BUY

CMP: **INR 569** Target Price: **INR 760** ▲ 34%

ICICI Securities

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21 August 2023

India | Equity Research | Initiating Coverage

IIFL Finance

Financial Services

Expanded footprint, diverse portfolio, asset-light approach to drive >20% RoE in near term

We initiate coverage on IIFL Finance (IIFL) with a **BUY** rating and a target price of INR 760. We believe IIFL Finance is a direct play on 'increasing financial formalisation' with its presence in high-growth segments. Its diversified product portfolio, along with strong >4,000 physical branches, focus on scaling high-margin products like gold loans, MFI, digital loans etc., end-to-end digital process, tight control on asset quality and capital optimisation via co-lending could help it sustain >20% growth and 20% RoE in the near term. IIFL has transitioned itself into a diversified retail-focused NBFC, with >60% of AUM generating 17-23% yields. Its transformation journey began in FY19 with it selling its highly cyclical CV business, and strategic move to reduce its reliance on wholesale business. As a result, the combined share of CV / CE / construction / capital market fell to ~5% by FY23 from >30% in FY17. The company aims to deliver 20-25% AUM growth in the near term with RoA of >3.5% and RoE of >20%. We believe its redefined business model with a retail focus would help it in executing the strategies as per the plan.

IIFL has transitioned into a diversified retail-focused NBFC, with >60% of AUM generating 17-23% yields. Its transformation journey began in FY19 with it selling its highly cyclical CV business and strategic move to reduce reliance on wholesale business – as a result, the combined share of CV / CE / construction / capital market fell to ~5% by FY23 from >30% in FY17. To accelerate retail asset growth and remain ahead of the competition, it added >1,700 branches (total branches at 4,267 in FY23) and expanded employee base to >30,000. Besides, the company has invested significantly in building digital capabilities which helps in increasing branch / employee level productivity. Product-level strategy, which improves visibility on better growth momentum, involves: i) focus on affordable housing and non-metro locations for home loans; ii) increased physical presence and product innovation driving gold loans; iii) incremental focus on small-ticket MSME and personal digital lending; iv) growth, credit cost and opex normalisation in MFI lending. The company aims to deliver 20-25% AUM growth in the near term with RoA of >3.5% and RoE of >20% going ahead and we believe its redefined business model with retail focus would help it in executing the strategies as per the plan.

Valuation

IIFL's business resiliency and its ability to navigate the challenging period better then peers reflect in average RoA of >2.5% and RoE at >18% during FY21-23 despite covid-led disruption. Its renewed asset mix with >60% of AUM generating >17% yields and digital led lending process would help it sustain >3% RoA over FY24-25E. We initiate coverage on the stock with a BUY rating and a target price of INR 760, valuing the stock at 2.5x Sep'24E BVPS. The stock is currently trading at 2.0x / 1.7x FY24/25E BVPS, respectively.

Financial Summary

Y/E March (INR mn)	FY22A	FY23A	FY24E	FY25E
Net Interest Income (NII)	30,314	40,128	49,609	61,174
PAT (Rs mn)	11,883	16,076	19,997	25,919
EPS (Rs)	31.3	42.3	52.6	68.1
% Chg YoY	55.9	35.0	24.4	29.6
P/E (x)	18.2	13.5	10.8	8.3
P/BV (x)	3.3	2.4	2.0	1.7
Gross Stage - 3 (%)	3.2	1.8	1.6	1.7
RoAA (%)	2.7	3.3	3.4	3.5
RoAE (%)	20.1	20.8	20.4	22.3

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Market Data

Market Cap (INR)	217bn
Market Cap (USD)	2,608mn
Bloomberg Code	IIFL IN Equity
Reuters Code	IIF.BO
52-week Range (INR)	633 /323
Free Float (%)	53.0
ADTV-3M (mn) (USD)	5.1

Price Performance (%)	3m	6m	12m
Absolute	22.5	25.0	63.2
Relative to Sensex	6.5	7.8	9.6

ESG Disclosure	2021	2022	Change
ESG score	34.7	35.2	0.4
Environment	0.8	2.1	1.3
Social	24.7	24.7	-
Governance	78.6	78.6	-

Note - Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures.

Source: Bloomberg, I-sec research

Retailisation journey embarked in FY19 is progressing well

IIFL Finance's successful execution track record reflects in its ability to pre-empt business cycles and set business priorities accordingly. Commencing its lending journey in 2006 by entering into loan against securities, the focus has always been on building sustainable and scalable asset portfolio – as a result, by FY17, its asset portfolio consisted of 28% business loans, 5% capital market, 25% home loans, 13% gold loans, 14% construction and real estate finance, 14% CV finance and 1% microfinance. However, in FY19, it strategically embarked on its retailisation journey, and as a part of its revised strategy, it sold CV business and started scaling down lumpy and volatile verticals like real estate and capital market financing. Notably, it delivered 17% AUM CAGR between FY19-23 driven by its retail portfolio (20% CAGR). Consequently, its retail book's share in total AUM increased to 95% as of Mar'23 from 84% in FY19. Gold and MFI loans primarily led with 35% and 44% CAGRs during FY19-FY23. However, CAGRs in other core products, namely home loans and business loans, were modest at 16%, 2% respectively. Management is expecting ~25% AUM growth in the near term.

Perfect mix of high-yielding, growth product portfolio

Within its retail portfolio, gold and MFI remained key growth drivers, contributing ~47% of total AUM as on Mar'23 and fetching 18% and 24% yield, respectively. Its other high-yielding product - business loans, including digital loans (~19% yield), stabilise in FY23 (up 21% YoY) after going through a transformation between FY20-22 (negative 2% CAGR). We believe its presence in high yielding and growth segment would help it deliver >3.5% RoA and >20% RoE going ahead.

Up-fronted investment towards franchise build up; improved visibility on AUM growth remaining robust going ahead

IIFL's AUM growth has been majorly driven by increased physical presence as its branch strength increased to 4,267 in FY23 from 1,947 in FY19. Along with increased branches, IIFL has also invested in building a technology infrastructure to drive process efficiency. Not only this, but also it is increasing digital sourcing (100% online loan application process) through My Money app, website, or WhatsApp for small-ticket business and personal loans. Digital disbursements contributed 48% of business loan disbursements in Q4FY23. IIFL believes in overall synergy of robust physical branch network with sophisticated technology integration ultimately leading to 'phygital' model.

One of the few large NBFCs to pursue asset-light model

IIFL is one of the few big NBFCs to have an asset-light model, as reflected in its reliance on off-book and co-lending portfolio. The proportion of off-book portfolio has risen to 38% as of Q4FY23 from 25% in FY21. IIFL aims to maintain it at a similar level going ahead as well. Within the off-book portfolio, assignment contributes ~26% and co-lending 12% as of Mar'23.

Asset quality under control through cycles

GNPA at <=2% till FY21 is testament to the company's underwriting and collection practices. However, presence in vulnerable segment like MFI / business loans that were impacted during covid and new norms for NPA recognition led to GNPL increasing to 3.2% in FY22. But during FY23, it improved to 1.8%, as of Mar'23.

While LAP, digital loans and MFI segments are driving the overall GNPAs for IIFL with 2.9% / 3.6% / 2.1% GNPL, respectively, as on Mar'23, gold and home loans remain the best performing segments with GNPL at 0.8% and 1.9%, respectively. Further detailing the company-level stage-2 assets at 5% as of Mar'23 suggests gold, business and CRE loan segments have relatively higher stage-2 assets of 6%, 7% and 5%, respectively.

This is primarily due to the customer profile in these segments that are generally prone to deferred payments being NTC customers (ex CRE loan) transitioning from the unorganised market.

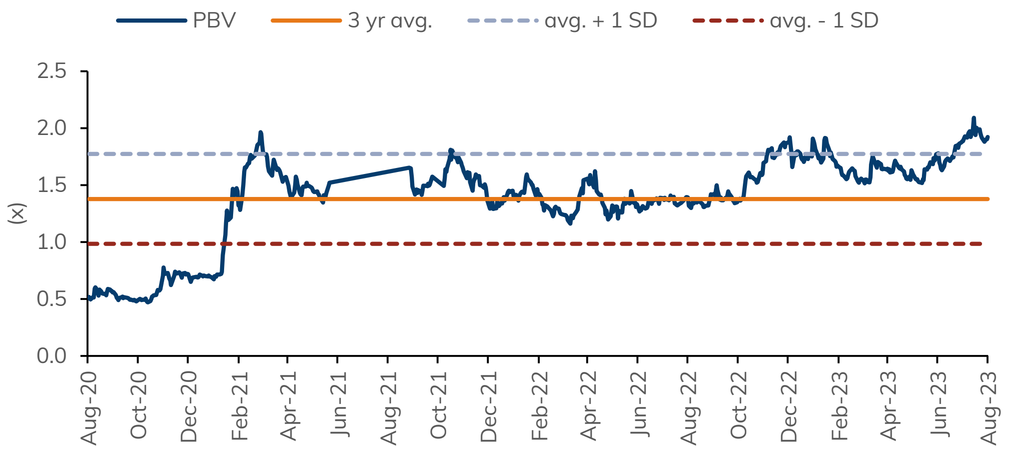
With negligible stressed asset pool (stage 2 @ 5% + NNPL @ 1.1%) and PCR at 41%, subsiding risk in vulnerable segment like MFI and business loans, management expects credit cost to be in the 1.5-2% range going ahead.

Valuation

IIFL Finance, with a decade-long experience in lending business, well-diversified borrowing profile, strong Retail asset portfolio and stable management team, is a direct play on 'increasing financial formalisation' with its presence in high-growth segments. We initiate coverage on IIFL Finance with a BUY rating and target price of Rs760, valuing the stock at 2.5x Sep-24E BVPS. The stock is currently trading at 2.0x / 1.7x FY24/25E BVPS, respectively, >30% discount to its peers like Aptus, Home First and CA Grameen. Considering better return & growth outlook, we believe valuation gap between IIFL Finance and peers is likely to narrow down going ahead.

Key risks – i) AUM growth deceleration and ii) lower demand for direct assignment and co-lending portfolio.

Exhibit 1: PBV (1 year forward) – re-rating to continue going forward



Source: Company data, I-Sec research

Exhibit 2: Relative valuation metrics

Particular	CMP	PE			P/BV			EPS			BV			RoA (%)			RoE (%)		
		FY23	FY24E	FY25E	FY2E	FY24E	FY25E	FY2E	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E
Credit Access	1,369	26.3	16.4	13.0	4.3	3.4	2.7	52	84	105	321	405	511	4.2	5.3	5.4	18.2	23.0	23.0
Spandana	805	460.7	11.1	7.9	1.8	1.6	1.3	2	73	102	437	509	611	0.2	5.1	5.4	0.4	15.4	18.2
Fusion	570	14.8	10.9	8.2	2.5	2.0	1.6	39	52	70	231	284	353	4.6	4.7	4.8	21.2	20.3	21.9
Aptus	272	26.9	22.2	17.7	4.1	3.6	3.1	10	12	15	67	75	86	7.8	7.6	7.5	16.1	17.2	18.9
Aavas	1,571	29.0	26.0	21.0	3.8	3.3	2.9	54	61	75	411	472	547	3.5	3.3	3.3	14.2	13.7	14.7
HomeFirst	863	33.2	26.0	19.8	4.3	3.6	3.1	26	33	44	199	237	277	3.9	3.8	3.9	13.5	15.0	17.0
PNB HF	635	10.3	11.8	10.0	1.0	1.1	1.0	62	54	64	649	571	634	1.5	2.0	2.1	10.0	10.8	10.6
LIC HF	412	7.8	5.5	4.8	0.8	0.7	0.6	53	75	85	492	559	636	1.1	1.4	1.4	11.2	14.3	14.3
Five Star	791	38.0	30.8	23.6	5.3	4.5	3.8	21	26	34	150	175	209	8.0	7.7	7.9	15.0	15.8	17.5
IIFL Finance	**576**	**13.6**	**11.0**	**8.5**	**2.4**	**2.1**	**1.7**	**42**	**53**	**68**	**236**	**278**	**333**	**3.3**	**3.4**	**3.5**	**20.8**	**20.4**	**22.3**

Source: Company data, I-Sec research

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Building retail-focused NBFC to bring scalability and sustainability

India's retail credit to GDP and mortgage penetration at 36% and 11%, respectively vs over 75% and 50% for most other economies, offers huge opportunity for lending to small businesses and HL segment. IIFL has strategically focused on serving self-employed segment via gold loans, digital loans, business loans and microfinance loans.

While IIFL started its lending journey way back in 2006 by entering into loan against securities segment, since 2019 it has shifted its focus toward building retail asset portfolio. As on Mar'23, it has successfully built retail asset portfolio consisting of – A) Home loans (34%), B) gold loans (32%), C) business loans (*including digital loans*, 14%), and D) MFI loans (15%) and continued to calibrate growth in construction financing (4%) and capital market loans (1%).

As a part of its retailisation journey, it sold CV portfolio in FY19 and started scaling down cyclical and lumpy businesses like capital market and construction financing. Hence, the combined share of these two businesses fell to 5% by Mar'23 from 17% in FY18.

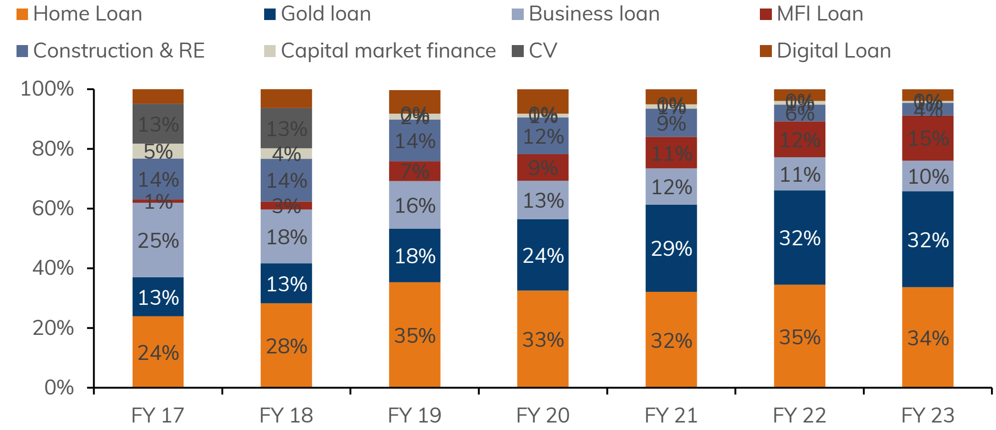
During its initial phase of consolidation (FY19-20), AUM growth moderated to 10% CAGR (FY18-20); however, post the consolidation and focused approach on scaling retail products, AUM growth was revised to 20% between FY21-23 despite covid-led disruption. Notably, AUM growth at 26% YoY in FY23, highest in the past 5 years, reinforces our view that consolidation phase is over and IIFL Finance is on a strong footing to deliver industry-leading growth over FY23-25E.

Exhibit 3: Incrementally, focusing on scaling up retail products

INR mn	FY 16	FY 17	FY 18	FY 19	FY 20	FY 21	FY 22	FY 23	FY 24E	FY 25E
AUM (INR mn)										
Home Loan	27,290	53,360	85,791	1,21,966	1,24,431	1,44,392	1,77,270	2,18,004	2,69,729	3,35,013
Gold loan	29,140	29,100	40,369	61,951	91,251	1,31,491	1,62,280	2,07,333	2,62,232	3,31,741
Business loan	61,800	66,510	57,323	57,616	49,036	54,392	56,753	66,712	81,702	1,02,926
Digital loans			22,313	27,541	29,232	20,251	18,837	25,115	33,277	43,479
MFI Loan	-	2,390	8,406	22,813	33,784	47,376	61,546	97,856	1,32,415	1,72,248
Construction & RE	28,110	30,670	43,351	50,549	47,270	42,349	28,992	26,941	31,118	36,071
Capital market finance	25,980	11,040	10,630	6,599	4,509	6,630	6,419	4,416	5,299	6,359
CV	22,820	29,740	44,097	-	-	-	-	-	-	-
Total AUM	**1,95,140**	**2,22,810**	**3,12,280**	**3,49,035**	**3,79,511**	**4,46,880**	**5,12,098**	**6,46,376**	**8,15,772**	**10,27,837**

Source: Company data, I-Sec research

Exhibit 4: AUM mix shifting towards high-yielding and fastest growing segments like MFI, gold and affordable housing.



Source: Company data, I-Sec research

In order to ensure product-wise focus, better control and scale, IIFL Finance carries out its lending business via three entities – A) IIFL Finance, B) IIFL Home Finance and C) IIFL Samasta Finance (MFI). Gold loans, business loans (including digital loan), home loans and microfinance loans would continue to be key focus products, while it may calibrate growth in construction financing and capital market loans.

