1st May 2023

To,

The Board of Directors,
Fincare Small Finance Bank Limited
301-306, 3rd Floor
Abhijeet V, Law Garden Road
Mithakhali, Ahmedabad - 380 006

Dear Sir,

Re.: **Proposed initial public offering of equity shares of Rs. 10/- each (the "Equity Shares") of the Fincare Small Finance Bank Limited (the "Bank" and such offer, the "Offer")**

We refer to your e-mail/ request dated 7th April 2023 regarding the content provided to you for your internal use by CRISIL MI&A as part of your subscription to its Industry Research on the following industry:

CRISIL MI&A Analysis of small finance banks and various retail loan products, April 2023 (the "**Report**")

As requested by you, we accord our no objection and give consent to your inclusion of our name, reproducing content from, and/or extracting or utilizing, whole or part of the Report (hereinafter referred to as `**Material**') available to you as part of the above subscription, or including references to the Material in the draft red herring prospectus ("**DRHP**") to be filed with Securities and Exchange Board of India ("**SEBI**") and the stock exchanges where the Equity Shares are proposed to be listed (the "**Stock Exchanges**"), the red herring prospectus ("**RHP**") and the prospectus ("**Prospectus**") to be filed with the Registrar of Companies, Gujarat at Ahmedabad ("**RoC**"), SEBI and the Stock Exchanges or any other document, including any publicity, presentations or press releases prepared by the Bank or its advisors, any international supplements of the foregoing for distribution to investors inside or outside India or other materials (collectively, the "**Offer Documents**") to be issued or filed in relation to the Offer, subject to the following:

- Your reproducing the Material on an `as is where is basis' clearly mentioning the document source & date of release. Eg. - CRISIL MI&A on **Analysis of small finance banks and various retail loan products,** April 2023 (the "**Report**")
- Your ensuring that there is no misrepresentation/modification to our views/opinions and that the Material is not mentioned out of context or misguidingly.
- Your ensuring that the Material consisting of charts/graphs also contains the relevant texts explaining the charts / graphs.
- Your ensuring that the disclaimer of CRISIL (given below) is also reproduced along with the Report, at the relevant place in the Offer Documents.

You agree and undertake not to misrepresent, make any changes to, obliterate or tamper with the Report or present any part thereof out of context or in violation of applicable laws and regulations, if any. Further, you acknowledge and agree that CRISIL does not accept responsibility for the Offer Documents or any part thereof subject to the inclusion of the disclaimer as mentioned below. We confirm that information contained in the Material have been obtained or derived from publicly available sources, interaction with industry participants and received from you, which we consider as reliable and after exercise of reasonable care and diligence by us.

We also consent to the Material (a) being designated as a material document in connection with the Offer, and being included as part of "*Material Contracts and Documents for Inspection*" in the Offer Documents, and (b) being kept open for inspection by members of the public as a material document in connection with the Offer from the date of the RHP till the date of closing of the Offer. We also consent to the disclosure of our date of appointment for the purpose of preparing the Report in the Offer Documents. We confirm that we are an independent agency and are not, in any manner, related to the Bank, its promoters, its directors or its key managerial personnel, as mentioned in Annexure A. Neither the Bank, nor its directors, its promoters or the book running lead managers to the Offer, are related parties to us as per the definition of 'related party' under the Companies Act, 2013, as amended, as on the date of this letter.

We further confirm that we have, where required, obtained requisite consent that may be required from any governmental authority or other person, in relation to any information used by us in the Material.

This consent letter does not impose any obligation on the Bank to include in any Offer Documents all or any part of the information with respect to which consent is being granted pursuant to this letter.

<u>Given below is the disclaimer to be used in the Offer Documents.</u>

"CRISIL MI&A, a division of CRISIL Limited (CRISIL) has taken due care and caution in preparing this report (Report) based on the Information obtained by CRISIL from sources which it considers reliable (Data). This Report is not a recommendation to invest / disinvest in any entity covered in the Report and no part of this Report should be construed as an expert advice or investment advice or any form of investment banking within the meaning of any law or regulation. Without limiting the generality of the foregoing, nothing in the Report is to be construed as CRISIL providing or intending to provide any services in jurisdictions where CRISIL does not have the necessary permission and/or registration to carry out its business activities in this regard. Fincare Small Finance Bank Limited will be responsible for ensuring compliances and consequences of non-compliances for use of the Report or part thereof outside India. CRISIL MI&A operates independently of, and does not have access to information obtained by CRISIL's Ratings Limited which may, in their regular operations, obtain information of a confidential nature. The views expressed in this Report are that of CRISIL MI&A and not of CRISIL's Ratings Limited. No part of this Report may be published/reproduced in any form without CRISIL's prior written approval."

The Material and this letter may be shared by the Bank, with the book running lead manager(s) and advisers concerned in relation to the Offer. We also authorize you to deliver this letter of consent and the Material to SEBI, the Stock Exchanges and the RoC pursuant to Section 26 and Section 32 of the Companies Act, 2013, and the rules thereunder, each as amended, or to any governmental, regulatory or any other authority, as may be required as per applicable law, in relation to the Offer.

We agree to keep strictly confidential, the non- public information relating to the Offer until such time that: (A) such disclosure by us is approved by the Company; or (B) such disclosure is required by law or regulation; or (C) such information is already in public domain or comes into public domain through no fault of ours.

For CRISIL Limited

Suresh

CRISIL Limited Mumbai

Suresh Krishnamurthy
Senior Director

Annexure A

1. List of Directors

S. No	Name of the Director	Executive/Non-Executive	Designation
1	Aarthi Sivanandh	Non-Executive	Independent Director
2	Alok Prasad	Non-Executive	Independent Director
3	Dhiraj Poddar	Non-Executive	Nominee Director
4	Divya Sehgal	Non-Executive	Nominee Director
5	Nanda Dave	Non-Executive	Independent Director
6	Narayanan Nadadur	Non-Executive	Independent Director
7	Pramod Kabra	Non-Executive	Part Time Chairperson
8	Rajeev Yadav	Executive	MD &CEO
9	Sunil Gulati	Non-Executive	Independent Director
10	Sameer Nanavati	Non-Executive	Nominee Director
11	Vinay Baijal	Non-Executive	Independent Director

2. List of Key Management Personnel

S. No	Name	Designation
1	Rajeev Yadav	Managing Director & Chief Executive Officer
2	Keyur Doshi	Chief Finance Officer
3	Shefaly Kothari	Company Secretary

3. List of BRLMs

- ICICI Securities Limited
- Axis Capital Limited
- IIFL Securities Limited
- SBI Capital Markets Limited
- Ambit Private Limited

Analysis of small finance banks and various retail loan products

April 2023

Macroeconomic scenario

World economy fighting inflation surge post Covid-19, while facing volatile commodity prices and tightening of liquidity

The global economy is witnessing tightening monetary conditions in most regions. According to IMF, a broad based and sharper than expected slowdown with high inflation is being faced across the globe. As per the IMF (World Economic Outlook Update –January 2023), global growth prospects are estimated to fall from 3.4% in 2022 to 2.9% in 2023 and then witness an increase in 2024 to 3.1%, the impact of which is expected to be witnessed in the Indian economy as well. Global trade is estimated to have reached a record level of approximately US$32 trillion in 2022, but its growth had turned negative during the second half of 2022. The trade outlook for CY 2023 is expected to be negatively impacted because of geopolitical frictions, persisting inflation and lower global demand. Further, deceleration in domestic growth could lead to some softening in imports.

According to the data released by the National Statistical Office ("NSO") in February 2023, the second advanced estimate for real GDP growth in Fiscal 2023 is pegged at 7.0% year-on-year compared with 9.1% in Fiscal 2022. Despite global slow down, for the Indian economy, recent RBI surveys indicate improving customer sentiments which will be a boost to the consumption demand. Further, rise in capacity utilisation rates in the manufacturing sector is favourable for private capex. This is especially true in case of infrastructure linked sectors (such as steel and cement) and Production Linked Incentive scheme-linked sectors. Digitisation, together with efficiency-enhancing reforms, will raise the contribution of productivity. CRISIL MI&A estimates that India's GDP will grow at 7.0% in Fiscal 2023. This is primarily because the slowdown in global growth has started to impact India's exports and industrial activity.

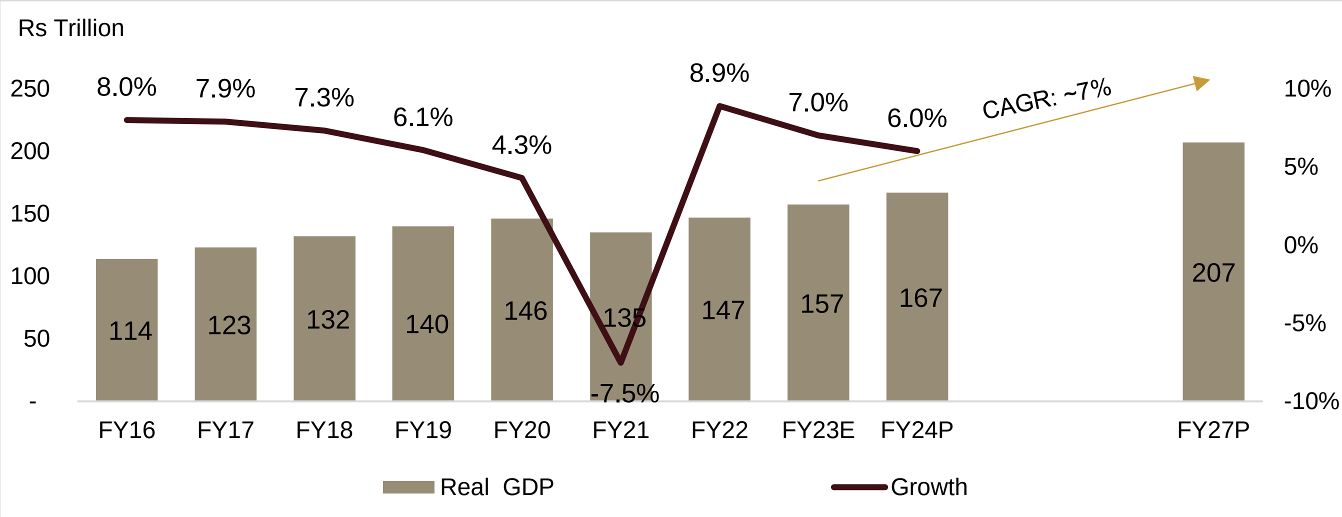
However, domestic demand remains supportive in Fiscal 2023, aided by a catch-up in contact-based services, government capex, relatively accommodative financial conditions, and overall normal monsoon for the fourth time in a row. Income prospects have improved in both rural and urban areas in FY23 which has boosted consumer confidence supported by easy credit. However, domestic demand is likely to come under pressure as interest rate hikes are transmitted further to consumers. The impact of rate hike can be already seen in Q3 FY23 GDP growth rate suggesting lower demand for goods. Consequently, CRISIL MI&A expects India's real GDP growth to slow down to 6.0% in Fiscal 2024. The risks to the forecast remain tilted downwards.

Russia - Ukraine war slowed global recovery; but India expected to remain one of the fastest growing economies

According to IMF, the economic damage from the ongoing war in Ukraine has contributed to a slowdown in global growth and rising inflation causing damage to various countries. The war has caused a humanitarian crisis in Eastern Europe, and various sanctions being imposed on Russia to end hostilities. In addition, frequent and wider-ranging lockdowns in China have slowed activity as it is a major manufacturing hub, which could cause new bottlenecks in the global supply chain. Further, Russia is a major supplier of oil, gases and metals and Ukraine is a major supplier of wheat and corn, and an anticipated decline in the supply of these essential commodities is likely to spike up the prices in the global commodities market.

CRISIL MI&A expects growth outlook for FY24 to be fettered with multiple risks including sluggish exports and lagged impact of rate hikes manifested fully into the economy. Nevertheless, India is expected to remain the fastest growing economy in the world with GDP growth of 6.0% projected in fiscal 2024 as per CRISIL MI&A. The IMF too estimates India's GDP to grow by 6.8% in calendar year 2022 due to its broad range of fiscal, monetary and health responses. However, the IMF projects the growth to slow down to 6.1% in CY 2023 before picking up to 6.8% in CY 2024.

India's economy to grow at 6.0% in fiscal 2024



Note: GDP growth for fiscals 2023 and 2024 is projected based on CRISIL MI&A estimates; Fiscal 2023-Fiscal 2027 is projected based on IMF estimates
Source: CRISIL MI&A, IMF (World Economic Outlook – January 2023 update)

Macroeconomic outlook for Fiscal 2024

Macro variables	FY23E	FY24P	Rationale for outlook
GDP (y-o-y)	7.0^%	6.0%	Slowing global growth is likely to weaken India's export in fiscal 2024. Domestic demand could also come under pressure as Reserve Bank of India (RBI) rate hikes are transmitted to consumers.
Consumer price index (CPI) inflation (y-o-y)	6.8%	5.0%	Lower commodity prices, base effect, expectation of softer food prices and cooling off domestic demand is likely to help in moderating inflation in fiscal 2024.
10-year Government security yield (fiscal-end)	7.5%	7.0%	A moderate increase in gross market borrowings is budgeted for fiscal 2024. This, coupled with lower inflation and the RBI's rate outs, is likely to moderate yields in fiscal 2024.
CAD (Current account balance)/GDP (%)	-3.0%	-2.4%	Lower crude prices and cooling off domestic demand is expected to lead to moderation of trade deficit in fiscal 2024.
Rs/$ (March average)	82.0	83.0	While a lower current account deficit (CAD) will support the rupee, challenging external financing conditions will continue to exert pressure in the next fiscal.

Note: (^): NSO second advance estimates , E- Estimated, P – Projected;
Source: Reserve Bank of India (RBI), National Statistics Office (NSO), CRISIL MI&A

Positive government measures to aid economic growth

Going forward, CRISIL MI&A expects India's gross domestic product (GDP) growth to decelerate to 6.0% in fiscal 2024 from 7.0% in fiscal 2023 due to global slowdown, monetary policy impact and volatile geopolitical scenario.

However, some optimism can be seen in form of moderating consumer inflation, capital and productivity increases aided by better physical and digital infrastructure. This growth is expected to be supported by the following factors:

- Production linked incentive (PLI) scheme which aims to incentivise local manufacturing by giving volume-linked incentives has been launched by the government for six of the India's top 10 export verticals which is likely to propel incremental exports. In fiscal 2024, PLI-driven exports will be the lone growth driver for India, helping improve the overall export growth to 2-4%.
- Focus on investments rather than consumption push enhancing the productive capacity of the economy. Policy push and new age opportunities to lead capex growth in fiscal 2024.
- Policies aimed towards greater formalisation of the economy, which are bound to lead to an acceleration in per capita income growth.

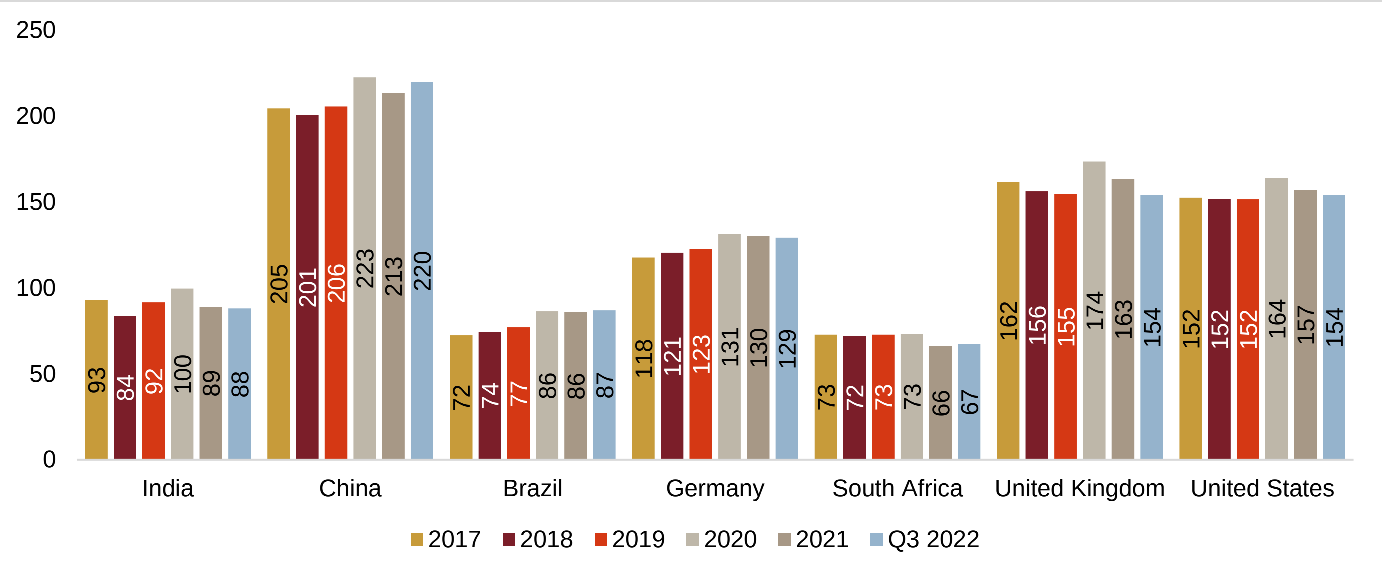
Financial inclusion

Current scenario and key developments

The COVID-19 pandemic has spread across the world, and India is no exception. The lockdown of nearly 1.4 billion people and a large number of businesses led to disruption and dislocation on a scale never imagined. It slammed the brakes on economic activity and caused enormous human suffering.

In these times of crisis, financial inclusion becomes more imperative than ever for vulnerable households and businesses to navigate the crises and recover after the pandemic. In terms of the credit to GDP ratio, India has a low credit penetration compared with other developing countries, such as China indicating that the existing gap needs to be bridged. Similarly, in terms of credit to households as a proportion of GDP as well, India lags other markets, with retail credit hovering at around 23% of GDP as of 31st December 2022.

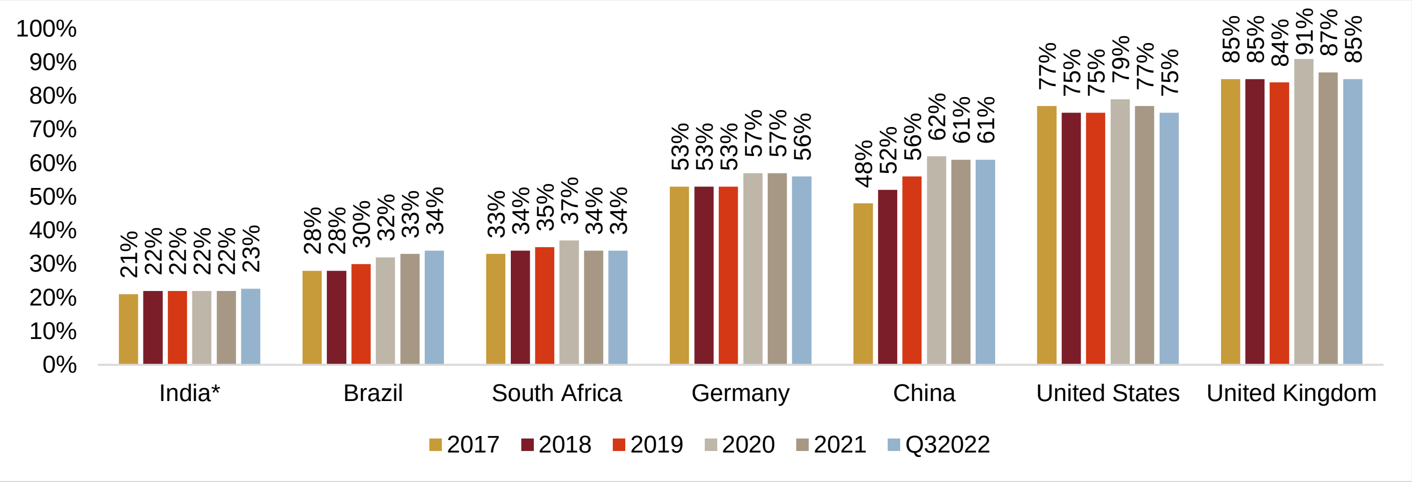
Credit to GDP ratio (%)



Note: Credit from all sectors to private non-financial sector

Source: Bank of International Settlements, CRISIL MI&A

Household Credit to GDP ratio

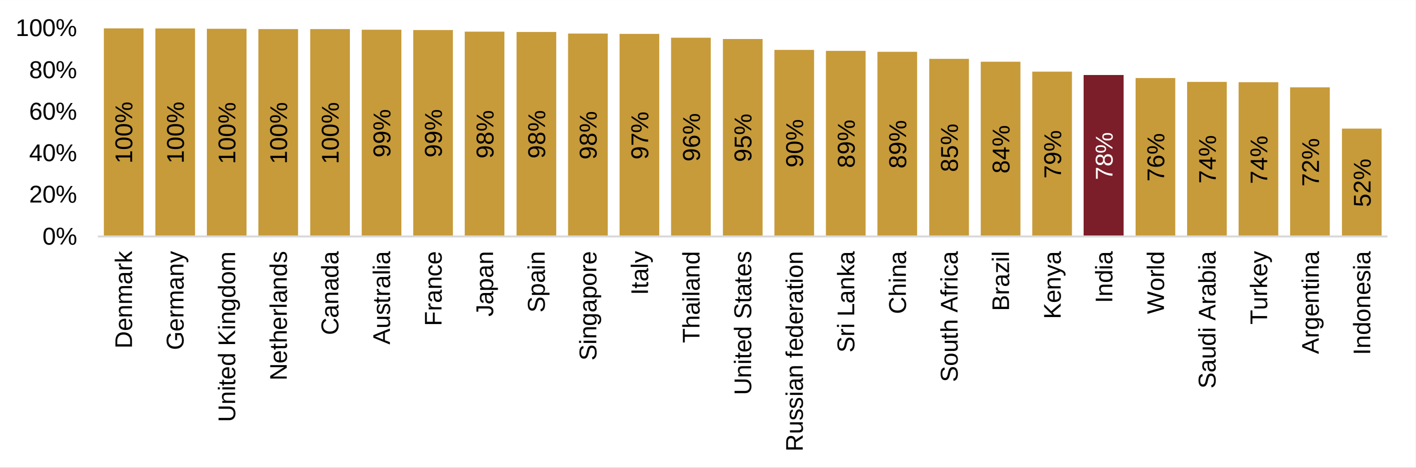


*Note: For countries except India, data is represented for calendar years. *For India, data represented is for FY18, FY19, FY20, FY21, FY22 and Q3FY23.*

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: 1. Global Findex data for India excludes northeast states, remote islands and selected districts. 2. Account penetration is for the population within the age group of 15+

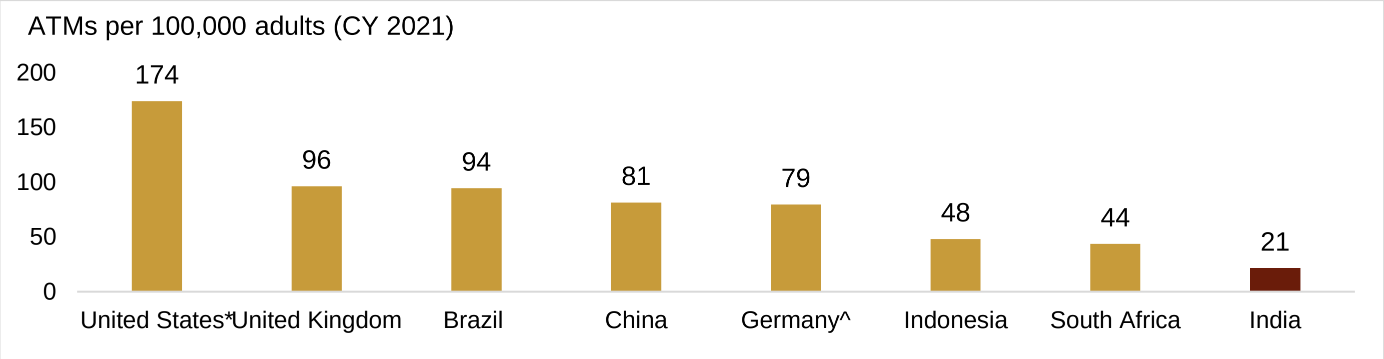
Source: World Bank - The Global Findex Database 2021, CRISIL MI&A

India has lower commercial bank branches and ATM penetration compared to other countries, indicating huge room for financial inclusion and banking services penetration. As of calendar year 2021, India has 14.6 branches and 21 ATMs for 100,000 adults according to World Bank data which is relatively lower than other developing and developed countries.

Commercial bank branch penetration across the world

Note: (*) UK data is as of 2013 calendar year, (^) Germany data is as of 2020 calendar year;
Source: World Bank, RBI, CRISIL MI&A

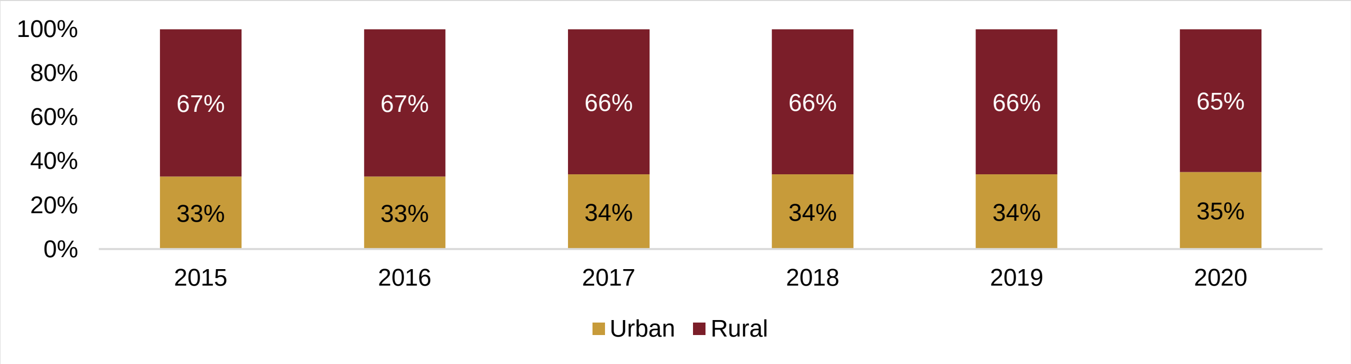
ATM penetration across the world



Note: (*) – US data is as of 2009 calendar year, (^)-Germany data as of 2020 calendar year;
Source: World Bank, RBI, CRISIL MI&A

The low levels of adults with bank accounts in comparison with various countries can be further explained by the large number of rural households in the country, which account for nearly two-thirds of the total households in the country. The shift in households towards urban regions is taking place albeit at a very slow pace.

Two-thirds of total households are in rural India



Source: World Bank; Census; CRISIL MI&A estimates (E)

Although the majority of Indian households are located in the rural region, the banking infrastructure in these regions is relatively inferior and, thus, there is a gap in the supply and demand of financial services in the backward regions of the country, which is a pocket of opportunity for the financial services sector.

To tackle financial exclusion, the Indian government introduced the PMJDY, a scheme that facilitates opening bank accounts by the unbanked. However, the effective use of these new accounts, increase in the number of transactions in these accounts and availability of credit remain key challenges, which need to be effectively addressed as borrowings from the formal sources still remains low.

