CENTRUM

Housing Finance

Thematic

India I Financials

05 July 2020

Institutional Research

A Blend of Resilience and Returns

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Sector Update

India I Financials

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NIFTY 50: 10607

BSE Sensex: 36021

Institutional Research

The COVID-19 lockdown has led to a massive economic disruption affecting domestic demand and cash flows of various entities. Consequently, the RBI allowed a 6-month asset quality standstill for all categories of lenders. Depending on the line of business, certain NBFCs could face a liquidity crunch since 60-100% of SME, CV, developer, or MFI loans have claimed moratorium under the first tranche. Contrastingly, housing finance (HF) saw a much lower moratorium at (20-25%) as home loans have the highest payment priority, giving an edge to combat the glaring asset quality risk in FY21E. Historically, HF has witnessed the best-in-class asset quality with GNPA below 2% owing to the collateral quality. Considering India's low Mortgage-to-GDP ratio, favourable demographics, rising urbanisation & nuclearisation and underpenetration in affordable housing, home loans could witness a strong demand once the economy rebounds post the COVID-19 impact. Notably, barring this COVID-19 impact, statistics indicated that, home loans could have seen 21% CAGR over FY19-22E. We prefer players focused on salaried home loans in the affordable segment with lesser reliance on developer loans. Initiate coverage on LICHF/Canfin with a BUY rating.

COVID-19 scenario poses lesser challenges for housing finance sector

During the pandemic led disruption, corporate and housing segments have claimed the least moratorium (20-25%), while a higher proportion of developer, SME and vehicle loans (60-75%) are under asset quality standstill. Asset quality for housing loans has been the best with GNPA under 2%. Once the moratorium ends in August 2020, HFCs would be the best placed to counter stress that could emanate since home loans have the highest payment priority, as per CIBIL. Housing demand could be weak in FY21E due to reduction in affordability given stretched customer cash flows; however, the affordable housing segment could see some demand.

Indian housing demand indicates low penetration in affordable segment

India's mortgage-to-GDP ratio at 10% is the lowest among peers; this could improve to 12% by FY22E. Notably, 80% of Indians will be below the age of 60 by 2031, of which 64% will be between 15-59 years. As per McKinsey, 40% of Indian population will be living in cities by 2030 (vs. 34% currently). Nuclearisation is also rising with household size falling from 5.5 in 1991 to 4.8 in 2011. All these factors might lead to a spur in housing demand in India. Incremental demand of Rs50-60tn suggests significant growth given outstanding home loans of Rs20tn in FY19. Barring COVID-19 impact, total home loans were expected to reach Rs35tn by FY22E showing a CAGR of 21% over FY19-22E.

Affordable housing progress and Indian housing finance industry dynamics

In terms of PMAY (U) progress, till December 27, 2019, sanctions were received for 10.3mn houses, of which 3.2mn were completed. Total subsidy released was Rs640bn, while utilised amount was Rs497bn. By FY20, total home loans have probably reached ~Rs23tn, of which share of banks/HFC would be 59%/41%. In FY19, HFCs had a total of Rs414bn loans under affordable housing. NPA levels have been higher under affordable, mainly led by the <Rs5lakh category, while in terms of overall housing, the Rs10-25 lakh bracket is the best in terms of asset quality. Delinquency level in HFC is second best to Pvt. Banks, at 1.8%/2.6% in home loans/LAP.

Initiate coverage on LICHF/Canfin with a BUY rating and TP at Rs500/Rs437

For LICHF, sovereign holding and salaried share at 80%+ has led to highest credit rating of CRISIL AAA leading to lower funding cost. Developer/LAP loans are slowing down and credit flow is shifting to housing. Share of affordable in individual disbursements for FY20 improved to 31% (vs. 20% a year ago). LICHF might take over IDBI's housing business. Expect FY22E RoA/RoE improve to 1.2%/12.8%. Valuation at 0.8x FY22ABV is compelling. Canfin has consistently maintained housing share at 90% and a lower ticket size with stringent income assessment has led to best-in-class asset quality (GNPA 0.8%). Sovereign holding, salaried share at 70%, affordable housing focus and reducing leverage has led to lowest funding cost (7.8%). CAR/CET-1 is strong at 22.3%/20.5%; we see FY22E RoA/RoE at 1.9%/17%. Valuation at 1.7x FY22ABV is attractive.

Nifty 50 vs. Nifty Midcap

Source: Bloomberg

Stock price performance (%)*

Company Name	1 Mth	3 Mth	6 Mth	1 Yr
LICHF	7.4	17.7	(37.5)	(51.8)
CANFIN	12.1	28.5	(10.7)	(1.3)

Source: Bloomberg; *as on 3 July 2020

Rating and Target prices

Company	Rating	CMP*(Rs)	TP (Rs)	Upside
LICHF	BUY	274	500	82%
CANFIN	BUY	352	437	24%

Source: Centrum Research Estimates, *as on 3 July 2020

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Fig 1: Relative valuation

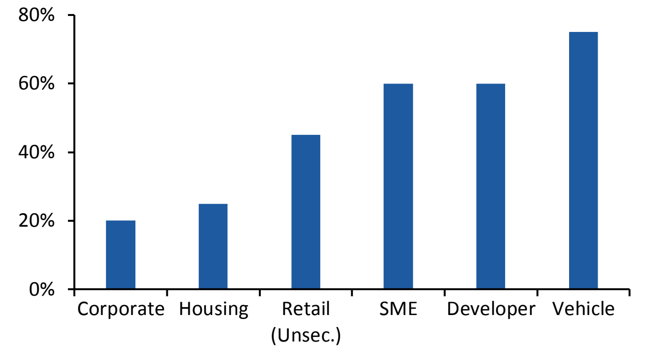
	Mkt Cap Rs bn	CAGR FY20-FY22E (%)			P/BVPS			RoA			RoE		
		Total inc	PPOP	PAT	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
LICHF	**139**	**5.0**	**4.6**	**5.7**	**1.1**	**0.7**	**0.6**	**1.1**	**0.9**	**1.2**	**13.9**	**10.2**	**12.8**
Canfin	47	8.1	7.8	10.0	2.1	1.9	1.6	1.9	1.6	1.9	19.1	15.1	17.1
HDFC	3271	6.0	9.7	7.4	3.7	3.6	3.4	3.2	1.8	2.0	19.7	11.8	13.0
Indiabulls	99	(8.4)	(30.9)	(9.7)	0.6	0.5	0.5	1.1	1.4	1.6	8.0	8.6	3.2
PNB	35	4.7	5.9	(1.0)	0.4	0.4	0.4	1.2	1.1	1.2	11.6	8.1	10.6
Repco*	8	11.1	12.1	12.8	0.4	0.4	0.3	2.5	2.3	2.4	17.6	15.1	15.1

Source: Centrum Research estimates, *In case of Repco, FY20 denotes estimates.

COVID-19 scenario poses lesser challenges for housing finance

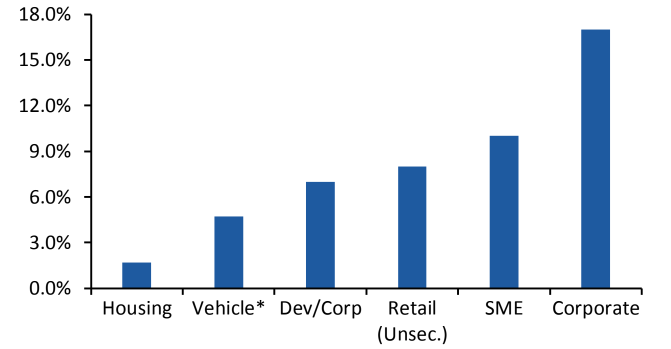
- Recent RBI directives on March 27, April 17, and May 22, announced moratorium-1 (March-May 2020) and moratorium-2 (June-Aug 2020). As per data given out by various companies in their Q4FY20 earnings release, the corporate and the housing segments have claimed a much lower moratorium, while developer, SME and vehicle financing segments have registered a higher proportion of loans under standstill.
- We also studied the historical segment-wise asset quality in terms of GNPA and housing finance segment has been the best performing followed by vehicle financing. In this challenging macro-economic environment owing to the pandemic led lockdown, focus for lenders would remain on asset quality vs. growth.

Fig 2: Moratorium proportion lower in housing finance



Source: Company, Centrum Research

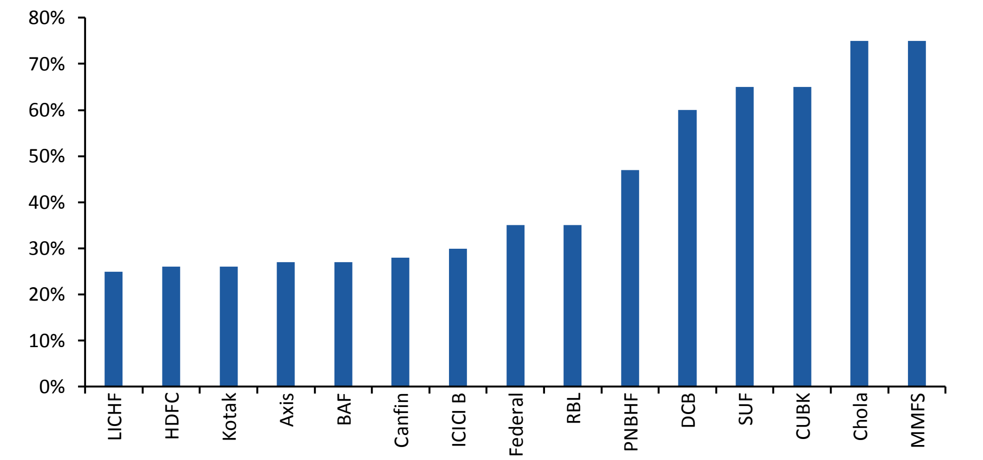
Fig 3: Lowest GNPA in case of housing finance



Source: RBI, Company, Centrum Research. *For NBFCs

- Basis the moratorium and the asset quality data, the HFC space would be the best placed to tide over the asset quality storm that could emanate in H2FY21E once the moratorium ends on August 31, 2020. According to a CIBIL study on payment hierarchy, home loans have the highest payment priority. In terms of individual companies, barring PNB Housing, all other HFCs have claimed a lower moratorium. For PNB Housing too, this number is higher owing to the developer portfolio.
- However, as per CIBIL, demand for housing could remain challenging in FY21E owing to reduction in affordability and postponement of home purchases due to stretched customer cash flows. On the supply side though, lenders would be more comfortable lending in the housing space due to its secured nature and lower default probability.

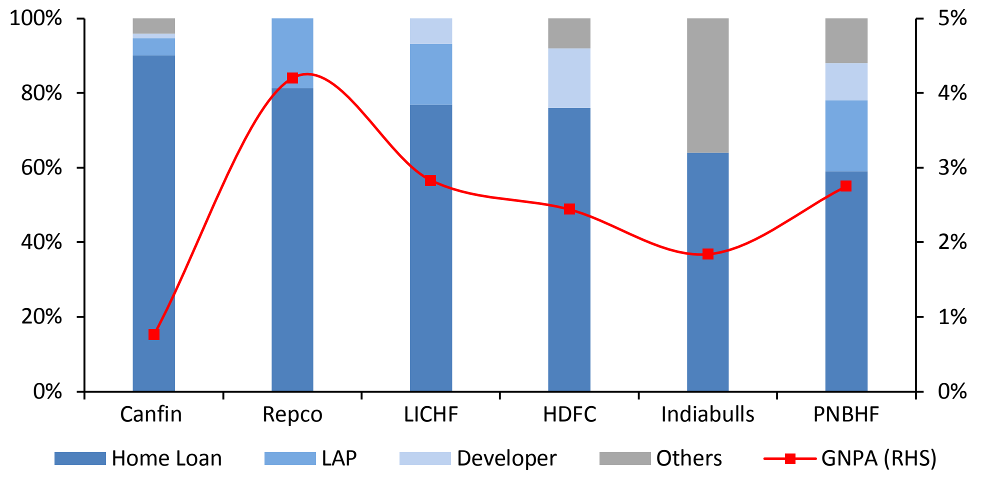
Fig 4: HFCs have a relatively lower percentage under moratorium in the first tranche



Source: Company

Prefer players focused on salaried and affordable housing with a lesser reliance on builder loans

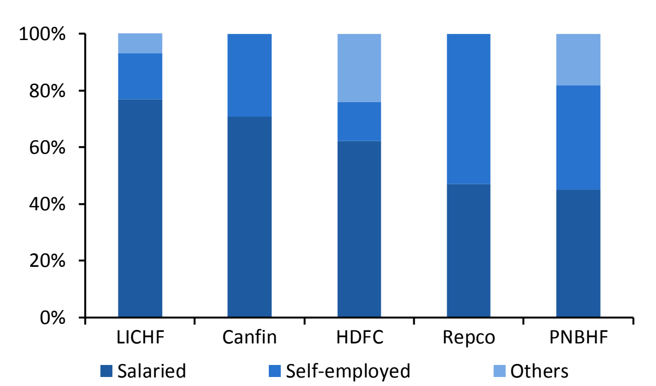
Fig 5: Canfin has negligible exposure to the challenging builder segment



Source: Company

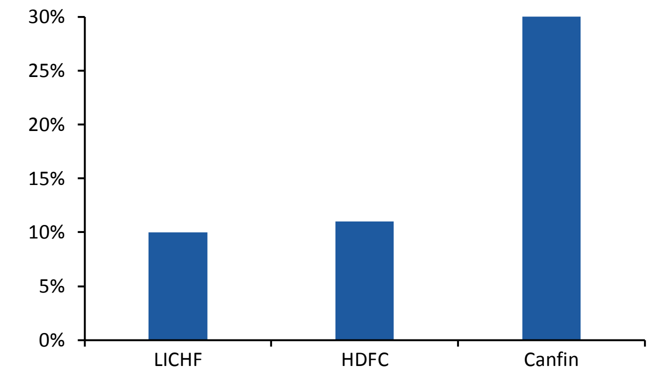
- In the HF space, we recommend players with least asset quality risk in terms of a lower developer and LAP portfolio coupled with a higher exposure to the salaried segment. Further, we also prefer companies that have a higher share of affordable housing loans considering the commentary by various companies suggests that demand in FY21E in this segment would be affected to a lesser extent as ticket sizes are lower and situation is better in tier-2, 3, 4 cities in terms of lockdown relaxations.
- The developer portfolio has been a challenge for most of the larger NBFCs with LICHF/PNBHF/HDFC having high GNPAs at 18%/8%/5% in this segment. With the lockdown in place in larger cities and cash flows being a challenge for companies at large, the worsening asset quality situation would only exacerbate once the asset quality standstill period ends in August 2020.
- Although from a demand perspective CIBIL expects a sharper decline in demand for secured credit (HL, LAP and auto) owing to reduction in affordability, drop in real estate prices and discretionary spending, lenders would mostly prefer housing loan (HL) over LAP, which could face higher default risk and irregular cash flows.
- We prefer salaried home loans compared to self-employed as salaried cash flows would likely be more stable. Moreover, salaried income is better documented as compared to assessed income, which provides a better asset quality cover. As per CRISIL data (as on April 2018), 2-year lagged NPAs in self-employed at ~1.8% is much higher compared to ~0.6% for salaried.

Fig 6: LICHF/Canfin/HDFC have a higher share of salaried



Source: Company

Fig 7: Canfin has the maximum exposure to affordable



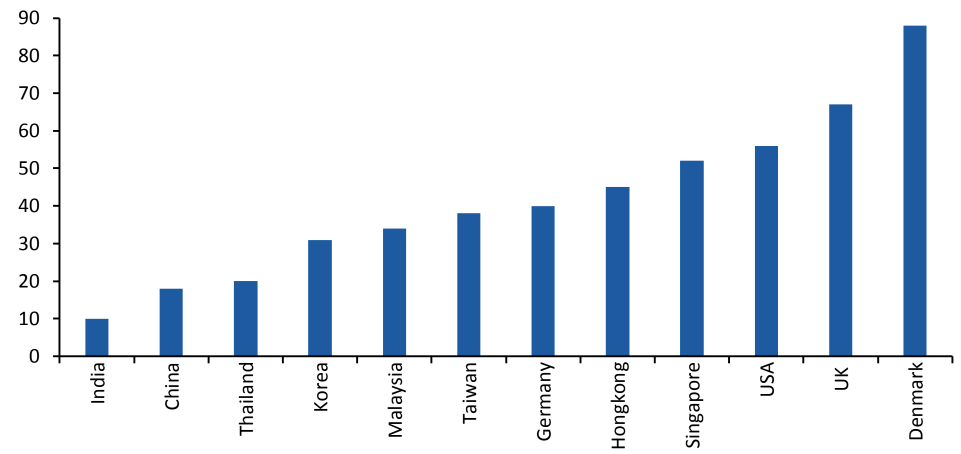
Source: Company, Centrum Research

Indian housing demand indicates penetration is low in affordable housing

Low mortgage-to-GDP ratio set to improve

- One of the key ownership methods for houses is through home loans (i.e. mortgages). Mortgages have become a popular means of facilitating a house purchase across all segments, even though the needs and product requirements vary significantly across the segments. India has a very low mortgage-to-GDP ratio compared to other nations. This ratio is expected to grow significantly over the next few years.

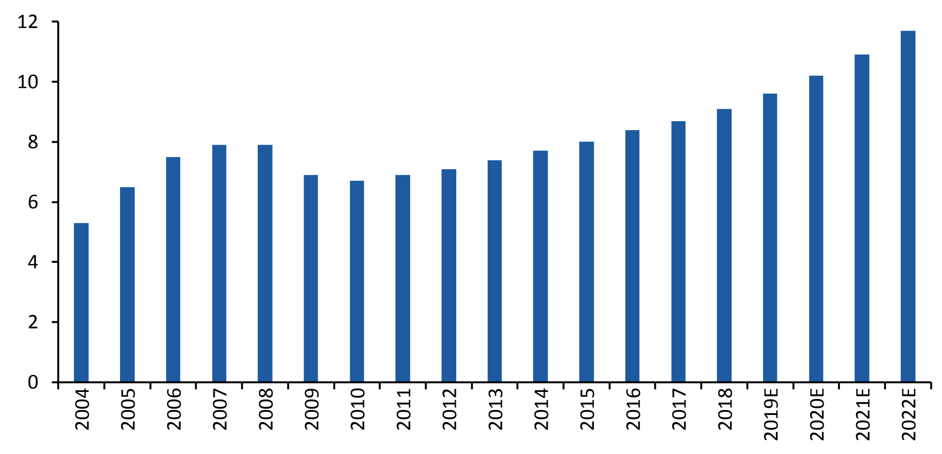
Fig 8: Mortgage-to-GDP ratio (%) lowest among peers for India



Source: RBI

- RBI's definition of a housing loan to qualify as priority sector lending is – Loans to individuals up to Rs3.5mn in metropolitan centres (population of 1mn and above) and loans up to Rs2.5mn in other (non-metro) centres for purchase/construction of a dwelling unit per family, provided the overall cost of the unit in the metropolitan centre and at other centres does not exceed Rs4.5mn and Rs3mn, respectively.
- The various segments of housing in India are commonly defined as 'Economically Weaker Section' (EWS), 'Low Income Group' (LIG) and 'Middle Income Group (MIG) and above' (MIG+). These segments are typically defined either with the income range of the principal home-owner or the loan value taken; the two variables tend to be correlated. The typical EWS, LIG and MIG segments have annual incomes of up Rs0.3mn, between Rs0.3-0.5mn, and above Rs0.6mn, respectively. The loan value cut-off in each segment is Rs1mn, between Rs1-2.5mn, and above Rs2.5mn respectively

Fig 9: Mortgage–to-GDP ratio to improve as per the RBI (est. before COVID-19 impact)

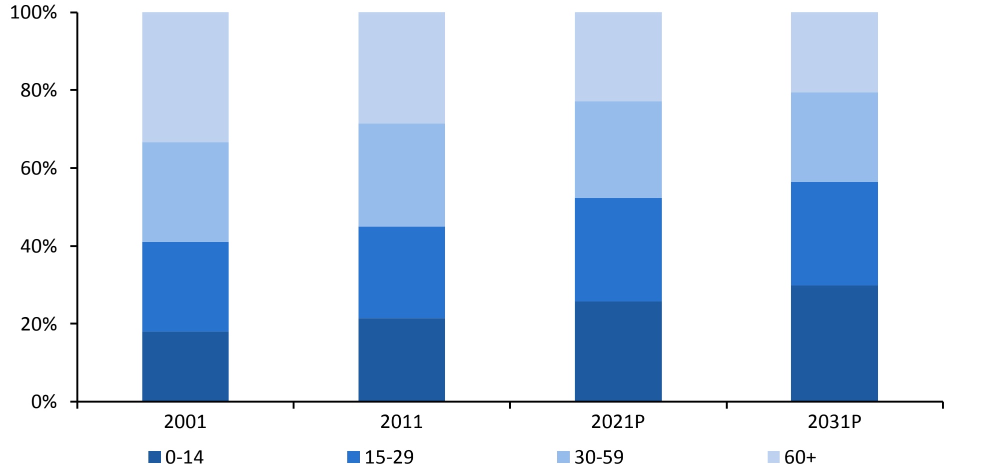


Source: CSO, RBI

Housing Finance drivers - Indian population demographics and increasing urbanisation

- Currently, India has one of the largest young populations in the world, with a median age of 28 years. It is estimated that ~80% of Indians will be below the age of 60 years by 2031, of which 64% will be in the range of 15-59 years. As of 2012, US, China and Brazil had 74%, 62% and 78% of their population below 60 years, respectively.

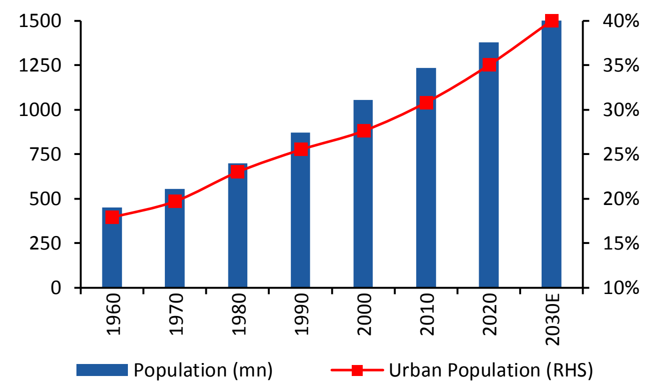
Fig 10: Indian population as per age; ~80% of the population could be below 60 by 2031E



Source: CRISIL Research

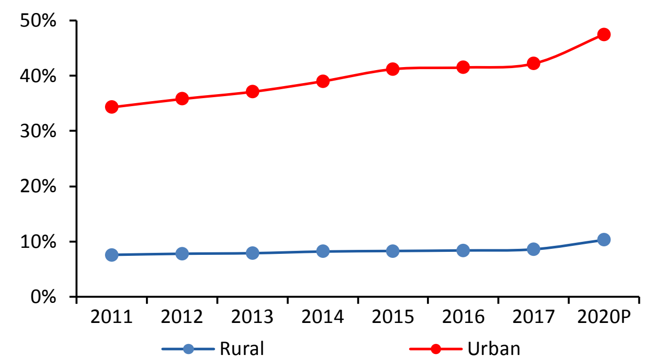
- **Urbanization:** According to the McKinsey Report (2010), India will have 40% of its population living in urban areas with 68 cities with one million plus population (from 42 currently) by 2030 (Chart 2). It estimates that the demand for affordable housing will increase to 38 million housing units in 2030 from 19 million in 2012. Currently, 34% of the Indian population resides in cities; estimated to be 40% by 2030.
- **Housing finance penetration in urban vs. rural:** There is also a difference in the penetration of housing finance between urban and rural areas. Over FY11-20, the urban housing finance penetration has risen from 34.3% to 47.5%, while rural penetration has risen from 7.6% to 10.3%. Notably, the finance penetration in rural areas has lagged behind, but it is catching up now. This trend suggests that rural areas could have a relatively greater share of future growth in housing finance.
- **Nuclearisation is rising:** Nuclearisation in urban areas is primarily driven by changing lifestyle of people, individualism, changing social/cultural attitudes, and increased mobility of labour in search of better employment opportunities. These trends are expected to continue and grow in future. Average household size has fallen from 5.5 in 1991 to 5.3 in 2001 and 4.8 in 2011, as per Census 2011.