Exhibit 5: IIFL sets up a separate subsidiary for home, microfinance loans for better focus and control

Product	Entity in which the loans get booked
Home loans	IIFL Home Finance
Gold loans	IIFL Finance (standalone entity)
Business Loans	Unsecured loans are booked in IIFL Finance
	Secured loans being primarily LAP are booked in IIFL Home Finance
	Secured loans (LAP) given to MFI borrowers are booked in IIFL Samasta Finance
Microfinance	IIFL Samasta Finance
Construction & Real Estate	Old Real Estate Loans, including against collateral of land, reside in IIFL Finance
	Incremental Construction finance loans for green and affordable projects are done through IIFL Home Finance
Capital Market Finance	IIFL Finance (standalone entity)

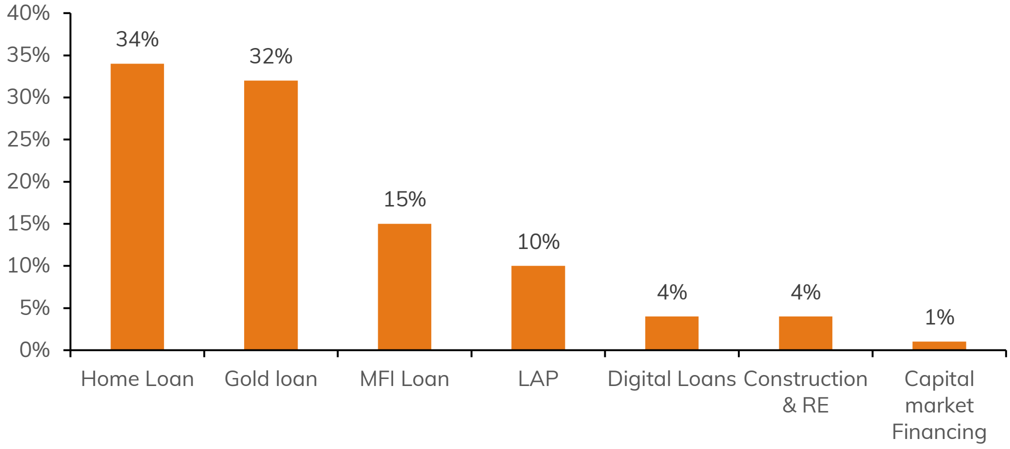
Source: Company data, I-Sec research

Exhibit 6: IIFL Finance is listed holding NBFC with 2 subsidiaries for housing and microfinance

As on Q4FY23 (INR mn)	IIFL Finance (standalone)	% of AUM	IIFL Home Finance	% of AUM	IIFL Samasta Finance	% of AUM	Consolidated
Home loans			2,18,004	100%			2,18,004
Gold loans	2,07,333	100%					2,07,333
LAP			59,046	89%	7,666	11%	66,712
Digital lending	25,115	100%					25,115
Microfinance					97,856	100%	97,856
Core Products (A)	**2,32,448**	**38%**	**2,77,050**	**45%**	**1,05,522**	**17%**	**6,15,020**
Construction & RE	18,870	70%	8,070	30%			26,940
Capital market Financing	4,416	100%					4,416
Synergistic Products (B)	**23,286**	**74%**	**8,070**	**26%**	**0**	**0%**	**31,356**
Total A+B	**2,55,734**	**40%**	**2,85,120**	**44%**	**1,05,522**	**16%**	**6,46,376**

Source: Company data, I-Sec research

Exhibit 7: AUM mix as on Mar'23 - with >60% of AUM generating 17-23% yields



Source: Company data, I-Sec research

Home loans – deep distribution, focus on less competitive salaried segment in tier-ii & iii cities and in-house sales to drive growth

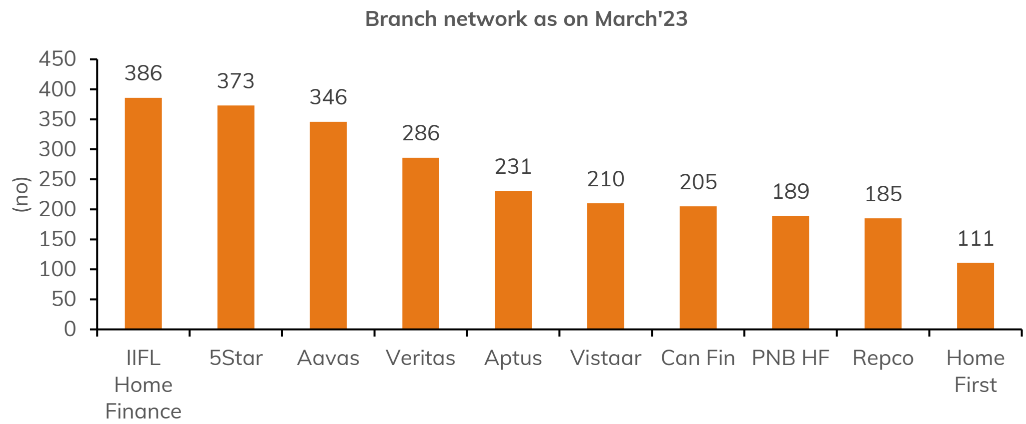
IIFL Finance entered HL segment in 2009 and forayed into affordable housing in FY14. The strategy in home loans is to focus on the less competitive, affordable home loan segment (in salaried segment) in non-metro and suburban metro regions. With average ticket size of its portfolio at INR 1.4mn, almost 86% of the segment falls under priority sector lending, and average yield at ~11% reflects its customer profile, which suggests IIFL's target market is less competitive.

Exhibit 8: Key insights on housing loan vertical

Home loan	IIFL
Underwriting	Centralised
Background check	3rd party
Technical / Valuer	3rd party
Legal	Centralised
Sourcing	Hybrid
TAT	3 days in HL
Customer mix	Salaried (65%) / elf-employed (35%)
Key states/UT	MH & Delhi (36%)

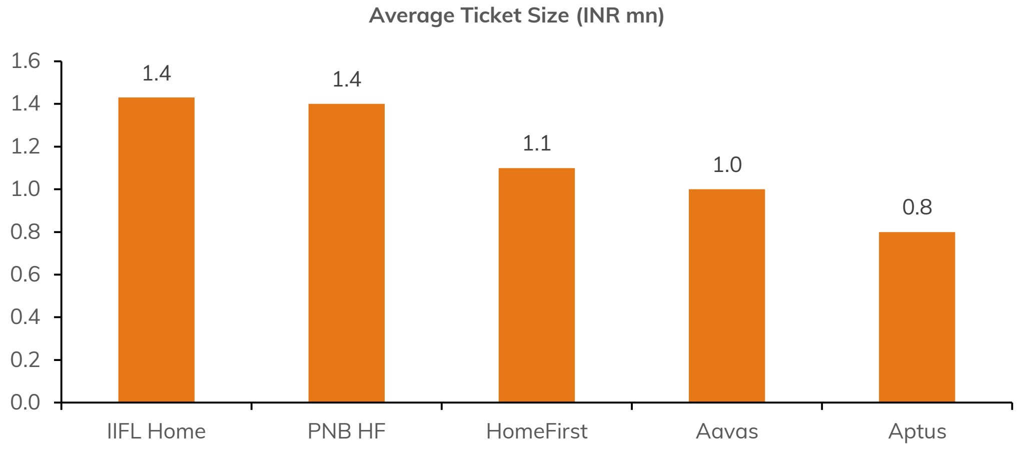
Source: Company data, I-Sec research

Exhibit 9: IIFL home finance segment has one of the highest branch networks (386) as on Mar'23



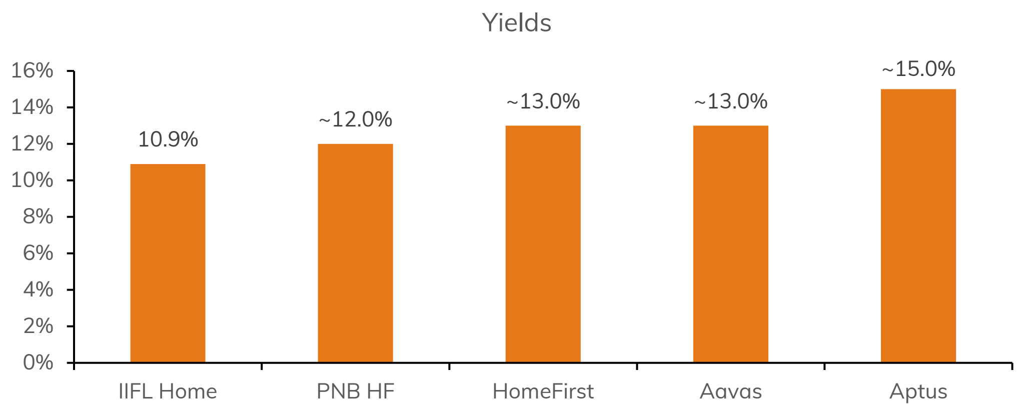
Source: Company data, I-Sec research

Exhibit 10: IIFL focuses on upper-end of the affordable housing ticket size…



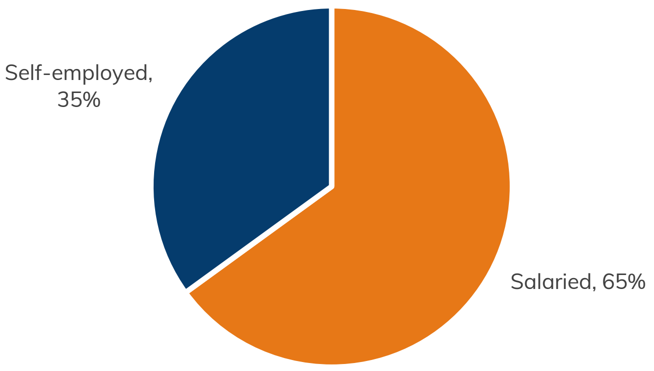
Source: Company data, I-Sec research

Exhibit 11: …the same reflects in lower yield, suggesting IIFL's risk-averse growth strategy



Source: Company data, I-Sec research

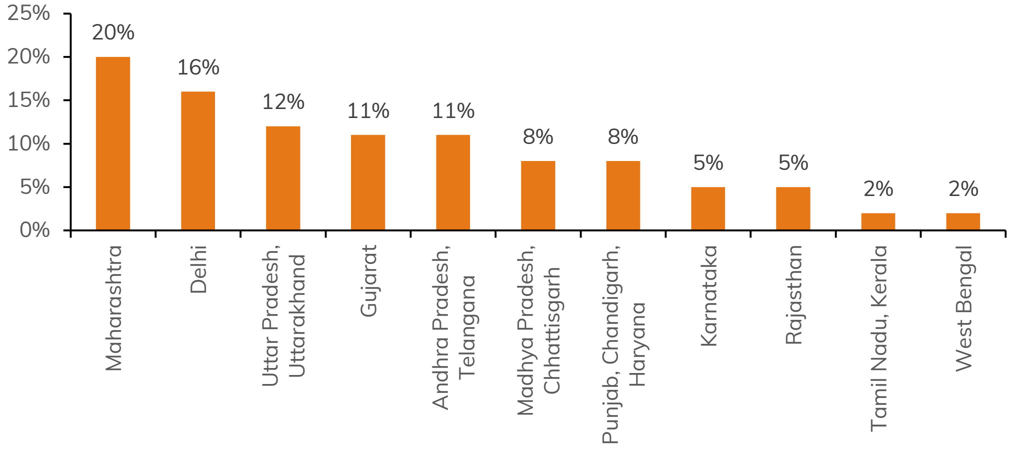
Exhibit 12: Strategically, IIFL focuses on salaried segment, given the most affordable housing finance players pre-dominantly cater to self-employed segment



Source: Company data, I-Sec research

The portfolio is also well diversified geographically with Maharashtra constituting 20%, Delhi 16%, UP/Uttarakhand 12%, Gujarat/AP/Telangana 11%, and MP/Chhattisgarh 8%.

Exhibit 13: Most diversified geographical presence



Source: Company data, I-Sec research

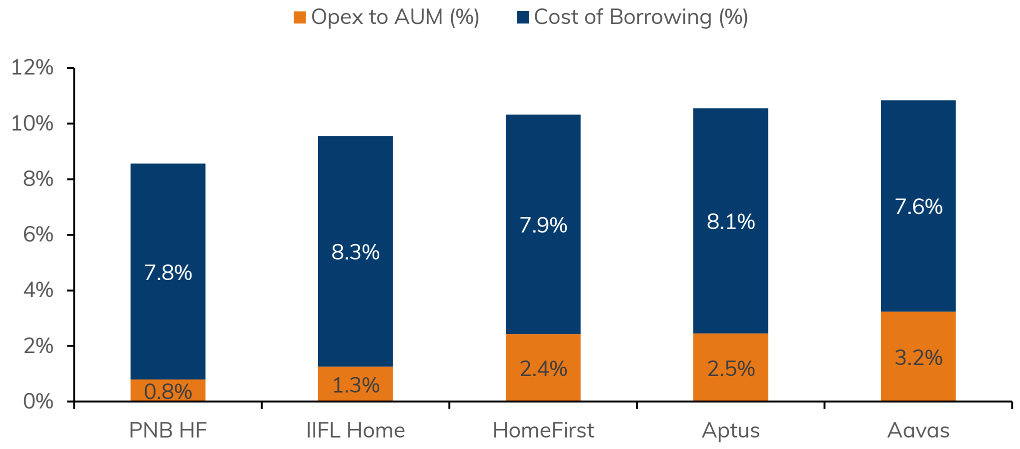
Exhibit 14: Peer analysis – One of the most efficient HL financiers as reflected in lowest cost, AUM ratio at 1.3% vs >2% for peers

FY23 (INR mn)	Aavas	Aptus	HomeFirst	IIFL Finance
AUM	**1,41,667**	**67,380**	**71,980**	**2,18,004**
Branches	**346**	**231**	**111**	**386**
Productivity				
AUM per employee	23	28	72	48
AUM per Branch	409	292	648	565
Employee per Branch	17	10	9	12
Average Ticket size	**1.0**	**0.8**	**1.1**	**1.4**
Customer profile				
Salaried	40%	29%	70%	65%
Self-employed	60%	71%	30%	35%
Staff cost as % FY23 AUM	2.1%	1.8%	1.5%	0.8%
Salary per employee (INR mn)	0.5	0.5	*1.1*	0.5
Other cost as % FY23 AUM	1.1%	0.7%	0.9%	0.4%
Total cost	**3.2%**	**2.5%**	**2.4%**	**1.3%**

Source: Company data, I-Sec research

Key strength of IIFL's home finance business lies in its phygital approach to affordable housing segment - operationally more efficient as evident in low 'opex to AUM' ratio of 1.3% in FY23. This is mainly due to digitisation as 99% home loans are on-boarded through the digital platform without physical movement of files. As a result of better operating efficiency, 100% in-house sourcing (no DSA pay-outs) IIFL's home finance business generated RoA / RoE of 4% / 18.2% in FY23, respectively.

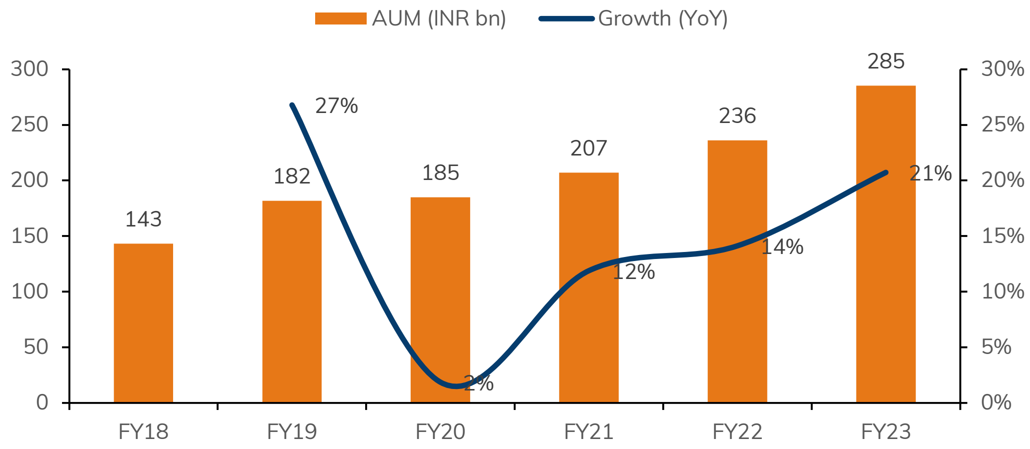
Exhibit 15: IIFL is one of the most competitive HL financiers – cost of delivery stood at 9.6% vs >10% for peers



Source: Company data, I-Sec research

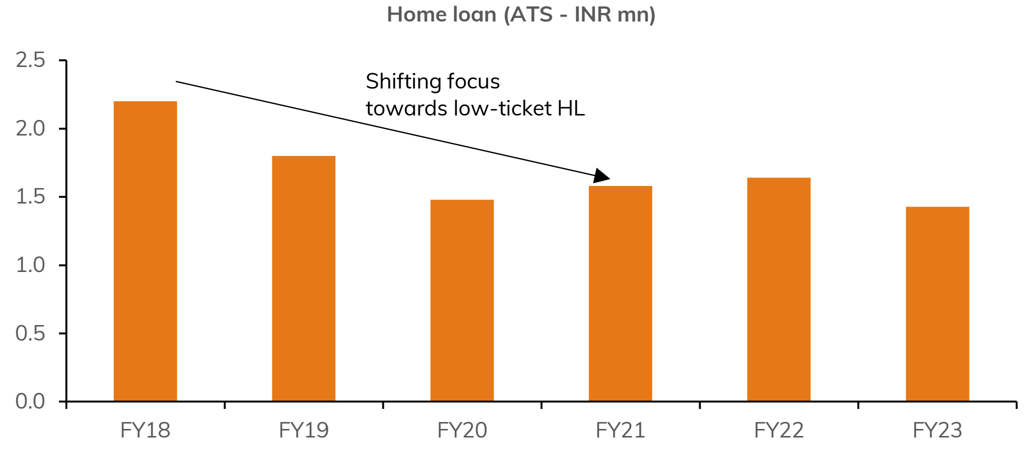
Home loan AUM grew at a relatively lower pace of 13% CAGR during FY19-FY22 as IIFL re-aligned its home loan strategy – shifting its focus from high-ticket HL to affordable housing in FY20. However, FY23 witnessed a sharp revival with AUM growth crossing the 20% mark. The growth was largely driven by accelerated branch expansion – total number of branches increased to 386 by Mar'23 from 125 in Mar'21. Consequently, its share in total AUM again increased to 34% in FY23 after decreasing to 32% in FY21.