State wise share of rural population (as per Census 2011)

States	Total population (in thousands)	Rural population (% of total population)	States	Total population (in thousands)	Rural population (% of total population)
Uttar Pradesh	199,812	78%	**Chhattisgarh**	25,545	77%
Maharashtra	112,374	55%	**Haryana**	25,351	65%
Bihar	104,099	89%	**Delhi**	16,788	2%
West Bengal	91,276	68%	**Jammu and Kashmir**	12,541	73%
Andhra Pradesh	84,581	67%	**Uttarakhand**	10,086	70%
Madhya Pradesh	72,627	72%	**Himachal Pradesh**	6,865	90%
Tamil Nadu	72,147	52%	**Tripura**	3,674	74%
Rajasthan	68,548	75%	**Meghalaya**	2,967	80%
Karnataka	61,095	61%	**Manipur**	2,856	61%
Gujarat	60,440	57%	**Nagaland**	1,979	71%
Odisha	41,974	83%	**Goa**	1,459	38%
Kerala	33,406	52%	**Arunachal Pradesh**	1,384	77%
Jharkhand	32,988	76%	**Mizoram**	1,097	48%
Assam	31,206	86%	**Chandigarh**	1,055	3%
Punjab	27,743	63%	**Sikkim**	611	75%

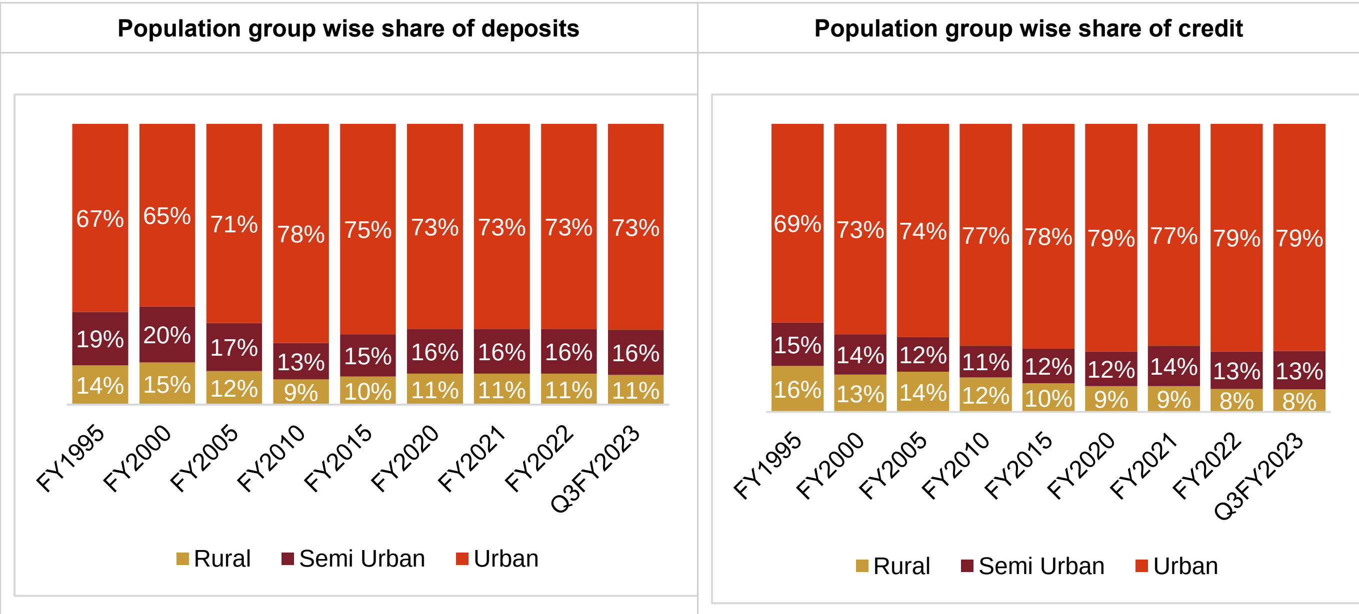
Source: Census 2011, CRISIL MI&A

Rural India accounts for about half of GDP, but only about 8% of total credit and 11% of total deposits

As of March 2022, there were about 640,000 villages in India, inhabited by close to 900 million people, comprising about 66% of the country's population. About 47% of India's GDP comes from rural areas. But their share in banking credit and deposits is abysmally low with just 8% of total credit and 11% of total deposits coming from rural areas as of 31st December 2022. The massive divergence in the rural areas' share of India's GDP and banking credit and deposit services compared with urban areas is as an indicator of the extremely low penetration of the banking sector in rural areas.

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

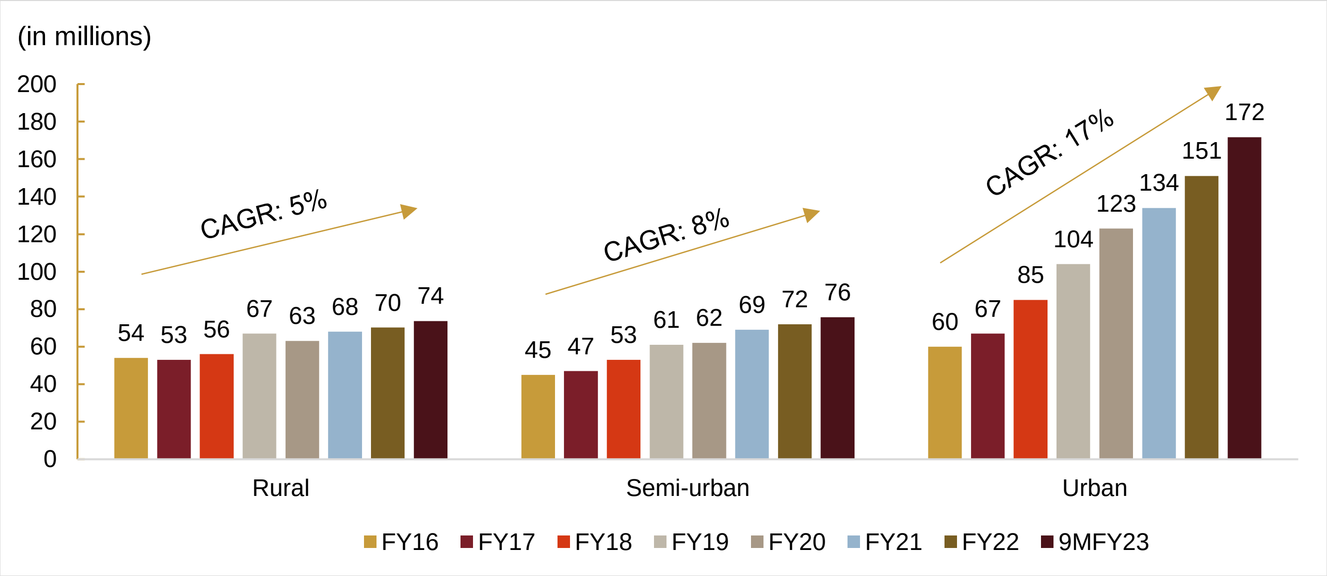


Source: CSO; RBI, CRISIL MI&A

As rural areas in India have lower financial inclusion compared with urban areas and there is less competition for banking services in rural areas compared with urban areas, this presents significant growth opportunities in rural areas.

The number of bank credit accounts in rural areas grew at a CAGR of 5% between the end of fiscal 2016 and 9MFY23. Between the end of fiscal 2016 and 9MFY23, the number of credit accounts in semi-urban areas grew at a CAGR of 8%. However, with small finance banks and payments bank increasing their reach and expanding into semi-urban and rural areas and increasing financial awareness, faster growth in rural areas can be expected in the future given the huge untapped potential. Between the end of fiscal 2016 and 9MFY23, the number of credit accounts in urban areas grew at a CAGR of 17%.

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



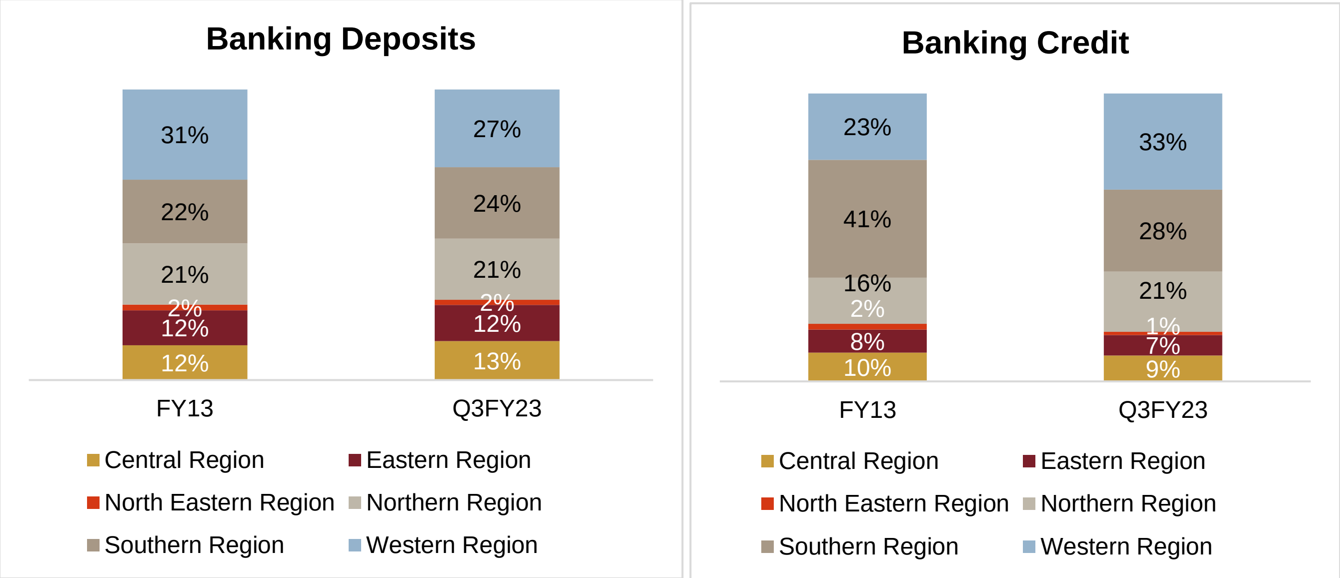
Note: Urban includes data for Urban and Metropolitan areas; Data represents only bank credit accounts

Source: RBI; CRISIL MI&A

Region-wise asymmetry: Central and eastern regions have a lower share in total bank credit and deposits

Bank credit and deposits are predominantly concentrated in the southern and western regions, whereas they have been especially low in the north-eastern and eastern regions. Deposit penetration in the southern region has increased over fiscal 2013 and nine months ended fiscal 2023 by 2%.

Region-wise share of banking credit and total deposits



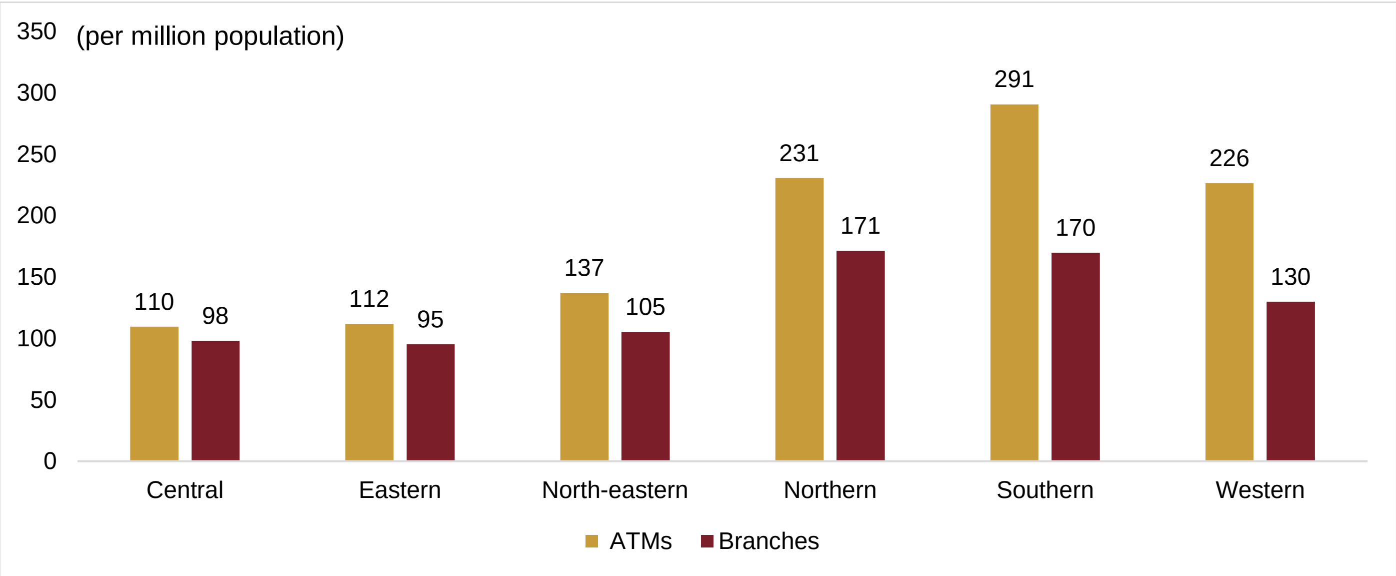
Note: The percentages are as of the end of the fiscal year indicated.

Source: RBI; CRISIL MI&A

Branch network and infrastructure has been weak in regions with lower credit and deposit share

The number of branches and ATM facilities in the eastern regions, where credit penetration and deposit-base are low is also below those of the southern and western regions, which CRISIL MI&A believes is largely due to lower focus from the bigger banks.

Region-wise presence of bank ATM and branches (as of 31st December 2022)



Note: population is as per the census data of 2011, ATM data includes ATMs of public sector banks, private sector banks, foreign banks, payment banks, small finance banks, co-operative banks, local area banks and regional rural banks.

Source: RBI; Census India; CRISIL MI&A

Large variation in credit availability across states and districts

There is a wide variation across states and within various districts in the same state as well in terms of credit, which indicates latent opportunity for providing banking services to unserved or underserved customers.

State-wise rural credit accounts in banks and top five districts concentration (as of 31st December 2022)

State	No. of districts	% share in overall population in India	Share in overall credit	Credit to Deposit ratio	Concentration of credit in top 5 districts^	% of credit in rural areas	Concentration of credit accounts in top 5 districts*	% credit accounts in rural areas
Maharashtra	36	9%	28%	100%	90%	2%	77%	6%
NCT of Delhi	11	1%	11%	93%	100%	0%	100%	0%
Tamil Nadu	38	6%	9%	103%	62%	12%	44%	26%
Karnataka	31	5%	7%	62%	75%	11%	50%	29%
Gujarat	33	5%	5%	70%	72%	7%	49%	16%
Telangana	33	3%	5%	99%	79%	10%	48%	21%
Uttar Pradesh	75	17%	5%	42%	38%	24%	23%	36%
Andhra Pradesh	26	4%	4%	133%	64%	20%	49%	29%
West Bengal	23	8%	4%	46%	73%	16%	47%	44%
Kerala	14	3%	3%	62%	66%	3%	52%	4%
Rajasthan	33	6%	3%	75%	53%	18%	40%	29%
Madhya Pradesh	52	6%	3%	69%	54%	14%	33%	25%
Haryana	22	2%	3%	55%	62%	10%	44%	19%
Punjab	23	2%	2%	52%	61%	22%	46%	27%
Bihar	38	9%	1%	41%	46%	29%	36%	47%
Odisha	30	3%	1%	41%	61%	24%	47%	50%
Chhattisgarh	28	2%	1%	67%	73%	11%	52%	22%
Assam	34	3%	1%	49%	50%	26%	37%	40%
Jharkhand	24	3%	1%	32%	68%	21%	53%	49%
Chandigarh	1	0%	1%	85%	100%	0%	100%	1%
Jammu & Kashmir	20	1%	1%	53%	60%	38%	50%	49%
Uttarakhand	13	1%	1%	35%	89%	23%	82%	32%
Himachal Pradesh	12	1%	0%	30%	74%	65%	68%	69%
Goa	2	0%	0%	25%	100%	18%	100%	31%
Puducherry	4	0%	0%	62%	100%	12%	100%	15%
Tripura	8	0%	0%	33%	87%	44%	83%	34%
Meghalaya	12	0%	0%	32%	93%	41%	88%	42%
Manipur	16	0%	0%	75%	83%	32%	82%	28%
Nagaland	12	0%	0%	52%	84%	22%	81%	28%
Arunachal Pradesh	25	0%	0%	31%	72%	29%	65%	34%

Note: Arranged in descending order of share in overall credit outstanding of banks, (*) As of FY21, (^) As of FY22.

Source: RBI, CRISIL MI&A

States with low financial penetration present a strong case for growth

Tripura recorded fastest growth between fiscal 2017-2022.

State-wise GDP and GDP growth (FY 2022)

States	GSDP - Constant Prices FY22 In Rs. Billion	Y-o-Y growth	CAGR (FY22-FY17)	Credit Account Penetration as on FY22	Deposit Account Penetration as on FY22	Branch Penetration as on FY22	ATM Penetration as on FY22	CRISIL Inclusix Score (FY2016)
Tamil Nadu	13,984	7.85%	6.17%	14%	184%	144	337	77.2
Karnataka	12,522	9.47%	5.86%	10%	183%	151	259	82.1
Uttar Pradesh	11,687	7.26%	2.93%	2%	127%	77	100	44.1
Andhra Pradesh	7,469	11.43%	6.69%	6%	156%	122	191	78.4
Rajasthan	7,330	11.04%	4.20%	4%	135%	103	140	50.9
Telangana	6,856	11.22%	6.18%	15%	203%	158	318	72.8
Madhya Pradesh	6,217	10.12%	5.72%	4%	142%	90	132	48.7
Haryana	5,888	9.80%	5.21%	11%	202%	177	235	67.7
Kerala	5,509	7.10%	2.57%	10%	211%	175	278	90.9
Bihar	4,820	11.0%	6.07%	1%	123%	62	73	38.5
Odisha	4,276	10.11%	4.86%	4%	149%	112	163	63
Punjab	4,162	5.12%	3.36%	10%	215%	212	239	70.9
Assam	2,738	9.13%	6.27%	4%	141%	84	120	47.9
Himachal Pradesh	1,244	8.35%	3.84%	5%	189%	213	268	72.3
Jammu & Kashmir	1,239	6.16%	NA	8%	157%	126	182	47.8
Tripura	469	12.16%	8.95%	43%	141%	140	129	66.2
Meghalaya	254	8.89%	3.14%	9%	96%	111	129	34.6

Note:

1. Credit account penetration is calculated as total number of retail bank credit accounts/population of the state
2. Deposit account penetration is calculated as total number of bank deposit accounts/ population of the state
3. Branch penetration is calculated as Number of bank branches per million people
4. ATM penetration is calculated as Number of ATMs per million people
5. For Credit and Deposit account penetration, this does not represent unique borrowers or depositors, total number of accounts have been considered
6. CRISIL Inclusix, India's first financial inclusion index, was launched in 2013 with the objective of creating a dependable yardstick that would become a policy input to further the cause of inclusion. CRISIL Inclusix weighs three service providers (banks, insurers and microfinance institutions) on four dimensions (branch, credit, deposit and insurance).
Source: RBI, MOSPI, CRISIL MI&A

State-wise GDP and GDP growth (FY 2021)

States	GSDP - Constant Prices FY21 In Rs. Billion	Y-o-Y growth	CAGR (FY21-FY16)	Credit Account Penetration as on FY22	Deposit Account Penetration as on FY22	Branch Penetration as on FY22	ATM Penetration as on FY22	CRISIL Inclusix Score (FY2016)
Maharashtra	18,893	-7.57%	2.69%	43%	176%	106	213	62.7
Gujarat	12,443	-1.95%	6.82%	9%	157%	128	186	62.4
West Bengal	7,927	1.06%	5.40%	4%	160%	91	123	53.7
Delhi	5,647	-3.86%	3.49%	26%	292%	192	400	86.1
Bihar	4,199	2.50%	7.21%	1%	123%	62	73	38.5
Chhattisgarh	2,455	-1.77%	5.19%	4%	145%	98	134	45.7
Jharkhand	2,271	-4.75%	5.36%	3%	145%	90	106	48.2
Uttarakhand	1,759	-6.55%	2.87%	9%	284%	289	378	69.0

Note:

1. Credit account penetration is calculated as total number of retail bank credit accounts/population of the state
2. Deposit account penetration is calculated as total number of bank deposit accounts/ population of the state
3. Branch penetration is calculated as Number of bank branches per million people
4. ATM penetration is calculated as Number of ATMs per million people
5. For Credit and Deposit account penetration, this does not represent unique borrowers or depositors, total number of accounts have been considered
6. CRISIL Inclusix, India's first financial inclusion index, was launched in 2013 with the objective of creating a dependable yardstick that would become a policy input to further the cause of inclusion. CRISIL Inclusix weighs three service providers (banks, insurers and microfinance institutions) on four dimensions (branch, credit, deposit and insurance).
Source: RBI, MOSPI, CRISIL MI&A

Small finance banking industry

In order to promote financial inclusion, the Indian banking industry has seen several changes in recent years. NBFCs, such as Bandhan and IDFC received permission to set up universal banks. Also, a few microfinance companies, local area banks and an NBFC as well as one urban co-operating bank have received permission to set up small finance banks (SFBs). As of March 2023, the RBI has awarded SFB licences to 12 players keeping in with the government's focus on financial inclusion and inclusive banking.

Comparison of different business models

	Scheduled commercial banks	SFBs	MFIs
		Priority sector lending	
Targeted lending to sectors	• 40% of their adjusted net bank credit (ANBC) or equivalent off-balance sheet exposure (whichever is higher) for priority sector lending ○ 18% of ANBC to agriculture ○ 7.5% of ANBC to micro-enterprises ○ 10% of ANBC to weaker sections	• 75% of their ANBC for priority sector lending ○ 18% of ANBC to agriculture ○ 7.5% of ANBC to micro-enterprises ○ 10% of ANBC to weaker sections • At least 50% of loan portfolio should constitute loans and advances of up to Rs. 2.5 million	• 75% of total assets should be qualifying micro-finance loans ○ Income generation loans > 50% of total loans
		Prudential norms	
Capital adequacy framework	• Minimum Tier-I capital: 7% • Minimum capital adequacy ratio: 9%	• Minimum Tier-I capital: 7.5%(Tier-II capital cannot be more than 100% of Tier-I capital) • Minimum capital adequacy ratio: 15%	• Tier-I capital > Tier-II capital • Minimum capital adequacy ratio: 15%
CRR / SLR	• Maintenance of CRR/SLR ratio mandatory • CRR – 3%, 3.5% begin. March 27, 2021, 4% beginning May 22, 2021, 4.5% beginning May 21, 2022. • SLR – 18%	• Maintenance of CRR/SLR ratio mandatory • CRR – 3%, 3.5% begin. March 27, 2021, 4% beginning May 22, 2021, 4.5% beginning May 21, 2022 • SLR – 18%,	• No such requirement
Leverage ratio	• Minimum leverage ratio of 4%	• Minimum leverage ratio of 4%	• No such requirement
LCR (liquidity coverage ratio)/ NSFR (net stable funding ratio)	• Mandatory requirement to maintain liquidity coverage ratio • NSFR applicable to scheduled commercial banks	• Minimum liquidity coverage ratio of 100% by April 1, 2021 • NSFR will be applicable to SFBs on par with scheduled commercial banks as and when finalised	• No such requirement
		Funding	

	Scheduled commercial banks	SFBs	MFIs
Deposits	• Primarily rely on deposits, CASA and term deposits, for funding requirements	• Primarily rely on deposits, CASA and term deposits, for funding requirements • Deposit ramp-up will take time	• Cannot accept deposits
Bank loans / market funding	• Access to broader array of market borrowings	• Access to bank loans and broader array of market borrowings	• Diversified funding sources, including bank loans, short-term and long-term market borrowings. Funding from NABARD, MUDRA loans etc.
Products			
Products offered	• Full spectrum of banking, savings, investment and insurance products	• Can offer savings and investment products apart from credit products / loans • Can act as corporate agent to offer insurance products • Cannot act as business correspondent to other banks	• Can act as business correspondent to another bank and offer savings, deposits, credit and investment products • Can act as corporate agent to offer insurance products

Source: RBI, CRISIL MI&A

Growth drivers for small finance banks

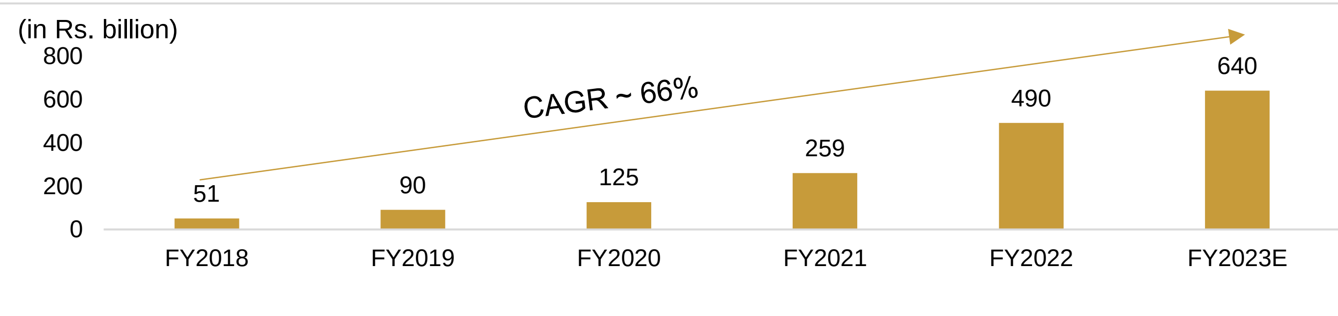
Customized products aided by technology and information availability

Greater use of technology is enabling lenders to provide customised products, that too at much lower turnaround time. Multiple data points are available for lenders that is facilitating quick decision making. In fact, they can take lending decisions within minutes using data-driven automated models. These models would help in supply of credit to small business units and the unorganised sector at low cost. Technology also helps these players expand their reach to under penetrated population in remote areas at a lower operating cost.

Availability of funds at cheaper rates

CASA and other retail deposits are a cheap source of funds for SFBs, which help them expand their product portfolio. They can provide lower rates in the market to compete with NBFCs. With SFBs expanding in the underserved regions further, their deposit base is expected to further widen. The CASA deposits for SFBs is estimated to have grown at 66% CAGR from fiscal 2018 to fiscal 2023.This will give them an advantage over NBFCs and help expand their asset book.

CASA Deposits for SFBs is estimated to reach Rs. 640 billion at the end of FY 2023



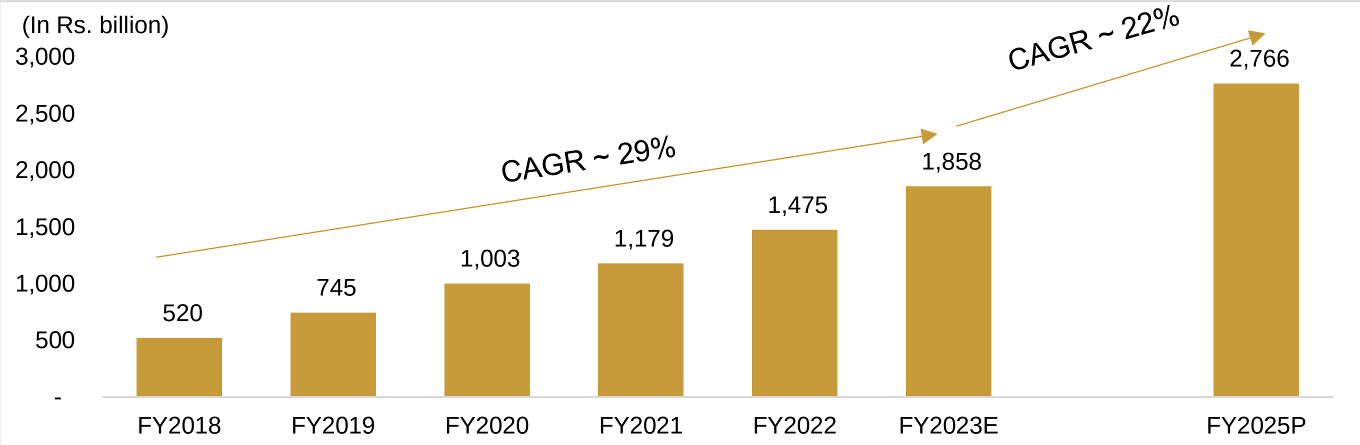
Note: E- Estimated
Source: RBI, CRISIL MI&A

Large Target audience

SFBs' target audience is the low-income segment, who can be wooed with a sachet level product suite. Unlike NBFCs, which expand horizontally with a special focus product, SFBs has a chance to expand vertically and horizontally. This will enable them to have a good mix of medium and low-value customers. Also, rural and microfinance borrowers have low credit penetration and migrate less from one player to another. This will enable SFBs to build longer and loyal customer relationships.

Industry growth and outlook

Huge opportunity to support growth over next two years (AUM)



Note: E: Estimated; P: Projected; The amounts are as of the end of the Fiscal indicated;
Source: Company reports, CRISIL MI&A

The Small finance banks' AUM is estimated to have clocked 29% CAGR from fiscals 2018 to fiscal 2023. CRISIL MI&A estimates that the top three SFBs accounted for ~62% of the aggregate AUM as of fiscal 2023, up from 55% as of Fiscal 2017 indicating the rising concentration and expansion of top 3 players within the SFBs. CRISIL MI&A also estimates that the top six players accounted for ~89% of the market share as of fiscal 2023.

