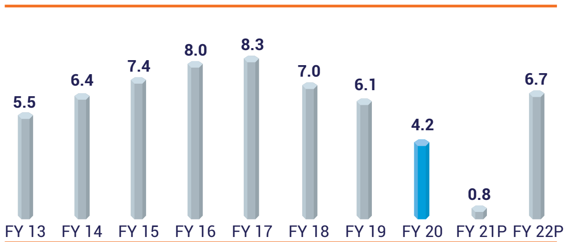
Management Discussion & Analysis

MACROECONOMIC OVERVIEW

Though the Indian economic growth has been faster than the world economy, it remained subdued as compared to previous years in FY20. The slowdown in the first 11 months of FY20 was mainly on account of the slump in the auto sector, contraction in capital goods output and slowdown in investment cycle. On the expenditure side, public expenditure remained moderately high whereas private expenditure was low as compared to the previous financial years. However, due to the onset of the COVID-19 pandemic in March, 2020 and the resultant lockdown, the output for March, 2020 has been low. India's services sector activity contracted during March as the COVID-19 pandemic dented demand, particularly in overseas markets. Business activity was reduced in response to weaker demand and firms responded by reducing their workforces as intakes of new business were insufficient to maintain payroll numbers. Indian economy grew by 4.2% in FY20 (Source: MoSPI).

Indian Economy Growth Output (%)



Source: MoSPI, Fitch

India Retail Inflation (%)

Source: Tradeindia.com / MoSPI

The retail inflation rate in India was at 6.58% in February, 2020 as compared to 7.59% in January, 2020 and 2.57% in February, 2019. The moderation in inflation has expectedly been led largely by food inflation while core inflation remains muted amidst moderate demand. The inflation trajectory is expected to continue to moderate going ahead led by deflationary trends from falling crude oil prices, lower food prices and weak demand. With domestic and global growth facing downside risks from the spread of COVID-19 and deflationary forces emerging along with cooling off of global crude prices, the inflation trend of India is expected to be impacted positively in future.

The outbreak of COVID-19 is the third shock to the economy in the last three & a half years, after demonetisation and GST. Prospects of a good Rabi harvest and stabilising high frequency data of the macro economy had raised hopes of a recovery after a deep slump. However, the shutdown due to the pandemic has derailed this nascent recovery. The government has enforced shutting down of non-essential businesses to prevent the spread of infection. The informal economy would be disproportionately impacted by these necessary steps. The recent weakness in consumption was partly driven by slowing income growth and a weak job market. The income growth or the job market is unlikely to improve given the disruption to the economy and hence growth is unlikely to recover till the first half of FY21. However, the Government along with the RBI has taken a slew of measures to reduce the slowdown, including:

1. All lenders can freeze repayments for six months (earlier 3 months) on term loans outstanding as on March 1, 2020
2. The Government of India along with the RBI has released a stimulus package of ₹ 20 trillion, which is approximately 10% of GDP. The package includes additional liquidity to sectors like NBFC (incl. HFC and MFI) and MSME, government guarantees on lending by banks, greater allocation to social spending schemes like MNREGA, direct bank transfers, free food grains for the poor, etc.
3. Out of the above ₹ 20 trillion package, the Government allocated ₹ 300 billion to buy investment-grade debt of NBFCs, HFCs and MFIs. The second measure is a partial guarantee scheme worth ₹ 450 billion on primary market paper sold by NBFCs.
4. Benchmark repo rate reduced to its lowest ever level of 4%
5. The time period for realisation and repatriation of export proceeds for exports made up to or on July 31, 2020, has been extended to 15 months from the date of export
6. Loans to commercial property projects that are delayed for reasons beyond the control of the developer are allowed to be treated as standard for another year

