MANAGEMENT DISCUSSION & ANALYSIS REPORT

Macroeconomic Overview

Robust growth, for the fourth year in a row, and strong macroeconomic fundamentals, characterized developments in the Indian economy in 2006-07 so far. Growth is expected to be 9.2 per cent in 2006-07. However, there are some genuine concerns on the inflation front. While the up-and-down pattern in agriculture continued with growth estimated at 6.0 per cent and 2.7 per cent in the two recent years, and services maintained its vigorous growth performance, there were distinct signs of sustained improvements on the industrial front. External sector continued to remain strong and supportive of growth, with stable capital flows financing moderate current account deficits. Inflation, with its roots in supply-side factors, was on an upward trend from the beginning of the year. Measured by the wholesale price index (WPI), year-on-year, it peaked at 6.7 per cent on February 3, 2007. Inflation was accompanied by buoyant growth of money and credit in 2005-06 and 2006-07 so far. Rapid accretion in foreign exchange reserves, which grew from US$151.6 billion at end-March 2006 to US$185.1 billion on February 9, 2007, was reflected in rapid growth in money supply. Reserve accretion, in turn, reflected, apart from valuation gains, buoyant capital flows (particularly foreign investment) stimulated by bullish sentiments in the domestic capital markets. The Sensex, the bellwether stock-index of the Bombay Stock Exchange (BSE), rallied from a low of 8,929 on June 14, 2006 to an all-time intra-day high of 14,724 on February 9, 2007. With robust macroeconomic fundamentals, particularly with tangible progress towards fiscal consolidation, a strong balance of payments position, and upsurge in domestic savings and investment rates, the outlook is distinctly upbeat.

GDP Growth

The advance estimates (AE) of gross domestic product (GDP) for 2006-07, released by the Central Statistical Organization (CSO) on February 7, 2007, places the growth of GDP at factor cost at constant (1999-2000) prices in the current year at 9.2 per cent. The ratcheting up of growth observed in recent years is reflected in the Eleventh Five Year Plan target of an average annual growth of 9 per cent relative to 8 per cent targeted by the Tenth Plan (2002-03 to 2006-07). A notable feature of the current growth phase is the sharp rise in the rate of investment in the economy.

Money, Banking And Capital Markets

Broad money (M3), year-on-year, grew by 21.1 per cent on January 19, 2007. The industrial resurgence and upswing in investment was reflected in, and sustained by, growth of gross bank credit (as per data covering 90 per cent of credit by scheduled commercial banks), for example, to industry (medium and large) at 31.6 per cent and for housing loans at 38.0 per cent in 2005-06. It was also observed in year-on-year growth of gross bank credit at 32.0 per cent in September 2006, albeit marginally down from 37.1 per cent in 2005-06. Liquidity conditions remained fairly comfortable up to early- September 2006 with the unwinding of the Central Government surplus balances with the RBI and continued intervention in the foreign exchange market to maintain orderly conditions. During 2006-07, up to September 8, 2006, the continuous flow of funds under reverse-repo indicated a comfortable liquidity position. In 2006-07, the reverse repo rate had been raised by 25 basis points each time on June 9 and July 25, 2006. With year-on-year inflation stubbornly above 5 per cent from early-August 2006, on October 31, 2006, the RBI announced more measures to stem inflationary expectations and also to contain the credit off-take at the desired growth rate of 20.0 per cent. Unlike the previous four times, when both the repo and the reverse repo rates were raised by the same 25 basis points, thereby keeping their spread constant at 100 basis points, on October 31, 2006, only the repo rate was raised by 25 basis points. With a repeat of this policy move on January 31, 2007, the repo rate reached 7.50 per cent with a spread of 150 basis points over the reverse repo rate. Since deposits are growing at a lower rate than credit, the higher repo rate signaled to the banks the higher price of accommodation they would have to pay in case of credit overextension.

The cash reserve ratio (CRR) was hiked by 25 basis points each time on December 23, 2006 (5.25 per cent) and January 6, 2007 (5.50 per cent). A further increase of CRR of 25 basis points was effected on February 17, and March 3, 2007. Sustained faster growth of M3 relative to that of reserve money (M0) observed in recent years continued in 2005-06 and 2006-07 so far with the money multiplier steadily increasing from 4.43 at end-March 2002 to 4.60 at end-March 2005, 4.76 at end-March 2006 and further to 4.79 on January 19, 2007. The increase in money-multiplier coincided with fast growth of M0 at 17.2 per cent during 2005-06 and year-on-year at 20.0 per cent on January 19, 2007, and resulted in the rapid growth of M3.