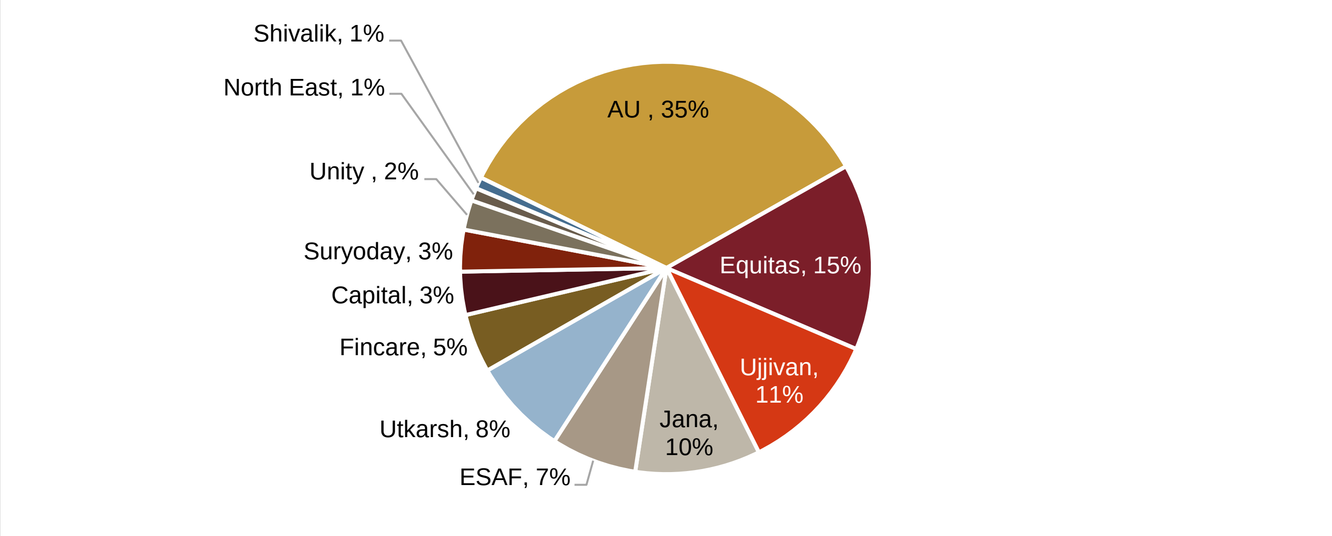
In FY2021 and 2022, new loan origination remained low as SFBs turned cautious and selective in disbursals due to the pandemic. However, as economy revived and business operations normalised, SFB AUM witnessed strong growth post pandemic. As of FY2023, SFB AUM is estimated to have crossed Rs. 1,800 billion growing at 26%-27% year on year. CRISIL MI&A expects the loan portfolio to see a strong ~22% CAGR between fiscal 2023 and fiscal 2025 as most of the SFBs have completed the transition phase and likely to get benefit from the operating leverage.

Growth in SFB AUM will be driven by following factors:

- **Huge market opportunity in the rural segment** – Despite its larger contribution to GDP of 47%, the rural segment's share in credit remains fairly low at ~9-10% of the overall credit outstanding as of fiscal 2022. This provides a huge market opportunity for SFBs and other players present in the segment
- **Presence of informal credit channels –** In remote areas, informal credit channels have a major presence. In other words, there is a huge section of unbanked population. SFBs have an opportunity to tap this market
- **Geographic diversification –** With increased focus on diversifying their portfolio and expanding their reach, SFBs are expected to log higher growth as they tap newer geographies
- **Loan recovery and control on aging NPAs –** SFBs are experienced in collection and monitoring of default risk. This will help them keep asset quality under check
- **Ability to manage local stakeholders –** With their microfinance experience, SFBs have the ability to manage local stakeholders and maintain operational efficiency
- **Access to low-cost funds & huge cross sell opportunity–** SFBs' cost of funds is low substantially as they are

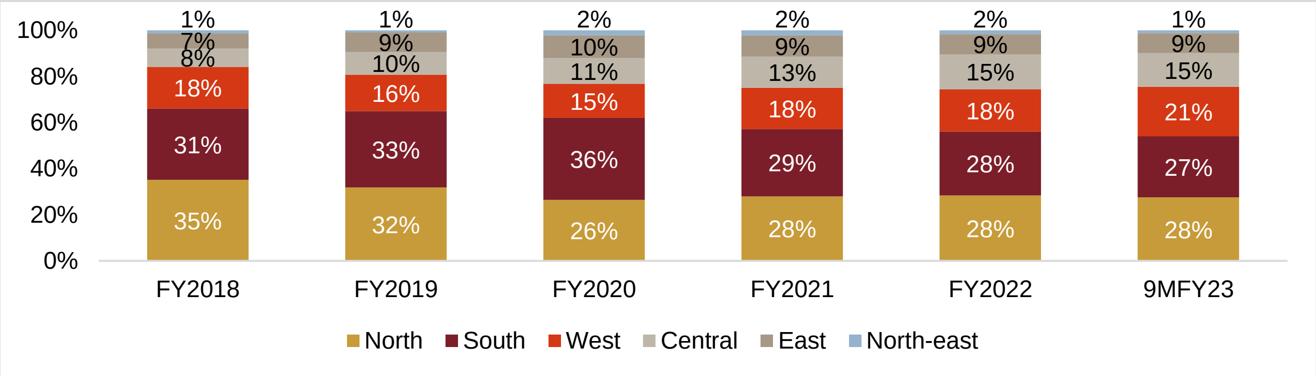
allowed to raise CASA deposits. This will also help them lend at more reasonable rates to its customers, hence enhancing their cross-sell opportunity in terms of asset products, insurance etc.

Top six players estimated for 84% of industry advances as of December 31, 2022



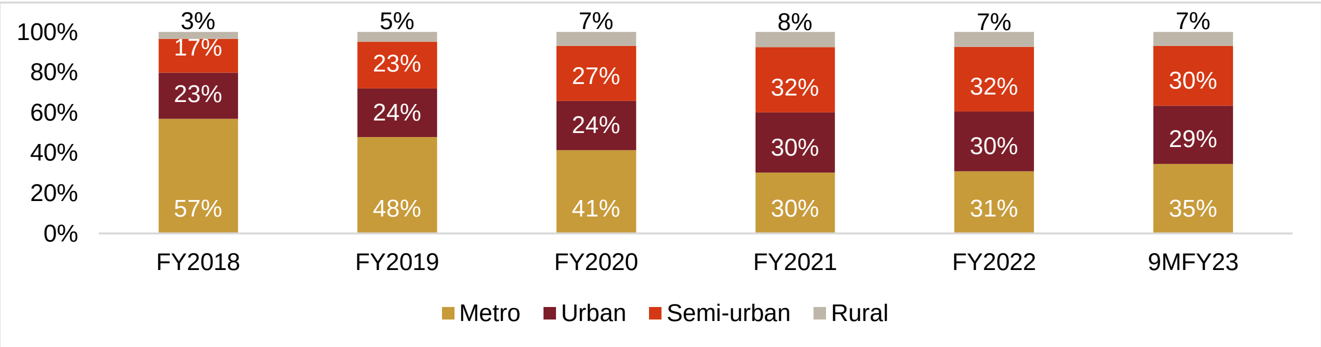
Note: The market share is estimated as of December 31, 2022;
Source: Company reports; CRISIL MI&A

Advances across regions for SFBs as of 31st December 2022



Source: RBI, CRISIL MI&A

Urban and semi-urban regions continue to have higher share of credit by SFBs



Note: Rural: Population less than 10,000, Semi urban: 10,000 <=Population <0.1 million, Urban: 0.1 million <=Population <1 million, Metropolitan: Population 1 million and above
Source: RBI, CRISIL MI&A

In terms of AUM, Rajasthan contributes to the largest share of loan portfolio for SFBs at 15%, followed by Tamil Nadu (14%) and Maharashtra (14%) as of 31st December 2022. However, in terms of growth, Karnataka state has seen the highest growth in the loan portfolio for SFBs from fiscal 2019 to 9MFY23 with a CAGR of 90%. CRISIL MI&A believes that with portfolio diversification into multiple states and increasing penetration of SFBs, the concentration of top 3 states will gradually reduce and its share will become more uniform in the overall state mix.

Top 10 states contribute approximately 82% of the SFB loan portfolio as of 31st December 2022

Top 10 States	Share as of Q3FY23	FY19-Q3FY23 CAGR growth
Rajasthan	15%	22%
Tamil Nadu	14%	20%
Maharashtra	14%	45%
Madhya Pradesh	8%	45%
Gujarat	7%	43%
Karnataka	6%	90%
Punjab	5%	27%
Uttar Pradesh	5%	50%
Bihar	4%	28%
Haryana	4%	51%

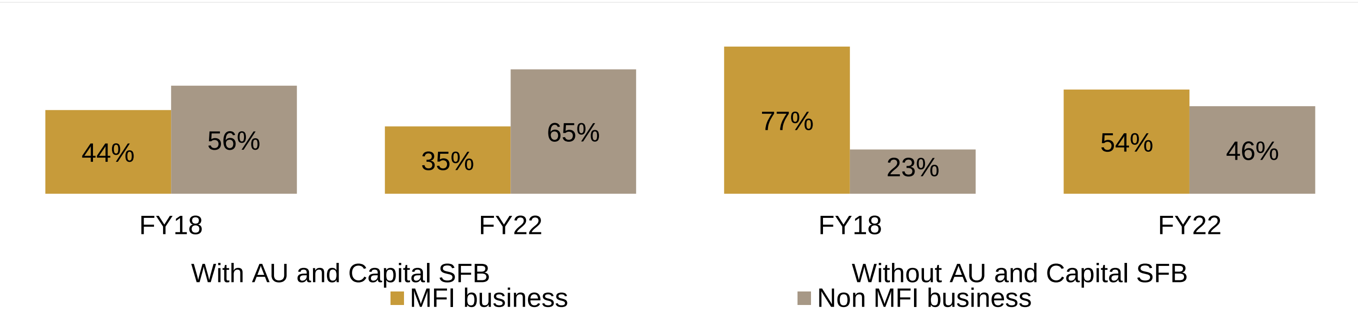
Source: RBI, CRISIL MI&A

SFBs continue to diversify their portfolio beyond microfinance business

Eight of the 10 firms that got SFBs licence in the initial phase were MFIs and for most of them microfinance is the central product. The microfinance segment accounts for 35% (including Capital and AU SFB) of overall business of SFBs in fiscal 2022.

In fact, SFBs have shifted their focus from microfinance to other products. But their core customer base is unlikely to have changed much because of the regulatory norms. After the conversion of NBFC-MFIs to SFBs, the focus is now on diversifying the product portfolio. As a result, the share of their MFI portfolio in total advances reduced to 35% as of Fiscal 2022 from 90-95% as of fiscal 2016. Going forward, SFBs will have to focus on small-ticket size lending to financially under-served and un-served segments (loans below Rs 2.5 million will have to form at least 50% of their loan book). CRISIL MI&A expects MFIs that converted to SFBs to further diversify and focus on allied segment loans, such as MSME loans, affordable housing finance, gold loans, CV/non-CV loans and two-wheeler loans, which will reduce the dominance of microfinance in their overall loan portfolio.

Advances mix for small finance banks



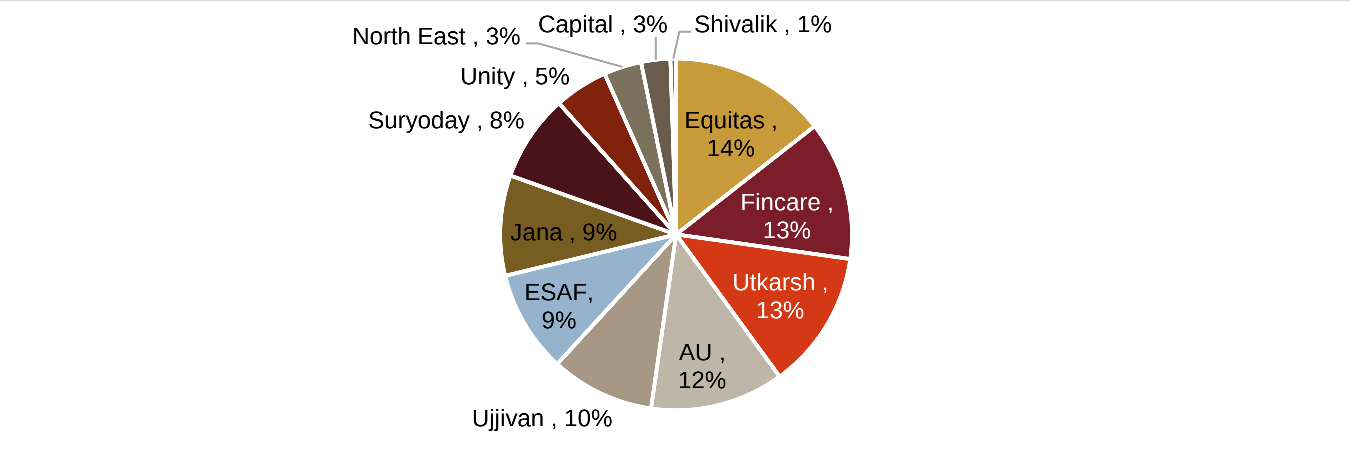
Notes: E: Estimated, 1) Capital and AU SFB are excluded as they mostly deal with non-MFI business, 2) Portfolio mix data for Capital SFB and ESAF SFB is as of March 2021, 3) Data includes data for 10 SFB

Source: Company reports, CRISIL MI&A

Growth in network base to curb geographic concentration of loan portfolio

SFBs have been given three years to align their banking network with the extant guidelines. As long as the existing structures continue, they would be treated as 'banking outlets', although not immediately reckoning for the 25% norm. During the three years, all banking outlets opened or converted from MFI branches in a year, will have to open 25% banking outlets in unbanked rural centres in the same year.

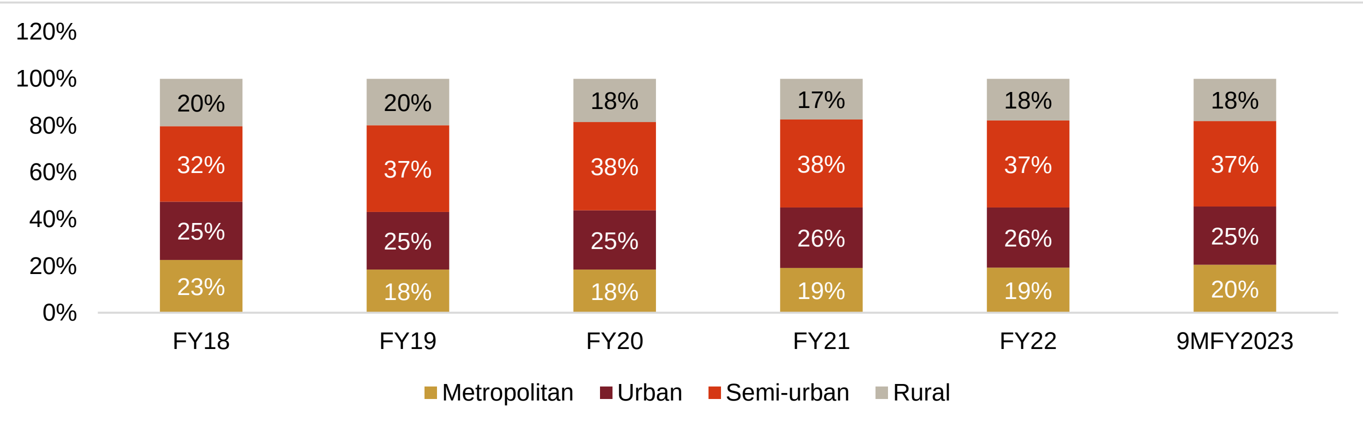
Top three players accounted for 40% of the total functioning offices as of 31st December 2022



Source: RBI; CRISIL MI&A

SFBs have seen strong growth in branch expansion to meet regulatory requirements. As of 31st December 2022, the top three players accounted for 40% of the total number of functioning offices. Expansion of functioning offices has also helped diversification of portfolio and overcome geographic concentration. As of 31st December 2022, top 10 states account for approximately 82% of the overall SFB portfolio. However, with rapid branch expansion and broad service offerings, the share of these states is expected to come down.

Share of semi-urban branches continue to increase for SFBs



Note: Rural: Population less than 10,000, Semi urban: 10,000 <=Population <0.1 million, Urban: 0.1 million <=Population <1 million, Metropolitan: Population 1 million and above

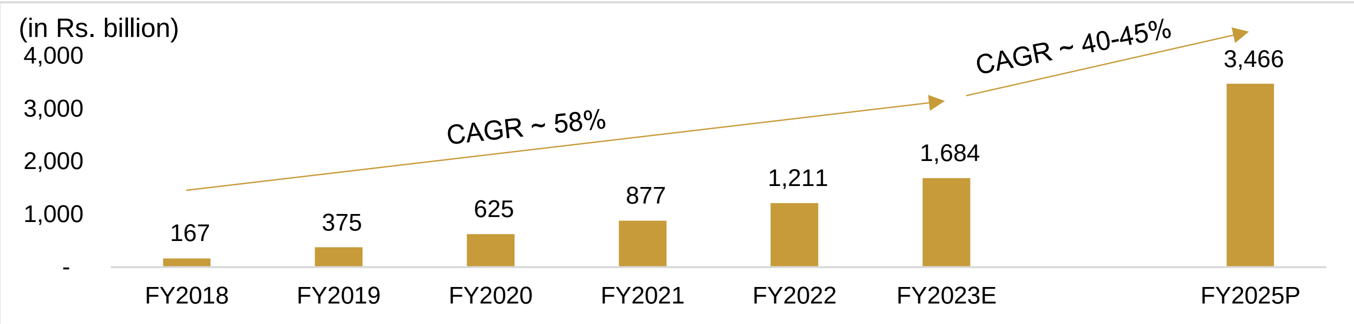
Source: RBI, CRISIL MI&A

SFB deposits to grow faster than private and public-sector banks

SFBs have a significant growth potential as most of them were functioning as NBFCs/MFIs previously. Immediately after commencement of their operation, all SFBs focussed on increasing their deposit base. Their overall deposit base doubled to around Rs 375 billion as of fiscal 2019. Further, proportion of CASA deposits has short up from nearly ~20% as of fiscal 2020 to ~39% as of 31st December 2023. The increase could be attributed to the higher interest rates they offer and increase in their branch network.

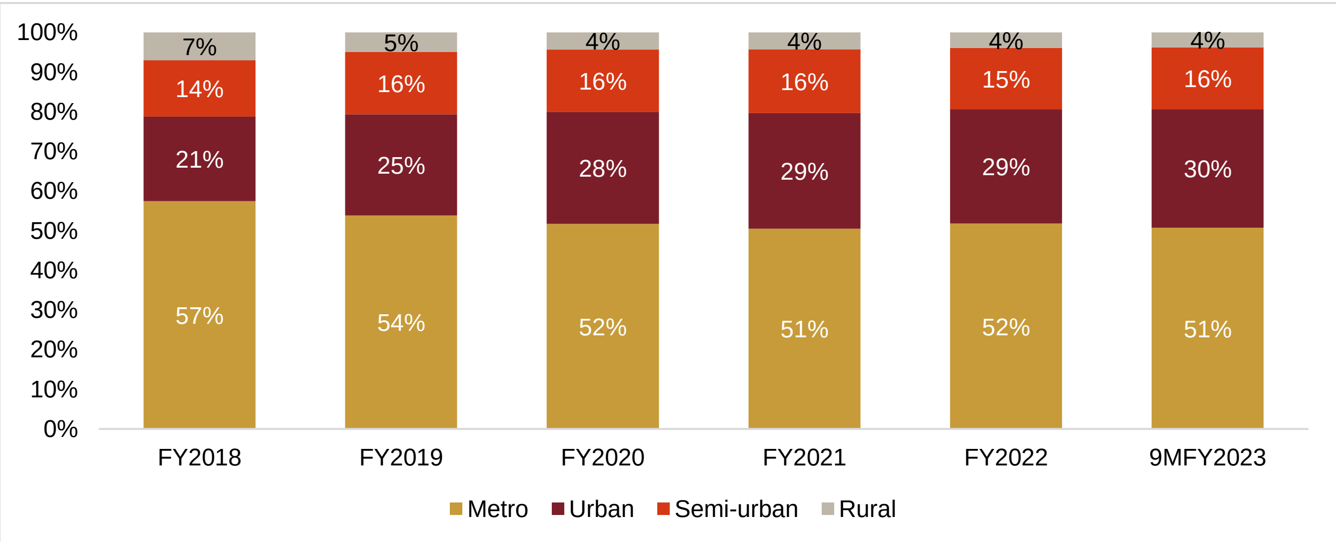
Deposit growth for SFBs continued to grow at a strong pace of 36% as of 9MFY2023 on-year and is estimated to have reached Rs. 1,684 billion at the end of FY 2023. Going forward, CRISIL MI&A expects SFBs' deposit to grow 40-45% CAGR over fiscals 2023-2025 as players focus on popularising convenient banking habits to cover the last mile and widen financial inclusion by deepening their penetration in untapped geographies.

Deposits for Small Finance Banks to grow robustly



Note: Amounts are as at the end of fiscal year indicated; P: Projected
Source: Company reports, CRISIL MI&A

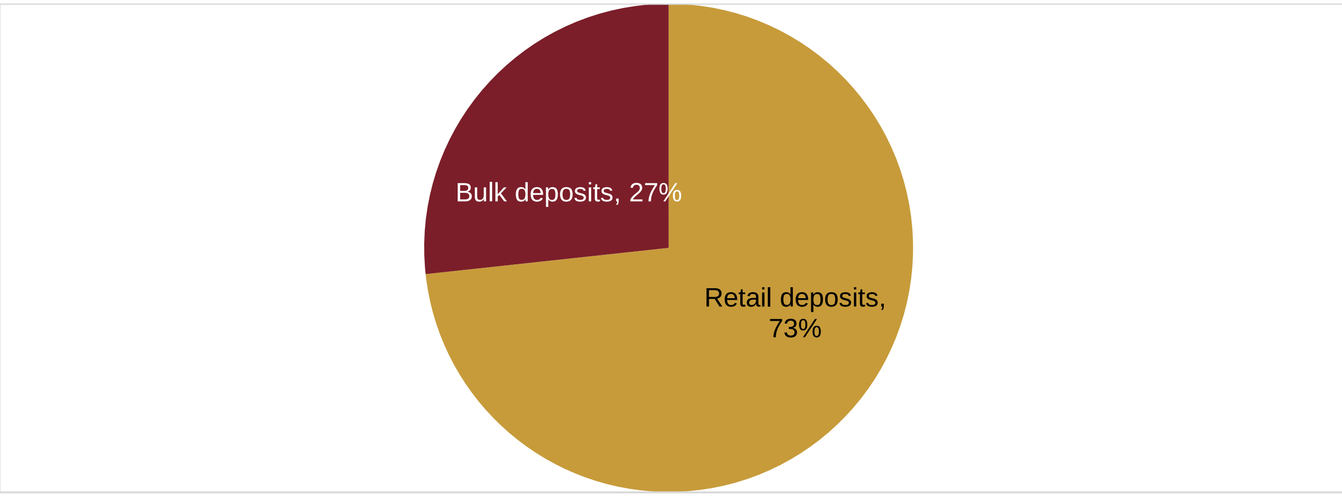
Around 80% deposits is from metropolitan and urban regions for SFBs



Note: Rural: Population less than 10,000, Semi urban: 10,000 <=Population <0.1 million, Urban: 0.1 million <=Population <1 million, Metropolitan: Population 1 million and above;

Source: RBI, CRISIL MI&A

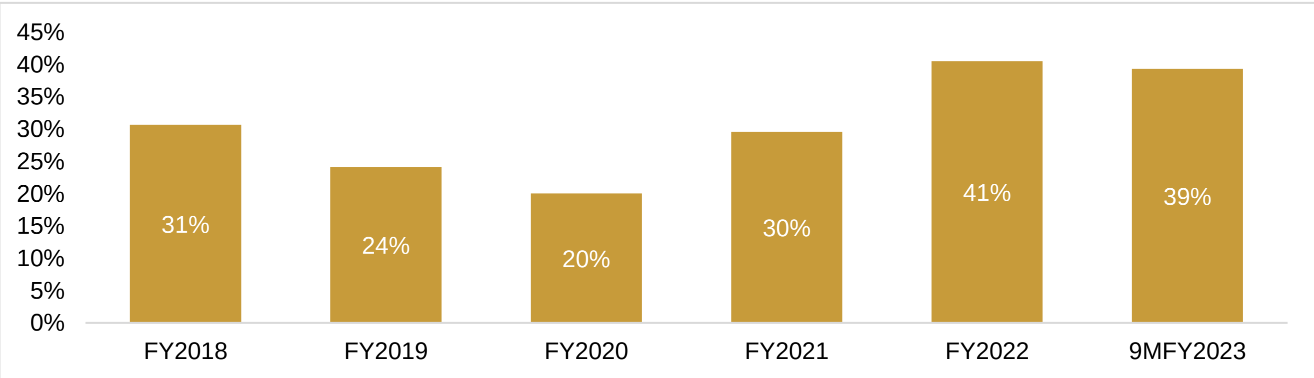
Share of retail deposit in total deposit (FY2022)



Note: Retail deposit include CASA and Retail term deposits; Data excludes data for Jana and North East SFB;

Source: Company reports, CRISIL MI&A

CASA Ratio for small finance banks



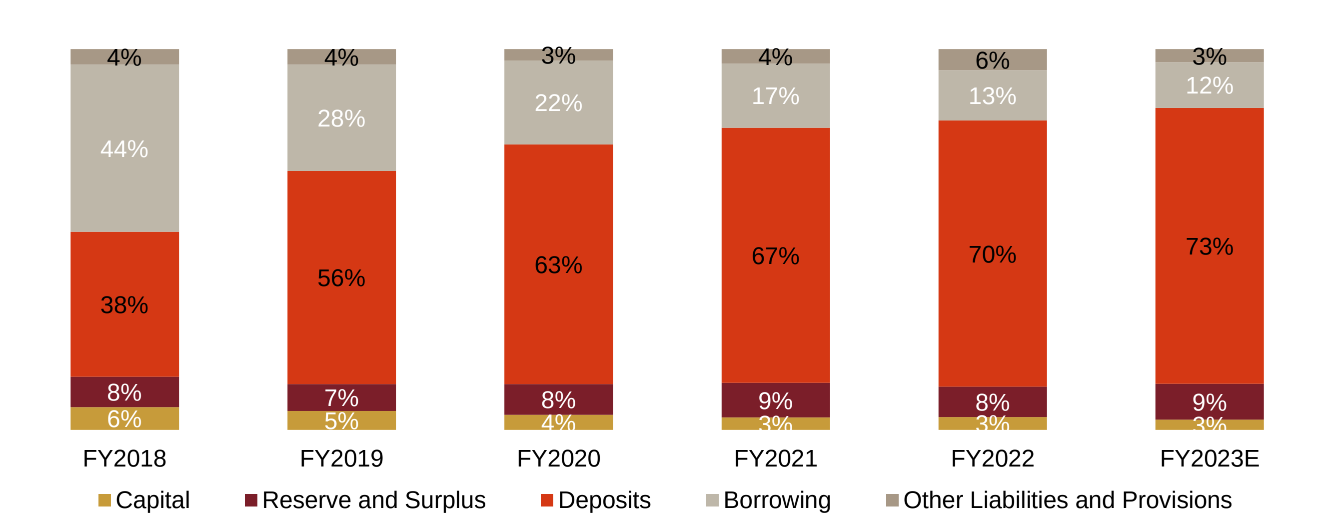
Source: RBI, Company Reports, CRISIL MI&A

Over the next couple of years, CRISIL MI&A expects SFBs to focus on gradually building their banking business and complying with tougher regulatory norms. In addition, transformation into SFBs will provide access to stable and granular public deposits over the long run, which will bring down their cost of funds.

Transformation in Resource profile of SFBs

The resource profile of SFBs has completely transformed in the last two to three years owing to a decrease in share of borrowings from 44% as of fiscal 2018 to 13% as of fiscal 2022 and a rise share of deposits from 38% to 70% during the same period. In fiscal 2023, the deposit rate lagged the credit growth rate. Further, CRISIL MI&A expects the deposits rate to inch up with increase in competition and to support the credit growth. Their asset-liability management (ALM) profile remains comfortable owing to conservative liquidity policy, mobilisation of deposits and shorter tenure loans. Their liquidity profile is also supported by regulatory requirements such as higher requirement of minimum net owned funds ensuring capital adequacy and mandatory maintenance of CRR/SLR ratio, which provides access to call money market and provide better cushion than other NBFCs.

