

27 September 2023

India | Equity Research | Sector Update

NBFCs

Small ticket LAP: <10% penetration implies huge untapped opportunity

Our recent interaction with financiers suggests most players are actively pursuing small ticket LAP (S-LAP) segment over medium ticket LAP. As per CRISIL MI&A, the estimated market size for S-LAP stands at INR 22trn, of which lenders have captured only INR 1.8trn (ticket size of up to INR 1.5mn) as on Mar'23, implying <10% penetration. Currently, S-LAP market is concentrated in five states namely Maharashtra (14% of total loans), Tamil Nadu (12%), Gujarat (10%), Karnataka (9%) and Rajasthan (8%), cumulatively accounting for 53% of total market. Shriram Finance, AU and Equitas SFB are the leading S-LAP players. In this report, we have focused on <INR 1.5mn ticket size LAP market and analysed the data for leading 16 financiers having total outstanding AUM of INR 1.5trn as of Mar'23.

S-LAP penetration remains at <10% as on Mar'23; strong growth momentum to continue

Total outstanding loans (secured LAP <INR 1.5mn) for 16 lenders covered in this report stand at ~INR 1trn and, as per CRISIL MI&A, the same stands at INR 1.8trn as on Mar'23, implying <10% penetration. Even including MSME loans of up to INR 3mn, total loans stand at INR 2.5trn as on Mar'23. Secured MSME loans have grown by 24% CAGR from INR 0.5mn-3mn between FY18-23 for NBFCs and 23% CAGR for others. The growth remained the highest at 29.3% CAGR in loans of <INR 0.5mn category.

Top-5 states account for ~53% of outstanding loans, implying persistence of state-wise diversity in credit penetration

While overall S-LAP penetration remained low at <10%, our state-wise analysis suggests penetration in top-5 states is >20% and for the rest it is between 1-15%. Penetration in Uttar Pradesh, Odisha, West Bengal, Assam and Bihar (high-growth states) is below 5% and these states cumulatively represent >40% of total addressable market. Telangana, Karnataka, Tamil Nadu, Maharashtra and Gujarat have >20% penetration and account for 25% of the addressable market. Refer Exhibit 5 for player-wise branch distribution in high-growth states.

District-wise analysis suggests that even in highly-penetrated states, top-5 districts account for >60% of outstanding portfolio

Our district-wise analysis suggests that even in highly-penetrated states like Maharashtra, Gujarat, Telangana and Karnataka, top-5 districts account for >60% of loans between INR 0.5mn-3mn ticket size. The same implies scope for further penetration even in states having overall penetration of >20%. In high-growth states, top-5 districts account for 45-55% of outstanding loans.

NBFCs command >50% market share in secured MSME loans <INR 3mn

Our interaction with several financiers suggests given the huge untapped secured MSME lending opportunity and better yields and profitability (Cal. RoA at >3.5%), most financiers are actively pursuing S-LAP over medium / high ticket LAP. S-LAP is predominantly captured by NBFCs as reflected in >50% market share in secured MSME loans below INR 3mn. SFBs are incrementally focusing on scaling S-LAP to leverage branch network and cost of fund advantage over NBFCs. Shriram Finance, AU and Equitas are market leaders in this segment with Aavas, Home First and Equitas having delivered >25% CAGR between FY20-23.

Renish Bhuva

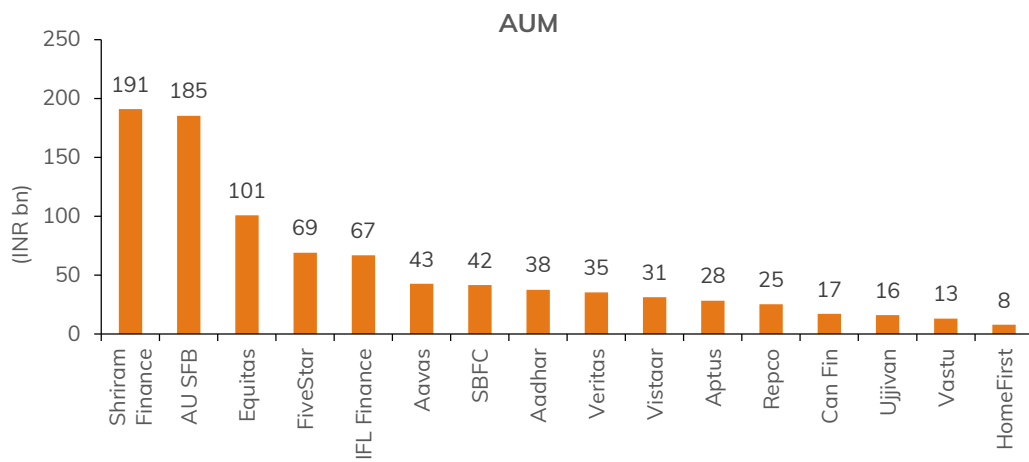
 renish.bhuva@icicisecurities.com
 +91 22 6807 7465

Vaibhav Arora

vaibhav.arora@icicisecurities.com

Current landscape of S-LAP

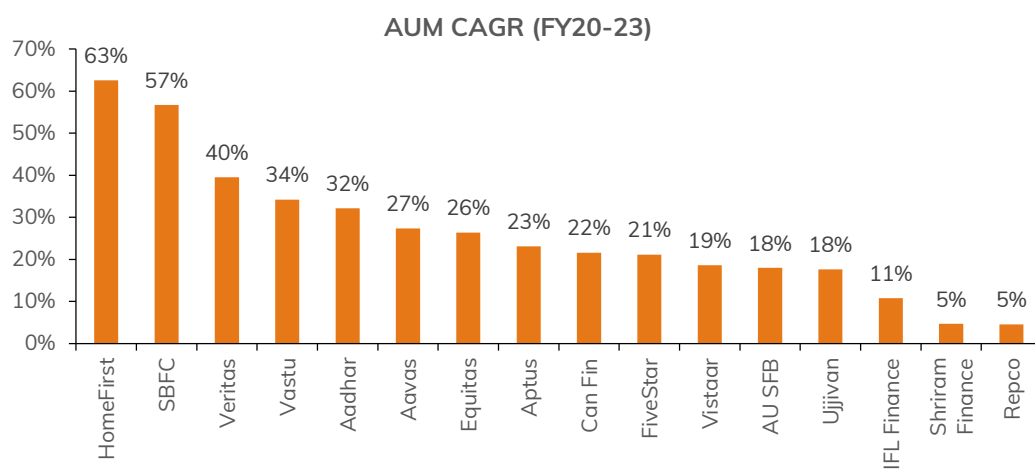
Exhibit 1: Shriram Finance, AU and Equitas dominate S-LAP segment



Source: Company data, I-Sec research

Note – we have considered MSME / LAP loans with ticket size <INR 1.5mn. For AHFCs, Non HL book is taken.

