CanFin Homes (CANHOM)

ICICI direct Research

CMP: ₹ 748 | Target: ₹ 935 (25%) | Target Period: 12 months | **BUY**

August 25, 2023

Structural transformation to aid long term performance

About the stock: CanFin Homes (CFHL) was promoted by Canara Bank in 1987, with ~30% stake as of June 2023. The HFC is spread across 205 locations across 21 states and UTs with south contributing ~72% of loans and focus on tier II & III cities. Most borrowers are first time home buyers with average age of 35 years.

- Housing loans comprise ~90% of advances of which ~74% is to salaried customers
- The company caters to customers in the mid & affordable segment with average ticket size being ₹ 22-24 lakh for housing and ₹ 8 lakh for non-housing loans

Investment Rationale

- **Geographic expansion & increase in ticket size to aid business growth:** CFHL has delivered consistent performance on growth and earnings along with prudent asset quality. Expect loan growth to continue at healthy pace of 17-18% CAGR in FY24-25E, driven by branch expansion (15 branches in FY24E), increase in ticket size (currently at ₹22 lakhs) & diversification in channel including "Approved project file".
- **Revamping of processes & IT transformation to enable faster turnaround:** Strategy to revamp process & implement technology, while preserving existing advantages, to result in faster turnaround with improvement in efficiency. Expect transformation to result in elevated cost to income ratio at ~17.5-18% in FY24-25E, post which efficiency is expected to kick in as business momentum starts gaining pace.
- **Repricing of liabilities largely done; NIM to remain stable:** CFHL has remained of lower cost of funds attributable to factors including parentage, diversified source of funding, strong credit rating and sustained repayment track record. Cost of funds expected to remain steady led while repricing of assets to gradually to pan out till Dec'23, expect margins at ~3.3-3.4% and spreads at 2.4-2.5% in FY24-25E.
- **Strengthening of risk management keeping core advantage intact to aid asset quality:** CFHL has managed to keep GNPA at <1% during various cycles and Covid-19 was no exception. Restructured book was at ₹ 690 crore (~2.2% of total loans) with ₹67 crore of provision and overlay provision of ₹ 17 crore. Expect GNPA ratio at 0.6-0.7% in FY24-25E with credit cost being largely steady.

Rating and Target price

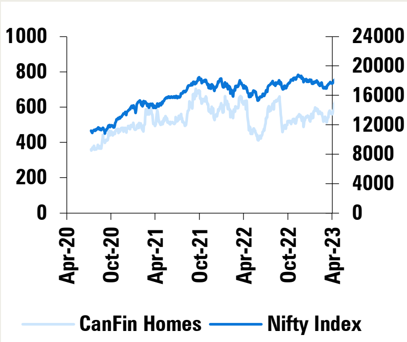
- CFHL has been best in class HFC player with a robust business model & underwriting practices, which resulted in healthy earnings growth with GNPA <1% across cycles. Strategy adopted by new management to strengthen processes & IT infrastructure to further aid business growth and RoA.
- At the CMP, CFHL trades at ~1.9x FY25E ABV, which seems a good opportunity given its fundamental strength and historical valuation. Hence, we assign a BUY rating with a target price of ₹ 935/share.

CanFinHomes Ltd (Sponsor: CANARA BANK) HOME LOANS ♦ DEPOSITS Translating Dreams into Reality

Particulars

Particulars	Amount
Market Capitalisation	₹ 9960 crore
52 week H/L	905 / 451
Net worth	₹ 3647 Crore
Face Value	₹ 2
DII Holding (%)	28.0
FII Holding (%)	10.7

Share price performance



Shareholding Pattern

Holding (%)	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23
Promoter	30.0%	30.0%	30.0%	30.0%	30.0%
FII	0.0%	9.3%	10.0%	10.4%	10.7%
DII	24.8%	23.3%	23.5%	25.0%	28.0%
Others	45.2%	37.4%	36.5%	34.7%	31.3%

