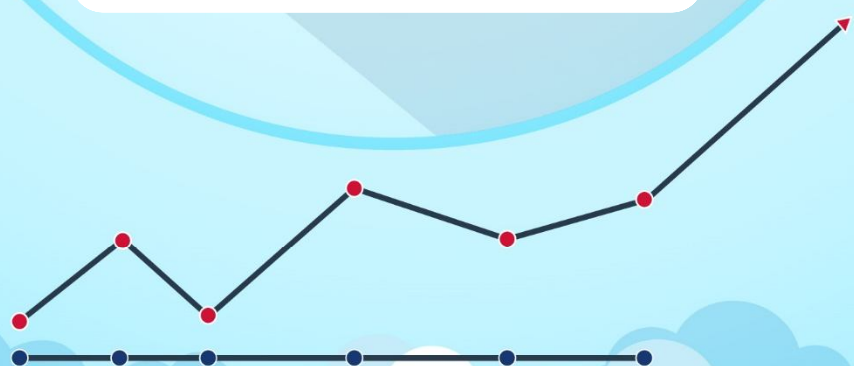
HDFC securities

EQUITY RESEARCH

Pick of the Week

RETAIL RESEARCH

Date: July 29, 2019



Can Fin Homes Ltd.

Key highlights

- Focus on non-metro areas amid increasing competition
- Residential sales starting to pick up
- Mortgage penetration in India poised to jump significantly
- Growing Urbanization and Housing Shortage
- Strong risk assessment measures leading to better asset quality

INDUSTRY	**ADD ON DIPS TO**
BFSI - NBFC	Rs 330-335
CMP	**SEQUENTIAL TARGETS**
Rs 387	Rs 439-475 RED FLAG Rs 307
RECOMMEND	**TIME HORIZON**
Buy at CMP and add on declines	3-4 quarters

Investors may sell 60-65% of their holdings on first target being achieved and later keep a stop loss of first target for the balance holdings, in case the second target takes time to be achieved.
Investors may also maintain Rs 307 as RED FLAG level, below which investment position needs to be reviewed, including the possibility to exit.

HDFC Scrip Code	CANFINEQNR
BSE Code	511196
NSE Code	CANFINHOME
Bloomberg	CANF IN
CMP Jul 26, 2019	386.80
Equity Capital (cr)	26.6
Face Value (Rs)	2
Eq- Share O/S (cr)	13.3
Market Cap (Rs cr)	5139.8
Book Value (Rs)	139.9
Avg.52 Wk Volume	14,50,000
52 Week High	420
52 Week Low	217

Shareholding Pattern % (Jun 30, 2019)	
Promoters	30.11
Institutions	1.85
Non Institutions	68.04
Total	100.0

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Investment rationale:

- Focus on non-metro areas amid increasing competition
- Residential sales starting to pick up
- Growing Urbanization and Housing Shortage
- Mortgage penetration in India poised to jump significantly
- Strong risk assessment measures leading to better asset quality

Concerns:

- Slowdown in real estate industry and delay in booking
- Delay in Project Approval
- Highly concentrated in the southern part of India
- Rising competition
- Increase in slippages

Company profile:

Incorporated in 1987, Can Fin Homes (CFHL) was the first housing finance company floated by any nationalised bank in India with the objective of promoting home ownership and increasing the housing stock of the country. Besides Canara Bank (which currently holds 29.99% stake) Canbank Financial Services, HDFC and UTI were the initial shareholders of the company. Headquartered in Bangalore with five clusters, CFHL has a pan-India presence. It operates out of 189 outlets comprising of 154 branches, 21 Affordable Housing Loan Centres, and 14 Satellite Offices spread across 100 cities and 21 States and Union Territories. At the end of Q1FY20 it had an outstanding loan book of Rs 19,000cr.

View and valuation:

CFHL has always remained conservative sticking to individual housing loans and has largely remained away from LAP financing which has led to higher NPAs for many of its peers. It is now concentrating on growing in the non-metro cities where the competition from banks is lower. Efforts to diversify into newer states and customer segment can result in strong loan book growth. CFHL sailed through the recent liquidity crisis on back of comfortable capital adequacy, strong profitability and support from parent. CFHL is not impacted by all the recent NHB regulations around leverage, tier 1 and subvention schemes.

Housing finance companies have come under selling pressure lately because of funding issues, slippages out of LAP portfolio, slow loan growth and capital adequacy issues. CFHL is not facing any of these issues and hence the recent weakness in the sector can be used to accumulate stocks like CFHL.

CFHL's parent is making another attempt at offloading its stake in CFHL to a willing buyer. The process is on and the management feels it must be through in before next quarter at the right valuation. If a marquee investor buys out this stake, then the accompanying buzz could lift the stock price soon.

We feel investors could buy the stock at the CMP and add on declines to Rs 330-335 band (1.9x FY21E ABV and ~11.6x FY21E EPS) for sequential targets of Rs 439 (2.5x FY21E ABV and ~15.3x FY20E EPS) and Rs 475 (2.7x FY21E ABV and ~16.6x FY21E EPS) in 3-4 quarters. At CMP of Rs 387 the stock is trading at 2.2x FY21E ABV and 13.5x FY21E EPS.

