Housing Finance

Are Banks set to conquer the home loan space? Not really!

This note attempts to put a question of larger sectoral significance in perspective: whether persistent sizable market share gains would enable banks to displace HFCs in the long run. The recent market share shift in favour of banks, riding high on the predicament of the liquidity-deprived and seemingly weaker HFCs, seems to have strengthened the conjecture that banks are set to dominate the home loan space.

However, an analysis of the three-year span preceding September 2018 has some pertinent revelations of a contrary nature: that banks were not eating into the HFC/NBFC market share. More importantly, even amid the current liquidity challenges, well-managed HFCs are not facing growth constraints; they are in fact closer to industry mark in terms of growth rate, and they are also simultaneously altering the funding mix. Having said that, HFCs reckoned as susceptible would likely take a few quarters to start growing in line with the market, which implies that few banks could gain further share in the interim.

In our view, a blanket aversion to HFCs could miss out on attractive long-term investment bets like Can Fin and Repco. The hypothesis, that banks would dominate the home loan industry in future, not only undermines the niche operational capabilities of many HFCs and NBFCs to serve the informal salaried and self-employed customers, it also exaggerates the capability of banks to offer loans to the said customers.

SBI, ICICI and Axis are the heavyweight banking players in the home loan space with respective books of nearly Rs3.5tn, Rs1.7tn and Rs0.9tn, growing at 15%, 18% and 12% respectively. Their market share gain has only been gradual, notwithstanding the abruptly enlarged opportunity given the fact that HFCs and NBFCs have been grappling with an adverse funding scenario for over a year now.

Yes, there will be a transient flight of market pie from DHFL, IHFL and a few others in favour of these banks; but on a steady-state basis, we don't see these banks creating a large displacement in the home loan market. They command 35-40% of the industry, so even their size doesn't support prospects of consistent outgrowth. With home loans available through balance transfers (BT) and securitization, their organic growth focus could also get diluted. In the medium term, their aggression in home loans will be governed by growth opportunities in other business segments.

Some of the other PSU Banks are also growing home loans at 20%+, but further acceleration can be precluded by availability of capital, typically laidback customer outreach/acquisition, distraction from easy opportunities in corporate and SME segments, and risk from non-continuation of current strategy. To emphasize on the last point, there is no certainty that the successor of an incumbent MD & CEO would be as keen to grow the home loan book at the same pace. The intent and execution of PSU Banks within a credit segment is determined by the MD & CEO keeping an eye on the prevalent growth opportunities in other segments. In general, many banks have not been sustainably aggressive in the home loan market and thus their current advantageous position should not be construed as the beginning of the end for HFCs and NBFCs.

March 06, 2019

Research Analyst: Rajiv Mehta rajiv.mehta@yessecuritiesltd.in | Sachit Damani sachit.damani@yessecuritiesltd.in
Head of Research: Amar Ambani amar.ambani@yessecuritiesltd.in

CAN FIN HOMES (CMP RS293, CURRENT P/BV 2.5X)

- ✓ Can Fin, who is predominantly serving salaried customers, has witnessed its portfolio run-off rate decline in the recent quarters. This is a net effect of some increase in loan poaching from banks and a substantial reduction in BT out to HFCs.
- ✓ Contrary to general perception, higher bout of liquidity is available to the company post September 2018 from banks, MFs and refinancing agencies, as lending institutions are chasing stronger HFCs for fund deployment. Thus, disbursement momentum remains healthy.
- ✓ With funding cost stabilizing and benefits from lending rate hikes yet to kick in fully (due to annual reset), the NIM is expected to recover some ground in ensuing quarters.
- ✓ Can Fin has a policy of borrowing through CPs against the cushion of CC/OD facilities, thus nullifying the risk associated with its repayment.
- ✓ It is the only listed HFC having ~100% retail portfolio; 90% being home loans and 10% smaller LAP. Consequently, there is negligible concentration risk with <Rs2.5mn loans comprising 77% of the book and >Rs5mn loans only 1%. Top ~300 accounts contribute ~0.8% to loan portfolio.
- ✓ History of negligible principal loss is underpinned by the focus on stable customers and strong underwriting principles such as funding only near-completion apartments.
- ✓ Stock valuation is likely to correct upwards as earnings growth accelerates.

Excerpts from conversation with the Management

- ✓ Incremental borrowing rate is just above 8%. Recent borrowing through 1-year CP was at 8.25%. CP is about 12% of borrowing and would be capped at 20%. Management prefers to borrow through 1-year CP off-late.
- ✓ Rs10bn was borrowed recently under NHB refinancing facility at an average cost of 7.85%.
- ✓ From banks, funding comes at MCLR or below (for loans linked to T-Bills). No spread is paid over MCLR. An existing large facility from a mid-sized private bank was renewed at sub-8%. While new lines are coming at MCLR, Can Fin has negotiated linkage with 3m MCLR instead of 1yr MCLR.
- ✓ With unutilized sanctions from large private banks and sizeable OD limits, the company does not need to keep more than normal liquidity on the balance sheet.
- ✓ Minimum lending rate was increased to 9.5% in early October and to 9% in April as compared to 8.5% in March 2018. Given annual reset mechanism, the back-book would witness upward repricing for many months to come. Thus, NIM may have likely made a bottom.
- ✓ Company does not resort to securitization as liquidity has never been a problem.
- ✓ Network expansion largely taking place in Tier-2 and Tier-3 locations which are the next growth areas for the company.
- ✓ ATS of loans in metros is Rs3-3.5mn and in non-metros is ~Rs1mn. If risk profile of the customer is same, the lending rate is same irrespective of location.