Exhibit 16: Steady improvement in AUM growth trajectory since FY21



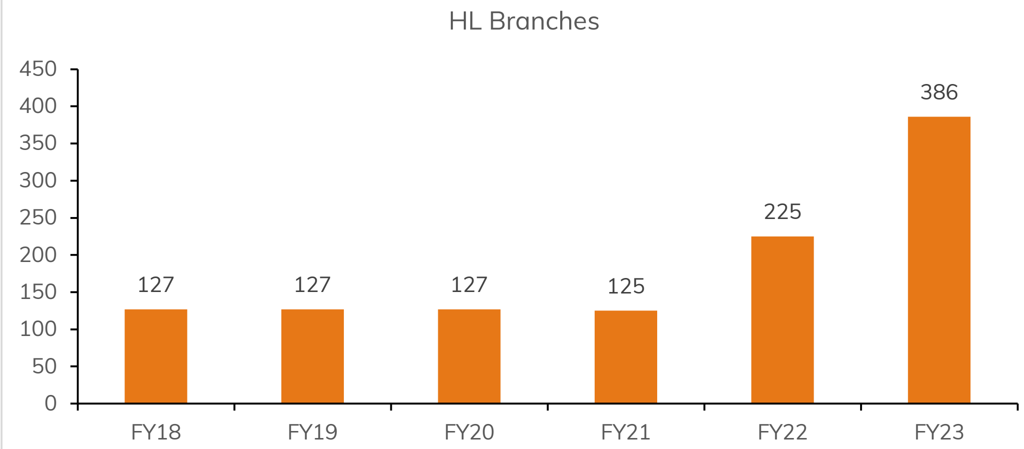
Source: Company data, I-Sec research

Exhibit 17: De-focusing high ticket HL resulted in AUM growth remaining lower between FY18-20



Source: Company data, I-Sec research

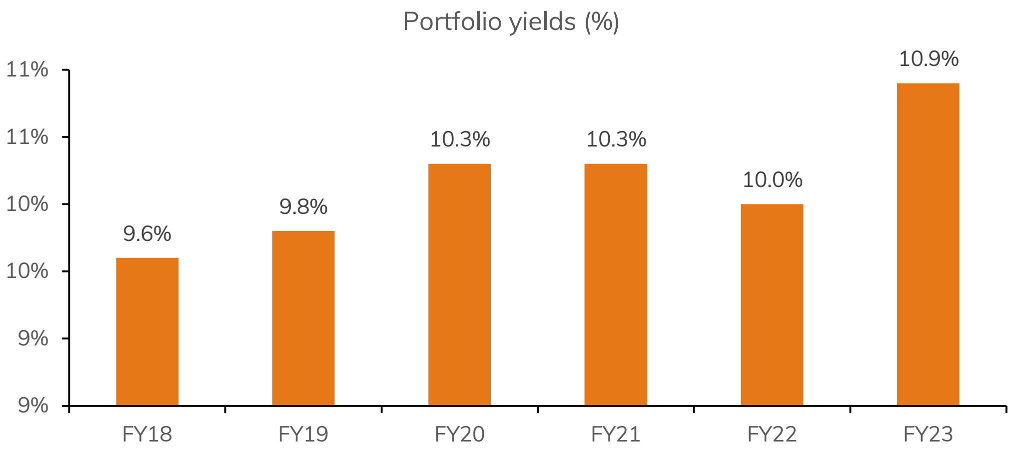
Exhibit 18: Acceleration in branch expansion since FY22 helped it in reviving growth in HL portfolio



Source: Company data, I-Sec research

Housing finance portfolio generates yield of 10-11% and NIMs of 4.3-4.5%. However, GNPA (on balance sheet loans) at 2% in FY23 is relatively higher than peers.

Exhibit 19: Steady portfolio yield at 10-11% across rate cycle



Source: Company data, I-Sec research

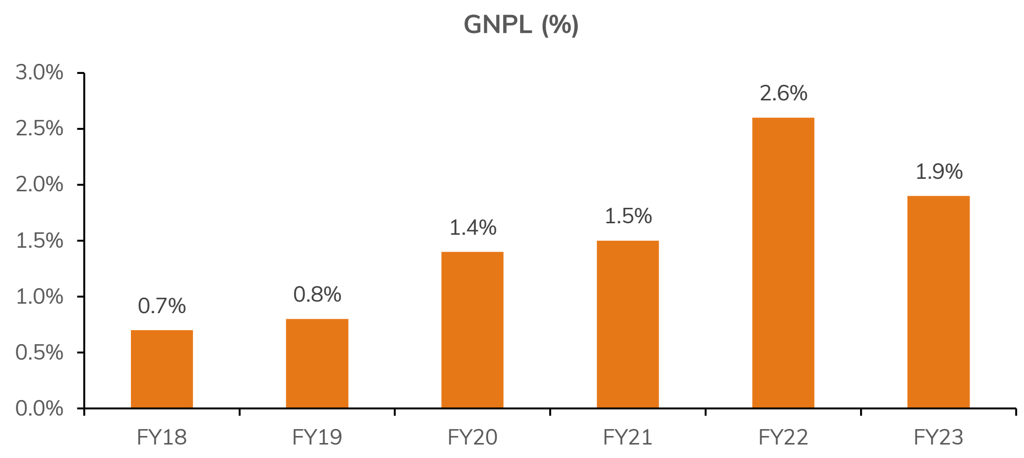
Digital underwriting, involving on-field feedback and rule-based output, backed by in-built tablet application capable of providing instant decision on eligibility not only improved TAT but also helped in maintaining better asset quality. The same reflects in GNPL remaining at an average 1% pre-covid.

Loan proposals are evaluated on the basis of tight credit filters such as past credit history, income source, KYC and property acceptance norms. Once the loan officer has sourced the customer and obtained his/her loan application, the officer submits all the requisite documents to the credit team for assessment.

Credit underwriting involves the following steps –

- Checking the eligibility based on defined credit parameters. If these parameters are met, the case is logged in for further processing.
- Performing various checks on the documents provided by the borrower to assess genuineness. These checks are done through an independent Fraud Control Unit.
- Conducting in-person meetings and/or video PD with borrowers by loan officers at their business premises or residence.
- Conducting credit and financial background check on each borrower.
- Conducting legal and technical evaluation of the offered security.

Exhibit 20: GNPA increased to 2.6% in FY22 due to covid and NPA recognition norms, but moderated sharply to 1.9% in FY23



Source: Company data, I-Sec research

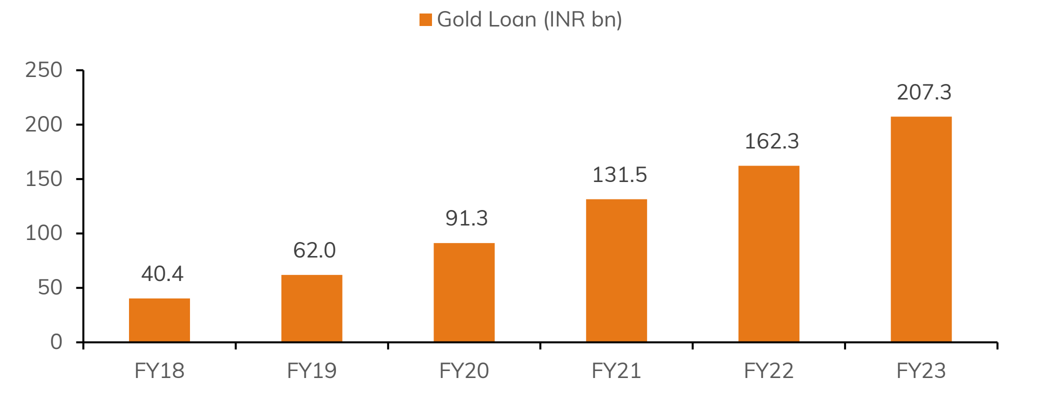
Note: GNPA was 1.8% in FY22 after excluding the impact of RBI circular

Gold loans – key focused product and amongst Top-3 gold financiers in India with ~14% market share as on Mar'23

Gold loan is IIFL's key focus area and over the years it has created strong position with over 2,600 dedicated gold loan branches spread across 25 states/UT, manned by ~15,000 employees – IIFL is possibly the second largest lender with ~14% market share in organised gold financing market. It delivered a robust 39% CAGR in gold loans during the past 5 years. Gold AUM now contributes 32% of total AUM as of Mar'23 vs 18% in FY19. Increased physical presence (standalone branches increased to >2,600 in FY23 from 1,357 in FY19), product innovation (gold at home), and investment in skilled employees (due to operationally intensive nature) aided IIFL to outpace peers in gold loan growth.

As a part of continued digital expansion, IIFL enhanced digital gold loans for top-up and online renewal of gold loans. It had earlier launched a technology-backed initiative called 'Gold Loan at home' in a few cities in FY23. Additionally, it collaborated with several banks for co-lending of gold loans, which saw significant traction during FY23.

Exhibit 21: IIFL delivered strong 39% AUM CAGR between FY18-23 despite intense competition



Source: Company data, I-Sec research

Its strategic focus on West and North, given the other two large gold NBFCs (mention names) were primarily focused on South, helped it in delivering strong 39% AUM CAGR in the past 5 years. Its strong customer connect (~70% repeat customers), aggressive investments in brand visibility and recall and digital innovation are key enablers for its industry-leading growth in the recent past.

Exhibit 22: IIFL has strategically focused on under-penetrated West and North markets

Break-up	AUM	Branch	Branch
States	**IIFL**	**Manappuram**	**Muthoot**
Gujarat & UT	20%	3%	4%
Maharashtra,Goa	11%	6%	7%
West	**31%**	**10%**	**11%**
Karnataka	8%	16%	11%
Telangana	8%	7%	7%
Kerala	0%	14%	11%
Andhra Pradesh	5%	13%	13%
Tamil Nadu, Puducherry	3%	16%	21%
South	**24%**	**67%**	**63%**
Punjab, Haryana, Chandigarh	8%	4%	7%
Rajasthan	7%	3%	3%
Uttarakhand, UP, HP	6%	1%	1%
Delhi	5%	2%	0%
MP, Chhattisgarh	4%	5%	3%
North	**30%**	**14%**	**14%**
Odisha	3%	4%	2%
Assam, Tripura	3%	1%	1%
Bihar, Jharkhand	2%	1%	1%
West Bengal	7%	3%	3%
East	**15%**	**9%**	**7%**

Source: Company data, I-Sec research

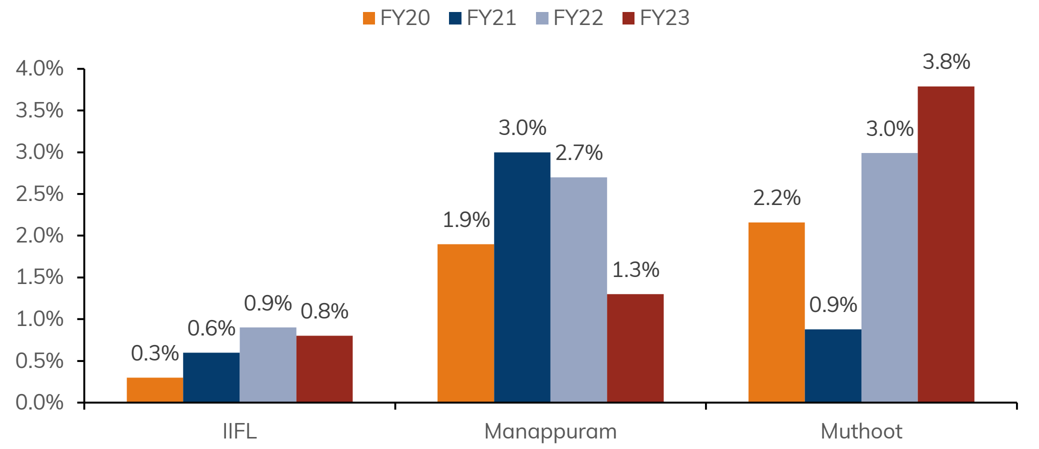
IIFL prioritises expansion with a strong emphasis on collections and resolutions. Further, it screens customers for previous defaults, scams, and negative customer lists through its in-house loan origination tablet application. Increased digitisation and strict security measures at the branch level helped it reduce frauds and contingencies. Stringent risk management and tight control on customer sourcing resulted in IIFL's GNPL, across cycles, remaining lower than peers.

Exhibit 23: Adequately invested in branch security with advanced technology

- Branches equipped with security guards, specialized security agencies, CCTV, IP cameras, and sensors strategically placed for enhanced surveillance
- Implementation of an Artificial Intelligence (AI) monitoring system in branches
- 24x7 control room with trigger-based remote surveillance, panic switches, and a two-way audio system
- Vaults reinforced with steel cage panels and vibration sensors, along with OTP-based authentication
- Branch vaults upgraded with cellular drawers featuring a dual key mechanism
- Utilization of technological advancements such as Artificial Intelligence and GPS-based tracking

Source: Company data, I-Sec research

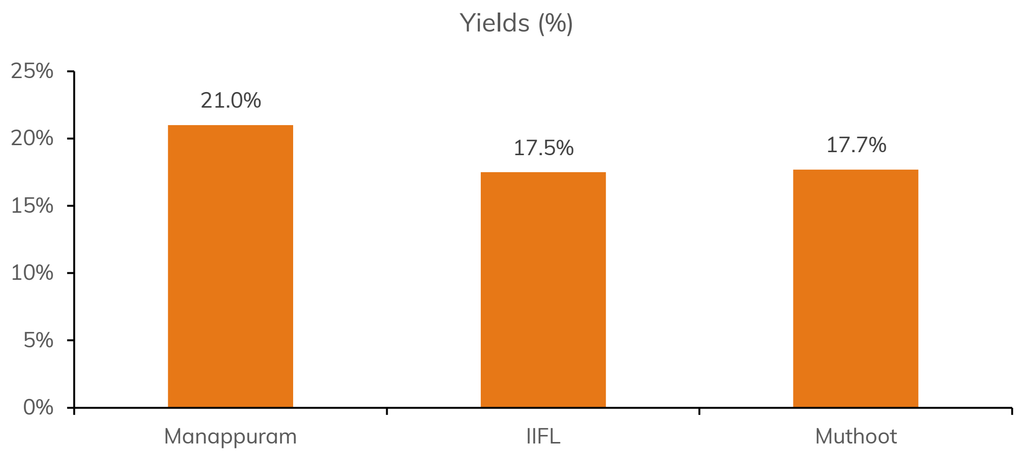
Exhibit 24: IIFL's asset quality in gold loan is amongst the best-in-class



Source: Company data, I-Sec research

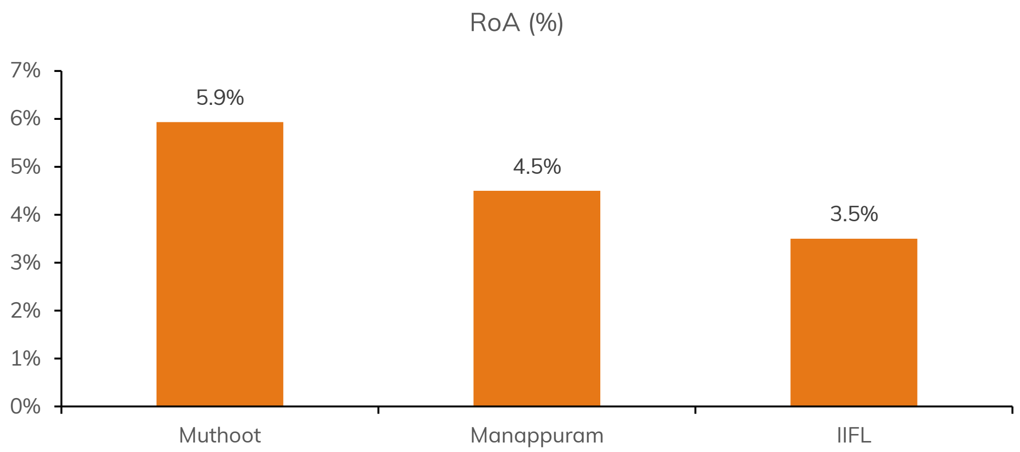
IIFL is equally competitive in pricing and interest on gold loans, (rather than offering bullet repayment for shorter-tenure loans), generating relatively lower yield (17.5%) vs competitors in this segment. This, coupled with aggressive branch expansion, has led to lower profitability than the market leader as reflected in standalone RoA / RoE of 3.5% / 17.6% in FY23, respectively.