Key Highlights

- ***Focus on non-metro and Tier II/III cities to drive its future growth. 80% of the branches added in last 3 years have been in non-metro areas***
- ***Government measures like interest subsidy, tax deductions leading to rise in sales especially in affordable housing***
- ***Growing urbanisation has created huge shortage of urban housing in India***
- ***CFHL's unyielding focus on asset quality, has resulted in one of the lowest GNPA levels among its peers***
- ***Higher share of salaried book at 73% provides fair degree of comfort in uncertain times***

Financial Summary

YE March (Rs cr)	Q4FY19	Q4FY18	YoY (%)	Q3FY19	QoQ (%)	FY18	FY19P	FY20E	FY21E
Net Interest Income	148	126	*17.1*	138	*7.4*	510	530	590	666
PPoP	132	114	*15.3*	118	*11.9*	453	471	527	600
APAT	81	75	*7.6*	67	*20.8*	286	297	335	381
EPS (Rs)	6.1	5.7	*7.6*	5.0	*20.9*	21.5	22.3	25.2	28.6
ABV (Rs)						109.3	127.9	149.3	175.7
P/E (x)						18.0	17.3	15.3	13.5
P/ABV (x)						3.5	3.0	2.6	2.2
RoAA (%)						2.0	1.7	1.7	1.6

(Source: Company, HDFC sec)

Company profile:

CFHL's focus has been on individual housing loans which account for 90% of its loan book. More than 70% of the loans have been given to salaried individuals, although the share of non-salaried loans have been gradually increasing. Regionwise, it has a dominant position in South (70% of its loan book with Karnataka accounting for 30%). The company got listed in 1991 and carries a legacy of uninterrupted dividend payment since inception.

Shri Sarada Kumar Hota, Managing Director & CEO (KMP) of the Company has resigned on June 27, 2019, on his repatriation to Canara Bank consequent to his appointment as the Managing Director (MD) of National Housing Bank. The selection process for the new MD is on.

Business Overview:

Loan Products:

Can Fin Homes Limited Offers 24 loan products under housing segment, non-housing Segment and tailor-made for the niche customer segment it caters to. The products basket covers individual housing loans for construction, purchase, extension, repairs and renovation, site purchase, composite loan, loans for rural housing, loans for urban housing etc and non-housing loans like mortgage loans, personal loans to existing customers, loans for commercial property, loans for rent receivables etc. CFHL introduced 4 new products, New Gruhalakshmi Rural Housing Scheme, New Urban Housing Scheme, CFHL Nishchint for Pensioners and CFHL-Topup loan during the FY18.

Distribution Channel:

The Company has engaged Direct Selling Agents (DSA) in all branches, authorizing them to source loan proposals from eligible customers on company's behalf.

Key company milestones

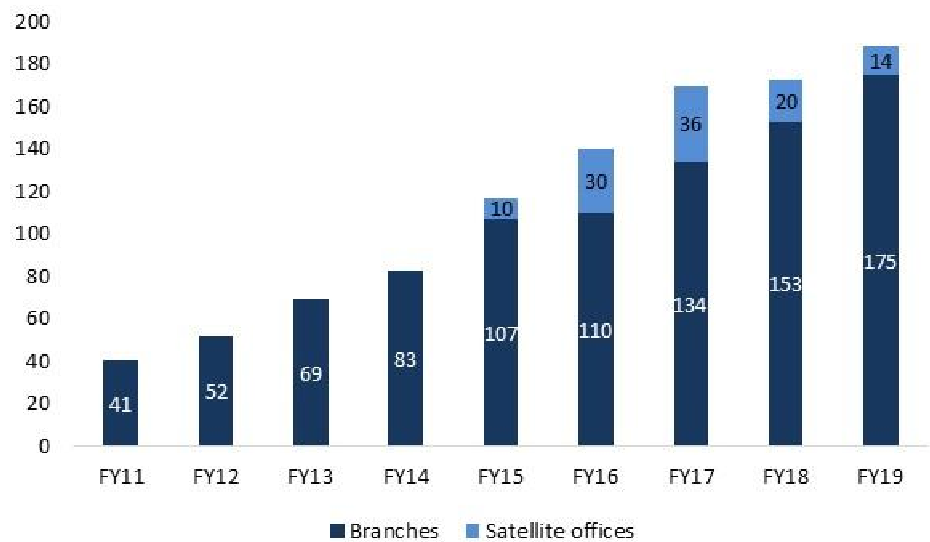
Year	Milestone
1987	Inaugurated 1st branch at Jayanagar, Bangalore
1988	Opened 1st branch outside South India at Delhi
1991	CFHL became a listed company; Loan book crossed Rs 100cr
2012	Disbursements crossed Rs 1,000cr per annum
2013	Loan book crossed Rs 10,000cr
2015	Raised Rs 276cr under rights issue
2017	Fresh approvals crossed Rs 5,000cr; Opened 15 Affordable Housing Loan Centres
2018	Forayed into Punjab and West Bengal; Maiden venture into cross selling