- ~90% of customers are first-time home buyers. Pre-dominant portfolio is funding of first and second sale of apartments.
- Supply of affordable apartments in the state of Karnataka has been hit by the tighter rules set by state authorities that requires RERA registration even for smaller affordable housing projects (if the land is admeasuring >5000 sq. ft. or if more than eight flats are built).
- Despite these issues in the home market of Karnataka, Can Fin is confident of growing at 15%+ yoy.
- After the announcement of GST reduction to 1% for affordable housing projects, there has been no material slowdown in loan approvals.
- Can Fin was holding extra NPL provisions after transitioning to Ind-AS. P&L may continue to show zero credit cost for next couple of quarters.
- While Canara Bank had earlier expressed their desire to sell entire stake in Can Fin, it is unlikely to act in depressed market conditions. Also, there is no MD & CEO at Canara Bank currently.
- Mr. Sarada Kumar Hota's term as the MD of Can Fin Homes would be getting over in April 2019. It can be extended by two more years, if he chooses to stay.

REPCO HOMES (CMP RS428, CURRENT P/BV 1.8X)

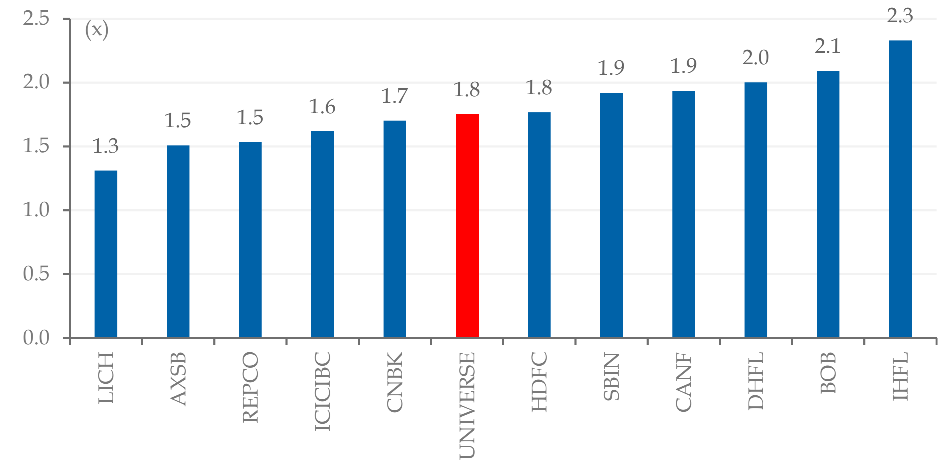
- Focus on informal salaried and self-employed customers and large presence in Tier-2 and Tier-3 markets implies relative resilience to competition.
- Liquidity from banks and NHB is sufficiently available to grow. NIL exposure to CPs as of Q3 FY19.
- Well capitalized and capacitated to grow, but bulk of growth may continue to come from outside the home state of Tamil Nadu. Tamil Nadu growth to depend on outcome of byelections (to be conducted along with general elections) which can influence the political mandate.
- Granular home loan portfolio; ticket size in LAP has been corrected substantially in recent years. Loan book concentration is low with Top 20 accounts comprising just 0.6%. About 78% of disbursements in FY19 have been below the ticket size of Rs2.5mn.
- De-risking taking shape through sustained reduction in Tamil Nadu concentration and gradual shift towards salaried customers where NPL levels have been lower.
- With a minimum lending rate and six-month reset mechanism in place, volatility in lending spread will decline and is likely to stabilize well above 3%.
- NPL correction to play out over the medium term as recoveries under SARFAESI fructifies. This coupled with negligible principal loss history to condition low credit cost.
- The trend profitability of 2.2-2.3% RoA and 18-20% RoE is intact. Current valuation not fully appreciating this.

Excerpts from conversation with the Management

- ✓ No material changes in incremental borrowing rate which was 8.8% in Q3 FY19. Funding from NHB coming at subsidized rate under affordable housing scheme. Blended financing rate from NHB is around 8%.
- ✓ Not all banks are charging a material spread over their MCLR to Repco. Funding from banks charging higher spread is available at 9%.
- ✓ Unutilized credit lines of ~Rs14bn (around Rs5bn from NHB) available to be tapped. Even CP market has opened-up, but the rates are slightly elevated.
- ✓ The minimum lending rate (MLR) for home loans stands at 9.15%, having increased from 8.6% in March and 9% in September 2018. At the start of Q3 FY19, the FY18-end portfolio got repriced at 9% MLR based on six-month reset mechanism. It should again reprice by another 15bps on 1st April 2019, assuming MLR is unchanged.
- ✓ Since the start of FY19, the loans disbursed have been linked to prevailing MLR with six-month reset frequency.
- ✓ MLR is reviewed monthly based on the extant cost of funds. Almost entire housing loan portfolio is on floating rate. Even LAP loans turn floating after being on fixed rate for initial one-to-three years.
- ✓ Metro and Tier-1 locations contribute about 30% of Repco's loan portfolio. Even in Chennai, the company has more presence in the periphery than in the city.
- ✓ PSU Banks are an indirect competition in most areas. They become a competitor after a loan seasons, especially for ones with higher tickets.
- ✓ Company has been steadily expanding its presence outside Tamil Nadu. In the new states, Repco targets the Tier-2 and Tier-3 markets and focuses on salaried home loans in the initial period. Underwriting rests with the central office.
- ✓ Incrementally, DSAs contribute 20% to disbursement and they are mostly used in the states of Maharashtra and Gujarat. In Tamil Nadu, loans are generally self-sourced through loan camps and other initiatives.
- ✓ The company has an enviable principal loss history of 5bps since inception and this drives a modest ECL-based credit cost.
- ✓ Incremental ATS in the LAP segment has significantly come down in the past 3-4 years (currently at Rs1.4-1.5mn). ATS of home loans has been steady at Rs1-1.2mn.
- ✓ Of the overall loan book, home loans for self-construction and outright purchase (row house, bungalows and apartments) stand at ~42% and ~25% respectively. In case of the latter, the supply comes from small local builders/contractors whose business activity is not impacted by regulations like RERA.
- ✓ Of the ~Rs4.1bn NPL stock, recovery from loans worth Rs2.8bn is being pursued under SARFAESI. Of this, cases worth Rs0.47bn are in the last stage of recovery where the property has been repossessed.
- ✓ In the past six months, NPLs worth Rs1.5bn have not paid a single EMI. About Rs1bn are technical NPLs serving their current EMIs.