Rapid ramp-up in deposits for SFBs



Note: E = Estimated; The percentages are as at the end of fiscal year indicated;

Source: Company reports, CRISIL MI&A

NBFC vs SFBs - liquidity, and ALM (Asset Liability Management)

For SFBs, the asset-liability mismatch deteriorated from March 2021, which can be also seen in March 2022, especially in short term buckets of in one-two months, two-three months, three six months and six months to a year owing to rapid growth in deposit base. However, in the long-term buckets, SFBs are placed much more comfortably as compared to NBFCs, which can be attributed to strong growth in advance of the SFBs due to portfolio diversification towards non-MFI asset classes.

Asset-Liability mismatch as percentage of liabilities

		1 to 30 Days	Over 1 Month to 2 Months**	Over 2 Months to 3 Months	Over 3 Months to 6 Months	Over 6 Months to Year	Over One Year to 3 Year	Over 3 to 5 Year	Over 5 Years
Mar-19	NBFCs	52%	8%	3%	26%	6%	-2%	15%	9%
	SFBs	27%	6%	-22%	-2%	-10%	-12%	45%	259%
Mar-20	NBFCs	44%	9%	1%	19%	13%	0%	10%	11%
	SFBs	-32%	-85%	-16%	-18%	-8%	2%	125%	320%
Mar-21	NBFCs	37%	27%	16%	29%	9%	-6%	37%	12%
	SFBs	30%	-30%	-5%	-21%	-21%	-21%	124%	441%
Mar-22	NBFCs	92%	47%	20%	37%	4%	-1%	38%	-4%
	SFBs	15%	-27%	-15%	-29%	-15%	-24%	318%	528%

Note: (**)- Data for North-East SFB for 31 days to 3 months is considered in 1 month to 2 month bracket for March-22, March-21 and March-20 as per the disclosure by company, Asset liability mismatch as % of liabilities calculated as = ((Advances + Investments) - (Deposits + Borrowings)) / (Deposits +Borrowings),

Source: RBI, Company reports, CRISIL MI&A

Profitability for SFBs bounced back in fiscal 2023

In fiscal 2020, the return on assets (RoA) of SFBs increased by 20-30 bps. However, outbreak of Covid-19 followed by the nationwide lockdown in the month of March 2020, caused a rise in credit costs for SFBs who made special Covid-19 provisioning, in addition to standard provisioning as of fiscal 2020.

In fiscal 2022, the industry RoA declined sharply to 0.7% from 1.5% in fiscal 2021 and 1.9% in fiscal 2020 largely due to increased provisioning made by many players in the industry, considering the likely impact of Covid-19 on asset quality. Players who had adequate capital went for front loading of credit costs in fiscal 2021 itself, while players who had lower margins and higher operating costs spread out the increased provisioning over the course of fiscal 2021 and fiscal 2022.

In fiscal 2023, to tackle inflation, RBI started increasing policy repo rating by 40 bps in May 2022, 50 bps in June, August and September 2022, and an additional 25 bps increase in February 2023. With faster increase in repo rates, yield on loans rose quickly. Moreover, interest income for SFBs increased at a faster pace than interest expenses which resulted in improvement of net interest margins. At the end of FY 2023, the net interest income ratio is estimated to reach 7.6% from 6.8% in FY 2022. Improvement in profitability is estimated to increase return on assets of SFBs to 1.8% at the end of FY 2023 from 0.7% in FY 2022.

Going forward, increasing interest income coupled with reduction in Opex and credit cost because of improved collection efficiency is expected to augment profitability for small finance banks.

Increasing credit cost amid COVID-19 pandemic to weigh on profitability of SFB in the near-term

RoA tree (SFB)	FY19	FY20	FY21	FY22	FY23E
Interest income	14.1%	14.5%	12.9%	11.8%	12.7%
Interest expense	6.6%	6.7%	6.0%	5.0%	5.1%
Net interest income	7.5%	7.8%	6.9%	6.8%	7.6%
Opex	6.1%	5.8%	4.9%	5.3%	5.5%
Other income	2.0%	1.7%	2.1%	1.6%	1.5%
Credit cost	0.9%	1.3%	2.2%	2.3%	1.2%
RoA	1.6%	1.9%	1.5%	0.7%	1.8%

Note: E: Estimated, Numbers are based on Ind-AS, Data excludes Jana, North East SFB and Shivalik SFB
Source: CRISIL MI&A

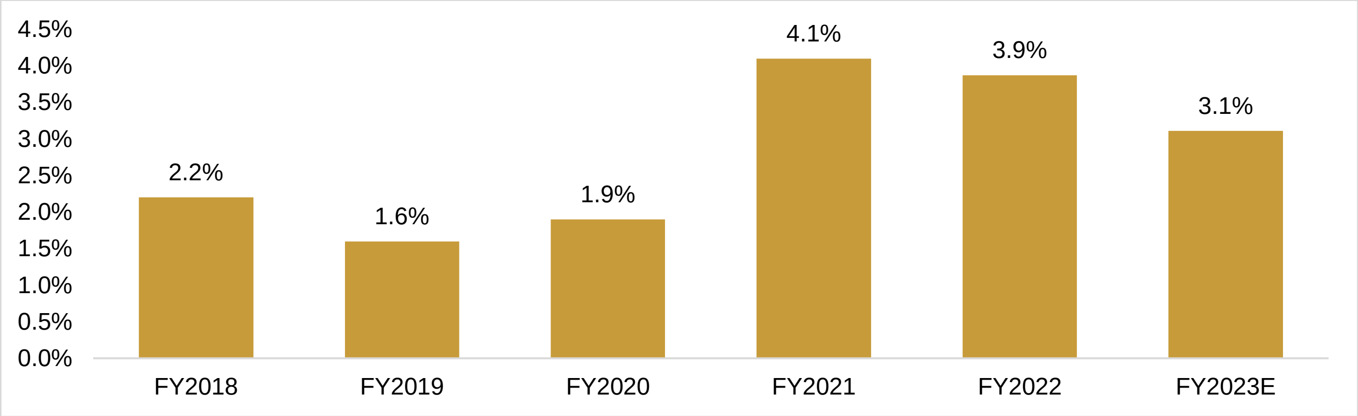
Asset quality for SFBs to marginally improve after pandemic related stress

GNPA of SFBs improved to 1.6% as of fiscal 2019 from 2.2% as of fiscal 2018 which was majorly impacted by demonetization and residual asset quality issues. This could be attributed to diversification of product mix into relatively less risky assets, write-off of legacy loans and reduction in microfinance loans due to better collection mechanism and deep understanding of their local geographies and customers. In fiscal 2021, SFBs faced severe asset quality issues, as near-term collections saw disruptions on account of Covid-19. However, RBI in March 2020 announced the moratorium on term loans/ working capital for instalments falling due between March 1, 2020 and May 31, 2020. This was subsequently extended in May 2020 by another three months to August 31, 2020. A stand-still in asset classification for accounts availing the moratorium was provided from March 1, 2020 to August 31, 2020. For all accounts classified as standard as on February 29, 2020, even if overdue, the moratorium period, wherever granted, was to be excluded by the lending institutions from the number of days past-due for the purpose of asset classification.

Despite government measures, the lockdown impacted the low- and middle-income segments the most. They also happened to be the target audience of SFBs. While banks offered moratorium period to borrowers, SFBs' asset quality deteriorated due to difficulties faced by their borrowers. In FY 2022, the GNPAs improved marginally to 3.9%. In FY 2023, the asset quality of SFBs improved on account of lower slippages, writing offs and improved collection efficiencies. GNPA for SFBs is estimated at 3.1% at the end of FY 2023.

Going forward, the asset quality of SFBs is expected to improve further, however, it will vary depending on efficiency in credit underwriting, monitoring and collection over the long term.

GNPA trend of overall SFB Industry



Note: E= Estimated; Data excludes data for Jana SFB and North-east SFB;

Source: Company reports, CRISIL MI&A

Peer Benchmarking

In this section, we have compared Fincare SFB with all its peers in India based on the latest available data as of nine months ended fiscal 2023. We have also looked at large listed microfinance players since many SFBs were present in this space before switching to SFB. This section also analyses the performance of private banks.

ESAF SFB recorded the highest growth of 34.2% among the SFBs from fiscal 2018 to nine months ended fiscal 2023

ESAF SFB recorded fastest growth in GLP from fiscal 2018 to nine months ended fiscal 2023 at 34.2% followed by Utkarsh SFB (33.5%).

Fincare SFB has the second highest number of functioning offices amongst all SFBs as of nine months ended fiscal 2023

Fincare SFB has 822 functioning offices across 19 states and 3 UTs as of nine months ended fiscal 2023 which is the second highest amongst its peer group. Equitas SFB has the highest number of functioning offices (928) as of nine months ended fiscal 2023.

AU SFB has the highest deposit CAGR among SFBs between fiscal 2018 to nine months ended fiscal 2023

AU SFB recorded the highest deposit CAGR of 53.7% among the SFBs between fiscal 2018 to nine months ended fiscal 2023.

SFBs and other players as of 31st December 2022

Players	Advances (Rs billion)	Advances growth (FY18-Q3FY23)	Deposit (In Rs. billion)	Deposit growth (FY18-Q3FY23)	Credit to deposit ratio	Disbursement – 9MFY23 (in Rs billion)	Disbursement -FY22 (in Rs. Billion)	Disbursement growth (FY19-FY22)
SFBs								
AU SFB	563*	30.0%	611	53.7%	91%	271	254	16.5%
Equitas SFB	249*	28.0%	234	35.1%	100%	119	105	7.1%
Ujjivan SFB	219*	25.1%	232	46.6%	84%	NA	141	8.3%
Jana SFB	161*	10.6%	152	NM	106%	NA	62#	NA
ESAF SFB	118^	34.2%	135^	45.2%	84%^	NA	63#	7.6%$
Utkarsh SFB	110^^	33.5%	117^	45.2%	97%^	NA	90	41.2%
Fincare SFB	70***	NA	65***	NA	109%***	NA	71	28.5%
Suryoday SFB	54*	29.3%	47	47.1%	113%	NA	35	7.3%
Microfinance								
Credit Access	148*	25.8%	NM	NM	NM	96	128	16.0%
Spandana	69*	17.6%	NM	NM	NM	51	34	(12.1%)
Universal banks								
Bandhan Bank	978*	26.2%	1,023	26.2%	90%	NA	317	(17.3%)

Note: (*) Advances as of December 2022; (^) As of September 2022; (^^) Gross Advances as of June 2022; (#)- As of fiscal 2021, ($)- CAGR of fiscal 2019-2021; (***) As of fiscal 2022; NA - Not available, NM – Not meaningful.

Source: Company reports, CRISIL MI&A

SFBs and other players as of 31st December 2022

Players	Functioning Offices $$	Presence in states and UTs	Number of Employees	Employee growth (FY19-Q3FY22)	Balance sheet size as of Q3FY23 (in Rs. Billion)	Balance sheet size growth (FY19-Q3FY23)
SFBs						
AU SFB	790	24	27,800	23.4%	807	27.3%

Players	Functioning Offices $$	Presence in states and UTs	Number of Employees	Employee growth (FY19-Q3FY22)	Balance sheet size as of Q3FY23 (in Rs. Billion)	Balance sheet size growth (FY19-Q3FY23)
Equitas SFB	928	18	20,005	8.7%	318	20.6%
Ujjivan SFB	613	25	16,674	3.3%	305	23.6%
Jana SFB	592	24*	16,212^	(1.6%) $	236	27.7%
ESAF SFB	604	21*	4,141**	24.1%***	182*	31.2%^^
Utkarsh SFB	819	22**	12,617**	26.2%***	165*	32.0%^^
Fincare SFB	822	22	NA	NA	NA	109**
Suryoday SFB	512	14	6,094	12.4%	89	25.5%
Microfinance						
Credit Access	1,251	13	16,807	21.6%	161	23.3%
Spandana	1,115	18*	8,732	7.5%	83#	15.0%
Universal banks						
Bandhan Bank	5,723	34	66,114	21.0%	1,423	28.0%

Notes: (*) As of September 2022; (**) As of fiscal 2022; (***) CAGR of FY2019 – FY2022; (^^) CAGR of FY2019 – H1FY2023; (^)-Values as of fiscal 2021; ($)- CAGR of FY2019-FY2021; (#) Consolidated balance sheet; ($$) Functioning Offices as per RBI for SFBs;

Source: Company reports, CRISIL MI&A

ESAF SFB has the highest proportion of retail deposits in total deposits as of nine months ended fiscal 2023

As of nine months ended fiscal 2023, ESAF SFB had the highest proportion of retail deposit in total deposits (93.7%).

Deposit details of SFBs and other players as of 31st December 2022

Q3FY23	Proportion of deposit to total loan book (%)	Proportion of deposit in total borrowing (%)	Proportion of Retail deposits in total deposits (%)	CASA (% of deposits)	Retail TD (% of deposits)	Bulk TD (% of deposits)	Share of top-20 accounts in deposits**
SFBs							
AU SFB	109.9%	90.8%	70.0%	38.4%	32.2%	28.5%	16.8%
Equitas SFB	100.5%	89.5%	81.7%	46.2%	35.5%	18.3%	13.8%
Ujjivan SFB	118.8%	90.9%	64.4%	26.2%	38.2%	35.0%	22.5%
Jana SFB	94.3%	73.0%	NA	20.9%	NA	NA	13.2%
ESAF SFB	118.7%*	83.8%*	93.7%^	22.8%^	NA	NA	15.9%
Utkarsh SFB	102.9%*	84.7%*	59.6%^	22.4%^	37.3%^	40.4%^	28.7%
Fincare SFB^	91.7%	68.7%	82.2%	36.3%	45.9%	17.8%	17.8%
Suryoday SFB	88.2%	66.5%	77.9%	14.1%	63.8%	NA	23.6%
Universal banks							
Bandhan Bank	111.1%	84.7%	69.5%	36.4%	33.1%	30.5%	20.1%

Notes: 1) NA - Not available. 2) Retail deposits includes CASA and retail term deposits. Bulk deposits include institutional deposits. Retail deposits include deposits less than Rs. 20 million. 3) CASA ratio is calculated based on overall deposits excluding certificates of deposits (CoD).4) (*)-Data as of September 2022. 5) (^) Data as of fiscal 2022. 6) (**) Share of top 20 accounts is as of fiscal 2022 7)

Source: Company reports, CRISIL MI&A

Operating efficiency of SFB's is relatively higher than microfinance players for most of the parameters. The use of paperless Aadhaar based on-boarding has helped banks to improve their operating efficiency as compared to NBFCs who are not allowed to use Aadhaar based enrolment. In nine months ended fiscal 2023, AU SFB leads its peers with leading business per branch as of nine months ended fiscal 2023. ESAF SFB has the highest business per employee among the SFBs.

Operational efficiency of SFBs as of 31st December 2022

Players	Advances per employee (in million)	Deposit per employee (in million)	Business per employee (in million)	Advances per branch (in million)	Deposit per branch (in million)	Business per branch (in million)	GLP per customer (Rs) ***	Opex per banking outlet (in million)
SFBs								
AU SFB	20	22	42	548	602	1150	170,825	24
Equitas SFB	12	12	23	258	260	518	NA	16
Ujjivan SFB	12	14	25	327	388	715	28,028	22
Jana SFB*	7	8	15	198	212	410	NA	19.5#
ESAF SFB	28^	31^	59^	198**	235**	432**	17,987	10**
Utkarsh SFB	8^	8^	16^	149^	147^	296^	35,435	11^
Fincare SFB	NA	NA	NA	NA	NA	NA	NA	NA
Suryoday SFB	9	8	16	93	82	176	26,372	6
Microfinance								
Credit Access	11	0	11	111	0	111	46,995	4
Spandana	7	0	7	58	0	58	28,613	3
Universal Banks								
Bandhan Bank	14	15	29	161	179	340	35,732	6

Note: (#) Banking outlets for fiscal 2021 considered for calculation; (*) Data as of fiscal 2021; (***) GLP per customer data as of fiscal 2022, Customer includes both loan customers as well as deposit customers; (**) Data as of September 2022; (^) Data as of fiscal 2022; NA-Not Available, NM-Not meaningful

Source: Company reports, CRISIL MI&A

Financial metrics of SFBs as of December 31, 2022

9MFY23 (in Rs billion)	Total income	Total net income	Other income	NII	PPOP	PAT	Investment	Borrowings
SFBs								
AU SFB	66.32	39.13	7.01	32.12	14.49	10.03	192.7	61.9
Equitas SFB	34.37	22.69	4.31	18.38	7.90	3.84	61.8	27.4
Ujjivan SFB	33.90	23.70	4.10	19.60	10.74	7.90	71.5	23.2
Jana SFB	26.90	16.56	4.64	11.93	7.20	1.75	56.6	56.5
ESAF SFB	22.74	15.31	1.94	13.37	6.75	2.01	NA	NA
Utkarsh SFB	20.44	13.50	2.30	11.19	6.30	2.71	NA	NA
Fincare SFB	14.04	9.34	1.37	7.97	3.05	0.12	NA	NA
Suryoday SFB	9.18	6.00	0.63	5.36	2.36	0.39	24.7	23.6
Microfinance								
Credit Access	20.53	13.47	0.02	13.45	8.52	4.89	4.4	112.4
Spandana	8.89	5.90	0.36	5.55	2.38	(1.04)	0.8	51.2
Universal Banks								
Bandhan Bank	134.76	86.27	18.39	67.88	34.56	13.86	310.9	184.3

Note: Total net income=NII +Other income.

Source: Company reports, CRISIL MI&A

Financial growth metrics of SFBs as of December 31, 2022

Growth (9MFY19-9MFY23)	Total income	Total net income	Other income	NII	PPOP	PAT
SFBs						
AU SFB	22%	28%	10%	33%	18%	22%
Equitas SFB	17%	21%	27%	20%	24%	24%
Ujjivan SFB	15%	19%	18%	19%	34%	42%
Jana SFB*	4%	5%	2%	6%	41%	90%
ESAF SFB	46%	52%	42%	54%	64%	30%
Utkarsh SFB*	15%	20%	36%	17%	24%	14%
Fincare SFB*	5%	8%	-2%	10%	25%	-60%
Suryoday SFB	14%	12%	0%	14%	24%	-11%
Microfinance						
Credit Access	19%	21%	-19%	21%	18%	17%
Spandana	-4%	-1%	16%	-2%	-26%	-134%
Universal Banks						
Bandhan Bank	14%	15%	21%	13%	-4%	-18%

Note: Total net income=NII +Other income, (*) CAGR from FY20- 9MFY23.

Source: Company reports, CRISIL MI&A

Product mix

Equitas SFB has the most diversified portfolio among peers, with reasonable book size in multiple asset classes as of nine months ended fiscal 2023. Most of the SFBs were erstwhile MFIs, and hence still have a huge concentration in MFI products whereas Equitas is diversified with other businesses. With SFBs' focus on portfolio diversification, we expect the product mix to be distributed into multiple asset classes in the coming years.

Product mix of all SFBs and banks (as of 31st December 2022)

Product mix	MFI	Vehicle loans	Mortgage loans	MSME	Large and mid-corporate loans	Gold loans	Others
SFBs							
AU SFB	-	35%	7%	32%	20%	-	7%
Equitas SFB	18%	25%	-	52%	3%	-	1%
Ujjivan SFB	69%	-	14%	8%	-	-	8%
ESAF SFB#	81%				4%	9%	6%
Utkarsh SFB#	75%	2%	3%	8%	9%	-	3%
Fincare SFB#	76%	-	12%	-	-	6%	6%
Suryoday SFB	61%	6%	11%	6%	-	-	16%

Note: (#) Data is as of March 2022;
Source: Company reports, CRISIL MI&A

Growth of MFI and Non MFI portfolio of SFBs (December 2022)

Product mix	MFI portfolio CAGR (FY18-9MFY23)	Non MFI portfolio CAGR (FY18-9MFY23)
AU SFB	NM	30%
Equitas SFB	18%	31%
Ujjivan SFB	18%	68%
ESAF SFB*	33%	161%

Utkarsh SFB*	30%	64%
Fincare SFB*	31%	74%
Suryoday SFB*	22%	78%

Note: NM: Not Meaningful; (*) CAGR calculated over fiscal 2018 – fiscal 2022;
Source: Company reports, CRISIL MI&A

Digital transaction growth

Digital transaction (in '000)	Mobile banking							Internet banking					
	FY18	FY20	FY21	FY22	9MFY23	CAGR (FY18-20)		FY18	FY20	FY21	FY22	9MFY23	CAGR (FY18-20)
SFBs													
AU SFB	30	200	370	NA	NA	158%		NA	NA	NA	NA	NA	NA
Equitas SFB	NA	NA	2085	NA	NA	NA		NA	NA	434	NA	NA	NA
Utkarsh SFB	7	7	NA	NA	NA	1%		14	210	NA	NA	NA	291%
Fincare SFB	NA	NA	NA	1677	NA	NA		NA	NA	NA	21	NA	NA
Suryoday SFB	8	102	NA	NA	NA	252%		18	338	NA	NA	NA	335%

Note: NA-Not Available,
Source: Company reports, CRISIL MI&A

Profitability

Utkarsh SFB has the lowest cost to income ratio amongst all SFBs

As of nine months ended fiscal 2023, Utkarsh SFB has the lowest cost to income ratio of 53.3% among SFBs followed by Ujivan SFB at 54.7% and ESAF SFB at 55.9%.

Profitability of players as of 31st December 2022 (9MFY23)

(Rs million)	Yield on advances (%)	Cost of borrowing** (%)	NIMs (%)	Non-interest income (%)	Cost to income (%)	Opex (%)	Credit cost (%)	ROE (%)	ROA (%)
SFBs									
AU SFB	12.8%	5.8%	5.7%	1.2%	63.0%	4.4%	0.2%	14.9%	1.8%
Equitas SFB	17.0%	6.5%	8.3%	1.9%	65.2%	6.7%	1.3%	11.5%	1.7%
Ujjivan SFB	19.9%	6.0%	9.7%	1.9%	54.7%	6.4%	0.1%	30.9%	3.9%
Jana SFB	20.4%#	7.1%	7.3%	2.7%	56.5%	5.7%	3.3%	16.0%	1.1%
ESAF SFB	21.2%*	6.2%*	9.9%*	1.4%*	55.9%	6.3%*	2.6%*	22.0%*	1.8%*
Utkarsh SFB	19.8%*	6.7%*	9.2%*	2.0%*	53.3%	5.9%*	2.3%*	21.2%*	2.2%*
Fincare SFB^	21.45%	7.1%	9.3%	2.1%	60.0%	6.9%	4.5%	0.8%	0.1%
Suryoday SFB	19.4%	6.3%	8.4%	1.0%	60.7%	5.7%	2.9%	3.4%	0.6%
Microfinance									
Credit Access	19.8%	8.7%	11.6%	0.0%	36.6%	4.3%	1.8%	15.4%	4.2%
Spandana	20.1%*	10.1%*	10.5%*	0.6%*	53.7%	6.4%*	11.0%*	3.7%*	1.6%*
Universal banks									
Bandhan Bank	14.4%	5.5%	6.4%	1.7%	38.6%	3.2%	3.3%	10.2%	1.3%

*Note: (*) As of September 2022 (H1FY23); (#) Total interest income is considered for calculation; ** Cost of borrowing is calculated on total borrowings, i.e., sum of borrowing and deposits; Yield on advances, cost of borrowing, net interest margins, opex ratio, credit cost, RoE and RoA have been annualized. (^) As of Fiscal 2022*

Source: Company reports, CRISIL MI&A

AU SFB has the highest average RoE and RoA amongst SFBs from fiscal 2019 to nine months ended FY2023

AU SFB has the highest average RoE and RoA from fiscal 2019 to 9M FY23 amongst SFBs at 17.2% and 1.9% respectively. Fincare had the average ROE of 9.7% and average ROA of 1.4% form fiscal 2019 to six months ended fiscal 2023.

Profitability of players (Average FY2019 to 9M FY2023)

	Average	
	RoE (%)	RoA (%)
SFBs		
AU SFB*	17.2%	1.9%
Equitas SFB*	10.2%	1.5%
Ujjivan SFB*	8.5%	1.2%
Jana SFB*	(29.9%)	(3.7%)
ESAF SFB#	13.7%	1.4%
Utkarsh SFB#	14.3%	1.6%
Fincare SFB#	9.7%	1.4%
Suryoday SFB*	4.4%	1.0%
Microfinance		
Credit Access*	11.3%	3.2%
Spandana#	8.7%	3.5%
Universal Banks		
Bandhan Bank*	16.2%	2.9%

Note: (*) Average from FY 2019 to 9MFY2023; (#) Average from FY2019 to H1FY2023; H1FY2023 and 9MFY2023 are annualized

NA – Not available

Source: Company reports, CRISIL MI&A

Fincare has superior return ratio as compared to its peers during the initial 2 years of operation

Players	1st full year of operation	Branch network growth		GLP growth		RoE (%)			Deposit growth	
		2nd year	3rd year	2nd year	3rd year	1st year	2nd year	3rd year	2nd year	3rd year
AU SFB	FY18	48%	16%	50%	27%	12.8%	14.0%	15.8%	145%	35%
Equitas SFB	FY18	0%	118%	50%	31%	1.6%	9.8%	9.8%	61%	14%
Ujjivan SFB	FY18	2%	21%	46%	28%	0.4%	11.5%	14.0%	96%	46%
Jana SFB	FY19	165%	NA	73%	NA	(177.0%)	3.5%	NA	130%	NA
ESAF SFB	FY18	253%	7%	44%	49%	7.9%	14.6%	19.2%	71%	63%
Utkarsh SFB	FY18	19%	5%	50%	43%	(15.3%)	15.8%	20.8%	73%	(12%)
Fincare SFB	FY19	25%	14%	51%	14%	20.3%	18.3%	11.8%	128%	14%
Suryoday SFB	FY18	58%	25%	71%	24%	1.9%	12.2%	11.4%	113%	79%

Note: NA: Not applicable

Source: Company reports, CRISIL MI&A

	CASA share			Credit to Deposit			Share of retail deposits		
Year of operation	1st year	2nd year	3rd year	1st year	2nd year	3rd year	1st year	2nd year	3rd year
AU SFB	32%	21%	16%	138%	129%	133%	47%	45%	49%
Equitas SFB	35%	28%	21%	194%	150%	130%	64%	58%	58%
Ujjivan SFB	4%	11%	14%	148%	103%	NA	27%	43%	49%
Jana SFB	-	7%	NA	125%	105%	93%	-	-	NA
ESAF SFB	10%	14%	14%	141%	123%	187%	96%	92%	95%
Utkarsh SFB	5%	10%	21%	135%	99%	NA	13%	31%	48%
Fincare SFB	11%	12%	24%	210%	170%	124%	56%	51%	91%

Suryoday SFB	10%	11%	12%		138%	129%	133%		39%	61%	66%

NA: Not applicable

Source: Company reports, CRISIL MI&A

AU SFB has the lowest GNPA and NNPA amongst SFBs at end of nine months ended fiscal 2023

At end of nine months ended fiscal 2023, AU SFB has the lowest GNPA amongst the SFBs at 1.81% followed by Ujjivan SFB (3.40%) and Equitas SFB (3.46%). At end of nine months ended fiscal 2023, Fincare SFB had a GNPA of 3.65%.

At end of nine months ended fiscal 2023, Ujjivan SFB had the lowest NNPA amongst the SFBs at 0.05% followed by AU SFB (0.51%) and Utkarsh SFB (0.72%). Fincare SFB had a NNPA of 1.72%.

Fincare SFB has 3rd highest Capital adequacy ratio (CAR) amongst all SFBs as of fiscal 2022

As of fiscal 2022, Fincare SFB has the third highest CAR of 22.32% amongst all SFB after Suryoday SFB (37.9%) and Equitas SFB (25.2%). Fincare SFB's CAR stands at 20.3% as of nine months ended fiscal 2023.