Investment rationale

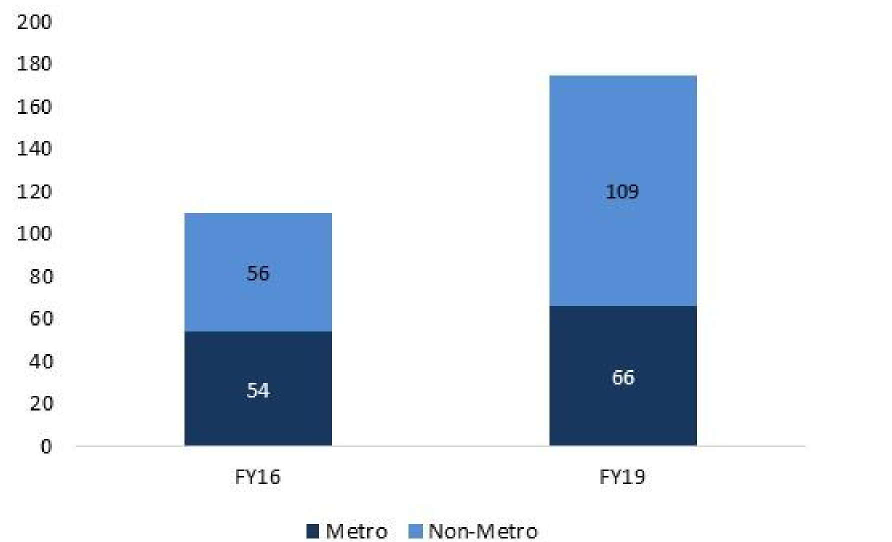
Focus on non-metro areas amid increasing competition

CFHL is shifting its focus to non-metro and Tier II/III cities to drive its future growth as there is huge competition from banks and NBFCs in metro and Tier I cities. Its loan book growth has suffered in the last few years due to other banks and NBFCs focusing on or starting housing finance verticals. Of the 65 branches added by the company over FY16-FY19, over 80% have been in non-metro areas.

Branch Network



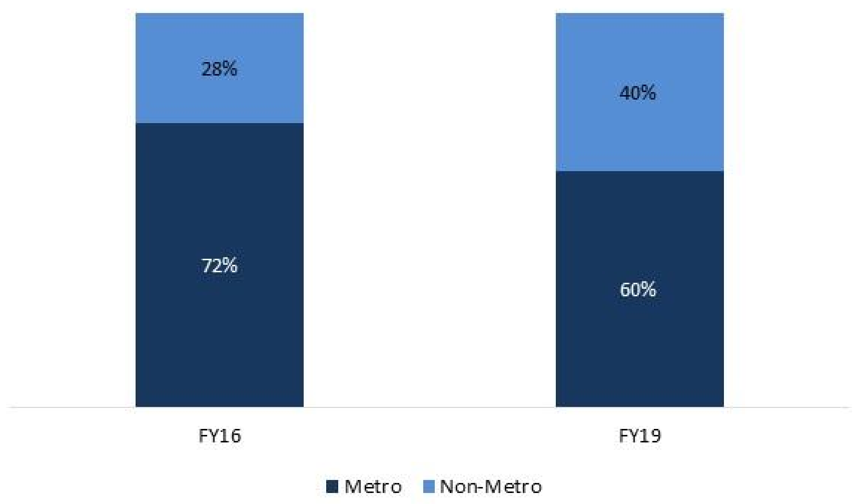
Branch network split



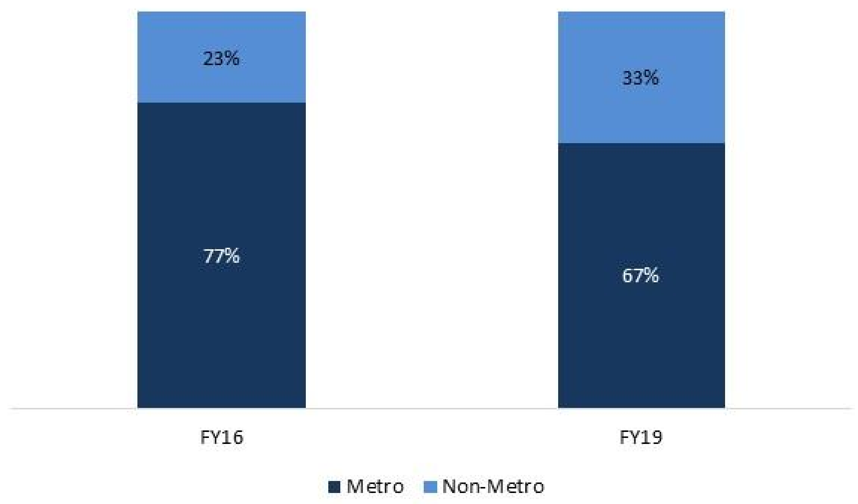
(Source: Company, HDFC sec)

Consequently the share of non-metro areas in sanctions has increased from 28% to 39% while in the outstanding loan book it has gone up from 23% to 32% during the same period. In FY19 metro loan book witnessed a growth of 11% as compared to 30% in non-metro loan book.

Share in Sanctions



Share in Loan Book



(Source: Company, HDFC sec)

CFHL has plans to add ~20 branches in FY20 with majority of them being in Tier III/IV growth centres taking the total branch/satellite office network to over 200.

Residential sales starting to pick up

The first quarter of 2019 has witnessed both housing sales and new supply rise, driven by several measures by the government, GST rate cuts and lowering of home loan rates post the Reserve Bank of India's recent repo rate cut.