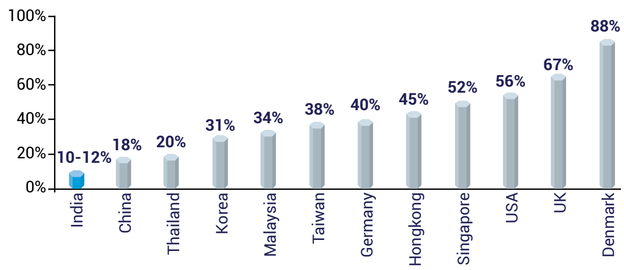
GDP growth is expected to be at 0.8% in FY21 (Source: Fitch). The pandemic is expected to subside in the second half of FY21. Also, the economic growth trajectory is highly dependent on a normal monsoon. The slump in growth is expected to remain in the first half of next fiscal. With expectations that the lockdown will be further eased slowly, the second half of FY21 should see recovery in growth.

INDUSTRY OVERVIEW

The housing finance market in India is financed by Scheduled Commercial Banks (SCBs) as well as NBFCs including HFCs. Though NBFCs and HFCs have different dynamics, HFCs will now be treated as one category under the NBFCs. In the interim Budget 2019, the Government handed over regulations of HFCs from NHB to RBI. However, till the time RBI issues fresh guidelines, HFCs will continue to be governed by NHB. The grievance redressal mechanism regarding HFCs will also continue to be with the NHB till then.

India's housing finance sector has remained relatively underpenetrated compared to its peers as evident by the low mortgage-to-GDP ratio (10-12% in FY19) as compared to its regional peers (FY15) (20% for Thailand, 18% for China, 34% of Malaysia) shown in the figure below (Source: CRISIL). While there has been substantial progress over the years, the sector continues to hold potential for long term growth.

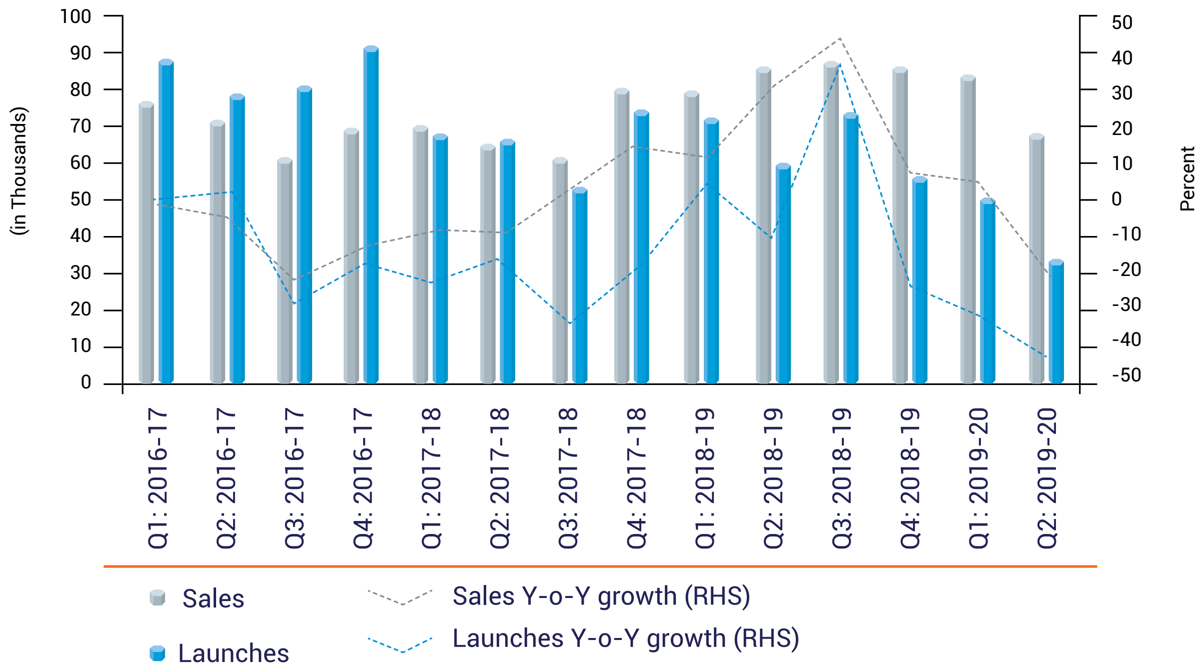
Low Mortgage Penetration (% of GDP) compared with other developing countries



