

5<sup>th</sup> August, 2022

To,

**The Board of Directors,**

Fincare Small Finance Bank Limited  
301-306, 3<sup>rd</sup> 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 22<sup>nd</sup> June 2022 regarding the content provided to you for your internal use by CRISIL Research as part of your subscription to its Industry Research on the following industry:

CRISIL Research Analysis of small finance banks and various retail loan products, August 2022 (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**") (as included herein in Annexure A) 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:

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- 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.

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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 B. 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.

**Given below is the disclaimer to be used in the Offer Documents.**

“CRISIL Research, 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 Research operates independently of, and does not have access to information obtained by CRISIL’s Ratings Limited / CRISIL Risk and Infrastructure Solutions Ltd (CRIS), which may, in their regular operations, obtain information of a confidential nature. The views expressed in this Report are that of CRISIL Research and not of CRISIL’s Ratings Limited / CRIS. 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



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Suresh Krishnamurthy  
Senior Director- CRISIL Research

***Analysis of small finance banks and various retail loan products***

***Fincare SFB – DRHP***

August 2022

## Macroeconomic scenario

### World economy fighting inflation surge post Covid-19 with Indian economy facing volatile commodity prices and tightening of liquidity

Fiscal 2020 was volatile for the global economy. The first three quarters were ensnared in trade protectionist policies and disputes among major trading partners, volatile commodity and energy prices, and economic uncertainties arising from United Kingdom's exit from the European Union (Brexit). Hopes of broad-based recovery in the fourth quarter were dashed by the COVID-19 pandemic, which led to considerable human suffering and economic disruption.

Global trade had a wonderful year in 2021, with merchandise trade growing 26% y-o-y in value terms in CY 2021. The positive trend was witnessed globally on account of easing of pandemic restrictions, recovery in demand owing to economic stimulus packages (particularly in advanced economies) and increase in commodity prices.

India's merchandise trade, too, reached record highs across both imports and exports, with imports growing by 62.8% on-year in May 2022 on a lower base owing to high crude oil and commodity prices, rising demand for consumer goods and partial recovery in industrial demand. Exports also grew by 20.6% on-year in May 2022, supported by both a lower base, robust external demand and higher oil prices which benefitted petroleum exports. However, going forward, CRISIL expects a reversal of trend with multiple headwinds such as slowdown in global growth, higher commodity prices and aggressive monetary tightening dampening the demand.

According to the latest provisional estimates released by the National Statistical Office (NSO) in May 2022, India's real Gross Domestic Product (GDP) growth has been pegged at 8.7% in fiscal 2022, lower than the last estimate of 8.9% released as second advance estimate in February 2022. In absolute terms, real GDP for fiscal 2022 is estimated at Rs 147.4 trillion, marginally less than Rs 147.7 trillion estimated earlier. The downward revision in GDP reflects a minor correction in first to third quarter GDP numbers, and a mild impact of third wave of Covid-19 and impact of Russia- Ukraine war in the fourth quarter. Further, given the large output loss due to Covid-19 pandemic, the real GDP is only 1.5% above the pre-pandemic level (fiscal 2020).

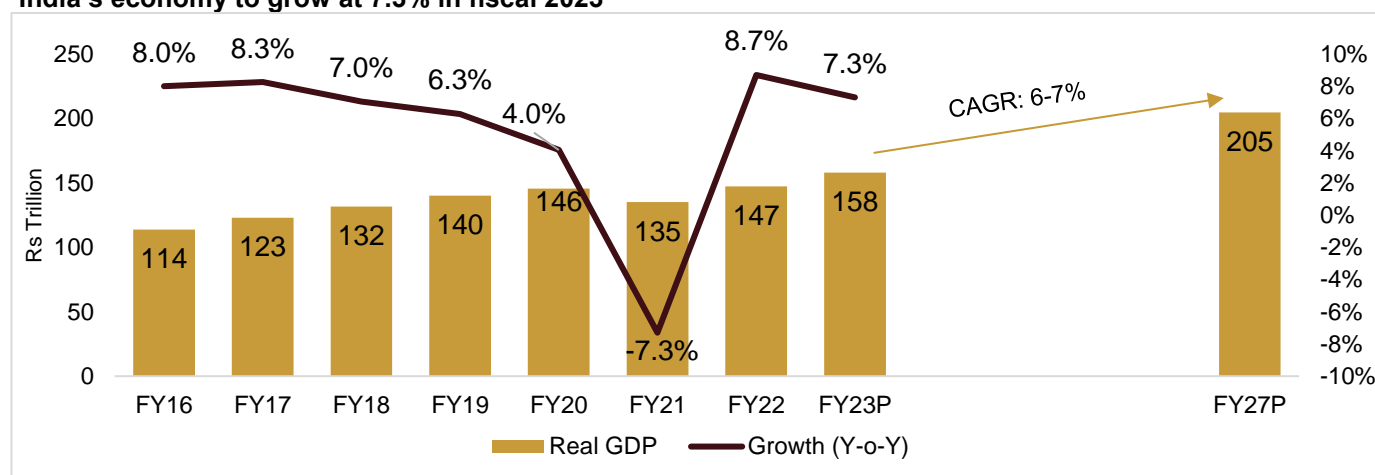
In the near-term, while risks due to the Covid-19 pandemic seem to be waning, high inflation, exacerbated by supply chain challenges as a result of the Russia-Ukraine war, and consequent tightening of interest rates by Central banks globally pose risks to economic growth globally and in India. According to IMF (*World Economic Outlook – July 2022*), global growth prospects have changed markedly since last year owing to geopolitical issues. In CY2021, global growth rebounded with a robust growth of 6.1% from -3.1% the previous year, but it is expected to slow in CY2022 to 3.2%, impact of which is expected to be witnessed in Indian economy as well. Further, there exist a downside risk arising from high inflation and the Ukraine war, which could push the world economy to the brink of recession, if unchecked.

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

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.

CRISIL Research expects growth outlook for FY2023 to be fettered with multiple risks. Nevertheless, India is expected to remain the fastest growing economy in the world with GDP growth of 7.3% projected in fiscal 2023 as per CRISIL Research. The IMF too estimates India's GDP to grow by 7.4% in CY 2022 due to its broad range of fiscal, monetary and health responses. However, IMF projects the growth to slow down to 6.1% in CY2023.

### India's economy to grow at 7.3% in fiscal 2023



Note: FY23 is projected based on CRISIL estimates FY24-FY27 is projected based on IMF estimates  
Source: CRISIL Research, IMF World Economic Outlook – July 2022

### Macroeconomic outlook for Fiscal 2023

Macro variables	FY22	FY23P	Rationale for outlook
GDP (y-o-y)	8.7*%	7.3%^	Fiscal 2023 growth to be influenced by inflation and external spillovers. Higher oil prices, slowing global demand for India's exports and higher inflation will act negative for the Indian economy. Inflation which reduces purchasing power would weigh in the revival of consumption, the largest component of GDP which has been backsliding for a while. However, a normal monsoon forecast and rebound in contact-intensive services are expected to bring some succor.
Consumer price index (CPI) inflation (y-o-y)	5.5%	6.8%	CPI inflation will be inflated due to external factors. This will be due to persistent high international commodity prices and input costs putting pressure on food, fuel and core inflation. The other factor is due to the heatwave's adverse impact on critical food items like wheat and vegetables.
10-year Government security yield (fiscal-end)	6.8%	7.5%	Increase in gross market borrowing by the government, rate hikes by the RBI and the Federal Reserve System (The Fed) along with surging crude oil price is expected to cause a surge in G-Sec yields.
CAD (Current account balance)/GDP (%)	-1.2%	-3%	India is expected to be vulnerable to external shocks raising current account deficit. Major factors will be elevated commodity prices, slowing global growth and supply chain snarls.

Rs/\$ (March average)	76.2	78	The rupee-dollar exchange rate will remain volatile with a depreciation bias in the near term due to widening trade deficit, foreign portfolio investment (FPI) outflows and strengthening of the US dollar index. US Dollar index will strengthen due to rate hikes by US Federal Reserve and safe-haven demand for the dollar amid the geopolitical risks.
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Note: \*NSO estimate, ^ with downside risk, P – Projected

Source: Reserve Bank of India (RBI), National Statistics Office (NSO), CRISIL Research

## Positive government regulations to aid economic growth

After clawing back in fiscal 2022, CRISIL Research forecasts India's GDP to grow at ~7% per annum between fiscals 2023 and 2025. This growth is expected to be supported by the following factors:

- Focus on investments rather than consumption push enhancing the productive capacity of the economy.
- The production linked incentive (PLI) scheme which aims to incentivise local manufacturing by giving volume-linked incentives to manufacturers in specified sectors
- Policies aimed towards greater formalisation of the economy, which are bound to lead to an acceleration in per capita income growth

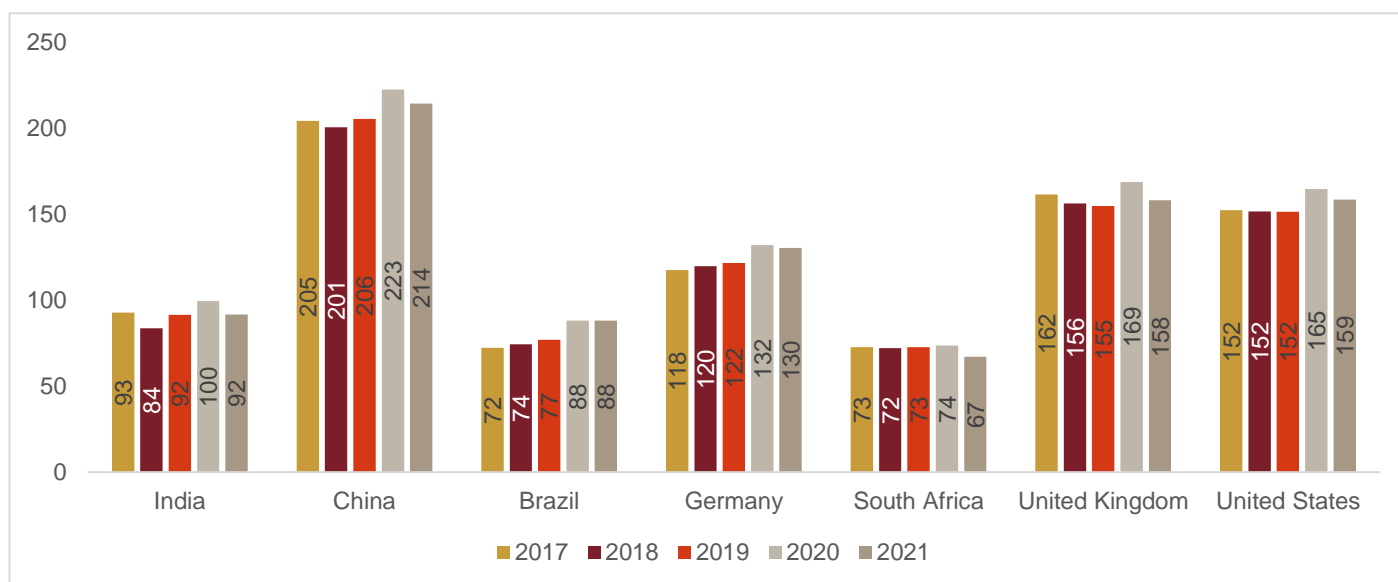
## Financial inclusion

### 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 22% of GDP as of fiscal 2020.

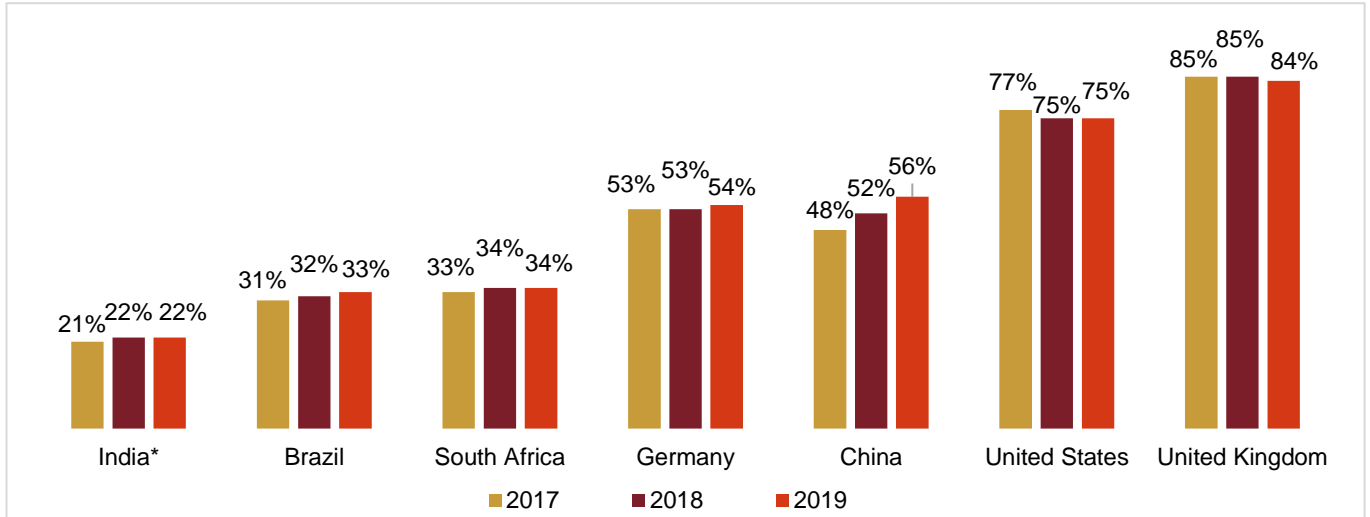
### Credit to GDP ratio (%)



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

Source: Bank of International Settlements, CRISIL Research

**Household Credit to GDP ratio (2017-2019)**

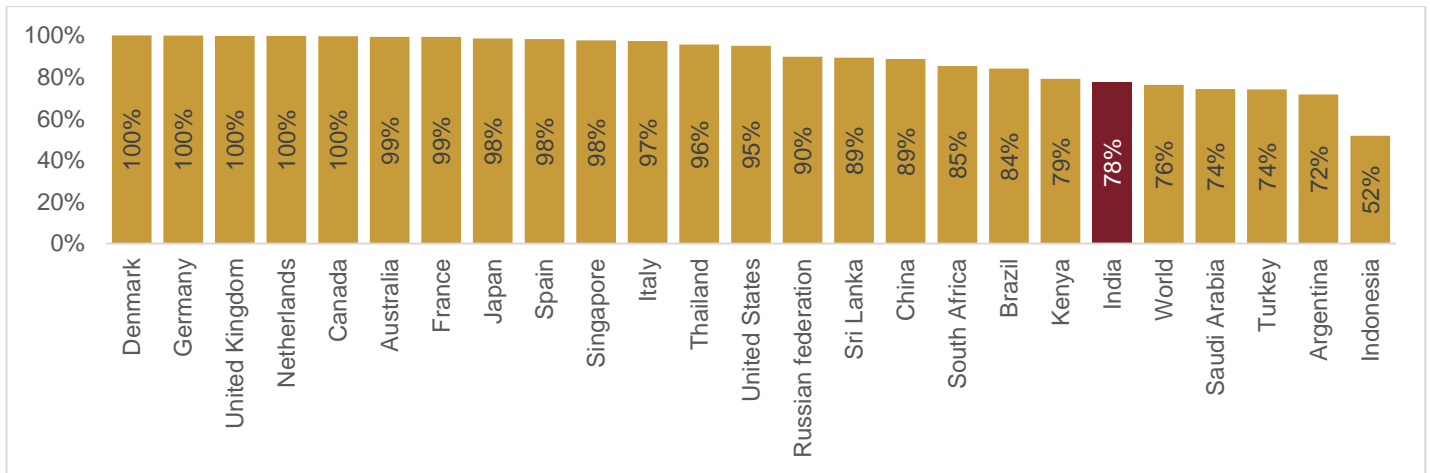


Note: For countries except India, data is represented for calendar years. \*For India, data represented is for FY18, FY19 and FY20

Source: Bank of International Settlements, CRISIL Research

**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**



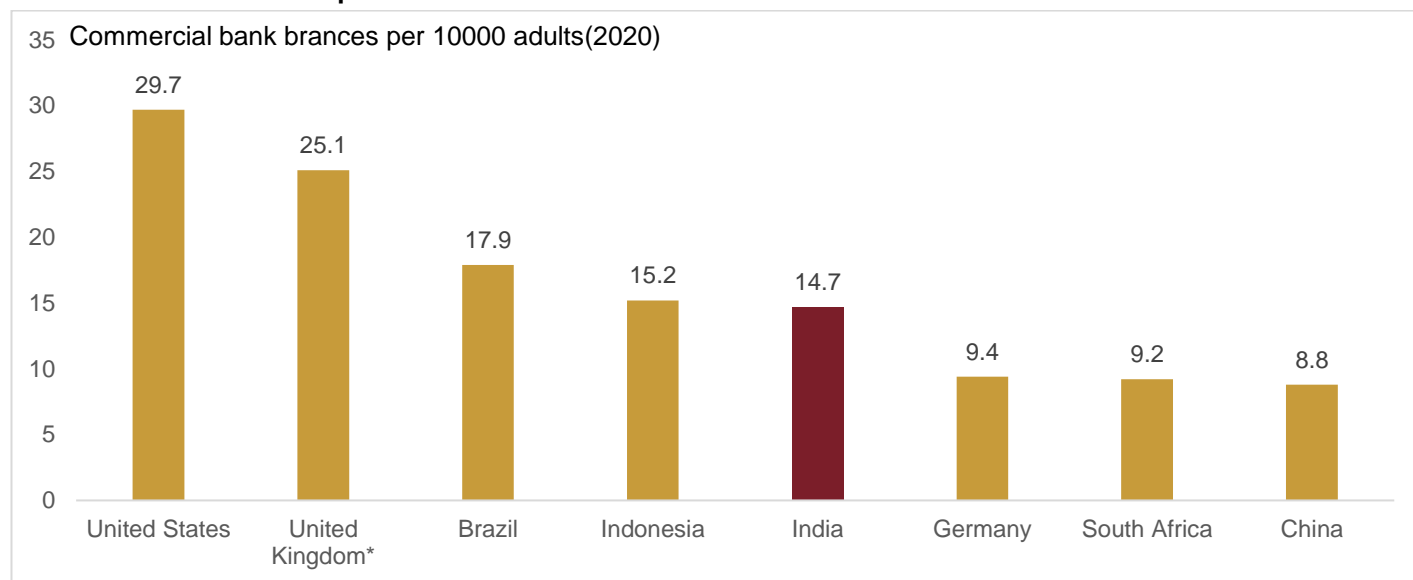
Note: 1. Global Findex data for India excludes northeast states, remote islands and selected districts. 2. Account penetration is for the population within the age group of 15+

Source: World Bank - The Global Findex Database 2021, CRISIL Research

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 2020, India has 14.7 branches and 22 ATMs for 100,000 adults according to World Bank data which is relatively lower than other developing and developed countries.