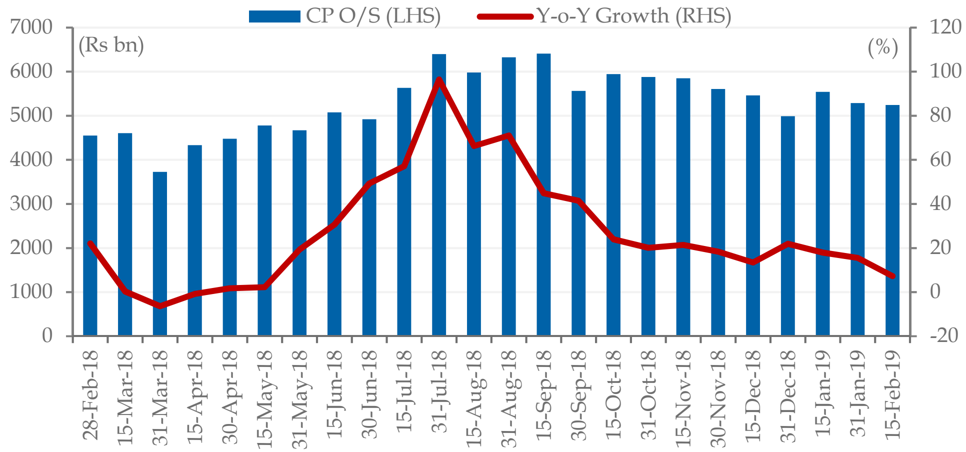
- Q4 FY19 is likely to witness a material NPL correction. Repco expects to end FY19 and FY20 with 3% and 2.5% Gross NPL ratio respectively.
- Issues around home registration in Tamil Nadu have been cleared, but there are delays in registration with designated authorities due to a large backlog. On the river sand availability front, while the mining ban has been lifted, not many sand quarries are operational. People building their own houses and even the small developers/contractors prefer river sand over manufactured sand.

Exhibit 1: Expansion in HL portfolio during Q2 FY16-Q2 FY19; no evidence of market share shift towards banks



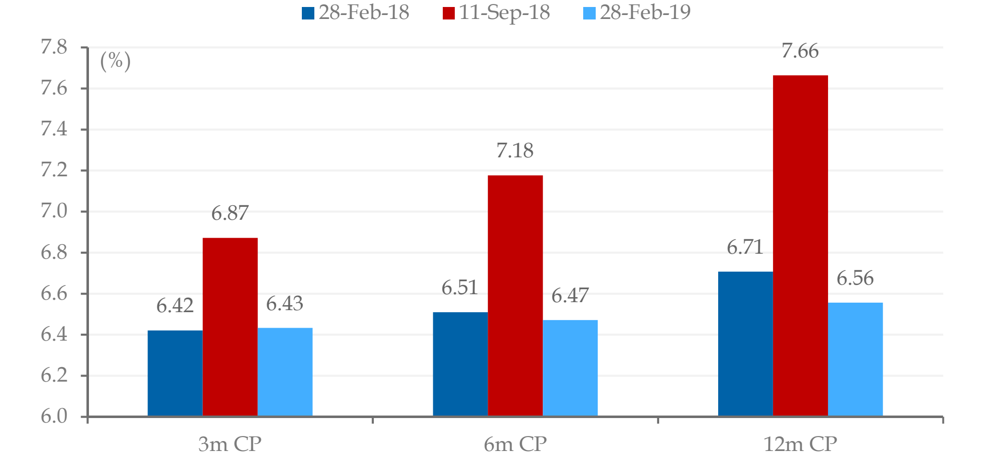
Source: Company, YES Sec - Research
Note: Universe is all the companies mentioned in the chart