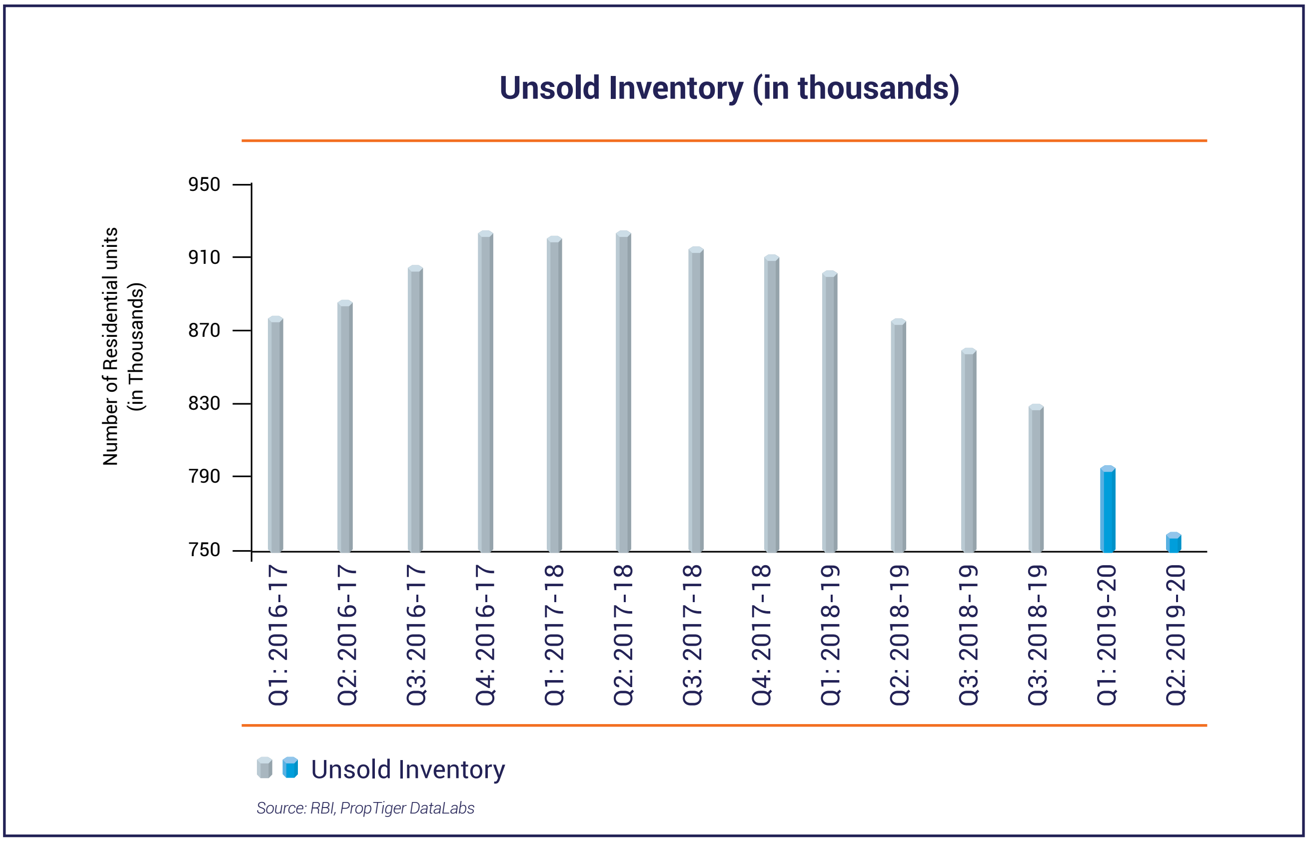
Source: CRISIL

Though housing prices in India reduced marginally, sales remained moderated in the first half of FY20. However, the launch of new projects fell down in H1FY20.