Fig 11: Urbanisation – A major driver for housing in India



Source: worldometers

Fig 12: Urban housing finance penetration much higher



Source: RBI, CRISIL

Housing shortage at 100mn in the medium term with industry potential of ~Rs60tn

Fig 13: Urban housing shortage and likely requirement by 2022

Year	2007	2012	Year	2022E
EWS	21.8	10.6	EWS	45.0
LIG	2.9	7.4	LIG	50.0
MIG and above	0.0	0.8	MIG and above	5.0
Shortage (mn)	**24.7**	**18.8**	**Requirement (mn)**	**100.0**
EWS	10.9	5.3	EWS	34.0
LIG	2.9	7.4	LIG	75.0
MIG and above	0.2	4.1	MIG and above	40.0
Value to be financed (Rs tn)	**14.0**	**16.8**	**Value to be financed (Rs tn)**	**149.0**
EWS	10.9	5.3	EWS	36.0
LIG	2.2	5.6	LIG	62.5
MIG and above	0.1	1.6	MIG and above	15.0
Construction costs (Rs tn)	**13.2**	**12.5**	**Construction costs (Rs tn)**	**113.5**

Source: RBI

- The current housing finance market in terms of value and number of houses has two divergent segments. The total value of housing finance is large in the high-value segment that has relatively low number of houses, while the very large number of houses, in the informal or low-value housing do not command large market value.
- The total value of housing in India is estimated to be Rs150tn, which is far greater than the market capitalisation of equity markets. Housing continues to remain one of the largest investment avenues for the citizens of India.
- Despite its large numbers, the current housing base does not meet housing needs of all citizens of India, leaving many of them in either poor-quality housing, or in some cases, without housing altogether.
- The shortage of housing is material both in terms of number of houses and the value of housing as detailed in the table above. The stock of housing in India requires significant upgrades, especially given the scenario of rising income with economic growth. Poor or non-justiciable legal and economic rights to the property can lead to shortage and lower quality of housing.
- Shortage of housing is pervasive across all states and all segments even as the intensity of the shortage may vary. It is noteworthy that the states that have higher per-capita income tend to have lower housing shortages. However, even such states have a significant unmet need for housing upgrades.
- As per the Twelfth Five Year Plan estimates, 10 states accounted for approximately 76% of the urban housing shortage. Uttar Pradesh has a housing shortage of over 3 million, followed by Maharashtra (1.94 million), West Bengal (1.33 million), Andhra Pradesh (1.27 million) and Tamil Nadu (1.25 million).
- Different segments also have different providers catering to the housing market; the real estate developers in one segment typically do not serve other segments. The geographical catchment area, even within a city, may be meaningfully different across the various segments.
- The income profile across segments also materially varies not just in terms of the income level but also the volatility or riskiness of the income. Given these differences, specialized providers have emerged to cater to unique needs in different segments.

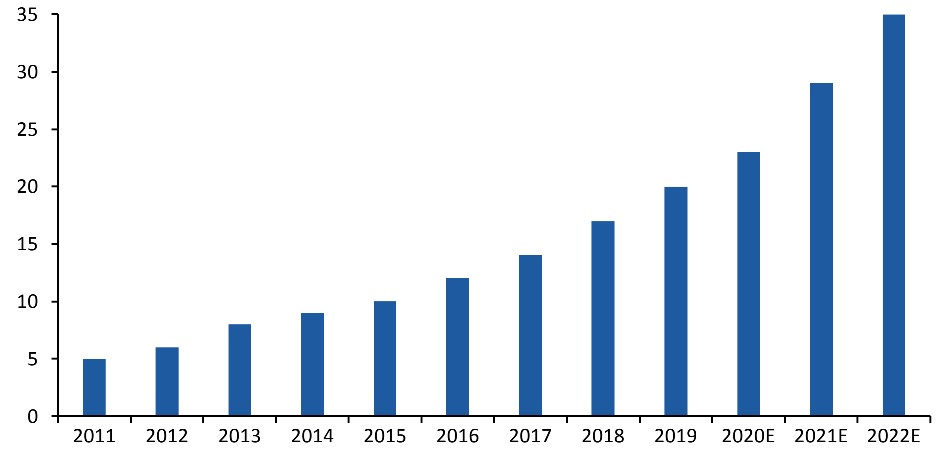
Fig 14: Aggregate demand for housing as per RBI

EWS	45.0
LIG	50.0
MIG and above	5.0
Demand (mn)	100.0
EWS	34.0
LIG	75.0
MIG and above	40.0
Value to be financed (Rs tn)	149.0
LTV (%)	
EWS	40.0
LIG	50.0
MIG and above	65.0
Credit penetration (%)	
EWS	40.0
LIG	80.0
MIG and above	85.0
EWS	5.4
LIG	30.0
MIG and above	22.1
Aggregate loan demand (Rs tn)	57.5

Source: RBI

- The table above provides estimates of mortgage financing in various housing market segments by 2022. These estimates suggest that the market is large in the MIG+ segment driven by the bigger ticket-sizes and similarly it is large in LIG due to the larger number of houses.
- These estimates also suggest that EWS category could continue to see low credit penetration even though the objective of the Governments at both Centre and States will be to address this market failure.
- The total incremental demand of Rs50-60tn suggests significant growth considering the total outstanding home loan amount at the end of FY19 was Rs20tn. By the end of FY22, the total outstanding home loans are expected to reach Rs35tn, which implies a 20%+ CAGR over the FY19 numbers.
- The penetration of housing finance differs across segments and each segment is served very differently by banks and HFCs. The housing finance market is relatively well-served in the MIG+ segment by commercial banks and some larger and more matured housing finance companies.
- As we move to the LIG and EWS segments, we find the proportion of loans given by HFCs, especially smaller HFCs, increases. Some of these loans are bought by banks from the HFCs to meet their priority sector lending obligation. However, in terms of disbursements, HFCs take the lead in the non-MIG+ segments.
- Given the unmet demand for housing and low penetration of mortgages in India, the housing market, and the financing market associated with it, is expected to see secular growth over the next many years.
- Barring the impact of the COVID-19 related slowdown, home loan outstanding was expected to increase from Rs20tn in FY19 to Rs35tn by FY22. The chart below details the total projection of the mortgage market over the next few years.

Fig 15: As per RBI report, housing finance would have seen a 21% CAGR over FY20-22E, barring COVID-19 impact



Source: RBI Report

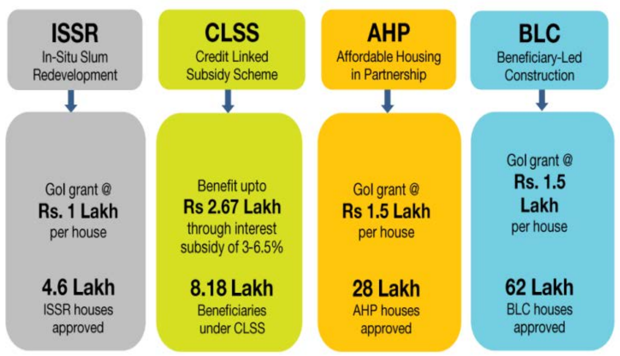
- Given the unmet demand for housing and low penetration of mortgages in India, the housing finance market is expected to see secular growth over the next many years. The chart above details the total projection of the mortgage market.
- In addition to rapid growth, another important change in the housing market over the next decade will be the impact of increased urbanisation. The level of urbanisation in India over the last many census years and the projections going forward is testament to the same.
- As per the NHB data, the level of urbanisation is expected to rise to 51% by 2051E compared to 34% in FY20. As Indian cities expand to take in more people, business will start to shift towards the current peri-urban areas.
- This shift has given rise to the affordable housing finance segment with more than 100 institutions, comprising both banks and HFCs as of March 2018.
- Owing to the COVID-19 related lockdown and its impact on the economy, demand, especially discretionary, is likely to be hit in FY21E. As per CRISIL estimates, new housing units are likely to see a 45% de-growth in FY21E over FY20.
- This would have a significant underlying impact on the loan/AuM growth for the Housing Finance Industry. While it is tough to envisage at this juncture as to what could be the AuM growth for the space; the severity and length of the lockdown would determine the loan/AuM growth.
- Our preliminary sense is that companies focusing on smaller cities i.e. tier-2, 3, 4 cities could have a lower impact or could see faster revival as most of the orange and green zones would overlap with these cities. The smaller cities saw lesser COVID-19 related cases as compared to the bigger cities.
- Our interaction with experts suggests that the HFC industry could grow in the range of 0-5% in FY21E assuming normalcy is restored in Q3FY21E.

Affordable housing progress in India

PMAY (Urban) and CLSS progression

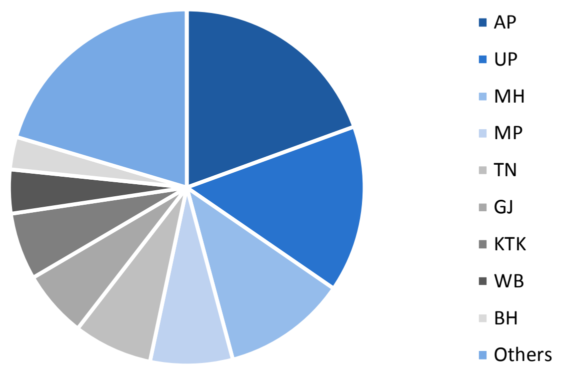
- PMAY (Urban) was launched on June 25, 2015 for implementation during 2015-2022 to ensure housing for all. The mission provides central assistance to agencies through States/Union Territories (UTs) and Central Nodal Agencies (CNAs) for providing houses to all eligible families/ beneficiaries against the demand of 11.2mn houses.
- In continuation of the Govt's efforts towards women empowerment from EWS and LIG, PMAY has made a mandatory provision for the female head of the family to be the owner/co-owner of the dwelling unit. The scheme involves the following options.
  1) **"In-situ" Slum Redevelopment (ISSR):** Slum redevelopment Central assistance of Rs1 lakh per house is admissible for all houses built for eligible slum dwellers under the component of ISSR using land as resource with participation of private developers. This slum rehabilitation grants can be utilised by States/UTs for any of the slum redevelopment projects. After redevelopment, de-notification of slums by State/UT Government is recommended under the guidelines.
  2) **Affordable Housing in Partnership (AHP):** Central assistance of Rs1.5lakh per EWS house is provided by the Govt. in projects where at least 35% of the houses in the projects are for EWS category and a single project has at least 250 houses.
  3) **Beneficiary-led individual house construction/enhancements (BLC)**: Under this component, central assistance of Rs1.5lakh is available to individual eligible families belonging to EWS categories.
  4) **Credit Linked Subsidy Scheme (CLSS):** Interest Subsidy up to Rs2.67lakh per house is admissible for beneficiaries of EWS/LIG, MIG-I and MIG-II seeking housing loans from Banks, HFCs and other institutions for acquiring/constructing houses. The interest subsidies of 6.5%, 4% and 3% on loan amount up to Rs6 lakh, Rs9 lakh and Rs12 lakh are admissible for a house with carpet area of up to 60, 160 and 200 sq. meter for EWS/LIG, MIG-I and MIG–II, respectively. The MIG scheme is extended up to March 31, 2021 (earlier, March 31, 2020). The benefit for EWS/LIG under CLSS works out to maximum Rs6 lakh for a 20-yr loan.
- In terms of PMAY (U) progress, as on December 27, 2019, sanctions under the scheme have been received for 10.3mn houses while 3.2mn houses have been completed. As regards, state-wise house sanctions, the states of Andhra Pradesh (2mn), Uttar Pradesh (1.6mn), Maharashtra (1.2mn), Madhya Pradesh (0.8mn), Tamilnadu (0.7mn), Gujarat (0.6mn) and Karnataka (0.6mn) make up for 73% of the houses sanctioned.

Fig 16: Various options under the PMAY (U)



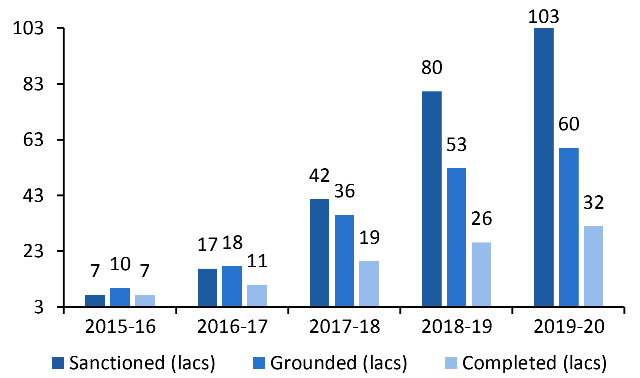
Source: MOHUA

Fig 17: State-wise 10.3mn houses sanctioned under PMAY



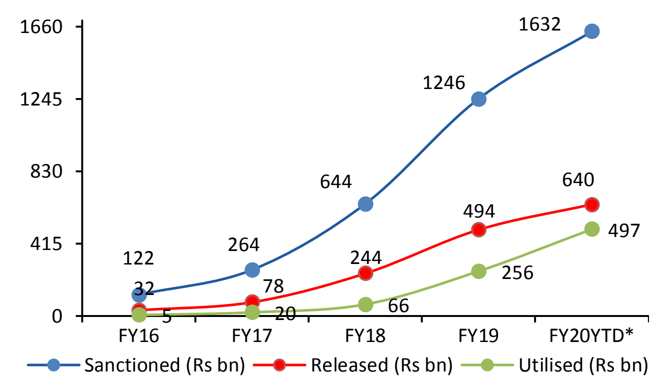
Source: MOHUA

Fig 18: Houses sanctioned/completed over FY16-20



Source: MOHUA

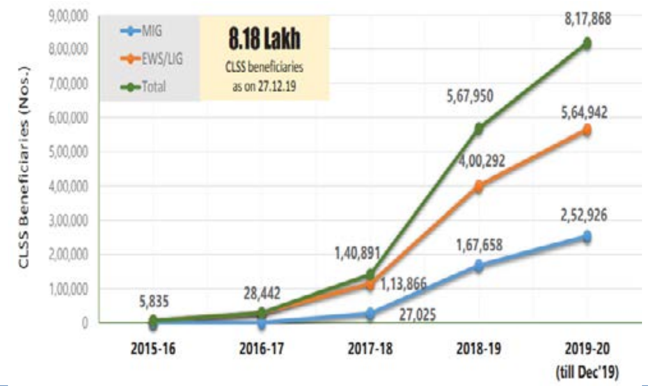
Fig 19: Central monetary assistance over FY16-20



Source: MOHUA. *Till Dec-19

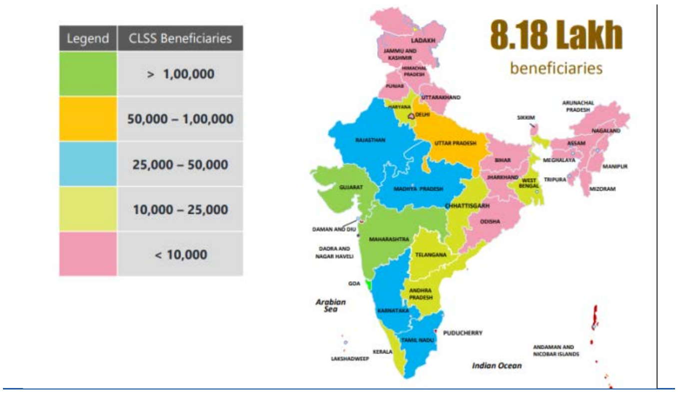
- The total investment involved for 10.3mn houses is Rs6.13tn, of which the beneficiary share is 49%, Central assistance is 27%, State grant is 20% and ULB share is 4%. The central share at 27% is tantamount to Rs1.63tn, of which the released amount is Rs640bn and utilised amount is Rs497bn.
- Of the 10.3mn houses, 0.818mn were the beneficiaries under the CLSS, of which 0.565mn were under EWS/LIG and the balance were under MIG. Maharashtra, Gujarat and Uttar Pradesh have the maximum number of CLSS beneficiaries.

Fig 20: Houses sanctioned/completed over FY16-20



Source: MOHUA

Fig 21: State-wise distribution of CLSS beneficiaries



Source: MOHUA

- Banks, HFCs and NBFCs lend under the CLSS scheme which mainly operates in the urban areas. Also, the MIG-I/II scheme that was to be in-effect till March 31, 2020 could get an extension going forward, however with the COVID-19 pandemic related issues, the priority of the Government would be different at this juncture.

Fig 22: CLSS scheme simplified

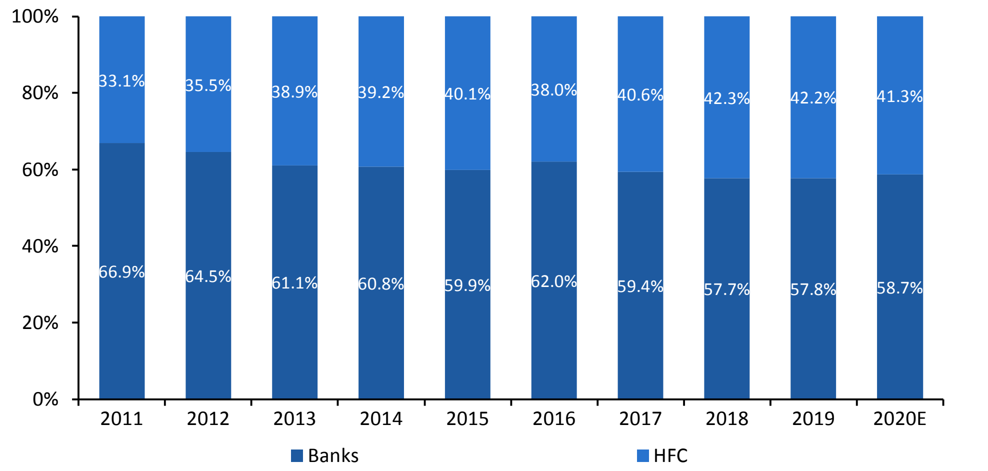
Economic Category	Annual HH Income (Rs lacs)	Int. Subsidy (%)	Max loan amt. (Rs lacs)	Max Int. subsidy (Rs lacs)	Max loan term	Max Carpet area (sq. m.)	Validity
EWS	Upto 3	6.5	6	2.67	20 years	30	2022
LIG	3-6	6.5	6	2.67	20 years	60	2022
MIG-I	6-12	4.0	9	2.35	20 years	120	2020
MIG-II	12-18	3.0	12	2.30	20 years	150	2020

Source: MOHUA, Centrum Research

Indian Housing Finance industry dynamics

- In India, home loans are provided mainly by commercial banks and Housing Finance Companies (HFCs). As a model, HFCs came into being in the early 1980s and were pioneers in home loans. Commercial banks entered this business in a significant way in early 2000s. By FY20, total home loans outstanding in the banking system are likely to be Rs13.5tn, (58.7% of the total home loans outstanding). HFCs are likely to have outstanding home loans of Rs9.3tn, around 42% of total home loans.

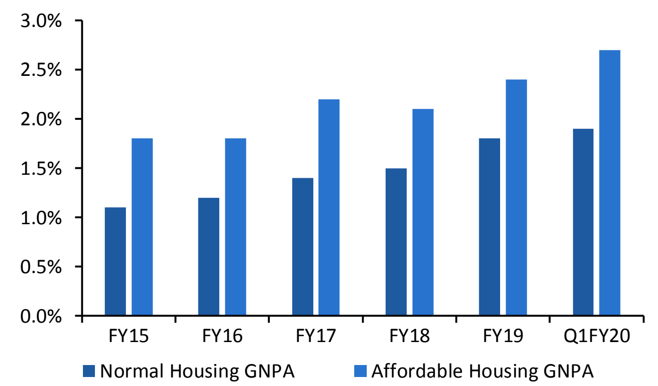
Fig 23: Banks have started to regain market share due to challenges surrounding NBFCs



Source: RBI Report, Centrum Research

- In terms of volumes, HFCs in the affordable new housing segment had a total outstanding of Rs413.6bn as of March 2019 (+19% YoY). In terms of composition, home loans comprised 62% of the affordable housing portfolio, while LAP and construction finance comprised 20% and 15%, respectively.
- The NPA level of the affordable housing sector has been consistently higher than the overall NPA level of the HFCs. As per the RBI, from a GNPA level of 2% in March 2014, it reached a peak of 5% in December 2018. Some improvement can be seen since then with the ratio dropping to 4.7% as of March 2019. However, this improvement was largely supported by write offs and sale of NPAs by some HFCs.
- The higher NPA levels in the affordable space are mainly driven by the tail end of the EWS loans (lower ticket size) as incomes would not be documented. Given the low income bracket & ticket size and higher proportion of self-employed, the GNPA levels are higher in affordable housing. As seen below, the less than Rs5 lakhs loans, or in other words the EWS, and to an extent the LIG segment, witness the maximum stress.

Fig 24: Higher GNPA in the affordable housing segment



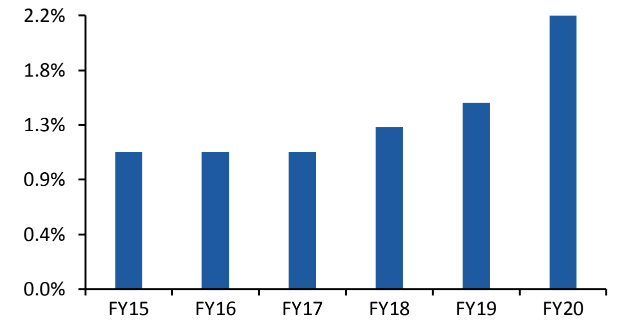
Source: CRISIL

Fig 25: Most of the stress in the <Rs5 lakhs ticket size

Housing loan slabs	FY18 GNPA*
Upto Rs2 lakhs	11.3%
> Rs2 lakhs to 5 lakhs	3.5%
> Rs5 lakhs to 10 lakhs	2.0%
> Rs10 lakhs to 25 lakhs	1.3%
> Rs25 lakhs	1.4%
Total	**1.6%**

Source: NHB. *For PSU Banks

Fig 26: GNPA rising for HFCs due to builder loans



Source: NHB, Centrum Research

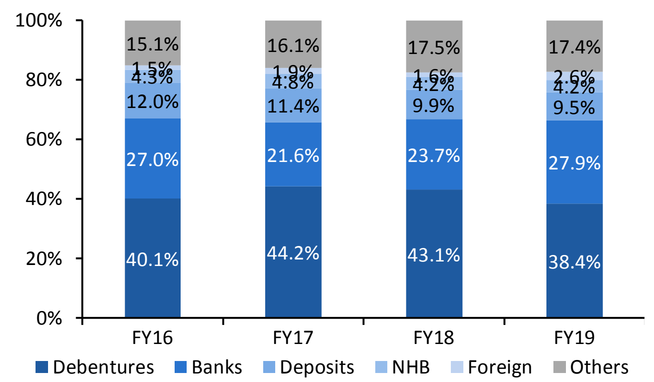
Fig 27: Delinquency across lenders in HL and LAP (Jun-19)

Lender type	Home loans	LAP
Private Banks	0.7%	1.6%
HFCs	1.8%	2.6%
PSU Banks	1.8%	6.5%
NBFCs	3.2%	5.2%
Industry	**1.7%**	**3.5%**

Source: RBI, CIBIL

- GNPA in the HFC industry has risen from 1.1% in FY17 to 2.2% in FY20 driven by stress in developer loans. For the home loan industry as a whole, the deterioration has not been as severe led by strong asset quality of private banks.
- Focus of private banks (GNPA at 0.7%) on the best customers, has kept delinquency lower in home loans at 1.7% in Q1FY20 (vs. 1.5% in FY17). Delinquencies in the LAP portfolio are double as compared to the home loan portfolio at 3.5%. This has been mainly led by PSU banks (6.5%) and NBFCs (5.2%). Further, over FY17-Q1FY20, LAP has seen asset quality worsen from 2.3% to 3.5%.
- The challenge is posed by the long maturity of home loans (15-20 years at origination). Even after adjusting for prepayments, home loans have a maturity of 8-10 years. Primary source of funding for banks are deposits, which includes CA and SA. In the Indian banking system, term deposits account for ~58%, SA ~33% and CA ~9%. The weighted average maturity of banking deposits is ~2.5 years.
- Unlike banks, HFCs are wholesale funded (only some have access to public deposits). About 40% of funding for HFCs is from banks (including debentures) and ~30% is from debentures issued to non-banks (e.g. mutual funds). Bank lending to HFCs generally has a maturity of less than 5 years.
- Of the 100 registered HFCs only the top 10 or so have the ratings and access to debt capital markets. Majority of smaller HFCs rely on bank borrowing as their only source of funding. They also have access to refinance facilities of NHB.
- Thus, for banks and especially HFCs home loans present an ALM mismatch problem. The challenge is more acute for smaller HFCs, where the only source of funding for them is banks and if for any reason this source dries up, they cannot grow.