The change in the liquidity and inflation environment is reflected in the continuous hardening of interest rates in 2005-06 and in 2006-07 so far. With the high demand for credit not adequately matched by deposit growth, there was steady increase in the credit deposit ratio and hardening of interest rates.

Prospects

The economy appears to have decidedly 'taken off' and moved from a phase of moderate growth to a new phase of high growth. Higher growth together with the demographic dividend (from a growing proportion of the population in the working age group) is likely to lead to a rise in the savings rate to finance more and more investment and hence reinforce growth itself. Concerns have been expressed about whether the country is growing beyond its growth potential thereby straining its labour force and capital stock, and hence engendering inflationary instabilities. The key to maintaining high growth with reasonable price stability lies in rapid capacity addition through investments, productivity improvements and ameliorating the skill shortages. While monetary policy will continue to play a critical role in maintaining price stability, the sustainability of high growth with moderate inflation will depend critically on bolstering the twin pillars of growth, namely fiscal prudence and high investment; and improving the effectiveness of Government intervention in critical areas such as education, health and support for the needy.
(Source : http//indiabudget.nic.in)

Housing Finance Industry

Despite a rising interest rate scenario and a continuing increase in property prices, the demand for home loans was strong. Some of the reasons for continued robust growth in home loans were fiscal concessions available to self-occupied residential home loan borrowers and rising disposable incomes from an increased number of double income households. Most customers of SHCL borrow for self occupied houses. Given the acute shortage of housing, it is expected that demand for home loans will remain strong.
Measures on the housing sector in the Union budget 2007-08 were a mixed bag – the positives included the announcement of the introduction of reverse mortgages for senior citizens and mortgage guarantee companies, both of which augur well for the sector. The drawbacks, however, included the amendment in the benefits available to housing finance companies (HFCs) under Section 36(1) (viii) of the Income Tax Act. Under this section, HFCs are permitted to transfer up to 40 percent of its taxable profits from the housing finance business to a Special Reserve and claim this amount as a deduction in computing the tax liability. The Finance Act 2007 has reduced this permitted transfer from 40% to 20% with effect from Assessment Year 2008-2009 i.e. Financial Year 2007-08. As a result, the effective tax rate for next year is expected to be higher. The other drawback includes the levy of service tax for renting of commercial property.

During the year, the regulators have tried to ensure through the issue of policy measures and directives that players in the housing finance market continue to adhere to prudent lending norms.

Current Scenario

The housing finance market has witnessed a gradual decline in the off-take as a result of rising property prices and interest rates in the economy, in spite of higher disposable

incomes, continued fiscal incentives on interest and principal repayments and increased urbanisation.
Though the housing shortage continues to be high in the country and especially in rural areas, it is expected that the demand for housing and home loans in urban areas will continue to rise faster as a result of the increased urbanization in the country. Not only have the metro cities witnessed rising population, but even Tier I and Tier II cities have been experiencing similar trends of increasing population and demand for housing. With investments flowing into urban infrastructure, this trend can only intensify in the times to come. The demand for housing and housing loans will therefore continue to grow in the medium to long-term.

According to a study of CRISIL, sharp increases in home prices and interest rates have impacted a home buyer's affordability. As a result, a slowdown in disbursement growth in the home loan segment could be imminent and growth could moderate over the next few years from over 30% shown in the last three years.

Interest Rate Scenario

In line with the rising interest rate scenario across the economy, SHCL revised its Retail Prime Lending Rate (RPLR) on housing loans six times during the year under review. The Company effected a total increase of 275 basis points in its interest rate during 2006-07. The housing loan borrowers continued to enjoy attractive rates of interest offered by the Company.

Market

The major players in the Indian housing market include HFCs, scheduled commercial banks and co-operative societies.

Loan Products

SHCL's major focus has been to provide home loans to individuals and families for purchase, construction, extension, repair and renovation of houses. The Company has also developed loan products for the families in the self-employed category where formal income proofs are not easily available and the repayment capacity of such families are appraised based on their cash flows.

A variety of loan products are available as mentioned below for the benefit of our valued customers.

Individual Housing Loans (HL)

This is the primary home loan product available to all Indian nationals / NRIs (selectively), to acquire / construct a house any where in India within the jurisdiction of SHCL's Branches / satellite offices.

Home Improvement Loans (HIL)

This loan is extended to help the borrower meet his requirement of improvement / renovation of the existing house.

Home Extension Loan (HEL)

This loan is given to enable the individual to expand the home / construct additional space to meet the growing requirements of the family.

Land Loans (LL)

- Strictly for non-agriculture land situated within approved layouts of Municipal/Development Authority limits.

