MANAGEMENT DISCUSSION AND ANALYSIS
ANNEXURE 3

ECONOMIC REVIEW

Global

The global GDP strengthened to 3.8% in 2017 owing to rebound in trade activities, resurgent investment spending across advanced economies and developing economies. Among the advanced economies, the US tweaked its fiscal policies and tax reforms,which resulted in a positive impact on the global economy. The cyclical recovery in Europe helped to maintain growth momentum. The Emerging Markets and Developing Economies (EMDEs) continued to sustain their momentum with reduction in financing costs resulting in increased profits and improved business sentiments. It is expected that the global economy will operate close to the full capacity

Indian

A number of key structural initiatives by Government of India for a sustained growth resulted in 6.7% GDP growth during the year. Despite temporary hiccups owing to demonetisation and Goods and Service Tax (GST) Implementation, the economy witnessed strong revival with recovery in private investment and consumption. India jumped 30 spots ahead compared to its last ranking on the World Bank's Ease of Doing Business rankings. The positive improvements were tinged with anxieties relating to macro-economic stability. Fiscal deficits, the current account deficit and inflation were all marginally higher than expectations. The increase in the international oil prices added to India's macro-economic vulnerability. The Government of India is expected to recapitalise the Public Sector Banks ("PSBs") and initiate reforms in the sector .This measure will credibly shrink the unviable PSBs and signal greater private sector participation . GST has indicated signs of stabilisation. The upgrade of India's sovereign credit rating by Moody's from Baa3 to Baa2 has brought an indication that Indian economy would perform better than its peers. Measures introduced in the union budget for Minimum Support Price for farmers,impetus on agricultural products,increased spending in infrastructure and housing would raise rural demand,which will give rise to the economy .Implementation of seventh pay commission recommendations would increase private consumption. In all, the Indian economy is expected to maintain its recognition as the fastest growing major economy in the world.

INDUSTRY REVIEW

Indian Financial Services Sector

The Indian financial services sector comprising of commercial banks, insurance companies, non-banking financial companies ("NBFC"), co-operatives, pension funds, mutual funds and several other smaller financial entities, will dominate Indian economy over the next few decades. All these players are poised for a significant growth over the next few years as the reach of these entities is enhanced with financial inclusion measures such as Jan Dhan Yojana. The Indian financial sector has been operating in a fast-evolving and dynamic regulatory framework with a constant demand for transparency. In addition, customers expect one-stop and improved integrated financial services from these entities. There has been a tech-tonic shift with introduction of e-wallets, Unified Payment Interface (UPI), digital technologies software, robotics, artificial intelligence, API banking and digital wallets. The traditional banking model is changing fast with different technologies with seamless services. Payment banks, small finance banks, digital wallet companies, on line facilities for loans and chat bots are the new additions in recent times. These facilities would lead the sector towards operational efficiencies and better customer services.

Indian non-banking financial companies (NBFCs)

NBFCs are integral part of Indian financial system and are fast emerging as an alternative to mainstream banking. NBFC play an important role for financial inclusion by offering lending services to the unbanked population in rural, semi-rural and some urban areas. NBFCs act as a financial intermediary engaged in bringing the saving and the investing community to a common platform. NBFCs provide services such as personal loans, housing loans, loans against pledge of gold, life insurance general insurance loans for purchasing vehicles/equipment, to name a few, besides funding Micro, Small and Medium Enterprises (MSMEs) which serve the backbone of Indian economy.

The growth of the NBFCs is owed to their reach,cost efficiency, control on NPAs, customised products and better customer services. Besides,NBFCs have expertise in tailoring the credit to the need of the borrower. Moreover, like most of the other segments of India's financial sector, NBFCs too are transforming rapidly by using digital technology to improve customer interface. The emergence of tech-savvy online based NBFCs is helping the market grow fast and to absorb more players in the business sector.