Fig 28: HFC borrowing tilting towards banks



Source: NHB, Centrum Research

Fig 29: Du-pont analysis over FY17-20 for HFCs

% of Avg. Assets	**FY17**	**FY18**	**FY19**	**FY20**
Interest inc.	9.5%	8.9%	9.1%	8.7%
Interest exp.	6.5%	6.1%	6.3%	6.2%
NII	**3.0%**	**2.8%**	**2.9%**	**2.5%**
Other income	0.2%	0.1%	0.1%	0.1%
Total income	3.2%	2.9%	3.0%	2.7%
Opex	0.4%	0.5%	0.4%	0.4%
PPoP	2.8%	2.4%	2.6%	2.3%
Provisions	**0.3%**	**0.5%**	**0.2%**	**0.9%**
PBT	2.5%	1.9%	2.4%	1.3%
Tax	0.8%	0.6%	0.7%	0.4%
PAT	1.7%	1.3%	1.6%	0.9%
RoE	16.9%	11.9%	13.4%	7.2%

Source: Centrum Research

C€NTRUM

LIC Housing Finance

Ready to bounce back

Initiating Coverage

India I Financials

05 July 2020

Buy

Target Price: Rs500

Price: Rs274

Forecast return: 82%

Institutional Research

We initiate coverage on LIC Housing Finance (LICHF) with a BUY and TP at Rs500. Sovereign holding and salaried share at 80%+ has led to highest credit rating of CRISIL AAA, which has enabled easier access to cheaper funding sources. Developer/LAP loans are slowing down and credit flow is shifting to housing, driven by affordable disbursements at Rs115bn for FY20 (31% of individual vs 20% for FY19). LICHF might not merge with IDBI and the former might take over the latter's housing business. Likely spike in FY21E developer/LAP stress is priced in. See FY22E RoA/RoE scale back to 1.2%/12.8%. Valuation at 0.8x FY22ABV is compelling.

Sovereign rating keeps funding cost lower which could protect near term NIM

LIC holds 40% in LICHF, which in effect makes it a sovereign entity. Also the proportion of salaried has consistently remained above 80% in retail. Hence, CRAs have assigned the highest credit rating to LICHF, which has enabled it raise funds at competitive rates. As at FY19, CRISIL assigned a "AAA/Stable" rating to LICHF. Easier access to money markets has allowed LICHF to substitute NCDs with lower cost Bank borrowing (share rose from 15% to 22% leading to NIM increase by 9bps YoY to 2.34% in FY20). Bank funding share could further improve in FY21E to 26% as 10-12% of NCDs might come up for repayment in FY21E. This would protect NIM in a challenging FY21E.

Salaried share at 80%+ of retail; LAP/builder book slowing, affordable loans rising

Salaried share for LICHF has consistently stayed at ~85% of retail loans, which is best-in-class. Over FY15-19 share of salaried declined from 93% to 76% since LAP/developer loans expanded to protect profitability. This led to sharp deterioration in asset quality. However, flow of credit is shifting back to individual housing (partially driven by affordable) and LAP + developer loan growth slowed down to 4% in FY20 (vs. 45% in FY19). Disbursements in affordable rose by 52% YoY to Rs115bn in FY20 and this segment now contributes 30-35% to quarterly credit flow. Focus is also increasing on top-7 cities with 55-60% of incremental credit flow being contributed by these cities.

Concerns of LICHF merging with IDBI Bank overstated

There has been a concern among investors that the LIC acquiring a controlling stake (51%) in IDBI Bank would tantamount to LICHF being merged with IDBI Bank. This could have led to a significant equity dilution for LICHF investors, as IDBI Bank's asset quality woes are far from over. One of the RBI mandated conditions laid down in the offer letter was that either IDBI Bank or LICHF, will have to cease conducting housing finance activity within a period of 5 years. In our opinion, it is highly unlikely that LICHF could be merged into IDBI Bank. We envisage LICHF would take over IDBI Bank's HF business since the former's asset base at Rs2.1tn is 10 times that of the latter.

Valuation and risks

Sovereign rating and higher salaried share gives LICHF an edge. LAP and developer loan accretion has drastically slowed down and asset quality risk from these segments is already priced in. Valuation at 0.8x with FY22E RoE at 13% is enticing. We assign a multiple of 1.4x FY22ABV. BUY with TP at Rs500. Risks: higher LAP/developer stress.

Financial and valuation summary

YE Mar (Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	FY20P	FY21E	FY22E
NII	10,947	12,211	(10.4)	12,486	(12.3)	47,799	47,874	52,586
PPoP	8,540	10,894	(21.6)	11,360	(24.8)	42,217	42,037	46,186
Provisions	273	1032	NM	3907	NM	9,527	16,124	10,287
PAT	4,214	6,936	(39.2)	5,975	(29.5)	24,018	19,383	26,853
AUM growth (%)	8.2	16.2	(8.0)	13.2	(5.0)	8.2	2.0	10.0
NIM (%)	2.2	2.7	(0.5)	2.6	(0.4)	2.3	2.2	2.3
C / I (%)	21.1	13.4	7.7	10.9	10.3	12.7	13.2	13.4
GNPA (%)	2.8	1.6	1.2	2.7	0.1	2.8	4.6	3.3
RoA (%)	1.3	1.3	(4bps)	1.3	(2bps)	1.1	0.9	1.2
RoE (%)	14.0	16.0	(2.0)	15.0	(1.0)	13.9	10.2	12.8
P / ABV (x)						1.6	1.0	0.8

Source: Company, Centrum Research estimates

Market Data

Bloomberg:	LICHF IN
52 week H/L:	Rs587/185
Market cap:	Rs139bn
Shares outstanding:	505mn
Free float:	48%
Avg. daily vol. 3mth:	7433053

Source: Bloomberg

LICHF relative to Nifty Midcap 100

Source: Bloomberg

Shareholding pattern

	Mar-20	Dec-19	Sep-19	Jun-19
Promoter	40.3	40.3	40.3	40.3
FIIs	32.3	32.7	32.9	32.5
DIIs	13.9	15.0	14.5	9.0
Public/oth	13.5	12.0	12.3	18.2

Source: BSE

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Financials Team

Thesis Snapshot

LIC Housing Finance versus Nifty Midcap 100

	1m	6m	1yr
LICHF IN	7.4	(37.6)	(51.7)
Nifty Midcap 100	8.0	(13.0)	(15.6)

Source: Bloomberg, NSE

Key assumptions

YE Mar (%)	FY21E	FY22E
AUM growth	2.0	10.0
NIM	2.2	2.3
Other inc / Assets	0.0	0.0
Cost / Assets	0.3	0.3
Provision costs	0.5	0.8

Source: Centrum Research estimates

Sensitivity analysis

		Credit cost				
		+10bps	+5bps	Current levels	-5bps	-10bps
NIM	-10bps	(12.6)	(9.5)	(6.3)	(3.2)	(0.1)
	-5bps	(9.5)	(6.3)	(3.2)	(0.0)	3.1
	Current levels	(6.3)	(3.1)	0.0	3.1	6.3
	+5bps	(3.1)	0.0	3.2	6.3	9.5
	+10bps	0.1	3.2	6.3	9.5	12.6

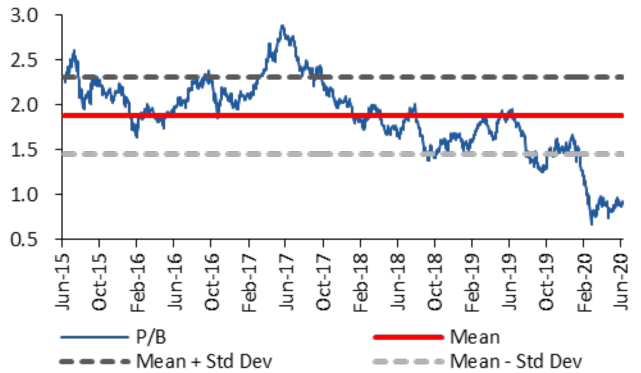
Source: Bloomberg, Centrum Research estimates

Valuations

Sovereign rating and higher salaried share gives LICHF an edge. LAP and developer loan accretion has drastically slowed down and asset quality risk from these segments is already priced in. Valuation at 0.8x with FY22E RoE at 13% is enticing. We assign a multiple of 1.4x FY22ABV. BUY with TP at Rs500. Risks: higher LAP/developer stress.

Valuations	
FY22E ABVPS (Rs)	354
Historical P/ABV (x)	1.9
Premium assigned	(25%)
Ascribed P/ABV (x)	1.4
Fair value/share (Rs)	500

P/ABV mean and standard deviation



Source: Bloomberg, Centrum Research estimates

Peer comparison

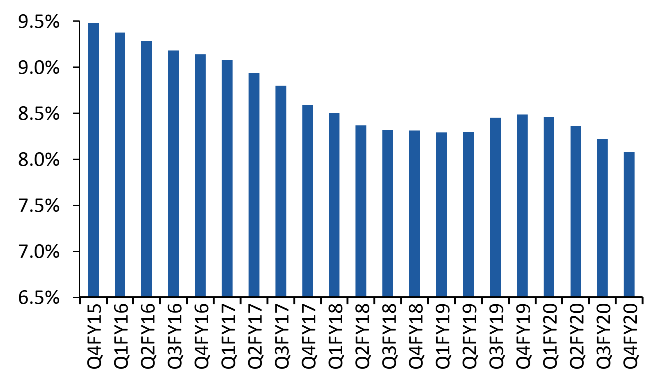
	Mkt Cap	CAGR FY20-FY22E (%)			P/BVPS			RoA			RoE		
	Rs bn	Total inc	PPOP	PAT	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
LICHF	**139**	**5.0**	**4.6**	**5.7**	**1.1**	**0.7**	**0.6**	**1.1**	**0.9**	**1.2**	**13.9**	**10.2**	**12.8**
Canfin	47	8.1	7.8	10.0	2.1	1.9	1.6	1.9	1.6	1.9	19.1	15.1	17.1
HDFC	3271	6.0	9.7	7.4	3.7	3.6	3.4	3.2	1.8	2.0	19.7	11.8	13.0
Indiabulls	99	(8.4)	(30.9)	(9.7)	0.6	0.5	0.5	1.1	1.4	1.6	8.0	8.6	3.2
PNB	35	4.7	5.9	(1.0)	0.4	0.4	0.4	1.2	1.1	1.2	11.6	8.1	10.6
Repco*	8	11.1	12.1	12.8	0.4	0.4	0.3	2.5	2.3	2.4	17.6	15.1	15.1

Source: Company, Centrum Research estimates. *In case of Repco, FY20 denotes estimates.

Sovereign rating and higher salaried share led to lower funding cost

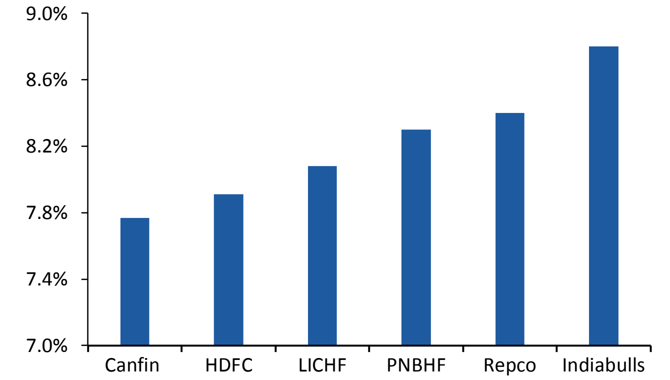
- Life Insurance Corporation of India (LIC) holds a 40% stake in LICHF, which in effect makes it a sovereign entity. Secondly, the proportion of the salaried segment has consistently remained at ~85%. Thirdly, the LTV has consistently remained below regulatory levels on incremental sanctions since FY16. Owing to the above reasons, rating agencies have assigned the highest credit rating to LICHF and consequently, this has enabled the company to raise funds in the money markets at competitive rates.
- As at FY19, LICHF has been assigned a credit rating of “CRISIL AAA/ Stable” by CRISIL, “CARE AAA” by CARE & “ICRA A1+” by ICRA. This rating indicates the highest degree of safety regarding timely payment of interest and principal. Due to its sovereign and highest credit rating, funding cost has been lower for LICHF vs. some peers

Fig 30: Incr. funding cost (WACC) improving for LICHF



Source: Company

Fig 31: Reported cost of funds lower vs. some peers

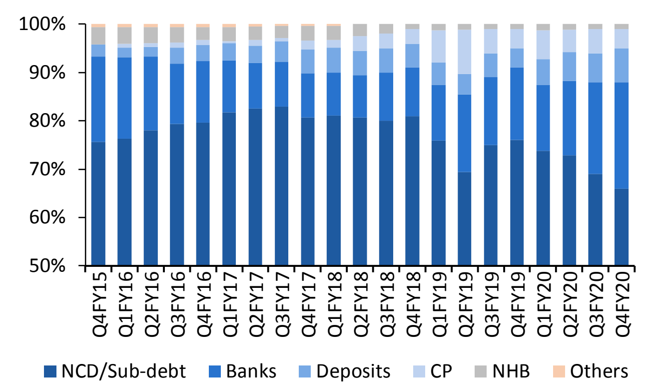


Source: Company

Lower cost bank share to enhance; focus also on NHB funding and deposits

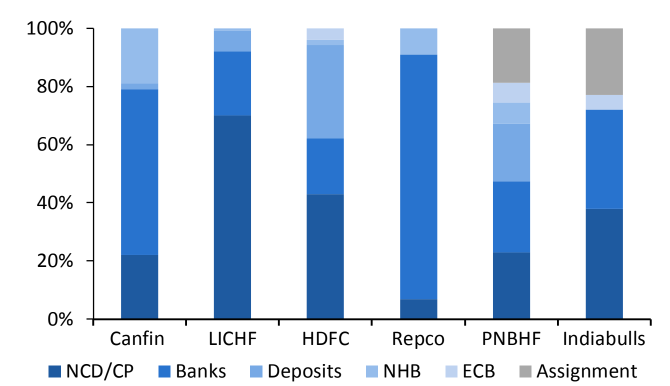
- Bank funding in the overall borrowing mix has increased from 10% in FY17 to 22% in FY20 and there is a benefit in terms of WACC, which is lower by 20-25bps in case of Banks. The management has suggested that it would be one of the important sources of funding going forward and focus would be on fetching the best pricing.
- Also, within the ALM requirement, bank funding has been increasing incrementally, which has recently also been coupled with easing liquidity conditions and muted interest rate environment, leading to lower funding cost. Banks have also been reducing their MCLR, presenting an opportunity for LICHF.

Fig 32: Funding mix: Bank share rising post the ILFS crisis



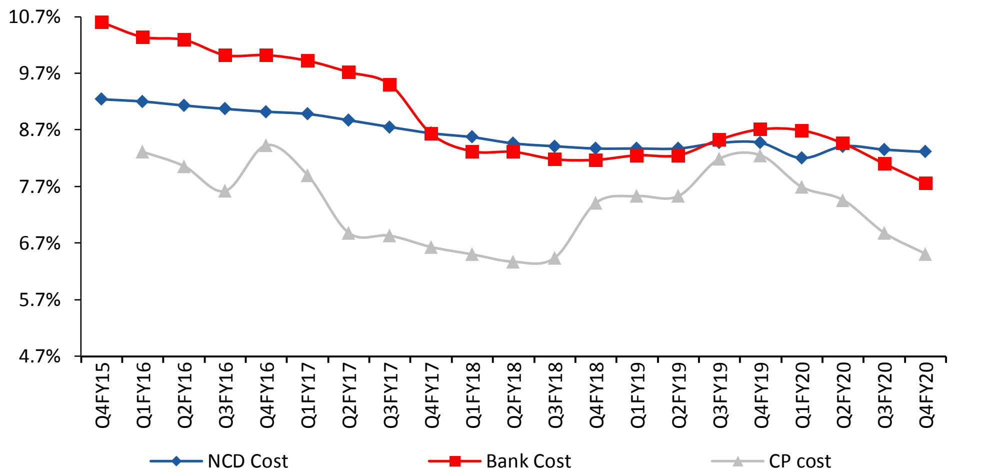
Source: Company

Fig 33: Funding mix compared to peers



Source: Company

Fig 34: NCD/Bank funding cost declined by 0.9%/2.8% over FY15-19

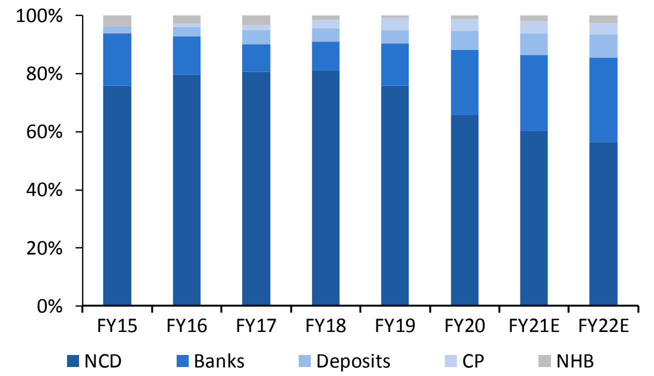


Source: Company, Centrum Research

- Contrary to the reduction in the bank funding cost, weighted average funding cost of NCD borrowings does not reflect a similar fall as bank borrowing is floating in nature and when the MCLR reduces, LICHF is able to negotiate a lower cost.
- NCD borrowings are fixed in nature so its cost comes down when the existing book matures and new funds are infused at a lower rate.
- Hence, the management expects a meaningful reduction in borrowing cost in the next 2-3 quarters as some of its NCD borrowings would mature in the coming quarters. As per the management, the next six months from Q3FY20 could see Rs150-160bn of NCDs coming up for redemption. This could see bank funding rise for LICHF.
- As the proportion of affordable housing would rise, the share of NHB funding would also increase since it is relatively lower cost. LICHF is also focusing on retail deposits and since FY19 the company has revamped the entire scheme with slightly more attractive rates and has also been a bit more aggressive in raising deposits. Consequently, the share of deposits has risen from 4.0% in FY19 to 7.0% in FY20.
- Owing to ease of funding, LICHF has adequate undrawn lines from banks and NHB. The quantum of such undrawn lines in Q3FY20 was Rs100bn from banks and Rs50-60bn from NHB, taking the total undrawn lines at Rs150-160bn.
- Over FY20-22E we expect the share of bank borrowings to rise to 26% in FY21E (vs. 22% in FY20), since bank borrowings, as a funding source, is getting cheaper given the muted interest rate environment and additional liquidity in the system. This would cushion the expected blip in FY21E NIM that could be led by higher interest reversals.
- The share of deposits/NHB could rise to 8%/2.5% by FY22E. In terms of CPs, the management alluded that CPs would be resorted to match the ALM and only to fund shorter term assets, which are anyways in a smaller proportion. Hence, the company has kept the CP proportion to be low.
- Further, in terms of ALM, the company used to run with a negative ALM in the less than 1-year bucket at -19% in FY19, which has reduced considering the NHB norms. As per NHB norms, the limit is -15%, while as at Q2FY20, LICHF stands at -13%.
- On the NIM front, LICHF saw a sharp contraction of 45bps in FY18 to 2.3% as the decline in yields (86bps) was faster as compared to cost of funds (40bps). In FY18, due to the sharp reduction in interest rates in the post-demonetization period, the company saw a lot of pre-payments and re-pricing on the back-book also due to the competitive intensity increasing, which led to compression in yields.
- At that juncture, post reduction in policy rates and deluge of pre-payments, LICHF too reduced its PLR which caused a substantial re-pricing of the back-book. This led to softening of the weighted average yields by 60-70bps to 9% over the 15-month time frame. Consequently, the differential between the back-book and the incremental rates has narrowed down to a large extent.

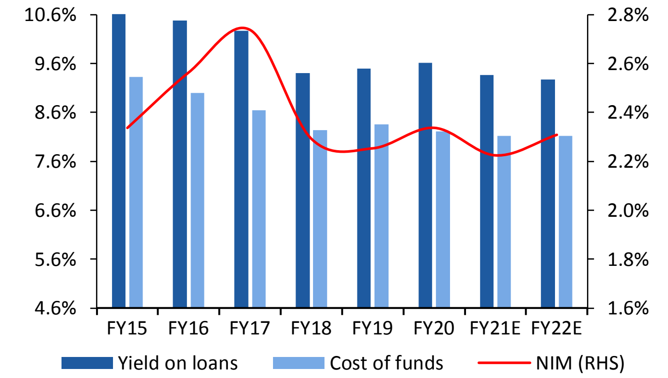
- Owing to the two systemic shocks of demonetisation in FY17-18 and the ILFS debacle in FY19, competition increased from banks, which anyway operate on a lean cost structure due to the deposit base including CASA.
- Hence, to protect its yields, the company strategized to increase its non-housing portfolio, i.e. LAP and the developer loans. From a yield proposition, these segments obviously are attractive as retail housing yield is 9% whereas for LAP it is 10.5% and builder loans it is 12.7%. This led to NIM protection over FY18-19.
- From a cost of funds perspective, LICHF did not see sharp increase in funding cost in FY19-20, as witnessed by some other NBFCs, owing to its sovereign credit rating.
- NIM for FY20 however, improved by 9bps YoY from 2.25% to 2.34%. This could happen due to improvement in yields by 12bps and reduction in funding cost by 14bps as the share of bank funding increased by 7% in FY19 to 22% in FY20. Funding cost since October 2018 has come down by 100-200bps across maturities.
- Going forward, as new infusion of funds come in at a lower rate in the form of bank funding in the next 4-6 quarters, there would be a reduction in borrowing cost. On the yield front, we expect a blip in FY21E due to higher slippages, hence we see NIM to contract by 12bps in FY21E to 2.2%.

Fig 35: Share of bank funding to increase by FY22E



Source: Company, Centrum Research

Fig 36: NIM might dip in FY21E due to higher slippages

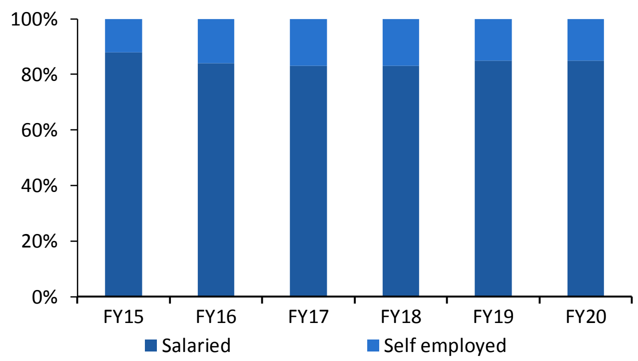


Source: Company, Centrum Research

Salaried share consistent at ~85%; builder loans and LAP slowing down

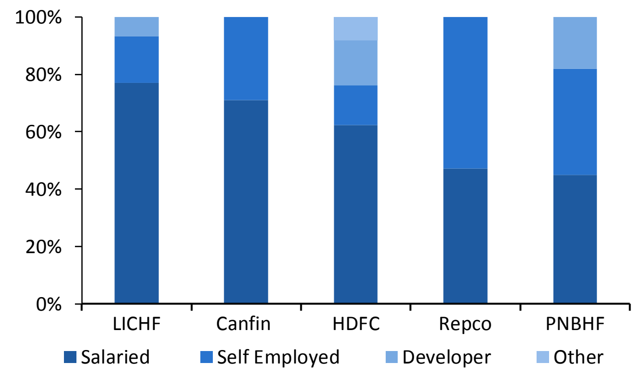
- LIC Housing Finance (LICHF) AUM stands at Rs2.1tn as at FY20 with the individual home loan contributing 77% and the non-housing portfolio contributing 23%. The salaried portfolio for LICHF has consistently stayed at ~85%, which is the best-in-class. This reduces asset quality risk in the challenging scenario of an extended lockdown.
- Of the salaried segment, ~30% are working with PSU companies while, ~50% with private companies. In terms of the self-employed share of 15%, self-employed professionals (SEP – doctors, lawyers, consultants, etc.), would be 2% of the outstanding loan portfolio.
- Effectively, 13% of the non-developer portfolio (93%) is exposed to lockdown related asset quality risk. Also, the LTV for LICHF is comfortable and low and has regularly been below regulatory limits. This indicates that the ultimate LGD could be lower, once the moratorium ends and the stress recognition begin.

