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Initiating Coverage

IIFL Finance Ltd.

28-April-2021

RETAIL RESEARCH

IIFL Finance Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
NBFC	Rs.266.2	Buy at LTP and add further at Rs.241	Rs.290	Rs.319	2 quarters

HDFC Scrip Code	IIFFINEQNR
BSE Code	532636
NSE Code	IIFL
Bloomberg	IIFL:IN
CMP Apr 27, 2021	266.2
Equity Capital (RsCr)	75.7
Face Value (Rs)	2
Equity Share O/S (Cr)	37.85
Market Cap (Rs Cr)	10,084
Adj. Book Value (Rs)	133
Avg. 52 Wk Volumes	1033529
52 Week High	346.55
52 Week Low	58.15

Share holding Pattern % (Mar, 2021)	
Promoters	24.96
Institutions	59.47
Non Institutions	15.57
Total	100.0

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Our take:

IIFL Finance Ltd (erstwhile IIFL Holdings Ltd) is one of the leading retail focused diversified NBFCs in India, engaged in the business of loans and mortgages along with its subsidiaries IIFL Home Finance Ltd and Samasta Microfinance Ltd. IIFL Finance, through its subsidiaries, offers a wide array of products. The growth in company's AUM which was at ~10% over the past two years till end of FY20 has picked pace and risen 11.1% in three quarters of FY21 to Rs.42,264 cr in December 2020. The company has been constantly focusing on building a granular retail franchise and thereby de-risking its business model. As of Q3FY21, the home loans segment constituted 32% of the total AUM, while gold loans constituted 29%, business loans 18% and microfinance loans 9%. Retail Lending and Digital Delivery is recognized as the cornerstone of the company's long-term strategy. Retail loans accounted for almost 90% of the AUM as of Q3FY21. It has been aggressively expanding its reach, mainly in Tier 2 and 3 locations, which hold ~85% of its total branches. Over the past five years, the company has more than doubled its branch network from 1,161 branches in FY15 to 2,439 branches in Q3FY21. The strategy of higher focus on retail loans has helped the company fetch higher margins; moreover, the segment is inherently less risky in terms of asset quality. The company is adequately capitalized and has a well-diversified resource profile.

IIFL Finance is led by a highly experienced management team with strong expertise in the financial services domain and is owned by marquee investors. As of Q4FY21, promoters hold 24.96%, the Fairfax group holds 22.4%, CDC Group PLC holds 15.44% and other foreign investors hold 21.50%. But the stock is under Additional Surveillance Measure (ASM) long term stage 1, which necessitates the presence of a high-risk appetite for taking short term positions in the stock.

Valuations and recommendation:

We have envisaged 19% CAGR for consolidated net interest income and 39% CAGR for net profit over FY20-FY23E. We have estimated that loan book would grow at 13.4% CAGR with maximum growth likely to come from retail lending book. The initial asset quality picture post moratorium seems positive and collection efficiencies have also reached the pre-COVID level. We believe that from FY22 onwards, the NPAs will start to reduce. We expect margin to remain stable around 8.5% while RoAA is expected to reach 3.1% in FY23 vs 2.3% in FY21E.

IIFL Finance Ltd.

We believe investors can buy IIFL Finance Ltd buy at LTP and add further at Rs.241 (1.23xFY23E ABV) for the base case fair value of Rs.290 (1.5xFY23E ABV) and bull case fair value of Rs.319 (1.63xFY23E ABV) over the next two quarters.

Financial Summary

Particulars (RsCr)	Q3FY21	Q3FY20	YoY-%	Q2FY21	QoQ-%	FY19	FY20	FY21E	FY22E	FY23E
NII	573.2	366.1	*56.6*	545.4	*5.1*	1924.7	1646.5	2148.3	2482.6	2741.9
PPOP	615	271	*127.3*	563	*9.2*	1394.7	1191.5	2326.6	2489.3	2753.9
PAT	268.3	182.5	*47.0*	212.6	*26.2*	796.3	553.6	854.7	1206.7	1478.6
EPS (Rs)						21.1	14.6	22.6	31.9	39.1
ABV (Rs)						110.8	118.6	135.6	162.1	196.0
P/E (x)						12.6	18.2	11.8	8.3	6.8
P/ABV (x)						2.4	2.2	2.0	1.6	1.4
RoAA (%)						2.0	1.6	2.3	2.9	3.1