Exhibit 2: Cumulative AUM of 16 lenders (listed below) has grown by 17% CAGR between FY20-23



Source: Company data, I-Sec research

Exhibit 3: Limited competition in micro-LAP segment

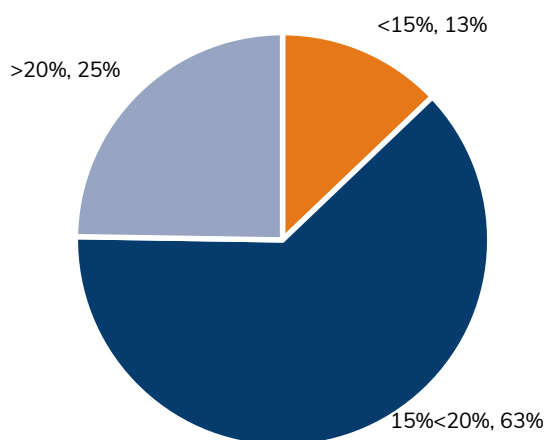
Ticket size	Players	Yields
=<INR 0.55mn	Equitas	20%
	FiveStar	24%
	Shriram Finance	14-20%
	Veritas	23%
	IIFL Finance	18%
>INR0.5mn-< INR1mn	Aavas	14%
	Aptus	21%
	HomeFirst	16%
	Can Fin	NA
	Vistaar	17%
	AU SFB	15%
	SBFC	16%
>INR1mn-<INR1.5mn	Aadhar	NA
	Repco	NA
	Vastu	NA

Source: Company data, I-Sec research

Note; ATS for S-LAP is assumed in line with HL ATS (for companies where Non HL ATS is not available).

For yields wherever S-LAP yield is not available, we have assumed 100-200bps higher yields than HL yields.

Exhibit 4: Within I-Sec sample size (16 entities), >60% of players cater to customer segment with yields at 15-20%; least competition in <15% segment given banks are dominant players, and thus, segment with >20% yields offers huge untapped market for NBFCs



Source: Company data, I-Sec research

Exhibit 5: Player-wise branch presence in high growth states

Players	Madhya Pradesh	Uttar Pradesh	West Bengal	Odisha	Bihar	Assam
Aavas	49	28	0	6	0	0
Aptus	0	0	0	2	0	0
HomeFirst	0	3	0	0	0	0
Repco	4	0	1	2	0	0
Can Fin	8	10	1	3	1	0
Vistaar	31	5	0	4	0	0
Veritas	26	0	40	13	0	0
Equitas	57	14	0	0	0	0
AU SFB	113	0	0	0	0	0
SBFC	12	20	4	0	6	9
IIFL Finance	28	0	8	0	0	0
Shriram Finance	28	56	11	7	12	0
FiveStar	49	0	0	0	0	0
Aadhar	45	68	8	2	2	0
Vastu	16	10	0	0	0	0
Total	465	214	73	39	21	9

Source: Company data, I-Sec research

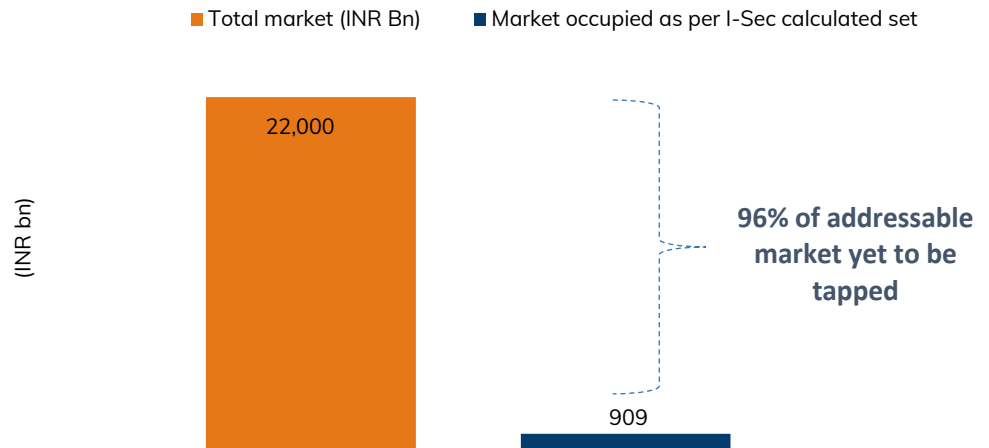
Note: For AU and IIFL, state-wise branch distribution is arrived by applying state-wise AUM mix to total branches. For Shriram Finance, we considered only e-SCUF branches.

Small ticket MSME credit gap at INR 22trn, of which only INR 8.5trn worth of market has been addressed as on Mar'23

Overall MSME credit gap stands at INR 92trn, but small ticket MSME credit gap is estimated at INR 22trn, as per CRISIL. Of the total addressable market, secured MSME portfolio outstanding as of Mar'23 stands at INR 8.5trn. Within overall outstanding secured MSME portfolio, around 30% of portfolio (INR 2.5trn) is towards small ticket LAP (ticket size between INR 0.5mn to INR 3.0mn). Further, portfolio outstanding under INR 1.5mn ticket size stands at INR 1.8trn as on Mar'23.

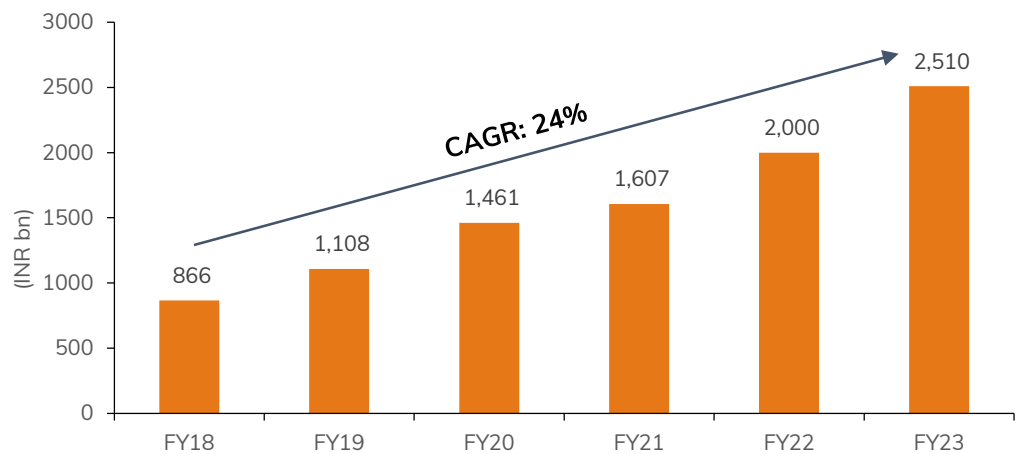
While the general perception is S-LAP is highly competitive and the same is likely to pressurise asset yields in near future, our analysis suggests S-LAP penetration is <10% and the same presents ample opportunities for players to grow profitably. The secured MSME portfolio within the ticket size of INR 0.5mn-INR 3.0mn grew by 24% CAGR between FY18-FY23, higher than overall MSME loan CAGR of 18% during the same period.