Fig 37: Salaried share has been consistently above 80%



Source: Company

Fig 38: Share of salaried is the best in class

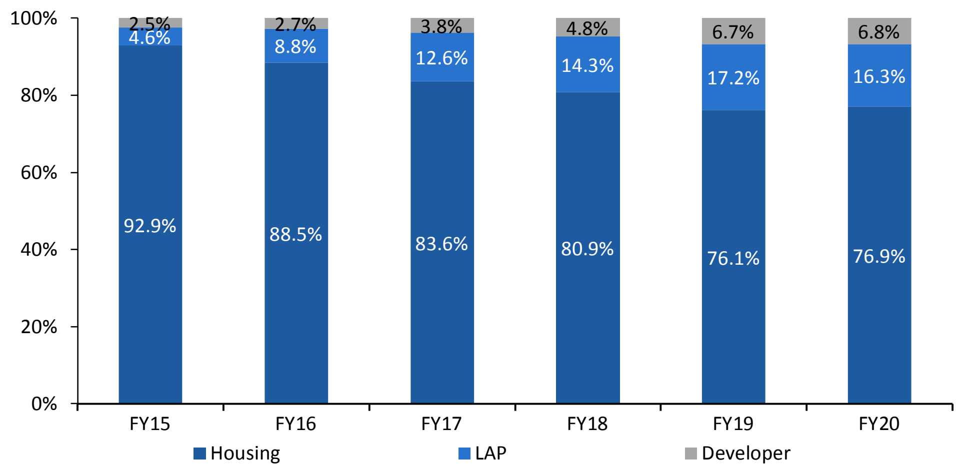


Source: Company

FY20 saw developer + LAP loans slow due to stress

- For LICHF, housing contributed 93% in FY15, which declined in FY19 to 76%, while the share of LAP and developer loans combined increased to 24% in FY19. With three systemic shocks, the first being demonetisation in FY17, second being RERA in FY18 and the third being the ILFS debacle in FY19, competition from banks increased, especially in the larger cities. Hence, LICHF decided to increase its exposure towards the non-housing portfolio mainly LAP and developer loans, which offer better yields.

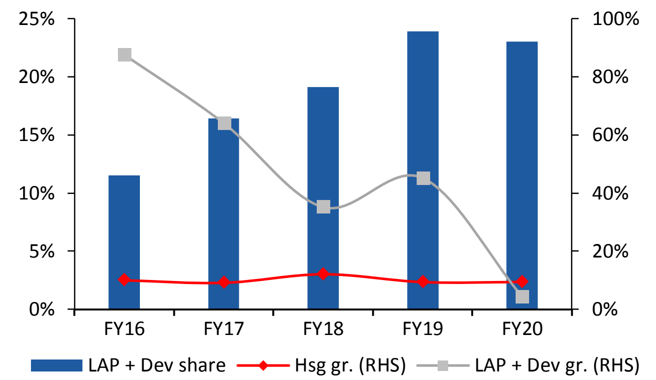
Fig 39: Developer + LAP share rose from 7% to 24% over FY15-19, slowed down in FY20



Source: Company, Centrum Research

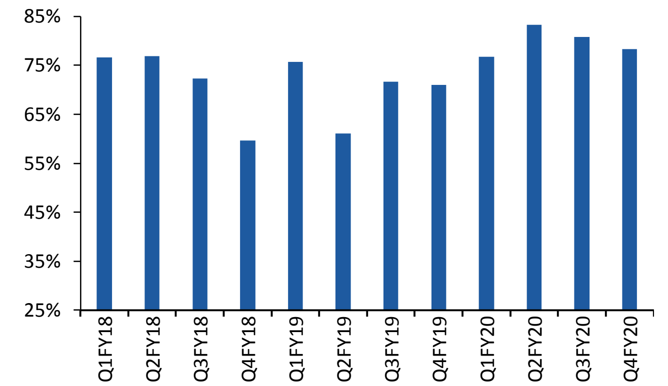
- Owing to asset quality challenges in LAP and developer loans and the RERA related issues being sorted out, the company, post FY19 has been seeing an uptick in retail home loans and is slowing down its share of non-housing.
- The share of retail home portfolio has seen an uptick from 76% in FY19 to 77% in FY20 with growth improving in Q3FY20 to 13% (vs. 9% a year ago). Growth in the non-housing is slowing down with LAP growth decreasing from 40% in FY19 to 2.4% in FY20 and developer loan growth declining from 61% in FY19 to 9% FY20.
- Disbursements for Q4FY20 saw a sharp decline of 34% YoY owing to the lockdown in March 2020. Hence, for FY20, total disbursements declined by 13% YoY to Rs469bn. Although, individual home loan disbursements saw a slight 1.7% YoY growth over FY19-20 to Rs375bn (vs. Rs369bn in FY19), which was a positive.
- On the non-housing front, LAP and developer disbursements were down 45% YoY to Rs94bn (vs. Rs170bn in FY19). Hence, the share of non-housing has marginally declined from 24% in FY19 to 23% in FY20.

Fig 40: FY20 saw LAP + developer growth slowing



Source: Company

Fig 41: Share of individual housing rising in disbursements

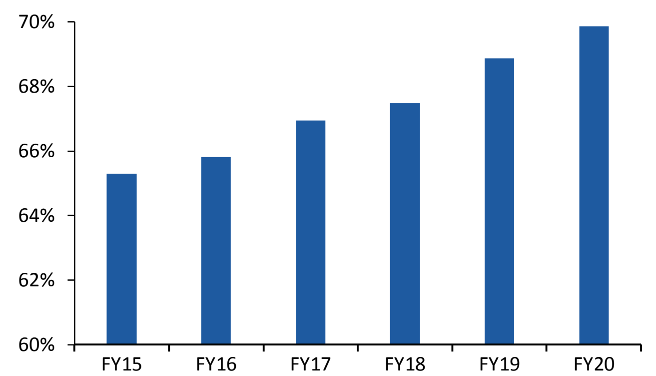


Source: Company

Focus on Tier-2, 3 cities; share of affordable housing rising

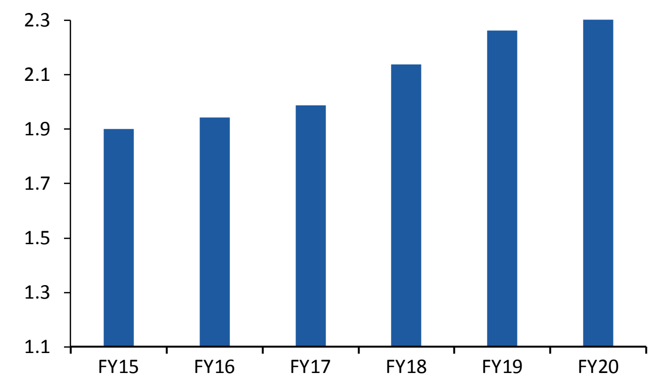
- Initially, for LIC Housing, growth was led by the top 7 cities but over FY15-20 the share of the branches in cities other than the top-7 cities has risen from 65% to 70%.
- This has gradually led to a shift in loan mix and 40-45% of disbursements, are contributed by the top 7 cities of Mumbai MMR region, NCR, Bengaluru, Chennai, Hyderabad, Pune and Kolkata, while the balance 55-60% are contributed by others.
- To penetrate deeper geographically, in FY18, two regional headquarters were created i.e. one at Bhopal and another at Patna, covering states of MP, Chhattisgarh, Bihar, Jharkhand and Orissa. These regions clocked growth rates between 30-40% in FY18.

Fig 42: Share of branches in cities other than top-7 rising



Source: Company

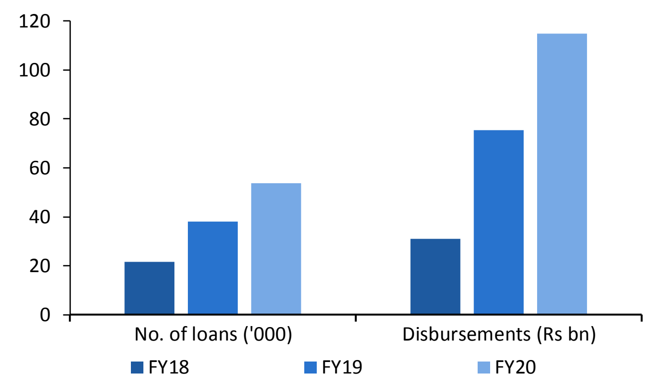
Fig 43: Low Incr. ATS (Rs mn) suggests focus on affordable



Source: Company

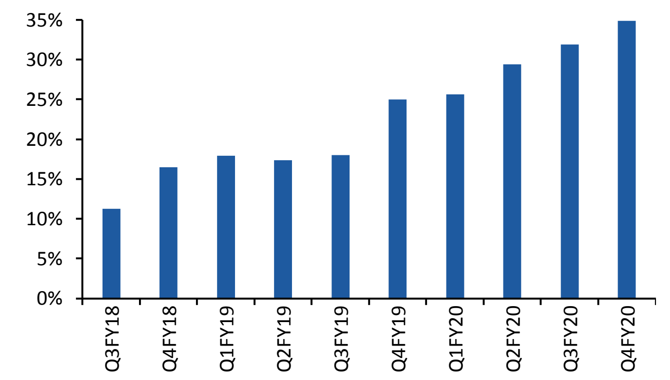
- In FY19, the plan was to open 23 marketing offices in tier 3 and 4 locations to tap the housing finance opportunity in these cities. Against this, 20 branches were opened in FY19 in cities other than the top-7 cities.
- With the enormous potential in the affordable housing space, the company started focusing on affordable housing since FY18. Although on a portfolio basis, the share of affordable housing could be lower at 10%, the share in incremental number of accounts and retail disbursements is rising.
- For FY20, disbursements in affordable housing have risen from Rs76bn in FY19 to Rs115bn in FY20 (+52% YoY). In volume and value terms, numbers have significantly improved. As per the management, the growth in the affordable housing space to remain strong and in Q4FY20 of the Rs88bn of individual housing disbursements, 35% were contributed by this segment.
- LICHF mainly focuses on MIG-1 and MIG-2 segments in affordable and it relies only on assessed or IT declared income and there is no dependence on surrogates.
- Earlier, owing to supply side issues, builders were not keen to enter this space. However, recently after the onset of RERA and Government support, developers have finally got the correct product in terms of demand satisfaction.
- Now affordable housing projects are much more viable as compared to 3 years back. Margins would be thinner per unit but volume would be much higher. Profit generated per area of land would be similar to higher ticket sized projects with the added advantage of visibility.
- An information base for potential CLSS customers has to be built by the company. Hence, the company has now started designing products that are similar to the requirements of the PMAY/CLSS and any information required would be taken before disbursing the amount.
- The objective has been procurement of business under PMAY/Affordable housing, to have a continuous focus in alignment with Government initiatives from time to time and ensuring achievement of targets in both numbers and amount in this segment.
- With the COVID-19 pandemic related lockdown hampering economic activity, cash flows could be stretched for customers. However, the affordable housing segment (mainly focused in tier-2, 3, 4 cities) would be lesser impacted as the top-7 cities have been severely impacted due to COVID-19. This will cushion demand for housing, which could see a sharp decline in FY21E.

Fig 44: Volume and value of affordable housing improving



Source: Company

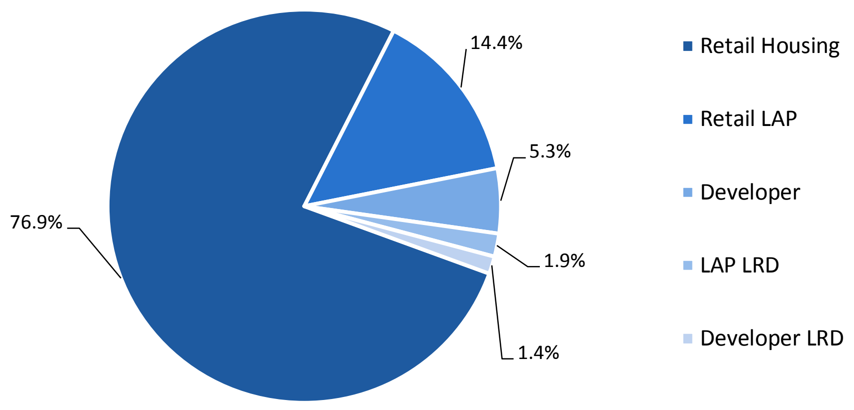
Fig 45: Share in retail disbursements of affordable rising



Source: Company

Clarity on each loan segment

Fig 46: LRD totals to 3.4% of the total portfolio



Source: Company, Centrum Research

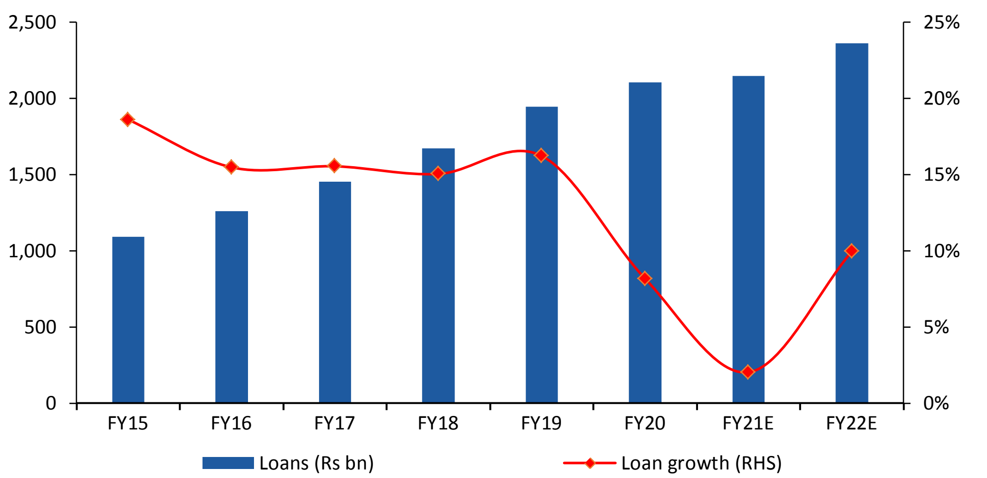
- Average LTV is close to 60% (against the regulatory limit of 90% for loans up to Rs2mn, 80% for loans above Rs2.0-7.5mn and 75% for loans above Rs7.5mn). LICHF's instalment to income ratio ranges between 30-40%, both being lower in the industry. The average ticket size (ATS) of the loan is ~Rs2.3mn and the salaried and SEP segment makes up for 87% of loan, while the self-employed is at 13%.
- **Retail Housing:** The company increased its focus on retail housing loans at all levels FY19 onwards. Some measures incorporated were Direct Marketing Executive (DME) channels were made a separate unit and Business Development Centre (BDCs) were opened at main centres.
- Metro centres like Mumbai, Pune, Delhi, Hyderabad, Chennai, Bangalore, Kolkata, Lucknow were to have minimum 2 BDCs. In other major cities, having more than 2 area offices, one office was to be converted as BDC.
- Creation of separate cell at Regional Offices (ROs) to handle high value loans of more than Rs100mn with post disbursement monitoring. This cell would be on similar lines to Project Finance Department in ROs.
- **Credit risk management**: For retail lending, credit risk management is being achieved by considering various factors like: (1) borrower's ability to pay, (2) security cover, (3) additional security cover, and (4) geographical risk management.
- A detailed assessment of borrower's capability to pay is conducted. The approach of assessment is laid down in the credit policy of the company. Various factors considered for assessment are credit information report, analysis of bank account statement and valuation of property.
- Security cover – Analysing the value of the property that is offered as security for the loan is essential for the overall underwriting of the loan. It is essential that it is valued before the disbursement of loan to arrive at a clear idea about its cost, valuation, marketability and loan to property ratio.
- Additional Security can be by way of pledge of acceptable additional collaterals such as LIC policies or other Securities like NSCs, FDs, Kisan Vikas Patra, etc. This is taken depending on nature of loan proposal and amount of risk involved.
- Geographical risk – The company monitors loan performance in a particular region to assess if there is any stress due to natural calamities, etc., impacting the performance of the loan in a particular geographic region.

- **Loan against property:** Increasing the composition of high margin business was a conscious decision made by the management a few years ago. The objective was to strategize an improvement in the margin stability.
- LAP lending is strictly done on self-occupied residential unencumbered property taking into consideration the repayment capacity of the person. Loan appraisal is done as if for a normal home loan. So the risk is controlled to that extent.
- The company is conscious of maintaining good asset quality in the LAP segment. Therefore, as this book grew the company ensured that the product was very tightly ring-fenced against all possible risks.
- The LTV is even lower than the core mortgage business. Moreover, most of such loans are given only to the salaried segment.
- The total LAP stands at 16.3% of which retail LAP is 14.4% and LRD is 1.9%. The average ticket size is Rs1.5-1.6mn in retail LAP and Rs400mn in LRD.
- Salaried is roughly around 70% and 30% of these customers would have been home loan customers like in-sourcing within the people who have repaid or either have been given a top-up loan.
- Having met the company’s interim strategy of margin stability the focus will be on the core mortgage business from here on.
- **Developer Loans:** The total developer book contributes 6.8% to total loans (Rs142bn) spread across 260 accounts, of which project loans are 5.3% and LRD is 1.4%. This book is mainly in the nature of builder loans and not corporate loans.
- LICHF only lends at the SPV level, which is construction linked finance. Further, 94.6% of loans would be towards the residential projects and the balance 5.4% would be commercial. The ATS would be Rs400-500mn.
- Completion in project loans would be 50-60%. The disbursements made in the past one year would be to properties that would have a similar level of completion.
- Geographically the entire builder book is spread across the top seven cities with 40% of the book being in western India including Mumbai.
- The minimum security cover taken is 1.5x and average LTV would be 40-50%, which would mean the security cover will be almost 2x without considering any appreciation in the land value from a point to point basis; though it does take time to recover.
- For example, Q1FY19 saw a recovery that was 70% higher than the exposure taken, as the underlying value of the security was quite good. The legislative process obviously takes time to get sorted but, the company is confident that all the project exposures will not cause any financial losses.
- As the company’s incremental focus is on affordable housing, on the project financing side they are open to good quality projects. The strategy is to promote those projects which cater to affordable housing.
- The company is cautious on lending project loans and the credit appraisal has become more stringent looking at the present environment. Focus is more on marketability so that the builder gets cash flows and repays the money in time.
- Also, LICHF has its own rating system (A++, A+, A, B, C) and post the ILFS debacle, the company has stopped disbursements to category B&C builders and is only giving loans to builders rated A and above.

COVID-19 shock to see a tough FY21; expect FY22E to rebound

- Proportion of under construction projects in residential retail has been declining over the last 3-4 years due to the uncertainty related to completion of projects and the customers' increasing preference towards occupying ready to move in houses.
- Hence, in the last 3-4 years, share of customers opting for a ready to move in house has increased significantly and the rate of new launches has been coming down.
- With RERA in place, customers have started to derive greater confidence and demand is gradually picking-up. With increased focus of LICHF on affordable housing, as this base improves, it would start to show up in the better loan growth.
- In FY21E, LAP and builder disbursements would remain weak owing to asset quality issues surrounding these segments. LICHF already saw a sharp decline in credit flow to these segments in FY20.
- Due to the existing lockdown in India owing to the COVID-19 pandemic, we envisage a sluggish economic activity in H1FY21E, post which recovery would be gradual. Till 2nd week of June 2020, disbursements were only Rs20bn (~20% of Q1FY20 disbursements), which means Q1FY21E might see a sharp drop in disbursements.
- Compared to our original base case scenario, as economic activity has been halted, we see loan growth of only 2% for FY21E (vs. base case of 13%) as the larger cities are severely impacted due to COVID-19, and for LICHF, 60-70% of the portfolio is concentrated in the top seven cities.
- There could be some growth opportunities in the tier-2, 3 cities, especially in the affordable housing space, which would provide some growth cushion.
- We expect a weak 2% YoY loan growth in FY21E, however, we see a rebound in FY22E with loan growth improving to 10%.

Fig 47: Loan growth to decline sharply in FY21E though FY22E could see a rebound



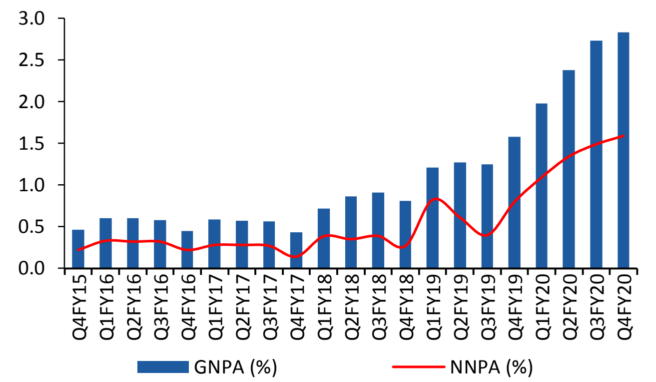
Source: Company, Centrum Research

Asset quality a key; developer loan resolution could lead to re-rating

LAP + developer problematic; retail saw a blip in Q3FY20

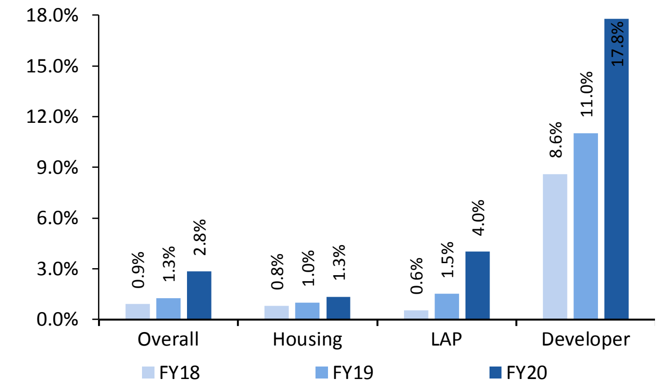
- To counter competitive intensity in terms of repayments/pre-payments and NIM, especially post the systemic shocks of demonetisation and ILFS, LICHF decided to increase the share of LAP and developer loans over FY15-19 to protect its margin profile. The non-housing segments grew at a CAGR of 57% over FY15-19 to Rs466bn.
- However, being riskier segments, yields were attractive; however, asset quality has been a challenge to manage. Owing to the real estate slowdown, especially post the ILFS crisis, a lot of developers were finding it tough to service their loans leading to asset quality challenges.
- Recently, the LAP portfolio has also started witnessing stress owing to the macro slowdown that has led to challenges in the SME/MSME space.

Fig 48: Asset quality deteriorating FY19 onwards



Source: Company

Fig 49: Asset quality worsening in LAP and developer



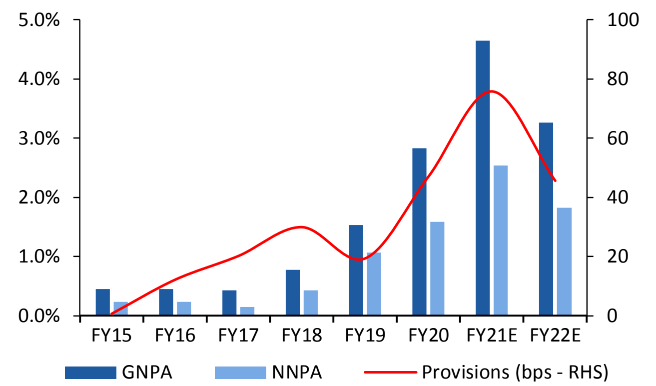
Source: Company, Centrum Research

- In Q3FY20, sequentially the overall retail segment (housing + LAP) saw a QoQ 20bps blip in NPA from 1.7% to 1.9%. Of this, Rs1.8bn were standard retail loans that turned NPA because the other loan taken by the same customer turned NPA. This has accounted for nearly 10bps of the 35bps increase in delinquencies for the quarter.
- Because of this technical reason, there was some spike in individual loan NPA having multiple accounts, implying that one account turned NPA, but that individual customer would have 3-4 loan accounts. Such cases are only 1% of the total customers and recovery is gradually happening in these accounts.
- The individual loans and LAP in the normal course also saw blip of ~Rs2.5bn each owing to a general economic slowdown. Also, from a stage II assets perspective, that has gone up from 3.8% in Q1FY19 to 5.7% in Q3FY20 (+100bps QoQ). This was mainly driven by the retail segment, mostly on account of delayed payments leading to these loans moving from the stage-1 to stage-2.
- However, the company has internally assessed that about 2,000 retail loan accounts which were NPA as on September 30, 2019, have started to pay, but these payments are not exactly equal to the EMI. Hence, the stage-2 portfolio sequentially improved partially due to this reason to 4.7% QoQ. These payments total to Rs400-500mn.
- To control asset quality in the retail loan book, the company has formed a task force to monitor each individual loan account, which is being closely monitored at the branch and back office levels. Before the due date, a reminder notice and SMS is sent to customers that they should pay. If there is a failure employees contact them.