Exhibit 2: Liquidity returning to the CP market



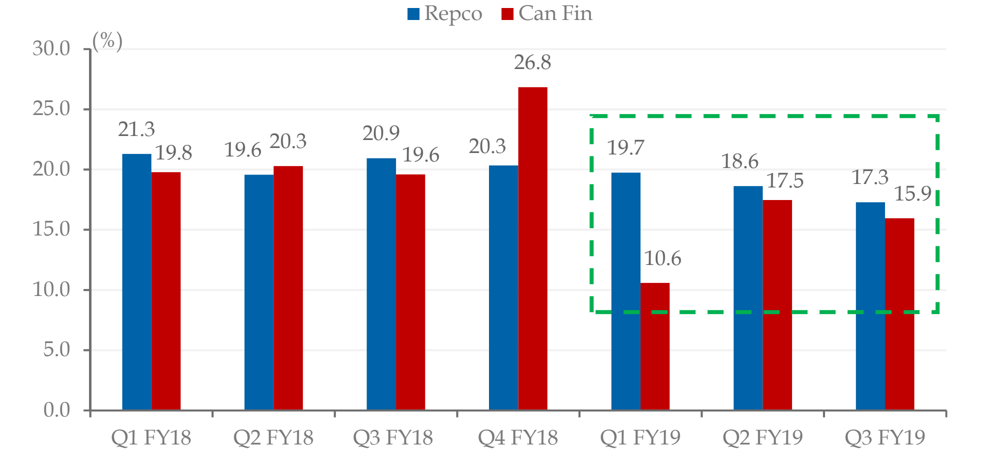
Source: Company, YES Sec - Research, Bloomberg

Exhibit 3: CP rates have normalized to a large extent



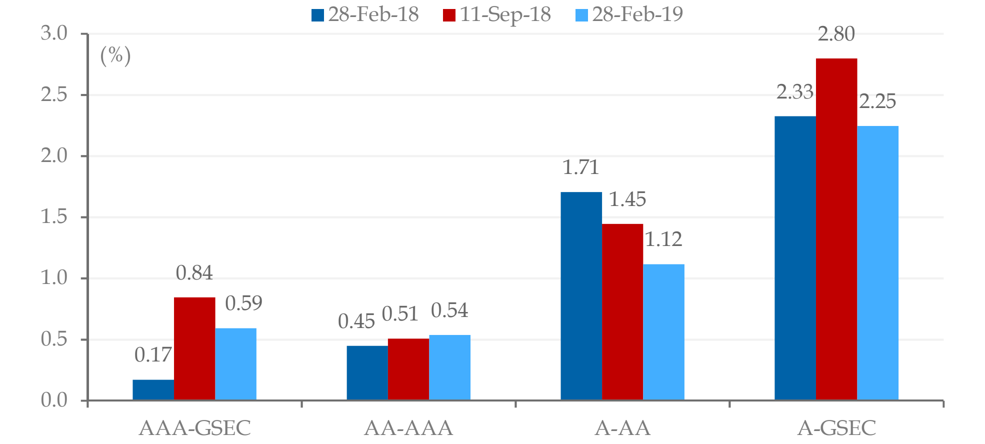
Source: Company, YES Sec - Research, Bloomberg

Exhibit 5: Material reduction in portfolio run-off rate



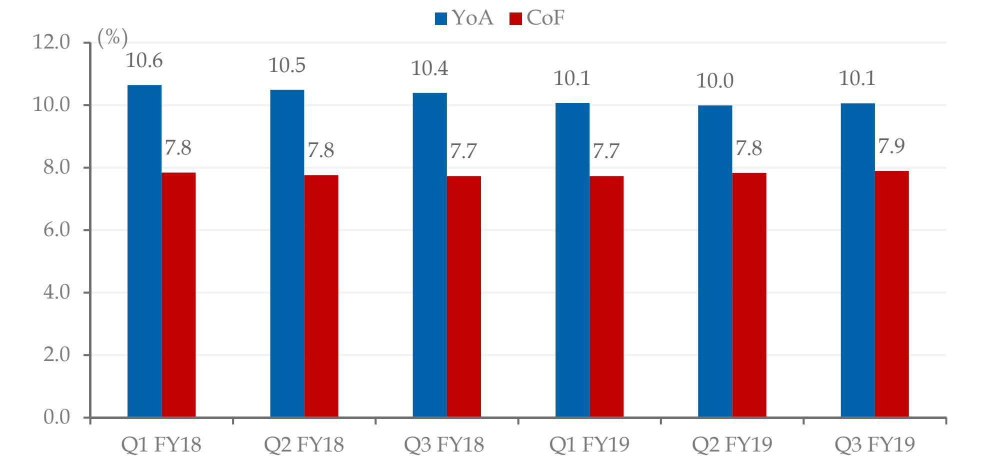
Source: Company, YES Sec - Research

Exhibit 4: Credit spreads correcting from peak



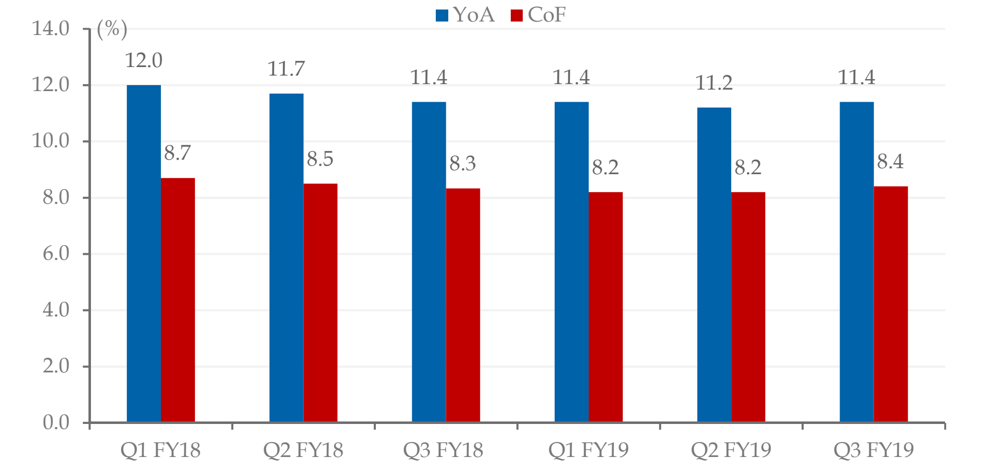
Source: Company, YES Sec - Research, Bloomberg