Key risks

- Increasing competitive intensity could impact growth
- Occurrence of irregularities remains a risk

Research Analyst

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Key Financial Summary

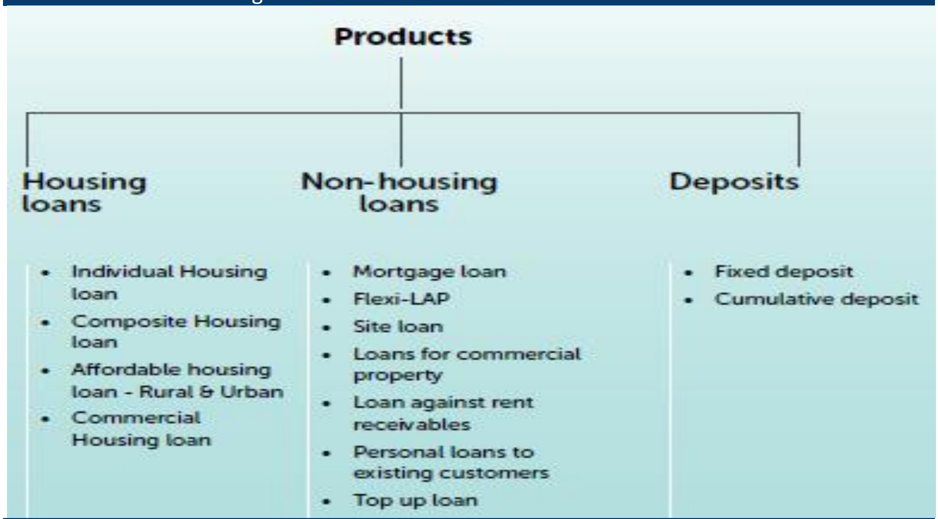
₹ crore	FY20	FY21	FY22	FY23	3 year CAGR (FY20-FY23)	FY24E	FY25E	2 year CAGR (FY23-25E)
NII	675	798	816	1015	14.6%	1210	1412	18.0%
PPP	579	686	682	866	14.4%	1043	1211	18.3%
PAT	376	456	471	621	18.2%	723	846	16.7%
ABV (₹)	153	186	224	268	20.5%	316	374	18.2%
P/E	26.1	21.5	20.8	15.8		13.6	11.6	
P/ABV	4.8	4.0	3.3	2.8		2.3	2.0	
RoA	1.9%	2.1%	1.9%	2.0%		2.0%	2.0%	
RoE	19.1%	19.2%	16.6%	18.5%		18.1%	17.9%	

Source: Source: Company, ICICI Direct Research

Company Background

Commencing operations in 1987, Can Fin Homes (CFHL) was promoted by Canara Bank. As of June 2023, Canara Bank held ~30% stake in CFHL. The HFC is spread across 205 locations across 21 states and union territories with south contributing ~72% of loans while balance is from non-south regions. CFHL offers housing loans for individuals, non-housing loans including mortgage loans, site loans, loans for commercial properties, loan against rent receivables, top up loans and personal loans. It has mainly focused on housing loans to individuals with ~90% of loan book comprising home loans and ~10% non-housing loans. The company caters to customers in the mid and affordable segment with average ticket size of loan at ₹ 22-24 lakh for housing loans and ₹ 8 lakh for non-housing loans. Most borrowers are first time home buyers with an average age of 35 years.

Exhibit 1: Product offerings



Source: Company, ICICI Direct Research

As of June 2023, the loan book was at ₹ 32,505 crore, in which ~73% are loans to salaried & professionals, ~27% are loans to self-employed & non-professionals. CFHL has been focusing on housing loans, that constitute 89% of overall loans, on a steady-state basis. Mortgage loans contributes ~5.4% followed by ~4.3% top up personal loans. Rest all segments contributes <1% of the total loan book.

