Can Fin Homes Limited (CFHL)

Issuer Credit Research

Ratings/Outlooks

Long-Term Issuer Rating	IND AA+/Stable
Non-Convertible Debentures (NCDs; INR38 billion)	IND AA+/Stable
Subordinated Debt (INR3 billion)	IND AA+/Stable
Commercial Paper (CPs; INR45 billion)	IND A1+

Financial Data

Can Fin Homes Ltd

	FY21	FY20
Total assets (INR billion)	220	210
Total equity (INR billion)	26.1	21.5
Net income (INR billion)	4.5	3.7
Return on assets (%)	2.1	1.9
Return on equity (%)	19.2	19.2
Tier I capital ratio (%)	23.8	20.5

India Ratings and Research (Ind-Ra) upgraded Can Fin Homes Limited's (CFHL) Long-term Issuer and debt ratings while affirming the short-term debt ratings in December 2021.

The rating upgrade reflects the resilient performance exhibited by CFHL despite the pandemic-led disruptions in the operating environment. Furthermore, the company managed to grow its franchisee in spite of the challenging scenario and simultaneously maintained a strong control over its asset quality. Ind-Ra has also factored in CHFL's operational track record of more than three decades and its ability to grow the franchisee in an improved operating environment. CFHL has displayed its strength in raising funds at competitive rates of interest, which helped in appropriate pricing of loans to stay competitive among banks and other housing finance companies (HFCs). Ind-Ra has also considered the moderation in CFHL's leverage due to lower growth in its loan book and its healthy internal accruals, which could support further portfolio growth. CFHL's operating profit buffers have remained healthy across cycles. The return ratios have remained stable throughout due to steady net interest margin and optimum operational efficiency.

Key Rating Drivers

Long Track Record of Operations; Well Positioned to Expand Franchisee: CFHL, which started operations in 1987, is a sizeable player in the housing finance industry, with assets under management of INR236 billion as on 30 September 2021. The entity has displayed the ability to manage the asset quality and grow the business through various business cycles. It is a fairly well-established player in the southern states of the country and an important player in the low-ticket granular housing finance segment. It has a stable business model, with a consistent track record of profitability due to strong control on credit cost and achievement of optimum operational efficiency. CFHL is well positioned to take advantage of the improving operating environment to expand its franchisee through increasing penetration in the existing geographies and diversifying into newer geographies.

Resilient Performance with Franchisee Growth despite Headwinds: CFHL was able to grow its book by 7% yoy in FY21, in line with the industry's performance. Moreover, as on 30 September 2021, the loan book growth stood at 13% yoy, much higher than the industry levels.

The headline NPA numbers have remained below 1% for the past few years. The access to funding avenues remains intact and CFHL could raise at cost-effective rates from banks, capital markets and National Housing Bank (NHB; 'IND AAA'/Stable; 23% of funding). The competitive cost of funding helped in the appropriate pricing of its loans, which helped the company remain competitive in face of pressure from banks. CFHL's operating profit buffers have been strong enough to absorb any possible increase in credit cost. Moreover, the profitability ratios have remained stable through the cycle for CFHL. The operating profit buffers have been healthy and stood at 10x in FY21 (FY20: 9.6x).

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Strong Control over Asset Quality: The pandemic had led to widespread disruptions in the economy due to the national and regional lockdowns, leading to volatility in the cash flows of borrowers. However, HFCs have shown remarkable resilience in managing asset quality. In line with the industry, CFHL has displayed strong control over asset quality, with stage 3 assets at 0.8% at 2QFYE22 (FYE21: 0.9%, FYE20: 0.76%). The credit cost has always remained rangebound due to the higher proportion of the home loan book (90%) targeted towards salaried and professional borrowers (74%) in the overall portfolio. Furthermore, CFHL has negligible exposure to construction finance, which has been facing headwinds

Around 3% of the book has been restructured, which is again in line with the housing finance industry. Even after assuming a material slippage from the restructured book, the incremental credit cost would not disproportionately impact the profitability. CFHL increased the provision coverage on stage 3 assets to 40% at end-2QFY22 (33% at FY21, 36% at end-2QFY21). The recent Reserve Bank of India (RBI) circular on NPA recognition, which stipulates daily stamping of the loan accounts for NPA mapping and the requirement of clearance of all the past overdues for the NPA account to become standard, can increase the headline NPA numbers. However, the impact on provisioning is not likely to be disproportionately high.