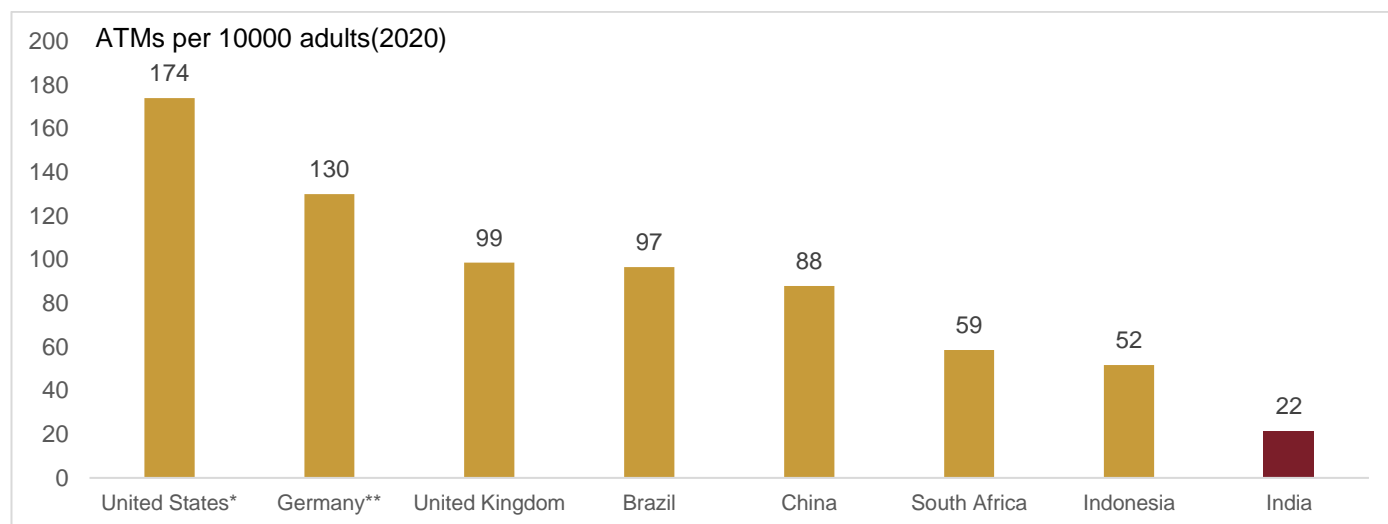
**Commercial bank branch penetration across the world**



Note: (\*) – UK data is as of 2013 calendar year

Source: World Bank, RBI, CRISIL Research

**ATM penetration across the world**

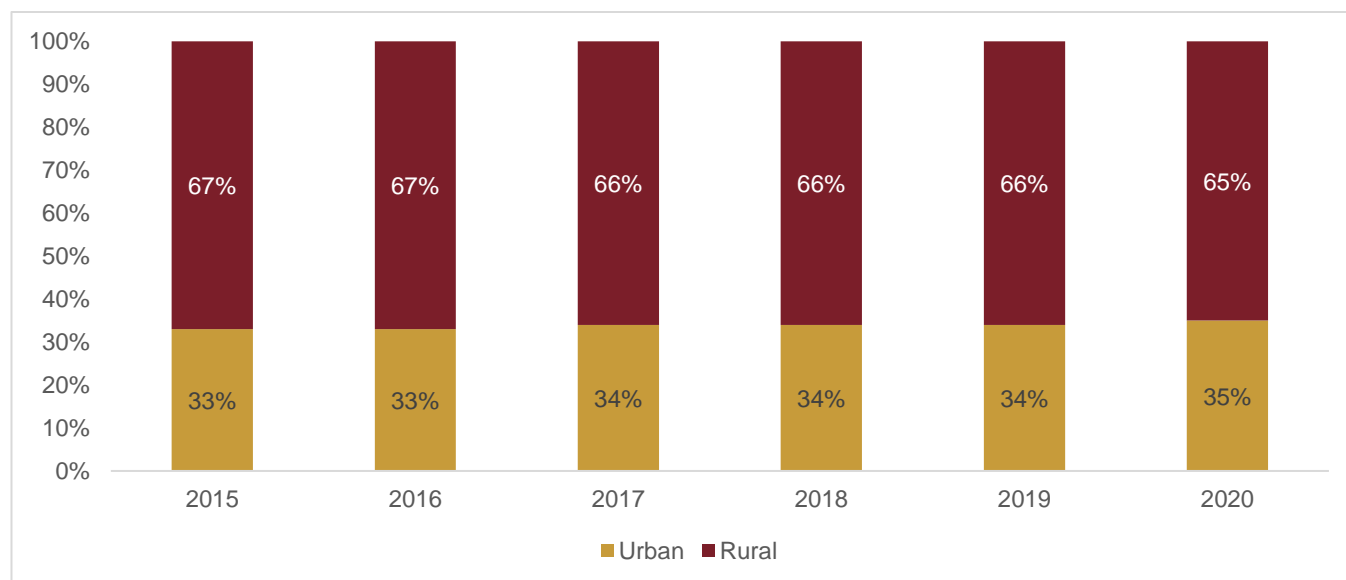


Note: (\*) – US data is as of 2009 calendar year, (\*\*)-Germany data as of 2019 calendar year

Source: World Bank, RBI, CRISIL Research

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 Research 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%

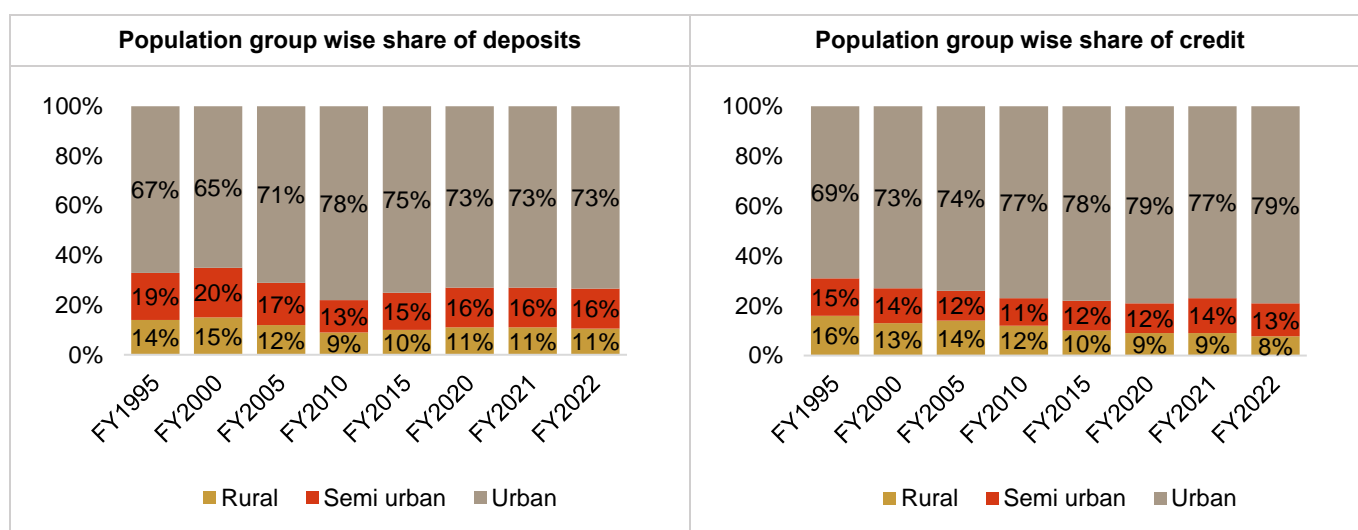
Source: Census 2011, CRISIL Research

**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. 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**

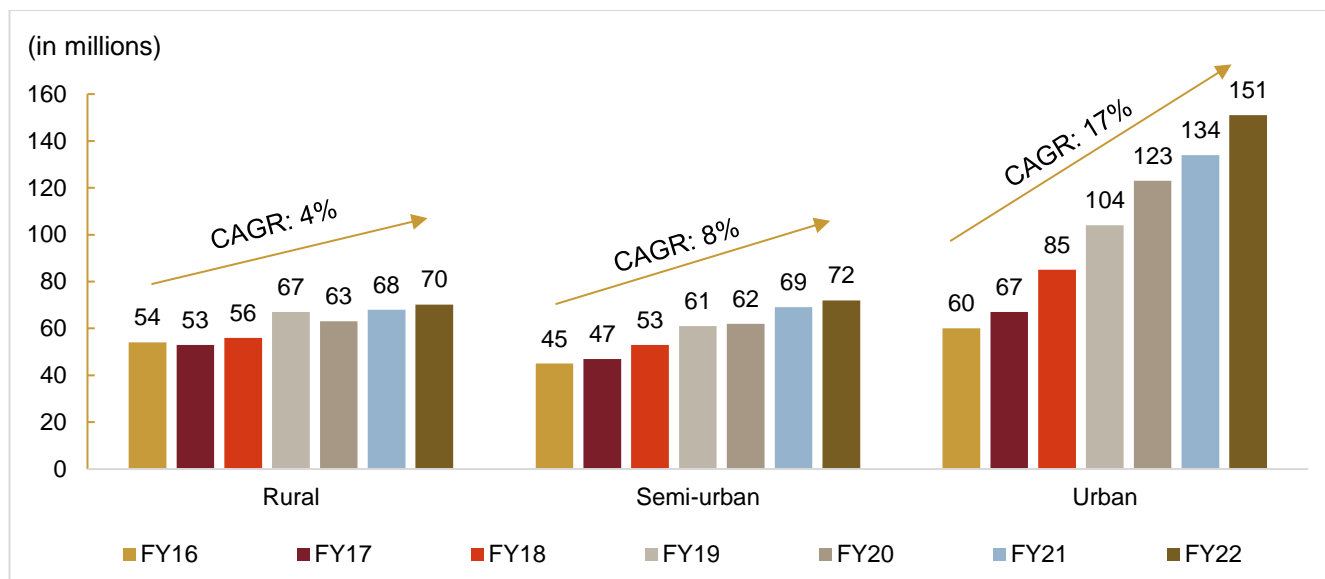


Source: CSO; RBI, CRISIL Research

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 4% between the end of fiscal 2016 and the end of fiscal 2022 and the number of bank deposit accounts grew at a CAGR of 5% during the same period. Between the end of fiscal 2016 and the end of fiscal 2022, the number of credit accounts in semi-urban areas grew at a CAGR of 8% and the number of deposit accounts grew at a CAGR of 6%. 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 fiscal 2022, the number of credit accounts in urban areas grew at a CAGR of 17% and the number of deposit accounts grew at a CAGR of 5%.

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



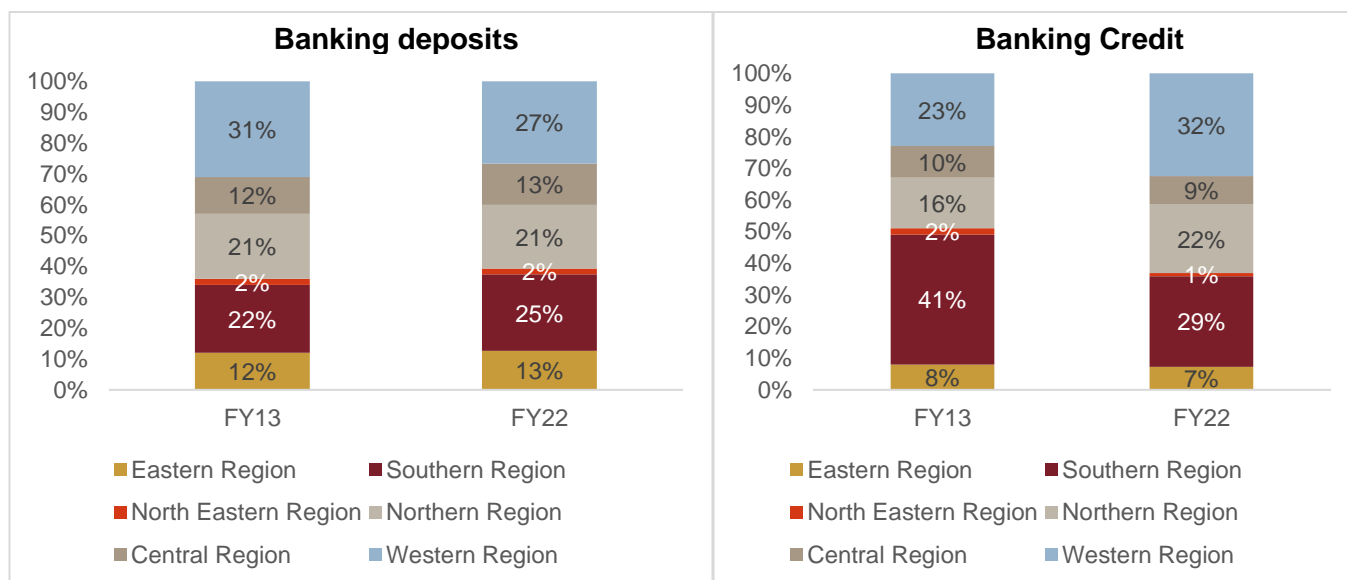
Note: Urban includes data for Urban and Metropolitan areas; amounts are as of the end of the fiscal year indicated. Data represents only bank credit accounts

Source: RBI; CRISIL Research

## 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 the past eight fiscal years by 3%.

### Region-wise share of banking credit and total deposits



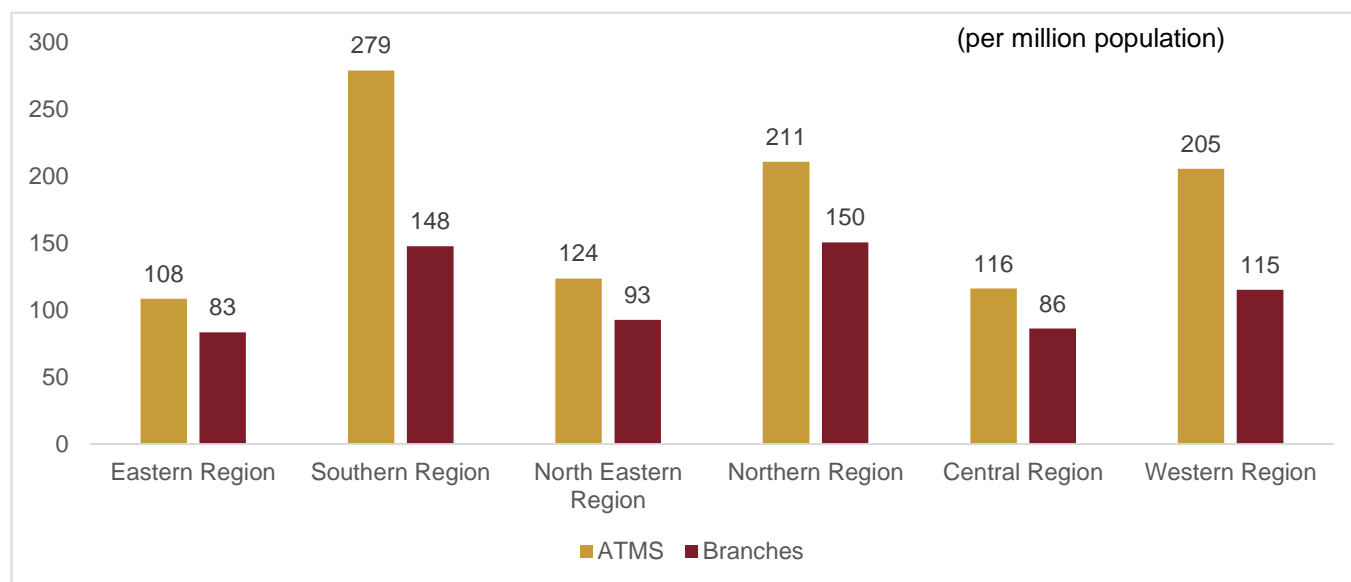
Note: The percentages are as of the end of the fiscal year indicated.

Source: RBI; CRISIL Research

**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 Research believes is largely due to lower focus from the bigger banks.

**Region-wise presence of bank ATM and branches (as of March 31, 2022)**



Note: population is as per the census data of 2011  
Source: RBI; Census India; CRISIL Research

**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 (FY22)**

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%	27%	92%	90%	2%	77%	7%
NCT of Delhi	11	1%	12%	93%	100%	0%	100%	0%
Tamil Nadu	38	6%	9%	99%	62%	11%	44%	27%
Karnataka	31	5%	7%	58%	75%	8%	50%	28%
Gujarat	33	5%	5%	69%	72%	6%	49%	18%
Telangana	33	3%	5%	92%	79%	6%	48%	22%
Uttar Pradesh	75	17%	5%	40%	38%	17%	23%	37%
Andhra Pradesh	26	4%	4%	128%	64%	15%	49%	29%
West Bengal	23	8%	4%	45%	73%	14%	47%	45%
Kerala	14	3%	3%	59%	66%	2%	52%	4%
Rajasthan	33	6%	3%	73%	53%	14%	40%	30%
Madhya Pradesh	52	6%	3%	65%	54%	12%	33%	25%

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
Haryana	22	2%	3%	53%	62%	8%	44%	19%
Punjab	23	2%	2%	52%	61%	19%	46%	28%
Bihar	38	9%	1%	38%	46%	22%	36%	48%
Odisha	30	3%	1%	39%	61%	19%	47%	51%
Chhattisgarh	28	2%	1%	64%	73%	8%	52%	22%
Assam	34	3%	1%	46%	50%	23%	37%	43%
Jharkhand	24	3%	1%	29%	68%	18%	53%	49%
Chandigarh	1	0%	1%	90%	100%	0%	100%	1%
Jammu & Kashmir	20	1%	1%	49%	60%	35%	50%	50%
Uttarakhand	13	1%	1%	34%	89%	21%	82%	32%
Himachal Pradesh	12	1%	0%	30%	74%	58%	68%	69%
Goa	2	0%	0%	24%	100%	17%	100%	31%
Puducherry	4	0%	0%	60%	100%	10%	100%	15%
Tripura	8	0%	0%	33%	87%	30%	83%	37%
Meghalaya	12	0%	0%	29%	93%	36%	88%	44%
Manipur	16	0%	0%	59%	83%	29%	82%	28%
Nagaland	12	0%	0%	43%	84%	23%	81%	27%
Arunachal Pradesh	25	0%	0%	23%	72%	27%	65%	33%

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

Source: RBI, CRISIL Research

## States with low financial penetration present a strong case for growth

Gujarat, Bihar, Telangana recorded fastest growth in fiscal 2016-2021

### State-wise GDP and GDP growth (FY 2021)

States	Real GDP Rs. Billion (FY 2021)	YOY growth	Real GDP growth CAGR (FY 2016-FY 2021)	Credit account penetration (FY 2022)	Deposit account penetration (FY 2022)	Branch penetration (FY 2022)	ATM penetration (FY 2022)	CRISIL Inclusix Score (2016)
Maharashtra*	21,341	29.0%	6.6%	43%	176%	106	213	62.7
NCT Of Delhi	5,790	-5.7%	4.0%	26%	292%	192	400	86.1
Uttar Pradesh	10,926	-6.4%	3.8%	2%	127%	77	100	44.1
Karnataka	11,138	-2.6%	6.0%	10%	183%	151	259	82.1
Tamil Nadu	12,967	1.4%	6.0%	14%	184%	144	337	77.2
West Bengal	7,927	1.1%	5.4%	4%	160%	91	123	53.7
Gujarat*	12,690	41.9%	9.1%	9%	157%	128	186	62.4
Kerala*	5,686	26.0%	6.0%	10%	211%	175	278	90.9
Telangana	6,446	-0.6%	6.8%	15%	203%	158	318	72.8
Haryana	5,281	-5.7%	5.0%	11%	202%	177	235	67.7
Rajasthan	6,432	-6.6%	2.7%	4%	135%	103	140	50.9
Madhya Pradesh	5,608	-3.4%	6.0%	4%	142%	90	132	48.7

<b>Punjab</b>	3,862	-6.6%	3.2%	10%	215%	212	239	70.9
<b>Bihar</b>	4,199	2.5%	7.2%	1%	123%	62	73	38.5
<b>Odisha</b>	3,975	-3.6%	6.3%	4%	149%	112	163	63
<b>Andhra Pradesh</b>	6,516	-2.6%	5.5%	6%	156%	122	191	78.4
<b>Jharkhand</b>	2,271	-4.7%	5.4%	3%	145%	90	106	48.2
<b>Chhattisgarh</b>	2,455	-1.8%	5.2%	4%	145%	98	134	45.7
<b>Assam*</b>	2,378	24.5%	5.6%	4%	141%	84	120	47.9
<b>Uttarakhand*</b>	1,997	30.8%	6.9%	9%	284%	289	378	69
<b>Jammu &amp; Kashmir</b>	1,197	0.5%	4.3%	8%	157%	126	182	47.8
<b>Himachal Pradesh</b>	1,147	-6.2%	3.6%	5%	189%	213	268	72.3
<b>Goa</b>	650	22.4%	7.1%	18%	350%	393	572	88.9
<b>Chandigarh*</b>	312	25.3%	5.8%	17%	187%	192	309	86.7
<b>Tripura</b>	418	4.0%	9.3%	43%	141%	140	129	66.2

Note: 1. (\*) – As of FY 2020

2. Credit account penetration is calculated as total number of retail bank credit accounts/population of the state

3. Deposit account penetration is calculated as total number of bank deposit accounts/ population of the state

4. Branch penetration is calculated as Number of bank branches per 1000 people

5. ATM penetration is calculated as Number of ATM per 1000 people

6. For Credit and Deposit account penetration, this does not represent unique borrowers or depositors, total number of accounts have been considered