Exhibit 2: Housing comprises ~90% of total loan book

Product wise - Breakup	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23
Housing Loans	89.9%	89.3%	90.1%	90.4%	89.5%	89.5%
Top up Personal Loans	3.2%	3.4%	3.6%	3.6%	4.0%	4.3%
Mortgage Loans / Flexicap	5.1%	4.8%	4.6%	4.6%	5.1%	5.4%
Loans for sites	1.1%	1.8%	1.1%	1.0%	0.9%	0.8%
Others	0.5%	0.5%	0.5%	0.4%	0.4%	0.3%
Builder Loans	0.0%	0.1%	0.0%	0.0%	0.0%	0.0%
Staff Loans	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%
Customer segment wise - Breakup	**Mar-18**	**Mar-19**	**Mar-20**	**Mar-21**	**Mar-22**	**Mar-23**
Salaried & Professional	73.2%	71.1%	70.9%	72.9%	74.2%	73.0%
Self employed & Non professional	26.7%	28.8%	29.0%	27.0%	25.7%	27.0%
Builder Loans	0.0%	0.1%	0.0%	0.0%	0.0%	0.0%
Staff Loans	0.1%	0.1%	0.1%	0.1%	0.1%	0.0%

Source: Company, ICICI Direct Research

CFHL has delivered a consistent performance over the past few years with NII growth at 15% CAGR in FY18-23 while PAT grew at 17% CAGR during the same period. RoA and RoE for FY23 were at ~2% and 18.5%, respectively. CFHL has best in class asset quality as it has managed to keep GNPA at <1% even during tough cycles. The company has a comfortable capital position with CRAR at 23.1%.

Investment Rationale

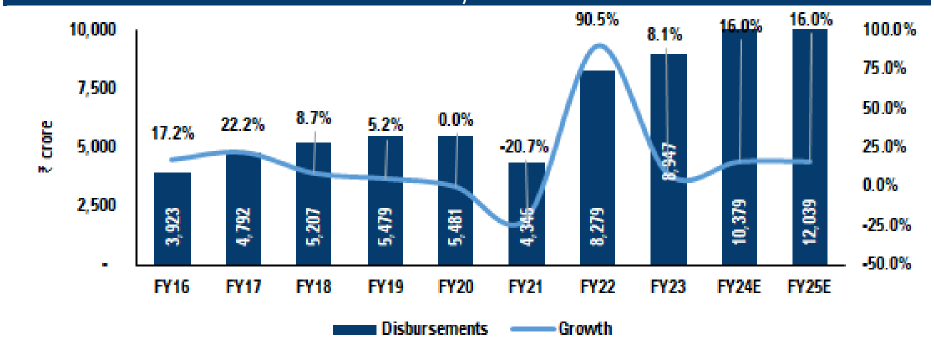
Geographic expansion & increase in ticket size to aid business growth

CFHL has delivered healthy growth on a consistent basis in the past with focus on a selective customer approach, which has led to growth in AUM and earnings along with steady asset quality. While region specific issues and Covid had impacted disbursement in the past (FY18-21), strong revival was seen with normalization in economy. Going ahead, rising housing demand, under-penetration and improved affordability led by government initiatives will continue to drive the pace of disbursements which is expected at 14-15% CAGR ahead.

CFHL continues to focus on tier II and tier III cities where competition from banks is less and it can benefit from pricing power with an increased focus on branch expansion (15 branches in FY24E) and increase in ticket size (currently at ₹22 lakhs). Plan to introduce new sourcing channel including "Approved project file" wherein individual financing would be undertaken with pre-approved property is seen to reduce dependence on DSA channel as well as enable improvement in ticket size. Expansion in new geographies (contribution from southern region targeted at ~60% from currently ~65%) to enable diversification of AUM. With the government's focus on affordable housing, largely in non-metro cities, CFHL is poised well to benefit in terms of an improved growth trajectory. Hence, we expect the loan book to grow at a healthy CAGR of ~17-18% in FY23-25E. The management has guided for ~20% loan growth in medium term.