Liquidity Indicator - Adequate: CFHL's structural liquidity statement (adjusted by removing pending disbursements of loans and also draw down of unutilised funding lines) for September 2021 shows negative cumulative mismatches in the one-year bucket. The peak negative cumulative gap stood at INR49 billion in the six-months-to-one-year bucket. The gaps are attributed to the longer tenure (15-20 years) of assets (67% of loan book flows in beyond the five-year bucket) than that of liabilities (eight-10 years; just 12% of debt liabilities mature beyond the five-year bucket) and CP (22% of borrowings) maturities within the one-year period. CFHL prepares its asset liability management statement on a contractual basis, unlike other HFCs, which factor in prepayments.

Operationally, CFHL always maintains a backup for CP borrowings in the form of unutilised bank lines. As on 30 September 2021, CFHL has unutilised bank facilities of INR50 billion, which can cushion the gaps in the liquidity profile.

On an operational level, CFHL monitors liquidity on a daily basis and ensures that cash and bank balance, liquid investments, unutilised bank lines minus CP outstanding and advances inflows are sufficient to take care of debt and disbursement commitments for six months. The unutilised bank lines are those that have been sanctioned and documentation for the same has been completed but the funds have not been availed. Furthermore, CFHL can raise funds through the securitisation/assignment route, although it has not tapped this avenue in the past. It also has a deposit mobilising license, but it has not relied on this source. CFHL has the ability to raise funds from the market at competitive rates.

Stable Profitability: CFHL has been consistently recording a net interest margin of over 3%. In FY21, CFHL reduced lending rates to stay competitive in face of competition from banks and an increased rate of foreclosures. However, the lower cost of funding helped it maintain the margins during the same period. It was able to raise funds from banks at 5.5% and the higher amount of CP funding also helped in reducing funding cost. NHB lines (23% of borrowing) come at a competitive pricing, although there are caps on lending rates. It did, however, raise lending rates twice in 1HFY22. CFHL has always maintained a strong control on credit cost and its operating cost has been modest (operating cost to average assets: 0.56% in 1HFY22, 0.58% in FY21, 0.54% in FY20). Increased competition could put some pressure on the margins. The continued ability to raise funding at competitive pricing and manage asset quality will be essential for CFHL to maintain its profitability.

Applicable Criteria

Financial Institutions Rating Criteria, 2 April 2019

Non-Bank Finance Companies Criteria, 2 April 2019

Rating Bank Subordinated and Hybrid Securities, 2 April 2019

Adequate Capital Buffers: CFHL's leverage (1HFY22: 7.3x, FY20: 7.4x, FY20: 8.7x) has declined over the last one year due to the tempered growth in the loan book. As the growth has been reviving, the leverage might inch up in FY23. However, due to reduced risk weights for small ticket home loans, tier 1 capitalisation (2QFY22: 23.5%) is significantly above the regulatory requirement. The internal accruals are sufficient to take care of the growth requirements of 17%-18%, and hence, CFHL might not need any external capital infusion to grow at this rate. However, CFHL plans to raise equity capital to grow the loan book by 18%-20%. The capital buffers are reasonable even under Ind-Ra's stress case scenario.

Moderately Diversified Resource Profile: CFHL has a larger proportion of borrowings from banks (46% of the borrowings at end-September 2021) than other sources with concentration among two banks. Additionally, the company has a sizeable proportion of funding from NHB. Funding through CP increased in proportion (1HFY22: 22%, FY21: 19%), as it was mobilised to redeem some NCDs, and CP funding was available at competitive rates. Sourcing through the debenture route is limited to 7% of the total funding. CFHL has a deposit-taking license; however, it has not tapped this source of funding to a large extent (only 2%). CFHL's access to funding remains adequate with large unutilised lines of INR50 billion at end-September 2021. CFHL mobilised INR41 billion through NHB, banks and NCDs in FY21.