- In other words Land Loans can be sanctioned only in case of Plots allotted by Development Authorities and Housing Board specifically for the construction of houses/flats (residential purpose) within Municipal limits.

Home Loan Plus (HLP)

- Existing Borrowers with good repayment track record are eligible to apply for this loan.

- Seasoning period of 6 months from the last/full disbursement of the existing loan.

Mortgage Loans (ML)

This loan is extended to those who own residential property with fixed sources of income and are looking for finances to meet immediate requirements like children's education, marriage, medical treatment etc.

Non Residential Property Loans (NRPL)

All professionals like practising Medicos, CA/ICWA/CS, Architect, Consulting Engineer, Solicitors may be considered for this loan for acquiring / constructing their Office premises, clinic etc.

Home Loan Enhancement (HLE)

In the case of existing good borrowers whose repayment track record is consistent and regular, can enhance existing loan for extension or renovation or repairs of the property.

Loan Take Over / Balance Transfer (BT)

- Exiting home loan takeover from HFCs / Banks.

- Exiting mortgage loan takeover from HFCs / Banks.

- Exiting non residential premises loan takeover from HFCs / Banks.

Marketing and Selling Arrangements

SHCL has set-up 14 branches covering major cities and towns for soliciting business. It has got a strong marketing team, which has taken steps to serve the customers at their door step which includes appointing Home Loan Agents, Direct Selling Agents and Home Loan Counsellors. The Company also caters to walk-in customers among others. Besides this, the Company is active in advertising and marketing arrangements through property exhibitions and housing loan *melas* organized from time to time.

Disbursements

During the year under review, SHCL disbursed housing loans aggregating to Rs. 33.31 Cr. as against Rs. 28.51 Cr. last year, registering a growth of 16.84 %. Year- wise cumulative disbursements during the last three years ended 31st March, 2007 is shown as below:

New Segments

The Company has been continuously analysing the housing needs and credit profile of under served market segments. Method of gaining a deeper understanding of these market segments are under review and would enable us to enlarge our customer base.

Business Strategy

To be a prominent Corporate Citizen in promoting housing activities through customer friendly finance schemes within a service oriented atmosphere. To consolidate and grow in a competitive environment reflecting the ethical standard of a good corporate citizen.

Outlook

In recent years, the housing finance industry grew on the back of maximum disbursements of loans with floating rates with a maximum loan to value of 85 per cent and an average size of approximately US$ 20,000. Besides, the industry growth was catalyzed by the increased role of direct sales and recovery agents, cross-sale of products, growth in Tier II and Tier III cities and a rapid growth in the non-residential real estate sector (particularly IT and ITeS sectors). This was the result despite interest rate increases and supply-side corrections like the hike in cash reserve ratio in 2006-07, credit growth was robust. On a year-on-year basis, personal loans continued to record the highest growth among major sectors: a growth of 34.9 per cent by December 2006 while housing loans increased by 30.3 per cent and real estate loans up by 66.7 per cent.

While a number of observers would conclude that the increase in interest rates is now expensive following the interest rate rebound, the reality is different when perceived across the medium-term: the interest rate is still at the level it was a few years ago - from around 13.25 per cent around the turn of the century to 10.50 per cent as on 31st March 2007.

After accounting for interest on housing loans and principal repayment being tax deductible, the net tax loan cost of 7.35 per cent for individual housing loans (capitalizing completely on tax incentives) today compares favourably with a net-tax cost of 9.28 per cent around the turn of the century.

The key 2007 budget measures incentivising the Indian housing finance market comprise the following:

• Tax exemptions on interest paid on home loans will continue. However, renting of immovable property for use in commerce or business has been brought under the purview of service tax.
• National Housing Bank (NHB) is expected to introduce 'reverse mortgage' under which a senior citizen who is owner of a house can avail of a monthly stream of income against mortgage of his/her house, while remaining the owner and occupying the house throughout his/her lifetime, without repayment or servicing of the loan.

• Regulations will be put in place to allow the creation of mortgage guarantee companies

With increasing migration to urban India, housing shortage will increase. The National Housing Policy document estimates a housing shortage of 23 mn units and the need to invest over Rs. 4, 00, 000 cr over 10 years.

Government action is required to strengthen foreclosure laws, land records need to be computerised and archaic land laws (especially rental laws) need overhaul. Small steps such as encouraging credit bureaus, introducing mortgage insurance, allowing real estate mutual funds and creating a favourable environment to facilitate foreign direct investment in housing will help stimulate sectoral growth.