Builder loans have been a pain point

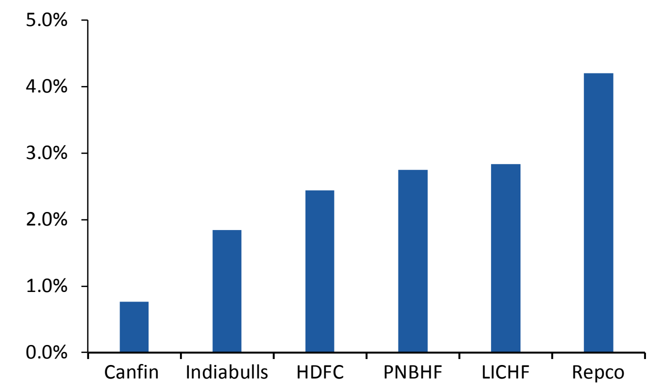
- The developer book as at FY20 stands at Rs142bn spread across 260 total accounts with a GNPA ratio of 17.8%. Sequentially, this ratio saw a 3.8% blip while on a YoY basis, this ratio has spiked substantially. PCR on this book would be 45-46% and 51.2% of the developer book has been provided for.
- NPA accounts are project loans having a vintage of 3-4 years. The underlying projects are almost complete but sales traction is absent leading to cash flow issues and eventually they have slipped to NPA. Also, as per new norms, suppose a builder has taken a loan on 2 projects and one project is standard but if the other is NPA, then it would be classified as NPA, which also had a bearing to an extent on LICHF.
- The top 10 exposure would be ~15% of which ~16% would be would be part of NPA. Around 25-27% (vs. 35-36% QoQ) of the developer book is under moratorium. Certain accounts that have come out of the moratorium had started paying in Q3FY20. The top 8 project loan NPAs account for 65% of the total project loan NPA, and efforts are underway to resolve this. SARFAESI has already been initiated for 3-4 accounts.
- On the resolution front, 5 cases have already been taken to NCLT though this process would be delayed owing to the COVID-19 impact. Also, there has been recovery to the tune of Rs250mn in this portfolio in Q3FY20, which led to a slight reduction in NPA by 23bps. Besides this, 14 accounts amounting to Rs10-11bn have been referred to AIF. They are eligible for this alternative investment fund, which is managed by SBICAP.
- There is a dedicated team to closely monitor each builder loan account and they are advised to take any action including legal. They are negotiating with builders to ensure that there is no further slippage. Also, to control incremental asset quality in this segment post the ILFS fiasco, LICHF has become more stringent in its due diligence and is not disbursing loans to any builders below A category.
- Presently, 25% of the overall book is under moratorium, of which, 75% developer loans and 35% of LAP loans are under standstill. This implies that only 14% of retail home loans are under moratorium.
- We remain concerned due to the lockdown and its impact on various sectors, especially the LAP and developer segment. The experience of some customers having multiple loan accounts slipping to NPA is a warning sign and the likelihood of such episodes occurring increases in this tough economic environment. Although, incremental focus on affordable housing is comforting, as asset quality is the best at 0.07%. We expect asset quality in the LAP and developer segment to remain challenged in FY21E. Expect GNPA spike to 4.6% in FY21E (vs. 2.8% in FY20).

Fig 50: Asset quality might see a spike in FY21E



Source: Company, Centrum Research

Fig 51: GNPA as compared to peers



Source: Company

Concerns of LICHF merging with IDBI overstated

Fig 52: Highlights of the LIC-IDBI deal

RBI had laid out the following restrictions on LIC called RBI Approval Conditions
• Acquire 51% in IDBI Bank (LIC completes acquisition of 51% stake in Jan'19)
• Bring IDBI Bank out of PCA by March 2020
• By December 2030, LIC would need to bring down its stake from 51% to 40%
• Either IDBI or LICHF will have to cease conducting housing finance activity within a period of 5 years

Source: Company

- There has been a concern among investors that LIC acquiring a controlling stake (51%) in IDBI Bank would tantamount to LICHF being merged with IDBI Bank. This could lead to a significant dilution of equity value to LICHF investors as IDBI Bank's asset quality woes are far from over. While the concerns are justified, we have tried to look at the transaction closely and the implications for each entity.
- The offer letter also lays down RBI mandated conditions that LIC would need to adhere for a stake purchase in IDBI Bank. Some of the important conditions are:

  1) LIC shall capitalize IDBI Bank adequately to ensure it meets the minimum capital requirements stipulated by RBI for a period of at least 5 years, with a view to, enabling IDBI Bank to move out of the RBI's PCA Framework by March 31, 2020.

  2) Voting rights for LIC in IDBI Bank shall be capped currently at 26%.

  3) LIC shall bring down its stake in IDBI Bank over a period of 12 years, to 40% of the total voting paid-up equity capital of IDBI Bank i.e. by December 31, 2030.

  4) In order to prevent any conflict of interest, LIC shall bring down its equity shareholding in other banks to 10% or below over a period of 2 years, as under: (i) where LIC's shareholding in a bank is more than 12%, it must be reduced to not more than 11% by December 31, 2019 and not more than 10% by September 30, 2020; and (ii) where LIC's shareholding in a bank is more than 10% and up to 12%, such shareholding must be reduced to not more than 10% by December 31, 2019.

  5) Either IDBI Bank or LICHF will have to cease conducting housing finance activity within a period of 5 years. In other words, housing finance activity shall be conducted by only one entity, i.e. either by IDBI Bank or LICHF and appropriate reorganisation shall be completed within a period of 5 years.
- The managements of both LICHF and IDBI Bank had clarified later that there was no proposal that was discussed for the merger of LICHF and IDBI Bank.

Our view

- While the concern over shareholder value dilution subsequent to merger is justified, in our opinion this is unlikely to materialise.
- After reading through the above RBI conditions, we envisage that that IDBI Bank would cease to conduct housing finance activity and not LICHF as the former's housing finance business stands at Rs200bn and LICHF has a loan base of Rs2 trillion.
- In other words, LICHF's housing finance business is 10 times that of IDBI Bank. Hence, it is highly unlikely that LICHF could be merged into IDBI Bank.
- On the contrary, we expect LICHF to take over IDBI Bank's housing finance business.

Key risks

- **Lockdown related vulnerable portfolio at 12%:** Owing to disruption caused in economic activity led by the COVID-19 related lockdown, the developer and self-employed segment has been one of the hardest hit. The developer segment would be impacted as demand for housing is expected to be weak as customer affordability would be hit. The self-employed segment is already facing a cash crunch as domestic demand is marred. For LICHF, the developer loan book is at 7% while the self-employed segment contributes 30% to LAP i.e. 5% of overall loans. Although we have been conservative in baking in asset quality estimates, these segments could see further deterioration in case the lockdown is extended as there is a looming fear of a second wave and COVID-19 cases are yet to peak in India. Also the remaining salaried LAP loans at 11% could also see a risk as ticket sizes are much larger in LAP. However, overall LGD in LAP could be lower due to lower LTV and adequate collateral.
- **Prolonged slowdown could see lower growth:** Given the pandemic has not yet peaked in India, we can see conservative measures taken by the respective state governments imposing lockdown with certain relaxations. Also, with the possibility of a second wave, the slowdown could be prolonged further impacting demand and credit growth. We have been prudent in estimating loan growth for LICHF at 2% YoY for FY21, though this number could come in lower if the lockdown continues.

Company Background

Incorporated in 1989, LIC Housing Finance Ltd (LICHFL) is one of the largest Housing Finance Companies in India. The Company went public in 1994. LICHF AuM stands at Rs2.1trn as at Q4FY20 and the company has 282 Branches with 87 of these in the top-7 cities. The company is promoted by LIC (holds a 40% stake in LICHF) which is the largest insurance provider in India. LICHF also undertakes project and LAP financing.

Salaried share for LICHF has consistently stayed at ~85% of retail loans which is best-in-class. Over FY15-19 the share of salaried declined from 93% to 76% since LICHF expanded into LAP/developer loans to protect profitability. CRISIL has assigned the highest credit rating of "AAA/Stable" as at FY19.

Fig 53: Profile of Board of Directors

Name of the Director	Designation	Profile
Shri M R Kumar	Chairman	Shri M R Kumar took charge as Chairman, LIC of India on 14th March, 2019. He joined LIC of India in 1983 as a Direct Recruit Officer. In a career spanning more than three and a half decades, he has had the unique privilege of heading three Zones of LIC of India. As an Executive Director he headed the Personnel Department as well as the Pension and Group Insurance vertical.
Shri Siddhartha Mohanty	MD and CEO	Prior to taking over as MD & CEO of LIC Housing Finance, one of the largest housing finance companies in India, Shri. Mohanty was the company's Chief Operating Officer. Shri Mohanty started his career as a direct recruit officer with LIC of India in 1985 and has risen through the ranks to this senior position. He has served as Chief of Investments (Monitoring), Regional Head of a marketing vertical of LIC's Western Zone spanning the States of Maharashtra, Gujarat and Goa. He was the Senior Divisional Manager in-charge of Raipur and Cuttack divisions of LICI
Shri Jagdish Capoor	Independent Director	Shri Jagdish Capoor served Reserve Bank of India in various capacities for 39 years and finally retired as Deputy Governor in 2001 after serving in that position for more than four years. After retirement from RBI, he served as Chairman of HDFC Bank, Agriculture Finance Corporation, Banyan Tree Bank Limited - Mauritius and the Bombay Stock Exchange.
Smt. Savita Singh	Independent Director	Smt. Savita Singh is a partner with the Real Estate team at Khaitan & Co LLP and is experienced in all kinds of property transactions, hospitality transactions, litigations arising out of property transactions and allied matters. Ms. Singh is a postgraduate in English Literature
Dr. Dharmendra Bhandari	Independent Director	Shri V K Kukreja, is a Chartered Accountant by profession with a vast experience in the area of accounts, finance, fund management, portfolio management, research analytics& reporting and information technology
Shri V K Kukreja	Independent Director	Shri Shankara Narayanan Subramanian (S Subramanian) has been appointed as an Additional Director (Non-executive Promoter) w.e.f. October 06, 2018. He is a graduate in B.Sc., a Diploma holder in Company Law and a CAIIB. Shri S Subramanian started his career in Canara Bank in the year 1981 and has more than 36 years of commercial banking experience..
Shri Ameet Patel	Independent Director	Shri. Ameet Patel was appointed as Independent Director of LIC Housing Finance Ltd. on 19th August, 2015. He qualified as a Chartered Accountant in 1986 with a rank at the all India level and has been in private practice since then
Shri Koteswara Rao	Director	Shri P Koteswara Rao is a Fellow member of Institute of Chartered Accountants of India (ICAI) with bachelor's degree in Commerce from Venkateswara University, Tirupati with a vast experience in the area of Accounts, Finance, Fund Management, Portfolio Management, Office Services, etc. He is also NSE Certified Market Professional..
Shri Kashi Prasad Khandelwal	Additional Director	Shri Kashi Prasad Khandelwal is Chartered Accountant by profession for last 42 Years. He was appointed as Financial Audit Consultant by World Bank, Washington, USA in August 2010 for the Emergency Monrovia Urban Sanitation (EMUS) Project, funded for Monrovia City Corporation, Govt. Of Liberia.

Source: Company Annual Report, Centrum Research

Fig 54: Quarterly financials

Particulars (Rs mn)	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20
Income statement								
Interest earned	40,338	41,873	44,242	46,213	47,863	49,552	49,708	48,989
Interest expended	30,253	32,683	34,655	34,002	36,066	36,984	37,222	38,042
Net interest income	10,085	9,190	9,587	12,211	11,797	12,568	12,486	10,947
Other income	255	206	150	366	209	238	257	(120)
Total income	10,339	9,396	9,737	12,577	12,007	12,807	12,743	10,827
Operating expenses	846	1,049	1,173	1,684	1,064	1,431	1,383	2,288
Employees	476	574	693	734	613	770	732	877
Others	370	475	480	950	451	662	651	1411
Operating profit	9,494	8,347	8,565	10,894	10,942	11,375	11,360	8,540
Provisions	1,610	894	-31	1,032	2,533	2,815	3,907	273
Profit before tax	7,884	7,453	8,596	9,862	8,409	8,561	7,453	8,267
Tax	2,205	1,722	2,633	2,927	2,302	839	1,478	4,053
Profit after tax	5,679	5,732	5,963	6,936	6,107	7,722	5,975	4,214
Balance sheet								
AUM	1,686,520	1,773,930	1,816,980	1,946,460	1,977,680	2,008,490	2,056,920	2,105,780
Borrowings	1,477,350	1,544,510	1,602,910	1,706,290	1,730,250	1,788,490	1,849,660	1,912,090
Equity (average)	139,543	142,638	136,267	151,937	158,621	167,623	176,038	171,561
Balance sheet ratios (%)								
AUM growth YoY (%)	14.7	17.2	16.3	16.2	17.3	13.2	13.2	8.2
Debt / Equity	9.9	10.1	10.9	10.4	10.1	9.9	9.8	10.5
Assets / Equity	11.6	11.4	12.8	11.9	11.8	12.7	11.4	10.8
Capital ratios (%)								
Total CAR		14.8		14.4		14.4		14.4
Tier-1		12.6		12.3		12.5		12.5
Tier-2		2.2		2.1		1.9		1.9
Profitability ratios (%)								
Yield on AUM	10.2	10.2	10.5	10.2	10.4	10.5	10.3	9.7
Cost of funds	8.7	9.1	9.3	8.6	9.0	8.9	8.6	8.4
NIM	2.6	2.2	2.3	2.7	2.6	2.7	2.6	2.2
Other income / Assets	0.1	0.1	0.0	0.1	0.0	0.1	0.1	0.0
Cost / Income (%)	8.2	11.2	12.0	13.4	8.9	11.2	10.9	21.1
Cost / Assets	0.2	0.3	0.3	0.4	0.2	0.3	0.3	0.5
RoA	1.4	1.4	1.3	1.3	1.3	1.3	1.3	1.3
RoE	16.3	16.0	17.0	16.0	15.4	16.5	15.0	14.0
Asset quality ratios (%)								
GNPA	1.2	1.3	1.3	1.6	2.0	2.4	2.7	2.8
NNPA	0.8	0.6	0.4	0.8	1.1	1.3	1.5	1.6
Provision coverage	32.0	51.9	68.2	49.6	44.9	43.6	45.4	43.8
Provision costs (%)	0.41	0.22	(0.01)	0.23	0.55	0.60	0.81	0.05

Source: Company, Centrum Research

Annual financials

P&L (Rs mn)	FY18	FY19	FY20P	FY21E	FY22E
Interest income	147,745	172,669	196,112	201,168	210,886
Interest expense	111,671	131,593	148,314	153,294	158,300
NII	**36,074**	**41,076**	**47,799**	**47,874**	**52,586**
Other income	661	977	586	571	767
Total income	36,735	42,053	48,384	48,445	53,353
Operating expenses	4,396	4,754	6,167	6,409	7,166
Employee	2,232	2,479	2,991	3,112	3,397
Others	2,164	2,275	3,176	3,297	3,769
PPOP	**32,339**	**37,299**	**42,217**	**42,037**	**46,186**
Provisions	4,684	3,504	9,527	16,124	10,287
PBT	27,655	33,796	32,690	25,913	35,899
Tax	7,630	9,486	8,672	6,530	9,047
PAT	**20,025**	**24,310**	**24,018**	**19,383**	**26,853**

Ratios	FY18	FY19	FY20P	FY21E	FY22E
Growth (%)					
AUM	15.0	16.2	8.2	2.0	10.0
Borrowings	15.0	17.5	12.1	(2.2)	8.8
NII	(3.3)	13.9	16.4	0.2	9.8
Other income	(44.2)	47.8	(40.1)	(2.5)	34.4
Opex	(29.0)	8.2	29.7	3.9	11.8
PPoP	0.1	15.3	13.2	(0.4)	9.9
Provisions	71.1	(25.2)	171.9	69.2	(36.2)
PAT	3.7	21.4	(1.2)	(19.3)	38.5
Profitability (%)					
Yield on IEA	9.4	9.5	9.6	9.3	9.3
Cost of funds	8.2	8.3	8.2	8.1	8.1
NIM	2.3	2.3	2.3	2.2	2.3
Other Inc/Total Inc	1.8	2.3	1.2	1.2	1.4
Other Inc/Assets	0.0	0.1	0.0	0.0	0.0
Cost / Income	12.0	11.3	12.7	13.2	13.4
Employee	6.1	5.9	6.2	6.4	6.4
Others	5.9	5.4	6.6	6.8	7.1
Opex / Assets	0.3	0.3	0.3	0.3	0.3
Provisions	0.3	0.2	0.5	0.8	0.5
Tax Rate	27.6	28.1	26.5	25.2	25.2
RoA	1.2	1.31	1.1	0.9	1.2
RoE	14.9	15.9	13.9	10.2	12.8
DuPont analysis (%)					
Interest income	9.2	9.3	9.4	9.2	9.1
Interest expense	6.9	7.1	7.1	7.0	6.8
NII	2.2	2.2	2.3	2.2	2.3
Other income	0.0	0.1	0.0	0.0	0.0
Total income	2.3	2.3	2.3	2.2	2.3
Operating expenses	0.3	0.3	0.3	0.3	0.3
Employee	0.1	0.1	0.1	0.1	0.1
Others	0.1	0.1	0.2	0.1	0.2
PPOP	2.0	2.0	2.0	1.9	2.0
Provisions	0.3	0.2	0.5	0.7	0.4
PBT	1.7	1.8	1.6	1.2	1.5
Tax	0.5	0.5	0.4	0.3	0.4
PAT	1.2	1.3	1.1	0.9	1.2

Source: Company, Centrum Research estimates

Balance Sheet (Rs mn)	FY18	FY19	FY20P	FY21E	FY22E
Financial assets	**1,702,958**	**1,996,422**	**2,155,652**	**2,210,330**	**2,411,814**
Cash	19,083	28,018	13,657	21,488	20,322
Bank balance	1,881	2,117	6,132	6,446	4,726
Loans	1,661,623	1,929,927	2,079,880	2,123,256	2,342,753
Investment	19,722	35,951	54,964	57,958	42,903
Others	649	409	1,019	1,182	1,111
Non-financial assets	**7,940**	**9,413**	**12,404**	**12,893**	**13,469**
Current tax	1830	1781	3541	3680	3845
Deferred tax	4,423	5,534	5,200	5,405	5,647
Fixed Assets	971	1,359	2,544	2,644	2,762
Others	716	740	1,119	1,163	1,215
Total Assets	**1,710,898**	**2,005,835**	**2,168,056**	**2,223,223**	**2,425,284**
Financial liabilities	**1,567,288**	**1,840,622**	**1,982,435**	**2,020,298**	**2,199,203**
Debt securities	1,195,212	1,346,157	1,320,823	1,193,776	1,218,639
Borrowings	232,887	340,513	577,494	664,458	804,584
Subordinated Debt	25,000	20,000	15,000	13,479	13,699
Others	114,189	133,952	69,118	148,585	162,281
Nonfinancial liabilities	**1,198**	**2,620**	**3,690**	**3,743**	**4,074**
Provisions	1,176	1,134	1,453	1,474	1,605
Others	22	1,487	2,237	2,269	2,469
Total equity	**142,412**	**162,593**	**181,931**	**199,182**	**222,007**
Share capital	1,010	1,010	1,010	1,010	1,010
Other equity	141,402	161,583	180,921	198,172	220,997
Total Liabilities	**1,710,898**	**2,005,835**	**2,168,056**	**2,223,223**	**2,425,284**

Ratios	FY18	FY19	FY20P	FY21E	FY22E
Balance Sheet (%)					
Debt / Equity	10.2	10.5	10.5	9.4	9.2
Assets / Equity	12.0	12.3	11.9	11.2	10.9
Cash / Borrowings	1.4	1.8	1.0	1.5	1.2
Capital (%)					
CRAR	15.5	14.4	14.4	14.6	14.6
Tier 1	13.1	12.3	12.5	12.8	12.5
Tier 2	2.4	2.1	1.9	1.7	2.1
Asset quality (%)					
GNPA (Rs mn)	13,036	29,717	59,594	99,831	76,987
NNPA (Rs mn)	7,117	20,812	33,474	54,580	43,157
GNPA	0.8	1.5	2.8	4.6	3.3
NNPA	0.4	1.1	1.6	2.5	1.8
PCR	45.4	30.0	43.8	45.3	43.9
NNPA/ Equity	5.0	12.8	18.4	27.4	19.4
Per share (Rs)					
EPS	39.7	48.1	47.6	38.4	53.2
BVPS	282.0	322.0	360.3	394.5	439.7
ABVPS	267.9	280.8	294.0	286.4	354.2
Valuation (x)					
P/E	13.1	10.2	11.6	7.1	5.2
P/BV	2.0	1.3	1.1	0.7	0.6
P/ABV	2.2	1.7	1.6	1.0	0.8

Source: Company, Centrum Research estimates

CENTRUM

Can Fin Homes

Focused to preserve credit quality

Initiating Coverage

India I Financials

05 July 2020

Buy

Target Price: Rs437

Price: Rs353

Forecast return: 24%

Institutional Research

We initiate coverage on Can Fin Homes (Canfin) with a BUY and TP of Rs437. Consistently maintaining individual housing at 90% of loans and a lower ticket size with stringent income assessment has led to best-in-class asset quality (GNPA 0.8%). Additionally, sovereign holding, affordable housing skew and reducing leverage has allowed access to cheaper borrowings (banks/NHB) leading to lowest funding cost (7.8%). Focus on smaller cities (lower penetration) and affordable loans will provide some growth cushion in a tough FY21E. CAR/CET-1 is strong at 22.3%/20.5%. Expect FY22E RoA/RoE at 1.9%/17%. Valuation at 1.7x FY22ABV is attractive.

Sticking to its core competency led to best-in-class asset quality

Over FY15-20, home loan share has been maintained at ~90% (highest among peers) and 99.8% of lending is to individuals, being mostly first time home buyers. Only declared income is considered with stringent collateral evaluation (alternate collaterals not accepted). LAP and developer segments contribute only 4.6% to loans. Exposure is fairly granular with ATS being Rs1.8mn (Rs1-2.5mn is 54% of loans). Share of salaried is 71%, and although self-employed has risen over FY15-20 from 15% to 29%, the higher yield compensates for the risk. GNPA in self-employed at 1.6% is lower than industry. These practices have led to best-in-class asset quality with GNPA at 0.8% in FY20.

Lowest funding cost led by sovereign holding, affordable focus, controlled stress

Funding cost is the lowest vs. peers due to (1) Canara Bank, being a sovereign entity having a with 30% stake in Canfin, (2) affordable housing being the mainstay, there is access to cheaper source of funds as ticket size is lower with a focus on Tier-2, 3, 4 cities, (3) NHB funding (lowest cost) increased from 7% in Q2FY19 to 19% in Q4FandY20, (4) Debt/equity has consistently declined over FY16-20 from 10.8x to 8.7x. Further, share of bank funding has increased from 19% in FY17 to 57% in FY20, contributing to substantial reduction in borrowing cost. Part of Canfin's portfolio also qualifies for PSLC, which happens at rates lower to MCLR.

Focus on non-metros and affordable to aid growth in a challenging FY21E

Canfin's incremental focus has been on Tier-2, 3, 4 cities where competition is lesser and pricing power exists. Non-metro branches largely cater to salaried whereas self-employed are served by metro centres. In smaller towns, a doorstep service is provided with better TAT and superior advice to customers on the property, legal and technical aspects. Non-metro branch share enhanced over FY16-20 from 51% to 64% resulting in sanctions/loan share improvement from 28%/23% to 45%/36%. Due to its focus on smaller cities, a chunk of the portfolio qualifies for affordable housing, which could be better placed to face the COVID-19 related slowdown in FY21E.

Valuation and risks

Canfin has been prudent in lending that has resulted in modest stress. Lower ticket individual home loans have been the mainstay which could see better asset quality vs. peers in FY21E. We assign a multiple of 2.2x FY22E ABV with TP of Rs437. Risks: higher stress in SENP, rise in cost of funds post the Canara Bank stake sale.

