India Ratings & Research
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India Ratings Affirms IIFL Finance's NCDs at 'IND AA'/Stable & Perpetual Debt at 'IND AA-'/Stable; Off Rating Watch with Negative Implications

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India Ratings and Research (Ind-Ra) has taken following actions on IIFL Finance Ltd's debt instruments:

Details of Instruments

Instrument Type	Date of Issuance	Coupon Rate	Maturity Date	Size of Issue (million)	Rating assigned along with Outlook/Watch	Rating Action
Non-convertible debentures*	-	-	-	INR2,500	IND AA/Stable	Affirmed; off Rating watch with Negative Implications
Perpetual debt (Tier 1 instrument) *#	-	-	-	INR 3,000	IND AA-/Stable	Affirmed; off Rating Watch with Negative Implications

*Yet to be issued

#Perpetual debt instruments are subject to coupon deferral if capital levels fall below the regulatory minimum, or if the servicing of coupon leads to capital levels falling below the regulatory minimum, or if the servicing of coupon leads to a loss after tax or an increase in loss after tax, and requires prior approval from the regulator, even if the capital levels then are above the regulatory minimum.

Analytical Approach

Ind-Ra continues to fully consolidate the business and financial risk profiles of IIFL Finance and its subsidiaries - IIFL Home Finance Ltd (79.59% stake; debt rated 'IND AA'/Stable) and IIFL Samasta Finance Ltd (99.56%; debt rated 'IND AA'/Stable), collectively referred to as the group hereafter, while arriving at the ratings. This is because of the significant operational, financial and managerial integration among the entities. Also, all the entities operate under a common brand.

Detailed Rationale of the Rating Action

Ind-Ra has resolved the Rating Watch with Negative Implications following the lifting of restrictions by the Reserve Bank of India on 19 September 2024 on sourcing, sanctioning, and disbursing of gold loans by IIFL Finance. The Reserve Bank of India had imposed the ban on the company on 4 March 2024. This is a significant development for the company, allowing it to focus on building back its gold business. There has been a ramp up in the company's gold loan portfolio post lifting of the embargo. Ind-Ra will continue to monitor the traction on this book complying with all the regulatory requirements. The group's profitability is likely to improve with the resumption of activities in the gold loan business, which is high yielding and offers good risk return trade off.

The ratings also factor in IIFL Finance's sizable franchisee, comfortable leverage and adequate resource raising ability. However, Ind-Ra opines that within the group, the asset quality for the microfinance (MFI) segment remains a monitorable and can witness some volatility in the medium term.

List of Key Rating Drivers

Strengths
- Significant player in major segments
- Adequate capitalisation
- Granularisation of loan book with reasonable mix of high-yielding asset classes
- Profitability could revive; although, credit cost a monitorable

Weaknesses
- Evolving funding profile; mobilisation from capital market - monitorable
- Asset quality could be volatile due to concerns in MFI book

Detailed Description of Key Rating Drivers

Significant Player in Major Segments: On a consolidated basis, the assets under management (AUM) declined 8.4% yoy to INR669.6 billion in 2QFY25 (FY24: INR789.6 billion, FY23: INR646.4 billion), largely due to the embargo placed on the gold finance business which was down 53.8% YTD in 1HFY25. Thus, regaining of the market share in the gold loan business will remain a rating monitorable. Post the lifting of the ban, IIFL Finance disbursed INR57.2 billion through 2,745 branches between 19 September 2024 and 6 November 2024, which is about 16% of its FY24 disbursements, reflecting tailwinds for the gold loan franchisee. Accordingly, gold AUM increased to INR126.8 billion on 6 November 2024 from INR108.0 billion in 2QFY25 (1QFY25: INR147.3 billion). The off-book was nearly 33.5% of the AUM mix in 2QFY25, including co-lending (about 12.7% of AUM). Furthermore, during the embargo period, IIFL took initiatives to focus on supply chain financing and secured business loan segment through the digital mode, leading to 53% yoy growth in the loan book to INR54.2 billion in 2QFY25. On the other hand, the share of non-core book reduced to 2.7% in 2QFY25 (FY24: 3.6%; FY19: 27%).