A surge in liquidity, regulatory arbitrage, and the state of PSBs converged together to bring more success to NBFCs. NBFCs would continue to do well in the traditional stronghold of retail finance and may also enter into the wholesale finance segment, leading to a strong overall credit growth. The financial assets of NBFCs have recorded a compound annual growth rate ("CAGR") of 19 per cent over the past few years, comprising 13 per cent of the total credit which is expected to reach nearly 18 per cent by FY19.

MANAGEMENT DISCUSSION AND ANALYSIS

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Indian MSME segment

MSME segment in India is the key the engine of growth and plays a prominent role in the development of the country. The segment forms 8% of GDP, employing over 50 million people. It is still one of the highly untapped growth segments in India and an essential partner for achieving socio-economic growth. MSMEs, which are spread across both urban and rural areas of the country are largely in the unorganised sector. Importantly, this segment survived almost all threats emerging out from both domestic and international markets. Despite some infrastructural deficiencies and challenges like flow of institutional credit and inadequate market linkages, the MSME segment has registered a remarkable success with regard to increase in number, quantum of investment and scale of production.

The Union Budget 2017-18 further strengthened the sector by making key structural changes, enabling ease of doing business and providing tax benefits. These changes include:

1. Bringing on board PSBs and corporates on the MSME bill discounting platform and linking it with the GST Network. This will significantly ease the cash flow challenge to MSMEs. Linking to GST will make credit assessment easier and faster.
2. Proposing to evolve a scheme to provide a unique identity to every enterprise in India on the lines of Aadhaar, which will assist the KYC verification process for lenders. Earmarking ₹ 3 lakh crores for FY19 under the Pradhan Mantri Mudra Yojana.
3. Examining the policy and institutional development measures needed for creating the right environment for the growth of fintech companies
4. Contributing 12 percent of the wages of new employees in the Employee Provident Fund (EPF) for select sectors over the next three years to attract quality talent at lower cost
5. Reducing income tax for smaller companies with a turnover of up to ₹ 250 crores to 25 percent (from the existing turnover of up to ₹ 50 crore)

Role of NBFC in MSME financing

MSMEs face serious challenges in raising finance from banks and financial institutions. It is estimated that there is a total MSME debt demand of over ₹ 32 lakh Crores borrowing process is largely paper- driven. The lending of banks to MSME sector has remained lukewarm due to lack of sufficient information to assess creditworthiness of the borrower . This has led MSMEs to informal sources of finance with high borrowing cost. *(source: knnindia)*

NBFCs are converting this challenge into an opportunity and have become a major source of financing working capital demand of MSMEs due to innovative products and timely disbursements with the help of technology and accurate understanding of the customer/business need. NBFCs focus on cash flow based financing unlike Banks, who have traditionally relied on collateral-backed lending and historical statements. This has provided additional advantage to NBFCs to fund MSMEs.

Role of NBFC in automobile loans financing

India has become the fourth largest automobile market globally

(Source: https://economic times. india times. com The Indian auto industry is on the cusp of transformation, moving from BS-IV to BS-VI and later to electric vehicles. The industry touched a new point in higher sales in the FY18 despite issues related to GST and lack of clarity on the electric vehicle policy. Some of the facts highlighting the milestones include

(source: times of india. india times)

Production of passenger vehicles crossed the 4 million mark of which 19% of was exported.

1. Recorded highest-ever passenger vehicles sales
2. Production of two-wheelers surged by 16.12 per cent to 23 million. The production of scooters crossed 7 million and motorcycles crossed 15 million.
3. Recorded highest ever sale of two-wheeler with 20.2 million units
4. Recorded highest-ever two-wheeler exports of 2.8 million with a growth of 20.29 per cent. Scooters and motorcycles individually touched exports peak at 314,000 and 2.4 million, respectively.
5. Recorded highest ever domestic commercial vehicles sales to 856,453 units
6. Recorded highest-ever three-wheelers production touching the 1 million mark
7. Recorded highest ever three-wheeler sales, a surge by 24%

An improving macroeconomic environment coupled with higher government focus on infrastructure will contribute to growth in automobile production and sales . The market opportunity for NBFCs will further stem from the Government's proposed Voluntary Vehicle Modernisation Program me. It is expected that this will help NBFCs to grow close to 15% CAGR in vehicle loans over the next three fiscals . Increasing disposable incomes, sharper focus on Tier II/III cities, growing consumer preference for higher-value UVs and improving penetration of formal finance are further expected to propel growth.