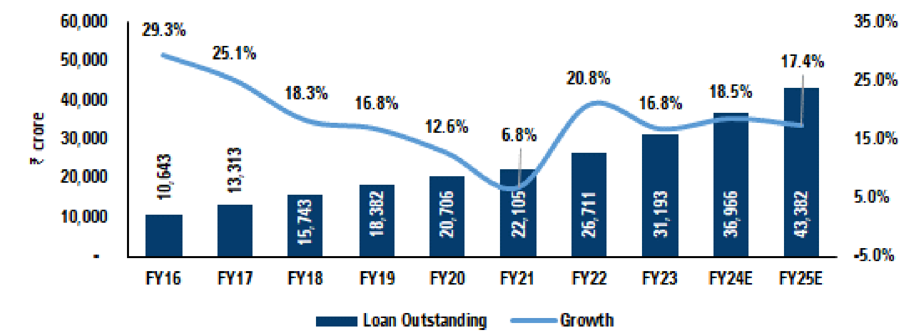
Loan growth to regain momentum leading to AUM CAGR of ~17-18% over FY22-25E

Exhibit 3: Disbursement seen to remain healthy in FY24-25E



Source: Company, ICICI Direct Research

Exhibit 4: …leading to ~17-18% CAGR growth in AUM



Source: Company, ICICI Direct Research

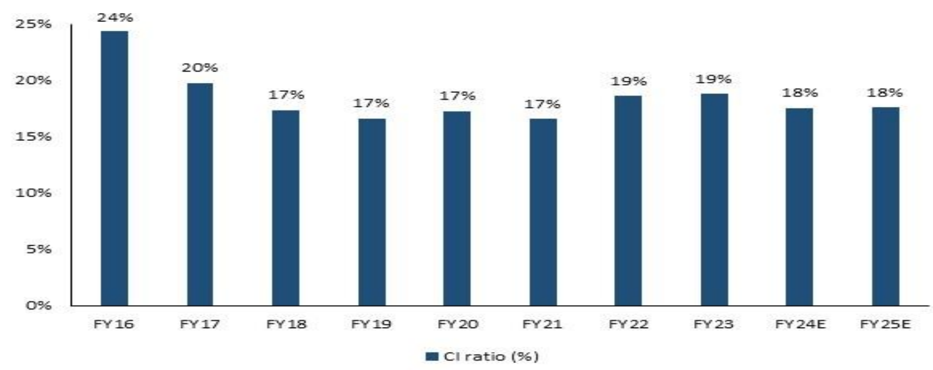
Revamping of processes & IT transformation to enable faster turnaround

CHFL has been focussing on housing loans business catering to urban and semi urban regions with ~205 location spread across states in India. Going ahead, management's strategy is to focus on revamping process and implementing technology, while preserving existing advantages, for faster turnaround with improvement in efficiency. Thus, IT transformation across process has been initiated (floated RFP with evaluation of bids underway), the same is expected to be undertaken in next 12-18 months with completion by March 2025.

With higher focus on risk management, disbursal and reconciliation is being centralised while local sanctioning (with limit of ₹ 35 lakhs) is to be preserved. Thus, faster sanctioning is expected to aid traction in customer demand, centralised disbursal is seen to enable efficiency and a check on asset quality. Further, training and fraud control unit are being set up. Responsibilities of heads are been reviewed to ensure adherence to the business model. Strengthening of processes has been initiated and is expected to complete in next 2-3 quarters.

We expect transformation in technology and process should not have any substantial impact on business growth, however, cost to income ratio is expected to remain elevated at ~17.5-18% in FY24-25E (approved ₹250 crore for IT infra spend including ₹ 60 crore for capex), post which efficiency is expected to kick in as business momentum starts gaining pace.