Exhibit 6: Can Fin's lending spread at the bottom



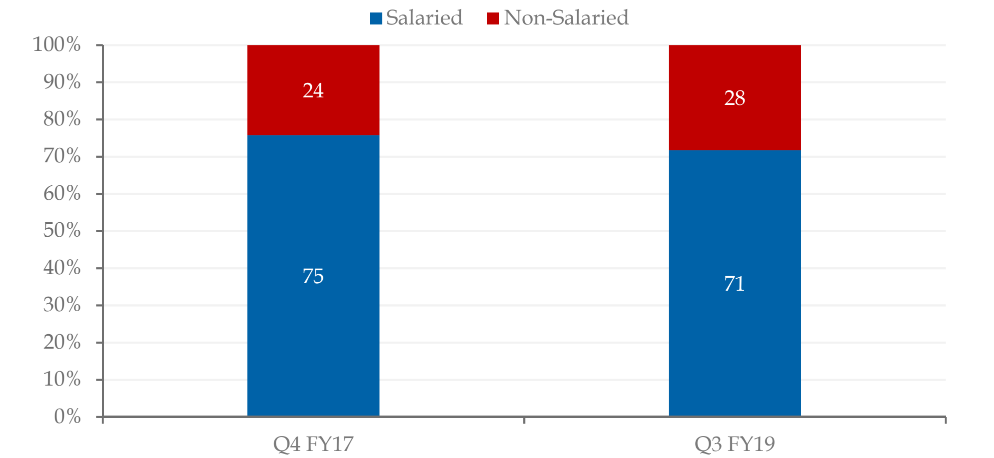
Source: Company, YES Sec - Research

Exhibit 7: Repco's lending spread unlikely to dip further



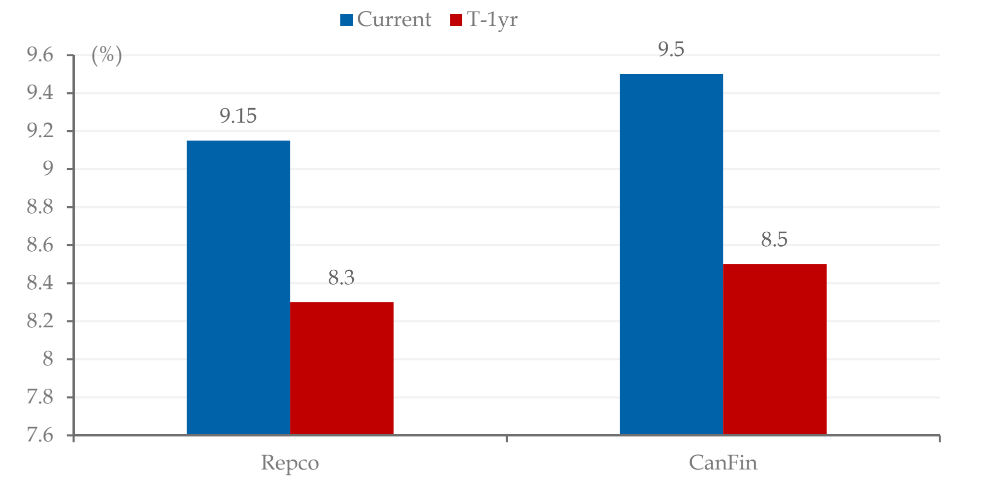
Source: Company, YES Sec - Research

Exhibit 9: Can Fin's loan mix moving towards non-salaried



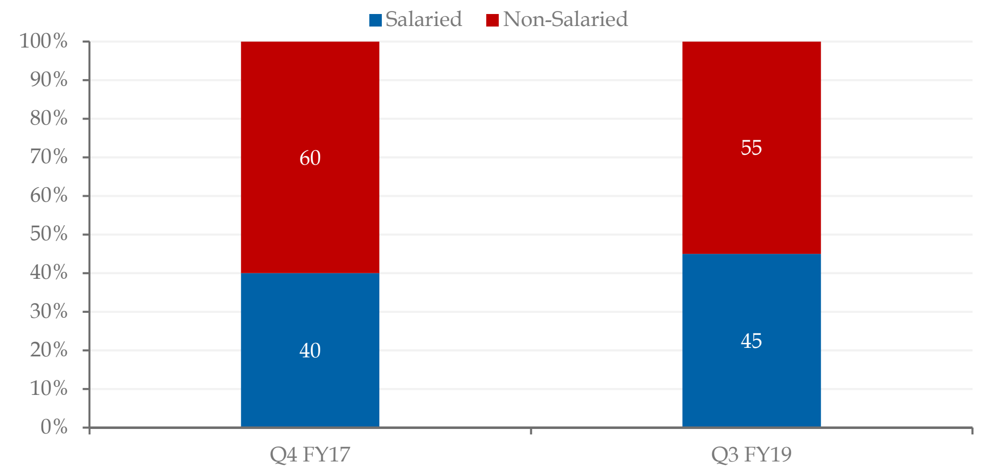
Source: Company, YES Sec - Research

Exhibit 8: Both cos raised Minimum Lending Rate significantly over past 12 months