Exhibit 6: Huge market gap in secured MSME space with less than 10% of addressable secured MSME market being occupied as per our calculated set



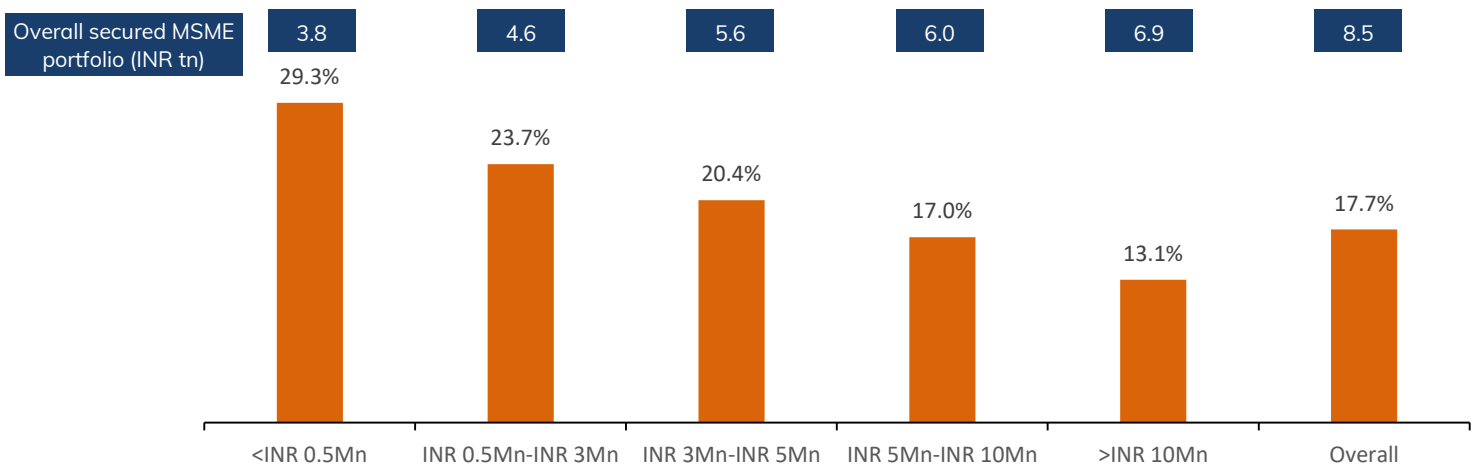
Source: Company data, I-Sec research

Exhibit 7: Secured MSME portfolio (ticket size of INR 0.5mn-INR 3.0mn) grew by 24% CAGR between FY18-FY23...



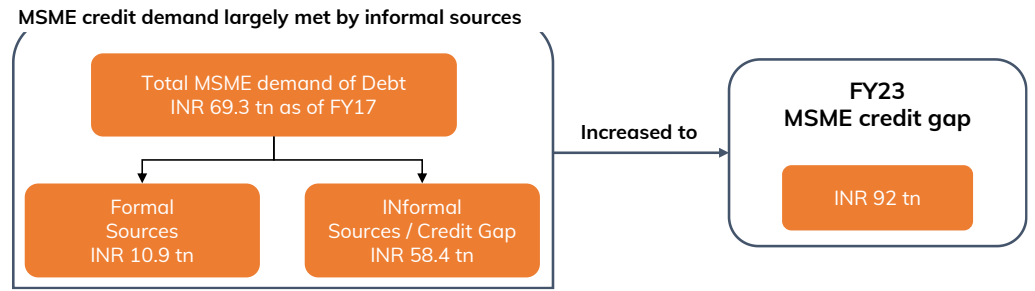
Source: Company data, I-Sec research

Exhibit 8: ...which remained higher than the overall secured MSME portfolio growth



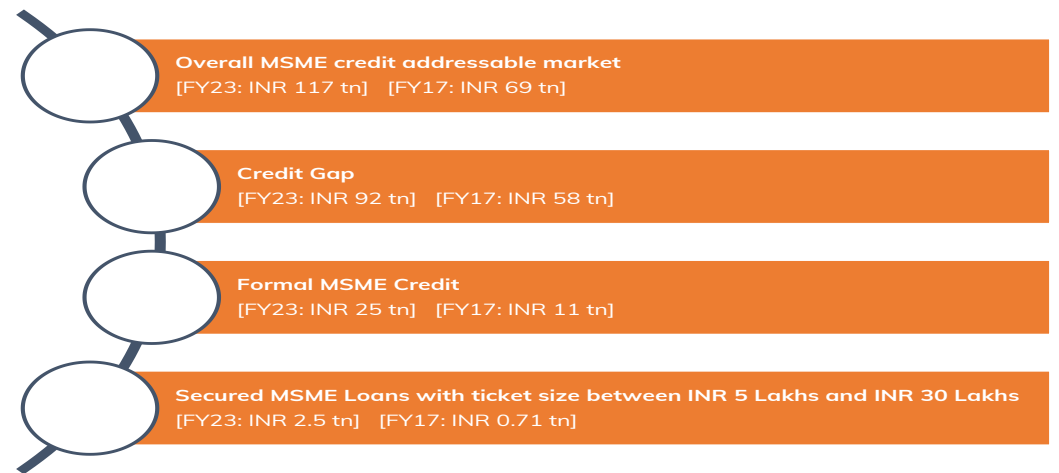
Source: Company data, I-Sec research

Exhibit 9: Overall MSME credit gap increased to INR 92 trn as on March'23



Source: IFC report on financing India's MSME dated November 2018, CRISIL M I&A

Exhibit 10: Secured MSME loan with ticket size INR0.5mn-3mn stands at INR 2.5 trn as on March'23