Residential property sales rose 58% from a year ago to 78,520 apartments during the quarter ended March across top 7 cities. The jump in sales was led by Mumbai Metropolitan Region (MMR), Pune and Delhi-National Capital Region (NCR) with an increase of over 95%, 80% and 52%, respectively, showed data from ANAROCK Property Consultants. Of the total new supply, affordable housing saw the maximum share at 44%.

The various interventions by the government have had not only a buffering but a boosting effect despite the ripple effect of NBFC crisis in H2CY18. Average residential prices across the top cities remained stagnant in during the quarter when compared to the previous quarter. More than 45% of new supply was added in the affordable segment while over 70% new supply was added in sub Rs 80 lakh price bracket, indicating that developers are aligning their offerings according to the current market dynamics.

The slash in GST rates to 5% for premium homes and 1% for affordable homes without ITC and change in definition of affordable housing to include properties upto Rs 45 lakh has been beneficial for buyers and likely to drive higher residential sales in the coming year.

CFHL is confident of growing its loan book by 25-26% over FY20 due to increase in supply because of new projects coming up after slow-down due to RERA implementation, Government schemes such as 'Housing for all by FY2022' will drive growth among the individuals and tax benefit on second home shall further push individuals to buy home for rental yields.

Growing Urbanization and Housing Shortage
According to "World Urbanization Prospects - The 2018 Revision" by the Population Division of the UN Department of Economic and Social Affairs (UN DESA), the urban expansion in India will happen at a faster pace. While it took nearly 40 years (from 1971 to 2008) for India's urban population to rise by nearly 230 million; it will take only half that time to add the next 250 million.

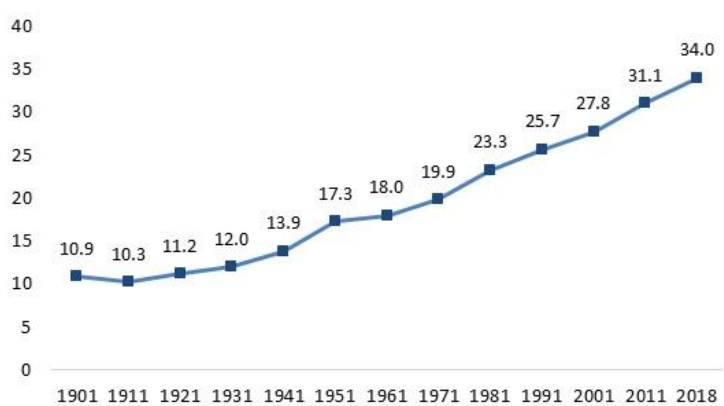
Census 2011 figures reveal that the housing stock has increased form 249mn in 2001 to 331mn in 2011, indicating a growth of 33 per cent. However, housing shortage is posing a challenge, since there is a mismatch between the people for whom the houses are being built and those who need them. As per the estimated housing shortage for 2012-17, urban area have about 95% shortage in EWS and LIG categories, whereas rural areas have about 90% shortage in below poverty line category.

Urban Housing			Rural Housing		
Category	Shortage (mn)	% to Total	Category	Shortage (mn)	% to Total
Economically Weaker Section (EWS)	10.55	56.2	Below Poverty Line (BPL)	39.30	90.0
Lower Income Group (LIG)	7.41	39.4	Above Poverty Line (APL)	4.37	10.0
Middle Income Group (MIG)	0.82	4.4			
Total	**18.78**	**100.0**		**43.67**	**100.0**

(Source: Company, HDFC sec)

The trend of migration from rural to urban is likely to continue. India's urban population is estimated to have grown at a CAGR of 2.8% over 2001-2011, resulting in an increase in the urbanisation rate from 27.8% to 31.2%. The rising population in urban has created huge shortage of urban housing in India. According to Ministry of Housing and Urban poverty alleviation (MHUPA), of the total urban housing shortage, 80% (14.99mn) households are living in congested houses requiring new houses. Thus large shortage of urban and rural housing offers immense growth opportunity going ahead.

Urban population to total population (%)