Number of Residential units (in thousands)



Source: RBI, PropTiger DataLabs



HFCs in India have shown rapid growth in its Asset under Management (AUM) from FY13 to the first half of FY19. It grew at a CAGR of 20% over the period (Source: CRISIL). This growth was mainly on account of the encouragement given by the Government to promote affordable housing in India, as a result of which demand for housing boosted in Tier 2 and 3 cities. Other factors that contributed to this growth were rising disposable income, increase in nuclear families and fiscal incentives on housing loans. However, the growth trajectory slowed down in H2FY19 and FY20. The second half of FY19 was marked by liquidity constraints which trickled over to FY20. HFCs are expected to grow by ~2% in FY20 (Source: Brickworks). The low growth rate in FY20 is also on account of the COVID-19 impact in March 2020, which halted disbursements and brought businesses across the country to a standstill.

Government measures for the Industry

The Government of India has given special focus for the housing sector in the Budget 2020 as well as to tackle the slowdown on account of COVID-19 lockdown.

Budget 2020

To boost affordable housing and achieve the vision of Housing for all by 2022, several initiatives have been undertaken, such as Pradhan Mantri Awas Yojana (PMAY) that aims to build 10 million homes in urban and rural India by 2022. In order to ensure that developers in this segment have access to cheaper loans, affordable housing has also been accorded infrastructure status.

Budget 2020 saw the Housing and Urban Affairs Ministry outlay touch ₹ 500.4 billion, 18.4% increase from the revised estimate of ₹ 423 billion for FY20. In 2020, the allocation for PMAY, the flagship scheme of the government, has been granted ₹ 275 billion as against the revised estimates of ₹ 253 billion in FY20, an 8.5% increase.

NHB Refinance

Also, the government has revised its ₹ 300 billion liquidity infusion facility scheme to encourage HFCs to avail refinance funds. Under the revised scheme, the earlier exposure cap of ₹ 7.5 billion per HFC and exposure ceiling of 50% of individual housing loan have been removed. The maximum exposure has been revised to 30% of HFCs net owned funds or 50% of NHBs net owned funds, whichever is lower. This scheme that was launched in August, 2019, can be availed till June 2020 by HFCs. This will help HFCs for their business expansion in FY21. In April 2020, the RBI also announced refinance facility for NHB worth ₹ 100 billion out of total ₹ 500 billion for various institutions. This is expected to boost liquidity in the system.

COVID-19 recovery

The Government of India has announced a ₹ 20 trillion economic package i.e. almost 10% of the GDP, which combined the government's recent announcements on supporting key sectors along with the measures rolled out by RBI to counter the COVID-19 impact. The goal is to address the problems of a wide range of sectors and become self-reliant.

Going forward

The resultant lockdown on account of the COVID-19 pandemic has slowed down businesses in the short run. Disbursements are expected to be low in H1FY21 and growth in H2FY21 will depend upon the extent of the pandemic spread and its impact on the economy. However, it is expected that businesses will pick up in the second half of FY21. **Co-lending** and **securitisation** are going to remain the catalyst of the next fiscal to boost HFCs growth trajectory. HFCs are expected to grow at 6% in FY21 (Source: India Ratings). HFCs are expected to fund a large size of their portfolio via assignment/ securitisation. This along with government measures, such as partial credit guarantee scheme, will improve liquidity and enable HFCs to better manage their asset-liability profile. One of the major synergistic partnerships between HFCs and banks-- co-lending, is expected to pick up pace in FY21. Banks can leverage HFCs' geographic reach and benefit from their origination and servicing capabilities, and HFCs will get access to better-profile clients and higher fee income. The affordable housing segment accounts for roughly 15% of the HFC portfolio. Given the government push towards affordable housing, co-lending in this space will provide required impetus to drive growth, hence it is attracting a lot of interest from banks.