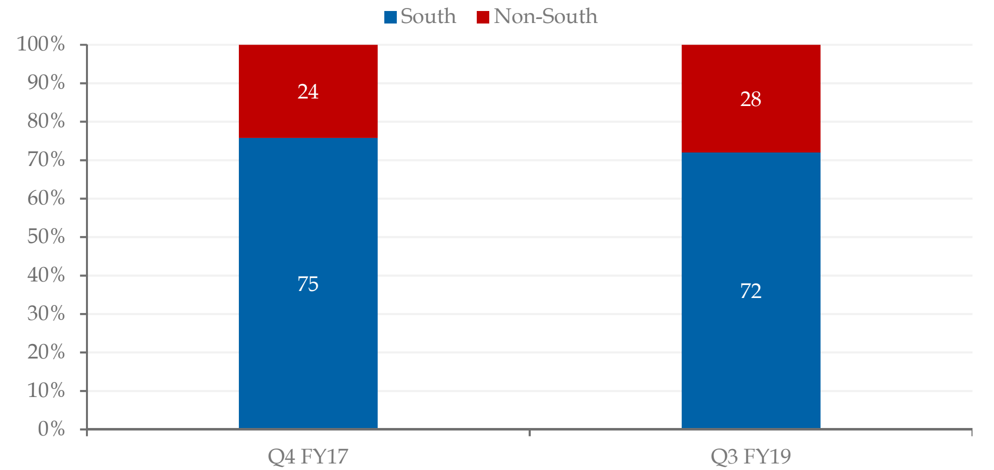
Source: Company, YES Sec - Research

Exhibit 10: Repco's loan mix shifting towards salaried



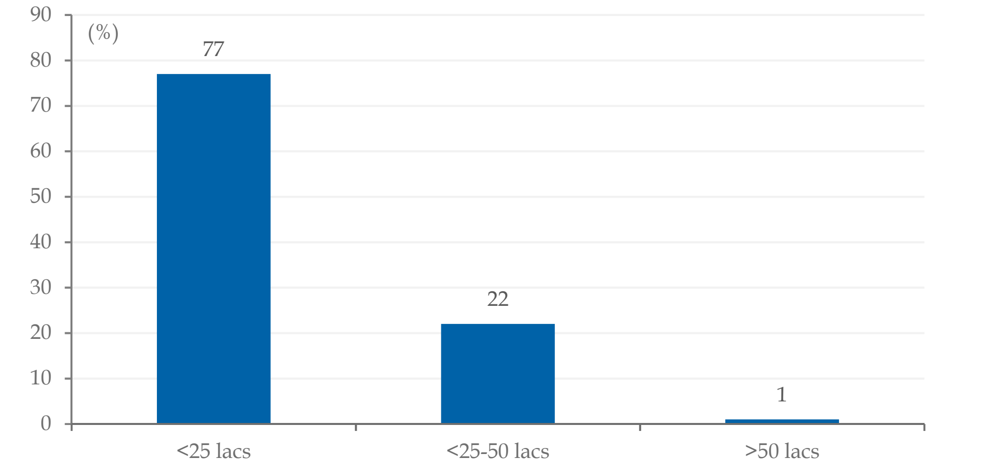
Source: Company, YES Sec - Research

Exhibit 11: Can Fin's portfolio growing faster outside South



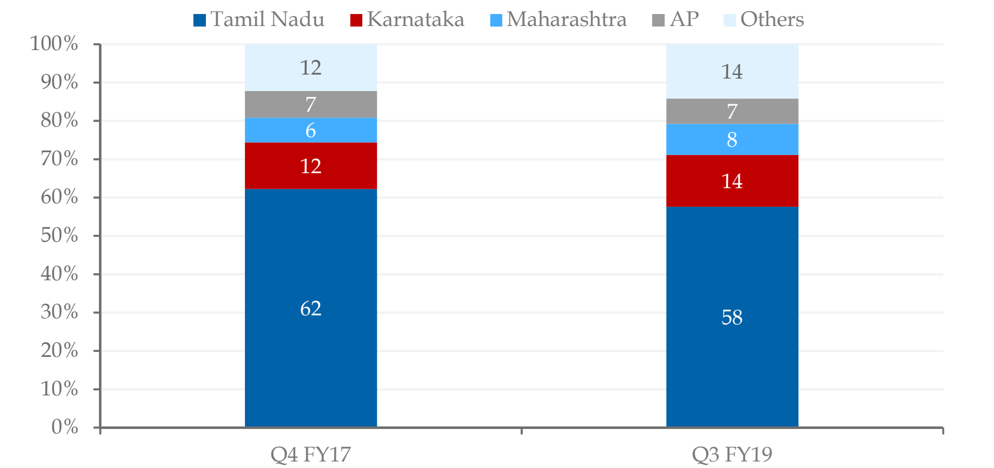
Source: Company, YES Sec - Research

Exhibit 13: Can Fin's portfolio ATS break-up



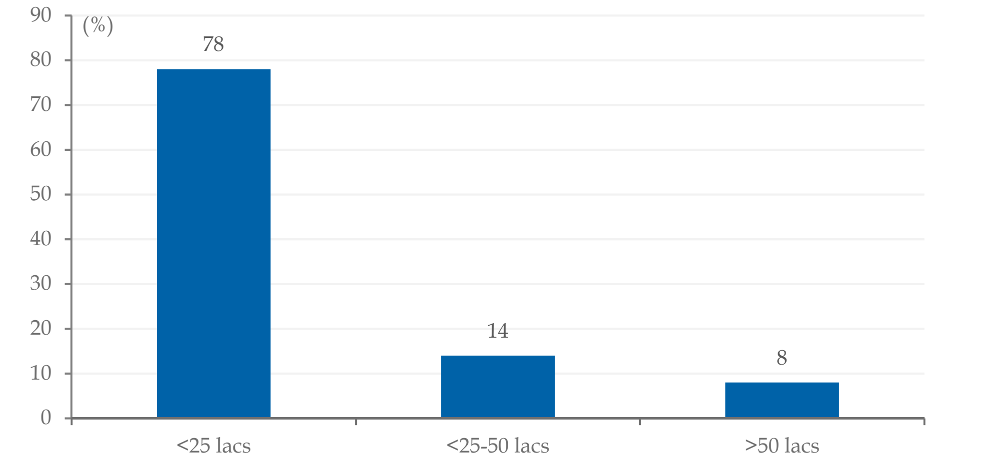
Source: Company, YES Sec - Research

Exhibit 12: Repco's portfolio is witnessing diversification



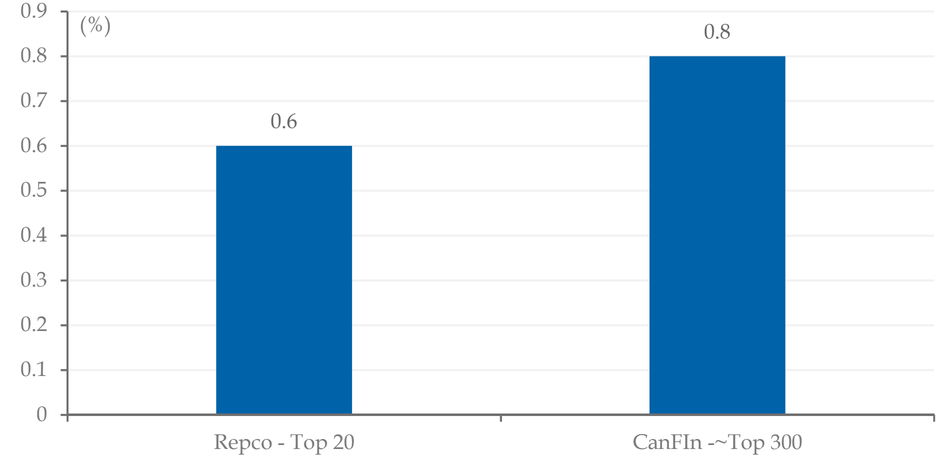
Source: Company, YES Sec - Research

Exhibit 14: Repco's 9M FY19 disbursements ATS break-up



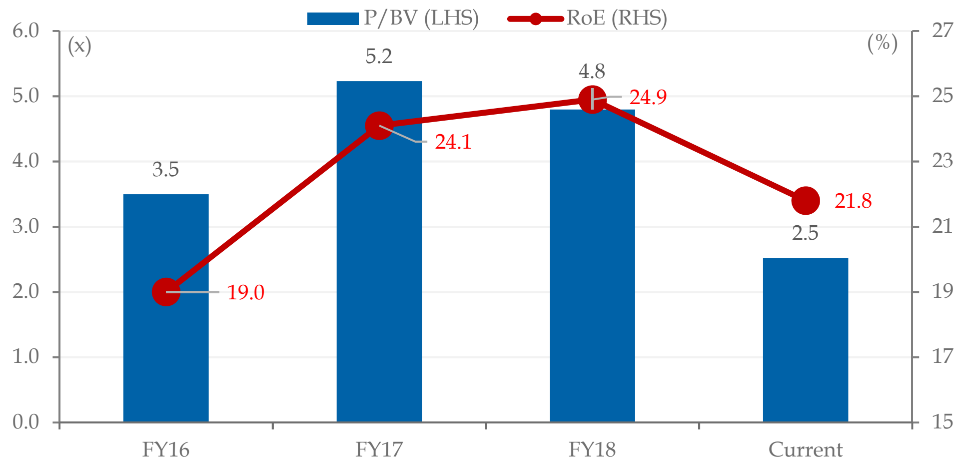
Source: Company, YES Sec - Research

Exhibit 15: Portfolio concentration is low



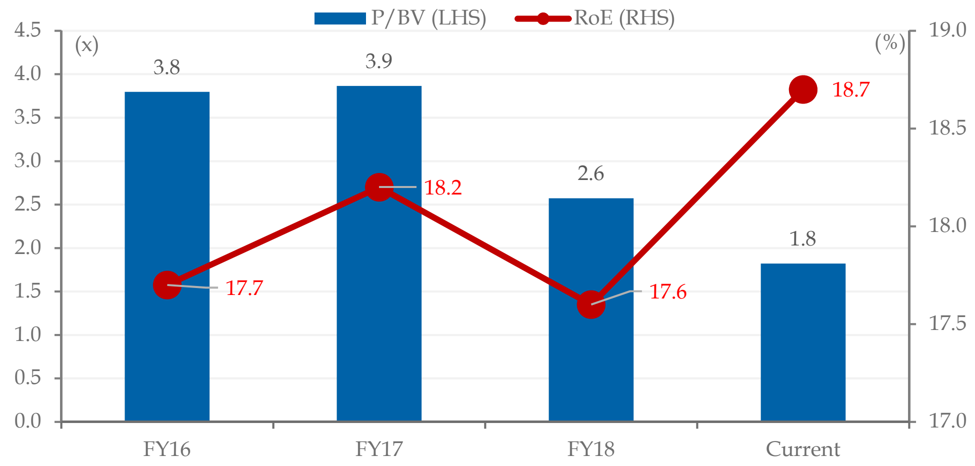
Source: Company, YES Sec - Research

Exhibit 16: Can Fin - Steep de-rating in valuation



Source: Company, YES Sec - Research

Exhibit 17: Repco – Valuation has been beaten down



Source: Company, YES Sec - Research

RECOMMENDATION PARAMETERS FOR FUNDAMENTAL REPORTS

Analysts assign ratings to the stocks according to the expected upside/downside relative to the current market price and the estimated target price. Depending on the expected returns, the recommendations are categorized as mentioned below. The performance horizon is 12 to 18 months unless specified and the target price is defined as the analysts' valuation for a stock. No benchmark is applicable to the ratings mentioned in this report.

BUY > 15%

ADD 5% to 15%

HOLD -15% to +5%

SELL > - 15%

NOT RATED

UNDER REVIEW

POSITIVE: Positive is rating given to stocks we like but yet to be formally included in our coverage universe.

NEGATIVE: Negative is rating given to stocks yet to be formally included in our coverage universe, but we find valuations expensive vis-a-vis fundamentals.

NEUTRAL: Neutral rating is given to stocks that are not under our formal coverage yet, but we find current valuation fairly representing fundamentals.

ABOUT YES SECURITIES (INDIA) LIMITED

YES SECURITIES (INDIA) LIMITED (''YSL'') was incorporated on 14th March 2013 as a wholly owned subsidiary of YES BANK LIMITED. YSL does not have any other associates. YSL is a SEBI registered stock broker holding membership of NSE and BSE. YSL is also a SEBI registered Category I Merchant Banker, Investment Adviser and a Research Analyst. YSL offers, inter alia, trading/investment in equity and other financial products along with various value added services. We hereby declare that there are no disciplinary actions taken against YSL by SEBI/Stock Exchanges.