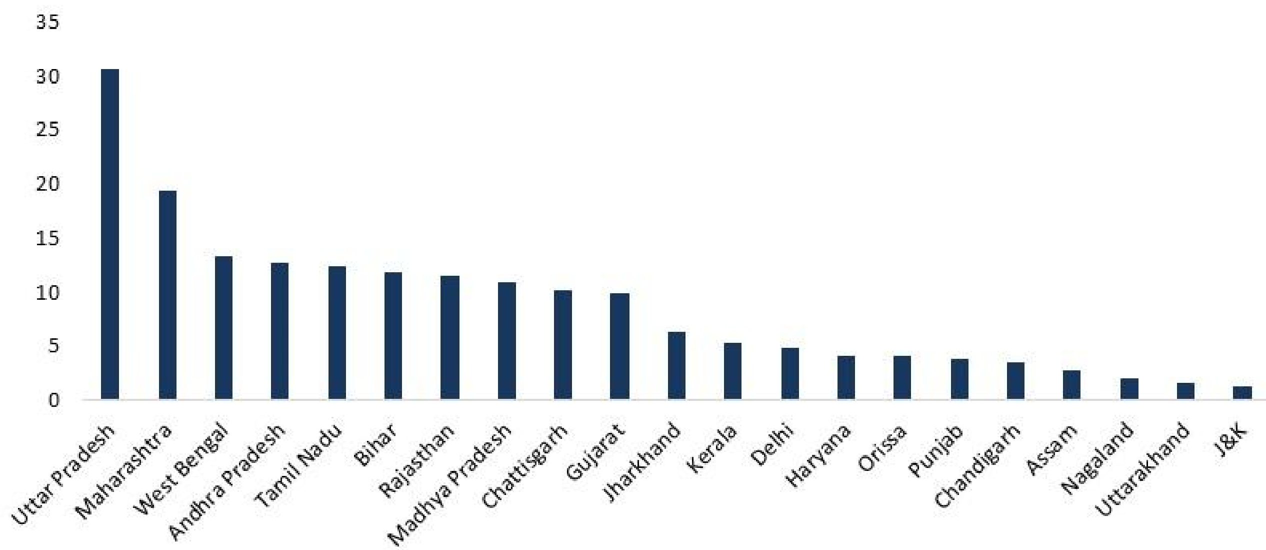


(Source: Crisil, HDFC sec)

10 States contribute to three-fourths of the urban housing shortage

The State-wise data shows a mixed picture where both developed as well as less developed states have families living in poor housing conditions. Uttar Pradesh has a housing shortage of over three million homes followed by Maharashtra (1.97mn), West Bengal (1.33mn), Andhra Pradesh (1.27mn) and Tamil Nadu (1.25mn). The top 10 states, in terms of urban housing shortage, contribute to 14.3mn or 76% of housing shortage.

Urban population to total population (%)

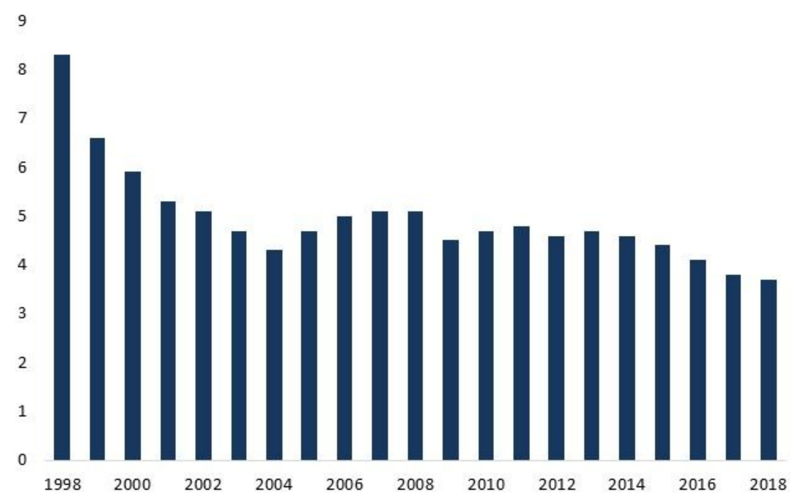


(Source: MHUPA, HDFC sec)

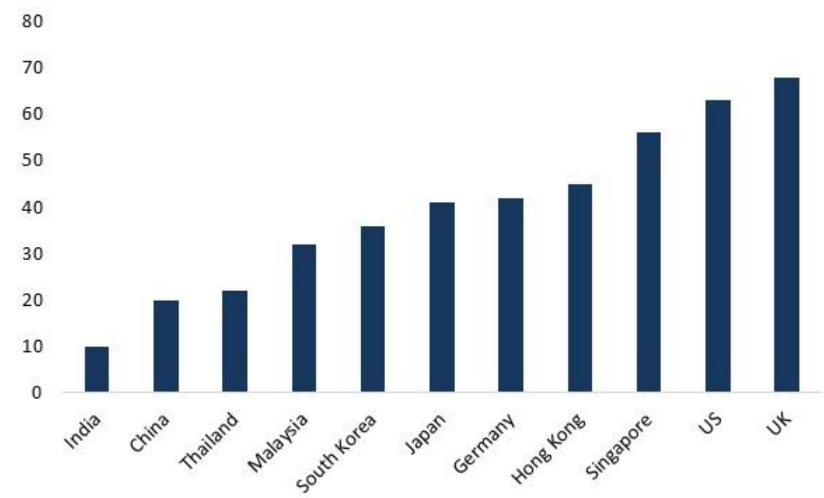
Mortgage penetration in India poised to jump significantly

The mortgage penetration in India is substantially low today compared to the developed and developing nations, leaving huge scope for growth in demand for housing loans due to: a) Interest subsidy by Govt on affordable housing; b) Tax deduction on housing loan is Rs 2 lakh on interest payment (2.5 lakhs for first time buyers) and the total tax rebate is Rs 4 lakh per annum, including interest and principal, c) Increasing affordability; d) Rapid urbanisation (currently it is ~34% which was 31.1% in 2011 and it is expected to reach 50% by 2030). In the Union Budget for FY20, the FM has proposed to increase the deduction that can be claimed for interest paid on loans taken for affordable housing by Rs 1.5 lakh to Rs 3.5 lakh per annum for houses valued up to Rs 45 lakh. The deduction is available on loans taken up to March 31, 2020. In light of these factors, mortgage penetration in India will increase substantially going forward.

Increasing affordability (number of years annual income)….