Financial and valuation summary

YE Mar (Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	FY20P	FY21E	FY22E
NII	1,885	1,411	33.5	1,737	8.5	6,747	6,808	7,856
PPoP	1,598	1,167	36.9	1,501	6.4	5,786	5,831	6,729
Provisions	408	11	NM	45	NM	603	1,204	650
PAT	909	661	37.5	1,066	(14.7)	3,761	3,461	4,547
AUM growth (%)	12.7	16.8	(4.1)	14.9	(2.3)	12.7	5.0	14.0
NIM (%)	3.9	3.3	0.6	3.7	0.2	3.4	3.2	3.4
C / I (%)	16.9	21.6	(4.7)	15.2	1.7	15.7	15.7	16.1
GNPA (%)	0.8	0.6	14bps	0.8	(4bps)	0.8	1.7	1.1
RoA (%)	1.9	1.6	0.3	2.3	(0.4)	1.9	1.6	1.9
RoE (%)	18.5	14.8	3.7	22.6	(4.1)	19.1	15.1	17.1
P / ABV (x)						2.4	2.1	1.7

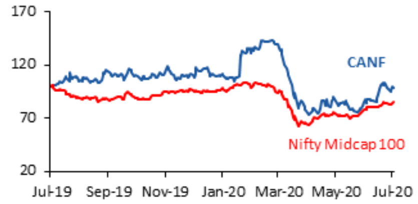
Source: Company, Centrum Research estimates

Market Data

Bloomberg:	CANF IN
52 week H/L:	Rs519/253
Market cap:	Rs47bn
Shares outstanding:	133mn
Free float:	53.8%
Avg. daily vol. 3mth:	687099

Source: Bloomberg

Can Fin relative to Nifty Midcap 100



Source: Bloomberg

Shareholding pattern

	Mar-20	Dec-19	Sep-19	Jun-19
Promoter	30.0	30.0	30.0	30.1
FIIs	0.0	0.0	0.0	0.0
DIIs	12.2	7.7	5.0	1.8
Public/oth	57.8	62.3	65.0	68.1

Source: BSE

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Thesis Snapshot

Can Fin Homes versus Nifty Midcap 100

	1m	6m	1yr
CANF IN	12.1	(10.6)	(1.3)
Nifty Midcap 100	8.0	(13.0)	(15.6)

Source: Bloomberg, NSE

Valuations

Canfin has been prudent in lending that has resulted in modest stress. Lower ticket individual home loans have been the mainstay which could see better asset quality vs. peers in FY21E. We assign a multiple of 2.2x FY22E ABV with TP of Rs437. Risks: higher stress in SENP, rise in cost of funds post the Canara Bank stake sale.

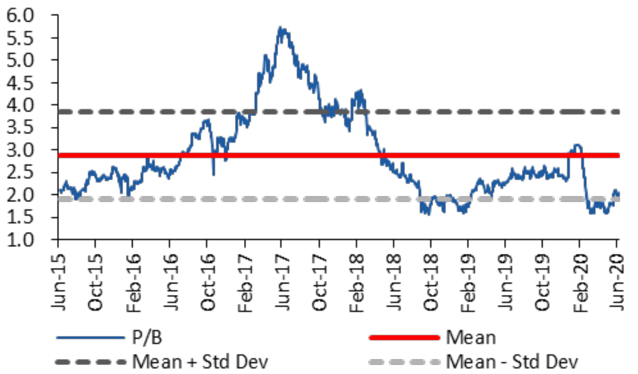
Valuations	
FY22E ABVPS (Rs)	201
Historical P/ABV (x)	2.9
Premium assigned	(25%)
Ascribed P/ABV (x)	2.2
Fair value/share (Rs)	437

Key assumptions

YE Mar (%)	FY21E	FY22E
AUM growth	5.0	14.0
NIM	3.2	3.4
Other inc / Assets	0.1	0.1
Cost / Assets	0.5	0.5
Provision costs	0.6	0.3

Source: Centrum Research estimates

P/ABV mean and standard deviation



Source: Bloomberg, Centrum Research estimates

Sensitivity analysis

		Credit cost				
		+10bps	+5bps	Current levels	-5bps	-10bps
NIM	-10bps	(7.7)	(5.7)	(3.8)	(1.9)	(0.0)
	-5bps	(5.7)	(3.8)	(1.9)	(0.0)	1.9
	Current levels	(3.8)	(1.9)	0.0	1.9	3.8
	+5bps	(1.9)	0.0	1.9	3.8	5.7
	+10bps	0.0	1.9	3.8	5.7	7.7

Source: Bloomberg, Centrum Research estimates

Peer comparison

	Mkt Cap	CAGR FY20-FY22E (%)			P/BVPS			RoA			RoE		
	Rs bn	Total inc	PPOP	PAT	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Canfin	47	**8.1**	**7.8**	**10.0**	**2.1**	**1.9**	**1.6**	**1.9**	**1.6**	**1.9**	**19.1**	**15.1**	**17.1**
LICHF	139	5.0	4.6	5.7	1.1	0.7	0.6	1.1	0.9	1.2	13.9	10.2	12.8
HDFC	3271	6.0	9.7	7.4	3.7	3.6	3.4	3.2	1.8	2.0	19.7	11.8	13.0
Indiabulls	99	(8.4)	(30.9)	(9.7)	0.6	0.5	0.5	1.1	1.4	1.6	8.0	8.6	3.2
PNBHF	35	4.7	5.9	(1.0)	0.4	0.4	0.4	1.2	1.1	1.2	11.6	8.1	10.6
Repco*	8	11.1	12.1	12.8	0.4	0.4	0.3	2.5	2.3	2.4	17.6	15.1	15.1

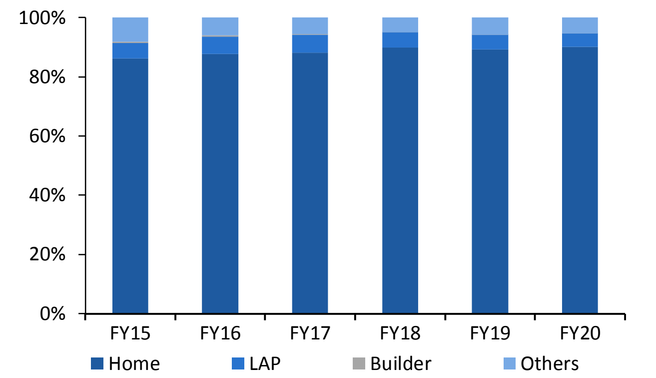
Source: Company, Centrum Research estimates. *In case of Repco, FY20 denotes estimates.

Sticking to its core competency led to controlled asset quality

Share of housing loans has consistently remained at ~90%

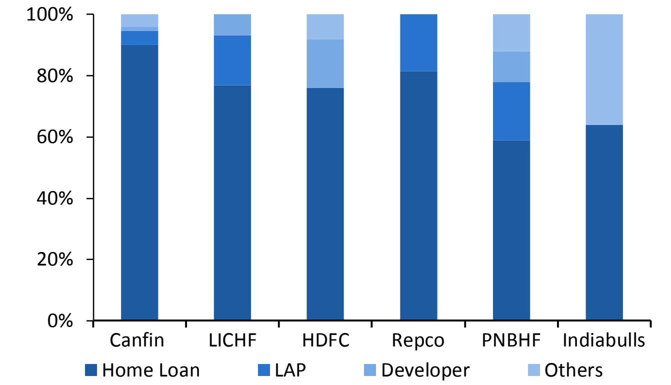
- Canfin largely focuses on home loans (share 90%) given that it is much safer as compared to non-home loans. Further, 99.8% of its lending is to individuals. The fact that Canfin has maintained its individual housing portfolio share at ~90% consistently over FY15-20 is commendable and indicates the clarity and focus of sticking to its core competencies. This has led to a strong control over asset quality.
- The non-home loan proportion is 10%. The non-home loan segment can further be bifurcated into top-up loans, LAP/flexi LAP, loans for sites and builder loans. A top-up loan (3.6% share) is an additional loan given to a home loan customer after a certain period, depending on the repayment track record. LAP contributes about 4.6% to loans and the average ticket size in LAP is less than Rs1mn.
- Site loans contribute 1.1% to the overall credit, which originates from composite loans. The other scheme called composite loans is for site purchase and subsequent construction. If the customer does not construct within the first 18 months, then the loan is automatically converted to a site Loan.

Fig 55: Housing share at 90%; builder exposure negligible



Source: Company

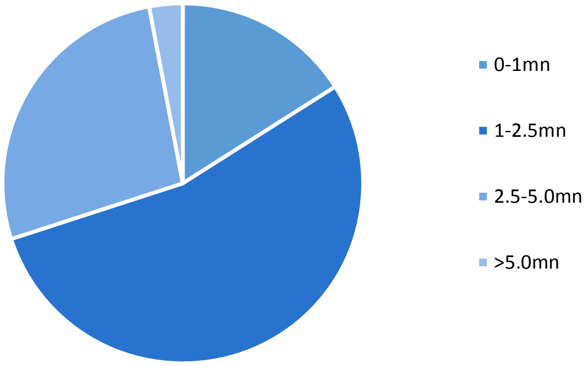
Fig 56: Highest share in housing, lowest in LAP & builder



Source: Company

- The builder loan exposure is miniscule at Rs60mn across 4-6 accounts. Though developer loans are seeing systemic stress, Canfin is least impacted as it operates in different segments and geographies. The company funds builders with low rise projects and smaller number of units. Funding starts only when the project is almost 70-80% complete. Therefore, the company is not impacted in terms of overall disbursement and asset quality.
- Canfin is fairly granular in terms of ticket size, which has also protected asset quality. Generally, Canfin operates in the Rs0-2.5mn ticket size with this segment contributing 70% to the total portfolio. Also, the company has 54% of loans in the Rs1-2.5mn bracket which has seen the lowest stress.
- Hence, most of the lending is in affordable housing. The greater than Rs5mn category contributes only 3% to the mix and greater than Rs10mn would be 40-50 cases.
- In terms of broader segments, average ticket size (ATS) in housing is Rs1.8mn and non-housing it is near Rs0.9mn. In metros usually it would be between Rs2.5-3mn and in non-metros it would be Rs1.0-1.5mn. Hence, ATS of an NPA would be Rs1.4mn.
- In terms of housing vs. non-housing growth, over the last 10-12 quarters, the growth rate of individual home loans has outpaced the growth of the non-housing segment.
- As per the management, moving to FY22, growth will be mainly witnessed in housing driven by the Housing for All scheme. Also, considering the fact that non-metro share is rising in branches, sanctions & loans and outstanding ATS would trend lower.

Fig 57: 70% of loans have a ticket size up to Rs2.5mn



Source: Company

Fig 58: Ticket sizes across various segments

Segment	ATS (Rs mn)
Housing	1.8
Non-housing	0.9
Metros	2.5-3
Non-metros	1-1.5
NPA	1.4

Source: Company

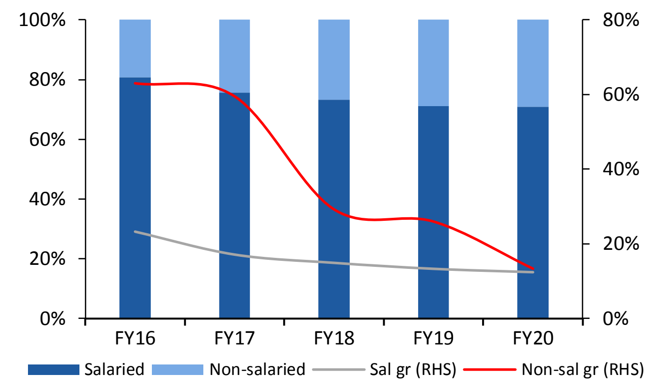
- Canfin operates in the first time home buyer small ticket segment. As far as this segment is concerned, it has faced supply side issues but demand is huge. Due to the implementation of the CLSS and RERA, customer confidence has been boosted, which is generating traction in that segment. With supply catching up, credit flow to this segment might increase. Also, interaction with various companies indicates that asset quality is better in the Rs1.0-3.0mn ticket size category.
- The smaller ticket loans are typically part of a 30-40 unit low rise projects. In this segment, defaults are minimum given there is a direct supervision of the homebuyer. The builder loan book constitutes these types of players who have been with the company for over a decade. In these projects delivery is faster (1 year.)
- Most of the defaults are happening in larger projects as many home buyers have locked-in their money in these projects and have taken the builder to NCLT. A big project takes 4 years to complete and the delivery time might be longer.

Higher share of the salaried segment has kept asset quality under control

- Salaried & self-employed (SEP) mix in terms of profile is 71% and self-employed non-professionals (SENP) is at 29%. Within salaried, split between private and Government employment is equal at 50:50.
- By design, SENP share is kept lower as this segment has seen high stress levels since the last 24 months. Within home loans, the increase in NPA is largely attributable to this segment. GNPA of salaried is 0.47%, while that of SENP is 1.57%. On a standalone basis, whether it is salaried or SENP, it is significantly better than industry ratios.
- On the way forward, Canfin aims to maintain this product mix and largely focuses on salaried and SEP. The salaried class might grow and will have a balancing effect, as generally if the self-employed class grows, its loan book tenure reduces. So from a long term perspective, salaried class is more beneficial despite yield being lesser.
- SEP could be an important segment, but Canfin will likely be selective. Exposure would be taken in geographies with traditionally lower credit losses, good repayment culture, and focus would be on small ticket, safe collaterals, profiles and variants.
- Salaried and non-salaried mix could vary depending on the geography. The northern region would have a slightly higher proportion of SENP. However, at an enterprise level, the company intends to be skewed towards salaried and SEP.
- The SENP proportion has increased over FY15-20 from 15% to 29%. Over the same timeframe, though GNPA has risen from 0.2% to 0.8%, it is well below industry levels and also that of peers. The SENP share rose due to two main reasons.

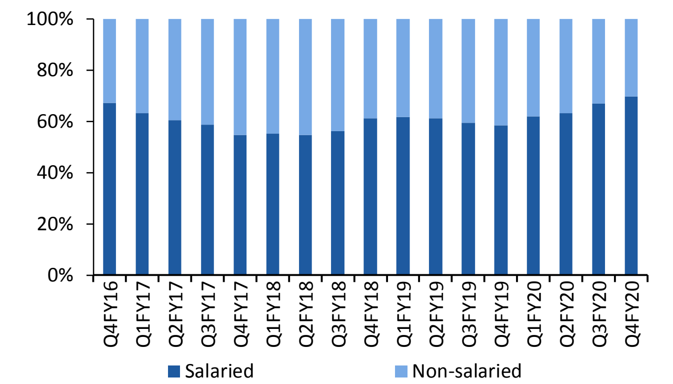
- Firstly, in the salaried space, particularly post-RERA, most of the demand was not met because the salaried people (being more informed) were choosy as RERA registered smaller ticket projects were lesser in numbers. They kept deferring their purchases and preferred a rental accommodation. Hence, in the last 2-2.5 years, the percentage of non-salaried has been a bit higher in the new approvals.
- Secondly, as new enterprises are set up, lending to these entrepreneurs will go up. As the income tax base is increasing for the country with more number of people filing tax returns, customer base for Canfin is expected to rise. The company would not underwrite where income is not evident and does not consider any perception-based income. Average income assessment is done basis the income tax return.

Fig 59: Growth issues in south saw non-salaried share rising



Source: Company

Fig 60: Incremental credit flow shifting back to salaried



Source: Company

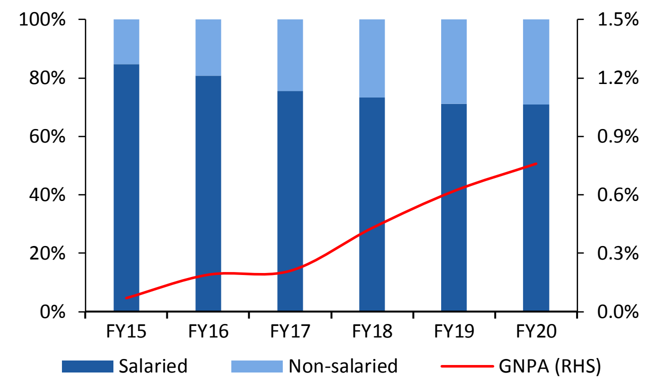
- To mitigate the exposure to the non-salaried segment, Canfin charges a higher yield by 75-125bps to price-in the risk associated.
- Also, in terms of underwriting, since non-salaried class requires special underwriting skills like reading balance sheets, etc., the company has curtailed sanctioning powers of the branches and has delegated those to centralized processing centres where the experience and expertise pool is greater.
- As indicated, credit flow to the salaried space is rising and with the affordable housing supply side issues being sorted in the south, this flow could increase going forward.
- Canfin intends to keep the salaried space at 70% or more. Moreover, with the salaried housing demand being met in the south, the salaried segment would play a greater role in loan growth over FY20-22 in the tier-2, 3, 4 cities.
- Thus, focus would primarily be on individual housing loans that too skewed towards salaried, whereas LAP and builder loans are not a focus area.

Solid lending practices and focus on lower ticket loans led to best in-class asset quality

Canfin has the best-in-class asset quality mainly owing to the below reasons:

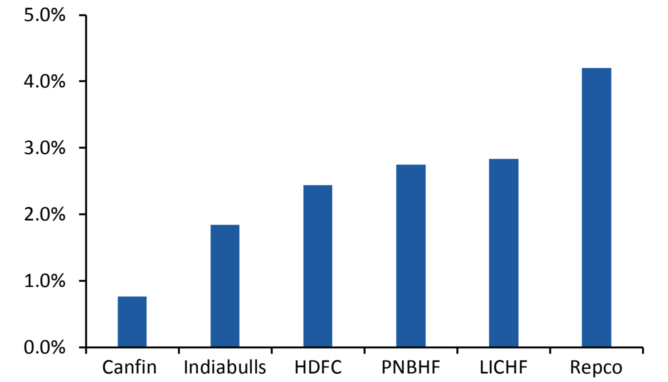
- Focus on salaried, which is a relatively safer segment to be in.
- Largely catering to affordable housing loans having a lower ticket size with average ticket size being Rs1.8mn. So, there is diversification of risk and in case the asset has to be liquidated, a loss would not be incurred, at least on the principal amount.
- The company operates in areas that not only offer a growth potential but also safer income profiles.
- Collateral evaluation is done with a focus on residential and commercial property. No alternate collaterals are accepted.
- Mostly, declared income is considered for assessment on which all variance is based, Surrogate income is not accepted.

Fig 61: GNPA rise in tandem with non-salaried



Source: Company

Fig 62: GNPA best in class compared to peers

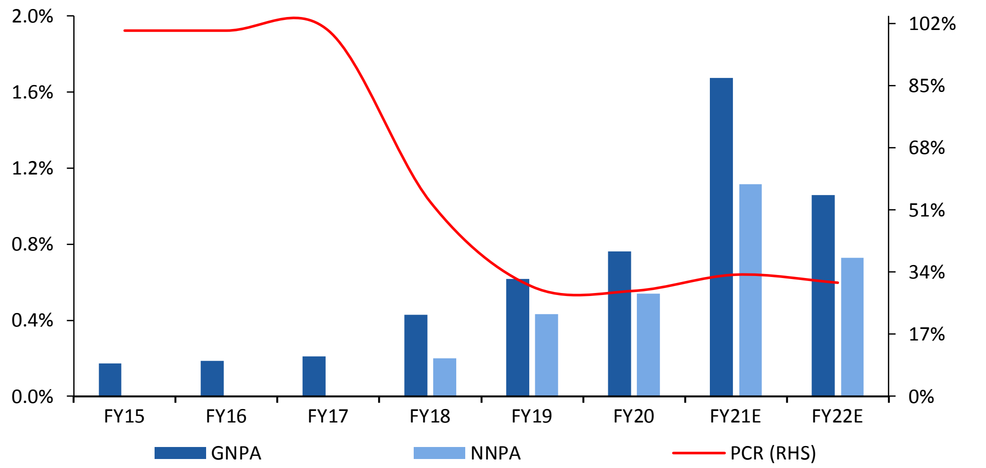


Source: Company

- As per the management commentary, asset quality is going to be one of the cornerstones of its future strategy and company would not deviate from the points discussed above. The company is very clear that higher growth would not happen at the expense of asset quality. The management emphasized that there is opportunity to grow at 25-30%, but this would also lead to a portfolio suffering.
- Canfin would rather prefer not taking additional risk and grow at 15-20% considering the tough market situation lending; this re-iterates that no compromise will be made on asset quality and profitability fronts. The conservative stance is indicated despite the market has been vacated by few large and small players; the company does not appear keen to chase market share.
- The company is not aggressive in gaining DHFL's market share despite lending being stopped by the latter and a huge vacuum created in the private sector. The reason being, Canfin has limited branches and man-power in the North and without appropriate credit filters, it cannot on-board DHFL's customers. At the branch level, it can handle limited files, that too after internal work and field visits.
- Secondly, compromising on the above processes and suddenly scaling up by hiring people and on-boarding new customers from this vacated space might lead to deterioration in the quality of assets. Each branch has a set of people who can handle say 50 files a month. They have to go for all kind of rebates, do due diligence and manage growth. Hence, a file is not cleared unless all the processes are followed.
- There is a branch model base with checks and balances in place. The branch team does sales and till a certain limit does underwriting and collections with necessary checks and balances. Every customer is made to meet Canfin's employee and there are centres where the file gets processed for certain value and above.
- Every different bucket entails a different strategy. Soft bucket is taken care by the branch as it is more efficient and easier to collect. For hard bucket, there is a vertical team and agencies too. Hence, it is a blended model, which is a mix of a branch and agency based, which could be more effective.
- There are specialized recovery hubs in metros, especially Bangalore and Chennai where designated officers are posted to take care of a certain area, because geographically these areas are large. Branches also find it difficult to reach out to all the areas; considering this, specific processes are established.
- Regarding bucketing parameters, 1-60 days is early or soft bucket, 61-90 and 90-plus will be hard buckets and anything greater than 180 would see agencies handling recoveries. Hence, the entire branch staff would be in handling collection in early buckets. Also it is a very flexible, city or geography specific need. For eg., recoveries in the South market are easily done by the branches due to a better credit culture.

- For certain categories, a vertical is being used while for certain geographies it would be agencies. Hence, it is a blend of both centralized as well as decentralized. For early buckets, it is more of decentralized, while for hard buckets depending on the segment or geography, a vertical or an agency could be utilised.
- On provisions, HFCs provide higher of the IRAC or Ind-AS norms for stage 3 assets, which would make them fairly conservative as compared to the NBFCs space. Also, on a combined basis the company already holds standard asset provisions, of which Rs365mn were made in Q4FY20, which were related to COVID-19.
- In terms of future outlook, the management pre-COVID-19, had suggested that NPA could decline because ticket size is lower and they are funding in geographies where competition is less and property value is lower. Higher the property value, higher could be the distress portion. But, if the property value is lower, by virtue of ticket size, recovery could be much higher, and therefore, the cost loss is absolutely zero.
- However, owing to the COVID-19 pandemic related lockdown, we envisage asset quality for FY21E to be negatively impacted, especially in the self-employed segment. Incremental NPA slippages could see a sharp spike in FY21E leading to doubling of credit costs to 60bps from FY20 levels. For the self-employed segment, GNPA could more than double, while the salaried segment too could see a sharp spike in NPA.
- We see GNPA ratio spike from 0.8% in FY20 to 1.7% in FY21E considering there would be slippages post the standstill ends in August 2020. Presently, 28% of the book is under moratorium. Due to a rebound expected in FY22E, we see GNPA scaling back to 1.1%. The management in the Q4FY20 concall suggested that GNPA could see a spike in the near term, but they would bring it back to pre-COVID levels in 4-5 quarters.
- Despite a sharp spike in FY21E GNPA, Canfin would still possess the best-in-class asset quality. In the past 2 years, the company has started initiating action under SARFAESI, which has also led to reduction in cost of collections, leading to better recovery in future. The company holds adequate stock which could be resolved under SARFAESI or under settlement, since historically it has seen more than 100% recovery on the principal amount, which means that the ultimate LGD could be lesser.