(Source: Company, HDFC sec)

Q3FY21 Result Update

IIFL Finance's net profit was Rs.268.3 cr in Q3FY21, which was up 26% QoQ and 47% YoY. The company recorded the highest-ever pre-provision operating profit (PPOP) of Rs.615 cr during the quarter, which was up 9% QoQ, 127% YoY. It was driven by volume growth, reduction in cost of funds, and higher efficiency in management of operating costs. AUM grew by 3%/17% QoQ/YoY to Rs.42,264 cr. Disbursements across core segments for the quarter were significantly higher than those at the same time last year. Disbursements for home loan grew by 90% YoY, gold loans by 25%, business loans by 43% and microfinance loans by 61%. Consolidated GNPAs and NNPAs stood at 1.61% and 0.77% as against 1.81% and 0.77% respectively in the September quarter. Without considering the effect to the Supreme Court interim order, proforma, GNPA and NNPA would have been 2.87% and 1.46% respectively. Collection efficiency across segments have bounced back to near pre-COVID levels. In Q3FY21, Gold Loan collection efficiency stood at 95%, while Home Loan stood at 90%, Business Loans at 75% and Microfinance at 77%. The company's annualized ROE and ROA for Q3FY21 stood at 18.4% and 2.6% respectively.

The assigned loan book, currently at Rs 11,371 Cr, is 27% of AUM. Besides, there are securitized assets of Rs.3,201 Cr. There exists significant opportunity for further assignment and securitization, given its granular and retail book.

Total CAR stood at 21.4% including Tier I capital of 18.0% as at December 31, 2020, as against statutory requirement of 15% and 10% respectively.

Segment Detail Q3FY21

Particulars	% Portfolio Share	GNPA %	NNPA%	Portfolio Yield %	Portfolio Avg Ticket Size (Rs. Lk)	Portfolio LTV %	Collection Efficiency trends (%)
Home Loans	32%	1.1%	0.9%	10.3%	17.8	71.0%	90.0%
Gold Loans	29%	0.0%	0.0%	18.9%	0.6	72.0%	95.0%
Business Loans	18%	3.3%	1.6%	15.9%	13	47.0%	75.0%
Microfinance	9%	2.2%	0.0%	21.6%	0.2	-	77.0%
Construction & Real Estate	10%	2.7%	1.3%	14.5%	3643.7	47.0%	
Capital Market Finance	2%	0.0%	0.0%	13.1%	122.6	35.0%	
Total	100%	1.6%	0.8%	15.4%			

(Source: Company, HDFC sec)

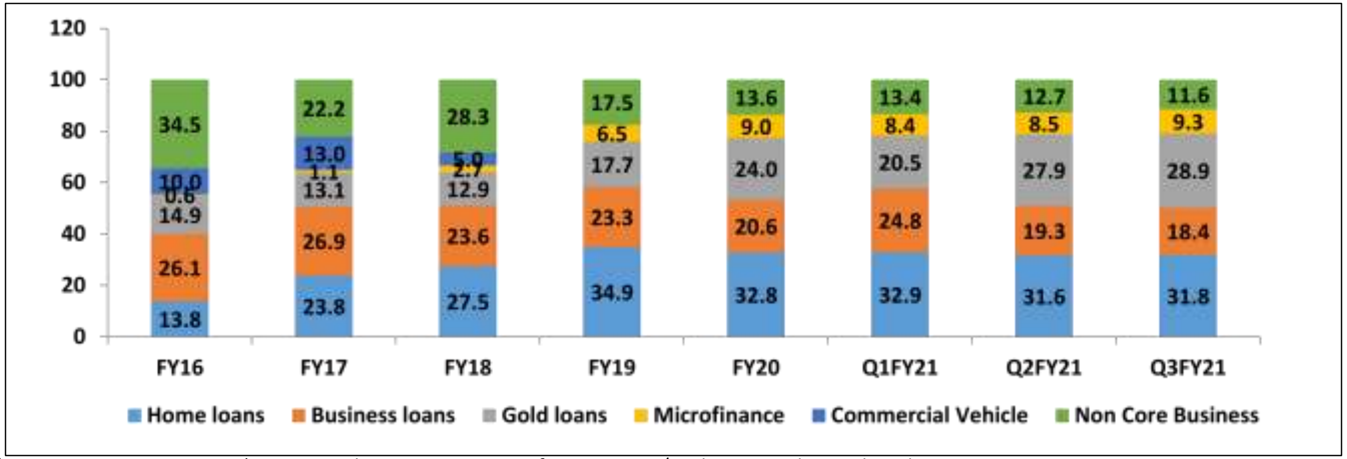
In line with the strategy of growing by partnership model during the quarter, the company entered a co-lending arrangement with Standard Chartered Bank and ICICI Bank for extending home loans and secured MSME loans.