7. 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 Research

## 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, a local area banks and an NBFC as well as one urban co-operating bank have received permission to set up small finance banks (SFBs). The RBI 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	MFI
<b>Priority sector lending</b>			
<b>Targeted lending to sectors</b>	<ul style="list-style-type: none"> <li>40% of their adjusted net bank credit (ANBC) or equivalent off-balance sheet exposure (whichever is higher) for priority sector lending               <ul style="list-style-type: none"> <li>18% of ANBC to agriculture</li> <li>7.5% of ANBC to micro-enterprises</li> <li>10% of ANBC to weaker sections</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>75% of their ANBC for priority sector lending               <ul style="list-style-type: none"> <li>18% of ANBC to agriculture</li> <li>7.5% of ANBC to micro-enterprises</li> <li>10% of ANBC to weaker sections</li> </ul> </li> <li>At least 50% of loan portfolio should constitute loans and advances of up to Rs. 2.5 million</li> </ul>	<ul style="list-style-type: none"> <li>75% of total assets should be qualifying micro-finance loans               <ul style="list-style-type: none"> <li>Income generation loans &gt; 50% of total loans</li> </ul> </li> </ul>
<b>Prudential norms</b>			
<b>Capital adequacy framework</b>	<ul style="list-style-type: none"> <li>Minimum Tier-I capital: 7%</li> <li>Minimum capital adequacy ratio: 9%</li> </ul>	<ul style="list-style-type: none"> <li>Minimum Tier-I capital: 7.5% (Tier-II capital cannot be more than 100% of Tier-I capital)</li> <li>Minimum capital adequacy ratio: 15%</li> </ul>	<ul style="list-style-type: none"> <li>Tier-I capital &gt; Tier-II capital</li> <li>Minimum capital adequacy ratio: 15%</li> </ul>
<b>CRR / SLR</b>	<ul style="list-style-type: none"> <li>Maintenance of CRR/SLR ratio mandatory</li> <li>CRR – 3%, 3.5% begin. March 27, 2021, 4% beginning May 22, 2021</li> <li>SLR – 18%, can be diluted up to 3% for liquidity (2% earlier), up to March 31, 2021</li> </ul>	<ul style="list-style-type: none"> <li>Maintenance of CRR/SLR ratio mandatory</li> <li>CRR – 3%, 3.5% begin. March 27, 2021, 4% beginning May 22, 2021</li> <li>SLR – 18%, can be diluted up to 3% for liquidity (2% earlier), up to March 31, 2021</li> </ul>	<ul style="list-style-type: none"> <li>No such requirement</li> </ul>
<b>Leverage ratio</b>	<ul style="list-style-type: none"> <li>Minimum leverage ratio of 4%</li> </ul>	<ul style="list-style-type: none"> <li>Minimum leverage ratio of 4%</li> </ul>	<ul style="list-style-type: none"> <li>No such requirement</li> </ul>
<b>LCR (liquidity coverage ratio)/ NSFR (net stable funding ratio)</b>	<ul style="list-style-type: none"> <li>Mandatory requirement to maintain liquidity coverage ratio</li> <li>NSFR applicable to scheduled commercial banks</li> </ul>	<ul style="list-style-type: none"> <li>Minimum liquidity coverage ratio of 100% by April 1, 2021</li> <li>NSFR will be applicable to SFBs on par with scheduled commercial banks as and when finalised</li> </ul>	<ul style="list-style-type: none"> <li>No such requirement</li> </ul>
<b>Funding</b>			



	Scheduled commercial banks	SFBs	MFIs
<b>Deposits</b>	<ul style="list-style-type: none"> <li>Primarily rely on deposits, CASA and term deposits, for funding requirements</li> </ul>	<ul style="list-style-type: none"> <li>Primarily rely on deposits, CASA and term deposits, for funding requirements</li> <li>Deposit ramp-up will take time</li> </ul>	<ul style="list-style-type: none"> <li>Cannot accept deposits</li> </ul>
<b>Bank loans / market funding</b>	<ul style="list-style-type: none"> <li>Access to broader array of market borrowings</li> </ul>	<ul style="list-style-type: none"> <li>Access to bank loans and broader array of market borrowings</li> </ul>	<ul style="list-style-type: none"> <li>Diversified funding sources, including bank loans, short-term and long-term market borrowings. Funding from NABARD, MUDRA loans etc.</li> </ul>
Products			
<b>Products offered</b>	<ul style="list-style-type: none"> <li>Full spectrum of banking, savings, investment and insurance products</li> </ul>	<ul style="list-style-type: none"> <li>Can offer savings and investment products apart from credit products / loans</li> <li>Can act as corporate agent to offer insurance products</li> <li>Cannot act as business correspondent to other banks</li> </ul>	<ul style="list-style-type: none"> <li>Can act as business correspondent to another bank and offer savings, deposits, credit and investment products</li> <li>Can act as corporate agent to offer insurance products</li> </ul>

Source: RBI, CRISIL Research

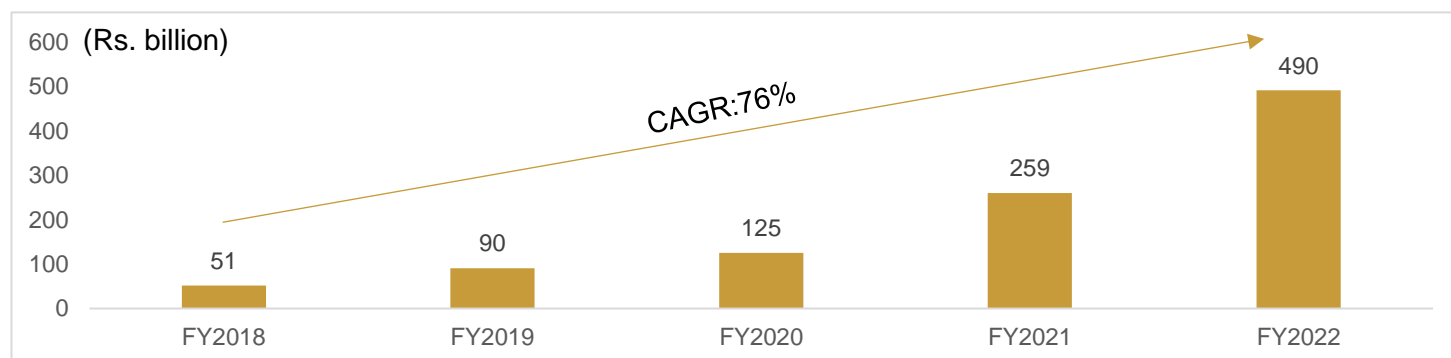
## Growth drivers for small finance banks

### 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 have grown at 76% CAGR from fiscal 2018 to fiscal 2022. This will give them an advantage over NBFCs and help expand their asset book.



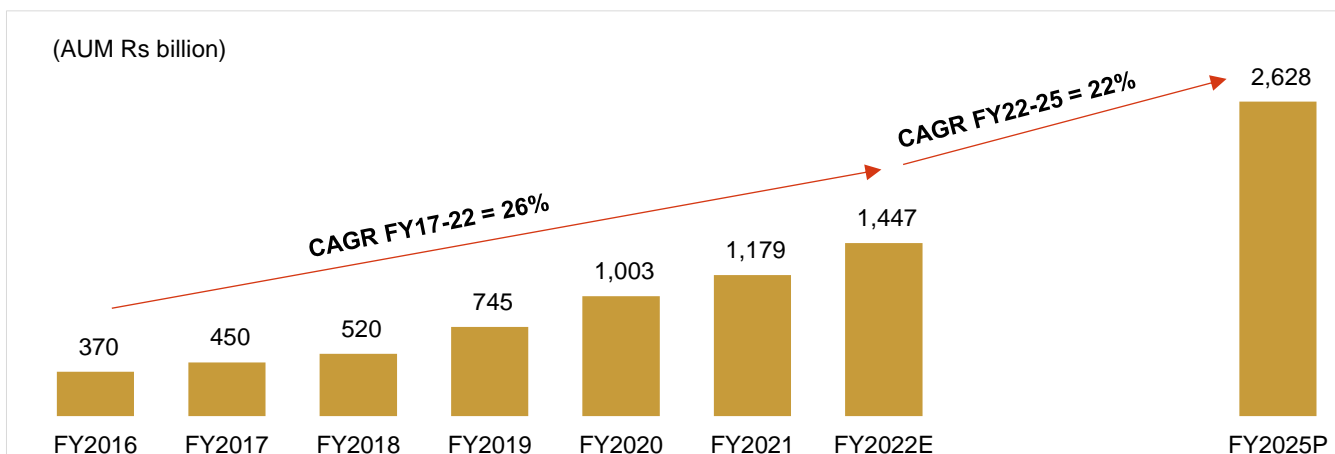
Source: RBI, CRISIL Research

### 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 three years (AUM)



Note: E: Estimated; P: Projected; Advances considered for other players; The amounts are as of the end of the fiscal indicated; Data includes data for 11 SFB

Source: Company reports, CRISIL Research

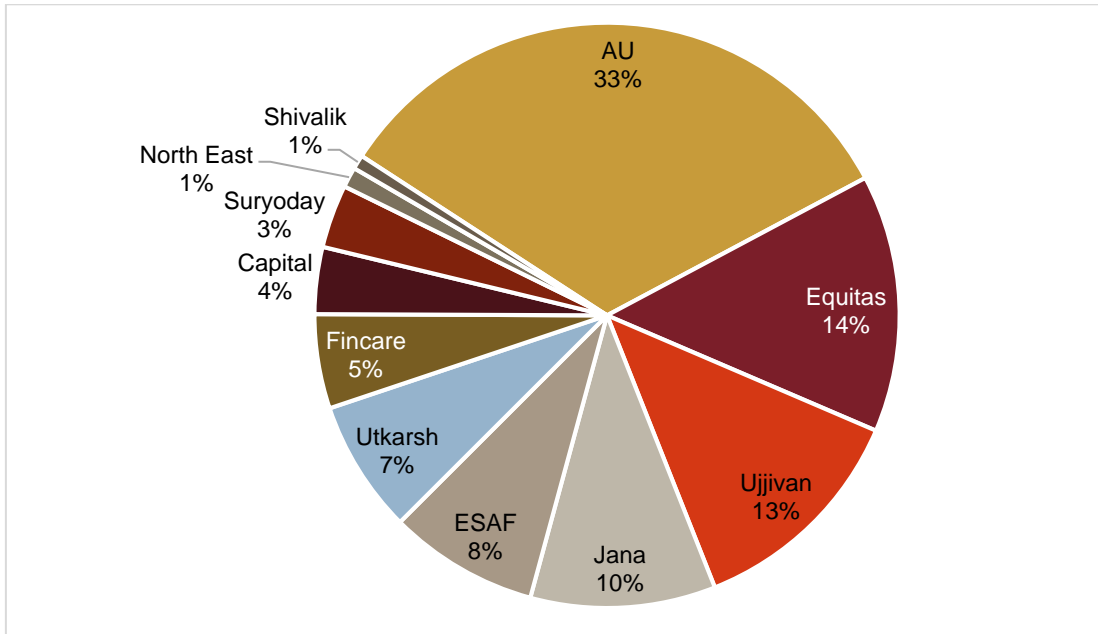
Small finance banks' AUM clocked 26% CAGR during fiscals 2016-2022. The top three accounted for ~60% of the aggregate AUM as of fiscal 2022, up from 55% as of fiscal 2017. These three players logged a 28% CAGR during the period. The top six players account for ~86% of the market share. CRISIL Research expects the sector's loan portfolio to see a strong ~22% CAGR in the near term as most of the SFBs have completed the transition phase and likely to get benefit from the operating leverage. New loan origination remained low as SFBs turned cautious and selective in disbursements due to the pandemic in fiscal 2022. However, as economy revives and business operations normalise, growth is likely to recover from fiscal 2023 onwards, largely supported by:

- **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 2020. 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.

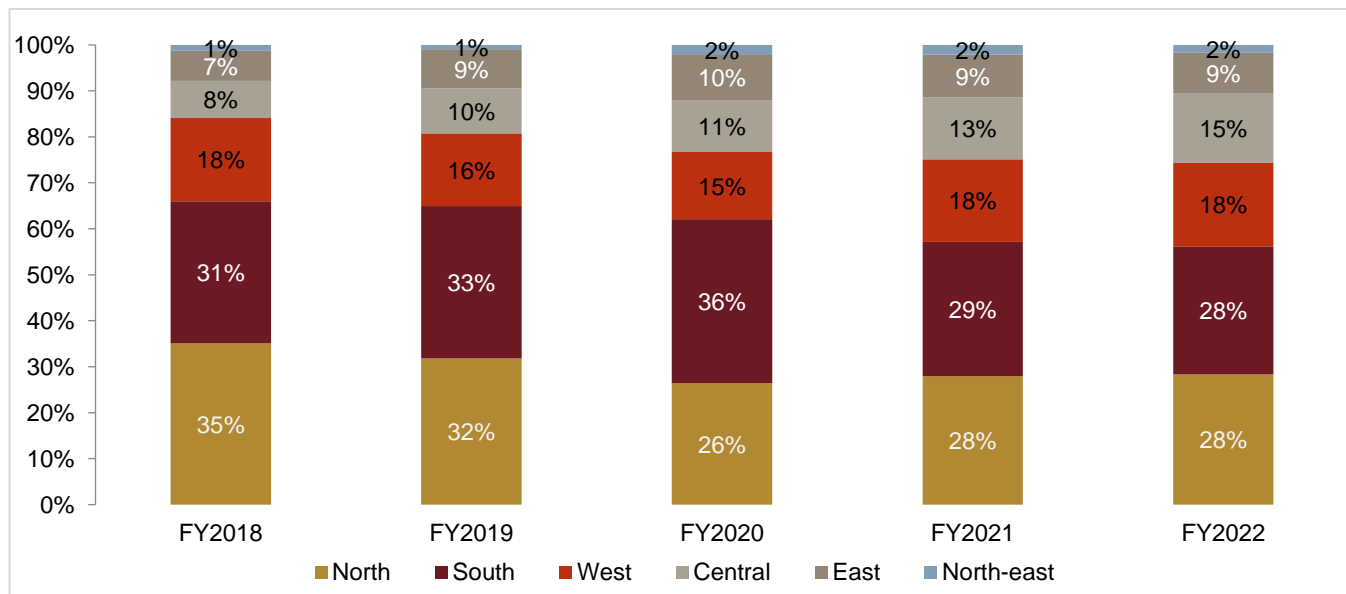
**Top six players accounted for 86% of industry AUM as of fiscal 2022**



Note: AUM for Jana SFB, ESAF SFB, Utkarsh SFB, Capital SFB, North East SFB and Shivalik SFB are based on advances; Data includes data for 11 SFB

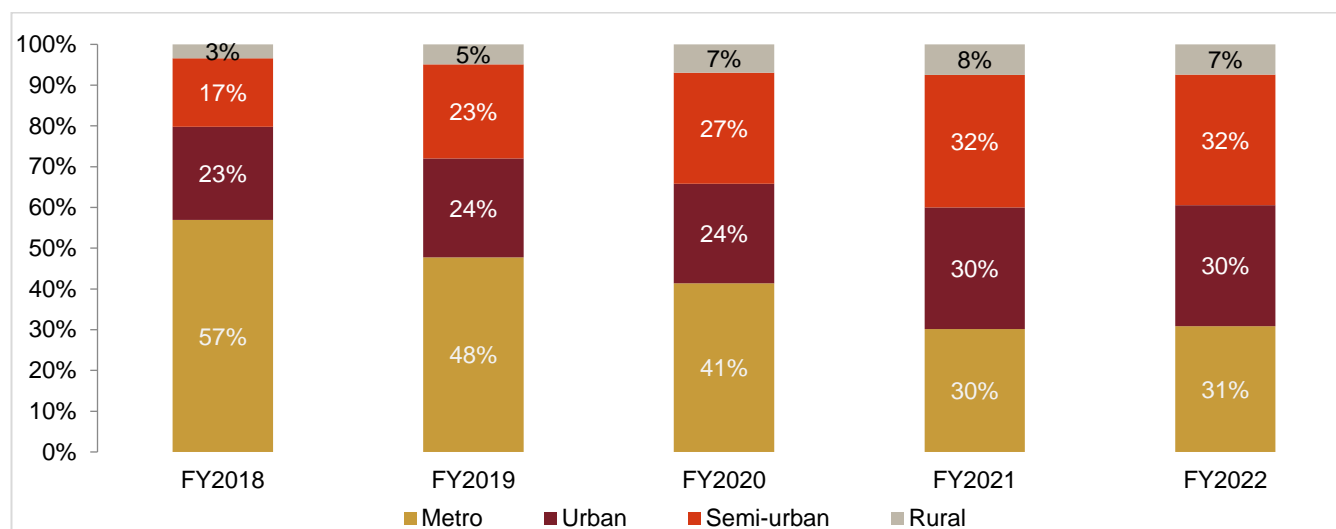
Source: Company reports; CRISIL Research

**Advances across regions for SFBs**



Source: RBI, CRISIL Research

## Share of urban and semi-urban regions in total advances 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 Research

State wise Rajasthan contributes to the largest share of loan portfolio for SFBs at 16%, followed by Tamil Nadu and Maharashtra as at end of fiscal 2022. Also Karnataka state has seen the highest growth in the loan portfolio for SFBs from fiscal 2019 to fiscal 2022 with CAGR of 109%.

For NBFC-MFIs Bihar contributes to the largest share of gross loan portfolio among the states with share of 12% followed by Tamil Nadu and Karnataka as at end of fiscal 2022. Tamil Nadu have seen the highest growth in the loan portfolio over the period fiscal 2019 to fiscal 2022 with the CAGR of 29%.

## Top 10 states contribute approximately 82% of the SFB loan portfolio

Top 10 States	Share as at end of FY22	FY19-22 CAGR growth
Rajasthan	16%	23%
Tamil Nadu	16%	20%
Maharashtra	11%	38%
Madhya Pradesh	9%	53%
Gujarat	7%	45%
Karnataka	6%	109%
Punjab	5%	28%
Uttar Pradesh	5%	53%
Kerala	4%	8%
Bihar	4%	28%

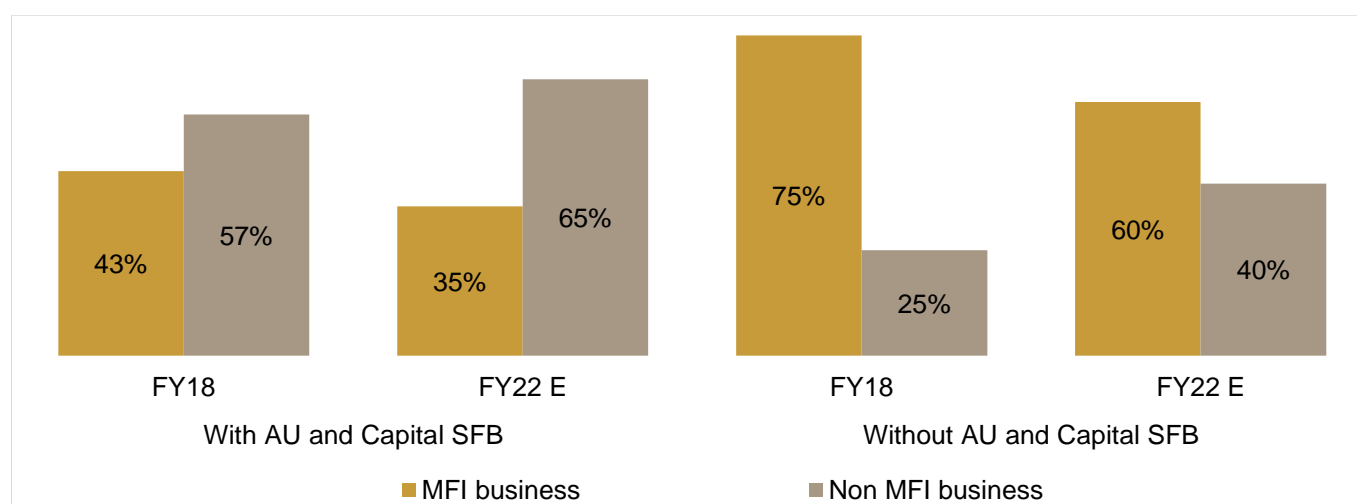
Source: RBI, CRISIL Research

### ***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 36% (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 36% 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 Research 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

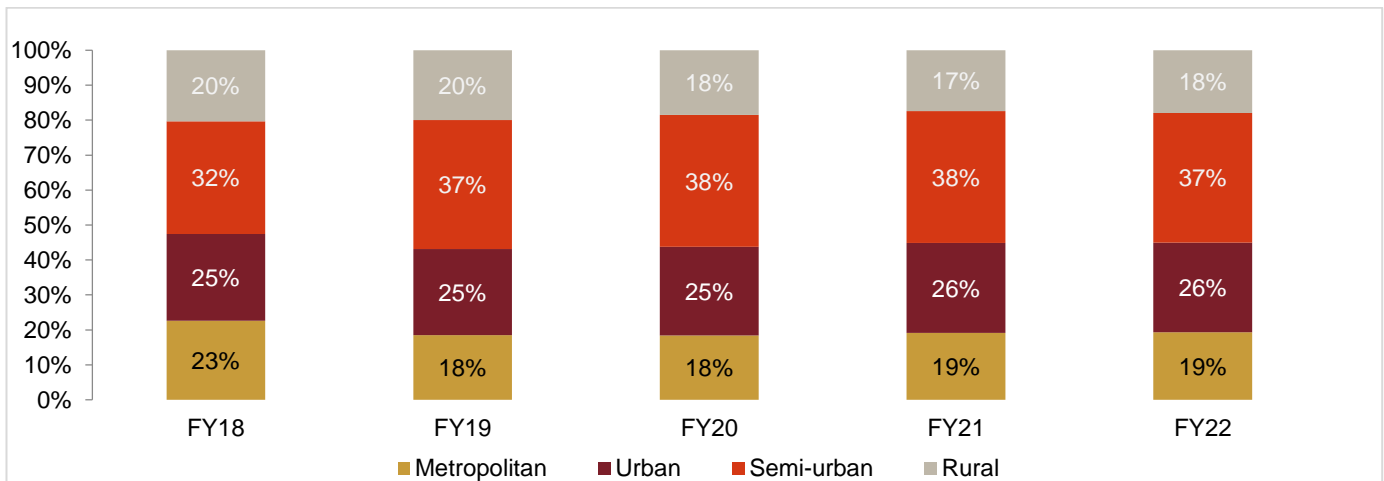
Source: Company reports, CRISIL Research

### ***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.

SFBs have seen strong growth in branch expansion in order to meet regulatory requirements. As of fiscal 2022, the top three players accounted for more than 40% of the total number of functioning offices. Expansion of functioning offices has also helped diversification of portfolio and overcome geographic concentration. As of fiscal 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

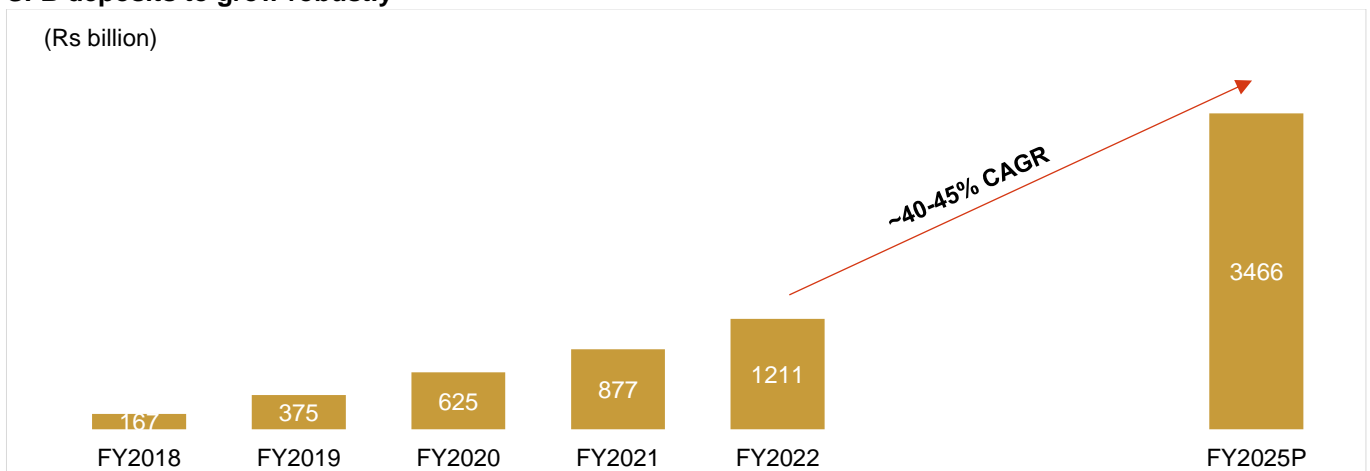
Source: RBI, CRISIL Research

### 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. It further increased ~48% CAGR to reach Rs 1,211 billion in fiscal 2022. Further, proportion of CASA deposits has short up from nearly ~20% as of fiscal 2020 to ~41% as of fiscal 2022. 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 38% in fiscal 2022. Going forward, CRISIL Research expects SFBs' deposit to grow 40-45% CAGR over fiscals 2022-2025 as players focus on popularising convenient banking habits to cover the last mile and widen financial inclusion by deepening their penetration in untapped geographies.

