which are specifically monitored by the Reserve Bank on the basis of a set of parameters and scoring methodology. The framework also envisages that top ten eligible NBFCs in terms of their asset size shall always reside in NBFC-UL. Accordingly, the Reserve Bank has identified and placed 16 NBFCs (including HFCs) in NBFC-UL. NBFC-TL shall ideally remain empty and will be populated if the Reserve Bank perceives a substantial increase in the potential systemic risk from specific NBFCs in NBFC-UL. Apart from scale, the new regulatory framework also prescribes activity-based regulation for NBFCs. The Reserve Bank also specified a Prompt Corrective Action (PCA) framework for NBFCs in the middle and upper layers to further strengthen its oversight over these segments.

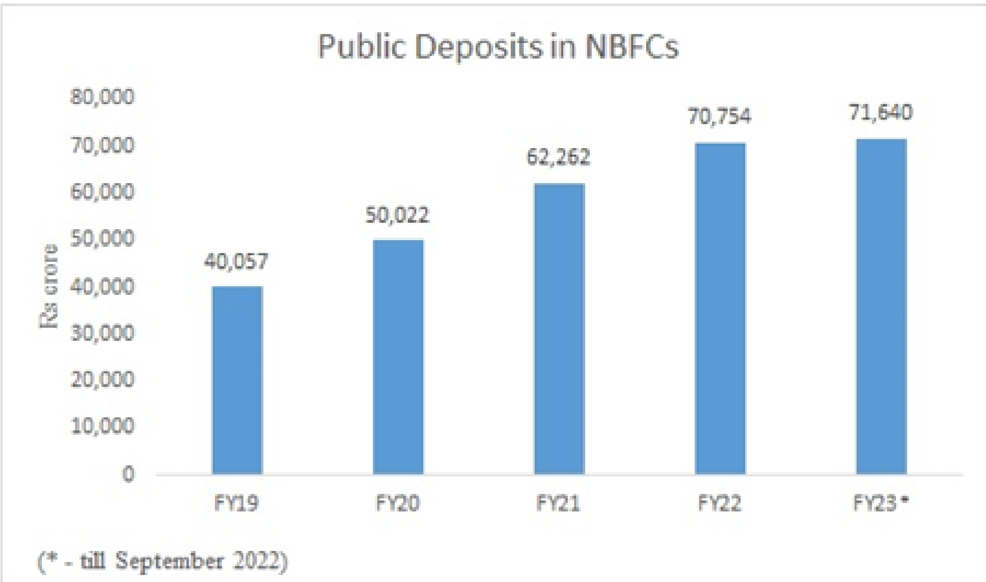


OWNERSHIP PATTERN :

The NBFCs-ND-SI category accounted for around 86 per cent of the total assets of the NBFC sector at end-March 2022. Although the category is largely populated by non-government companies, a few large government-owned NBFCs hold a substantial share of the assets of the NBFCs-ND-SI sub-sector. At end-March 2022, NBFCs-D accounted for 14.4 per cent of the total assets of the NBFC sector. Non-government public limited companies dominate this category, with a share of 88.3 per cent of the total assets of NBFCs-D.

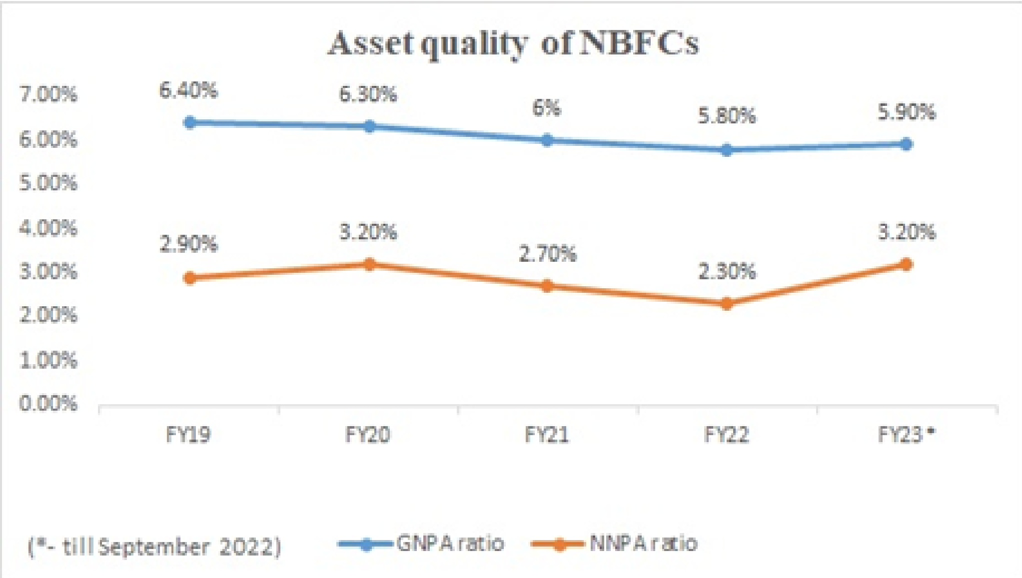
PUBLIC DEPOSITS IN NBFCs :