Competition

The housing finance industry is one of the most keenly competitive segments of the economy, with the banking sector having a significant presence. Commercial Banks have entered the housing finance sector in a big way, attracted as they are backed by the mortgage-based security, and helped by their access to large funds at a relatively low-cost. Also housing finance is now classified as priority sector lending for banks and therefore more banks are entering this field. However, recently RBI through its credit policy announcements has amended its guidelines / norms making it mandatory for banks to increase their provisioning required from 0.4 % to 1.0 % on housing loans above Rs. 20 lakhs, real estate advances etc. This has resulted in banks going slow in housing finance lending.

The era of easy access to home loans appear over following the 300 – basis - points increase in home loan rates and a near doubling of property prices in 2006 – 07. As a result home loan growth rates are expected to be halved in the financial year 2007 – 08. Competition has propelled the players to engage in price wars. Aggressive rate cuts are employed by the players to attract consumers. In the scenario where the interest rates are going up HFCs will find pressure on their interest margins.

Strengths

- Mature business space with more than 350 participants.
- Priority sector for the Government, resulting in favourable policies driving the growth of the housing sector.
- Huge unsatiated housing demand in India, a ready market for industry participants.
- Increased organised sector presence, improving systems, processes and techniques to reach international benchmarks.

Weaknesses

- Highly regulated operations, limiting the scope of innovative growth.
- Increased competition reducing yields for financiers.
- Increase in incidence of delinquency.
- Increase in loan risk weightage from 100 per cent to 150 per cent, increasing the amount locked in maintaining capital adequacy.
- Dearth of credible documentation; inordinate delay in property valuation.
- Disparity and high rates of stamp duty across the country on registration leading to the suppression of property value / evasion of registration.
- Imposition of stamp duty on equitable mortgages (i.e. on property used as a collateral for taking a home loan), the rate of which across states acts as a deterrent in availing housing finance as the prime security for these loans is equitable mortgage of the property financed.
- The focus of housing finance companies was mostly limited to the middle-income and high income groups; rural India and the bottom of the social pyramid remained under-penetrated.
- Lack of foreclosure norms for housing finance companies prevents loan disbursal.

Opportunities

- ◊ The gap between the demand and supply of housing continues to be a great opportunity for housing finance companies. According to the National Housing Bank, there was a housing shortage of 19.4 mn units in 2003. CRIS INFAC has estimated that the shortage of housing units in financial year 2004 was 19.7 mn housing units. According to India's current "five year plan", there will be a housing shortage of approximately 22.7 mn housing units in financial year 2007. CRIS INFAC expects the housing shortage to continue despite the fact that approximately 4.7 mn new housing units were added to India's housing supply in financial year 2005 and that new housing units are expected to increase to 5.3 mn annually by financial year 2010 (Source: Crisinfac Construction Annual Review- February, 2006).

- ◊ The Information Technology (IT) industry alone will need 150-200 million square feet of space over the next five years (the real estate sector will continue to derive its growth from the booming IT sector, since an estimated 70 per cent of new construction is for the IT sector, as per a report by Price Waterhouse Coopers).

- ◊ As the retail industry expands, demand for property can only rise. Since the competition in the market is intense, builders are going out of their way to be different. Specialized malls have become the order of the day. Gurgaon will soon have an auto mall, while Bangalore is about to get an exclusive furniture mall. The easy availability of housing finance and stability in property prices are strong growth drivers.

- ◊ Investment in housing is a prioritized item on the national agenda as it contributes substantially in the country's GDP growth, directly and indirectly. Most builders are trying to woo investors with interesting features. Closed-circuit television and earthquake proofing are expected as standard features in most up market blocks. Some of the residential projects boast of air-conditioning, club and recreational facilities and modular kitchens. Unlike other finance companies, the risk of non-payments is minimal due to the emotional and social dimension in house ownership which induces the borrower to service the loan.

- ◊ Tax incentives have increased and so have salaries. So for the first time, the salaried Indian has been able to leverage current earnings to buy a future asset. The average age of a new homeowner is now 32 years compared with 45 years a decade ago. There is also an overall transparency in the sector which was hitherto missing and as banks and financial institutions are lending heavily both to the investor and the developer.

- ◊ Relaxation of foreign direct investment (FDI) ceiling has meant more foreign investment in the sector. New technology has meant faster and better completion of projects, so return on investments (ROI) is higher.

Threats

- There are, however, a number of factors that can spoil the party. Land costs, which are a major constituent of housing costs in metros; have risen much faster than property prices. To offset this, developers are moving to smaller cities where prices are also rising. This would affect some of the smaller players, and experts feel that in time there would be a shakeout with private equity deals and joint ventures.