Long-term triggers

Diversified portfolio

Strong physical and digital infrastructure enables the company to give customers the highest standards in service. Through its pan-India network of branches and customer touch points, backed by a robust digital infrastructure, the company provides a comprehensive range of financial products and services to customers. It has 2,439 branches spread across 25 states, ~85% of which are in Tier 2 and Tier 3 cities. The company has a diverse product spectrum such as Home Loans, Gold Loans, Business Loans including LAPs and MSME Financing, Microfinance, Construction and Real Estate and Capital Markets Finance. The AUMs stood at Rs. 42,264 Cr as on 31 December 2020, with home loans constituting 32% of it, while gold loans constituted 29%, business loans 18% and microfinance loans 9%. IIFL Finance and its subsidiaries have partnered with three banks for sourcing and co-lending: Standard Chartered Bank, ICICI Bank, and CSB Bank.

AUM Mix Trend (%)



(Source: Company, HDFC sec) #Non-Core business comprises of Construction/Real estate and Capital Market Finance segment

Home loans

In Q3FY21, the retail home loan asset stood at Rs. 13,445 cr with average ticket size of Rs.17.8 lakhs. The key product offerings in this segment include affordable home loans and non-metro housing loans. Apart from this, it also provides loans for home renovation, home construction and plot purchase. Its primary focus is on affordable and non-metro housing finance to customer segments across Tier 1 suburbs, Tier 2 and Tier 3 cities. Its business strategy is aligned with government mission of “Housing for All”. Around 49,500 customers were benefitted with a subsidy of over Rs 1,000 cr under the Pradhan Mantri Awas Yojana – Credit Linked Subsidy Scheme. 60% of the customers are salaried.

The mortgage penetration in India is substantially low compared to the developed and other developing nations, leaving huge scope for growth in demand for housing loans, which would be furthered by (a) interest subsidy by government on affordable housing; (b) favorable demographics, (c) increasing affordability, (d) rapid urbanization. In light of these factors, mortgage penetration in India will increase substantially, going forward. The demand for affordable housing alone could be 25 mn homes by 2022-23, which is four times the entire current housing stock. All these factors show that the housing industry is in a decadal structural upswing and in a good place for delivering future growth.

Since the past five years, the residential real estate sales were almost stagnant. The COVID-19 pandemic has created a sharp price cut in the segment. The early economic indicators are encouraging. The government's constant aids to the sector along with lowest interest rates are the main factors why we believe that the real estate and the housing finance sectors have bottomed out.

Gold loans:

IIFL began with the gold loan business in 2010 in order to diversify its product portfolio. Over the past decade, from negligible presence in this segment, the company has scaled up its gold loans AUMs to Rs. 12,212 cr in Q3FY21. Gold loans are provided through its widespread presence in 600+ cities across 25 states to salaried, self-employed, and MSME customer segments. The average ticket size is ~ Rs 60,000 with tenure of ~1 year. The strong emphasis on collections and resolution has resulted in negligible losses. The company has in-house loan origination and tablet application, which is equipped to screen customers for earlier defaults, frauds, and negative customer lists.

India's gold loan market is expected to reach Rs 461,700cr by 2022, growing at a five-year CAGR (FY18 to FY22) of 13.4%, according to a report by KPMG. 25,000 tonnes of gold is held by Indian Households (65% in Rural India) and 47% of total gold globally is in the form of jewelry. Organized gold loan penetration remains significantly low, providing ample opportunity for organized financiers' loan book growth. The overall gold loan stock with the organized sector forms a minuscule part of the total gold stock in the economy. However, this has been increasing at a steady overall pace. The organized gold loan market comprising banks (public, private, small finance, and co-operative), non-banking finance company (NBFCs) and Nidhi companies contribute to nearly 35 % of the Indian gold loan market. Stable gold price outlook and instant disbursal and risk aversion by lenders will push borrowers to pledge gold in exchange for loan.