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Role of NBFC in gold loans

In India, gold has been considered as a liquid asset and a universally accepted commodity with continuous value appreciation. It enjoys a special connection with Indians in terms of financial security, social status and rich cultural legacy in addition to emotional value .Due to these quotients , a large section of the population prefers to pledge its physical gold holdings as collateral and secure short-term loan against it instead of selling the gold. Loan against gold are offered both by Formal sector (banks, NBFCs and co-operatives) and informal sector (pawnbrokers, local moneylenders).The interest rate offered by banks/NBFCs is much lower than that of informal sector. In addition,the following reasons make Gold loans from NBFCs attractive:

1. Credibility and credentials: Borrowers would obviously entrust their physical gold to lenders in the locality who would ensure safekeeping and would return these intact upon the loan being settled. The NBFCs extending loan against gold have branches in urban/semi urban areas with sufficient security measures to safe keep the gold offered by customers. Besides, NBFCs insure the gold against theft and other unforeseen events. Periodic audits and inspections confirm the continued integrity of the holdings. Handling and storage is also done carefully, so as not to damage the ornaments.
2. Standard KYC checks: NBFCs ensure proper KYC (know your customer) as well as Fair Practice Codes in order to confirm the identity of borrowers and offer them a fair deal. In the event of loan default, auctions are resorted to, but only after giving the borrowers notice of such action and a chance to repay before auction.
3. Convenience: NBFCs having branch in urban/semi urban areas offer the advantage of proximity to the borrower, thereby helping him avoid carrying gold and cash to a distant place.

At present, NBFCs have a 32% share of the total gold loan market and the volumes are expected to grow in future. (source: https://www.moneycontrol.)

Role of NBFCs in housing loan

Buying a home is now a closer reality, with housing finance loans gaining prominence. Housing Finance constitutes a large part of disbursements for NBFCs besides being a critical segment for job creation, thus accounting for 5-6% of India's GDP and capital formation. Increase in a young working population, rapid nuclearisation of families and strong latent demand will further drive the housing demand.

Affordable housing has been attracting the interest of more developers. The Government has taken several noteworthy steps towards generating greater credit off take and supplies in affordable housing including implementation of Real Estate (Regulation and Development) Act or RERA. RERA is a milestone step towards stronger governance and greater transparency. It is a well-timed initiative to ensure industry development and a catalyst to meet the objectives of 'Housing for All by 2022'.

In view of growth in affordable housing,there would be greater credit demand for this segment,which would be a key growth driver for the housing finance companies(HFCs). In the consumer index pyramid, there is a huge demand for housing, especially at the lower and middle-income groups. Emergence of HFCs will make the industry broad-based, enhance demand and expand financial inclusion. During FY18 , the National Housing Board (NHB) amended its risk weight age rules for loans given by HFCs, thereby increasing the availability of funds with HFCs to lend. This move would also reduce the gap in the cost of funds to HFCs vis-a-vis banks for the purpose of giving home loans. NBFCs are well positioned to leverage their large distribution networks and dedicated customer service, to handle the voluminous business.

Personal Loan

India's personal loan scenario has been changing constantly. The lending and borrowing processes are getting easier and quicker. With the increasing popularity of digital finance in the country, personal loans have become accessible to almost every person. Personal loans account for about 22% of the overall bank credit given in the country. And, a major portion of this is given for housing. Even as all major sub-segments such as credit to industry, services and agriculture have shown either low or negative growth, personal loans (for housing, auto, education, as well as general) have begun to look up.