- Listing out the challenges for the real estate market in India, a report by Price Waterhouse Coopers said that the Indian government's tax policy was not in tandem with the liberalization initiatives being undertaken in the sector. According to it, "There are no substantial tax incentives for real estate development except in the limited circumstances. Even in these situations, the tax incentive windows have a short life left.

- The prevailing tenancy laws in India are not in favour of owners of the land." The Urban Land Ceiling Act and Rent Control Act have distorted property markets in cities, leading to exceptionally high property prices. Moreover, a high percentage of land holdings do not have clear titles. This is a sentiment echoed by many industry bigwigs, who feel that the Urban Land Ceiling Act should be scrapped to encourage more FDI. The Rent Control Act, in existence since independence, is meant to protect tenancy rights but really is a major irritant for investors. There seems to be little will to repeal it, since commercial tenants are too strong a lobby.

- At present, real estate developers are required to obtain as many as 33 clearances before putting up a township. It is felt that a single window clearance system would mitigate this to great extent. Land is generally non-corporatised and typically held by individuals or families. This restricts organized dealing and hinders transfer of titles. Moreover, legal processes for property disputes are time consuming. Stamp duties continue to be as high as 10-13 per cent in certain states. If the government puts into place land reforms and addresses the challenges facing the real estate and infrastructure, these sectors have potential to contribute immensely to the country's GDP.

Segment wise Reporting

Accounting Standard 17 regarding Segment wise reporting does not apply to the Company since revenues are derived mainly from one segment i.e. housing finance activity. As a result, the Company's profit & Loss Account reflects the working of the business.

Human Resources

The progress made by the company so far has been to a great extent due to the commitment and contribution of the dedicated team of staff members. The company recognises the imperatives of developing the human resources for future development of the company. The principal of higher productivity per employee and need based recruitment has been followed. The Company continued to appraise performance across all employee categories for considering promotions under laid down procedures, rules and regulations. The total staff strength of the company as of 31st March, 2007 is 50 employees.

Going ahead the Company intends to strengthen the quality of its manpower resources at the different regional offices by effectively recruiting qualified professionals whenever required.

Risk , Concerns And Their Management

SHCL manages various risks associated with the mortgage business. These risks include credit risk, liquidity risk, and interest rate risk, operational risk market risk. SHCL manages credit risk through stringent credit norms. Liquidity risk and interest rate risk arising out of maturity mismatch of assets and liabilities are managed through regular monitoring of the maturity profiles, and yield management by way of risk, return, and portfolio management. The company proposes to manage the increased risk through available methods of portfolio churning by the RMBS route as well as rate SWAP arrangements with Banks/Institutions. For operational risk the Company has a comprehensive internal control and security system, which provides for appropriate checks and balances. Asset-Liability management is presently not applicable to the Company.

Internal Audit and Control

The company has internal control system commensurate with the size of its operations. Adequate records and documents are maintained as required by law from time to time. Internal audits and checks are regularly conducted and internal auditor's recommendations are seriously considered for improving systems and procedures. The company's audit committee reviews the internal control system and looks into the observations of the statutory and internal auditors.

Critical Success Factors

In view of the tough competition from banks and declining spread, the players in the Industry should have sustainable advantages to remain profitable in the long-term.

(i) Cost of Funds

For Housing Finance Companies (HFCs) cost of funds is the most crucial determinant of profitability. After the entry of banks in the business, which have access to low cost deposits, the spread of the HFCs have come under pressure.

(ii) Cost of Operation

Cost of Operation is also instrumental in determining the profitability of the Housing Finance Companies (HFCs). The average cost of operation of HFCs ranges from 0.7 per cent to 1 per cent of average total assets (one time cost).

(iii) Product Diversification

Housing Finance Industry is getting increasingly commoditized. Features like adjustable rate plans, lower processing fees, monthly rest, low EMI, lower margin money, no pre-payment penalty have become common across the Industry. As a result loan products can be differentiated by offering free add-ons.

To make the loan products more attractive, HFCs have begun to include the cost of registration, stamp duty and other associated costs while sanctioning loans. This has further lowered the threshold limit for purchasing a house.

Software

The system solution software is being developed by CMC and operational systems were developed in-house by professionals recruited from the industry. The company plans to migrate to the web-based technology in a year's time.

Discussion Of Financial Performance With Respect To Operational Performance

This has been discussed in another section of the Annual Report.

Cautionary Statement:

Some of the statements included in the 'Management Discussion and Analysis Report' describing the company's objectives, estimations, projections, expectations may be "forward looking statements" based on the management's current expectations and beliefs concerning future developments and their potential effect upon the Company. Several factors could make significant difference to the company's operations. These include economic conditions affecting demand and supply, Government regulations and taxation, natural calamities, etc. over which the company does not have any direct control.