OPPORTUNITIES

Affordable Housing

By the year 2030, more than 40% of the Indian population will live in urban India, as against the current figure of 34%, which is likely to create a demand for 25 million additional affordable housing units (Source: RICS and Knight Frank Report). Increasing urbanisation will boost per-capita GDP and increase the number of nuclear families. This in turn will lead to rise in demand for more urban households. Also, with the rate cuts announced by the RBI, housing demand is expected to improve along with the liquidity conditions of real estate companies in FY21. With the stock market witnessing a lot of fluctuation in these times of uncertainty, we anticipate that a lot of people will consider investing in property, as that is a more stable, long-term asset. Affordable housing segment is going to be the core growth segment for HFCs in the years to come.

Government Push for the sector:

The current government has viewed housing as the core of its economic policy and announced various schemes and policies to increase home ownership. It has been realised that in addition to its social aspects, housing is also a key driver of economic growth with its ability to create employment and its linkages to multiple other sectors. Housing is the fourth largest contributor to Indian GDP and the sector has the potential to become the engine of domestic growth for the Indian economy in the coming years.

The moratorium of six months on term loans, including home loans, would provide relief and enable real estate companies to focus more on the operational requirement and recalibrate their business strategies

Housing for Investment- Millennials

Millennials, especially financially independent women, are preferring investment in real estate from erstwhile gold and fixed deposits. Nearly 57% women respondents preferred real estate as an investment asset class followed by 28% for the stock market, 11% for fixed deposits and a mere 4% for gold (Source: Anarock-LIC Housing Finance Ltd consumer sentiment survey). Millennial women are emerging as a crucial homebuyer segment in India, unlike earlier being just a niche segment. This provide ample of opportunities for developers to include them as a major target customer. Also, the government of India to empower women of the low-income segment as per the Housing for All by 2022 mission, has made it mandatory for them to be either co-owners or sole owners of affordable homes.

Lower effective interest rates:

Pradhan Mantri Awaz Yojana (PMAY) subsidy and tax incentives have led to lower effective interest rates for the affordable housing sector borrowers. This will provide good demand for housing in FY21 and beyond.

Demand for rural and semi urban sector:

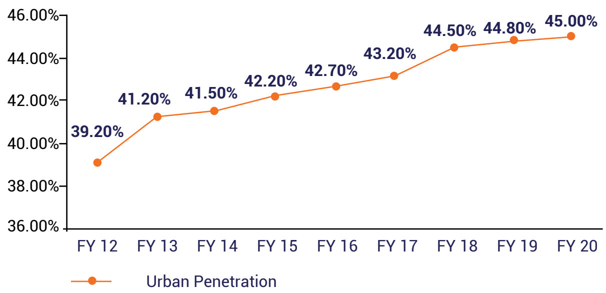
With rising rural incomes and the government investing heavily in enhancing rural demand, in the coming years there could be high demand coming from the rural and semi-urban areas.

Rising Finance penetration

With growing urbanisation and rising finance penetration in India, the growth in housing finance sector is expected to rise. With this, like in FY20, in FY21 also the demand for housing is expected to come from tier II and tier II cities in urban areas. The finance penetration in Indian urban areas rose from 39.2% in FY12 to an estimated 45% in FY20

(Source: CRISIL). With more number of people moving from rural to urban areas, growing digitisation and financial awareness, these trends are only expected to rise in the years coming.

Uptick in finance penetration in urban areas (%)



(Source: CRISIL)

Threats

Fall in real estate sales and unsold inventory

Enforcement of the nationwide lockdown following the spread of COVID-19 has caused a temporary slump in housing sales. Also, a slowing economy along with constraint in liquidity may cause reduction in sales and thereby leading to rise in unsold inventory. This may dissuade developers from launching new projects. Fall in real estate sales and unsold inventory remains a threat in FY21.

Disruption by new/emerging technologies

Besides using AI and Natural Language Processing (NLP) for first level customer interactions (chat box etc.), finance companies are using AI for risk management, marketing, portfolio management, HR, hiring, collections, and employee on-boarding. As companies grow digital channels, business growth increases the risk of doing business with an unknown entity on the other side of the device. High volumes of online payments, require review of vast quantities of transactions in thousands of a second, to manage existing compliance requirements.