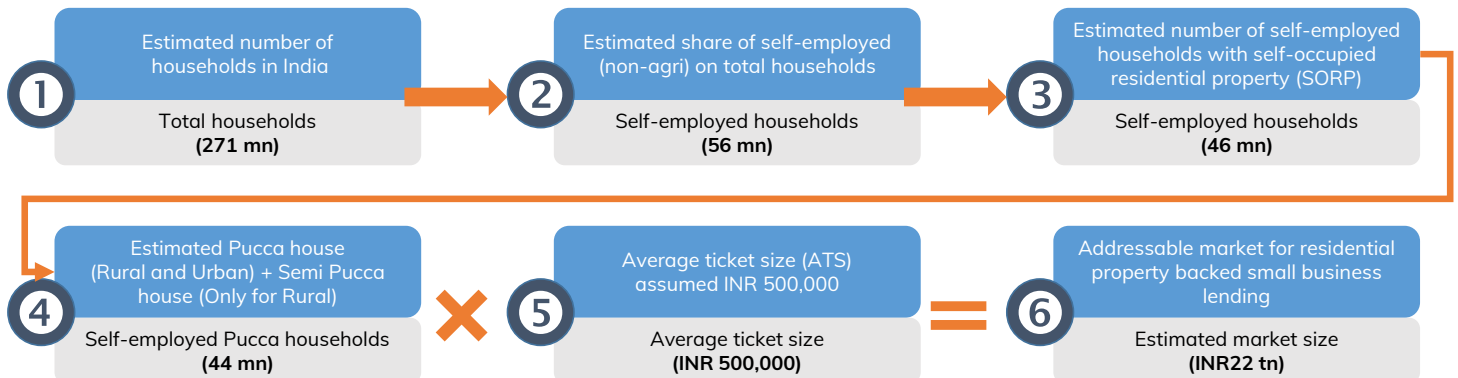


Note: Overall formal MSME credit given above includes all kinds of secured and unsecured loans given to MSMEs across ticket sizes by organised lenders.

Source: MSME Ministry Annual report for Fiscal 2021, IFC report on Financing India's MSMEs dated November 2018, CRIF Highmark, CRISIL MI&A

As per CRISIL Research, addressable MSME credit gap stood at INR 92trn as on March'23. Of this, secured MSME loan portfolio outstanding as of FY23 stood at INR 8.5trn, implying <10% penetration. Within this market, small ticket LAP portfolio for ticket size INR 0.5mn-3mn stood at INR 2.5trn and INR 1.8trn for ticket size INR 0.5mn-1.5mn (S-LAP). Our calculated set also represents >50% of S-LAP market.

Exhibit 11: Estimated market size for small ticket MSME loan stands at INR 22 trillion

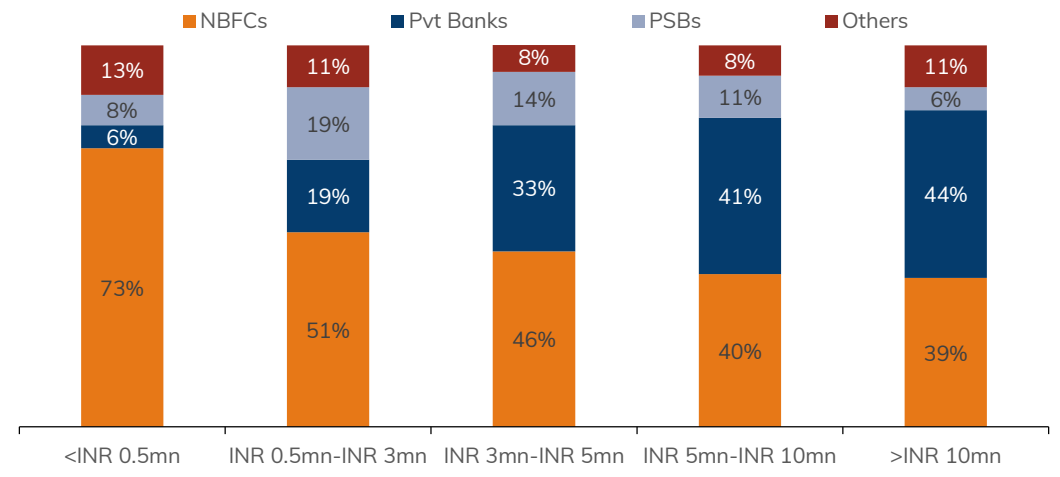


Source: Company data, I-Sec research

NBFCs command >50% market share in secured MSME loans below INR 3mn

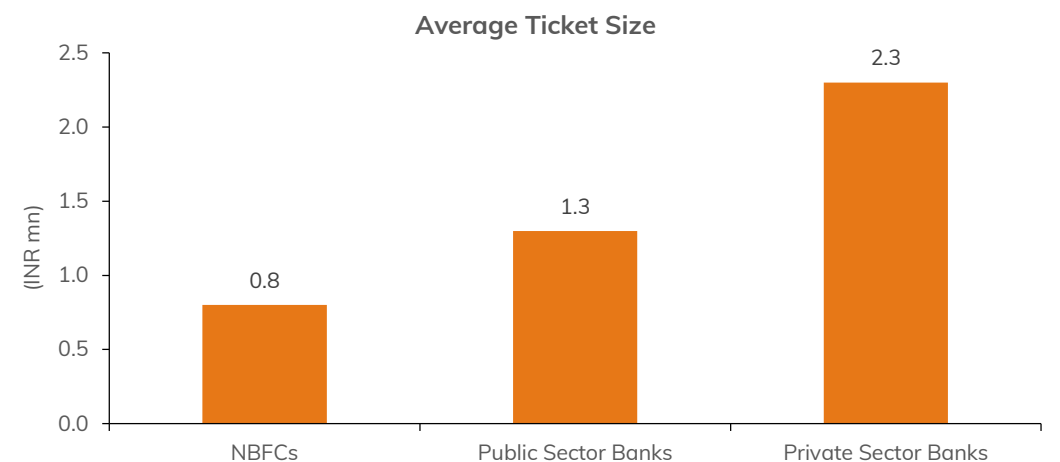
- Our interaction with several financiers suggests given the huge untapped secured MSME lending opportunity, better yields and profitability (Cal. RoA at >3.5%), most financiers are actively pursuing S-LAP over medium / high ticket LAP. S-LAP is predominantly captured by NBFCs as reflected in >50% market share in secured MSME loans below INR 3mn.
- In less than INR 0.5mn category, NBFCs command >70% market share. Shriram Finance and Five Star are the key players in this category. This segment has grown at 29% CAGR between FY18-23.
- SFBs are incrementally focusing on scaling S-LAP to leverage branch network and cost of fund advantage over NBFCs.
- Shriram Finance, AU and Equitas are market leaders (in-terms of AUM) in S-LAP segment with Aavas, Home First and Equitas having delivered >25% CAGR between FY20-23.

