September 15, 2021

In this letter:

- Key takeaways from our on the ground visits
- **Travel dates:** 06-08 September 2021
- **Cities:** Ahmedabad, Vadodara and adjoining talukas in Gujarat
- **Focus sector:** BFSI – heavy index weight – most impacted due to Covid-19
- **Positive observations:** collections have improved, businesses are getting ready for festive season, housing demand remains strong, low ticket-size lending has massive growth run-way
- **Negative observations:** stress in low ticket-size book, gold loans used to evergreen other loans, LCV/local taxi operators (Ola/Uber) under stress, auto dealerships & apparel retail facing the heat

Dear Investors,

We at Anived have always believed it's crucial to spend time on the ground to get a first-hand feel of happenings in the marketplace. We firmly believe in the concept that the map is not the territory. What appears in annual and quarterly reports of a company is a reduced representation of the actual picture on the ground. Softer issues like the demand drivers, competitive intensity, supply chain dynamics, new product launches, etc for companies are better understood from on-the-ground feedback. For financial services, one needs to dig deeper than paper and excel reports to understand parameters like asset quality, collection efficiency, file rejections, and sourcing.

While we used to do this exercise once every 4-6 months, the Covid pandemic restricted our travel for the last 18 months. We have had umpteenth conversations with our portfolio companies, dealers, DSAs, promoters, brokers, real estate companies, stockists, etc in the last 18 months but nothing like where rubber meets the road

Please note the key takeaways mentioned below are based on our meetings with a few key personnel ranging from branch managers, regional collection heads, credit officers, business heads, and DSAs at the financial services firms. Since these snippets are related to a few cities and centers in Gujarat we would advise readers not to extrapolate these as national trends. However, in our view, this should give us a fair idea of what's happening on the ground.

- Most businesses seem to have bounced back from the April-May lows in 2021. Collection efficiency has significantly improved in the months of July-August and is now running as high as 99%+ in most cases.
- Some business segments remain under heavy duress and will take 12-18 months more to bounce back assuming the third Covid is not severe. These include restaurants, apparel retail, travel & tourism, school-dependent vendors, and businesses with higher fixed costs like auto dealerships, hotels, and malls.
- <u>Huge spikes in delinquencies as moratorium ended in October 2020</u>
    - October 2020 saw significant increases in stress cases as there was a moratorium on EMI payments till August 2020. Delinquencies in the 1 to 5 buckets jumped by 5-10x for most lenders in October 2020. However, the situation improved swiftly by January 2021 as collections infrastructure was ramped up and income generation resumed with opening up businesses. The Indian government's implementation of the Emergency Credit Line Guarantee Scheme (ECLGS) boosted confidence and eased pressure in the MSME segment. The option of One Time Restructuring (OTR) was also taken in cases with significant income challenges.
- Most financiers tightened their lending norms in the wake of the first Covid wave. The second wave further increased the scrutiny on fresh lending. Rejection cases have gone up meaningfully and a large portion is getting rejected at the login stage itself. Most financiers have raised the minimum required CIBIL score for new loans.
- <u>Housing on a turnaround cycle but challenges exists</u>
    - Across all discussions, the feedback was that there is a steady rebound in housing loans. After August/September 2020, housing loans have started doing very well driven by improved affordability led by a combination of low-interest rates, registration/stamp duty discounts, stagnation in real estate prices.
    - On probing further what also became apparent was that there seems to be a decent element of balance transfers happening between the players. The new home buyers seemed limited excluding certain suburbs of Ahmedabad (S.G Highway) and Vadodara (Vasna-Bhaili Road, Gotri Road, Old Padra Road).
    - Affordable housing demand with ticket sizes of INR 15-30 lakhs remains extremely strong driven by people moving out of old city areas to outskirts. Also, people from neighboring towns and villages are relocating to these cities for children's education, work, and a better lifestyle.

- Affordable housing lending is a 'feel and touch' based on business. Borrowers tend to be non-salaried or cash salaried and apart from ability-to-pay it becomes imperative to judge the intention-to-pay as well. Financiers need to regularly follow up on borrowers with physical visits to ensure the loan remains current.
- Surat remains an extremely tough housing market (mostly affordable) due to the large cash salaried segment and a high proportion of out-of-town labor. Morbi, a huge tiles and watches manufacturing hub, also has a high share of cash salaried. Vadodara remains a sweet market with almost 60-65% salaried class with large manufacturing companies like GNFC, IPCL, ABB, L&T, Alstom, and Linde.
- The housing cycle is picking up after a lull since 2017. Earlier some financiers faced serious asset quality issues, especially under-writing housing loans significantly beyond city limits.
- Resolutions under SARFAESI have been slow (6-18 months) and not remunerative. In best of cases, up to 60% of the loan value is successfully recovered. There is also a cultural barrier against buying auctioned properties.