Rating Sensitivities

Positive: A substantial proportion of granular stable funding in the borrowing mix with diversification in the funding avenues, sizeable expansion in the franchisee, gaining market leadership, expanding presence across multiple geographies while maintaining credit costs will be positive for the ratings.

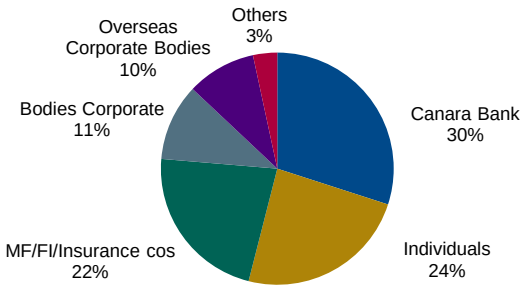
Negative: Future developments that could, individually or collectively, lead to a negative rating action include:

- significant deterioration in asset quality resulting in the operating buffers falling below 2.5x on a sustained basis
- sustained high leverage
- deterioration in the asset liability maturity profile creating sizeable asset-liability tenor mismatch
- fall in competitiveness on account of challenges in raising cost-effective funding or otherwise

Profile

Figure 1

Shareholding – December 2021



Source: Ind-Ra

CFHL is an HFC started in 1987 by Canara Bank ('IND AAA'/Stable) in association with Housing Development and Finance Corporation and Unit Trust of India. 68% of the home loan portfolio is less than INR25,00,000 in ticket size. 76% of home loan book is towards salaried individuals and 22% is towards self-employed non-professionals. 90% of the portfolio comprises housing loans and the rest comprises non-home loan and loan against property (LAP). It has negligible exposure to construction finance and only 2% of the home loans are above INR5 million ticket size. At end-December 2021, CFHL had a loan book of INR251 billion and a network of 187 branches and affordable housing centres and 13 satellite offices.

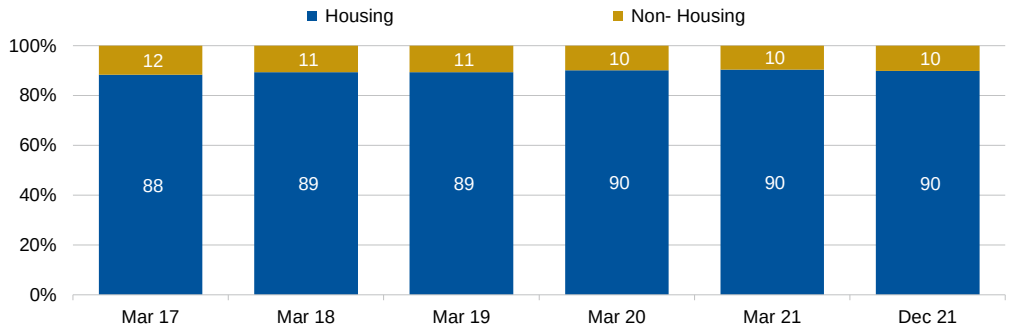
Management Strategy

CFHL's strategy is to target customers in the Tier II to Tier IV cities where the loan ticket size is small. The target customer has documented income and there is less underwriting based on surrogate income. There is no construction risk since it finances units which are 80%-85% complete; further there is no concentration of funding in a single project. The sourcing is 50% through in-house sales team and 50% through intermediaries. Given the challenging operating environment, CFHL was focused on collections than growing the loan book. However, since 2QFY22 as the situation has improved, CFHL is focusing on growing the book. It had reduced lending rates to thwart competition from banks in FY21; however, it raised lending rates thrice in FY22. It has plans to marginally grow the ticket size, but remain in the affordable category. The strategy is to maintain a higher proportion of salaried and professional customers in the home loan category. Growth would be calibrated by opening 12-15 new branches every year in areas which are contiguous to the regions where they already have a presence. It plans to grow at 18%-20% yoy in FY23, while maintaining asset quality. In the long run, it plans to diversify in other states; however, South would remain 62%-63% of the overall portfolio. The funding mix would remain more or less intact, with a reasonable proportion of NHB funding.