Exhibit 12: NBFCs market share in ticket size of less than INR 3.0mn (FY23) stands much higher at >50%



Source: Company data, I-Sec research

Exhibit 13: S-LAP market is largely serviced by NBFCs and PSBs



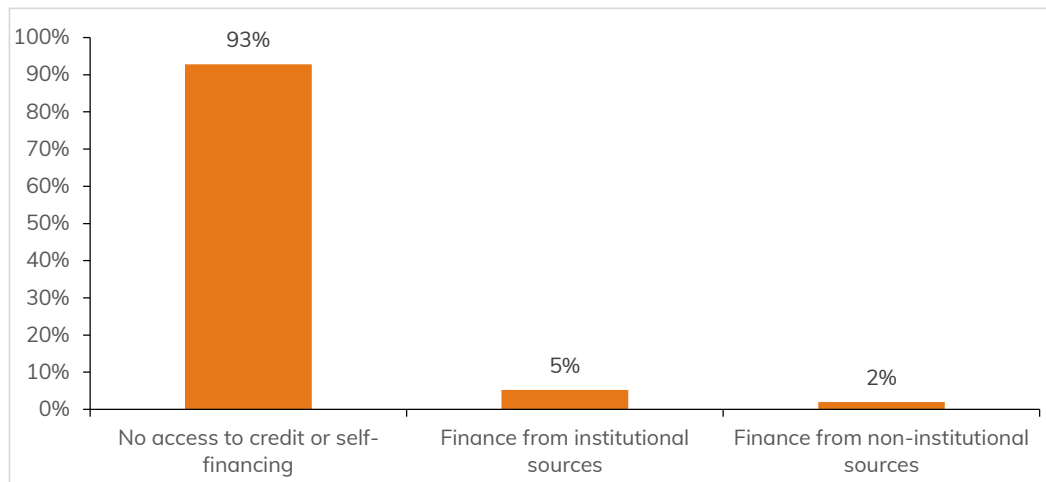
Source: Company data, I-Sec research

Increasing ‘formalisation’ augurs well for S-LAP segment; >90% of SMEs are still dependent on informal financing

MSME registration under ‘Udyam’ grew robust 60% (CAGR) between FY16-23 driven by micro enterprise which grew 63% (highest CAGR), followed by medium enterprises by 47% and small at 30%. As per Udyam data, 97% of units are micro enterprise (investment in plant and machinery <INR 10mn) as of Sep’23 vs 94% in Sep’21. The same implies increasing ‘formalisation’ especially amongst small units.

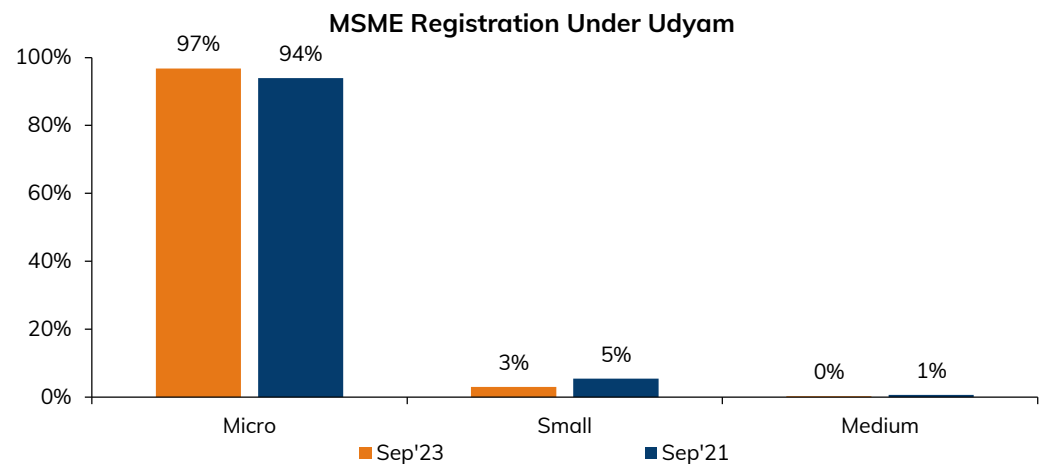
Given >90% of SMEs are dependent on informal financing, increasing ‘formalisation’ augurs well for S-LAP segment.

Exhibit 14: Finance requirement for >90% of SMEs is met via informal sources



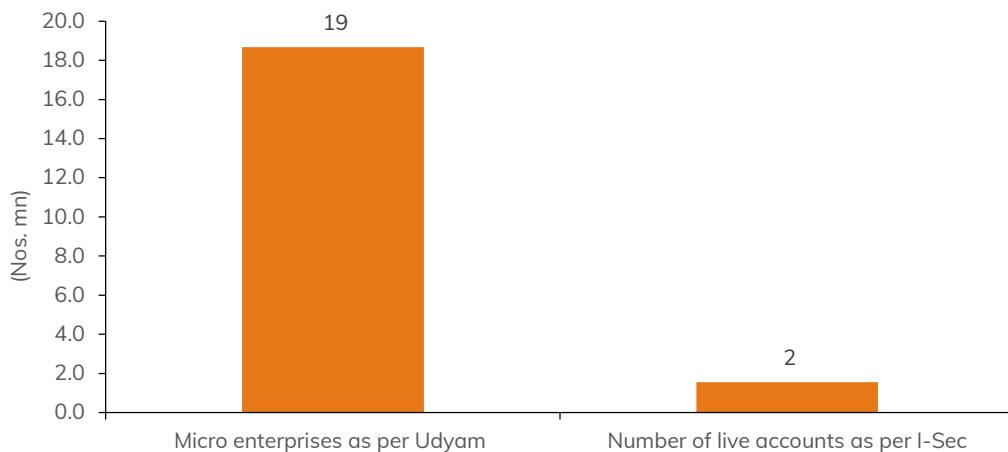
Source: Source: Fourth Census of the MSME sector (September 2009)

Exhibit 15: Registration of micro enterprises under Udyam increased to 97% as on Sep’23 vs 94% in Sep’21