…would lead to higher mortgage penetration (%)

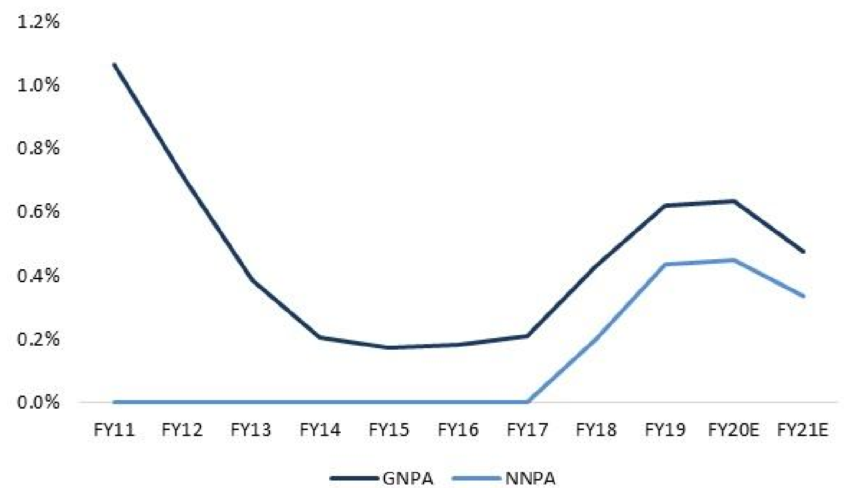


(Source: Industry, HDFC sec)

Strong risk assessment measures leading to better asset quality

Risk assessment of the customers is made at the time of initial appraisal for the purpose of pricing and granting the loans. CFHL also makes a portfolio risk analysis at frequent intervals with its stringent review mechanism. The follow-up of the Special Mention Accounts (SMA) at the nascent stage along with technological assistance

Asset quality amongst the best in peer group



(Source: Company, HDFC sec)

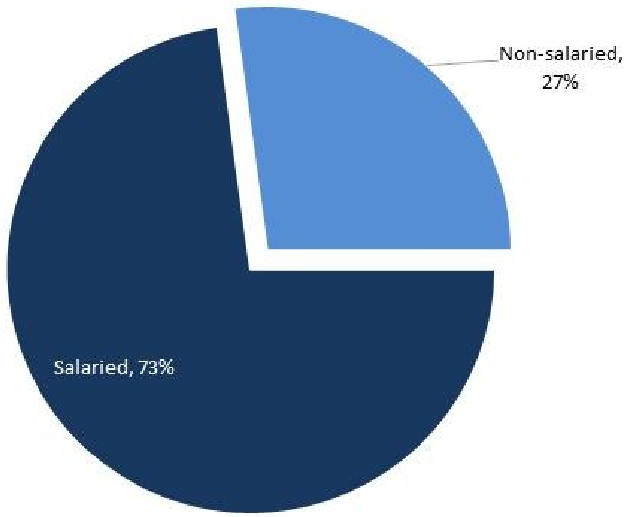
has helped arrest slippages into NPA. Special campaigns are being conducted every quarter for all the branches with the active involvement of their staff. On account of CFHL's unyielding focus on asset quality, it has been able to maintain one of the lowest GNPA levels among its peers.

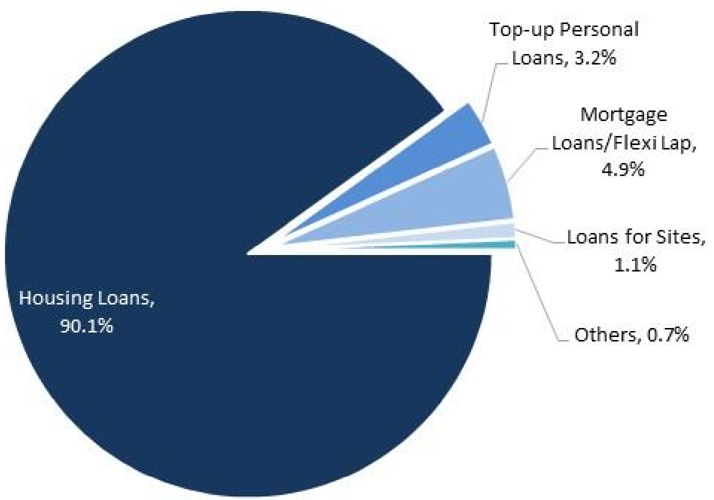
CFHL has taken recourse to SARFAESI proceedings in 367 accounts in FY19, of which it has sold 46 accounts (Rs 9.3cr) and upgraded 307 accounts (Rs 38.2cr) through cash recovery. CFHL will need to make IND-AS provisions (14-16 bps) in FY20.

Higher share of salaried book provides comfort

CFHL's customer profile has remained skewed in favour of the salaried class. Although the share has declined from 86% in FY14 to 72.7% in Q1FY20, it provides a fair degree of comfort in uncertain times. The proportion of self-employed individuals for CFL remains higher in metros. 90% of the loan book is for housing loans while LAP loans account for only 5% of the book.

Loan Book breakup (Q1FY20)





(Source: Company, HDFC sec)

Fee income to see a boost

CFHL has joined hands with Canara HSBC Oriental Bank of Commerce Life Insurance for a three year corporate agency tie-up to sell its policies to potential home buyers. All the life insurance products of the company would be made available to customers of CFHL. The third party distribution business is a lucrative opportunity for the company to boost its non-interest income and contribute meaningfully in the coming years.