Asset Quality and Liquidity ratios for players as of 31st December 2022

Players	Provision Coverage Ratio (%) ^^	Liquidity Coverage Ratio (%)	Collection efficiency	GNPA (%)	NNPA (%)	CRAR	Tier-1 ratio
SFBs							
AU SFB	75%	NA	107%	1.81%	0.51%	22.0%	20.0%
Equitas SFB	51%	216%	NA	3.46%	1.73%	24.3%	23.7%
Ujjivan SFB	99%	198%	100%	3.40%	0.05%	26.0%	22.8%
Jana SFB	NA	NA	NA	6.40%	3.60%	15.8%	NA
ESAF SFB	NA	NA	NA	7.24%	3.73%	20.3%	NA
Utkarsh SFB	NA	NA	NA	3.58%	0.72%	20.4%	NA
Fincare SFB	NA	NA	NA	3.65%	1.72%	20.3%	18.4%
Suryoday SFB	79%	NA	110%	4.20%	2.70%	36.4%	33.5%
Microfinance							
Credit Access	NA	NA	98%	1.48%	0.42%	28.4%	27.7%
Spandana	55%	NA	102%	5.10%	2.30%	39.1%	NA
Universal Banks							
Bandhan Bank	NA	NA	96%	7.15%	1.86%	19.1%	18.1%

Note:(^^) Provision coverage ratio as declared by the companies; NA – Not Available

Source: Company reports, CRISIL MI&A

Asset Quality and Liquidity ratios for players in fiscal 2022

Players	Provision Coverage Ratio (%)	Provisions as %of GLP	Liquidity Coverage Ratio (%)	Collection efficiency	Restructured book as % of advanced	GNPA (%)	NNPA (%)	Stressed book$	CRAR	Tier-1 ratio
SFBs										
AU SFB	75.0%	0.8%	125.0%	106%	2.5%	2.0%	0.5%	3.0%	21.0%	19.7%
Equitas SFB	58.6%	2.6%	134.0%	99%^	9.2%	4.1%	2.4%	11.6%	25.2%	24.5%
Ujjivan SFB	92.0%	6.9%	152.0%	100%	5.2%	7.1%	0.6%	5.8%	19.0%	28.0%
Jana SFB	32.2%	3.8%	NA	NA	2.7%	5.7%	1.8%	6.6%	15.3%	11.8%
ESAF SFB	49.9%^^	3.5%	129.6%	NA	4.7%	7.8%	3.9%	8.6%	18.6%	16.2%
Utkarsh SFB	63.6%	4.3%	173.4%	100%	1.3%	6.1%	2.3%	3.6%	21.6%	18.1%
Fincare SFB	44.0%	6.2%	206.0%	97%	5.3%	7.8%	3.6%	8.9%	22.3%	19.5%
Suryoday SFB	49.2%^^	8.5%	208.2%	116%	10.7%	11.8%	6.0%	16.7%	37.9%	34.4%
Microfinance										
Credit Access	69.9%^^	3.6%	NA	96%	1.8%	3.1%	0.9%	2.7%	26.5%	25.9%
Spandana	50.0%^^	6.5%	NA	94%	18.0%	5.7%	2.8%	24.0%	51.1%	39.7%^

Universal banks										
Bandhan Bank	74.3%^^	8.5%	NA	99%	5.2%	6.5%	1.7%	8.2%	20.1%	18.9%

Note:(^) Data is as of March 2021; (^^) Provision coverage ratio is calculated as (GNPA-NNPA)/ GNPA; NA – Not Available; ($) Stressed book = Restructured book as a % of advances + NNPA

Source: Company reports, CRISIL MI&A

Monthly collection efficiency trend for MFIs

Apr-20	May-20	Jun-20	Sep-20	Dec-20	Mar-21	May-21	Jun-21	Sep-21	Dec-21	Mar-22
<10%	<45%	45-65%	80-85%	90-93%	92-95%	70-80%	80-85%	94-97%	90-93%	95-98%

Note: 1) Collection Efficiency numbers are estimated 2) Monthly Collection efficiency = {Current + Overdue collections (excluding prepayments)} / Scheduled billing assuming no moratorium, Source: CRISIL MI&A

SFBs have better management depth as compared to NBFC-MFIs, as its average team size is 20 as compared to 13 of NBFC-MFIs. Fincare's average management experience is 26 years which is more with the industry average for SFBs.

Experience of leadership team (FY23)

Player Name	Team size	Average experience (years)
SFBs		
AU SFB	27	19
Equitas SFB	12	27
Ujjivan SFB	14	28
Jana SFB	16	28
ESAF SFB	34	23
Utkarsh SFB	19	24
Fincare SFB	22	26
Suryoday SFB*	15	24
Average	**20**	**25**
Microfinance		
Credit Access	15	24
Satin Creditcare	11	26
Average	**13**	**25**

Note: As of FY22; Source: Company reports, CRISIL MI&A

Geographical concentration of loan portfolio

Ujjivan SFB had the most geographically diversified portfolio among peers with the top state, top 3 states and top 5 states accounting for 16%, 42% and 60% respectively in fiscal 2022.

State mix of Gross Loan Portfolio (Q3FY23)

GLP^	Share of top state	Share of top 3 states	Share of top 5 states
SFBs			
AU SFB	37%	55%	65%
Equitas SFB	53%	76%	85%
Ujjivan SFB	16%	41%	58%

Note: NA = Not available; (^) On gross advances;

Source: Company reports, CRISIL MI&A

State mix of Gross Loan Portfolio (FY22)

GLP	Share of top state	Share of top 3 states	Share of top 5 states
SFBs			
AU SFB	41%	58%	68%

Equitas SFB	54%*	77%*	85%*
Ujjivan SFB	16%	42%	60%
Jana SFB	20%**	42%^	66%**
ESAF SFB	46%#	77%#	85%*
Utkarsh SFB	34%	70%	83%
Fincare SFB	22%	53%	74%
Suryoday SFB	34%	72%	87%

Note: NA – Not available, (*)-Data as of March 2021, (**)- Data as of September 2020, (^) Data as of September 2022, (#) Data as of March 2022

Source: Company reports, CRISIL MI&A

Geographical concentration of deposits

State mix of deposits (Q3FY23)

Deposits	Share of top state	Share of top 3 states	Share of top 5 states
SFBs			
AU SFB	29%	60%	77%
Equitas SFB	31%	54%	68%

Source: Company reports, CRISIL MI&A

State mix of deposits (FY22)

Deposits	Share of top state	Share of top 3 states	Share of top 5 states
SFBs			
AU SFB	30%	64%	80%
Equitas SFB*	25%	51%	66%
Jana SFB**	15%	39%	57%
ESAF SFB*	97%	90%	92%
Utkarsh SFB	17%	47%	66%
Fincare SFB	15%	41%	61%
Suryoday SFB	42%	74%	89%

Note: NA – Not available, (*)-Data as of March 2021, (**)- Data as of September 2020
Source: Company reports, CRISIL MI&A

List of formulae

Sl. No.	Parameters	Formula
1	RoA	Profit after tax / average of total assets on book
2	RoE	Profit after tax / average net worth
3	NIM	(Interest income – interest paid) / average of total assets on book
4	Yield on advances	Interest earned on loans and advances / average of total advances on book
5	Cost to income	Operating expenses / (net interest income + other income)
6	Cost of funds	Interest paid / (average of deposits and borrowings)
7	Non-interest income	(Total income – interest income)/ average of total assets on book
8	Credit cost	Provisions / average of total assets on book
9	Credit to Deposit Ratio	Advances / Deposit

Analysis of various segments

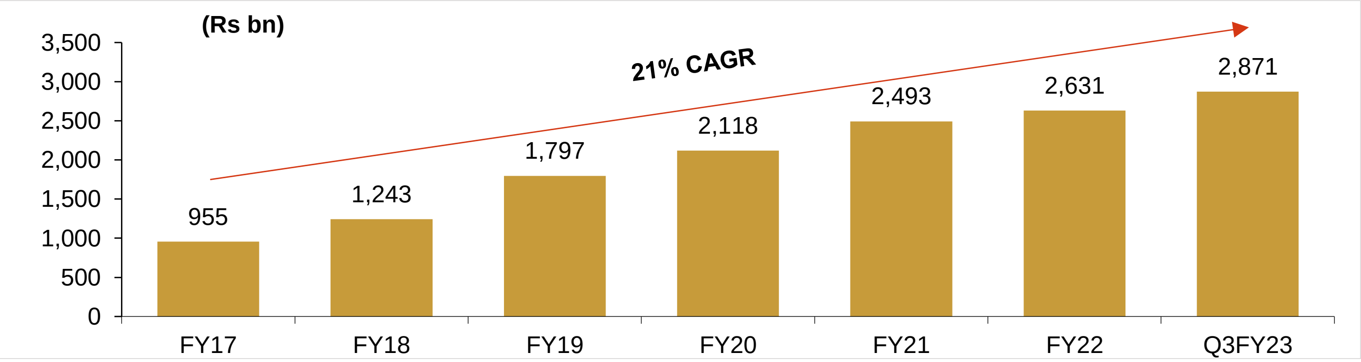
Overall Microfinance Industry

Industry GLP surged at 21% CAGR since fiscal 2017 nine months ended fiscal 2023

The microfinance industry (JLG portfolio) has recorded healthy growth in the past few years. The industry's gross loan portfolio (GLP) increased at a CAGR of 21% since fiscal 2017 to reach ~Rs 2.9 trillion as of nine months ended fiscal 2023 with NBFC MFIs growing at a faster pace as compared to other player groups.

In fiscal 2021, the industry had been adversely impacted due to the onset of the Covid-19 pandemic. While disbursements came to a standstill in the first quarter of the year, they picked up subsequently. Disbursements reached to the pre-Covid levels for NBFC-MFI in the third and fourth quarter of fiscal 2021. The second wave of covid-19 led to a slow start in fiscal 2022, however, the situation improved from the second half, as number of cases declined, and collections started improving. The revised regulation by the RBI, applicable from October 1 of 2022 (post revision), would give more flexibility to NBFC-MFIs and is expected to gain share from banks. CRISIL MI&A estimates the overall microfinance industry to have grown by 20-25% year on year in fiscal 2023 on account of improved collection efficiency, steady demand and lower GNPA levels. Going forward, the overall microfinance industry will continue to see strong growth on back of 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 fiscals 2017 and nine months ended fiscal 2023



Note: Data includes only 0-179 day's portfolio, 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

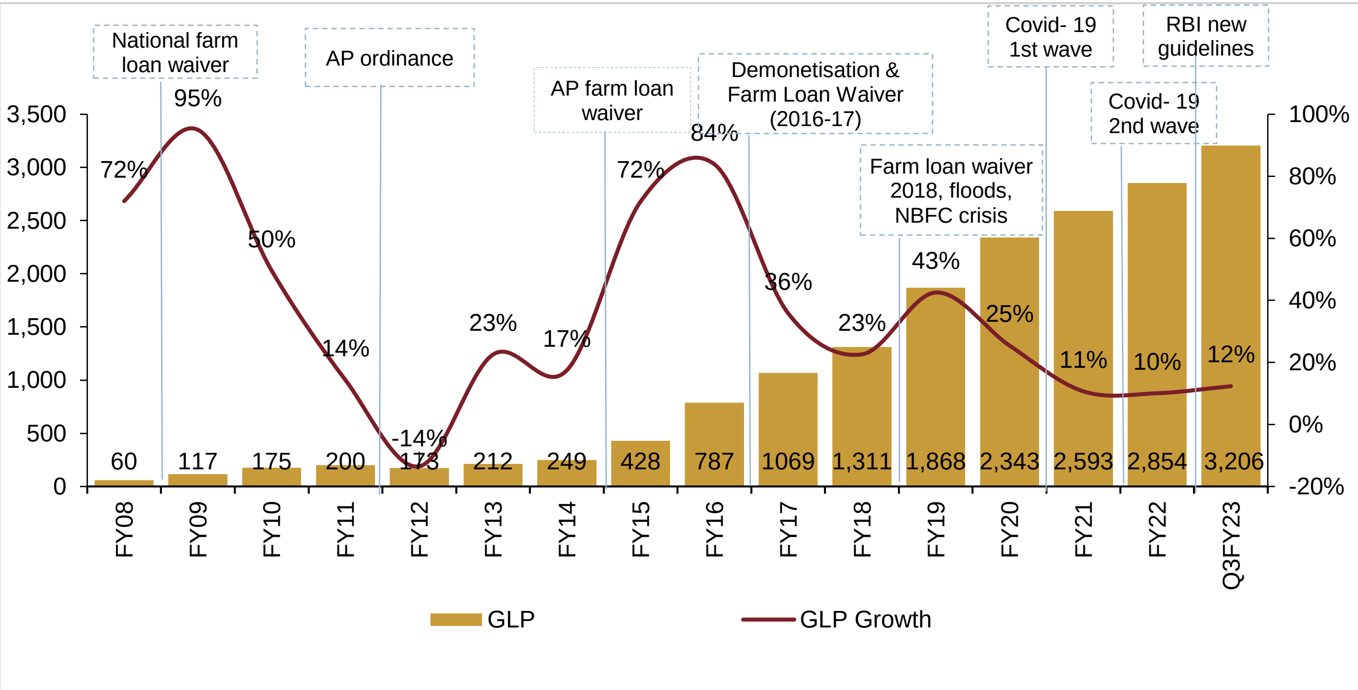
Source: Equifax, Company reports, Industry and CRISIL MI&A

Industry resilient despite major setbacks and changing landscape

The industry's growth has been regardless facing various headwinds in the past decade – national farm loan waivers (2008), the Andhra Pradesh crisis (2010), Andhra Pradesh farm loan waiver (2014), demonetisation (2016), and farm loan waiver across some more states (2017 and 2018). Of these events, the Andhra Pradesh crisis of 2010 had a lasting impact on the industry. Some players had to undertake corporate debt restructuring and found it difficult to sustain business. Since then, however, no other event has affected a complete state to such a degree. While demonetisation of Rs 500 and Rs 1,000 denomination banknotes in November 2016 hurt the industry, the impact was not as serious as the Andhra Pradesh crisis and limited to certain districts. Portfolio at risk (PAR) data as of September 2018 indicates that the industry has recovered fairly strongly from the aftermath of demonetisation. Furthermore, collections of loan disbursements since September 2017 have been healthy. The liquidity crisis in 2018, however, has had a ripple effect on microfinance lending as smaller NBFC-MFIs with capital constraints and lenders relying on NBFCs for funding slowed down disbursements.

NBFC- MFIs faced initial hiccups at the start of fiscal 2021 due to the Covid-19 pandemic on account of uncertainty over collections and aversion by lenders to extend further funding to them; however, the situation improved gradually and most NBFC-MFIs, with the exception of a few, were able to improve the liquidity buffers during the course of the year by raising funds and support from various government schemes. While the resurgence of Covid-19 again led to a fresh bout of uncertainty in respect of collections in first quarter of fiscal 2022, the impact was not as pronounced as in the early part of the previous fiscal. The industry gradually rebounded in fiscal 2022 on account of increased disbursements. The industry grew in fiscal 2023 on account of change in RBI guidelines, higher consumption demand and lower slippages.

MFI industry has shown resilience over the past decade

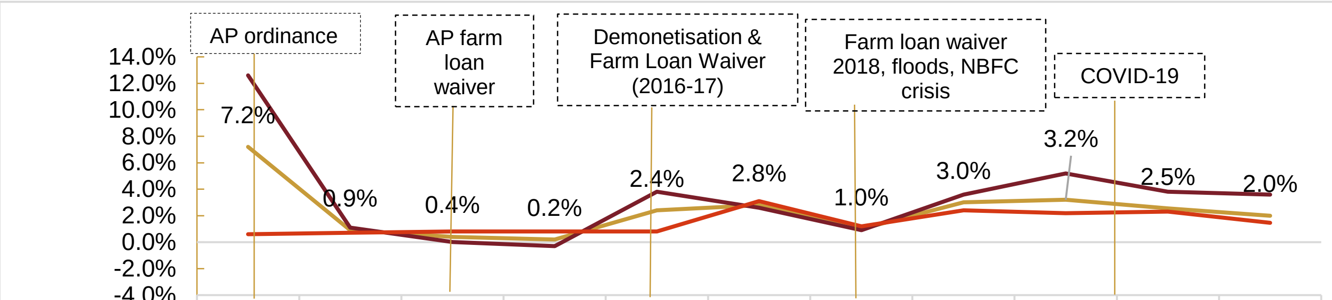


Note: Data includes data for Banks lending through joint liability group (JLG), SFBs, NBFC-MFIs, other NBFCs and non-profit MFIs. It excludes data for Banks lending through SHG. The amounts are as at the end of fiscal year and as the end of quarter for Q3FY23

Source: MFIN, CRISIL MI&A

Over the years, MFIs have proven their resilience. They have played an important role in promoting inclusive growth by providing credit to borrowers at the bottom of the economic pyramid. Despite catering to a vulnerable audience, the MFIs have historically proven their ability to recover effectively from crisis situations like that of Demonetization within a few months and have been able to maintain profitability over a cycle. Amidst the Covid-19 pandemic, MFIs have bolstered their capital position by raising fresh equity capital. The ability of these entities to raise capital, even in such uncertain time, can be attributed to the latent growth potential of the sector, ability of the industry to wade through periods of crisis by taking proactive steps, social impact of MFI lending and healthy profitability over business cycles. Furthermore, MFI lending is closely regulated by RBI and over the years, the regulator has come out with various regulations to enable long-term sustainable growth in the sector and reduce systemic risks.

Credit costs for microfinance industry across various events

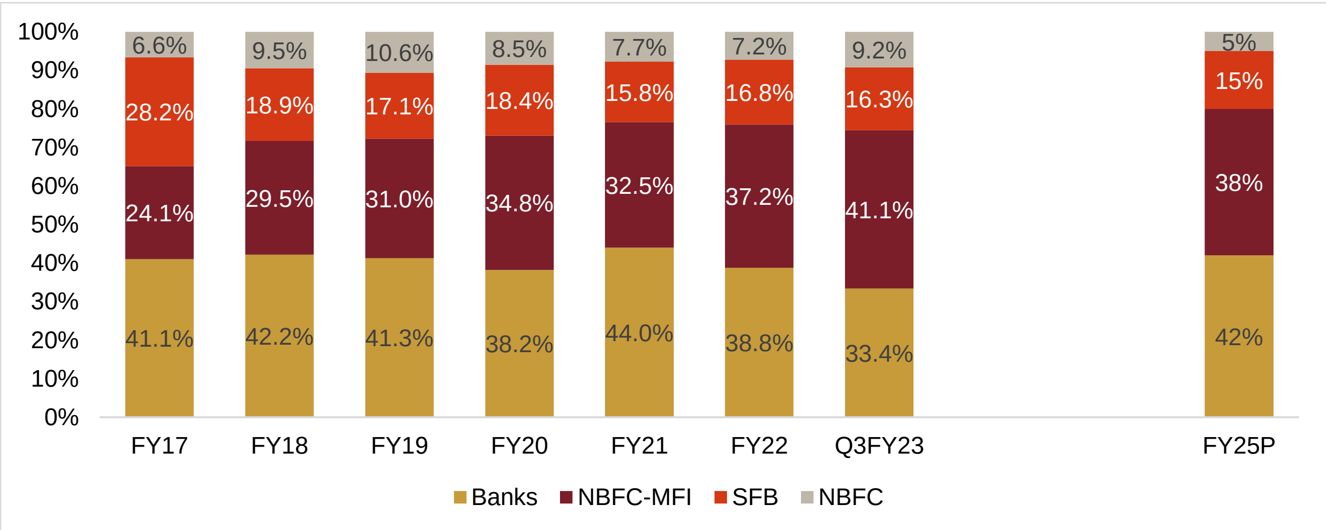


	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23E
Overall	7.2%	0.9%	0.4%	0.2%	2.4%	2.8%	1.0%	3.0%	3.2%	2.5%	2.0%
MFIs	12.6%	1.1%	0.0%	-0.3%	3.8%	2.6%	0.9%	3.6%	5.2%	3.8%	3.6%
SFBs	0.6%	0.7%	0.8%	0.8%	0.8%	3.1%	1.2%	2.4%	2.2%	2.3%	1.5%

Note: E: Estimated, Data includes data for 12 MFIs (includes NBFC MFIs) & 8 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

SFBs share in overall MFI industry to reduce to ~15% by fiscal 2025



Note: P = Projected; 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, NBFC-MFI data includes data for NBFC-MFIs and other MFIs

Source: Equifax, CRISIL MI&A

Demonetisation (2016)

On November 8, 2016, the Indian government announced the demonetisation of Rs 500 and Rs 1,000 notes. This shook the industry, as ~86% of the currency in value terms (Rs 500 and Rs 1,000 notes) was removed from circulation while replacement of currency (with Rs 100 and Rs 2,000 notes) by the central bank was sluggish. As a consequence, GLP of the MFI industry, which grew at ~70% in the first half of fiscal 2017, suddenly slumped to 22% by the end of the year. The collections were also severely hit, thereby adversely impacting asset quality as PAR>90 jumped to 5.9% as of March 2017 from 1.3% as of March 2016.

Farm loan waivers in fiscals 2017 and 2018

Uttar Pradesh, Maharashtra, Karnataka and Punjab had announced farm loan waivers with varying coverage, which impacted collections initially. However, efforts by MFIs to educate borrowers about the applicability of the scheme have led to a gradual pick-up in loan collection. Even the government and industry associations helped players by making related announcements through media to educate borrowers.

State	Total registered farmers (million)	% of marginal & small farmers in total registered farmers (%)	Extent of loan waiver (Rs billion) *	Key features of loan waiver
Uttar Pradesh	23.3	92.5	363.59	Crop loans up to Rs 0.1 million per farmer taken by small and marginal farmers until March 31, 2016 would be waived
Maharashtra	13.7	57.3	340.22	Farm loans of all indebted farmers, regardless of their land holdings, whose loan accounts went into default from April 1, 2009 to June 30, 2016, would be waived with a cap of Rs 0.15 million per farmer. Farmers with loans over Rs 0.15 million have been allowed to repay the loans in three instalments beyond June 30, 2017, with the government providing a one-time settlement by depositing the last instalment of Rs 0.15 million in their accounts. A bonus of 25% of debt, capped at Rs 25,000, to farmers who have regularly repaid their loans until July 31, 2017. *A one-time settlement scheme for farmers, whose loans have been restructured – the government would contribute Rs 0.15 million per account.*
Karnataka	7.8	77.3	86.15	*Crop loans of up to Rs 50,000 per farmer, if borrowed from co-operative banks, would be waived off.*
Punjab	1.1	34.1	100.00	Crop loans of up to Rs 0.2 million per farmer would be waived off. The scheme would mostly cover farmers having up to 5 acre of land *Overall, outstanding institutional crop loans of households, where a farmer has committed suicide, would be waived off.*

*Note: The number of operational holdings assumed as a proxy for the number of registered farmers, *Reported by state governments in press statements*

Source: National Sample Survey Office (NSSO) situation assessment survey of agricultural households (2013), CRISIL MI&A

It led to a slowdown in lending, and it was mostly due to lower repayments caused by disturbance in the repayment cycle in the mentioned states. However, the impact on NBFC-MFIs was lesser than on banks due to regular touch with the customer, which helped them maintain a healthy collection rate.

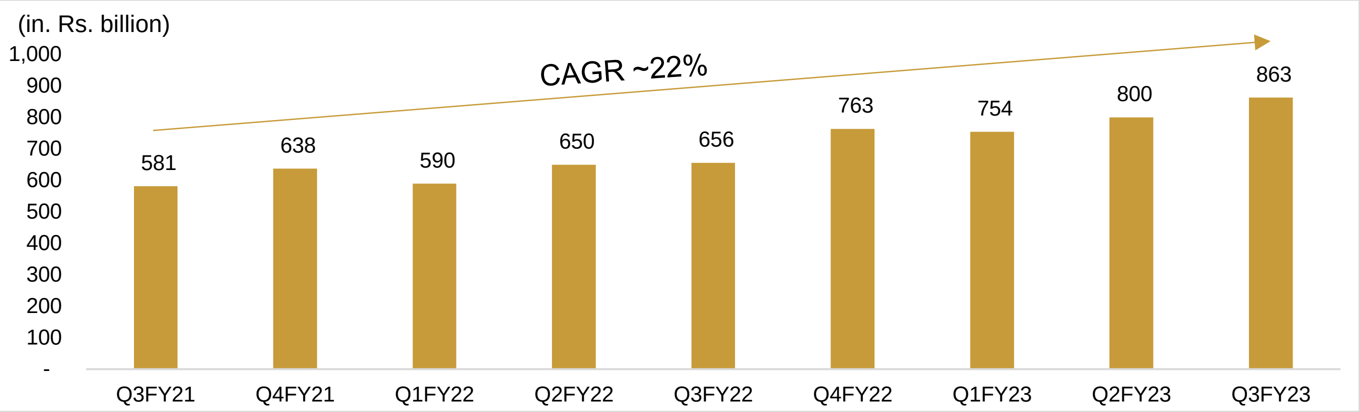
Impact of floods in Kerala and Odisha (2018-20)

In 2018, southern India suffered severe floods. Kerala was one of the most affected; its microfinance industry was adversely impacted, and credit quality of most borrowers deteriorated due to loss of income-generating businesses. In May 2019 and May 2020, Odisha witnessed the worst cyclones, Cyclone Fani and Cyclone Amphan, in 20 years. These cyclones impacted the states of West Bengal and Odisha severely and resulted in a near-term spike in NBFC-MFIs and SFBs' PAR portfolio.

NBFC liquidity crisis

The liquidity crisis plaguing NBFCs in India had a minor ripple effect on micro-lenders. The lenders who relied on NBFCs for funding slowed down disbursement and started looking at different avenues to raise money. However, the impact of the crisis was not that profound as large NBFC-MFIs had a diversified funding mix and were able to leverage this to their advantage as industry witnessed NBFC-MFIs' outstanding borrowings to grow at 24% CAGR from March 2019 to March 2022.

Funding trend of NBFC-MFIs (outstanding borrowing as at end of December 2022)



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

Impact of covid-19 pandemic

The extended nationwide lockdown to contain the spread of Covid-19 affected the income-generation ability and the savings of borrowers accessing MFIs, who typically have weaker credit profiles compared with other borrowers. About 50-60% of the micro loans were under moratorium as of August 2020. Also, because of the nationwide lockdown, and several state-imposed lockdowns thereafter, normal operations of MFIs – loan origination and collections – were a challenge, especially during the first few months post-Covid. This had an adverse impact on MFIs as their operations are field-intensive, involving high personal interactions, such as home visits and physical collection of cash.

Prior to the lockdown, many MFIs had managed to shore up their liquidity by March-end in fiscal 2020, majority of the collection had already happened before the lockdown was announced. In fact, collection efficiency was largely intact at 98-99%. The MFIs also drew down bank loans for the purpose of on-lending in the last week of March, which is typically a period marked by high business activity. However, planned disbursements did not happen on account of the lockdown. Disbursements reached to the pre-covid level in the third and fourth quarter of fiscal 2021 led by rural and semi-urban as the covid-19 impact was relatively lower.

Key steps taken by the government with respect to microfinance to counter Covid-19 crisis

- **Reducing debt servicing burden through moratorium period:** The RBI initially permitted lending institutions to allow a moratorium of three months on repayment of instalments for term loans outstanding as on March 1, 2020 and defer interest payments due on working capital facilities outstanding. The moratorium was further extended by another three months till August 31, 2020. However, the banks were instructed to provide 10% additional provisioning for availing of this benefit which could be later adjusted against the provisioning requirements for actual slippages. These measures were intended to boost confidence in the economy and provide relief to the borrowers.

- **Refinance support from RBI:** In April 2020, the RBI announced refinancing support of Rs 250 billion to NABARD, which provides support to NBFC-MFIs, RRBs and co-operative banks

- **Loan interest subvention scheme:** Under this scheme, the government provided 2% interest subvention to loans given under the Mudra-Shishu scheme. These loans were up to a ticket size of Rs 50,000, and are primarily given by NBFC-MFIs catering to low income groups.

- On May 5, 2021, the RBI announced that fresh lending by Small Finance Banks to NBFC – MFIs with asset size less than INR 500 Crore for on-lending to individual borrowers will be classified under Priority Sector Lending. Extending the priority-sector lending eligibility to NBFC - MFIs with asset size up to Rs 500 crore encouraged flow of credit to smaller MFIs, which were facing relatively bigger funding-access challenges. The facility to SFBs was made available up to March 31, 2022.
- The RBI announced special long term repo operation (SLTRO) programme for SFB amounting Rs 100 billion to soften the impact of the second pandemic wave. The first auction took place on May 17, 2021 and on subsequent months till the amount is fully utilised. The amount borrowed from this scheme was to be utilised to lend to small business units and other unorganised sectors.
- On June 28 2021, the Finance Minister announced the Credit Guarantee scheme through micro finance institutions (MFIs) for the first 2.5 million customers for a maximum tenure of 3 years. The 75% of guarantee was provided to scheduled commercial banks for ticket size up to Rs. 1.25 lakh to new or existing NBFC-MFIs. This addressed the severe cash flow distress caused by the 2nd wave of the pandemic to the individuals and small businesses.