Fig 63: See NPA spike to 1.7% in FY21E but FY22E could see NPA reduce to 1.1%

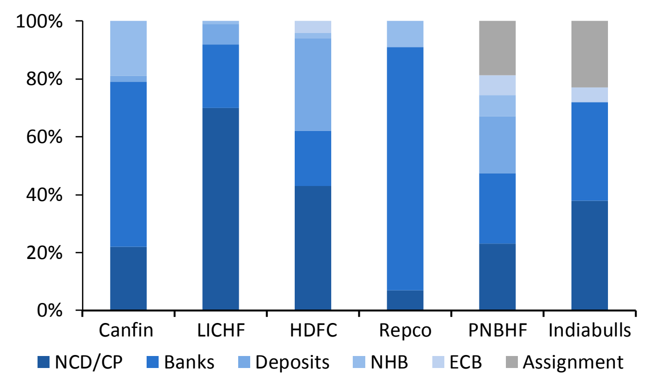


Source: Company, Centrum Research

Lowest funding cost led by sovereign holding, non-metro affordable focus and modest stress

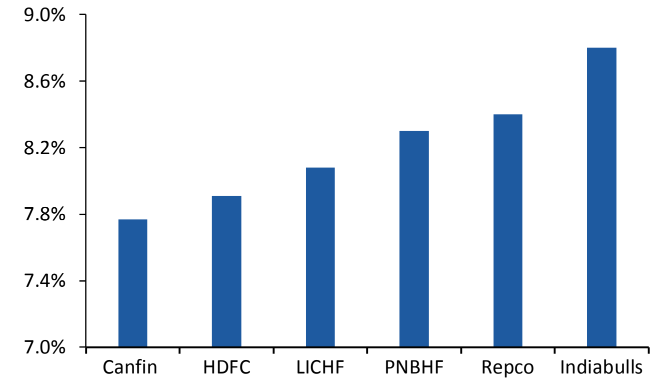
- Canfin has the lowest funding cost in the market owing to multiple reasons i.e. Canara Bank, being a sovereign entity holds 30% stake in the company and given the fact that it mainly operates in the affordable housing space (90% of loans are individual housing), it has been able to tap cheaper source of funds.
- Further, owing to incremental focus on non-metro growth, which is characterised by lower ticket sizes, overall average ticket size is much lower at Rs1.7-1.8mn, which has kept the exposure granular in nature reducing concentration risk. Maintaining a lower ticket size with a focus on individual salaried housing loans has kept asset quality in check, which has led to it garnering funds at lowest cost.

Fig 64: Borrowing mix vs peers; higher reliance on banks



Source: Company

Fig 65: Reported funding cost lowest compared to peers



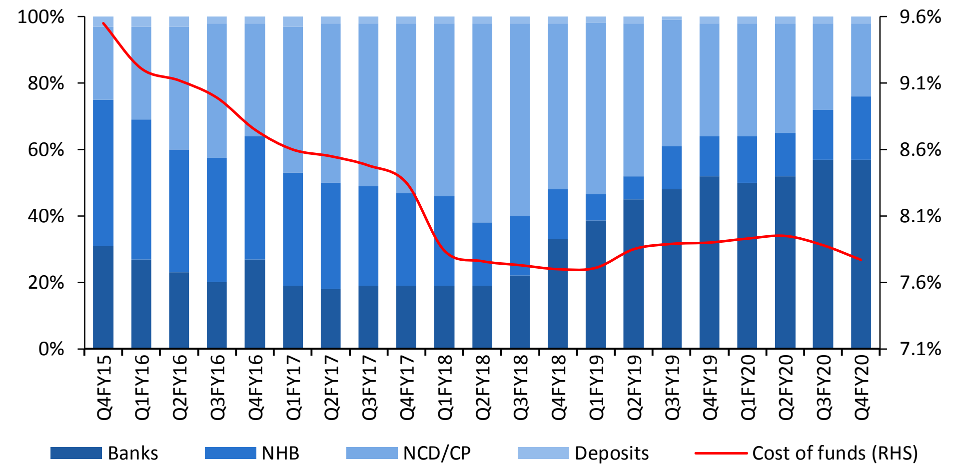
Source: Company

Share of banks and NHB rising due to attractive pricing

- Over the past ten quarters, from Q2FY18 onwards, the funding mix has been shifting towards Banks and NHB and the proportion of NCDs and CPs has been declining. Share of Banks/NHB stands at 76%, while that of NCD/CP is 22%.
- Share of NHB refinancing has risen from 7% in Q2FY19 to 19% in Q4FY20. NHB refinancing has been more advantageous as recently NHB started the Affordable Housing Fund (AHF), which is direct lending sourced at a much cheaper rate, while the company makes a 3.5% spread.
- Share of NHB declined to 7% over FY16-Q2FY19 as these funds were not available under direct lending, they were only available under general refinance. Over the same timeframe, Canfin was able to source cheaper funds from the market and banks.
- Affordable Housing Fund is supportive of all HFCs and NHBs and is playing a proactive and positive role to ensure the PMAY scheme is benefiting eligible customers.
- Under this scheme, a company can access the AHF and source cheaper funds if it lends to customers in the LIG category of the PMAY (ticket size Rs1-2mn), having an income less than Rs0.6mn per year.
- Below Rs0.6mn income, 57% is by number and almost 40-43% by volume of incremental borrowings. The company might source more funds under this scheme.
- Bank borrowing has also risen for Canfin from 19% in FY17 to 57% in FY20. Smaller ticket size enables a company to access bank sources of funding.
- Under banks or NHB funding, borrowings are not under the same conditions. Under bank funding, one source is general lending, that is done by banks at MCLR under corporate loans as NBFC lending. Another source comes under priority sector lending (PSL), which is lower to MCLR. Funding under AHF is much below the MCLR (very close to a CASA for a bank), which is the reason for increased funding of banks and NHBs.

- Also, as the company grows in the non-metros (upcountry locations) ticket size may come down. But, as long as the company is giving housing loans to salaried customers basis assessed income, ample funding should be available.
- The company does not plan to enter the cash salary segment where income is not evidenced. Consequently, the company has been able to garner bank/NHB funding at cheaper rates that has led to a consistent reduction in its funding cost.
- Moreover, due to its sovereign holding and conservative granular lending profile, many banks are willing to lend. The largest funding is not from the parent as it has a restriction that the exposure to a related party should be restricted to 10% of capital. The major lender to Canfin is State Bank of India.
- In terms of market borrowings, the reliance has reduced on NCDs, as Bank/NHB funding was more attractive. Further, NCD/CP combined share has declined from 60% in Q2FY18 to 22% in Q4FY20. The company was able to raise long-term funds from banks at a much lower rate i.e. at AAA rates despite a rating notch downgrade.

Fig 66: Substantial increase in Banks/NHB source has led to reduction in funding cost



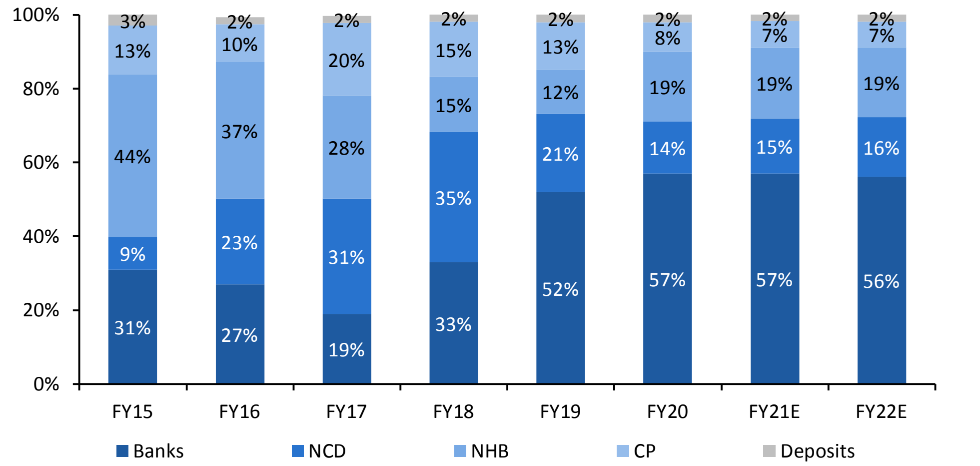
Source: Company, Centrum Research

Share of NCD/Deposits might slightly rise

- Since the decision is out on the Canara Bank stake sale i.e. it has been cancelled, the company is engaging with rating agencies that are deriving greater comfort and the management is expecting a revision in rating, which might further reduce market borrowing cost.
- There are certain stipulations by SEBI that require a certain portion of incremental borrowings to be in the form of NCDs. Hence, there is a plan to raise NCDs, but the endeavour would be to keep the cost low, as NCD cost is slightly higher than bank funding. Thus, the share of NCD might increase marginally.
- On the CP front, the share is 8% as at Q4FY20. As a funding source, CP would only be resorted to as a back-up source and by design the company intends to keep the CP share low considering the risk. At any time, the share of CP would be below 15%.
- Henceforth, there would be a focus on sourcing deposits as the company feels in the longer term, stable retail deposits would help it in the future. Initially, there was a lesser preference in raising deposits due to the cost involved.
- The branch focus during the last few years was to lend and not get diverted in sourcing deposits, as lending itself involves investment of time and manpower. The head office had the task to borrow and make funds available to the branches. Building up a deposit franchise is not easy as it comes in small ticket sizes.

- Now directions have been given to branches to go for resource mobilization as it not only helps the company diversify the borrowing mix, but also increases customer footfalls, which lead to higher inquiries on loan products. Deposit targets have been set as they have been for lending. Hence, the company expects deposit share to rise.
- Basis the current trajectory and the management commentary, the overall liability mix would not change substantially over the next 3-4 years. Over FY20-22, we expect the share of banks to slightly fall in favour of NCD and deposits.

Fig 67: Envisage a slight shift from banks and CPs to NCD/deposits over FY19-22E



Source: Company, Centrum Research

No liquidity challenges; healthy unsanctioned credit lines

- Funding and liquidity have never been a challenge for Canfin; not even during the NBFC crisis post the ILFS debacle. In fact, given controlled asset quality and focus on lesser risky affordable housing segments, the company was able to substitute market borrowings (NCD/CP) with Bank/NHB Funding to the tune of ~8% in Q3FY19.
- The expected liquidity position too has been improving sequentially with liquidity surplus enhancing since Q3FY19 indicating the comfort of lenders. The company has undrawn bank lines of Rs40bn.

NIM may blip in FY21E but may retrace to FY20 levels in FY22E

- Share of lower ticket housing loans increasing, LAP and builder loans declining on a combined basis and reducing debt to equity ratio over FY15-20 coupled with its sovereign rating has led to the lower cost of funds.
- Even during the ILFS crisis post which most NBFCs faced liquidity constraints, Canfin was an exception and the liquidity pipeline for the company was pretty healthy.
- Immediately post September 2018, in the months of October, November and December, the company managed to grow and funding never stopped.
- For FY20, the company saw an enhancement in NIM by 27bps to 3.4% as the company could pass on the cost increase post the ILFS scenario to its customers. Yield on a YoY basis increased by 30bps to 10.3% with costs staying stable on a YoY basis. I
- ncremental cost of funding has been coming down for Canfin, and with the exciting softer interest rate environment, borrowing cost might ease in FY21E.

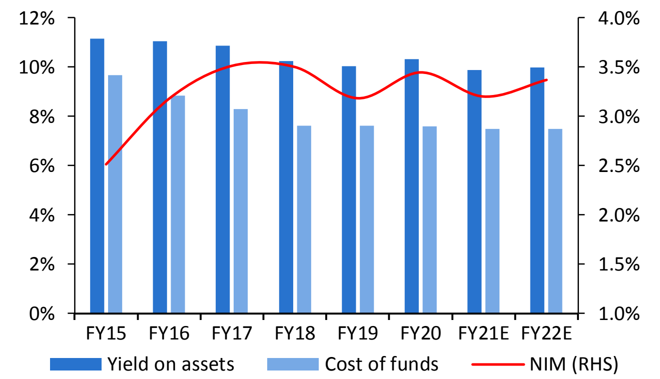
Fig 68: Stressed segments and D/E ratio declining led to lower funding cost

Particulars	FY15	FY16	FY17	FY18	FY19	FY20
Share of Housing	86.2%	87.7%	88.2%	89.9%	89.3%	90.0%
Share of builder/LAP	5.7%	6.2%	6.2%	5.1%	4.9%	4.6%
D/E ratio (x)	9.6	10.8	11.0	9.4	9.4	8.6
Funding cost	9.7%	8.8%	8.3%	7.6%	7.7%	7.6%

Source: Company

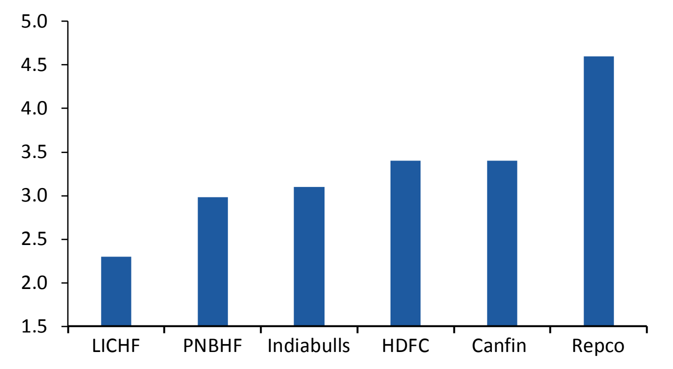
- NIM, going forward, would be driven by the factors discussed. Firstly, FY21E could see interest reversals due to higher slippages. Secondly, the credit flow increasing to salaried might lead to a slight uptick in this segment.
- To add to this, housing share is expected to remain at ~90%. Both these factors might drag yields. Further, due to increased competition from banks and SFBs, the leeway to keep yields elevated is limited.
- With a challenging FY21E in terms of the COVID-19 lockdown leading to increased slippages, high systemic liquidity, sluggish demand and annual resetting, yields are expected to come down for Canfin in tandem with the financial system and efforts to maintain market share. However, NIM level and trajectory for a housing finance company is more driven by its funding cost than yields, as product differentiation is not material.
- The funding cost is where the company differentiates itself to competition, which was discussed above. With incremental lending happening in the affordable housing space in non-metros, Canfin is eligible for AHF funding from NHB, which is lowest cost. This could be a tailwind to NIM. Also, NCD proportion might not rise substantially going forward, which could cushion the borrowing cost.
- To conclude, there are both headwinds and tailwinds to NIM, but the management has suggested that whatever benefit they would receive in terms of lower funding cost, they would pass on in order to stay relevant in the market and tackle competition.
- We see 25bps contraction in NIM over FY20-21E from 3.4% to 3.2%. However, as the economy rebounds in FY22E, NIM could retrace back to FY20 levels of 3.4% in FY22E.

Fig 69: NIM profile indicates funding cost is passed on



Source: Company, Centrum Research.

Fig 70: NIM profile better than peers



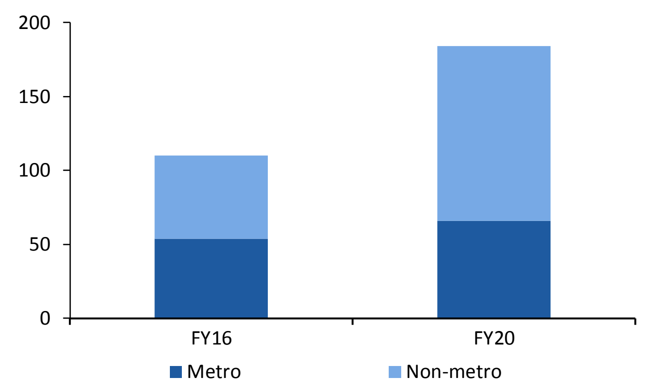
Source: Company

Concentration on non-metros and affordable housing to cushion growth in a tough FY21E

Focus on non-metros where growth could be better due to lesser impact of COVID-19

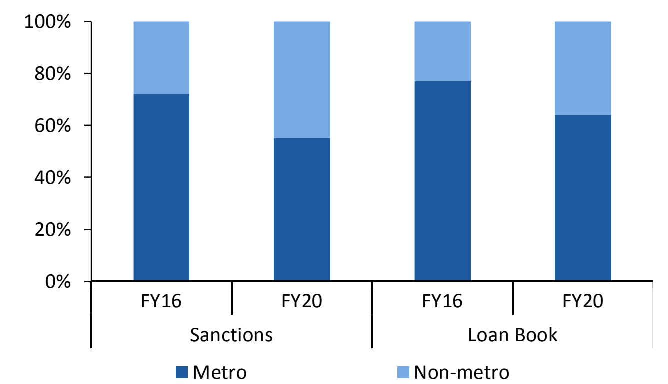
- The company's focus is mainly on Tier-2, 3 and 4 cities, because in these cities competition is lesser and pricing power exists. In top cities, there is more competition, especially from banks. Therefore, in bigger cities, Canfin focuses more on the outskirts and otherwise it is largely present in smaller towns and cities.
- Smaller markets are not price-sensitive compared to top cities. In top cities, higher the loan better is the negotiating power, which may not hold in case of a lower loan amount. In terms of competition with banks, there could be 10-15% overlap because any market would have PSU banks. However, considering their product proposition, service and TAT, Canfin is able to get better business and share.
- There is no major yield difference for Canfin between the metro/non-metro though ticket size may differ. In the metro, the average ticket size would be around Rs3mn, while in the non-metro it would be between Rs1-1.2mn. When the ATS is Rs1-1.2mn, sourcing funds can be under PSL or Affordable Housing. When it is Rs3mn, funding is from the general market or general refinance or via bank borrowings. Hence, pricing would be determined by the cost of funding.
- In terms of customer profile, in the non-metro it would largely be salaried; there would be teachers, road transporters, governments employees, railway employees, etc. Self-employed would be more in the metros, not in non-metros.
- Depending on the geography, the mix could vary since Canfin is present in most geographies. The Northern region would have a slightly higher proportion of self-employed non-professionals. However, at an enterprise level, the company intends to be largely skewed towards salaried and SEP.
- In the areas of its operations i.e. Tier-2, 3, 4 cities, the company provides a doorstep service with various sourcing models. Canfin's TAT is better coupled with superior advice to customers on the property, legal and technical fronts.
- Therefore, business growth in these markets has been healthy. Also, since Canfin screens the customer and provides a door step service, which actually customers prefer, gives the company an edge over competitors.
- The dependence on developers would be low as these smaller towns have fewer builders. These certain projects will be low rise in which number of units would be lower. Therefore, in such cases, it is fairly easy to assess and manage the completion risk. Small markets, because of lesser competition, would be able to fetch a higher yield.

Fig 71: Non-metro branch share increasing…



Source: Company

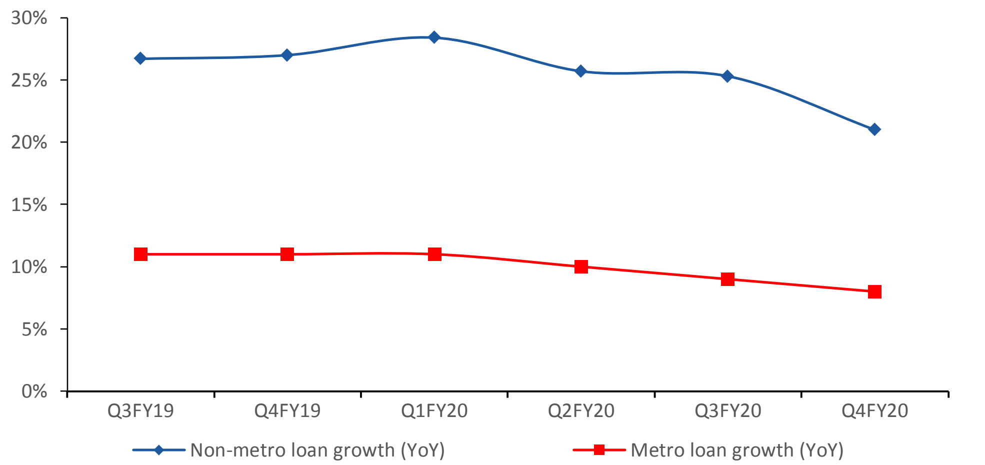
Fig 72: …leading to rise in share of sanctions and loan mix



Source: Company

- The strategy of focusing on incrementally expanding in non-metro cities has played out well with its share improving from 51% in FY2016 to 64% in FY20. As a consequence, its share in sanctions has risen from 28% to 45% over FY16-20 resulting in its loan share enhancing from 23% to 36% over the same time frame.
- Growth is typically 9-10% in metros and about 25-30% in non-metros. Thus, incremental business is coming from the non-metro space. Also, non-south branches have increased from 18 in FY11 to 76 in Q3FY20. In terms of non-south markets, Delhi, NCR, and Jaipur are performing well.

Fig 73: Non-metro portfolio seeing healthy 25-30% growth vs. 9-10% in metros



Source: Company, Centrum Research

Lesser competition in the non-metros

- The company is being nimble footed in tackling competition. Now the focus has shifted to Tier-2, 3, 4 cities, which would be the mainstay for HFCs going forward. During the previous expansion plan over FY11-16, growth for Canfin was primarily in metros.
- Nevertheless, still 2/3rd of the business is sourced from metros, but growth in metros is much lower at 9-10%. Focus is there on metros too, however the competition has come to that level and pricing is such vis-à-vis the banks that the gap has widened between banks and HFCs and the marginal cost of funds for HFCs has gone up substantially.
- Banks target bigger ticket loans with ATS from Rs4-5mn. In metros, Canfin's ticket size would be around Rs2.5-3mn and in non-metros it would be Rs1-1.5mn.
- Though the company targets the same segment as banks in metros, the tickets size differentiation gives Canfin an edge over banks as it becomes non-viable for banks in terms of target achievement or they have to do a higher volume.
- Also, post the ILFS crisis, many small players have not been able to garner funds and even if a few were able to do so, the interest cost would have been much higher. Hence, the space has been vacated and the number of lenders has also come down.
- Therefore, the market has been vacated but if there are operations in a geography where there is competition from banks it becomes extremely difficult to operate as pricing would be much lower for banks.
- Hence, there could be an overlap of 10-15% with banks. Consequently, Canfin is targeting segments and geographies where it can fetch a better yield.

Focus on affordable housing

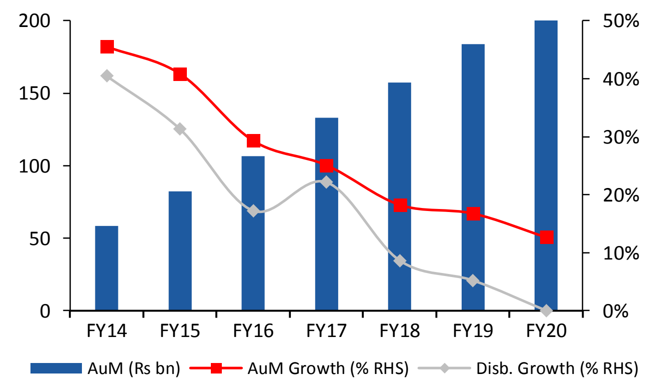
- Canfin operates mostly in the first-time home loan buyers segment. The average age of its incremental borrowers is ~40. It mainly operates in the LIG and MIG segments.
- Affordable housing segment (especially CLSS) accounts for almost 97% of customers. Further, 57% of accounts and 42% of new approvals come under the LIG segment and almost 40% of accounts and 53% of new approvals are under the MIG segment.
- During the housing boom, the market for multiple homes (2nd home and 3rd home) was increasing. But now, multiple homebuyers have been discouraged and holding a second housing loan is disadvantageous. Earlier, one could avail a tax benefit on the entire interest of a second housing loan, which is now capped.
- On the contrary, the first home owner has been given more benefits. Earlier this segment faced supply side constraints, but now developers too are being given advantages if they are creating a stock in the affordable housing segment.
- Further, FY19 onwards, supply side issues in affordable housing have been sorted and established developers are also entering this space. There is an inherent demand of affordable housing and with supply catching up with demand Canfin stands out as an attractive player.
- As per CIBIL, housing demand could be sharply hit in FY21E owing to expected reduction in affordability, which could lead to postponement of home purchases. This could lead to weaker home loan demand, especially in the higher ticket size segment, that too in the larger cities where the COVID-19 cases are much higher.
- However, demand for affordable housing would be lesser impacted especially in the smaller cities as these cities are witnessing lesser COVID-cases, which could see lesser strict lockdown measures. Subsequently, the earnings impact for employees working in these cities would also be lesser. Hence, Canfin, operating in these geographies and affordable segment makes it an attractive player.