IIFL Home Finance is the largest player in the affordable housing finance segment with 387 network points and AUM of INR370.1 billion (2QFY25: up 19.3% yoy); the segment was not much impacted because of the embargo. Similarly, IIFL Samasta Finance, with 1,645 branches, created a sizeable presence in non-banking finance company (NBFC)-MFI space, and was among the top two players. AUM growth for the MFI business was largely flattish at 2.4% yoy mainly because of industry-wide asset quality issues; this will remain a key rating monitorable.

Adequate Capitalisation: The group's capitalisation remained adequate in 2QFY25 with a tangible net worth of INR137.23 billion (FY24: INR120.56 billion; FY23: INR102.02 billion). The improvement in net worth during 1HFY25 was supported by the rights issue of INR12.7 billion in IIFL Finance during May 2024. The gross leverage (debt/equity) stood at 2.9x in 2QFY25 (FY24: 3.9x; FY21: 3.9x). The group's capitalisation is further supported by the large share of off-balance sheet portfolio of 33.5% at 2QFYE25 (FYE24: 35.6%; FYE23: 38.0%). This leads to optimum utilisation of capital and improved return ratios. Ind-Ra believes the gross leverage is unlikely to increase substantially hereafter, given lower AUM growth than the historical trends.

On a standalone basis, IIFL Finance 's capitalisation remained adequate with tier 1 ratio of 20.07% at 2QFYE25 (FYE24: 12.56%; FYE23: 12.85%) and gross leverage of 2.4x (3.6x; 3.4x). IIFL Home Finance's tier 1 ratio was 44.4% at 2QFYE25 (FYE24: 37.62%; FYE23: 39.2%) and gross leverage was 2.4x (2.7x; 2.7x), while IIFL Samasta Finance's tier 1 ratio was 23.88% (17.7%; 13.5%) and gross leverage was 3.6x (4.6x, 5.4x).

Granularisation of Loan Book with Reasonable Mix of High-yielding Asset Classes: The retail orientation of the loan portfolio started in FY19, when IIFL Finance sold its commercial vehicle business and started scaling down wholesale vertical - real estate and capital market financing. It has high-yielding segments such as gold, MFI and digital loans, and also has a presence in safer asset classes such as mortgage. Even the gold loan business, while offering high yields, has minimal through-the-cycle credit cost. IIFL's AUM grew at a CAGR of 18% between FY19 and FY24, driven by its retail portfolio (21% CAGR). Consequently, its retail book's share in the total AUM increased to 97.5% at FYE24 (FYE19: 83.6%).

Under the commercial real estate exposure, the group finances the completion of projects already funded by it and looks at small-ticket construction finance through IIFL Home Finance. The capital market portfolio comprises loans against shares towards known customers of IIFL Securities Ltd.

Profitability Could Revive; Although, Credit Cost a Monitorable: IIFL Finance's AUM exposure is largely towards high-yielding segments. Ind-Ra expects the company's profitability to revive on scaling up of the gold loan book (about 19 yield). Effective management of credit costs will be key to fully leverage on the benefits of operating scale. Additionally, higher off-balance sheet share in AUM helps to enhance return ratios without heavy capital consumption.

The restrictions on making incremental disbursements during the embargo impacted the group's profitability in 1HFY25. IIFL Finance, on a standalone basis, reported a loss of INR4.64 billion in 1HFY25, largely due to an INR5.87 billion provision for alternate investment fund (AIF) investments, lack of assignment income due to the restrictions, and continuation of operating expenditure since IIFL Finance did not resort to rationalisation of branches and employees. The company's management expects some recovery from the security receipt book due to sale of AIF investment to ARC over the medium term.

On a consolidated basis, the spreads declined 80bp to 7.1% in 1HFY25, largely due to weaker traction in gold and MFI businesses, which impacted the overall yields; although the cost of funds increased only 10bp to 9.2% from 4QFY25. The operating expenditure to AUM increased to 4.05% in 1HFY25 (FY24: 3.91%; FY23: 3.88%), leading to a 20% yoy decline in the pre-provision operating profit (PPOP) to INR13.8 billion and a fall in the overall PPOP/AUM to 4.48% (4.85%; 5.14%). The credit cost stood at 1.8% in 1HFY25 (FY24: 2.0%, FY23: 2.35%) with the management providing for higher provisions in the real estate and MFI book. This led to an increase in the provision coverage ratio in stage 2 and stage 3 to 14.6% and 55.5%, respectively, in 1HFY25 (4QFY24: 8.4% and 49.1%, respectively).