Exhibit 5: Tech spends to keep CI ratio elevated in FY24-25E



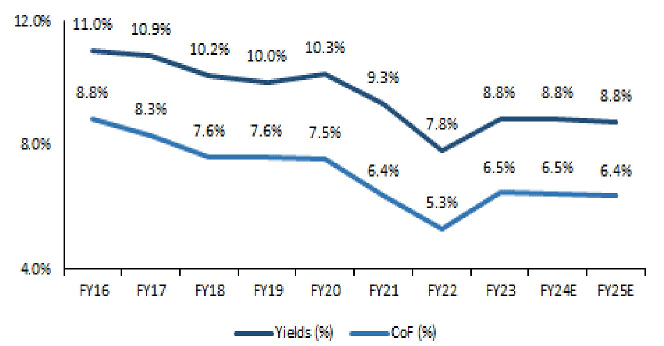
Source: Company, ICICI Direct Research

Repricing of liabilities largely done; NIM to remain stable

CFHL has remained of lower cost of funds attributable to factors including parentage, diversified source of funding, strong credit rating and sustained repayment track record.

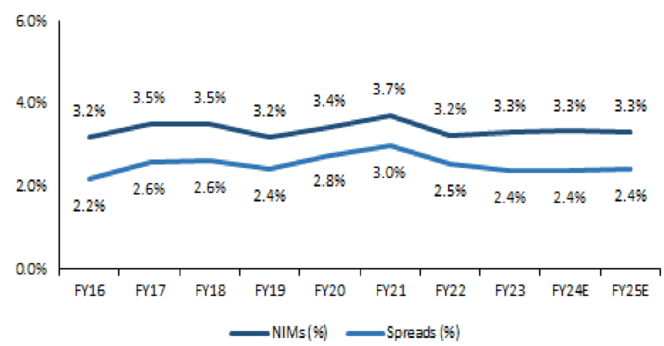
Going ahead, cost of funds is expected to remain steady led by 1) steady rates of CP and NCD, 2) maturity of NCDs raised at higher rates, 3) negotiation with banks to lower spreads and 4) substantial proportion of MCLR based borrowing being repriced (~40% linked to MCLR). With cost of funds to remain steady and repricing of assets to gradually to pan out till Dec'23, expect margins at ~3.3-3.4% and spreads at 2.4-2.5% in FY24-25E. Further, gradual increase in proportion of non-individual book (including builder finance) to further aid yield and thus margins trajectory.

Exhibit 6: Substantial repricing to keep CoF steady....



Source: Company, ICICI Direct Research

Exhibit 7: ....which is expected to keep spreads stable



Source: Company, ICICI Direct Research

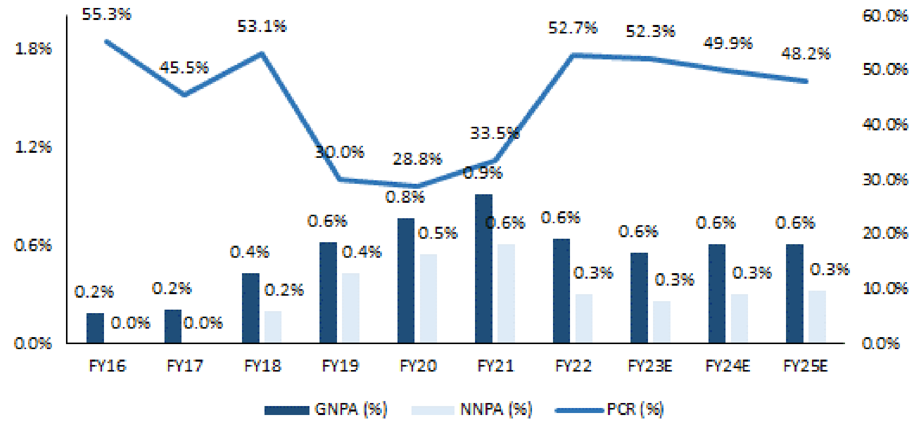
Strengthening of risk management keeping core advantage intact to aid asset quality

CFHL has managed to keep GNPA at <1% during various cycles and Covid-19 was no exception. This shows the company's prudent underwriting standards further supported by a healthy business mix (majority being salaried customers). Despite substantial exposure to small ticket loans in tier II and III cities, CFHL has consistently delivered a steady performance on asset quality as well as credit cost.