Rising penetration to support continued growth of the industry

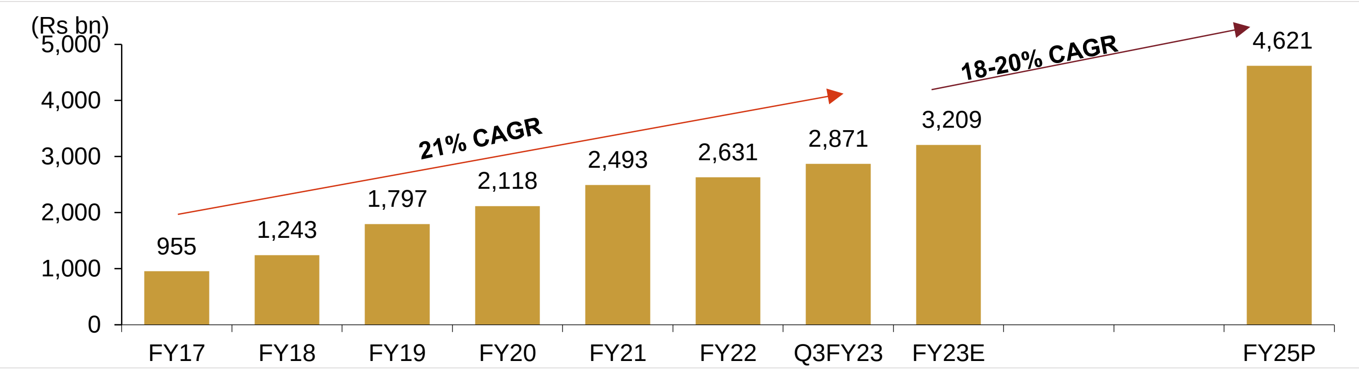
Although India's household credit penetration on MFI loan has increased it is still on the lower side as only few states have higher penetration. There is huge untapped market available for MFI players. As at the end of March 2022, the microfinance industry had grown at a CAGR of 22% since fiscal 2017. As of nine months ended fiscal 2023, the industry reached Rs 2.9 trillion.

CRISIL MI&A expects the MFI loan portfolio to clock 18-20% CAGR between fiscal 2023 and fiscal 2025. Key drivers behind superior growth outlook of the MFI industry include increasing presence of MFIs deep into the hinterland and expansion into newer states, faster growth in rural segment, expansion in average ticket size, and support systems like Credit Bureaus. The presence of self-regulatory organisations (SRO) like MFIN and Sa-Dhan is also expected to support sustainable growth of the industry going forward. Microfinance sector in India regulated by the Reserve Bank of India (RBI). The RBI's new regulatory regime for microfinance loans effective October 2022, which has done away with interest rate cap applicable on loans given by NBFC-MFIs, will also support growth by enabling players to calibrate pricing in line with customer risk.

Key enablers behind superior growth outlook of the MFI industry

- Digitalisation to bring down costs, improve collection efficiency and profitability for MFIs. 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.
- MFIs have built a large distribution network in urban and rural India. Now these MFIs are leveraging this network to distribute financial and non-financial products including insurance and product financing of other institutions to members at a cost lower than competition.

MFI Industry GLP to grow at 18-20% CAGR over fiscal 2023-25



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. FY23 GLP estimated as per CRISIL MI&A. P: Projected

Source: Equifax, Company reports, Industry and CRISIL MI&A

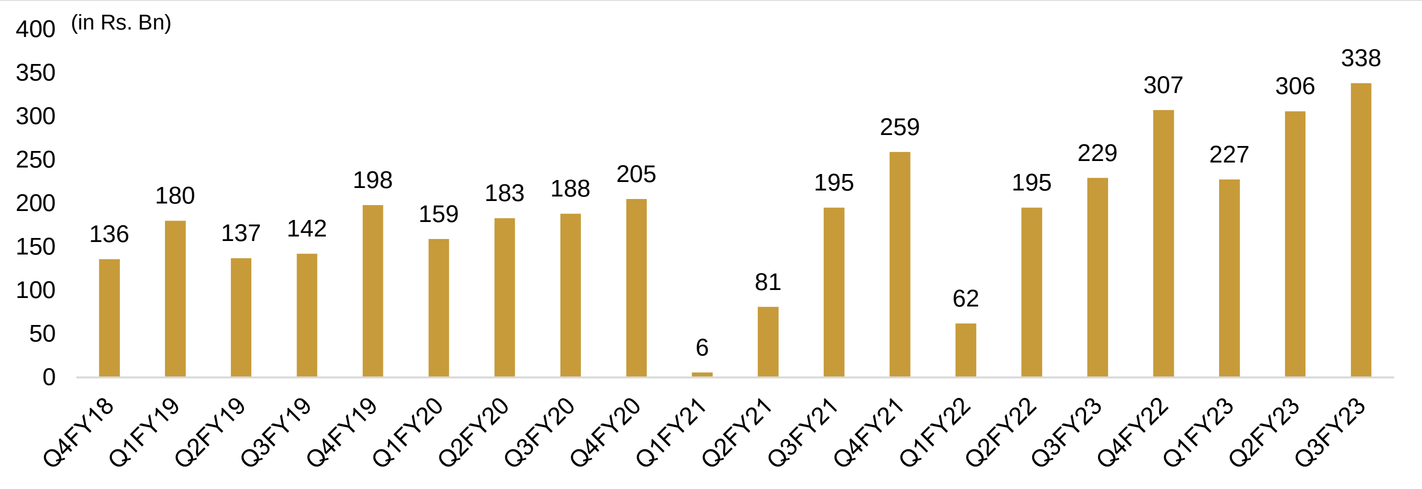
Growth in the MFI business is expected to come from increasing presence in newer states, expanding the client base, and gradual increasing of the ticket size.

Disbursements have surpassed pre-Covid levels

MFI loan disbursements dropped significantly in the first quarter of fiscal 2021 on account of negligible collections due to the moratorium granted to customers post-Covid and focus of players on preserving liquidity. However, as borrowers were made aware about the impact of moratorium and as lockdowns were eased, collections started to pick up, giving comfort to the lenders towards the sector. Disbursements started to increase towards the second half of the second quarter of the fiscal 2021, and by the third quarter, disbursements were back at pre-Covid levels. Disbursements grew 26% on year in the fourth quarter of fiscal 2021.

The growth in disbursements was halted by the second wave of Covid-19 and it dropped by ~76% over the previous quarter in Q1FY22. However, with a recovery in economy from July 2021, collections started to improve, and disbursements increased by 141% and 17% on-year in Q2FY22 and Q3FY22 respectively. In Q4FY22 as well, disbursements continued to remain robust and witnessed a growth of 19% on year. Collection efficiency of most players reached 98-99% in the fourth quarter of fiscal 2022. Disbursements declined in the first quarter of fiscal 2023 owing to disruptions related to the transition to the RBI's new guidelines on MFI lending.

Disbursements gaining traction after Covid-19 impact



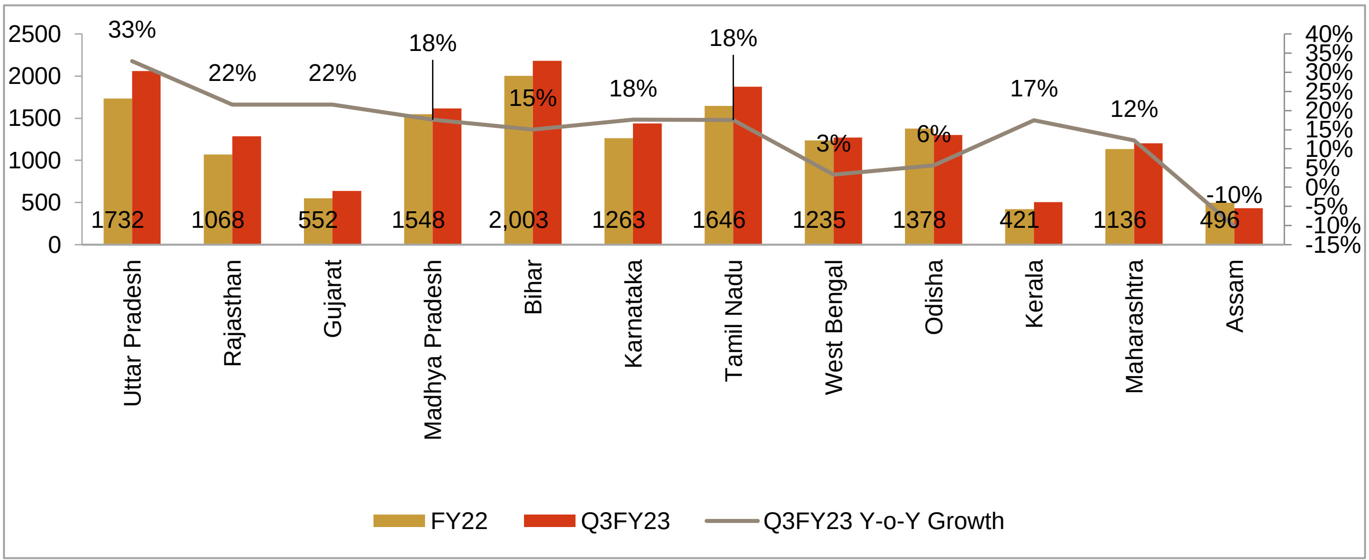
Note:Data includes data for NBFC-MFI

Source: MFIN, CRISIL MI&A

Players tapping newer states and districts to widen client base

CRISIL MI&A has seen a significant jump in the number of MFIs operating in Uttar Pradesh, Rajasthan, Gujarat and Madhya Pradesh. The total number of branches in these states have seen significant growth in recent years, leading to a jump in GLP for these states. The availability of borrower credit related data from credit information companies also ensured that MFIs have access to more data on borrowers, helping them make informed lending decisions.

Total branches of MFIs in each state/UT

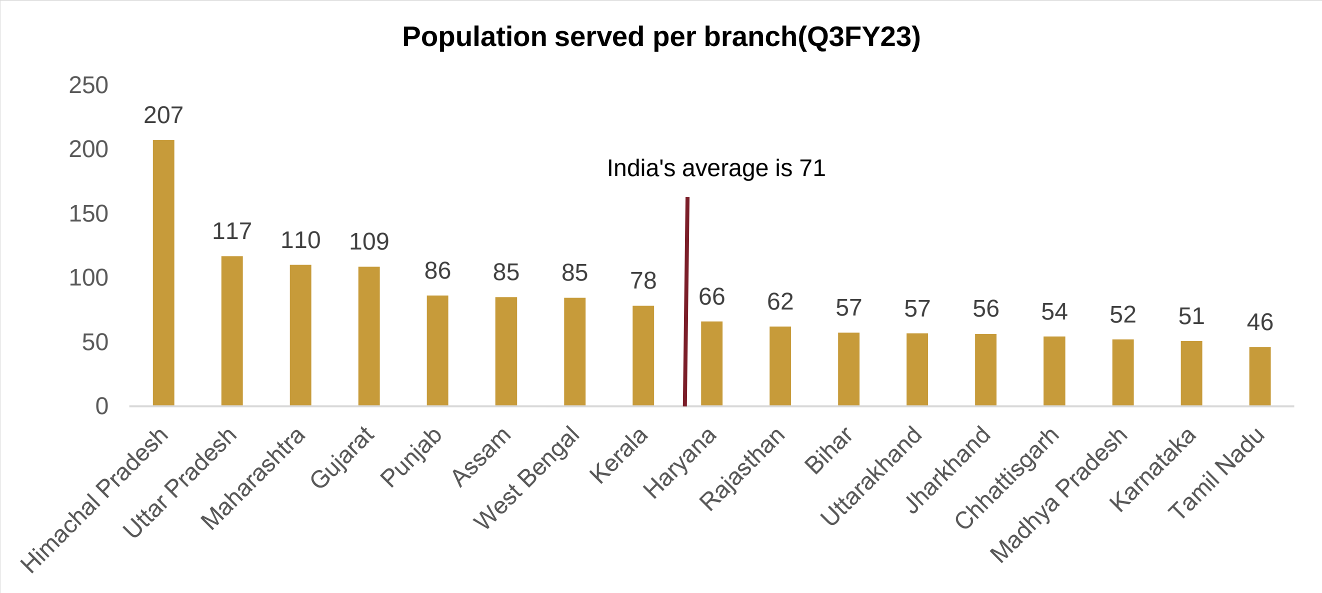


Note: Data includes only NBFC-MFI players and those states where five or more MFIs are operating

Source: MFIN, CRISIL MI&A

In the last few years, many MFIs have opened branches in untapped districts, thus increasing their penetration. Some of the highly populated states like Uttar Pradesh, Maharashtra and West Bengal are highly penetrated as these states have at least one branch for 85,000 people. In states where the presence of MFIs and banks is strong, CRISIL MI&A has witnessed an increase in ticket size as well. Going forward, CRISIL MI&A expects penetration to deepen, which will further drive growth. Madhya Pradesh, Bihar and Tamil Nadu are the few states with the large number of population unserved and, hence, provides an opportunity for existing players to improve their penetration and market share.

Population served per branch in each state/UT



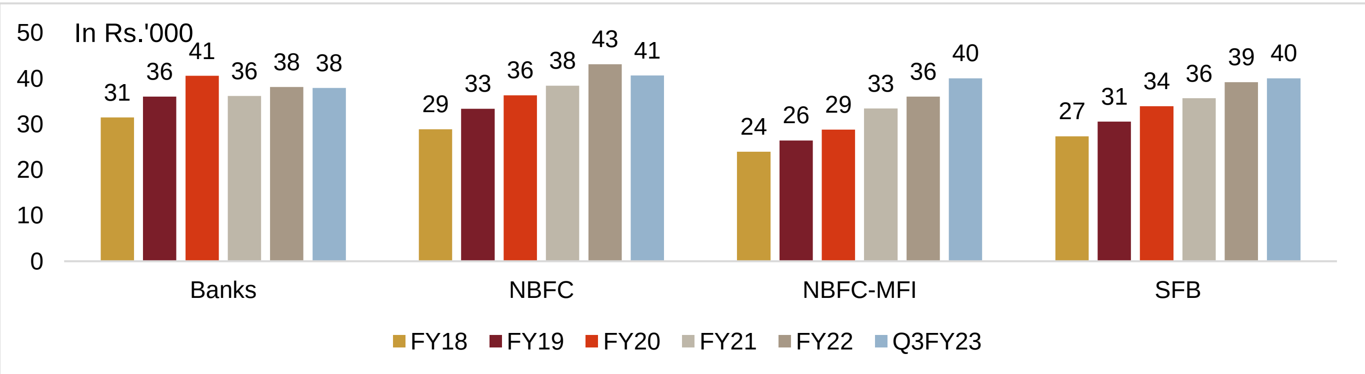
Note: Data includes only NBFC-MFI players and those states where five or more MFIs are operating

Source: MFIN, CRISIL MI&A

Average ticket size to expand, but at slower pace

The average ticket size for MFI players have grown at ~11% CAGR from Rs. 23,978 to Rs. 40,061 between fiscal 2018 and nine months ended fiscal 2023. Going forward, the average ticket size for MFI industry is expected to clock ~2-2.5% CAGR from fiscal 2023 to fiscal 2025 reaching ~Rs. 40,500. The average ticket size of the MFI loans of SFB has risen by ~8% over fiscal 2018 and nine months ended fiscal 2023 to Rs. 40,044. Going forward, CRISIL MI&A expects MFI ticket size growth would be higher in newer under-penetrated states, but ticket size growth in other states with high penetration is expected to be lower. Further, growth would be faster in rural areas, where ticket sizes are relatively low. Consequently, increase in average ticket size at the industry level is projected to be much lower than in the past.

Average ticket size of SFB is better compared to NBFC MFI and Banks



Note: Average ticket size on the basis of disbursement, NBFC-MFI included other MFIs

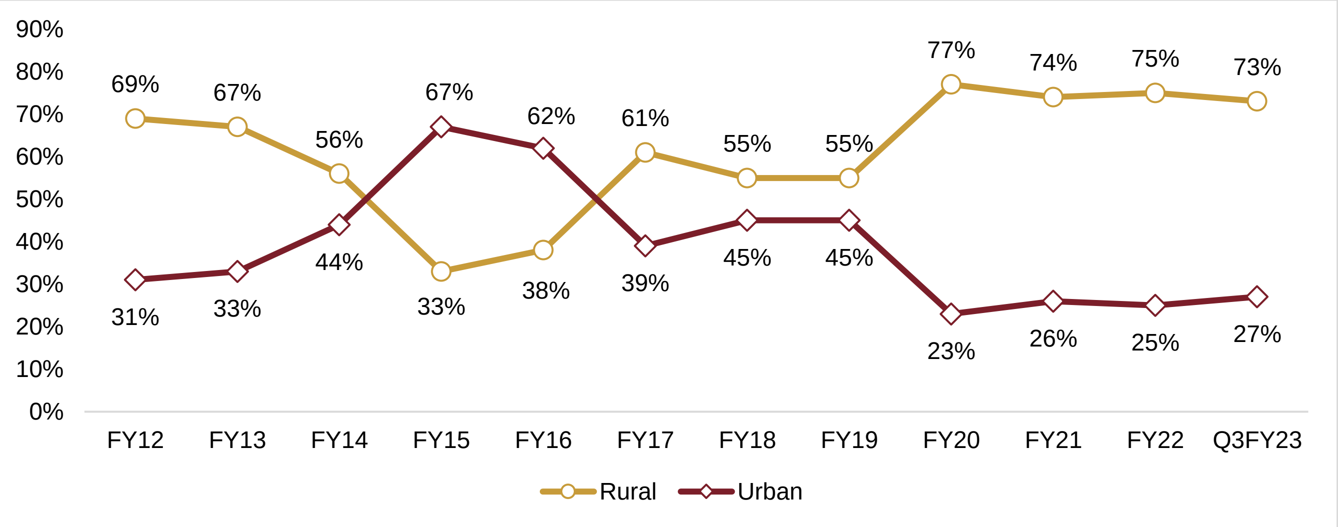
Source: Equifax, CRISIL MI&A

Higher share of rural segment in MFI business to drive growth

CRISIL MI&A expects the share of rural segment in MFIs' business to remain higher, with burgeoning demand expected from this segment. With fewer branches and outlets in rural areas as compared with urban areas, the rural market in India is still under-penetrated, thereby opening up a huge opportunity for savings and loan products.

Over four years until fiscal 2015, the share of the MFIs' urban clients rose sharply. According to Sa-dhan, share of urban borrowers increased due to rising focus of bigger lenders on urban clientele to achieve maximum operational efficiency and maintain profitability given the margin cap regulations. While only 33% of MFI clients were from rural areas in fiscal 2015, with bigger players converting to SFBs and their exclusion, the share rose to 61% in fiscal 2017. After fiscal 2016, share of rural clientele has been higher and further increased to 75% in fiscal 2022. Compared to banks, MFIs have higher focus on rural areas. 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.

Share of rural and and urban clients



Source: Sa-Dhan, CRISIL MI&A

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. As of Fiscal 2022, the rural pie had accounted for 71% of the overall disbursement. Additionally, in terms of GLP, rural regions accounted for 75% of the overall portfolio of NBFC-MFIs, other NBFCs, and non-profit MFIs.

Disbursement and number of borrowers in rural areas (as of Fiscal 2022)

(Rs billion)	Disbursement (FY22)	Share of disbursement	Portfolio outstanding	Share of GLP	Share of borrowers
Rural	566	71%	721	75%	75%
Urban	231	29%	240	25%	25%

Note: The data for the industry given above is estimated using the data available for MFIs as per Bharat Microfinance Report 2020. Amounts have been rounded to the nearest 10 million

Source: Sa-Dhan, CRISIL MI&A

With higher focus on rural areas, over the past few fiscals, NBFC-MFIs have been able to maintain better asset quality in rural areas compared to that in urban areas. Such a trend in asset quality forms a strong base for NBFC-MFIs to penetrate more into rural areas.

Advantages in rural focussed business

- **Huge market opportunity in the rural segment** – Despite its larger contribution to GDP of 47%, the rural segment's share in credit remains fairly low at ~8% of the overall credit outstanding. This provides a huge market opportunity for MFI players present in the segment
- **Less competition –** In remote areas, informal credit channels have a major presence. In other words, there is a huge section of unbanked population with low competition. MFI players are better placed to tap this market
- **Geographic diversification –** With increased focus on diversifying their portfolio and expanding their reach, MFI players are expected to log higher growth as they tap newer geographies
- **Ability to manage local stakeholders –** With their microfinance experience, have the ability to manage local stakeholders and maintain operational efficiency
- **Lower delinquency rates:** Asset quality of rural region is better than urban and semi urban region since fiscal 2017 due to better risk profile of customer and better credit discipline than the urban and semi-urban region.
- **Loan recovery and control on aging NPAs –** MFI players are experienced in collection and monitoring of default risk. This will help them keep asset quality under check. For instance, monthly roll back rates for 1-30 dpd and 31-90 dpd buckets increased in March 2022 after declining between December 2021 and February 2022. For 91-180 dpd bucket, the monthly roll back rates increased in Jan 2022, but declined in Feb 2022 and again increased in March 2022.

Challenges in rural-focused business

The microfinance industry mainly caters to the poorer section of society, because of which there are some inherent challenges faced by the institutions, especially in rural areas:

- **High cost of reaching customer:** Providing microfinance loans in rural India requires reaching people in remote and sparsely populated regions, where deploying manpower and requisite infrastructure for disbursing loans and for recovery can often be expensive. The high cost of reaching out, and the small volume and ticket size of transactions elongates the breakeven period. Therefore, players who use technology will have an edge in reducing their operational cost and optimising their delivery model, especially in the initial stages of operations.
- **Lack of financial awareness:** Lack of financial and product awareness is a major challenge for institutions in rural areas. They are faced with the task of educating people about the benefits of financial inclusion, about the product and services offered by them, and establish trust before selling the product
- **Vulnerability of household's income to local developments:** Uncertainty and unpredictability faced by low income households, and vulnerability of their incomes to local developments can make it difficult for the borrowers to make repayments on time
- **High proportion of cash collections:** Despite having a large proportion of loans disbursed through the cashless mode, the collection process in unbanked and rural areas is still done through cash. This leads to increased time spent on reconciliation, risk involved in handling cash, and higher TAT from the financier's perspective

However, the rural economy has been resilient in the last year, amidst the covid-19 pandemic. India has witnessed above normal, timely and largely well distributed monsoon, benefitting the agriculture industry and rural India. The government is also committed to their cause towards rural India. For instance, increase in the agriculture credit target and allocation of infrastructure fund for the development of Agriculture Produce and Livestock Market Committee (APMC) reiterates government's commitment and is expected to provide a thrust to rural India.

Regulations

New regulatory regime for microfinance loans, effective October 2022, levels the playing field

The RBI, in its master directions on microfinance loans, released in March 2022, has done away with the interest rate cap applicable on loans given by NBFC-MFIs. Entities providing microfinance loans will have to put in place a Board approved policy for the pricing of loans. The policy should include the interest rate model, range of spread of each component for categories of borrowers, and ceiling on interest rate and all other charges on MFI loans.

The RBI's move levels the playing field, with both NBFC-MFIs and banks/SFBs providing microfinance loans now being subject to the same rules, which was not the case in the earlier regime. This move is expected to positively impact NBFC-MFIs.

The increase in the annual household income cap for micro finance borrowers (to Rs 3,00,000 in both urban and rural areas), removal of the two-lender norm for lending by NBFC-MFIs and allowing NBFC-MFIs greater flexibility to offer non-MFI loans (MFI loans required to account for 75% of total assets for NBFC-MFIs, as per then new regulations) would increase the market opportunity available to MFIs and enable them to create a more balanced portfolio.

On the flip side, the increase in annual household income threshold could increase the maximum permissible indebtedness limit of borrowers from the old level of Rs 1,25,000. While the limit on the loan repayment obligation would act as a safeguard against excessive leveraging, the increased permissible debt limit and possibility of divergences in household income assessment criteria across lenders still pose risks. Proper data infrastructure would be required to analyze and estimate household incomes, especially in rural areas.

Subsequent to RBI's revised regulations for MFI loans, effective October 1, 2022, some MFIs have increased interest rates for borrowers by 150-200 bps, especially those who are credit untested.

CRISIL MI&A expects the rates to slowly settle down as MFIs begin to adapt to the new regime and put in place processes for household income, leverage and risk capture, given the new guidelines. Competitive forces would prevent a substantial spurt in rates for MFI customers, especially those with a good repayment track record and credit behaviour.

Area of regulation	Existing regulations		Revised regulations (effective from April 01, 2022)
	For NBFC-MFIs	For Banks and SFBs	For all Regulated Entities*
Loan pricing	Margin cap at 10% for large MFIs (loan portfolios >Rs 1 billion); 12% for small MFIs (loan portfolios <Rs 1 billion)	No restrictions for Banks and SFBs	No pricing cap; underwriting of loans will be done on a risk-based analysis, and a risk premium will be charged based on the borrower. Board approved policy for pricing of loans to be put in place. The policy should include the interest rate model, range of spread of each component for categories of borrowers, and ceiling on interest rate and all other charges on MFI loans.
Processing fees	Not more than 1% of gross loan amount		
Qualifying criteria	85% loans unsecured	Have to meet the target set for priority sector loans (PSL)	The minimum requirement of microfinance loans for NBFC-MFIs revised to 75 per cent of the total assets. The maximum limit on microfinance loans for NBFCs other than NBFC-MFIs revised to 25% of the total assets from 10% earlier
Household income	Rural areas: Rs 1,25,000 per annum	No restrictions for Banks and SFBs	<u>Annual household income:</u> Up to Rs 3,00,000 in urban as well as rural areas (This amount is higher than what was stated in

Area of regulation	Existing regulations		Revised regulations (effective from April 01, 2022)
	For NBFC-MFIs	For Banks and SFBs	For all Regulated Entities*
	Urban areas: Rs 2,00,000 per annum		the consultation paper issued in June 2021 – up to Rs 1,25,000 for rural areas and Rs 2,00,000 for urban and semi-urban areas) Board-approved policy for assessment of household income
Ticket size of loans	Rs 75,000 in the first cycle and Rs 1,25,000 in the subsequent cycles		
Tenure of loans	Not to be less than 24 months for loan amount in excess of Rs. 30,000		
Lending to the same borrower	Not more than 2 lenders allowed per borrower	More than 2 banks can lend to same borrower	Limit on Maximum Loan Repayment Obligation of a household towards all loans: 50% of monthly household income
Overall borrower indebtedness	Should not exceed Rs 1,25,000	No restrictions for Banks and SFBs	

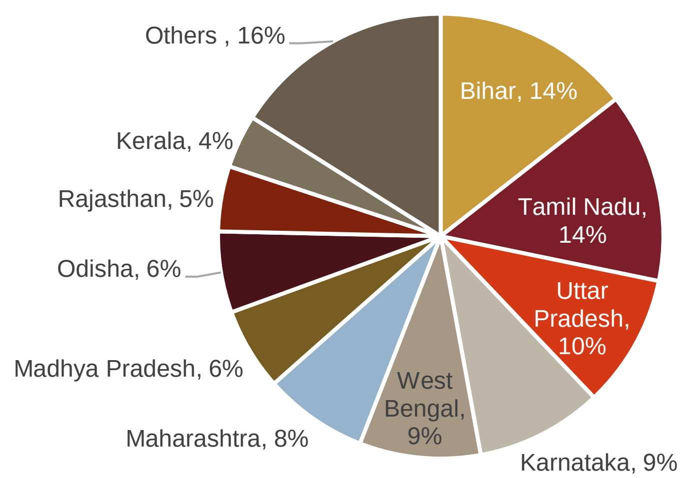
Note: Regulated entities: All Commercial Banks (including Small Finance Banks, Local Area Banks, and Regional Rural Banks) excluding Payments Banks, All Primary (Urban) Co-operative Banks/ State Co-operative Banks/ District Central Co-operative Banks, All Non-Banking Financial Companies (including Microfinance Institutions and Housing Finance Companies)*
Source: RBI, CRISIL MI&A

State-wise Analysis

Top 10 states contribute about 83% of MFI loans

Over 80% of the gross loan portfolio is concentrated in the top 10 states with Bihar (14%), Tamil Nadu (14%), and Uttar Pradesh (10%) recording the highest shares as of December 2022. Within top 10 states, Tamil Nadu witnessed fastest disbursement growth of 35% from fiscal 2018 to fiscal 2022 followed by Gujarat (24%) and Karnataka (21%).