Increasing Competition

Increasing competition from Banks to gain market share in the growing affordable housing segment could be a challenge for HFCs.

COMPANY OVERVIEW

IIFL Home Finance Limited (IIFL HFL) (previously known as India Infoline Housing Finance Limited), incorporated in 2006, is a 100% subsidiary of IIFL Finance Limited (IIFL). IIFL HFL got registered with National Housing Bank (NHB) in 2009 and commenced operations. In line with its motto,'Ghar Aapka, Loan Hamaara', the Company majorly provides home loans to customers for purchasing affordable homes. Besides, loans are also offered for home renovation and home construction. Loan against Property is provided to Small and Medium Enterprises (SMEs) for their working capital requirements, business use and to acquire commercial property and construction financing.

The Company is guided by the professional values and ethos of its parent and ultimate holding company, IIFL Finance. The Company has gained a reputation for reliability, transparency of operation and absolute integrity. Over the years, the Company has maintained its high quality loan and investment portfolios through focused customer approach, a comprehensive risk assessment process and thorough risk remediation procedure. The Company aims to focus on steady earnings growth through conservative risk management techniques and by accessing low-cost funds.

Business Overview & Strategy

In FY20, the company closed the year with total loan assets under management of ₹ 184,947.4 million and balance sheet size of ₹ 144,970.7 million. The home loan contribution to total loan book remains stable y-o-y at 67% with continued focus on low ticket size loan. Through our Swaraj Home loans, a dedicated home loan product to cater to the needs of underserved section of the society, the Company has continued to support the Government in its vision of "Housing for All". The Company benefited 38300+ customers with ₹ 9,000+ million subsidy till date.

During the year the Company has been able to securitise and assign ₹ 28,100.6 million worth of assets, enabled by the trust and confidence of our securitisation investors and our portfolio quality. The acceptance of IIFL Home Finance granular loan book portfolio across investors is a testimony of its strong underwriting capabilities and strong portfolio quality.

Strength

Wide Presence: Our network of brick and mortar branches and channel partners coupled with digital touch points (Website and Mobile App), enables us to build enduring bonds of trust and loyalty with the customers. As on March 31, 2020, we have 127 branches nationwide to support mid income affordable housing segment. In addition to our network and online channels, we have vast Group's network of 2300+ touch points to reach potential customers in Tier II & Tier III cities.

Customer First Approach: Knowledgeable, attentive and empathetic Customer First approach is at the core of our operations. With wide range of customised products, continued focus on customer experience, transparency in all our operations and process and investment in creating cutting edge technology have enabled us to serve more than 1,24,000+ customers over the years.

Prudent credit policy and process: We have robust in house credit appraisal process. Our credit policies are designed to mitigate risk and formalise procedures for determining acceptable risk. We have also brought smart technologies for a flawless credit appraisal, underwriting and monitoring, leading to seamless end to end loan sanction process. Robust credit approval mechanism, credit control processes, audit and risk management process and policies have helped us to maintain our portfolio quality.

Focus on Technology: We continue to invest in cutting edge technologies to expand our technology landscape and upgrade innovative technology solutions, thereby increasing customer delight and employee efficiency. The technology platform covers all functions starting from sales to loan underwriting, customer management, collection management and financial accounting.

The mobile platform empowers our employees to manage their work on the go thereby improving the overall employee experience and efficiency.

The investment in technology has not only helped us in improving customer experience, but also in reducing operating cost and development of new business opportunities.

SEGMENT OVERVIEW

Home Loans

We offer affordable home loans to diverse set of customers such as salaried, self-employed, professionals and entrepreneurs. We provide financial aid for home purchase, home renovation, home construction and plot purchase. Through our affordable home loans offering - Swaraj Home Loans, we cater to the underserved segment of the country. Home loan constitutes 74% of the total disbursements in FY20 of which affordable segment were 39%.

Our retail loan processing is done through our proprietary application "Jhatpat Loans" in which underwriting is automated with pre-defined business rule engines thereby leading to reduced TAT and increased standardisation of decisions.