CHFL envisages to continue its focus on retail (salaried) segment, though will look for opportunities in developer segment with aggregate exposure restricted at 1%.

The restructured book was at ₹ 690 crore (~2.2% of total loans) as of June 2023. Of the same, ~₹ 250 crore is out of moratorium with majority of the loans to come out of moratorium by Nov'23. Slippages from restructured pool stands at ₹ 19.5 crore. CFHL carries ₹67 crore of provision in lieu of restructured pool, overlay provision of ₹ 17 crore provides comfort, management's expectation of maximum slippages from restructured pool at ~10% provides comfort. Expect GNPA ratio at 0.6-0.7% in FY24-25E with credit cost being largely steady.

Exhibit 8: GNPA to remain <1%; R/s book adequately covered



Source: Company, ICICI Direct Research

Valuation and outlook

CFHL has been a best in class HFC player with a robust business model and underwriting practices, which resulted in healthy earnings growth with moderate stress. Focus on the salaried segment and lower ticket size are expected to aid in maintaining GNPA <1% levels (vs. peers). Across cycles, CFHL has maintained its healthy growth trajectory and consistently delivered above industry average performance.

We expect NII to grow at a CAGR of 18% in FY23-25E to ₹ 1412 crore, while PAT is expected to grow at 17% CAGR over the same period to ₹ 846 crore. Appointment of new management puts an end to the ambiguity on leadership vacuum. While recent frauds has enumerated some concerns of further irregularities cropping up, management remains confident that such instances might not occur with focus on improvement in risk mitigation processes and IT stacks.

At the CMP, CFHL trades at ~1.9x FY25E ABV, which seems a good opportunity given its fundamental strength and historical valuation. Hence, we assign a **BUY** rating with a target price of ₹ 930/share.

Exhibit 9: Peer comparison

(Year-end March)	RoE				RoA				P/BV			
	FY22	FY23E	FY24E	FY25E	FY22	FY23E	FY24E	FY25E	FY22	FY23E	FY24E	FY25E
CanFin Homes	16.6%	18.5%	18.1%	17.9%	1.9%	2.0%	2.0%	2.0%	3.2	2.7	2.3	1.9
LICHF	10.1%	11.9%	12.9%	13.4%	0.9%	1.1%	1.2%	1.3%	1.0	0.9	0.8	0.7
PNBHF	8.8%	8.5%	9.0%	9.5%	1.2%	1.4%	1.5%	1.7%	1.1	1.0	1.0	0.9
Repco	8.9%	11.3%	11.9%	12.0%	1.6%	2.1%	2.3%	2.4%	1.1	1.0	0.9	0.8
HFFC	12.6%	13.1%	14.4%	15.5%	3.9%	3.8%	3.8%	3.6%	4.7	4.2	3.6	3.1

Source: Company, Bloomberg, ICICI Direct Research

Key risks and concerns

Occurrence of irregularities remains a risk

Recently CFHL has reported fraud by employee at a branch to the tune of ~₹38 crore. As the management is focussed on gradually bringing in changes in processes for enhancing monitoring standards and revamping procedures, concerns on cropping of irregularities and its impact on earnings cannot be ruled out, though management remains confident of such event not happening ahead.

Restructured loans were at ₹ 690 crore as of June 2023. The management has guided that ~10% of restructured pool may slip into NPA. Hence, we remain watchful on the trend in restructured book in upcoming quarters.