Microfinance:

The MFI segment has witnessed a phenomenal growth post acquisition of Bengaluru-based microlender Samasta Microfinance Ltd in FY16. The total assets of this company as on FY16 stood at ~Rs.100cr. The company has scaled up its microfinance business by almost 40x at present and has loan AUMs of Rs 3,920 Cr as on 31 December 2020. The company offers small ticket micro loans to self-employed women for income generating activities, based on a joint liability group model. Through deep presence in rural and semi-urban areas (17 states, 232 districts), it promotes the wellbeing of communities by providing micro loans, credit linked insurance and group-based savings accounts. The microfinance customer base increased to over 15 lakh customers. The average ticket size of micro finance loans stood at ~Rs 20,000 with ~2 years tenure.

The MFI segment has faced numerous disruptions over the past decade and bounced back even stronger. With every crisis, the industry has consolidated. Now, the industry AUMs are largely concentrated in the hands of the top 6-7 players, which currently account for ~50% of the total. Penetration levels have improved over the past few years, but the opportunity is still huge. Rural area is highly underpenetrated with low competition. We believe this segment would drive future growth. . IIFL Finance has a unique positioning in Joint Liability Group - JLG-based lending, especially to women customers, in the underserved rural areas, which puts it in a sweet spot.

Business loans:

Under the business loan segment, the company offers products like small ticket Insta loans, cash flow backed business loans, and Loans Against Property (LAP). As of Q3FY21, the AUM stood at Rs.7,788 cr, with 69% secured loans. The average ticket size as of Q3FY21 is Rs 7 lakhs and the tenure is up to 12 years. The company has been aggressively focusing on scaling up and increasing the pie of its small ticket size loans with extremely low delinquencies. This is clearly evident from its constantly decreasing average ticket size (ATS). Its ATS has decreased from Rs. 89 lakh in FY16 Rs.18 lakh as on FY20. As a result, the business loans segment, which constituted almost 51% of its AUM in FY11, has come down significantly to 21% in FY20. Along with this, on the positive side, there has been a constant improvement in its boarding yield, which has grown from 13.4% in FY16 to 19.6% in FY20. The credit gap in the MSME segment is high in India. MSME contributes significantly to economic growth and is one of the critical growth engines for the 2024 milestone. The future remains positive for the sector.

Construction and real estate

In this segment, it provides loans to developers for construction and development of residential and mixed-use projects. Affordable residential projects contribute 75%, followed by mid-income, premium and commercial, which contribute 11%, 7% and 7% respectively. As of FY20, Construction and Real Estate constituted 12% of total AUMs while its average ticket size stood at Rs, 28cr.

IIFL Asset Management Ltd(IIFL AMC) has executed a binding term sheet with a renowned global alternate investment manager (investor) for 33.3% contribution by the investor in the AIF, subject to due diligence to satisfy the investor. The AIF will have sponsor’s contribution of around 33.3% from IIFL Finance Ltd. The balance contribution in the AIF is expected from other investors. The AIF will have target size of Rs.3,600 cr for secondary purchase of NCDs of real estate projects and provide additional liquidity for completion of the same.

Capital Market Finance

As of Q3FY21, the company has AUM of Rs.580 cr. It offers short term loans secured by pledge of listed equity shares, vested ESOPs, equity and debt mutual fund units, structured notes, bonds, and debentures. The average ticket size of the loans stood at ~0.9 cr.

Retail focused business strategy

Retail Lending and Digital Delivery is recognized as the cornerstone of the company's long-term strategy. It aims to address the emerging financial requirements of the retail lending market with diversified credit solutions and leading-edge technologies. Retail loans accounted for almost 90% of the AUM as on 31 December 2020. The company has greater access to finance in Tier 2 and 3 markets via widespread branch network and digital means. Going forward, the group plans to leverage business synergies with other IIFL entities for cross-selling of financial products. The retail focus helps the company fetch higher margins; moreover, the segment is inherently less risky in terms of asset quality.