State-wise distribution of MFI loans portfolio outstanding (December 2022)



Source: Equifax, CRISIL MI&A

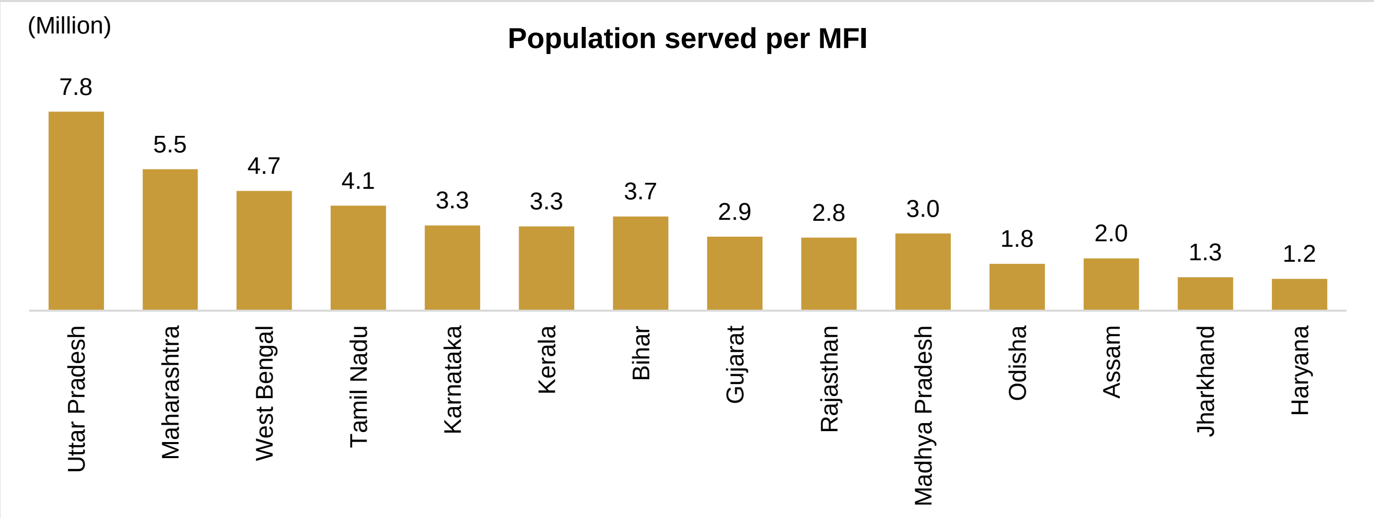
State-wise distribution of MFI loans disbursement

Rs bn	FY18	FY19	FY20	FY21	FY22	9MFY23	FY18-22 CAGR growth
Tamil Nadu	29	54	77	61	96	90	35%

Gujarat	9	14	16	12	21	23	24%
Karnataka	43	102	20	76	91	80	21%
Rajasthan	20	41	30	26	42	48	20%
Bihar	56	100	95	61	105	129	17%
Punjab	10	20	22	13	18	17	16%
Uttar Pradesh	45	68	60	38	74	92	13%
Madhya Pradesh	39	51	62	49	59	60	11%
Jharkhand	18	26	12	17	24	30	7%
West Bengal	38	83	63	32	48	64	6%
Maharashtra	56	76	72	46	65	57	4%
Uttarakhand	6	3	4	8	6	6	1%
Odisha	68	89	65	42	67	92	0%
Kerala	24	28	86	13	21	23	-4%
Chhattisgarh	26	19	21	15	17	16	-10%
Assam	10	28	24	7	5	8	-16%
Haryana	50	14	1	10	16	15	-24%

Source: MFIN, CRISIL MI&A

MFI penetration across states (December 2022)



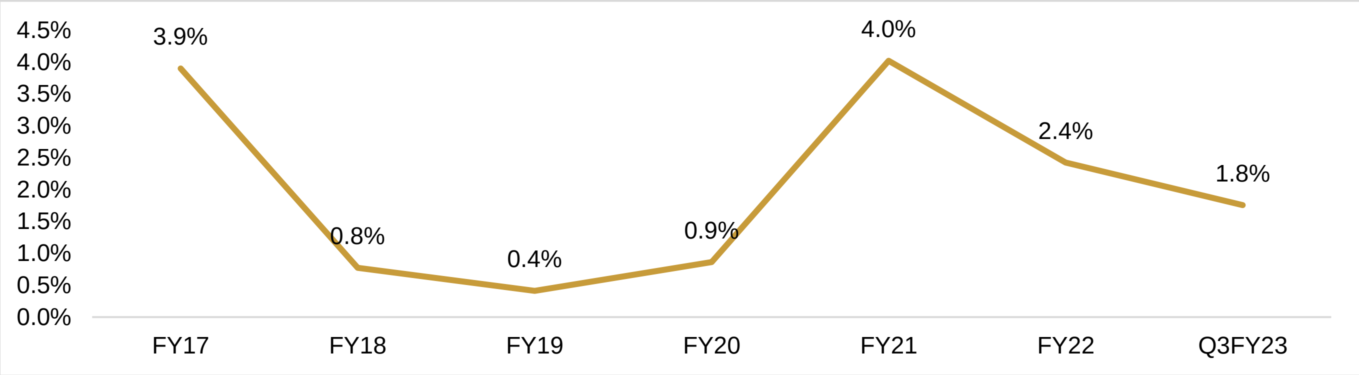
Note: 1. Data includes only NBFC-MFI players and those states where five or more MFIs are operating as of FY22, 2. Player penetration is calculated as state population divided by number of MFI players. 3. State population considered as of fiscal 2022.

Source: MFIN, CRISIL MI&A

Asset quality

In fiscal 2021, the asset quality of the industry deteriorated quite sharply, reflecting the adverse impact of Covid-19 on the industry. PAR>90 for the industry shot up to 4.0% in fiscal 2021 from 0.9% in fiscal 2020. In Fiscal 2022 the PAR >90 for the industry moderated from fiscal 2021 levels at 2.4% mainly due to rise in economic activities post lockdown and better collections recorded by the MFI lenders. PAR >90 further decreased as of Q3FY23. However, slippages from the restructured portfolio still remains a monitorable going forward.

Asset quality trend over the years



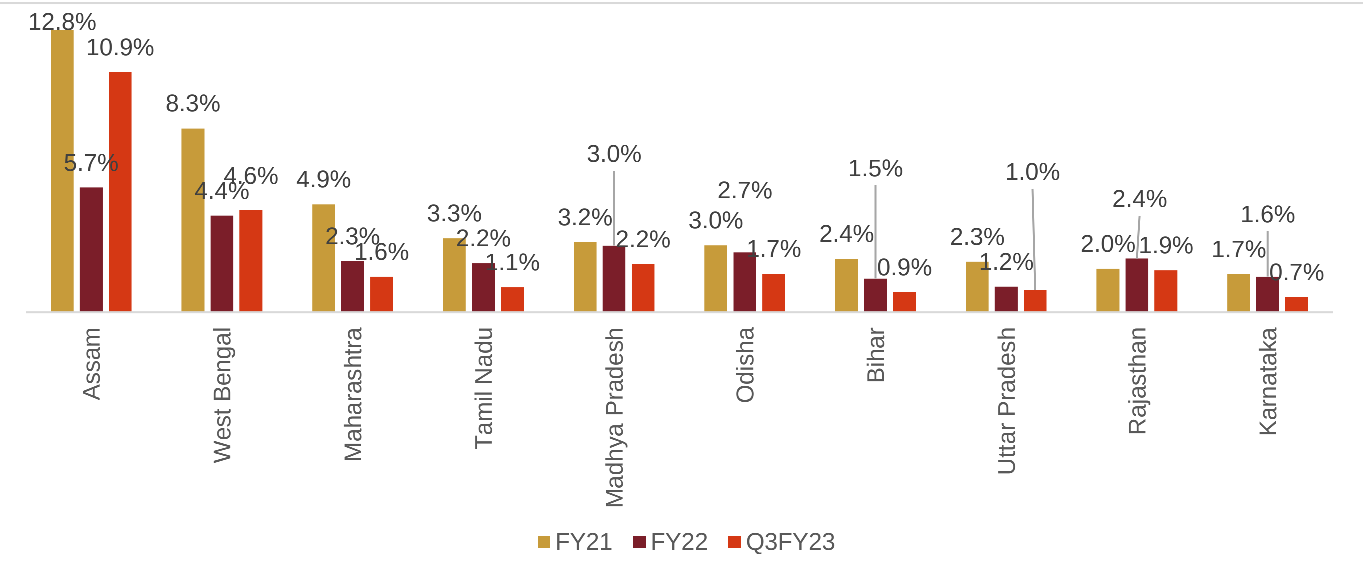
Note: PAR 90+ doesn't include delinquency beyond 180 days of MFI industry

Source: Equifax, CRISIL MI&A

Asset quality moderated across states in fiscal 2022 compared to fiscal 2021

Asset quality has moderated across states in fiscal 2022 compared to fiscal 2021. Assam has seen highest moderation in the asset quality in fiscal 2022, with PAR90+ declining to 5.7% from 12.8%, however, the asset quality further deteriorated as of Q3FY23. Other states like West Bengal and Madhya Pradesh have lower asset quality as compared to other states as of Q3FY23.

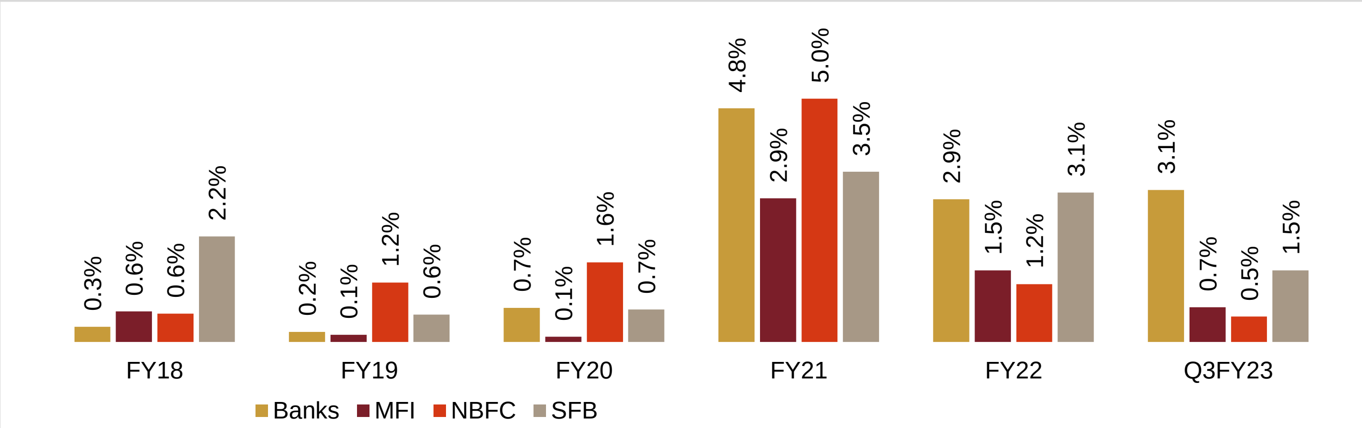
State-wise asset quality of top states (FY21 and FY22)



Note: 1) 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: Equifax, CRISIL MI&A

Asset quality of player groups in microfinance industry (PAR 90+ days)



Note: PAR 90+ doesn't include delinquency beyond 180 days of MFI industry

Source: Equifax, CRISIL MI&A

As at March 2022, overall PAR >90 for the industry was 2.4%, but SFBs have relatively higher PAR >90 at 3.1% as at the same date and is still higher than pre-pandemic level. As of December 2022, overall PAR>90 decreased to 1.8% and PAR> 90 for SFBs also decreased to 1.5%.

MFI collection efficiency almost back to pre-pandemic levels

Collections of microfinance institutions (MFIs), which had plunged to near zero in April 2020 because of the nationwide lockdown due to the COVID-19 pandemic, rebounded to 80-85% in September 2020, with restrictions being lifted gradually. In December 2020, collection efficiency for the industry rebounded further to 90-93%, as per CRISIL MI&A estimates. This is despite MFI borrowers having relatively weaker credit profiles and field-intensive operations involving high personal touch, such as home visits and physical collection of cash.

Borrowers in rural areas and those involved in essential sectors of animal husbandry and agriculture started paying their instalments. Lower number of COVID-19 infection in rural areas, a good harvest time also played a positive impact on rural repayments. In the third quarter of fiscal 2021, collection efficiency for the industry rebounded further to 85-93%, as per CRISIL MI&A estimates. Subsequently, in the fourth quarter of fiscal 2021, collections further improved to 92-95%.

The second Covid-19 wave again dented collections in April and May 2021 due to localised lockdowns imposed by several states. The medical impact of the second wave of the pandemic was much worse than the first wave; the impact was seen across rural and urban areas, unlike the first wave impact which was largely urban centric. Southern states witnessed a sharper fall in collections as compared to other states in May 2021, as the lifting of lockdowns was delayed till June, whereas northern states were impacted largely in April. Ground-level infrastructural and operational challenges, as well as restrictions on movement of people, impinged on the MFI sector's collection efficiency. As per CRISIL MI&A estimates overall collection efficiency witnessed a swift recovery from 80-85% in June 2021 and reached pre-pandemic level of 95-98% in March 2022 as the economic activity picked up pace.

Going forward, the trend in the restructured book would need close monitoring to assess incremental slippages. The microfinance sector restructured around 10% of its loan book under the Resolution framework 2.0 announced by the RBI in the wake of the second Covid-19 wave. As of May 2022, collection efficiency for the restructured book, billing for which began in Q4FY22, was in the range of 60-70%.

Monthly collection efficiency trend for MFIs

Apr-20	May-20	Jun-20	Sep-20	Dec-20	Mar-21	May-21	Jun-21	Sep-21	Dec-21	Mar-22

<10%	<45%	45-65%	80-85%	90-93%	92-95%	70-80%	80-85%	94-97%	90-93%	95-98%

Note: 1) Collection Efficiency numbers are estimated 3) Monthly Collection efficiency = {Current + Overdue collections (excluding prepayments)} / Scheduled billing assuming no moratorium

Source: CRISIL MI&A

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

In fiscal 2021 and 2022, the cost of borrowings has remained stable despite stress of the pandemic. However, with an increase in repo rates in fiscal 2023, the cost of borrowings for MFIs are estimated to increase, which is likely to be offset by steeper lending rates, thereby cushioning NIMs. Further, enhanced flexibility to set lending rates will be one of the drivers supporting a revival in the profitability of microfinance institutions in fiscal 2024. This emanates from the Reserve Bank of India's (RBI) removal of the interest margin cap on lending rate under its new regulatory framework for microfinanciers.

Over the course of fiscal 2021 and fiscal 2022, annual credit costs for microfinance industry have shot up to 4-5% because of pandemic-related provisioning However, most MFIs increased provisioning levels to fortify their balance sheets against asset quality risks. In fiscal 2023, CRISIL MI&A expects credit cost to decrease on account of lower provisions and improvement in repayment levels of borrowers.

Majority of the microfinance borrowers are charged fixed rate of interest by the NBFC-MFIs, due to the shorter span of the loan, any change in repo rate will be immediately passed on to the borrowers. However, the revised yields will be applicable only to new borrowers, as older ones will still be under the older rate structure. With the repo rate increase, CRISIL MI&A expects yields to increase, however on an aggregate basis NIMs are expected to remain rangebound. Going forward, CRISIL MI&A expects credit costs to decrease gradually in fiscal 2024, thereby augmenting profitability of the sector. In this context, the new RBI framework augurs well for MFIs owing to higher income eligibility threshold and enhanced flexibility to price loans, which is likely to aid industry.

Profitability (RoA) of microfinance industry to improve in fiscal 2024

RoA tree	FY18	FY19	FY20	FY21	FY22	FY23E	FY24P
Interest income	17.7%	19.1%	18.4%	17.5%	17.3%	17.8%	18.0%
Interest expense	8.6%	8.4%	7.7%	7.7%	7.7%	7.9%	8.2%
Net interest income	9.1%	10.6%	10.7%	9.8%	9.6%	10.4%	9.8%
Opex	5.3%	5.5%	5.4%	5.1%	5.1%	5.0%	4.8%
Other income	1.2%	2.0%	2.5%	1.2%	1.5%	1.4%	1.4%
Credit cost	1.5%	1.0%	2.7%	5.0%	4.2%	3.6%	3.4%
RoA	2.3%	4.1%	3.5%	0.7%	1.3%	2.5%	2.6%

Note: E: Estimated; P: Projected

Source: CRISIL MI&A

Loan against property (LAP) – ticket size <Rs. 5 million

Evolving landscape of the LAP market

Key factors that contributed to high LAP growth are:

- **Quick turnaround time, lower interest rate, lesser documentation:** LAP loans are disbursed in about half the time taken for a secured MSME loan. It is also offered at a lower interest rate than secured MSME loans, unsecured personal and business loans. LAPs require lesser documentation than other secured SME products, leading to fewer hassles for customers

- **Greater transparency in the system:** Demonetisation, GST, and the government's strong push for digitisation have led to higher transparency in the system. This will keep pushing up loan amount eligibility of borrowers. Formalisation will also help many new borrowers come under the ambit of formal lending channels

- **Rising penetration of formal channels:** Increase in penetration and availability of formal lending channels outside the top 10 cities will eat into the market share of moneylenders

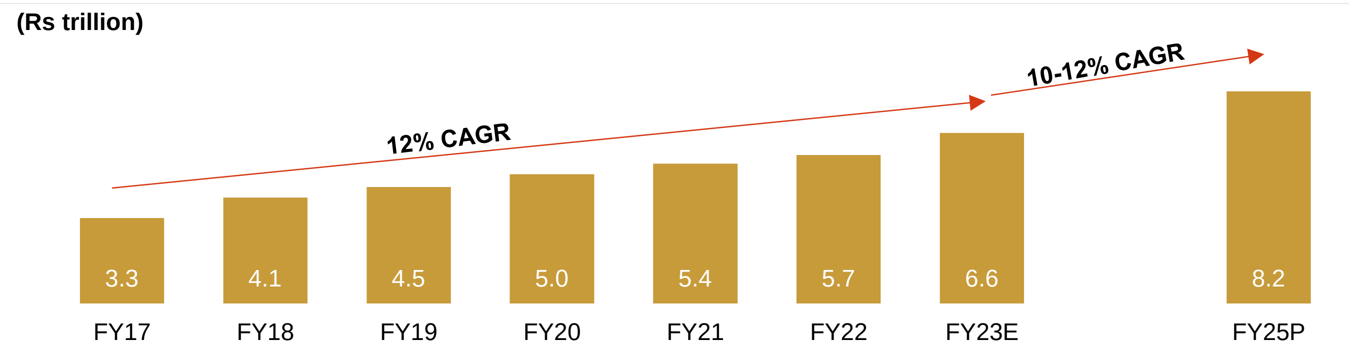
- **Higher comfort for lenders:** Lenders are comfortable disbursing LAP loans, as they offer favourable risk-return characteristics, compared with MSMEs and unsecured loans. They also offer higher recovery in case of default (supported by the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002) and better asset quality, which is only partly offset by lower yields.

Overall LAP segment advances growth picked up momentum in fiscal 2023

LAP (banks and non-banks) clocked a CAGR (compounded annual growth rate) of ~15% between fiscals 2017 and 2020, driven by rising penetration of formal channels and higher comfort for the lenders to lend. However, the growth slowed to ~8% in fiscal 2021 owing to the outbreak of the COVID-19 pandemic that affected economic activity and subsequently borrower's cash flow, which affected collections and reduced asset quality. This turned lenders cautious while lending to LAP segment and industry continued to grow at slow pace of 6% in fiscal 2022 as well. However, Outstanding LAP market grew 11% between fiscal 2022 and nine months ended fiscal 2023 on the back of improving economic conditions due to normalisation of business activities. CRISIL MI&A estimates the outstanding LAP market to have reached Rs. 6.6 trillion in fiscal 2023.

Going forward in fiscal 2024, LAP market will see continued growth aided by increasing lender focus and penetration of such loans, enhanced availability of data increasing lender comfort while underwriting such loans, enhanced use of technology, newer players entering the segment, and continued government support. Banks are expected to register strong growth in the segment due to their higher market penetration, lower cost of funds and adequate liquidity support. Overall LAP market is projected to grow at 10-12% CAGR between fiscal 2023 and fiscal 2025.

Overall LAP advances growth is expected to grow at 10-12% over fiscal 2023 and 2025

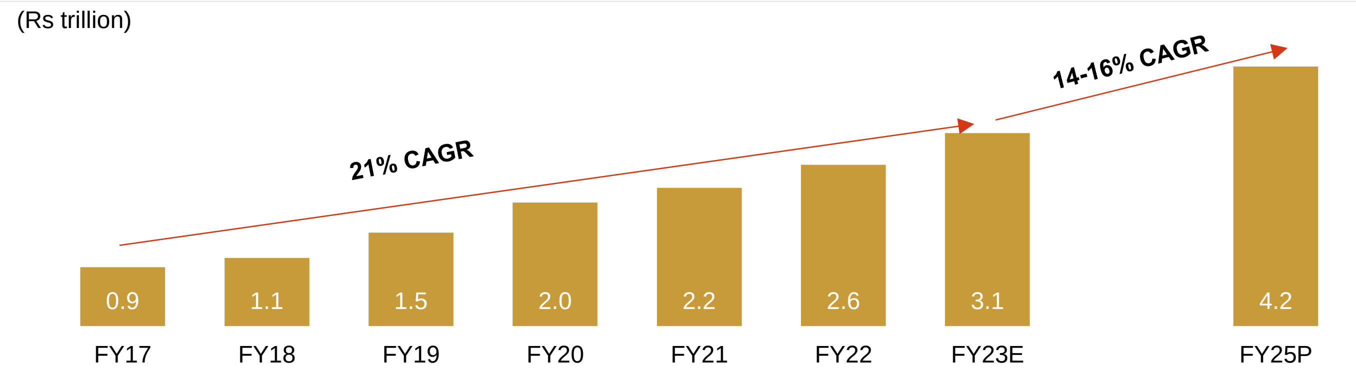


Note: P: Projected; E: Estimated; Data Includes data for banks and non-banks

Source: CRISIL MI&A

In the past, lower ticket size LAP (ticket size < Rs 5 million) witnessed a faster growth of ~22% between fiscal 2017 and fiscal 2022. The growth in this segment is attributed to increasing finance penetration and increase in number of players serving this specific target market. In fiscal 2022 when the industry logged slow growth, the growth in the low-ticket size LAP market has outpaced the overall industry and has grown by strong 15-18%. This has also led to the share of lower ticket size LAP in overall LAP industry to increase. In fiscal 2023, CRISIL MI&A estimates overall LAP market to have grown at 15% year on year and LAP market (ticket size < Rs 5 million) to have grown at a faster rate of 20% year on year. Going forward given the relatively low penetration levels, the vast market available, and increasing interest of financiers, CRISIL MI&A expects low ticket sized LAP (ticket size < Rs 5 million) credit to grow at a faster rate, leading to a CAGR of 14-16% between fiscal 2023 and fiscal 2025.

GLP for ticket size less than Rs.5 million registered faster growth compared to overall LAP industry

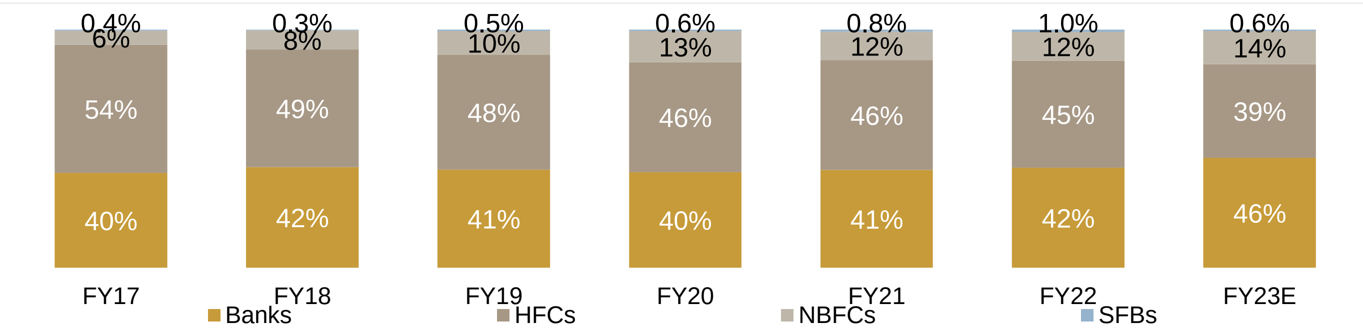


Note: P: Projected; E – Estimated; Data Includes data for banks and non-banks

Source: CRISIL MI&A

Competitive scenario

Banks & SFBs have gained market share from HFCs and NBFCs; SFBs still at an emerging stage



Note: E: Estimated, Banks includes Public Banks, Private Banks and others.

Source: Industry, CRISIL MI&A

Gold loans

Gold loans AUM is expected to grow at 10-12% CAGR between fiscal 2023 and 2025

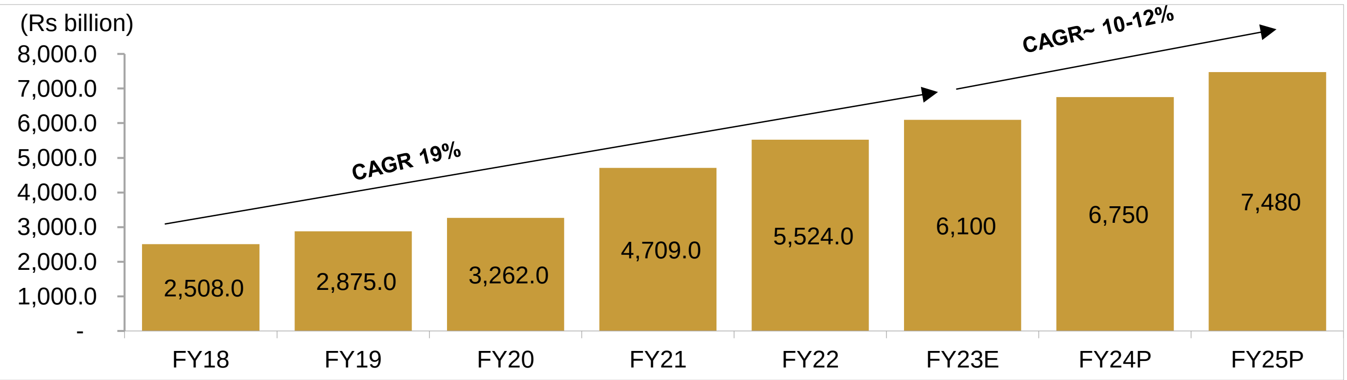
Gold loans are typically small ticket, short duration, convenient and instant credit. Though moneylenders and pawn brokers understand the psyche of the local borrowers and offer immediate liquidity without any documentation formalities, customers are left vulnerable to exploitation, due to the absence of regulatory oversight. Such players also give lower loan-to-value ratio compared with organized ones. As banks and NBFCs aggressively moved in to seize this vast untapped market, they cornered a significant market share from unorganized lenders, growing at a compounded annual growth rate (CAGR) of 76% between fiscals 2009 and 2012. Sustained increase in gold price till 2012 saw the gold loan business boom in India. In such a scenario, customers could be offered higher and higher loan amounts on their gold, while lenders would benefit by price increases acting as a natural hedge, in the event of default. Gold prices in India, rose at a rapid rate until 2013 following which it decreased in line with global prices. Gold prices declined in India until 2015-2016 following which the gold prices have seen a continuous uptrend resulting in the overall gold loan market growing at a CAGR of 8% between fiscal 2015 and fiscal 2020.

In fiscal 2020, gold loan industry (including Banks and NBFCs) AUM grew ~13% YoY to reach Rs 3.3 trillion on account of increased focus of players on diversifying their regional presence, strong growth in non-southern regions and rise in gold prices by ~19% in fiscal 2020. In fiscal 2021, the demand for gold loan finance witnessed a massive surge with AUM shooting up from Rs 3.3 trillion to Rs 4.7 trillion, as India's economy coped with the devastating effect of the global pandemic and consumers availed of gold loans to meet their consumption and emergency funding needs. Many consumers, who had gold stock and ornaments lying with them, considered gold loans as an option to meet their credit requirements during this period. The demand for gold loans was also supported by a consistent surge in gold price, liquidity crunch in the immediate aftermath of the pandemic and lenders' hesitancy to give unsecured loans due to risk aversion.