Source: Company data, I-Sec research

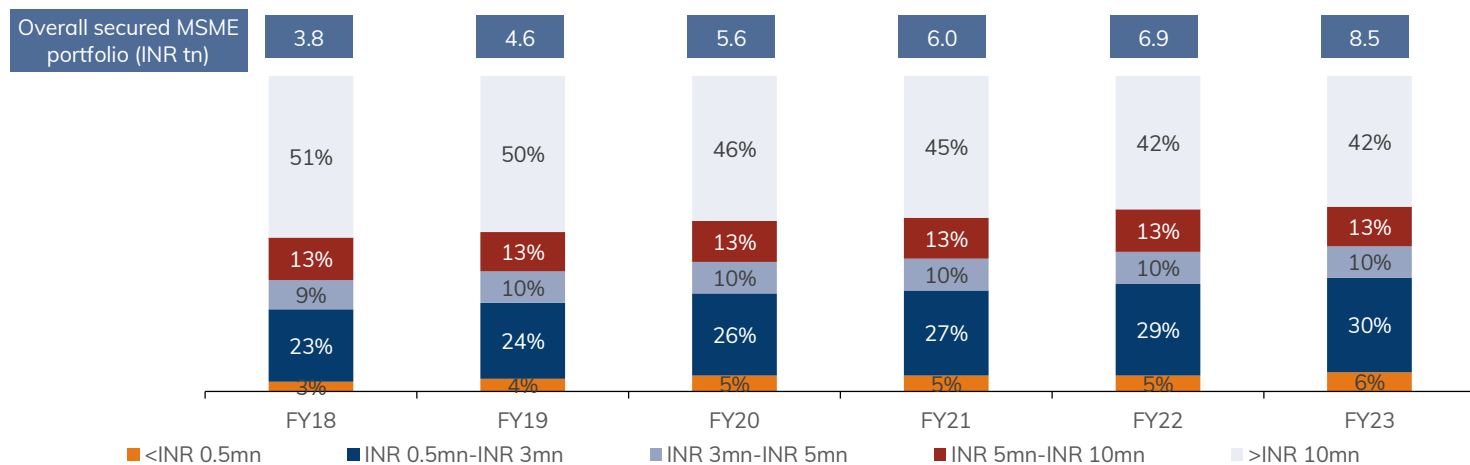
Exhibit 16: Number of micro enterprises financed through formal sources stands at <10% of total Udyam registration



Source: Company data, I-Sec research

S-LAP segment grew at a CAGR of 24% to INR 2.5trn and the same was higher than overall secured MSME portfolio growth at 18% between FY18-FY23. The same resulted in the share of small ticket LAP portfolio in overall secured MSME portfolio increasing to 30% in FY23 from 23% in FY18. The industry has seen further dip in the market as the share of secured MSME portfolio with less than INR 0.5mn ticket size has increased from 3% in FY18 to 6% in FY23.

Exhibit 17: Share of portfolio within ticket size of INR 0.5mn to INR 3mn increased from 23% in FY18 to 30% in FY23 in overall secured MSME portfolio



Source: Company data, I-Sec research

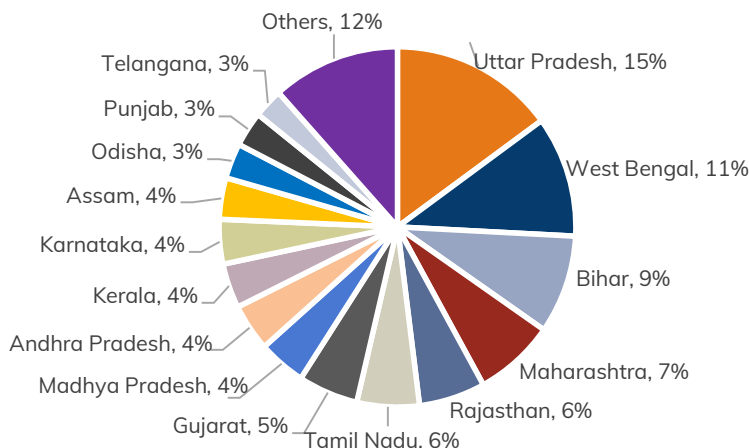
Top-5 states account for ~53% of outstanding loans, implying persistence of state-wise diversity in credit penetration

While overall S-LAP penetration remained low at <10%, our state-wise analysis suggests 5 states having penetration of >20% and for the rest it is between 1-15%. Penetration in Uttar Pradesh, Odisha, West Bengal, Assam and Bihar (high-growth states) is below 5% and these states cumulatively represent >40% of total addressable market.

Telangana, Karnataka, Tamil Nadu, Maharashtra and Gujarat have >20% penetration and account for 25% of the addressable market. Even for states with highest penetration, our district-wise analysis suggests top-5 districts account for >50% of outstanding AUM in these states, implying enough headroom for growth even in highly penetrated states.

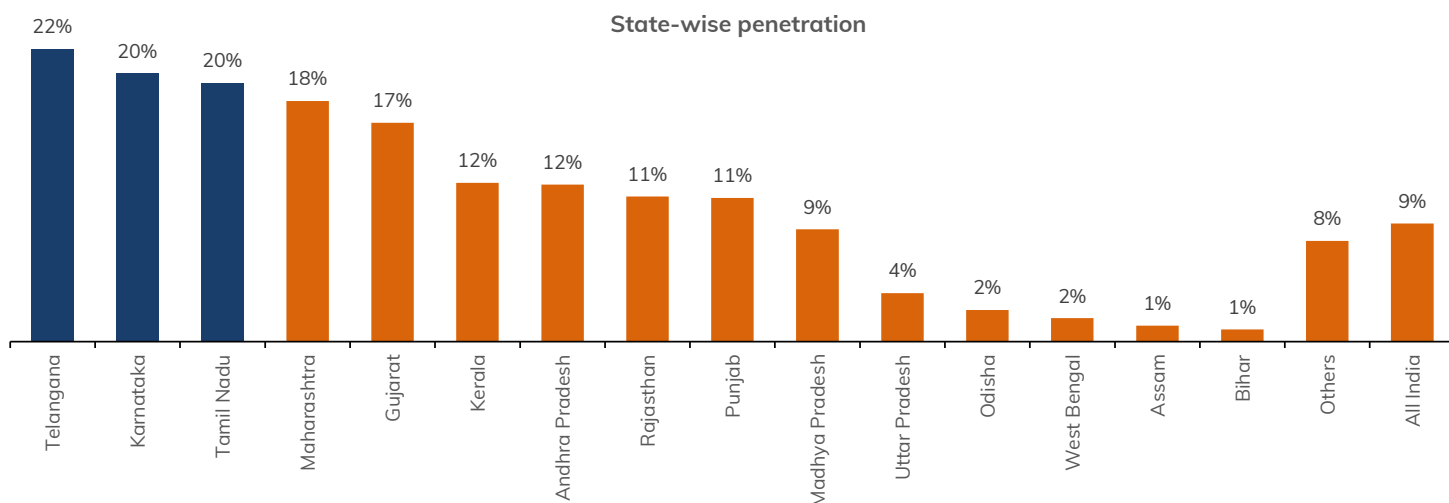
Top-5 states contribute >50% of the total outstanding secured MSME loans (INR 0.5-3mn) – Maharashtra, Tamil Nadu, Gujarat, Karnataka and Rajasthan.