DISCLAIMER

Investments in securities market are subject to market risks, read all the related documents carefully before investing.

The information and opinions in this report have been prepared by YSL and are subject to change without any notice. The report and information contained herein are strictly confidential and meant solely for the intended recipient and may not be altered in any way, transmitted to, copied or redistributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of YSL.

The information and opinions contained in the research report have been compiled or arrived at from sources believed to be reliable and have not been independently verified and no guarantee, representation of warranty, express or implied, is made as to their accuracy, completeness, authenticity or validity. No information or opinions expressed constitute an offer, or an invitation to make an offer, to buy or sell any securities or any derivative instruments related to such securities. Investments in securities are subject to market risk. The value and return on investment may vary because of changes in interest rates, foreign exchange rates or any other reason. Investors should note that each security's price or value may rise or fall and, accordingly, investors may even receive amounts which are less than originally invested. The investor is advised to take into consideration all risk factors including their own financial condition, suitability to risk return profile and the like, and take independent professional and/or tax advice before investing. Opinions expressed are our current opinions as of the date appearing on this report. Investor should understand that statements regarding future prospects may not materialize and are of general nature which may not be specifically suitable to any particular investor. Past performance may not necessarily be an indicator of future performance. Actual results may differ materially from those set forth in projections.

Technical Analysis reports focus on studying the price movement and trading turnover charts of securities or its derivatives, as opposed to focussing on a company's fundamentals and opinions, as such, may not match with reports published on a company's fundamentals.