Exhibit 25: Stiff competition in gold loan financing kept yield under pressure



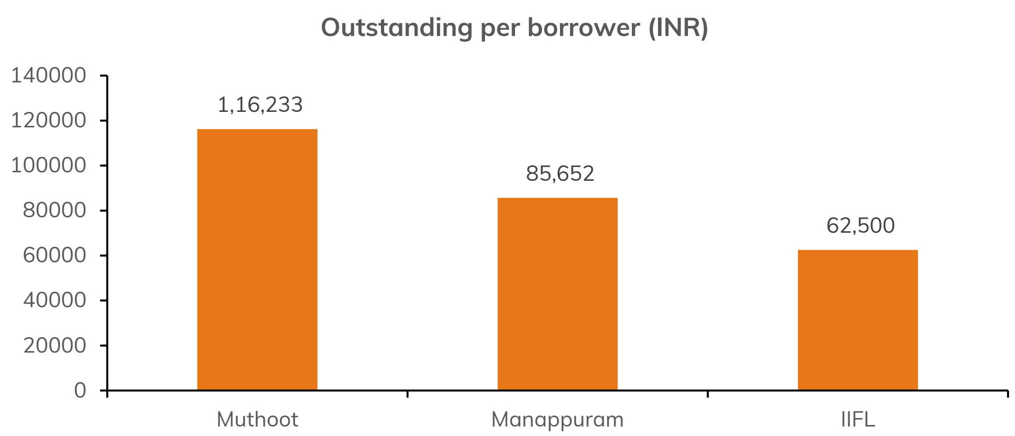
Source: Company data, I-Sec research

Exhibit 26: Lower yield and accelerated investment towards branch expansion are resulting in lower profitability than peers



Source: Company data, I-Sec research

Exhibit 27: Ample scope for productivity improvement for IIFL given the outstanding per borrower is lowest amongst peers – on boarding ATS is at INR 63k



Source: Company data, I-Sec research

Exhibit 28: Productivity metrics

Company	Branches	AUM (INR mn)	AUM per Branch (INR mn)
Muthoot	5,858	618,750	**106**
IIFL	2,653	207,330	**78**
Manappuram	3,985	197,000	**49**

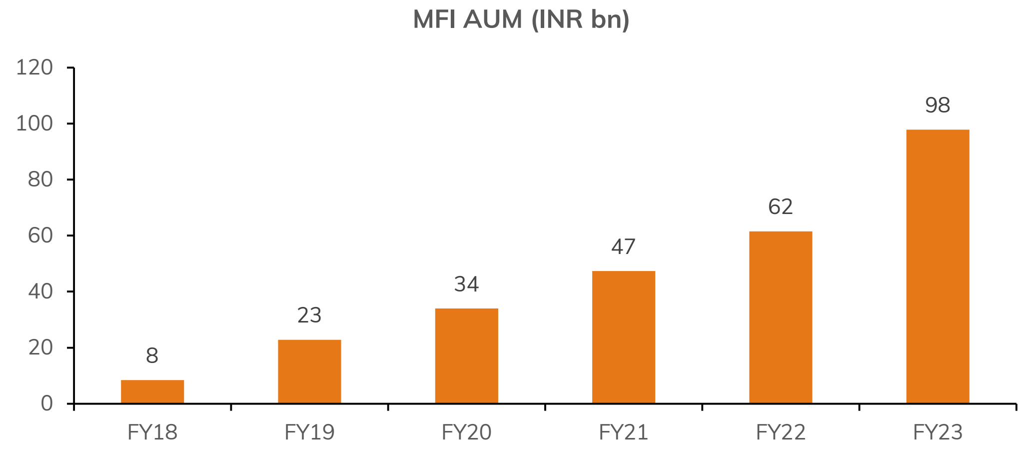
Source: Company data, I-Sec research

Microfinance – one of the leading players with 10% market share amongst NBFCs-MFIs

IIFL is one of the largest microfinance players in India commanding ~10% market share amongst NBFCs-MFIs and is well positioned to capture the growth opportunity –credit demand in MFI segment is expected to reach INR 17trn by FY26E.

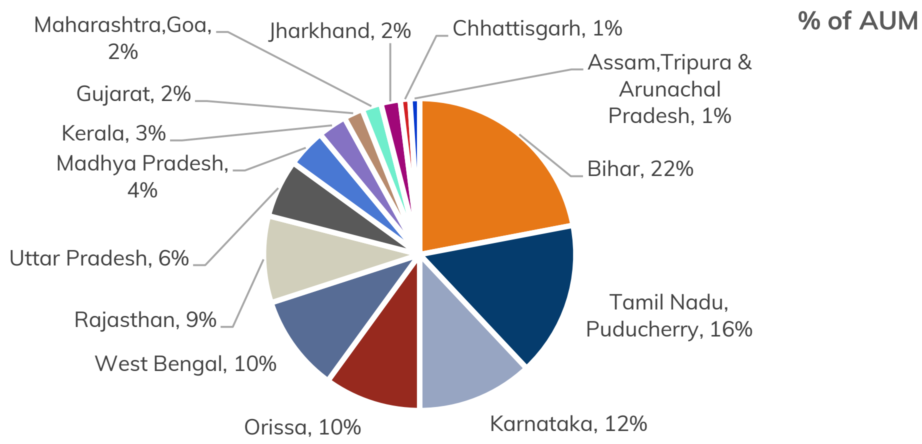
IIFL Finance runs its microfinance business through its subsidiary IIFL Samasta and delivered robust 5-year CAGR of 66% in FY18-23, making it the second largest player (after CA Grameen) in the NBFC-MFI space. As on Mar'23, it has 1,267 dedicated MFI branches covering 19 states and 322 districts. Geographically, its MFI loan book is fairly diversified with Tamil Nadu / Puducherry, Bihar, Karnataka, West Bengal, Odisha and Rajasthan contributing 16%, 22%, 12%, 10%, 10% and 9%, respectively, as of Mar'23 with other states constituting the remaining 21% of the portfolio.

Exhibit 29: Robust AUM CAGR of 63% between FY18-23



Source: Company data, I-Sec research

Exhibit 30: Well diversified geographical presence with no single state contributing >22% of AUM



Source: Company data, I-Sec research

IIFL's strength lies in maintaining higher spreads – as reflected in its net revenue / avg. assets at 15% vs 12-13% for peers. However, higher opex at >7% (average for Top-3 players is ~5%) and elevated credit cost at ~6% vs ~2% for CA Grameen / Fusion led to its profitability remaining lower than CA Grameen and Fusion and marginally better than Spandana.

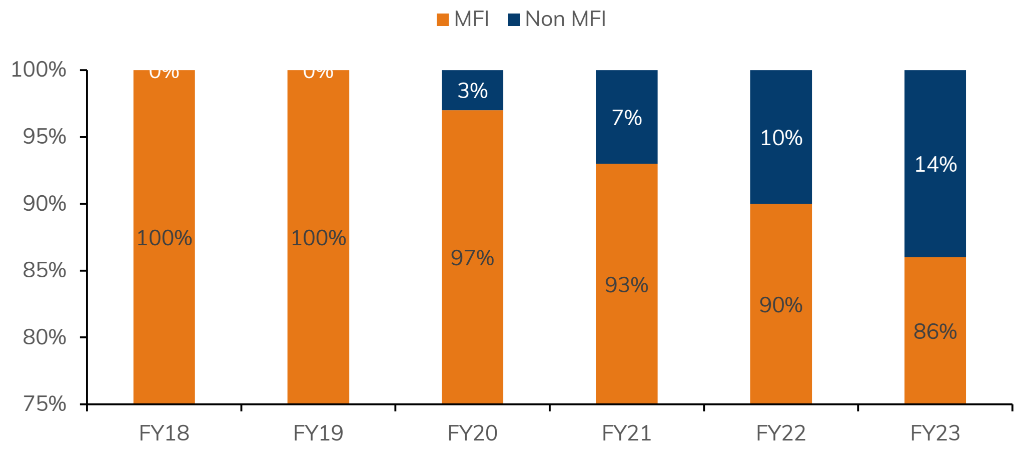
Exhibit 31: IIFL Samasta's profitability in FY23 remained lower than peers due to elevated credit cost

	CA Grameen	Fusion	Spandana	IIFL Samasta
Total interest income	**18.1%**	**21.6%**	**17.9%**	**19.2%**
Int exp	6.2%	7.7%	5.6%	7.7%
Net Revenue	**11.9%**	**13.9%**	**12.4%**	**15.0%**
Total Opex	**4.2%**	**5.3%**	**5.6%**	**7.2%**
PPoP	**7.7%**	**8.6%**	**6.8%**	**7.8%**
Credit cost	2.0%	2.4%	6.6%	5.8%
PBT	**5.6%**	**6.1%**	**0.2%**	**2.0%**
Tax	1.4%	1.5%	0.1%	0.4%
RoA	**4.2%**	**4.6%**	**0.2%**	**1.6%**
RoE	**18.2%**	**21.2%**	**0.4%**	**11.0%**

Source: Company data, I-Sec research

Its contribution to overall AUM scaled up to 15% in Q4FY23 from 7% in FY19. In MFI, apart from joint liability loans, it has also started doing individual loans, which contributed ~14% of total MFI portfolio in FY23.

Exhibit 32: Gradually building strong cross-sell engine to leverage strong non-MFI product portfolio at group level



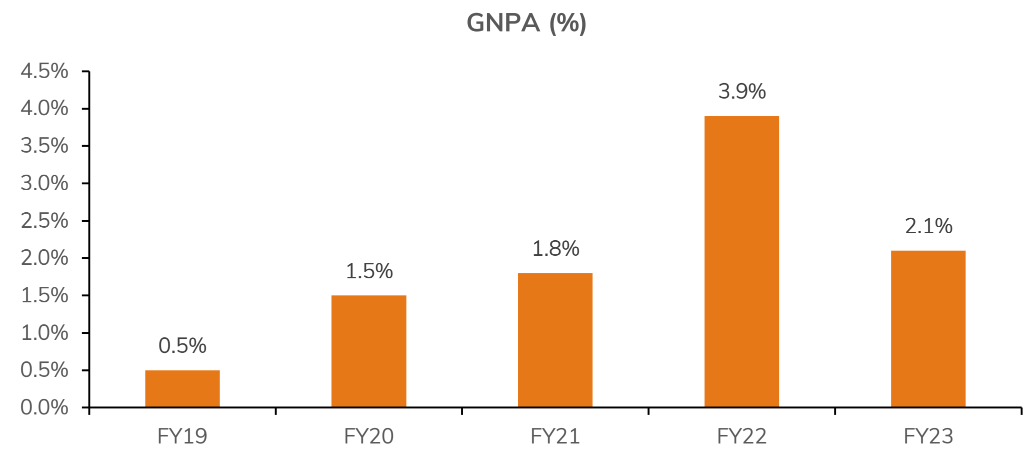
Source: Company data, I-Sec research

In line with the industry, asset quality metrics inched up with GNPA and credit cost increasing to 3.9% / 2.1% and 4.7% / 7.0% in FY22 / FY23, respectively, from 1.8%/ 4% in FY21.

Branch selection process: A detailed area survey is conducted at field level which takes into account the credit culture, economic activity, political stability law and order situation, occurrence of natural events, demographic detail etc. Based on the area surveyed reports' assessment, an approval will be signed off jointly by risk and business team centrally.

Separation of sales and credit function to ensure quality underwriting - A customer relationship officer is responsible for customer acquisition, while a branch manager and credit manager scrutinise and validate KYC documents. It has a dedicated credit manager at every branch, who carries out all the pre-disbursement checks in addition to that done by the branch manager, which helps in establishing the veracity of application documents. The loan application is processed only after the branch manager approves the customer upon physical verification of customer's address and documents provided. Most of the applications and approval mechanism is controlled through the technology to avoid any human error.

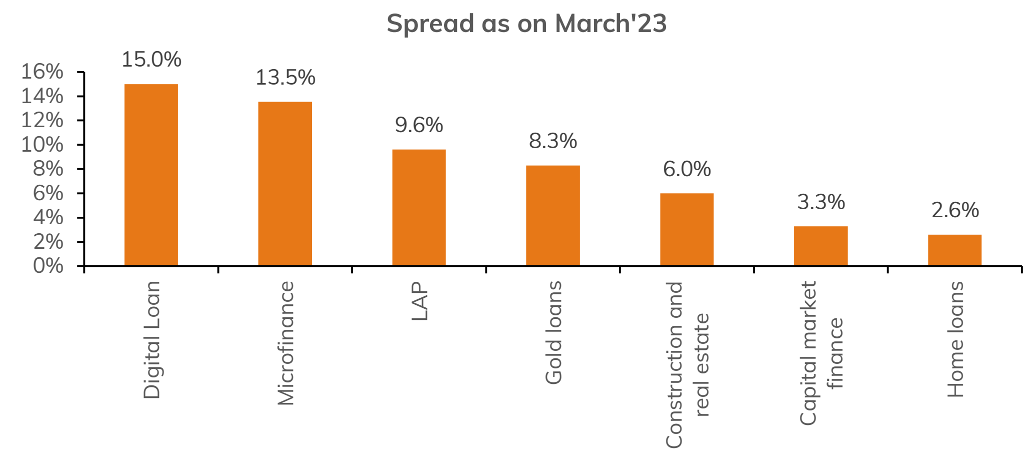
Exhibit 33: Asset quality improved in FY23 and the trend continued in Q1FY24



Source: Company data, I-Sec research

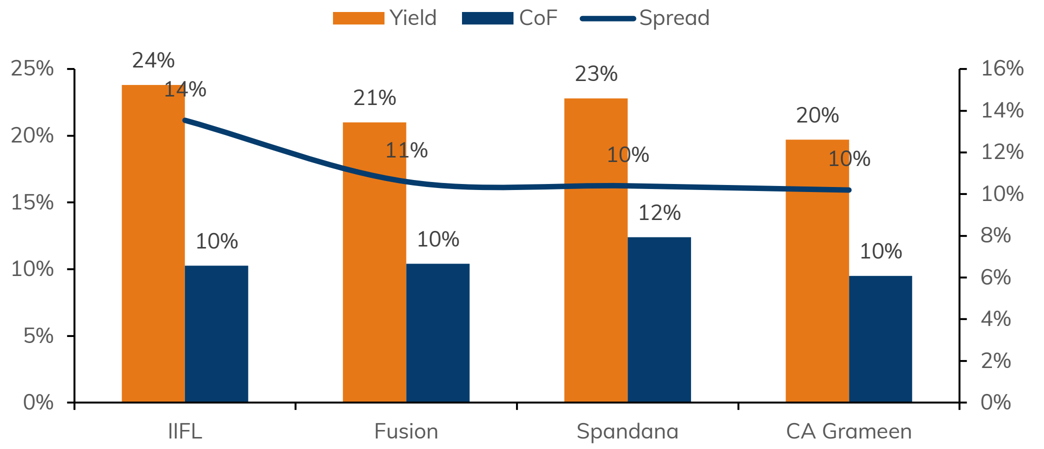
MFI business remained the key earning driver, given the higher spread at 13.5% as on Mar'23 – one of the highest within its product portfolio. Steady asset yield at 22-24% over the past 5 years reflects its strong pricing power and the same enabled it to maintain high spread despite ~40bps increase in the cost of funds during H2FY23. While profitability was impacted during covid phase, resilience of its MFI business reflects in IIFL not reporting losses between FY20-23. Notably, MFI segment generated RoA at 4%-5% and RoE at ~29% in FY19-20 and the same reinforces our view that MFI segment is well placed to deliver >25% RoE in the medium term given its strong industry tailwinds.