Exhibit 18: State-wise addressable MSME market size break-up; UP, West Bengal, Bihar, Maharashtra and Rajasthan are taking 50% of the pie



Source: Company data, I-Sec research

Exhibit 19: Small-ticket LAP (ticket size between INR 0.5mn to INR 3.0mn) remained highly penetrated in Telangana, Karnataka and Tamil Nadu



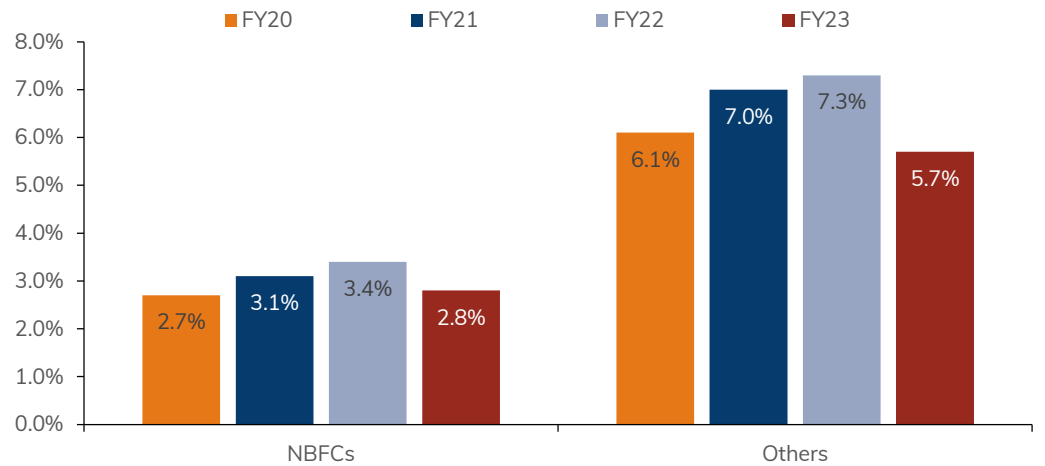
Source: Company data, I-Sec research

NBFCs have created niche in serving S-LAP segment as reflected in significantly lower GNPLs than industry average

Overall GNPL level remained marginally higher than other retail products at 4.2% as on Mar'23. The segment is not yet completely out of the woods as reflected in GNPL as on Mar'23 remaining higher than pre-covid level of ~3%. However, asset quality performance of NBFCs has been better than SFBs and banks. GNPL for NBFCs remained average 3% between FY20-23 vs average 6.5% for SFBs and banks. The same also reflects NBFCs' edge over other financiers in S-LAP segment.

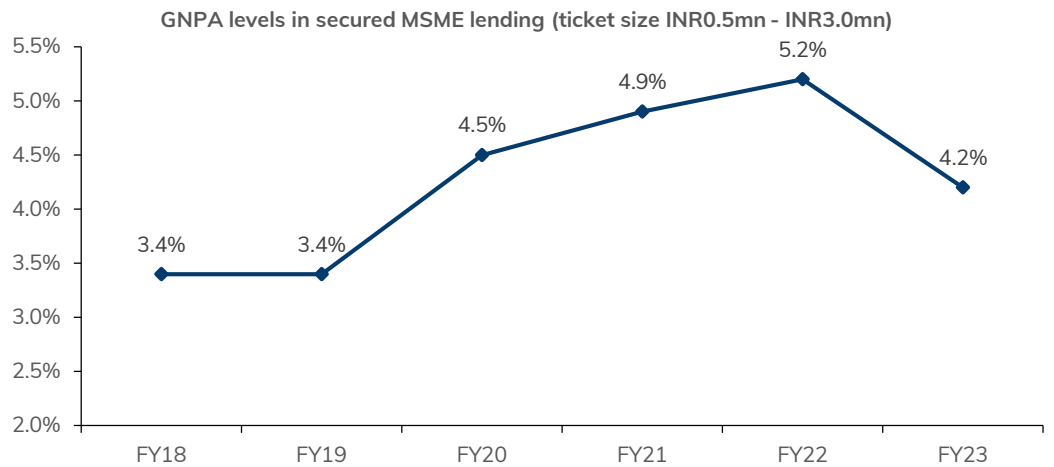
While the inherent customer profile is relatively risky than formal customer segment, the same gets offset by higher yields in this portfolio. Most players charge between 15-20%, while few operate in >20% yield category.

Exhibit 20: Asset quality for NBFCs is better than other financiers in loans with ticket size between INR 0.5mn- INR 3.0mn



Source: Company data, I-Sec research

Exhibit 21: GNPL level moderated to 4.2% in FY23 but still higher than pre-covid level



Note: (1) Data includes secured MSME loans for ticket size (₹0.5 million - ₹3.0 million) as reported in consumer bureau
 Source: CRIF Highmark, CRISIL MI&A

"In case of industry/sector reports or a report containing multiple stocks, the rating/recommendation for a particular stock may be based on the last released stock specific report for that company."

This report may be distributed in Singapore by ICICI Securities, Inc. (Singapore branch). Any recipients of this report in Singapore should contact ICICI Securities, Inc. (Singapore branch) in respect of any matters arising from, or in connection with, this report. The contact details of ICICI Securities, Inc. (Singapore branch) are as follows: Address: 10 Collyer Quay, #40-92 Ocean Financial Tower, Singapore - 049315, Tel: +65 6232 2451 and email: navneet_babbar@icicisecuritiesinc.com, Rishi_agrawal@icicisecuritiesinc.com.

"In case of eligible investors based in Japan, charges for brokerage services on execution of transactions do not in substance constitute charge for research reports and no charges are levied for providing research reports to such investors."