Tight cost to Income ratio

The cost-to-income ratio of CFHL is ~16%, one of lowest among HFCs, barring HDFC Limited (~7%). This ratio is expected to remain low as loan generation through DSA is declining (currently 46%) and maturing branches will enhance productivity.

Technology initiatives to control costs.
CFHL has embarked on several technology initiatives to improve its operational efficiency. It has implemented C-KYC (Central KYC) which acts as a centralised repository of KYC records and can be used across the financial sector. It has revamped its website to make it interactive and more user friendly. It has also introduced online application module in its website and a customer portal to access account statements/ certificates and online money transfer. These measures are likely to aid in controlling the operating expenses thereby reducing cost-income ratio and drive higher direct sourcing.

Adequate capitalization levels
Capital Adequacy Ratio (CAR) of CFHL stood at 19.59% at the end of Q1FY20 against the 12% stipulation by NHB with Tier I ratio of 17.96%. CAR remained adequate even after the growth in the outstanding loan book by 17% in Q1FY20. CFHL leverage levels (overall advances/net worth) was at 10.3x. High proportion of Tier I CAR provides cushion to raise additional Tier-II capital to fund future growth.

However as a cushion for future, CFHL plans to raise Rs 7,000cr through a mix of debt securities and equity allotment to fund its business growth, meet working capital requirement and repay debt. Of this, Rs 6,000cr will be raised by issuing non-convertible debentures (NCDs), while Rs 1,000cr is to be mopped up through issuing equity shares or specialised securities.

Concerns

Slowdown in real estate industry and delay in booking:
Over the last 2-3 years, housing sector has seen an inventory pile up situation in India and launching of new projects has come down in the past one and half year. A number of houses, flats and apartments are being sold without getting booked. Slowdown in demand for loan has been reported in the high end segments, which are driven by investment demand. However CFHL has an average ticket size of Rs 18 lakhs for housing loans and Rs 10 lakhs for non-housing loans.

Delay in Project Approval:
Several home buyers faced the issue of project delays. Project delays can happen mainly either because of delay in the building process, or due to quality check. On the other hand, there have been situations when several state governments have delayed the licensing process for building a property, even after the builders have collected money from their clients.

Highly concentrated in the southern part of India:
CFHL is highly concentrated in the southern part of the country, and now spreading its presence in the rest part of the country. Any political and economy uncertainty in that region could impact the business of CFHL.

Rising competition:
CFHL's 87% loans are retail individual housing loans. There is competition with banks in retail segment in the metro and larger cities. Can Fin has no plans to increase focus on builder loans, personal loans and commercial housing loans segment.

Increase in slippages
Slippages at CFHL are under control but continued slowdown in the economy could result in higher slippages.

Q1FY20 Result Review

NII of the company increased by 17.1% yoy to Rs 148cr driven by higher disbursement in the quarter. Sanctions increased by 7% while disbursements were up by 9.6% yoy as compared to an average of 5% growth in the last 4 quarters. Outstanding loan book grew by 17% yoy to Rs 19,003cr. Home Loans -HL (90% of loan book) grew 16.5% yoy, with self-employed HL portfolio growing at 24% compared to 14% growth in the salaried HL book. NIMs were stable yoy, but expanded 4bps qoq to 3.18% as overall cost of funds was stable in Q1FY20 at 7.93%. Portfolio yield improved by 22/16 bps yoy/qoq to 10.22% as interest spreads increased 3/13 bps. Increase in NPAs was largely seasonal. GNPA/NNPA increased by 11/9 bps qoq even as CHFL made provision of Rs 8.7cr. Overall the company holds Rs 107cr of provisions against NNPA of Rs 99cr.

Management expects loan book growth to pick up in coming quarters as Q1 is generally a lean quarter. NIMs are expected to improve further on the back of residual asset re-pricing (for loans disbursed in Q2FY19), and moderation in funding cost driven by considerable fall in decline in Bank MCLRs. It has set a target of Rs 23,000 loan book by the end of FY20 which entails growth of 26%. CFHL would continue to focus on fresh loans and not looking at buying out any loans.

Quarterly Financials

(Rs cr)	Q4FY19	Q4FY18	YoY-%	Q3FY19	QoQ-%
Interest Income	477.3	396.4	*20.4*	345.8	*38.0*
Interest Expenses	329.4	270.1	*22.0*	226.9	*45.1*
Net Interest Income	147.9	126.3	***17.1***	118.9	***24.4***
Non interest income	6.9	7.8	*-11.5*	15.7	*-56.0*
Total Income	154.8	134.1	***15.4***	134.5	***15.0***
Operating Expenses	23.2	19.9	*16.4*	24.1	*-3.5*
Pre Provisioning Profit	131.6	114.1	*15.3*	110.5	*19.1*
Provisions & Contingencies	8.7	0.0	*#DIV/0!*	0.0	*#DIV/0!*
Profit Before Tax	122.9	114.1	*7.7*	110.5	*11.3*
Provision for Tax	41.9	38.9	*7.8*	39.6	*5.8*
PAT	81.0	75.3	***7.6***	70.9	***14.3***
EPS	6.1	5.7	*7.6*	5.3	*14.2*
			(bps)		(bps)
GNPA	0.73	0.66	*7*	0.62	*11*
NNPA	0.52	0.44	*8*	0.43	*9*