Company review

Incorporated in 1986, Shriram City Union Finance Limited ("Company") is amongst the major players in providing retail finance with an AUM of ₹ 27,461 crores and employee base of 28,665 as on March 31, 2018. It offers multiple loan products to small business owners and for acquiring assets such as two wheelers, commercial vehicles, passenger vehicles, loan against gold and personal loans. The Company operates across India with 969 branches.

MANAGEMENT DISCUSSION AND ANALYSIS

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Product wise performance review

Type loan	Disbursement during the year (₹ in crores)	Growth in disbursement over last year (%)	Asset under management (₹ in crores)	Growth in AUM over last year (%)
MSMEs	10,346	13	15,472	22
2-Wheeler	5,059	22	5022	24
Gold Loans	6722	1	3374	(2)
Personal	1924	38	2140	37
Auto	871	(16)	1453	2

Core Competencies

- Experienced Management
- Strong credit appraisal techniques
- Hub & Spoke model
- Consistent growth
- Shriram group strength
- Stringent risk-management framework

RISK MANAGEMENT

Shriram City Union Finance Limited has built a robust risk management framework over the years. Engaged, as it is, in retail financing, the Company has to manage various risks, including credit risk, market risk and operational risk. The Audit and Risk Management Committee review and monitor these risks on a regular basis. The Company manages credit risk through stringent credit norms established through several decades of experience in retail lending and continues to follow the time tested practice of personally assessing every borrower, before committing to a credit exposure.

Risk management is therefore made an integral part of the company's effective management practice.

Credit risk:

Credit risk arises when a borrower is unable to meet financial obligations to the lender. This could be either because of wrong assessment of the borrower's payment capabilities or due to uncertainties in future. The effective management of credit risk requires the establishment of appropriate credit risk policies and processes.

The Company has comprehensive and well-defined credit policies across various businesses, products and segments, which encompass credit approval process for all businesses along with guidelines for mitigating the risks associated with them. The appraisal process includes detailed risk assessment of the borrowers, tele verifications and field visits. The Company has a robust post sanction monitoring process to identify credit portfolio trends and early warning signals. This enables it to implement necessary changes to the credit policy, whenever the need arises. The Company developed a business decision model with support of McKinsey for credit assessment of its retail MSME portfolio

Market risk:

Market Risk is the possibility of loss arising from changes in the value of a financial instrument as a result of changes in market variables such as interest rates, exchange rates and other asset prices. The Company's exposure to market risk is a function of asset liability management activities. The Company is exposed to interest rate risk and liquidity risk.

The Company continuously monitors these risks and manages them through appropriate risk assessments. The Asset Liability Management Committee

(ALCO) reviews market-related trends and risks and adopts various strategies related to assets and liabilities, in line with the Company's risk management framework.

Operational risk:

Operational risks arise from inadequate or failed internal processes, people and systems or from external events. These are adequately addressed by the internal control systems. These systems are continuously reviewed, monitored and modified, as necessary. A stable and experienced management team provides much needed continuity and expertise in managing the dynamic changes in the market environment. Process improvements and quality control are on-going activities and are built into the employees' training modules, as well. The Company has well documented Standard Operating Procedures for all processes to ensure better control over transaction processing and regulatory compliance.

The Company also undertakes Risk based audits on a regular basis across all business units / functions. While examining the effectiveness of control framework through self-assessment, the risk-based audit would assure effective implementation of self-certification and internal financial controls adherence, thereby, reducing enterprise exposure. The Company has put in place a robust Disaster Recovery (DR) plan, which is periodically tested. Business Continuity Plan (BCP) is further put in place to ensure seamless continuity of operations including services to customers, when confronted with adverse events such as natural disasters, technological failures, human errors, terrorism, etc. Periodic testing is carried out to address gaps in the framework, if any. DR and BCP audits are conducted on a periodical basis to provide assurance regarding the effectiveness of the Company's readiness. The Company is continuously engaged in creating risk awareness and culture across the organisation through training on risk management tools.