In fiscal 2022 as well, the gold loan market continued to witness strong growth, with industry AUM increasing by 17% on-year to touch Rs 5.5 trillion as of March 2022. In Fiscal 2023, the growth for gold loans NBFCs is estimated to have moderated owing to increased competition from banks and lower demand from the target audience.

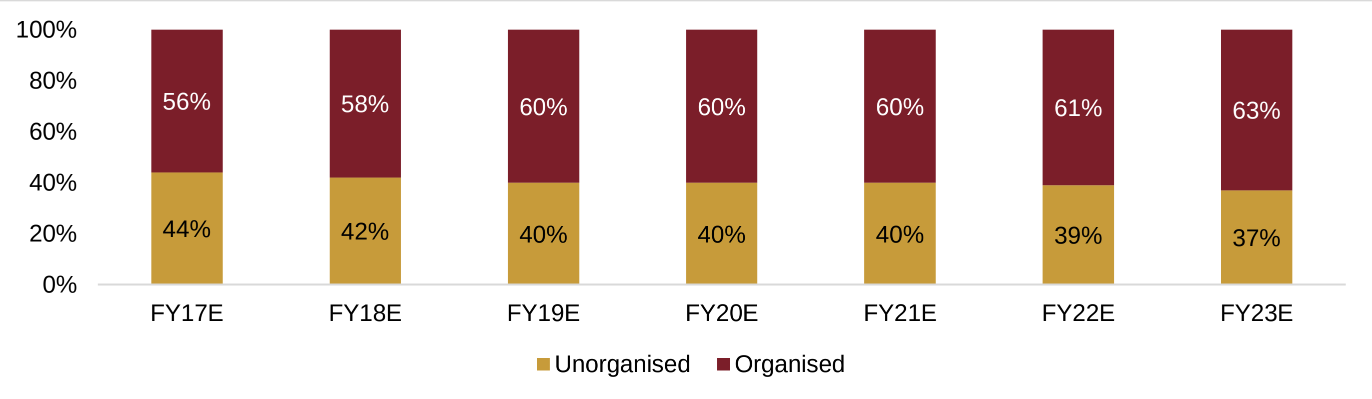
Going forward, CRISIL MI&A believes that the scope to capture share from unorganised gold loan financiers', initiatives to increase awareness and increasing comfort of customers with gold loans due to the convenience are expected to help the industry grow moderately along with geographic diversification 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 Rs 7,480 billion by March 2025, translating into a 10-12% CAGR between fiscal 2023 and 2025.

Growth in gold loan AUMs of organized lenders



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

Share of organized and organized lenders

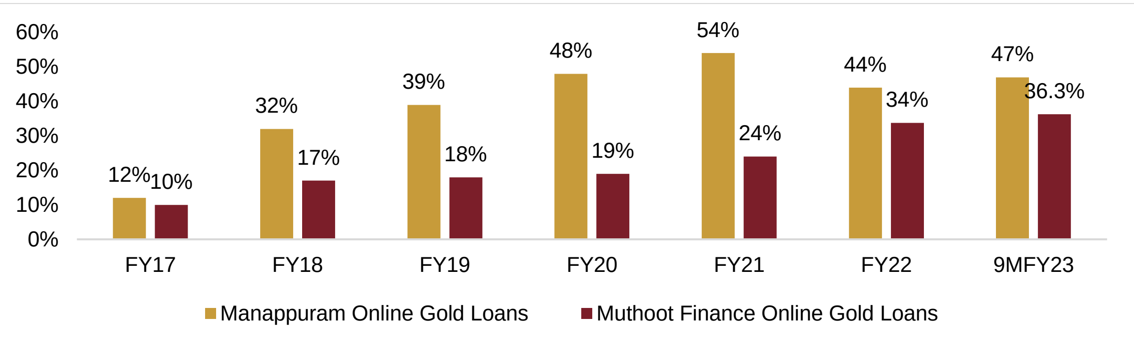


Note: E: Estimated
Source: CRISIL MI&A

Online gold loans and doorstep disbursement schemes to help the gold loan market

Digital gold loans products offer the feature of loan sanction within few hours through the online process. These loans can be accessed through mobile applications, online platform, prepaid card etc. KYC, registration and disbursements are all possible through online platform. For example, entities such as IIFL Finance, Manappuram Finance and Muthoot Finance are constantly making investments in digital and technological capabilities to adapt to constantly changing world. For example, IIFL Finance launched digital gold loans for top up and online renewal of gold loans. Further, gold at home disbursements for IIFL Finance increased from ₹ 0.18 billion in the fourth quarter of Fiscal 2021 to ₹ 2.08 billion in the fourth quarter of Fiscal 2022. Similar shift towards digital modes is witnessed for Muthoot Finance, which saw its share of online gold loans increase from 24% in Fiscal 2021 to 34% in Fiscal 2022. At the end of nine months of Fiscal 2023, the share of online gold loans further increased to 36% and 47% for Muthoot Finance and Manappuram Finance, respectively.

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



Source: Company Reports, CRISIL MI&A

New age FinTech players such as Rupeek along with players like Fedbank Financial Services, SBFC Finance, Muthoot Finance, IIFL and Manappuram Finance also offer gold loans at customer's doorstep wherein the customer can get a gold loan sitting at home. The complete loan underwriting-to-disbursal process takes place within 30 minutes, just as it happens in case of a loan availed through a NBFC branch. In case of doorstep offering, verification of the gold ornaments as well as gold collection is done at the customer's residence. These are managed through a central application that is simultaneously accessed by all branches for each and every transaction. Due to these advantages as well as increasing focus by players in both doorstep delivery and online gold loans, the addressable market for gold loans is expected to expand over the next few years.

Doorstep gold loans operating model

	Traditional Models	Door step model
Loan Application	Branch walk in	Phone call, Mobile or app based request
Gold Valuation	Valuation by employee/loan officer at branch	Doorstep valuation by loan officer
Loan Processing	Manual entry of customer data and Paper based KYC	TAB based data entry and KYC
Gold Storage	Vaults in Branch	Vaults in branch, Barcodes and RFID for tracking and retrieval
Loan Disbursement	Disbursal in 10-20 mins	Disbursal in 10-20 mins after completion of entire process at doorstep
Collection	Cash or Cheque at branch, ECS (Electronic Clearing System) / NACH (National Automatic Clearing House), Direct transfer from customer account	Cash collection at doorstep, ECS/NACH, Direct Transfer

Source: CRISIL MI&A

Greater accessibility and growing customer base to boost growth for SFBs

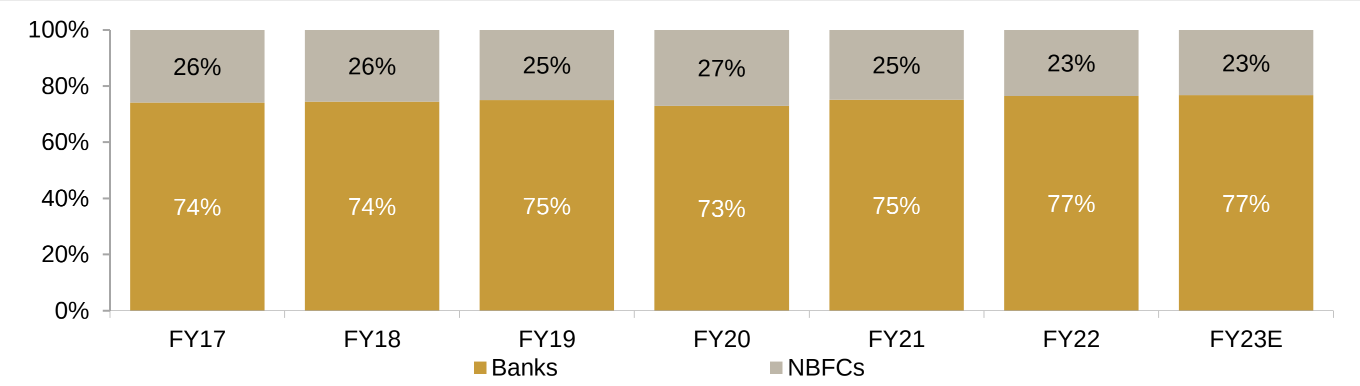
Over the past decade, specialized gold loan NBFCs have witnessed exceptional growth amongst organized players. This growth is driven by aggressive expansion of branches, heavy spend on marketing and rapid acquisition of customers. NBFCs and banks approach the gold loan market differently, reflected in their interest rates, ticket sizes and loan tenures. NBFCs focus more single-mindedly on the gold loans business and have, accordingly, built their service offerings by investing significantly in manpower, systems, processes and branch expansion. This has helped them attract and serve more customers. Some of their advantages are:

- Less documentation enabling faster turnaround.
- Adequate systems to ensure quick disbursals. For example, NBFCs have dedicated personnel to value the gold jewellery at the branches.
- Flexible repayment options, wherein the borrower can pay both the interest and principal at closure of the loan; and
- Greater accessibility due to better penetration, ability to serve non-bankable customers.

SFBs to witness strong growth due to following reasons:

- **Large customer base**: With experience in the MFI industry over the years, SFBs have access to large customer segment, both, agriculture and non-agriculture. Large set of such loans would classify under PSL, and customers would get subsidies. This would help SFBs cater customers by providing gold loans at competitive interest rates as compared to gold loan NBFCs.
- **Greater accessibility:** SFBs will be able to better penetrate in the gold loan segment due to their ability or past experience to serve non-bankable and underbanked customers in tier III and tier IV cities. This would not only help SFBs to capture share in organised market but will also increase the share of organised financiers in the industry by catering untapped customers in remote regions.

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



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

Comparison of Gold loan institutions on select business parameters

	Banks	Gold loan NBFCs	Unorganised moneylenders
Interest rate	9-18%	21-26%	25-45%
LTV	Up to 75%	Up to 75%	More than 75%
Tenure	8-12 months	2-12 months	6-12 months
Processing fee	Higher than NBFCs	No/minimal processing fees	None
Regulator	RBI	RBI	None
Documentation required	KYC Compliance	Minimal	Minimal
Product focus and customer service	Non-core product	Gold loan is core focus, excellent customer service	Gold loan is core focus
Mode of disbursements	Mainly cheque and direct transfer to account	Cash/ cheque and direct transfer to account	Mostly cash
Turnaround time	30 min - 2 hours	10 - 20 mins	10 - 20 mins
Opening hours	Banking hours	Beyond banking hours	More flexible than banks in terms of working hours

Source: Company Website as on 10th April 2023,CRISIL MI&A

Affordable housing loans- Ticket size <2.5 million

Housing finance (loans up to Rs. 2.5mn) sector witnessing encouraging trends; Market to bounce back more strongly in longer term

Housing loans (up to Rs. 2.5 million ticket size) logged a CAGR of ~12% during fiscals 2015-2020. This was largely because of the government's increased focus on the housing loans (up to Rs. 2.5mn) segment. In fiscal 2019, however, the growth slowed down considerably to 10% on year due to liquidity constraints in NBFCs and HFCs. The growth further weakened to ~6% on year in fiscal 2020 and 0-2% in fiscal 2021 and 2022 due to economic slowdown.

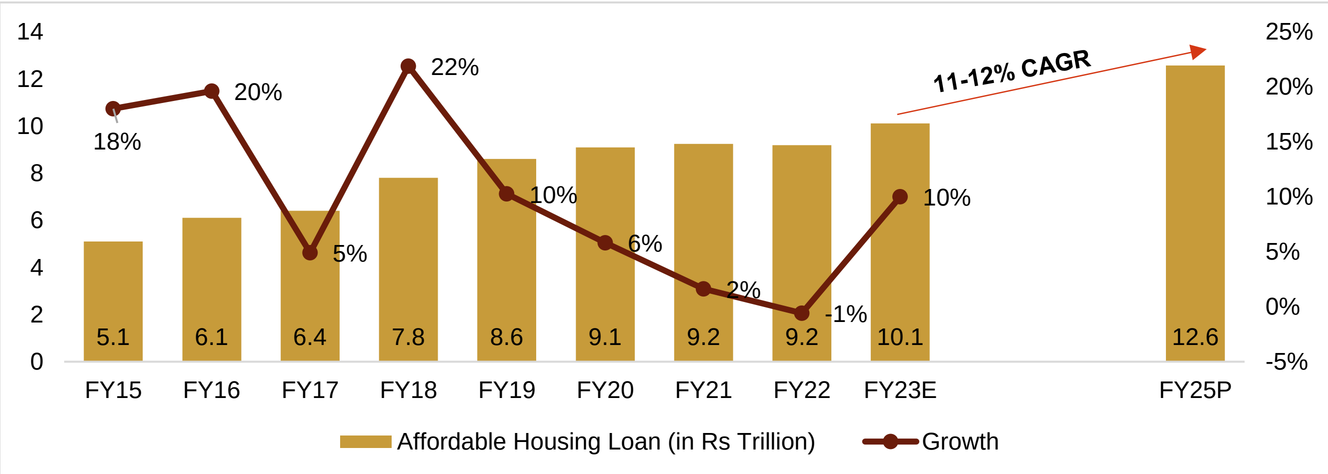
In fiscal 2021, lenders reported sharp fall in disbursements in April and May due to the lockdown. Furthermore, the Covid-19 pandemic's second wave hampered loan offtake in the first quarter of fiscal 2022. Overall HFC disbursements plunged 40-60% sequentially. Moreover, affordable HFCs had to grapple with high gross non-performing assets (GNPAs) and liquidity issues.

In fiscal 2023, CRISIL MI&A estimates affordable housing market to have witnessed strong growth due to increased loan disbursals. Going forward, increased disbursals supported by improvement in the economic activities for the economic weaker section and low-income group segments will aid the growth of affordable housing market. CRISIL MI&A expects the affordable housing market to grow 10-12% year on year in fiscal 2024.

In longer term CRISIL MI&A expects the segment to grow at ~11-12% CAGR over FY23-25 on account of following.

- Favourable government and regulatory support to promote housing loans (up to Rs. 2.5mn) industry
- Recovery in economic activity over the medium term
- Increased supply of affordable homes
- Rising demand for affordable homes as consumers increasingly work out of Tier 2/3/4 cities in a post-Covid world
- Work from home scenario pushing purchase decision for houses
- Ease of access to finance and rise in finance penetration

Housing loan growth (up to Rs. 2.5 mn) to grow at 11-12% CAGR from fiscal 2023 to fiscal 2025



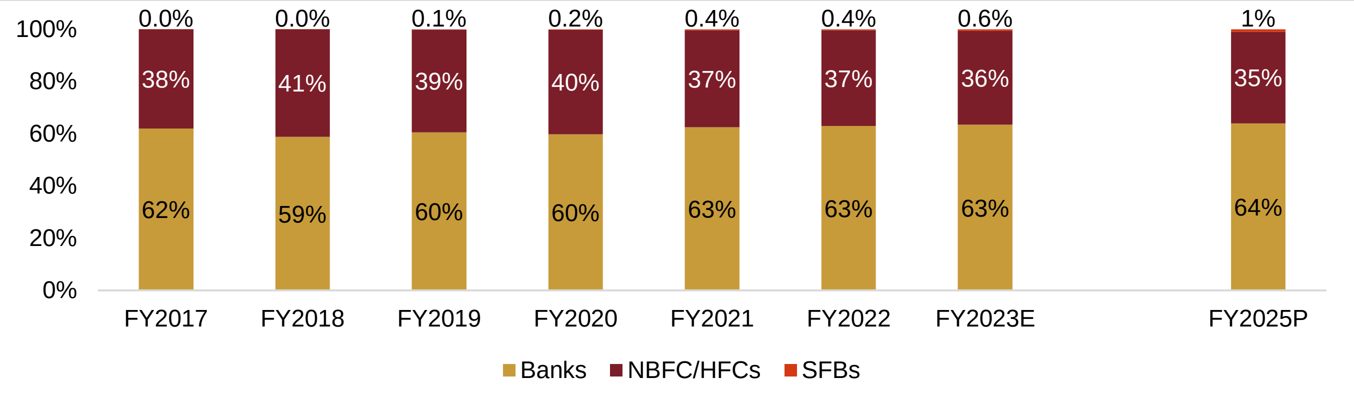
Note: P- Projected, E – Estimated

Source: Company reports, RBI, CRISIL MI&A

Banks to gain market share in housing finance (up to Rs. 2.5 mn)

CRISIL MI&A expect banks to grow at a faster pace vis-à-vis HFCs in housing loans (up to Rs. 2.5 mn), given their advantage in terms of cost of funds and base of deposit accounts. Despite HFCs focus on housing loans (up to Rs. 2.5mn), as they attempt to ward off competition from banks and protect profitability, the liquidity crisis coupled with sluggish economic activity post Covid-19 has plagued their share. CRISIL MI&A expects that SFBs are also expected to grow at a faster pace as compared to other banks and HFCs over the next two to three years.

Banks to continue to increase their foothold in this segment



Note: E: Estimated, P: Projected

Source: Company reports, CRISIL MI&A

Key factors contributing to high competitiveness of SFBs in housing loans (up to Rs. 2.5 mn) will be:

- **Clear understanding of target market:** Given the target borrower's profile, players need to have a clear and deeper understanding of micro markets and develop a strong local network. The strong network helps players to source business from niche customer category by having references from their existing customers. It is observed that successful players in the segment generally focus on a few geographies where they have a good understanding and scale up gradually to manage costs and asset quality better.
- **Collection Efficiency:** Given that players in the segment typically cater to the lower income customer segment, many of whom may not be financially literate, a strong focus and understanding of SFBs on collections and monitoring risk of default at customer level will help them to keep asset quality under check.
- Access to public deposits for the SFBs gives it a pricing advantage due to lower cost of funds as compared to HFCs

Long-term growth drivers for housing finance

Higher transparency in the sector, increasing affordability and urbanisation, and government incentives will push up the housing finance market in longer term.

Government Initiatives	• **PMAY-U:** The scheme aims to fill the supply-demand gap in the housing sector. On supply side, the scheme offers incentives for beneficiary-led housing, public private partnerships (PPP) in building homes for economicaly weaker sections (EWS) and low income group (LIG) by offering incentives such as allowing higher floor space index and announcing grants and subsidies for slum redevelopment. On the demand side, the PMAY provides credit-linked subsidies to stmulate demand • **PMAY-G:** The scheme is for the rural population who don't have their own houses. It provides financial assistance and interest rate subsidy • **Special financing window:** This window is expected to help revive stalled housing projects which require a last-mile funding to reach completion • **Relaxation of ECB guidelines:** The relaxed external commercial borrowing (ECB) guidelines will enable easier access to overseas funds and stimulate the sector • **Tax incentives:** Provides various tax benefits to home loan borrowers • **RERA:** The law was introduced in order to make the sector transparent • **GST:** The GST rate for affordable housing projects was cut • **EPF corpous withdrawal:** Permission to withdraw 90% of employees provident fund (EPF) corpus enables prospective home buyers to make the down payment and pay their home loan EMIs
Regulator initiatives	• Risk weight rationalisation on housing loans to improve sentiment for the real estate sector • **SARFAESI Act**: Bringing HFCs under the ambit of the SARFAESI Act has helped them accelerate recoveries • **NHB refinance:** The NHB refinancing schemes help HFCs lower their borrowing costs • **PSL guidelines revised:** The RBI increased the threshold limit for home loans to be classified as PSL in order to promote PMAY
Other factors	• **Low mortgage penetration** • **Rising urbanisation and nuclearisation:** Decreasing average household size and rising level of urban population create more housing demand. • **Rising income levels:** Rising income levels help improve the affordability of houses • **Rising independent housing demand:** Increase in share of independent houses helps housing finance market grow in the long term

Source: CRISIL MI&A

Two-wheeler loans

Two wheeler industry to record growth in fiscals 2023 and 2024 led by improving demand sentiments

The two-wheeler industry sales clocked a 7% CAGR from fiscal 2015 to fiscal 2019, but in fiscal 2020, sales fell sharply by 18% as the decline in economic growth hurt demand. In fiscal 2021 and fiscal 2022 as well, sales continued to be under pressure due to the debilitating impact of Covid-19 on consumer incomes, especially in the lower middle-class segment.

Domestic two-wheeler wholesale sales plunged by around 13% on year in fiscal 2020-21. Demand sentiment in urban areas were impacted due to widespread COVID-19 cases, several corporates in employee-intensive sectors preferring to allow their employees to work from home and the relatively higher reliance on services sector activity. The continued closure of key demand segments such as students in educational institutes also impacted demand. In rural India as well, the decline in manufacturing and service sector activity in the immediate aftermath of Covid-19 hurt demand, albeit lesser than in urban areas, which led to two-wheeler sales decreasing by 11% in fiscal 2022.

Sales volumes are estimated to increase in fiscal 2023 aided by recovery in scooter sales as educational institutions and offices re-open, and many more people need commute influenced by recovering urban sentiments. Normal monsoons prediction is expected to support demand for motorcycles segment positively.

However, two wheeler sales volume growth is expected to slow down in fiscal 2024 due to price hikes seen in the segment over the last few years across both ownership and acquisition, which have dampened consumer sentiment. The price of two wheeler is estimated to have increased by 15-20% since fiscal 2019 owing to safety norms, BS-VI implementation and higher input costs.

In the medium to long term, we expect two-wheeler sales to grow at 8-10% CAGR between fiscal 2023 to fiscal 2025 owing to:

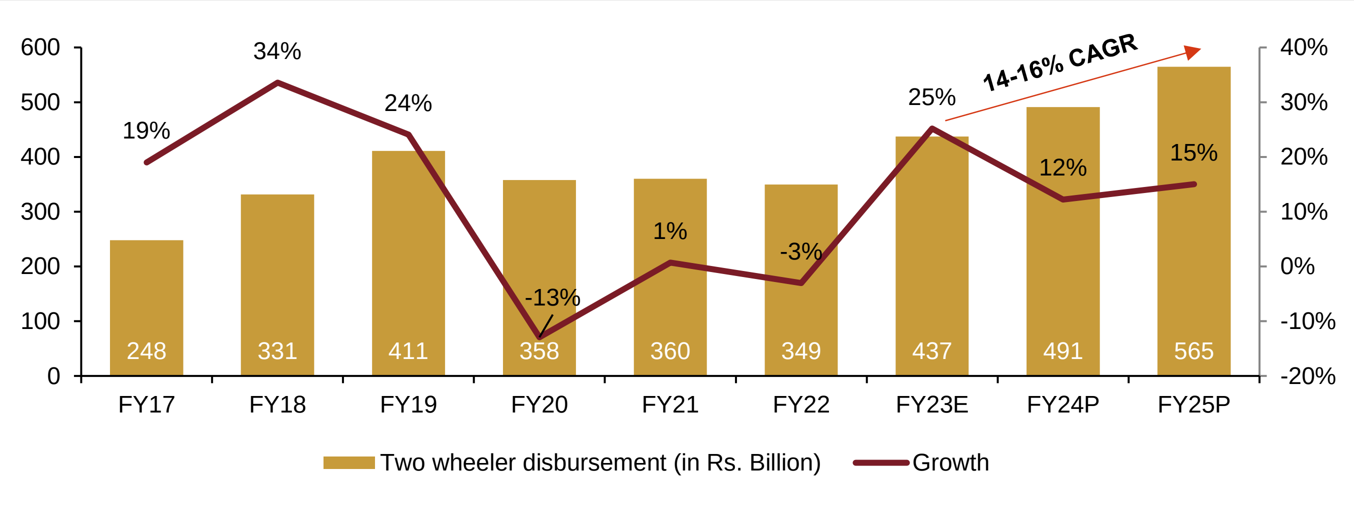
- Manufacturers focus on expansion in distribution network in semi-urban and rural areas, new model launches in the affordable segment for scooters and premium segment for motorcycles.
- Improving rural productivity, diversification towards horticultural crops, government income support schemes and structural 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.
- Ramp up seen in road construction

Two-wheeler disbursements expected to grow at a 14-16% CAGR from fiscal 2023 and fiscal 2025

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 loan-to-value (LTV), and higher finance penetration.

Two wheeler disbursement decreased by 4% in fiscal 2022 owing to 11% fall in two-wheeler sales during the fiscal due to increasing realisation. CRISIL MI&A estimates two wheeler disbursement to have increased by 25% in fiscal 2023 on account of healthy growth in two wheeler domestic sales. CRISIL MI&A expects two wheeler disbursements to grow at 14-16% CAGR driven by sales volume growth, gradual increase in finance penetration, and steady increase in the average ticket size with vehicle prices rising.

Growth in two wheeler loan disbursements



E: Estimated; P: Projected

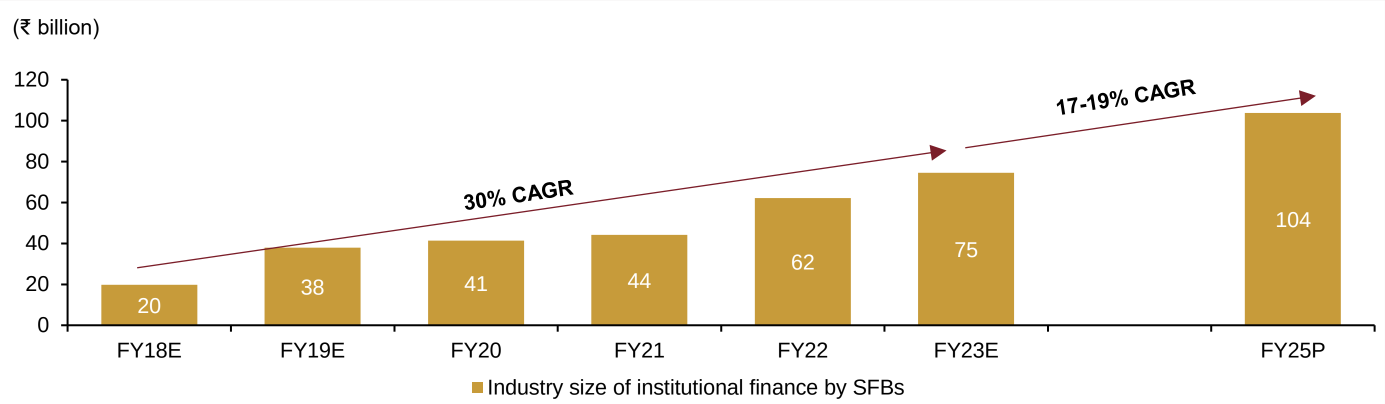
Source: CRISIL MI&A

Institutional financing

Institutional finance represents lending services to medium-sized and large corporate firms, institutional customers and real estate developers by banks and other financial institutions. It encompasses long- and short-term funding. In our analysis, we have considered lending to NBFCs, HFCs, MFIs and medium and large corporates by Small Finance Banks (SFBs).

Default of IL&FS in September 2018 had made SFBs to take a cautious approach to a few segments like wholesale finance. Pandemic also affected the institutional financing segment as evident from moderate growth of AUM in fiscal 2021. Institutional lending growth rebounded in FY22, with the segment growing at 40% year on year. CRISIL MI&A estimates the institutional lending market to have grown 20% year on year in fiscal 2023 on account of increase in yields due to rate hike and strong credit demand. Going forward, CRISIL MI&A expects the SFB institutional finance segment growth to remain at a healthy 17-19% CAGR over fiscal 2023-25.

Institutional finance segment growth for SFBs expected to be ~17-19% over fiscal 2023 and fiscal 2025



Note: Data for ESAF SFB is estimated

Source: Company reports, CRISIL MI&A

Better profitability is one of the key features of SFBs' institutional finance lending

SFBs' institutional financing segment enjoys higher profitability owing to lower cost of funds due to access to customer deposits, higher yield ranges between 10-15% coupled with low provision due to better asset quality.

Other key features of the industry

- NBFCs together account for ~60-65% which is followed by HFCs, which accounts for 20-25% of SFBs overall advances. Others include fintechs, gold finance companies and medium and large corporates.
- At sectors level MSME and real estate together accounts for majority of the share, it is followed by auto 15-20%.
- In states, Maharashtra, Delhi, Karnataka and Rajasthan together form 70-75% of institutional finance advances.
- Average ticket size amongst Rs 10-20 crore with few players disbursing up to Rs. 50 crores. Typical tenure ranges between 1-3 years and some players lend up to 7 years

Key challenges

Concentrated portfolio: Few players dominate institutional finance book; a few slippages can result in high level of gross NPAs.

Limited refinancing avenues: Due to increasing asset quality concerns in institutional finance segment and liquidity crunch, repayments will have to be made through the actual cash flows received from the borrowers. Economic downturn and poor demand in the real estate, borrowers are witnessing tight cash issues which increases the default risks.

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.