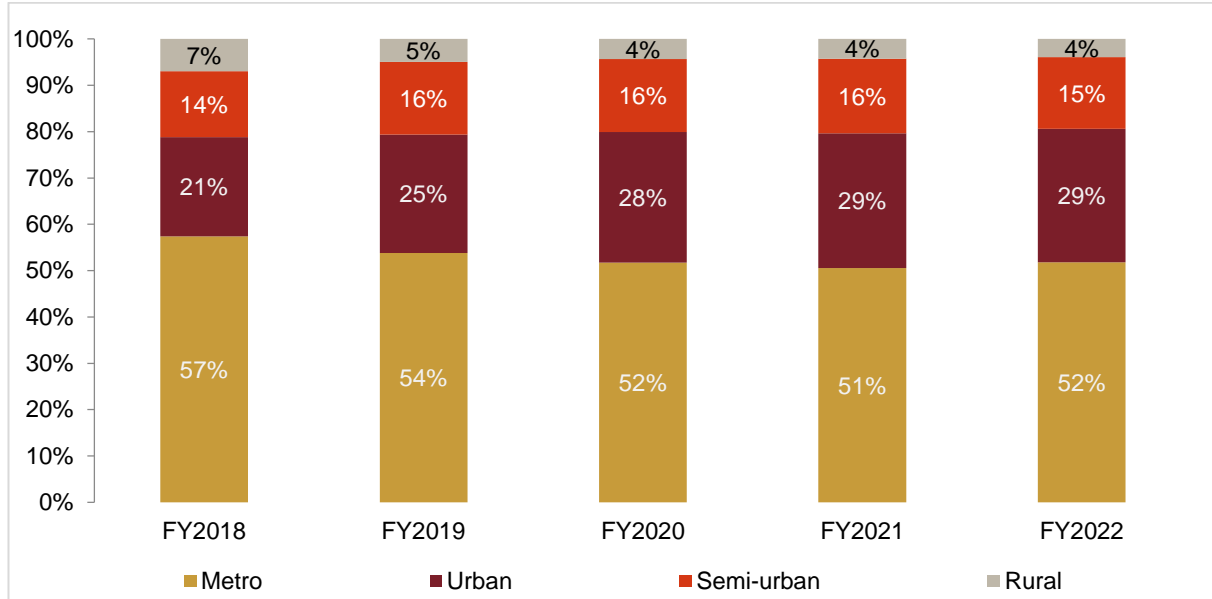
### SFB deposits to grow robustly



Note: Amounts are as at the end of fiscal year indicated; P: Projected

Source: Company reports, CRISIL Research

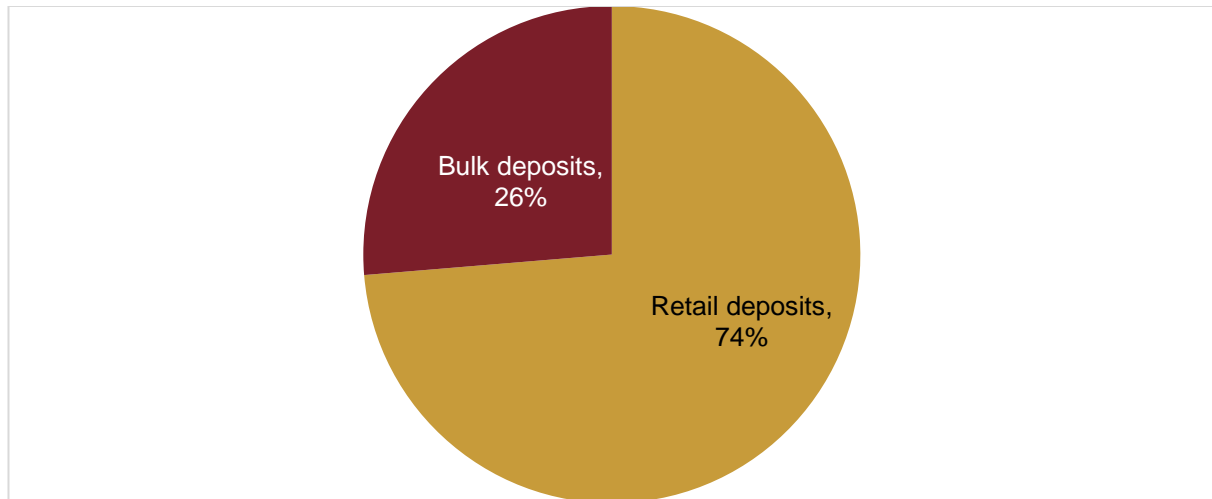
**Around 80% deposits is from metropolitan and urban regions for SFBs**



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 Research

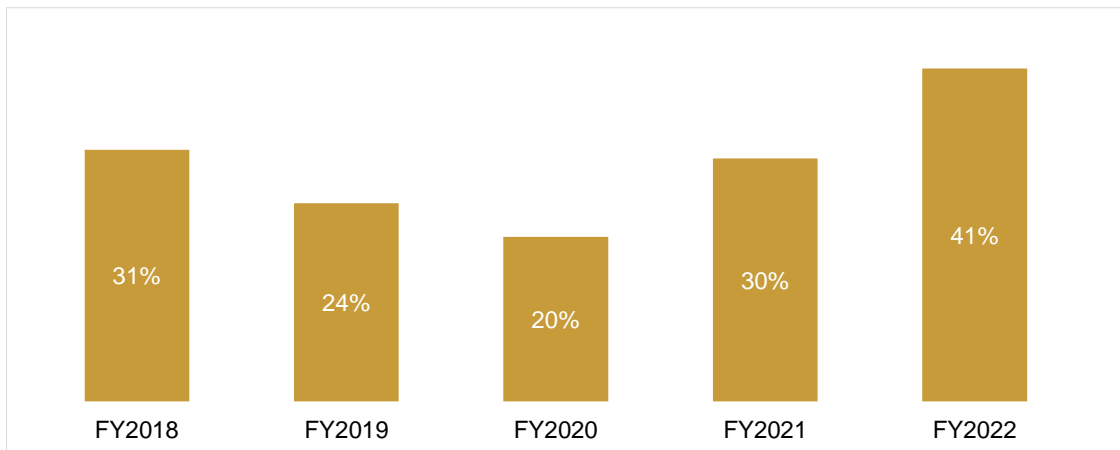
**Share of retail deposit in total deposit (FY2022)**



Note: Retail deposit include CASA and Retail term deposits; Data excludes data for Jana and North East SFB; Retail deposit split for Utkarsh SFB, ESAF SFB and Capital SFB is as of fiscal 2021

Source: Company reports, CRISIL Research

**CASA Ratio for small finance banks**



Source: RBI, Company Reports, CRISIL Research

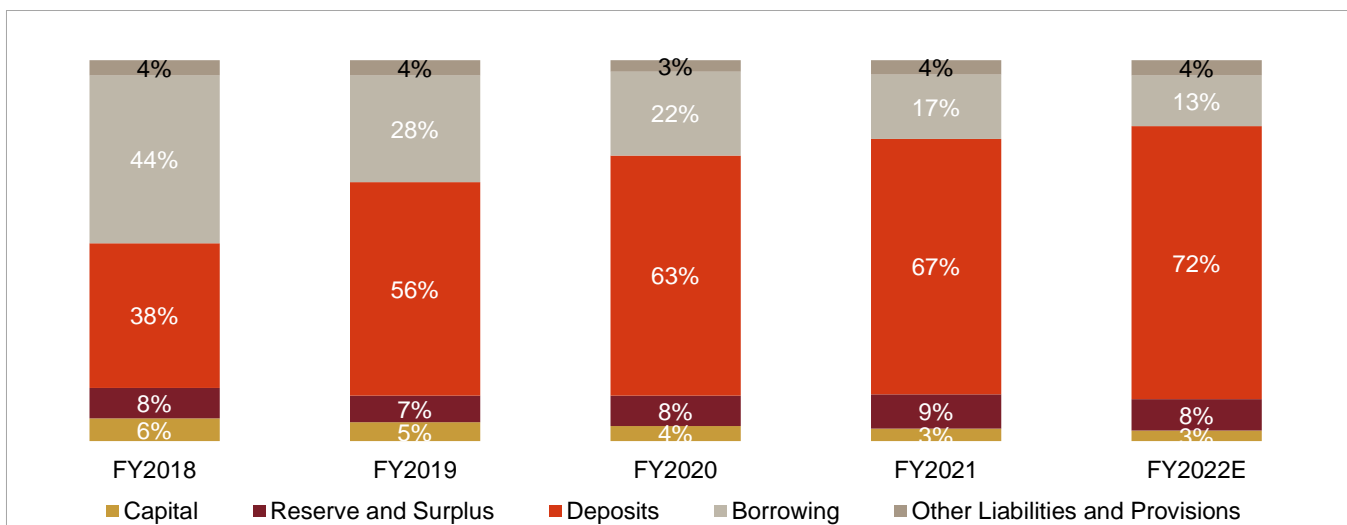
Over the next couple of years, CRISIL Research expects SFBS to focus on gradually building their banking business and complying with tougher regulatory norms. In addition, transformation into SFBS will provide access to stable and granular public deposits over the long run, which will bring down their 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 72% during the same period. 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; Data includes data for 10 SFBS

Source: Company reports, CRISIL Research

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

For SFBS, the asset-liability mismatch deteriorated from March 2021 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*	76%	21%	22%	15%	16%	-8%	32%	1%
	SFBs#	44%	-32%	-29%	-41%	-13%	-21%	608%	204%

Note: (\*)- Data as of September 2021, (#)-For March 2022, Data for AU SFB, ESAF SFB, Fincare SFB, Suryoday SFB and Ujjivan SFB is not available (\*\*)- 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 Research

### Profitability for SFBs to bounce 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 1.48% in fiscal 2021 and 1.91% in fiscal 2020 largely due 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 have lower margins and higher operating costs spread out the increased provisioning over the course of fiscal 2021 and fiscal 2022.

Going forward, with the waning impact of the Covid-19 and increasing interest income coupled with reduction in opex and credit cost as a result of improved collection efficiency, overall profitability for SFBs is expected to gradually improve.

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

RoA tree (SFB)	FY19	FY20	FY21	FY22	FY23P
Interest income	14.1%	14.5%	12.9%	11.8%	12.4%
Interest expense	6.6%	6.7%	6.0%	5.0%	5.3%
Net interest income	7.5%	7.8%	6.9%	6.8%	7.1%
Opex	6.1%	5.8%	4.9%	5.3%	5.2%
Other income	2.0%	1.7%	2.1%	1.6%	1.6%
Credit cost	0.9%	1.3%	2.2%	2.0%	1.7%
RoA	1.65%	1.91%	1.48%	0.7%	1.6%

Note: P: Projected, Numbers are based on Ind-AS, Data excludes Jana, North East SFB and Shivalik SFB

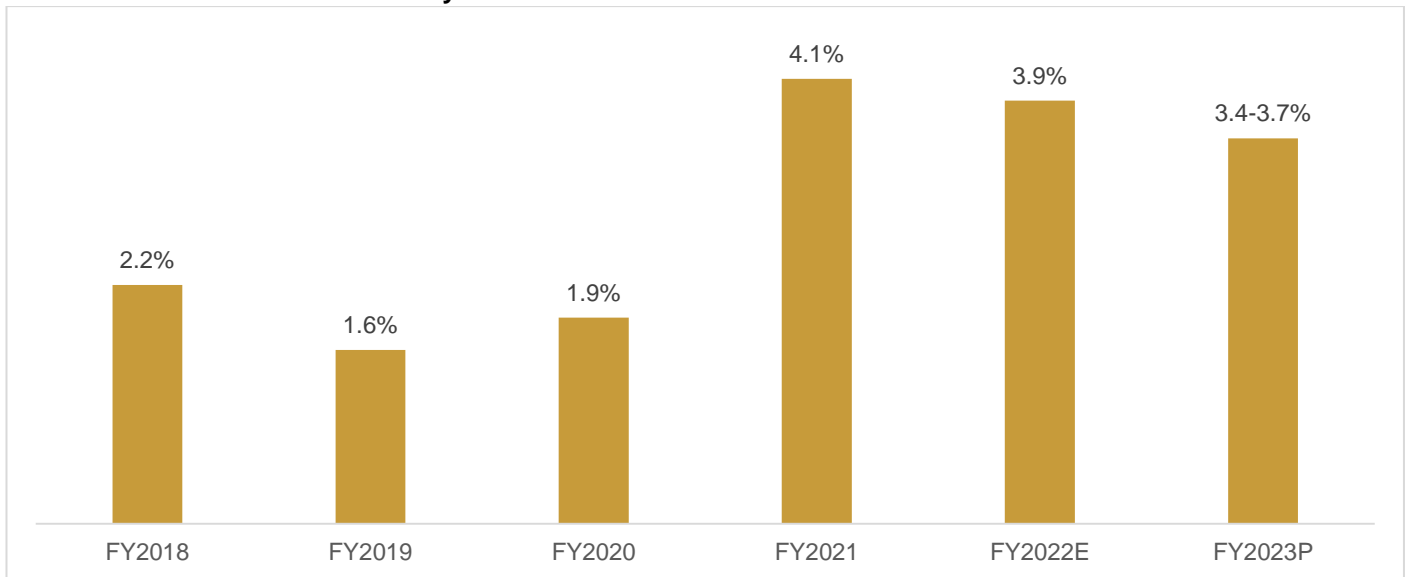
Source: CRISIL Research

**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. Recently, Government of India and RBI has announced various measures to support the stability of the financial service sector. These measures are likely to contain the impact of COVID-19 and economic slowdown.

Despite government measures, the lockdown impacted the low- and middle-income segments the most. They also happen 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. GNPA levels is estimated to improve marginally in fiscal 2022. Going forward, CRISIL Research expects that asset quality to further improve to 3.4-3.7%, 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,P-Projected

Source: Company reports, CRISIL Research

## Peer Benchmarking

In this section, we have compared Fincare SFB with all its peers in India based on the latest available data as of fiscal 2022. 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.

### Fincare SFB recorded 3<sup>rd</sup> highest AUM growth of 28.8% among the SFBs from fiscal 2019 to fiscal 2022

Fincare SFB recorded a 3-year CAGR of 28.8% in AUM between fiscal 2019 to fiscal 2022. ESAF SFB recorded fastest growth in AUM from fiscal 2019 and fiscal 2022 at 36.8% followed by Utkarsh SFB (31.6%).

### Fincare SFB has the highest banking outlets amongst all SFBs along with AU SFB as of fiscal 2022

Fincare SFB has 919 banking outlets across 18 states as of fiscal 2022 which is the highest amongst its peer group along with AU SFB (919 branches across 18 states).

### Fincare SFB has the 2<sup>nd</sup> highest deposit CAGR among SFBs between fiscal 2019 to fiscal 2022

Fincare recorded second highest deposit CAGR of 46.7% among the SFBs between fiscal 2019 to fiscal 2022. Jana SFB recorded highest deposit growth (47.7%) among the SFBs during the same period.

### SFBs and other players as of end-fiscal 2022

Players	AUM (Rs billion)	AUM growth (FY19-FY22)	Deposit (In Rs. billion)	Deposit growth (FY19-FY22)	Credit to deposit ratio	Disbursement (in Rs. Billion)	Disbursement growth (FY19-FY22)
<b>SFBs</b>							
AU SFB	478	25.4%	526	39.4%	88%	254	16.5%
Equitas SFB	206	20.7%	190	28.1%	102%	105	7.1%
Ujjivan SFB	182	18.0%	183	35.3%	89%	141	8.3%
Jana SFB	130*	27.9%	135	47.7%	96%	62#	NA
ESAF SFB	116*	36.8%	128	43.7%	91%	NA	NA
Utkarsh SFB	106	31.6%	101	38.5%	102%	59#	14.1%\$
Fincare SFB	75	28.8%	65	46.7%	109%	71	28.5%
Suryoday SFB	51	19.0%	39	34.2%	123%	35	7.3%
<b>Microfinance</b>							
Credit Access	137	24.2%	NM	NM	NM	128	16.0%
Spandana	66	14.6%	NM	NM	NM	34	(12.1%)
<b>Universal banks</b>							
Bandhan Bank	993	30.4%	963	30.6%	98%	317	(17.3%)

(\*)-\* Advances as of fiscal 2022 is considered instead of AUM, #- As of fiscal 2021, \$- CAGR of fiscal 2019-2021; NA - Not available, NM – Not meaningful.

Source: Company reports, CRISIL Research

### SFBs and other players as of end-fiscal 2022

Players	Banking outlets	Presence in states and UTs	Number of Employees	Employee growth (FY19-FY22)	Balance sheet size (in Rs. Billion)	Balance sheet size growth (FY19-FY22)
<b>SFBs</b>						
AU SFB	919	18	27,817	30.1%	691	31.7%
Equitas SFB	869	18	17,607	6.3%	270	19.6%

Players	Banking outlets	Presence in states and UTs	Number of Employees	Employee growth (FY19-FY22)	Balance sheet size (in Rs. Billion)	Balance sheet size growth (FY19-FY22)
Ujjivan SFB	575	24	16,895	4.6%	236	19.8%
Jana SFB	585*	22*	16,212*	(1.6%)**	202	28.8%
ESAF SFB	553*	18*	3803*	32.4%**	177	35.9%
Utkarsh SFB	686	22	12,617	26.2%	151	34.2%
Fincare SFB	919	18	11,733	28.7%	109	37.8%
Suryoday SFB	565	14	5,252	10.1%	82	29.6%
<b>Microfinance</b>						
Credit Access	1,164	14	11,951	14.0%	148	26.2%
Spandana	1049	10	8,763	9.6%	68	11.4%
<b>Universal banks</b>						
Bandhan Bank	5,639	34	60,211	23.0%	1,389	35.0%

Notes: (\*)-Values as of fiscal 2021, (\*\*) - CAGR of FY2019-FY2021, A - not available

Source: Company reports, CRISIL Research

### Fincare SFB has the 3rd highest proportion of retail deposit in total deposits as of fiscal 2022

As of fiscal 2022, Fincare SFB has the third highest proportion of retail deposits of 82.2% in total deposits after ESAF SFB (97.7%) and Equitas SFB (89.4%). This reflects the greater granularity in the deposits base for Fincare SFB.