Increasing competitive intensity

For affordable housing finance companies, concentration in tier I and tier II cities means huge competition from banks and large HFCs. Hence, affordable housing finance companies (AHFCs) need to penetrate deeper in tier II and beyond cities to benefit from pricing power.

CFHL is mainly focused on the salaried segment, which is largely catered to by banks. Also, the company is focusing on tier II and tier III cities where most AHFCs are also present in similar geographies. The increasing competition between AHFCs may impact the business momentum of CFHL in future.

Trend in restructured book to be watched

Restructured loans were at ₹ 690 crore as of June 2023. The management has guided that ~10% of restructured pool may slip into NPA. Hence, we remain watchful on the trend in restructured book in upcoming quarters.

Change in parentage

At present, Canara Bank (promoter) holds ~30% stake in CFHL. In the past, Canara Bank had indicated its intention to exit partially, which was called off later. Currently, CFHL is able to source funds at competitive interest rates led by strong parentage – brand name and management support. Any change in parentage (the government has asked PSU banks to review investments in non-core business) could have an impact on borrowing cost, leverage and pose supply pressure on the stock price.

Financial Summary

Exhibit 10: Profit & Loss statement			(₹ crore)	
(Year-end March)	FY22	FY23	FY24E	FY25E
Interest Earned	1,970	2,715	3,209	3,728
Interest Expended	1,154	1,701	1,999	2,317
Net Interest Income	816	1,015	1,210	1,412
% growth	2.3	24.3	19.2	16.7
Non Interest Income	19	28	34	36
Net Income	835	1,042	1,244	1,448
Employee cost	77	84	91	108
Other operating Exp.	76	93	110	129
Operating Profit	682	866	1,043	1,211
Provisions	47	42	60	61
PBT	635	824	983	1,151
Taxes	164	203	261	305
Net Profit	471	621	723	846
% growth	3.3	31.9	16.3	17.0
EPS (₹)		46.6	54.3	63.5

Source: Company, ICICI Direct Research

Exhibit 11: Key ratios				
(Year-end March)	FY22	FY23	FY24E	FY25E
Valuation				
No. of Equity Shares	13.3	13.3	13.3	13.3
EPS (₹)	35.4	46.6	54.3	63.5
BV (₹)	230.3	273.9	324.9	384.6
ABV (₹)	224.2	267.7	316.5	374.2
P/E	21.1	16.0	13.8	11.8
P/BV	3.2	2.7	2.3	1.9
P/adj.BV	3.3	2.8	2.4	2.0
Yields & Margins (%)				
Yield on interest earning assets	7.8%	8.8%	8.8%	8.8%
Avg. cost on funds	5.3%	6.5%	6.5%	6.4%
Net Interest Margins	3.2%	3.3%	3.3%	3.3%
Spreads	2.5%	2.4%	2.4%	2.4%
Quality and Efficiency				
Cost / Total net income	18.6%	18.8%	17.6%	17.6%
GNPA%	0.6%	0.6%	0.6%	0.6%
NNPA%	0.3%	0.3%	0.3%	0.3%
ROE (%)	16.6%	18.5%	18.1%	17.9%
ROA (%)	1.9%	2.0%	2.0%	2.0%

Source: Company, ICICI Direct Research

Exhibit 12: Balance Sheet Statement			(₹ crore)	
(Year-end March)	FY22	FY23	FY24E	FY25E
Sources of Funds				
Capital	27	27	27	27
Reserves and Surplus	3,040	3,621	4,300	5,095
Networth	3,067	3,647	4,327	5,122
Borrowings	24,648	29,068	34,153	39,932
Other Liabilities & Provisior	230	355	444	520
Total	27,944	33,070	38,923	45,574
Applications of Funds				
Fixed Assets	35	45	48	50
Investments	1,126	1,459	1,674	1,856
Advances	26,378	31,193	36,966	43,382
Other Assets	406	373	235	286
Total	27,944	33,070	38,923	45,574

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%

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