Loan Portfolio

Figure 2

Share of Loan Book



Source: Company, Ind-Ra

CFHL's loan book primarily comprises housing loans (90%) to salaried and self-employed customers. As per the management, 50% of the salaried customers are government employees. The end-use of a CFHL's housing loan is for purchase of ready flats, or to construct on the plot already owned by the borrower, or for purchase of a plot and construction. 75% of the housing loan book is non-builder linked and 25% is builder linked, and loans are for properties that are nearing completion. CFHL also gives top-up loans to existing customers against the same property when there is some room for loan to value on the repayment of existing loan, provided the track record is satisfactory. These top-up loans are booked as non-housing loans in their books but since these are to existing customers; they reflect the credit behaviour of the housing loan book. 68% of the housing loan book, 60% of non-loan book and 87% of the LAP book is

less than INR2500,000 in ticket size. 89% of the LAP book was originated at less than 50% LTV. 66% of the housing loan book is in the southern states.

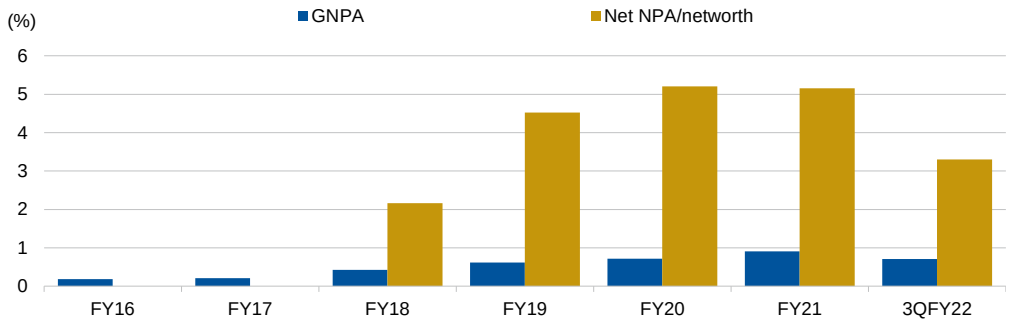
Asset Quality

CFHL offers mortgage loans with average ticket size of INR2 million to middle income customer who may be salaried or self-employed. The exposure to self-employed class of customers has increased over time and the gross NPA has increased marginally due to some stress seen in this segment. The underwriting is based on the documented salary income and in the case of self-employed customers, income tax returns form the basis of underwriting. SARFAESI action helps in the recovery of NPAs and as per the management, the ultimate credit loss is negligible in this category of loans. The loans are sanctioned based on the agreement value of the transaction instead of the market value, as assessed by valuers which result into a conservative LTV ratio. There is negligible exposure to builder loans and loans with higher ticket size (more than INR5000,000) are small in number in the entire loan book.

CFHL has maintained good control on its asset quality, with GNPA remaining below 1% even during the worst times of the pandemic. This is because of the granular exposure on salaried class of customers underwritten with documented income. Also, CHFL has expertise in the southern states and has the experience of managing asset quality for over three decades in that region. The delinquency levels were also modest (gross stage 3: 0.71% at wnd-3QFY22) due to nil exposure to the construction finance segment. CFHL restructured 3% of the book on which it has made a provision of 10%. There could be 7%-8% slippage from this book. However, the headline numbers would remain in a comfortable range. The recent RBI circular on NPA recognition has not resulted in any tangible increase in the headline NPA numbers. Also, as against other asset classes such as LAP or vehicle finance, home loan customers show a disciplined credit behaviour which would help in keeping NPA under check.