### Deposit details of SFBs and other players as end-fiscal 2022

FY22	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
<b>SFBs</b>							
AU SFB	114.1%	89.8%	66.0%	37.0%	30.9%	32.1%	23.4%*
Equitas SFB	97.8%	87.9%	89.4%	52.0%	37.4%	10.6%	13.8%
Ujjivan SFB	112.2%	91.2%	58.1%	28.5%	29.6%	42.0%	NA
Jana SFB	104.1%	75.0%	NA	NA	NA	NA	13.2%
ESAF SFB	110.1%	81.3%	97.7%*	19.4%*	78.3%*	2.7%*	9.0%*
Utkarsh SFB	98.5%	79.7%	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	81.0%	60.1%	78.1%	20.2%	57.9%	21.9%	NA
<b>Universal banks</b>							
Bandhan Bank	102.5%	82.9%	77.3%	41.6%	35.7%	22.7%	19.0%*

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 fiscal 2021

Source: Company reports, CRISIL Research

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 fiscal 2022, Fincare SFB's deposit per employee at Rs 6 million and business per employee at Rs 11 million is in-line with Suryoday, Utkarsh and Jana SFB. AU SFB leads its peers with leading business per employee and business per branch as of fiscal 2022.

### Fincare SFB has the lowest Operating expense per banking outlet amongst SFBs

Fincare SFB had the lowest operating expense per banking outlet of Rs 7 million. It is followed by Suryoday SFB (Rs. 7.3 million) and Utkarsh SFB (Rs. 10.7 million).

### Operational efficiency of SFBs as of end-fiscal 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)	AUM per customer (Rs)**	Opex per banking outlet (in million)
<b>SFBs</b>								
AU SFB	17	19	35	502	572	1074	170,825	26.3
Equitas SFB	11	11	22	223	218	441	NA	19.6
Ujjivan SFB	10	11	20	284	318	602	28,028	26.0
Jana SFB*	7	8	15	198	212	410	NA	19.5#
ESAF SFB*	21	24	45	148	163	310	17,987	15.6#
Utkarsh SFB	8	8	16	149	147	296	35,435	10.7
Fincare SFB	6	6	11	77	70	147	13400	7.0
Suryoday SFB	9	7	16	84	68	152	26,372	7.3
<b>Microfinance</b>								
Credit Access	10	NM	10	105	NM	105	46,995	4.6
Spandana	6	NM	6	49	NM	49	28,613	3.2
<b>Universal Banks</b>								
Bandhan Bank	16	16	32	167	171	337	35,732	6.2

Note: # Banking outlets for fiscal 2021 considered for calculation, (\*)-Data as of fiscal 2021 \*\*Customer includes both loan customers as well as deposit customers, NA-Not Available, NM-Not meaningful

Source: Company reports, CRISIL Research

### Financial growth metrics of SFBs as of end-fiscal 2022

Growth (FY19-FY22)	Total income	Total net income	Other income	NII	PPOP	PAT
<b>SFBs</b>						
AU SFB	27%	33%	17%	40%	97%	44%
Equitas SFB	18%	22%	24%	21%	13%	10%
Ujjivan SFB	15%	17%	15%	17%	39%	(228%)
Jana SFB	31%	46%	40%	47%	(171%)	(114%)
ESAF SFB	23%	26%	24%	26%	33%	(15%)
Utkarsh SFB	29%	31%	46%	29%	24%	(13%)
Fincare SFB	35%	34%	43%	33%	42%	(56%)
Suryoday SFB	20%	19%	12%	20%	6%	(202%)
<b>Microfinance</b>						
Credit Access	23%	22%	112%	18%	15%	6%
Spandana	13%	12%	(7%)	13%	9%	(27%)
<b>Universal Banks</b>						

Growth (FY19-FY22)	Total income	Total net income	Other income	NII	PPOP	PAT
<b>Bandhan Bank</b>	29%	28%	38%	25%	25%	(60%)

Note: (\*)CAGR of fiscal 2019-2021, Total net income=NII +Other income

Source: Company reports, CRISIL Research

## Product mix

Equitas SFB has the most diversified portfolio among peers, with reasonable book size in multiple asset classes as of fiscal 2022. 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 end-fiscal 2022)

Product mix	MFI	Vehicle loans	Mortgage loans	MSME	Large and mid-corporate loans	Gold loans	Others
<b>SFBs</b>							
AU SFB	-	36%	6%	35%	17%	-	6%
Equitas SFB	19%	25%	-	52%	4%	-	1%
Ujjivan SFB	67%	-	15%	9%	-	-	9%
ESAF SFB#	85%	-	-	-	5%	-	10%
Utkarsh SFB	75%	2%	3%	8%	9%	-	3%
Fincare SFB	76%	-	12%	-	-	6%	6%
Suryoday SFB	67%	7%	9%	5%	-	-	13%

Note: # Data is as of March 2021, \*- Retail loans, Source: Company reports, CRISIL Research

## Digital transaction growth

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

Note: (\*)- DNA-Not Available, Source: Company reports, CRISIL Research

## Profitability

### Fincare SFB has the highest NIMs amongst all SFBs

As of fiscal 2022, Fincare has the highest NIMs of 9.3% followed by Ujjivan SFB (8.1%), Equitas SFB (7.9%) and Suryoday SFB (7.9%). Spandana Sphoorty had the highest NIMs of 12.1% amongst all player groups as at the end of fiscal 2022.

### Fincare SFB has the 3<sup>rd</sup> lowest cost to income ratio amongst SFB in fiscal 2022

Amongst SFBs, AU SFB had the lowest cost to income ratio of 57.1%, followed by Utkarsh with 59.1% and Fincare SFB with 60.0% as of end of fiscal 2022. Ujjivan SFB has the highest cost to income among SFBs at 71.7%.

**Profitability of players in fiscal 2022**

(Rs million)	Yield on advances (%)	Cost of borrowing** (%)	NIMs (%)	Non-interest income (%)	Cost to income (%)	Opex (%)	Credit cost (%)	ROE (%)	ROA (%)
<b>SFBs</b>									
AU SFB	12.1%	5.3%	5.4%	1.6%	57.1%	4.0%	0.6%	16.6%	1.9%
Equitas SFB	17.3%	6.8%	7.9%	2.1%	66.1%	6.6%	1.9%	7.4%	1.1%
Ujjivan SFB	16.7%	5.7%	8.1%	1.4%	71.7%	6.8%	5.2%	(14.0%)	(1.9%)
Jana SFB	22.2%*	7.6%	7.1%	1.6%	66.5%	5.8%	2.9%	0.5%	0.0%
ESAF SFB	19.6%*	6.0%	7.6%	1.4%	63.7%	5.7%	2.8%	4.0%	0.4%
Utkarsh SFB	17.9%	6.9%	7.8%	1.4%	59.1%	5.4%	3.0%	4.2%	0.5%
Fincare SFB	21.5%	7.1%	9.3%	2.1%	60.0%	6.9%	4.5%	0.8%	0.1%
Suryoday SFB	18.7%	6.3%	7.9%	1.3%	60.9%	5.6%	5.3%	(6.0%)	(1.3%)
<b>Microfinance</b>									
Credit Access	19.2%	8.2%	9.7%	1.4%	35.4%	3.9%	3.3%	10.1%	2.8%
Spandana	21.5%	11.9%	12.1%	0.5%	38.6%	4.8%	6.3%	2.4%	0.9%
<b>Universal banks</b>									
Bandhan Bank	13.9%	4.9%	6.9%	2.2%	30.5%	2.8%	6.2%	0.7%	0.1%

Note: \* Total interest income is considered for calculation; # Data as of fiscal 2021; \*\* Cost of borrowing is calculated on total borrowings, i.e. sum of borrowing and deposits;

Source: Company reports, CRISIL Research

**Fincare has the 2nd highest average RoE and RoA amongst SFBs from fiscal 2019 to fiscal 2022**

AU SFB has the highest average RoE and RoA from fiscal 2019 to fiscal 2022 amongst SFBs at 17.7% and 1.9% respectively. Fincare had the second highest average ROE(12.8%) and average ROA(1.8%) from fiscal 2019 to fiscal 2022

**Profitability of players (Average FY2019 to FY2022)**

Average FY2019-FY2022		
	RoE (%)	RoA (%)
<b>SFBs</b>		
AU SFB	17.7%	1.9%
Equitas SFB	9.9%	1.4%
Ujjivan SFB	3.0%	0.5%
Jana SFB	(41.3%)	(4.9%)
ESAF SFB	11.6%	1.3%
Utkarsh SFB	12.6%	1.4%
Fincare SFB	12.8%	1.8%
Suryoday SFB	4.6%	1.1%
<b>Microfinance</b>		
Credit Access	10.3%	3.0%
Spandana	10.4%	4.1%
<b>Universal Banks</b>		
Bandhan Bank	14.0%	2.5%

Note: NA – Not available

Source: Company reports, CRISIL Research

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

Players	1 <sup>st</sup> full year of operation	Branch network growth		AUM growth		RoE (%)			Deposit growth	
		2 <sup>nd</sup> year	3 <sup>rd</sup> year	2 <sup>nd</sup> year	3 <sup>rd</sup> year	1 <sup>st</sup> year	2 <sup>nd</sup> year	3 <sup>rd</sup> year	2 <sup>nd</sup> year	3 <sup>rd</sup> 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 Research

Year of operation	CASA share			Credit to Deposit			Share of retail deposits		
	1 <sup>st</sup> year	2 <sup>nd</sup> year	3 <sup>rd</sup> year	1 <sup>st</sup> year	2 <sup>nd</sup> year	3 <sup>rd</sup> year	1 <sup>st</sup> year	2 <sup>nd</sup> year	3 <sup>rd</sup> 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 Research

## AU SFB has the lowest GNPA and NNPA amongst SFBs at end of fiscal 2022

At end of fiscal 2022, AU SFB has the lowest GNPA amongst the SFBs at 2.0% followed by Equitas SFB (4.1%) and Jana SFB (5.7%). At end of fiscal 2022, Fincare SFB had a GNPA of 7.8%.

At end of fiscal 2022, AU SFB also has the lowest NNPA amongst the SFBs at 0.5% followed by Ujjivan SFB (0.6%) and Jana SFB (1.8%). Fincare SFB had a NNPA of 3.6%.

## Fincare SFB has the 2<sup>nd</sup> highest LCR at end of fiscal 2022

At end of fiscal 2022, Suryoday SFB has the highest LCR at 223.0% followed by Fincare SFB (206.0%) and Utkarsh SFB (173.4%).

## Fincare SFB has 3<sup>rd</sup> 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%).



**Asset Quality and Liquidity ratios for players in fiscal 2022**

Players	Provision Coverage Ratio (%)	Provisions as % of AUM	Liquidity Coverage Ratio (%)	Collection efficiency	Restructured book as % of advanced	GNPA (%)	NNPA (%)	Stressed book <sup>5</sup>	CRAR	Tier-1 ratio
<b>SFBs</b>										
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%^	3.0%^	NA	NA	2.7%	5.7%	1.8%	6.6%	15.3%	11.8%
ESAF SFB	49.9%^	4.1%^	132.4%*	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%	223.0%*	116%	10.7%	11.8%	6.0%	16.7%	37.9%	34.4%
<b>Microfinance</b>										
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%^
<b>Universal banks</b>										
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; \*- Data is as of December 2021; \*\* Data is as of September 2021; NA – Not Available; \$ Stressed book = Restructured book as a % of advances + NNPA

Source: Company reports, CRISIL Research

**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 Research

SFBs have better management depth as compared to NBFC-MFIs, as its average team size is 19 as compared to 13 of NBFC-MFIs. Also, its average experience of 25 is higher than 23 for NBFC-MFI players. Fincare's average management experience is 25 years which is at par with the industry average for SFBs.

**Experience of leadership team (FY22)**

Player Name	Team size	Average experience (years)
<b>SFBs</b>		
AU SFB	26	19
Equitas SFB	13	26
Ujjivan SFB	13	27
Jana SFB	16	27
ESAF SFB	34	25
Utkarsh SFB	16	25
Fincare SFB	21	25
Suryoday SFB	15	23
<b>Average</b>	<b>19</b>	<b>25</b>
<b>Microfinance</b>		
Credit Access	13	22
Satin Creditcare	12	23
<b>Average</b>	<b>13</b>	<b>23</b>

Source: Company reports, CRISIL Research

## 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 AUM (FY22)

AUM	Share of top state	Share of top 3 states	Share of top 5 states
<b>SFBs</b>			
AU SFB	41%	58%	68%
Equitas SFB*	54%	77%	85%
Ujjivan SFB	16%	42%	60%
Jana SFB**	20%	53%	66%
ESAF SFB*	56%	79%	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

Source: Company reports, CRISIL Research

## Geographical concentration of deposits

### State mix of deposits (FY22)

Deposits	Share of top state	Share of top 3 states	Share of top 5 states
<b>SFBs</b>			
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 Research

## 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

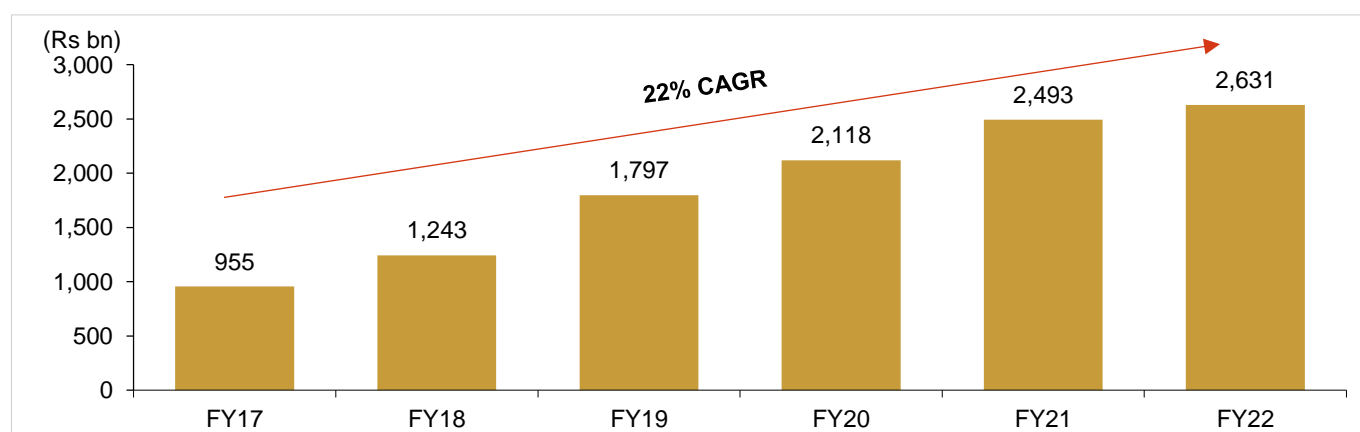
### Overall Microfinance Industry

#### **Industry GLP surged at 22% CAGR since fiscal 2017 to fiscal 2022**

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 22% since fiscal 2017 to reach ~Rs 2.6 trillion in fiscal 2022 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. However, the key monitorable will be impact of any new waves if they materialise, any new regulatory interventions, collection efficiency of players, and income generation capabilities of borrowers.

#### **GLP clocked 22% CAGR between fiscals 2017 and 2022**



*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*

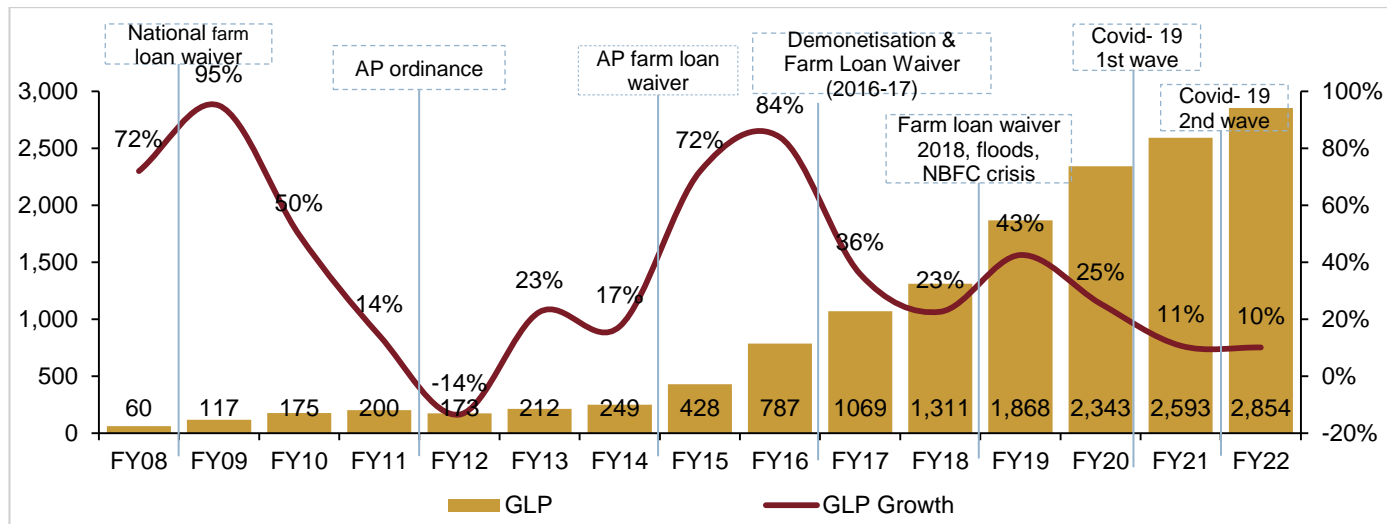
*Source: Equifax, Company reports, Industry and CRISIL Research*

#### **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 and is expected to grow at healthy pace over the next few years as well, given the low penetration of credit amongst the target population.

### MFI industry has shown resilience over the past decade

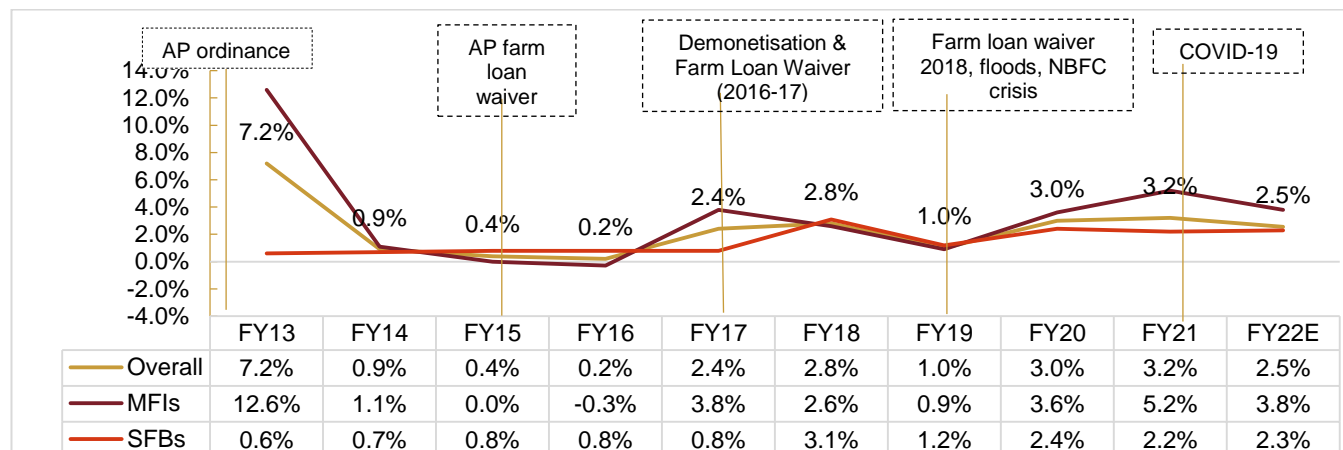


Note: Data includes data for Banks lending through joint liability group (JLG), SFBs, NBFC-MFIs, other NBFCs and non-profit MFIs. It excludes data for Banks lending through SHG. The amounts are as at the end of fiscal year

Source: MFIN, CRISIL Research

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 various regulations to enable long-term sustainable growth in the sector and reduce systemic risks.