New I-Sec investment ratings (all ratings based on absolute return; All ratings and target price refers to 12-month performance horizon, unless mentioned otherwise)
BUY: >15% return; ADD: 5% to 15% return; HOLD: Negative 5% to Positive 5% return; REDUCE: Negative 5% to Negative 15% return; SELL: < negative 15% return

ANALYST CERTIFICATION

I/We, Renish Bhuvra, CFA (ICFAI); Vaibhav Arora, MBA; authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report. Analysts are not registered as research analysts by FINRA and are not associated persons of the ICICI Securities Inc. It is also confirmed that above mentioned Analysts of this report have not received any compensation from the companies mentioned in the report in the preceding twelve months and do not serve as an officer, director or employee of the companies mentioned in the report.

Terms & conditions and other disclosures:

ICICI Securities Limited (ICICI Securities) is a full-service, integrated investment banking and is, inter alia, engaged in the business of stock brokering and distribution of financial products. Registered Office Address: ICICI Venture House, Appasaheb Marathe Marg, Prabhadevi, Mumbai - 400 025. CIN: L67120MH1995PLC086241, Tel: (91 22) 6807 7100. ICICI Securities is Sebi registered stock broker, merchant banker, investment adviser, portfolio manager, Research Analyst and Alternative Investment Fund. ICICI Securities is registered with Insurance Regulatory Development Authority of India Limited (IRDAI) as a composite corporate agent and with PFRDA as a Point of Presence. ICICI Securities Limited Research Analyst SEBI Registration Number – INH000000990. ICICI Securities Limited SEBI Registration is INZ000183631 for stock broker. ICICI Securities AIF Trust's SEBI Registration number is IN/AIF3/23-24/1292 ICICI Securities is a subsidiary of ICICI Bank which is India's largest private sector bank and has its various subsidiaries engaged in businesses of housing finance, asset management, life insurance, general insurance, venture capital fund management, etc. ("associates"), the details in respect of which are available on www.icicibank.com.

ICICI Securities is one of the leading merchant bankers/ underwriters of securities and participate in virtually all securities trading markets in India. We and our associates might have investment banking and other business relationship with a significant percentage of companies covered by our Investment Research Department. ICICI Securities and its analysts, persons reporting to analysts and their relatives are generally prohibited from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover.

Recommendation in reports based on technical and derivative analysis centre on studying charts of a stock's price movement, outstanding positions, trading volume etc as opposed to focusing on a company's fundamentals and, as such, may not match with the recommendation in fundamental reports. Investors may visit icicidirect.com to view the Fundamental and Technical Research Reports.

Our proprietary trading and investment businesses may make investment decisions that are inconsistent with the recommendations expressed herein.

ICICI Securities Limited has two independent equity research groups: Institutional Research and Retail Research. This report has been prepared by the Institutional Research. The views and opinions expressed in this document may or may not match or may be contrary with the views, estimates, rating, and target price of the Retail Research.

The information and opinions in this report have been prepared by ICICI Securities and are subject to change without any notice. The report and information contained herein is strictly confidential and meant solely for the selected recipient and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ICICI Securities. While we would endeavour to update the information herein on a reasonable basis, ICICI Securities is under no obligation to update or keep the information current. Also, there may be regulatory, compliance or other reasons that may prevent ICICI Securities from doing so. Non-rated securities indicate that rating on a particular security has been suspended temporarily and such suspension is in compliance with applicable regulations and/or ICICI Securities policies, in circumstances where ICICI Securities might be acting in an advisory capacity to this company, or in certain other circumstances. This report is based on information obtained from public sources and sources believed to be reliable, but no independent verification has been made nor is its accuracy or completeness guaranteed. This report and information herein is solely for informational purpose and shall not be used or considered as an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ICICI Securities will not treat recipients as customers by virtue of their receiving this report. Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to your specific circumstances. The securities discussed and opinions expressed in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient. This may not be taken in substitution for the exercise of independent judgment by any recipient. The recipient should independently evaluate the investment risks. The value and return on investment may vary because of changes in interest rates, foreign exchange rates or any other reason. ICICI Securities accepts no liabilities whatsoever for any loss or damage of any kind arising out of the use of this report. Past performance is not necessarily a guide to future performance. Investors are advised to see Risk Disclosure Document to understand the risks associated before investing in the securities markets. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

ICICI Securities or its associates might have managed or co-managed public offering of securities for the subject company or might have been mandated by the subject company for any other assignment in the past twelve months.

ICICI Securities or its associates might have received any compensation from the companies mentioned in the report during the period preceding twelve months from the date of this report for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory service in a merger or specific transaction.

ICICI Securities or its associates might have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the companies mentioned in the report in the past twelve months.

ICICI Securities encourages independence in research report preparation and strives to minimize conflict in preparation of research report. ICICI Securities or its associates or its analysts did not receive any compensation or other benefits from the companies mentioned in the report or third party in connection with preparation of the research report. Accordingly, neither ICICI Securities nor Research Analysts and their relatives have any material conflict of interest at the time of publication of this report.

Compensation of our Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions.

ICICI Securities or its subsidiaries collectively or Research Analysts or their relatives do not own 1% or more of the equity securities of the Company mentioned in the report as of the last day of the month preceding the publication of the research report.

Since associates of ICICI Securities and ICICI Securities as a entity are engaged in various financial service businesses, they might have financial interests or actual/ beneficial ownership of one percent or more or other material conflict of interest in various companies including the subject company/companies mentioned in this report.

ICICI Securities may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report.

Neither the Research Analysts nor ICICI Securities have been engaged in market making activity for the companies mentioned in the report.

We submit that no material disciplinary action has been taken on ICICI Securities by any Regulatory Authority impacting Equity Research Analysis activities.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ICICI Securities and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

This report has not been prepared by ICICI Securities, Inc. However, ICICI Securities, Inc. has reviewed the report and, in so far as it includes current or historical information, it is believed to be reliable, although its accuracy and completeness cannot be guaranteed.

Investment in securities market are subject to market risks. Read all the related documents carefully before investing.

Registration granted by SEBI and certification from NISM in no way guarantee performance of the intermediary or provide any assurance of returns to investors. None of the research recommendations promise or guarantee any assured, minimum or risk free return to the investors.

Name of the Compliance officer (Research Analyst): Mr. Atul Agrawal, Contact number: 022-40701000, **E-mail Address** : complianceofficer@icicisecurities.com

For any queries or grievances: [Mr. Prabodh Avadhoot](mailto:Mr.Prabodh.Avadhoot) Email address: headservicequality@icicidirect.com Contact Number: 18601231122