* <u>Small ticket lending – long run way to growth but near-term concerns</u>
    - Lending opportunity in ticket sizes less than INR 2 lakhs remains significant. Most of these customer segments are informal and are trying to migrate away local money-lenders. Rates in unorganized unsecured segments border around 3-5% a month. Even gold loans, secured with 60-70% LTV, the lending rates are almost 2-3% a month. The sheer size of the market within this bracket provides massive opportunities for SFB's/tier-2 NBFC's.
    - However, the key here is the quality of underwriting of the financiers as stress at times is just one shock event away. Like the ongoing Covid pandemic. Cashflows of borrowers in the ticket sizes up to INR 5 lakh segments are still under severe stress. While some of these loans have got restructured wherever possible they will take at least 18-24 months to normalize and a good portion will still eventually slip to NPA.
    - We came across an interesting anecdote where a few borrowers who had missed their last few EMIs and have cheque bounce history were still able to obtain refinancing to clear dues of an existing financier. It could be a case of a new financier hoping for a turnaround scenario if economic activity picks up.
    - <u>All that glitter is not gold.</u> We also encountered many instances wherein the primary financiers helped customers get gold loans from other financiers to keep their loans current. Gold loan financing, especially at the lower end, seems to be a classic case of

kicking the can down the road. Gold loans are easier to process and disburse versus a personal loan. The latter has a much more tedious under-writing procedure. The processing fee on a gold loan is minimal versus the 1.5-3.0% charged in personal loans. As per RBI data, loans against gold by banks grew 82% in FY21. The figure will be higher if NBFCs and unorganized money lenders are included.

- <u>MFIs in collection-only mode</u>
  - MFI in Gujarat is a smaller market when compared to Southern or Eastern states. In the geographies that we visited, MFI lending focused on roadside vendors, proprietorship firms, and small businesses run from homes.
  - The stress in this segment is very high. These businesses have been badly hit by the Covid pandemic and current income levels are barely half of what they used to be pre-pandemic.
  - Many of these borrowers have taken a hit of medical expenses in the second wave. Any liquidity that they can muster now is put aside for future exigencies. It looks unlikely that their cashflows will reach normalcy even 12-18 months down the line.
- <u>Ola/Uber – high diesel prices affecting cash flows of drivers</u>
  - Another segment that has got hit meaningfully in recent times is the whole Ola/Uber eco-system due to the increase in fuel prices, particularly diesel.
  - During our stay in Vadodara, we had multiple instances of our trips being canceled by drivers as they only wanted cash payments even though each trip was yielding INR 1800-2000 for an 8-10 hour rental. Most of these drivers found a workaround solution to manage their daily working capital. They ran a negative balance with Ola/Uber - they collected the payments in cash paid Ola/Uber the commission and GST.
  - The increase in diesel prices has dented the Ola/Uber math severely. The following table is our understanding from a few drivers (bear with us and take it with pinch of salt).

Exhibit 1: Uber-Ola Driver Economics

Uber-Ola Driver Economics	
Revenues per km charged to customer	₹ 15.00
Net revenues made by Drivers (adjusted for GST) - 25-30% Payout +	**₹ 11.00**
Operating Costs	
Diesel - INR 100/litre - Mileage at 16-17kms/litre	₹ 6.00
Insurance	₹ 0.75
Maintenance and Out of Pocket	₹ 1.25
Total Operating Costs per km	**₹ 8.00**
Net take-home to Drivers per kms	**₹ 3.00**

Source: Anived PMS

- Assuming that a driver does 70kms per day and 28 days a month, he ends up driving ~2,000kms. Net take home works out to ~ INR 6,000/month (even after stretching it further could end up at INR 8,000/month). The EMI for the car is INR10,000-15,000/month depending on pricing, own share, vintage, etc of the vehicle. In the current environment, the whole math has fallen flat.
- The only silver lining from the increased fuel prices is the rising demand for CNG vehicles. Most CNG car models of Maruti have many months waiting period as under the BS6 regime installing a non-OEM CNG kit is illegal.

In conclusion, assuming that the third covid wave impact is muted and more localized, we believe that economic recovery will take 9-12 months to become more broad-based.

PS – Small businesses like your local apparel retailer, restaurants, taxis, day workers remain under significant stress. While following the Covid-19 protocols do your bit as much as you can.

Once again, we thank you for showing your interest in Anived PMS and look forward to your continued relationship with us. In case you have any queries, please feel free to contact us.

We wish you and your family good health and safety in the current challenging times.

Warm Regards,

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