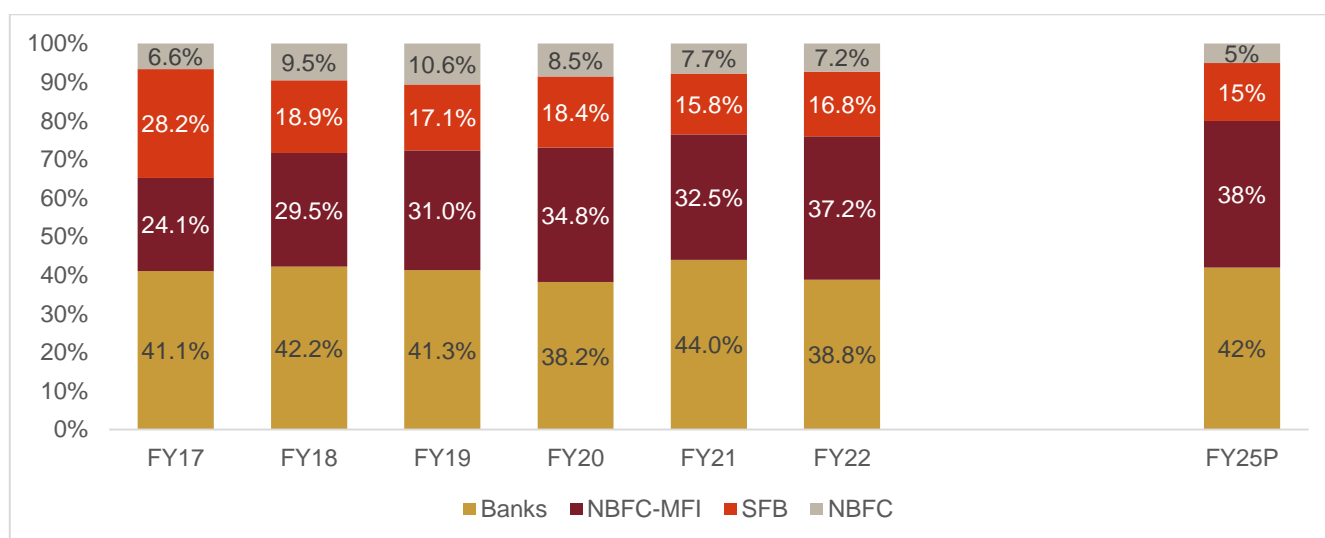
**Credit costs for microfinance industry across various events**



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 Research

**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 Research

**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
<b>Uttar Pradesh</b>	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
<b>Maharashtra</b>	13.7	57.3	340.22	<p>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.</p> <p>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.</p> <p>A bonus of 25% of debt, capped at Rs 25,000, to farmers who have regularly repaid their loans until July 31, 2017.</p> <p><i>A one-time settlement scheme for farmers, whose loans have been restructured – the government would contribute Rs 0.15 million per account.</i></p>
<b>Karnataka</b>	7.8	77.3	86.15	<i>Crop loans of up to Rs 50,000 per farmer, if borrowed from co-operative banks, would be waived off.</i>
<b>Punjab</b>	1.1	34.1	100.00	<p>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</p> <p><i>Overall, outstanding institutional crop loans of households, where a farmer has committed suicide, would be waived off.</i></p>

*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 Research*

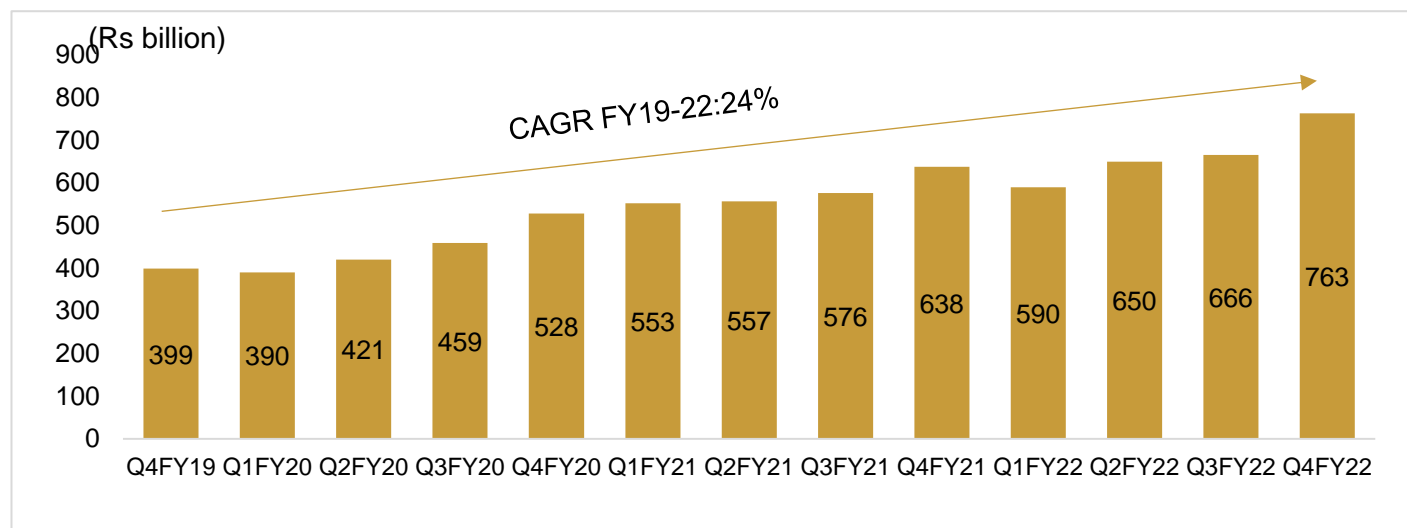
It led to a slowdown in lending, and it was mostly due to lower repayments caused by disturbance in the repayment cycle in the mentioned states. However, the impact on NBFC-MFIs was lesser than on banks due to regular touch with the customer, which helped them maintain a healthy collection rate.

### **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 March 2022)**


Note: Data includes only NBFC-MFIs, Source: MFIN, CRISIL Research

**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 2<sup>nd</sup> 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. In fiscal 2022, the industry grew by 9.8% on year to reach Rs 2.6 trillion as of March 2022.

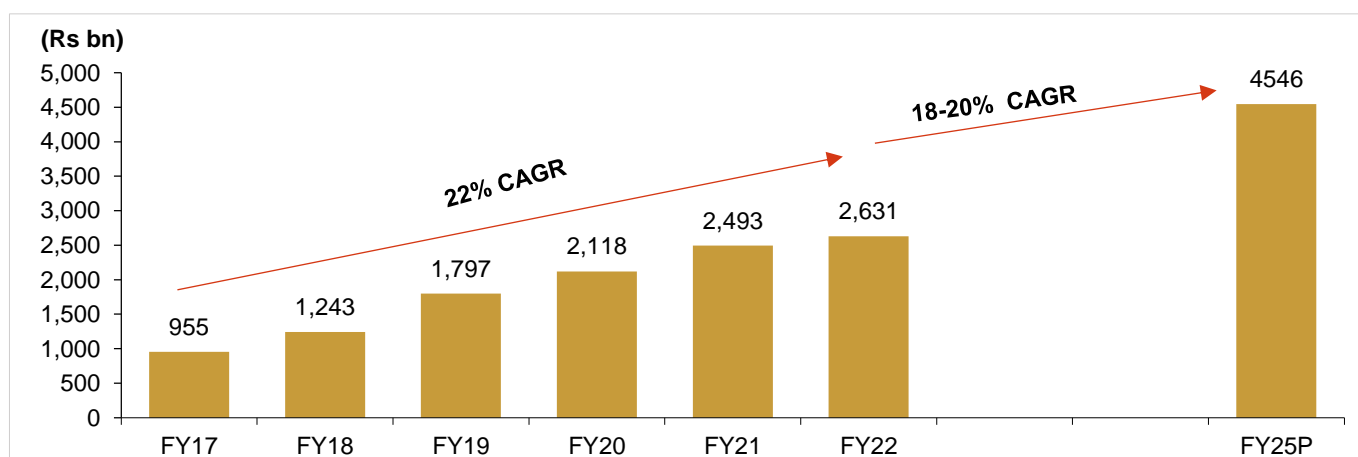
CRISIL Research expects the MFI loan portfolio to clock 18-20% CAGR. Key drivers behind superior growth outlook of the MFI industry include increasing presence of MFIs deep into the hinterland and expansion into newer states, faster growth in rural segment, expansion in average ticket size, and support 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 April 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 Research 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 2022-25**



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. The amounts are as at the end of fiscal year, P: Projected

Source: Equifax, Company reports, Industry and CRISIL Research

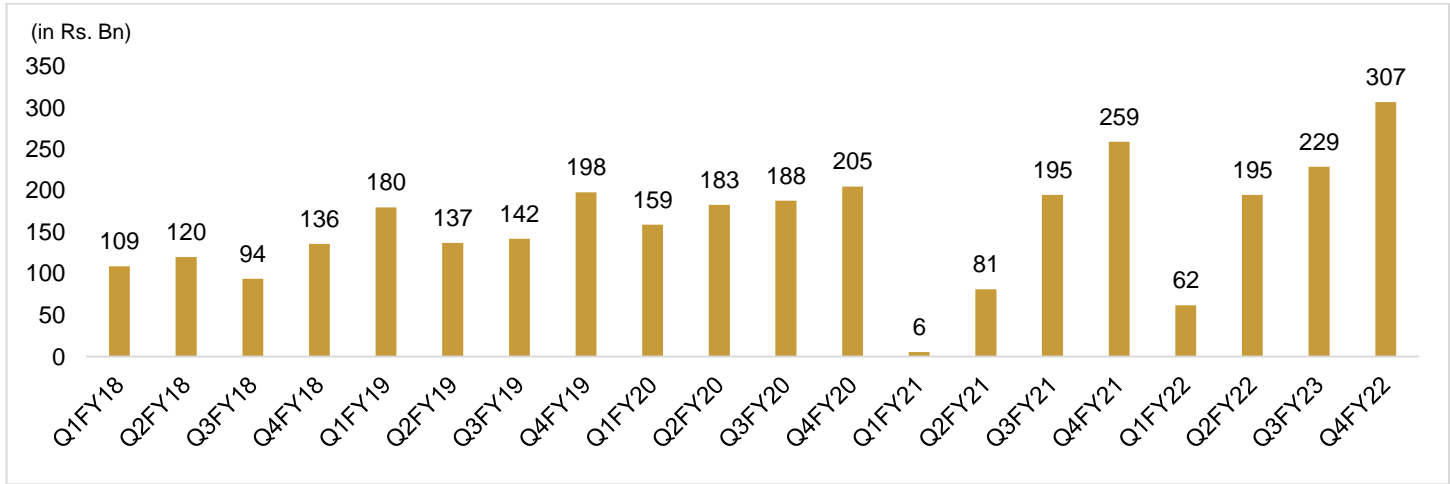
Growth in the MFI business is expected to come from increasing presence in newer states, expanding the client base, and gradual increasing of the ticket size.

### **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. dyn

**Disbursements gaining traction after Covid-19 impact**



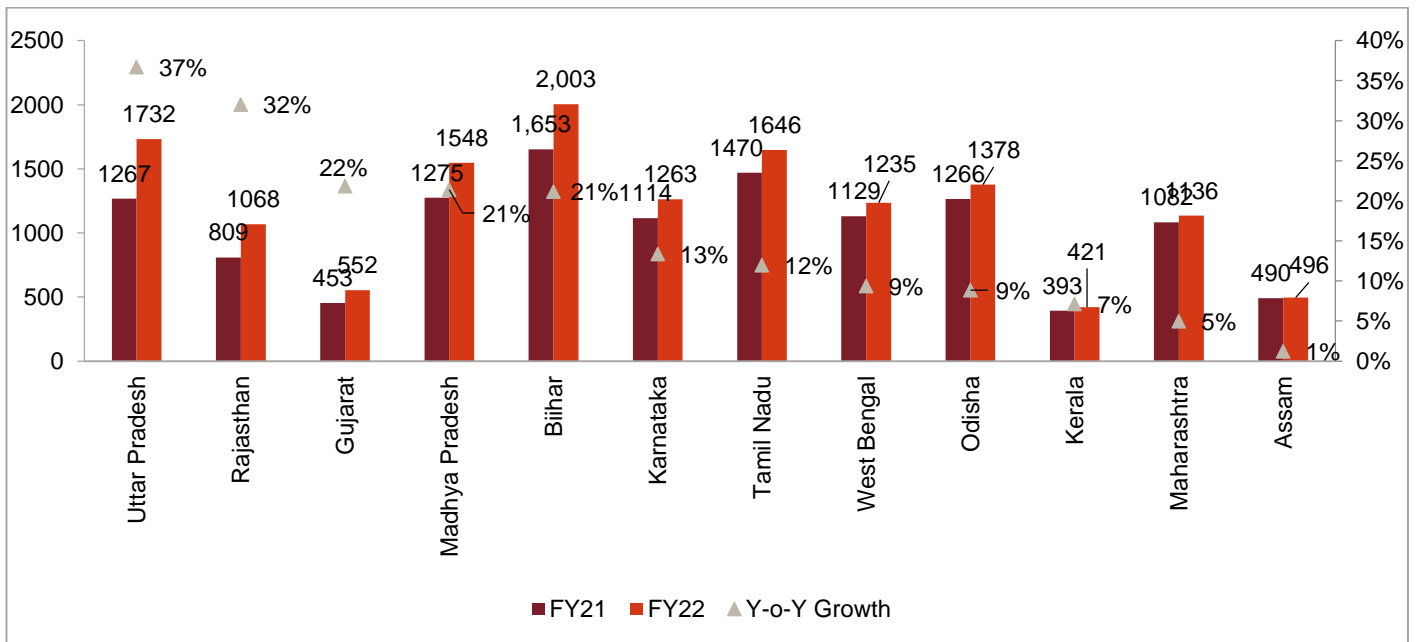
Note: E: Estimated, Data includes data for NBFC-MFI

Source: MFIN, CRISIL Research

**Players tapping newer states and districts to widen client base**

CRISIL Research has seen a significant jump in the number of MFIs operating in Uttar Pradesh, Rajasthan, Gujarat and Madhya Pradesh over FY2022. 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**

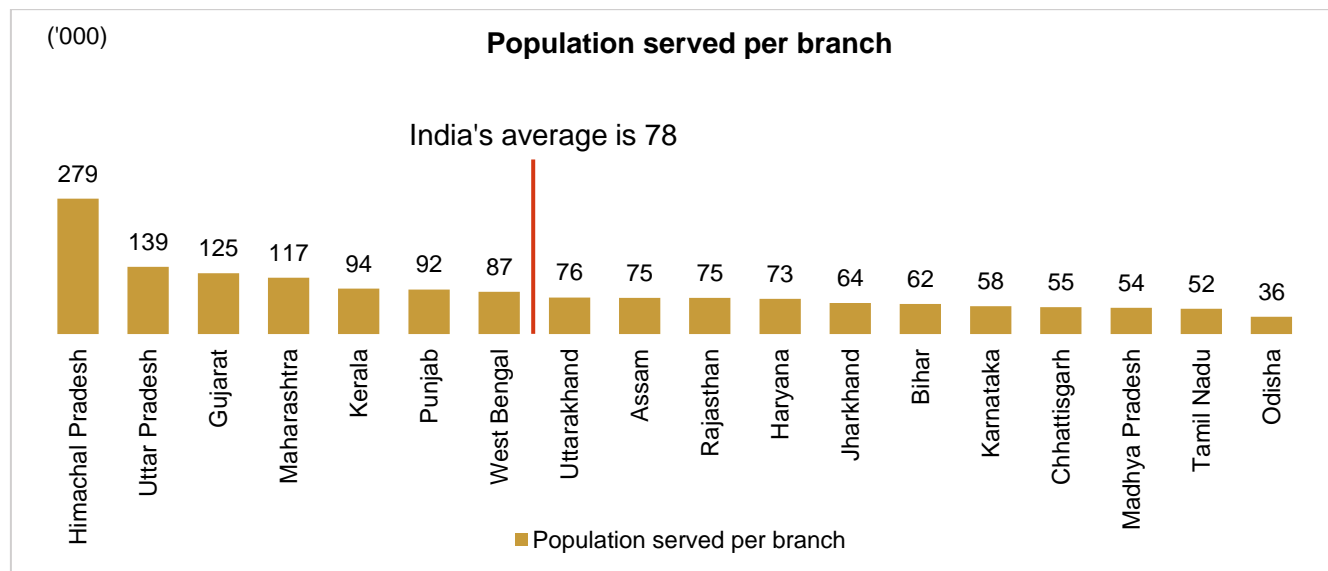


Note: Data includes only NBFC-MFI players and those states where five or more MFIs are operating

Source: MFIN, CRISIL Research

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 Research has witnessed an increase in ticket size as well. Going forward, CRISIL Research 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 .**



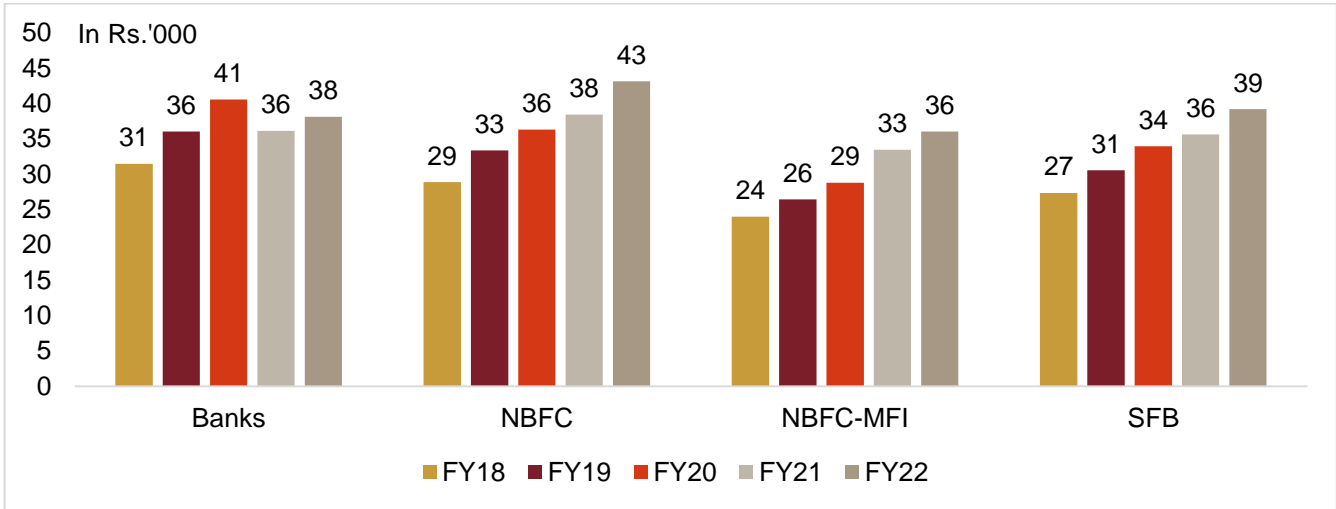
Note: Data includes only NBFC-MFI players and those states where five or more MFIs are operating

Source: MFIN, CRISIL Research

**Average ticket size to expand, but at slower pace**

The average ticket size for MFI players have grown at ~8% CAGR from Rs. 27,976 to Rs. 37,810 between fiscal 2018 and fiscal 2022. Going forward, the average ticket size for MFI industry is expected to clock ~2-2.5% CAGR from fiscal 2022 to fiscal 2025 reaching ~Rs. 40,500. The average ticket size of the MFI loans of SFB has risen by ~9% over fiscal 2018-22 to Rs 39,201 in fiscal 2022. Going forward, CRISIL Research 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

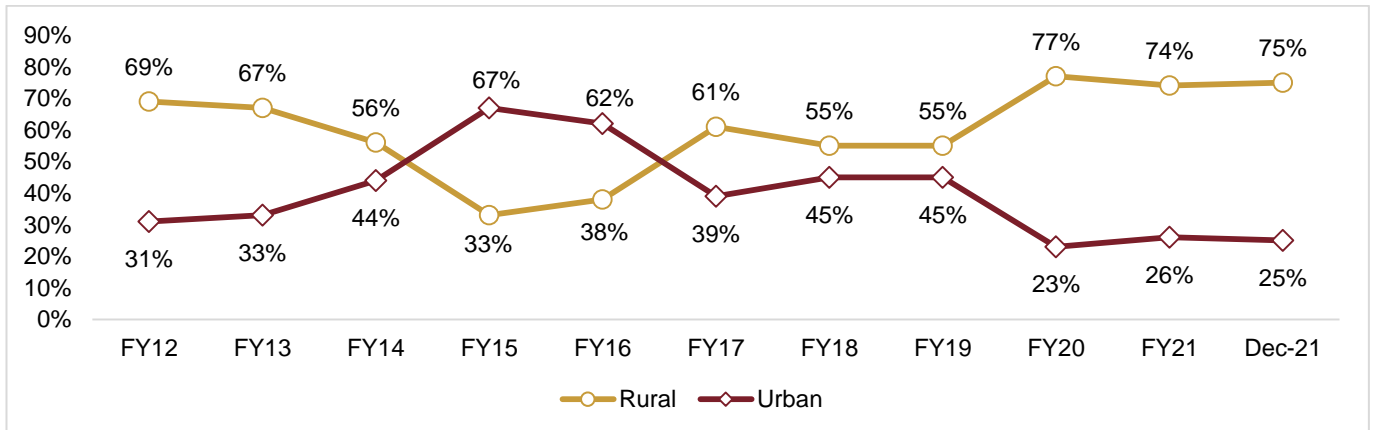
Source: Equifax, CRISIL Research

**Higher share of rural segment in MFI business to drive growth**

CRISIL Research 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 Research 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 urban clients**



Source: Sa-Dhan, CRISIL Research

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

December 2021, 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 December 2021)

(Rs billion)	Disbursement (April-December 2021)	Share of disbursement	Portfolio outstanding	Share of GLP	Share of borrowers
Rural	475	71%	647	75%	75%
Urban	194	29%	217	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 Research*

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 April 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 April 1, 2022, some MFIs have increased interest rates for borrowers by 150-200 bps, especially those who are credit untested.