Figure 3

Stable Asset Quality



Source: Ind-Ra

Profitability

CFHL's profitability (ROA: 9MFY22: 1.9%, FY21: 2.1%, FY19: 1.9%) is driven by its low cost of borrowings, lower operating and credit cost. CFHL has been consistently recording a net interest margin of over 3%. To stay competitive in the market, CFHL reduced interest rates in FY21; however, it has raised rates thrice in FY22 when the competitive pressure has reduced. Incremental lending yield for home loans is 8%. If the rates harden in FY23, CFHL has the ability to reset rates on the portfolio and protect its margins.

CFHL has a long track record in the mortgage lending space and the operations are mature with better rationalisation of cost (9MFY22: 0.58%, FY21: 0.58%, FY19: 0.54%). Due to the Canara Bank parentage, CFHL has obtained long-tenor funds from banks at competitive rates. It also has NHB line of funding which again is at a lower rate and has a longer tenure. Credit cost has

remained range bound due to a consistent policy of lending small ticket loans to its salaried and self-employed customer base. Due to prudent LTVs and small ticket loans, the ultimate credit cost is negligible. Return on equity is in the range of 17%-20% which can support growth to that extent.

Capitalisation and Funding

Due to tempered growth in the loan book (FY21: 6.7% yoy), CFHL's leverage has corrected and stood at 7.7x at end-December 2021 (FY19: 9.5x, FY20: 8.7x). As per the management, CFHL could grow the book without equity support till the leverage reaches 8x. However, CFHL has plans to raise equity capital to accelerate growth. From the risk cushion perspective, CFHL's capital buffers are adequate with net NPA to equity of 3.3%.

CFHL has higher reliance on bank loans for meeting its funding requirements. It has bank lines from multiple banks however, two banks account for a higher proportion of bank funding. NHB funding under various schemes at 23% of the total borrowings brings down the cost of funds and increases the weightage average tenor of borrowings. CP borrowings stood at 15% of the total borrowings; however, these are totally backed by unutilised bank lines. It has access to public deposits; however, CFHL has not tapped this source aggressively.

CFHL's structural liquidity statement (adjusted by removing pending disbursements of loans and also draw down of unutilised funding lines) for September 2021 shows negative cumulative mismatches till the one-year bucket. The peak negative cumulative gap stood at INR49 billion in the six-months-to-one-year bucket. The gaps are attributed to longer tenure (15-20 years) of assets (67% of loan book flows in beyond the five-year bucket) than that liabilities (eight to 10 years; just 12% of debt liabilities mature beyond the five-year bucket) and also CP (22% of borrowings) maturities till the one-year period. CFHL has unutilised bank facilities of INR50 billion, which can cushion the gaps in the liquidity profile. CFHL can also raise funds through securitisation/assignment route, although it has not tapped this avenue so far.

Balance Sheet Analysis

	31 Mar 2019		31 Mar 2020		31 Mar 2021		31 Dec 2021	
	Year-End (INR million)	As % of assets	Year-End (INR million)	As % of assets	Year-End (INR million)	As % of assets	Year-End (INR million)	As % of assets
A. Loans and advances	**1,83,837**	**98.0**	**2,05,257**	**97.5**	**2,18,915**	**99.2**	**2,50,910**	**96.9**
B. Other interest-bearing assets	**161**	**0.1**	**243**	**0.1**	**496**	**0.2**	**3,792**	
Other interest-bearing loans								
Investments	161	0.1	243	0.1	496	0.2	3,792	
Operating leases								
C. Loan loss reserves	**992**	**0.5**	**0**	**0.0**		**0.0**		
D. Total earning assets	**1,83,006**	**97.6**	**2,05,500**	**97.7**	**2,19,411**	**99.4**	**2,54,702**	**98.4**
E. Fixed assets	**99**	**0.1**	**379**	**0.2**	**378**	**0.2**		
F. Non-Earning assets	**4,454**	**2.4**	**4,557**	**2.2**	**948**	**0.4**	**0**	
Cash	4,203	2.2	3,924	1.9	215	0.1		
Others	251	0.1	633	0.3	733	0.3		
G. Total assets	**1,87,558**	**100.0**	**2,10,436**	**100.0**	**2,20,737**	**100.0**	**2,58,828**	**100.0**
H. Total borrowings	**1,66,945**	**89.0**	**1,87,484**	**89.1**	**1,92,929**	**87.4**	**2,27,768**	**88.0**
I. Other non-interest bearing liabilities	**2,766**	**1.5**	**788**	**0.4**	**687**	**0.3**		
J. Provisions	**266**	**0.1**	**662**	**0.3**	**1,023**	**0.5**		
K. Tangible net worth	**17,582**	**9.4**	**21,501**	**10.2**	**26,098**	**11.8**	**29,580**	**11.4**
L. Total liabilities and equity	**1,87,559**	**100.0**	**2,10,436**	**100.0**	**2,20,737**	**100.0**	**2,58,828**	**100.0**