FY21E to be an aberration; growth engine in place to support a rebound in FY22E

Disbursement growth was muted over FY18-20

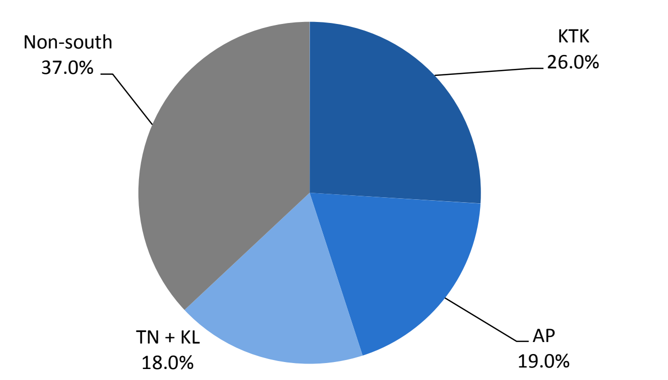
- Canfin's AUM stood at Rs207bn as at Q4FY20 with south India contributing ~65% to the AUM. Over FY11-17 AUM grew at a healthy CAGR of 35% albeit on a lower base. However, FY18 onwards, disbursements remained muted due to a slowdown in south India, particularly Karnataka and Tamil Nadu, as a chunk (~40%) of the AUM at that point was contributed by Karnataka. Over FY18-20, disbursements saw a weak 2.6% CAGR (vs. CAGR of 27.5% over FY13-17).
- There were a multitude of reasons that led to the slower disbursement off-take like the RERA implementation from May 01, 2017, saw supply and demand side constraints especially in Karnataka.
- On the supply side, due to RERA compliance, the segments that Canfin operates in i.e. projects having housing loans with a ticket size of Rs2.5-3.5mn, significantly suffered. The disruption was caused for almost 2 years post RERA implementation.
- On the demand side too there was some disruption caused due to RERA. A significant portion of salaried prospective first home buyers were deferring home purchases (due to access to information) particularly in the LIG, and lower MIG segment, in FY18/19, and staying on rent due to demonetisation and lack of clarity on RERA. This led to incremental portfolio of non-salaried to gradually increase in FY19, because for the non-salaried class, their earnings are not related to economic policies.

Fig 74: FY18/19/20 saw muted disbursement growth



Source: Company

Fig 75: Karnataka and TN were a drag on disbursements



Source: Company

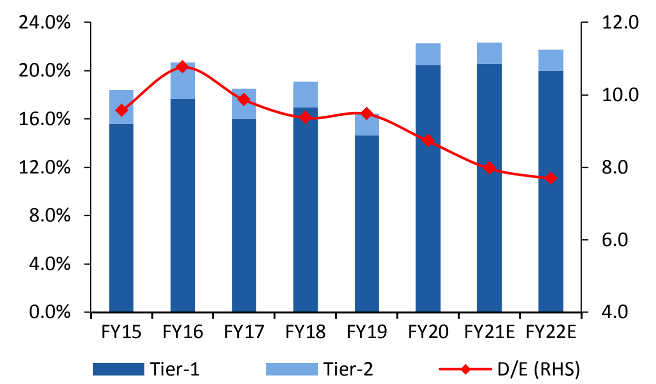
- Further, Tamil Nadu that contributes ~15% to the AUM was also affected as far as primary sales were concerned. This was because a High Court case was pending that had halted real estate development. There have also been issues in Tamil Nadu from September 2015 as registrations and MODT were not happening, which impacted the housing supply and demand in the state.
- Moreover, H2FY19 also saw the ILFS debacle that negatively impacted the entire NBFC space and funding was challenging, although for short time for quality NBFCs like Canfin. This to an extent negatively impacted growth.
- Finally, due barring COVID-19 related lockdown in March 2020, disbursement growth would have been ~17% YoY that could have led to a 2.3% higher loan growth for FY20 to 15% (vs. actual 12.7%).
- Southern markets for Canfin started to recover since H2FY19 and these markets were going back to normalcy in terms of growth. Tamil Nadu already started improving since Q3FY19. Karnataka too is improving and in Q4FY19, though annual growth for Karnataka was 6.5%, disbursement growth was strong at ~18% YoY for the quarter.

- Growth is coming back in Karnataka (+6-7% YoY), which was de-growing earlier. As per Canfin, there is immense potential in Karnataka and other smaller locations pan India. In these areas loans would be mainly given either for house purchase, which is a ready possession, or for plot construction, or for plot purchase and construction.
- As at Q3FY20, Karnataka disbursement growth touched 10%. The Karnataka cluster showed a sanction increase of 12% YoY and this figure was negative for the first three quarters of FY19 as takeovers were the highest in Karnataka, particularly Bangalore. This cooled down and the conversion of disbursement into loans has been fairly good.
- Also, before the COVID-19 crisis hit India there were signs that, unsold inventory in Karnataka was depleting at a faster pace. New projects, especially under affordable housing, were coming-up in the outskirts of Bangalore and other cities.
- Although branch expansion currently may be halted, Canfin had been opening good number of branches in areas other than Bangalore in Karnataka. Simultaneously, the company has also been opening more branches in the outskirts of Bangalore, in order to address the inherent demand.

Strong capital adequacy to fuel future growth (FY22E onwards)

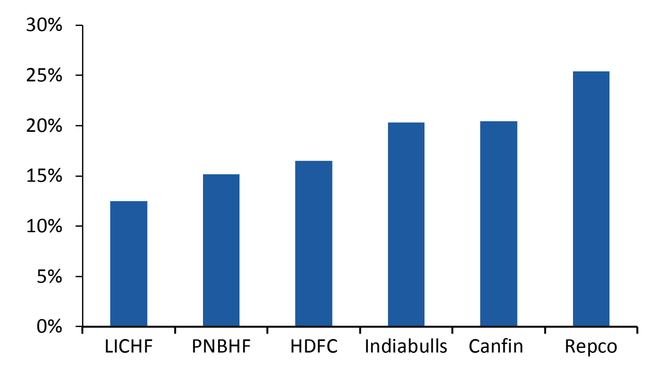
- The company is adequately capitalised with the best CAR ratio in the industry. As at Q4FY20 the CAR stands at 22.1% with Tier-1 at 20.5% and Tier-2 at 1.7%.
- The management recently guided to raising fresh equity capital in FY21E. Although current capital is sufficient to fund future growth, the company wants to be more conservative and reduce its leverage ratio.
- By design, the company intends to maintain a lower level of leverage given that NHB has tightened its leverage norms and also to provide comfort to bankers and industry players. We believe this would ensure in controlling the funding cost for Canfin.
- We have not factored any capital raise over FY20-22E as we believe that profitability growth would be sufficient to fund future AUM growth. Also at this juncture, owing to a challenging macro environment, it would be tough to predict the amount of capital raise to be baked in.
- Given its conservative stance on capital, planned capital raise and improving leverage ratio, the company does have headroom to accelerate loan accretion.

Fig 76: Well capitalised with declining leverage



Source: Company, Centrum Research

Fig 77: Higher tier-1 capital compared to peers

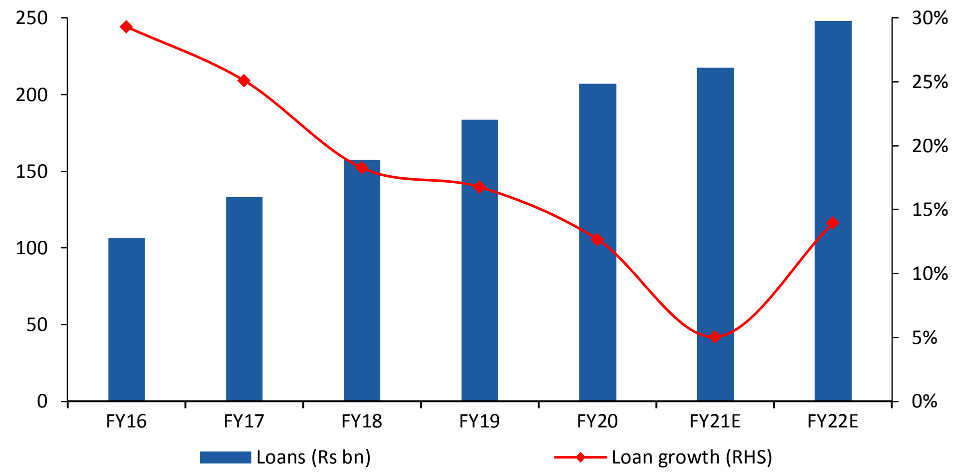


Source: Company

FY21E to be an aberration due to COVID-19 lockdown; see rebound in FY22E

- Karnataka and Tamil Nadu (contributing ~45% to loans) that had seen a slowdown are recovering. As at Q3FY20, Karnataka saw a disbursement growth of 10% as compared to flat or declining disbursements some quarters back. Supply side bottlenecks, that were affecting demand off-take, have been sorted out and the pipeline of new RERA compliant smaller projects in smaller cities and towns is healthy to address demand.
- Challenges in the south markets also partially impacted credit flow to the salaried segment that saw its share decline over FY16-19. Due to the implementation of RERA, salaried persons were assessing its impact and postponing their decisions to purchase a property, which led to muted disbursement growth.
- However, with successful implementation of RERA, credit flow is shifting back to the salaried space with its share improving to 70% in Q4FY20 from 55% in Q2FY18. In the medium term, emphasis will be on the salaried and the self-employed professional (SEP) segment and in the near term, bulk of the flow would be towards that segment.
- As the supply of RERA complied projects having affordable houses rises, sales in this segment will pick-up as the economy rebounds post the COVID-19 impact and credit flow towards small ticket affordable housing loans will increase. The south markets will be a bigger beneficiary of this supply headroom created as a lot of projects were nearing completion and the number of RERA registered projects is also increasing.
- Owing to competition in the metros and these cities seeing a stricter lockdown due to higher COVID-19 impact, non-metros are better placed to tide over the COVID-19 storm, as the lockdown relaxations are higher leading to lesser impact on customer cash flows. Canfin is in a better spot due to its focus on tier-2, 3, 4 cities. Hence, growth in these regions would cushion overall loan growth, and also reduce concentration risk.
- Lesser competition in non-metros coupled with the doorstep service and faster TAT, has enabled Canfin to retain customers that too while commanding better pricing power. Post the ILFS crisis, some players vacated the space, as they were constrained for funding. We expect Canfin to capitalise on this and gain market share.
- In terms of capital adequacy, the company has a healthy CET-1 ratio of 20.5%, which gives it enough leeway to grow at ~15% post FY21E. Owing to the COVID-19 related lockdown, we see loan growth to be 5% in FY21E. As the economy rebounds in FY22E assuming COVID-19 cases peak out in H1FY21E, we see loan growth at 14% in FY22E.

Fig 78: See loan growth shrink to 5% in FY21E; expect it to bounce back to 14% in FY22E



Source: Company, Centrum Research

Key risks

- **Self-employed share at 29%:** Owing to disruption caused in economic activity led by the COVID-19 related lockdown, the self-employed segment has been one of the hardest hit and they are already facing a severe cash crunch as demand is marred. For Canfin, the self-employed segment contributes 29% to overall loans. Although we have been conservative in baking in asset quality estimates, this segment could see further deterioration in case the lockdown is extended as there is a looming fear of a second wave since COVID-19 cases are yet to peak in India.
- **Funding cost may increase post the Canara Bank stake sale:** The management has been suggesting that Canara Bank intends to sell its 30% stake although the timeline is not yet decided. This could impact the low funding cost Canfin enjoys as the sovereign support could be withdrawn.
- **Prolonged slowdown could see lower growth:** Given the pandemic has not yet peaked in India, we can see conservative measures taken by the respective state governments imposing lockdown with certain relaxations. Also, with the possibility of a second wave, the slowdown could be prolonged further impacting demand and credit growth. We have been prudent in estimating loan growth for Canfin at 5% YoY for FY21, though this number could come in lower if the lockdown continues.

Company background

Can Fin Homes Ltd (Canfin) set up in 1987, is a South India based Home Finance Company promoted by Canara Bank (30% holding). The company is focused on lending in Tier-1, Tier-2 & non-metro cities. Its AuM stands at Rs207bn as at Q4FY20 with south India contributing over 60% to the AuM. It is Headquartered in Bangalore and the company has 163 Branches, 21 Affordable Housing Loan Centres (AHLCs) & 14 Satellite offices spread across various locations of the country. The company offers a range of loan products-housing loans as well as non-housing loans and is predominantly retail focused.

Canfin has a focus on salaried and professional with its share being 71%. 99.8% of its lending is to individuals, being mostly first time home buyers. Incrementally the company is more focused on growing non metro, Tier2/3/4 cities book. Non-metro branch share enhanced from over FY16-20 from 51% to 64% resulting in sanctions/loan share improvement from 28%/23% to 45%/36%. Due to its focus on smaller cities, a chunk of the portfolio qualifies for affordable housing.

Fig 79: Profile of Board of Directors

Name of the Director	Designation	Profile
Smt Bharati Rao	Chairperson	Smt Bharati Rao was appointed by the Board of Directors on September 05, 2017. She is an Independent and Non-Executive Chairperson of the Company. She is a post graduate degree holder in Economics (M.A.) and Certified Associate of Indian Institute of Bankers (CAIIB). She has more than 42 years of experience in the banking
Shri Girish Kousgi	Managing Director	Appointed w.e.f September 05, 2019, Shri Girish Kousgi is a graduate in B.Com. and MBA. He is a Banking professional with 24+ years of experience. He has an extensive experience of managing assets and liabilities and has gained expertise in mortgage, retail lending, SME and Agri business. During his career, he has worked in HDFC Ltd., ICICI Bank, IDFC Bank and Tata Capital. He has dealt with a variety of loan products and gained wide experience in handling sales, product, credit underwriting, risk and operations
Shri Debashish Mukherjee	Additional Director (Non-Executive promoter)	Shri Debashish Mukherjee has been appointed as an Additional Director (Non-executive Promoter) w.e.f March 12. MBA (Finance) from the University of Kolkata, he started his career with PNB as a Financial Analyst in scale II in 1994. He joined UBI as an Asst. General Manager (Credit) in 2006. He has vast experience in Corporate Credit, Credit Monitoring /Recovery.
Shri G Naganathan	Independent Director	The Board of Directors have appointed Shri G Naganathan, FCA, as a director of the Company on September 07, 2016. Shri G Naganathan is a rank holder in Chartered Accountancy and Cost Accountancy. He has completed the DISA and CISA Presently, he is the Managing Partner in M/s. R K Kumar & Co., Chartered Accountants. He has put in a practice of 35 years in R K Kumar & Co
Shri Shreekant M Bhandiwad	Deputy Managing Director	Shri Shreekant M Bhandiwad has been appointed as the Deputy Managing Director of Company w.e.f April 28, 2018. He is a M.Sc.(Agri) and a CAIIB. He started his career as an Officer in Canara Bank in the year 1994. During his service in the Bank he has headed different branches, Circle Offices and various departments at the Circle and Corporate level. Shri Bhandiwad is a senior banker with 25 years of commercial banking experience having served across the States ofHaryana, Rajasthan and Karnataka.
Dr. Yeluri Vijayanand	Independent Director	Dr Yeluri Vijayanand has been appointed as an Additional Director w.e.f. August 29, 2018. Dr Yeluri V Vijayanand is PhD in Economics, M.A in Economics, Bachelor of Laws and CAIIB. He retired from State Bank of India as Deputy Managing Director on August 31, 2007 after serving for more than 37 years.
Shri S Subramanian	Independent Director	Shri Shankara Narayanan Subramanian (S Subramanian) has been appointed as an Additional Director (Non-executive Promoter) w.e.f. October 06, 2018. He is a graduate in B.Sc., a Diploma holder in Company Law and a Certified Associate of Indian Institute of Bankers (CAIIB). Shri S Subramanian started his career in Canara Bank in the year 1981 and has more than 36 years of commercial banking experience. During this, he has handled various duties at various branches.

Source: Company Annual Report, Centrum Research

Fig 80: Quarterly financials

Particulars (Rs mn)	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20
Income statement								
Interest earned	3,964	4,142	4,376	4,552	4,772	4,940	5,135	5,251
Interest expended	2,701	2,838	3,015	3,140	3,286	3,379	3,398	3,366
Net interest income	1,263	1,304	1,361	1,411	1,486	1,561	1,737	1,885
Other income	63	76	55	77	69	67	33	38
Total income	1,326	1,380	1,415	1,489	1,555	1,628	1,770	1,923
Operating expenses	199	176	216	322	239	256	269	325
Employees	106	60	85	163	126	123	138	155
Others	94	116	131	159	113	134	130	170
Operating profit	1,126	1,204	1,200	1,167	1,316	1,372	1,501	1,598
Provisions	0	0	0	11	87	63	45	408
Profit before tax	1,126	1,204	1,200	1,156	1,229	1,309	1,456	1,189
Tax	394	388	451	495	419	333	390	280
Profit after tax	732	816	749	661	810	976	1,066	909
Balance sheet								
AUM	161,990	169,350	175,690	183,810	190,030	196,000	201,940	207,080
Borrowings	144,171	150,722	156,364	163,591	169,127	174,440	178,111	178,111
Equity	14,432	16,330	17,259	17,822	18,855	19,372	20,438	21,501
Balance sheet ratios (%)								
AUM growth YoY (%)	17.3	17.2	16.7	16.8	17.3	15.7	14.9	12.7
Debt / Equity	10.0	9.2	9.1	9.4	9.0	8.9	8.7	8.6
Assets / Equity	11.0	10.2	10.1	10.2	10.0	10.0	9.7	9.3
Capital ratios (%)								
Total CRAR	18.7	18.7	19.4	16.4	19.6	18.8	22.1	22.3
Tier-1	16.7	16.7	17.5	14.6	18.0	17.3	20.4	20.5
Tier-2	2.0	2.0	1.9	1.8	1.6	1.5	1.7	1.8
Profitability ratios (%)								
Yield on AUM	10.6	10.6	10.7	10.7	10.8	10.8	10.9	10.7
Cost of funds	8.1	8.1	8.3	8.3	8.4	8.3	8.1	7.9
NIM	3.4	3.3	3.3	3.3	3.4	3.4	3.7	3.9
Other inc. / Total inc.	4.7	5.5	3.9	5.2	4.4	4.1	1.8	2.0
Cost / Income (%)	15.0	12.8	15.2	21.6	15.4	15.7	15.2	16.9
Cost / Assets	0.5	0.4	0.5	0.8	0.5	0.6	0.6	0.7
RoA	2.0	2.1	1.8	1.6	1.8	2.1	2.3	1.9
RoE	22.9	23.1	20.0	14.8	19.5	21.9	22.6	18.5
Asset quality ratios (%)								
GNPA	0.7	0.6	0.7	0.6	0.7	0.8	0.8	0.8
NNPA	0.4	0.4	0.5	0.4	0.5	0.6	0.6	0.5
Provision coverage	33.4	33.4	28.7	30.0	29.2	26.9	26.2	28.8

Source: Company, Centrum Research

Annual financials

P&L (Rs mn)	FY18	FY19	FY20P	FY21E	FY22E
Interest income	14,909	17,134	20,189	21,035	23,264
Interest expense	9,813	11,693	13,442	14,227	15,408
NII	**5,096**	**5,441**	**6,747**	**6,808**	**7,856**
Other income	311	179	115	110	165
Total income	5,407	5,621	6,862	6,918	8,021
Opex	870	915	1,076	1,087	1,292
Employee	448	414	542	553	669
Others	422	501	534	534	623
PPOP	**4,537**	**4,706**	**5,786**	**5,831**	**6,729**
Provisions	221	11	603	1,204	650
PBT	4,316	4,695	5,183	4,627	6,079
Tax	1,449	1,728	1,422	1,166	1,532
PAT	**2,867**	**2,967**	**3,761**	**3,461**	**4,547**

Ratios	FY18	FY19	FY20P	FY21E	FY22E
Growth (%)					
AUM	18.3	16.8	12.7	5.0	14.0
Borrowings	17.3	20.7	11.2	3.7	12.7
NII	20.8	6.8	24.0	0.9	15.4
Other inc	(33.9)	(42.3)	(35.6)	(4.7)	49.9
Opex	9.0	5.1	17.7	1.0	18.9
PPoP	16.6	3.7	23.0	0.8	15.4
Provisions	17.5	(95.1)	NA	99.6	(46.1)
PAT	21.9	3.5	26.8	(8.0)	31.4
Profitability (%)					
Yield on IEA	10.2	10.0	10.3	9.9	10.0
Cost of funds	7.6	7.6	7.6	7.5	7.5
NIM	3.5	3.2	3.4	3.2	3.4
Other Inc/Total Inc	5.7	3.2	1.7	1.6	2.1
Other Inc/Assets	0.2	0.1	0.1	0.1	0.1
Cost/Income	16.1	16.3	15.7	15.7	16.1
Employee	8.3	7.4	7.9	8.0	8.3
Others	7.8	8.9	7.8	7.7	7.8
Opex / Assets	0.6	0.5	0.5	0.5	0.5
Provisions	0.2	0.0	0.3	0.6	0.3
Tax Rate	33.6	36.8	27.4	25.2	25.2
RoA	2.0	1.7	1.9	1.6	1.9
RoE	21.3	18.2	19.1	15.1	17.1
DuPont analysis (%)					
Interest inc	10.3	9.9	10.1	9.7	9.9
Interest exp	6.8	6.8	6.7	6.6	6.5
NII	3.5	3.2	3.4	3.1	3.3
Other income	0.2	0.1	0.1	0.1	0.1
Total income	3.7	3.3	3.4	3.2	3.4
Opex	0.6	0.5	0.5	0.5	0.5
Employee	0.3	0.2	0.3	0.3	0.3
Others	0.3	0.3	0.3	0.2	0.3
PPOP	3.1	2.7	2.9	2.7	2.8
Provisions	0.2	0.0	0.3	0.6	0.3
PBT	3.0	2.7	2.6	2.1	2.6
Tax	1.0	1.0	0.7	0.5	0.6
PAT	2.0	1.7	1.9	1.6	1.9

Source: Company, Centrum Research estimates

Balance Sheet (Rs mn)	FY18	FY19	FY20P	FY21E	FY22E
Financial assets	**156,815**	**186,735**	**209,457**	**219,942**	**249,131**
Cash	7	4,015	3,723	3,915	2,975
Bank balance	183	187	201	239	297
Loans	156,440	182,342	205,257	215,487	245,564
Investment	160	163	243	261	248
Others	25	28	33	39	47
Non-financial assets	**480**	**560**	**979**	**870**	**892**
Current tax	138	206	240	214	219
Deferred tax	232	240	339	259	264
Fixed Assets	96	99	379	379	390
Others	14	15	20	18	19
Total Assets	**157,295**	**187,295**	**210,436**	**220,812**	**250,023**
Financial liabilities	**141,687**	**169,059**	**188,114**	**195,383**	**220,332**
Debt securities	69,739	56,347	38,096	39,320	45,852
Borrowings	69,471	111,425	148,360	154,375	172,491
Subordinated Debt	0	1,029	1,029	1,064	1,292
Others	2,477	258	630	623	697
Non-financial liabilities	**738**	**414**	**821**	**968**	**1,092**
Provisions	336	266	662	781	880
Others	401	148	159	187	211
Total equity	**14,871**	**17,822**	**21,501**	**24,461**	**28,599**
Share capital	266	266	266	266	266
Other equity	14,605	17,556	21,234	24,194	28,333
Total Liabilities	**157,295**	**187,295**	**210,436**	**220,812**	**250,023**

Ratios	FY18	FY19	FY20P	FY21E	FY22E
Balance Sheet ratios (%)					
Debt / Equity	9.4	9.5	8.7	8.0	7.7
Assets / Equity	10.6	10.5	9.8	9.0	8.7
Cash / Borrowings	0.1	2.5	2.1	2.1	1.5
Capital (%)					
CRAR	19.1	16.4	22.3	22.3	21.8
Tier 1	17.0	14.6	20.5	20.6	20.0
Tier 2	2.1	1.8	1.8	1.8	1.8
Asset quality (%)					
GNPA (Rs mn)	675	1,135	1,571	3,632	2,613
NNPA (Rs mn)	316	795	1,118	2,424	1,801
GNPA	0.4	0.6	0.8	1.7	1.1
NNPA	0.2	0.4	0.5	1.1	0.7
PCR	53.1	30.0	28.8	33.3	31.1
NNPA/ Equity	2.1	4.5	5.2	9.9	6.3
Per share (Rs)					
EPS	21.5	22.3	28.2	26.0	34.1
BVPS	111.7	133.8	161.5	183.7	214.8
ABVPS	109.3	127.9	153.1	165.5	201.2
Valuation (x)					
P/E	23.8	11.1	15.0	13.5	10.3
P/BV	4.0	1.9	2.1	1.9	1.6
P/ABV	4.2	2.1	2.4	2.1	1.7

Source: Company, Centrum Research estimates

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Canfin Homes

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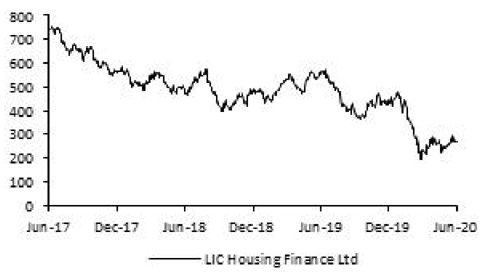

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