YSL, its research analysts, directors, officers, employees and associates accept no liabilities for any loss or damage of any kind arising out of the use of this report. This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject YSL and associates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

DISCLOSURE OF INTEREST

Name of the Research Analyst : Rajiv Mehta, Sachit Damani

The analyst hereby certifies that opinion expressed in this research report accurately reflect his or her personal opinion about the subject securities and no part of his or her compensation was, is or will be directly or indirectly related to the specific recommendation and opinion expressed in this research report.

Sr. No.	Particulars	Yes/No
1	Research Analyst or his/her relative's financial interest in the subject company(ies)	No
2	Research Analyst or his/her relative or YSL's actual/beneficial ownership of 1% or more securities of the subject company(ies) at the end of the month immediately preceding the date of publication of the Research Report	No
3	Research Analyst or his/her relative or YSL has any other material conflict of interest at the time of publication of the Research Report	No
4	Research Analyst has served as an officer, director or employee of the subject company(ies)	No
5	YSL has received compensation or other benefits from the subject company(ies) or third party in connection with this research report	No
6	Broking/Investment Banking/Merchant Banking relationship with the subject company at the time of publication of Research Report	No
7	YSL has managed or co-managed public offering of securities for the subject company in the past twelve months	No
8	Research Analyst or YSL has been engaged in market making activity for the subject company(ies)	No

Since YSL and its associates are engaged in various businesses in the financial services industry, they may have financial interest or may have received compensation for investment banking or merchant banking or brokerage services or for any other product or services of whatsoever nature from the subject company(ies) in the past twelve months or associates of YSL may have managed or co-managed public offering of securities in the past twelve months of the subject company(ies) whose securities are discussed herein.

Associates of YSL may have actual/beneficial ownership of 1% or more and/or other material conflict of interest in the securities discussed herein.