Evolving Funding Profile; Mobilisation from Capital Market - Monitorable: During embargo, funding was a key monitorable for IIFL Finance as there were continuous repayments from gold loan book, which was entirely short term and specifically during the embargo from 4 March 2024 to 20 September 2024, IIFL Finance was able to mobilise INR90.8 billion of liquidity, of which INR33.8 billion of funding was through the direct assignment route, INR24.6 billion through term loans, INR16.8 billion through co- lending and INR8.8 billion through non-convertible debenture (NCD) route and CP of INR3.5 billion. Moreover, post 19 September 2024, IIFL raised INR62.8 billion, of which INR21.5 billion was from terms loans, INR9.95 billion through direct assignment route, INR19.7 billion through co-lending, INR3.65 billion through NCDs and INR8 billion through commercial paper (CP). Furthermore, as of 2QFY25, nearly 75% of the entire AUM remains priority sector lending compliant (FY24 :70%, FY23:68%) and can be securitised to raise immediate liquidity.

At 2QFYE25, on a consolidated basis, excluding securitisation, the borrowings were largely driven by term loans (52%), followed by debentures (25%), debt refinancing (16%), short-term debt (4%) and CP (2%). During embargo, IIFL Finance has demonstrated its capability to raise capital with the rights issue in May 2024. This, along with the company's ability to increase its off-book share during stressful periods, strengthens its position in the medium term. However, the share of capital market funding in the borrowing profile remains limited and is a rating monitorable in the medium term.

Asset Quality Could be Volatile due to Concerns in MFI Book: The group's gross non-performing assets were 2.4% in 2QFY25 (FY24: 2.3%; FY23: 1.8%) and net non-performing assets were 1.1% (1.2%; 1.1%). Gold loan (16.1% of AUM at 2QFYE25) and home finance (43.5% of AUM), which are larger segments of the business and primarily secured, reported 1+ days past due (dpd) of 25.8% and 9.8%, respectively, higher than comparable peers; delinquency from these segments remains to be seen. The group's credit cost has been declining since FY21 (FY24: 2%; FY23: 2.35%; FY22: 2.69%; FY21 3.77%), however, inched up to 2.75% in 1HFY25 (annualised), largely because of headwinds in the MFI business and the trailing impact of the run down in the gold business. The provision coverage ratio for the consolidated book for stage 2 and stage 3 stood at 14.6% and 55.5%, respectively, in 2QFY25. The overall provisioning stood at 3.19% of the loan book, which provides comfort. IIFL Finance also offers unsecured business loans such as digital loans; the risk-return trade-off in these loans has been adequate so far. However, being unsecured, the asset quality in this segment can be volatile.

The MFI industry witnessed headwinds due to events such as heatwaves, elections, and field-level attrition and overleveraging in certain geographies, for which the Microfinance Institutions Network has recently issued guardrails.

At 2QFYE25, IIFL Samasta 's 1+dpd and 90+dpd increased to 8.3% and 3.4%, respectively, (FY24: 3.8% and 2.1%, respectively), leading to the increase in the credit costs to 7.37% in 1HFY25 (annualised) from 4.87% in FY24. The credit costs were also impacted by a decline in the collection efficiency to 92% in September 2024 (April 2024: 96%, May 2024: 96.7%) . As of 2QFY25, IIFL Samasta had adequately provided for stress, with provision coverage of 87% on stage 3 assets and restructured assets worth INR0.07 billion, which is around 0.06% of the loan book; it expects to limit credit cost to 4%-5% in FY25. IIFL Samasta's ability to sustain collection efficiency and eventually reach the pre-pandemic levels of over 99%, along with incremental delinquencies on a steady-state basis will be a key rating monitorable.

Liquidity

Adequate: Based on the consolidated ALM (prepared on behavioural basis) for September 2024, IIFL Finance had a cumulative surplus of 16.4% of assets until one year. The asset-liability maturity profile is supported by the short tenure book of gold loans and MFI loans; however, the mortgage book has a long tenure. The mortgage book's behavioural tenure is shorter than the contractual tenure, which supports the ALM profile. IIFL Finance can raise liquidity by assigning/securitising the loan book. IIFL Finance has not heavily relied on the CP route, which alleviates early redemption pressures to a certain extent. As of October 2024, on a consolidated basis, the group had cash and unutilised bank lines of INR46.0 billion, sufficient to cover 104% and 59% of outflows over the next three months and six months, respectively.