NBFCs are subdivided into deposit-taking NBFCs (NBFCs-D) - which accept and hold public deposits - and non-deposit taking NBFCs (NBFCs-ND). Public Deposits in NBFCs rose from Rs 70,754 crore at end-March 2022 to Rs 71,640 crore at end-September 2022. Public deposits constituted 12.8 per cent of total liabilities of NBFCs-D at end-March 2022. Competitive interest rates offered along with robust credit ratings contributed to their steady growth.



ASSEST QUALITY :

The gross non-performing assets (GNPA) ratio of NBFCs eased from 6.40 per cent in FY19 to 5.90 per cent in FY23 (till September 2022). However, Net Non-Performing Assets (NNPA) ratio of sector increased from 2.9 per cent in FY19 to 3.2 per cent in FY23 (till September 2022). In 2021-22, asset quality of the sector improved as evident from the decline in both GNPA and NNPA ratios. While business conditions improved, the deferment in the NPA upgradation norms by the Reserve Bank, better recovery and lower fresh accretions facilitated the decline in NPAs during the period.



NBFC EDUCATION LOANS EXPECTED TO SHOW SOLID GROWTH IN FY24 :

There is expectation that non-banking financial companies education loans will reach around Rs 35,000 crore in current financial year (FY24). Specialised business models and the increasing number of students travelling abroad have raised the demand for education loans. Over 90 per cent of the education loans are for studying abroad, with India-based courses accounting for the rest. A total of 7.5 lakh students (expected) travelled abroad for studies in FY23. In fiscal 22-23, educational loans with NBFCs have doubled to over Rs 25,000 crore from Rs 13,000 crore in the previous year. The growth had flat-lined in fiscal 2021 as the Covid-19 pandemic stalled international travel. In fact, the number of students travelling abroad dropped to 2.6 lakh, falling over 50 per cent from the previous year.

NBFCs' AUM EXPECTED TO GROW IN DOUBLE-DIGIT IN CURRENT FISCAL :

Assets under management (AUM) of non-banking finance companies is expected to show double-digit growth in current financial year (FY24). Stronger balance sheets with higher provisioning and lower leverage, receding asset-quality concerns and steadily normalising funding access provide a solid foundation for NBFCs to capitalise on credit demand. The demand from home, vehicle and unsecured finance will continue to lead the growth in AUMs despite headwinds from higher borrowing costs and competition from banks. There is expectation that the housing loan segment - which comprises 40-45 per cent of NBFCs' AUM - to grow in double-digit in FY24, led by continued end-user demand despite the impact of rising real estate prices and interest rates. Housing finance companies specifically, though, could continue to lose market share to banks owing to higher borrowing costs and competition on interest rates, especially in the urban and the formal salaried segments. The second-largest segment of vehicle finance, which accounts for 20-25 per cent of NBFCs' AUM is also expected to witness double-digit in FY24 on rising demand and new launches driving car and utility vehicle sales. With interest-rate sensitivity of borrowers being high, NBFCs are expected to sharpen focus on used-vehicle financing, which offers higher yields and better profitability from a risk-adjusted return perspective, the rebound in economic activity, demand for fleet replacement, and focus on last-mile connectivity will also support commercial vehicle sales.