Adequate capitalization

IIFL Finance is adequately capitalized with total CAR at 21.4%, including Tier 1 capital of 18.0% as on 31 December 2020, as against the statutory requirement of 15% and 10% respectively. During the quarter, the company raised Rs 3,987 cr through term loans and refinance from banks. Cash and cash equivalents and committed credit lines from banks and institutions of Rs 5,149 cr were available as on 31 December 2020. It has surplus liquidity (positive ALM) across all the time buckets. Adequate fund raising has also enabled IIFL Finance to grow its AUM in the last few quarters.

Also, the company has a well-diversified resource profile, with increasing share of bank loans. As of Q3FY21, 52% of borrowing mix was contributed from Term Loans, 37% from Bonds and 11% from Refinance.

Effective risk management

The company has set robust risk filters and systems that enable it to detect early warning signals and embrace appropriate actions. It has in place product specific lending policies, credit approval committees, and regular monitoring of exposures. It routinely monitors credit risk, risk concentration and compliance with board approved policies. Credit monitoring for retail products is undertaken at portfolio level wherein risk assessment is undertaken on various parameters like demographics, sector, and geography, among others. The Effective Risk Management framework has helped the company consistently maintain higher asset quality across business cycles.

Experienced management and Marquee investors

IIFL Finance Group is led by a highly experienced management team with strong expertise in financial services. The board consists of Mr. Nirmal Jain (the founder of IIFL Group and chairman of IIFL Finance), Mr. R. Venkataraman (co-promoter and managing director of IIFL Finance) and other independent directors. Mr. Rajesh Rajak is CEO of IIFL Finance. As of Q4FY21, promoters hold 24.96%, the Fairfax group holds 22.4%, CDC Group PLC holds 15.44% and other foreign investors hold 21.50%.

Risks and concerns:

Competition

NBFCs have always faced competition from small finance banks (SFBs), MFIs, and banks. Recently, they have also been facing stiff competition from new-age FinTechs, which have captured a greater market share with their technology-heavy low-cost operating models and for giving heightened customer experience.

Unfavorable Policies

Any unfavorable change in rules and regulatory policies could have a negative impact on earnings outlook of the company. Also, a sharp rise in interest rate could also impact the business in a negative way.

Macro situation

Slower-than-expected pick-up in the economy may impact the AUM growth for the company. Lower-than-expected loan growth and more-than-expected deterioration in asset quality remain key risks to our thesis.

COVID-19 woes

The recent COVID-19 issue is likely to have multiple-order and far-reaching impact on the financial sector. Credit growth is already heading southwards and given the extensive nature of the lockdown, asset quality issues are likely to spread to many sectors. The ongoing stress in corporate and SME segment might accelerate and retail loan segment might emerge as the new source of stress.
Sustainability of improvement in collection efficiency will be the key monitorable.

Limited seasoning
On the back of entry into new segments, the company's loan book has risen impressively in the past 2-3 years. However, the portfolio remains unseasoned, especially for asset classes like home loans and MSME loans,which have not seen a complete cycle due to longer tenure. So, for these products, the company's ability to control asset quality is yet to be tested.

Liquidity challenges
NBFCs keep facing challenges of raising liquidity for lending purposes from time to time depending on the asset quality risks perceived by the depositors/lenders, changes in regulations etc.

Stock is under ASM
The stock is under Additional Surveillance Measure (ASM) Long term stage-1 whereby the price circuit limit has been reduced to 5%. This necessitates the presence of high-risk appetite for taking positions in the stock. The stock has been included in this list as it fell into the parameters like price variation over different periods, concentration of trading volumes, average delivery percent, PE ratio compared to Nifty PE etc set by the exchanges.