CRISIL Research 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 Urban areas: Rs 2,00,000 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 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	<u>Limit on Maximum Loan Repayment Obligation of a household towards all loans:</u> 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)

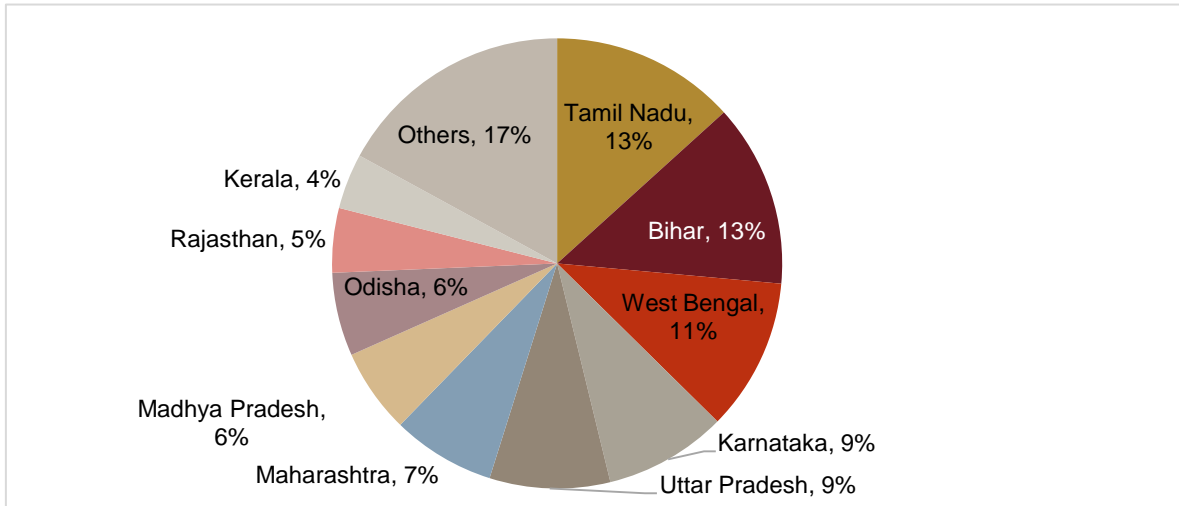
Source: RBI, CRISIL Research

## 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 Tamil Nadu (13%), Bihar (13%), and West Bengal (11%) recording the highest shares as of March 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 (FY22)



Source: Equifax, CRISIL Research

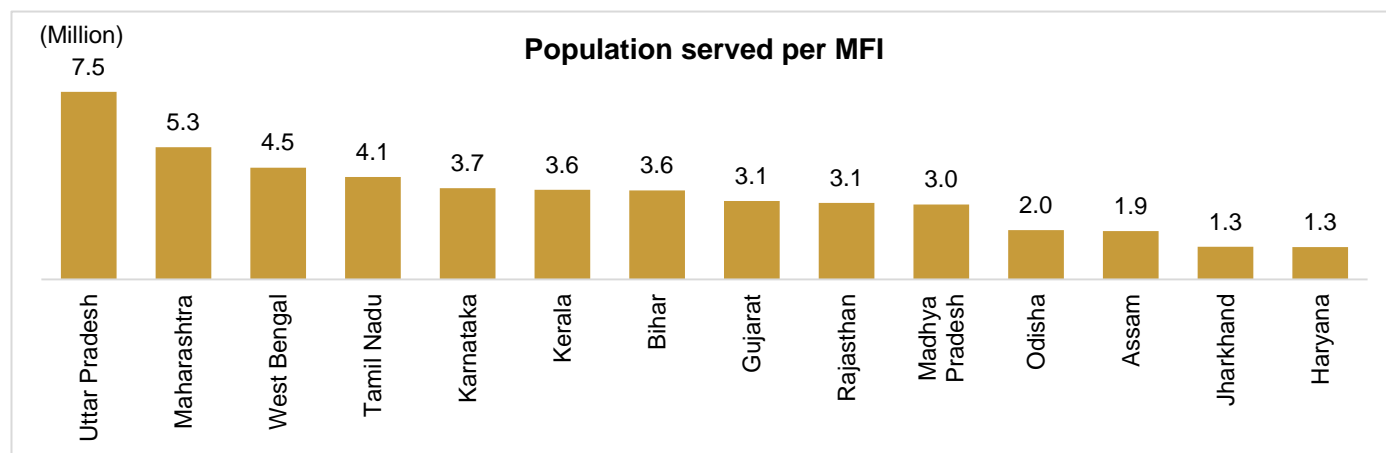
### State-wise distribution of MFI loans disbursement

Rs bn	FY18	FY19	FY20	FY21	FY22	FY18-22 CAGR growth
Tamil Nadu	29	54	77	61	96	35%
Gujarat	9	14	16	12	21	24%
Karnataka	43	102	20	76	91	21%
Rajasthan	20	41	30	26	42	20%
Bihar	56	100	95	61	105	17%
Punjab	10	20	22	13	18	16%
Uttar Pradesh	45	68	60	38	74	13%
Madhya Pradesh	39	51	62	49	59	11%
Jharkhand	18	26	12	17	24	7%
West Bengal	38	83	63	32	48	6%
Maharashtra	56	76	72	46	65	4%
Uttarakhand	6	3	4	8	6	1%
Odisha	68	89	65	42	67	0%
Kerala	24	28	86	13	21	-4%
Chhattisgarh	26	19	21	15	17	-10%
Assam	10	28	24	7	5	-16%
Haryana	50	14	1	10	16	-24%

Source: MFIN, CRISIL Research



**MFI penetration across states (March 2022)**



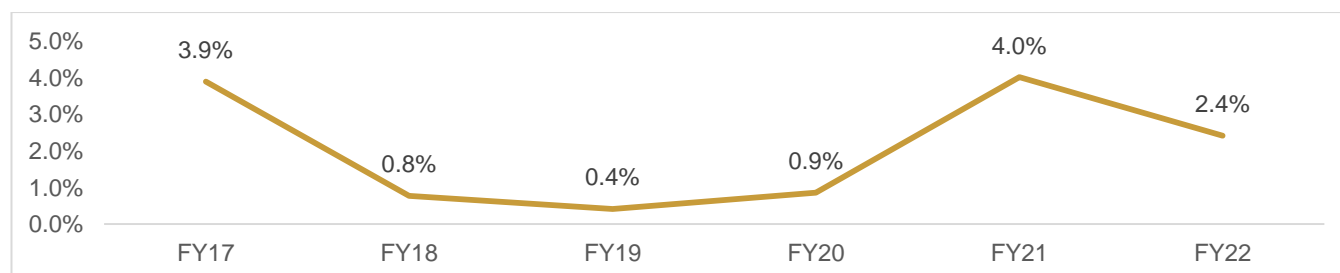
Note: 1. Data includes only NBFC-MFI players and those states where five or more MFIs are operating as of FY22, 2. Player penetration is calculated as state population divided by number of MFI players.

Source: MFIN, CRISIL Research

**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.

**Asset quality trend over the years**



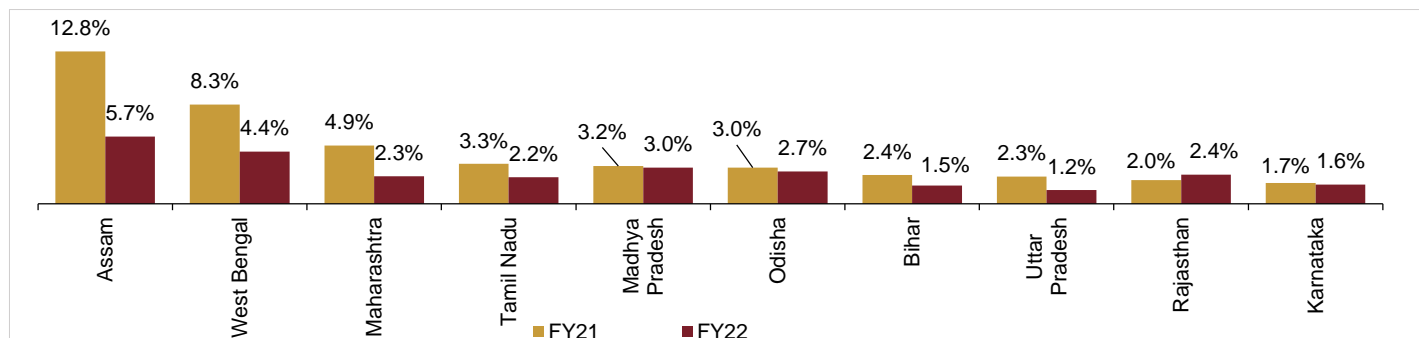
Note: PAR 90+ doesn't include delinquency beyond 180 days of MFI industry

Source: Equifax, CRISIL Research

**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%, after having deteriorated in fiscal 2021 due to the proposed bill on microfinance. Other states such as West Bengal and Maharashtra has also witnessed some improvement in asset quality, however, Madhya Pradesh and Odisha are some of the states where PAR 90+ remained at elevated levels in fiscal 2022 as compared to overall microfinance industry.

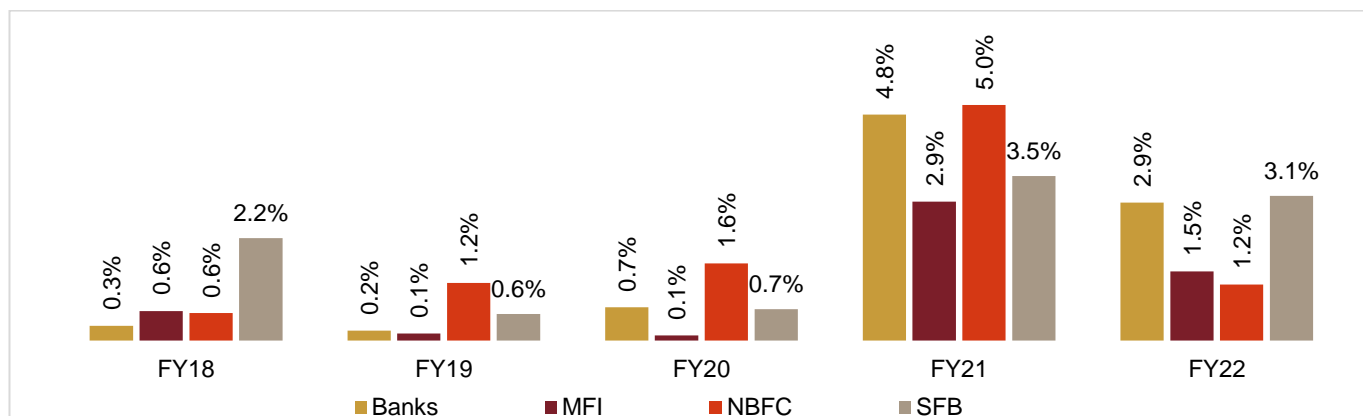
### State-wise asset quality of top states (FY21 and FY22)



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 Research

### 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 Research

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.

### **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 Research 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 Research 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 Research 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 Research

### 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 expected 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 2023. 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. Going forward, CRISIL expect the credit costs to decrease gradually in fiscals 2023 and 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 2023

RoA tree	FY18	FY19	FY20	FY21	FY22E	FY23P
Interest income	17.7%	19.1%	18.4%	17.5%	17.3%	18.0%
Interest expense	8.6%	8.4%	7.7%	7.7%	7.7%	8.3%
Net interest income	9.1%	10.6%	10.7%	9.8%	9.6%	9.7%
Opex	5.3%	5.5%	5.4%	5.1%	5.1%	5.4%
Other income	1.2%	2.0%	2.5%	1.2%	1.5%	1.9%
Credit cost	1.5%	1.0%	2.7%	5.0%	4.2%	3.0%
Tax	1.2%	2.1%	1.6%	0.2%	0.5%	1.0%
RoA	2.3%	4.1%	3.5%	0.7%	1.3%	2.2%

Note: E: Estimated; P: Projected

Source: CRISIL Research

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

### ***Evolving landscape of the LAP market***

Key factors that contributed to high LAP growth are:

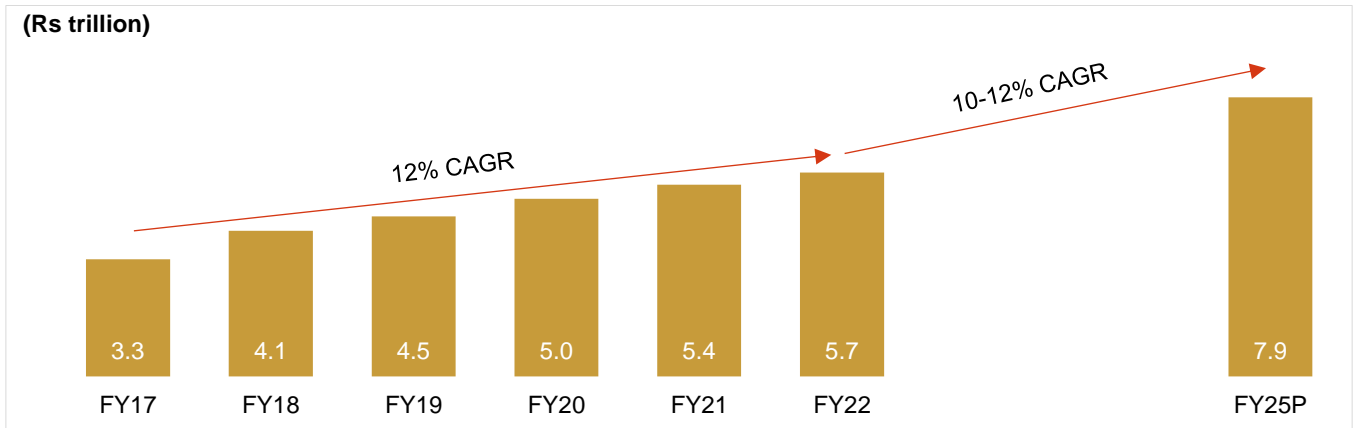
- **Quick turnaround time, lower interest rate, lesser documentation:** LAP loans are disbursed in about half the time taken for a secured MSME loan. It is also offered at a lower interest rate than secured MSME loans, unsecured personal and business loans. LAPs require lesser documentation than other 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 slowed in fiscal 2021 and fiscal 2022***

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.

Going forward in fiscal 2023, with improvement in the economy and lenders being positive towards mortgage-based lending, the LAP segment is expected to perform better. Banks are expected to register strong growth in the segment due to their higher market penetration, lower cost of funds and adequate liquidity support. However, lenders are unlikely to be as aggressive as they were in the past and the overall market is projected to grow at 10-12% CAGR between fiscal 2022 and fiscal 2025.

**Overall LAP advances growth is expected to grow over FY22-25 as impact of Covid-19 wanes out**

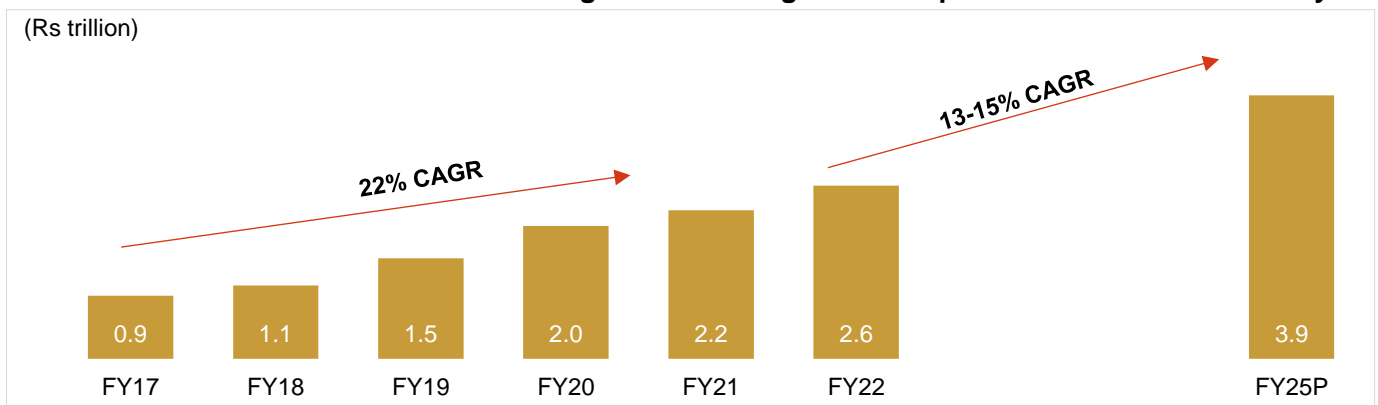


Note: P: Projected; Data Includes data for banks and non-banks

Source: CRISIL Research

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. Given the relatively low penetration levels, the vast market available, and increasing interest of financiers, CRISIL Research expects low ticket sized LAP (ticket size < Rs 5 million) credit to grow at a faster rate, leading to a CAGR of 13-15% between fiscal 2022 and fiscal 2025.

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

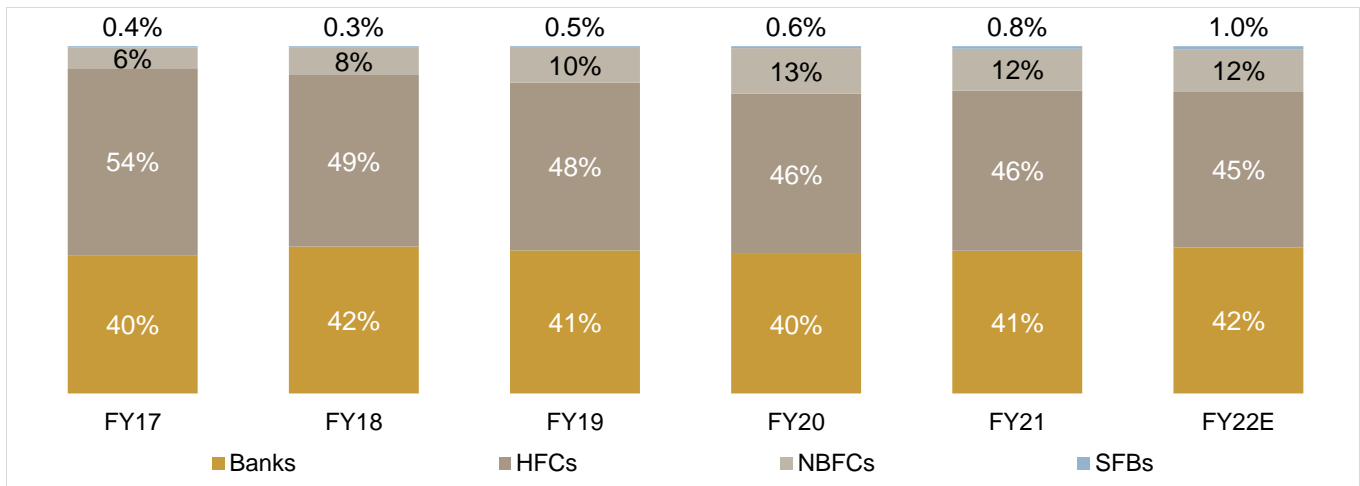


Note: P: Projected; Data Includes data for banks and non-banks

Source: CRISIL Research

**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 Research

## Gold loans

### **Gold loans AUM is expected to grow at 11% CAGR between fiscal 2022 and 2025**

Gold loans are typically small ticket, short duration, convenient and instant credit. Though moneylenders and pawn brokers understand the psyche 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.

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.

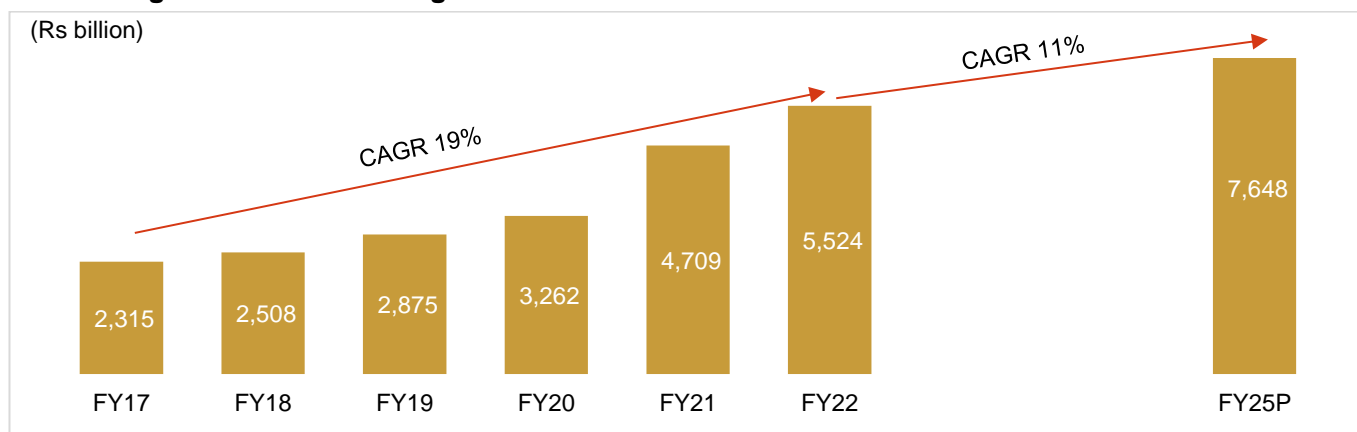
In fiscal 2021, the demand for gold loan finance witnessed a massive surge with AUM shooting up from Rs 3.3 trillion to Rs 4.7 trillion, as India's economy coped with the devastating effect of the global pandemic and consumers availed of gold loans to meet their consumption and emergency funding needs. 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. The RBI also revisited its guidelines for banks' lending gold loans by increasing the maximum LTV allowed to 90% from existing 75% for non-agricultural gold loans extended during August 2020 to March 2021 to help stressed borrowers to unlock more value. The growth was also supported by players continued focus to wean away consumers from the unorganised

gold loan market by means of awareness and diversifying their regional presence with the help of branch as well as digital channels.