MANAGEMENT DISCUSSION AND ANALYSIS

ANNEXURE 3 (Contd.)

INTEREST RATE RISK MANAGEMENT

Rate of interest of the various borrowings cannot be completely under control and cannot be only 'during course correction'. Various risk management techniques are adopted viz managing the business after assessing the various risks involved, to evaluate the interest rate risks & tolerance levels to manage the risks .Based on expected movement of interest rate in future, the types of funding i.e. wholesale, retail, fixed rate instruments, floating rate instruments etc are decided by taking into consideration the enhancement of relationship, the long term interest.

Interest rate risk management also involves Analysis & monitoring of the risk profiles forecasts by considering the effects of various possible changes in market conditions related to the balance sheet and arrive at the action needed to be within the internal limits.

Resources Risk Management and Liquidity Risk Management

Liquidity is the ability to meet liabilities as they become due. Liquidity can have impact on profitability in an adverse situation. Management of Assets and liabilities largely depend upon the interest rates, liquidity and respective risk profiles. Measuring and managing interest risks and liquidity risks are vital. Liquidity has to be tracked through maturity or cash flow mismatches.

For measuring and managing liquidity risk, the use of a maturity ladder and calculation of cumulative surplus/ deficit of funds at selected maturity dates is adopted as a standard tool. Not only the liquidity position is measured on an ongoing basis but same is done under various scenarios at various stressed levels.

Human Resource Risk Management:

The Company believes in crafting a workspace where people from diverse background can thrive and come together to contribute. The ever-changing customer needsis one of the key factors that dictates the direction of the People framework. The Company constantly works towards providing the best suited framework in partnership with business leadership. We have utilised the insights from thec urrent, past and potential employees. These have helped uscraft the employee value proposition for the organisation. The Company is committed towards it's people's development with adequate training and institutionalisation of the people review process. Employees at each level are encouraged for openness and for developmental conversations .The work force planning is strategically done . This has helped us create a long-term road map for gaining and managing future capabilities in the most optimum manner. The Company enjoyed a cordial relation with employees with no unrest .The Company is an equal opportunity provider and has implemented policy on prevention of sexual harassment of women employees at work place. Total number of employees as on March 31, 2018 was 28665.

CYBER RISK MANAGEMENT

Cyber security is a major concern for small businesses, individuals, large enterprises, the government and essentially anyone who participates in modern society.

Cyber Security at SCUF has set up an effective governance framework to manage cyber security. A suitable organisational structure has been put in place to monitor various cyber security threats and minimise them.

In order to protect critical assets from cyber-attacks, the Cyber Security Operations Center (SoC) operates on a 24/7 basis. In the year under review, SCUF further enhanced SoC to manage, respond and resolve cyber security.

In order to supplement the cyber security practice SCUF also conducts:

- Regular vulnerability assessments and penetration tests to assess/ remedy vulnerabilities in applications and IT infrastructure.
- Anti-phishing services have been subscribed to ensure that the phishing sites are observed in a timely manner and customers prevented from being lured to fraudulent sites.
- Risk engine and process monitoring systems are implemented to analyze and validate potential flow of transactions on Internet and other channels.
- The critical websites of the organisation are scanned and monitored continuously for early detection of any malware.
- Humans being the weakest link in cyber security, continuous awareness is carried out among employees and associates.