Exhibit 34: Spread in MFI segment stood at 13.5% - one of the highest in IIFL's entire asset product portfolio



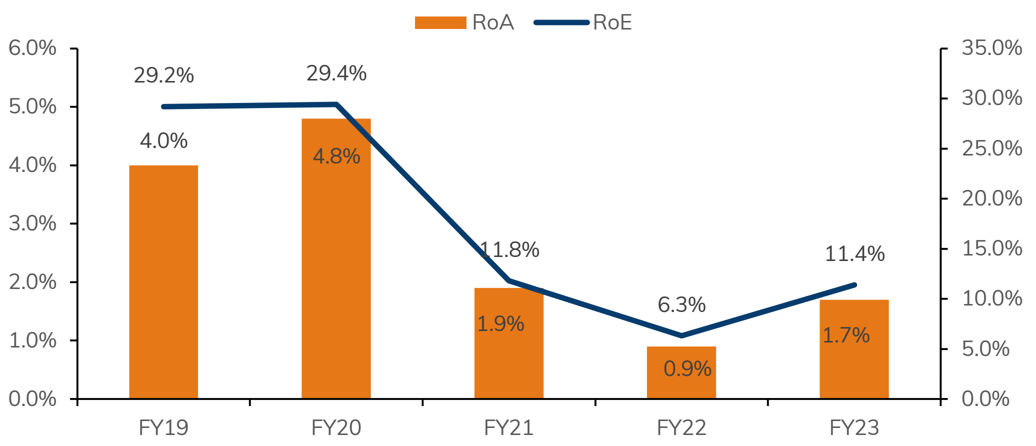
Source: Company data, I-Sec research

Exhibit 35: IIFL Samasta' spread at 14% is the highest within NBFC-MFI space



Source: Company data, I-Sec research

Exhibit 36: MFI segment profitability revived in FY23

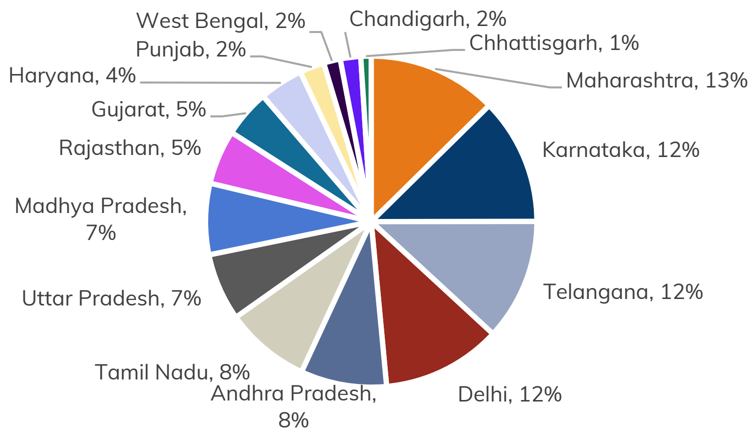


Source: Company data, I-Sec research

Business loans – shift from high-ticket LAP (>INR 2mn) to small-ticket LAP (<INR 1mn) may drive profitability

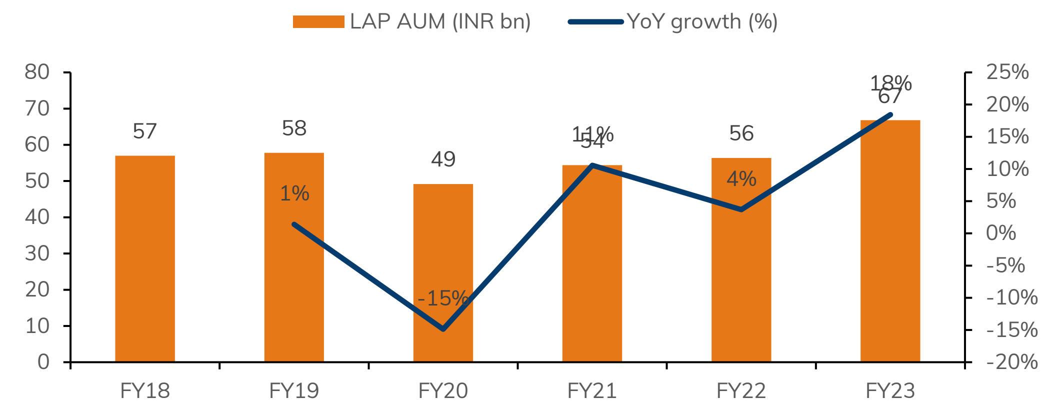
IIFL is the leading player in secured business loan segment with an outstanding AUM of INR 66.7bn and dedicated branch network of 386 (branches) as on Mar'23. It primarily focuses on tier 2 towns and beyond and caters to self-employed segment (81%) having informal income sources. It predominantly operates in sub- INR 3mn secured BL space.

Exhibit 37: Geographically well diversified with no single state contributing >15% of AUM



Source: Company data, I-Sec research

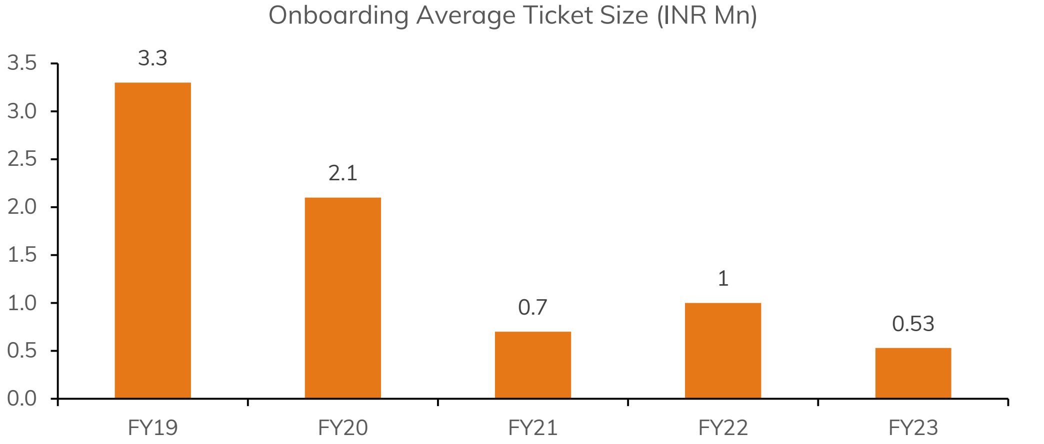
Exhibit 38: Growth in LAP segment remained muted in recent past; however, with streamlined business process, growth is likely to revive in FY24E



Source: Company data, I-Sec research

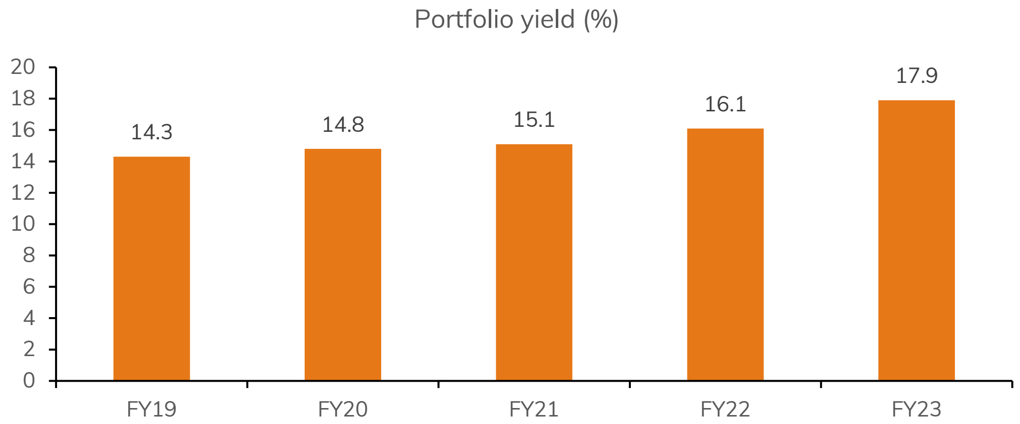
In business loan segment, the company has reduced its focus on large-ticket LAP and structurally shifted focus towards originating small-ticket loans to MSMEs and individuals. This is also reflected in a decrease in average on-boarding ticket-size to INR 0.5mn in FY23 from INR 7.7mn in FY18. Consequently, business loan growth remained muted at -1% CAGR between FY19-22. Nonetheless, the changed strategy helped in building up the portfolio as reflected in strong 18% YoY growth in FY23. Contribution of this product segment in overall AUM declined from 17% in FY19 to 10% in FY23.

Exhibit 39: Strategic shift towards low-ticket LAP impacted growth in recent past…



Source: Company data, I-Sec research

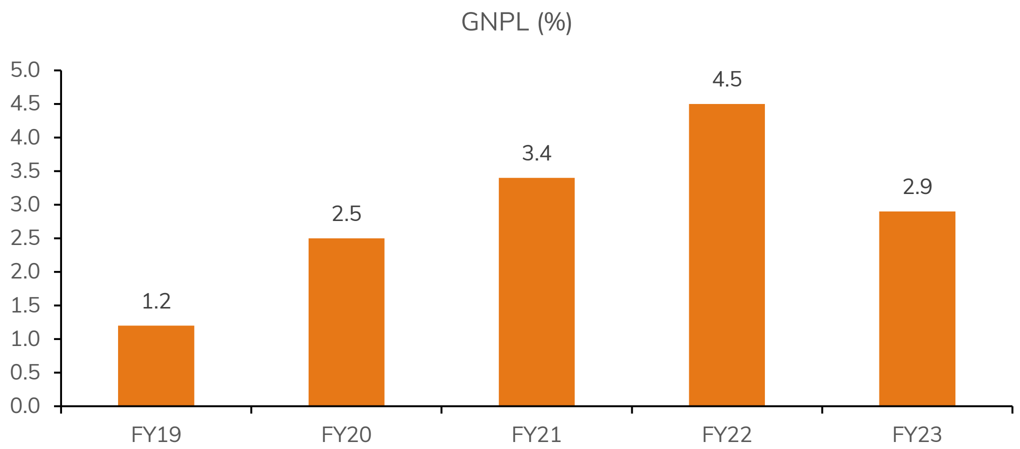
Exhibit 40: …however, the same led to >350bps improvement in yields



Source: Company data, I-Sec research

Now the focus is on balancing prudent credit underwriting with instant in-principle decision based on analytical scorecards. Hence, business loan segment grew 12% QoQ in Q4FY23. IIFL does both secured and unsecured lending with secured to unsecured ratio being 73:28 as of Q4FY23.

Exhibit 41: Trend in GNPL ratio in LAP segment



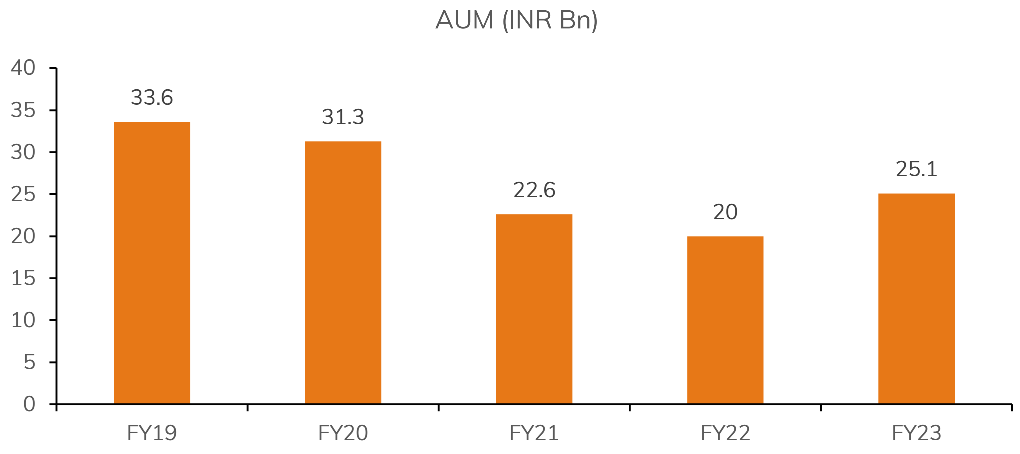
Source: Company data, I-Sec research

Digital loans – leveraging technology to scale up unsecured business loans

Considering a series of measures by the RBI intended towards fortifying the digital ecosystem, robust India Stack (Aadhaar, UPI, Account Aggregator, OCEN) forms the biggest enabler and with 1.1bn accounts linked on its Account Aggregator network, IIFL has strategically planned to leverage its strong in-house data base and deep understanding of business loan segment. It built end-to-end digital business loan journey and was the first to launch an end-to-end loan to disbursal journey on WhatsApp with digital fraud checks and verification.

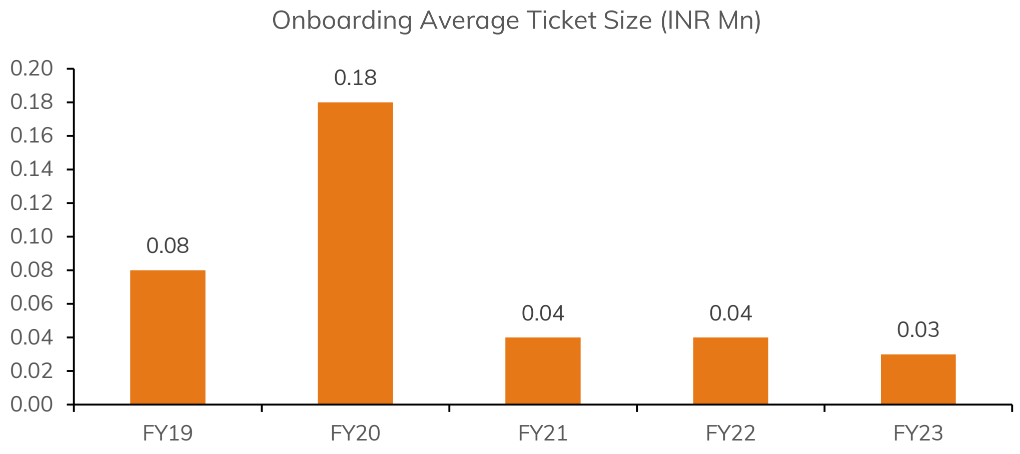
It segregated its business loan segment into two verticals – i) secured loans (LAP) and ii) unsecured business loans in FY19 for better focus and control. Later, it further realigned its unsecured business loans – a) by de-focusing large-ticket unsecured loans and b) moving away from fleet-on-street model. The same resulted in unsecured business loans falling to INR 20bn by Mar'23 from INR 31bn in Mar'18. However, in FY23, digital loans grew 33% YoY as it heavily invested in building robust digital ecosystem to scale up unsecured business loans during covid phase.

Exhibit 42: AUM growth in digital loan segment revived in FY23, up 33% YoY



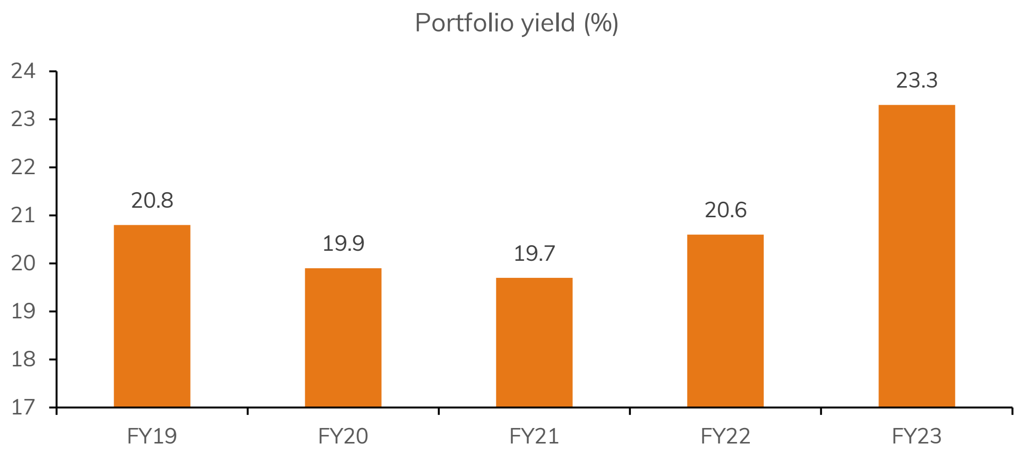
Source: Company data, I-Sec research

Exhibit 43: Shifted focus towards low-ticket business loans...



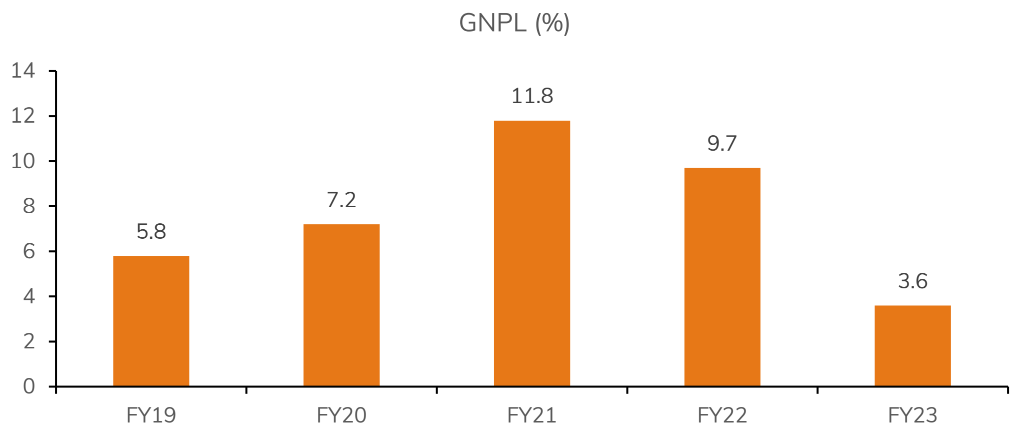
Source: Company data, I-Sec research

Exhibit 44: ...offering better asset yields



Source: Company data, I-Sec research

Exhibit 45: Asset quality was impacted during covid but witnessed steady improvement over FY22-23



Source: Company data, I-Sec research

Capital optimisation – market leader in co-lending

IIFL is actively looking to leverage its robust digital capabilities and wide physical distribution by transforming to a new business strategy - from a lending institution to a lending platform. Given its niche in underwriting retail loans (mostly informal segment), and banks having a strong capital base and risk appetite, it plans to leverage its capital resources more effectively by entering into co-lending model.