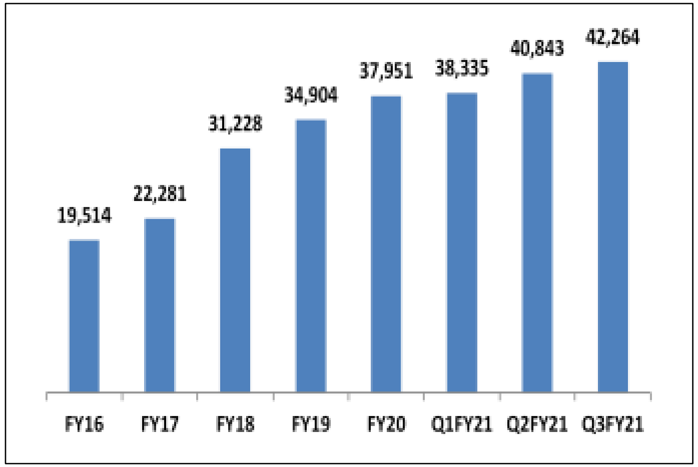
Company background

IIFL Finance Ltd is one of the leading retail-focused diversified NBFCs in India, which is engaged in the business of loans and mortgages along with its subsidiaries IIFL Home Finance Ltd and Samasta Microfinance Ltd. IIFL Finance, through its subsidiaries, offers a wide spectrum of products such as home loan, gold loan, business loan, microfinance, capital market finance and developer & construction finance to over 4 million customers. IIFL Finance has widened its pan-India reach through extensive network of branches spread across the country and various digital channels. It has 2,439 branches spread across 25 states, of which ~85% branches are in Tier 2 and Tier 3 cities. It smartly sold its CV book (AUM Rs.3620 cr) to Indostar in FY19.

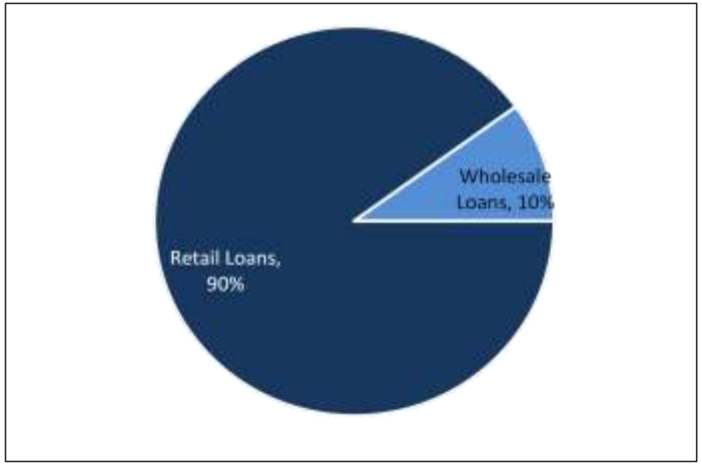
IIFL Finance (erstwhile IIFL Holdings Ltd) was the holding company for the entire IIFL group. As a part of corporate restructuring, the securities and wealth businesses of IIFL Holdings Ltd were demerged into IIFL Securities Ltd and IIFL Wealth Management Ltd respectively. IIFL Holdings Ltd was renamed IIFL Finance Ltd and now is the holding company for the lending businesses of the IIFL group with effect from 30 March 2020.

IIFL Finance Ltd.

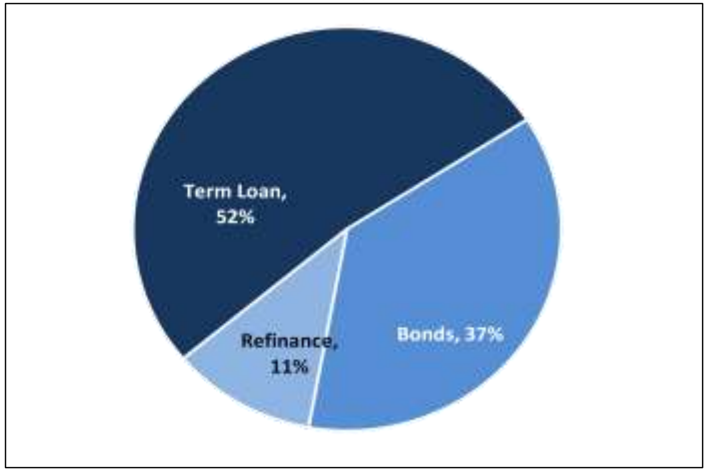
AUM (Rs Cr)