COMPETITION FROM BANKS AND RISING INTEREST RATES ARE KEY CHAELLENGES :

While NBFCs are relatively well placed currently as compared with the past few years, competition from banks and the rising interest rate scenario pose challenges. Competition from banks has intensified, especially in the traditional segments. The banking system has also gone through its fair share of cycles. Grappling with asset quality concerns, inadequate provisioning and weak capital buffers in 2018, the banking sector now has manageable non-performing assets (NPAs) with a healthy provision coverage ratio (PCR) and comfortable capital buffers; and is well placed to tap growth opportunities. In fact, banks have outpaced NBFCs in growth since March 2020. While the gap has narrowed in FY23, NBFCs continue to lag. At the same time, rising interest rates will limit the competitiveness of NBFCs in some segments. The repo rate has been increased by 250 basis points (bps) in FY23. This will impact the borrowing cost for NBFCs.

CVs and PVs TO DRIVE OVERALL VEHICLE FINANCE GROWTH OF NBFCs :

The automotive industry is considered to be one of the major drivers of economic growth due to its linkages with multiple industries. The growth of this sector benefits commodity sector as vehicle manufacturing requires steel, aluminium, plastic, etc. It also holds importance for the NBFC/Banks in form of automobile financing. The domestic sales of the Automobile industry remained robust with all the segments reporting double-digit growth in April-December period of 2022-23 on the back of steady component supplies and consumer demand. In 2022-23 (April-December), passenger vehicles (PVs) segment recorded growth of 33.64 per cent at 28.72 lakh units for the period under review, as compared to 21.49 lakh units in the April-December period in the previous year. Commercial vehicles (CVs) segment, two-wheelers and three-wheelers segments recoded growth of 46.39 per cent, 88.27 per cent and 20.41 per cent, respectively. There is expectation that demand for CVs and PVs will continue to rise in coming futures. The growth in sales volume across segments will be supported by healthy demand in the urban sector, increasing replacement demand, higher infrastructure spending, a growing demand for utility vehicles in the passenger vehicle segment.

RECENT DEVELOPMEMTS :

• Identification of NBFCs in the Upper Layer:

Considering the evolution of NBFCs in terms of size, complexity, and interconnectedness within the financial sector, the Reserve Bank had issued 'Scale Based Regulation (SBR): A Revised Regulatory Framework for NBFCs' on October 22, 2021 to align the regulations for NBFCs with their changing risk profile. The framework categorised NBFCs in Base Layer (NBFC-BL), Middle Layer (NBFC-ML), Upper Layer (NBFC-UL) and Top Layer (NBFC-TL) and stated that the Upper Layer shall comprise those NBFCs which are specifically identified by the Reserve Bank, based on a set of parameters and scoring methodology as provided in the framework. The top ten NBFCs in terms of their asset size shall always reside in the Upper Layer. Accordingly, a list of sixteen NBFCs categorised as NBFC-UL was released on September 30, 2022.

• Regulatory framework for NBFC - Account Aggregators (Amendments):

To facilitate cash flow-based lending to MSMEs, it has been decided to include the Goods and Services Tax Network (GSTN) as a Financial Information Provider (FIP) under the Account Aggregator (AA) framework. The Department of Revenue shall be the regulator of the GSTN for this specific purpose and Goods and Services Tax (GST) Returns viz. Form GSTR-1 and Form GSTR-3B, shall be the Financial Information.

OUTLOOK :

Outlook for non-banking finance companies industry will be positive for coming time. Assets under management of NBFCs is expected to grow in double-digit in current financial year. Stronger balance sheets, receding asset-quality concerns and steadily normalising funding access provide a solid foundation for NBFCs to capitalise on credit demand. There is expectation that the housing loan segment of Industry will show solid growth in FY24, led by continued end-user demand despite the impact of rising real estate prices and interest rates. Further, vehicle finance segment of Industry is expected to witness double-digit growth in current fiscal owing to rising demand for CVs, PVs and new launches driving car and utility vehicle. Besides, non-banking financial companies education loans are expected to witness solid growth in current fiscal.

sukhanidhi
INVESTMENT ADVISORS
Equity Research & Advisory Services

CONTACT INFORMATION

info@sukhanidhi.in

https://sukhanidhi.in/industry-anaylsis/

+91 8310770674

Toll Free: 1800 889 0255

EQUITY HELPLINE!

Have Questions About Investing in Stocks(Shares)?

Call Us

1800 889 0255

VINAYAK SAVANUR
FOUNDER & CIO

https://sukhanidhi.in/