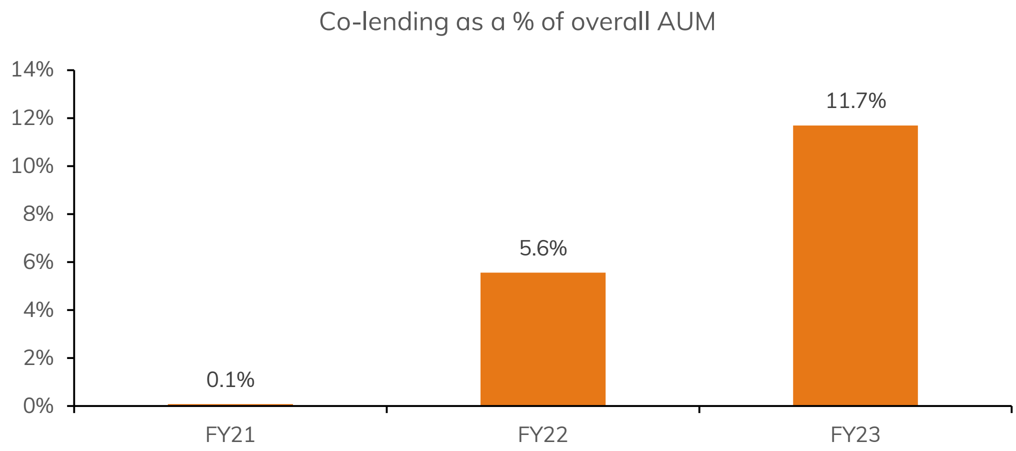
IIFL has entered into co-lending agreements with banks for gold loan, home loan and secured MSME loan. It has already commenced disbursements under these tie-ups and currently IIFL Finance is the market leader in co-lending. Several fintech players have also partnered with IIFL to get access to lending platform for their innovative strategies to source and underwrite.

The company's presence in the market is further enhanced by its partnerships with other lenders for co-origination and business correspondence book. The company has partnered with large PSBs/private sector banks such as SBI, PNB, ICICI Bank, IDBI Bank, etc, to expand its portfolio. The share of co-lending book increased from 0.1% in FY21 to 12% in FY23.

Exhibit 46: 16+ partnerships to build co-lending/BC book

Source: Company data, I-Sec research

Exhibit 47: Share of co-lending in overall AUM increased to 12% in last 2 years

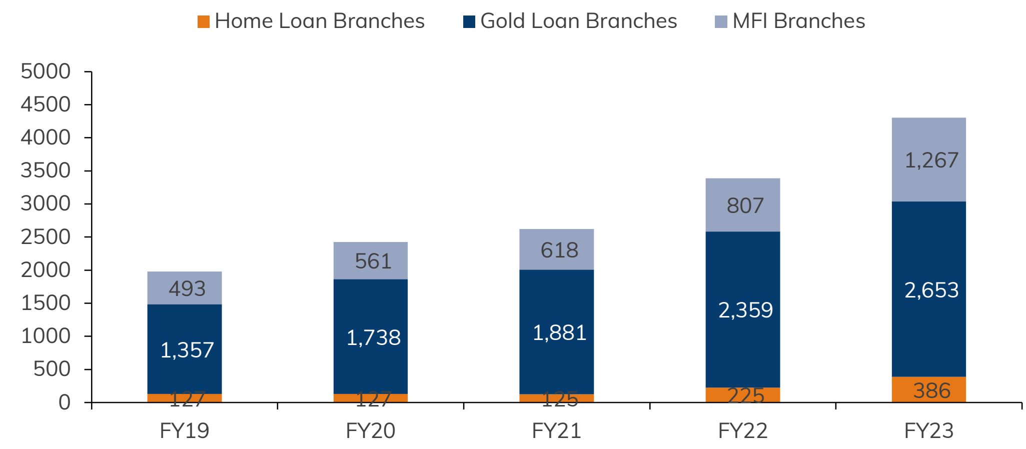


Source: Company data, I-Sec research

‘Phygital approach’ to support retailisation strategy

IIFL, with its strategic focus on scaling retail lending, has followed the hybrid model (combination of physical branches + digital platform). Over the past 5 years, it has built a strong branch network of >4,000 physical branches and has also developed strong digital capabilities to reach the last mile.

Exhibit 48: One of the highest physical distribution networks with >4,000 branches

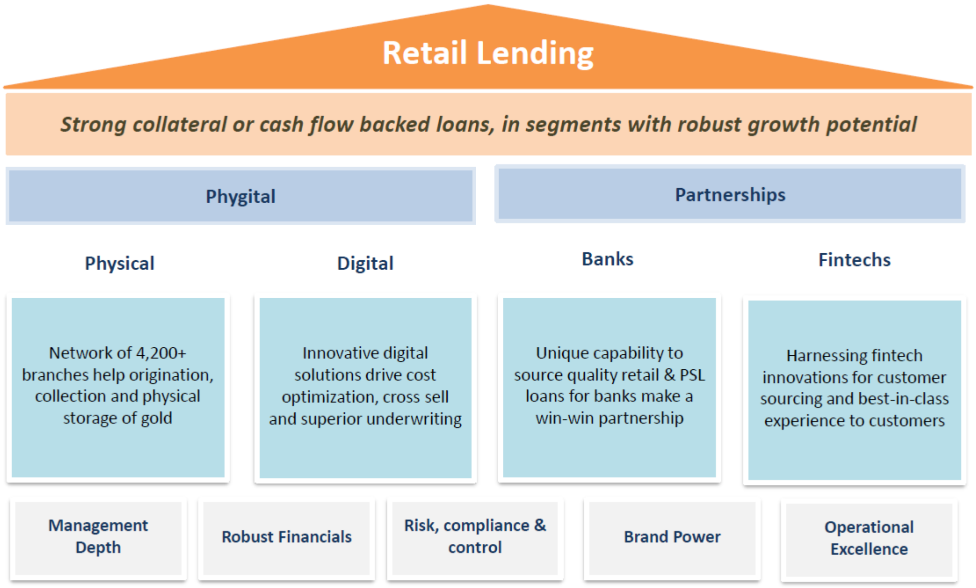


Source: Company data, I-Sec research

Total branch network increased to 4,267 as on Mar’23 from ~1,300 in Mar’18 and the same supported successful scale up of its retail AUM to INR 615bn in Mar’23 from INR 214bn in Mar’18. Increased physical presence has helped the company drive its gold loan and MFI businesses. Of the total 4,267 branches, 2,653 are dedicated gold loan branches spread across 25 states/union territories, followed by 1,267 dedicated MFI branches. Furthermore, around 84% of total gold loan branches were located in non-metros, semi-urban and rural areas, which remains in line with the company’s strategy to reach the last-mile connectivity. Consequently, the company has been able to achieve a large customer base of 5mn and 2.4mn customers in gold and MFI segments, respectively.

In order to enhance its reach and improve customer experience, the company has been consistently investing and upgrading its technology platforms. It has put in place a strong digital infrastructure which helps it generate leads in a faster manner through its website or mobile application. By leveraging large in-house data, alternate data points and analytics, 99% of home loan customers are on-boarded and decisioned through the digital platform.

Exhibit 49: Phygital approach to support retailisation strategy



Source: Company data

The company's adoption of 'phygital model' helps it reach a larger footprint and serve a larger diversified customer base pan-India. Through its presence, the company also leverages upon the opportunity to cross-sell its diversified product offerings to customers.

Cycle tested credit model – average GNPL stood at 2% in the past 5 years despite covid-led disruption

Stringent underwriting, robust collection mechanism and reduced exposure in lumpy and cyclical businesses such as CV, CRE and capital market financing helped IIFL in containing GNPL ratio at an average 2% in the past 5 years. Product specific credit policies, extensive use of technology to minimise human error and robust risk management practice are the key enablers of its pristine asset quality indicators. As a part of its risk management practices, the company has set a detailed-criteria and it takes into account multiple data sets for analysing its customers. Some of the key risk management practices adopted by the company are as follows -

- *Hygiene data checks* – Demographics, geography, sector, credit bureau records and other KYC documents.
- *Individual assessment* – Individual earnings profile, credit history and ability to repay loans in the past, followed by personal interviews and marketing and banking reference checks for all the applicants to the loan.
- *Institutional assessment* – In addition to the above mentioned checks, the company also verifies the business viability, experience of the promoter/management and business reputation for its institutional borrowers.

Additionally, the company's asset-light model, with 38% of overall AUM directed towards co-lending and securitisation, further provides comfort on credit cost resulting from the risk-sharing with partners.

Credit cost remained at an average of 1.7% in the last five years (FY19-FY23) owing to the well-diversified retail asset portfolio of the company which has helped it manage its asset-quality metrics fairly well. The asset-quality indicators for the company remained comfortable despite the pandemic waves with GNPL ratio of 2.0%/2.0%/3.2%/1.8% in FY20/FY21/FY22/FY23, respectively. While GNPL ratio increased to 3.2% in FY22, the same remained well under control and was in line with industry trends. The increase in GNPL in FY22 was primarily driven by the impact of the second-wave of Covid-19 on the vulnerable segments of affordable home loan, LAP and MFI, wherein, the GNPL ratio increased to 2.6%, 4.8% and 3.9%, respectively, as compared to 1.4%, 2.5% and 1.5% in FY20.

Exhibit 50: Asset quality: IIFL Finance – consolidated

	FY18	FY19	FY20	FY21	FY22	FY23
Gross NPA on loan book (%)	1.6%	1.7%	2.0%	2.0%	3.2%	1.8%
Net NPA on loan book (%)	0.6%	0.5%	0.8%	0.9%	1.8%	1.1%
Standard asset provision + SICR (INR bn)	5.0	4.6	4.6	9.4	8.7	9.3
NPA provision (INR bn)	3.1	3.7	3.7	3.9	4.5	3.0
Total provision coverage	162%	153%	129%	186%	123%	167%
Specific provision coverage	63%	68%	58%	55%	42%	41%

Source: Company data, I-Sec research

With strong collection efforts being put down by the company, GNPL ratio for home loan, LAP and microfinance came down to 1.9%/2.9%/2.1%, thereby, moving towards the pre-covid levels of 0.8%/1.2%/0.5%, respectively.

Exhibit 51: Controlled asset quality metrics despite the pandemic

	FY18	FY19	FY20	FY21	FY22	FY23
GNPA on loan book (%)	**1.7%**	**2.0%**	**2.3%**	**2.1%**	**3.2%**	**1.8%**
Home Loan	0.7%	0.8%	1.4%	1.5%	2.6%	1.9%
Gold Loan	0.3%	0.2%	0.3%	0.6%	0.9%	0.8%
LAP	0.9%	1.2%	2.5%	3.4%	4.8%	2.9%
Digital Loan	2.7%	5.8%	7.2%	11.8%	9.7%	3.6%
Microfinance	0.8%	0.5%	1.5%	1.8%	3.9%	2.1%
CRE	2.4%	4.4%	5.0%	1.4%	4.3%	0.4%
Capital Market	0.0%	1.5%	0.0%	0.0%	0.0%	0.0%

Source: Company data, I-Sec research

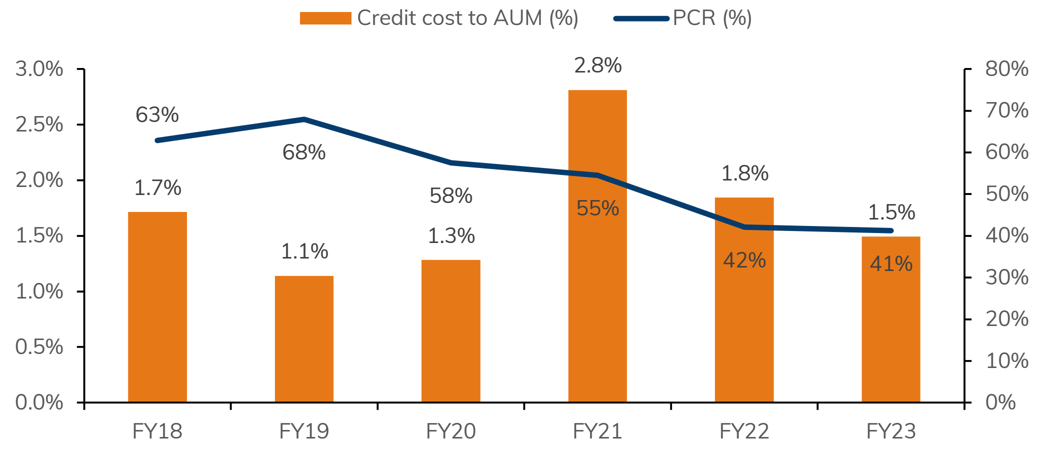
The company continues to create adequate ECL provisioning of 2.9% as on Mar'23, with credit cost of 1.5% in FY23 as compared to the peak of 2.8% in FY21 (covid-related provisioning). We expect credit cost to remain at sub-1.5% in FY24E/FY25E.

Exhibit 52: Segment-wise, stage-wise portfolio spilt; stage-2 assets across products improved in FY23

	FY21	FY22	FY23
Stage 1 assets			
Home Loans	95.2%	94.1%	94.1%
Gold Loans	80.7%	94.2%	93.2%
Business Loans	82.4%	83.0%	89.4%
Microfinance	94.3%	90.6%	95.0%
Construction and real estate	89.7%	91.5%	94.2%
Capital market finance	76.4%	99.8%	97.9%
Total	87.9%	91.4%	93.2%
Stage 2 assets			
Home Loans	3.3%	3.3%	3.9%
Gold Loans	18.7%	4.9%	6.0%
Business Loans	11.9%	11.0%	7.5%
Microfinance	3.9%	5.5%	2.9%
Construction and real estate	9.2%	4.3%	5.4%
Capital market finance	23.6%	0.2%	2.1%
Total	10.1%	5.5%	4.9%
Stage 3 assets			
Home Loans	1.5%	2.6%	1.9%
Gold Loans	0.6%	0.9%	0.8%
Business Loans	5.7%	6.0%	3.2%
Microfinance	1.8%	3.9%	2.1%
Construction and real estate	1.1%	4.2%	0.4%
Capital market finance	0.0%	0.0%	2.2%
Total	2.0%	3.2%	1.8%

Source: Company data, I-Sec research

Exhibit 53: Credit cost reached the pre-pandemic levels after the peak in FY21



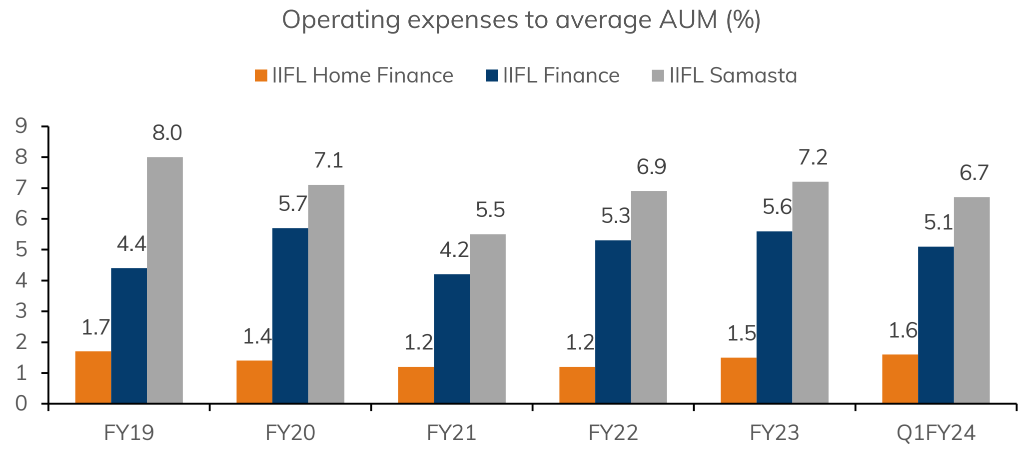
Source: Company data, I-Sec research

Focus on cost rationalisation – digitised process to drive operational efficiencies

In order to build strong retail asset franchise, IIFL has accelerated its investment towards branch expansion and technology given its deep distribution network and digitally enabled loan processes are prerequisite to build pan-India retail asset business. It added >1,600 branches between FY21-23 – with >700 gold loan branch additions, >600 MFI branches and >250 HL branches. As a result, its cost AUM increased to 1.5% / 5.6% / 7.2% in FY23 from 1.2% / 4.2% / 5.5% in FY21 for IIFL Home, IIFL Finance and IIFL Samasta, respectively.

Apart from expanding physical footprint, it focused on digitising all organisational functions as it believes technology-driven processes would aid in product innovation, quick turnaround times, cost optimisation and superior customer experience. IIFL aims to streamline processes across the loan lifecycle including sourcing and on-boarding, underwriting, administration, monitoring and collection in order to further improve turnaround times, enhance the customer service quality as well as improve operational efficiencies.