View and valuation

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Peer Comparison

(FY19)	CMP (Rs)	Mcap (Rs cr)	NII (Rs)	PAT (Rs)	Cost of Funds (%)	CAR (%)	Cost-Inc (%)	RoE (%)	NNPA (%)	P/ABV (x)	Loan Bk (Rs cr)	Loan book gwth (%)
Can Fin	387	5150	530	297	7.9	19.6	16.3	18.2	0.43	3.0	18382	16.8
Repco	325	2036	469	235	8.3	23.9	20.7	17.7	1.88	1.7	11037	12.0
GIC HF	244	1313	357	172	8.0	16.8	22.7	15.2	0.56	1.1	12747	16.6

Financials: Income Statement

(Rs cr)	FY17	FY18	FY19	FY20E	FY21E
Interest Income	1306.0	1490.6	1699.5	1964.9	2265.7
Interest Expenses	884.0	981.0	1169.1	1375.0	1600.0
Net Interest Income	**422.0**	**509.6**	**530.4**	**589.9**	**665.7**
Non interest income	47.1	31.4	31.8	39.5	46.0
Operating Income	**469.1**	**541.0**	**562.2**	**629.4**	**711.7**
Operating Expenses	80.7	87.8	91.6	102.1	111.2
PPP	388.4	453.2	470.6	527.2	600.5
Prov & Cont	18.8	22.1	1.1	19.7	23.0
Profit Before Tax	369.6	431.1	469.5	507.5	577.5
Tax	134.9	144.9	172.8	172.5	196.3
PAT	**234.7**	**286.2**	**296.7**	**334.9**	**381.1**

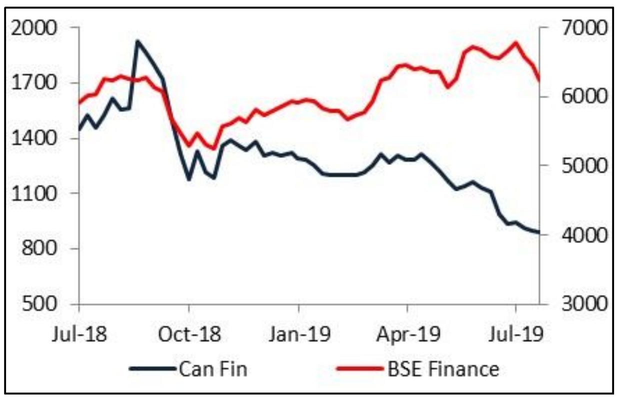
Balance Sheet

(Rs cr)	FY17	FY18	FY19	FY20E	FY21E
Share Capital	26.6	26.6	26.6	26.6	26.6
Reserves & Surplus	1049.7	1460.4	1755.6	2055.3	2396.5
Shareholder funds	**1076.3**	**1487.0**	**1782.2**	**2082.0**	**2423.2**
Borrowings	11872.0	13921.0	16694.4	19206.2	22461.3
Other Liab & Prov.	429.8	321.5	303.2	324.2	379.0
SOURCES OF FUNDS	**13378.1**	**15729.5**	**18779.8**	**21612.4**	**25263.4**
Fixed Assets	10.2	9.6	9.9	10.0	10.2
Investment	15.9	16.0	16.1	21.2	24.8
Cash & Bank Balance	12.5	19.0	420.3	318.2	371.9
Advances	13332.3	15644.0	18284.5	21210.0	24794.5
Other Assets	7.7	40.9	49.1	53.0	62.0
TOTAL ASSETS	**13378.5**	**15729.5**	**18779.8**	**21612.4**	**25263.4**

Key Ratios

Particulars	FY17	FY18	FY19E	FY20E	FY21E
Profitability Ratios					
Calc. Yield on adv	10.9%	10.3%	10.0%	10.0%	9.9%
Calc. Cost of borr	8.3%	7.6%	7.6%	7.7%	7.7%
NIM	3.5%	3.5%	3.1%	3.0%	2.9%
RoAE	24.0%	22.3%	18.2%	17.3%	16.9%
RoAA	1.9%	2.0%	1.7%	1.7%	1.6%
Asset Quality Ratios					
GNPA (%)	0.2%	0.4%	0.6%	0.6%	0.5%
NNPA (%)	0.0%	0.2%	0.4%	0.4%	0.3%
Growth					
Advances	24.4%	17.3%	16.9%	16.0%	16.9%
Borrowings	25.7%	17.3%	19.9%	15.0%	16.9%
NII	40.2%	20.8%	4.1%	11.2%	12.9%
PPP	42.1%	16.7%	3.8%	12.0%	13.9%
PAT	49.4%	22.0%	3.7%	12.9%	13.8%
Valuation Ratios					
EPS	17.6	21.5	22.3	25.2	28.6
P/E	21.9	18.0	17.4	15.4	13.5
Adj. BVPS	80.9	109.3	127.9	149.3	175.7
P/ABV	4.8	3.5	2.9	2.5	2.1
Dividend per share	2.0	2.0	2.0	2.2	2.5
Dividend Yield (%)	0.5	0.5	0.5	0.6	0.6
Operating Efficiency					
Cost-Income	17.2	16.2	16.3	16.2	15.6
Leverage	12.4	10.5	10.3	10.2	10.2

Daily Closing Price Chart



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