Rating Sensitivities

Positive: Developments that could collectively result in a positive rating action are:
- a significant expansion of the group franchise, along with increasing the market share and maintaining the leadership position in the core business lines, as well as maintaining capitalisation levels,
- a continuous demonstration of ability to manage asset quality with minimum volatility through the cycle,
- an improvement of profitability buffers,
- diversification in the funding profile with optimum proportion of on-book and off-book assets.

Negative: Developments that could individually or collectively, result in a negative rating action include:
- sustained deterioration in the market share or a significant loss of the franchise,
- a sharp increase in the credit cost, leading to sustained depletion of the operating buffers,
- funding challenges and a decline in the liquidity buffer,
- depletion of the capital buffers such that consolidated the gross leverage exceeding 4.5x on a sustained basis.

ESG Issues

ESG Factors Minimally Relevant to Rating: Unless otherwise disclosed in this section, the ESG issues are credit neutral or have only a minimal credit impact on IIFL Finance, due to either their nature or the way in which they are being managed by the entity. For more information on Ind-Ra's ESG Relevance Disclosures, please click here. For answers to frequently asked questions regarding ESG Relevance Disclosures and their impact on ratings, please click here.

About the Company

IIFL Finance began its operations in 2006. At 2QFYE25, it had an AUM of INR669.6 billion and operated through 4,777 branches. IIFL Home Finance constitutes 55.4% of the total AUM, followed by IIFL Finance (standalone) and IIFL Samasta at 26.0% and 18.6% of the AUM, respectively.

Key Financial Indicators

Particulars (Consolidated)	FY24	FY23
Assets (INR billion)	624	530
Equity (INR billion)	120.6	102.0
Profit after tax (INR billion)	19.7	16.1
Return on average assets	3.06	3.03
Return on managed assets	2.35	2.29
Equity/assets (%)	19.31	19.25
Source: Ind-Ra, IIFL Finance		

Particulars (Standalone)	FY24	FY23

Assets (INR billion)	275.9	240.8
Equity (INR billion)	56.0	51.1
Profit after tax (INR billion)	5.8	8.1
Return on average assets	3.4	3.3
Return on equity	18.4	19.9
Equity/assets (%)	20.3	21.2
Source: Ind-Ra, IIFL Finance		

Status of Non-Cooperation with previous rating agency

Not applicable

Rating History

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook			
	Rating Type	Rated Limits (million)	Rating	9 September 2024	13 March 2024	22 February 2024	16 January 2024
Non-convertible debentures	Long-term	INR2,500	IND AA/Stable	IND AA/Rating Watch with Negative Implications	IND AA/Rating Watch with Negative Implications	IND AA/Positive	IND AA/Positive
Perpetual debt (Tier 1 instrument)	Long-term	INR3,000	IND AA-/Stable	IND AA-/Rating Watch with Negative Implications	IND AA-/Rating Watch with Negative Implications	IND AA-/Positiv e	-

Complexity Level of the Instruments

Instrument Type	Complexity Indicator
Non-convertible debenture	Low
Perpetual debt (Tier 1 instrument)	High

For details on the complexity level of the instruments, please visit https://www.indiaratings.co.in/complexity- indicators.

Contact

Primary Analyst
Pankaj Naik
Director
India Ratings and Research Pvt Ltd
Wockhardt Towers, 4th Floor, West Wing, Bandra Kurla Complex, Bandra East,Mumbai - 400051
+91 22 40001723
For queries, please contact: infogrp@indiaratings.co.in

Secondary Analyst
Ankit Jain
Senior Analyst
+91 22 40356160

Media Relation
Ameya Bodkhe
Marketing Manager
+91 22 40356121

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Ind-Ra currently maintains coverage of corporate issuers, financial institutions (including banks and insurance companies), finance and leasing companies, managed funds, urban local bodies and project finance companies.

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APPLICABLE CRITERIA AND POLICIES

Non-Bank Finance Companies Criteria

Evaluating Corporate Governance

Policy for Placing Ratings on Rating Watch

Financial Institutions Rating Criteria

The Rating Process