A testimony to the organisation crisis preparedness is that it has secured ISO 27001 certification for its critical information assets. Particularly in the year under review, SCUF made significant initiatives in strengthening protection against Distributed Denial of Service (DDoS) attacks and Web Application Firewall (WAF). The organisation also performs regular and strict cyber security drills to identify weak links and strengthen defense. It will continue to invest further in the coming years in the areas of cyber security to take it to the next level. During the year under review, it implemented a multi-faced disaster recovery solution for its back bone ERP application in case of a cyber-attack. This ensured that Core Business Application went without any prolonged outage. In addition, the Company has a well-rehearsed disaster recovery set-up, so as to ensure 99.5% up-time of important applications.

INFORMATION TECHNOLOGY RISK MANAGEMENT

Information Technology risk seeks to establish stringent information security structure to prevent data loss and threats.

MANAGEMENT DISCUSSION AND ANALYSIS

ANNEXURE 3 (Contd.)

The Company has implemented a robust IT Policy & Information Security Policy. These policies are in line with international best practices. They are reviewed periodically and suitably strengthened to address emerging threats.

Regular security drills and employee awareness programs are conducted to ensure security and increase awareness. The Company is a forerunner in setting up of a state of art Security Operations Centre (SoC) for 24 x 7 monitoring of various attacks and threats on its IT infrastructure.

The SoC has the following attributes:

Visibility over the security threats from within and outside of the organisation and improves Incident Reporting and Management.

Disaster Recovery Drills are conducted regularly as an initiative to achieve best in class RPO (Recovery Point Objective) and RTO (Recovery Time Objective).

In addition, the Company has a stringent security reviews before launching an application in order to ensure no potential loss to the users and also for the organisation.

In a dynamic environment where threat perceptions keep changing every moment the SoC is geared up to mitigate the risk and address the challenges continuously under the principles of confidentiality integrity and availability.

Liquidity Risk Management

The Company has Asset Liability Management ("ALM") Policy and it operates within the policy frame work .The ALM Committee constituted by the Board of Directors of the Company reviews the different liquidity positions (Structural ,Dynamic etc) of the Company periodically.

INTERNAL AUDIT

The Company's Internal Audit department performs independent and objective assessment to monitor adequacy, effectiveness and adherence to the internal controls, processes and procedures instituted by the management and extant regulations. This function supports Company's role in safeguarding its assets. The function has adopted a Risk-based approach of Internal Audit (RBIA). The primary focus of the audit is on key risk areas, which are of substantial importance to the Company. The RBIA approach has been thoughtfully structured taking into account the RBI guidelines and internationally established practices.

The Internal Audit department reports to the Managing Director & CEO for day-to-day activities and to the Audit Committee for Audit Planning & Reporting. All audit reports are circulated to the relevant management teams and the Audit Committee of the Board. The Audit Committee regularly reviews the audit findings as well as the adequacy and effectiveness of the internal control measures.

INTERNAL CONTROL OVER FINANCIAL REPORTING

The Company has documented its internal financial controls considering the essential components of various critical processes, physical and operational. This includes its design, implementation and maintenance along with periodical internal review of operational effectiveness and sustenance which are commensurate with the nature of its business and the size and complexity of its operations.

This ensures orderly and efficient conduct of its business, including adherence to the Company's policies, safeguarding of its assets, prevention of errors, accuracy and completeness of the accounting records and the timely preparation of reliable financial information.

The internal financial controls with reference to the financial statements were adequate and operating effectively.

CAUTIONARY STATEMENT

Statements made in this Management Discussion and Analysis Report may contain certain forward-looking statements based on various assumptions on the Company's present and future business strategies and the environment in which it operates. Actual results may differ substantially or materially from those expressed or implied due to risk and uncertainties. These risks and uncertainties include the effect of economic and political conditions in India and abroad, volatility in interest rates and in the securities market, new regulations and Government policies that may impact the Company's businesses as well as the ability to implement its strategies. The information contained herein is as of the date referenced and the Company does not undertake any obligation to update these statements. The Company has obtained all market data and other information from sources believed to be reliable or its internal estimates, although its accuracy or completeness cannot be guaranteed.