Exhibit 54: During the past 3 years, IIFL has been investing in franchise build up; incrementally focusing on sweating the existing infrastructure



Source: Company data, I-Sec research

With IIFL's phygital approach, robust risk management and capabilities in data analytics, it has been taking multiple steps to streamline its processes and achieve high operational efficiencies. Some of the key steps taken by the company are as follows –

- ***End-to-end data capturing and analysis:*** The company has its in-house loan origination system, wherein, all the data and the necessary documents are uploaded by the sales team on the application. The process starts with inputting the phone number and PAN details post which all the information pertaining to KYC, credit bureau, etc is automatically extracted. This, along with other 35-40 inputs, are then analysed through AI/ML tools, thereby, reducing the overall TAT.
- ***Partnerships with fintechs:*** The company has partnered with multiple fintech platforms such as Indifi, Kreditbee, Mobiwik, Tata Digital etc, which are well integrated into the application systems. It takes the advantage of these innovative digital models for the purpose of customer sourcing, which enables it to give them the best-in-class customer experience.
- ***Instant approvals for unsecured loans and top-up home and MSME loans:*** As the company is aggressively investing in its digital transformation journey, through its 'My Money' app and WhatsApp, it is able to provide instant approvals for unsecured loans and top-up on home loans and secured MSME, with the entire journey being paperless, having no manual intervention till the disbursements,

Diversified funding sources and strong credit profile

IIFL's 15+ years of experience, diversified retail base resulting in controlled asset quality metrics and stable business and financial performance with average credit cost of 1.7% and average net gearing of 4.7 times in FY19-FY23, has helped it improve its credit rating with no credit rating downgrade over the years of its rating history. As on Aug'23, IIFL had a rating of AA/Stable.

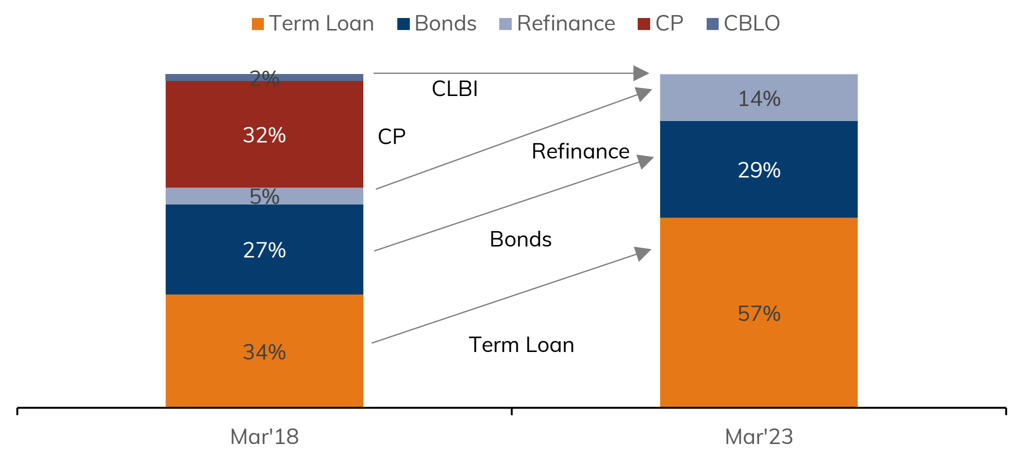
Exhibit 55: Credit rating history

		FY20	FY21	FY22	FY23
CRISIL	Bank facilities	CRISIL AA/Negative	CRISIL AA/Stable	CRISIL AA/Stable	CRISIL AA/Stable
	Non-convertible debentures	CRISIL AA/Negative	CRISIL AA/Stable	CRISIL AA/Stable	CRISIL AA/Stable
ICRA	Bank facilities	ICRA AA/Negative	ICRA AA/Negative	ICRA AA/Stable	ICRA AA/Stable
	Non-convertible debentures	ICRA AA/Negative	ICRA AA/Negative	ICRA AA/Stable	ICRA AA/Stable
CARE	Bank facilities		CARE AA/Negative	CARE AA/Stable	CARE AA/Stable
	Non-convertible debentures		CARE AA/Negative	CARE AA/Stable	CARE AA/Stable

Source: Company data, I-Sec research

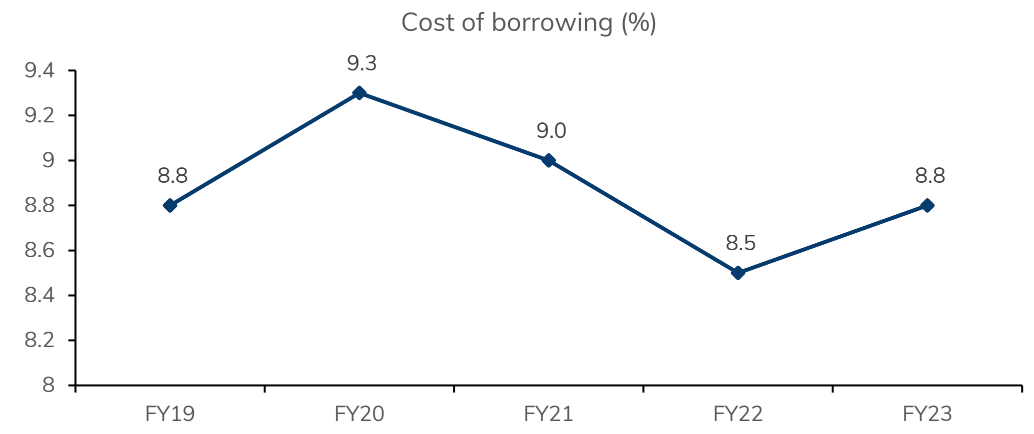
With stable business and financial performance, along with stable credit history, IIFL has maintained a diversified lender base spread across public sector banks, private sector banks, foreign banks, mutual funds and other financial institutions. The long-established relationships with these lenders has further helped the company to raise funds at competitive rates in the market. The funding profile of the company primarily consists of long-term funds through banks and NCDs, with bank funding (relatively low cost) at 57% of overall borrowings, as compared to 34% in FY18. The average cost of borrowing for the company stood at 8.8% in FY23.

Exhibit 56: Resource mix dominated by low-cost bank funding



Source: Company data, I-Sec research

Exhibit 57: Cost of borrowing fell by 20bps to 8.6% in FY23 despite rising rate cycle



Source: Company data, I-Sec research

Even in terms of short-term funding requirements, the company has been able to maintain sufficient liquidity with no ALM mismatches across buckets. As of Mar'23, the company had free cash and undrawn lines of INR 9.4bn.

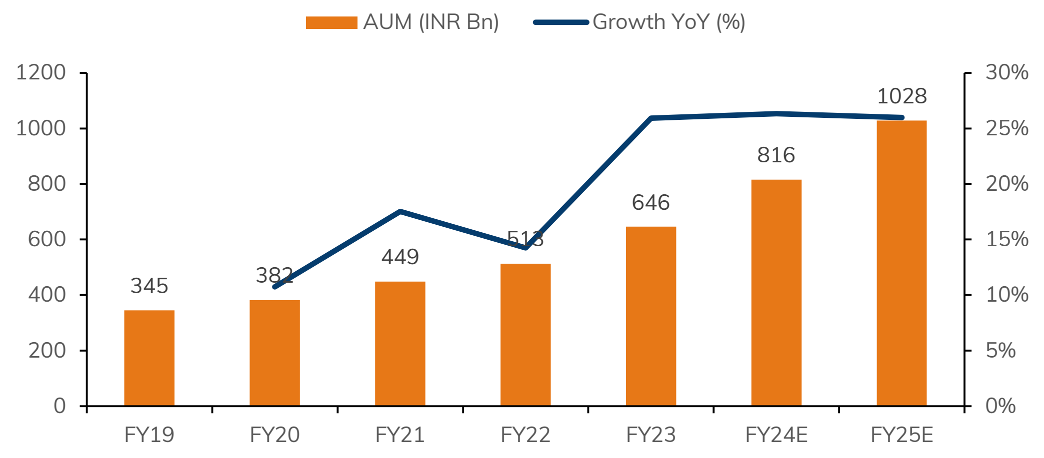
Financial outlook

Expanded distribution with most diversified retail portfolio, healthy capital position, strong liquidity position, to drive 25%+ AUM CAGR over FY23-FY25E

Business realignment between FY18-20 (defocusing cyclical and lumpy businesses such as CV / CE / CRE / capital market financing) and covid-led disruption in FY21-22 resulted in muted AUM CAGR at 14% during FY18-22. However, realigned business process and improving productivity (especially in newly-opened branches between FY21-22) led to growth reviving to robust 26% YoY in FY23. Notably, growth recovery was spread across products – HL grew 23% YoY, gold loans grew 28%, business loans grew 18%, digital loans grew 26% and MFI loans grew 59% while exposures in CRE fell by 7% and 31% for capital market financing in FY23.

Considering the vast untapped opportunity at ~INR 17trn in small-ticket lending, its deep distribution network with >4,000 branches, coupled with adequate capital and diversified funding sources, could help IIFL sustain its current high growth. We estimate 26% AUM CAGR over FY23-FY25E.

Exhibit 58: AUM CAGR likely to remain at 26% over FY23-FY25E



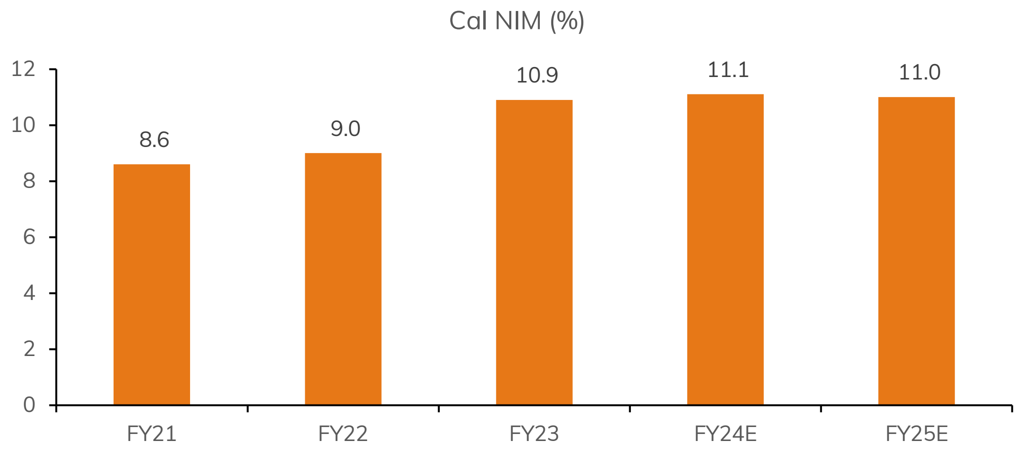
Source: Company data, I-Sec research

Improved credit rating, portfolio mix changing towards high-yielding products to ensure NIM at ~11% over FY23-25E

Over the years, IIFL has built diversified sources of funding including public, private and foreign banks, NBFCs, NCDs, etc. In order to ensure timely access to funds, it strategically replaced CP funding with bank funding. As on Mar'23, funding from banking channel stands as high as 57%, while CP funding fell from 32% in FY18 to nil in Mar'23. Healthy payment track record and strong financial performance across cycles have helped IIFL improve credit rating on continued basis. The same resulted in the cost of borrowing reducing from 8.9% in FY20 to 8.6% in FY23, despite increasing rate cycle. While we expect an increase in the borrowing cost in the near term (overall cost of funds increased to 9.1% in Q1FY24 from 8.6% in Q2FY23), incremental growth in high-yielding products like MFI, digital loan etc. would offset the impact of increasing borrowing cost on NIMs.

Between FY19-23, the share of MFI (yields at 24%) loans in overall AUM increased to 15% by Mar'23 from 7% in FY19. Gold loans (yields at 17.5%) share jumped to 32% by Mar'23 from 18% in FY19. The share of home loans remained steady at ~32-35% with average yield at 11%. We believe increased share of high-yielding products could offset the likely increase in the cost of borrowing. Hence, we expect NIM to remain stable at current level of ~11% during FY23-25E.

Exhibit 59: NIMs would sustain ~11% over FY23-25E



Source: Company data, I-Sec research

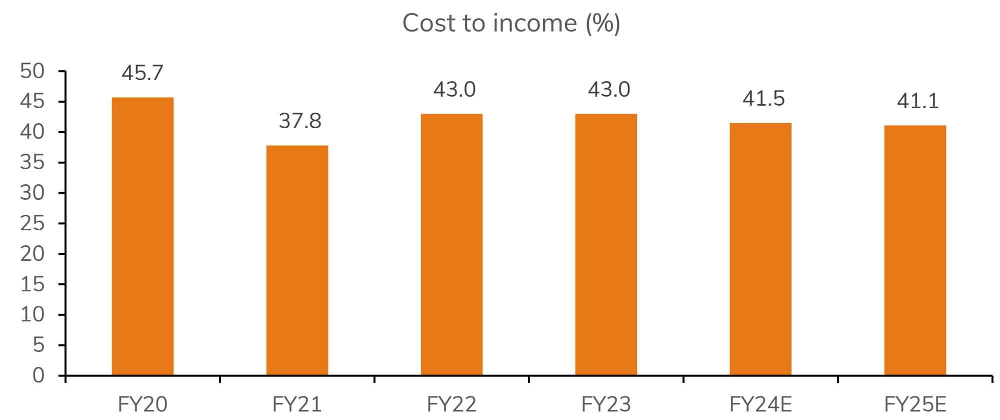
Productivity improvement and enhanced digital platform to drive cost efficiency

IIFL is at an inflection point with build-out phase now behind, hence, operating leverage is likely to drive profitability in the near term. Cost-income ratio moderated to 43% in FY23 from 52% in FY19. In the past 3 years, it added >1,600 branches. FY20-22 cost ratios include business build-up cost for branch expansion and technology upgradation.

IIFL has formulated an IT strategic roadmap for the next 3 years that closely aligns with business growth plans, which manage growing business volumes without increasing costs proportionately. For example, end-to-end digital process to avoid repetitive tasks such as data entry and quality check and the same enables handling of growing business volumes without increasing human capital.

It is currently focusing on productivity and process improvement by adopting the latest technology to drive cost/asset lower over FY23-25E.

Exhibit 60: Focus on cost optimisation to continue

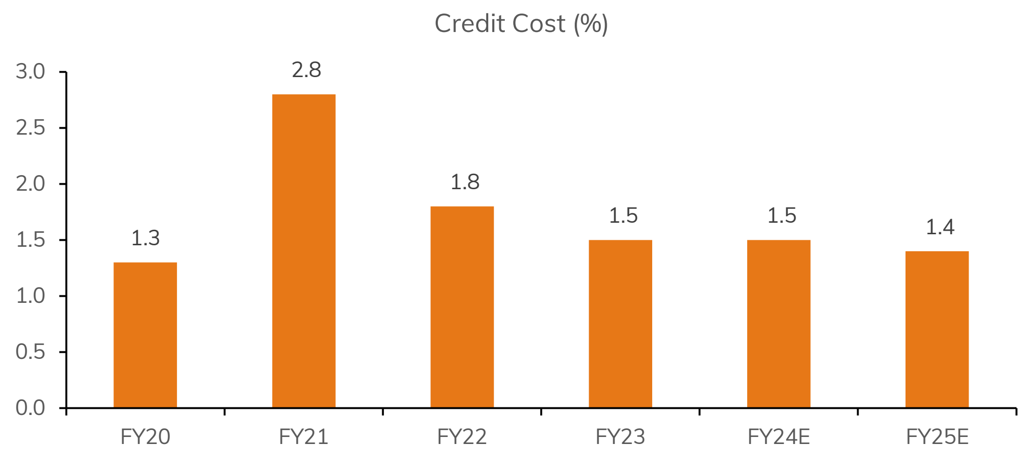


Source: Company data, I-Sec research

Proactive risk management and stringent underwriting process coupled with negligible stressed asset pool to drive credit cost lower

Credit cost in the past 3 years (FY21-23) remained leveraged at an average >2% largely due to covid-led disruption. However, change in business strategy like – reducing exposure in lumpy and cyclical businesses (combined share of CV/CE/CRE/capital market financing fell to 5% by Mar'23 from 14% in Mar'20), thrust on technology led underwriting processes and stringent risk management policies have resulted in healthy portfolio quality indicators during covid. GNPL ratio during FY21/22/FY23 remained at 2.0% / 3.2% / 1.8%, respectively. NNPL at 1.08% and strong PCR at >40% (with PCR in MFI & CRE @ >60%) would ensure credit cost remaining <1.5% over FY23-25E.