Loan Against Property (LAP)

We offer loans backed by mortgage of residential or commercial properties to small and medium enterprises. These loans are predominantly used for working capital requirement, business use and purchase of commercial property. We also offer small ticket size variant named Samman. LAP contributed 15% of the disbursed units in FY20.

Project Loans

The developers often need size-able funds for the construction and development of residential and mixed-use projects. A strong emphasis is being placed on the identification of environment & social friendly projects with Green Certification for funding under this segment. In line with our broader retail strategy also, a project loan is an important offering to the developers. The projects funded under the Construction Finance vertical provide an opportunity for retail home loans via the Approved Project Finance route. The contribution of construction finance loans within the total disbursements was only 10% in FY20.

FINANCIAL OVERVIEW

For the financial year ending March 31, 2020, AUM of the Company has grown by 2% y-o-y to ₹ 184,947.4 million from ₹ 181,578.3 million, as on March 31, 2019. At the segment level, there is moderate growth in the home loan and LAP segments whereas the real estate segment has de-grown y-o-y. Loan book has de-grown by 4% y-o-y to ₹ 128,139.6 million as on March 31, 2020 from ₹ 134,002.6 million as on March 31, 2019. Loan Book growth has de-grown in comparison to AUM growth due to high assignment of portfolio during the year.

For FY20, IIFL Home Finance reported a Profit After Tax (PAT) of ₹ 2,449.2 million down by 20% y-o-y. The decline in profit has been mainly on account of the additional provisioning for COVID-19 impact. Operating profit (excluding provision and Write off) was down by only 3% y-o-y. With a capital adequacy of 23.7% (Tier-I CAR of 18.4%), the Company is well capitalised for growth. The Company has striven to maintain the key qualitative and quantitative parameters. The Company has continued to maintain decent return ratios, RoA of 1.8% and ROE of 13.8%. Gross NPA (IND AS) is 1.6% with provision coverage ratio of 23.5% for the year under review. Provision coverage ratio including standard asset provision (Stage1 and Stage 2) stands at 84.5%.

Provision charge for Expected Credit Loss, including additional COVID-19 provision, as a percentage of average loan book stands at 1.0%.

RISKS AND CONCERNS

Risk Management

The Company has a well-defined risk governance structure which includes periodic reviews and close monitoring to enable building a sustainable business that takes care of the interests of all stakeholders. The Company's risk management policy is steered by the Board, with the overall responsibility assigned to the Risk Management Committee.

Regulatory Risk:

Regulatory risk is the risk that can materially impact a company due to changes in laws and regulations made by the government or a regulatory body like NHB, SEBI etc. It can increase the costs of operating the business, and/or change the competitive landscape. The Company is able to mitigate the same by making quick change in its systems and practices to realign itself with the changed regulatory framework from time to time as required.

Credit Risk:

Lending involves a number of risks, largely related to the creditworthiness of the borrowers. A credit risk is the risk of default that may arise from a borrower failing to make payments towards their debt .This is inherent and most dominant of the risks in the lending business. The credit risk arises because of the quality of the loan portfolio and it is extremely important to control this risk.

We have well defined policy guidelines which are built in the "Jhatpat application" for rule based underwriting which reduces the frequency of judgment-based errors. We use technology to verify the identity and other loan documents submitted by the borrower along with digital underwriting. This integration of new data sources enables better insights for credit decisions, while real-time data processing, reporting, and monitoring further improves overall risk-management capabilities.

Our portfolio management uses advanced analytics and machine-learning tools to identify the problematic loans at an early stage. Based on the continuous review mechanism, credit policies and processes are being reviewed and appropriate changes are undertaken.

An independent internal audit team conducts regular review of credit files on a sample basis to ensure adherence to the policies.

Operational Risk:

Operational risk management is defined as a continuous process which includes risk assessment, decision making, and implementation of controls, which results in acceptance, mitigation or avoidance of risk. To have a preventive vigilance and control the transaction risk, Risk Containment Units have been established at major locations, wherein hind sighting, upfront scrutiny and curbing of malpractices are undertaken. Operational costs are also reduced as credit processes are digitised. A greater share of time and resources can be dedicated to value-added activities, as inputs and outputs become standardised and paperless.