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. Increase in AUM can be attributed to factors such as high gold prices, strong demand and increased promotion by financiers to acquire unorganised gold loan market by means of awareness and diversifying their regional presence with the help of branch as well as digital channels. Financiers also were very aggressive in tapping new customers during the year with some of them running campaigns offering gold loans at a lower interest rate for short tenures. For instance, Manappuram Finance introduced low interest rate, for retail customers with a tenure of 3 months.

Going forward, CRISIL Research 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 Research expects AUM to touch close to Rs 7,648 billion by March 2025, translating into a 11-12% CAGR between fiscal 2022 and 2025.

**Growth in gold loan AUMs of organized lenders**



Note: P: Projected

Source: CRISIL Research

### Greater accessibility and growing customer base to boost growth for SFBs

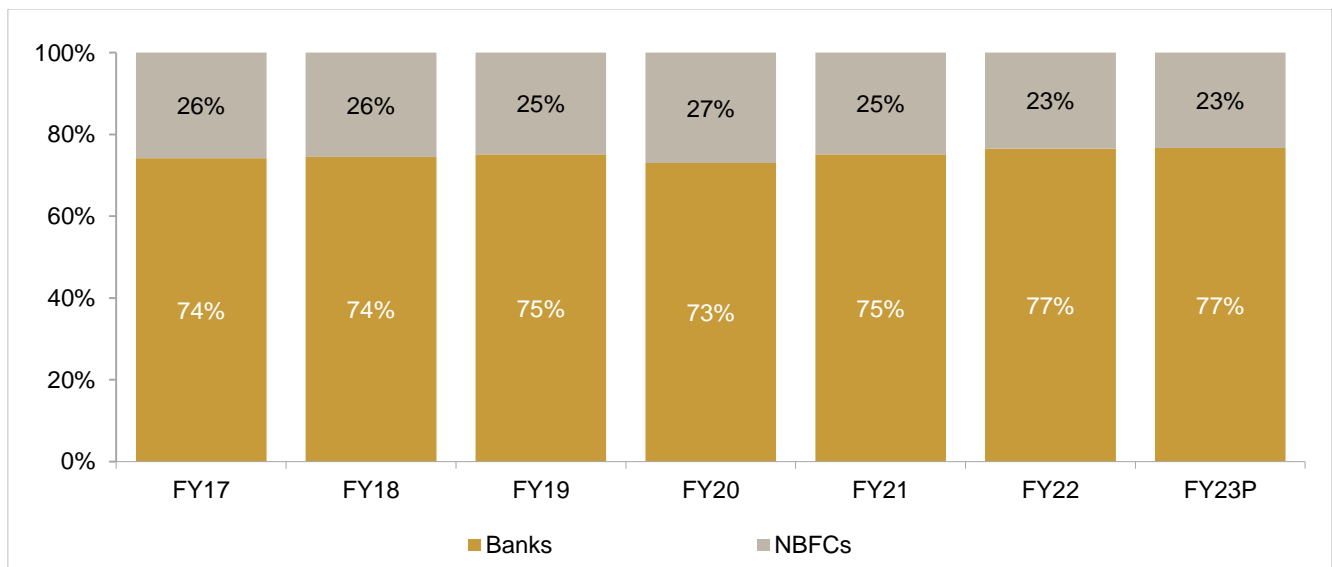
Over the past decade, specialized gold loan NBFCs have witnessed exceptional growth amongst organized players. This growth is driven by aggressive expansion of branches, heavy spend on marketing and rapid acquisition of customers. NBFCs and banks approach the gold loan market differently, reflected in 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: P - Projected

Source: CRISIL Research



**Comparison of Gold loan institutions on select business parameters**

	Banks	Gold loan NBFCs	Unorganised moneylenders
<b>Interest rate</b>	7-15%	18-24%	25-45%
<b>LTV</b>	Up to 75%	Up to 75%	More than 75%
<b>Tenure</b>	8-12 months	2-12 months	6-12 months
<b>Processing fee</b>	Higher than NBFCs	No/minimal processing fees	None
<b>Regulator</b>	RBI	RBI	None
<b>Documentation required</b>	KYC Compliance	Minimal	Minimal
<b>Product focus and customer service</b>	Non-core product	Gold loan is core focus, excellent customer service	Gold loan is core focus
<b>Mode of disbursements</b>	Mainly cheque and direct transfer to account	Cash/ cheque and direct transfer to account	Mostly cash
<b>Turnaround time</b>	30 min - 2 hours	10 - 20 mins	10 - 20 mins
<b>Opening hours</b>	Banking hours	Beyond banking hours	More flexible than banks in terms of working hours

Source: CRISIL Research

**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***

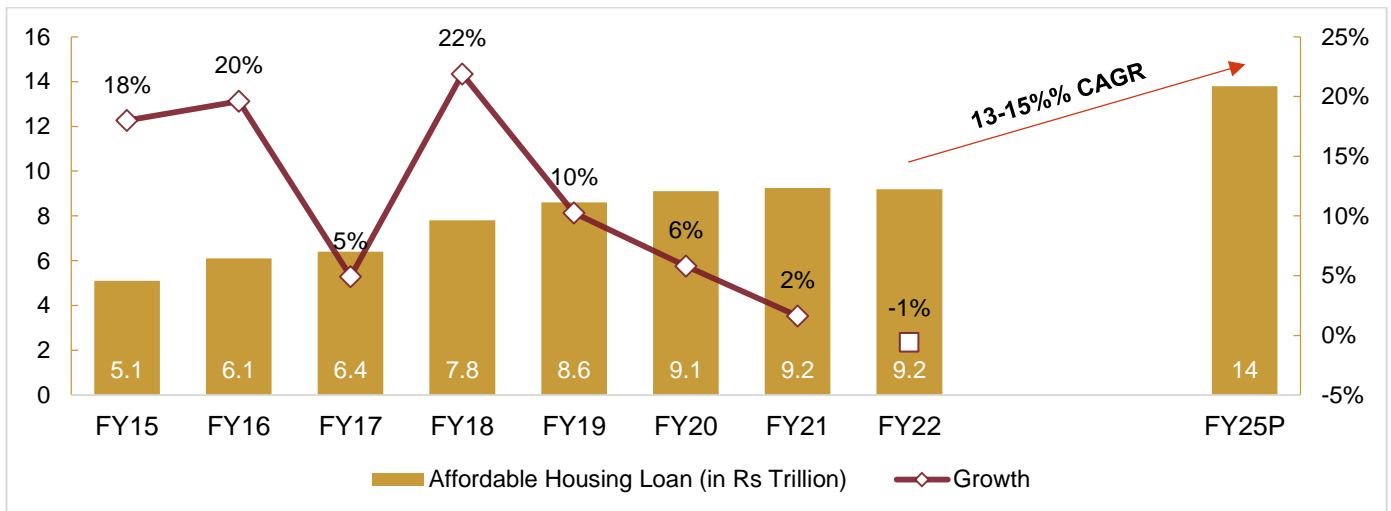
Housing loans (up to Rs. 2.5 million ticket size) logged a CAGR of ~12% during fiscals 2015-2020. This was largely because of the government's increased focus on the housing loans (up to Rs. 2.5mn) segment. In fiscal 2019, however, the growth slowed down considerably to 10% on year due to liquidity constraints 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 longer term CRISIL Research expects the segment to bounce back sharply and grow at ~13-15% CAGR over FY22-25 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 accelerate from fiscal 2022**



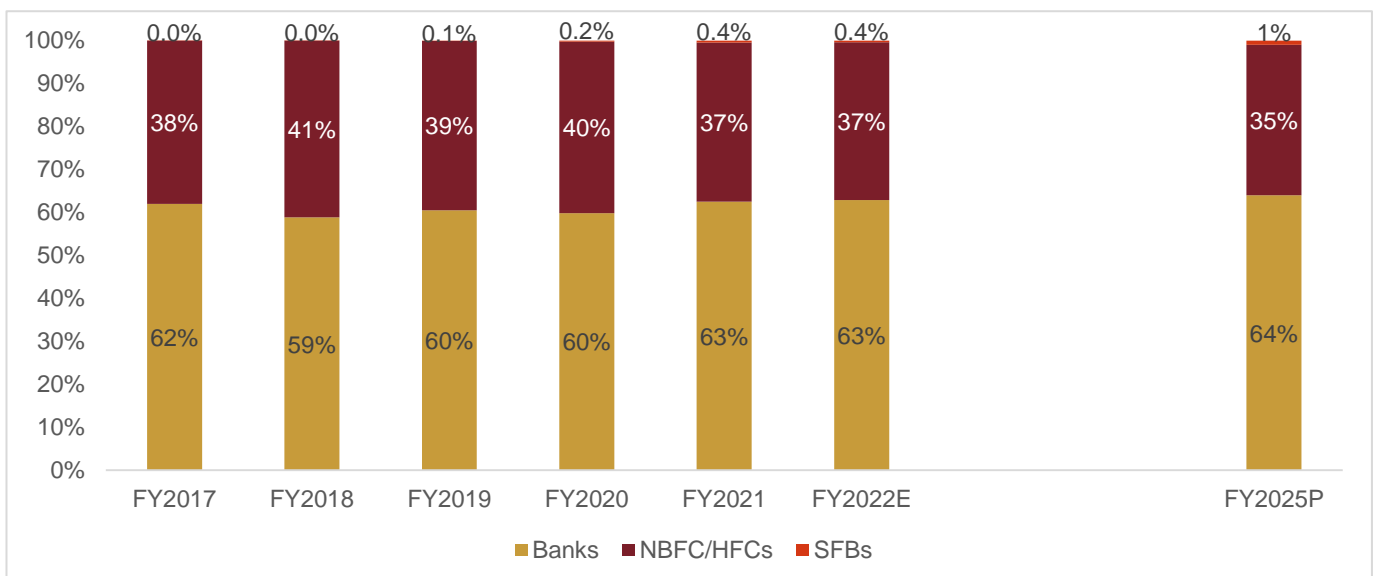
Note: P- Projected

Source: Company reports, RBI, CRISIL Research

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

CRISIL Research 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 Research 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 Research

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

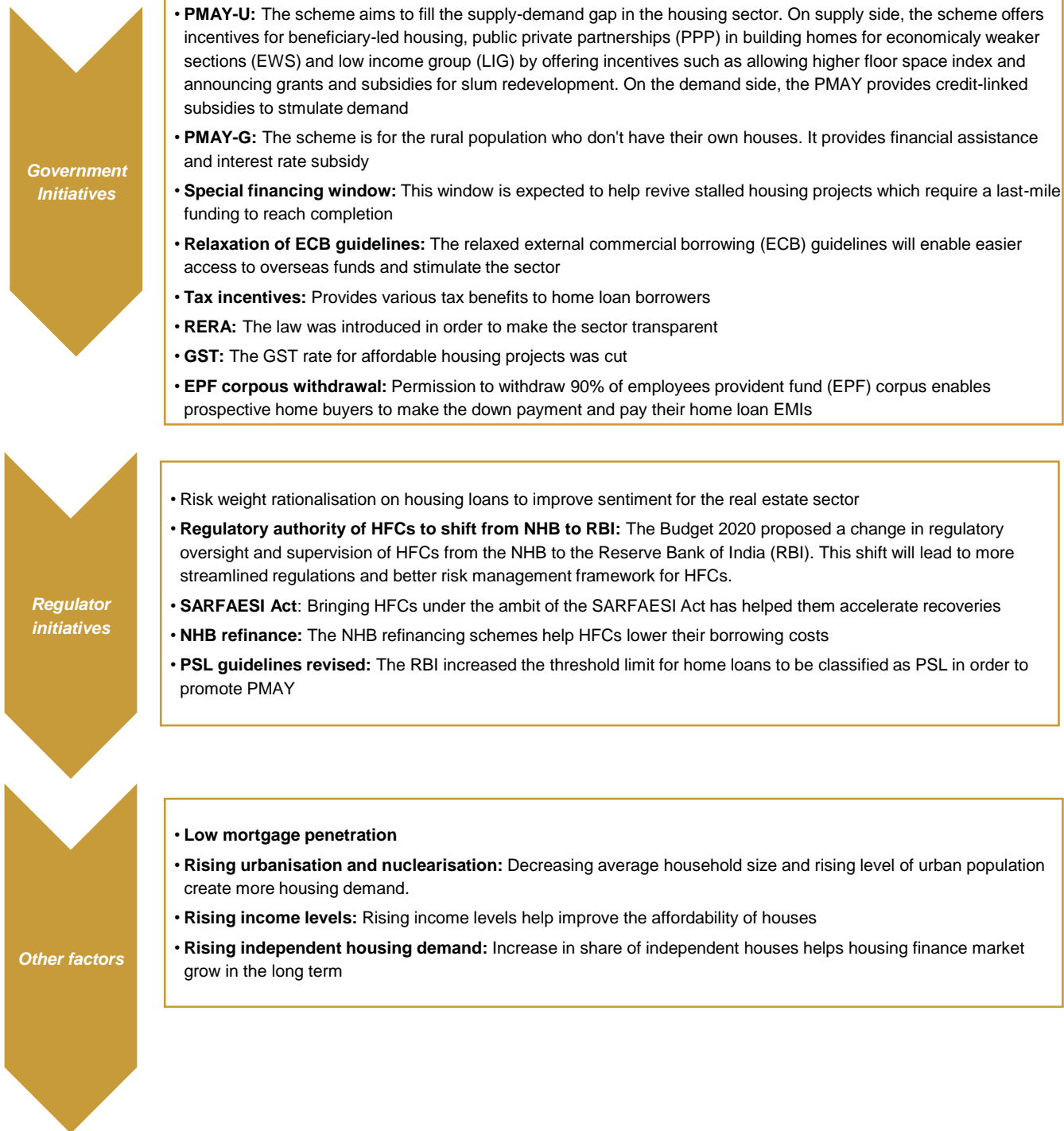
- **Clear understanding of target market:** Given the target borrower's profile, players need to have a clear and

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.



Source: CRISIL Research

## Two-wheeler loans

### ***Improving income sentiments and increased mobility to buoy two-wheelers in fiscal 2023***

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.

Post consecutive years of decline in wholesale domestic volumes since fiscal 2020, two-wheeler volumes are projected to improve by ~3-8% in fiscal 2023.

Volumes are expected to be driven by recovery in scooter sales as educational institutions and offices re-open, more people commute to office, and urban income sentiment improves. Normal monsoons prediction is expected to support demand for motorcycles segment positively.

In the medium to long term, we expect two-wheeler sales to grow at 9-11% CAGR between fiscal 2022 to fiscal 2025 owing to:

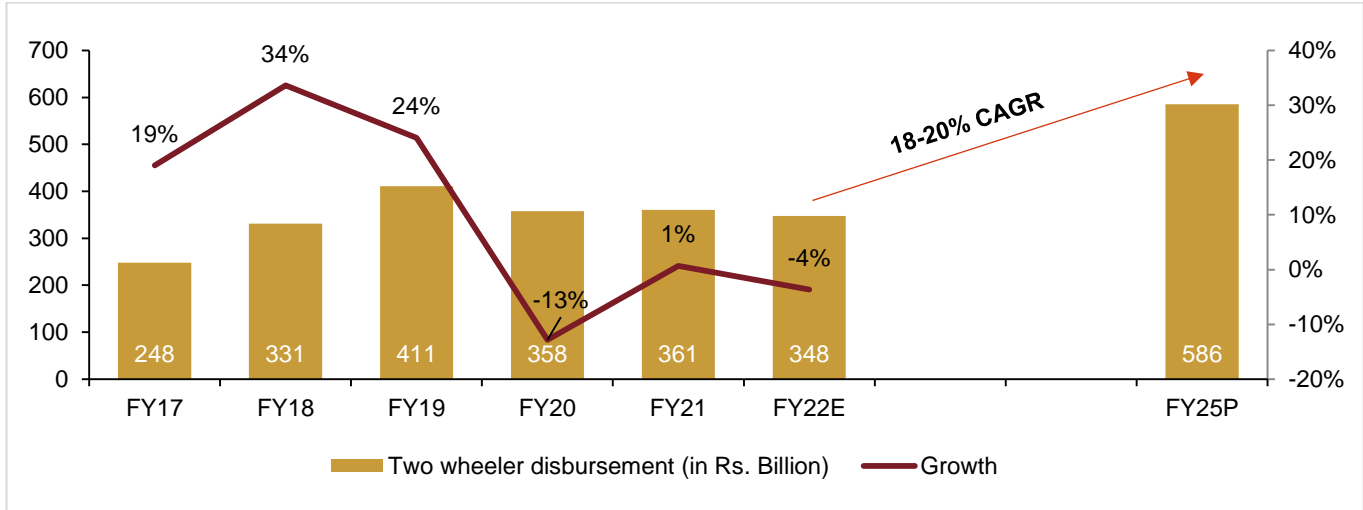
- Manufacturers focus on expansion in distribution network in semi-urban and rural areas, new model launches in the affordable segment for scooters and premium segment for motorcycles.
- Improving rural productivity, diversification towards horticultural crops, government income support schemes and structural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

### **Two-wheeler disbursements estimated to de-grow in fiscal 2022; disbursements expected to grow at a 18-20% CAGR in the subsequent 3 years**

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.

CRISIL Research expects disbursements to de grow by 4% in fiscal 2022 owing to 11% fall in two-wheeler sales during the fiscal due to increasing realisation. Over the next 3 years ending fiscal 2025, we expect disbursements to grow at 18-20% CAGR on a weak base of the previous few years, 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

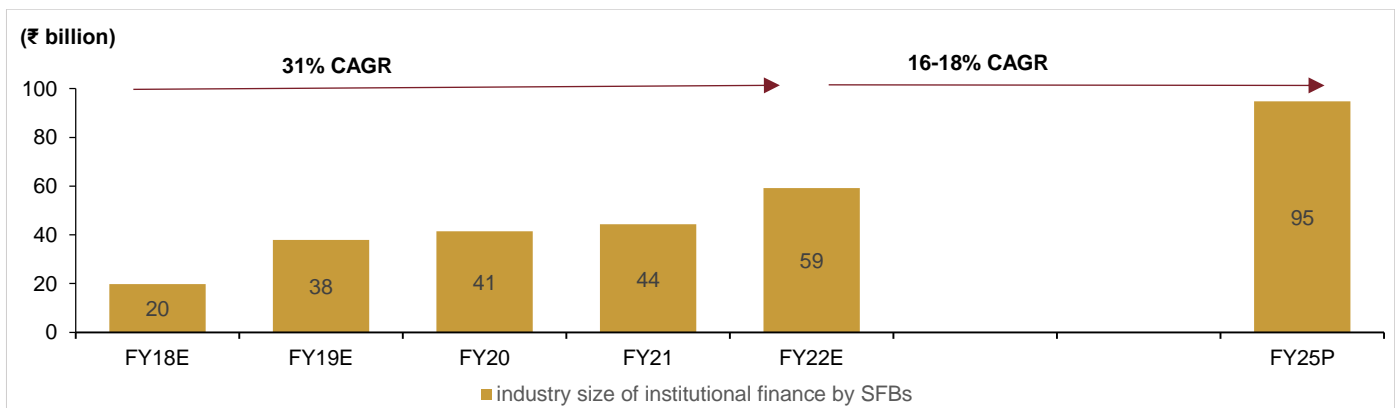
Source: CRISIL Research

### 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).

Institutional finance book of SFBs is estimated at ~Rs 59 billion in fiscal 2022, after moderate growth of growth of ~7% compared to fiscal 2021, the segment rebounded in fiscal 2022 owing to increase in corporate demand and lower base with on-year growth of ~33%. 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. Going forward, CRISIL Research expects the SFB institutional finance segment growth to remain at a healthy 16-18% over fiscal 2022-25.

### Institutional finance segment growth for SFBs expected to be ~16-18% over next three years



Note: Data for ESAF and Fincare SFB is estimated

Source: Company reports, CRISIL Research

***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 crore. 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.

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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. 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.

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