Exhibit 61: Credit cost as percentage of AUM to remain at <1.5% over FY23-25E



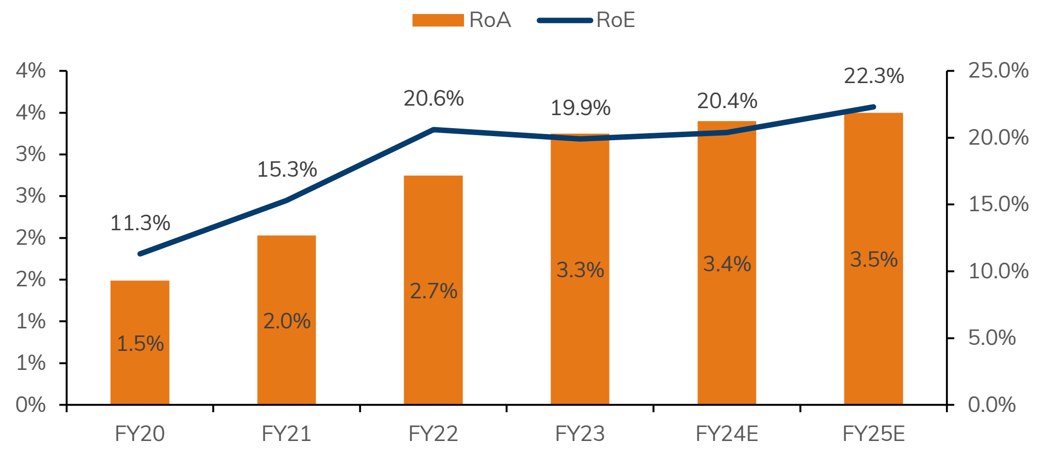
Source: Company data, I-Sec research

Healthy RoE of 20%+ to sustain over FY23-25E

IIFL, over the past 2 years, has shown >100bps of RoA improvement largely driven by: i) Credit cost moderating to 1.8% in FY23 from 3.1% in FY21 and ii) average earnings spread improving to 7.8% by FY23 from 5.9% in FY21. While cost ratio remained elevated in the past 2 years (4.5% in FY23 vs 3.2% in FY21), we believe IIFL's investment phase broadly concluded in FY23 in terms of investments towards building branch distribution and workforce, and deployment of technology. As a result, we expect cost-income ratio to moderate FY24E onwards.

While investment towards rapidly evolving technology and branches would continue, it would be more calibrated and specific to business needs. Hence, we expect cost ratios to broadly remain stable between 4.5% and 5% over FY23-25E. Negligible stressed asset pool at ~1% and PCR at >40% would ensure credit cost settling much lower at <2% during FY24-25E vs past 3-year average of >2%. The same reinforces our view that IIFL would sustain current healthy profitability (of >20% RoE) over FY23-25E.

Exhibit 62: Improving trajectory in return ratios to continue

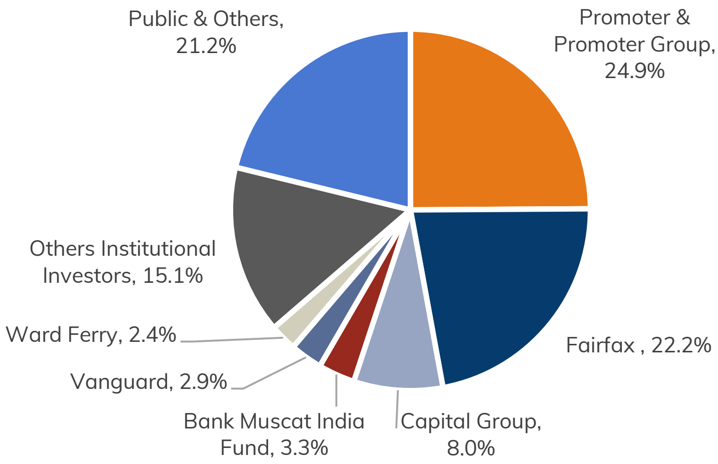


Source: Company data, I-Sec research

Company overview

IIFL Finance was incorporated in 1995 as a research firm and it started its lending business from 2006. The company is led by Mr Nirmal Jain (MD) and Mr R Venkataraman (Joint MD) and has strong institutional ownership with Fairfax Group holding 22.2%% as of Mar 31, '23.

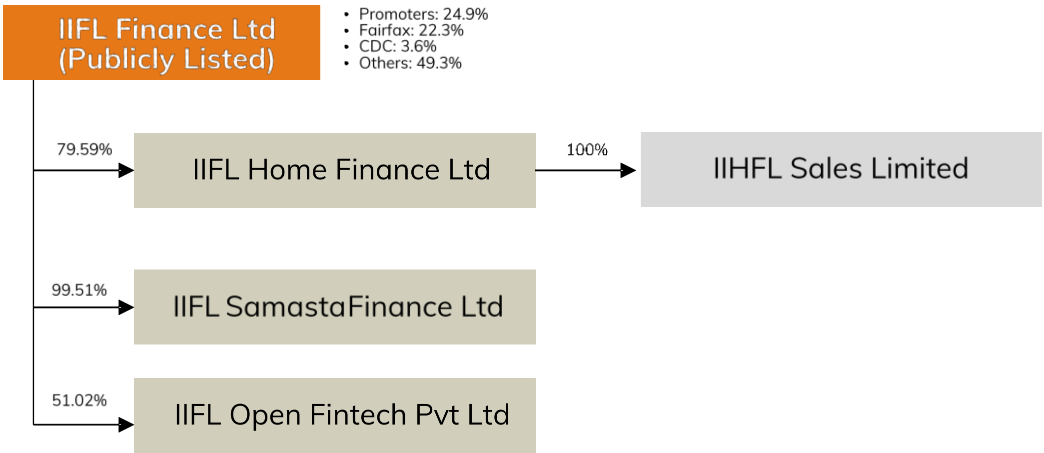
Exhibit 63: Shareholding pattern as on Mar 31, '23



Source: Company data

IIFL Finance operates through three subsidiaries, i.e. IIFL Home Finance Limited, IIFL Samasta Finance Limited and IIFL Open Fintech Limited. The company, along with its subsidiaries, offers a diverse range of retail financing products, comprising gold loans, home loans, loans against property, microfinance loans and digital loans.

Exhibit 64: Organisation structure



Source: Company data, I-Sec research

Exhibit 65: Entity-wise product portfolio

Product	Entity in which the loans get booked
Home loans	IIFL Home Finance
Gold loans	IIFL Finance (standalone entity)
Business Loans	Unsecured loans are booked in IIFL Finance
	Secured loans being primarily LAP are booked in IIFL Home Finance
	Secured loans (LAP) given to MFI borrowers are booked in IIFL Samasta Finance
Microfinance	IIFL Samasta Finance
Construction & Real Estate	Old Real Estate Loans, including against collateral of land, reside in IIFL Finance
	Incremental Construction finance loans for green and affordable projects are done through IIFL Home Finance
Capital Market Finance	IIFL Finance (standalone entity)

Source: Company data, I-Sec research

The company follows 'phygital' model and has a robust distribution network across tier I, II and III cities. It has an extensive network of 4,200+ branches, combined with well-developed digital infrastructure. While the branches help in supporting gold loans, home loans, LAP and microfinance segments, digital platforms, on the other hand, help in expanding its reach in MSME and personal loans segments. As a result of its vast distribution, the company has pan-India presence in 30 states, serving over 8mn customers across different business segments. The company had consolidated AUM of INR 646.4bn (5-year CAGR of 16%), networth of INR 89.9bn and capital adequacy of 20.4% in FY23. It currently holds a rating of AA/Stable from CRISIL, ICRA and CARE.

Key Management Personnel

Name and Designation	Experience
Nirmal Jain Managing Director	Mr Nirmal Jain holds a PGDM (Post Graduate Diploma in Management) from the Indian Indian Institute of Management, Ahmedabad (IIMA) and is a rank holder Chartered Accountant and Cost Accountant. He started his career in 1989 with Hindustan Unilever Limited and founded IIFL Group as an independent equity research Company in 1995. He has close to three decades of experience spearheading diverse businesses in the financial services sector.
R Venkataraman Joint Managing Director	Mr. R. Venkataraman holds Post Graduate Diploma in Management from the Indian Institute of Management (IIM), Bangalore and Bachelor in Electronics and Electrical Communications Engineering from IIT Kharagpur. He joined the Company's Board in July 1999. He has been contributing immensely in the establishment of various businesses and spearheading key initiatives of the Group over the past 24 years. He previously held senior managerial positions in ICICI Limited, including ICICI Securities Limited, their investment banking joint venture with J P Morgan of US and Barclays –BZW. He worked as an Assistant Vice President with G E Capital Services India Limited in their private equity division. He has a varied experience of more than 31 years in the financial services sector.
Kapish Jain Group Chief Financial Officer	Mr Kapish Jain is a qualified Chartered Accountant, Company Secretary, Cost Accountant & CPA. He comes with more than 25 years of experience in the BFSI sector across all areas of Finance, Strategy, Treasury, IR, FP&A and Accounts. His earlier BFSI experience includes PNB Housing Finance, AU Small Finance Bank, Deutsche Bank, ICICI Prudential Life Insurance, etc.
Rupal Jain Company Secretary & Compliance Officer	Ms. Rupal Jain is a qualified member of Institute of Company Secretaries of India, a law graduate and a graduate in commerce. She has more than 10 years of experience in the field of Secretarial, Compliance, Legal, Regulatory Reporting and Joint Ventures. Her earlier experience includes National Stock Exchange, Centrum, Mahindra and Future Group.

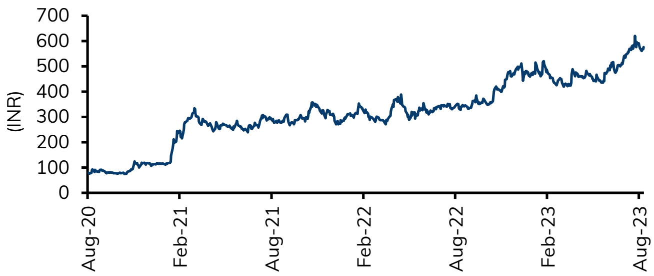
Source: Company data, I-Sec research

Exhibit 66: Shareholding pattern

%	Dec'22	Mar'23	Jun'23
Promoters	24.9	24.9	24.8
Institutional investors	31.7	32.2	34.2
MFs and others	0.6	0.6	2.0
FIs/Banks	0.0	0.0	0.0
Insurance	1.9	2.1	1.9
FIIs	29.2	29.5	30.3
Others	43.4	42.9	41.0

Source: Bloomberg

Exhibit 67: Price chart



Source: Bloomberg

Financial Summary

Exhibit 68: Profit & Loss

(INR mn, year ending March)

	FY22A	FY23A	FY24E	FY25E
Interest Income	60,224	72,346	87,900	1,09,470
Interest Expenses	(29,910)	(32,218)	(38,291)	(48,297)
Net Interest Income (NII)	**30,314**	**40,128**	**49,609**	**61,174**
Other Income	9,839	12,125	14,622	18,436
Total Income (net of interest expenses)	**40,153**	**52,253**	**64,230**	**79,610**
Employee benefit expenses	(9,307)	(13,295)	(15,575)	(19,093)
Depreciation and amortization	(1,217)	(1,526)	(1,788)	(2,191)
Other operating expenses	(5,394)	(7,645)	(9,325)	(11,431)
Total Operating Expense	**(15,918)**	**(22,466)**	**(26,687)**	**(32,715)**
Pre Provisioning Profits (PPoP)	**24,235**	**29,787**	**37,543**	**46,895**
Provisions and write offs	(8,875)	(8,661)	(11,115)	(12,649)
Profit before tax (PBT)	**15,360**	**21,125**	**26,428**	**34,246**
Total tax expenses	(3,477)	(5,050)	(6,431)	(8,328)
Profit after tax (PAT)	**11,883**	**16,076**	**19,997**	**25,919**

Source Company data, I-Sec research

Exhibit 69: Balance sheet

(INR mn, year ending March)

	FY22A	FY23A	FY24E	FY25E
Share capital	759	761	761	761
Reserves & surplus	63,879	89,160	1,05,180	1,25,921
Shareholders' funds	**64,638**	**89,921**	**1,05,941**	**1,26,682**
Borrowings	3,57,252	3,96,040	4,94,455	6,28,725
Provisions & Other Liabilities	37,153	31,952	39,160	43,299
Total Liabilities and Stakeholder's Equity	**4,59,102**	**5,30,013**	**6,53,019**	**8,13,936**
Cash and balance with RBI	81,569	58,390	71,418	88,302
Fixed assets	7,986	9,029	10,294	11,730
Loans	**3,36,929**	**4,00,011**	**4,95,369**	**6,19,731**
Investments	11,922	35,110	38,621	42,483
Current Assets including cash and bank	20,696	27,473	37,318	51,689
Total Assets	**4,59,102**	**5,30,013**	**6,53,019**	**8,13,936**

Source Company data, I-Sec research

Exhibit 70: Key ratios

(Year ending March)

	FY22A	FY23A	FY24E	FY25E
AUM and Disbursements (Rs mn)				
AUM	5,13,230	6,46,380	8,15,772	10,27,837
On-book Loans	3,17,830	3,93,660	5,12,380	6,41,440
Off-book Loans	1,95,400	2,52,720	3,03,392	3,86,397
Growth (%):				
Total AUM (%)	14.2	25.9	26.2	26.0
Loan book (on balance sheet) (%)	0.5	18.7	23.8	25.1
Total Assets (%)	12.9	15.4	23.2	24.6
Net Interest Income (NII) (%)	13.5	32.4	23.6	23.3
Non-interest income (%)	42.2	23.2	20.6	26.1
Total Income (net of interest expenses) (%)	19.4	30.1	22.9	23.9
Operating Expenses (%)	33.7	41.1	18.8	22.6
Employee Cost (%)	28.7	42.8	17.1	22.6
Non-Employee Cost (%)	49.1	41.7	22.0	22.6
Pre provisioning operating profits (PPoP) (%)	11.5	22.9	26.0	24.9
Provisions (%)	(24.1)	(2.4)	28.3	13.8
PBT (%)	52.9	37.5	25.1	29.6
PAT (%)	56.2	35.3	24.4	29.6
EPS (%)	55.9	35.0	24.4	29.6
Yields, interest costs and spreads (%)				
NIM on loan assets (%)	9.0	10.9	11.1	11.0
NIM on IEA (%)	5.6	6.2	6.2	6.1
NIM on AUM (%)	6.3	6.9	6.8	6.6
Yield on loan assets (%)	17.9	18.1	17.7	17.7
Yield on IEA (%)	11.0	11.1	11.0	10.9
Yield on AUM (%)	12.5	12.5	12.0	11.9
Cost of borrowings (%)	8.8	8.6	8.6	8.6
Interest Spreads (%)	9.1	9.5	9.1	9.1
Operating efficiencies				
Non-interest income as % of total income	14.0	14.4	14.3	14.4
Cost to income ratio	39.6	43.0	41.5	41.1
Op.costs/avg assets (%)	3.7	4.5	4.5	4.5
Op.costs/avg AUM (%)	3.3	3.9	3.7	3.5
Salaries as % of non-interest costs (%)	58.5	59.2	58.4	58.4
Capital Structure				
Average gearing ratio (x)	5.5	4.4	4.7	5.0
Leverage (x)	7.1	5.9	6.2	6.4

Source Company data, I-Sec research

	FY22A	FY23A	FY24E	FY25E
Asset quality and provisioning				
GNPA (%)	3.2	1.8	1.6	1.7
NNPA (%)	1.8	1.1	1.0	1.1
GNPA (Rs mn)	13,093	10,092	13,252	17,928
NNPA (Rs mn)	8,572	6,856	8,424	11,442
Coverage ratio (%)	41.9	41.3	36.4	36.2
Credit Costs as a % of avg AUM (bps)	184	149	152	137
Credit Costs as a % of avg on book loans (bps)	270	243	245	219
Return ratios				
RoAA (%)	2.7	3.3	3.4	3.5
RoAE (%)	20.1	20.8	20.4	22.3
ROAAUM (%)	2.5	2.8	2.7	2.8
Valuation Ratios				
No of shares	380	380	380	380
No of shares (fully diluted)	380	380	380	380
EPS (Rs)	31.3	42.3	52.6	68.1
EPS fully diluted (Rs)	31.3	42.3	52.6	68.1
Price to Earnings (x)	18.2	13.5	10.8	8.3
Price to Earnings (fully diluted) (x)	18.2	13.5	10.8	8.3
Book Value (fully diluted)	170	236	278	333
Adjusted book value	148	218	256	303
Price to Book	3.3	2.4	2.0	1.7
Price to Adjusted Book	3.9	2.6	2.2	1.9

Source Company data, I-Sec research

Exhibit 71: Key metrics

(Year ending March)

	FY22A	FY23A	FY24E	FY25E
DuPont Analysis				
Average Assets (Rs mn)	4,32,885	4,94,557	5,91,516	7,33,478
Average Loans (Rs mn)	3,36,130	3,68,470	4,47,690	5,57,550
Average Equity (Rs mn)	59,257	77,279	97,931	1,16,311
Interest earned (%)	13.9	14.6	14.9	14.9
Interest expended (%)	6.9	6.5	6.5	6.6
Gross Interest Spread (%)	**7.0**	**8.1**	**8.4**	**8.3**
Credit cost (%)	2.1	1.8	1.9	1.7
Net Interest Spread (%)	**5.0**	**6.4**	**6.5**	**6.6**
Operating cost (%)	3.7	4.5	4.5	4.5
Lending spread (%)	**1.3**	**1.8**	**2.0**	**2.2**
Non-interest income (%)	2.3	2.5	2.5	2.5
Operating Spread (%)	**3.5**	**4.3**	**4.5**	**4.7**
Tax rate (%)	22.6	23.9	24.3	24.3
ROAA (%)	**2.7**	**3.3**	**3.4**	**3.5**
Effective leverage (AA/ AE)	7.3	6.4	6.0	6.3
RoAE (%)	**20.1**	**20.8**	**20.4**	**22.3**

Source Company data, I-Sec research

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