INTERNAL CONTROL SYSTEMS AND THEIR ADEQUACY

The Company has an elaborate system of internal controls commensurate with the size, scale and complexity of its operations. Regular internal audits are conducted to check and to ensure that responsibilities are discharged effectively. The Internal Audit Department monitors and evaluates the efficacy and adequacy of internal control systems in the Company, its compliance with regulatory directives, adherence to the accounting procedures and policies. Wherever required, the internal audit efforts are supplemented by audits conducted by specialised consultants/audit firms. Based on the report of the Internal Auditors, process owners undertake corrective actions, in their respective areas and thereby strengthen the controls.

The Company has also placed its focus on making its internal control system digitalised. The Company has introduced an in-house internal control system software for better monitoring of audit processes at PAN India level.

HUMAN RESOURCES

Our people supported by digital power will prove to be our competitive advantage. To ensure that we remain agile and focused, we are harnessing digital power to build upon people and organisational capabilities. We are on our way to have an all inclusive digital ecosystem which will create a culture of fairness, transparency and process & policy compliance and hence ensure a sustainable and measurable organisational and people performance. We are creating a unique employee on-boarding experience, getting the right job-fit candidates in the system and ensuring right and timely interventions at each stage of employee life cycle at IIFL Home Finance, so that there is a unique employee journey for each employee to experience here.

TRAINING & DEVELOPMENT

Our Money Versity app offers a variety of business, domain & wellness centered channels for our employees. We have helped the employees learn on the go in a very engaging multimedia & interactive way. For the high-fliers there are MDPs at premier B-schools to ensure their growth in organisation is well-supported. The Company arranges Classroom Training for First Time managers across functions. Also, there are customised Lunch Bunch Sessions for specialised teams focusing on enhancing team bonding & cohesiveness.

PERFORMANCE MANAGEMENT & REWARDS

We have a fair and transparent performance appraisal system for employees across all levels and functions with a 4 point rating scale- Flyer, Runner, Learner, Walker. We have introduced LEAP Program for the sales workforce pan India in order to focus on continuous assessment of the targets achieved by the team. We encourage and reward our best performers, both individual and at team level, during the annual R&R program- PRIDE 4.0

EMPLOYEE ENGAGEMENT AND WELLNESS

Employee centered chat bot have been introduced for all employees to capture their real time sentiment across various tenures within the organisation. The leadership also connects with the teams every quarter during the 'CPlogue: HFC Townhall with the CEO', to address all employee queries, discuss game plan for the coming quarter and share achievements of the quarter gone by. Focus has been given on Employee health and wellness by introducing the new Healthify App for the employees to keep a tab on their health parameters.

Our workplace is on the path of becoming more inclusive and sustainable with focus on Complete Profitability, an ESG initiative. It is our aim to empower our employees to create their own Complete Profitability story through everyday steps towards sustainability. IIFL Home Finance has been recognised as a Great Place to Work for the 2nd time in a row. This year, 78% of our sampled employees rated the organizational culture & employee practices at 4 and above, on a scale of 5 (5 being the highest).

As on March 31, 2020, the Company has a strong workforce of 2,131 employees.

OUTLOOK

Though the COVID-19 pandemic is expected to result in significant adverse economic impacts globally, Indian economy is expected to show moderate growth in H2FY21 mainly dependant on the expected economic activity spurt in the second half of FY21. Private consumption growth is expected to face strong headwinds. With the restrictions on non-essential activities getting lifted in less contagious regions in the country coupled with an increase in government expenditure, we can expect an uptick economic recovery in the second half of the FY21.

For IIFL Home Finance Limited,

Monu Ratra
Executive Director & CEO
DIN: 07406284

Date: June 7, 2020
Place: Gurugram

Sumit Bali
Director
DIN: 02896088

Date: June 7, 2020
Place: Mumbai