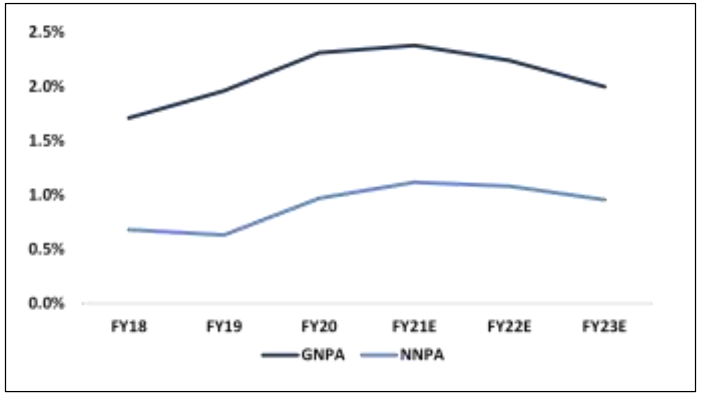
Retail Focused AUM



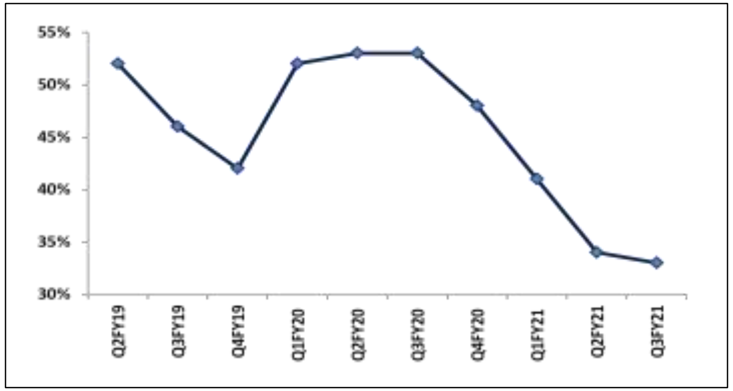
Well diversified liability profile



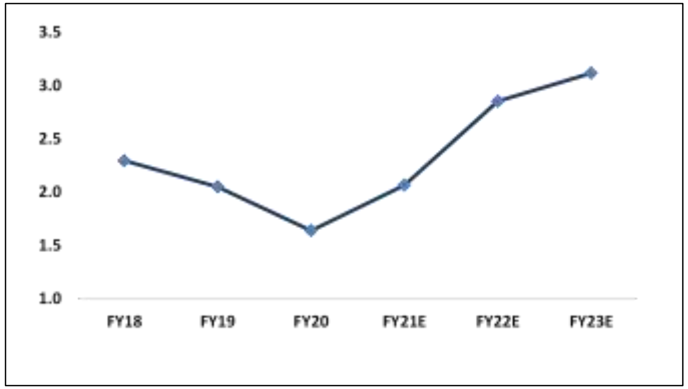
NPA Trend Consolidated Business



Cost to Income on decline



Return Ratios



Source: Company, HDFC sec Research)

IIFL Finance Ltd.

Financials (Consolidated)

Income Statement

(Rs Cr)	FY19	FY20	FY21E	FY22E	FY23E
Interest Income	4509.7	4043.3	4660.5	5366.0	5965.9
Interest Expenses	2585.0	2396.8	2512.2	2883.5	3224.0
Net Interest Income	**1924.7**	**1646.5**	**2148.3**	**2482.6**	**2741.9**
Income from assigned assets	245.0	576.0	1000.0	1000.0	1100.0
Non interest income	330.1	201.4	372.8	286.2	278.4
Operating Income	**2499.8**	**2423.9**	**3521.2**	**3768.8**	**4120.3**
Operating Expenses	1105.2	1232.5	1194.6	1279.5	1366.4
PPP	1394.7	1191.5	2326.6	2489.3	2753.9
Prov & Cont	368.7	466.0	1118.5	858.6	755.7
Profit Before Tax	1025.9	725.4	1208.0	1630.7	1998.2
Tax	334.2	171.8	300.3	424.0	519.5
PAT	**691.7**	**553.6**	**907.7**	**1206.7**	**1478.6**