Source: Ind-Ra

Income Statement Analysis

	31 Mar 2019		31 Mar 2020		31 Mar 2021		31 Dec 2021	
	Year-End (INR million)	As % of average earning assets	Year-End (INR million)	As % of average earning assets	Year-End (INR million)	As % of average earning assets	Year-End (INR million)	As % of average earning assets
Interest earned	16,996	10.01	20,189	10.39	20,064	9.44	14,138	7.95
Interest expended	11,691	6.89	13,442	6.92	12,083	5.69	8,350	4.70
Net interest income	5,305	3.12	6,747	3.47	7,981	3.76	5,788	3.26
Other operating income	317	0.19	116	0.06	121	0.06	134	0.08
Personnel expenses	414	0.24	542	0.28	700	0.33	585	0.33
Operating expenses	502	0.30	534	0.28	540	0.25	463	0.26
Pre-provision operating profit	4,705	2.77	5,787	2.98	6,861	3.23	4,874	2.74
Provisions for losses (incl standard assets)	11	0.01	603	0.31	685	0.32	167	0.09
Operating income after provisions	4,694	2.76	5,183	2.67	6,176	2.91	4,707	2.65
Other non-operating income	1	0.00						
Pre-tax profit	**4,695**	**2.77**	**5,183**	**2.67**	**6,176**	**2.91**	**4,707**	**2.65**
Taxes	1,728	1.02	1,422	0.73	1,615	0.76	1,225	0.69
Net profit	**2,967**	**1.75**	**3,762**	**1.94**	**4,561**	**2.15**	**3,482**	**1.96**
Ratio analysis (%)								
A. Profitability								
Net income/equity (avg.)	18.42		19.25		19.16		16.68	
Net income/total assets (avg.)	1.72		1.89		2.12		1.94	
Non-interest expenses/(net interest income + other operating income)	16.30		15.68		15.31		17.70	
Net interest income/ total assets (avg.)	3.08		3.39		3.70		3.22	
Pre-provision operating profit/total assets (avg.)	2.73		2.91		3.18		2.71	
Operating profit after provision/total assets (avg.)	2.72		2.60		2.86		2.62	
Interest expense/ total borrowings (avg.)	7.64		7.59		6.35		5.29	
Yield on loans (%)	9.95		10.38		9.46		8.02	
Opex to assets (%)	0.53		0.54		0.58		0.58	
B. Capitalization								
Equity/total assets	9.37		1021.7%		11.82		11.43	
Equity/loans	9.56		10.48		11.92		11.79	
Tier-I capital ratio	14.64		20.47		23.83			
Total capital ratio	16.44		22.28		25.63		24.20	
Debt/equity (times)	9.50		8.72		7.39		7.70	
C. Asset quality								
Provision for loan losses/loans (avg.)	0.01		0.31		0.32		0.09	
PPOP/CC	431.68		9.59		10.01		29.19	
Gross NPLs/gross loans	0.62		0.76		0.91		0.71	
Specific loan loss reserves/gross NPLs	30.00		0.29		0.34		0.45	
Net NPLs/equity	4.52		520%		5.15		3.28	

Source: Ind-Ra

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