BALANCE SHEET

(Rs Cr)	FY19	FY20	FY21E	FY22E	FY23E
Share Capital	75.6	75.7	75.7	75.7	75.7
Non-controlling interest	4.4	5.6	5.6	5.6	5.6
Reserves & Surplus	4278.7	4684.3	5425.5	6462.0	7732.5
Shareholder funds	**4358.7**	**4765.6**	**5506.8**	**6543.3**	**7813.8**
Borrowings	26625.8	27066.8	31356.3	35700.7	39276.2
Other Liab & Prov.	2254.3	2508.7	2630.2	2825.1	3042.6
SOURCES OF FUNDS	**33238.7**	**34341.1**	**39493.4**	**45069.1**	**50132.6**
Fixed and Other Intengible Asset	111.9	395.0	623.7	653.7	683.7
Investment	475.9	957.9	252.1	303.5	332.8
Cash & Bank Balance	2521.6	3215.9	3530.8	4655.2	5928.9
Advances	27377.5	28532.0	33608.1	37939.1	41606.1
Other Assets	2751.8	1240.3	1478.8	1517.6	1581.0
TOTAL ASSETS	**33238.7**	**34341.1**	**39493.4**	**45069.1**	**50132.6**

(Source: Company, HDFC sec Research)

IIFL Finance Ltd.

Key Ratios (%)

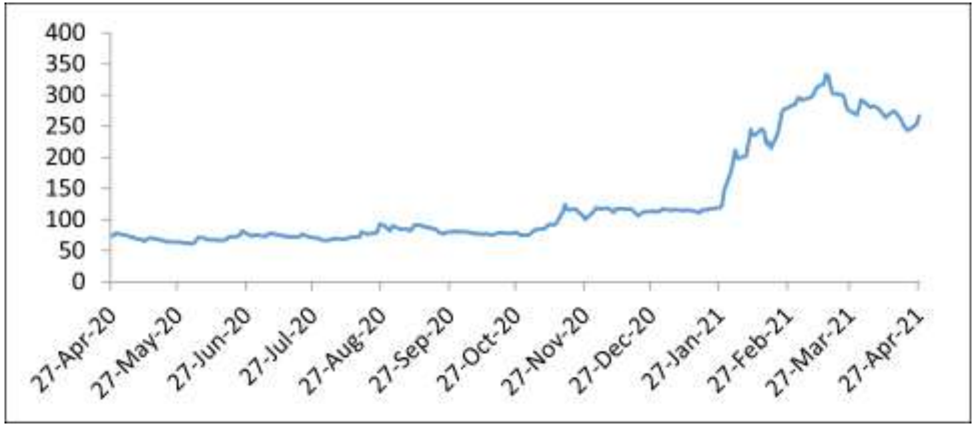
	FY19	FY20	FY21E	FY22E	FY23E
Return Ratios					
Calc. Yield on adv	14.3%	14.5%	15.0%	15.0%	15.0%
Calc. Cost of borr	9.7%	8.9%	8.0%	8.1%	8.2%
NIM	6.1%	5.9%	6.9%	6.9%	6.9%
RoAE	15.0%	12.1%	16.6%	20.0%	20.6%
RoAA	2.0%	1.6%	2.3%	2.9%	3.1%
Asset Quality Ratios					
GNPA	2.0%	2.3%	2.4%	2.2%	2.0%
NNPA	0.6%	1.0%	1.1%	1.1%	1.0%
PCR	68%	58%	53%	52%	52%
Growth Ratios					
Advances	-23.3%	4.2%	17.8%	12.9%	9.7%
Borrowings	-23.0%	1.7%	15.8%	13.9%	10.0%
NII	31.0%	-14.5%	30.5%	15.6%	10.4%
PPP	-16.6%	-14.6%	95.3%	7.0%	10.6%
PAT	-22.0%	-30.5%	54.4%	41.2%	22.5%

(Source: Company, HDFC sec Research)

Key Ratios (%)

	FY19	FY20	FY21E	FY22E	FY23E
Valuation Ratios					
EPS	21.1	14.6	22.6	31.9	39.1
P/E	12.6	18.2	11.8	8.3	6.8
Adj. BVPS	110.8	118.6	135.6	162.1	196.0
P/ABV	2.3	2.1	1.8	1.5	1.3
Dividend per share	5.0	2.3	3.0	4.5	5.5
Dividend Yield (%)	1.9	0.8	1.1	1.7	2.1
Other Ratios					
Cost-Income	44.2	50.8	33.9	34.0	33.2
Leverage	6.3	6.0	6.1	5.8	5.3

One Year Price Chart



RETAIL RESEARCH

Disclosure:

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